LEARNING OBJECTIVES

After studying this chapter, you should be able to:

LO1 Describe the macro business environment and explain why managers must be aware of changes taking place. (p. 21)

LO2 Explain how managers use the PEST model to analyze external business opportunities and threats. (pp. 21–25)

LO3 Explain how sociocultural and technological forces can impact the profitability of a business. (pp. 25–29)

LO4 Describe how Porter’s five forces model is used to analyze the ways competition affects an industry. (pp. 30–32)

LO5 Summarize the four degrees (levels) of competition that may exist within an industry. (pp. 32–33)

LO6 Explain why government in Canada allows some monopolies to exist and how consumer interests are protected. (p. 33)

LO7 Explain the impact that perfect competition has on selling price. (pp. 33–34)
OPENING DISCUSSION: COFFEE, ECONOMICS, AND FAIR TRADE

Every morning about 28 million Canadians start their day with a cup (often cups) of the world’s most popular beverage. No, not beer . . . coffee! Worldwide, over 400 billion cups of coffee are consumed every year—enough to fill over 47,000 Olympic-sized swimming pools, or, if each cup were lined up side by side, enough to circle Earth 962 times. Coffee is the second most-traded commodity in the world, preceded only by crude oil. Annually, the coffee industry generates sales in excess of $100 billion—ahead of other commodities such as natural gas, gold, and sugar. In Canada, as in many parts of the industrialized world, “coffee culture” has become central to society, shaping our language, habits, and even our national identity: At work, we “take a coffee break”; we scope out new romantic relationships by “going for coffee”; and as Canadians, Tim Hortons is a national icon (most non-Canadians have no idea what a large double-double is).

With coffee growing only in the tropics, you’d think that Brazil, Vietnam, and Colombia would be prospering as the world’s leading producers, but this is far from the case. The majority of the world’s coffee is grown on small family-operated farms that have no more than five to seven acres of land. Entire communities come together and usually harvest the coffee beans by hand. It is a long and meticulous process. To be paid the full market price, farmers must transport the beans to nearby cities where roasters purchase them; however, because coffee is grown in remote mountainous locations and few farmers can afford their own truck, they are often forced to sell to middlemen (referred to as “Coyotes”) who generally pay them half the market price. The result is that farmers usually bring in a cash income of only $500–$1000 a year.

So who benefits from the $100 billion coffee industry? At Starbucks, one pound of Dark Roast sells for $16.95. One pound can also brew 26 tall-size cups at $1.85 each and will generate revenues of $89. Obviously coffee shops in Canada have expenses related to roasting, importing, handling, labour, and rent, but overall 90 percent of the profits from the coffee industry go to the traders and retailers.

The basic economics of the coffee crop is a major source of this inequity. As a commodity, the market price of coffee is extremely volatile. For example, despite the impressive amount of coffee being consumed, global production exceeded demand by almost 7 million 132-pound bags in 2013. This surplus caused coffee prices to drop to less than $1.50 per pound, but it costs the farmers more than that to grow and harvest the beans.

This is where fair trade comes in. The basic concept is that farmers are guaranteed to receive a minimum price that is intended to cover production costs and allow for a fair wage for their effort. When market prices are low, farmers are guaranteed the floor price; however, when market prices are higher participating buyers agree to pay the higher amount. In addition to the fair trade price, there is an additional sum of money called a fair trade premium. This money is used to improve the social, economic, and environmental conditions in the farmers’ communities.

Understanding that their success is tied to the existence of thousands of coffee farmers, the three biggest coffee companies in Canada have begun investing in responsible coffee purchasing practices to ensure a long-term supply of high-quality coffee. Tim Hortons, for example, is involved in a partnership program focused on creating sustainable coffee farming communities, McDonald’s sells 100% fair trade espresso and 25% fair trade coffee, and Starbucks has been buying fair trade coffee since 2000 and has plans to only sell ethically sourced coffee by 2015. Although these kinds of initiatives increase costs for coffee companies, it seems likely that the benefit goes beyond ethical motives—it may also make good business sense.

DISCUSSION QUESTIONS

1. Why do you think coffee has become so central to our culture? Can you think of any other current social–cultural issues that might be shaping our society?
2. Thousands of small coffee farmers are victims of the volatility of coffee prices. What could these small farmers do to strengthen their bargaining position and increase their profitability?

3. Why do companies like Starbucks and Tim Hortons participate in fair trade programs when it forces them to pay more for coffee? How might this be good for business?

**ENVIRONMENTS OF BUSINESS**

**LO1** Describe the macro business environment and explain why managers must be aware of changes taking place.

**The Macro Business Environment**

**What strategic issues are outside of management’s control?** Imagine playing a game of chess where, without warning, the rules could change. At any time a third or fourth competitor could enter the game or players could even team up, the size of the game board could increase or decrease, new game pieces with different “powers” could be added, or the objective could switch from taking your opponent’s king to some other random piece. In some ways, you might think about the environments of business as “the rules of the game,” and these rules are always changing. Using certain analytical tools, organizations attempt to predict these changes and then create or modify strategies in the hopes of achieving positive results.

A **business environment** refers to forces outside the business that can affect the firm’s industry and competitive environment. These forces include government regulations and policies, the economy, social and cultural issues, demographic shifts, as well as evolving technologies. Competition in particular has a large impact on all businesses, and this not only includes the strength of rivals but also factors affecting customers, suppliers, distributors, and even products offered by other industries that may not be obvious competitors.

**What are the different business environments in which organizations operate?**

Organizations operate within a macro business environment and are also affected by their competitive environment. Both affect their potential for success.

The **macro environment** is the external environment over which the organization can exert little influence. This environment is often referred to by the acronym **PEST** (political–legal, economic, sociocultural, and technological). These factors create opportunities for and pose threats to the organization. For example, changes in government policy, fluctuations in the economy, social change, and new technologies can all have a significant effect on a company’s success.

