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Introduction to Business 2e

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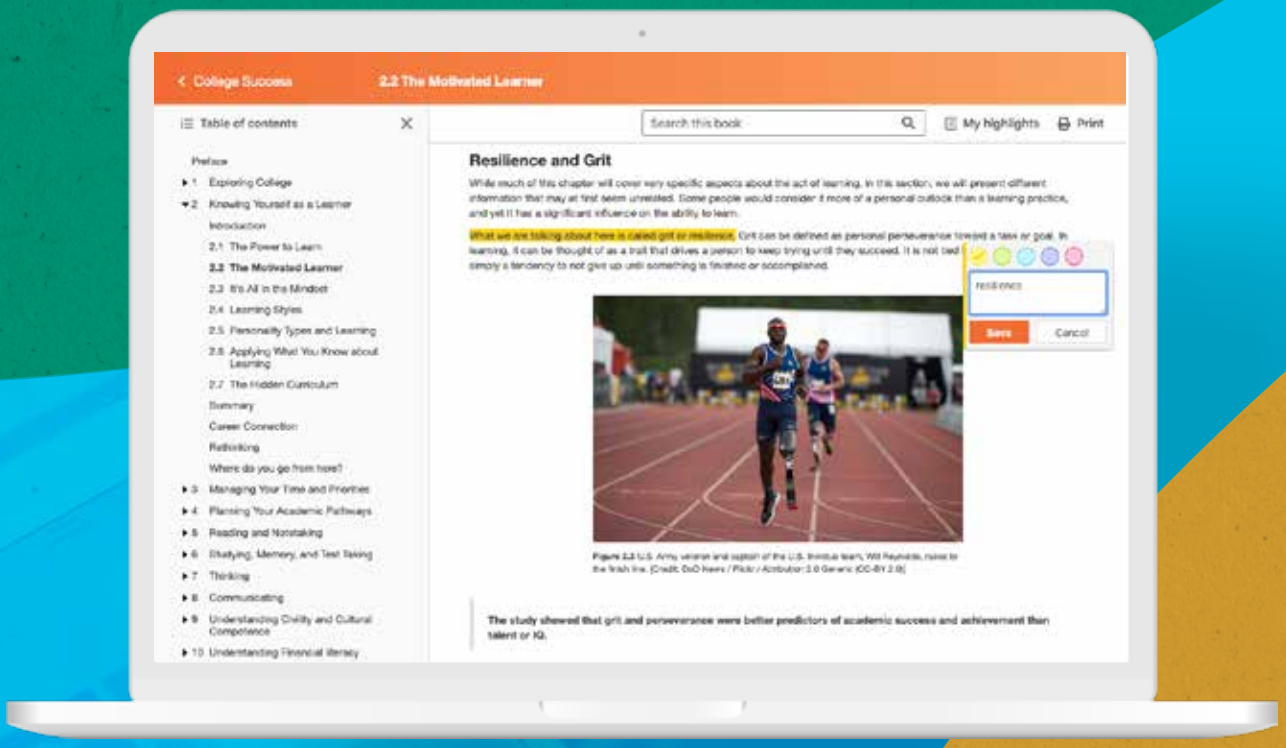

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CONTENTS

Preface 1

1 Understanding Economic Systems and Business 9

Introduction 9
1.1 The Nature of Business 11
1.2 Understanding the Business Environment 16
1.3 How Business and Economics Work 20
1.4 Macroeconomics: The Big Picture 25
1.5 Achieving Macroeconomic Goals 29
1.6 Microeconomics: Zeroing in on Businesses and Consumers 32
1.7 Competing in a Free Market 38
1.8 Trends in the Business Environment and Competition 40
Key Terms 45
Summary of Learning Outcomes 47
Preparing for Tomorrow's Workplace Skills 49
Ethics Activity 49
Working the Net 50
Critical Thinking Case 51
Hot Links Address Book 52

2 Making Ethical Decisions and Managing a Socially Responsible Business 53

Introduction 53
2.1 Understanding Business Ethics 55
2.2 How Organizations Influence Ethical Conduct 58
2.3 Managing a Socially Responsible Business 62
2.4 Responsibilities to Stakeholders 65
2.5 Trends in Ethics and Corporate Social Responsibility 68
Key Terms 70
Summary of Learning Outcomes 70
Preparing for Tomorrow's Workplace Skills 71
Ethics Activity 72
Working the Net 72
Critical Thinking Case 73
Hot Links Address Book 74

3 Competing in the Global Marketplace 77

Introduction 77
3.1 Global Trade in the United States 79
3.2 Why Nations Trade 82
3.3 Barriers to Trade 84

3.4 Fostering Global Trade 86
3.5 International Economic Communities 88
3.6 Participating in the Global Marketplace 92
3.7 Threats and Opportunities in the Global Marketplace 96
3.8 The Impact of Multinational Corporations 100
3.9 Trends in Global Competition 104
Key Terms 108
Summary of Learning Outcomes 109
Preparing for Tomorrow's Workplace Skills 111
Ethics Activity 111
Working the Net 111
Critical Thinking Case 112
Hot Links Address Book 113

4 **Forms of Business Ownership 115**

Introduction 115
4.1 Going It Alone: Sole Proprietorships 117
4.2 Partnerships: Sharing the Load 119
4.3 Corporations: Limiting Your Liability 122
4.4 Specialized Forms of Business Organization 129
4.5 Franchising: A Popular Trend 131
4.6 Mergers and Acquisitions 138
4.7 Trends in Business Ownership 140
Key Terms 143
Summary of Learning Outcomes 144
Preparing for Tomorrow's Workplace Skills 145
Ethics Activity 146
Working the Net 147
Critical Thinking Case 148
Hot Links Address Book 149

5 **Entrepreneurship: Starting and Managing Your Own Business 151**

Introduction 151
5.1 Entrepreneurship Today 153
5.2 Characteristics of Successful Entrepreneurs 158
5.3 Small Business: Driving America's Growth 161
5.4 Ready, Set, Start Your Own Business 164
5.5 Managing a Small Business 172
5.6 Small Business, Large Impact 174
5.7 The Small Business Administration 176
5.8 Trends in Entrepreneurship and Small-Business Ownership 177
Key Terms 181
Summary of Learning Outcomes 181
Preparing for Tomorrow's Workplace Skills 182

Ethics Activity 183
Working the Net 184
Critical Thinking Case 184
Hot Links Address Book 185

6 Management and Leadership in Today's Organizations 187

Introduction 187
6.1 The Role of Management 188
6.2 Planning 190
6.3 Organizing 195
6.4 Leading, Guiding, and Motivating Others 197
6.5 Controlling 202
6.6 Managerial Roles 203
6.7 Managerial Skills 206
6.8 Trends in Management and Leadership 207
Key Terms 211
Summary of Learning Outcomes 212
Preparing for Tomorrow's Workplace Skills 213
Ethics Activity 214
Working the Net 215
Critical Thinking Case 215
Hot Links Address Book 216

7 Designing Organizational Structures 217

Introduction 217
7.1 Building Organizational Structures 219
7.2 Contemporary Structures 225
7.3 Using Teams to Enhance Motivation and Performance 227
7.4 Authority—Establishing Organizational Relationships 231
7.5 Degree of Centralization 233
7.6 Organizational Design Considerations 234
7.7 The Informal Organization 238
7.8 Trends in Organizational Structure 239
Key Terms 243
Summary of Learning Outcomes 244
Preparing for Tomorrow's Workplace Skills 246
Ethics Activity 247
Working the Net 247
Critical Thinking Case 248
Hot Links Address Book 249

8 Managing Human Resources and Labor Relations 251

Introduction 251

8.1 Achieving High Performance through Human Resources Management 253
8.2 Employee Recruitment 257
8.3 Employee Selection 260
8.4 Employee Training and Development 263
8.5 Performance Planning and Evaluation 266
8.6 Employee Compensation and Benefits 268
8.7 The Labor Relations Process 271
8.8 Managing Grievances and Conflicts 277
8.9 Legal Environment of Human Resources and Labor Relations 280
8.10 Trends in Human Resource Management and Labor Relations 284
Key Terms 287
Summary of Learning Outcomes 288
Preparing for Tomorrow's Workplace Skills 290
Ethics Activity 291
Working the Net 292
Critical Thinking Case 293
Hot Links Address Book 294

9 Motivating Employees 295

Introduction 295
9.1 Early Theories of Motivation 297
9.2 The Hawthorne Studies 299
9.3 Maslow's Hierarchy of Needs 300
9.4 McGregor's Theories X and Y 302
9.5 Herzberg's Motivator-Hygiene Theory 304
9.6 Contemporary Views on Motivation 306
9.7 From Motivation Theory to Application 309
9.8 Trends in Employee Motivation 313
Key Terms 320
Summary of Learning Outcomes 320
Preparing for Tomorrow's Workplace Skills 322
Ethics Activity 323
Working the Net 323
Critical Thinking Case 324
Hot Links Address Book 325

10 Achieving World-Class Operations Management 327

Introduction 327
10.1 Production and Operations Management—An Overview 329
10.2 The Production Process: How Do We Make It? 331
10.3 Location, Location, Location: Where Do We Make It? 334
10.4 Pulling It Together: Resource Planning 337
10.5 Production and Operations Control 342
10.6 Looking for a Better Way: Improving Production and Operations 344

10.7 Transforming the Factory Floor with Technology 347
10.8 Trends in Production and Operations Management 350
Key Terms 353
Summary of Learning Outcomes 355
Preparing for Tomorrow's Workplace Skills 356
Ethics Activity 358
Working the Net 358
Critical Thinking Case 359
Hot Links Address Book 359

11 Creating Products and Pricing Strategies to Meet Customers' Needs 361

Introduction 361
11.1 The Marketing Concept 362
11.2 Creating a Marketing Strategy 365
11.3 Developing a Marketing Mix 369
11.4 Buyer Behavior 371
11.5 Market Segmentation 375
11.6 What Is a Product? 379
11.7 Creating Products That Deliver Value 383
11.8 The Product Life Cycle 386
11.9 Pricing Strategies and Future Trends 388
11.10 Trends in Developing Products and Pricing 392
Key Terms 395
Summary of Learning Outcomes 397
Preparing for Tomorrow's Workplace Skills 399
Ethics Activity 399
Working the Net 400
Critical Thinking Case 401
Hot Links Address Book 401

12 Distributing and Promoting Products and Services 403

Introduction 403
12.1 The Nature and Functions of Distribution (Place) 405
12.2 Wholesaling 408
12.3 The Competitive World of Retailing 409
12.4 Using Supply Chain Management to Increase Efficiency and Customer Satisfaction 413
12.5 Promotion Strategy 414
12.6 The Huge Impact of Advertising 417
12.7 The Importance of Personal Selling 419
12.8 Sales Promotion 421
12.9 Public Relations Helps Build Goodwill 425
12.10 Trends in Social Media 427
12.11 Trends in E-Commerce 428
Key Terms 430

Summary of Learning Outcomes 431
Preparing for Tomorrow's Workplace Skills 433
Ethics Activity 434
Working the Net 434
Critical Thinking Case 435
Hot Links Address Book 436

13 Using Technology to Manage Information 437

Introduction 437
13.1 Transforming Businesses through Information 438
13.2 Linking Up: Computer Networks 443
13.3 Management Information Systems 449
13.4 Technology Management and Planning 453
13.5 Protecting Computers and Information 455
13.6 Trends in Information Technology 460
Key Terms 464
Summary of Learning Outcomes 465
Preparing for Tomorrow's Workplace Skills 466
Ethics Activity 467
Working the Net 467
Critical Thinking Case 468
Hot Links Address Book 468

14 Using Financial Information and Accounting 471

Introduction 471
14.1 Accounting: More than Numbers 473
14.2 The Accounting Profession 477
14.3 Basic Accounting Procedures 480
14.4 The Balance Sheet 484
14.5 The Income Statement 487
14.6 The Statement of Cash Flows 490
14.7 Analyzing Financial Statements 492
14.8 Trends in Accounting 496
Key Terms 500
Summary of Learning Outcomes 501
Preparing for Tomorrow's Workplace Skills 503
Ethics Activity 505
Working the Net 506
Critical Thinking Case 506
Hot Links Address Book 507

15 Understanding Money and Financial Institutions 509

Introduction 509

15.1 Show Me the Money 511
15.2 The Federal Reserve System 514
15.3 U.S. Financial Institutions 517
15.4 Insuring Bank Deposits 525
15.5 International Banking 526
15.6 Trends in Financial Institutions 527
Key Terms 531
Summary of Learning Outcomes 531
Preparing for Tomorrow's Workplace Skills 532
Ethics Activity 533
Working the Net 534
Critical Thinking Case 534
Hot Links Address Book 536

16 Understanding Financial Management and Securities Markets 537

Introduction 537
16.1 The Role of Finance and the Financial Manager 539
16.2 How Organizations Use Funds 541
16.3 Obtaining Short-Term Financing 543
16.4 Raising Long-Term Financing 545
16.5 Equity Financing 547
16.6 Securities Markets 549
16.7 Buying and Selling at Securities Exchanges 555
16.8 Trends in Financial Management and Securities Markets 561
Key Terms 562
Summary of Learning Outcomes 563
Preparing for Tomorrow's Workplace Skills 565
Ethics Activity 566
Working the Net 566
Critical Thinking Case 567
Hot Links Address Book 568

17 Your Career in Business 571

Introduction 571
17.1 Learn the Basics of Business 572
17.2 Developing Interpersonal Skills Is Key to Your Success 573
17.3 Make Your Future Happen: Learn to Plan 577
17.4 Optimize Your Education 580
17.5 Get Your Career Off on the Right Track 586
17.6 Self-Test Scoring Guidelines 596

A Understanding the Legal and Tax Environment 599

Index 613

References 621

Preface

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About *Introduction to Business*

Introduction to Business 2e provides a strong, multidimensional foundation in the concepts, skills, and real-world examples of contemporary business. The textbook presents principles and emerging trends in fields including decision making, ethics, management, leadership, production, marketing, and finance. Through

welcoming narrative, a wide array of examples, and extensive activities and assessments, students will acquire the knowledge, skills, and competencies to prepare for the competitive workplace.

Coverage and scope

Introduction to Business 2e covers the scope and sequence of most introductory business courses. The book provides detailed explanations in the context of core themes such as ethics, entrepreneurship, customer satisfaction, global business, and managing change. *Introduction to Business 2e* includes hundreds of current business examples from a range of industries, geographic locations, and featuring a variety of individuals. The outcome is a balanced approach to the theory and application of business concepts, with attention to the knowledge and skills necessary for student success in this course and beyond.

Pedagogical foundation

Consistent, integrated learning. Targeted learning outcomes are listed at the beginning of each chapter and then repeated throughout the chapter. The learning outcomes connect to the text and the additional resources that accompany *Introduction to Business 2e*. After reading each section, students can test their retention by answering the questions in the Concept Checks. Every learning goal is further reinforced by a summary.

Hundreds of business examples to bring concepts to life. This book is designed to speak to the typical student. We have done a lot of research about student needs, abilities, experiences, and interests, and then we have shaped the text around them. We have used experiences both inside and outside the classroom to enrich a book that is both readable and enjoyable. We believe that the real business applications found throughout every chapter set the standard for readability and understanding of key concepts.

Learning business terminology, made easy. As students begin to study business, they will explore new words and concepts. To help them learn this language of business, we define each new term in the chapter, display the terms in bold, and offer a complete glossary at the end of the book.

Engaging business themes

Ethics. Business presents outstanding opportunities to do good. Through responsible business practices and the development and distribution of helpful products and services, businesspeople can positively affect their community. A paramount theme of this text is that business must be conducted in an ethical and socially responsible manner. **Chapter 2**, Making Ethical Decisions and Managing a Socially Responsible Business, is completely devoted to business ethics and social responsibility. We discuss techniques for setting personal ethical standards, how managers influence organizational ethics, tools for creating employee ethical awareness, and the concept of individual and corporate responsibility. *Introduction to Business 2e* also features ethics activities at the end of each chapter. All ethical dilemmas are taken right out of today's business world.

Customer satisfaction and quality. Because customer satisfaction and quality are the foundation of all business principles, these important topics are addressed in most chapters within *Introduction to Business 2e*. Each chapter stresses that satisfied customers who experience high-quality products and services become loyal customers. A box in every chapter called "Customer Satisfaction and Quality" demonstrates how these concepts are applied in actual companies.

Managing change. Change in the business or consumer environment can lead to failures like Kodak's and successes like Apple's. The Managing Change boxed feature describes how companies have recognized and responded to changes in technology, competition, economic forces, demographics, and culture.

Entrepreneurship and small business management. Because many students will either open their own businesses or go to work for small organizations, entrepreneurship and small business principles are covered throughout the text. **Chapter 5**, Entrepreneurship: Starting and Managing Your Own Business, delivers interesting discussions on starting and managing a small business and the associated advantages and disadvantages. In addition, a feature called "Catching the Entrepreneurial Spirit" offers practical insights into

the challenges and rewards of actually owning and managing a small business.

Global business economy. In Chapter 3, Competing in the Global Marketplace, we discuss why global trade is important to the United States, why nations trade, barriers to international trade, how companies enter the global marketplace, and a host of other international concepts and topics. The Trends section of each chapter frequently includes a discussion of how globalization will affect specific business activities. In addition, our Global Business box demonstrates how businesses are expanding their workforce, products, and customer base throughout the world in order to grow.

Changes to the Second Edition

Introduction to Business 2e retains the same organizational structure, key elements, and pedagogical features as the first edition. Based on faculty and student feedback, as well as trends and developments in business, the authors made extensive changes in the examples, data, and references in the text. Dozens of companies, organizations, and people are newly represented in the material. We've updated all descriptions and business practices related to and affected by legislation, court decisions, regulations, and similar changes. Economic, financial, and employment information has been updated to reflect 2025 and 2026 data wherever possible. And over 750 citations and references were updated or replaced.

From a thematic perspective, the second edition includes significant focus on artificial intelligence in business and professional contexts. The authors also focused on the evolution of organizations and the workplace, including evolving approaches to team dynamics and management and current means of communication. We've deepened representation of women entrepreneurs and businesspeople, and increased the breadth of the types of companies used as examples and cases.

A detailed transition guide, describing the chapter-by-chapter changes, is available within the book's instructor resources on OpenStax.org (https://openstax.org).

Features

Rather than provide a dry recitation of facts, we illustrate concepts with contemporary examples. In addition to the in-text examples, we have several boxed features that provide more extensive examples in areas of importance in today’s business environment. Each of the boxed features described below includes a series of critical thinking questions to prompt the student to consider the implications of each business strategy.

Ethics in Practice. Ethics in Practice features demonstrate how businesses are responsible not only to the bottom line, but to providing goods and services in a responsible manner.

Customer Satisfaction and Quality. Because customer satisfaction and quality are essential to attracting and keeping customers, the Customer Satisfaction and Quality box addresses how these concepts are illustrated and applied in actual companies.

Expanding Around the Globe. Upon entering today’s workplace, you are very likely to conduct business with colleagues, clients, and vendors from around the world. The Expanding Around the Globe feature offers insights into the global economy and highlights the strategies firms take to expand their business and improve their productivity by utilizing global resources.

Managing Change. The turbulent business climate requires companies to adapt their business strategies in response to a variety of economic, social, competitive, and technological forces. The Managing Change feature highlights how businesses have altered their business strategies in response to these forces.

Catching the Entrepreneurial Spirit. This feature highlights the challenges and opportunities available in small businesses and other entrepreneurial ventures.

Activities and cases that put knowledge to work

Introduction to Business 2e helps students develop a solid grounding in the skills that they can apply in the

workplace. These skill-building activities and resources help build and polish competencies that future employers will value.

Preparing for tomorrow's workplace skills and team activities. These activities are designed to help build students' business skills and to help them practice teamwork. We have developed assignments focused on five important workplace competencies: using and allocating resources, working with others, acquiring and using information, understanding systems, and working with technology. Team activities in every chapter give students an opportunity to work together, building communication skills and interpersonal skills.

Ethics activities. Ethics activities at the end of each chapter present real-world ethical challenges and prompt students to choose the most ethical course of action.

Working the net activities. These activities guide students through a step-by-step analysis of actual e-business practices and give them opportunities to build online research skills.

Creative thinking cases. The Creative Thinking case in each chapter invites students to explore business strategies of various companies, analyze business decisions, and prepare comments.

Answers to Questions in the Book

All answers to Ethics Activities, Working the Net, and Critical Thinking Cases are provided in the Instructor's Manual via the Instructor Resources page. Answers to Concept Check questions and Preparing for tomorrow's workplace skills questions are not provided as the scope and response type can be differ based on faculty requirements.

Additional resources

Student and instructor resources

We've compiled additional resources for both students and instructors, including Getting Started Guides, an instructor's manual, test bank, and image slides. Instructor resources require a verified instructor account, which you can apply for when you log in or create your account on OpenStax.org. Take advantage of these resources to supplement your OpenStax book.

Comprehensive instructor's manual. Each component of the instructor's manual is designed to provide maximum guidance for delivering the content in an interesting and dynamic manner. The instructor's manual includes an in-depth lecture outline, which is interspersed with lecture "tidbits" that allow instructors to add timely and interesting enhancements to their lectures. Authored by Linda Hefferin, Elgin Community College.

Test bank. With nearly 2,000 true/false, multiple-choice, fill-in-the-blank, and short answer questions in our test bank, instructors can customize tests to support a variety of course objectives. The test bank is available in Word format. Authored by Amit Shah, Frostburg State University.

PowerPoint lecture slides. The PowerPoint slides provide images and descriptions as a starting place for instructors to build their lectures.

Community Hubs

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1

Understanding Economic Systems and Business

Exhibit 1.1 (Credit: Marco Verch /flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. How do businesses and not-for-profit organizations help create our standard of living?
2. What are the sectors of the business environment, and how do changes in them influence business decisions?
3. What are the primary features of the world's economic systems, and how are the three sectors of the U.S. economy linked?
4. How do economic growth, full employment, price stability, and inflation indicate a nation's economic health?
5. How does the government use monetary policy and fiscal policy to achieve its macroeconomic goals?
6. What are the basic microeconomic concepts of demand and supply, and how do they establish prices?
7. What are the four types of market structure?
8. Which trends are reshaping the business, microeconomic, and macroeconomic environments and competitive arena?

EXPLORING BUSINESS CAREERS

Team Rubicon: Disaster Relief and a Sense of Purpose

Accounting for a substantial amount of economic activity in the United States, not-for-profits are an undeniable force in the business world, even though their focus on goals other than profit falls outside the traditional model of a for-profit business. But it is this shift away from a focus on profit that allows them to pursue missions of social improvement and contributions to society as a whole. To be truly effective in a not-for-profit organization, a person must share the organization's vision.

The vision for Team Rubicon was shaped by its cofounders, Jake Wood and William McNulty, who saw the devastation caused by the Haiti earthquake in 2010 and sprang into action. Both marines, Wood and McNulty knew they could do something to help in this devastating and chaotic situation. Within 24 hours, they enlisted the help of six other military veterans and first responders, gathered donations and supplies from friends and family, and made their way to Haiti to help with disaster relief, and Team Rubicon was born.

Exhibit 1.2 Team Rubicon volunteers get hands-on training from agencies to help with disaster relief. (Credit: Jamie Mobley, Bureau of Land Management Oregon /Flickr/ Attribution 2.0 Generic (CC BY 2.0))

The organization gets its name from the Rubicon, a river in northern Italy that Julius Caesar and his troops crossed on their epic march to Rome, with the river marking the point of no return. The name underscores the cofounders' experiences during the Haitian disaster, where despite advice from government officials and other aid organizations not to proceed, their small team crossed into Haiti from the Dominican Republic carrying crucial gear and medical supplies to thousands of earthquake victims.

Team Rubicon is a veteran-led humanitarian organization that serves communities before, during, and after disasters by mobilizing the skills of military veterans, first responders, and civilian volunteers. It delivers swift, effective relief while providing veterans with continued purpose, community, and opportunities to serve.

Through the organization's efforts, Team Rubicon seeks to provide volunteers, including veterans, a purpose gained through involvement in disaster relief and support for humanitarian crises, a sense of community built by serving with a mixed volunteer base, and a feeling of identity from recognizing the impact one individual can make.

Headquartered in the Los Angeles area, Team Rubicon is staffed by energetic employees who work both domestically and internationally with thousands of volunteers ready to deploy within 24 hours. Similar to company operations in for-profit organizations, staff positions at Team Rubicon include regional administrators; field operations (including membership and training); marketing, communications, and social media; fundraising and partnership development; finance and accounting; and people operations.

Team Rubicon's staff members bring professional and/or military experience to their daily jobs, but they all share the organization's vision. Many staff members started as volunteers for Team Rubicon while working in for-profit careers, while others took advantage of the organization's strong internship program to become familiar with its mission and focus on disaster relief.

In 2023, Team Rubicon trained nearly 30,000 veterans and other volunteers and responded to over 200 disasters and humanitarian efforts. As of 2024 cumulatively, the organization has logged over 250,000 volunteer hours and has impacted more than 3 million people in many communities across the world. Team Rubicon relies on partnerships—including Southwest Airlines, which supports volunteer travel

through its Rapid Rewards "Points for a Purpose" program and in-kind assistance to help deploy teams quickly.

Team Rubicon actively engages its nationwide community at every level of the organization, from volunteer to board member, and every step of its operation: from training to planning to implementation to seeking donations and volunteers to help with any type of disaster relief. Team Rubicon has been recognized as one of the top nonprofits to work for by *The NonProfit Times*, based on employee surveys and business partners' input about the organization's work environment.

The not-for-profit world may not be for everyone, but if its growth is any indication within the overall economy, it does appeal to many. With a resolve to assist those in need, including both disaster victims and returning military personnel, Team Rubicon offers opportunities for those interested in nonprofit careers as well as those passionate about helping others.

Sources: Mark Hrywna, "2017 NPT Best Nonprofits to Work," *The NonProfit Times,* https://thenonprofittimes.com, accessed May 27, 2017; Mark Hrywna, "2016 NPT Best Nonprofits to Work," *The NonProfit Times,* https://thenonprofittimes.com, accessed May 27, 2017; Kyle Dickman, "The Future of Disaster Relief Isn't the Red Cross," *Outside,* https://www.outsideonline.com, August 25, 2016; "About Us," https://teamrubiconusa.org, accessed March 5, 2026; Art delaCruz, "Team Rubicon Provides Veterans with Their Next Mission," Team Rubicon, https://teamrubiconusa.org, November 18, 2020; "2023 Disaster Relief and Humanitarian Aid Year in Review," https://teamrubiconusa.org, accessed March 5, 2026; "Financials & Annual Reports," https://teamrubiconusa.org, accessed March 5, 2026; kknox, "Southwest Airlines Announces Points For A Purpose Holiday Promotion For Rapid Reward Members," *Southwest Newsroom*, https://www.swamedia.com, December 1, 2023.

This module provides the basic structures upon which the business world is built: how it is organized, what outside forces influence it, and where it is heading. It also explores how the world's economies and governments shape economic activity. Each day in the United States, thousands of new businesses are born. Only a rare few will make it to the Fortune 500 List. Unfortunately, many others will never see their first anniversary. Those who succeed understand that change is the one constant in the business environment. Those organizations pay attention to the business environment in which they operate and the trends that affect all businesses and then successfully adapt to those trends. In this module, we will meet many businesses, both large and small, profit and not-for-profit, that prosper because they track trends and use them to identify potential opportunities. This ability to manage change is a critical factor in separating the success stories from the tales of business failure.

We begin our study of business by introducing you to the primary functions of a business, the relationship between risk and profits, and the importance of not-for-profit organizations. We'll also examine the major components of the business environment and how changing demographic, social, political and legal, and competitive factors affect all business organizations. Next, we'll explore how economies provide jobs for workers and also compete with other businesses to create and deliver products to consumers. You will also learn how governments attempt to influence economic activity through policies such as lowering or raising taxes. Then, we discuss how supply and demand determine prices for goods and services. Finally, we conclude by examining key trends in the business environment, economic systems, and the competitive environment.

1.1 The Nature of Business

1. How do businesses and not-for-profit organizations help create our standard of living?

Take a moment to think about the many different types of businesses you come into contact with on a typical day. As you commute to class or work, you may pass a gas station that is part of a major national oil company

or a fast food chain such as Chipotle or Chick-Fil-A or the neighborhood pizza place. When you need to manage money, you can do your banking on a smartphone or other device via mobile apps. You don't even have to visit the store anymore since online shopping brings the stores to you, offering everything from clothes to food, furniture, and electronics.

A **business** is an organization that strives for a profit by providing goods and services desired by its customers. Businesses meet the needs of consumers by providing medical care, autos, and countless other goods and services. **Goods** are tangible items manufactured by businesses, such as laptops. **Services** are intangible offerings of businesses that can't be held, touched, or stored. Physicians, lawyers, hairstylists, car washes, and airlines all provide services. Businesses also serve other organizations, such as hospitals, retailers, and governments, by providing machinery, goods for resale, computers, and thousands of other items.

Thus, businesses create the goods and services that are the basis of our standard of living. The **standard of living** of any country is measured by the output of goods and services people can buy with the money they have. The United States has one of the highest standards of living in the world. The standard of living also incorporates the prices of goods and services. So although some countries may have higher average wages than the United States, their standard of living may not necessarily be higher because of higher prices for goods and services. They are able to buy less because of the higher prices, despite higher average wages. For example, in the United States, you can purchase a combo meal at a fast food restaurant often for less than $10, while in another country, a similar meal might cost nearly $20.

Businesses play a key role in determining our quality of life by providing jobs and goods and services to society. **Quality of life** refers to the general level of human happiness based on such things as life expectancy, educational standards, health, sanitation, and leisure time. Building a high quality of life is a combined effort of businesses, government, and not-for-profit organizations. In 2024, Luxembourg, Denmark, and the Netherlands ranked the highest in quality of life with Switzerland, Finland, and Oman close behind. It may come as a surprise that the United States is not one of the top 10 countries in terms of quality of life. The United States was ranked 14th. The majority of the top 10 countries are in western Europe, and the lower end of the scale includes Bangladesh, Venezuela, and Nigeria.[1] Creating a quality of life is not without risks, however. **Risk** is the potential to lose time and money or otherwise not be able to accomplish an organization's goals. Without enough blood donors, for example, the American Red Cross faces the risk of not meeting the demand for blood by victims of disaster. Businesses such as Procter & Gamble face the risk of falling short of their revenue and profit goals. **Revenue** is the money a company receives by providing services or selling goods to customers. **Costs** are expenses for rent, salaries, supplies, transportation, and many other items that a company incurs from creating and selling goods and services. For example, some of the costs incurred by Procter & Gamble in producing consumer products such as paper towels and diapers include expenses for salaries, manufacturing facilities, raw materials to make the products, and advertising. If Procter & Gamble has money left over after it pays all costs, it has a **profit**. A company whose costs are greater than revenues shows a loss.

When a company such as Procter & Gamble uses its resources intelligently, it can often increase sales, hold costs down, and earn a profit. Not all companies earn profits, but that is the risk of being in business. In U.S. business today, there is generally a direct relationship between risks and profit: the greater the risks, the greater the potential for profit (or loss). Companies that take too conservative a stance may lose out to more nimble competitors who react quickly to the changing business environment.

Take Sony, for example. The Japanese electronics giant, once a leader with its Walkman music player and Trinitron televisions, steadily lost ground—and profits—over just a short time period to other companies by not embracing new technologies such as the digital music format and flat-panel TV screens. Sony misjudged what the market wanted and stayed with proprietary technologies rather than create cross-platform options for consumers. Apple, at the time an upstart in personal music devices, quickly grabbed the lion's share of the digital music market with its iPods and iTunes music streaming service. As a result, Sony had to restructure its

business portfolio and has since experienced substantial success with its gaming console and original gaming content.[2]

Not-for-Profit Organizations

Not all organizations strive to make a profit. A **not-for-profit organization** is an organization that exists to achieve some goal other than the usual business goal of profit. Organizations such as Feeding America, the Smithsonian Institution, and Amnesty International are not-for-profit organizations, as are most hospitals, zoos, arts organizations, civic groups, and religious organizations. The number of nonprofit organizations—and the employees and volunteers who work for them continues to increase. Government is our largest and most pervasive not-for-profit group. In addition, nearly 2 million nongovernmental not-for-profit entities operate in the United States today and contribute more than $1 trillion annually to the U.S. economy.[3]

Like their for-profit counterparts, these groups set goals and require resources to meet those goals. However, their goals are not focused on profits. For example, a not-for-profit organization's goal might be assisting with food security, preserving the environment, increasing attendance at an arts center, or preventing drunk driving. Not-for-profit organizations do not compete directly with one another in the same manner as, for example, Walmart and Target, but they do compete for talented employees, people's limited volunteer time, and donations.

Exhibit 1.3 Rescue boat Following Hurricane Irma, the Kentucky and Hawaii National Guard assisted storm victims in Puerto Rico by donating to disaster relief efforts. Some not-for-profit charities focused aid toward the people of the region, but others delivered care to a different group of sufferers: animals and pets. Although most animal hospitals are not normally a refuge for displaced animals, many facilities opened their doors to pet owners affected by the torrential rains. *Why are tasks such as animal rescue managed primarily through not-for-profit organizations?* (Credit: Hawaii and Kentucky National Guard /flickr /Attribution 2.0 Generic (CC BY))

The boundaries that formerly separated not-for-profit and for-profit organizations have blurred, leading to a greater exchange of ideas between the sectors. As discussed in detail in the ethics chapter, for-profit businesses are now addressing social issues. Successful not-for-profits apply business principles to operate more effectively. Not-for-profit managers are concerned with the same concepts as their colleagues in for-profit companies: developing strategy, budgeting carefully, measuring performance, encouraging innovation, improving productivity, demonstrating accountability, and fostering an ethical workplace environment.

In addition to pursuing a museum's artistic goals, for example, top executives manage the administrative and business side of the organization: human resources, finance, and legal concerns. Ticket revenues cover a fraction of the museum's operating costs, so the director spends a great deal of time seeking major donations and memberships. Today's museum boards of directors include both art patrons and business executives who want to see sound fiscal decision-making in a not-for-profit setting. Therefore, a museum director must walk a fine line between the institution's artistic mission and financial policies.

Factors of Production: The Building Blocks of Business

To provide goods and services, regardless of whether they operate in the for-profit or not-for-profit sector, organizations require inputs in the form of resources called **factors of production**. Those factors are categorized into four groupings: land (including natural resources), labor (people and the skills they bring), capital (money used to purchase needed assets), and entrepreneurship (business acumen to bring it all together). By using the factors of production efficiently, a company can produce more goods and services with the same resources.

Commodities that are useful inputs in their natural state are known as natural resources. They include farmland, forests, mineral and oil deposits, and water. Sometimes natural resources are simply called land, although, as you can see, the term means more than just land. Companies use natural resources in different ways. Procter & Gamble uses cotton to make diapers and Exxon Mobil may use water and oil to produce gasoline. Today urban sprawl, pollution, and limited resources have raised questions about resource use. Conservationists, environmentalists, and government bodies work toward creating legislation to require land-use planning and resources conservation that help ensure responsible usage of our natural resources.

Labor, or human resources, refers to the economic contributions of people working with their minds and muscles. This input includes the talents of everyone—from a restaurant cook to a nuclear physicist—who performs the many tasks of manufacturing and selling goods and services.

The tools, machinery, equipment, and buildings used to produce goods and services and get them to the consumer are known as **capital**. Sometimes the term *capital* is also used to mean the money that buys machinery, factories, and other production and distribution facilities. However, because money itself produces nothing, it is not one of the basic inputs. Instead, it is a means of acquiring the inputs. Therefore, in this context, capital does not include money.

Entrepreneurs are the people who combine the inputs of natural resources, labor, and capital to produce goods or services with the intention of making a profit or accomplishing a not-for-profit goal. These people make the decisions that set the course for their businesses; they create products and production processes or develop services. Because they are not guaranteed a profit in return for their time and effort, they must be risk-takers. Of course, if their companies succeed, the rewards may be great.

Today, many individuals want to start their own businesses. They are attracted by the opportunity to be their own boss and reap the financial rewards of a successful firm. Many start their first business from their dorm rooms, such as Mark Zuckerberg of Meta, or while living at home, so their cost is almost zero. Entrepreneurs include people such as Amazon's founder, Jeff Bezos, as well as Elon Musk of Tesla and SpaceX, and Walt Disney. Many thousands of individuals have started companies that, while remaining small, make a major contribution to the U.S. economy.

CATCHING THE ENTREPRENEURIAL SPIRIT

StickerGiant Embraces Change

Entrepreneurs typically are not afraid to take risks or change the way they do business if it means there is a better path to success. Company founder John Fischer fits the profile.

The drawn-out U.S. presidential election in 2000 between Bush and Gore inspired Fischer to create a bumper sticker that claimed, “He’s Not My President,” which became a top seller. As a result of this venture, Fischer started an online retail sticker store, which he viewed as possibly the “Amazon of Stickers.” Designing and making stickers in his basement, Fischer’s start-up would eventually become a multimillion-dollar company, recognized in 2017 by *Forbes* as one of its top 25 small businesses.

The StickerGiant online store was successful, supplying everything from sports stickers to ones commemorating rock and roll bands and breweries. By 2011, the business was going strong; however, the entrepreneur decided to do away with the retail store, instead focusing the business on custom orders, which became StickerGiant's main product.

As the company became more successful and added more employees, Fischer once again looked to make some changes. In 2012 he decided to introduce a concept called open-book management, in which he shares the company's financials with employees at a weekly meeting. Other topics discussed at the meeting include customer comments and feedback, employee concerns, and colleague appreciation for one another. Fischer believes sharing information about the company's performance (good or bad) not only allows employees to feel part of the operation, but also empowers them to embrace change or suggest ideas that could help the business expand and flourish.

Innovation is also visible in the technology StickerGiant uses to create miles and miles of custom stickers. The manufacturing process involves digital printing and laser-finishing equipment. Fischer says only five other companies worldwide have the laser-finishing equipment StickerGiant uses as part of its operations. Because of the investment in this high-tech equipment, the company can make custom stickers in large quantities overnight and ship them to customers the next day.

This small business continues to evolve with an entrepreneur at the helm who is not afraid of making changes or having fun. In 2016, StickerGiant put together Saul the Sticker Ball, a *Guinness World Records* winner that weighed in at a whopping 232 pounds. Fischer and his employees created Saul when they collected more than 170,000 stickers that had been lying around the office and decided to put them to good use. StickerGiant, now part of Resource Label Group (acquired in 2021), operates with roughly 50 to 200 employees and estimated revenue well above $10 million.

Questions for Discussion

1. How does being a risk-taker help Fischer in his business activities?
2. If you were a small business owner, would you consider sharing the company's financial data with employees? Explain your reasoning.

Sources: "All About StickerGiant," https://www.stickergiant.com, accessed May 29, 2017; Bo Burlingham, "Forbes Small Giants 2017: America's Best Small Companies," *Forbes,* https://www.forbes.com, May 9, 2017; Karsten Strauss, "Making Money and Breaking Records in the Sticker Business," *Forbes,* https://www.forbes.com, January 26, 2016; Emilie Rusch, "StickerGiant Does Big Business in Tiny Town of Hygiene," *Denver Post,* April 19, 2016, https://www.denverpost.com; Eric Peterson, "StickerGiant," *Company Week,* https://companyweek.com, September 5, 2016; Resource Label Group, "Resource Label Group Completes Acquisition of StickerGiant.com" *Business Wire*, https://www.businesswire.com, October 7, 2021.

A number of outstanding managers and noted academics emphasize knowledge as a key factor of production. **Knowledge** refers to the combined talents and skills of the workforce and has become a primary driver of economic growth. Today's competitive environment places a premium on knowledge and learning over physical resources. Statistics suggest that the number of U.S. **knowledge workers** is over 70 million and represents nearly 50 percent of the total workforce. Although some jobs and tasks have been replaced by automation or outsourced globally, technological advancements have actually created more jobs that require specialized knowledge and skills.[4]

CONCEPT CHECK

1. Explain the concepts of revenue, costs, and profit.
2. What are the five factors of production?
3. What is the role of an entrepreneur in society?

1.2 Understanding the Business Environment

2. What are the sectors of the business environment, and how do changes in them influence business decisions?

Businesses do not operate in a vacuum but rather in a dynamic environment that has a direct influence on how they operate and whether they will achieve their objectives. This external business environment is composed of numerous outside organizations and forces that we can group into broad categories, as **Exhibit 1.4** illustrates: economic, political/legal, social, technological, global, demographic, and competitive. Each of these sectors creates a unique set of challenges and opportunities for businesses.

Business owners and managers have a great deal of control over the internal environment of business, which covers day-to-day decisions. They choose the supplies they purchase, which employees they hire, the products they sell, and where they sell those products. They use their skills and resources to create goods and services that will satisfy existing and prospective customers. However, the external environmental conditions that affect a business are generally beyond the control of management and change constantly. To compete successfully, business owners and managers must continuously study the environment and adapt their businesses accordingly.

Other forces, such as natural disasters and human-made disasters, can also have a major impact on businesses. While still in the rebuilding stage after Hurricane Katrina hit in 2005, the U.S. Gulf Coast suffered another disaster in April 2010 as a result of an explosion on the Deepwater Horizon oil-rig, which killed 11 workers and sent more than 3 million barrels of oil into the Gulf of Mexico. This event, which played out for more than 87 days, severely affected the environment, businesses, tourism, and people's livelihoods. Global oil conglomerate BP, which was responsible for the oil spill, has spent more than $60 billion in response to the disaster and cleanup. Years after the explosion, tourism and other businesses are recovering, although scientists will continue to discover the long-term environmental consequences of the oil spill.[5]

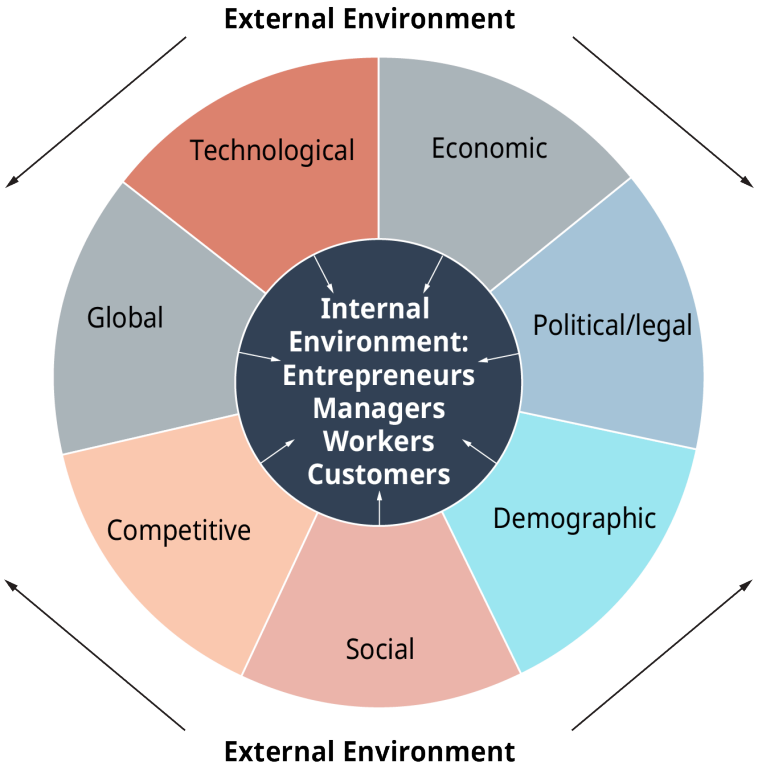

Exhibit 1.4 The Dynamic Business Environment (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

No one business is large or powerful enough to create major changes in the external environment. Thus, managers are primarily adapters to, rather than agents of, change. Global competition is basically an uncontrollable element in the external environment. In some situations, however, a firm can influence external events through its strategies. For example, major U.S. pharmaceutical companies have been successful in getting the Food and Drug Administration (FDA) to speed up the approval process for new drugs.[6] The five largest companies in the S&P Index—Apple, Microsoft, NVIDIA, Alphabet (Google), and Amazon, with Meta (Facebook) following close behind—annually spend millions on lobbying activities in the nation's capital in an effort to help policy makers understand the tech industry and the importance of innovation and an "open" internet.[7] Let's now take a brief look at these varied environmental influences.

Economic Influences

This category is one of the most important external influences on businesses. Fluctuations in the level of economic activity create business cycles that affect businesses and individuals in many ways. When the economy is growing, for example, unemployment rates are low, and income levels rise. Inflation and interest rates are other areas that change according to economic activity. Through the policies it sets, such as taxes and interest rate levels, a government attempts to stimulate or curtail the level of economic activity. In addition, the forces of supply and demand determine how prices and quantities of goods and services behave in a free market.

Political and Legal Influences

The political climate of a country is another critical factor for managers to consider in day-to-day business operations. The amount of government activity, the types of laws it passes, and the general political stability of a government are three components of political climate. For example, a multinational company such as 3M will evaluate the political climate of a country before deciding to locate a plant there. Is the government stable, or might a coup disrupt the country? How restrictive are the regulations for foreign businesses, including foreign ownership of business property and taxation? Import tariffs, quotas, and export restrictions also must be taken into account.

In the United States, laws passed by Congress and the many regulatory agencies cover such areas as competition, minimum wages, environmental protection, worker safety, and copyrights and patents. For example, Congress passed the Telecommunications Act of 1996 to deregulate the telecommunications industry. As a result, competition increased and new opportunities arose as traditional boundaries between service providers blurred. With the technological advancements, the focus of the telecommunications industry has shifted to AI, network infrastructure and optimization to reduce costs, and cybersecurity.[8]

Federal agencies play a significant role in business operations. When Johnson & Johnson wants to bring a new medication for heart disease to market, it must follow the procedures set by the Food and Drug Administration for testing and clinical trials and secure FDA approval. Before issuing stock, Johnson & Johnson must register the securities with the Securities and Exchange Commission. The Federal Trade Commission will penalize Johnson & Johnson if its advertisements promoting the drug's benefits are misleading. These are just a few ways the political and legal environment affect business decisions.

States and local governments also exert control over businesses—imposing taxes, issuing corporate charters and business licenses, setting zoning ordinances, and similar regulations. We discuss the legal environment in greater detail in a separate appendix.

Demographic Factors

Demographic factors are an uncontrollable factor in the business environment and extremely important to managers. **Demography** is the study of people's vital statistics, such as their age, gender, race and ethnicity, and location. Demographics help companies define the markets for their products and also determine the size and composition of the workforce. You'll encounter demographics as you continue your study of business.

Demographics are at the heart of many business decisions. Businesses today must deal with the unique shopping preferences of different generations, which each require marketing approaches and goods and services targeted to their needs. For example, the more than 75 million members of the millennial generation were born between 1981 and 1997, becoming America's largest generation.[9] The marketing impact of millennials continues to be immense. They are technologically savvy and digitally connected with billions of dollars to spend mostly on travel and entertainment.[10] Other age groups, such as Generation X—people born between 1965 and 1980—and the baby boomers—born between 1946 and 1964—also have their own spending patterns. Many boomers have money and are willing to spend it on healthcare, dining out, and leisure activities. As demographics shift, businesses are adapting and offering more products that appeal to the current spenders.[11]

In addition, minorities represent nearly half of the total population, with immigration bringing millions of new residents to the country over the past several decades. By 2060 the U.S. Census Bureau projects the minority population to increase to 56 percent of the total U.S. population.[12] Companies recognize the value of hiring a diverse workforce that reflects our society. Minorities' buying power has increased significantly as well, and companies are developing products and marketing campaigns that target different ethnic groups.

Social Factors

Social factors—our attitudes, values, ethics, and lifestyles—influence what, how, where, and when people purchase products or services. They are difficult to predict, define, and measure because they can be very subjective. They also change as people move through different life stages. Although we can develop traditional consumer profiles, people have a range of interests that might present a deviation from expected purchasing habits. Family dynamics change and evolve over time. Shifts such as dual-income households, higher demand for time-saving goods and services, and changing family shopping patterns from in-store to online all present challenges to businesses when marketing their products. In addition, companies are facing a emphasis on managing ethical behavior in their organizations and navigating the challenges of societal shifts with regard to diversity and inclusion.

MANAGING CHANGE

Balancing Comes Easy at H&R Block

In an industry driven by deadlines and details, it's hard to imagine striking a balance between work and everyday life for full-time employees and seasonal staff. Fortunately, the management team at H&R Block not only believes in maintaining a strong culture, it also tries to offer flexibility to its more than 70,000 employees and seasonal workers in 12,000 retail offices worldwide.

Based in Kansas City, Missouri, and built on a culture of providing exceptional customer service, H&R Block has been repeatedly named the top U.S. business with the best work-life balance by online job search site Indeed. Analyzing more than 10 million company reviews by employees, Indeed researchers annually identify the top 20 firms with the best "Work Well-Being." H&R Block is consistently listed in the top 20, along with mortgage lender Network Capital Funding Corporation, fast food chain In-N-Out Burger, Texas food retailer H-E-B, and health services company Kaiser Permanente, among others.

According to Paul Wolfe, former SVP of human resources at Indeed, empathy on the part of organizations is a key factor in helping employees achieve balance. Wolfe says companies that demonstrate empathy and work diligently to provide personal time for all employees tend to take the top spots on the work-life balance list. "Comments we have seen from employee reviews for these companies indicate 'fair' and 'flexible work environments,'" he says.

In this 24/7 world, when no one is far from a text or tweet, finding time for both family and work can be difficult, especially in the tax services industry, which is so schedule driven for a good part of the year. Making a commitment to help workers achieve a healthy work-life balance not only helps its employees, but it also helps H&R Block retain workers in a tight labor market where individuals continue to have choices when it comes to where and for whom they want to work.

Questions for Discussion

1. How does management's support of employee work-life balance help the company's bottom line?
2. What can other organizations learn from H&R Block when it comes to offering employee perks that encourage personal time for workers even during the busy tax season?

Sources: "Career Opportunities," https://www.hrblock.com, accessed May 25, 2017; "About Us," https://newsroom.hrblock.com, accessed May 25, 2017; Abigail Hess, "The 20 Best Companies for Work-Life Balance," *CNBC,* https://www.cnbc.com, May 4, 2017; Kristen Bahler, "The 20 Best Companies for Work-Life Balance," *Money,* https://time.com, April 20, 2017; Rachel Ritlop, "3 Benefits Companies Can Provide to Boost Work-Life Balance," *Forbes,* https://www.forbes.com, January 30, 2017.

Technology

The application of technology can stimulate growth under capitalism or any other economic system. **Technology** is the application of science and engineering skills and knowledge to solve production and organizational problems. New equipment and software that improve productivity and reduce costs can be among a company's most valuable assets. The emergence and growth of AI technology is having a significant impact on the business environment. This technology can expedite solving production and organizational problems as well as open up new business opportunities. It can be incorporated into virtually all business functions in some capacity. As the technology evolves, businesses will need to adapt to take advantage of the benefits. **Productivity** is the amount of goods and services an individual can produce. Our ability as a nation to maintain and build wealth depends in large part on the speed and effectiveness with which we use technology—to invent and adapt more efficient equipment to improve manufacturing productivity, to develop

new products, and to process information and make it instantly available across the organization and to suppliers and customers.

Many U.S. businesses, large and small, use technology to create change, improve efficiencies, and streamline operations. For example, advances in cloud computing provide businesses with the ability to access and store data without running applications or programs housed on a physical computer or server in their offices. Such applications and programs can now be accessed through the internet. Mobile technology allows businesses to communicate with employees, customers, suppliers, and others at the swipe of a tablet or smartphone screen. Robots help businesses automate repetitive tasks that free up workers to focus on more knowledge-based tasks critical to business operations.[13]

CONCEPT CHECK

1. Define the components of the internal and the external business environments.
2. What factors within the economic environment affect businesses?
3. Why do demographic shifts and technological developments create both challenges and new opportunities for business?

1.3 How Business and Economics Work

3. What are the primary features of the world's economic systems, and how are the three sectors of the U.S. economy linked?

A business's success depends in part on the economic systems of the countries where it is located and where it sells its products. A nation's **economic system** is the combination of policies, laws, and choices made by its government to establish the systems that determine what goods and services are produced and how they are allocated. **Economics** is the study of how a society uses scarce resources to produce and distribute goods and services. The resources of a person, a firm, or a nation are limited. Hence, economics is the study of choices—what people, firms, or nations choose from among the available resources. Every economy is concerned with what types and amounts of goods and services should be produced, how they should be produced, and for whom. These decisions are made by the marketplace, the government, or both. In the United States, the government and the free-market system together guide the economy.

You probably know more about economics than you realize. Every day, many news stories deal with economic matters: employees at a large corporation decide to strike demanding higher wages and better benefits, interest rates are changed by the Federal Reserve, the S&P 500 has a record day, lawmakers review a proposal to cut taxes, consumer spending responds to changes in the inflation rate, to mention just a few examples.

Global Economic Systems

Businesses and other organizations operate according to the *economic systems* of their home countries. Today the world's major economic systems fall into two broad categories: free market, or capitalism; and planned economies, which include communism and socialism. However, in reality many countries use a mixed market system that incorporates elements from more than one economic system.

The major differentiator among economic systems is whether the government or individuals decide:

- How to allocate limited resources—the factors of production—to individuals and organizations to best satisfy unlimited societal needs
- What goods and services to produce and in what quantities
- How and by whom these goods and services are produced

- How to distribute goods and services to consumers

Managers must understand and adapt to the economic system or systems in which they operate. Companies that do business internationally may discover that they must make changes in production and selling methods to accommodate the economic system of other countries. Table 1.1 summarizes key factors of the world's economic systems.

The Basic Economic Systems of the World				
	Capitalism	**Communism**	**Socialism**	**Mixed Economy**
Ownership of Business	Businesses are privately owned with minimal government ownership or interference.	Government owns all or most enterprises.	Basic industries such as railroads and utilities are owned by government. Very high taxation as government redistributes income from successful private businesses and entrepreneurs.	Private ownership of land and businesses but government control of some enterprises. The private sector is typically large.
Control of Markets	Exercised by private individuals and businesses, where the forces of supply and demand control the market with limited governmental control.	Complete government control of markets.	Some markets are controlled, and some are free. Significant central-government planning. State enterprises are managed by bureaucrats. These enterprises are rarely profitable.	Some markets, such as nuclear energy and the post office, are controlled or highly regulated.
Worker Incentives	Strong incentive to work and innovate because profits are retained by owners.	Working is a societal obligation to advance the common good, an obligation of citizenship.	Private-sector incentives are the same as capitalism, and public-sector incentives are the same as in a planned economy.	Private-sector incentives are the same as capitalism. Limited incentives in the public sector.
Management of Enterprises	Each enterprise is managed by owners or professional managers with little government interference.	Centralized management by the government bureaucracy. Little or no flexibility in decision-making at the factory level.	Significant government planning and regulation. Bureaucrats run government enterprises.	Private-sector management similar to capitalism. Public sector similar to socialism.

