Economic Challenges Facing Contemporary Business

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Learning Objectives

[1] Discuss microeconomics and explain the forces of demand and supply.

[2] Describe macroeconomics and the issues for the entire economy

[3] Identify how to evaluate economic performance

[4] Discuss managing the economy’s performance

[5] Describe the global economic challenges of the 21st century
Economics

- Social science which analyzes the choices people and government make in allocating scarce resources
- Everyone is involved in producing, distributing, or consuming goods and services
- The choices you make may actually be international in scope
- Businesses and not-for-profits make economic decisions
- Affects each of us
Two Branches of Economics

- **Microeconomics**
  - The study of small economic units, such as individuals or consumers, families, and businesses

- **Macroeconomics**
  - Addresses how an economy uses its resources
  - How government policies affect people’s standards of living
An individuals’ economic activities and choices determine:

- Prices of goods and services sold
- Amounts of goods and services sold

The exchange process between a buyer and seller involves demand and supply.

Demand refers to the willingness and ability of buyers to purchase goods and services at different prices.

Supply refers to the amount of goods and services for sale at different prices.
Factors Driving Demand

- Demand Curve shows the amount of product buyers will purchase at different prices.
- Driven by a variety of factors such as competition, price, larger economic events, and consumer preferences.

### Expected Shifts in Demand Curves

<table>
<thead>
<tr>
<th>Factor</th>
<th>To the Right IF:</th>
<th>To the Left IF:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer preferences</td>
<td>Increase</td>
<td>Decrease</td>
</tr>
<tr>
<td>Number of buyers</td>
<td>Increase</td>
<td>Decrease</td>
</tr>
<tr>
<td>Buyers’ incomes</td>
<td>Increase</td>
<td>Decrease</td>
</tr>
<tr>
<td>Prices of substitute goods</td>
<td>Increase</td>
<td>Decrease</td>
</tr>
<tr>
<td>Prices of complementary goods</td>
<td>Decrease</td>
<td>Increase</td>
</tr>
<tr>
<td>Future expectations become</td>
<td>Optimistic</td>
<td>Pessimistic</td>
</tr>
</tbody>
</table>
A change in the overall demand shifts to a new demand curve.
Factors Driving Supply

- **Production** plays a central role in determining overall supply.
- **Supply Curve** shows the relationship between different prices and quantities sellers will offer for sale.

<table>
<thead>
<tr>
<th>TABLE</th>
<th>Expected Shifts in Supply Curves</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>SUPPLY CURVE SHIFTS</strong></td>
</tr>
<tr>
<td>FACTOR</td>
<td><strong>TO THE RIGHT IF:</strong></td>
</tr>
<tr>
<td>Costs of inputs</td>
<td>Decrease</td>
</tr>
<tr>
<td>Costs of technologies</td>
<td>Decrease</td>
</tr>
<tr>
<td>Taxes</td>
<td>Decrease</td>
</tr>
<tr>
<td>Number of suppliers</td>
<td>Increase</td>
</tr>
</tbody>
</table>

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A supply curve shows the relationship between different prices and the quantities that sellers will offer for sale.
How Demand and Supply Interact

- Supply and demand curves meet at the equilibrium price.
- Buyers and sellers make choices that restore the equilibrium price.
- Changes affect both supply and demand.
Macroeconomics

- The study of a country’s overall economic issues
- Each nation’s policies and choices help determine its economic system
- The political, social, and legal environments differ in every country
- These systems can be classified into three categories:
  - **Private enterprise system**: capitalism or market economy
  - **Planned economies**: socialism and communism
  - **Mixed economies**: combinations of the two
Capitalism

- Most industrialized nations operate economies based upon a **private enterprise system or market economy**
- A **private enterprise system** rewards businesses for meeting the needs and demands of consumers
- Government favor a **hands-off** attitude toward controlling business ownership, profits, and resource allocation
# Types of Competition