The **competitive environment** includes groups and organizations that have a direct relationship with the business. For example, suppliers, distributors, competitors, and external customers deal with the firm regularly and have a direct interest in the activities of the company because they are clearly affected by its actions.

**THE PEST MODEL**

**LO2** Explain how managers use the PEST model to analyze external business opportunities and threats.

Organizations must continuously consider the environments within which they operate because changes in these environments feed all aspects of corporate planning. Measuring changes in business environments allows organizations to take actions to sustain the company or gain a competitive advantage.

To help analyze the macro environment, managers use several analysis processes to gather, analyze, and dispense information for tactical or strategic purposes. One option is...
to analyze external factors using the PEST model. This classification distinguishes among the following factors:

- **Political–legal factors.** Government policy and political decisions can affect many vital areas of business. Factors may include ethical considerations, employment laws, competition laws, product regulations, consumer laws, sustainable environmental practices, and health and safety legislation.

- **Economic factors.** Changes in the local, national, or global economy can affect business operations. Factors may include interest rates, economic growth, industry changes, inflation and exchange rates, and taxation changes.

- **Sociocultural factors.** Consumer behaviour and preferences will affect decisions about product offerings. For example, environmentally friendly business processes affect demand patterns and create business opportunities. Other factors may include social trends, demographics, and ethical considerations.

- **Technological factors.** As technology changes, companies must adjust business practices to compete in the global business world. Factors include new technologies, online shopping, research and development, and global access.

There are several variations of the PEST model. Other forms you may encounter include SLEPT analysis (social, legal, economic, political, and technological) or STEEPLE analysis (social/demographic, technological, economic, environmental (nature), political, legal, and ethical), and sometimes PESTLE or PESTEL and PESTLIED (where the I represents international). The PEST model used above incorporates all these factors.

Managers regularly analyze the changes measured by the PEST model (see Table 2.1) on local, national, and global scales so they can make informed decisions, set goals, and implement strategies to increase business revenue. These factors may include changes in government, popular opinion, fashion trends, weather, and new technology. In addition, changes in one external environment can have an impact on the other external environments. For example, cigarette smoking has steadily declined over the past five decades. In 1965 over 50 percent of Canadians smoked, versus less than 20 percent in 2011.9 No-smoking laws, higher taxes on cigarettes, and the social stigma attached to smoking have all contributed to this decline in sales. Recognizing these threats, tobacco giant Philip Morris entered the e-cigarette market at the end of 2013. Electronic cigarette sales are projected to surpass regular cigarettes by 2047.10 PEST analysis is a useful tool for understanding market demand or decline, current business position, and potential threats and opportunities.
How do politics affect an organization?

The political–legal environment reflects the government’s relationship with business. It is often a direct consequence of the political parties in power, which represent the popular opinion of the citizens of a region. Organizations hire lobbyists to influence legislation and run advocacy ads that state their point of view on public issues. Special interest groups have grown in number and power, putting more constraints on marketers. The public is placing high expectations on organizations to be ethical and responsible. Politicians work to get re-elected by listening to the concerns of their citizens, which can affect businesses in many ways. For example, if citizens protest having a new shopping mall built in their neighborhood because they will lose a playground, the shopping mall may be forced to relocate.

Political decisions that affect the education of the workforce, the health of the nation, and the quality of an economy’s infrastructure (such as roads and rail systems) can have an impact on many vital areas of a business. Here are three examples of how political decisions might affect a business:

1. If less of the workforce receives higher education because education fees rise, then qualified employees could be more difficult for businesses to find. Once found, these employees could demand higher wages, which would increase business costs.
2. If the cost of health care rises for individuals, then households will have less money to spend on the goods and services that they may have otherwise purchased from businesses, which would decrease business profits.
3. If roads and rail systems are not kept in good repair because the government decides to spend tax money elsewhere, businesses may be forced to choose alternate transport methods or increase transport time by travelling a longer route, which would increase business costs.

Table 2.1 PEST Model for Analysis

<table>
<thead>
<tr>
<th>Political–Legal</th>
<th>Economic</th>
<th>Sociocultural</th>
<th>Technological</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government type and stability</td>
<td>Levels of disposable income (after paying taxes) and income distribution</td>
<td>Cultural aspects, health consciousness, population growth rate, age, distribution</td>
<td>Maturity of technology, rate of obsolescence, and competing technologies</td>
</tr>
<tr>
<td>World trade agreements, regulations, and restrictions</td>
<td>Interest rates, taxes, and inflation</td>
<td>Migration flows—labour mobility</td>
<td>Research and technological breakthroughs and improvements</td>
</tr>
<tr>
<td>Environmental regulations and protection</td>
<td>Overseas economic growth and emerging markets</td>
<td>Consumer demand for environmentally safe business practices</td>
<td>Government spending on research and development</td>
</tr>
<tr>
<td>Freedom of press, rule of law, and levels of bureaucracy and corruption</td>
<td>Current and projected economic growth</td>
<td>Lifestyle changes and trends</td>
<td>Industry focus on technology</td>
</tr>
<tr>
<td>Tax policies and trade and tariff controls</td>
<td>Stage in the business cycle</td>
<td>Demographics: gender, age, family size, etc.</td>
<td>Energy use and costs</td>
</tr>
<tr>
<td>Consumer protection laws, employment laws, health and safety laws and regulations</td>
<td>Impact of technological changes on the economy</td>
<td>Living conditions, level of education, and earning capacity</td>
<td>Information technology, Internet, and mobile technology</td>
</tr>
<tr>
<td>Political stability</td>
<td>Government spending</td>
<td>Work–life balance attitudes</td>
<td>Global and local communications</td>
</tr>
<tr>
<td>Competition laws and regulations</td>
<td>Unemployment and supply of labour</td>
<td>Ethical and moral standards governing the practices of business—customer values, market values, stakeholder values</td>
<td>Technology access, licensing, intellectual property issues, and advances in manufacturing</td>
</tr>
<tr>
<td>Government organization and attitude</td>
<td>Labour costs and supply</td>
<td>Waste removal and recycling</td>
<td></td>
</tr>
</tbody>
</table>

Political–Legal Environment

Video: Talking Politics in the Workplace
Chapter 2  The Environment of Business

Political stability is also an important consideration, especially for international firms. Many companies would not be willing to do business in a country where there is political unrest or where trade relationships are not defined and stable. For example, Canadian firms are more likely to do business with the United States, Mexico, and England than with Afghanistan or Haiti.