Table 1.1

The Basic Economic Systems of the World				
	Capitalism	**Communism**	**Socialism**	**Mixed Economy**
Adaptation to Change	Quick response to change allowing the market to drive the adoption of new products and technologies.	Strategic approach to change driven by government.	Slow and steady growth with centralized decisions based on what is socially optimal.	Some government intervention to control the market, so change is not as swift or as organic as in a capitalist economy.
Historic Examples	United States	Cuba, North Korea	Finland, India, Israel	Great Britain, France, Sweden, Canada

Table 1.1

Capitalism

In recent decades, more countries have shifted toward free-market economic systems and away from planned economies. Sometimes, as was the case of the former East Germany, the transition to capitalism was painful but fairly quick. In other countries, such as Russia, the movement has been characterized by false starts and backsliding. **Capitalism**, also known as the *private enterprise system*, is based on competition in the marketplace and private ownership of the factors of production (resources). In a competitive economic system, a large number of people and businesses buy and sell products freely in the marketplace. In pure capitalism, all the factors of production are owned privately, and the government does not try to set prices or coordinate economic activity.

A capitalist system guarantees certain economic rights: the right to own property, the right to make a profit, the right to make free choices, and the right to compete. The right to own property is central to capitalism. The main incentive in this system is profit, which encourages entrepreneurship. Profit is also necessary for producing goods and services, building manufacturing plants, paying dividends and taxes, and creating jobs. The freedom to choose whether to become an entrepreneur or to work for someone else means that people have the right to decide what they want to do on the basis of their own drive, interest, and training. The government does not create job quotas for each industry or give people tests to determine what they will do.

Competition is good for both businesses and consumers in a capitalist system. It leads to better and more diverse products, keeps prices stable, and increases the efficiency of producers. Companies try to produce their goods and services at the lowest possible cost and sell them at the highest possible price. But when profits are high, more businesses enter the market to seek a share of those profits. The resulting competition among companies tends to lower prices. Companies must then find new ways of operating more efficiently if they are to keep making a profit—and stay in business.

Exhibit 1.5 McDonald's China (sold in 2017 to Citic Capital and The Carlyle Group) Since joining the World Trade Organization in 2001, China has continued to embrace tenets of capitalism and grow its economy. China is the world's largest producer of mobile phones, PCs, and tablets, and the country's over one billion people constitute a gargantuan market. The explosion of KFC franchises (operating over 10,000 locations in China) epitomizes the success of American-style capitalism in China, and Beijing's hosting of the 2022 Winter Olympics is a sign of economic openness. This McCafe is an example of changing Western products to suit Chinese tastes. *Do you think China's capitalistic trend can continue to thrive under the ruling Chinese Communist Party that opposes workers' rights, free speech, and democracy?* (Credit: Marku Kudjerski/ flickr/ Attribution 2.0 Generic (CC BY 2.0)

Communism

The complete opposite of capitalism is **communism**. In a communist economic system, the government owns virtually all resources and controls all markets. Economic decision-making is centralized: the government, rather than the competitive forces in the marketplace, decides what will be produced, where it will be produced, how much will be produced, where the raw materials and supplies will come from, who will get the output, and what the prices will be. This form of centralized economic system offers little if any choice to a country's citizens. Early in the 20th century, countries that chose communism, such as the former Soviet Union and China, believed that it would raise their standard of living. In practice, however, the tight controls over most aspects of people's lives, such as what careers they can choose, where they can work, and what they can buy, led to lower productivity. Individuals work because of a moral obligation to the overall good of the society. Working is viewed as a requirement of citizenship. Because of the centralized control and planning of market activity and resource allocations, supply shortages can occur.

These factors were among the reasons for the 1991 collapse of the Soviet Union into multiple independent nations. Recent reforms in Russia, China, and most of the eastern European nations have moved these economies toward more capitalistic, market-oriented systems. North Korea and Cuba are the best remaining examples of communist economic systems. Time will tell whether Cuba takes small steps toward a market economy now that the United States reestablished diplomatic relations with the island country.[14]

Socialism

Socialism is an economic system in which the basic industries are owned by the government or by the private sector under strong government control. A socialist state controls critical, large-scale industries such as transportation, communications, and utilities. Smaller businesses and those considered less critical, such as retail, may be privately owned. To varying degrees, the state also determines the goals of businesses, the prices and selection of goods, and the rights of workers. Socialist countries typically provide their citizens with a higher level of services, such as health care and unemployment benefits, than do most capitalist countries. As a result, taxes and unemployment may also be higher in socialist countries. For example, the top individual tax rate in France is 45 percent, compared to 37 percent in the United States. Tax cuts are often a campaign promise in election years as part of an overall economic agenda.[15]

Many countries, including the United Kingdom, Denmark, India, and Israel, have socialist systems, but the

systems vary from country to country. In Denmark, for example, most businesses are privately owned and operated, but two-thirds of the population is sustained by the state through government welfare programs.

Mixed Economic Systems

Pure capitalism and communism are extremes; real-world economies fall somewhere between the two. The U.S. economy leans toward pure capitalism, but it uses government policies to promote economic stability and growth. Also, through policies and laws, the government uses funds to provide social supports, such as to low-income or unemployed individuals, or people with disabilities. American capitalism has produced some very powerful organizations in the form of large corporations, such as Johnson & Johnson and Verizon. To protect smaller firms and entrepreneurs, the government has passed legislation that requires that the giants compete fairly against weaker competitors.

Canada, Sweden, and the UK, among others, are also called **mixed economies**; that is, they use more than one economic system. Sometimes, the government is basically socialist and owns basic industries. In Canada, for example, the government owns the communications, transportation, and utilities industries, as well as some of the natural-resource industries. It also provides health care to its citizens. But most other activity is carried on by private enterprise, as in a capitalist system. In 2016, UK citizens voted for Britain to leave the European Union. The impact of the Brexit decision on the UK economy and other economies around the world has been mixed, with some highlighting that the positive outcomes outweigh the short-term negative impacts.[16]

The few factors of production owned by the government in a mixed economy include some public lands, the postal service, and some water resources. But the government is extensively involved in the economic system through taxing, spending, and welfare activities. The economy is also mixed in the sense that the country tries to achieve many social goals—income redistribution and retirement pensions, for example—that may not be attempted in purely capitalist systems.

Macroeconomics and Microeconomics

The state of the economy affects both people and businesses. Personal economic decisions involve deciding how and when to spend or save money for items such as education or leisure activities. Every business also operates within the economy. Based on their economic expectations, businesses decide what products to produce, how to price them, how many people to employ, how much to pay these employees, how much to expand the business, and so on.

Economics has two main subareas. **Macroeconomics** is the study of the economy as a whole. It looks at *aggregate* data for large groups of people, companies, or products considered as a whole. In contrast, **microeconomics** focuses on individual parts of the economy, such as households or firms.

Both *macroeconomics* and *microeconomics* offer a valuable outlook on the economy. For example, Toyota might use both to decide whether to introduce a new line of vehicles. The company would consider such macroeconomic factors as the national level of personal income, the unemployment rate, interest rates, fuel costs, and the national level of sales of new vehicles. From a microeconomic viewpoint, Toyota would judge consumer demand for new vehicles versus the existing supply, competing models, labor and material costs and availability, and current prices and sales incentives.

Economics as a Circular Flow

Another way to see how the sectors of the economy interact is to examine the **circular flow** of inputs and outputs among households, businesses, and governments as shown in **Exhibit 1.6**. Let's review the exchanges by following the middle ring of the diagram. Households provide inputs (natural resources, labor, capital, entrepreneurship, knowledge) to businesses, which convert these inputs into outputs (goods and services) for consumers. In return, households receive income from rent, wages, interest, and ownership profits (blue circle). Businesses receive revenue from consumer purchases of goods and services.

The other important exchange in **Exhibit 1.6** takes place between governments (federal, state, and local) and

both households and businesses. Governments supply many types of publicly provided goods and services (highways, schools, police, courts, health services, unemployment insurance, social security) that benefit consumers and businesses. Government purchases from businesses also contribute to business revenues. When a construction firm repairs a local stretch of state highway, for example, government pays for the work. As the diagram shows, government receives taxes from households and businesses to complete the flow.

Changes in one flow affect the others. If government raises taxes, households have less to spend on goods and services. Lower consumer spending causes businesses to reduce production, and economic activity declines; unemployment may rise. In contrast, cutting taxes can stimulate economic activity. Keep the circular flow in mind as we continue our study of economics. The way economic sectors interact will become more evident as we explore macroeconomics and microeconomics.

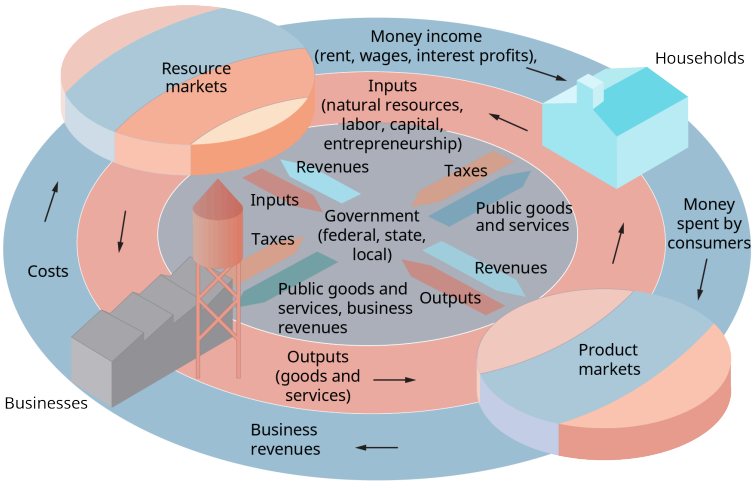

Exhibit 1.6 Economics as a Circular Flow (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

CONCEPT CHECK

1. What is economics, and how can you benefit from understanding basic economic concepts?
2. Compare and contrast the world's major economic systems. Why is capitalism growing, communism declining, and socialism still popular?
3. What is the difference between macroeconomics and microeconomics?

1.4 Macroeconomics: The Big Picture

4. How do economic growth, full employment, price stability, and inflation indicate a nation's economic health?

Have you ever looked at CNN's *Headline News* on a mobile device or turned on the radio and heard something like, "Today the Labor Department reported that for the second straight month unemployment declined"? Statements like this are macroeconomic news. Understanding the national economy and how changes in government policies affect households and businesses is a good place to begin our study of economics.

Let's look first at macroeconomic goals and how they can be met. The United States and most other countries have three main macroeconomic goals: economic growth, full employment, and price stability. A nation's economic well-being depends on carefully defining these goals and choosing the best economic policies for achieving them.

Striving for Economic Growth

Perhaps the most important way to judge a nation's economic health is to look at its production of goods and services. The more the nation produces, the higher its standard of living. An increase in a nation's output of goods and services is **economic growth**.

The most basic measure of economic growth is the **gross domestic product (GDP)**. GDP is the total market value of all final goods and services produced within a nation's borders each year. The Bureau of Labor Statistics publishes quarterly GDP figures that can be used to compare trends in national output. When GDP rises, the economy is growing.

The rate of growth in real GDP (GDP adjusted for inflation) is also important. For many years, the U.S. economy has been growing at a slow but steady rate of between 3 and 4 percent annually. This growth rate has meant a steady increase in the output of goods and services and relatively low unemployment. When the growth rate slides toward zero, the economy begins to stagnate and decline.

One country that continues to grow more rapidly than most is China, whose GDP has been growing around 5 percent per year. Today few things in the global marketplace are not or cannot be made in China. The primary contributor to China's rapid growth has been technology. For example, most tablets and laptops are manufactured in China.

The level of economic activity is constantly changing. These upward and downward changes are called **business cycles**. Business cycles vary in length, in how high or low the economy moves, and in how much the economy is affected. Changes in GDP trace the patterns as economic activity expands and contracts. An increase in business activity results in rising output, income, employment, and prices. Eventually, these all peak, and output, income, and employment decline. A decline in GDP that lasts for two consecutive quarters (each a three-month period) is called a **recession**. It is followed by a recovery period when economic activity once again increases. The Great Recession began in December 2007 and ended in June 2009. However, the more recent recession was during the beginning of the COVID-19 pandemic.

Businesses must monitor and react to the changing phases of business cycles. When the economy is growing, companies often have a difficult time hiring good employees and finding scarce supplies and raw materials. When a recession hits, many firms find they have more capacity than the demand for their goods and services requires. During a recession, many businesses operate at substantially lower than capacity. When plants use only part of their capacity, they operate inefficiently and have higher costs per unit produced. Let's say that Mars Inc. has a huge plant that can produce one million bags of Skittles a day, but because of a recession Mars can sell only half a million candy bars a day. The plant uses large, expensive machines. Producing Milky Ways at 50 percent capacity does not efficiently utilize Mars's investment in its plant and equipment.

Keeping People on the Job

Another macroeconomic goal is **full employment**, or having jobs for all who want to and can work. Full employment doesn't actually mean 100 percent employment. Some people choose not to work for personal reasons (attending school, raising children) or are temporarily unemployed while they wait to start a new job. Thus, the government defines full employment as the situation when about 94 to 96 percent of those available to work actually have jobs. During the COVID-19 recession in the United States, the unemployment rate rose to nearly 15 percent in the early months of the pandemic. Today, that rate hovers at about 4 percent.[17]

Maintaining low unemployment levels is of concern not just to the United States but also to countries around the world. For example, high youth unemployment rates (for workers 25 years of age and younger) in Spain, Italy, and Greece have caused protests in these European countries as elected officials struggle with how to turn around their respective economies and put more people, particularly young people, back to work. Changes such as the UK's exit from the European Union have the potential for widespread impacts to the labor market that could be both positive and negative.[18]

Measuring Unemployment

To determine how close we are to full employment, the government measures the **unemployment rate**. This rate indicates the percentage of the total labor force that is not working but is actively looking for work. It excludes "discouraged workers," those not seeking jobs because they think no one will hire them. Each month the U.S. Department of Labor releases statistics on employment. These figures help us understand how well the economy is doing.

Types of Unemployment

Economists classify unemployment into four types: frictional, structural, cyclical, and seasonal. The categories are of small consolation to someone who is unemployed, but they help economists understand the problem of unemployment in our economy.

Frictional unemployment is short-term unemployment that is not related to the business cycle. It includes people who are unemployed while waiting to start a better job, those who are reentering the job market, and those entering for the first time, such as new college graduates. This type of unemployment is always present and has little impact on the economy.

Structural unemployment is also unrelated to the business cycle but is involuntary. It is caused by a mismatch between available jobs and the skills of available workers in an industry or a region. For example, if the birthrate declines, fewer teachers will be needed. Or the available workers in an area may lack the skills that employers want. Retraining and skill-building programs are often required to reduce structural unemployment.

Cyclical unemployment, as the name implies, occurs when a downturn in the business cycle reduces the demand for labor throughout the economy. In a long recession, cyclical unemployment is widespread, and even people with good job skills can't find jobs. The government can partly counteract cyclical unemployment with programs that boost the economy.

In the past, cyclical unemployment affected mainly less-skilled workers and those in heavy manufacturing. Typically, they would be rehired when economic growth increased. Since the 1990s, however, competition has forced many U.S. companies to downsize so they can survive in the global marketplace. These job reductions affected workers in all categories, including middle management and other salaried positions. Firms continue to reevaluate workforce requirements and downsize to stay competitive to compete with companies worldwide. For example, after a strong rebound from the Great Recession in the early 2000s when the auto industry slashed more than 200,000 hourly and salaried workers from their payrolls, the automakers are now taking another close look at the size of their global workforces. For example, Ford's workforce in North America was increased by 25 percent over a 5-year time period. Then, in response to leveling car sales figures, the workforce was reduced to lower costs, boost profits, and manage the stock value for shareholders.[19]

The last type is **seasonal unemployment**, which occurs during specific times of the year in certain industries. Employees subject to seasonal unemployment include retail workers hired for busy holiday seasons, agricultural laborers varying throughout growing seasons, and service employees in seasonal tourist destinations.

Keeping Prices Steady

The third macroeconomic goal is to keep overall prices for goods and services fairly steady. The situation in which the average of all prices of goods and services is rising is called **inflation**. Inflation's higher prices reduce **purchasing power**, the value of what money can buy. Purchasing power is a function of two things: inflation and income. If incomes rise at the same rate as inflation, there is no change in purchasing power. If prices go up but income doesn't rise or rises at a slower rate, a given amount of income buys less, and purchasing power falls. For example, if the price of a basket of groceries rises from $30 to $40 but your salary remains the same, you can buy only 75 percent as many groceries ($30 ÷ $40) for $30. Your purchasing power

declines by 25 percent ($10 ÷ $40). If incomes rise at a rate faster than inflation, then purchasing power increases. So you can, in fact, have rising purchasing power even if inflation is increasing. Typically, however, inflation rises faster than incomes, leading to a decrease in purchasing power.

Inflation affects both personal and business decisions. When prices are rising, people tend to spend more—before their purchasing power declines further. Businesses that expect inflation often increase their supplies, and people often speed up planned purchases of cars and major appliances.

Historically, the inflation rate in the United States has hovered around 4 percent; however, it has surged as high as nearly 14 percent in response to economic conditions. For example, in the 1980s, the United States had periods of inflation in the 12 to 13 percent range.[20] Some nations have had high double- and even triple-digit inflation rates. For example, the inflation rate in Cuba is nearly 30 percent and Argentina's is almost 200 percent.[21]

Exhibit 1.7 Nespresso Buyers of Nespresso coffee and other Nestlé products are paying more for these items as the company responds to increased input costs of raw materials. These price increases have been challenging for food-related businesses, raising the prices of production, packaging, and logistics. *How might fluctuations in the producer price index (PPI) affect the consumer price index (CPI) and why?* (Credit: Kārlis Dambrāns/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Types of Inflation

There are two types of inflation. **Demand-pull inflation** occurs when the demand for goods and services is greater than the supply. Would-be buyers have more money to spend than the amount needed to buy available goods and services. Their demand, which exceeds the supply, tends to pull prices up. This situation is sometimes described as “too much money chasing too few goods.” The higher prices lead to greater supply, eventually creating a balance between demand and supply.

Cost-push inflation is triggered by increases in production costs, such as expenses for materials and wages. These increases push up the prices of final goods and services. Wage increases are a major cause of cost-push inflation, creating a “wage-price spiral.” For example, assume the UAW (United Automobile, Aerospace, and Agricultural Implement Workers of America International Union—labor union advocating for employees in those industries) negotiates a three-year labor agreement that raises wages 3 percent per year and increases overtime pay. Carmakers will then raise car prices to cover their higher labor costs. Also, the higher wages will give autoworkers more money to buy goods and services, and this increased demand may pull up other prices. Workers in other industries will demand higher wages to keep up with the increased prices, and the cycle will push prices even higher.

How Inflation Is Measured

The rate of inflation is most commonly measured by looking at changes in the **consumer price index (CPI)**, an index of the prices of a “market basket” of goods and services purchased by typical urban consumers. It is

published monthly by the Department of Labor. Major components of the CPI, which are weighted by importance, are food and beverages, clothing, transportation, housing, medical care, recreation, and education. There are special indexes for food and energy. The Department of Labor collects about 100,000 retail price quotes and 8,000 housing rent figures to calculate the CPI.

The CPI sets prices in a base period at 100. The base period, which now is 1982–1984, is chosen for its price stability. Current prices are then expressed as a percentage of prices in the base period. A rise in the CPI means prices are increasing. For example, the CPI was 324.8 in September 2025, meaning that prices have more than tripled since the base period.

Changes in wholesale prices are another important indicator of inflation. The **producer price index (PPI)** measures the prices paid by producers and wholesalers for various commodities, such as raw materials, partially finished goods, and finished products. The PPI, which uses 1982 as its base year, is actually a family of indexes for many different product categories, including crude goods (raw materials), intermediate goods (which become part of finished goods), and finished goods. For example, the PPI for finished goods is currently 266.01, which represents an annual growth rate of approximately 3 percent. The PPI for chemicals is 350.83, with an annual growth rate of nearly 3.5 percent. Examples of other PPI indexes include processed foods, lumber, containers, fuels and lubricants, metals, and construction. Because the PPI measures prices paid by producers for raw materials, energy, and other commodities, it may foreshadow subsequent price changes for businesses and consumers.

The Impact of Inflation

Inflation has several negative effects on people and businesses. For one thing, inflation penalizes people who live on fixed incomes. Let's say that a couple receives $2,000 a month retirement income beginning in 2026. If inflation is 10 percent in 2027, then the couple can buy only about 91 percent (100 ÷ 110) of what they could purchase in 2018. Similarly, inflation hurts savers. As prices rise, the real value, or purchasing power, of a nest egg of savings deteriorates.

CONCEPT CHECK

1. What is a business cycle? How do businesses adapt to periods of contraction and expansion?
2. Why is full employment usually defined as a target percentage below 100 percent?
3. What is the difference between demand-pull and cost-push inflation?

1.5 Achieving Macroeconomic Goals

5. How does the government use monetary policy and fiscal policy to achieve its macroeconomic goals?

To reach macroeconomic goals, countries must often choose among conflicting alternatives. Sometimes political needs override economic needs. For example, bringing inflation under control may call for a politically difficult period of high unemployment and low growth. Or, in an election year, politicians may resist raising taxes to curb inflation. Still, the government must try to guide the economy to a sound balance of growth, employment, and price stability. The two main tools it uses are monetary policy and fiscal policy.

Monetary Policy

Monetary policy refers to a government's programs for controlling the amount of money circulating in the economy and interest rates. Changes in the money supply affect both the level of economic activity and the rate of inflation. The **Federal Reserve System (the Fed)**, the central banking system of the United States, projects the likely demand for new currency, and places an order with the Department of the Treasury's

Bureau of Engraving and Printing for U.S. Currency (paper money), and the U.S. Mint makes U.S. Coins and charges the Fed for the cost of production. The money supply is also controlled by the Fed's regulation of certain bank activities.

When the Fed increases or decreases the amount of money in circulation, it affects interest rates (the cost of borrowing money and the reward for lending it). The Fed can change the interest rate on money it lends to banks to signal the banking system and financial markets that it has changed its monetary policy. These changes have a ripple effect. Banks, in turn, may pass along this change to consumers and businesses that receive loans from the banks. If the cost of borrowing increases, the economy slows because interest rates affect consumer and business decisions to spend or invest. The housing industry, business, and investments react most to changes in interest rates.

As a result of the Great Recession (2007–2009) and the global financial crisis that ensued, the Fed dropped the federal funds rate—the interest rate charged on overnight loans between banks—to 0 percent in December 2008 and kept the rate at zero until December 2015, when it raised the rate to 0.25 percent. This decision marked the first increase in the federal-funds rate since June 2006, when the federal funds rate was 5.25 percent. As the U.S. economy showed a slow but steady expansion after the Great Recession, the Fed subsequently increased the federal funds rate to a range of 0.75 to 1 percent. As the economy continued to recover from the Great Recession, interest rates were further adjusted. The interest rate in early 2026 was 3.75 to 4.0 percent. As expected, this change has a ripple effect: the regional Federal Reserve Banks increase the discount rate they charge commercial banks for short-term loans, many commercial banks raise the interest rates they charge their customers, and credit card companies increase the annual percentage rate (APR) they charge consumers on their credit card balances.[22]

As you can see, the Fed can use monetary policy to contract or expand the economy. With **contractionary policy**, the Fed restricts, or tightens, the money supply by selling government securities or raising interest rates. The result is slower economic growth and higher unemployment. Thus, contractionary policy reduces spending and, ultimately, lowers inflation. With **expansionary policy**, the Fed increases, or loosens, growth in the money supply. An expansionary policy stimulates the economy. Interest rates decline, so business and consumer spending go up. Unemployment rates drop as businesses expand. But increasing the money supply also has a negative side: more spending pushes prices up, increasing the inflation rate.

Exhibit 1.8 Powell As chair of the Board of Governors of the Federal Reserve System, Jerome (Jay) Powell is considered the face of U.S. monetary policy. Powell took over the chair in February 2018 from Janet Yellen, the first woman ever to be appointed Fed chair. *What are the responsibilities of the chair of the Board of Governors of the Federal Reserve System?* (Credit: Federalreserve/ Flickr/ Public Domain)

Fiscal Policy

The other economic tool used by the government is **fiscal policy**, its program of taxation and spending. By cutting taxes or by increasing spending, the government can stimulate the economy. Look again at **Exhibit 1.6**. The more government buys from businesses, the greater the business revenues and output. Likewise, if consumers or businesses have to pay less in taxes, they will have more income to spend for goods and services. Tax policies in the United States therefore affect business decisions. High corporate taxes can make it

harder for U.S. firms to compete with companies in countries with lower taxes. As a result, companies may choose to locate facilities abroad to reduce their tax burden.

Taxes are, of course, the major source of revenue for our government. Every year, the president prepares a budget for the coming year based upon estimated revenues and expenditures. Congress receives the president's report and recommendations and then, typically, debates and analyzes the proposed budget for several months. The president's original proposal is always modified in numerous ways. Exhibit 1.9 shows the sources of revenue and expenses for the U.S. budget.

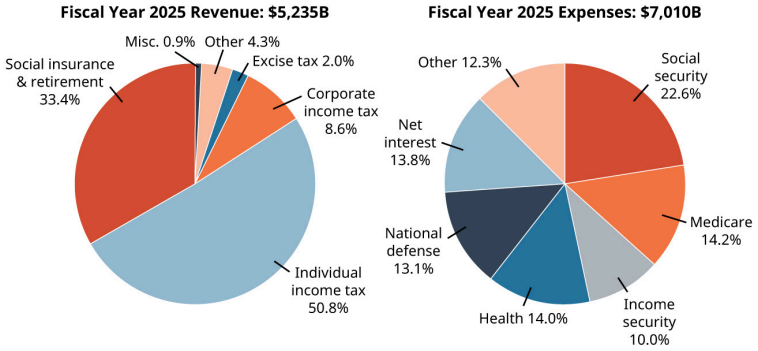

Exhibit 1.9 Revenues and Expenses for the Federal Budget Source: U.S. Department of the Treasury / Bureau of the Fiscal Service, *Final Monthly Treasury Statement for Fiscal Year 2025*, September 2025, fiscaldata.treasury.gov, accessed March 5, 2026.

Whereas fiscal policy has a major impact on business and consumers, continual increases in government spending raises another important issue. When government takes more money from business and consumers (the private sector), a phenomenon known as **crowding out** occurs. Here are three examples of crowding out:

1. The government spends more on public libraries, and individuals buy fewer books at bookstores.
2. The government spends more on public education, and individuals spend less on private education.
3. The government spends more on public transportation, and individuals spend less on private transportation.

In other words, government spending is crowding out private spending.

If the government spends more for programs (social services, education, defense) than it collects in taxes, the result is a **federal budget deficit**. To balance the budget, the government can cut its spending, increase taxes, or do some combination of the two. When it cannot balance the budget, the government must make up any shortfalls by borrowing (just like any business or household).

In 1998, for the first time in a generation, there was a federal budget surplus (revenue exceeding spending) of about $71 billion. That budget surplus was short lived, however. By 2005, the deficit was more than $318 billion. In the fiscal year of 2009, the federal deficit was at a record high for that time period of more than $1.413 trillion. However, by the end of 2015, the deficit had decreased to $439 billion.[23] The U.S. government has run budget deficits for many years. The accumulated total of these past deficits is the **national debt**, which now amounts to $40 trillion, or over $100,000 per person in the United States. Total interest on the debt is over $1 trillion per year.[24] To cover the deficit, the U.S. government borrows money from people and businesses in the form of Treasury bills, Treasury notes, and Treasury bonds. These are federal IOUs that pay interest to their owners.

The national debt is an important issue debated not only in the halls of Congress, but by the public as well. Some believe that deficits contribute to economic growth, high employment, and price stability. Others have the following reservations about such a high national debt:

- *Not Everyone Holds the Debt:* The government is very conscious of who actually bears the burden of the national debt and keeps track of who holds what bonds. If only those with higher incomes were bondholders, then they alone would receive the interest payments and could end up receiving more in

interest than they paid in taxes. In the meantime, individuals in the lower income brackets, who held no bonds, would end up paying taxes that would be transferred to the rich as interest, making the debt an unfair burden to them. At times, therefore, the government has instructed commercial banks to reduce their total debt by divesting some of their bond holdings. That's also why the Treasury created **savings bonds**. Because these bonds are issued in relatively small denominations, they allow more people to buy and hold government debt.

- *It Crowds Out Private Investment:* The national debt also affects private investment. If the government raises the interest rate on bonds to be able to sell them, it forces private businesses, whose corporate bonds (long-term debt obligations issued by a company) compete with government bonds for investor dollars, to raise rates on their bonds to stay competitive. In other words, selling government debt to finance government spending makes it more costly for private industry to finance its own investment. As a result, government debt may end up crowding out private investment and slowing economic growth in the private sector.

CONCEPT CHECK

1. What are the two kinds of monetary policy?
2. What fiscal policy tools can the government use to achieve its macroeconomic goals?
3. What problems can a large national debt present?

1.6 Microeconomics: Zeroing in on Businesses and Consumers

6. What are the basic microeconomic concepts of demand and supply, and how do they establish prices?

Now let's shift our focus from the whole economy to *microeconomics,* the study of households, businesses, and industries. This field of economics is concerned with how prices and quantities of goods and services behave in a free market. It stands to reason that people, firms, and governments try to get the most from their limited resources. Consumers make purchases for a variety of reasons, from getting the best quality at the lowest price, to purchasing products to support local businesses, or to support their lifestyle by purchasing organic products, as just a few examples. Businesses want to keep costs down and revenues high to earn larger profits. Governments also want to use their revenues to provide the most effective public goods and services possible. These groups choose among alternatives by focusing on the prices of goods and services.

As consumers in a free market, we influence what is produced. If Mexican food is popular, the high demand attracts entrepreneurs who open more Mexican restaurants. They want to compete for our dollars by supplying Mexican food at a lower price, of better quality, or with different features, such as Santa Fe Mexican food rather than Tex-Mex. This section explains how business and consumer choices influence the price and availability of goods and services.

Exhibit 1.10 Galaxy Note 7 Samsung's strategy to take on Apple's iPhone domination hit a terrible snag in 2016, when its Galaxy Note 7 mobile phone was recalled and the product eliminated. Defective batteries in the Note 7 made them catch fire and cause serious damage. Samsung eventually killed the entire line of Note 7 phones, recalling nearly 3 million phones, which cost the company more than $5 billion. The U.S Consumer Product Safety Commission stepped in and publicly stated that the device was a fire hazard, prompting Samsung's eventual discontinuation of the entire product line. *How do businesses determine the optimum quantity of products or services to make available to consumers?* (Credit: Paul Sullivan/ flickr/ Attribution-NoDerivs 2.0 Generic (CC BY-ND 2.0))

The Nature of Demand

Demand is the quantity of a good or service that people are willing to buy at various prices. The higher the price, the lower the quantity demanded, and vice versa. A graph of this relationship is called a **demand curve**.

Let's assume you own a store that sells cold-weather gear for winter sports enthusiasts. From past experience, you know how many jackets you can sell at different prices. The demand curve in **Exhibit 1.11** depicts this information. The *x*-axis (horizontal axis) shows the quantity of jackets, and the *y*-axis (vertical axis) shows the related price of those jackets. For example, at a price of $100, customers will buy (demand) 600 snowboard jackets.

In the graph, the demand curve slopes downward and to the right because as the price falls, people will want to buy more jackets. Some people who were not going to buy a jacket will purchase one at the lower price. Also, some snowboarders who already have a jacket will buy a second one. The graph also shows that if you put a large number of jackets on the market, you will have to reduce the price to sell all of them.

Understanding demand is critical to businesses. Demand tells you *how much you can sell* and *at what price*—in other words, how much money the firm will take in that can be used to cover costs and hopefully earn a profit. Gauging demand is difficult even for the very largest corporations, but particularly for small firms.

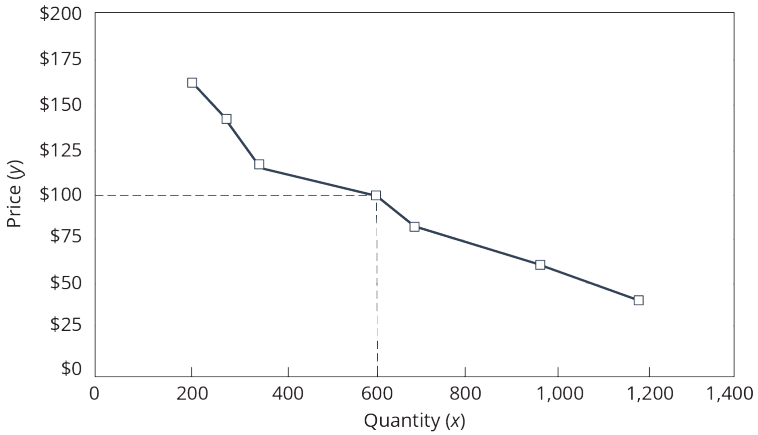

Exhibit 1.11 Demand Curve for Jackets for Snowboarders (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

The Nature of Supply

Demand alone is not enough to explain how the market sets prices. We must also look at **supply**, the quantity of a good or service that businesses will make available at various prices. The higher the price, the greater the number of jackets a supplier will supply, and vice versa. A graph of the relationship between various prices and the quantities a business will supply is a **supply curve**.

We can again plot the quantity of jackets on the *x*-axis and the price on the *y*-axis. As Exhibit 1.12 shows, 800 jackets will be available at a price of $100. Note that the supply curve slopes upward and to the right, the opposite of the demand curve. If snowboarders are willing to pay higher prices, suppliers of jackets will buy more inputs (for example, Gore-Tex® fabric, dye, machinery, labor) and produce more jackets. The quantity supplied will be higher at higher prices, because manufacturers can earn higher profits.

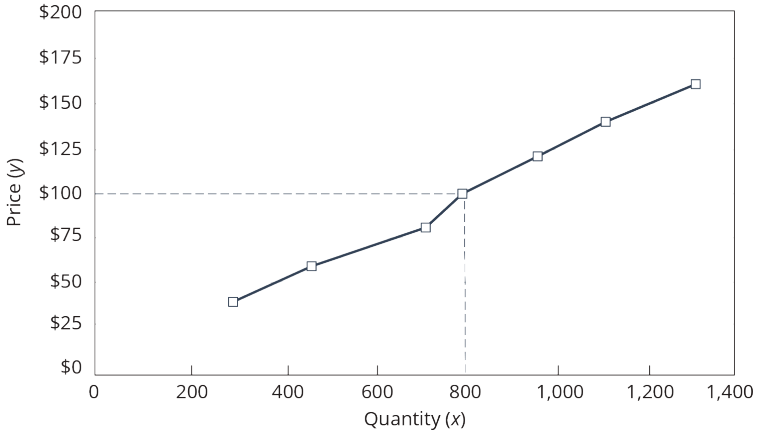

Exhibit 1.12 Supply Curve for Jackets for Snowboarders (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

How Demand and Supply Interact to Determine Prices

In a stable economy, the number of jackets that snowboarders demand depends on the jackets' price. Likewise, the number of jackets that suppliers provide depends on price. But at what price will consumer demand for jackets match the quantity suppliers will produce?

To answer this question, we need to look at what happens when demand and supply interact. By plotting both the demand curve and the supply curve on the same graph in Exhibit 1.13, we see that they cross at a certain quantity and price. At that point, labeled E, the quantity demanded equals the quantity supplied. This is the point of **equilibrium**. The equilibrium price is $80; the equilibrium quantity is 700 jackets. At that point, there is a balance between the quantity consumers will buy and the quantity suppliers will make available.

Market equilibrium is achieved through a series of quantity and price adjustments that occur organically. If the

price increases to $160, suppliers produce more jackets than consumers are willing to buy, and a surplus results. To sell more jackets, prices will have to fall. Thus, a surplus pushes prices downward until equilibrium is reached. When the price falls to $60, the quantity of jackets demanded rises above the available supply. The resulting shortage forces prices upward until equilibrium is reached at $80.

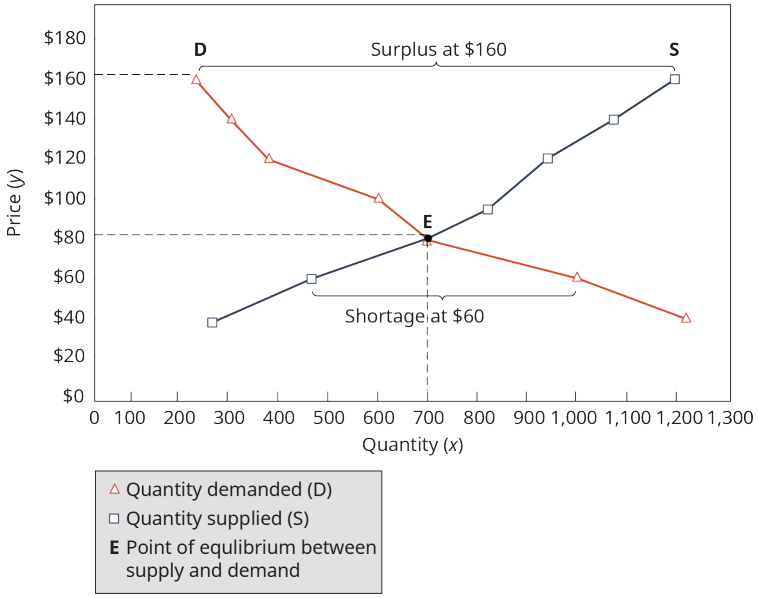

Exhibit 1.13 Equilibrium Price and Quantity for Jackets for Snowboarders (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

The number of snowboard jackets supplied and bought at $80 will tend to rest at equilibrium unless there is a shift in either demand or supply. If demand increases, more jackets will be purchased at every price, and the demand curve shifts to the right (as illustrated by line D_2 in **Exhibit 1.14**). If demand decreases, less will be bought at every price, and the demand curve shifts to the left (D_1). When demand decreased, snowboarders bought 500 jackets at $80 instead of 700 jackets. When demand increased, they purchased 800.

Changes in Demand

A number of things can increase or decrease demand. For example, if snowboarders' incomes go up, they may decide to buy a second jacket. If incomes fall, a snowboarder who was planning to purchase a jacket may wear an old one instead. Changes in fashion or tastes can also influence demand. If snowboarding were suddenly to go out of fashion, demand for jackets would decrease quickly. A change in the price of related products can also influence demand. For example, if the average price of a snowboard rises to $1,000, some people may be priced out of snowboarding, and jacket demand will fall.

Another factor that can shift demand is expectations about future prices. If you expect jacket prices to increase significantly in the future, you may decide to go ahead and get one today. If you think prices will fall, you may postpone your purchase. Finally, changes in the number of buyers will affect demand. Snowboarding attracts a broad range of individuals, so interest in the sport may be expected to increase. Therefore, the demand for snowboard jackets should increase.

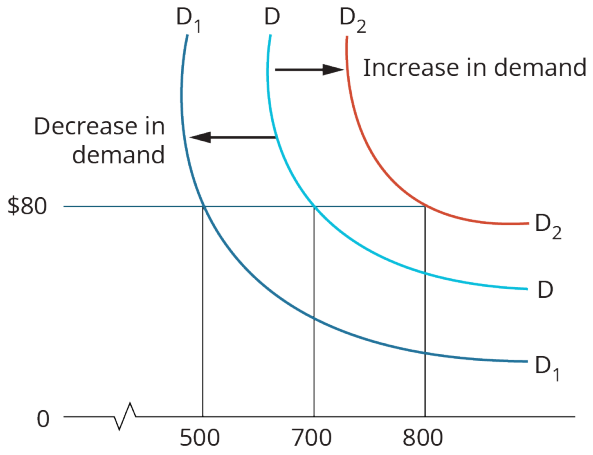

Exhibit 1.14 Shifts in Demand for Jackets for Snowboarders (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

Changes in Supply

Other factors influence the supply side of the picture. New technology typically lowers the cost of production. For example, Columbia Sportswear, a supplier of ski and snowboard jackets, purchased laser-guided pattern-cutting equipment and computer-aided pattern-making equipment. Each jacket was cheaper to produce, resulting in a higher profit per jacket. This provided an incentive to supply more jackets at every price. If the price of resources such as labor or fabric goes up, Columbia Sportswear will earn a smaller profit on each jacket, and the amount supplied will decrease at every price. The reverse is also true. Changes in the prices of other goods can also affect supply.

Let's say that snow skiing becomes a really hot sport again. The number of skiers jumps dramatically, and the price of ski jackets soars. Columbia Sportswear can use its machines and fabrics to produce either ski or snowboard jackets. If the company can make more profit from ski jackets, it will produce fewer snowboard jackets at every price. Also, a change in the number of producers will shift the supply curve. If the number of jacket suppliers increases, they will place more jackets on the market at every price. If any suppliers stop making jackets available, the supply will naturally decrease. Taxes can also affect supply. If the government decides, for some reason, to tax the supplier for every snowboard jacket produced, then profits will fall, and fewer jackets will be offered at every price. **Table 1.2** summarizes the factors that can shift demand and supply curves.

To better understand the relationship between supply and demand across the economy, consider the impact of Hurricane Katrina (2005) on U.S. energy prices. Oil and gas prices were already at high levels before Hurricane Katrina disrupted production in the Gulf Coast. Most U.S. offshore drilling sites are located in the Gulf of Mexico, and almost 30 percent of U.S. refining capacity is in Gulf States that were hit hard by the storm. Prices rose almost immediately as supplies fell while demand remained at the same levels.

The storm drove home the vulnerability of the U.S. energy supply to not only natural disasters, but also terrorist attacks and price increases from foreign oil producers. Many energy policy experts questioned the wisdom of having such a high concentration of oil facilities—about 25 percent of the oil and natural gas infrastructure—in hurricane-prone states. Refiners were already almost at capacity before Katrina's devastation.[25]

Factors That Cause Demand and Supply Curves to Shift		
	Shift Demand	
Factor	**To the Right If**	**To the Left If**
Buyers' incomes	Increase	Decrease
Buyers' preferences/tastes	Increase	Decrease
Prices of substitute products	Increase	Decrease
Expectations about future prices	Will rise	Will fall
Number of buyers	Increases	Decreases
	Shift Supply	
	To the Right If	**To the Left If**
Technology	Lowers cost	Increases cost
Resource prices	Fall	Rise
Changes in prices of other products that can be produced with the same resources	Profit of other product falls	Profit of other product rises
Number of suppliers	Increases	Decreases
Taxes	Decreases	Increases

Table 1.2

High energy prices affect the economy in many ways. With oil at the time costing $50 to $60 a barrel—more than double the 2003 price—both businesses and consumers across the United States felt the pinch in their wallets. A majority of U.S. grain exports, especially corn and soybeans from the Midwest, move through Gulf ports, with the balance via the Pacific Northwest and other regions. With fewer usable docking spaces, barges couldn't unload and return for more crops. The supply of both transportation services and grain products was inadequate to meet demand, pushing up transportation and grain costs. Fluctuations in oil and fuel prices can contribute to rising overall prices, as a percentage of shipping costs are directly related to fuel.

Since Katrina and with other significant events, such as the pandemic, U.S. gas prices have fluctuated dramatically, with the cost of a gallon of regular gasoline peaking mid-year 2022 at nearly $5.00 and dropping as low as less than $2.00. Research reveals that around half of what is saved from lower gas prices ends up being spent by consumers, which helps the overall economy.[26]

CONCEPT CHECK

1. What is the relationship between prices and demand for a product?
2. How is market equilibrium achieved? Describe the circumstances under which the price for gasoline would have returned to equilibrium in the United States after Hurricane Katrina.
3. Draw a graph that shows an equilibrium point for supply and demand.

1.7 Competing in a Free Market

7. What are the four types of market structure?

One of the characteristics of a free-market system is that suppliers have the right to compete with one another. The number of suppliers in a market defines the **market structure**. Economists identify four types of market structures: (1) perfect competition, (2) pure monopoly, (3) monopolistic competition, and (4) oligopoly. Table 1.3 summarizes the characteristics of each of these market structures.

Perfect Competition

Characteristics of **perfect (pure) competition** include:

- A large number of small firms are in the market.
- The firms sell similar products; that is, each firm's product is very much like the products sold by other firms in the market.
- Buyers and sellers in the market have good information about prices, sources of supply, and so on.
- It is easy to open a new business or close an existing one.

Comparison of Market Structures

Characteristics	Perfect Competition	Pure Monopoly	Monopolistic Competition	Oligopoly
Number of firms in market	Many	One	Many, but fewer than perfect competition	Few
Firm's ability to control price	None	High	Some	Some
Barriers to entry	None	Subject to government regulation	Few	Many

Table 1.3

Comparison of Market Structures				
Characteristics	**Perfect Competition**	**Pure Monopoly**	**Monopolistic Competition**	**Oligopoly**
Product differentiation	Very little	No products that compete directly	Emphasis on showing perceived differences in products	Some differences
Examples	Agricultural products such as wheat and corn	Electricity, sanitation, and telecommunications	Clothing brands, fast food chains, and beauty/salons	Pharmaceuticals, media/entertainment, and automotive industries

Table 1.3

In a perfectly competitive market, firms sell their products at prices determined solely by forces beyond their control. Because the products are very similar and each firm contributes only a small amount to the total quantity supplied by the industry, price is determined by supply and demand. A firm that raised its price even a little above the going rate would lose customers. In the wheat market, for example, the product is essentially the same from one wheat producer to the next. Thus, none of the producers has control over the price of wheat.

Perfect competition is an ideal. No industry shows all its characteristics, but the stock market and some agricultural markets, such as those for wheat and corn, come closest. Farmers, for example, can sell all of their crops through national commodity exchanges at the current market price.

Pure Monopoly

At the other end of the spectrum is **pure monopoly**, the market structure in which a single firm accounts for all industry sales of a particular good or service. The firm *is* the industry. This market structure is characterized by **barriers to entry**—factors that prevent new firms from competing equally with the existing firm. Often the barriers are technological or legal conditions. The Polaroid Company, for example, held major patents on instant photography for years. When Kodak (Eastman Kodak) tried to market its own instant camera, Polaroid sued, claiming patent violations. Polaroid collected millions of dollars from Kodak. Another barrier may be one firm's control of a natural resource. DeBeers Consolidated Mines Ltd., for example, controlled 80 to 85 percent of the world's supply of uncut diamonds until the early 2000s.

Public utilities, such as gas and water companies, are pure monopolies. Some monopolies are created by a government order that outlaws competition. The United States Postal Service (USPS) is currently one such monopoly.

Monopolistic Competition

Three characteristics define the market structure known as **monopolistic competition**:

- Many firms are in the market.
- The firms offer products that are close substitutes but still differ from one another.
- It is relatively easy to enter the market.

Under monopolistic competition, firms take advantage of product differentiation. Industries where monopolistic competition occurs include fast food chains, beauty product lines, and clothing brands. Firms

under monopolistic competition have more control over pricing than do firms under perfect competition because consumers do not view the products as perfect substitutes. Nevertheless, firms must demonstrate product differences to justify their prices to customers. Consequently, companies use advertising to distinguish their products from others. Such distinctions may be significant or superficial. For example, Nike says "Just Do It," and Tylenol is advertised as being easier on the stomach than aspirin.

Oligopoly

An **oligopoly** has two characteristics:

- A few firms produce most or all of the output.
- Large capital requirements or other factors limit the number of firms.

Boeing and Airbus (large commercial aircraft) and Apple and Google (smartphone operating systems) are major players in distinct oligopolistic industries.

With so few firms in an oligopoly, what one firm does has an impact on the other firms. Thus, the firms in an oligopoly watch one another closely for new technologies, product changes and innovations, promotional campaigns, pricing, production, and other developments. Sometimes they go so far as to coordinate their pricing and output decisions, which is illegal. Many antitrust cases—legal challenges arising out of laws designed to control anticompetitive behavior—occur in oligopolies.

The market structure of an industry can change over time. Take, for example, the telecommunications industry. In the 1970s and 1980s, AT&T had a monopoly on long-distance telephone service nationwide. Then the U.S. government divided the company into seven regional phone companies in 1984, opening the door to greater competition. Other companies such as Sprint entered the fray and built state-of-the-art fiber-optic networks to win customers from the traditional providers of phone service. The 1996 Telecommunications Act changed the competitive environment yet again by allowing local phone companies to offer long-distance service in exchange for letting competition into their local markets. The telecommunications industry, including the computing and mobile markets, will change as companies evolve through mergers and acquisitions in response to market forces such as those discussed previously.

CONCEPT CHECK

1. What is meant by market structure?
2. Compare and contrast perfect competition and pure monopoly. Why is it rare to find perfect competition?
3. How does an oligopoly differ from monopolistic competition?

1.8 Trends in the Business Environment and Competition

8. Which trends are reshaping the business, microeconomic, and macroeconomic environments and competitive arena?

Trends in the business and economic environment occur in many areas. As noted earlier, today's workforce is more diverse than ever, with increasing numbers of minorities and older workers. Competition has intensified. Technology has accelerated the pace of work and the ease with which we communicate. Technological advancements, such as AI and machine learning, go beyond accelerating work and easing communication. The power of AI can be seen across the entire business environment and across industries. AI and machine learning can be utilized to facilitate innovation with product design, to tighten quality control metrics, or to identify new markets or trends. Not only can the pace of work be accelerated, but through AI technologies, the

quality and precision of work can be increased. This can lead to cost savings and higher quality products and services being delivered to the end customer. Let's look at how companies are meeting the challenges of a changing workforce, the growing demand for energy, and how companies are meeting competitive challenges.

Changing Workforce Demographics

As the baby boomer generation ages, so does the U.S. workforce. In 2010, more than 25 percent of all employees were retirement age. Fast forward to the U.S. labor force in 2024, however, and millennials have taken over the top spot in the labor market with about 40 percent of the total workforce. Furthermore, some plan to keep working rather than making the decision to retire at the traditional retirement age of 65. No longer is retirement an all-or-nothing proposition, and individuals in the baby boomer generation are taking a more positive attitude toward their later years. Some Americans expect to work full- or part-time after "retirement," and most would probably work longer if phased retirement programs were available at their companies. Financial reasons motivate most of these older workers, who worry that their longer life expectancies will mean outliving the money they saved for retirement, especially after retirement savings took a hit during the Great Recession (2007–2009). For others, however, the satisfaction of working and feeling productive is more important than money alone.[27]

These converging dynamics continue to create several major challenges for companies today. Additional generational shifts that could occur in the U.S. labor force will have an effect on how companies do business and retain their employees. Today's workforce spans five generations: Generation or Gen Alpha (aged under 16); Generation Z (recent college graduates); people in their 30s and 40s (Generation Y or Millennials); Generation X (aged 46-60); and Baby Boomers (people in their 60s and beyond). It is not unusual to find a worker who is 50, 60, or even 70 working for a manager who is not yet 30. People in their 50s and 60s offer their vast experience of "what's worked in the past," whereas those in their 20s and 30s tend to be experimental, open to options, and unafraid to take risks. The most effective managers will be the ones who recognize generational differences and use them to the company's advantage.[28]

Many companies have developed programs such as flexible hours and telecommuting to retain older workers and benefit from their practical knowledge and problem-solving skills. In addition, companies should continually track where employees are in their career life cycles, know when they are approaching retirement age or thinking about retirement, and determine how to replace them and their knowledge and job experiences.[29]

Another factor in the changing workforce is the importance of recognizing diversity among workers of all ages and fostering an inclusive organizational culture. According to reporting by Pew and the U.S. Census Bureau, millennials are the largest generation in U.S. history, and about 44 percent classify themselves as something other than "White." In addition, women continue to make progress on being promoted to management, despite obstacles on the path to CEO. Statistics suggest that around 10 percent of Fortune 500 companies have women CEOs. The most successful organizations will be the ones that recognize the importance of diversity and inclusion as part of their ongoing corporate strategies.[30]

MANAGING CHANGE

EY Makes Diversity and Inclusiveness a Top Priority

As older workers continue to leave the U.S. labor force and younger individuals begin work or move to other jobs to further their careers, businesses must recognize the importance of diversity and inclusiveness as key corporate strategies. This is particularly critical as multicultural millennials become the dominant group in the U.S. workforce. One leader in embracing diversity as an important part of corporate life is EY

(formerly Ernst & Young), a global leader in assurance, tax, and advisory services.

EY believes its core values and business strategies are firmly based on diversity and inclusiveness, as evidenced by the company landing in the top spot of DiversityInc's 2017 list of the top companies for diversity. The company has made diversity and inclusiveness key goals for nearly 400,000 employees around the world. With a diverse workforce becoming the norm, it is no longer acceptable for companies to simply hold a random seminar or two for their managers and employees to discuss diversity and inclusiveness in the workplace.

Karyn Twaronite, EY's global diversity and inclusiveness officer, believes that a simple, ongoing approach is the most effective way to address diversity and inclusiveness in the workplace. The company uses a decision-making strategy called PTR, or preference, tradition, and requirement, to help managers think about diversity and inclusiveness. The strategy challenges managers to examine preferences toward job candidates who are similar to themselves, asks them whether their decision about hiring a specific candidate is influenced by traditional characteristics of a certain role, and urges them to make their selection based on the requirements of the job rather than on their personal preferences. In other words, the decision-making tool gives people a way to question the status quo without accusing colleagues of being biased.

Another way EY fosters inclusiveness is sponsoring professional network groups within the organization. These groups provide members with opportunities to network across various EY divisions, create informal mentoring relationships, and strengthen leadership skills. Some of the established employee/business resource groups within EY include Unity (LGBTQ+), Black Professional Network, Latinx Professional Network, Veterans Network, and AccessAbilities (people with disabilities).

As a global company that works with clients in many countries, EY knows the importance of acknowledging different perspectives and cultures as part of its daily business. The company is committed to making sure employees as well as clients respect different viewpoints and individual differences, including background, education, gender, ethnicity, religious background, sexual orientation, ability, and technical skills. According to EY's diversity and inclusiveness page, research shows that a company's diverse teams are more likely to improve market share and have success in new markets and that they demonstrate stronger collaboration and better retention.

Questions for Discussion

1. How does EY's approach to diversity and inclusiveness translate to additional revenues for the company?
2. Would a company's commitment to diversity make a difference to you when interviewing for a job? Why or why not?

Sources: Company website, "A Diverse and Inclusive Workforce," https://www.ey.com, accessed May 29, 2017; "DiversityInc Top 50: #1—EY: Why They're on the List," https://www.diversityinc.com, accessed May 29, 2017; "Founded on Inclusiveness; Strengthened by Diversity: A Place for Everyone," https://exceptionaley.com, accessed May 29, 2017; Grace Donnelly, "Here's EY's Simple But Effective Strategy for Increasing Diversity," *Fortune,* https://fortune.com, February 10, 2017; "EY Facts and Figures," *EY*, https://www.ey.com, October 2024; "Inclusiveness and Belonging," https://www.ey.com, accessed March 5, 2026; Christine Cube, "How EY Took Diversity and Inclusion to the Next Level," YPO, https://www.ypo.org, October 26, 2020.