- Pure Competition
- Monopolistic Competition
- Oligopoly
- Monopoly

## Table 3.3: Types of Competition

<table>
<thead>
<tr>
<th>CHARACTERISTICS</th>
<th>PURE COMPETITION</th>
<th>MONOPOLISTIC COMPETITION</th>
<th>OLIGOPOLY</th>
<th>MONOPOLY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of competitors</td>
<td>Many</td>
<td>Few to many</td>
<td>Few</td>
<td>No direct competition</td>
</tr>
<tr>
<td>Ease of entry into industry by new firms</td>
<td>Easy</td>
<td>Somewhat difficult</td>
<td>Difficult</td>
<td>Regulated by government</td>
</tr>
<tr>
<td>Similarity of goods or services offered by competing firms</td>
<td>Similar</td>
<td>Different</td>
<td>Similar or different</td>
<td>No directly competing products</td>
</tr>
<tr>
<td>Control over price by individual firms</td>
<td>None</td>
<td>Some</td>
<td>Some</td>
<td>Considerable in a pure monopoly; little in a regulated monopoly</td>
</tr>
<tr>
<td>Examples</td>
<td>Small-scale farmer in Indiana</td>
<td>Local fitness center</td>
<td>Boeing aircraft</td>
<td>Rawlings Sporting Goods, exclusive supplier of major-league baseballs</td>
</tr>
</tbody>
</table>
Two Forms of Planned Economies

- Socialism
  - Government ownership and operation of major industries
  - Belief is that major industries are too important left in private hands
  - Government-owned businesses can serve the public’s interest better than private firms
  - Some private ownership of industries allowed

- Communism
  - Karl Marx formed the basis of communist theory.
  - Under the direction of a strong central government,
  - All property shared equally by the people of a community
  - Marx believed that a classless society would benefit all
Mixed Market Economics

- Private enterprise systems and planned economies adopt opposite approaches to operating economies
- Many countries operate mixed market economies, which draw from both types of economies
- **Privatization** refers to the conversion of government-owned and operated companies into privately held businesses
### Comparison of Alternative Economic Systems

<table>
<thead>
<tr>
<th>SYSTEM FEATURES</th>
<th>CAPITALISM (PRIVATE ENTERPRISE)</th>
<th>COMMUNISM</th>
<th>SOCIALISM</th>
<th>PLANNED ECONOMIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership of enterprises</td>
<td>Businesses are owned privately, often by large numbers of people. Minimal government ownership leaves production in private hands.</td>
<td>Government owns the means of production with few exceptions, such as small plots of land.</td>
<td>Government owns basic industries, but private owners operate some small enterprises.</td>
<td>A strong private sector blends with public enterprises.</td>
</tr>
<tr>
<td>Management of enterprises</td>
<td>Enterprises are managed by owners or their representatives, with minimal government interference.</td>
<td>Centralized management controls all state enterprises in line with three- to five-year plans. Planning now is being decentralized.</td>
<td>Significant government planning pervades socialist nations. State enterprises are managed directly by government bureaucrats.</td>
<td>Management of the private sector resembles that under capitalism. Professionals may also manage state enterprises.</td>
</tr>
<tr>
<td>Rights to profits</td>
<td>Entrepreneurs and investors are entitled to all profits (minus taxes) that their firms earn.</td>
<td>Profits are not allowed under communism.</td>
<td>Only the private sector of a socialist economy generates profits.</td>
<td>Entrepreneurs and investors are entitled to private-sector profits, although they often must pay high taxes. State enterprises are also expected to produce returns.</td>
</tr>
<tr>
<td>Rights of employees</td>
<td>The rights to choose one’s occupation and to join a labor union have long been recognized.</td>
<td>Employee rights are limited in exchange for promised protection against unemployment.</td>
<td>Workers may choose their occupations and join labor unions, but the government influences career decisions for many people.</td>
<td>Workers may choose jobs and labor union membership. Unions often become quite strong.</td>
</tr>
<tr>
<td>Worker incentives</td>
<td>Considerable incentives motivate people to perform at their highest levels.</td>
<td>Incentives are emerging in communist countries.</td>
<td>Incentives usually are limited in state enterprises but do motivate workers in the private sector.</td>
<td>Capitalist-style incentives operate in the private sector. More limited incentives influence public-sector activities.</td>
</tr>
</tbody>
</table>
An economic environment should provide a stable business environment and sustained growth.