**How does the law affect an organization?**  Laws pertaining to taxes, competition, consumers, products, and the environment (land, air, and water) are some of the laws that organizations need to be aware of. For example, in Canada, there are strict regulations about advertising for alcohol, tobacco, and broadcasting. In December 2013, The Canadian Radio-television and Telecommunications Commission (CRTC) implemented a new “wireless code” in response to many complaints from Canadians about their wireless service providers. This new code attempts to better protect consumers by allowing them to cancel contracts with no charge after two years, placing limits on roaming and data overage charges, and ensuring that contracts are written in plain language that clearly describes the services.11

Laws and regulations tell organizations what they can and cannot do, and companies that do not abide might be fined, have their managers imprisoned, or have their businesses closed for noncompliance with the law.

**Economic Environment**

**How does the economic environment affect an organization?**  The economic environment consists of factors that affect consumer purchasing power and spending patterns. Such factors might include the changing value of the Canadian dollar, a skilled-labour shortage, and environmental sustainability. When there is a period of low sales, low employment, and low productivity (a recession), many people are out of work and household incomes are lower, thus consumer spending is lower. Less consumer spending means less revenue for businesses, which means businesses cannot afford to expand operations, hire additional employees, or spend money on researching and developing new products. When there is a period of high sales, high employment, and high productivity (business, and therefore the economy, are said to be “booming”), most people have jobs and make a good income, thus consumer spending rises. Economic change can also have a strong impact on a firm’s behaviour. For example, higher interest rates can deter businesses from obtaining loans to expand their operations, a strong domestic currency might make exporting more difficult if it increases prices in terms of foreign currencies, and inflation might provoke higher wage demands from employees and increase operating costs.

**How does globalization affect business?**  Globalization is the movement toward a more interconnected and interdependent world economy. This means that economies around the world are merging as technology, goods and services, labour, and capital move back and forth across international borders. The effects of globalization on the business world vary, from economic transformation in India to the shutting down of major manufacturing plants in Canada.

The Internet and modern technological advances are making it possible for a company of any size from anywhere in the world to compete globally. Competition between businesses consists of trying to get the customer to buy one company’s product instead of the one offered by its competitor. They compete to see which company has the greater

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One of the many purposes of laws and regulations is to protect consumers. One example is the CRTC’s recent changes to the wireless code, making it easier for consumers to change wireless providers and find out details about their programs.
market share (percentage of sales of a particular product or service in a given region) and thus is more successful. While Canada competes with its traditional economic partners and international allies, the United States and the United Kingdom, it must also compete with new emerging economies, such as China and India. To remain competitive in the global arena, Canada’s competitiveness policies will have to strengthen the economic relationships with its traditional allies while at the same time developing sustainable and competitive economic relationships with emerging economies.

**Sociocultural Environment**

LO3 Explain how sociocultural and technological forces can impact the profitability of a business.

**How does the sociocultural environment affect an organization?** A sociocultural environment is made up of different demographic factors such as race, ethnicity, gender, age, income distribution, sexual orientation, and other characteristics. Social, economic, and political movements and trends cause the social environment to change constantly;
an influx of immigrants can change racial demographics, or an economic slump can change income distribution demographics. These changes affect where people live, what they buy, and how they choose to spend their money. To best serve employees, customers, and the community, businesses must consider shifts and changes in the social environment when making decisions.

How does an aging population affect business? Changing demographics—age, gender, family size, income level, educational level—can change patterns in consumer demand. An aging population presents challenges as well as opportunities. Not only are older Canadians living longer, healthier lives, they are also better educated, wealthier, and have achieved a higher standard of living than previous generations. Baby boomers, the generation born between 1943 and 1960, represent the majority of the aging Canadian population. By 2020, they will be 60 to 75 years old, and most of them will have begun their retirement. Over the past 50 years, the median age of Canadians has risen from 27.2 to 38.8 years, while the share of those aged 65 and older has increased from 7.7 to 13.2 percent. According to Statistics Canada, by 2026—when most baby boomers will have retired—the median age of Canadians will rise to 43.3 years and seniors will make up 21.2 percent of the population. By 2051, these figures are estimated to rise to 46.8 years and 26.4 percent, respectively.¹⁴

Opportunities exist for businesses to market to baby boomers as they age. As boomers become empty-nesters, they will most likely move to smaller homes or condominiums closer to the cities, where they can be close to shopping, restaurants, and entertainment. Boomers are also tech savvy and will continue to use the Internet, satellite connections, and other electronic devices. Many companies market specific product lines to boomers. For example, cosmetics company Revlon is targeting the aging population with an anti-aging beauty line aimed at baby boomer women. Revlon is hoping this product line will generate US$200 million in new sales.¹⁵

Although an aging population presents many opportunities for corporations, it also presents challenges for the Canadian economy. As the ratio of the nonworking population to the working population increases, problems could occur, such as increased health care needs, higher taxes, and a reduction in government spending on pensions and health care.

According to Statistics Canada, by 2056 seniors will account for 25 to 30 percent of the Canadian population. While the senior segment is increasing, children and young people make up a decreasing segment of the Canadian population. As many older Canadians retire, relatively fewer young people are moving into the workforce to replace them, which means there will be a decreasing number of people available to provide social and economic support for seniors. In 2006 there were five working-age people (aged 20 to 64) for every senior, down from seven in 1971. By 2056, it is estimated (medium-growth scenario) that there will be only two working-age people for every senior in Canada.¹⁶ As shown in Figure 2.1, the result of such a trend could be a severe labour shortage for many years.