Global Energy Demands

As standards of living improve worldwide, the demand for energy continues to rise. Emerging economies such as China and India need energy to grow. Their demands are placing pressure on the world's supplies and

affecting prices, as the laws of supply and demand would predict. For example, in recent years, China and India were responsible for more than half of the growth in oil products consumption worldwide. Government-backed oil and energy companies in these countries can place additional competitive pressure on privately owned companies.[31]

Countries worldwide worry about relying too heavily on one source of supply for energy. The United States imports a large share of its crude oil from Canada; Saudi Arabia supplies a smaller share than in the past. Instead of relying solely on one major source for energy, Europeans now get their natural gas from a variety of countries including Norway, Algeria, and Russia.[32] Foreign governments can use the dependence on energy supply as a political tool. For example, Russia's invasion of Ukraine in 2022 caused the EU to diversify suppliers. The EU reduced their reliance on Russia for natural gas from around 45 percent in 2021 to under 20 percent by 2023.[33]

Countries and companies worldwide are seeking additional sources of supply to prevent being held captive to one supplier. For example, the relatively new technology of extracting oil from shale rock formations in the United States (known as fracking) has help create an important resource for the country's oil industry. This innovative approach to finding new sources of energy now accounts for more than half of the country's oil output, which can help reduce U.S. dependence on foreign oil and create new jobs.[34]

Meeting Competitive Challenges

Companies are turning to many different strategies to remain competitive in the global marketplace. One of the most important is **relationship management**, which involves building, maintaining, and enhancing interactions with customers and other parties to develop long-term satisfaction through mutually beneficial partnerships. Relationship management includes both *supply chain management*, which builds strong bonds with suppliers, and *relationship marketing*, which focuses on customers. In general, the longer a customer stays with a company, the more that customer is worth. Long-term customers buy more, take less of a company's time, are less sensitive to price, and bring in new customers. Best of all, they require no acquisition or start-up costs. Good long-standing customers are worth so much that in some industries, reducing customer defections by as little as five points—from, say, 15 percent to 10 percent per year—can double profits.

Another important way companies stay competitive is through **strategic alliances** (also called *strategic partnerships*). The trend toward forming these cooperative agreements between business firms is accelerating rapidly, particularly among high-tech firms. These companies have realized that strategic partnerships are more than just important—they are critical. Strategic alliances can take many forms. Some companies enter into strategic alliances with their suppliers, who take over much of their actual production and manufacturing. For example, Nike partners with independent manufacturers to assemble much of their product lines.

Other companies with complementary strengths team up. For example, Harry's, a men's grooming brand that started as a direct-to-consumer razor subscription that now sells subscriptions and products at major retailers, teamed up with retail giant Target to improve sales and boost its brand presence among Target shoppers. Harry's products became available in Target's brick-and-mortar stores and on Target's website as part of an exclusive deal that made Target the only mass retailer to carry Harry's grooming products. In the U.S., men's razors and blades generate about $3 to $3.5 billion annually, with the overall men's shaving category higher.[35]

CONCEPT CHECK

1. What steps can companies take to benefit from the aging of their workers and to effectively manage a multigenerational workforce?
2. Why is the increasing demand for energy worldwide a cause for concern?

3. Describe several strategies that companies can use to remain competitive in the global economy.

Key Terms

barriers to entry Factors, such as technological or legal conditions, that prevent new firms from competing equally with an existing firm.

business An organization that strives for a profit by providing goods and services desired by its customers.

business cycles Upward and downward changes in the level of economic activity.

capital The inputs, such as tools, machinery, equipment, and buildings, used to produce goods and services and get them to the customer.

capitalism An economic system based on competition in the marketplace and private ownership of the factors of production (resources); also known as the *private enterprise system.*

circular flow The movement of inputs and outputs among households, businesses, and governments; a way of showing how the sectors of the economy interact.

communism An economic system characterized by government ownership of virtually all resources, government control of all markets, and economic decision-making by central government planning.

consumer price index (CPI) An index of the prices of a "market basket" of goods and services purchased by typical urban consumers.

contractionary policy The use of monetary policy by the Federal Reserve System to tighten the money supply by selling government securities or raising interest rates.

cost-push inflation Inflation that occurs when increases in production costs push up the prices of final goods and services.

costs Expenses incurred from creating and selling goods and services.

crowding out The situation that occurs when government spending replaces spending by the private sector.

cyclical unemployment Unemployment that occurs when a downturn in the business cycle reduces the demand for labor throughout the economy.

demand The quantity of a good or service that people are willing to buy at various prices.

demand curve A graph showing the quantity of a good or service that people are willing to buy at various prices.

demand-pull inflation Inflation that occurs when the demand for goods and services is greater than the supply.

demography The study of people's vital statistics, such as their age, gender, race and ethnicity, and location.

economic growth An increase in a nation's output of goods and services.

economic system The combination of policies, laws, and choices made by a nation's government to establish the systems that determine what goods and services are produced and how they are allocated.

economics The study of how a society uses scarce resources to produce and distribute goods and services.

entrepreneurs People who combine the inputs of natural resources, labor, and capital to produce goods or services with the intention of making a profit or accomplishing a not-for-profit goal.

equilibrium The point at which quantity demanded equals quantity supplied.

expansionary policy The use of monetary policy by the Fed to increase, or loosen, the growth of the money supply.

factors of production The resources used to create goods and services.

federal budget deficit The condition that occurs when the federal government spends more for programs than it collects in taxes.

Federal Reserve System (the Fed) The central banking system of the United States.

fiscal policy The government's use of taxation and spending to affect the economy.

frictional unemployment Short-term unemployment that is not related to the business cycle.

full employment The condition when all people who want to work and can work have jobs.

goods Tangible items manufactured by businesses.

gross domestic product (GDP) The total market value of all final goods and services produced within a nation's borders each year.

inflation The situation in which the average of all prices of goods and services is rising.

knowledge The combined talents and skills of the workforce.
knowledge workers Workers who create, distribute, and apply knowledge.
macroeconomics The subarea of economics that focuses on the economy as a whole by looking at aggregate data for large groups of people, companies, or products.
market structure The number of suppliers in a market.
microeconomics The subarea of economics that focuses on individual parts of the economy, such as households or firms.
mixed economies Economies that combine several economic systems; for example, an economy where the government owns certain industries but others are owned by the private sector.
monetary policy A government's programs for controlling the amount of money circulating in the economy and interest rates.
monopolistic competition A market structure in which many firms offer products that are close substitutes and in which entry is relatively easy.
national debt The accumulated total of all of the federal government's annual budget deficits.
not-for-profit organization An organization that exists to achieve some goal other than the usual business goal of profit.
oligopoly A market structure in which a few firms produce most or all of the output and in which large capital requirements or other factors limit the number of firms.
perfect (pure) competition A market structure in which a large number of small firms sell similar products, buyers and sellers have good information, and businesses can be easily opened or closed.
producer price index (PPI) An index of the prices paid by producers and wholesalers for various commodities, such as raw materials, partially finished goods, and finished products.
productivity The amount of goods and services one worker can produce.
profit The money left over after all costs are paid.
purchasing power The value of what money can buy.
pure monopoly A market structure in which a single firm accounts for all industry sales of a particular good or service and in which there are *barriers to entry*.
quality of life The general level of human happiness based on such things as life expectancy, educational standards, health, sanitation, and leisure time.
recession A decline in GDP that lasts for at least two consecutive quarters.
relationship management The practice of building, maintaining, and enhancing interactions with customers and other parties to develop long-term satisfaction through mutually beneficial partnerships.
revenue The money a company receives by providing services or selling goods to customers.
risk The potential to lose time and money or otherwise not be able to accomplish an organization's goals.
savings bonds Government bonds issued in relatively small denominations.
seasonal unemployment Unemployment that occurs during specific seasons in certain industries.
services Intangible offerings of businesses that can't be held, touched, or stored.
socialism An economic system in which the basic industries are owned either by the government itself or by the private sector under strong government control.
standard of living A country's output of goods and services that people can buy with the money they have.
strategic alliance A cooperative agreement between business firms; sometimes called a *strategic partnership.*
structural unemployment Unemployment that is caused by a mismatch between available jobs and the skills of available workers in an industry or region; not related to the business cycle.
supply The quantity of a good or service that businesses will make available at various prices.
supply curve A graph showing the quantity of a good or service that businesses will make available at various prices.
technology The application of science and engineering skills and knowledge to solve production and organizational problems.
unemployment rate The percentage of the total labor force that is not working but is *actively looking for*

work.

Summary of Learning Outcomes

1.1 The Nature of Business

1. How do businesses and not-for-profit organizations help create our standard of living?

Businesses attempt to earn a profit by providing goods and services desired by their customers. Not-for-profit organizations, though not striving for a profit, still deliver many needed services for our society. Our standard of living is measured by the output of goods and services. Thus, businesses and not-for-profit organizations help create our standard of living. Our quality of life is not simply the amount of goods and services available for consumers but rather the society's general level of happiness.

Economists refer to the building blocks of a business as the factors of production. To produce anything, one must have natural resources, labor (human resources), capital, and entrepreneurship to assemble the resources and manage the business. Today's competitive business environment is based upon knowledge and learning. The companies that succeed will be those that learn fast, use knowledge efficiently, and develop new insights.

1.2 Understanding the Business Environment

2. What are the sectors of the business environment, and how do changes in them influence business decisions?

The external business environment consists of economic, political and legal, demographic, social, competitive, global, and technological sectors. Managers must understand how the environment is changing and the impact of those changes on the business. When economic activity is strong, unemployment rates are low, and income levels rise. The political environment is shaped by the amount of government intervention in business affairs, the types of laws it passes to regulate both domestic and foreign businesses, and the general political stability of a government. Demographics, or the study of people's vital statistics, are at the heart of many business decisions. Businesses today must deal with the unique preferences of different generations, each of which requires different marketing approaches and different goods and services. The population is becoming increasingly diverse: currently minorities represent more than 40 percent of the total U.S. population, and that number will continue to increase over the next several decades. Minorities' buying power has increased significantly as well, and companies are developing products and marketing campaigns that target different ethnic groups. Social factors—our attitudes, values, and lifestyles—influence what, how, where, and when people purchase products. They are difficult to predict, define, and measure because they can be very subjective. They also change as people move through different life stages.

1.3 How Business and Economics Work

3. What are the primary features of the world's economic systems, and how are the three sectors of the U.S. economy linked?

Economics is the study of how individuals, businesses, and governments use scarce resources to produce and distribute goods and services. Today there is a global trend toward capitalism. Capitalism, also known as the *private enterprise system,* is based upon marketplace competition and private ownership of the factors of production. Competition leads to more diverse goods and services, keeps prices stable, and pushes businesses to become more efficient.

In a communist economy, the government owns virtually all resources, and economic decision-making is done by central government planning. Governments have generally moved away from communism because it is inefficient and delivers a low standard of living. Socialism is another centralized economic system in which the basic industries are owned by the government or by the private sector under strong government control. Other industries may be privately owned. The state is also somewhat influential in determining the goals of

business, the prices and selection of products, and the rights of workers. Most national economies today are a mix of socialism and capitalism.

The two major areas in economics are macroeconomics, the study of the economy as a whole, and microeconomics, the study of households and firms. The individual, business, and government sectors of the economy are linked by a series of two-way flows. The government provides public goods and services to the other two sectors and receives income in the form of taxes. Changes in one flow affect the other sectors.

1.4 Macroeconomics: The Big Picture

4. How do economic growth, full employment, price stability, and inflation indicate a nation's economic health?

A nation's economy is growing when the level of business activity, as measured by gross domestic product (GDP) is rising. GDP is the total value of all goods and services produced in a year. The goal of full employment is to have a job for all who can and want to work. How well a nation is meeting its employment goals is measured by the unemployment rate. There are four types of unemployment: frictional, structural, cyclical, and seasonal. With price stability, the overall prices of goods and services are not moving very much either up or down. Inflation is the general upward movement of prices. When prices rise, purchasing power falls. The rate of inflation is measured by changes in the consumer price index (CPI) and the producer price index (PPI). There are two main causes of inflation. If the demand for goods and services exceeds the supply, prices will rise. This is called demand-pull inflation. With cost-push inflation, higher production costs, such as expenses for materials and wages, increase the final prices of goods and services.

1.5 Achieving Macroeconomic Goals

5. How does the government use monetary policy and fiscal policy to achieve its macroeconomic goals?

Monetary policy refers to actions by the Federal Reserve System (the Fed) to control the money supply. When the Fed restricts the money supply, interest rates rise, the inflation rate drops, and economic growth slows. By expanding the money supply, the Fed stimulates economic growth. The government also uses fiscal policy—changes in levels of taxation and spending—to control the economy. Reducing taxes or increasing spending stimulates the economy; raising taxes or decreasing spending does the opposite. When the government spends more than it receives in tax revenues, it must borrow to finance the deficit. Some economists favor deficit spending as a way to stimulate the economy; others worry about our high level of national debt.

1.6 Microeconomics: Zeroing in on Businesses and Consumers

6. What are the basic microeconomic concepts of demand and supply, and how do they establish prices?

Demand is the quantity of a good or service that people will buy at a given price. Supply is the quantity of a good or service that firms will make available at a given price. When the price increases, the quantity demanded falls, but the quantity supplied rises. A price decrease leads to increased demand but a lower supply. At the point where the quantity demanded equals the quantity supplied, demand and supply are in balance. This equilibrium point is achieved by market adjustments of quantity and price.

1.7 Competing in a Free Market

7. What are the four types of market structure?

Market structure is the number of suppliers in a market. Perfect competition is characterized by a large number of buyers and sellers, very similar products, good market information for both buyers and sellers, and ease of entry into and exit from the market. In a pure monopoly, there is a single seller in a market. In monopolistic competition, many firms sell close substitutes in a market that is fairly easy to enter. In an oligopoly, a few firms produce most or all of the industry's output. An oligopoly is also difficult to enter, and what one firm does will influence others.

1.8 Trends in the Business Environment and Competition

8. Which trends are reshaping the business, microeconomic, and macroeconomic environments and competitive arena?

To remain competitive, businesses must identify and respond to trends in the various sectors of the business environment. As the population ages, large numbers of baby boomers are reaching retirement age. Companies must plan for this exodus of employees and find ways to retain the vast amounts of knowledge they represent. Many individuals are choosing to continue working after traditional retirement age, creating a five-generation workforce. Worldwide demand for energy is challenging oil companies worldwide to reevaluate their long-term strategies to incorporate technological advances and alternative energy sources. Companies are using relationship management and strategic alliances to compete effectively in the global economy.

Preparing for Tomorrow's Workplace Skills

1. Select a not-for-profit organization whose mission interests you. What are the organization's objectives? What resources does it need to achieve those goals? Select a for-profit business that provides a similar service, and compare the two organizations. How does each use the factors of production? (Resources, Information, Systems)
2. **Team Activity** Form seven teams. Each team is responsible for one of the sectors of the external business environment discussed in the chapter (economic, political/legal, demographic, social, competitive, global, and technological). Your boss, the company president, has asked each team to report on the changes in that area of the external environment and how they will affect the firm over the next five years. The firm is the Boeing Company. Each team should use the library, the internet, and other data sources to make its projections. Each team member should examine at least one data source. The team should then pool the data and prepare its response. A spokesperson for each team should present the findings to the class. (Interpersonal, Resources, Information)
3. If a friend claimed, "Economics is all theory and not very practical," how might you counter this claim? Share your rationale with the class. (Interpersonal, Information)
4. **Team Activity** Create two teams of four people each. Have one side choose a communist economy and the other capitalism. Debate the proposition that "capitalism/a command economy is good for nations with emerging economies." (Interpersonal, Information)
5. What are the latest actions the federal government has taken to manage the economy? Has it used monetary policy or fiscal policy to achieve its macroeconomic goals? Summarize your findings. (Information, Systems)
6. As a manufacturer of smart watch accessories, you are questioning your pricing policies. The CPI has increased around 3 percent per year over the last five years, but the prices of your products have increased at an average of 8 percent for the first 3 years and then 2 percent for the subsequent two years. What does this information tell you about the economic forces such as demand and supply that have influenced the market for your smart watch accessories? (Resources, Information)

Ethics Activity

Historically, diesel cars have not been big sellers in the U.S. auto market, mainly because their engines couldn't pass the strict emissions standards set up by the Environmental Protection Agency and the California Air Resources Board. In response, Volkswagen decided to develop engines specifically manufactured to meet U.S. emission standards.

By 2010, VW had introduced several models of diesel cars in the United States, and their sales helped propel Volkswagen to the number-two slot in global auto sales, after Toyota and ahead of GM. While VW was receiving major media attention for its clean diesel models, researchers from West Virginia University discovered that these so-called clean engines had been constructed with a "defeat device"—software that

could actually tell when the car was being tested off road for emissions and lower the level of emissions that harm the environment.

By December 2014, Volkswagen agreed to voluntarily recall more than a half-million clean diesel cars in the United States to address the emissions issues. But the scandal continued to escalate, with accusations that senior management knew about the rigged engines, and VW's CEO resigned and several other executives were fired.

Class-action lawsuits and other litigation followed, and in April 2017, VW agreed to a $4.3 billion settlement, which included a criminal fine of $2.8 billion, as well as various buyback plans for the affected diesel cars. Since then, VW has experienced changes in sales in the U.S. market and has worked to develop strategies to mitigate the damage caused by the scandal.

Using a web search tool, locate information about this topic, and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: How can VW ensure that its diesel cars now comply with U.S. emissions standards? What have they done and how effective have their strategies been? Do you agree with the billions of dollars in fines that VW will have to pay to move beyond the emissions debacle?

Sources: "VW Diesel Crisis: Timeline of Events," https://www.cars.com, May 19, 2017; Jack Ewing, "Inside VW's Campaign of Trickery," *The New York Times,* https://www.nytimes.com, May 7, 2017; Christoph Rauwald, "How a Top-Secret Deal Could Have Stopped VW's Diesel Scandal," *Bloomberg,* https://www.bloomberg.com, January 12, 2017; "6 VW Execs Indicted as Carmaker Agrees to $4.3 Billion Diesel Cheat Settlement," *Fortune,* https://fortune.com, January 12, 2017; Geoffrey Smith and Roger Parloff, "Hoaxwagen: Inside Volkswagen's Diesel Fraud," *Fortune*, https://fortune.com, March 7, 2016; "Volkswagen Sales Data, Trends, Analysis & Current Lineup for the U.S Automotive Market," https://www.goodcarbadcar.net, accessed March 5, 2026.

Working the Net

1. The Bureau of Labor Statistics compiles demographic data. Visit **https://www.bls.gov/bls/demographics.htm**, and describe the different types of information it provides. What kinds of changes are likely to occur in the United States over the next 25 years? Navigate to the "Subjects" menu and then click on Spending & Time Use and select How Americans Spend Time to read about the American Time Use Survey. What trends can you identify?
2. Go to the Wired **(https://www.wired.com)** site and research technology trends. Compile a list of three trends that sound most promising to you, and describe them briefly. How will they affect businesses? What impact, if any, will they have on you personally?
3. Use the Bureau of Labor Statistics site **(https://www.bls.gov/)** to determine the current trends in GDP growth, unemployment, and inflation. What do these trends tell you about the level of business activity and the business cycle? If you owned a staffing agency, how would this information affect your decision-making?
4. What's the latest U.S. economic news? Follow the link to the Economy page on the CNBC website, which categorizes news about the world economy, the U.S. economy, and other important topics **(https://www.cnbc.com/economy/)**. Read the various articles about the U.S. economy, and then do the same for GDP Outlook **(https://www.cnbc.com/rapid-update/)**. Prepare a summary of what you learned, and use it to discuss where you think the economy is headed for the next 6 to 12 months.
5. How would you spend the national budget if you were president? Here's your chance to find out how your ideas would affect the federal budget. Go online to Committee for a Responsible Federal Budget, at **https://www.crfb.org/debtfixer**, which is an exercise in making difficult decisions and how government officials make trade-offs when they prepare the federal budget. Experiment with your own budget ideas at the site. What are the effects of your decisions?

Critical Thinking Case

Walmart Gets Serious about E-Commerce

As the world's largest retailer by total sales, Walmart has built thousands of brick-and-mortar stores in the United States, Mexico, and elsewhere. Although a success story when it comes to traditional retail locations, Walmart has struggled with its e-commerce efforts, with online sales accounting for nearly 20 percent of the company's $680 billion in annual sales by 2025. The company has tried several different e-commerce strategies in the past, but none of them was an overwhelming success. Some company insiders objected to the pricing strategy used for online purchases; they were fearful that Walmart's lower prices online would take customers (and sales) away from the retail locations.

Doug McMillon, Walmart's CEO since 2014, believed a significant change was needed in the company's e-commerce business. Between 2014 and 2016, Walmart spent billions to acquire several online companies to expand its e-commerce business in an effort to take a small bite out of retail giant Amazon's success. In 2016, Walmart purchased Jet.com, an e-commerce site that sells a little bit of everything (books, clothing, electronics, etc.) at discount prices. The goal was to use the acquisition to fuel Walmart's e-commerce efforts. Four years after the acquisition, Walmart made the decision to discontinue the Jet.com brand and website. Walmart's leadership utilized the expertise in e-commerce from Jet.com to boost their own efforts in building Walmart's market share in online sales. Additionally, Walmart worked to identify other established online companies to add to their e-commerce profile.

First Walmart purchased footwear e-tailer ShoeBuy for $70 million in January 2017. The following month, Walmart bought outdoor specialty retailer Moosejaw for $51 million (sold to Dicks Sporting Goods in 2023). Then in March, Walmart paid $75 million for ModCloth, an eclectic shopping site for women's fashions (sold to Go Global Retail in 2019). Walmart also purchased Bonobos, a hip fashion retailer geared toward millennial men, and then later sold the company to WHP Global and Express in 2023.

Reaction to the acquisitions has been mixed, depending on whom you ask. Retail analysts applaud the company's radical move, pointing out that several well-known traditional retailers have closed their doors or filed bankruptcy because they failed to take part in the e-commerce revolution. However, McMillon's decision to allow the online retailers to operate independently may help retain loyal customers. The focus on e-commerce may also prompt in-store customers to take advantage of the expanded offerings available through Walmart.com.

Critical Thinking Questions

1. What are some advantages of Walmart purchasing established web businesses?
2. What impact has Walmart's acquisition of nontraditional retailers had on the shopping habits of Walmart's customers?
3. How did the aggressive e-commerce plan implemented by Walmart affect operations at its retail locations?

Sources: Brad Stone and Matthew Boyle, "Amazon Won't Know What Hit 'Em!" *Bloomberg Businessweek,* https://www.bloomberg.com, May 8–May 14, 2017; "What an Acquisition of Bonobos Would Signal About Wal-Mart's Strategy," *Forbes,* https://www.forbes.com, May 9, 2017; "Walmart Acquires Niche Online Retailers, to the Dismay of Hipsters," *Denver Post,* https://www.denverpost.com, March 24, 2017; Alana Abramson, "Walmart Acquires Online Women's Retailer ModCloth," *Fortune,* https://fortune.com, March 17, 2017; Phil Wahba, "Walmart's 29% Online Holiday Season Growth Sends Shares Jumping," *Fortune,* https://fortune.com, February 21, 2017; Laura Heller, "Take That Amazon: Walmart Buys Moosejaw for $51 Million," *Forbes,* https://www.forbes.com, February 15, 2017; "Walmart Acquires ShoeBuy for $70 Million," *Business Insider,* https://www.businessinsider.com, January 6, 2017; "Walmart Inc. (WMT) Revenue," https://wallstreetnumbers.com, accessed March 5, 2026; "Wal-Mart Expands Online Reach with ShoeBuy Acquisition," *Associated Press*, https://apnews.com, January 5, 2017; Joan Verdon, "Reborn at Age 18: Modcloth's New Owners Give the Vintage-Inspired Clothing Brand New Tools for Growth," *CO—*,

https://www.uschamber.com, August 10, 2020; Melissa Repko, "Walmart Winds Down Jet.com Four Years after $3.3 Billion Acquisition of E-Commerce Company," *CNBC*, https://cnbc.com, May 19, 2020; Julia Waldow, "'Not a Core Competency:' Why Moosejaw No Longer Fits in Walmart's Portfolio," *Modern Retail Daily*, https://www.modernretail.co, February 27, 2023; Gabrielle Fonrouge, "Walmart Sells Bonobos to WHP Global and Express in $75 Million Deal," *CNBC*, https://www.cnbc.com, April 13, 2023; Christian Stadler, "What Is The Secret To Walmart's Success?" *Forbes*, https://www.forbes.com, May 24, 2024; "Walmart US Turns Ecommerce Profitable for the First Time," *Ecommerce North America*, https://www.ecommercenorthamerica.org, April 14, 2025.

Hot Links Address Book

1. What makes a company good to work for or most admired? Find out by checking *Fortune*'s special lists at **https://fortune.com/companies/**.
2. Which country has the largest GDP? The most people? The answers can be found in The World Factbook at **https://www.cia.gov/the-world-factbook/**.
3. Get the scoop on the latest technology trends affecting our lives from CNET's website at **https://www.cnet.com**. The site also includes product reviews, how-to videos, and smart home features.
4. The Federal Reserve Board issues a variety of statistical information about the state of the U.S. economy. Find it at the Federal Reserve's site by clicking on the Economic Research and Data links: **https://www.federalreserve.gov**.
5. Want to know the current public debt per citizen, or even what it was in 1790? Go to **https://fiscaldata.treasury.gov/datasets/** and you can filter the data for any date range including 1790 to present day.
6. The U.S. Bureau of Economic Analysis (BEA) tracks national and regional economic statistics, including the GDP. To find the latest GDP statistics, visit the BEA at **https://www.bea.gov/data/gdp/gross-domestic-product**.
7. How are the job prospects in your area? Your region's unemployment statistics can give you an idea of how hard it will be to find a job. Find the most recent unemployment statistics from the Bureau of Labor Statistics at **https://www.bls.gov**.
8. How do the PPI and the CPI differ? Get the answers to this and other questions about the PPI by visiting the Bureau of Labor Statistics PPI site at **https://www.bls.gov/ppi**.

2

Making Ethical Decisions and Managing a Socially Responsible Business

Exhibit 2.1

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What philosophies and concepts shape personal ethical standards?
2. How can organizations encourage ethical business behavior?
3. What is corporate social responsibility?
4. How do businesses meet their social responsibilities to various stakeholders?
5. What are the trends in ethics and corporate social responsibility?

EXPLORING BUSINESS CAREERS

Playing with a Purpose at Hasbro

Hasbro is a global play and entertainment company that takes corporate social responsibility (CSR) very seriously. Founded nearly a century ago in Rhode Island, Hasbro integrates its CSR efforts throughout the organization with the goal of helping to make the world a better place for children of all ages.

The company has often been recognized in the "100 Best Corporate Citizens" rankings, published annually by *Corporate Responsibility* magazine. Hasbro is no stranger to this achievement; over the past five years, Hasbro has consistently been in the top five spots on this prestigious list—and that is no accident.

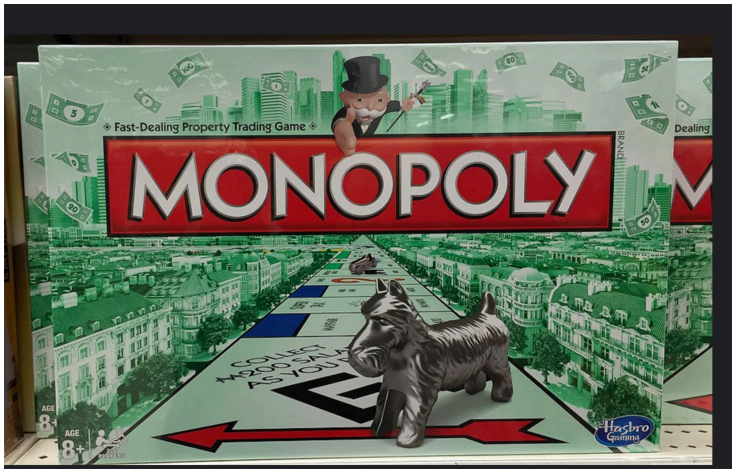

Exhibit 2.2 Hasbro's Monopoly game (Credit: Ben Tsai/ Flickr/ Public Domain)

With around 5,000 employees, Hasbro relies heavily on its strategic brand blueprint to guide its efforts in CSR, innovation, philanthropy, and product development. With a business portfolio that includes such well-known brands as Nerf, Play-Doh, Transformers, Monopoly, and The Game of Life, the company focuses its CSR efforts on four key areas: product safety, environmental sustainability, human rights and ethical sourcing, and community.

According to the company, product safety is its highest priority. Hasbro uses a five-step quality assurance process that starts with design and then moves to engineering, manufacturing, and packaging. Another key part of product safety at Hasbro is incorporating continuous feedback from both consumers and retailers and insisting that these high standards and quality processes apply to all third-party factories worldwide that manufacture its products.

Hasbro is also committed to finding new ways to reduce its environmental footprint. Over the past decades, the company has reduced energy consumption, cut greenhouse gas emissions, and reduced water consumption and waste production in its production facilities. In addition, Hasbro has totally eliminated the use of wire ties in all of its product packaging, thereby reducing the amount of non-biodegradable products from their brands making it into landfills.

Human rights and ethical sourcing remains a key ingredient of Hasbro's CSR success. Treating people fairly is a core company value, as is working diligently to make great strides in diversity and inclusion at all levels of the organization. Company personnel work closely with third-party factories to ensure that the human rights of all workers in the Hasbro global supply chain are recognized and upheld.

Philanthropy, corporate giving, and employee volunteering are key components of the Hasbro community. Through its various charitable programs, Hasbro made $15 million in financial contributions and product donations in 2023, which reached nearly 4 million children around the globe. Several years ago the company started an annual Global Day of Joy as a way of engaging its employees worldwide in community service. Each year, Hasbro employees participate in the company's Global Day of Joy. This effort, centered on service projects, occurs in December, and virtually all employees from around the world participate in the day of giving.

Hasbro is in the business of storytelling, and its CSR efforts tell the story of an ethical, responsible organization whose mission is to create the world's best play experiences. Its ability to be accountable for its actions and to help make the world a better place one experience at time continues to make it a highly successful company.

Sources: Brian Goldner, "Who Are You Really?—Brian Goldner, President & CEO for Hasbro, Inc.," https://insights.ethisphere.com, accessed June 29, 2017; "CSR Fact Sheet," https://csr.hasbro.com, accessed

June 23, 2017; "The World's Biggest Public Companies: Hasbro," *Forbes,* https://www.forbes.com, accessed June 23, 2017; "2016 Global Philanthropy & Social Impact," https://csr.hasbro.com, accessed June 23, 2017; Elizabeth Gurdus, "Hasbro CEO Reveals the Magic Behind the Toymaker's Earnings Beat," *CNBC,* https://www.cnbc.com, April 24, 2017; Jade Burke, "Hasbro Reaches Top Spot in CSR Listing," *Toy News,* https://www.toynews-online.biz, April 21, 2017; Kathrin Belliveau, "CSR at Hasbro: What It Means to Play with Purpose," *LinkedIn,* https://www.linkedin.com, April 20, 2017; "Global Philanthropy and Social Impact," https://globalphilanthropy.hasbro.com, accessed January 23, 2026.

Every day, managers and business owners make business decisions based on what they believe to be right and wrong. Through their actions, they demonstrate to their employees what is and is not acceptable behavior and shape the moral standard of the organization. As you will see in this module, personal and professional ethics are important cornerstones of an organization and shape its ultimate contributions to society in the form of corporate social responsibility. First, let's consider how individual business ethics are formed.

2.1 Understanding Business Ethics

1. What philosophies and concepts shape personal ethical standards?

Ethics is a set of moral standards for judging whether something is right or wrong. The first step in understanding business ethics is learning to recognize an **ethical issue**. An ethical issue is a situation where someone must choose between a set of actions that may be ethical or unethical. For example, Martin Shkreli, former CEO of Turing Pharmaceuticals, raised the price of a critical, life-saving drug by 4000 percent, defending the price increase as a "great business decision." This act resulted in Shkreli being banned from participating in the industry for life.[1] Few people would call that ethical behavior. But consider the actions of the stranded, hungry people in New Orleans who lost everything in the aftermath of Hurricane Katrina. They broke into flooded stores, taking food and bottled water without paying for them. Was this unethical behavior? Or what about the small Texas plastics manufacturer that employed over 100 people and specialized in the Latin American market? The president was distraught because he knew the firm would be bankrupt by the end of the year if it didn't receive more contracts. He knew that he was losing business because he refused to pay bribes. Bribes were part of the culture in his major markets. Closing the firm would put many people out of work. Should he start paying bribes in order to stay in business? Would this be unethical? Let's look at the next section to obtain some guidance on recognizing unethical situations.

Recognizing Unethical Business Activities

Researchers from Brigham Young University tell us that all unethical business activities will fall into one of the following categories:

1. *Taking things that don't belong to you.* The unauthorized use of someone else's property or taking property under false pretenses is taking something that does not belong to you. Even the smallest offense, such as using the printer at your office for personal use or exaggerating your travel expenses, belongs in this category of ethical violations.
2. *Saying things you know are not true.* Often, when trying for a promotion and advancement, fellow employees discredit their coworkers. Falsely assigning blame or inaccurately reporting conversations is lying. Although "This is the way the game is played around here" is a common justification, saying things that are untrue is an ethical violation.
3. *Giving or allowing false impressions.* The salesperson who permits a potential customer to believe that cardboard boxes will hold the customer's tomatoes for long-distance shipping when the salesperson knows the boxes are not strong enough has given a false impression. A car dealer who fails to disclose that a car has been in an accident is misleading potential customers.
4. *Buying influence or engaging in a conflict of interest.* A conflict of interest occurs when the official

responsibilities of an employee or government official are influenced by the potential for personal gain. Suppose a company awards a construction contract to a firm owned by the parent of the state attorney general while the state attorney general's office is investigating that company. If this construction award has the potential to shape the outcome of the investigation, a conflict of interest has occurred.

5. *Hiding or divulging information.* Failing to disclose the results of medical studies that indicate your firm's new drug has significant side effects is the ethical violation of hiding information that the product could be harmful to purchasers. Taking your firm's product development or trade secrets to a new place of employment constitutes the ethical violation of divulging proprietary information.
6. *Taking unfair advantage.* Many current consumer protection laws were passed because so many businesses took unfair advantage of people who were not educated or were unable to discern the nuances of complex contracts. Credit disclosure requirements, truth-in-lending provisions, and new regulations on auto leasing all resulted because businesses misled consumers who could not easily follow the jargon of long, complex agreements.
7. *Committing improper personal behavior.* Although the ethical aspects of an employee's right to privacy are still debated, it has become increasingly clear that personal conduct outside the job can influence performance and company reputation. Thus, a company driver must abstain from substance abuse because of safety issues. Even the traditional company holiday party and summer picnic have come under scrutiny due to the possibility that employees at and following these events might harm others through alcohol-related accidents.
8. *Abusing power and mistreating individuals.* Suppose a manager sexually harasses an employee or subjects employees to humiliating corrections or reprimands in the presence of customers. In some cases, laws protect employees. Many situations, however, are simply interpersonal abuse that constitutes an ethical violation.
9. *Permitting organizational abuse.* Many U.S. firms with operations overseas, such as Apple, Pandora, and Pfizer, have faced issues of organizational abuse. The unfair treatment of workers in international operations appears in the form of child labor, unfairly low wages, and excessive work hours. Although a business cannot change the culture of another country, it can perpetuate—or stop—abuse through its operations there.
10. *Violating rules.* Many organizations use rules and processes to maintain internal controls or respect the authority of managers. Although these rules may seem burdensome to employees trying to serve customers, a violation may be considered an unethical act.
11. *Condoning unethical actions.* What if you witnessed a fellow employee embezzling company funds by forging their signature on a check? Would you report the violation? Overlooking others' unethical behavior is itself unethical.[2]

After recognizing that a situation is unethical, the next question is what do you do? The action that a person takes is partially based upon his or her ethical philosophy. The environment in which we live and work also plays a role in our behavior. This section describes personal philosophies and legal factors that influence the choices we make when confronting an ethical dilemma.

Justice—The Question of Fairness

Another factor influencing individual business ethics is **justice**, or what is fair according to prevailing standards of society. We all expect life to be reasonably fair. You expect your exams to be fair, the grading to be fair, and your wages to be fair, based on the type of work being done.

Today we take justice to mean an equitable distribution of the burdens and rewards that society has to offer. The distributive process varies from society to society. Those in a democratic society believe in the "equal pay for equal work" doctrine, in which individuals are rewarded based on the value the free market places on their services. Because the market places different values on different occupations, the rewards, such as wages, are not necessarily equal. Nevertheless, many regard the rewards as just. A politician who argued that a supermarket clerk should receive the same pay as a physician, for example, would not receive many votes. At

the other extreme, communist theorists have argued that justice would be served by a society in which burdens and rewards were distributed to individuals according to their abilities and their needs, respectively.

Utilitarianism—Seeking the Best for the Majority

One of the philosophies that may influence choices between right and wrong is **utilitarianism**, which focuses on the consequences of an action taken by a person or organization. The notion that people should act so as to generate the greatest good for the greatest number is derived from utilitarianism. When an action affects the majority adversely, it is morally wrong. One problem with this philosophy is that it is nearly impossible to accurately determine how a decision will affect a large number of people.

Another problem is that utilitarianism always involves both winners and losers. If sales are slowing and a manager decides to fire five people rather than putting everyone on a 30-hour workweek, the people who keep their full-time jobs are winners, but the other five are losers.

A final criticism of utilitarianism is that some "costs," although small relative to the potential good, are so negative that some segments of society find them unacceptable. What if scientists deliberately killed animals by breaking their backs to conduct spinal cord research that someday could lead to a cure for spinal cord injuries? To a number of people, the "costs" of killing these animals are simply too horrible for this type of research to occur.

Following Our Obligations and Duties

The philosophy that says people should meet their obligations and duties when analyzing an ethical dilemma is called **deontology**. This means that a person will follow his or her obligations to another individual or society because upholding one's duty is what is considered ethically correct. For instance, people who follow this philosophy will always keep their promises to a friend and will follow the law. They will produce very consistent decisions, because they will be based on the individual's set duties. Note that this theory is not necessarily concerned with the welfare of others. Say, for example, a technician for Spectrum Internet has decided that it's their ethical duty (and is very practical) to always be on time to meetings with homeowners. Today they are running late. How are they supposed to drive? Is the technician supposed to speed, breaking their duty to society to uphold the law, or are they supposed to arrive at the client's home late, breaking their duty to be on time? This scenario of conflicting obligations does not lead us to a clear ethically correct resolution, nor does it protect the welfare of others from the technician's decision.

Individual Rights

In our society, individuals and groups have certain rights that exist under certain conditions regardless of any external circumstances. These rights serve as guides when making individual ethical decisions. The term *human rights* implies that certain rights—to life, to freedom, to the pursuit of happiness—are bestowed at birth and cannot be arbitrarily taken away. Denying the rights of an individual or group is considered to be unethical and illegal in most, though not all, parts of the world. Certain rights are guaranteed by the government and its laws, and these are considered *legal rights.* The U.S. Constitution and its amendments, as well as state and federal statutes, define the rights of U.S. citizens. Those rights can be disregarded only in extreme circumstances, such as during wartime. Legal rights include the freedom of religion, speech, and assembly; protection from improper arrest and searches and seizures; and proper access to counsel, confrontation of witnesses, and cross-examination in criminal prosecutions. Also held to be fundamental is the right to privacy in many matters. Legal rights are to be applied without regard to race, color, creed, sex or ability.

CONCEPT CHECK

1. How are individual business ethics formed?
2. What is utilitarianism?
3. How can you recognize unethical activities?

2.2 How Organizations Influence Ethical Conduct

2. How can organizations encourage ethical business behavior?

People choose between right and wrong based on their personal code of ethics. They are also influenced by the ethical environment created by their employers. Consider the following headlines:

- Investment advisor Bernard Madoff sentenced to 150 years in prison for swindling thousands of clients out of more than $65 billion. He passed away in prison in 2021.
- Volkswagen CEO, Martin Winterkorn, resigned after the company was ordered to pay over $30 billion for deceptive software designed to mislead consumers about the environmental impact of their vehicles.
- Renaud Laplanche, the founder of Lending Club, is fired because of misrepresentation of data to investors and deceptive loan practices to consumers.
- Wells Fargo CEO John Stumpf resigned after company employees opened more than 2 million fake accounts to meet aggressive sales targets.[3]

As these actual stories illustrate, poor business ethics can create a very negative image for a company, can be expensive for the firm and/or the executives involved, and can result in bankruptcy and jail time for the offenders. Organizations can reduce the potential for these types of liability claims by educating their employees about ethical standards, by leading through example, and through various informal and formal programs.

Leading by Example

Employees often follow the examples set by their managers. That is, leaders and managers establish patterns of behavior that determine what's acceptable and what's not within the organization. Ben Cohen, co-founder of Ben & Jerry's ice cream, instituted a policy that no one could earn a salary more than seven times that of the lowest paid employee. He wanted upper management to work toward increasing pay for all employees in order to retain a higher salary themselves. This meant that the CEO of Ben & Jerry's was making around $150,000 at the time—while executives at other companies might be earning millions. Cohen's actions helped shape the ethical values of Ben & Jerry's. Although acquired by Unilever in 2021, Ben & Jerry's still retains the reputation of having ethical practices and leadership.

Offering Ethics Training Programs

In addition to providing a system to resolve ethical dilemmas, organizations also provide formal training to develop an awareness of questionable business activities and practice appropriate responses. Many companies have some type of ethics training program. The ones that are most effective, like those created by PepsiCo, Hershey, and Procter & Gamble, begin with techniques for solving ethical dilemmas such as those discussed earlier. Next, employees are presented with a series of situations and asked to come up with the "best" ethical solution. One of these ethical dilemmas is shown in **Table 2.1**. According to a survey by the Ethics Resource Center, most U.S. companies provide some sort of ethics training for employees, with nearly 80 percent providing this training targeting new managers.[4]

An Ethical Dilemma Used for Employee Training
Robin was a middle manager of a large manufacturer of lighting fixtures in Newark, New Jersey. Robin had moved up the company ladder rather quickly and seemed destined for upper management in a few years. Robin's boss, Taylor, had been applying pressure about the semiannual reviews concerning Misha, one of Robin's employees. Taylor, it seemed, would not accept any negative comments on Misha's evaluation forms. Robin had found out that a previous manager who had given Misha a bad evaluation was no longer with the company. As Robin reviewed Misha's performance for the forthcoming evaluation period, there were many areas of subpar performance. Moreover, a major client had called recently complaining that Misha had filled a large order improperly and then had been rude to the client when they called to complain.
Discussion Questions 1. What ethical issues does the situation raise? 2. What courses of action could Robin take? Describe the ethics of each course. 3. Should Robin confront Taylor? Taylor's boss? 4. What would you do in this situation? What are the ethical implications?

Table 2.1

Establishing a Formal Code of Ethics

Most large companies and thousands of smaller ones have created and distributed codes of ethics. In general, a **code of ethics** provides employees with the knowledge of what their firm expects in terms of their responsibilities and behavior toward fellow employees, customers, and suppliers. Some ethical codes offer a lengthy and detailed set of guidelines for employees. Others are not really codes at all but rather summary statements of goals, policies, and priorities. Some companies have their codes framed and hung on office walls, included as a key component of employee handbooks, and/or posted on their corporate websites.

Examples of company codes of ethics:

Costco https://customerservice.costco.com/app/answers/detail/a_id/829/~/what-is-costcos-mission-statement-and-code-of-ethics%3F

PepsiCo https://www.pepsico.com/about/global-code-of-conduct

Do codes of ethics make employees behave in a more ethical manner? Some people believe that they do. Others think that they are little more than public relations gimmicks. If senior management abides by the code of ethics and regularly emphasizes the code to employees, then it will likely have a positive influence on behavior.

The “100 Best Corporate Citizens” as ranked by 3BL's annual report are selected based on 219 factors across seven categories, including climate change, employees, environment, governance, human rights, stakeholders and society, and overall performance.[5] The top corporate citizens in 2025 were:

1. HP Inc.
2. Ingersoll Rand
3. Owens Corning
4. Dell Technologies
5. Graphic Packaging Holding Company
6. The Hershey Company
7. Intel Corporation
8. Jones Lang LaSalle (JLL)

9. Hewlett Packard Enterprise (HPE)
10. CBRE Group

CUSTOMER SATISFACTION AND QUALITY

Campbell's Adds CSR to Its Recipe

The Campbell Soup Company is no longer just about traditional cans of processed soup. Under the guidance of its management team, particularly its former CEO Denise Morrison (Morrison retired from Campbell's in May of 2018), Campbell's has undergone a transformation that includes a strong emphasis on organics and fresh food—and a large serving of corporate citizenship.

Once recognized in the Best Corporate Citizens rankings, Campbell's is working to make sustainability and transparency part of its business DNA, and this culture shift has had an important influence on the company's business strategies.

Morrison, who took over as CEO in 2011, is a firm believer in the company's central vision: real food that matters for life's moments. "We can make a profit and make a difference, and we are doing both through our business . . . in a way that's authentic, that's transparent, and that truly matters," she explains.

Under Morrison's watch, the company acquired several fresh food and organic companies, including Bolthouse Farms, one of the largest suppliers of fresh carrots in the United States, and Pacific Foods of Oregon, which produces organic soups. Tracking the strong change in consumer preference for healthier food, Campbell's continues to be on the lookout for strategic acquisitions that align with this goal to help solidify the company's reputation for fresh ingredients with millennials and their families.

Inherent in the company's reinvention is the strong emphasis on corporate citizenship—doing good and giving back seem to be top priorities for Campbell's. In addition to acquiring sustainable and fresh food companies, Campbell's has also made a conscious decision to support the communities where their employees live and work. For example, the company launched a healthy communities initiative in Camden, New Jersey, where Campbell's is headquartered—an urban city that has seen its share of economic and social challenges in the past. In partnership with several local organizations, this initiative has helped fund community gardens, food pantries, nutrition education, and cooking classes that help build healthy communities. The Camden experience has been so successful that the company has expanded the program to other cities where it operates, including Detroit, Michigan, and Norwalk, Connecticut.

The company's ongoing commitment to fresh food, community involvement, and corporate social responsibility has helped change the narrative when it comes to being a sustainable and ethical organization.

Questions for Discussion

1. How does Campbell Soup Company's recent business acquisitions help support its CSR strategies?
2. Provide examples of how the company's transformation from a processed food giant to a purveyor of fresh ingredients can help attract a new group of customers.

Sources: "Corporate Responsibility and Sustainability Are Good for Business," https://www.campbellsoupcompany.com, accessed June 27, 2017; "Campbell Soup Wants to Make You a Personal Eating Plan (video)," *Fortune,* https://fortune.com, May 2, 2017; Don Seiffert, "Campbell Soup CEO Makes 3 Predictions about the Future of Food," *Boston Business Journal,* https://www.bizjournals.com, April 13, 2017; Aaron Hurst, "How Denise Morrison Took Processed Food Icon Campbell's on a Fresh Food Buying Spree," *Fast Company,* https://www.fastcompany.com, March 2, 2017; Abigail Stevenson, "Campbell Soup CEO: Stunning Disruption in the Ecosystem of Food," *CNBC,* https://www.cnbc.com, July 21, 2016; Richa

Naidu and Svea Herbst-Bayliss, “Campbell Soup Names Industry Veteran Mark Clouse as New CEO,” *Reuters*, https://www.reuters.com, accessed January 23, 2026.

Making the Right Decision

In many situations, there may be no simple right or wrong answers. Yet there are several questions you can ask yourself, and a couple of self-tests you can do, to help you make the right ethical decision. First, ask yourself, “Are there any legal restrictions or violations that will result from the action?” If so, take a different course of action. If not, ask yourself, “Does it violate my company’s code of ethics?” If so, again find a different path to follow. Third, ask, “Does this meet the guidelines of my own ethical philosophy?” If the answer is “yes,” then your decision must still pass two important tests.

The Feelings Test

You must now ask, “How does it make me feel?” This enables you to examine your comfort level with a particular decision. Many people find that, after reaching a decision on an issue, they still experience discomfort that may disrupt sleep or create unsettling feelings. Those feelings of conscience can serve as a future guide in resolving ethical dilemmas.

The Headline or Social Media Test

The final test involves the top-of-page news headline or social media posts. The question to be asked is how an objective reporter would describe your decision in a front-page newspaper story, an online media site, or a social media platform such as X or Facebook. Some managers rephrase the test for their employees: How will the headline read if I make this decision, or what will be the reaction of my social media followers? This test is helpful in spotting and resolving potential conflicts of interest.

Exhibit 2.3 Making an ethical decision might come down to how you feel about the decision or to the newspaper or social media post test. The question to ask yourself is how the decision would make you feel if an objective reporter described the decision in a news headline or via a social media post on X or Facebook—all of which would be viewed by many, many people. Speaking of social media, it plays a pivotal role in ethical decision-making today, when people use the medium to share critical comments about friends as well as employers, business colleagues, and competitors. *Should companies view employees’ social media pages on a regular basis, or is that information off-limits to employers?* (Credit: Mike MacKenzie/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

CONCEPT CHECK

1. What is the role of top management in organizational ethics?
2. What is a code of ethics?

2.3 Managing a Socially Responsible Business

3. What is corporate social responsibility?

Acting in an ethical manner is one of the four components of the pyramid of **corporate social responsibility (CSR),** which is the concern of businesses for the welfare of society as a whole. It consists of obligations beyond those required by law or union contract. This definition makes two important points. First, CSR is voluntary. Beneficial action required by law, such as cleaning up factories that are polluting air and water, is not voluntary. Second, the obligations of corporate social responsibility are broad. They extend beyond investors in the company to include workers, suppliers, consumers, communities, and society at large.

Exhibit 2.4 portrays economic responsibility as the foundation for the other three responsibilities. At the same time that a business pursues profits (economic responsibility), it is expected to obey the law (legal responsibility); to do what is right, just, and fair (ethical responsibility); and to be a good corporate citizen (philanthropic responsibility). These four components are distinct but together constitute the whole. Still, if the company doesn't make a profit, then the other three responsibilities won't matter.

Many companies continue to work hard to make the world a better place to live. Data suggest that Fortune 500 companies spend approximately $20 billion annually on CSR activities. Consider the following examples:

- Starbucks has donated more than 100 million meals to local communities via its FoodShare program and alliance with Feeding America, with 100 percent of their over 10,000 company-owned stores participating.
- Salesforce encourages its employees to volunteer in community activities and pays them for doing so, up to 56 paid hours every year. Salesforce also has a matching grant program to donate to the employee's nonprofit of choice.
- Employees who work for Deloitte, a global audit, consulting, and financial services organization, can get paid for up to 5 hours of volunteer work per week. Deloitte's professionals volunteer nearly 160,000 hours each year to their communities. [6]

Understanding Social Responsibility

Peter Drucker, the late globally respected management expert, said that we should look first at what an organization does *to* society and second at what it can do *for* society. This idea suggests that social responsibility has two basic dimensions: legality and responsibility.

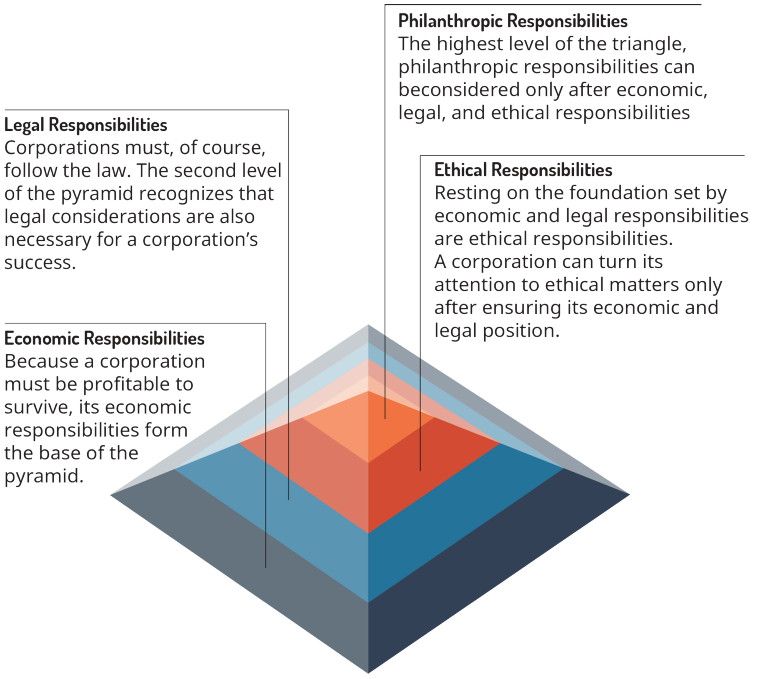

Exhibit 2.4 The Pyramid of Corporate Social Responsibility (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Illegal and Irresponsible Behavior

The idea of corporate social responsibility is so widespread today that it is hard to conceive of a company continually acting in illegal and irresponsible ways. Nevertheless, such actions do sometimes occur, which can create financial ruin for organizations, extreme financial hardships for many former employees, and general struggles for the communities in which they operate. Unfortunately, top executives still walk away with millions. Some, however, will ultimately pay large fines and spend time in prison for their actions. Federal, state, and local laws determine whether an activity is legal or not. The laws that regulate business are discussed later in this module.

Irresponsible but Legal Behavior

For example, the Minnesota-based company MyPillow was fined $1 million by the state of California for making unsubstantiated marketing claims about the effectiveness of the pillow in alleviating certain medical conditions. The company insisted that the claims were made by customers of the product as testimonials. These testimonials were on the company website, but were later removed as a result of the controversy. The company has also faced several additional lawsuits, and the Better Business Bureau lowered its rating and removed its accreditation as a result of consumer complaints.[7]

CATCHING THE ENTREPRENEURIAL SPIRIT

Badger Company Founder Walks the Walk

As a carpenter, Bill Whyte was always looking for a solution to his dry, cracked hands, especially in the harsh New Hampshire winters. After trying many commercial lotions that didn't really work, Whyte experimented with olive oil and beeswax to come up with a soothing balm to help heal rough hands. Mixing up the concoction at home, Whyte came up with a product that seemed to work and was made from natural ingredients.

Originally called Bear Paw, the lotion became known as Badger Balm after a friend found a competing

product already named Bear Paw. Whyte set up a production line at home to fill the tins. Soon he was pounding the pavement in the town of Gilsum, trying to sell the new product to hardware stores, lumber yards, and health food stores.

Fast-forward from his early days of experimentation, and Whyte (affectionately known as the "head badger") runs W.S. Badger Company with the same goals and passions he started with back in the mid-1990s. Badger emphasizes certified-organic botanicals and beeswax across its products and uses mineral actives (such as non-nano zinc oxide) in sunscreens. The company sources ingredients worldwide, including organic extra virgin olive oil from Spain, organic rose essential oil from Bulgaria, and bergamot oil from southern Italy.