In a stable business environment, the supply of needed goods and services is aligned with the overall demand for these items.

Growth is the continuous expansion of the amount of goods and services produced from the nations’ resources.

Growth leads to expanded job opportunities, improved wages, and an increased standard of living.
A nation’s economy flows through various stages of a business cycle.

Business decisions and consumer behavior differ at various stages of the business cycle:

- **Prosperity**: low unemployment, high consumer confidence
- **Recession**: cyclical contraction that lasts for six months or more
- **Depression**: a prolonged recession
- **Recovery**: when the economy emerges from recession and consumer spending picks up
Productivity

- Productivity is the relationship between goods and services produced (output) in a nation each year and the inputs needed to produce them (input).

\[
\text{Total Productivity} = \frac{\text{Output (goods or services produced)}}{\text{Input (human/natural resources, capital)}}
\]

- As productivity rises, so does an economy’s growth and the wealth of its citizens.

- Productivity further describes the relationship between the number of units produced and the number of human and other production inputs necessary to produce them.
The sum of all goods and services produced within a nation’s boundaries

A measure of a nation’s economic strength and standard of living

Tracked by the Bureau of Economic Analysis (BEA), a division of the U.S. Department of Commerce

A new economic aggregate, Gross Output (GO), will measure total sales volume at all production stages rather than final output.
Nations with Highest GDP

Price-Level Changes

- **Inflation** refers to rising prices caused by a combination of excess consumer demand and increases in the cost of raw materials, component parts, human resources, and other factors of production.
- The core inflation rate is the inflation rate of an economy after energy and food prices are removed.
- **Inflation** devalues money because people can purchase less with the money they have.
- **Deflation** is when prices continue to fall, and this too can cause a weak economy.
Measuring Price-Level Changes

- Price level changes are measured through the **Consumer Price Index, or CPI**
- The **CPI** is calculated based upon prices of a market basket or goods and services most commonly purchased by urban consumers
- The CPI is calculated by the Bureau of Labor Statistics or BLS
The unemployment rate is the percentage of total workforce actively seeking work, but currently unemployed.
Managing the Economy’s Performance
Monetary Policy

- The Federal Reserve System is responsible for the nation’s monetary policy -- to increase or decrease money supply.
- Banking requirements and interest rates influence a bank’s willingness to make loans.
- Spending is a function of loan cost and availability.
- **Expansionary monetary policy**: increases the money supply to cut the cost of borrowing, which encourages business decision makers.
- **Restrictive or contractionary monetary policy**: reduces the money supply to curb rising prices, economic growth, and overexpansion.
Managing the Economy’s Performance

Fiscal Policy

- A technique that is used to control inflation, reduce unemployment, improve the standard of living, and encourage economic growth

- **Fiscal policy:** government actions to influence economic activity through decisions about taxes and spending

- Increased taxes may restrict economic activities

- Lower taxes and increased government spending usually boost spending and profits, cut unemployment rates, and fuel economic expansion
The Federal Budget

- **The Federal Budget**: Annual plan for how the government will raise and spend money for the upcoming fiscal year.

- **Primary sources of government funds**: taxes, borrowing, and fees

- **Budget deficit**: When the government spends more than it raises

- **Budget surplus**: When the government has more money than it spends

- [U.S. Debt Clock](#)
<table>
<thead>
<tr>
<th>CHALLENGE</th>
<th>TYPE OF RISK</th>
<th>FACTS AND EXAMPLES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chronic Fiscal Imbalances</td>
<td>Economic</td>
<td>Failure to redress excessive government debt obligations</td>
</tr>
<tr>
<td>Rising Greenhouse Gas Emissions</td>
<td>Environmental</td>
<td>Governments, businesses, and consumers fail to reduce greenhouse gas emissions and expand carbon sinks.</td>
</tr>
<tr>
<td>Water Supply Crisis</td>
<td>Societal</td>
<td>Decline in the quality and quantity of fresh water combine with increased competition among resource-intensive systems, such as food and energy production.</td>
</tr>
<tr>
<td>Mismanagement of Population Aging</td>
<td>Societal</td>
<td>Failure to address both the rising costs and social challenges associated with population aging.</td>
</tr>
</tbody>
</table>