Despite these challenges, catering to the needs of an older population will ultimately present businesses with...
opportunities for growth—especially in the health care, pharmaceutical, and travel industries, as a bigger population translates to a larger market for these goods and services.

**How does diversity affect business?** As Canada becomes more diverse, it is important for businesses to reflect that diversity in their workforce. By 2031, between 25 and 28 percent of the population could consist of people born outside of Canada. Between 29 and 32 percent of the population could belong to a visible minority group, as defined by the Employment Equity Act. By 2031, visible minority groups could comprise 63 percent of the population in Toronto, 59 percent in Vancouver, and 31 percent in Montreal. This means that in some companies, visible minorities could account for the majority of the workforce. RBC has more than 52,000 full-time employees in Canada, with 26 percent of employees being visible minorities. Boeing Canada has close to 1500 employees, with 26 percent of employees being visible minorities.

However, in today’s business climate, increasing and managing a company’s diversity involves more than just employing an ethnically diverse workforce. Companies must develop a **diversity initiative**, which outlines their goals and objectives for managing, retaining, and promoting a diverse workforce. A diversity initiative might include a non-discrimination policy, minority network, or diversity education. According to Harvard sociology professor Frank Dobbin, “To increase diversity, executives must treat it like any other business goal.”

Although the inclusion and advancement of racial minorities in the workplace is an important step in establishing a diverse workforce, it is only part of the process. Today, the term **minority** applies to more than just people of different ethnicities. Some minority groups represent a person’s gender, culture, religion, sexual orientation, or disability. Companies must include these minority groups in their diversity initiative to ensure that all minority employees are treated fairly by management and co-workers.

**How does the “green movement” affect business?** In a 2007 United Nations study, many of the world’s most respected environmental scientists reported that the threat of global warming and climate change is real. As environmental anxieties become prevalent throughout society, it is important for businesses to get involved in a **green economy**—one that factors ecological concerns into business decisions. Businesses that manufacture products that contribute to higher emissions of carbon dioxide and consume inordinate amounts of fossil fuels must adapt to this new environmental awareness if...
they want to be relevant in a green economy. As an example, Toyota has seen its sales increase largely because of its Prius hybrid vehicles, which run on electricity as well as gasoline. Hybrid vehicles have not only become strong sellers, they have become part of our popular culture.21

A focus on environmental issues also creates a new market that will be increasingly important in the future. The demand for more green products presents new opportunities for entrepreneurs to meet those needs, and “green-collar” jobs could revitalize the currently decimated Canadian and US manufacturing economies. Creating wind energy turbines, installing solar panels, and weatherproofing houses and office buildings are going to be necessary businesses of the twenty-first century.

# Technological Environment

**How do technological changes affect the business environment?** The technological environment includes human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems used to perform business activities. Over the past 20 years, advancements in information technology (IT) have been revolutionary. In today’s business world, it is a necessity to stay on the cutting edge of technology to remain competitive. Regardless of the type of business, technology can be used to keep a company flexible, organized, and well connected—with either customers or employees.

Product and service technologies are used for creating products and services for customers. Organizations must constantly be watching for technological breakthroughs that might make their products or services better than those of their competitors. Organizations also have to be mindful of technologies that might make their products or services obsolete and thereby threaten their survival. For example, when DVDs hit the market, VHS sales dropped; now VHS is no longer on the market, and online streaming is quickly replacing DVDs and Blu-ray discs. For some companies (such as IBM, Apple, Microsoft, Rogers, and Dell), technology is the basis for competition; because these companies market themselves as being technological leaders, they need to invest large amounts in research and development to stay ahead—or even just to keep up.

Research and development technologies are being used to create new products, services, and processes. For example, SunChips uses solar energy at one of its eight manufacturing plants to produce snacks that are not only better for the consumer, but better for the planet as well. Technological improvements and innovation in general are important to the economic development of a country.

**How expensive is it to keep up with technology?** There is no question that keeping up with the pace of technology is an expensive and time-consuming task. The rapid pace of technological innovation means that computers are outdated after three years and obsolete after five years.22 In addition, there is the cost of applicable software, training, and infrastructure, which often makes IT the largest expense in many companies.23 However, cost is not the only aspect of technology to consider. In the same way that robotics completely revolutionized the automotive industry, advancements in computer and telecommunications technology are completely changing the foundation and focus of how many businesses are run.

Technology, when used and implemented effectively, can help streamline businesses; cut costs; increase productivity, security, and transparency; and improve communication with customers. Giving employees the technology they need to get their work done more efficiently and effectively is the simplest way to increase productivity. If employees can get more work done in a shorter time, productivity goes up. When employees are more productive, they are more valuable. This, in turn, makes the whole company more valuable. In addition, the right technology can help streamline a business’s internal operations, so the business can be more effective, efficient, and productive.
Thirty years ago, businesses were often centrally located with all employees in one building. Today, this is less common. Technology is making it possible for employees to telecommute, or work from home or another location away from the office. The “virtual global workforce,” or telecommuters who work on a global scale, expands the pool of potential employees, so that the right employee can be found for the job regardless of where he or she lives.24 Teleconferencing (and videoconferencing) is keeping CEOs and other corporate representatives from having to travel constantly for meetings. It is also allowing companies to communicate more easily, regardless of distance. These advancements are saving money on what used to be necessary expenses. With less travel, there is less money spent on plane tickets, hotel rooms, and food, and with more employees telecommuting, many businesses can operate out of smaller offices, which are cheaper and easier to manage.