Badger's homey culture is no accident. In fact, in the early days, Whyte made soup every Friday for the small staff. Badger is led by co-CEOs Rebecca Hamilton and Emily Schwerin-Whyte. Co-founder Katie Schwerin serves as COO, and founder Bill Whyte remains involved. All embrace the ethical and social principles of this family business that have made the company a success.

To reinforce the commitment of being socially responsible and demonstrating transparency, W.S. Badger Company became a Certified Benefit Corporation, or B Corp for short. This certification requires companies to meet rigorous standards for transparency, accountability, and social and environmental performance. (Benefit Corporations are discussed in more detail later in this module.)

Becoming a B Corp has helped the company organize how it operates. For example, pay for the highest-paid full-time employee is capped at five times that of the lowest paid, which is more than double New Hampshire's minimum wage; a portion of company profits flows to employees via profit sharing, and all employees participate in a bonus plan; and new parents are encouraged to bring their babies to work, a program that has helped foster a new style of teamwork for the entire organization, as well as increase employee morale. In addition, Badger donates 10 percent of its pre-tax profits annually to nonprofits focused on children's health and welfare, environmental education, and local community needs. The company also supports employee giving and volunteerism through internal programs. (Historically, Badger has matched employee donations and made additional birthday-directed gifts to charities).

Badger staff, about 80 to 90 employees, enjoy a living wage, great benefits, and a socially responsible work environment thanks to a visionary who found an eco-friendly way to soothe his rough hands and created an ethical business as part of his journey.

Questions for Discussion

1. How does Badger's approach to social responsibility help attract and retain employees?
2. Does the company's certification as a Benefit Corporation provide Badger with a competitive advantage? Explain your reasoning.

Sources: "Badger's History & Legend," "Babies at Work Policy," and "2016 Annual Impact Report," https://www.badgerbalm.com, accessed June 27, 2017; "About Badger," https://www.bcorporation.net, accessed June 27, 2017; "Badger 'Still In' on Climate Action, Asks New Hampshire Businesses, State Officials, and Local Leaders to Join Forces in Honoring Paris Agreement," https://www.prweb.com, June 22, 2017; Amy Feldman, "Badger Balm Creator Once Dismissed Being a B Corp as 'Just Marketing.' Now He's a True Believer," *Forbes,* https://www.forbes.com, May 9, 2017; "About Our Ingredients" and "Who We Are," https://www.badgerbalm.com, accessed January 23, 2026; "How B Corps Do Business Better: Narrowing the Income Gap by Reducing Pay Ratios and Uplifting Workers," *Medium*, https://www.bthechange.com, accessed January 23, 2026.

Legal and Responsible Behavior

The vast majority of business activities fall into the category of behavior that is both legal and responsible.

Most companies act legally, and most try to be socially responsible. Research shows nearly three-fourths of consumers prefer purchasing from companies that have excellent ethical track records and community involvement. Outdoor specialty retailer REI, for example, established partnerships with other entities to provide sustainable, solar energy initiatives to low-income households. A member cooperative, the company invested nearly $9 million in its 300 nonprofit partners in 2024.[8]

CONCEPT CHECK

1. What are the four components of social responsibility?
2. Give an example of legal but irresponsible behavior.

2.4 Responsibilities to Stakeholders

4. How do businesses meet their social responsibilities to various stakeholders?

What makes a company be admired or perceived as socially responsible? Such a company meets its obligations to its stakeholders. **Stakeholders** are the individuals or groups to whom a business has a responsibility. The stakeholders of a business are its employees, its customers, the general public, and its investors.

Responsibility to Employees

An organization's first responsibility is to provide a job to employees. Keeping people employed and letting them have time to enjoy the fruits of their labor is the finest thing business can do for society. Beyond this fundamental responsibility, employers must provide a clean, safe working environment that is free from all forms of discrimination. Companies should also strive to provide job security whenever possible.

Enlightened firms are also empowering employees to make decisions on their own and suggest solutions to company problems. Empowerment contributes to an employee's self-worth, which, in turn, increases productivity and reduces absenteeism.

Each year, in collaboration with Great Place to Work®, *Fortune* conducts an extensive employee survey of the best places to work in the United States. For 2025, the top companies included Hilton, Synchrony, Cisco, American Express, Wegmans Food Markets, and Marriott International. Some companies offer unusual benefits to their employees. For example, Cisco offers all employees four company-wide paid "Day for Me" mental-health/wellbeing days per year when the whole company pauses work. Additionally, Cisco subsidizes the first four hours of back up child/elder care through a partnership with Care.com.[9]

Responsibility to Customers

To be successful in today's business environment, a company must satisfy its customers. A firm must deliver what it promises, as well as be honest and forthright in everyday interactions with customers, suppliers, and others. Recent research suggests that many consumers, particularly millennials, prefer to do business with companies and brands that communicate socially responsible messages, utilize sustainable manufacturing processes, and practice ethical business standards.[10]

Responsibility to Society

A business must also be responsible to society. A business provides a community with jobs, goods, and services. It also pays taxes that go to support schools, hospitals, and better roads. Some companies have taken an additional step to demonstrate their commitment to stakeholders and society as a whole by becoming Certified Benefit Corporations, or B Corps for short. Verified by B Lab, a global nonprofit

organization, B Corps meet the highest standards of social and environmental performance, public transparency, and legal accountability and strive to use the power of business to solve social and environmental problems via an impact assessment that rates each company on a possible score of 200 points. To become certified as a Benefit Corporation, companies need to reach a score of at least 80 and must be recertified every two years. There are more than 9,000 companies worldwide that have been certified as B Corps, including The Body Shop, Kickstarter, Ben & Jerry's, Warby Parker, Toms, Patagonia, Coursera, and Moodle.[11]

Environmental Protection

Business is also responsible for protecting and improving the world's fragile environment. Deforestation is a worldwide issue to be addressed. Estimates indicate that 10 million hectares of the world's forests are cut down annually. There are nearly 10,000 critically endangered species. A continent-size hole is opening up in the earth's protective ozone shield. Each year, nearly 3,000 pounds of trash per person is discarded, much going into the already nearly full landfills.

To slow the erosion of the world's natural resources, many companies have become more environmentally responsible. For example, Toyota now uses renewable energy sources such as solar, wind, geothermal, and water power for electricity to run its facilities. Toyota's Port of Long Beach facility was converted using state-of-the-art sustainable technology to emit nearly no pollutants. The vehicle-processing plant is entirely powered with renewable energy that is created on site, helping the auto giant move closer to its goal of eliminating carbon emissions in all of its operations.[12]

ETHICS IN PRACTICE

This Fish Story Has a Tasting Ending

Duncan Berry, co-founder of Fishpeople Corp., has always been an environmentalist at heart. Brought up on the Oregon coast, he was a sea captain at an early age, spending nearly two decades on the ocean before going on to become a successful entrepreneur in the organic cotton industry. After selling the textile business at the age of 50, he retired back to the Oregon coast to work on a state initiative to preserve marine habitats.

He quickly discovered that the state's commercial fishing industry had gone into major disrepair since his seafaring adventure years earlier. Berry learned the majority of seafood consumed in the United States was being imported from other countries and more than 90 percent of U.S. seafood was being exported. In addition, great harm was being done to the ocean because it was being overfished.

Although several groups were already working to improve the commercial fishing industry, he observed that one key group was not part of the discussion: consumers. Berry decided a key component of change had to be involving consumers in the process. He spent more than a year meeting with everyone involved in the Oregon fishing industry—from fishermen to processors, distributors, truck drivers, chefs, and consumers—to gain perspective on why the industry was failing. His "aha" moment occurred when he realized the majority of fish is consumed in restaurants because consumers think preparing fish at home is too difficult and time-consuming. That's when he co-founded Fishpeople Seafood.

Started in 2012, Fishpeople has a mission of changing the way people think about seafood by being transparent about where the seafood comes from, how it is processed, and how it is handled. Berry believes the company's transparency helps consumers understand how the process translates into sustainable food that tastes good and is good for you. The company sells fresh and frozen seafood offerings. Fishpeople built its brand on package codes that let consumers trace catch area, vessel, and even the people doing the catching via the website through its "Trace your Fish" feature. Consumers can discover everything about the

seafood's origin, down to the fisherman who caught it. Fishpeople also operates a processing plant in Toledo, Oregon, where workers are paid a livable wage and receive health insurance—benefits typically unheard of in the fishing industry.

Fishpeople built national retail distribution in the late 2010s (including Whole Foods) and today focuses on traceable fresh and frozen seafood through regional retail and its coastal seafood market in Garibaldi, Oregon. In 2017, Fishpeople merged with Ilwaco Landing Fishermen—operators of landings in Ilwaco, Washington, and Garibaldi, Oregon—to integrate supply, expand species, and strengthen traceability and job stability for local fleets.

Questions for Discussion

1. How does Fishpeople's transparency contribute to the company's success?
2. What responsibility, if any, does Fishpeople have to the local fishing industry?

Sources: Company website, https://fishpeopleseafood.com, accessed June 27, 2017; J. David Santen, Jr., "Adding Value to Oregon Seafood," *Built Oregon,* https://builtoregon.com, accessed June 27, 2017; Elizabeth Crawford, "Fishpeople Wants to Fix the 'Fundamentally Broken' Seafood Industry with Increased Transparency," *Food Navigator,* https://www.foodnavigator-usa.com, May 25, 2017; Fishpeople Seafood Announces Merger with Ilwaco Landing Fishermen," *Tillamook County Pioneer*, https://www.tillamookcountypioneer.net, May 22, 2017; Leigh Buchanan, "Why This Entrepreneur Ditched Fashion for the 'Hunting and Gathering' Business," *Inc.,* https://www.inc.com, April 2017 issue; Kate Harrison, "This Former Green Textile Maven Is Making Microwaved Seafood Sustainable," *Forbes,* https://www.forbes.com, August 25, 2015; "FishPeople Seafood," https://fishchoice.com, accessed January 23, 2026.

Corporate Philanthropy

Companies also display their social responsibility through corporate philanthropy. **Corporate philanthropy** includes cash contributions, donations of equipment and products, and support for the volunteer efforts of company employees. Statistics suggest U.S. corporate philanthropy exceeds more than $44 billion annually.[13] American Express is a major supporter of the American Red Cross. The organization relies almost entirely on charitable gifts to carry out its programs and services, which include disaster relief, armed-forces emergency relief, blood and tissue services, and health and safety services. The funds provided by American Express have enabled the Red Cross to deliver humanitarian relief to victims of numerous disasters around the world.[14] When Hurricane Katrina hit the Gulf Coast, Bayer sent 45,000 diabetes blood glucose monitors to the relief effort. Within weeks of the disaster, Abbott, Alcoa, Dell, Disney, Intel, UPS, Walgreens, Walmart, and others contributed more than $550 million for disaster relief.[15]

Exhibit 2.5 Hybrid cars and all-electric vehicles such as Rivian models are turning heads and changing the way the world drives. Electric vehicles are more eco-friendly, but they are also more expensive to own. Even though up-front costs may be higher, electric cars can save owners money in the long run compared to conventional gas-powered vehicles. *Do the environmental benefits associated with electric cars justify the higher cost of ownership?* (Credit: Ajay Suresh/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Responsibilities to Investors

Companies' relationships with investors also entail social responsibility. Although a company's economic responsibility to make a profit might seem to be its main obligation to its shareholders, some investors increasingly are putting more emphasis on other aspects of social responsibility.

Some investors are limiting their investments to securities (e.g., stocks and bonds) that coincide with their beliefs about ethical and social responsibility. This is called **social investing**. For example, a social investment fund might eliminate from consideration the securities of all companies that make tobacco products or liquor, manufacture weapons, or have a history of being environmentally irresponsible. Not all social investment strategies are alike. Some ethical mutual funds will not invest in government securities because they help to fund the military; others freely buy government securities, with managers noting that federal funds also support the arts and pay for AIDS research. In 2022, assets invested using socially responsible strategies total more than $8 trillion.[16]

Perhaps partly as the result of the Great Recession in the early 2000s, over the last several years companies have tried to meet responsibilities to their investors as well as to their other stakeholders. Recent research suggests that now more than ever, CEOs are being held to higher standards by boards of directors, investors, governments, media, and even employees when it comes to corporate accountability and ethical behavior. Increasingly, CEOs are being forced out due to issues beyond company financial troubles, such as ethical lapses in their organizations or personal behavior controversies. Strategies to promote ethical behavior in leadership and at all levels throughout the organization include establishing a culture of integrity with clear ethical guidelines, holding employees accountable for ethical behavior, providing ethical training regularly, aligning decisions with company core values, and addressing ethical issues promptly and directly.[17]

1. How do businesses carry out their social responsibilities to consumers?
2. What is corporate philanthropy?
3. Is a company's only responsibility to its investors to make a profit? Why or why not?

2.5 Trends in Ethics and Corporate Social Responsibility

5. What are the trends in ethics and corporate social responsibility?

Three important trends related to ethics and corporate social responsibility are strategic changes in corporate philanthropy, a new social contract between employers and employees, and the growth of global ethics and corporate social responsibility.

Changes in Corporate Philanthropy

Historically, corporate philanthropy has typically involved companies seeking out charitable groups and giving them money or donating company products or services. Today, the focus has shifted to **strategic giving**, which ties philanthropy and corporate social responsibility efforts closely to a company's mission or goals and targets donations to the communities where a company does business. Some of the top businesses recognized for their efforts in giving back to the communities in which they operate include technology giant Salesforce, San Antonio's NuStar Energy, mortgage lender Veterans United, and software leader Intuit.[18]

A Social Contract between Employer and Employee

Another trend in social responsibility is the effort by organizations to redefine their relationship with their employees. Many people have viewed social responsibility as a one-way street that focuses on the obligations of business to society, employees, and others. Now, companies recognize that the social contract between employer and employee is an important aspect of the workplace and that both groups have to be committed to working together in order for the organization to prosper. The social contract can be defined in terms of four important aspects: compensation, management, culture, and learning and development.[19]

When it comes to compensation, companies today must recognize that most employees do not stay with one organization for decades. Thus, companies need to change their compensation structure to acknowledge the importance of short-term performance and to update their methods for determining compensation, including benefits and other nontraditional perks such as increased paid leave and telecommuting options.

In the workplace, where employees are likely to change jobs on average nearly every three years, managers need to take a more active and engaged approach to supervising employees and perhaps change the way they think about loyalty, which may be difficult for managers used to supervising the same group of employees for a long period of time. Engaging employees on a regular basis, setting realistic expectations, and identifying specific development paths may help retain key employees.

Thanks to today's labor market, some employees feel empowered to demand more from their employer and its overall culture via strategies such as increased flexibility, transparency, and fairness. This increased importance of the employee's role in the company's culture helps workers stay engaged in the mission of the organization and perhaps makes them less likely to look elsewhere for employment.

Finally, changing and emerging technologies continue to shift the learning and development component for employees and companies. The critical skills needed by employees over the next several years are likely to evolve. Employers will need to carefully assess the skills needed to meet company goals.

Global Ethics and Social Responsibility

When U.S. businesses expand into global markets, they must take their codes of ethics and policies on corporate social responsibility with them. As a citizen of several countries, a multinational corporation has several responsibilities. These include respecting local practices and customs, ensuring that there is harmony between the organization's staff and the host population, providing management leadership, and developing a solid group of local managers who will be a credit to their community. When a multinational firm makes an investment in a foreign country, it should commit to a long-term relationship. That means involving all stakeholders in the host country in decision-making. Finally, a responsible multinational will implement ethical guidelines within the organization in the host country. By fulfilling these responsibilities, the company will foster respect for both local and international laws.

Multinational corporations often must balance conflicting interests of stakeholders when making decisions regarding social responsibilities, especially in the area of human rights. Questions around child labor, workplace conditions, and fair wage practices are at the forefront. For example, Gap, Inc., publishes the list of its global factories every six months in an effort to provide transparency about its suppliers and their efforts to improve working conditions around the world. The company partners with several non-governmental organizations, particularly focused on Central America and Southeast Asia, that are focused on ensuring fair labor practices, enhanced opportunities for under-served populations, and safer working conditions. By soliciting feedback from factory workers making its products, Gap is hoping to improve working conditions and help these factories become leaders in their local communities.[20]

CONCEPT CHECK

1. Describe strategic giving.
2. What role do employees have in improving their job security?
3. How do multinational corporations demonstrate social responsibility in a foreign country?

Key Terms

code of ethics A set of guidelines prepared by a firm to provide its employees with the knowledge of what the firm expects in terms of their responsibilities and behavior toward fellow employees, customers, and suppliers.

corporate philanthropy The practice of charitable giving by corporations; includes contributing cash, donating equipment and products, and supporting the volunteer efforts of company employees.

corporate social responsibility (CSR) The concern of businesses for the welfare of society as a whole; consists of obligations beyond those required by law or contracts.

deontology A philosophy in which a person will follow his or her obligations to an individual or society because upholding one's duty is what is ethically correct.

ethical issue A situation where a person must choose from a set of actions that may be ethical or unethical.

ethics A set of moral standards for judging whether something is right or wrong.

justice What is considered fair according to the prevailing standards of society; an equitable distribution of the burdens and rewards that society has to offer.

social investing The practice of limiting investments to securities of companies that behave in accordance with the investor's beliefs about ethical and social responsibility to encourage businesses to be more socially responsible.

stakeholders Individuals or groups to whom a business has a responsibility; includes employees, customers, the general public, and investors.

strategic giving The practice of tying philanthropy and corporate social responsibility efforts closely to a company's mission or goals and targeting donations to the communities where a company does business.

utilitarianism A philosophy that focuses on the consequences of an action to determine whether it is right or wrong; holds that an action that affects the majority adversely is morally wrong.

Summary of Learning Outcomes

2.1 Understanding Business Ethics

1. What philosophies and concepts shape personal ethical standards?

Ethics is a set of moral standards for judging whether something is right or wrong. A utilitarianism approach to setting personal ethical standards focuses on the consequences of an action taken by a person or organization. According to this approach, people should act so as to generate the greatest good for the greatest number. Every human is entitled to certain rights such as freedom and the pursuit of happiness. Another approach to ethical decision-making is justice, or what is fair according to accepted standards.

2.2 How Organizations Influence Ethical Conduct

2. How can organizations encourage ethical business behavior?

Top management must shape the ethical culture of the organization. They should lead by example, offer ethics-training programs, and establish a formal code of ethics.

2.3 Managing a Socially Responsible Business

3. What is corporate social responsibility?

Corporate social responsibility is the concern of businesses for the welfare of society as a whole. It consists of obligations beyond just making a profit and goes beyond what is required by law or union contract. Companies may engage in illegal and irresponsible behavior, irresponsible but legal behavior, or legal and responsible behavior. The vast majority of organizations act legally and try to be socially responsible.

2.4 Responsibilities to Stakeholders

4. How do businesses meet their social responsibilities to various stakeholders?

Stakeholders are individuals or groups to whom business has a responsibility. Businesses are responsible to employees. They should provide a clean, safe working environment. Organizations can build employees' self-worth through empowerment programs. Businesses also have a responsibility to customers to provide good, safe products and services. Organizations are responsible to the general public to be good corporate citizens. Firms must help protect the environment and provide a good place to work. Companies also engage in corporate philanthropy, which includes contributing cash, donating goods and services, and supporting volunteer efforts of employees. Finally, companies are responsible to investors. They should earn a reasonable profit for company owners.

2.5 Trends in Ethics and Corporate Social Responsibility

5. What are the trends in ethics and corporate social responsibility?

Today, corporate philanthropy is shifting away from simply giving to any group in need and is focusing instead on strategic giving, in which the philanthropy relates more closely to the corporate mission or goals and targets donations to areas where the firm operates.

A second trend is toward a new social contract between employer and employee. Instead of the employer having the sole responsibility for maintaining jobs, now the employee must assume part of the burden and find ways to add value to the organization.

As the world increasingly becomes a global community, multinational corporations are now expected to assume a global set of ethics and responsibility. Global companies must understand local customs. They should also involve local stakeholders in decision-making. Multinationals must also make certain that their suppliers are not engaged in human rights violations.

Preparing for Tomorrow's Workplace Skills

1. Many CEOs have sold shares of their company's stock when prices were near their high points. Even though their actions were legal, it soon became apparent that they knew that the stock was significantly overpriced. Was the CEO ethically obligated to tell the public that this was the case—even knowing that doing so could cause the stock price to plummet, thereby hurting someone who bought the stock earlier that day? (Systems)
2. Jeffrey Immelt, former chairman and CEO of General Electric, one of the world's most-admired companies according to *Fortune* magazine, says that execution, growth, and great people are required to keep the company on top. Immelt said that these are predictable, but a fourth factor is not—virtue, and virtue was at the top of his list. Using a search engine, find articles on what GE is doing to enhance its corporate citizenship. Report your findings to the class. Could GE do more, or are they already doing too much? Why? (Systems, Technology)
3. Boeing Corp. makes business ethics a priority, asking employees to take refresher training every year. It encourages employees to take the Ethics Challenge with their work groups and to discuss the issues with their peers. You can take your own ethics challenge. Go to the Ethics Quick Test (https://openstax.org/r/ethicstest) and answer the questions. Summarize your findings. Were there any answers that surprised you? (Information)
4. Identify the potential ethical and social responsibility issues confronting the following organizations: General Motors, Adidas, Johnson & Johnson, and Target. Make recommendations on how these issues should be handled. (Systems)
5. **Team Activity** Divide the class into teams. Debate whether the only social responsibility of the employer to the employee is to provide a job. Include a discussion of the employee's responsibility to bring value to the firm. Also, debate the issue of whether the only social responsibility of a firm is to earn a profit. (Interpersonal)

Ethics Activity

Let's Be Honest

The Honest Company is a consumer-goods business offering baby, personal care, beauty, and home cleaning products made with a "clean, conscious" ingredient approach. Cofounded by actress Jessica Alba, Honest Co. is built on the promise of "telling all and doing our best to live up to your expectations."

Over the years the company has received high praise and media buzz about its ethical approach to making products that are not only good for people but good for the environment. On its website, Honest Co. goes to great lengths to share with consumers its guiding principles that products are made without harming people or the planet.

Several years ago, however, the company experienced some bad press when *The Wall Street Journal* reported that two independent lab tests found samples of Honest laundry detergent contained a cleaning agent on the list of chemicals the company pledged to avoid. At first, pushback from company officials was loud and clear: they denied their products were anything but eco-friendly and safe for consumers and went as far as calling the report "false" and "junk science."

Unfortunately, the reports about Honest products and their harmful ingredients didn't go away. After the laundry detergent story faded, the company quietly reconfigured the ingredients that went into the detergent as well as other products. But that wasn't the end of the story. Several months later, Honest Co. voluntarily recalled organic baby powder that might cause infections and later recalled diaper wipes that appeared discolored.

Despite these challenges, The Honest Company is still successful and was rumored to be on the short list of possible acquisitions for global conglomerates such as Kimberly-Clark, Johnson & Johnson, and Unilever. These consumer-good giants are snapping up smaller, eco-friendly firms that have blossomed into full-fledged ethically and environmentally conscious organizations with strong sales and solid reputations among consumers. In 2016, Unilever acquired one of Honest Co.'s biggest rivals, Seventh Generation, Inc., leaving Honest Co. to again rethink its business strategies, including hiring a new CEO.

Using a web search tool, locate information about this topic and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Do you think the company's reaction to reports of hazardous ingredients hurt its reputation for honesty and ethical behavior? Do you think the company's missteps caused Unilever to shy away from acquiring the company? Or, do you take the stance that Alba's entertainment background played a part in the press going after the company? If you were an advisor to the new CEO, what suggestions would you give for keeping the company on track, especially when it comes to corporate social responsibility?

Sources: "Our Principles," https://www.honest.com, accessed June 27, 2017; Eun Kyung Kim, "Jessica Alba's Honest Company Recalls Diaper Wipes over Mold Concerns," *Today,* https://www.today.com, May 16, 2017; Steve Tobak, "Jessica Alba's 'Honest' Mess," *Entrepreneur,* https://www.entrepreneur.com, March 29, 2017; Jason Del Rey, "Jessica Alba's Honest Company Is Replacing Its CEO after a Sale to Unilever Fell Through," *Recode,* https://www.recode.net, March 16, 2017; Serena Ng, "Jessica Alba's Honest Co. to Drop Use of Disputed Ingredient," *The Wall Street Journal,* https://www.wsj.com, September 30, 2016; Kathryn Vasel, "The Honest Company Gets Sued . . . Again," *CNN Money,* https://money.cnn.com, April 27, 2016.

Working the Net

1. You will find the listing for the 100 Best Corporate Citizens at the 3BL website (**https://100best.3blmedia.com/**). Review the current list of companies and pay close attention to those marked with a "yellow card" caution and a "red card" caution. These are companies that have either been removed from the list due to unethical behavior or have been warned that some of their actions border on

unethical. What surprised you about the companies that have been flagged? Select one of the flagged companies and explain what they can do to improve their CSR profile.

2. Richard S. Scrushy, former CEO of HealthSouth Corporation, was charged with $1.4 billion in fraud. He was acquitted. Bernie Ebbers, former CEO of WorldCom, was found guilty of helping mastermind an $11 billion accounting fraud. Go to the internet and read several articles about the charges against both executives. Find articles on why one was guilty on all counts and the other acquitted on all counts. Explain the ethical issues involved with each.
3. Visit the website of People for the Ethical Treatment of Animals (PETA), **https://peta.org**, and under the Animal Rights Issues tab, read about PETA's view of Animals Used for Clothing. Do you agree with this view? Why or why not? How do you think manufacturers of fur clothing would justify their actions to someone from PETA? Would you work for a store that sold fur-trimmed clothing? Explain your answer.
4. GreenMoney Journal (**https://greenmoney.com**) is an online journal covering impact investing, sustainable business, and ESG, publishing themed issues and articles year-round. What are the current topics of concern in this area? Explore the page to find articles on socially responsible investing and two areas of corporate social responsibility. Summarize what you have learned.
5. Double the Donation, **https://doublethedonation.com**, is a website that provides information on top forms of corporate philanthropy, highlights companies with strong giving programs, and integrates with fundraising platforms to automate employer matching programs. Research several companies and their philanthropic activities and provide details about what makes these organizations excellent corporate citizens.

Critical Thinking Case

Uber Hits a Bumpy Road

Uber Technologies, Inc. (NYSE: UBER) is a leading mobility and delivery platform. Formerly the world's most valuable startup, it is now a public company with a market capitalization well above its pre-IPO ~$70 billion private valuation. But that doesn't mean it has been smooth sailing for the ride-hailing company since its start in 2009. Despite disrupting and revolutionizing the transportation industry in a short period of time, Uber's meteoric rise has caused some shortcuts in organizational structure, corporate culture, and effective HR practices that have left the company with self-inflicted wounds that may take a long time to heal.

Uber has experienced several scandals over the past few years, including drivers demanding to be classified as employees (not contractors), a tool called "greyball" that allows data collected from the Uber app to identify and avoid enforcement officers trying to catch Uber drivers in cities where the service was illegal, and resignations of top executives, including the company's president and the heads of product development and engineering. But nothing has been quite as damaging as a controversial blog post by a former employee, which detailed the inappropriate behavior that seemed to be commonplace in Uber's workplace culture.

The allegations of sexual harassment put forth by former Uber engineer Susan Rigetti (nee Fowler) were explosive. Detailed in a February 2017 blog post, Fowler says she alerted company HR about her manager's inappropriate behavior, even taking screenshots of his suggestive emails, but Fowler was told her boss would not be fired for sexual harassment because he was a "high performer" for the company. After Fowler's story went public, the company hired former U.S. attorney Eric Holder to investigate the allegations and other workplace issues. Holder's recommendations, which the Uber board of directors unanimously approved, include changes to senior leadership, enhanced oversight by the company's board, changes to the company's internal financial and audit controls, revisions to the company's cultural values, mandatory leadership training for senior executives and other managers, improvements to the overall HR function and complaint process, and the establishment of an employee diversity advisory board. In addition, as the result of a separate investigation, Uber fired more than 20 other people because of harassment claims.

With increasing pressure from the company's board and other investors, CEO Travis Kalanick said he would

take a leave of absence while still mourning the unexpected death of his mother in a recent boating accident. However, most board members lost faith that Kalanick would be able to come back after his leave and make things better. At the urging of the board, two venture capitalists were dispatched to Chicago, where Kalanick was interviewing COO candidates, to present him with a letter from five of Uber's major investors demanding his resignation. After hours of discussion, Kalanick agreed to step down.

Critical Thinking Questions

1. According to data, less than 45 percent of Uber's current employees are women. How do you think this situation helped perpetuate a flawed corporate culture?
2. What can Uber do to ensure its competitors are not chipping away at its dominant market share as a result of such bad press?
3. Do you think installing an experienced woman CEO would help the company change its culture and workplace environment? Explain your reasoning.

Sources: Marisa Kendall, "Uber: Here's Who's Running the Show Now," *Mercury News*, https://www.mercurynews.com, June 23, 2017; Eric Newcomer, "Uber CEO Travis Kalanick Quits Under Pressure from Investors," *Bloomberg News,* https://www.bloomberg.com, June 21, 2017; Mike Issac, "Inside Travis Kalanick's Resignation as Uber's C.E.O.," *The New York Times,* https://www.nytimes.com, June 21, 2017; "Holder Recommendations on Uber," *The New York Times,* https://www.nytimes.com, June 13, 2017; Eric Newcomer, "Uber Fires More Than 20 Employees in Harassment Probe," *Bloomberg Technology,* https://www.bloomberg.com, June 6, 2017; Erin Griffith, "The Uncomfortable Reality Behind Uber's Culture Meltdown," *Fortune,* https://fortune.com, April 20, 2017; Johana Bhuiyan, "Uber Has Published Its Much Sought After Diversity Numbers for the First Time," *Recode,* https://www.recode.net, March 28, 2017; Marco della Cava, "Uber President Quits as Company Searches for COO," *USA Today,* https://www.usatoday.com, March 20, 2017; Mike Isaac, "How Uber Deceives the Authorities Worldwide," *The New York Times,* https://www.nytimes.com, March 3, 2017; Susan J. Fowler, "Reflecting on One Very, Very Strange Year at Uber," https://www.susanjfowler.com/blog, February 19, 2017; Bo Young Lee, "Uber's 2022 People & Culture Report," https://www.uber.com, accessed January 23, 2026.

Hot Links Address Book

1. Find out which companies test their products on animals and which don't in the campaign section of the PETA website, **https://www.peta.org**.
2. How is the International Business Ethics Institute working to promote business ethics worldwide? Find out at **https://www.business-ethics.org**.
3. Ben & Jerry's ice cream has always taken its responsibilities as a corporate good citizen seriously. Learn about the company's positions on various issues and products that support social issues at its website, **https://www.benjerry.com**.
4. What does IBM require from its employees in terms of ethical business conduct? You will find the information on IBM's website under its policies at **https://www.ibm.com/responsibility/data-and-policies#policies**.
5. Levi Strauss's unique corporate culture rewards and recognizes employee achievement. To learn about its employee community involvement program, go to the Levi Strauss website at **https://www.levistrauss.com**.
6. Want to see how the global environment is changing and learn the latest about global warming? Check out **https://www.climatehotmap.org**.
7. General Motors is committed to continuous improvement in its environmental performance. Check out GM's Sustainability Report at **https://www.gmsustainability.com**.
8. Before donating to any charity, check out its credentials and overall track record at **https://charitywatch.org**.
9. Learn how U.S. businesses gain competitive advantage through corporate social responsibility programs

at the Business for Social Responsibility (BSR) website, **https://www.bsr.org**.

3

Competing in the Global Marketplace

Exhibit 3.1 (Credit: Xiquinho Silva /Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. Why is global trade important to the United States, and how is it measured?
2. Why do nations trade?
3. What are the barriers to international trade?
4. How do governments and institutions foster world trade?
5. What are international economic communities?
6. How do companies enter the global marketplace?
7. What threats and opportunities exist in the global marketplace?
8. What are the advantages of multinational corporations?
9. What are the trends in the global marketplace?

EXPLORING BUSINESS CAREERS

Mike Schlater Domino's Pizza

Domino's Pizza has more than 21,000 stores worldwide. Mike Schlater, former executive vice president of Domino's Pizza international division, was also president of Domino's Canada and oversaw nearly 500 stores. Originally from Ohio, Schlater started his career with Domino's as a pizza delivery driver and worked his way up into management. Schlater saved his earnings, and with some help from his brother, he was able to accept the opportunity to have the first international Domino's franchise in Winnipeg, Manitoba, in 1983. Within weeks, Schlater's store in Canada reached higher sales than his previous store in Ohio had ever attained. However, it was not an easy start. Schlater had to identify the international suppliers and get them approved to sell their products to Domino's. This shows one of the challenges that organizations face when entering new global markets. To meet quality standards designed to protect a brand, companies must undertake an extensive review of potential new suppliers to ensure consistent product quality. By

2007, Schlater and a partner unified all of the franchises under one corporate umbrella, and Schlater is now president of Domino's of Canada, Ltd., which operates more than 600 stores and is located in every province, as well as the Yukon and Northwest Territories.

Exhibit 3.2 Domino's store. (Credit: Mr. Blue Mau Mau/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Such an impressive career path might seem like luck to some, but Schlater achieved his success due to determination and attention to detail. Luck did play a role in one specific event in his life, though. Schlater manages dough in his business but also came into "dough" by winning $250,000 in a lottery. Since Schlater believes in philanthropy, he donated the entire amount to Cardinal Carter High School in his hometown. Over the years, Schlater has donated millions of dollars to foundations and charities, such as The London Health Sciences Foundation, because he now has the ability to financially support them after spending decades climbing the corporate ladder at Domino's Pizza. A father of three, he moved to Essex County from Winnipeg after buying the Domino's master franchise for Canada. He wanted to live close to the border because some of his children attended school in that area.

The master franchisees of Domino's Pizza's international business are individuals or entities who, under a specific licensing agreement with Domino's, control all operations within a specific country. They operate their own stores, set up a distribution infrastructure to transport materials into and throughout the country, and create subfranchisees. One particular benefit of master franchisees is their local knowledge. As discussed in this chapter, a major challenge when opening a business on foreign soil is negotiating the political, cultural, and economic differences of that country. Master franchisees allow Domino's, and the franchisee, to take advantage of their local expertise in dealing with marketing strategies, political and regulatory issues, and the local labor market. It takes local experience to know, for example, that access to the internet can be limited so carryout might need to be the focus of the business; that Turkey has changed its street names three times in the past 30 years, so delivery is much more challenging; or that, in Japanese, there is no word for pepperoni, the most popular topping worldwide. These are just a few of the challenges that Domino's has had to overcome on the road to becoming the worldwide leader in the pizza delivery business. Under the leadership of people like Schlater, and with the help of dedicated, local master franchisees, Domino's has been able to not only compete in but to lead the global pizza delivery market.

Sources: "Domino's Pizza Corporate Facts," https://phx.corporate-ir.net, accessed June 20, 2017; Domino's Canada website, https://www.dominos.ca, accessed June 20, 2017; Trevor Wilhelm, "Domino's CEO, who lives in Leamington, will donate $250K lotto winnings to high school," *Windsor Star*, February 27, 2015; David Crowther, "Domino's Now Has 21,000 Restaurants Around the World," *Sherwood*, https://sherwood.news, October 10, 2024; "Domino's® Expands Global DoorDash Partnership: Delivering Canadian Favourites from Coast to Coast," *DoorDash*, https://ir.doordash.com, October 6, 2025; Ridvika Arora, "Pizza Restaurant Chains Statistics: Market Share, Sales Performance & Consumer Trends," *Restroworks*, https://www.restroworks.com, June 3, 2025.

This chapter examines the business world of the global marketplace. It focuses on the processes of taking a business global, such as licensing agreements and franchisees; the challenges that are encountered; and the regulatory systems governing the world market of the 21st century.

Today, global revolutions are under way in many areas of our lives: management, politics, communications, and technology. The word *global* refers to boundless mobility and competition in social, business, and intellectual arenas. The purpose of this chapter is to explain how global trade is conducted. We also discuss the barriers to international trade and the organizations that foster global trade. The chapter concludes with trends in the global marketplace.

3.1 Global Trade in the United States

1. Why is global trade important to the United States, and how is it measured?

Having a global vision has become an imperative for some businesses, especially large corporations, manufacturers, and retailers. A global vision can also be an important consideration for smaller firms as they work to manage costs, optimize efficiencies, and grow their market reach. Having a **global vision** means recognizing and reacting to international business opportunities, being aware of threats from foreign competitors in all markets, and effectively using international distribution networks to obtain raw materials and move finished products to the customer.

U.S. managers must develop a global vision if they are to recognize and react to international business opportunities, as well as remain competitive at home. Often a U.S. firm's toughest domestic competition comes from foreign companies. Moreover, a global vision enables a manager to understand that customer and distribution networks operate worldwide, blurring geographic and political barriers and making them increasingly irrelevant to business decisions. Over the past three decades, world trade has climbed to more than $35 trillion.[1] U.S. companies play a major role in this growth in world trade, with 27 percent of the Fortune 500 companies contributing nearly 40 percent to the "global profit pool." Among these companies are names such as Apple, Microsoft, Alphabet, U.S. Postal Service, Exxon Mobil, and Samsung Electronics.[2]

Starbucks Corp. has become a fast-growing global brand committed to its core mission while integrating aspects to adapt culturally across their locations worldwide. Of Starbucks' approximately 37,000 stores, almost 50 percent are international stores that contribute a substantial amount to the company's revenues, which have grown from $21.3 billion in 2016 to nearly $40 billion in 2026.[3]

Go into a Paris McDonald's and you may not recognize where you are. Instead of utilitarian tables and other plastic features, you might find some unique and more elegant McDonald's restaurants. For example, just outside of Paris, the restaurant is housed in an old railway station built in 1905. The French typically prefer to preserve historic buildings rather than replace them with modern structures. These buildings bring with them architecture and features not typically seen in McDonald's, including original woodwork, ornate facades, and dining terraces. Many locations feature local menu items—such as French cheeses or macarons—along with the traditional McDonald's offerings.

Global business is not a one-way street, where only U.S. companies sell their wares and services throughout the world. Foreign competition in the domestic market used to be relatively rare but now occurs in almost every industry. In fact, U.S. makers of electronic goods, cars, shoes, clothing, and a host of other consumer and industrial products have struggled to maintain their domestic market shares against foreign competitors. Toyota now has over 15 percent of the U.S. auto market, followed by Honda and Nissan at approximately 8 percent.[4] Nevertheless, the global market has created vast new business opportunities for many U.S. firms.

The Importance of Global Business to the United States

Many countries depend more on international commerce than the United States does. For example, Germany derives around 80 percent of their gross domestic product (GDP) from world trade, with France and Great

Britain around 60 percent, compared to 28 percent for the United States.[5] Nevertheless, the impact of international business on the U.S. economy is still impressive:

- About 20 percent of U.S. jobs are trade-dependent and have grown at a rate four times the growth of U.S.-dependent jobs.
- Nearly every U.S. state has realized a growth of jobs attributable to trade.
- Trade has an effect on both service and manufacturing jobs.[6]

These statistics might seem to imply that practically every business in the United States is selling its wares throughout the world, but most is accounted for by big business. About 85 percent of all U.S. exports of manufactured goods are shipped by 250 companies. Yet, 98 percent of all exporters are small and medium-size firms.[7]

The Impact of Conflict on Global Trade

Global conflicts can change the way the world conducts business. The immediate impacts of conflicts abroad include short-term shrinkages of global trade. Globalization, however, will continue because the world's major markets are too vitally integrated for globalization to stop. Nevertheless, conflicts abroad can cause slow growth and can make globalization efforts more costly.[8]

For example, companies are investing in additional insurance to provide security for overseas staff and property. Movements of cargo can be impacted by border restrictions and inspections, which can force firms to stock more inventory. Immigration policies and relationships across borders can impact the employment pool in certain industries. The impact of conflicts abroad may lessen over time, but multinational firms will need to continue to consider how conflicts across the globe impact their business model and operations.[9]

Measuring Trade between Nations

International trade can improve relationships across borders, can help ease tensions among nations, and—economically speaking—bolsters economies, raises people's standard of living, provides jobs, and improves the quality of life. The value of international trade is over $30 trillion a year and growing. This section takes a look at some key measures of international trade: exports and imports, the balance of trade, the balance of payments, and exchange rates.

Exports and Imports

Higher-income nations (those with mature communication, financial, educational, and distribution systems) are the major players in international trade. They account for about 50 percent of the world's exports and imports. **Exports** are goods and services made in one country and sold to others. **Imports** are goods and services that are bought from other countries. The United States is the largest importer and second largest exporter in the world.

Each year the United States exports more semiconductors, pharmaceutical and medical devices, and industrial goods than the year before, in addition to soybeans, wheat, and cotton. A third of U.S. farm acreage is devoted to crops for export. The United States is also a major exporter of high-tech equipment, such as aerospace components and manufacturing equipment. For more than 300,000 U.S. companies (approximately 98 percent of them small- and medium-sized firms), international trade offers exciting and profitable opportunities. Among the largest U.S. exporters are Exxon Mobile, Apple, Ford Motor Company, Cargill, and Caterpillar.[10]

Despite the availability of many resources and great variety of products, imports to the United States are also growing. Some of these imports are minerals and oil, mechanical equipment, gem stones and precious metals, plastics, and organic chemicals. Differences in facilities and access to resources such as natural resources and labor in other countries make it cheaper to import materials than to produce them domestically. Many hot beverages popular in the United States—coffee, tea, and cocoa—are imported. Several factors, including lower manufacturing costs, have accounted for increases in imports from abroad.

Balance of Trade

The difference between the value of a country's exports and the value of its imports during a specific time is the country's **balance of trade**. A country that exports more than it imports is said to have a *favorable* balance of trade, called a **trade surplus**. A country that imports more than it exports is said to have an *unfavorable* balance of trade, or a **trade deficit**. When imports exceed exports, more money from trade flows out of the country than flows into it.

Although U.S. exports have been growing, we still import more than we export. We have had an unfavorable balance of trade throughout the last several decades. In 2025, U.S. exports totaled $2.4 trillion, yet our imports were approximately $3.5 trillion. Thus, in 2025 the United States had a trade deficit of $900 billion.[11] America's exports continue to grow, but not as fast as our imports: The export of goods, such as computers, trucks, and airplanes, is very strong. The sector that is lagging in significant growth is the export of services. Although America exports many services—ranging from maintenance and repair services to travel to financial services—part of the problem is due to piracy, which leads companies to restrict the distribution of their services to certain regions. The FBI estimates that the theft of intellectual property from products, books and movies, and pharmaceuticals totals tens of billions every year.[12]

Balance of Payments

Another measure of international trade is called the **balance of payments**, which is a summary of a country's international financial transactions showing the difference between the country's total payments to and its total receipts from other countries. The balance of payments includes imports and exports (balance of trade), long-term investments in overseas plants and equipment, government loans to and from other countries, gifts and foreign aid, military expenditures made in other countries, and money transfers in and out of foreign banks.

From 1900 until 1970, the United States had a trade surplus, but in the other areas that make up the balance of payments, U.S. payments exceeded receipts, largely due to the large U.S. military presence abroad. Hence, almost every year since 1950, the United States has had an unfavorable balance of payments. And since 1970, both the balance of payments *and* the balance of trade have been unfavorable. What can a nation do to reduce an unfavorable balance of payments? It can foster exports, reduce its dependence on imports, decrease its military presence abroad, or reduce foreign investment. The U.S. balance of payments deficit was approximately $200 billion in 2025.[13]

The Changing Value of Currencies

The exchange rate is the price of one country's currency in terms of another country's currency. If a country's currency *appreciates*, less of that country's currency is needed to buy another country's currency. If a country's currency *depreciates*, more of that currency will be needed to buy another country's currency.

How do appreciation and depreciation affect the prices of a country's goods? If, say, the U.S. dollar depreciates relative to the Japanese yen, U.S. residents have to pay more dollars to buy Japanese goods. To illustrate, suppose the dollar price of a yen is $0.0065 and that a Toyota is priced at 2 million yen. At this exchange rate, a U.S. resident pays just under $13,000 for a Toyota ($0.0065 × 2 million yen = $12,909). If the dollar depreciates to $0.012 to one yen, then the U.S. resident will have to pay $24,000 for a Toyota.

As the dollar depreciates, the prices of Japanese goods rise for U.S. residents, so they buy fewer Japanese goods—thus, U.S. imports decline. At the same time, as the dollar depreciates relative to the yen, the yen appreciates relative to the dollar. This means prices of U.S. goods fall for the Japanese, so they buy more U.S. goods—and U.S. exports rise.

Currency markets operate under a system called **floating exchange rates**. Prices of currencies "float" up and down based upon the demand for and supply of each currency. Global currency traders create the supply of and demand for a particular currency based on that currency's investment, trade potential, and economic

strength. If a country decides that its currency is not properly valued in international currency markets, the government may step in and adjust the currency's value. In a **devaluation**, a nation lowers the value of its currency relative to other currencies. This makes that country's exports cheaper and should, in turn, help the balance of payments.

In other cases, a country's currency may be undervalued, giving its exports an unfair competitive advantage. Many people believe that China's huge trade surplus with the United States is partially because China's currency was undervalued. Countries can impact their exchange rate through fiscal policies and through buying and selling large amounts of its currency. This prompts the country's currency to be undervalued, giving exports an unfair competitive advantage. Countries such as China, Japan, and Switzerland have been accused of manipulating their currencies to increase the attractiveness of their exports.[14]

CONCEPT CHECK

1. What is global vision, and why is it important?
2. What impact does international trade have on the U.S. economy?
3. Explain the impact of a currency devaluation.

3.2 Why Nations Trade

2. Why do nations trade?

One might argue that the best way to protect workers and the domestic economy is to stop trade with other nations. Then the whole circular flow of inputs and outputs would stay within our borders. But if we decided to do that, how would we get resources like cobalt and coffee beans? The United States simply can't produce some things, and it can't manufacture some products, such as steel and some clothing, at the low costs we're used to. The fact is that nations—like people—are good at producing different things: you may be better at financial services than developing an app. In that case, you benefit by "exporting" your financial services and "importing" the app development you need from a skilled programmer. Economists refer to specialization like this as *advantage.*

Absolute Advantage

A country has an **absolute advantage** when it can produce and sell a product at a lower cost than any other country or when it is the only country that can provide a product. The United States, for example, has an absolute advantage in high-tech sectors.

Suppose that the United States has an absolute advantage in air traffic control systems for busy airports and that Brazil has an absolute advantage in coffee. The United States does not have the proper climate for growing coffee, and Brazil lacks the technology to develop air traffic control systems. Both countries would gain by exchanging air traffic control systems for coffee.

Comparative Advantage

Even if the United States had an absolute advantage in both coffee and air traffic control systems, it should still specialize and engage in trade. Why? The reason is the **principle of comparative advantage**, which says that each country should specialize in the products that it can produce most readily and cheaply and trade those products for goods that foreign countries can produce most readily and cheaply. This specialization ensures greater product availability and lower prices.

For example, India and Vietnam have a comparative advantage in producing clothing because of lower labor costs. Japan has long held a comparative advantage in consumer electronics because of technological

expertise. The United States has an advantage in computer software, airplanes, some agricultural products, heavy machinery, and jet engines.

Thus, comparative advantage acts as a stimulus to trade. When nations allow their citizens to trade whatever goods and services they choose without government regulation, free trade exists. **Free trade** is the policy of permitting the people and businesses of a country to buy and sell where they please without restrictions. The opposite of free trade is **protectionism**, in which a nation protects its home industries from outside competition by establishing artificial barriers such as tariffs and quotas. In the next section, we'll look at the various barriers, some natural and some created by governments, that restrict free trade.

Concerns about Trade and Globalization

Protests at meetings of groups such as the World Trade Organization, World Bank, and the International Monetary Fund (the organizations are discussed later in the chapter) provide some evidence that there is concern about world trade and globalization. What are the concerns? The negatives of global trade are as follows:

- It has been reported that millions of Americans have lost jobs due to imports or production operations shifting abroad. Many can find new positions but sometimes not at the same pay they previously earned.
- Millions of others fear losing their jobs, especially at those companies operating under competitive pressure.
- Employees fear that firms will export their jobs if they do not work for lower wages or agree to pay cuts.
- Service-industry jobs such as IT and customer service are increasingly vulnerable to operations moving offshore.

Sending domestic jobs to another country is called **outsourcing**, a topic you can explore in more depth. Many U.S. companies, such as JPMorgan Chase, Comcast, and Verizon have set up call centers in India, the Philippines, and other countries. Now even engineering and research and development jobs are being outsourced. Outsourcing, the trade deficit, and the labor market are highly debated issues that are often the topic of political debates. Additionally, U.S. jobs and trade are frequently significant components of both state and national elections. Through government interventions, in some cases jobs can be retained in the United States. There are many factors that are considered by firms when deciding to move jobs or functions overseas. It is important to remember that the economic factors work in conjunction with the firms' needs. In some cases, the business needs push the company to globalize.[15]

Exhibit 3.3 Anti-globalization groups oppose America's free-trade stance, arguing that corporate interests are hurting the U.S. economy and usurping the power of the American people. The 2017 protests at the G20 meetings in Hamburg, Germany, expressed anti-free-trade sentiment, supporting the idea that multinational corporations wield too much power. *Are fears expressed by anti-globalization activists and nationalists justified? Why or why not?* (Credit: fiction of reality/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

So is outsourcing good or bad? If you happen to lose your job, it's obviously bad for you. However, some economists say it leads to cheaper goods and services for U.S. consumers because costs are lower. Also, it should stimulate exports to fast-growing countries. No one knows how many jobs will be lost to outsourcing in coming years. According to estimates, over 4 million U.S. jobs were outsourced in 2025.[16]

Benefits of Globalization

A closer look reveals that globalization has been the engine that creates jobs and wealth. Benefits of global trade include the following:

- Productivity grows more quickly when countries produce goods and services in which they have a comparative advantage. Living standards can increase faster. One problem is that big **G20** countries have added nearly 2,300 restrictive export and import measures since 2008.
- Global competition and cheap imports keep prices down, so inflation is less likely to stop economic growth. However, in some cases this is not working because countries manipulate their currency to get a price advantage.
- An open economy spurs innovation with fresh ideas from abroad.
- Through infusion of foreign capital and technology, global trade provides lower-income countries with the chance to develop economically by spreading prosperity.
- More information is shared between two trading partners that may not have much in common initially, including insight into local cultures and customs, which may help the two nations expand their collective knowledge and learn ways to compete globally.[17]

CONCEPT CHECK

1. Describe the policy of free trade and its relationship to comparative advantage.
2. Why do people fear globalization?
3. What are the benefits of globalization?

3.3 Barriers to Trade

3. What are the barriers to international trade?

International trade is carried out by both businesses and governments—as long as no one puts up trade barriers. In general, trade barriers keep firms from selling to one another in foreign markets. The major obstacles to international trade are natural barriers, tariff barriers, and nontariff barriers.

Natural Barriers

Natural barriers to trade can be either physical or cultural. For instance, even though raising beef in the Argentinean climate may cost less than raising beef in a colder climate such as Siberia, the cost of shipping the beef from Argentina to Siberia might drive the price too high. *Distance* is thus one of the natural barriers to international trade.

Language is another natural trade barrier. People who can't communicate effectively may not be able to negotiate trade agreements or may ship the wrong goods.

Tariff Barriers

A **tariff** is a tax imposed by a nation on imported goods. It may be a charge per unit, such as per barrel of oil or per new car; it may be a percentage of the value of the goods, such as 5 percent of a $500,000 shipment of shoes; or it may be a combination. No matter how it is assessed, any tariff makes imported goods more costly,

so they are less able to compete with domestic products.

Protective tariffs make imported products less attractive to buyers than domestic products. The United States, for instance, has protective tariffs on imported agricultural goods (grain, dairy, meat), steel and aluminum, and some plastics. Canada has imposed tariffs and quotas on U.S. dairy, poultry, and eggs that were as much as 245 percent in some cases. This was in an effort to protect Canadian producers of these products to ensure farm profits.

Arguments for and against Tariffs

Congress has debated the issue of tariffs since 1789. The main arguments *for* tariffs include the following:

- Tariffs protect vulnerable industries by giving them time for their costs to become competitive globally.
- Tariffs can be instrumental in retaining business and production domestically, thus keeping jobs in the United States.
- Tariffs aid in military preparedness. Tariffs on industries and technology vital to military efforts during peacetime can protect these products/industries in the event of conflict.

The main arguments *against* tariffs include the following:

- Tariffs interrupt free trade and the principle of competitive advantage, making markets less efficient.
- Tariffs can impact prices and decrease consumers' purchasing power. In 2025, the United States imposed a 50 percent global tariff (25 percent for the UK) on steel. The idea was to give U.S. steel manufacturers a fair market and to boost employment domestically in the steel and manufacturing industries. The effects of these tariffs are still playing out, but higher steel prices have been realized. Heavy users of steel such as construction and transportation industries have seen increases in their production costs.[18]

Nontariff Barriers

Governments also use other tools besides tariffs to restrict trade. One type of nontariff barrier is the **import quota**, or limits on the quantity of a certain good that can be imported. The goal of setting quotas is to limit imports to the specific amount of a given product. The United States protects many commodity products, such as cotton, dairy products, and some textiles with quotas. A complete list of the commodities and products subject to import quotas is available on line at the U.S. Customs and Border Protection Agency website.[19]

A complete ban against importing or exporting a product is an **embargo**. Often embargoes are set up for defense purposes. For instance, the United States does not allow various high-tech products, such as unmanned aerial vehicles/drones or electronic intelligence surveillance systems to be exported abroad to some countries. Although this embargo costs U.S. firms billions of dollars each year in lost sales, it keeps enemies from using the latest technology in their military hardware.

Government rules that give special privileges to domestic manufacturers and retailers are called **buy-national regulations**. One such regulation in the United States mandates that nearly all (at least 95 percent) of the iron and steel used in constructing highways must be produced domestically. Many state governments have buy-national rules for supplies and services. In a more subtle move, a country may make it hard for foreign products to enter its markets by establishing customs regulations that are different from generally accepted international standards, such as requiring bottles to be quart size rather than liter size.

Exchange controls are laws that require a company earning foreign exchange (foreign currency) from its exports to sell the foreign exchange to a control agency, usually a central bank. For example, assume that Rolex, a Swiss company, sells 300 watches to Zales Jewelers, a U.S. chain, for US$600,000. If Switzerland had exchange controls, Rolex would have to sell its U.S. dollars to the Swiss central bank and would receive Swiss francs. If Rolex wants to buy goods (supplies to make watches) from abroad, it must go to the central bank and buy foreign exchange (currency). By controlling the amount of foreign exchange sold to companies, the government controls the amount of products that can be imported. Limiting imports and encouraging exports helps a government to create a favorable balance of trade.

CONCEPT CHECK

1. Discuss the concept of natural trade barriers.
2. Describe several tariff and nontariff barriers to trade.

3.4 Fostering Global Trade

4. How do governments and institutions foster world trade?

Antidumping Laws

U.S. firms don't always get to compete on an equal basis with foreign firms in international trade. To level the playing field, Congress has passed antidumping laws. **Dumping** is the practice of charging a lower price for a product (perhaps below cost) in foreign markets than in the firm's home market. The company might be trying to win foreign customers, or it might be seeking to get rid of surplus goods.

When the variation in price can't be explained by differences in the cost of serving the two markets, dumping is suspected. Most industrialized countries have antidumping regulations. They are especially concerned about *predatory dumping,* the attempt to gain control of a foreign market by destroying competitors with impossibly low prices.

For example, assume that a country was found to be pricing lumber nearly 10 percent below their costs to try to gain control of the market. The United States could respond with imposing a tariff on lumber from that country. Those tariffs could be as high as 30 percent, depending on the business, as a punitive measure against the country for their predatory dumping practices.[20]

From our discussion so far, it might seem that governments act only to restrain global trade. On the contrary, governments and international financial organizations work hard to increase it, as this section explains.

Trade Negotiations and the World Trade Organization

The **Uruguay Round** of trade negotiations is an agreement that dramatically lowers trade barriers worldwide. Adopted in 1994, the agreement was signed by 123 nations and is now observed by the WTO's 166 participant countries. One of the more ambitious global trade agreements, the Uruguay Round reduced tariffs by one-third worldwide, a move that increased access for both consumers and producers to industrial goods. Perhaps the most notable aspect of the agreement is its recognition of new global realities. For the first time, an agreement covered services, intellectual property rights, and trade-related investment measures such as exchange controls.

As a follow-up to the Uruguay Round, a negotiating round started in the capital of Qatar in 2001 is called the Doha Round. The negotiations were not successful, and the Doho Round was ended by 2017 after years of back-and-forth discussions. Some nations continue to advocate for trade reform, especially in the agriculture sector. These lower-income countries say that policies such as farm subsidies abroad stimulate overproduction, which drives down global agricultural prices. Because emerging-market nations' primary exports are agricultural commodities, low prices mean that they cannot compete in the global marketplace. On the other hand, the United States and Europe are interested in bringing down trade barriers in services and manufacturing. The continuing talks have sustained the concerns of protesters, who claim that the World Trade Organization (WTO) serves the interests of multinational corporations, promotes trade over preserving the environment, and treats low-income nations unfairly.[21]

The **World Trade Organization** replaces the old General Agreement on Tariffs and Trade (GATT), which was created in 1948. The GATT contained extensive loopholes that enabled countries to evade agreements to

reduce trade barriers. Today, all WTO members must fully comply with all agreements under the Uruguay Round. The WTO also has an effective dispute settlement procedure with strict time limits to resolve disputes.

The WTO has emerged as the world's most powerful institution for reducing trade barriers and opening markets. The advantage of WTO membership is that member countries lower trade barriers among themselves. Countries that don't belong must negotiate trade agreements individually with all their trading partners. Only a few countries, such as North Korea, Turkmenistan, and Eritrea, are not members of the WTO.[22]

Exhibit 3.4 Headquartered in Toulouse, France, Airbus is one of the world's top commercial aircraft manufacturers, operating design and manufacturing facilities in Europe, Japan, China, and the United States. The airliner's current product lineup of approximately 10 jet-aircraft types ranging from 100 seats to 850 seats is heavy competition for Boeing, a top U.S. airline firm with which Airbus has ongoing subsidy-related disputes. *What is the World Trade Organization's role in settling disputes between competing multinational corporations?* (Credit: Bartlomiej Mostek/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

The United States has had mixed results in bringing disputes before the WTO. To date, it has won about 70 percent of the cases it has presented to the WTO, but it has only won about 20 percent of the cases brought against it by other countries. One of America's losses came in a ruling where the U.S. claimed that tuna imported from Mexico was not meeting the "dolphin safe" criteria that protects them during the commercial fishing of tuna. The United States has also filed cases against European countries, South Korea, India, Canada, and Argentina. The disputes ranged from European aviation practices to Indian trade barriers affecting U.S. automakers.

One of the larger and longest disputes that was brought before the WTO involved the United States and the European Union. The dispute was filed in 2004 and lasted nearly 20 years. The United States claimed that Europe gave Airbus $15 billion in aid to develop airplanes. The European Union in response claimed that the U.S. government provided $23 billion in military research that has benefited Boeing's commercial aircraft business. It also claimed that the state of Washington (headquarter location of Boeing) has given the company over $3 billion in unfair tax breaks. There were retaliatory measures enacted on both sides during the dispute. The case was finally resolved with a negotiated settlement that included a commitment to work together on issues surrounding the large aircraft sector.[23]

The World Bank and International Monetary Fund

Two international financial organizations are instrumental in fostering global trade. The **World Bank** offers low-interest loans to developing nations. Originally, the purpose of the loans was to help these nations build infrastructure such as roads, power plants, schools, drainage projects, and hospitals. Now the World Bank offers loans to help developing nations relieve their debt burdens. To receive the loans, countries must pledge to lower trade barriers and aid private enterprise. In addition to making loans, the World Bank is a major source of advice and information for developing nations. The United States has granted the organization millions to create knowledge databases on nutrition, family planning, engineering and technology, product development, and business management practices.

The **International Monetary Fund (IMF)** was founded in 1945, one year after the creation of the World Bank, to promote trade through financial cooperation and eliminate trade barriers in the process. The IMF makes short-term loans to member nations that are unable to meet their budgetary expenses. It operates as a lender of last resort for troubled nations. In exchange for these emergency loans, IMF lenders frequently extract significant commitments from the borrowing nations to address the problems that led to the crises. These steps may include curtailing imports or even devaluing the currency.

Some global financial problems do not have a simple solution. One option would be to pump a lot more funds into the IMF, giving it enough resources to bail out troubled countries and put them back on their feet. In effect, the IMF would be turned into a real lender of last resort for the world economy.

The danger of counting on the IMF, though, is the "moral hazard" problem. Investors would assume that the IMF would bail them out and would therefore be encouraged to take bigger and bigger risks in emerging markets, leading to the possibility of even deeper financial crises in the future.

CONCEPT CHECK

1. Describe the purpose and role of the WTO.
2. What are the roles of the World Bank and the IMF in world trade?

3.5 International Economic Communities

5. What are international economic communities?

Nations that frequently trade with each other may decide to formalize their relationship. The governments meet and work out agreements for a common economic policy. The result is an economic community or, in other cases, a bilateral trade agreement (an agreement between two countries to lower trade barriers). For example, two nations may agree upon a **preferential tariff**, which gives advantages to one nation (or several nations) over others. When member countries of the EU trade with each other, they pay lower (or even zero) tariffs than do other nations. For example, there are no tariffs on steel when traded within the European Union. However, when trading outside of the EU, imported steel from an EU country into the United States is subject to a 50 percent tariff. In other cases, nations may form free-trade associations. In a **free-trade zone**, few duties or rules restrict trade among the partners, but nations outside the zone must pay the tariffs set by the individual members.

North American Free Trade Agreement (NAFTA)

The **North American Free Trade Agreement (NAFTA)** created the world's largest free-trade zone. The agreement was ratified by the U.S. Congress in 1993. It includes Canada, the United States, and Mexico, with a combined population of 510 million and an economy of over $30.9 trillion.[24] NAFTA has since been replaced by the U.S.-Mexico-Canada Agreement (USMCA), which went into effect on July 1, 2020.

Canada, one of the largest U.S. trading partners, entered a free-trade agreement with the United States in 1988. Thus, most of the new long-run opportunities opened for U.S. business under NAFTA are in Mexico, America's third-largest trading partner. Before NAFTA, tariffs on Mexican exports to the United States averaged just 4 percent, and most goods entered the United States duty-free, so NAFTA's primary impact was to open the Mexican market to U.S. companies. When the treaty went into effect, tariffs on about half the items traded across the Rio Grande disappeared. Since NAFTA (now USMCA) came into effect, U.S.-Mexican trade has increased from $80 billion to over $750 billion annually. The agreement removed several barriers to trade including licensing requirements, quotas, and tariffs that limited transactions in the countries for goods and services. For example, the agreement allows U.S. and Canadian financial services companies to own

subsidiaries in Mexico, which had long been previously prohibited.

Exhibit 3.5 The softwood lumber dispute between the United States and Canada that has resulted in the U.S. imposing tariffs on Canadian softwood lumber imports is one of the longest trade disputes between the two nations. The dispute is the result of disagreements about Canadian lumber production and imports between the two nations. The main contention in the softwood lumber dispute is the U.S. claim that the Canadian government is unfairly subsidizing Canadian lumber production by providing access to public land while U.S. producers harvest softwood lumber on their own property. *Why do anti-free-trade groups support these tariffs when the result will be higher prices for softwood lumber?* (Credit: Jesse Wagstaff/ Flickr/ Attribution-NoDerivs 2.0 Generic (CC BY 2.0))

The real test of USMCA will be whether it can deliver rising prosperity on both sides of the Rio Grande. To be effective, the agreement needs to provide rising wages and benefits and increased purchasing power to Mexico so it will continue to buy goods from the U.S. and Canada. At the Delphi Corp. auto parts plant in Ciudad Juárez, just across the border from El Paso, Texas, the assembly line is a cross section of working-class Mexico. In the years since NAFTA lowered trade and investment barriers, Delphi has significantly expanded its presence in the country and has restructured into multiple entities that employ thousands and receive millions of U.S.-made components to assemble into parts. The wages are modest by U.S. standards—an assembly-line worker with two years' experience earns about $4 to $6 per hour—but that's much higher than Mexico's minimum wage of around $2.50 per hour, making these positions highly coveted.[25]

One of the largest new trade agreement is **Mercosur**, which includes Argentina, Bolivia, Brazil, Paraguay, and Uruguay as full members. The elimination of most tariffs among the trading partners has resulted in trade revenues that exceed $80 billion annually. Economic conditions have impacted some growth, but trade among Mercosur countries has continued to grow. Another relatively recent trade agreement is the Regional Comprehensive Economic Partnership (RCEP). This trade agreement includes fifteen (15) Asian States and signals to investors that the region is still committed to multilateral trade integration. One item that is most notable about this trade agreement is that the U.S. is not a member.

Central America Free Trade Agreement

Another key free trade agreement is the Central America Free Trade Agreement (CAFTA) passed in 2005. Besides the United States, the agreement includes Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua. As the United States was already a principal exporter to these nations, there has not been a major increase in U.S. exports. However, the agreement did reduce tariffs on exports to CAFTA countries. Nearly all of the goods imported into the United States from CAFTA nations are tariff free. Additional benefits can be realized as U.S. multinational firms deepen investment in the region.

The European Union

In 1993, the member countries of the European Community (EC) ratified the Maastricht Treaty, which proposed to take the EC further toward economic, monetary, and political union. Although the heart of the treaty deals

with developing a unified European Market, Maastricht was also intended to increase integration among **European Union (EU)** members.

The EU has helped increase this integration by creating a borderless economy for the 27 European nations, shown on the map in **Exhibit 3.6**.[26]

EU27 Member States:	Candidate Countries:
• Austria • Belgium • Bulgaria • Croatia • Cyprus • Czechia • Denmark • Estonia • Finland • France • Germany • Greece • Hungary • Ireland • Italy • Latvia • Lithuania • Luxembourg • Malta • The Netherlands • Poland • Portugal • Romania • Slovakia • Slovenia • Spain • Sweden	• Albania • Boznia and Herzegovina • Georgia • Moldova • Montenegro • North Macedonia • Serbia • Turkey • Ukraine

European Union member states have set up common institutions to which they delegate some of their sovereignty so that decisions on specific matters of joint interest can be made democratically at the European level. This pooling of sovereignty is also called **European integration**. On January 31, 2020, the United Kingdom formally withdrew from the European Union, more commonly known as Brexit.[27]

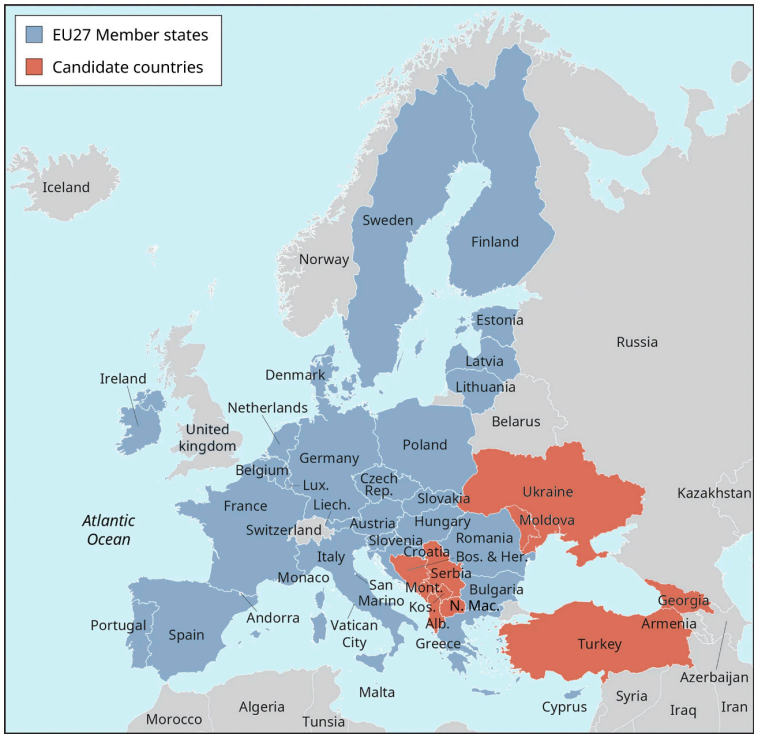

Exhibit 3.6 The European Union Sources: European Union, "EU Countries," https://european-union.europa.eu, accessed March 10, 2026; European Union, "Glossary:Candidate Countries," Eurostat, https://ec.europa.eu, accessed March 10, 2026.

One of the principal objectives of the European Union is to promote economic progress of all member countries. The EU has stimulated economic progress by eliminating trade barriers, differences in tax laws, and differences in product standards, and by establishing a common currency. A new European Community Bank was created, along with a common currency called the euro. The European Union's single market has prompted a growth in the labor force to over 221 million and more than an 85 percent increase in GDP per capita just since 2024.[28] Under pressure of competition, the prices of airfares in Europe have fallen and passengers from the EU are entitled to compensation when flights are significantly delayed. The removal of national restrictions has enabled millions of Europeans to go to other EU countries to work or spend their retirement.

The EU utilizes a tough two-tier antitrust enforcement system. In 2026, the EU fined X (formerly Twitter) $140 million for deceptive practices. They have also opened investigations against Alphabet and Meta.[29] Unlike in the United States, the EU can seal off corporate offices for unspecified periods to prevent destruction of evidence and enter the homes, cars, yachts, and other personal property of executives suspected of abusing their companies' market power or conspiring to fix prices.

Microsoft has been at odds with the EU since 2020 regarding the bundling of their product Teams with Office 365 licenses. The complaint was brought by a competitor, Slack, who asserted that the act forced customers to use the product and hid the true cost. The dispute was settled in late 2025 when Microsoft agreed to unbundle Teams from the Office Suite, and it now is purchased as a separate product. Another big U.S. company, Coca-Cola, agreed to revise its packaging regarding recycling content in response to a complaint filed by a consumer that the company's statements were misleading. Previously, the company agreed to limits on its sales tactics by not signing exclusive agreements with retailers to ban competing brands or give retailers rebates based on the sales volume of their products. They also agreed to give competitors space in their branded coolers. Violations of these agreements will result in fines that could be in the billions.[30]

Another key issue facing global businesses is the industry protectionist measures enacted by the EU against imports. For example, anti-dumping tariffs, quotas, and technical barriers to trade have all been enacted not only to regulate trade from outside the EU, but also to create a more equitable trade environment within EU

countries. The member countries do not always agree on the tactics used as each considers its own economy and the impact such measures like quotas and tariffs will have on producers and consumers.

Interestingly, a number of large U.S. companies have a stronger foothold in Europe than some European companies. Coke and Kellogg's are considered classic European brand names. Apple, Microsoft, and Alphabet dominate in their markets, while General Electric and AT&T are strong brands all over Europe.

CONCEPT CHECK

1. Explain the pros and cons of NAFTA.
2. What is the European Union? Will it ever be a United States of Europe?

3.6 Participating in the Global Marketplace

6. How do companies enter the global marketplace?

Companies decide to "go global" for a number of reasons. Perhaps the most urgent reason is to earn additional profits. If a firm has a unique product or technological advantage not available to other international competitors, this advantage should result in major business successes abroad. In other situations, management may have exclusive market information about foreign customers, marketplaces, or market situations. In this case, although exclusivity can provide an initial motivation for going global, managers must realize that competitors will eventually catch up. Finally, saturated domestic markets, excess capacity, and potential for cost savings can also be motivators to expand into international markets. A company can enter global trade in several ways, as this section describes.

Exporting

When a company decides to enter the global market, usually the least complicated and least risky alternative is **exporting**, or selling domestically produced products to buyers in another country. A company, for example, can sell directly to foreign importers or buyers. Exporting is not limited to huge corporations such as Caterpillar or Intel. Indeed, small companies typically enter the global marketplace by exporting. China is the world's largest exporter, followed by the United States.[31] Many small businesses claim that they lack the money, time, or knowledge of foreign markets that exporting requires. The U.S. Small Business Administration (SBA) now offers the Export Working Capital Program, which helps small and medium-size firms obtain working capital (money) to complete export sales. The SBA also provides counseling and legal assistance for small businesses that wish to enter the global marketplace. Companies such as American Building Restoration Products of Franklin, Wisconsin, have benefited tremendously from becoming exporters. American Building is now selling its chemical products to building restoration companies in Mexico, Israel, Japan, and Korea. Exports account for more than 5 percent of the firm's total sales.

Government assistance and education is available when a company decides to begin exporting. Export Assistance Centers (EAC) provide a one-stop resource for help in exporting. Around 150 EACs are located in major cities and trade hubs around the country. Often the SBA is located in the same building as the EAC. The SBA can guarantee loans of up to $5 million to help an exporter grow its business. Online help is also available at https://www.ustr.gov. The site lists international trade events, offers international marketing research, and has practical tools to help with every step of the exporting process. Companies considering exporting for the first time can go to https://www.export.gov and get answers to questions such as: What's in it for me? Am I ready for this? What do I have to do? The site also provides a huge list of resources for the first-time exporter.

Licensing and Franchising

Another effective way for a firm to move into the global arena with relatively little risk is to sell a license to manufacture its product to a firm in a foreign country. **Licensing** is the legal process whereby a firm (the *licensor*) agrees to let another firm (the *licensee*) use a manufacturing process, trademark, patent, trade secret, or other proprietary knowledge. The licensee, in turn, agrees to pay the licensor a royalty or fee agreed on by both parties.

International licensing is a multibillion-dollar-a-year industry. Technology/patent, trademark, and character licensing (such as Batman or Marvel comics characters) are strong sources of revenue in the licensing sector. Caterpillar licenses its brand for both shoes and clothing, which is very popular in Europe.

U.S. companies have eagerly embraced the licensing concept. For instance, Disney's Epcot entered into a licensing agreement with General Motors to create a Chevy-themed attraction at the park. The Spalding Company receives more than $2 million annually from license agreements on its sporting goods. Fruit of the Loom lends its name through licensing to 45 consumer items in Japan alone, for at least 1 percent of the licensee's gross sales.

The licensor must make sure it can exercise sufficient control over the licensee's activities to ensure proper quality, pricing, distribution, and so on. Licensing may also create a new competitor in the long run if the licensee decides to void the license agreement. International law is often ineffective in stopping such actions. Two common ways that a licensor can maintain effective control over its licensees are by shipping one or more critical components from the United States and by locally registering patents and trademarks in its own name.

Franchising is a popular form of licensing. U.S. franchisors operate thousands of outlets across the world. Approximately half of the international franchises are for fast-food restaurants and business services.

Having a big-name franchise doesn't always guarantee success or mean that the job will be easy. For example, Home Depot opened 12 stores across 6 different cities in Asia and closed them all in less than 10 years from opening. This was in large part due to the lack of adaptation to the culture. Had they done more market research, they would have better understood the target customer and their needs. Those needs, vastly different from a U.S. consumer, included certain stylistic choices and less physically demanding projects.[32] When Subway opened its first sandwich shop in China, it faced numerous challenges, many of which were cultural differences. Patrons were not accustomed to the ordering procedures and were unsure of the quality of the ingredients, which were presented differently than they were used to seeing in markets. The cold-sandwich concept was not part of the Chinese food culture, and the price point was too high. However, with time, the company adapted their approach and menu offerings to better appeal to the local market. The franchise has grown, and in 2025 they opened their 1,000th location in China with aggressive plans to open more stores in the future.

It's not unusual for Western food chains to adapt their strategies when selling in China. In popular chains such as McDonald's and KFC, it is commonplace to see unique menu offerings that appeal to the local market that consumers will not see in U.S. locations.

Contract Manufacturing

In **contract manufacturing**, a foreign firm manufactures private-label goods under a domestic firm's brand. Marketing may be handled by either the domestic company or the foreign manufacturer. Levi Strauss, for instance, entered into an agreement with the French fashion house of Cacharel to produce a new Levi's line, Something New, for distribution in Germany.

The advantage of contract manufacturing is that it lets a company test the water in a foreign country. By allowing the foreign firm to produce a certain volume of products to specification and put the domestic firm's brand name on the goods, the domestic firm can broaden its global marketing base without investing in overseas plants and equipment. After establishing a solid base, the domestic firm may switch to a joint venture

or direct investment, explained below.

Joint Ventures

Joint ventures are somewhat similar to licensing agreements. In a **joint venture**, the domestic firm buys part of a foreign company or joins with a foreign company to create a new entity. A joint venture is a quick and relatively inexpensive way to enter the global market. It can also be very risky. Many joint ventures fail. Others fall victim to a takeover, in which one partner buys out the other.

Sometimes countries have required local partners in order to establish a business in their country. China once had this requirement, and during that time, a joint venture was the only way to enter the market. Joint ventures help reduce risks by sharing costs and technology. Often joint ventures will bring together different strengths from each member. In a now-dissolved joint venture between General Motors and Suzuki in Canada (ended in 2011), both parties contributed and gained. The alliance, CAMI Automotive, was formed to manufacture low-end cars for the U.S. market. The plant, which was run by Suzuki management, produced several GM models, as well as the new Suzuki SUV. Through CAMI, Suzuki gained access to GM's dealer network and expanded their market for parts and components. GM avoided the cost of developing lower-end models and obtained models it needed to expand its offerings to consumers of various demographics and revitalize its average fuel economy rating. The CAMI factory, now fully owned by GM, is a highly productive plant in North America through GM's acquisition of Japanese work teams, flexible assembly lines, and efficient quality control measures.[33]

Direct Foreign Investment

Active ownership of a foreign company or of overseas manufacturing or marketing facilities is **direct foreign investment**. Direct investors have either a controlling interest or a large minority interest in the firm. Thus, they stand to receive the greatest potential reward but also face the greatest potential risk. A firm may make a direct foreign investment by acquiring an interest in an existing company or by building new facilities. It might do so because it has trouble transferring some resources to a foreign operation or obtaining that resource locally. One important resource is personnel, especially managers. If the local labor market is tight, the firm may buy an entire foreign firm and retain all its employees instead of paying higher salaries than competitors.

Sometimes firms make direct investments because they can find no suitable local partners. Also, direct investments avoid the communication problems and conflicts of interest that can arise with joint ventures. IBM, in the past, insisted on total ownership of its foreign investments because it did not want to share control with local partners, but today it utilizes joint ventures, partnerships, and strategic alliances.

Walmart now has around 5,300 stores located outside of the United States. In 2025, international sales were over $150 billion. Walmart's expansion strategy has shifted toward e-commerce over physical stores as they look to grow their presence in global markets.[34]

Not all of Walmart's global investments have been successful. In the late 1990s, Walmart entered the German market by purchasing two existing retail chains: Wertkauf and Interspar. Many factors contributed to the failure of the initiative, including cultural differences as Walmart attempted to replicate the American Walmart experience in the German locations. Additional roadblocks included differences in management styles, restrictions on operating hours, customer loyalty to existing stores, and negative press around labor issues. By 2006, Walmart left Germany with about $1 billion in financial losses.

Walmart has turned the corner on its international operations. It is pushing operational authority down to country managers in order to respond better to local cultures. Walmart enforces certain core principles such as everyday low prices, but country managers handle their own buying, logistics, building design, and other operational decisions.

Global firms change their strategies as local market conditions evolve. For example, major oil companies have to continue to react and adapt to changes in the price of oil due to technological advances.

MANAGING CHANGE

Managing Fluctuating Oil Prices

In 2014, crude oil was $90 a barrel, but increased production due to the shale oil boom and the reluctance of OPEC countries to reduce output led to a price drop to $45–$60 throughout the first quarter of 2015. While this is terrific news for consumers, it does provide challenges to managers at both large and small companies connected to the oil industry. The companies in the oil industry saw dramatic reductions in their earnings in 2015, which was also reflected in lower stock prices.

The action taken by senior executives at Chevron was to trim their planned capital expenditures by $5 billion in 2016, resulting in the elimination of 1,500 jobs, while then ExxonMobil executives Jeff Woodbury (retired in 2018) and CEO Rex Tillerson (retired as of 2016 and now the former U.S. Secretary of State) were less specific; they planned several cost-saving strategies built around several years of low oil prices. Likewise, Ben van Beurden, then CEO of Royal Dutch Shell (retired in 2023), announced plans to reduce their workforce and planned for expected lower oil prices.

Since 2016, inflation-adjusted oil prices per barrel have fluctuated widely from a low of less than $20 in 2020 to a high of nearly $120 per barrel in 2022. Since 2000, the inflation-adjusted average price has hovered around $80 per barrel. These wide fluctuations make it necessary for those firms in the industry to be resilient and to pivot when necessary to deal with the challenges of rapidly changing conditions.

In addition to layoffs, actions that oil company managers can employ include mergers for companies that don't have the ability to become fully efficient themselves. They can merge with other companies that can improve overall efficiencies and operations. Contrary to the cost-cutting plans mentioned earlier, some companies might consider increasing their spending plans. Going against the reduced expenditures trend is Ovintiv (formerly Encana), a North American oil producer, which instead increased its overall spending during the 2014–2016 years. Some of the factors that allowed the firm to increase spending was its low debt-to-equity ratio and its growth, which exceeded the industry average.

Growth is an important component of a company's strategy, and reactive short-term strategies can often hurt long-term growth. By implementing performance-improvement programs, companies can address problems and inefficiencies within the company and allow them to focus on innovation. Another strategy that companies can use is to review and alter their supply chain by focusing on costs and efficiency. Companies can expand their supplier base, thus increasing competition and reducing costs. This also requires companies to embrace a lean manufacturing mindset.

New technology can also be used as a cost driver. New technologies such as AI and machine learning are being used for preventative maintenance, reservoir management, and for improving exploration and drilling, all of which can lead to increased production. Adopting new technology can also lead to changes in the workers that companies employ. New technology impacts the types of skills and training needed in the workforce.

The fluctuations in oil prices continue to be a challenge for energy companies. The companies that employ multiple strategies to improve efficiency are the ones that will survive and prosper.

Critical Thinking Questions

1. Do you think that Royal Dutch Shell and ExxonMobil would have been more successful if they had considered strategies other than cutting spending and eliminating jobs? Why or why not?
2. How should oil companies react if oil prices rise to the $90 to $100 per barrel level? Explain your reasoning.

Sources: Stanley Reed and Clifford Krauss, “Royal Dutch Shell Profits Continue to Fall, Prompting Layoffs,” *The New York Times*, https://www.nytimes.com, July 30, 2015; John Biers, “More Belt-tightening Ahead as Exxon, Chevron Profits Dive,” *Yahoo! News*, https://www.yahoo.com, July 31, 2015; Aisha Tejani, “How Oil Companies Are Responding to the Oil Price Drop,” https://www.castagra.com, accessed June 30, 2017; Tsvetana Paraskova, "Goldman Sachs Hikes Year-End Oil Price Forecast by $6 Per Barrel," *Oil Price*, https://oilprice.com, February 23, 2026; "Crude Oil," https://tradingeconomics.com, accessed March 10, 2026; "Inflation Adjusted Monthly Average Crude Oil Prices (1946-Present) in June 2025 Dollars," *InflationData.com*, https://inflationdata.com, July 16, 2025; "History," https://www.ovintiv.com, accessed March 10, 2026; Julia Voloshchenko, "5 In-Demand Technologies in the Oil and Gas Industry," *Usetech*, https://usetech.com, April 15, 2025.

Countertrade

International trade does not always involve cash. Today, countertrade is a fast-growing way to conduct international business. In **countertrade**, part or all of the payment for goods or services is in the form of other goods or services. Countertrade is a form of barter (swapping goods for goods), an age-old practice whose origins have been traced back through history. Estimates are that between 5 and 15 percent of all international trade involves countertrade. The practice is primarily used in emerging markets and nations. Many U.S. companies, including Fortune 500 firms, barter billions of goods and services every year. For example, China and the Malaysian government reached a barter deal to exchange Malaysian palm oil for construction and natural resources products along with civilian equipment.

CONCEPT CHECK

1. Discuss several ways that a company can enter international trade.
2. Explain the concept of countertrade.

3.7 Threats and Opportunities in the Global Marketplace

7. What threats and opportunities exist in the global marketplace?

To be successful in a foreign market, companies must fully understand the foreign environment in which they plan to operate. Politics, cultural differences, and the economic environment can represent both opportunities and pitfalls in the global marketplace.

Political Considerations

We have already discussed how tariffs, exchange controls, and other governmental actions threaten foreign producers. The political structure of a country may also jeopardize a foreign producer’s success in international trade.

Intense nationalism, for example, can lead to difficulties. **Nationalism** is the sense of national consciousness that boosts the culture and interests of one country over those of all other countries. Countries with high levels of nationalism such as Vietnam and Finland often discourage investment by foreign companies. In other forms of nationalism, the government may take actions to hinder foreign operations. France, for example, requires pop music stations to play at least 40 percent of their songs in French. This law was enacted because the French love American rock and roll. Without airtime, American music sales suffer. In another example of nationalism, U.S.-based PPG made an unsolicited bid to acquire a Netherlands-based firm. There was opposition from Dutch politicians to the idea of a foreign takeover of a domestic paint manufacturer, and the

government expressed support for preventing the hostile takeover event. The Dutch firm took to social media to bolster support for their rejection of the takeover attempt. PPG dropped its efforts to take over the company just a month after announcing their interest.[35]

In a hostile climate, a government may *expropriate* a foreign company's assets, taking ownership and compensating the former owners. Perhaps a more severe tactic is *confiscation,* when the owner receives no compensation. Historically, this has happened during wartime conflicts such as the Civil War and World War II.

Cultural Differences

Central to any society is the common set of values shared by its citizens that determine what is socially acceptable. Culture underlies the family, educational system, religion, and social class system. The network of social organizations generates overlapping roles and status positions. These values and roles have a tremendous effect on people's preferences and thus on marketers' options. For example, in China Walmart holds live fishing contests on the premises, and in South Korea the company hosts a food competition with variations on a popular Korean dish, kimchee.

Language is another important aspect of culture. Marketers must take care in selecting product names and translating slogans and promotional messages so as not to convey the wrong meaning. For example, there are several cases of product names that, when translated into the local language, are off-putting or derogatory. Mitsubishi Motors had to rename its Pajero model in some Spanish-speaking countries because of the meaning of the word in Spanish. Toyota Motor's MR2 model dropped the *2* in France because the combination sounds like a French swear word. The literal translation of Coca-Cola in Chinese characters means "bite the wax tadpole."

Each country has its own customs and traditions that determine business practices and influence negotiations with foreign customers. For example, doing business in many European countries can be difficult during the month of August. Many, if not most, businesses completely close for the better part of the month. In many countries, personal relationships are more important than financial considerations. For instance, not attending a social engagement invitation in Mexico could lead to a lost sale. Negotiations in Japan can include things such as dining and entertaining to develop the personal relationship first, before working through a business

deal. Table 3.1 presents some cultural dos and don'ts.

Cultural Dos and Don'ts Guidelines and Examples	
DO:	**DON'T:**
• Always receive and present business cards in Asian countries with both hands. Be sure to accept a business card with care as opposed to quickly putting it away. • Use a more subtle approach when promoting a product in Japan as opposed to hard-sell tactics. Build trust and confidence in both you and the product or service you are selling through careful listening and attention to their needs. • Understand the role of religion in business transactions. In the Muslim religion, Ramadan is a holy month when most people fast. In majority-Muslim countries or industries, this is a time when everything slows down, particularly business. • Have a local person available to culturally and linguistically interpret any advertising that you plan to do.	• Overuse hand gestures, back-slapping, or first names on your first business meeting in Asia. If you do, you will not garner the same respect as if you were more formal in your approach. • Discuss your personal life at a business dinner with the French. Business professionals in France keep a strong boundary between their work and personal lives. • Arrive late to a meeting in Germany. Punctuality is highly valued, and arriving a few minutes early is expected.

Table 3.1

Economic Environment

The level of economic development varies considerably, ranging from countries where meeting basic needs can be a challenge, such as Sudan and Eritrea, to industrialized countries such as Switzerland and Greece. In general, complex, more technologically advanced industries are found in higher-income nations, and more traditional industries centered on natural resources are found in lower-income nations. Average family incomes are higher in the more industrialized countries than in the less developed and emerging market economies. Larger incomes mean greater purchasing power and demand, not only for consumer goods and services but also for the machinery and workers required to produce consumer goods.

Business opportunities are usually better in countries that have an economic infrastructure in place. **Infrastructure** is the basic institutions and public facilities upon which an economy's development depends. In the U.S., for example, when we consider how our own economy works, we tend to take our infrastructure for granted. It includes the financial system that provide the major investment loans to our nation's businesses; the educational system that turns out the incredible varieties of skills and basic research that actually run our nation's production lines; the extensive communications networks—interstate highways, railroads, airports, canals, telecommunication networks, WiFi and fiber optic internet access, streaming networks, shipping and mail service, and public transportation systems—that link almost every piece of our geography into one market; the energy and utility distribution networks that power our factories; and, of course, the market system itself, which brings our nation's goods and services into our homes and businesses.

Table 3.2 provides a glimpse of global wealth, which is determined in part by gross national income. Gross National Income is the value of the final goods and services produced by a country (Gross Domestic Product) together with its income received from other countries (such as interest and dividends) less similar payments made to other countries. Final goods are the goods ultimately consumed rather than used in the production of

another good. For example, a car sold to a consumer is a final good; the components, such as tires sold to the car manufacturer, are not. They are intermediate goods used to make the final good. However, those same tires could be considered a final good if sold directly to the consumer separately. In that case, the intermediate goods would be the rubber and materials used to produce the tire.

Gross National Income Per Capita (USD)		
Country	**Most Recent Year**	**Most Recent Value**
Top 10		
Monaco	2025	168,000
Liechtenstein	2025	116,600
Norway	2025	98,280
Switzerland	2025	95,900
Luxembourg	2025	91,470
United States	2025	83,660
Iceland	2025	78,480
Ireland	2025	77,920
Qatar	2025	76,270
Singapore	2025	74,750
Bottom 10		
Congo, Dem. Rep.	2025	640
Somalia	2025	600
Mozambique	2025	550
Malawi	2025	540
Central African Republic	2025	520
Madagascar	2025	510
Yemen	2025	470
Afghanistan	2025	370

Table 3.2 Source: Ryan Miller, "Ranked: Richest Countries by GNI (nominal) per Capita, 2025," *CEOWorld Magazine*, https://ceoworld.biz, July 14, 2025.

Gross National Income Per Capita (USD)		
Country	**Most Recent Year**	**Most Recent Value**
South Sudan	2025	350
Burundi	2025	190

Table 3.2 Source: Ryan Miller, "Ranked: Richest Countries by GNI (nominal) per Capita, 2025," *CEOWorld Magazine*, https://ceoworld.biz, July 14, 2025.

CONCEPT CHECK

1. Explain how political factors can affect international trade.
2. Describe several cultural factors that a company involved in international trade should consider.
3. How can economic conditions affect trade opportunities?

3.8 The Impact of Multinational Corporations

8. What are the advantages of multinational corporations?

Corporations that move resources, goods, services, and skills across national boundaries without regard to the country in which their headquarters are located are **multinational corporations**. Some rival small countries in terms of size and income. For example, the market value of Home Depot is equivalent to the GDP of Malaysia, and UnitedHealth Group is approximately five times the GPD of Luxembourg. Multinational companies are heavily engaged in international trade. The successful ones take political and cultural differences into account.

Many global brands sell much more outside the United States than at home. Coca-Cola, Philip Morris's Marlboro brand, Pepsi, Kellogg, Pampers, Nescafe, and Gillette, are examples.

The Fortune 500 made over $2.3 trillion in profit in 2025. In slow-growing, developed economies like Germany and the Netherlands, a weaker dollar helps, because it means cheaper products to sell into those markets, and profits earned in those markets translate into more dollars back home. Meanwhile, emerging markets such as Bangladesh, India, and Brazil are growing steadily. General Electric generated about one-third of its revenue from Asia, the Middle East, and Africa in 2025. Brown-Forman, the spirits company, is targeting emerging markets to grow its distribution of Jack Daniels. Nearly 20 percent of IBM's 2025 revenues came from Asia with another 30 percent from Europe, the Middle East, and Africa.[36]

The largest multinational corporations in the world are shown in **Table 3.3**.

In some markets such as India and Brazil, research indicates that consumers are losing trust in American brands and those brands are seeing double drops in intent to purchase compared to non-American brands.

Exhibit 3.7 As overseas investment grows, so does the need for global branding. NBA star Giannis Antetokounmpo has several endorsement deals for major brands because of his broad international appeal. Recognizable to NBA fans the world over, Antetokounmpo personifies a youthful, dynamic spirit that transcends cultural and geographic boundaries. *Why is it increasingly important that multinational advertisers identify and sign celebrity spokespersons capable of bridging different cultures?* (Credit: Erik Drost/ Flickr/ Attribution-ShareAlike 2.0 Generic (CC BY 2.0))

The Multinational Advantage

Large multinationals have several advantages over other companies. Taiwan and South Korea, for example, had long-standing embargoes against Japanese cars for political reasons and to help their domestic automakers. As the economic and political climates have shifted, along with pressure from the World Trade Organization and increasing consumer demand for Japanese vehicles, these restrictions have largely been lifted. In another example, BASF, a major chemical drug manufacturer in Germany, moved its cancer and immune-system research to Cambridge, Massachusetts, in response to concerns about biotechnology research processes.

Another advantage for multinationals is their ability to sidestep regulatory problems. For example, global pharmaceutical firms often deal with different and sometimes conflicting environmental and safety regulations. To manage these differing regulatory issues, companies often choose to move manufacturing to countries with fewer and less stringent regulations. They then keep their research and development activities in countries that have more protections for intellectual property.

Exhibit 3.8 Samsung produces high-tech Neo QLED (quantum dot light-emitting diode) back-lit LED TVs for the home theater market. Samsung's large 98-inch screen is among the largest. Unfortunately, giant-sized Samsung TVs, with a price point of nearly $35,000, can be too costly for most of the world's consumers. *How does being a multinational corporation enable Samsung to succeed in the high-end electronics market?* (Credit: Kārlis Dambrāns/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Multinationals can also shift production from one plant to another as market conditions change. For example, when European demand shifted for a solvent, Dow Chemical then shifted its German plant's manufacturing to a chemical that had been imported from the United States. Computer models help Dow make decisions like these so it can run its plants more efficiently and keep costs down.

World's Largest Corporations			
Rank	**Company**	**Revenue**	**Home Country**
1	Walmart	$703.06 B	USA
2	Amazon	$691.33 B	USA
3	Saudi Aramco	$461.56 B	S. Arabia
4	Sinopec	$444.74 B	China
5	Apple	$435.61 B	USA
6	UnitedHealth	$435.15 B	USA
7	McKesson	$397.95 B	USA
8	Berkshire Hathaway	$397.14 B	USA
9	PetroChina	$394.62 B	China
10	CVS Health	$394.08 B	USA

Table 3.3 Source: "Companies Ranked by Revenue," https://companiesmarketcap.com, accessed March 10, 2026.

EXPANDING AROUND THE GLOBE

U.S. Brands Face Global Competition

America is the cradle of the consumer goods brand. Here, a free-spending and marketing-saturated public nurtured Costco, Dell, Ford, Microsoft, and countless others to maturity. Many of those brands grew to break into other markets as well.

Although still strong, American brands show some evidence of losing popularity in the global marketplace. Firms such as Samsung and Toyota—as well as product lines in the food, clothing, and personal wellness sectors—are gaining on American brands as they turn out top-quality goods and sell them at that price point rather than trying to compete on price alone. "There are longer-term trends toward greater competition. The United States was the only global brand country [but] that's no longer the case," says Earl L. Taylor, chief knowledge officer of the Marketing Science Institute. "Consumers prefer brands that they take to be of higher quality" regardless of the country of origin, he notes. "Increasingly, there will be other successful global brands in the U.S. [market]."

Of the brands at the top of Interbrand's 2025 list of the world's most valuable, four of the top five still originate in the United States; the five most valuable are Apple, Google, Coca-Cola, Amazon, and Microsoft. American companies have lost ground because countries have been replacing U.S. products with those originating from other countries. This is in part due to lack of cultural adaptation of products and a loss of trust in American brands.

One area from which U.S. brands are feeling the pressure is the Asia-Pacific region, which harbors the fastest-growing emerging markets today. In the appliance category, Chinese company Haier is a major player in the industry and is a top competitor for well-known U.S. brands like Whirlpool. In fact, Haier bought GE's appliance division in 2016. The Chinese branding trend is not confined only to hard goods. Sporting goods and sportswear brand Li Ning, well known within China, is building its international profile. While the Chinese basketball team wore Nike uniforms at the Athens Olympic Games, the Spanish team wore Li Ning apparel. The threat to U.S. brands is not confined to China, however. South Korean brands, such as Samsung, LG, and Hyundai, have emerged on the global stage in specific categories, such as smartphones, household appliances, and automobiles.

Perceptions toward the United States have translated into a preference for European or Asian brands. These competing brands have garnered some of the U.S. market share in many categories, and their products are viewed as higher quality than some U.S. brands.

Meanwhile, European brands are gaining momentum in the areas of household and consumer goods, putting the pressure on such well-known U.S. brands as Bissell and Hoover, experts say. For instance, Gaggenau is a popular, high-end European kitchen appliance brand, along with Bosch, AEG, and Bertazzoni. Other European brands recognizable in the U.S. market as well include Absolut, Virgin, Mini (as in Cooper), Red Bull, and Ikea.

Critical Thinking Questions

1. What can U.S. multinational firms do to grow their leadership in global branding? In which sectors and product areas are U.S. brands gaining share?
2. Why do you think there is a perception that the quality of American products is declining? Give an example of a product as you explain your position.

Sources: "Interbrand: Best Global Brands 2016 Rankings," https://interbrand.com, accessed June 30, 2017; Vasileios Davvetas and Adamantios Diamantopoulos (2016), "How Product Category Shapes Preferences toward Global and Local Brands: A Schema Theory Perspective," *Journal of International Marketing*, 24 (4), 61–81; Alaen, "Why American Brands are Being Replaced," *Substack*, https://alaen.substack.com, August 8, 2025; "Ipsos' Brand America Report Explains the International Impact of an American Brand Image," *Ipsos*, https://www.ipsos.com, September 18, 2025; "Best Global Brands 2025," https://interbrand.com, accessed March 10, 2026; "Asia–Pacific: Why the World's Fastest-Growing Region Is Becoming a Prime Destination for FDI," *AIM Congress*, https://www.aimcongress.com, December 4, 2025.

Multinationals can also tap new technology from around the world. Volvo and the Chinese car brand Geely joined and created Lynk & Co. Through the sharing of technologies across borders, their new venture launched a hybrid SUV called the 01 that became available in 2021 in Europe. Versions of the super-concentrated detergent that Procter & Gamble first formulated in Japan in response to a rival's product are now being sold under the Gain and Tide labels in the United States. Also, consider Otis Elevator's development of the Elevonic 411, an elevator that is programmed to send more cars to floors where demand is high. It was developed by six research centers in five countries. Otis's group in Farmington, Connecticut, handled the systems integration, a Japanese group designed the special motor drives that make the elevators ride smoothly, a French group perfected the door systems, a German group handled the electronics, and a Spanish group took care of the small-geared components. The elevator was in production until the mid 2010s when it was replaced with newer technologies. Nonetheless, this example shows how multinational corporations can leverage joint ventures and partnerships to bring products to the marketplace more efficiently and more quickly while saving money.

Multinationals can often save a good deal in costs, even labor costs. For example, when Volvo and Geely joined forces, they leveraged their purchasing power by jointly procuring items such as batteries and motors. They

worked together to develop the autonomous driving technology used in their vehicles. Finally, they shared electrified components to manage costs and to facilitate quicker development times, all the while maintaining independent corporate structures.

CONCEPT CHECK

1. What is a multinational corporation?
2. What are the advantages of multinationals?

3.9 Trends in Global Competition

9. What are the trends in the global marketplace?

In this section, we will examine several underlying trends that will continue to propel growth in world trade. These trends are market expansion, resource acquisition, and growth in China and India.

Market Expansion

The need for businesses to expand their markets is perhaps the most fundamental reason for the growth in world trade. The limited size of domestic markets often motivates corporations to seek markets beyond their national borders. The economies of large-scale manufacturing demand big markets. Domestic markets, particularly in small markets such as Denmark and the Netherlands, simply can't generate enough demand. Nestlé is a good example of a business expanding globally because of the limited size of its home country market, Switzerland. Nestlé was shipping milk to nearly 20 different countries as early as 1875. Today, hundreds of thousands of businesses are recognizing the potential rich rewards to be found in international markets.

Resource Acquisition

More and more companies are going to the global marketplace to acquire the resources they need to operate efficiently. These resources may be skilled and unskilled labor, scarce raw materials, technology, or capital. Nike, for example, has manufacturing facilities in many Asian countries in order to use cheaper labor. Honda opened a design studio in southern California to put that "California flair" into the design of some of its vehicles. Large multinational banks such as Bank of New York and Citigroup have offices in Geneva, Switzerland. Geneva is the private banking center of Europe and attracts capital from around the globe.

The Emergence of China and India

China and India—two fast-growing economies—are impacting businesses around the globe, in very different ways. The boom in China's worldwide exports has left few sectors unaffected, be they produce growers in California, apparel makers in Mexico, or plastics manufacturers in South Korea. India's impact has altered how hundreds of service companies worldwide compete for billions of dollars in contracts.

The causes and consequences of each nation's growth are somewhat different. China's exports have boomed largely thanks to foreign investment: lured by low labor costs, big manufacturers have surged into China to expand their production base and push down prices globally. Manufacturers of all sizes, making everything from household supplies to automotive goods to clothing, are evaluating their processes either to reduce costs domestically or to outsource more of what they make to locations in China and India.[37]

Indians are playing invaluable roles in the global innovation chain. Hewlett-Packard, Cisco Systems, and other tech giants now rely on their Indian teams to devise software platforms and multimedia features for next-generation devices. Google distinguished research scientist Krishna Bharat set up the Google Bangalore lab

complete with colorful furniture, exercise balls, and a Yamaha organ—like Google's Mountain View, California, headquarters—to work on core search-engine technology. Firms in India utilize new technologies, such as AI and machine learning, to optimize designs of everything from car engines to forklifts to aircraft wings for clients such as General Motors and Boeing. India has the potential to vault over Japan as the world's fourth-biggest economy, and China is poised to move into the number one spot.[38]

Globally, AI integration is at the forefront. Firms are heavily investing in this technology, and new firms are emerging to support AI growth. According to Stanford University, private investment in the United States in AI was over $105 billion in 2024, which was twelve-fold higher than China's investment at $9.3 billion. Morgan Stanley reports that firms that adopt AI are seeing cash-flow margins that are twice that of the global average. Data also suggests nearly two-thirds of firms using AI indicate that the technology is fostering innovation in their organization, which is a key component of competing in the global marketplace. Additionally, governments are evaluating existing infrastructures (such as electricity grids) to determine if they are positioned to handle AI needs. According to the Federal Reserve, the United States, Canada, and France are at the top of the list in terms of the Global Innovation Index (WIPO GII). This index measures a country's capacity and preparedness for AI technology in terms of investment conditions, infrastructure requirements, and computing capacity.[39]

ETHICS IN PRACTICE

The United Nations Sustainable Development Goals

Corporations like Albertson's, Unilever, Kimberly Clark, and Siemens are starting to take action on the United Nations Sustainability Development Goals. For many years, through corporate social responsibility (CSR) programs, corporations have donated money and employee time to address various social and environmental problems, both globally and in their own backyards. The Carnegie Foundation and the Bill and Melinda Gates Foundation are examples of this commitment. While these efforts have achieved some progress in environmental protection, ethical business practices, building sustainable positive impacts, and economic development by organizations, they require deeper and longer engagement. Because the benefits to corporations' profitability are mostly peripheral, short-term impacts such as a drop in demand often mean that attention is drawn away from CSR programs to attending to immediate bottom-line issues.

In 2015, the United Nations member-nations adopted 17 resolutions aimed at ending poverty, ensuring sustainability, and ensuring prosperity for all. The aggressive goals were set to be met over the next 15 years in order to achieve the UN's 2030 Agenda for Sustainable Development.

1. End poverty in all its forms everywhere.
2. End hunger, achieve food security and improved nutrition, and promote sustainable agriculture.
3. Ensure healthy lives and promote well-being for all at all ages.
4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.
5. Achieve gender equality and empower all women and girls.
6. Ensure availability and sustainable management of water and sanitation for all.
7. Ensure access to affordable, reliable, sustainable, and modern energy for all.
8. Promote sustained, inclusive, and sustainable economic growth; full and productive employment; and decent work for all.
9. Build resilient infrastructure, promote inclusive and sustainable industrialization, and foster innovation.
10. Reduce inequality within and among countries.
11. Make cities and human settlements inclusive, safe, resilient, and sustainable.
12. Ensure sustainable consumption and production patterns.
13. Take urgent action to combat climate change and its impacts.

14. Conserve and sustainably use the oceans, seas, and marine resources for sustainable development.
15. Protect, restore, and promote sustainable use of terrestrial ecosystems; sustainably manage forests; combat desertification; and halt and reverse land degradation; and halt biodiversity loss.
16. Promote peaceful and inclusive societies for sustainable development; provide access to justice for all; and build effective, accountable, inclusive institutions at all levels.
17. Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development.

Companies like Albertson's recognize that a robust CSR program can enhance a corporation's reputation, which can indirectly boost the bottom line. They used number 14 on the United Nations Sustainability Development list in concert with World Oceans Day to announce that they as a company pledged to meet the U.N. goals. "We recognize that the wellbeing of people and the sustainability of our oceans are interdependent. As one of the largest U.S. retailers of seafood, we are committed to protecting the world's oceans so they can remain a bountiful natural resource that contributes to global food security, the livelihoods of hard-working fishermen and the global economy," said Buster Houston, VP of national merchandising at Albertson's Companies. The company is also committed to the concept of fair trade and was the first retailer to sell tuna with the fair trade seal.

Siemens, the German-based multinational company, also supported the adoption of meeting the United Nations Sustainability Development goals, which they believe aligns with their company values—responsibility, excellence, innovation. They define sustainable development as the means to achieve profitable and long-term growth. In doing so, they align themselves with the goals of the UN's 2030 Agenda for Sustainable Development.

Critical Thinking Questions

1. Why would companies pledge to meet the United Nations Sustainability Development goals when their competitors could ignore them in the name of greater, perhaps short-term, profits?
2. Are you as a consumer more likely to purchase products from Albertson's rather than another grocery chain that did not agree to the United Nations sustainability program? If you were working for a company deciding to purchase a large industrial component that was 10% more expensive than a competing product, would Siemens's affirmation of meeting the United Nations Sustainability Development goals sway your decision? How would you explain the rationale for your decision?

Sources: Thane Kreiner, "Corporations and Social Entrepreneurship: A Shift?" https://www.scu.edu, accessed June 30, 2017; United Nations Sustainable Development website: https://www.un.org, accessed June 30, 2017; "Practicing Sustainability—in the Interest of Future Generations," https://www.siemens.com, accessed June 30, 2017; "Albertsons Companies Commits to United Nations Sustainable Development Goals, Joins Influential Seafood Task Force," *Cision PR Newswire,* https://www.prnewswire.com, June 6, 2017; Ingrid Embree, "How 17 Companies Are Tackling Sustainable Development Goals (and Your Company Can, Too)," *Huffington Post,* https://www.huffingtonpost.com, September 14, 2016; "The 17 Goals," https://sdgs.un.org, accessed March 10, 2026.

An emerging and growing trend is that technical and managerial skills in both China and India are becoming more critical. China's focus remains on mass manufacturing and building their capacity for both electronics and heavy industrial plants. India is taking a lead in software design and services and precision engineering.

CONCEPT CHECK

1. What trends will foster continued growth in world trade?

2. Describe some of the ways businesses can take advantage of these trends to “go global.”

Key Terms

absolute advantage The situation when a country can produce and sell a product at a lower cost than any other country or when it is the only country that can provide the product.

balance of payments A summary of a country's international financial transactions showing the difference between the country's total payments to and its total receipts from other countries.

balance of trade The difference between the value of a country's exports and the value of its imports during a specific time.

buy-national regulations Government rules that give special privileges to domestic manufacturers and retailers.

contract manufacturing The practice in which a foreign firm manufactures private-label goods under a domestic firm's brand name.

countertrade A form of international trade in which part or all of the payment for goods or services is in the form of other goods and services.

devaluation A lowering of the value of a nation's currency relative to other currencies.

direct foreign investment Active ownership of a foreign company or of manufacturing or marketing facilities in a foreign country.

dumping The practice of charging a lower price for a product in foreign markets than in the firm's home market.

embargo A total ban on imports or exports of a product.

European integration The delegation of limited sovereignty by European Union member states to the EU so that common laws and policies can be created at the European level.

European Union Trade agreement among 27 European nations.

exchange controls Laws that require a company earning foreign exchange (foreign currency) from its exports to sell the foreign exchange to a control agency, such as a central bank.

exporting The practice of selling domestically produced goods to buyers in another country.

exports Goods and services produced in one country and sold to other countries.

floating exchange rates A system in which prices of currencies move up and down based upon the demand for and supply of the various currencies.

free trade The policy of permitting the people and businesses of a country to buy and sell where they please without restrictions.

free-trade zone An area where the nations allow free, or almost free, trade among each other while imposing tariffs on goods of nations outside the zone.

G20 Forum that brings together 19 countries plus the European Union and the African Union—the largest and fastest-growing economies in the world.

global vision The ability to recognize and react to international business opportunities, be aware of threats from foreign competition, and effectively use international distribution networks to obtain raw materials and move finished products to customers.

import quota A limit on the quantity of a certain good that can be imported.

imports Goods and services that are bought from other countries.

infrastructure The basic institutions and public facilities upon which an economy's development depends.