How has the Internet changed the way business is done? While IT is the tool that is changing the function of business, the Internet is the tool that is changing the scope. The Internet is a global data communications system. It offers a way for consumers and businesses to communicate with each other, as well as a way for businesses to communicate with other businesses and consumers to communicate with other consumers. Using the Internet to conduct online business is a concept known as e-commerce or ebusiness. Although IT by itself would be extremely influential for the business world, the Internet makes it truly revolutionary. In 1995, the Internet was just starting to proliferate. Even though it had been commercially available for years at that point, the Internet had only recently become viable after the advent of the World Wide Web a few years before. Many people were intimidated by this new technology, and companies that operated solely on the Internet were not expected to do well. This changed in 1995, when both eBay.com and Amazon.com launched. These companies showed that Internet-based businesses were not only possible, but also potentially lucrative. Their high-profile success paved the way for today’s ebusiness merchant.25

Many businesses that exist in the bricks-and-mortar (physical store) world of commerce are now finding they also need to have an Internet presence to compete for customer loyalty. Many new business startups begin as online stores, with no physical location where consumers can shop. Every year, conducting business over the Internet becomes a more significant element of the overall economy. As it becomes easier for consumers to find even the most obscure items at competitive prices, the sale of goods and services online will continue to be a driving force in our economy. As the Internet and its influence continue to grow, so will its economic importance and necessity for businesses. However, the prevalence of the Internet also presents dangers and concerns for business.

One important concern is privacy. Emails, internal documents, and chat transcripts all contain private information not intended for public viewing. Nevertheless, many of these documents can be accessed online, because online storage has become a convenient alternative to hard drives. Web-based email and documents (“the cloud”) are also becoming more common. Even gaining access to a work or home computer from a remote location is a simple process that is becoming more popular. With this universal access, it is increasingly difficult to ensure that information remains private. Web-based storage and services offer many benefits to business, yet privacy and security concerns cannot be overlooked.
The Environment of Business

How does competition influence business? In a market-based economy, such as those of the Canada and the United States, there is an emphasis on individual economic freedom and a limit on governmental intervention—although Canada’s government interacts with business and the economy to a greater degree than the US government does. In a market economy, competition is the driving force. Competition arises when two or more businesses (local, national, or global) compete with one another to attract customers and gain an advantage. Canada’s private enterprise system is based on the belief that competition benefits consumers by motivating businesses to produce a greater variety of better and cheaper goods and services. Competition is good for consumers, good for the economy, and can be good for businesses. For example, 7UP created a new market because of extremely fierce competition in the cola industry. It positioned itself as the “un-cola,” and with the launch of Cherry 7UP and Diet Cherry 7UP, the company secured its third-place spot in the soft drink industry in early 1987. The two new “light, refreshing” drinks seized 1.4 percent of the more than US$40 billion total soft drink market in their first year and boosted 7UP’s total share to 6.2 percent.

Competition varies within industries and has a big influence on how companies operate. Competing for a finite number of consumers means that less-efficient companies and less-desirable products are usually eliminated from the marketplace. Because profit is the ultimate goal, it is the job of a successful business to convince customers that its product is either better or less expensive than that of its competitors. For example, there is currently competition among cable TV services (e.g., Rogers), satellite TV services (e.g., Bell), and Internet TV services (e.g., Netflix). How serious a threat is streaming content over the Internet? Sales of Internet-connected TVs, such as Apple TV, are growing. In addition, there are already devices such as Blu-ray DVD players, video game consoles, and network media players that provide Internet access. With Internet TV, consumers can pay for the services they want without all the other packaged services, offering consumers a low-cost and focused option. Are satellite and cable companies going to offer the same option? Can satellite and cable companies continue if consumers don’t want to pay for a multitude of channels they don’t watch? It will be interesting to see what happens.

Porter’s Five Forces Model

One of the most important external factors that affects most companies is the degree of industry competition—how fiercely businesses compete for the same customers, the same resources, or with products or services that are very similar to each other. To be effective, managers must understand the company’s competitive situation and then develop competitive strategies to take advantage of opportunities and combat threats in the industry. One tool used by managers to analyze competitive situations is Porter’s five forces model, which depicts the five forces that affect industry competition (see Figure 2.2).

**Figure 2.2** Michael Porter’s Five Forces Model: The Five Forces That Shape Industry Competition

Let’s examine these five forces in more detail.

1. **Threat of new entrants.** How easy is it for new entrants to start competing? Some industries, such as automotive manufacturing, require huge capital investments and therefore are extremely difficult to enter. Other industries, such as home cleaning or lawn care, require very little capital and therefore are relatively easy to enter. Government regulations may restrict entrance until certain criteria are met. The threat of entry of new competitors is high when brand names are not well known, capital investment is low, government regulation is not restrictive, and there is little differentiation between products.

2. **Threat of substitutes.** How easily can customer needs be satisfied by the products or services offered by other industries? For example, newspapers keep subscribers informed about daily events, but so can television and Internet sources. Coffee provides a morning caffeine rush, but so do tea and Red Bull. If there are many substitutes available, the industry is more competitive and the profit potential for the firms in the industry is decreased. To combat the threat of substitutes, companies try to differentiate their products and services in many ways, some of which may include price (Walmart’s lowest-price guarantee), quality (Maytag says you’ll never need to call the repairman), service (WestJet is known for superior service), or image (the now iconic “hip Mac” versus “stuffy PC” commercials). The threat of substitutes is high if consumers can easily switch to the products of another industry that are cheaper, can find a substitute that has better quality or performance, or can switch at a low personal cost.

3. **Bargaining power of buyers.** How strong is the position of buyers? Can they order large volumes to push the cost down? When there are only a few buyers and many suppliers the buyers have a great deal of bargaining power, but when there are only a few suppliers and many buyers the buyers have little bargaining power. The bargaining power of buyers is high when buyers purchase products in high volume, buyer switching costs are low, and substitutes are available.