International Monetary Fund (IMF) An international organization, founded in 1945, that promotes trade, makes short-term loans to member nations, and acts as a lender of last resort for troubled nations.

joint venture An agreement in which a domestic firm buys part of a foreign firm or joins with a foreign firm to create a new entity.

licensing The legal process whereby a firm agrees to allow another firm to use a manufacturing process, trademark, patent, trade secret, or other proprietary knowledge in exchange for the payment of a royalty.

Mercosur Trade agreement between Argentina, Bolivia, Brazil, Paraguay, and Uruguay.

multinational corporations Corporations that move resources, goods, services, and skills across national boundaries without regard to the country in which their headquarters are located.

nationalism A sense of national consciousness that boosts the culture and interests of one country over those of all other countries.
North American Free Trade Agreement (NAFTA) A 1993 agreement creating a free-trade zone including Canada, Mexico, and the United States; now replaced by the United States-Mexico-Canada Agreement (USMCA).
outsourcing Sending work functions to another country, resulting in domestic workers losing their jobs.
preferential tariff A tariff that is lower for some nations than for others.
principle of comparative advantage The concept that each country should specialize in the products that it can produce most readily and cheaply and trade those products for those that other countries can produce more readily and cheaply.
protectionism The policy of protecting home industries from outside competition by establishing artificial barriers such as tariffs and quotas.
protective tariffs Tariffs that are imposed in order to make imports less attractive to buyers than domestic products are.
tariff A tax imposed on imported goods.
trade deficit An unfavorable balance of trade that occurs when a country imports more than it exports.
trade surplus A favorable balance of trade that occurs when a country exports more than it imports.
Uruguay Round A 1994 agreement originally signed by 117 nations to lower trade barriers worldwide.
World Bank An international bank that offers low-interest loans, as well as advice and information, to developing nations.
World Trade Organization (WTO) An organization established by the Uruguay Round in 1994 to oversee international trade, reduce trade barriers, and resolve disputes among member nations.

Summary of Learning Outcomes

3.1 Global Trade in the United States

1. Why is global trade important to the United States, and how is it measured?

International trade improves relations with friends and allies, eases tensions among nations, helps bolster economies, raises people's standard of living, and improves the quality of life. The United States remains a top importer and exporter in the world market. We export a majority of our industrial production and about 20 percent of our farm crops.

Two concepts important to global trade are the balance of trade (the difference in value between a country's exports and its imports over some period) and the balance of payments (the difference between a country's total payments to other countries and its total receipts from other countries). The United States has both a negative balance of trade and a negative balance of payments. Another important concept is the exchange rate, which is the price of one country's currency in terms of another country's currency. Currencies float up and down based upon the supply of and demand for each currency. Sometimes a government steps in and devalues its currency relative to the currencies of other countries.

3.2 Why Nations Trade

2. Why do nations trade?

Nations trade because they gain by doing so. The principle of comparative advantage states that each country should specialize in the goods it can produce most readily and cheaply and trade them for those that other countries can produce most readily and cheaply. The result is more goods at lower prices than if each country produced by itself everything it needed. Free trade allows trade among nations without government restrictions.

3.3 Barriers to Trade

3. What are the barriers to international trade?

The three major barriers to international trade are natural barriers, such as distance and language; tariff barriers, or taxes on imported goods; and nontariff barriers. The nontariff barriers to trade include import quotas, embargoes, buy-national regulations, and exchange controls. An argument against tariffs is that they discourage free trade and keep the market from working efficiently. An argument in favor of tariffs is that they protect domestic industries, companies, and jobs.

3.4 Fostering Global Trade

4. How do governments and institutions foster world trade?

The World Trade Organization, established by the Uruguay Round of trade negotiations, has dramatically lowered trade barriers worldwide. This trade agreement covers services, intellectual property rights, and exchange controls. The World Bank makes loans to developing nations to help build infrastructures. The International Monetary Fund makes loans to member nations that cannot meet their budgetary expenses.

3.5 International Economic Communities

5. What are international economic communities?

International economic communities reduce trade barriers among themselves while often establishing common tariffs and other trade barriers toward nonmember countries. The more well-known economic communities are the European Union, NAFTA, CAFTA, and Mercosur.

3.6 Participating in the Global Marketplace

6. How do companies enter the global marketplace?

There are a number of ways to enter the global market. The major ones are exporting, licensing, contract manufacturing, joint ventures, and direct investment.

3.7 Threats and Opportunities in the Global Marketplace

7. What threats and opportunities exist in the global marketplace?

Domestic firms entering the international arena need to consider the politics, economies, and culture of the countries where they plan to do business. For example, government trade policies can be loose or restrictive, countries can be nationalistic, and governments can change. In the area of culture, many products fail because companies don't understand the culture of the country where they are trying to sell their products. Some emerging economies also lack an economic infrastructure, which often makes it very difficult to conduct business.

3.8 The Impact of Multinational Corporations

8. What are the advantages of multinational corporations?

Multinational corporations have several advantages. First, they can sidestep restrictive trade and licensing restrictions because they frequently have headquarters in more than one country. Multinationals can also move their operations from one country to the next depending on which location offers more favorable economic conditions. In addition, multinationals can tap into a vast source of technological expertise by drawing upon the knowledge of a global workforce.

3.9 Trends in Global Competition

9. What are the trends in the global marketplace?

Global business activity will continue to escalate due to several factors. Firms that desire a larger customer base or need additional resources will continue to seek opportunities outside their country's borders. China and India have emerged as global economic powerhouses.

Preparing for Tomorrow's Workplace Skills

1. How can a country's customs create barriers to trade? Select a country (perhaps one not discussed in the chapter) and describe such barriers in that country. Then give examples of problems that U.S. business professionals might experience when interacting with colleagues in that country. (Information)
2. How has Brexit impacted the UK? The European Union as a whole? (Systems)
3. Do you think that CAFTA has a major impact on the U.S. economy? Why? (Systems)
4. What do you think is the best way for a small company to enter international trade? Why? (Information)
5. How can the United States navigate the growth happening in China and India? (Information)
6. Identify some U.S. multinational companies that have been successful in world markets. How do you think they have achieved their success? (Information)
7. **Team Activity** Divide the class into teams. Each team should choose a country and research its infrastructure to determine how it will help or hinder trade. Include a variety of countries representing differently sized economies. (Resources, Interpersonal, Information, Technology)

Ethics Activity

The executives of a clothing manufacturer want to outsource some of their manufacturing to more cost-efficient locations globally. After visiting several possible sites, they choose one and begin to negotiate with local officials. They discover that it will take about six months to get the necessary permits. One of the local politicians approaches the executives over dinner and mentions that he can speed up the process for an advisory fee of $5,000.

Using a web search tool, locate articles about bribery, and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Is paying the advisory fee a bribe or an acceptable cost of doing business in that area of the world? What should the executives do before agreeing to pay the fee?

Sources: Eric Markowitz, "The Truth about Bribery and Doing Foreign Business," *Inc.*, https://www.inc.com, accessed March 19, 2018; Roberto A. Ferdman, "How the World's Biggest Companies Bribe Foreign Governments," *The Washington Post,* https://www.washingtonpost.com, accessed March 19, 2018; David Rising, "The 10 Countries Most Likely to Use Bribery in Business," *Huffington Post*, https://www.huffingtonpost.com, accessed March 19, 2018.

Working the Net

1. Go to the International Trade Administration's Trade Compliance Center (**https://www.trade.gov/**) and navigate to the Research Center. Choose Research by Country and Country Commercial Guides. Pick a country that interests you. Read the most current available reports for that country. Would this country be a good market for a small U.S. business? If so, what are some businesses that you think might be successful in that country? Why? What are some barriers to trade that a company might face?
2. While still at the International Trade Administration's Trade Compliance Center (**https://www.trade.gov/**), click on Trade Agreements and research various types. Select one that interests you, and summarize what you learn about it.
3. Review the historical data about exchange rates between the U.S. dollar and the Japanese yen available at **https://www.x-rates.com**. Pull up charts comparing the yen to the dollar for several years. List any trends you spot. What years would have been best for a U.S. company to enter the Japanese marketplace? Given current exchange rate conditions, do you think Japanese companies are increasing or decreasing their exporting efforts in the United States?
4. Visit Foreign Trade Online, **https://www.foreign-trade.com**, and browse through the resources of this international business-to-business trade portal. What types of information does the site provide? Which would be most useful to a company looking to begin exporting? To a company who already exports and

wants to find new markets? Rate the usefulness of the site and the information it offers.
5. Go to International Trade Centre (**https://www.intracen.org/**). Go to the Resources tab, then Publications. Select two or three publications and use the information to explain how they could help a U.S. manufacturer that wants to go global.
6. Go to the World Trade Organization site at **https://www.wto.org**. Next, click on News and Events. Inform the class about current activities and actions at the WTO.
7. Go to **https://www.worldbank.org** and then to **https://www.imf.org**. Compare the types of information available on each website. Pick one example from each site, and report your findings to the class.

Critical Thinking Case

Netflix's Global Reach

Netflix is a well-known, global streaming service. However, it did not start out that way. Netflix was founded in 1997 as an online DVD-rental service located only in the United States. The company was founded to utilize technology not only to compete with brick-and-mortar movie rental options, but also to change the entire industry. Within just 10 years, technology and internet speeds had increased to the point where the firm saw more potential in the streaming market. Netflix's streaming service as we know it today was launched in 2007.

Moving from the original business model of mailing DVD rentals to offering streaming services gave Netflix the opportunity to expand beyond domestic borders. Canada was the first target, and Netflix began offering subscription streaming services broadly in the country in 2010. Latin America followed in 2011. The concept caught on quickly and grew in popularity. Within a year, Netflix had nearly 3 percent of the Canadian population as subscribers. That grew to nearly 30 percent of English-speaking residents in less than 5 years, accounting for nearly 6 million subscribers. In 2014, the company expanded to the UK, followed by Australia in 2020. Despite this growth in customers, there were issues with content. In the United States, nearly 11,000 unique titles were offered on the platform. However, in Canada, there were less than 2,700. Even as recently as 2019, only around 2.5 percent of the content was local for Australians.

Netflix's phased approach to moving into global markets was guided by pursuing those markets with the greatest potential. They also selected the markets based on consumer preferences, availability of strong internet networks, and the regulatory environment in those countries. Once they entered the global market, competition was considered. After their initial success in Canada, they were more aggressive during the years of 2015–2017 and expanded to about 130 new countries. Since 2017, the company has focused on more steady growth coupled with addressing the localization of the content they provide to subscribers. They have invested in producing local content, acquiring the rights to local movies and shows, collaborating and partnering with local telecommunications providers, and evaluating their plans and pricing models to adjust to the needs of the various markets.

Netflix has more than 230 million subscribers worldwide, with around 75 million located in the United States. The streaming service is now available in 190 countries across the globe.

Critical Thinking Questions

1. Do you think Netflix's future lies mostly in its international operations? Explain your reasoning.
2. What types of political, economic, and competitive challenges does Netflix face by operating worldwide?
3. What are some challenges with the company's aggressive strategy to expand globally to over 100 countries in a short amount of time?
4. How has Netflix overcome cultural differences to create a world brand?

Sources: Refiloe Batshua Mokgalaka, "Case Study: Netflix's Global Expansion Strategy," *LinkedIn*, https://www.linkedin.com, March 10, 2025; "Netflix's International Expansion: Reed Hastings' Global Strategy," *Pressfarm*, https://press.farm, October 2, 2025; janeiromediagroup, "The History of Netflix: From DVDs to Streaming Giant," *World History Journal*, https://worldhistoryjournal.com, July 31, 2025; "From Local to Global: Netflix's Strategic Approach to Worldwide Expansion," *The Strategy Institute*,

https://www.thestrategyinstitute.org, July 18, 2025.

Hot Links Address Book

1. A good starting place for help in doing business in foreign markets is the U.S. government's export portal. Here you will find links to export basics, regulations, exchange rates, country and industry research, and much more: **https://www.trade.gov/export-solutions**.
2. For links to a wealth of statistics on world trade, go to the U.S. International Trade Administration's (ITA) Office of Trade and Economic Analysis website, **https://www.trade.gov/about-us/office-trade-and-economic-analysis**. Go to the For U.S. Businesses tab. Then select the Research Center and Overview. Choose Tradestats Express - National and Trade Data to find trade data on products, industries, and geographic locations.
3. Check out the current U.S. balance of trade with various countries at **https://www.bea.gov**.
4. Get up-to-the-minute exchange rates at **https://www.exchange-rates.org/converter**.
5. The World Trade Organization tracks the latest trade developments between countries and regions around the world. For the most recent global trading news, visit the WTO's website at **https://www.wto.org**.
6. Gain additional insight into the workings of the International Monetary Fund at **https://www.imf.org**.
7. For the latest information about the USMCA, visit **https://www.trade.gov/usmca**.
8. Think you'd like to work overseas? For information about jobs in foreign countries, visit **https://www.internationaljobs.com/**.

4

Forms of Business Ownership

Exhibit 4.1 (Credit: pxhere / Attribution CC0 Public Domain)

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What are the advantages and disadvantages of the sole proprietorship form of business organization?
2. What are the advantages of operating as a partnership, and what downside risks should partners consider?
3. How does the corporate structure provide advantages and disadvantages to a company, and what are the major types of corporations?
4. What other options for business organization does a company have in addition to sole proprietorships, partnerships, and corporations?
5. What makes franchising an appropriate form of organization for some types of business, and why does it continue to grow in importance?
6. Why are mergers and acquisitions important to a company's overall growth?
7. What current trends will affect the business organizations of the future?

EXPLORING BUSINESS CAREERS

Jessica MacLean, Sole Proprietor

In most any elementary school classroom, at least one child's answer to the question, "What do you want to be when you grow up?" will be, "A lawyer." One of the most popular careers, lawyers are powerful figures in society, shaping our laws and ensuring that we adhere to them. Their prominence and power have led to the stereotype of rich, career-driven lawyers, often leaving no room in our minds for those who truly want to bring justice to the world. However, Jessica MacLean, a lawyer focusing primarily on women's rights, is quick to say that, as with many stereotypes, that is only one side of the story. "I know because I lived that—I was on my way to being a successful corporate lawyer. But I realized what I was doing and how different

that was from why I'd started practicing. So I walked away from it all to start my own practice."

Nervous about the prospect of private practice, she has chosen to operate as a sole proprietorship for now. Sole proprietorships are easy to set up for people who want to work on their own, prefer direct control of the business, and desire the flexibility to sell the business or close the doors at any time. "For me, it's the best choice because I am not responsible for or to anyone else. I can easily dissolve the business if I find it is not proceeding how I'd planned. More positively, too, if it does succeed, I know that success is due to my hard work.

Indeed MacLean's law career was not always in corporate law. She turned her sights toward law after a gender and communications professor at DePaul University suggested her argumentative style might be an asset in that profession. "She said I needed to tone it down for class—that the other students seemed afraid to speak up—but then asked if I'd ever considered being a lawyer." MacLean, who had always been interested in issues of justice and legality surrounding women, took her professor's advice and made the leap into law.

While in law school, she clerked for the city of Chicago in their department of personnel's sexual harassment office and volunteered for the Cook County state's attorney's office in the domestic violence division. The cases she worked on were emotionally trying. Despite the difficulty of the cases, she was drawn to them, compelled by the people she helped and the change she was able to effect. After school, she continued in related practice, working first for the Cook County state's attorney's office.

After several years with the state's attorney's office, she needed a change. It was then that MacLean decided to work for a corporation, a form of business that you will learn about in this chapter. "Why did I switch to corporate law? I think I was burnt out, to some extent. It's so hard to work on those cases, day after day. I needed to see if I would be better somewhere else."

Having enjoyed the rewards of working with the state's attorney's office and a corporation and being a sole proprietor, in 2014 MacLean joined a limited liability partnership (LLP, a form of business that you will learn about in this chapter) firm in Chicago. As her needs changed, the form and type of business organization she has worked for has changed also.

This chapter discusses sole proprietorships, as well as several other forms of business ownership, including partnerships and corporations, and compares the advantages and disadvantages of each.

With a good idea and some cash in hand, you decide to start a business. But before you get going, you need to ask yourself some questions that will help you decide what form of business organization will best suit your needs.

Would you prefer to go it alone as a *sole proprietorship,* or do you want others to share your burdens and challenges in a *partnership*? Or would the limited liability protection of a *corporation,* or perhaps the flexibility of a *limited liability company (LLC),* make more sense?

There are other questions you need to consider too: Will you need financing? How easy will it be to obtain? Will you attract employees? How will the business be taxed, and who will be liable for the company's debts? If you choose to share ownership with others, how much operating control would they want, and what costs would be associated with that?

Sole proprietorships are the most popular form of business ownership, accounting for about three-fourths of all businesses, compared with around 10 percent for partnerships and under 20 percent for corporations. Because most sole proprietorships and partnerships remain small, corporations generate the vast majority of total business revenues and more than half of total profits.

Most start-up businesses select one of these major ownership forms. In the following pages, we will discover

the advantages and disadvantages of each form of business ownership and the factors that may make it necessary to change from one form of organization to another as the needs of the business change. As a company expands from small to midsize or larger, the form of business structure selected in the beginning may no longer be appropriate.

4.1 Going It Alone: Sole Proprietorships

1. What are the advantages and disadvantages of the sole proprietorship form of business organization?

Jeremy Shepherd was working full-time for an airline when, at the age of 22, he wandered into an exotic pearl market in China, searching for a gift for his girlfriend. The strand of pearls he handpicked by instinct was later valued by a jeweler back in the States at 20 times what he paid for it. Jeremy cashed his next paycheck and hurried back to Asia, buying every pearl he could afford. Founded in 1996, his company Pearl Paradise was brought online in 2000. Shepherd chose the **sole proprietorship** form of business organization—a business that is established, owned, operated, and often financed by one person—because it was the easiest to set up. He did not want partners, and low liability exposure made incorporating unnecessary.

Fluent in Mandarin Chinese, Japanese, and Spanish and immersed in Asian culture, Shepherd believed the internet was the way to market his pearls (**https://www.pearlparadise.com**). Pearl Paradise is a leading online pearl retailer based in Los Angeles, with an appointment-only showroom and a growing livestream sales program that showcases farm-direct and one-of-a-kind pieces.[1]

Advantages of Sole Proprietorships

Sole proprietorships have several advantages that make them popular:

- *Easy and inexpensive to form*. Sole proprietorships have few legal requirements (local licenses and permits) and are not expensive to form, making them the business organization of choice for many small companies and start-ups.
- *Profits all go to the owner*. The owner of a sole proprietorship obtains the start-up funds and gets all the profits earned by the business. The more efficiently the firm operates, the higher the company's profitability.
- *Direct control of the business*. All business decisions are made by the sole proprietorship owner without having to consult anyone else.
- *Freedom from government regulation*. Sole proprietorships have more freedom than other forms of business with respect to government controls.
- *No special taxation*. Sole proprietorships do not pay special franchise or corporate taxes. Profits are taxed as personal income as reported on the owner's individual tax return.
- *Ease of dissolution*. With no co-owners or partners, the sole proprietor can sell the business or close the doors at any time, making this form of business organization an ideal way to test a new business idea.

Disadvantages of Sole Proprietorships

Along with the freedom to operate the business as they wish, sole proprietors face several disadvantages:

- *Unlimited liability.* From a legal standpoint, the sole proprietor and the company are one and the same, making the business owner personally responsible for all debts the company incurs, even if they exceed the company's value. The owner may need to sell other personal property—their car, home, or other investments—to satisfy claims against the business.
- *Difficulty raising capital.* Business assets are unprotected against claims of personal creditors, so business lenders view sole proprietorships as high risk due to the owner's unlimited liability. Owners must often use personal funds—borrowing on credit cards, second-mortgaging their homes, or selling investments—to finance their business. Expansion plans can also be affected by an inability to raise additional funding.
- *Limited managerial expertise.* The success of a sole proprietorship rests solely with the skills and talents of

the owner, who must wear many different hats and make all decisions. Owners are often not equally skilled in all areas of running a business. A graphic designer may be a wonderful artist but not know bookkeeping, how to manage production, or how to market their work.

- *Trouble finding qualified employees.* Sole proprietors often cannot offer the same pay, fringe benefits, and advancement as larger companies, making them less attractive to employees seeking the most favorable employment opportunities.
- *Personal time commitment.* Running a sole proprietorship business requires personal sacrifices and a huge time commitment, often dominating the owner's life with 12-hour workdays and 7-day workweeks.
- *Unstable business life.* The life span of a sole proprietorship can be uncertain. The owner may lose interest, experience ill health, retire, or die. The business will cease to exist unless the owner makes provisions for it to continue operating or puts it up for sale.
- *Losses are the owner's responsibility.* The sole proprietor is responsible for all losses, although tax laws allow these to be deducted from other personal income.

The sole proprietorship may be a suitable choice for a one-person start-up operation with no employees and little risk of liability exposure. For many sole proprietors, however, this is a temporary choice, and as the business grows, the owner may be unable to operate with limited financial and managerial resources. At this point, the owner may decide to take in one or more partners to ensure that the business continues to flourish.

CATCHING THE ENTREPRENEURIAL SPIRIT

Work-Life Balance Important in Small Business

Survey data suggest that about half of small business owners are satisfied with how they balance their personal lives and work schedules, with some reporting working twice as much as regular employees. Surveys indicate that over half of small business owners work more than 50 hours per week, with nearly 40 percent working over 60 hours per week.

Many business owners face stress and mental exhaustion, with financial concerns being top-of-list on stress points. However, being a small business owner puts a person in charge of their destiny, offers freedom, and can be very rewarding. Despite the stress and work hours, many are satisfied with being small business owners in general. Dennis Jacobe, chief economist at Gallup, argues, "People see the benefits more closely tied to them when they're the owner," he says. "Working hard and long is a natural aspect of the kind of people willing to start their own business."

But if employees have trouble balancing work and life, odds are they will have less confidence in you as a leader. When leaders model work-life balance and implement flexible work options, they create a culture of trust and support. Supported employees are generally more productive and less likely to leave.

The Society for Human Resource Management's (SHRM) research also shows work-life balance has a great impact on how employees feel about their leaders. Jennifer Schramm, former manager in SHRM's Workplace/Workforce Trends & Forecasting program, and now a senior strategic policy advisor at AARP, predicts that as companies try to maximize the productivity of each employee, work-life balance and the resulting employee satisfaction will become increasingly more important. And research shows that happy employees can yield happy returns for businesses.

Critical Thinking Questions

1. Many small business owners expect their employees to be as committed and to work as hard as they do. How would you avoid falling into that trap while still demanding the best from your workers?
2. As a small business owner, consider some strategies to ensure an appropriate work-life balance for your employees.

Sources: "Disclosures," https://www.truist.com, accessed February 23, 2026; Luis Merchan, "How Many Hours Do Small Business Owners Really Work a Week?" *Venturu*, https://www.venturu.com, August 26, 2025; "Small Business Owner Work-Life Balance: Mastering the Juggle," https://letsbuildup.org, accessed February 23, 2026; "Intuit QuickBooks Small Business Index Annual Report 2023," *QuickBooks Blog*, https://quickbooks.intuit.com, October 6, 2023; Josee Ng, "Behind the Hustle: The Quiet Mental Health Crisis Among Small Business Owners," *Success*, https://www.success.com, September 10, 2025; Katie Sullivan Porter, "Rethinking Work-Life Balance for Leaders and Their Teams," *Leadership Circle*, https://leadershipcircle.com, April 21, 2025.

CONCEPT CHECK

1. What is a sole proprietorship?
2. Why is this a popular form of business organization?
3. What are the drawbacks to being a sole proprietor?

4.2 Partnerships: Sharing the Load

2. What are the advantages of operating as a partnership, and what downside risks should partners consider?

Can **partnerships**, an association of two or more individuals who agree to operate a business together for profit, be hazardous to a business's health? Let's assume partners Reggie and Liz own a stylish and successful beauty salon. After a few years of operating the business, they find they have contrasting visions for their company. Liz is happy with the status quo, while Reggie wants to expand the business by bringing in investors and opening salons in other locations.

How do they resolve this impasse? By asking themselves some tough questions. Whose view of the future is more realistic? Does the business actually have the expansion potential Reggie believes it does? Where will he find investors to make his dream of multiple locations a reality? Is he willing to dissolve the partnership and start over again on his own? And who would have the right to their clients?

Reggie realizes that expanding the business in line with his vision would require a large financial risk and that his partnership with Liz offers many advantages he would miss in a sole proprietorship form of business organization. After much consideration, he decides to leave things as they are.

For those individuals who do not like to "go it alone," a partnership is relatively simple to set up. Offering a shared form of business ownership, it is a popular choice for professional-service firms such as lawyers, accountants, architects, stockbrokers, and real estate companies.

The parties agree, *either orally or in writing,* to share in the profits and losses of a joint enterprise. A *written partnership agreement,* spelling out the terms and conditions of the partnership, *is recommended* to prevent later conflicts between the partners. Such agreements typically include the name of the partnership, its purpose, and the contributions of each partner (financial, asset, skill/talent). It also outlines the responsibilities and duties of each partner and their compensation structure (salary, profit sharing, etc.). It should contain provisions for the addition of new partners, the sale of partnership interests, and procedures for resolving conflicts, dissolving the business, and distributing the assets.

There are two basic types of partnerships: *general and limited*. In a **general partnership**, all partners share in the management and profits. They co-own the assets, and each can act on behalf of the firm. Each partner also

has unlimited liability for all the business obligations of the firm. A **limited partnership** has two types of partners: one or more **general partners**, who have unlimited liability, and one or more **limited partners**, whose liability is limited to the amount of their investment. In return for limited liability, limited partners agree not to take part in the day-to-day management of the firm. They help to finance the business, but the general partners maintain operational control.

There are also limited liability partnerships (LLP), which are similar to a general partnership except that partners are not held responsible for the business debt and liabilities. Another type is a limited liability limited partnership (LLLP), which is basically a limited partnership with addition of limited liability, hence protecting the general partner from the debt and liabilities of the partnership.

Advantages of Partnerships

Some advantages of partnerships come quickly to mind:

- *Ease of formation.* Like sole proprietorships, partnerships are easy to form. The partners agree to do business together and draw up a *partnership agreement.* For most partnerships, applicable state laws are not complex.
- *Availability of capital.* Because two or more people contribute financial resources, partnerships can raise funds more easily for operating expenses and business expansion. The partners' combined financial strength also increases the firm's ability to raise funds from outside sources.
- *Diversity of skills and expertise.* Partners share the responsibilities of managing and operating the business. Combining partner skills to set goals, manage the overall direction of the firm, and solve problems increases the chances for the partnership's success. To find the right partner, you must examine your own strengths and weaknesses and know what you need from a partner. Ideal partnerships bring together people with complementary backgrounds rather than those with similar experience, skills, and talents. In **Table 4.1** you'll find some advice on choosing a partner.
- *Flexibility.* General partners are actively involved in managing their firm and can respond quickly to changes in the business environment.
- *No special taxes.* Partnerships pay no income taxes. A partnership must file a partnership return with the Internal Revenue Service, reporting how profits or losses were divided among the partners. Each partner's profit or loss is then reported on the partner's personal income tax return, with any profits taxed at personal income tax rates.
- *Relative freedom from government control.* Except for state rules for licensing and permits, the

government has little control over partnership activities.

Perfect Partners
Picking a partner is both an art and a science. Someone may have all the right credentials on paper, but does that person share your vision and the ideas you have for your company? Are they a straight shooter? Honesty, integrity, and ethics are important, because you may be liable for what your partner does. Be prepared to talk about everything, and trust your intuition and your gut feelings—they're probably right. Ask yourself and your potential partner the following questions—then see how well your answers match up: 1. Why do you want a partner? 2. What characteristics, talents, and skills does each person bring to the partnership? 3. How will you divide responsibilities—from long-range planning to daily operations? Who will handle such tasks as marketing, sales, accounting, and customer service? 4. What is your long-term vision for the business—its size, life span, financial commitment, etc.? 5. What are your personal reasons for forming this company? Are you looking to create a small company or build a large one? Are you seeking a steady paycheck or financial independence? 6. Will all parties put in the same amount of time, or is there an alternative arrangement that is acceptable to everyone? 7. Do you have similar work ethics and values? 8. What requirements will be in the partnership agreement?

Table 4.1

Disadvantages of Partnerships

Business owners must consider the following disadvantages of setting up their company as a partnership:

- *Unlimited liability*. All general partners have unlimited liability for the debts of the business. In fact, any one partner can be held personally liable for all partnership debts and legal judgments (such as malpractice)—regardless of who caused them. As with sole proprietorships, business failure can lead to a loss of the general partners' personal assets. To overcome this problem, many states now allow the formation of *limited liability partnerships (LLPs),* which protect each individual partner from responsibility for the acts of other partners and limit their liability to harm resulting from their own actions.
- *Potential for conflicts between partners.* Partners may have different ideas about how to run their business, which employees to hire, how to allocate responsibilities, and when to expand. Differences in personalities and work styles can cause clashes or breakdowns in communication, sometimes requiring outside intervention to save the business.
- *Complexity of profit sharing.* Dividing the profits is relatively easy if all partners contribute equal amounts of time, expertise, and capital. But if one partner puts in more money and others more time, it might be more difficult to arrive at a fair profit-sharing formula.
- *Difficulty exiting or dissolving a partnership.* As a rule, partnerships are easier to form than to leave. When one partner wants to leave, the value of their share must be calculated. To whom will that share be sold, and will that person be acceptable to the other partners? If a partner who owns more than 50 percent of the entity withdraws, dies, or becomes disabled, the partnership must reorganize or end. To avoid these problems, most partnership agreements include specific guidelines for transferring partnership interests and buy–sell agreements that make provision for surviving partners to buy a deceased partner's interest. Partners can also purchase special life insurance policies designed to fund such a purchase.

Business partnerships are often compared to marriages. As with a marriage, choosing the right partner is critical. So if you are considering forming a partnership, allow plenty of time to evaluate your and your

potential partner's goals, personality, expertise, and working style before joining forces.

CONCEPT CHECK

1. How does a partnership differ from a sole proprietorship?
2. Describe the four main types of partnerships, and explain the difference between a limited partner and a general partner.
3. What are the main advantages and disadvantages of a partnership?

4.3 Corporations: Limiting Your Liability

3. How does the corporate structure provide advantages and disadvantages to a company, and what are the major types of corporations?

When people think of corporations, they typically think of major, well-known companies, such as Meta, Costco, JPMorgan Chase, and Verizon. But corporations range in size from large multinationals with thousands of employees and billions of dollars in sales to midsize or even smaller firms with few employees and revenues well under the millions of dollars that large corporations garner.

A **corporation** is a legal entity subject to the laws of the state in which it is formed, where the right to operate as a business is issued by state charter. A corporation can own property, enter into contracts, sue and be sued, and engage in business operations under the terms of its charter. Unlike sole proprietorships and partnerships, corporations are taxable entities with a life separate from their owners, who are not personally liable for its debts.

At launch, the founder of Executive Property Management Services chose to incorporate to obtain the liability protection of the corporate form of business organization. The company specialized in providing customized property management services to corporate executives with long-term work assignments abroad. Taking care of substantial properties in the million-dollar range and above was no small responsibility. Therefore, the protection of a corporate business structure, along with carefully detailed contracts outlining the company's obligations, were crucial in providing the liability protection needed—and the peace of mind to focus on running the business without constant worry. Note that an LLC does not provide unlimited protection; you can still get in trouble for such things as mingling personal and business funds.[2]

MANAGING CHANGE

PacSun's Golden Glow

It all started as a little surf shop in 1980 in Newport Beach, California. It wasn't called PacSun then. It wasn't even all that different from other shops carrying surfboards and wax, except for one thing. The founders had a better idea.

During Southern California's wet, cool winters, the beaches got empty, and the surf store business went dry. Where did everyone go? To the mall, of course. Their idea—to be the first surf shop to move into California's popular mall locations—worked. The company soon grew to 21 stores, selling such popular name brands as Billabong, Gotcha, Stussy, and Quiksilver, as well as its own private-label brands.

What began as a little surf shop became a leading mall-based specialty retailer in the fast-growing surf, skate, and hip-hop apparel markets. With close to a thousand stores in the United States and Puerto Rico

and sales topping $1 billion, how did the founders make the leap from selling and waxing surfboards to being a major player in the youth apparel market? How has Pacific Sunwear of California, Inc. (**https://www.pacsun.com**) succeeded when thousands of other clothing companies failed?

"We listen and we change," says the CEO of Pacific Sun. "The kids have the answers, so we listen to get the trends, the solutions, and find out what we are doing right." To remain on the cutting edge of teen tastes, the company regularly hosted an open house at its corporate headquarters in Anaheim, California, where vendors presented their wares to PacSun's savvy team of buyers. In 2025, PacSun organized the Purpose Partner Summit, which gathered leaders from various industries to discuss aspects of youth culture. Being able to distinguish between short-lived fads and actual trends is important when making merchandise choices. The company's focus on "active brand management" is what kept its sales climbing.

The founders' philosophy had served their business well. In 1993, the 60-store company sold stock to the public. It had grown to over 1,000 stores in 50 states and Puerto Rico, with 12,000 employees. The company's PacSun stores cater to a completely different customer than its d.e.m.o. hip-hop stores. In April 2006, PacSun launched its third concept, One Thousand Steps, a footwear store.

With changing trends and online shopping challenges facing many brick-and-mortar retailers, companies such as Wet Seal and Quicksilver filed for bankruptcy in 2015, and PacSun filed for bankruptcy in April 2016. At the time of bankruptcy filing, the company had 593 PacSun stores employing approximately 2,000 employees. In September 2016, PacSun emerged from the bankruptcy after it cut debt and closed stores. The company also turned over all of its stock to the private equity firm Golden Gate Capital, its senior lender.

As its business took off, PacSun successfully made the leap from the small sole proprietorship form of business organization to corporate retailing giant. Facing changing trends and technologies, the firm hit a bump in the road, worked hard to reestablish, and has continued to remain at the forefront of youth culture and trends. The company is indeed a thousand steps away from its humble beginnings.

Critical Thinking Questions

1. How did PacSun manage its evolution from a small, local business to a leading mall-based specialty retailer? What could be the reasons for its missteps resulting in the bankruptcy filing?
2. What form of business organization might PacSun have chosen when it started, and what might have prompted it to change as it grew?

Sources: Marie Driscoll, "Pacific Sun's Golden Glow," *Business Week Online*, November 9, 2004, https://www.businessweek.com; Ron Ehlers (VP Information Services, Pacific Sunwear of California, Inc.) "Pacific Sunwear: Maintain a Fresh Brand by Anticipating Consumer Needs," presentation to the Retail Systems MIX Summit, May 25, 2005, https://www.retailsystems.com; Samantha Masunaga, "PacSun files for Chapter 11 bankruptcy protection, plans to go private," *Los Angeles Times,* https://www.latimes.com, accessed August 17, 2017; Steven Church, "Pacific Sunwear Has 'Retailer's Dream' as Bankruptcy Wraps Up," *Bloomberg,* https://www.bloomberg.com, accessed August 2017; "The Pacsun Purpose Partner Summit Unites Powerful Voices in Youth Culture and Community through Purpose-Driven Leadership," *PR Newswire*, https://www.prnewswire.com, September 22, 2025.

Corporations play an important role in the U.S. economy. As previously discussed, corporations account for a small portion of all businesses but generate the vast majority of all revenues and profits. Company type and size vary; however, when you look at the top companies by revenue in the United States or globally, they include many familiar names that affect our daily lives.

In the United States, according to *Fortune* magazine, the top three corporations in 2025 were (1) Walmart (revenue: $681.0 billion), (2) Amazon (revenue: $638.0 billion), and (3) UnitedHealth Group (revenue: $400.3

billion). According to the *Forbes* Global 2000 list for 2025, which ranks companies using a composite score of sales, profits, assets, and market value, the top three U.S. corporations are: JPMorgan Chase (revenue: $285.1 billion), Berkshire Hathaway (revenue: $371.4 billion), and Amazon (revenue: $638.0 billion). Note that while Amazon ranks third on the Global 2000 list, it actually has the highest revenue of the top three because the *Forbes* ranking uses a composite methodology that factors in not just revenue/sales, but also profits, assets, and market capitalization. By comparison, the top three companies according to December 2025 market capitalization rankings are (1) Nvidia (market cap: ~$4.9–5.0 trillion), (2) Apple (market cap: ~$4.0–4.2 trillion), and (3) Microsoft (market cap: ~$3.9 trillion). These corporations rise and fall on the various lists based on the differing metrics used in the ranking processes, which often include measures beyond simply ranking by revenues. Although the lists do not always align, it is clear that corporations have a significant impact on the economy.[3]

The Incorporation Process

Setting up a corporation is more complex than starting a sole proprietorship or partnership. Most states base their laws for chartering corporations on the Model Business Corporation Act of the American Bar Association, although registration procedures, fees, taxes, and laws that regulate corporations vary from state to state.

Exhibit 4.2 Incorporated in 1969, Walmart is one of America's most popular retail stores. Opened as Walmart Discount City by retailer Sam Walton in 1962, the retailer quickly established a strong brand image. Today, Walmart operates in nearly 20 countries, and the Walmart icon is among the most recognizable trademarks in all of business. *What steps must companies take to become incorporated?* (Credit: Mike Mozart/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

A firm does not have to incorporate in the state where it is based and may benefit by comparing the rules of several states before choosing a state of incorporation. Although Delaware is a small state with few corporations actually based there, its procorporate policies make it the state of incorporation for many companies, including about half the Fortune 500. Incorporating a company involves the following phases:

- Select the company's name
- Choose a company location
- Decide on a corporate classification
- Write the articles of incorporation (see **Table 4.2**) and file them with the appropriate state office, usually the secretary of state
- Obtain an EIN (employer identification number) from the IRS
- Establish a business bank account
- File the required state licenses and permits and pay fees/taxes

The state issues a corporate charter based on information in the articles of incorporation. Once the corporation has its charter, it holds an organizational meeting to adopt bylaws, elect directors, and pass initial

operating resolutions. Bylaws provide legal and managerial guidelines for operating the firm.

Articles of Incorporation
Articles of incorporation are prepared on a form authorized or supplied by the state of incorporation. Although they may vary slightly from state to state, all articles of incorporation should include the following elements: • Name and address of the corporation • Type of corporation • Names and addresses of the initial members of the board of directors • Type(s) of stock and number of shares to issue • Life of the corporation (usually "perpetual," meaning with no time limit)

Table 4.2

The Corporate Structure

As **Exhibit 4.4** shows, corporations have their own organizational structure with three important components: stockholders, directors, and officers.

Stockholders (or shareholders) are the owners of a corporation, holding shares of stock that provide them with certain rights. They may receive a portion of the corporation's profits in the form of dividends, and they can sell or transfer their ownership in the corporation (represented by their shares of stock) at any time. Stockholders can attend annual meetings, elect the board of directors, and vote on matters that affect the corporation in accordance with its charter and bylaws. Each share of stock generally carries one vote.

The stockholders elect a **board of directors** to govern and handle the overall management of the corporation. The directors set major corporate goals and policies, hire corporate officers, and oversee the firm's operations and finances. Laws vary by state, but small firms may have as few as 3 directors, whereas large corporations usually have 9 to 12.

The boards of large corporations typically include both corporate executives and outside directors (not employed by the organization) chosen for their professional and personal expertise. Outside directors often bring a fresh view to the corporation's activities because they are independent of the firm.

Hired by the board, the *officers* of a corporation are its top management and the CEO (chief executive officer), the chief financial officer (CFO), and the lead operations officer, who are responsible for achieving corporate goals and policies. Officers may also be board members and stockholders.

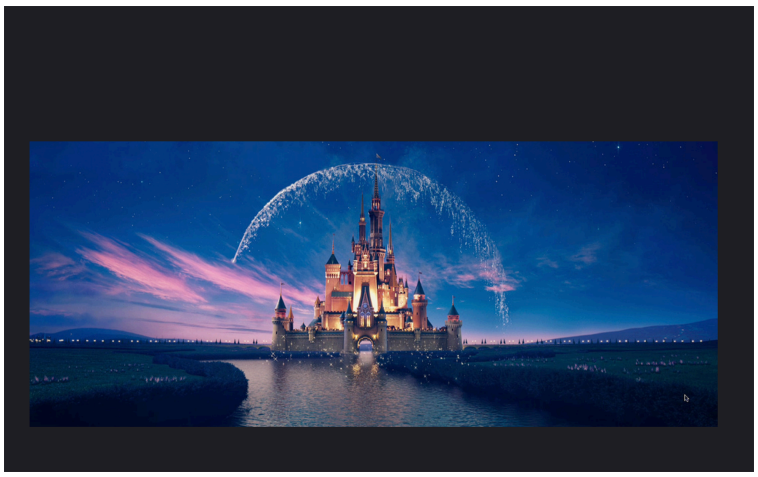

Exhibit 4.3 When Walt Disney cast his now-famous mouse as Steamboat Willie back in the 1920s, he had little idea that his animation

project would turn into one of the largest entertainment companies in the world. The house that Walt built, with its magical theme parks, movie studios, and product lines, is overseen today by visionary directors with accomplished backgrounds in media, technology, and government. *What important tasks and responsibilities are entrusted to Disney's board of directors?* (Marc Levin/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Advantages of Corporations

The corporate structure allows companies to merge financial and human resources into enterprises with great potential for growth and profits:

- *Limited liability.* A key advantage of corporations is that they are separate legal entities that exist apart from their owners. Owners' (stockholders') liability for the obligations of the firm is limited to the amount of the stock they own. If the corporation goes bankrupt, creditors can look only to the assets of the corporation for payment.
- *Ease of transferring ownership.* Stockholders of public corporations can sell their shares at any time without affecting the status of the corporation.
- *Unlimited life.* The life of a corporation is unlimited. Although corporate charters specify a life term, they also include rules for renewal. Because the corporation is an entity separate from its owners, the death or withdrawal of an owner does not affect its existence, unlike a sole proprietorship or partnership.
- *Tax deductions.* Corporations are allowed certain tax deductions, such as operating expenses, which reduces their taxable income.
- *Ability to attract financing.* Corporations can raise money by selling new shares of stock. Dividing ownership into smaller units makes it affordable to more investors, who can purchase shares of stock which represent portions of ownership in the company. The large size and stability of corporations also helps them get bank financing. All these financial resources allow corporations to invest in facilities and human resources and expand beyond the scope of sole proprietorships or partnerships. Sole proprietorships and partnerships do not have access to the same level of financing as corporations. As such, it can be challenging for these entities to obtain the capital necessary for large-scale operations.

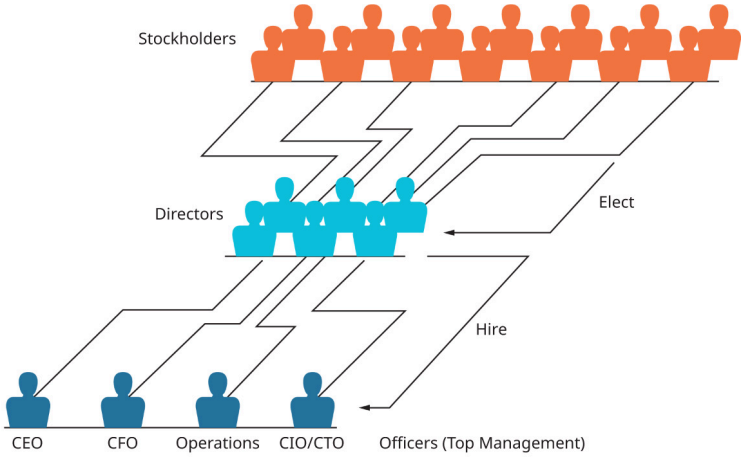

Exhibit 4.4 Organizational Structure of Corporations Attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license

Disadvantages of Corporations

Although corporations offer companies many benefits, they have some disadvantages:

- *Double taxation of profits.* Corporations must pay federal and state income taxes on their profits. In addition, any profits (dividends) paid to stockholders are taxed as personal income, although at a somewhat reduced rate.
- *Cost and complexity of formation.* As outlined earlier, forming a corporation involves several steps, and costs can vary based on the location and complexity of the corporation but could be several thousand dollars, including state filing, registration, and license fees, as well as the cost of attorneys and

accountants.

- *More government restrictions.* Unlike sole proprietorships and partnerships, corporations are subject to many regulations and reporting requirements. For example, corporations must register in each state where they do business and must also register with the Securities and Exchange Commission (SEC) before selling stock to the public. Unless it is closely held (owned by a small group of stockholders), a firm must publish financial reports on a regular basis and file other special reports with the SEC and state and federal agencies. These reporting requirements can impose substantial costs, and published information on corporate operations may also give competitors an advantage.

Types of Corporations

Three types of corporate business organization provide limited liability. The **C corporation** is the conventional or basic form of corporate organization. Small businesses may achieve liability protection through S corporations or limited liability companies (LLCs). An **S corporation** is a hybrid entity, allowing smaller corporations to avoid double taxation of corporate profits as long as they meet certain size and ownership requirements. Organized like a corporation with stockholders, directors, and officers, an S corporation is taxed like a partnership. Income and losses flow through to the stockholders and are taxed as personal income. S corporations are allowed a maximum of 100 qualifying shareholders and one class of stock. The owners of an S corporation are not personally liable for the debts of the corporation.

A newer type of business entity, the **limited liability company (LLC)**, is also a hybrid organization. Like S corporations, they appeal to small businesses because they are easy to set up and not subject to many restrictions. LLCs offer the same liability protection as corporations as well as the option of being taxed as a partnership or a corporation. LLCs are most often taxed as pass-through entities wherein the LLC itself does not pay taxes; instead, the income is passed to the members of the LLC who then report the income on their individual tax returns much like a sole proprietorship. First authorized in Wyoming in 1977, LLCs became popular after a 1988 tax ruling that treats them like partnerships for tax purposes. Today all states allow the formation of LLCs.

Table 4.3 summarizes the advantages and disadvantages of each form of business ownership.

Advantages and Disadvantages of Major Types of Business Organization		
Organization Type	**Advantages**	**Disadvantages**
Sole Proprietorship	• Owner receives all profits. • Low organizational costs. • Income taxed as personal income of proprietor. • Independence. • Maintain control of trade secrets and intellectual property. • Ease of dissolution.	• Owner receives all losses. • Owner has unlimited liability; total wealth can be taken to satisfy business debts. • Limited fundraising ability can inhibit growth. • Proprietor may have limited skills and management expertise. • Few long-range opportunities and benefits for employees. • Lacks continuity when owner dies.
Partnership	• More expertise and managerial skills available. • Relatively low organizational costs. • Income taxed as personal income of partners. • Fundraising ability is enhanced by more owners.	• Owners have unlimited liability; may have to cover debts of other, less financially sound partners. • Dissolves or must reorganize when partner dies. • Difficult to liquidate or terminate. • Potential for conflicts between partners. • Difficult to achieve large-scale operations.

Table 4.3

Advantages and Disadvantages of Major Types of Business Organization		
Organization Type	**Advantages**	**Disadvantages**
Corporation	• Limited liability protects owners from losing more than they invest. • Can achieve large size due to marketability of stock (ownership). • Receives certain tax advantages. • Greater access to financial resources allows growth. • Can attract employees with specialized skills. • Ownership is readily transferable. • Long life of firm (not affected by death of owners).	• More expensive and complex to form. • Subject to more government regulation. • Financial reporting requirements make operations public. • Double taxation because both corporate profits and dividends paid to owners are taxed, although the dividends are taxed at a reduced rate.

Table 4.3

CONCEPT CHECK

1. What is a corporation? Describe how corporations are formed and structured.
2. Summarize the advantages and disadvantages of corporations. Which features contribute to the dominance of corporations in the business world?
3. Why do S corporations and limited liability companies (LLCs) appeal to small businesses?

4.4 Specialized Forms of Business Organization

4. What other options for business organization does a company have in addition to sole proprietorships, partnerships, and corporations?

In addition to the three main forms, several specialized types of business organization also play an important role in our economy. We will look at cooperatives and joint ventures in this section and take a detailed look at franchising in the following section.

Cooperatives

When you eat a Sunkist orange or spread Land O'Lakes butter on your toast, you are consuming foods produced by cooperatives. A **cooperative** is a legal entity with several *corporate features,* such as limited liability, an unlimited life span, an elected board of directors, and an administrative staff. Member-owners pay

annual fees to the cooperative and share in the profits, which are distributed to members in proportion to their contributions. Because they do not retain any profits, cooperatives are not subject to taxes.

There are currently 3 million cooperatives with one billion members employing nearly 300 million employees in more than 145 countries worldwide. Cooperatives operate in every industry, including agriculture, education, financial services, food retail, healthcare, insurance, and utilities. They range in size from large enterprises such as Fortune 500 companies to small local storefronts and fall into the following categories: consumer and purchasing, financial, producer and processing, housing, and worker.[4]

Cooperatives are autonomous businesses owned and democratically controlled by their members—the people who buy their goods or use their services—not by investors. Unlike investor-owned businesses, cooperatives are organized solely to meet the needs of the member-owners, not to accumulate capital for investors. As democratically controlled businesses, many cooperatives practice the principle of "one member, one vote," providing members with equal control over the cooperative.

There are two types of cooperatives. **Buyer cooperatives** combine members' purchasing power. Pooling buying power and buying in volume increases purchasing power and efficiency, resulting in lower prices. At the end of the year, members get shares of the profits based on how much they bought. Obtaining discounts to lower costs gives the corner Ace Hardware store the chance to survive against retailing giants such as Menards and Home Depot.

Founded in 1924, Ace Hardware is one of the nation's largest cooperatives and is wholly owned by its independent hardware retailer members in stores spanning all 50 states and 70 countries. In August 2017, Ace opened its 5,000th store. In the second quarter of 2025, the company reported revenues of $2.8 billion, which was an increase of 3.9 percent from the second quarter of 2024. The net income for the second quarter of 2025 was $119.1 million, an increase of $4.7 million (4.1 percent) from the second quarter of 2024. Ace Hardware's revenue has nearly doubled since the second quarter of 2017, showing significant growth during the time period.[5]

Seller cooperatives are popular in agriculture, wherein individual producers join to compete more effectively with large producers. Member dues support market development, national advertising, and other business activities. In addition to Sunkist and Land O'Lakes, other familiar cooperatives are Calavo (avocados), Ocean Spray (cranberries and juices), and Blue Diamond (nuts). CHS Inc., the largest cooperative in the United States, sells energy, supply, food, and grain.

Cooperatives empower people to improve their quality of life and enhance their economic opportunities through self-help. Throughout the world, cooperatives are providing members with credit and financial services, energy, consumer goods, affordable housing, telecommunications, and other services that would not otherwise be available to them. There are several principles that cooperatives should follow according to the National Cooperative Business Association CLUSA International. They include (1) voluntary and open membership, which means that cooperatives are open to all people to use their services; (2) democratic member control, which means that organizations are controlled by their members; (3) members' economic participation, which means that members contribute equally to the capital of the cooperative; (4) autonomy and independence, which means cooperatives are self-help organizations controlled by their members; (5) education, training, and information, which means that cooperatives provide education and training for their members while also electing representatives, managers, and employees; (6) cooperation among cooperatives, which means that individual cooperatives work together for the betterment of all members; and (7) concern for community, which means the cooperatives' work takes into consideration both local and global community concerns.[6]

Joint Ventures

In a **joint venture**, two or more companies form an alliance to pursue a specific project, usually for a specified time period. There are many reasons for joint ventures. The project may be too large for one company to

handle on its own, and joint ventures also afford companies access to new markets, products, or technology. Both large and small companies can benefit from joint ventures.

In 2025, Hyundai and General Motors (GM) announced a strategic alliance to jointly develop five vehicles with production to begin in 2028. The venture allows sharing both the costs and benefits of new technological development in the sector. The companies will sell the vehicles with their individual brand names and will have some brand-specific design elements. Hyundai is gaining access to GM's expertise in the truck market, whereas GM is benefiting from Hyundai's expertise in hybrid and EV technologies.[7]

CONCEPT CHECK

1. Describe the two types of cooperatives and the advantages of each.
2. What are the benefits of joint ventures?

4.5 Franchising: A Popular Trend

5. What makes franchising an appropriate form of organization for some types of business, and why does it continue to grow in importance?

When Amare Strayer decided to buy a franchise, he researched the usual suspects: Jiffy Lube, McDonald's, and Quiznos Subs. Strayer, then 38, was a top executive at a dying technology firm. Instead of becoming another McDonald's franchisee, Strayer chose to remain in the technology sector by purchasing a Geeks on Call franchise. Geeks on Call is a company that provides on-site computer assistance via a large pool of experienced techies. Strayer makes residential and commercial "house calls" as a Geeks on Call franchisee.[8]

Choosing the right franchise can be challenging. Franchises come in all sizes and demand different skills and qualifications. And with somewhere around 3,000 different franchised businesses in the United States, Bostin had a lot to choose from—from cookie-bouquet peddlers and dog trainers to acupuncture specialists. **Table 4.4** shows the top franchises for 2017 from various sources. *Entrepreneur's* rankings utilize among other factors costs/fees, brand strength, support, and financial strength. *Franchise Business Review* focuses on owner satisfaction, whereas *Franchise Gator* utilizes a formula with factors such as financial stability and engagement.

Exhibit 4.5 Chance the Rapper's 2017 Grammy award was also validation for a new business model. Rather than being born through a deal with a traditional record label, the winning album was the first streaming-only album to earn a Grammy. *How might this approach benefit other aspiring music artists to gain footing and become a force in the music industry?* (Credit: Julio Enriquez/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Top Franchises for 2026			
***Entrepreneur* Franchise 500**			
Company	**Industry**	**Rank**	**Initial Investment**
Taco Bell	Food and Beverage	1	$611,000–$4,000,000
Jersey Mike's Subs	Food and Beverage	2	$204,000–$1,300,000
Dunkin'	Food and Beverage	3	$436,000–$1,800,000
Popeyes Louisiana Kitchen	Food and Beverage	4	$471,000–$3,900,000
Ace Hardware	Hardware Stores	5	$602,000–$2,000,000
The UPS Store	Shipping Services	6	$216,000–$609,000
Culver's	Food and Beverage	7	$2,600,000–$8,600,000
Wendy's	Food and Beverage	8	$310,000–$2,800,000
Hampton by Hilton	Hotel Chain	9	$15,200,000–$25,900,000
Kumon	Education	10	$73,123–$165,000
***Franchise Business Review* Most Innovative and Awarded Franchises**			
Franchise	**Industry**	**Initial Investment**	**Min. Cash Required**
Two Men and a Truck	Home Services	$107,100–$538,700	$80,000
Kona Ice	Food & Beverage	$102,365–$189,300	$20,000
NextHome	Real Estate	$16,250–$220,345	$4,500
360clean	Cleaning & Maintenance	$21,800 – $35,600	$15,000
Cruise Planners	Travel & Hospitality	$2,295 – $23,465	$1,945
Dream Vacations-CruiseOne	Travel & Hospitality	$2,590 – $21,870	$3,500
Wild Birds Unlimited	Retail	$224,373–$379,957	$40,000

Table 4.4 Sources: "Franchise 500," https://www.entrepreneur.com, accessed February 23, 2026; "Most Innovative Franchises," https://franchisebusinessreview.com, accessed February 23, 2026; "Top 100 Franchises," https://www.franchisegator.com, accessed February 23, 2026.

Top Franchises for 2026			
Christian Brothers Automotive	Automotive	$520,250 – $645,400	$85,000
Payroll Vault	Financial & Tax	$77,375–$111,885	$100,000
Tropical Smoothie Cafe	Food & Beverage	$300,000–$720,500	$175,000
***Franchise Gator* Top 100 Franchises**			
Franchise	**Industry**	**Rank**	**Min. Cash Required**
Zoomin Groomin	Pet	1	$90,000
PostalAnnex+	Business Services	2	$40,000
Visiting Angels Living Assistance Services	Healthcare & Senior Care	3	$100,000
Ledgers	Business Services	4	$50,000
Fibrenew	Automotive	5	$25,000
Salty Dawg Pet Salon + Bakery	Pet	6	$100,000
College Hunks Hauling Junk & Moving	Cleaning & Maintenance	7	$70,000
Kiddie Academy	Children's	8	$250,000
The Brass Tap - Craft Beer Bar	Food	9	$250,000
Maid My Home	Cleaning & Maintenance	10	$10,000

Table 4.4 Sources: "Franchise 500," https://www.entrepreneur.com, accessed February 23, 2026; "Most Innovative Franchises," https://franchisebusinessreview.com, accessed February 23, 2026; "Top 100 Franchises," https://www.franchisegator.com, accessed February 23, 2026.

Chances are you recognize some of the names listed in **Table 4.4** and deal with franchise systems in your neighborhood every day. When you have lunch at Taco Bell or Jamba Juice, change your oil at Jiffy Lube, buy candles at Wicks 'n' Sticks, or mail a package at The UPS Store, you are dealing with a franchised business. These and other familiar name brands mean quality, consistency, and value to consumers. Franchised businesses provided about 8.9 million direct jobs with a $890 billion economic output for the U.S. economy.[9]

Franchising is a form of business organization that involves a **franchisor**, the company supplying the product or service concept, and the **franchisee**, the individual or company selling the goods or services in a certain geographic area. The franchisee buys a package that includes a proven product or service, proven operating methods, and training in managing the business. Offering a way to own a business without starting it from

scratch and to expand operations quickly into new geographic areas with limited capital investment, franchising is one of the fastest growing segments of the economy. If you are interested in franchising, food companies represent the largest number of franchises.

A **franchise agreement** is a contract that allows the franchisee to use the franchisor's business name, trademark, and logo. The agreement also outlines rules for running the franchise, services provided by the franchisor, and financial terms. The franchisee agrees to follow the franchisor's operating rules by keeping inventory at certain levels, buying a standard equipment package, keeping up sales and service levels, taking part in franchisor promotions, and maintaining a relationship with the franchisor. In return, the franchisor provides the use of a proven company name and symbols, help in finding a site, building plans, guidance and training, management assistance, managerial and accounting systems and procedures, employee training, wholesale prices for supplies, and financial assistance.

Advantages of Franchises

Like other forms of business organization, franchising offers some distinct advantages:

- *Increased ability for franchisor to expand.* Because franchisees finance their own units, franchisors can grow without making a major investment.
- *Recognized name, product, and operating concept.* Consumers know they can depend on products and services from franchises such as Chick-Fil-A, Visiting Angels, and Sports Clips. As a result, the franchisee's risk is reduced and the opportunity for success increased. The franchisee gets a widely known and accepted business with a proven track record, as well as operating procedures, standard goods and services, and national advertising.
- *Management training and assistance.* The franchisor provides a structured training program that gives the new franchisee a crash course in how to start and operate their business. Ongoing training programs for managers and employees are another plus. In addition, franchisees have a peer group for support and sharing ideas.
- *Financial assistance.* Being linked to a nationally known company can help a franchisee obtain funds from a lender. Also, the franchisor typically gives the franchisee advice on financial management, referrals to lenders, and help in preparing loan applications. Many franchisors also offer short-term credit for buying supplies, payment plans, and loans to purchase real estate and equipment. Although franchisors give up a share of profits to their franchisees, they receive ongoing revenues in the form of royalty payments.

Exhibit 4.6 Countless franchise opportunities exist for entrepreneurs with access to start-up capital. Despite the broad range of franchise opportunities available, lists of the fastest-growing franchises are heavily weighted with restaurant chains and cleaning services. Start-up costs for a Quiznos franchise can be pricey; expenses associated with opening a Club Pilates franchise or a Visiting Angels adult care service can often be lower. *How do entrepreneurs evaluate which franchising opportunity is right for them?* (Credit: Mr. Blue Mau Mau/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Disadvantages of Franchises

Franchising also has some disadvantages:

- *Loss of control.* The franchisor has to give up some control over operations and has less control over its franchisees than over company employees.
- *Cost of franchising.* Franchising can be a costly form of business. Costs will vary depending on the type of business and may include expensive facilities and equipment. The franchisee also pays fees and/or royalties, which are usually tied to a percentage of sales. Fees for national and local advertising and management advice may add to a franchisee's ongoing costs.
- *Restricted operating freedom.* The franchisee agrees to conform to the franchisor's operating rules and facilities design, as well as inventory and supply standards. Some franchises require franchisees to purchase from only the franchisor or approved suppliers. The franchisor may also restrict the franchisee's territory or site, which could limit growth. Failure to conform to franchisor policies could mean the loss of the franchise.

Franchise Growth

Many of today's major franchise brands, such as McDonald's and KFC, started in the 1950s. Through the 1960s and 1970s, many more types of businesses, including personal and business services, used franchising to distribute their goods and services. Growth comes from expansion of established franchises—for example, Subway, Pizza Hut, and OrangeTheory Fitness—as well as new entrants such as those identified by *Entrepreneur* and *Franchise Gator* among other sources. According to *Entrepreneur* magazine, the top three new franchises in 2025 are (1) Koala Insulation, (2) Travelin' Tom's Coffee, and (3) QC Kinetix, whereas according to *Franchise Gator,* the top three emerging franchises for 2026 are (1) Zoomin Groomin (pet industry), (2) PostalAnnex+ (business services), and (3) Mr. Electric (home services & repair). Ranking lists are generated based on different factors such as ease of opening, start-up costs, and potential for growth.[10]

Changing demographics drive franchise industry growth, in terms of who, how, and what experiences the most rapid growth. The continuing growth and popularity of technology and personal computing is responsible for the rapidly multiplying number of eBay drop-off stores, and tech consultants such as Geeks on Call are in greater demand than ever. Other growth franchise industries are personal services such as fitness franchises, retail food, and senior care.

The Next Big Thing in Franchising

All around you, people are talking about the next big thing—Closets By Design is the solution for a perfectly organized home, the workout at Planet Fitness is the answer to America's fitness needs—and you are ready to take the plunge and buy a trendy franchise. But consumers' desires can change with the tide, so how do you plan an entrance—and exit—strategy when purchasing a franchise that's a big hit today but could be old news by tomorrow? **Table 4.5** outlines some tips on purchasing a franchise.

International Franchising

Like other forms of business, franchising is part of our global marketplace economy. As international demand for all types of goods and services grows, most franchise systems are already operating internationally or planning to expand overseas. Quick-service restaurants, lodging, business services, and personal services are popular international franchises.

Franchisors in foreign countries face many of the same problems as other firms doing business abroad. In addition to tracking markets and currency changes, franchisors must understand local culture, language differences, and the political environment. Franchisors in foreign countries also face the challenge of aligning

their business operations with the goals of their franchisees, who may be located across the world.

Tips for Purchasing a Franchise
1. Reflect on your reasoning for the venture and assess the skills needed to be successful. 2. Do your research and consult with tax advisors and attorneys before signing. 3. Complete the application process. 4. Determine your business structure and location. 5. Apply for financing as needed. 6. Utilize training and support offered by franchisor.

Table 4.5 Source: Max Freedman, "Ultimate Guide to Business Franchising," *Business News Daily*, https://www.businessnewsdaily.com, January 16, 2024.

Is Franchising in Your Future?

Are you ready to be a franchisee? Before taking the plunge, ask yourself some searching questions: Are you excited about a specific franchise concept? Are you willing to work hard and put in long hours? Do you have the necessary financial resources? Do you have prior business experience? Do your expectations and personal goals match the franchisor's?

Qualities that rank high on franchisors' lists are passion about the franchise concept, desire to be your own boss, willingness to make a substantial time commitment, assertiveness, optimism, patience, and integrity. Prior business experience is also a definite plus, and some franchisors prefer or require experience in their field.

EXPANDING AROUND THE GLOBE

Setting Up (Sandwich) Shop in China

Lured by China's fast-food industry, estimated today at $180 billion, Jim Bryant (former China Subway franchise owner, now retired), 50, was not the only entrepreneur to discover it is hard to do business in China. Over ten years, Bryant opened 19 Subway stores in Beijing—only half the number he was supposed to have by then—while other companies such as Chili's and Dunkin' have made the decision to leave the Chinese market.

Subway, or Sai Bei Wei (Mandarin for "tastes better than others"), is now in the top five largest U.S. fast-food chains in China, along with McDonald's, KFC, and Starbucks. Although Bryant had never eaten a Subway sandwich before, Jana Brands, the company Bryant worked for in China, sold $20 million in crab to Subway annually, so he knew it was big business. When Subway founder Fred DeLuca visited Beijing in 1994, Bryant took him to a place not on the official tour: McDonald's. It was Sunday night, and the place was packed. "We could open 20,000 Subways here and not scratch the surface," Bryant remembers DeLuca saying.

Two weeks later, Bryant called Subway's headquarters in Milford, Connecticut, and asked to be the company representative in China. He would recruit local entrepreneurs, train them to become franchisees, and act as a liaison between them and the company. He would receive half the initial $10,000 franchise fee and one-third of their 8 percent royalty fees. He could also open his own Subway restaurants. Steve Forman, the founder of Jana Brands, invested $1 million in return for a 75 percent stake.

All foreign businesses in China had to be joint ventures with local partners, so Bryant used the Chinese business practice of relying on local relationships to find a manager for his first restaurant in Beijing. The

project ran into problems immediately. Work on the store was delayed, and construction costs soared. It didn't take Bryant long to realize that he and Forman had been swindled out of $200,000.

When it finally opened, the restaurant was a hit among Americans in Beijing, but the locals weren't sure what to make of it. They didn't know how to order and didn't like the idea of touching their food, so they held the sandwich vertically, peeled off the paper, and ate it like a banana. Most of all, the Chinese didn't seem to want sandwiches.

But Subway did little to alter its menu—something that still irks some Chinese franchisees. Tailoring menu items to local tastes could show potential customers respect for local culture. Bryant, however, insisted that with time, sandwiches would catch on in China. Maybe he's right: Tuna salad, which he couldn't give away at first, is now the number one seller. Today there are around 670 Subway stores in China, with China's fast-food industry estimated at over $180 billion.

Critical Thinking Questions

1. What are some of the main problems U.S. franchisors encounter when attempting to expand their business in a country such as China?
2. What steps can franchisors take to ensure a smooth and successful launch of a new franchise business in a foreign country?

Sources: Subway, "Explore Our World," https://www.subway.com, accessed April 2, 2018; Carlye Adler, "How China Eats a Sandwich," *Fortune*, March 21, 2005, p. F210-B; Julie Bennett, "Chinese Market Offers Franchise Challenges," *Startup Journal–The Wall Street Journal Online*, https://www.startupjournal.com; Wang Zhuoqiong, "Fast-Food Giants Deepen Market Reach in 2024," *China Daily*, https://www.chinadailyasia.com, February 12, 2025; "Fast-Food Restaurants in China Industry Data and Analysis," *IBIS World*, https://www.ibisworld.com, May 2024.

So what can you do to prepare when considering the purchase of a franchise? When evaluating franchise opportunities, professional guidance can prevent expensive mistakes, so interview advisers to find those that are right for you. Selecting an attorney with franchise experience will hasten the review of your franchise agreement. Getting to know your banker will speed up the loan process if you plan to finance your purchase with a bank loan, so stop by and introduce yourself. The proper real estate is a critical component for a successful retail franchise, so establish a relationship with a commercial real estate broker to begin scouting locations. Doing your homework can spell the difference between success and failure, and some early preparation can help lay the groundwork for the successful launch of your franchised business.

If the franchise route to business ownership seems right for you, begin educating yourself on the franchise process by investigating various franchise opportunities. You should research a franchise company thoroughly before making any financial commitment. Once you've narrowed your choices, ask for the *Franchise Disclosure Document* (FDD) for that franchisor, and read it thoroughly. The Federal Trade Commission (FTC) requires franchisors to prepare this document, which provides a wealth of information about the franchisor, including its history, operating style, management, past or pending litigation, the franchisee's financial obligations, and any restrictions on the sale of units. Interviewing current and past franchisees is another essential step.

Would-be franchisees should also check recent issues of small-business magazines such as *Entrepreneur, Inc., Startups,* and *Success* for industry trends, ideas on promising franchise opportunities, and advice on how to choose and run a franchise. The International Franchise Association website at **https://www.franchise.org** has links to *Franchising World* and other useful sites. (For other franchise-related sites, see the "Working the Net" questions.)

CONCEPT CHECK

1. Describe franchising and the main parties to the transaction.
2. Summarize the major advantages and disadvantages of franchising.
3. Why has franchising proved so popular?

4.6 Mergers and Acquisitions

6. Why are mergers and acquisitions important to a company's overall growth?

A **merger** occurs when two or more firms combine to form one new company. For example, in 2016, Johnson Controls, a leading provider of building efficiency solutions, agreed to merge with Ireland's Tyco International, a leading provider of fire and security solutions, resulting in a company that will be a leader in products, technologies, and integrated solutions for the building and energy sectors. At the time, the merger was valued at $30 billion, with new Johnson Controls PLC to be based in Ireland. As another example, AT&T and Time Warner merged, representing a significant change in the telecommunications landscape. The newly merged company brought together both content and delivery under one umbrella. Mergers such as this one, in a well-established industry, can produce winning results in terms of improved efficiency and cost savings.[11]

In an **acquisition**, a corporation or investor group finds a target company and negotiates with its board of directors to purchase it. In 2025, T-Mobile acquired U.S. Cellular for over $4 billion. This strategic move by T-Mobile allows the existing U.S. Cellular customers the ability to seamlessly move to T-Mobile. Additionally, for T-Mobile, the acquisition opens up new rural networks to align with their strategic goals.[12]

Worldwide merger activity was up significantly in 2025 after several years of decline, in part due to stabilizing interest rates and favorable economic conditions. There was a good deal of activity in the tech sector specifically.[13] We will discuss the increase in international mergers later in this chapter.

Types of Mergers

The three main types of mergers are horizontal, vertical, and conglomerate. In a **horizontal merger**, companies at the same stage in the same industry merge to reduce costs, expand product offerings, or reduce competition. Many of the largest mergers are horizontal mergers to achieve economies of scale. Its $1.25 billion acquisition of trucking company Overnite allowed UPS, one of the world's largest shipping carriers, to step up expansion of its heavy freight–delivery business, thus expanding its product offerings.[14]

In a **vertical merger**, a company buys a firm in its same industry, often involved in an earlier or later stage of the production or sales process. Buying a supplier of raw materials, a distribution company, or a customer gives the acquiring firm more control. AT&T's deal with Time Warner is a good example. The move enabled Time Warner to have a hand in the distribution of their content through AT&T's networks.[15]

A **conglomerate merger** brings together companies in unrelated businesses to reduce risk. Combining companies whose products have different seasonal patterns or respond differently to business cycles can result in more stable sales. The Philip Morris Company, now called Altria Group, started out in the tobacco industry but diversified as early as the 1960s with the acquisition of Miller Brewing Company. It diversified into the food industry with its subsequent purchase of brands including General Foods, Kraft Foods, and Nabisco, among others. Later spinning off many businesses, current product categories include cigarettes, smokeless tobacco such as Copenhagen and Skoal, cigars, e-vapor products such as MarkTen, and wines.

A specialized, financially motivated type of merger, the **leveraged buyout (LBO)** became popular in the 1980s but is less common today. LBOs are corporate takeovers financed by large amounts of borrowed money—as

much as 90 percent of the purchase price. LBOs can be started by outside investors or the corporation's management. For example, in the healthcare sector, Athenahealth was purchased by a private equity firm in 2021 for nearly $20 billion in a leveraged buyout.[16]

Often a belief that a company is worth more than the value of all its stock is what drives an LBO. They buy the stock and take the company private, expecting to increase cash flow by improving operating efficiency or selling off units for cash to pay off debt. Although some LBOs do improve efficiency, many do not live up to investor expectations or generate enough cash to pay their debt.

Merger Motives

Although headlines tend to focus on mega-mergers, "merger mania" affects small companies too, and motives for mergers and acquisitions tend to be similar regardless of the company's size. The goal is often strategic: to improve overall performance of the merged firms through cost savings, elimination of overlapping operations, improved purchasing power, increased market share, or reduced competition. For example, Oracle Corp. acquired Adi Insights in 2022 to expand its software portfolio to include workforce management features such as scheduling and overtime management.[17]

Company growth, broadening product lines, acquiring technology or management skills, and the ability to quickly acquire new markets are other motives for acquiring a company. As a notable example, Yahoo Inc.'s $1 billion cash purchase of a 40 percent stake in China's biggest e-commerce firm, Alibaba.com, instantly strengthened its ties to an international internet marketplace.[18]

Purchasing a company can also offer a faster, less risky, less costly option than developing products or markets in-house or expanding internationally. Amazon's strategic purchase of Whole Foods in 2017 was a move to enter the retail grocery sector. In addition to the new product market, this move offers Amazon opportunity to sell Amazon tech products in the grocery stores as well as access to an entirely new set of data on consumers.[19]

Another motive for acquisitions is financial restructuring—cutting costs, selling off units, laying off employees, and refinancing the company to increase its value to stockholders. Financially motivated mergers are based not on the potential to achieve economies of scale, but rather on the acquirer's belief that the target has hidden value to be unlocked through restructuring. Most financially motivated mergers involve larger companies. When Facebook (now Meta) acquired Instagram for $1 billion, Instagram was a newer company that had yet to generate any revenue. Although the company had a strong customer base and a hold on the photo sharing market, they were struggling financially. The acquisition brought Instagram to the forefront, supported by the financial strength of Meta.[20]

Emerging Truths

Along with the technology boom of the late 1990s, merger activity increased. This was in part due to favorable economic conditions and deregulation. Activity was centered on global expansion and mergers in the technology sector. Companies were using their stock, which had been pushed to unrealistically high levels, to buy each other. When the technology bubble burst in 2000, the level of merger activity dropped as well. It fell even further after the United States was attacked on September 11, 2001. Then massive corporate wrongdoing began to surface. Stocks plummeted in reaction to these events, and merger transactions, which generally track stock market movements, fell as a result.

Today, merger activity is once again on the rise. Propelled by a solid economy, low interest rates, good credit, rising stock prices, and stockpiles of cash, activity in mergers and acquisitions is expected to be up nearly 25 percent over 2024 globally.[21]

Size is definitely an advantage when competing in the global marketplace, but bigger does not always mean better in the merger business. Study results show that heady mega-mergers can, in fact, be a bust for investors who own those shares. So companies are wise to consider their options before stuffing their dollars

in the biggest merger slot machine they can find. In their eagerness to snare a deal, many buyers pay a premium that wipes out the merger's entire potential economic gain. Often managers envision grand synergies that prove illusory or unworkable or buy a company that isn't what it seems—not fully understanding what they are getting.

Integrating acquisitions is both an art and a science. Acquirers often underestimate the costs and logistical nightmare of consolidating the operations of merged companies with very different cultures. As a result, they may fail to keep key employees aboard, sales forces selling, and customers happy.

Companies will always continue to seek out acquisition candidates, but the fundamental business case for merging will have to be strong. So what should companies look for to identify mergers with a better-than-even chance of turning out well?

- A purchase price that is low enough—a 10 percent premium over market as opposed to 50 percent—so the buyer doesn't need significant creative solutions to make the deal work.
- A target that is significantly smaller than the buyer—and in a business the buyer understands. The more "transformational" the deal, such as entering a new business arena, the bigger the risk.
- A buyer who pays in cash and not overinflated stock.
- Evidence that the deal makes both business and financial sense and isn't purely the brainchild of an empire-building CEO. Mergers are tough—culturally, commercially, and logistically. The most important quality a company can bring to a merger may be humility.

CONCEPT CHECK

1. Differentiate between a merger and an acquisition.
2. What are the most common motives for corporate mergers and acquisitions?
3. Describe the different types of corporate mergers.

4.7 Trends in Business Ownership

7. What current trends will affect the business organizations of the future?

As we learned earlier, an awareness of trends in the business environment is critical to business success. Many social, demographic, and economic factors affect how businesses organize. When reviewing options for starting or organizing a business or choosing a career path, consider the following trends.

"Baby Boomers" and "Millennials" Drive Franchise Trends

We all hear and read a great deal about the "graying of America," which refers to the "baby boomer" generation heading toward retirement age. By 2030, the 73 million members of the baby boomer generation will be over 65, which is driving the ongoing battle to stay young, fit, and healthy. Boomers have transformed every life stage they've touched so far, and their demographic weight means that business opportunities are created wherever they go.

With their interest in staying fit, Boomers are contributing to the growth of fitness and weight-loss franchises. This category is well represented in *Entrepreneur's* Franchise 500 with multiple fitness franchises on the list. And according to IHRSA, nearly 70 million Americans belong to a health club—up from previous years—so there are plenty of consumers feeding this growing trend.[22]

Another area of boomer-driven franchise growth is eldercare. Founded in 1994, Home Instead Senior Care is the largest senior care franchise in the world with a network of over 1,200 independently owned and operated franchises in several countries. And as the world's population continues to age, the need for its unique services

will continue to increase.

Home Instead Senior Care provides a meaningful solution for older adults who prefer to remain at home. Compared with the annual cost for a nursing home placement (over $100,000), home care can vary significantly and can be as much as $70 to $80 per hour. Quality of life is enhanced by Home Instead Senior Care's part-time, full-time, and around-the-clock services, designed for people who are capable of managing their physical needs but require some assistance and supervision. Home Instead Senior Care provides meal preparation, companionship, light housekeeping, medication reminders, incidental transportation, and errands. These services make it possible for older individuals to remain in the familiar comfort of their own homes for a longer period of time.[23]

But the best deal yet may be adult day services, a fast-growing franchise opportunity and "still one of the best-kept secrets around" according to *Entrepreneur* magazine. Based on the concept of day care services for children, Sarah Adult Day Services, Inc. offers a franchising opportunity that meets the two criteria for a successful and socially responsible business: a booming demographic market with great potential for growth, and excellent eldercare. Programs such as SarahCare centers are highly affordable for its clients, costing around $75 per day. The SarahCare franchise allows entrepreneurs to become part of an expanding industry while restoring a sense of dignity and vibrancy to the lives of older adults.[24]

Millennials—individuals born between the early 1980s and 2000—are the largest living generation in the United States, according to Pew Research. Millennials dine out at a higher rate than the general population. They have been recognized as changing the restaurant scene by expecting digital interfaces, unique dining experiences to share on social media, and diverse menus. Recent estimates indicate that nearly three-fourths of Millennials and Gen Zers are interested in entrepreneurship. Personal career fulfillment is cited as one of the primary reasons Millennials want to take the entrepreneurship path. When it comes to owning a franchise, growth potential and meeting a flexible, fulfilling lifestyle are both something that attracts Millennials. According to Intelligent.com, nearly half of college graduates want to start a business after graduation. However, data also indicate that graduates lack the skills necessary to be successful. Franchising is the perfect solution to these issues. For example, Chicago area native and millennial Sal Rehman grew up working in his family's diner. Sal had a dream of operating his own restaurant, and he decided to take the franchising path. In 2015, at the age of 27, Sal opened his first Wing Zone store in suburban Glendale Heights, Illinois.[25]

Boomers Rewrite the Rules of Retirement

At age 64, Mahlik Larson could be the poster child for retirement except that the concept makes him recoil. Mahlik and his husband are living their dream in a comfortable house on the shore where Mahlik kicks back by floating in the pool when he's not spoiling his grandkids with trips to Disneyland. "The only way you can get me out of here is to carry me out," Larson says, referring to the consulting company he founded and runs from his basement office. "I love my work, and I cannot imagine sitting at home and doing nothing."

Larson is not alone. Today's boomers are working longer at their jobs and embracing postretirement second careers, which often means starting their own small business. As retirees opt to go into business for themselves, they are choosing different forms of business organizations depending on their needs and goals. Some may start small consulting businesses using the simple sole proprietorship form of business organization, while couples or friends might choose to become partners in a retail or franchise venture.

The more healthy and energetic the baby boomer generation remains, the more interested it is in staying active and engaged—and that may mean postponing retirement or not retiring at all. In fact, 53 percent of Boomers plan to work in some capacity during their retirement years, and 36 percent indicated that they will retire past 70 years old or not retire at all.[26]

Mergers and Foreign Investment Boom, Too

Both in North America and worldwide, mergers and acquisitions are expected to continue to increase after

several years of decline. These increases are expected to occur across sectors. The increase is the result of improving economic growth and better stock prices.

This current boom in mergers feels different from earlier merger mania, however. New players are entering the arena, and the number of U.S. and foreign companies making cross-border acquisitions has increased. Whether these new mergers will be good for the global economy remains to be seen. Transactions that lead to cost savings, streamlined operations, and more funding for research and capital investment in new facilities will have positive effects on profitability. Many deals, however, may fail to live up to the acquirers' expectations.

Foreign investment in U.S. companies has also increased dramatically. Annual foreign direct investment reached over $40 trillion in 2025. The jump is the result of a worldwide investment in advanced manufacturing and AI technologies, as well as the continued attraction of the U.S. economy to investors worldwide.[27]

And what about U.S. investment abroad? This investment too is increasing. According to reporting from the U.S. Department of Commerce, the outflows from the United States into other countries is now nearly $7 trillion a year.[28] In addition to the attraction of cheap labor and resources, U.S. companies of all sizes continue to tap the intellectual capital of developing economies such as China and India, outsourcing such functions as payroll, information technology (IT), web/email hosting, customer relationship management (CRM), and human resources (HR) to keep costs under control and enhance profitability.

CONCEPT CHECK

1. What are some of the demographic trends currently impacting business in the United States?
2. As a prospective business owner, what could you do to capitalize on these trends?
3. What other economic trends are influencing today's business organizations?

Key Terms

acquisition The purchase of a target company by another corporation or by an investor group typically negotiated with the target company board of directors.

board of directors A group of people elected by the stockholders to handle the overall management of a corporation, such as setting major corporate goals and policies, hiring corporate officers, and overseeing the firm's operations and finances.

buyer cooperative A group of cooperative members who unite for combined purchasing power.

C corporation A conventional or basic form of corporate organization.

conglomerate merger A merger of companies in unrelated businesses; done to reduce risk.

cooperative A legal entity typically formed by people with similar interests, such as suppliers or customers, to reduce costs and gain economic power. A cooperative has limited liability, an unlimited life span, an elected board of directors, and an administrative staff; all profits are distributed to the member-owners in proportion to their contributions.

corporation A legal entity with an existence and life separate from its owners, who are not personally liable for the entity's debts. A corporation is chartered by the state in which it is formed and can own property, enter into contracts, sue and be sued, and engage in business operations under the terms of its charter.

franchise agreement A contract setting out the terms of a franchising arrangement, including the rules for running the franchise, the services provided by the franchisor, and the financial terms. Under the contract, the franchisee is allowed to use the franchisor's business name, trademark, and logo.

franchisee In a franchising arrangement, the individual or company that sells the goods or services of the *franchisor* in a certain geographic area.

franchising A form of business organization based on a business arrangement between a *franchisor,* which supplies the product or service concept, and the *franchisee,* who sells the goods or services of the franchisor in a certain geographic area.

franchisor In a franchising arrangement, the company that supplies the product or service concept to the *franchisee*.

general partners Partners who have unlimited liability for all of the firm's business obligations and who control its operations.

general partnership A partnership in which all partners share in the management and profits. Each partner can act on behalf of the firm and has unlimited liability for all its business obligations.

horizontal merger A merger of companies at the same stage in the same industry; done to reduce costs, expand product offerings, or reduce competition.

joint venture Two or more companies that form an alliance to pursue a specific project, usually for a specified time period.

leveraged buyout (LBO) A corporate takeover financed by large amounts of borrowed money; can be started by outside investors or the corporation's management.

limited liability company (LLC) A hybrid organization that offers the same liability protection as a corporation but may be taxed as either a partnership or a corporation.

limited partners Partners whose liability for the firm's business obligations is limited to the amount of their investment. They help to finance the business but do not participate in the firm's operations.

limited partnership A partnership with one or more *general partners*, who have unlimited liability, and one or more *limited partners*, whose liability is limited to the amount of their investment in the company.

merger The combination of two or more firms to form one new company.

partnership An association of two or more individuals who agree to operate a business together for profit.

S corporation A hybrid entity that is organized like a corporation, with stockholders, directors, and officers, but taxed like a partnership, with income and losses flowing through to the stockholders and taxed as their personal income.

seller cooperative Individual producers who join together to compete more effectively with large producers.

sole proprietorship A business that is established, owned, operated, and often financed by one person.

stockholders (or shareholders) The owners of a corporation who hold shares of stock that carry certain rights.

vertical merger A merger of companies at different stages in the same industry; done to gain control over supplies of resources or to gain access to different markets.

Summary of Learning Outcomes

4.1 Going It Alone: Sole Proprietorships

1. What are the advantages and disadvantages of the sole proprietorship form of business organization?

The advantages of sole proprietorships include ease and low cost of formation, the owner's rights to all profits, the owner's control of the business, relative freedom from government regulation, absence of special taxes, and ease of dissolution. Disadvantages include owner's unlimited liability for debts and personal absorption of all losses, difficulty in raising capital, limited managerial expertise, difficulty in finding qualified employees, large personal time commitment, and unstable business life.

4.2 Partnerships: Sharing the Load

2. What are the advantages of operating as a partnership, and what downside risks should partners consider?

The advantages of partnerships include ease of formation, availability of capital, diversity of managerial skills and expertise, flexibility to respond to changing business conditions, no special taxes, and relative freedom from government control. Disadvantages include unlimited liability for general partners, potential for conflict between partners, sharing of profits, and difficulty exiting or dissolving the partnership. Partnerships can be formed as either general or limited partnerships. In a general partnership, the operations of the business are controlled by one or more general partners with unlimited liability. The partners co-own the assets and share the profits. Each partner is individually liable for all debts and contracts of the partnership. In a limited partnership, the limited partners are financial partners whose liability is limited to their investment; they do not participate in the firm's operations.

4.3 Corporations: Limiting Your Liability

3. How does the corporate structure provide advantages and disadvantages to a company, and what are the major types of corporations?

A corporation is a legal entity chartered by a state. Its organizational structure includes stockholders who own the corporation, a board of directors elected by the stockholders to govern the firm, and officers who carry out the goals and policies set by the board. Stockholders can sell or transfer their shares at any time and are entitled to receive profits in the form of dividends. Advantages of corporations include limited liability, ease of transferring ownership, unlimited life tax deductions, and the ability to attract financing. Disadvantages include double taxation of profits, the cost and complexity of formation, and government restrictions.

4.4 Specialized Forms of Business Organization

4. What other options for business organization does a company have in addition to sole proprietorships, partnerships, and corporations?

Businesses can also organize as limited liability companies, cooperatives, joint ventures, and franchises. A limited liability company (LLC) provides limited liability for its owners but is taxed like a partnership. These two features make it an attractive form of business organization for many small firms. Cooperatives are collectively owned by individuals or businesses with similar interests that combine to achieve more economic power. Cooperatives distribute all profits to their members. Two types of cooperatives are buyer and seller cooperatives. A joint venture is an alliance of two or more companies formed to undertake a special project. Joint ventures can be set up in various ways, through partnerships or special-purpose corporations. By sharing

management expertise, technology, products, and financial and operational resources, companies can reduce the risk of new enterprises.

4.5 Franchising: A Popular Trend

5. What makes franchising an appropriate form of organization for some types of business, and why does it continue to grow in importance?

Franchising offers entrepreneurs a "ready made" business opportunity. It involves an agreement between a franchisor, the supplier of goods or services, and a franchisee, an individual or company that buys the right to sell the franchisor's products in a specific area. With a franchise, the business owner does not have to start from scratch but buys a business concept with a proven product or service and operating methods. The franchisor provides use of a recognized brand-name product and operating concept, as well as management training and financial assistance. Franchises can be costly to start, and operating freedom is restricted because the franchisee must conform to the franchisor's standard procedures. The growth in franchising is attributed to its ability to expand business operations quickly into new geographic areas with limited capital investment.

4.6 Mergers and Acquisitions

6. Why are mergers and acquisitions important to a company's overall growth?

In a merger, two companies combine to form one company. In an acquisition, one company or investor group buys another. Companies merge for strategic reasons to improve overall performance of the merged firm through cost savings, eliminating overlapping operations, improving purchasing power, increasing market share, or reducing competition. Desired company growth, broadened product lines, and the rapid acquisition of new markets, technology, or management skills are other motives. Another motive for merging is financial restructuring—cutting costs, selling off units, laying off employees, and refinancing the company to increase its value to stockholders.

There are three types of mergers. In a horizontal merger, companies at the same stage in the same industry combine for more economic power, to diversify, or to win greater market share. A vertical merger involves the acquisition of a firm that serves an earlier or later stage of the production or sales process, such as a supplier or sales outlet. In a conglomerate merger, unrelated businesses come together to reduce risk through diversification.

4.7 Trends in Business Ownership

7. What current trends will affect the business organizations of the future?

Several generations now make up the workforce. Individuals are choosing to continue working into retirement. The service sector is booming in efforts to meet the demand for fitness, health, and eldercare.

Other key trends include an escalation of worldwide foreign investment through the number of mergers taking place. All forms of business organization can benefit from outsourcing, tapping into the intellectual capital of developing countries.

Preparing for Tomorrow's Workplace Skills

1. Suppose you are considering two job offers for a computer programming position, one at a two-year-old consulting firm with 10 employees owned by a sole proprietor and one at a publicly traded software developer with sales of $500 million. In addition to comparing the specific job responsibilities, consider the following:
    - Which company offers better training? Do you prefer the on-the-job training you'll get at the small company, or do you want formal training programs as well?
    - Which position offers the chance to work on a variety of assignments?
    - What are the opportunities for advancement? Employee benefits?

- What happens if the owner of the young company gets sick or decides to sell the company?
- Which company offers a better working environment for you?

Answering these and similar questions will help you decide which job meets your particular needs. (Resources, Information)

2. Before starting your own company, you should know the legal requirements in your area. Call the appropriate city or county departments, such as licensing, health, and zoning, to find out what licenses and permits you need and any other requirements you must meet. Do the requirements vary depending on the type of company? Are there restrictions on starting a home-based business? Contact your secretary of state or other agency that handles corporations to get information on how to incorporate. (Information)
3. Sasha Hildebrandt wants to open a business selling her handmade chocolates over the internet. Although she has some money saved and could start the business solo, she is concerned about her lack of bookkeeping and management experience. A friend knows an experienced businessperson seeking involvement with a start-up company. As Sasha's business consultant, prepare recommendations regarding an appropriate form of business organization, outlining the issues to consider and the risks involved, supported by reasons for your suggestions. (Interpersonal, Information)
4. You and a partner co-own Swim-Clean, a successful pool supply and cleaning service. Because sales have tapered off, you want to expand your operations to another town 10 miles away. Given the high costs of expanding, you decide to sell Swim-Clean franchises. The idea takes off, and soon you have 25 units throughout the region. Your success results in an invitation to speak at a local Rotary Club luncheon. Prepare a brief presentation describing how you evaluated the benefits and risks of becoming a franchisor, the problems you encountered, and how you established good working relationships with your franchisees. (Information)
5. Do you have what it takes to be a successful franchisee? Start by making a list of your interests and skills, and do a self-assessment using some of the suggestions in this chapter. Next you need to narrow the field of thousands of different franchise systems. At the Franchise Handbook site (**https://www.franchisetimes.com/the-franchise-handbook/**), you'll find articles with checklists to help you thoroughly research a franchise and its industry, as well as a directory of franchise opportunities. Armed with this information, develop a questionnaire to evaluate a prospective franchise. (Resources, Interpersonal, Information)
6. Find news of a recent merger using an online search or a business periodical such as *Bloomberg Businessweek, Fortune,* or *The Wall Street Journal*. Research the merger using a variety of sources including the company's website and news articles. Discover the motives behind the merger, the problems facing the new entity, and the company's progress toward achieving its objectives. (Information)
7. **Team Activity** After pulling one too many all-nighters, you realize your college needs an on-campus coffee/food delivery service and decide this might be a good business opportunity for you and some friends. Split the class into small groups. Start by outlining the management, technical, and financial resources that are needed to start this company. Then evaluate what resources your group brings to the table and what you will need from partners. Using **Exhibit 4.3** as a guide, develop a list of questions for potential partners. After each group presents its findings to the class, it should pair up with another group that seems to offer additional resources. Interview the other group's members using your questions to decide if the teams could work together and if you would proceed with this venture. (Resources, Interpersonal)

Ethics Activity

After seeing a Quiznos franchise recruitment infomercial to recruit franchisees, you are tempted to apply to open your own Quiznos sub shop. However, your research on the company turns up some disturbing information. Some franchisees were concerned with the company's management and practices, among them excessive food costs, lack of promised support, and selling new franchise locations that are too close to

existing stores. A group of New Jersey franchisees sued Quiznos for selling them franchises but not providing locations 18 months after taking their franchise fees. Some franchise owners question Quiznos's purchasing tactics, choosing food and beverage suppliers based on the referral fees it receives instead of the lowest-cost provider. Other franchisees have suffered major financial losses.

Quiznos, which now has less than 350 locations worldwide with around 150 in the United States, disputes the various claims. The president of the company points out that in a franchise operation, there will always be unhappy franchisees and those who can't make a success of their units. Besides, Quiznos's franchise offering materials clearly state that the company may open stores in any locations it selects.

Using a web search tool, locate articles about this topic, and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: What are Quiznos's obligations to its franchisees? Is it ethical for the company to open new franchises very close to existing units and to choose vendors based on fees to the parent company rather than the cost to franchisees?

Sources: The Franchise King, "What Happened to Quiznos?" https://www.thefranchiseking.com, accessed September 14, 2017; Karsten Strauss, "Is Quiznos Toast?" *Forbes,* https://www.forbes.com, June 17, 2015; Venessa Wong, "Can Quiznos Be Saved?" *BuzzFeed News,* https://www.buzzfeed.com, December 8, 2015; Kristi Arellano, "Quiznos' Success Not without Problems," *Denver Post,* June 19, 2005, p. K1; Dina Berta, "Quiznos Denies Franchisees' Charges of Cost Gouging, Encroachment Problems," *Nation's Restaurant News,* June 20, 2005, P. 1+; "Quiznos Denies Fraud Suit Charges by 17 Franchisees," *Nation's Restaurant News,* May 16, 2005, p. 102; Jonathan Maze, "A Brief History of Quiznos' Collapse," *Restaurant Business*, https://www.restaurantbusinessonline.com, June 13, 2018.

Working the Net

1. Consult *Entrepreneur* at **https://www.entrepreneur.com**. Search for "business legal structures" to read articles about S corporations and LLCs. If you were starting a company, which would you choose and why?
2. Research how to form a corporation and LLC in your state using search engines to find relevant sites. Here are two to get you started: **https://www.incorporate.com** and **https://www.usa-corporate.com**. Find out what steps are necessary to set up a corporation in your state. How do the fees compare with other states? If you were incorporating a business, what state would you choose and why?
3. The Federal Trade Commission is the government agency that monitors and regulates franchises. Visit the FTC site (**https://www.ftc.gov**), and explore the links to its resources on franchising, including details on the legal responsibilities of franchisors and franchisees. What kinds of problems should a prospective franchisee look out for when considering a franchise? What kinds of scams are typical in the franchise industry?
4. Select three franchises that interest you. Research them at sites such as the Franchise Handbook (**https://www.franchisetimes.com/the-franchise-handbook/**), *Entrepreneur* magazine's Franchise 500 (**https://www.entrepreneur.com**), and Be the Boss (**https://www.betheboss.com**). Prepare a chart comparing your selections, including history, number and location of units, financial requirements (initial franchise fee, other start-up costs, royalty and advertising fees), and any other information that would help you evaluate the franchises.
5. *Inc.* magazine (**https://www.inc.com**) has many franchising articles in its section on Startup. It offers insights into how franchisors and franchisees can better manage their businesses. Using the site's resources, discuss ways the owner of a franchise can motivate employees. What specific revenue items and expenses should you monitor daily in a franchise restaurant business to ensure that you are profitable?

Critical Thinking Case

I'm an Owner of a Professional Sports Team!

Many of the richest individuals have added professional sports teams to their ownership portfolios. Paul Allen bought the Seattle Seahawks after founding Microsoft. Upon his death, the franchise passed to the Paul Allen Estate. Another Microsoft alumnus, Steve Balmer, now owns the Los Angeles Clippers. They, like most other owners of sports teams, including Shahid Khan (Jacksonville Jaguars), Jerry Jones (Dallas Cowboys), the Rickets family (Chicago Cubs of Major League Baseball), and Geoff Molson (Montreal Canadiens of the National Hockey League), all have corporate structures that operate as for-profit organizations. There is one exception to the corporate structure, however.

The Green Bay Packers are unique among North American sports teams in that they are a community-owned not-for-profit. They do have shareholders, but the shareholders have limited rights and most shares are bought so that fans can claim ownership and use the stock certificate as a piece of pride of ownership in a unique community treasure. The shares do not pay dividends, and any proceeds from any possible sale or liquidation of the team go to a charity, not the shareholders. This system, plus transfer restrictions and a cap on the number of shares that any single individual can own, ensures that the team remains in public hands and will never leave the city of Green Bay.

Every shareholder in the Green Bay Packers received a ballot for electing the team's board of directors, who then select an executive committee of seven individuals who will meet with chief executive officer Ed Policy. Policy is charged with hiring other leadership positions, such as the general manager, who then hires the head coach, who is charged with hiring the assistant coaches.

So, what are the negatives to what seems like a perfect organizational structure? Many owners in other cities are able to price their tickets to the market and also able to create revenue streams from corporate advertising in the stadium as well as stadium-naming rights. The Packers have some of the lowest-priced tickets in the league despite 140,000 requests on their season ticket waiting list. Also, teams in other cities can negotiate with city, county, and other government agencies for subsidies and tax breaks for building new stadiums and use the threat of a move to another city as a bargaining chip. For instance, the St. Louis Rams and San Diego Chargers recently moved to Los Angeles while the Oakland Raiders now call Las Vegas home.

Another potential drawback is that the organizational structure of the Packers restricts the ability to make organizational changes such as changing the general manager or head coach quickly if things are going badly. Luckily for the Packers, this has not been much of a problem over the decades having had success with star quarterbacks such as Aaron Rodgers.

Critical Thinking Questions

1. Is the not-for-profit form of business organization appropriate for the Green Bay Packers? Why or why not?
2. Why has this form of ownership not been replicated in other cities?
3. What are the limitations and constraints that this form of business has on the operations of the Green Bay Packers?

Sources: "Ted Thompson Has No Obligation to Communicate," *Total Packers*, https://www.totalpackers.com, August 8, 2017; Green Bay Packers website, "Packers Hall of Fame to Host Shareholders: A Story of Resilience, Community and Pride," https://www.packers.com, June 23, 2017; Mike Florio, "Packers Ownership Structure Works Well, Until It Doesn't," *NBC Sports*, https://profootballtalk.nbcsports.com, November 26, 2016; "Green Bay Packers Shareholder on What It's Like to Own an NFL Team," *Sporting News,* https://www.sportingnews.com, September 30, 2014; Ken Reed, "Green Bay Packers' Ownership Structure Remains Ideal," *League of Fans*, https://www.leagueoffans, April 6, 2012; Karl Taro Greenfeld, "The Green Bay Packers Have the Best Owners in Sports," *Bloomberg Businessweek,* https://www.bloomberg.com, October 20, 2011.

Hot Links Address Book

1. Which Fortune 500 company had the biggest revenue increase? The highest profits? The highest return to investors? What is the largest entertainment company? Get all the details on U.S. companies at **https://www.fortune.com/fortune500**.
2. Confused about the differences between regular corporations, S corporations, and LLCs? Compare these three business structures at **https://www.sba.gov/business-guide/launch-your-business/choose-business-structure**.
3. Did you know there are 65,000 co-op establishments in the U.S., and 1 in 3 Americans are members? For more co-op statistics, check the National Cooperative Business Association website at **https://www.ncba.coop/**.
4. Combine your sweet tooth with your good business sense by owning a candy franchise. Indulge yourself by finding out the requirements for owning a Rocky Mountain Chocolate Factory franchise at **https://www.rmcf.com**.
5. Want to know what's hot and what's not in franchising? Improve your chances for success at **https://www.entrepreneur.com/franchises**.

5

Entrepreneurship: Starting and Managing Your Own Business

Exhibit 5.1 (Credit: Christian Heilmann / flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. Why do people become entrepreneurs, and what are the different types of entrepreneurs?
2. What characteristics do successful entrepreneurs share?
3. How do small businesses contribute to the U.S. economy?
4. What are the first steps to take if you are starting your own business?
5. Why does managing a small business present special challenges for the owner?
6. What are the advantages and disadvantages facing owners of small businesses?
7. How does the Small Business Administration help small businesses?
8. What trends are shaping entrepreneurship and small-business ownership?

EXPLORING BUSINESS CAREERS

Natalie Tessler, Spa Space

Natalie Tessler has always had an entrepreneurial spirit. After she graduated from New York University's law school, she began working as a tax attorney for a large firm in Chicago. But Tessler soon realized that this left her feeling unfulfilled. She didn't want to practice law, and she didn't want to work for someone else. "I wanted to wake up and be excited for my day," Tessler said. Not until one night, though, when she was having dinner with a friend who recently had begun a writing career, did she realize it was time. "I was listening to her talk about how much she loved her job. Her passion and excitement—I wanted that. I wanted something that grabbed me and propelled me through the day—and being a lawyer wasn't it."

She began searching for what "it" was. She had a tremendous passion and talent for hospitality, entertaining others, and presentation. Seeking an outlet for that flair, she found the spa industry, and the idea for Spa Space was born.

"People think that, owning a spa, I'm able to live this glamorous lifestyle," she laughs. "Owning a spa is nothing like going to one—my nails always are broken from fixing equipment; my back is usually in pain from sitting hunched over a computer trying to figure out the budget or our next marketing promotion." Tessler is a true entrepreneur, embodying the spirit and drive necessary to see her vision become a reality.

Tessler wanted to design a spa that focused on something new: creating a comfortable, personalized environment of indulgence while not neglecting the medical technology of proper skin care. "My father's a dermatologist, so we discussed the importance of making this more than a spa where you can get a frou-frou, smell-good treatment that might actually harm your skin. We both thought it was important to create an experience that is as beneficial for people's skin as it is for their emotional well-being." To address this need, Spa Space has a medical advisory board that helps with product selection, treatment design, and staff training.

Armed with a vision and a plan, Tessler turned her sights toward making it a reality. Spa Space opened in 2001 and has received a great deal of national recognition for its service excellence, unique treatments and products, and its fresh approach to appealing to all genders. But it hasn't always been smooth sailing for Spa Space. Tessler had to steer the business through several obstacles, including the 9/11 tragedy just three months after the spa's grand opening, and then the Great Recession. Tessler learned to adapt her strategy by refining her target market and the services Spa Space offered. Her resiliency enabled the company to not only survive difficult economic periods, but to thrive and grow into what has been recognized as Chicago's best spa.

Tessler eventually turned the reins over to Ilana Alberico, another entrepreneur and founder of Innovative Spa Management, a company that was twice named on *Inc.* magazine's list of fastest growing companies. When Alberico met Natalie Tessler and learned about her vision, she was inspired to invest in Spa Space. "Natalie's vision still resonates . . . I'm inspired to champion her vision into the future." Today, the companies operate under Arch Amenities Group.

Sources: "Our Team," https://spaspace.com, accessed February 26, 2026; Jennifer Keishin Armstrong, "Spa Reviews: Spa Space in Chicago," *Day Spa* magazine, https://www.dayspamagazine.com, accessed February 1, 2018; "About Us," https://ismspa.com, accessed February 1, 2018; Arch Amenities Group, "Arch Amenities Group Acquires Innovative Spa Management, Privai and Spa Space," *PR Newswire*, https://www.prnewswire.com, September 12, 2022.

Typical of many who catch the entrepreneurial bug, Natalie Tessler had a vision and pursued it single-mindedly. She is just one of thousands of entrepreneurs from all age groups and backgrounds. Even kids are starting businesses and high-tech firms. College graduates are shunning the corporate world to head out on their own. Downsized employees, midcareer executives, and retirees who have worked for others all their lives are forming the companies they have always wanted to own.

Companies started by entrepreneurs and small-business owners make significant contributions to the U.S. and global economies. Hotbeds of innovation, these small businesses take leadership roles in technological change and the development of new goods and services. Just how important are small businesses to our economy? **Table 5.1** provides insight into the role of small business in today's economy.

You may be one of the millions of people who are considering joining the ranks of business owners. As you read this chapter, you'll learn why entrepreneurship continues to be a popular area of business activity. Then you'll get the information and tools you need to help you decide whether owning your own company is the right career path for you. Next you'll discover what characteristics you'll need to become a successful entrepreneur. Then we'll look at the importance of small businesses in the economy, guidelines for starting and managing a small business, the many reasons small businesses continue to thrive in the United States, and the role of the Small Business Administration. Finally, the chapter explores the trends that shape

entrepreneurship and small-business ownership today.

5.1 Entrepreneurship Today

1. Why do people become entrepreneurs, and what are the different types of entrepreneurs?

Brothers Fernando and Santiago Aguerre exhibited entrepreneurial tendencies at an early age. At 8 and 9 years old respectively, they sold strawberries and radishes from a vacant lot near their parents' home in Plata del Mar on the Atlantic coast of Argentina. At 11 and 12, they provided a surfboard repair service from their garage. As teenagers, Fer and Santi, as they call each other, opened Argentina's first surf shop, which led to their most ambitious entrepreneurial venture of all.

The flat-footed brothers found that traipsing across hot sand in flip-flops was uncomfortable, so in 1984 they sank their $4,000 savings into manufacturing their own line of beach sandals. Now offering sandals and footwear for adults and children, as well as clothing for men, Reef sandals remain a popular beach footwear, with a presence in nearly every surf shop in the United States.[1]

The Economic Impact of Small Business
• There are over 36 million small businesses in the United States. • Over 470,000 new businesses are formed each month. • California, Texas, and Florida have with the highest number of small businesses. • Over 99 percent of all businesses in the United States are small businesses. • Small businesses contribute over 43 percent of the U.S. GDP. • Small businesses account for nearly 50 percent of private sector employment. • Small businesses create 9 out of every 10 jobs, representing 88.9 percent of net job creation. • Small businesses account for 33 percent of total exports. • About 40 percent of small businesses carry debt over $100,000. • Nearly 30 million sole proprietorships exist in the United States. • There are over 1 million woman-owned businesses in the United States.

Table 5.1 Sources: U.S. Small Business Administration, "New Advocacy Report Shows the Number of Small Businesses in the U.S. Exceeds 36 Million," https://advocacy.sba.gov, June 30, 2025; Dean Kaplan, "54 Small Business Statistics for 2025," *The Kaplan Group*, https://www.kaplancollectionagency.com, September 5, 2025; "The Impact of Small Businesses on the United States Economy," https://nationalbusiness.org, accessed March 2, 2025.

CATCHING THE ENTREPRENEURIAL SPIRIT

Young Entrepreneur Living the Dream

Jack Bonneau is the quintessential entrepreneur. In his first three years in business, he expanded his product line, opened multiple locations, established strategic partnerships, and secured sponsorship from several national brands. His business has garnered publicity from *The New York Times, The Denver Post, The Today Show*, *Good Morning America*, and numerous other media. He has shared his business success on several stages, speaking at TechStars and the Aspen Ideas Festival, and delivering the closing keynote speech at a national STEM conference. He even landed a gig on *Shark Tank*. And he achieved all of this by age 11.

Jack Bonneau is smart, charismatic, an excellent spokesperson, and persistent in his mission. And today he is under 20 years old—which makes his accomplishments even that much more impressive given his age.

Jack's business was born from a need that most kids have: a desire for toys. He asked his dad, Steve Bonneau, for a LEGO Star Wars Death Star. The problem was that it cost $400. Jack's dad said he could have it but only if he paid for it himself. This led Jack to do what a lot of kids do to earn some extra cash. He opened a lemonade stand. But he quickly learned that this would never help him realize his dream, so, with the advice and help of his father, he decided to open a lemonade stand at a local farmers market. "There were lots of people who wanted to buy great lemonade from an eight-year-old," says Jack. In no time, Jack had earned enough to buy his LEGO Death Star. "I had sales of around $2,000, and my total profit was $900," Jack said.

Jack realized that he was on to something. Adults love to buy things from cute kids. What if he could make even more money by opening more locations? Jack developed an expansion plan to open three new "Jack Stands" the following spring. Realizing that he would need more working capital, he secured a $5,000 loan from Young Americas Bank, a bank in Denver that specializes in loans to children. Jack made $25,000 in 2015.

The following year, Jack wanted to expand operations, so he secured a second loan for $12,000. He opened stands in several more locations, including shopping malls during the holiday season, selling apple cider and hot chocolate instead of lemonade. He also added additional shop space and recruited other young entrepreneurial kids to sell their products in his space, changing the name to Jack's Stands and Marketplace. One of his first partnerships was Sweet Bee Sisters, a lip balm and lotion company founded by Lily, Chloe, and Sophie Warren. He also worked with 18 other young entrepreneurs selling a range of products from organic dog treats to scarves and headbands.

Jack's strategy worked, and the business brought in more than $100,000 in 2017. In 2018, he became the spokesperson for Santa Cruz Organic Lemonade and began looking at expanding into other cities such as Detroit and New Orleans. In 2023, Jack's continued accomplishments were honored when he was named one of 25 Prudential Emerging Visionaries for that year, owing to his ongoing support of teen entrepreneurship, including his ventures through his TeenHustl company. That same year, he began his college education.

Even though Jack is a young adult, he has already become skilled in financial literacy, customer service, marketing and sales, social skills, and other sound business practices—all the qualities of a successful entrepreneur.

Critical Thinking Questions

1. What do you think enabled Jack Bonneau to start and grow a successful business at such a young age?
2. What personal characteristics and values has Jack needed to continue running his business while also attending school full-time?