4. **Bargaining power of suppliers.** Do many potential suppliers exist or only a few? If there are many suppliers from which a company can order its supplies, then the suppliers do not have much bargaining power (the company has the power). When there are

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**Biz Chat**

**Apple: Taking a Bite Out of Microsoft?**

Apple and Microsoft have a history of bitter rivalry revolving around the desire to dominate the personal computer market. The main point of contention between these companies is the graphical user interface (GUI), which is the user interface for the main program that runs personal computers. Apple released the first GUI to include folders and long file names in 1983. When Microsoft released Windows 2.0 in 1988, Apple took Microsoft to court, complaining that the “look and feel” of the Windows interface was stolen from the Apple interface. This suit continued until 1992, when Apple finally lost.

Microsoft led the competition in the early 1990s. It became industry standard to have Windows operating systems preinstalled on most PCs, which were dominating the personal computer market at the time. The 10-year battle finally ended when Apple announced an official alliance with Microsoft in 1997. Microsoft and Apple agreed to a five-year deal in which Microsoft would continue to develop Office software for Apple computers, and Apple agreed to bundle Microsoft’s Internet Explorer in all its operating systems.27

The computer industry went through some tough times around the turn of the century, but Apple and Microsoft remained two of the most successful companies in the world. The element of competition between these companies drove them to succeed, and perhaps led to the production of higher-quality operating software.

**Discussion Questions**

1. Some people say that Microsoft imitated Apple’s “look and feel” in their user interface. Why might they do that?

2. You likely remember the TV commercials that pitted the cool Mac guy against the awkward PC nerd. Are these ads effective in illustrating the competition between the two companies? Why or why not?

3. Are you a Mac or PC person? How do you think you developed this preference?
only a few suppliers from which a company can order the supplies it needs to do business, then the suppliers have a great deal of bargaining power. The bargaining power of suppliers is high when the product is highly differentiated or substitutes are unavailable.

5. **Rivalry among existing competitors.** Does a strong competition between the existing players exist? Is one player dominant, or are they mostly equal in strength and size? Companies are always trying to increase market share (more sales and more customers). To do this, they must devise creative marketing strategies, cut costs, and improve customer service and product quality. Some companies focus on quality, image, or service (e.g., BMW), while others focus on lower prices (e.g., Walmart). The intensity of rivalry is high when there are many competitors, competitors have equal size or market share, there is little differentiation between products, or consumers have no preference for a particular brand.

**LO5** Summarize the four degrees (levels) of competition that may exist within an industry.

### The Degrees (Levels) of Competition

Some products or services have no substitutes, whereas others share the market with many similar products. Various industries experience different degrees of competition, ranging from many competitors to few or no competitors. The number of substitutes for a certain product or service determines the degree (level) of competition. Economists have identified **four degrees of competition:**

- monopoly
- oligopoly
- monopolistic competition
- perfect competition

These degrees of competition are four points on a scale, not absolute measures (see Figure 2.3). For example, many industries fall somewhere between monopolistic competition and oligopoly.

**Is there any competition if there is only one seller?** If one Internet company were the sole provider of Internet services, that company would be considered a monopoly. Likewise, if Eddie’s Coffee Kiosk is the only place students can buy coffee on campus, then Eddie has a monopoly. A **monopoly** occurs when there is only one provider of a service or product and no substitutes for the product exist. In Canada as well as in other countries, large monopolies are rarely allowed. In fact, Canada’s Competition Bureau reviews all mergers in all sectors to determine whether they will likely result in substantial lessening or prevention of competition. For example, Rogers Communications acquired Atria Networks following approval from the Competition Bureau. But Canada’s Competition Bureau denied Interac’s request to become a for-profit organization, and has challenged the Canadian Real Estate Association over rules they say limit consumer choices. In November 2013, the Competition Bureau issued a “no-action letter” with

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**Video: iPhone-Mania: How Long Can It Last?**

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**Figure 2.3** Degrees of Competition: The Further Right on the Scale, the Greater the Monopoly Power
respect to TELUS’s proposed purchase of Public Mobile after determining that the acquisition would unlikely reduce or prevent competition in the mobile wireless industry of Southern Ontario and Greater Montreal. A no-action letter confirms that the Bureau has reviewed a specific proposed transaction and concluded that it will not, at this time, challenge that proposed transaction before the Competition Tribunal under the merger provisions of the Competition Act. 29

**LO6** Explain why government in Canada allows some monopolies to exist and how consumer interests are protected.

**Natural monopolies** include public utilities, such as those that sell gas or water. These organizations require huge investments, and it would be inefficient to duplicate the products they provide; therefore, they may be permitted to hold monopolies in an effort to conserve natural resources. However, the government regulates the prices for these goods and services. **Legal monopolies** occur when a company receives a patent giving it exclusive use of an invented product or process. Polaroid held a patent on instant photography technology for a number of years (patents exist for a predetermined amount of time). During this time, Polaroid benefited from having no competition and was able to recover the high costs of bringing the new technology to the market. Without competition, the company enjoyed a monopolistic position with regard to pricing.

**What happens when another seller enters a monopoly?** An oligopoly may be formed when another company enters a monopoly. An **oligopoly** is a form of competition in which only a few sellers exist. In the example of Eddie’s Coffee Kiosk, a bookstore on campus might open a café that offers coffee to the students. Students now have a choice to buy coffee either at the bookstore or at Eddie’s Coffee Kiosk. The situation has now changed from a monopoly to an oligopoly. When there are few sellers in a given market, each seller has a fairly large share of the market. Typically, oligopolies occur in industries in which there is a high investment to enter, so oligopolies are often major corporations in the airline, pharmaceutical, high-tech, automobile, and tobacco industries.

Because there is little differentiation among products, competition is strong in an oligopoly and prices differ only slightly, if at all, among the few suppliers. If one company cuts prices, its action is usually matched quickly by the competition. Therefore, competition in an oligopoly is centred on product differentiation (making one product stand out from another) more than on price.

**What if there are many sellers with little difference between their products, but buyers perceive them as different?** **Monopolistic competition** occurs when there are many buyers and sellers and little differentiation between the products, but consumers perceive there to be a difference so they favour one product offering over another. As an example, assume that the campus cafeteria begins to offer Tim Hortons brand coffee. Also assume that the perception among students is that Tim Hortons coffee is superior to Eddie’s and the bookstore’s coffee. The added choice of a perceived superior product creates monopolistic competition. Eddie’s Coffee Kiosk faces new competition that is perceived to be better than his product, and demand for his coffee decreases.

Monopolistic competition is everywhere. It exists in the shoe industry among Nike, Adidas, Under Armour, and others; in the coffee industry among Tim Hortons, Starbucks, Country Style, and others; and in the ice cream industry among Breyers, Häagen-Dazs, and Chapman’s, to name a few. These are traditional monopolistic competitive businesses because there are many buyers and sellers and the products are similar but not identical.

**LO7** Explain the impact that perfect competition has on selling price.

**Perfect competition** A form of competition where there are many buyers and sellers of products that are virtually identical, and any seller can easily enter and exit the market. When these conditions exist, no single supplier can influence the price. Selling price will be determined by the market based on available supply and existing demand for the product. In reality, there are few, if
Chapter 2  The Environment of Business

**On Target**

**All Kinds of Tablets**

Welcome to the world of tablets. Worldwide tablet orders continue to grow, reaching 142.5 percent growth year over year in the first quarter of 2013. But let's go back to the beginning for a moment—Apple's initial release of the iPad, a tablet device designed for media engagement and light content creation. In April 2010, the iPad was greeted by eager consumers and its introduction resulted in surging sales. Within a week of the launch of the basic model, an estimated 450,000 units were sold, and 3 million were sold within three months. By the end of 2010, nearly 15 million iPads had been sold worldwide. After the iPad 2 was launched, Apple reported combined sales for all iPads of more than 15 million in just the last three months of 2011! Compare this to the initial sales for Amazon's ebook reader, the Kindle. The Kindle was first introduced to the market nearly two-and-a-half years earlier than the iPad and sold approximately 250,000 units in the first year.

Fast forward to 2013, several iPad generations later (at a recent Apple conference, chief executive Tim Cook revealed that Apple has sold 170 million iPad units since the product's inception), with competition heating up in the industry to include Samsung's Galaxy, ASUS's Nexus device, and Microsoft's Surface and Surface Pro tablets, among others. At the end of the second quarter of 2013, Amazon's share of the global tablet market was 2.3 percent.

Apple remains the dominant player with the iPad, but Samsung has made the most gains in the space, rising from a 7.5 percent share in 2012 to 18.9 percent in the second quarter of 2013. ASUS, Acer, and Lenovo have also made gains, and now rank above Amazon in terms of market share.

**Discussion Questions**

1. A market that was once thought of as a pure monopoly by Apple has now opened up to some interesting competition. Or do you think Apple and Samsung have a lock in the tablet market?
2. In what ways has increased competition in the tablet market benefited consumers?
3. How do the manufacturers of tablets attempt to differentiate their products to compete for sales?

**CHAPTER SYNOPSIS**

**LO1** Describe the macro business environment and explain why managers must be aware of changes taking place. (p. 21)

The business environment refers to forces outside the business that can affect the firm's industry and competitive environment. These forces include government regulations and policies, the economy, social and cultural issues, demographic shifts, as well as evolving technologies. Competition in particular has a large impact on all businesses, and this not only includes the strength of rivals, but also factors affecting customers, suppliers, distributors, and even products offered by other industries that may not be obvious competitors. The business environment is constantly changing, so managers must be aware of how these changes may affect their industry so that they can develop strategies to pursue opportunities and protect the company from emerging threats.

**LO2** Explain how managers use the PEST model to analyze external business opportunities and threats. (pp. 21–25)

To help understand the business environment, one option for managers is to analyze external factors using the PEST model, which is a useful tool for understanding market demand or decline, current business position, and potential opportunities and obstacles. PEST helps guide managers to focus on emerging
issues and trends in categories related to political–legal, economic, sociocultural, and technological factors.

**L03** Explain how sociocultural and technological forces can impact the profitability of a business. (pp. 25–29)

Sociocultural factors refer to things such as social trends, population, demographics, and ethical considerations, all of which can directly impact consumer behaviour and preferences, which will ultimately affect decisions about product offerings. For example, environmentally friendly business processes are affecting demand patterns and creating business opportunities.

As technology changes, companies must adjust business practices to compete in the global business world. Factors include new technologies, online shopping, research and development, and global access, all of which affect how business is conducted, the costs of doing business, and may even cause the formation of entirely new industries.

**L04** Describe how Porter’s five forces model is used to analyze the ways competition affects an industry. (pp. 30–32)

Competition arises when two or more businesses compete with one another to attract customers and gain an advantage. Porter’s five forces model depicts the five forces that affect industry competition: threat of new entrants, threat of substitutes, bargaining power of suppliers, bargaining power of buyers, and rivalry among existing competitors. The intensity of the competition within an industry has a big influence on how a company operates.

Michael Porter’s Five Forces Model: The Five Forces That Shape Industry Competition

**L05** Summarize the four degrees (levels) of competition that may exist within an industry. (pp. 32–33)

The number of substitutes for a certain product or service determines the degree (level) of competition. The four degrees of competition are monopoly, oligopoly, monopolistic competition, and perfect competition.

**L06** Explain why government in Canada allows some monopolies to exist and how consumer interests are protected. (p. 33)

Natural monopolies include public utilities, such as those that sell gas or water. These organizations require huge investments, and it would be inefficient to duplicate the products they provide. Therefore, they may be permitted to hold monopolies in an effort to conserve natural resources. However, the government regulates the prices for these goods and services.

Legal monopolies occur when a company receives a patent giving it exclusive use of an invented product or process. This temporary period of reduced competition gives innovative firms the opportunity to recover the high costs of bringing the new technology to the market.

**L07** Explain the impact that perfect competition has on selling price. (pp. 33–34)

Perfect competition occurs when there are many buyers and sellers of products that are virtually identical, and any seller can easily enter and exit the market. When these conditions exist, no single supplier can influence the price. Selling price will be determined by the market based on available supply and existing demand for the product.

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**KEY TERMS**

- business environment (p. 21)
- competition (p. 30)
- competitive environment (p. 21)
- diversity initiative (p. 27)
- economic environment (p. 24)
- four degrees of competition (p. 32)
- globalization (p. 24)
- green economy (p. 27)
- legal monopolies (p. 33)
- macro environment (p. 21)
- monopolistic competition (p. 33)
- monopoly (p. 32)
- natural monopolies (p. 33)
- oligopoly (p. 33)
- perfect competition (p. 33)
- PEST model (p. 22)
- political–legal environment (p. 23)
- Porter’s five forces model (p. 30)
- sociocultural environment (p. 25)
- technological environment (p. 28)
CRITICAL THINKING QUESTIONS

1. It is not unusual to encounter businesses that have streamlined their activities to accommodate for environmental forces. Can you think of examples of businesses that might be forced to alter their business decisions based on how they are impacting the environment? How might these decisions affect their profits?
2. Most business owners agree that keeping up with the pace of technological change is a challenging task. Imagine you are the owner of a new restaurant business and must decide what technology would best suit your needs. From what types of technology would this business benefit?
3. You are considering the possibility of opening a grocery store. What kinds of government regulations do you think will impact your business? What are the advantages and disadvantages of government regulation of business?

APPLICATION EXERCISES

1. Demographics. Imagine you are starting a new retail clothing business in the city where you attend school. To what demographic area would you market? Think about the following factors: race, ethnicity, gender, age, income, and sexual orientation. Visit www.statcan.gc.ca to locate reports on the demographic area in which you are interested. Do you believe your business can thrive in this area? If not, what area would be conducive to your obtaining future customers? Would you have to change your retail clothing products in any way for the demographic market?
2. Languages of the global marketplace. As globalization increases and the world markets become more intertwined, language barriers become important. Investigate online resources for automated translation tools. What happens if you want to read a webpage posted by a German firm? Can you make online purchases from a company based in Asia? What resources are there for translating telephone conversations in real time? Investigate Babelfish.com and personal interpreter services such as LanguageLine.com.
3. Ecommerce. Did you know there are websites dedicated to keeping businesses and consumers up to date on the latest ecommerce news and trends? Check out www.ecommercetimes.com, find a recent ecommerce trend, and write a brief summary.
4. Political–legal environment. The political–legal environment of business affects business operations in many ways. For instance, many provincial governments have changed the consumer tax structure into a single federally administered tax, the harmonized sales tax (HST). You will find information online at www.cra-arc.gc.ca and www.hstincanada.com. Previously, businesses applied a goods and services tax (GST) and a provincial sales tax (PST) to most sales transactions. How might this change affect business operations? Does HST apply to all provinces, all businesses, and all consumers?
5. Sociocultural environment. Public opinion has a huge impact on how companies and the Canadian government act. Conduct online research to find a recent news event that discusses consumers responding negatively to some business venture or change. For example, communities often respond negatively to garbage dumps and nuclear power plants being placed in their neighbourhoods. They protest through rallies, writing letters to government, posting online discussions and opinions, word of mouth, meetings with company leaders, and emails. Share your findings with the class.

TEAM TIME

Cultural Awareness: An Unwritten Law

There are many challenges facing multinational companies where diversity and cultural awareness are concerned.

PROCESS

Step 1. Divide into six groups, each representing one of the following countries: China, France, Germany, Japan, Mexico, and Canada. Examine the cultural practices, customs, and values of the country you will represent. This may be done in class if you have Internet access or as homework.

Step 2. Each group should pair together with a second group as follows: Canada with Japan, Mexico with Germany, and China with France.

Step 3. Each group should produce one scenario of a business transaction that would be affected by cultural differences found in your research. Fabricate specific companies, characters, interactions, and resolutions.

Step 4. Answer these questions and discuss with the class: What were some challenges encountered in your business scenario and how did you overcome them? Why is it important for multinational companies to research a foreign country with which they intend to conduct business?

CLOSING CASE

How Much Snooping Is Too Much Snooping?

BlackBerry, founded in 1984 as Research In Motion and led by Mike Lazaridis and Jim Balsillie, is headquartered in Waterloo, Ontario, with offices throughout North America, Asia-Pacific, and Europe. In addition to designing and manufacturing the BlackBerry smartphone, the company also creates software for businesses and the operating system that allows the company to provide mobile access to email, instant messaging (IM), smartphone applications (apps), media files, and the Internet.

In the past several years, BlackBerry has been facing challenges from the governments of India, United Arab Emirates, and Saudi Arabia. In the name of national security, these countries have been demanding access to the company’s secure
customer data, as they see such access as a necessary tool in their
fight against terrorists. Each of these countries threatened to ban
BlackBerry service unless the company complied.

Concerned that terrorists may exploit the encryption in
smartphones to plan illegal activity, the Indian government is
urging telecommunications companies to devise solutions to
meet its security needs. The government said it would ask
BlackBerry, Google, Skype, and other service providers to
establish local servers and authorize security agencies to moni-
tor email traffic. “They have to install servers in India,” Home
Secretary G.K. Pillai told reporters in New Delhi, adding, “This
applies to all.” He said notices would be sent to the companies
for “lawful access” by India’s security agencies.  Companies
that do not comply could be banned. For BlackBerry, more
than a million of its smartphone users would be affected by a
ban, and the company would have to halt expansion into the
world’s second-biggest mobile phone market.32

DISCUSSION QUESTIONS
1. Do you think it is an invasion of privacy for a government
to want to monitor digital communications? Is it the govern-
ment’s right to do so? Why or why not?
2. What political–legal and sociocultural pressures is Black-
Berry dealing with?
3. What might happen to BlackBerry’s sales if it permits
monitoring of digital communications? If the communica-
tions service provider does not oblige the Indian govern-
ment, do you think the country would ban the service?
Why or why not?