Sources: "About Jack's Stands & Marketplaces," https://www.jackstands.com, accessed February 26, 2026; Peter Gasca, "This 11-Year-Old Founder's Advice Is As Profound as Any You Could Receive," *Inc.,* https://www.inc.com, July 27, 2017; Claire Martin, "Some Kids Sell Lemonade. He Starts a Chain," *The New York Times,* https://www.nytimes.com, February 26, 2016; "About," https://www.teenhustl.com, accessed March 2, 2025; Chris Sands, "Jack's Stands: Here's What Happened After Shark Tank," *Food Republic*, https://www.foodrepublic.com, August 1, 2023.

Christy Glass Lowe, who monitors surf apparel for USBX Advisory Services LLC, notes, "They [Reef] built a brand from nothing and now they're the dominant market share leader."

The Aguerres, who currently live two blocks from each other in La Jolla, California, sold Reef to VF Corporation for more than $100 million in 2005. In selling Reef, "We've finally found our freedom," Fernando says. "We traded money for time," adds Santiago. Fernando remains active with surfing organizations, serving as

president of the International Surfing Association, where he became known as “Ambassador of the Wave” for his efforts in getting all 90 worldwide members of the International Olympic Committee to unanimously vote in favor of including surfing in the 2020 Olympic Games.[2] He has also been named “Waterman of the Year” by the Surf Industry Manufacturers Association.[3] Santi was heavily involved in expanding and raising funds for SurfAid, but retired from serving on the board over a decade ago. Both siblings are enjoying contributing to an industry that has served them so well.

The United States is blessed with a wealth of entrepreneurs such as the Aguerres who want to start a **small business**. According to research by the Small Business Administration, two-thirds of college students intend to be entrepreneurs at some point in their careers, aspiring to become the next Bill Gates or Roxanne Quimby, founder of Burt's Bees. But before you put out any money or expend energy and time, you’d be wise to check out **Table 5.2** for some preliminary advice.

The desire to be one’s own boss cuts across all age, gender, and ethnic lines. Data of new business startups and ownership show that minority groups and women are becoming business owners at a much higher rate than the national average. **Table 5.3** illustrates these minority-owned business demographics.

Why has entrepreneurship remained such a strong part of the foundation of the U.S. business system for so many years? Because today’s global economy rewards innovative, flexible companies that can respond quickly to changes in the business environment. Such companies are started by **entrepreneurs**, people with vision,

drive, and creativity, who are willing to take the risk of starting and managing a business to make a profit.

Are You Ready to Be an Entrepreneur?
Here are some questions would-be entrepreneurs should ask themselves: 1. What is new and novel about your idea? Are you solving a problem or unmet need? 2. Are there similar products/services out there? If so, what makes yours better? 3. Who is your target market? How many people would use your product or service? 4. Have you talked with potential customers to get their feedback? Would they buy your product/service? 5. What about production costs? How much do you think the market will pay? 6. How defensible is the concept? Is there good intellectual property? 7. Is this innovation strategic to my business? 8. Is there a clear marketing message to communicate? 9. How might this product evolve over time? Would it be possible to expand it into a product line? Can it be updated/enhanced in future versions? 10. Where would someone buy this product/service? 11. How will the product/service be marketed? What are the costs to sell and market it? 12. What are the challenges involved in developing this product/service?

Table 5.2 Sources: Jess Ekstrom, "5 Questions to Ask Yourself Before You Start a Business," *Entrepreneur,* https://www.entrepreneur.com, accessed February 1, 2018; "Resources," https://www.marketsmarter.com, accessed February 1, 2018; Monique Reece, *Real-Time Marketing for Business Growth: How to Use Social Media, Measure Marketing, and Create a Culture of Execution* (Upper Saddle River, NJ: FT Press/Pearson, 2010); Mike Collins, "Before You Start–Innovator's Inventory," *The Wall Street Journal,* May 9, 2005, p. R4.

Statistics for Minority-Owned Businesses
• Over 1 million firms are minority owned, with over 650,000 Asian American owned and over 450,000 Hispanic owned. • There are nearly 200,000 African American owned U.S. businesses. • About 22 percent of all companies with employees are owned by women. • Approximately 7 percent of all businesses in the U.S. are Hispanic-owned.

Table 5.3 Sources: Rachel Arledge, "A Profile of the Nation's Hispanic-Owned Businesses," U.S. Census Bureau, https://www.census.gov, October 10, 2024; Rebecca Leppert, "A Look at Black-Owned Businesses in the U.S.," *Pew Research Center*, https://www.pewresearch.org, February 12, 2025; U.S. Census Bureau, "Census Bureau Releases New Data on Minority-Owned, Veteran-Owned and Women-Owned Businesses," https://www.census.gov, December 19, 2024.

Entrepreneur or Small-Business Owner?

The term *entrepreneur* is often used in a broad sense to include most small-business owners. The two groups share some of the same characteristics, and we'll see that some of the reasons for becoming an entrepreneur or a small-business owner are very similar. But there is a difference between entrepreneurship and small-business management. Entrepreneurship involves taking a risk, either to create a new business or to greatly change the scope and direction of an existing one. Entrepreneurs typically are innovators who start companies to pursue their ideas for a new product or service. They are visionaries who spot opportunities.

Although entrepreneurs may be small-business owners, not all small-business owners are entrepreneurs. Small-business owners are managers or people with technical expertise who started a business or bought an existing business and made a conscious decision to stay small. For example, the proprietor of your local market is a small-business owner. Allison Ellsworth, co-founder of Poppi, also sells items found in this market

and other food-related retailers. But Ellsworth is an entrepreneur. She developed a new soda brand that has taken off and has found its place on the shelves of many major retailers. Entrepreneurs are less likely to accept the status quo, and they generally take a longer-term view than the small-business owner.

Types of Entrepreneurs

Entrepreneurs fall into several categories: classic entrepreneurs, multipreneurs, and intrapreneurs.

Classic Entrepreneurs

Classic entrepreneurs are risk-takers who start their own companies based on innovative ideas. Some classic entrepreneurs are *micropreneurs* who start small and plan to stay small. They often start businesses just for personal satisfaction and the lifestyle. Miho Inagi is a good example of a micropreneur. On a visit to New York with college friends in 1998, Inagi fell in love with the city's bagels. "I just didn't think anything like a bagel could taste so good," she said. Her passion for bagels led the young office assistant to quit her job and pursue her dream of one day opening her own bagel shop in Tokyo. Although her parents tried to talk her out of it, and bagels were virtually unknown in Japan, nothing deterred her. Other trips to New York followed, including an unpaid six-month apprenticeship at Ess-a-Bagel, where Inagi took orders, cleared trays, and swept floors. On weekends, founder and former owner Florence Wilpon let her make dough.

In August 2004, using $20,000 of her own savings and a $30,000 loan from her parents, Inagi finally opened tiny Maruichi Bagel. The timing was fortuitous, as Japan was about to experience a bagel boom. After a slow start, a favorable review on a local bagel website brought customers flocking for what are considered the best bagels in Tokyo. Initially, Inagi earned about the same amount she was making as a company employee. "Before I opened this store I had no goals," she says, "but now I feel so satisfied."[4]

In contrast, *growth-oriented entrepreneurs* want their business to grow into a major corporation. Most high-tech companies are formed by growth-oriented entrepreneurs. Allison Ellsworth, after experiencing multiple health issues, found a solution that worked for her: apple cider vinegar. In her kitchen, she combined the ingredient with various flavors in an attempt to make it more palatable. This provided the launching point for Poppi. After gaining support with a SharkTank deal, Ellsworth's vision of creating a healthier alternative to traditional sodas came to life. Now part of PepsiCo, Poppi can be found in retailers nationwide. Ellsworth stated, "Pepsi gives us reach. We're in fifty thousand stores, and they can put us in three hundred and fifty thousand stores."[5]

Multipreneurs

Then there are *multipreneurs,* entrepreneurs who start a series of companies. They thrive on the challenge of building a business and watching it grow. In fact, over half of the chief executives at *Inc.* 500 companies say they would start another company if they sold their current one. Brothers Jeff and Rich Sloan are a good example of multipreneurs, having turned numerous improbable ideas into successful companies. Over the past 20-plus years, they have renovated houses, owned a horse breeding and marketing business, invented a device to prevent car batteries from dying, and so on. The brothers launched StartupNation, a multimedia company that helps individuals realize their entrepreneurial dreams. Rich continues these efforts in his role as Entrepreneur in Residence at UNLV by helping university faculty commercialize their research. Jeff has since launched SportsCaster.com, which is a platform for fans to create and share sports-related content through broadcasts, podcasts, and video. The brothers continue to look for new opportunities to continue their entrepreneurial legacy.[6]

Exhibit 5.2 You have likely encountered Canva if not become a regular user of the program. Melanie Perkins co-founded Canva having little knowledge of technology. She set out to create a platform that students could use to design their own school yearbooks. After hundreds of investor rejections, her perseverance resulted in a company with billions in revenue that has become a leading tech firm in the industry. *What entrepreneurial type best describes Melanie Perkins?* (Credit: Eóin Noonan, Web Summit via Sportsfile/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Intrapreneurs

Some entrepreneurs don't own their own companies but apply their creativity, vision, and risk-taking within a large corporation. Called **intrapreneurs**, these employees enjoy the freedom to nurture their ideas and develop new products, while their employers provide regular salaries and financial backing. Intrapreneurs have a high degree of autonomy to run their own minicompanies within the larger enterprise. They share many of the same personality traits as classic entrepreneurs, but they take less personal risk. According to Gifford Pinchot, who coined the term *intrapreneur* in his book of the same name, large companies provide seed funds that finance in-house entrepreneurial efforts. These include Intel, IBM, Texas Instruments (a pioneering intrapreneurial company), Salesforce.com, 3M, and Procter & Gamble.

Why Become an Entrepreneur?

As the examples in this chapter show, entrepreneurs are found in all industries and have different motives for starting companies. The most common reasons cited by entrepreneurs as reported by Shopify is turning a passion into a financial gain, followed by the desire to control their own destiny when it comes to job security. Two important motives mentioned in other surveys are a feeling of personal satisfaction with their work, and creating the lifestyle that they want. Do entrepreneurs feel that going into business for themselves was worth it? The answer is a resounding yes. Most say they would do it again.

CONCEPT CHECK

1. Describe several types of entrepreneurs.
2. What differentiates an entrepreneur from a small-business owner?
3. What are some major factors that motivate entrepreneurs to start businesses?

5.2 Characteristics of Successful Entrepreneurs

2. What characteristics do successful entrepreneurs share?

Do you have what it takes to become an entrepreneur? Having a great concept is not enough. An entrepreneur must be able to develop and manage the company that implements their idea. Being an entrepreneur requires special drive, perseverance, passion, and a spirit of adventure, in addition to managerial and technical ability.

Entrepreneurs *are* the company; they tend to work longer hours, take fewer vacations, and cannot leave problems at the office at the end of the day. They also share other common characteristics as will be discussed.

The Entrepreneurial Personality

Studies of the entrepreneurial personality find that entrepreneurs share certain key traits. Most entrepreneurs are

- *Ambitious:* They are competitive and have a high need for achievement.
- *Independent:* They are individualists and self-starters who prefer to lead rather than follow.
- *Self-confident:* They understand the challenges of starting and operating a business and are decisive and confident in their ability to solve problems.
- *Risk-takers:* Although they are not averse to risk, most successful entrepreneurs favor business opportunities that carry a moderate degree of risk where they can better control the outcome over highly risky ventures where luck plays a large role.
- *Visionary:* Their ability to spot trends and act on them sets entrepreneurs apart from small-business owners and managers.
- *Creative:* To compete with larger firms, entrepreneurs need to have creative product designs, bold marketing strategies, and innovative solutions to managerial problems.
- *Energetic:* Starting and operating a business takes long hours. Even so, some entrepreneurs start their companies while still employed full-time elsewhere.
- *Passionate.* Entrepreneurs love their work, as Miho Inagi demonstrated by opening a bagel shop in Tokyo despite the odds against it being a success.
- *Committed.* Because they are so committed to their companies, entrepreneurs are willing to make personal sacrifices to achieve their goals.

CUSTOMER SATISFACTION AND QUALITY

Ethical Choices Transform Family Business into International Brand

Ever since Apollonia Poilâne was a young child growing up in Paris, she always knew what she wanted to do when she grew up: take over the family business. But she didn't anticipate how quickly this would happen. When her father—Lionel Poilâne—and her mother died in a helicopter crash in 2002, France lost its most celebrated baker, and Apollonia stepped into the role. She was just 18 years old at the time with plans to matriculate to Harvard in the fall, but the moment her parents had prepared her for had come. As her Harvard admissions essay said, "The work of several generations is at stake."

With organization and determination, Apollonia managed one of the best French bakeries in the world—based in Paris—from her apartment in Cambridge, Massachusetts. She would usually wake up an extra two hours before classes to make sure she would get all the phone calls done for work. When asked how she managed all of this, she explained, "After classes I check on any business regarding the company and then do my homework, and before I go to bed I call my production manager in Paris to check the quality of the bread." Because the name Poilâne has earned a place with a very small group of prestige bakers, the 18-year-old was determined to continue the tradition of customer satisfaction and quality her grandfather established in 1932. When her grandfather suffered a stroke in 1973, his 28-year-old son, Lionel, poured his heart into the business and made the family bread into the global brand it is today. Lionel opened two more bakeries in Paris and another in London. He developed and nurtured a worldwide network of retailers and celebrities where bread is shipped daily to upscale restaurants and wealthy clients around the world.

Experimenting with sourdough is what distinguished Poilâne's products from bread produced by Paris's

other bakers, and it has remained the company's signature product. It is baked with a "P" carved into the crust, a throwback to the days when the use of communal ovens forced bakers to identify their loaves, and it also ensures that the loaf doesn't burst while it's baking. Today, Poilâne also sells croissants, pastries, and a few specialty breads, but the company's signature item is still the four-pound *miche*, a wheel of sourdough, a country bread, *pain Poilâne*.

Apollonia's passion is evident. She believes in the work her father started and is committed to continuing this legacy by leading the company into the future.

Apollonia's work ethic and passion fueled her drive even when she was a student. Each day presented a juggling act of new problems to solve in Paris while other Harvard students slept. As Apollonia told a student reporter from *The Harvard Crimson* writing a story about her, "The one or two hours you spend procrastinating I spend working. It's nothing demanding at all. It was always my dream to run the company."

Her dedication paid off, and Apollonia retained control of important decisions, strategy, and business goals, describing herself as the "commander of the ship," determining the company's overall direction. Today, Poilâne is a $12 million business employing approximately 140 people. The company operates five retail bakeries in Paris and one in London, along with a robust wholesale business. They ship internationally to clients throughout Europe, North America, and Asia, including the United States, Japan, Hong Kong, and Singapore.

Critical Thinking Questions

1. What type of entrepreneur is Apollonia Poilâne?
2. What personal ethics drove Apollonia's decision to take over the family business?

Sources: "About Us," https://www.poilane.com, accessed February 1, 2018; Meg Bortin, "Apollonia Poilâne Builds on Her Family's Legacy," *The New York Times,* https://www.nytimes.com, accessed February 1, 2018; Lauren Collins, "Bread Winner: A Daughter Upholds the Traditions of France's Premier Baking Dynasty," *The New Yorker,* https://www.newyorker.com, December 3, 2012; Gregory Katz, "Her Daily Bread," *American Way* magazine, July 15, 2005, p. 34; Clarel Antoine, "No Time to Loaf Around," *Harvard Crimson,* https://www.thecrimson.com, October 16, 2003; Jackie Cooperman, "Apollonia Poilâne on Taking Over Her Family's Storied Business as a Teenager," *Worth*, https://worth.com, November 14, 2019; "Apollonia Poilâne," https://www.barclayagency.com, accessed March 2, 2025; "Poilâne," https://www.poilane.com/en, accessed March 2, 2025; Nell Porter-Brown, "Her Bread and Butter," *Harvard Magazine*, https://www.harvardmagazine.com, October 11, 2023.

Most entrepreneurs combine many of the above characteristics. Marah Lidey and Naomi Hirabayashi identified a need to make mental health wellness more accessible to younger individuals. They envisioned an online platform that would incorporate daily motivational quotes, meditations, and other support. This was contrary to traditional approaches to mental well-being. They were persistent, understood the market, and focused on ways to differentiate their approach to reach a new audience. In another example, Sara Blakely launched Spanx when a personal style dilemma prompted the need for a solution. Sara felt that if she had a need for smoothing undergarments, there were others with the same need. "It's really important to be resourceful and scrappy—a glass half-full mindset," she has said. Blakely embodies many of the characteristics discussed and has turned Spanx into a household name.[7]

Exhibit 5.3 Katie Witkin utilized her experience working in corporate marketing and combined it with the visionary insight of where the industry was going—social media—to create her own company, AGW Group. The company focuses on digital marketing management, sees revenues around $3 million, and has clients ranging from HBO to Red Bull. *What personality traits are common to successful young entrepreneurs such as Witkin?* (Credit: photo provided by AGW Group)

Managerial Ability and Technical Knowledge

A person with all the characteristics of an entrepreneur might still lack the necessary business skills to run a successful company. Entrepreneurs need the technical knowledge to carry out their ideas and the managerial ability to organize a company, develop operating strategies, obtain financing, and supervise day-to-day activities. Jim Crane, who built Eagle Global Logistics from a start-up into a $250 million company, addressed a group at a meeting saying, "I have never run a $250 million company before so you guys are going to have to start running this business."[8]

Good interpersonal and communication skills are important in dealing with employees, customers, and other business associates such as bankers, accountants, and attorneys. As we will discuss later in the chapter, entrepreneurs believe they can learn these much-needed skills. When Jim Steiner, now manager of Mountain Pacific Enterprises, started his toner cartridge remanufacturing business, Quality Imaging Products, his initial investment was $400. He spent $200 on a consultant to teach him the business and $200 on materials to rebuild his first printer cartridges. He made sales calls from 8.00 a.m. to noon and made deliveries to customers from noon until 5:00 p.m. After a quick dinner, he moved to the garage, where he filled copier cartridges until midnight, when he collapsed into bed, sometimes covered with carbon soot. And this was not something he did for a couple of months until he got the business off the ground—this was his life for 18 months.[9] But entrepreneurs usually soon learn that they can't do it all themselves. Often they choose to focus on what they do best and hire others to do the rest.

CONCEPT CHECK

1. Describe the personality traits and skills characteristic of successful entrepreneurs.
2. What does it mean when we say that an entrepreneur should work on the business, not in it?

5.3 Small Business: Driving America's Growth

3. How do small businesses contribute to the U.S. economy?

Although large corporations dominated the business scene for many decades, in recent years small businesses have once again come to the forefront. Downsizings that accompany economic downturns have caused many people to look toward smaller companies for employment, and they have plenty to choose from. Small businesses play an important role in the U.S. economy, representing over 40 percent of U.S. GDP and employing nearly 50 percent of the private sector workforce.

What Is a Small Business?

How many small businesses are there in the United States? Estimates range from 5 million to nearly 40 million, depending on the size limits government agencies and other groups use to define a small business or the number of businesses with or without employees. The Small Business Administration (SBA) established size standards to define whether a business entity is small and therefore eligible for government programs and preferences that are reserved for "small businesses." Size standards are based on the types of economic activity or industry, generally matched to the North American Industry Classification System (NAICS).[10]

Small businesses are defined in many ways. Statistics for small businesses vary based on criteria such as new/start-up businesses, the number of employees, total revenue, length of time in business, nonemployees, businesses with employees, geographic location, and so on. Due to the complexity and need for consistent statistics and reporting for small businesses, several organizations are now working together to combine comprehensive data sources to get a clear and accurate picture of small businesses in the United States. **Table 5.4** provides a more detailed look at small-business owners.

Snapshot of Small-Business Owners
• Business creation and ownership has been on the rise since 2014 and continues to grow at a faster pace than ever before. • Start-up activity has been on a steady rise since 2021, reaching over 20 percent in 2025. • Nearly half of business owners start their business to fill a gap or solve a problem rather than out of necessity. • There are nearly 40,000 small businesses that are making between $1 million and $2.5 million per year. • 20 percent of businesses do not make it through their first year, with only half making it to their fifth year of operation. • Only about one-third of businesses remain in business longer than a decade.

Table 5.4 Sources: Mehdi Punjwani and Sierra Campbell, "Small Business Statistics in 2024," *USA Today*, https://www.usatoday.com, October 16, 2024; The AFE Editorial Team, "Why Most Entrepreneurs Start Businesses," *Association for Entrepreneurship*, https://afeusa.org, November 18, 2024; Wendy Edelberg and Noadia Steinmetz-Silber, "The Changing Demographics of Business Ownership," *The Brookings Institute*, https://www.brookings.edu, April 23, 2024; "How Long Businesses Survive and Why They Fail," https://www.clearlypayments.com, accessed March 3, 2026; Ricardo, "33 Entrepreneurship Statistics in 2026: Global Trends, Challenges & Insights," *Hostinger*, https://www.hostinger.com, January 13, 2026.

One of the best sources to track U.S. entrepreneurial growth activity is the Ewing Marion Kauffman Foundation. The Kauffman Foundation is among the largest private foundations in the country, with an asset base of approximately $2 billion, and focuses on projects that encourage entrepreneurship and support education through grants and research activities. In 2025, they initiated a three-year distribution of over $30 million in grants.[11]

The Kauffman Foundation supports new business creation in the United States through two research programs. The annual Kauffman Indicators of Entrepreneurship measures and interprets indicators of U.S. entrepreneurial activity at the national, state, and metropolitan level.[12] The Kauffman Indicators of Entrepreneurship annual reporting measures how people and businesses contribute to America's overall economy. What is unique about the Kauffman reports is that the indexes don't focus on only inputs (as most small-business reporting has been done in the past); it reports primarily on entrepreneurial outputs—the

actual results of entrepreneurial activity, such as new companies, business density, and growth rates. The Kauffman Indicators of Entrepreneurship include comprehensive, interactive data visualizations that enable users to explore entrepreneurial trends nationally and at the state level.[13]

The Kauffman Indicators of Entrepreneurship consists of three separate indicator series: Early-Stage Entrepreneurship Indicators, New Employer Business Indicators, and Entrepreneurial Jobs Indicators.

- The Kauffman Early-Stage Entrepreneurship series focuses on new business creation activity and people engaging in business start-up activities using the following components: rate of new entrepreneurs, opportunity share of new entrepreneurs, start-up early job creation, and start-up early survival rate.
- The New Business Employer series compiles data about trends in new employer businesses and the impact on overall payroll in the United States. The components in the series include: rate of new employer business actualization, rate of new employer businesses, new employer business velocity, and employer business newness.
- The Kauffman Indicator Entrepreneurial Jobs series provides information about the types and quantities of private sector jobs with comparisons among industries and geographic regions. The components included are contribution, compensation, creation, and constancy.

Data sources for the Kauffman Indicators of Entrepreneurship calculations include the Current Population Survey (CPS), Bureau of Labor Statistics Business Employment Dynamics (BED), Business Formation Statistics (BFS), Business Dynamics Statistics (BDS), and Longitudinal Employer-Household Dynamics (LEHD).

Small businesses in the United States can be found in almost every industry, including services, retail, construction, wholesale, manufacturing, finance and insurance, agriculture and mining, transportation, and warehousing. Typically, small businesses are defined as companies that have fewer than 500 employees, but that can vary based on industry and specific standards established by the Office of Advocacy. **Table 5.5** provides the breakdown of small business by the number of employees.

Number of Employees, by Percentage of Established Small Businesses	
Number of Employees	**Percentage of Businesses**
1–4	78.43%
5–9	12.17%
10–19	5.09%
20–49	2.58%
50–99	0.96%
100–249	0.56%
250–499	0.002%

Table 5.5 Source: "Detailed Business Counts," https://www.naics.com/business-lists/counts-by-company-size/, accessed March 3, 2026.

CONCEPT CHECK

1. What are three ways small businesses can be defined?
2. What social and economic factors have prompted the rise in small business?

5.4 Ready, Set, Start Your Own Business

4. What are the first steps to take if you are starting your own business?

You have decided that you'd like to go into business for yourself. What is the best way to go about it? Start from scratch? Buy an existing business? Or buy a franchise? About 60 percent of businesses created are brand new organizations, with the remaining either buying an existing company or starting a franchise. Franchising may have been discussed elsewhere in your course, so we'll cover the other two options in this section.

Getting Started

The first step in starting your own business is a self-assessment to determine whether you have the personal traits you need to succeed and, if so, what type of business would be best for you. Table 5.6 provides a checklist to consider before starting your business.

Finding the Idea

Entrepreneurs get ideas for their businesses from many sources. It is not surprising that about 80 percent of *Inc.* 500 executives got the idea for their company while working in the same or a related industry. Starting a firm in a field where you have experience improves your chances of success. Other sources of inspiration are personal experiences as a consumer; hobbies and personal interests; suggestions from customers, family, and friends; industry conferences; and college courses or other education.

Business Launch Action Steps
Before you start your own small business: • Find the Idea: consider your personal skills, reasoning for starting the business, and your experience. • Conduct market research and determine the market niche your business will fill. • Choose a form of business organization. • Plan the start-up by writing a business plan. • Determine how to fund the business. • Prepare to launch.

Table 5.6 Source: Emily Heaslip, "Ready, Set, Startup Checklist: Steps to Starting a New Business," *CO—*, https://www.uschamber.com, May 22, 2025.

An excellent way to keep up with small-business trends is by staying on top of information from small business and entrepreneurship news sites and resources. With articles on everything from idea generation to selling a business, they provide an invaluable resource and profile some of the entrepreneurs and their successful business ventures (Table 5.7).[14]

Successful Entrepreneurs	
Name	**Company and Description**
Philip Kimmey	Kimmey's dog-sitting and dog-walking network, Rover.com, raised over $310 million in venture capital funding. The company went public via SPAC in 2021 and was acquired by Blackstone for $2.3 billion in February 2024.
Alexandra Cristin White	White founded Glam Seamless, which sells tape-in hair extensions. Starting with $1,500 in 2012, her self-funded company grossed $2.5 million by 2016. She sold the company to Beauty Industry Group in 2019 and exited as CEO in 2023. She now focuses on her size-inclusive activewear brand Tribe 35 and other ventures.
Allen Gannett	Gannett founded TrackMaven, a web-marketing analytics company, in 2012; by 2016, his company was grossing $6.7 million a year. In October 2018, TrackMaven merged with Skyword to form a leading content marketing platform. Gannett served as Chief Strategy Officer and is now an active angel investor and author of *The Creative Curve* (2018).
Jake Kassan and Kramer LaPlante	Kassan and Kramer launched their company, MVMT, through Indiegogo in 2013, raising $290,000. By 2016, they were grossing $60 million, selling primarily watches and sunglasses. In 2018, they sold the bootstrapped company to Movado Group for $100 million upfront (up to $200 million total). Jake Kassan is now an active angel investor.
Natalya Bailey and Louis Perna	Accion Systems began in 2014 and raised $10 million in early venture funding. By 2016, it grossed $4.5 million. The company went on to raise a total of $71.6 million, including a $42 million Series C in 2021 that valued the company at $83.5 million. Accion now operates as Revolution Space, continuing to develop advanced space propulsion systems.
Jessy Dover	Dover, along with cofounders Melissa Mash and Deepa Gandhi, founded Dagne Dover in 2013, making storage-efficient handbags for professional women. The company grossed $4.5 million in 2016 and debuted on Nordstrom.com in 2017. By 2024, the bootstrapped company reached a $100 million revenue run rate with nearly 10 percent EBITDA margins, and won Founder of the Year at the 2023 Modern Retail Awards.

Table 5.7

These dynamic individuals, who are already so successful in their 20s and 30s, came up with unique ideas and concepts and found the right niche for their businesses.

Interesting ideas are all around you. Many successful businesses get started because someone identifies a need and then finds a way to fill it. Do you have a problem that you need to solve? Or a product that doesn't work as well as you'd like? Raising questions about the way things are done and seeing opportunity in adversity are great ways to generate ideas.

Choosing a Form of Business Organization

A key decision for a person starting a new business is whether it will be a sole proprietorship, partnership, corporation, or limited liability company. As discussed earlier, each type of business organization has advantages and disadvantages. The choice depends on the type of business, number of employees, capital requirements, tax considerations, and level of risk involved.

Developing the Business Plan

Once you have the basic concept for a product or service, you must develop a plan to create the business. This planning process, culminating in a sound **business plan**, is one of the most important steps in starting a business. It can help to attract appropriate loan financing, minimize the risks involved, and be a critical determinant in whether a firm succeeds or fails. Many people do not venture out on their own because they are overwhelmed with doubts and concerns. A comprehensive business plan lets you run various "what if" analyses and evaluate your business without any financial outlay or risk. You can also develop strategies to overcome problems well before starting the business.

Taking the time to develop a good business plan pays off. A venture that seems sound at the idea stage may not look so good on paper. A well-prepared, comprehensive, written business plan forces entrepreneurs to take an objective and critical look at their business venture and analyze their concept carefully; make decisions about marketing, sales, operations, production, staffing, budgeting and financing; and set goals that will help them manage and monitor its growth and performance.

Exhibit 5.4 Each year, a variety of organizations hold business plan competitions to engage the growing number of college students starting their own businesses. The University of Essex and the iLearn entrepreneurship curriculum developed by the University of Texas in Austin, which partnered with Trisakti University in Jakarta, Indonesia, and the U.S. embassy to help run an entrepreneurship course and competition are examples of such competitions. Seven students from 2015's "iLearn: Entrepreneurship" were selected as finalists to pitch their business plans to a panel of Indonesian business leaders and embassy representatives. The winning business plan, which was an ecotourism concept, earned $1,000 in seed money. *What research goes into a winning business plan?* (Credit: University of Essex /flickr/ Attribution 2.0 Generic (CC BY 2.0))

The business plan also serves as the initial operating plan for the business. Writing a good business plan takes time. But many businesspeople neglect this critical planning tool in their eagerness to begin doing business, getting caught up in the day-to-day operations instead.

The key features of a business plan are a general description of the company, the qualifications of the owner(s), a description of the products or services, an analysis of the market (demand, customers, competition), sales and distribution channels, and a financial plan. The sections should work together to demonstrate why the business will be successful, while focusing on the uniqueness of the business and why it will attract customers. Table 5.8 describes the essential elements of a business plan.

A common use of a business plan is to persuade lenders and investors to finance the venture. The detailed information in the plan helps them assess whether to invest. Even though a business plan may take months to write, it must capture potential investors' interest within minutes. For that reason, the basic business plan should be written with a particular reader in mind. Then you can fine-tune and tailor it to fit the investment goals of the investor(s) you plan to approach.

Key Elements of a Business Plan
Executive summary provides an overview of the total business plan. Written after the other sections are completed, it highlights significant points and, ideally, creates enough excitement to motivate the reader to continue reading.
Vision and mission statement concisely describe the intended strategy and business philosophy for making the vision happen. Company values can also be included in this section.
Company overview explains the type of company, such as manufacturing, retail, or service; provides background information on the company if it already exists; and describes the proposed form of organization. This section should include company name and location, company objectives, nature and primary product or service of the business, current status (start-up, buyout, or expansion) and history (if applicable), and legal form of organization—sole proprietorship, partnership, or corporation.
Product and/or service plan describes the product and/or service and points out any unique features, as well as explains why people will buy the product or service. This section should offer the following descriptions: product and/or service; features and benefits of the product or service that provide a competitive advantage; available legal protection—patents, copyrights, and trademarks.
Marketing plan shows who the firm's customers will be and what type of competition it will face; outlines the marketing strategy and specifies the firm's competitive edge; and describes the strengths, weaknesses, opportunities, and threats of the business. This section should offer the following descriptions: analysis of target market and profile of target customer; methods of identifying, attracting, and retaining customers; a concise description of the value proposition; selling approach, type of sales force, and distribution channels; types of marketing and sales promotions, advertising, and projected marketing budget; product and/or service pricing strategy; and credit and pricing policies.
Management plan identifies the key players—active investors, management team, board members, and advisors—citing the experience and competence they possess. This section should offer the following descriptions: management team, outside investors and/or directors and their qualifications, outside resource people and their qualifications, and plans for recruiting and training employees.
Operating plan explains the type of manufacturing or operating system to be used and describes the facilities, labor, raw materials, and product-processing requirements. This section should offer the following descriptions: operating or manufacturing methods, operating facilities (location, space, and equipment), quality-control methods, procedures to control inventory and operations, sources of supply, and purchasing procedures.

Table 5.8 Sources: "7 Elements of a Business Plan," https://quickbooks.intuit.com, accessed February 2, 2018; David Ciccarelli, "Write a Winning Business Plan with These 8 Key Elements," *Entrepreneur,* https://www.entrepreneur.com, accessed February 2, 2018; Patrick Hull, "10 Essential Business Plan Components," *Forbes,* https://www.forbes.com, accessed February 2, 2018; Justin G. Longenecker, J. William Petty, Leslie E. Palich, and Frank Hoy, *Small Business Management: Launching & Growing Entrepreneurial Ventures,* 18th edition (Mason, OH: Cengage, 2017); Monique Reece, *Real-Time Marketing for Business Growth: How to Use Social Media, Measure Marketing, and Create a Culture of Execution* (Upper Saddle River, NJ: FT Press/Pearson, 2010).

Key Elements of a Business Plan
Financial plan specifies financial needs and contemplated sources of financing, as well as presents projections of revenues, costs, and profits. This section should offer the following descriptions: historical financial statements for the last 3–5 years or as available; projected financial statements for 3–5 years, including income statements, balance sheets, cash flow statements, and cash budgets (monthly for first year and quarterly for second year); financial assumptions; breakeven analysis of profits and cash flows; and planned sources of financing.
Appendix of supporting documents provides materials supplementary to the plan. This section should offer the following descriptions: management team biographies; the company's values; information about the company culture (if it's unique and contributes to employee retention); and any other important data that support the information in the business plan, such as detailed competitive analysis, customer testimonials, and research summaries.

Table 5.8 Sources: "7 Elements of a Business Plan," https://quickbooks.intuit.com, accessed February 2, 2018; David Ciccarelli, "Write a Winning Business Plan with These 8 Key Elements," *Entrepreneur,* https://www.entrepreneur.com, accessed February 2, 2018; Patrick Hull, "10 Essential Business Plan Components," *Forbes,* https://www.forbes.com, accessed February 2, 2018; Justin G. Longenecker, J. William Petty, Leslie E. Palich, and Frank Hoy, *Small Business Management: Launching & Growing Entrepreneurial Ventures,* 18th edition (Mason, OH: Cengage, 2017); Monique Reece, *Real-Time Marketing for Business Growth: How to Use Social Media, Measure Marketing, and Create a Culture of Execution* (Upper Saddle River, NJ: FT Press/Pearson, 2010).

But don't think you can set aside your business plan once you obtain financing and begin operating your company. Entrepreneurs who think their business plan is only for raising money make a big mistake. Business plans should be dynamic documents, reviewed and updated on a regular basis—monthly, quarterly, or annually, depending on how the business progresses and the particular industry changes.

Owners should adjust their sales and profit projections up or down as they analyze their markets and operating results. Reviewing your plan on a routine basis will help you identify strengths and weaknesses in your marketing and management strategies and help you evaluate possible opportunities for expansion in light of both your original mission and goals, current market trends, and business results. The Small Business Administration (SBA) offers sample business plans and online guidance for business plan preparation under the "Business Guide" tab at https://www.sba.gov.

Financing the Business

Once the business plan is complete, the next step is to obtain financing to set up your company. The funding required depends on the type of business and the entrepreneur's own investment. Businesses started by lifestyle entrepreneurs require less financing than growth-oriented businesses, and manufacturing and high-tech companies generally require a large initial investment.

Who provides start-up funding for small companies? Like Miho Inagi and her Tokyo bagel shop, nearly 80 percent of business owners raise start-up funds from personal savings. Personal assets and money from family and friends are important for new firms, whereas funding from financial institutions may become more important as companies grow. About one-third of companies are launched on less than $10,000.[15]

The two forms of business financing are **debt**, borrowed funds that must be repaid with interest over a stated time period, and **equity**, funds raised through the sale of stock (i.e., ownership) in the business. Those who provide equity funds get a share of the business's profits. Limits are placed by lenders on the amount that can be borrowed. As such, some entrepreneurs may choose to use equity financing to assist with their funding needs. For example, in exchange for giving you $5,000 toward start-up expenses, you could offer your family member a percentage of the profits earned at the end of the year. Corporations regularly use equity financing (selling shares of stock) to raise capital, but that is often after the business is established.

Exhibit 5.5 FUBU has generated over $6 billion in global retail sales to date. Daymond John (far right) became a main investor on ABC's hit show *Shark Tank* in 2009. As of 2017, he had invested over $8.5 million of his own money in Shark Tank companies. John's net worth was estimated at $350 million in 2025. FUBU is featured in the Smithsonian's National Museum of African American History and Culture, demonstrating its historical and cultural significance and impact. *How do start-ups obtain funding?* (Credit: U.S. Embassy Nairobi/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

One way to finance a start-up company is bootstrapping, which is basically funding the operation with your own resources. If the resources needed are not available to an individual, there are other options. Two sources of equity financing for young companies are angel investors and venture-capital firms. **Angel investors** are individual investors or groups of experienced investors who provide financing for start-up businesses by investing their own money, often referred to as “seed capital.” This gives the investors more flexibility on what they can and will invest in, but because it is their own money, angels are careful. Angel investors often invest early in a company’s development, and they want to see an idea they understand and can have confidence in.

Table 5.9 offers some guidelines on how to attract angel financing.

Presenting to Investors
You need financing for your start-up business. How do you get individuals interested in investing in your business venture? • Show them something they understand, ideally a business from an industry they've been associated with. • Know your business details: Information important to potential investors includes annual sales, gross profit, profit margin, and expenses. • Be able to describe your business—what it does and who it sells to—in less than a minute. Limit presentations to 10 slides. • Angels can always leave their money in the bank, so an investment must interest them. It should be something they're passionate about. And timing is important—knowing when to reach out to an angel can make a huge difference. • They need to see management they trust, respect, and like. Present a competent management team with a strong, experienced leader who can explain the business and answer questions from potential investors with specifics. • Angels prefer something they can bring added value to. Those who invest could be involved with your company for a long time or perhaps take a seat on your board of directors. • They are more partial to deals that don't require huge sums of money or additional infusions of angel cash. • Emphasize the likely exits for investors and know who the competition is, why your solution is better, and how you are going to gain market share with an infusion of cash.

Table 5.9 Sources: Guy Kawasaki, "The Art of Raising Angel Capital," https://guykawasaki.com, accessed February 2, 2018; Murray Newlands, "How to Raise an Angel Funding Round," *Forbes,* https://www.forbes.com, March 16, 2017; Melinda Emerson, "5 Tips for Attracting Angel Investors," *Small Business Trends,* https://smallbiztrends.com, July 26, 2016; Nicole Fallon, "5 Tips for Attracting Angel Investors," *Business News Daily,* https://www.businessnewsdaily.com, January 2, 2014; Stacy Zhao, "9 Tips for Winning over Angels," *Inc.,* https://www.inc.com, June 15, 2005; Rhonda Abrams, "What Does It Take to Impress an Angel Investor?" *Inc.,* https://www.inc.com, March 29, 2001.

Venture capital is financing obtained from *venture capitalists,* investment firms that specialize in financing small, high-growth companies. Venture capitalists receive an ownership interest and a voice in management in return for their money. They typically invest at a later stage than angel investors.

Buying a Small Business

Another route to small-business ownership is buying an existing business. Although this approach is less risky, many of the same steps for starting a business from scratch apply to buying an existing company. It still requires careful and thorough analysis. The potential buyer must answer several important questions: Why is the owner selling? Do they want to retire or move on to a new challenge, or are there problems with the business? Is the business operating at a profit? If not, can this be corrected? On what basis has the owner valued the company, and is it a fair price? What are the owner's plans after selling the company? Will they be available to provide assistance through the change of ownership of the business? And depending on the type of business it is, will customers be more loyal to the owner than to the product or service being offered? Customers could leave the firm if the current owner decides to open a similar business. To protect against this, many purchasers include a *noncompete clause* in the contract of sale, which generally means that the owner of the company being sold may not be allowed to compete in the same industry of the acquired business for a specific amount of time.

You should prepare a business plan that thoroughly analyzes all aspects of the business. Get answers to all

your questions, and determine, via the business plan, whether the business is a sound one. Then you must negotiate the price and other terms of purchase and obtain appropriate financing. This can be a complicated process and may require the use of a consultant or business broker.

Risky Business

Running your own business may not be as easy as it sounds. Despite the many advantages of being your own boss, the risks are great as well. Over a period of five years, 50 percent of small businesses fail according to the Bureau of Labor Statistics.[16]

Businesses close down for many reasons—and not all are failures. Some businesses that close are financially successful and close for nonfinancial reasons. But the causes of business failure can be interrelated. For example, low sales and high expenses are often directly related to poor management. Some common causes of business closure are:

- Economic factors—business downturns and high interest rates
- Financial causes—inadequate capital, low cash balances, and high expenses
- Lack of experience—inadequate business knowledge, management experience, and technical expertise
- Personal reasons—the owners may decide to sell the business or move on to other opportunities

Inadequate early planning is often at the core of later business problems. A thorough feasibility analysis, from market assessment to financing, is critical to business success. Yet even with the best plans, business conditions change and unexpected challenges arise. An entrepreneur may start a company based on a terrific new product only to find that a larger firm with more marketing, financing, and distribution clout introduces a similar item.

The stress of managing a business can also take its toll. The business can consume your whole life. Owners may find themselves in over their heads and unable to cope with the pressures of business operations, from the long hours to being the main decision-maker. Even successful businesses have to deal with ongoing challenges. Growing too quickly can cause as many problems as sluggish sales. Growth can strain a company's finances when additional capital is required to fund expanding operations, from hiring additional staff to purchasing more raw material or equipment. Successful business owners must respond quickly and develop plans to manage its growth.

So, how do you know when it is time to quit? "Never give up" may be a good motivational catchphrase, but it is not always good advice for a small-business owner. Yet, some small-business owners keep going no matter what the cost. For example, Ian White's company was trying to market a new kind of city map. White maxed out 11 credit cards and ran up more than $100,000 in debt after starting his company. He ultimately declared personal bankruptcy and was forced to find a job so that he could pay his bills. Maria Martz didn't realize her small business would become a casualty until she saw her tax return showing her company's losses in black and white—for the second year in a row. It convinced her that enough was enough and she gave up her gift-basket business to become a full-time homemaker. But once the decision is made, it may be tough to stick to. "I got calls from people asking how come I wasn't in business anymore. It was tempting to say I'd make their basket but I had to tell myself it is finished now."[17]

CONCEPT CHECK

1. How can potential business owners find new business ideas?
2. Why is it important to develop a business plan? What should such a plan include?
3. What financing options do small-business owners have? What risks do they face?

5.5 Managing a Small Business

5. Why does managing a small business present special challenges for the owner?

Managing a small business is quite a challenge. Whether you start a business from scratch or buy an existing one, you must be able to keep it going. The small-business owner must be ready to solve problems as they arise and move quickly if market conditions change.

MANAGING CHANGE

Learning How to Pivot

Most small business owners either use, or at least know of, the iconic email service MailChimp, once an independent company with revenues reaching $800 million annually. It was acquired in 2021 by Intuit for $12 billion in cash and stock. Since the acquisition, the company has posted revenues nearing $1.3 billion, a significant increase over their previous performance. Former CEO and co-founder, Ben Chestnut, says it took MailChimp several years to figure out what it did well.

When Chestnut was laid off from his job at the Cox Media Group in Atlanta, he founded Rocket Science Group, a web design firm. Cofounder Dan Kurzius (who taught himself to code) joined Chestnut, and they began to focus their sales efforts on tech companies. But when the tech bubble burst, they pivoted to focus on selling to airline and travel companies. Then 9/11 hit, and they needed to change focus again, this time on the real estate market. However, both Chestnut and Kurzius discovered they didn't enjoy sales (and they weren't very good at it), nor did they like the bureaucracy of working with large companies. "The only companies we could relate to were small businesses, and they always asked for email marketing."

This insight helped Chestnut to recall a product feature the Rocket Science Group had previously developed for an email greeting card project. So Chestnut and Kurzius evaluated the marketing software and began to test it with small businesses. "Our day jobs felt like going to these big organizations and pitching to them, and it was miserable," Chestnut says. "But we really loved our nighttime jobs, which were helping the small businesses use this email marketing app." Their passion, along with market feedback, led to their decision to completely focus on email marketing for small businesses. But it wasn't until almost 2009 that MailChimp found its sweet spot. The founders initially wanted to give away one product that collected subscribers and then charge for another, which was sending emails, but it would have been very difficult to divide the product into two pieces. That's when they decided on positioning their services using the "freemium" business approach: "Let's just make the whole thing free," said Chestnut.

The idea was that if they made it cheap and easy for small businesses to try MailChimp, their business would grow and they would be in a better position to pay for MailChimp services. MailChimp allows customers to send an email for free to up to 250 contacts at once with a limit of 500 emails per month. If businesses need more than this quantity, additional packages are available starting around just $13 per month.

The idea quickly proved to be a huge success. MailChimp has over 11 million users globally as of 2024.

The MailChimp founders learned a lot of lessons during their years in business. One of their most important lessons is knowing when to change. When you see an opportunity, don't be afraid to pivot and change course, especially if it means focusing on a market you're passionate about. Listening to market feedback and following their passion earned MailChimp's founders recognition as the "Best Digital Marketing Platform" in 2026 by Better Business Advice.

Critical Thinking Questions

1. What led MailChimp's founders to change its focus on the customers they were selling to?
2. What was MailChimp's "big idea" that changed the business, and why was it so successful?

Sources: Maria Aspan, "Want Proof That Patience Pays Off? Ask the Founders of This 17-Year-Old $525 Million Email Empire," *Inc.*, https://www.inc.com, Winter 2017/January 2018 issue; "MailChimp: From Startup to Inc. Magazine's Top Company," *CNBC,* https://www.cnbc.com, December 12, 2017; Farhad Manjoo, "MailChimp and the Un-Silicon Valley Way to Make It as a Start-Up," *The New York Times,* https://www.nytimes.com, October 5, 2016; Kenrick Cai, "Mailchimp's $12 Billion Sale To Intuit A Major Payday For Its Billionaire Bootstrapping Founders," *Forbes*, https://www.forbes.com, September 13, 2021; "Intuit Completes Acquisition of Mailchimp," https://mailchimp.com, November 1, 2021; Eric Mandel, "Mailchimp Co-Founder Ben Chestnut Steps Down as CEO," *Atlanta Business Chronicle*, https://www.bizjournals.com, August 11, 2022.

A sound business plan is key to keeping the small-business owner in touch with all areas of their business. Hiring, training, and managing employees is another important responsibility because the owner's role may change over time. As the company grows, others will make many of the day-to-day decisions while the owner focuses on managing employees and planning for the firm's long-term success. The owner must constantly evaluate company performance and policies in light of changing market and economic conditions and develop new policies as required. They must also nurture a continual flow of ideas to keep the business growing. The types of employees needed may change too as the firm grows. For instance, a larger firm may need more managerial talent and technical expertise.

Using Outside Consultants

One way to ease the burden of managing a business is to hire outside consultants. Nearly all small businesses need a good certified public accountant (CPA) who can help with financial record keeping, decision-making, and tax planning. An accountant who works closely with the owner to help the business grow is a valuable asset. An attorney who knows about small-business law can provide legal advice and draw up essential contracts and documents. Consultants in areas such as marketing, employee benefits, and insurance can be used on an as-needed basis. Outside directors with business experience are another way for small companies to get advice. Resources such as these free the small-business owner to concentrate on medium- and long-range planning and day-to-day operations.

Some aspects of business can be outsourced or contracted out to specialists. Among the more common departments that use outsourcing are information technology, marketing, customer service, order fulfillment, payroll, and human resources. Hiring an outside company—in many cases another small business—can save money because the purchasing firm buys just the services it needs and makes no investment in additional human resources. Management should review outsourced functions as the business grows because at some point it may be more cost-effective to bring them in-house.

Hiring and Retaining Employees

It is important to identify all the costs involved in hiring an employee to make sure your business can afford it. Recruiting, onboarding, training, and benefits can add as much as 10 to 15 percent to their salary. Hiring an employee may also mean more work for you in terms of training and management. It's a catch-22: To grow you need to hire more people, but making the shift from solo worker to boss can be stressful.

Attracting good employees is more difficult for a small firm, which may not be able to match the higher salaries, better benefits, and advancement potential offered by larger firms. Small companies need to be creative to attract the right employees and convince applicants to join their firm. Once they hire an employee, small-business owners must make employee satisfaction a top priority in order to retain good people. A

company culture that nurtures a comfortable environment for workers, flexible hours, employee benefit programs, opportunities to help make decisions, and a share in profits and ownership are some ways to do this.

Business owners can create and implement employee-friendly policies to recruit and retain the best staff for the venture. Policies such as flexible scheduling, opportunities for advancement and leadership positions, profit-sharing programs, and benefits for employee personal development are tools that owners can use to attract the best workers. Offering these non-salary benefits does carry costs that must be considered, but the benefits can significantly outweigh these costs if the business owner has employees who are trustworthy, reliable, loyal, and help with realizing the goals of the organization.

Going Global with Exporting

More and more small businesses are discovering the benefits of looking beyond the United States for market opportunities. The global marketplace represents a huge opportunity for U.S. businesses, both large and small. Small businesses' decision to export is driven by many factors, one of which is the desire for increased sales and higher profits. The price of U.S. goods to overseas buyers is impacted by the exchange rate of the U.S. dollar versus foreign currencies, so this can create opportunities for U.S. companies to sell globally. Additionally, economic conditions both domestic and abroad—such as recessions, tariffs, foreign competition, political relations, or access to new markets—may encourage U.S. companies to consider exporting their products.

Like any major business decision, exporting requires careful planning. Small businesses may hire international-trade consultants or distributors to get started selling overseas. These specialists have the time, knowledge, and resources that most small businesses lack. Export trading companies (ETCs) buy goods at a discount from small businesses and resell them abroad. Export management companies (EMCs) act on a company's behalf. For fees of 1 to 5 percent of the value of the goods, they handle all aspects of exporting, including finding customers, billing, shipping, and helping the company comply with foreign regulations.

Many online resources are also available to identify potential markets for your goods and services, as well as to decipher the complexities involved in preparing to sell in a foreign country. The Small Business Association's Office of International Trade has links to many valuable sites. The Department of Commerce offers services for small businesses that want to sell abroad. Contact its Trade Information Center, 1-800-USA-TRADE, or its Export Center (**https://www.export.gov**).

CONCEPT CHECK

1. How does the small-business owner's role change over time?
2. How does managing a small business contribute to its growth?
3. What are the benefits to small firms of doing business internationally, and what steps can small businesses take to explore their options?

5.6 Small Business, Large Impact

6. What are the advantages and disadvantages facing owners of small businesses?

An uncertain economy has not stopped people from starting new companies. According to the Pew Research Center, over 85 percent of Americans view small businesses as a positive influence on life in the U.S. This is not surprising when you consider the many reasons why small businesses continue to thrive in the United States:

- *Independence and a better lifestyle:* Large corporations no longer represent job security or offer the fast-

track career opportunities they once did. Mid-career employees leave the corporate world—either voluntarily or as a result of downsizing—in search of the new opportunities that self-employment provides. Many new college and business school graduates shun the corporate world altogether to start their own companies or look for work in smaller firms.

- *Personal satisfaction from work:* Many small-business owners cite this as one of the primary reasons for starting their companies. They love what they do.
- *Best route to success:* Business ownership can provide advancement opportunities for women and minorities. It also offers small-business owners the potential for profit.
- *Rapidly changing technology:* Technology advances and decreased costs provide individuals and small companies with the power to compete in industries that were formerly closed to them.
- *Major corporate restructuring and downsizing:* These force many employees to look for other jobs or careers. They may also provide the opportunity to buy a business unit that a company no longer wants.
- *Outsourcing:* As a result of downsizing, corporations may contract with outside firms for services they used to provide in-house. Outsourcing creates opportunities for smaller companies that offer these specialized goods and services.
- *Small businesses are resilient:* They are able to respond fairly quickly to changing economic conditions by refocusing their operations.

There are several cities and regions that are regarded as the best locations for start-up businesses and entrepreneurs. Among them are Sioux Falls, South Dakota; Overland Park, Kansas; urban Honolulu, Hawaii; Oklahoma City, Oklahoma; West Valley City, Utah; and Omaha, Nebraska.[18]

Why Stay Small?

Owners of small businesses recognize that being small offers special advantages. Greater flexibility and an uncomplicated company structure allow small businesses to react more quickly to changing market forces. Innovative product ideas can be developed and brought to market more quickly, using fewer financial resources and personnel than would be needed in a larger company. And operating more efficiently keeps costs down as well. Small companies can also serve specialized markets that may not be cost-effective for large companies. Another feature is the ability to fill a market niche with unique products or services that are not widely found in the marketplace. This can create a client base that will bring customers back to the small business for the niche products or services, such as specialized restaurants or food carts, fitness facilities with targeted programs not found at larger gyms, small fashion boutiques offering one-of-a-kind clothing, or experience-based ventures such as those that offer painting or craft classes.

Divya Goenka noticed an under-served market in the retail clothing industry—stylish and affordable options for extended sizes not offered in traditional outlets. In 2017, Goenka founded The Pink Moon in India. The goal was to provide modern styles coupled with a customer-centric focus to serve this market that is often overlooked. The company operates as a direct-to-consumer online business with in-house manufacturing. This feature allows the company to provide a wide variety of designs and collections that are tailored for different occasions. The Pink Moon prides itself on stellar customer service by following up with customers after each purchase to garner details about the fit and design of the garments. The company has 10 employees and generates nearly $400,000 in revenue annually.[19]

On the other hand, being small is not always an asset. The founders may have limited managerial skills or encounter difficulties obtaining adequate financing, potential obstacles to growing a company. Complying with federal regulations is also more expensive for small firms. Research indicates that nearly 70 percent of small businesses spend more on compliance per employee than do larger firms. Specifically, businesses with fewer than five employees spend around $10,000 per employee on compliance efforts, whereas larger businesses spend less than $1,500 per employee. In addition, starting and managing a small business requires a major commitment by the owner. Long hours, the need for owners to do much of the work themselves, and the stress of being personally responsible for the success of the business can take a toll.

But managing your company's growing pains doesn't need to be a one-person job. Four years after he started DrinkWorks (now Whirley DrinkWorks), a company that makes custom drinking cups, Richard Humphrey was logging 100-hour weeks. "I was concerned that if I wasn't there every minute, the company would fall apart." Humphrey got sick, lost weight, and had his engagement fall apart. When forced by a family emergency to leave the company in the hands of his five employees, Humphrey was amazed at how well they managed in his absence. "They stepped up to the plate and it worked out," he says. "After that the whole company balanced out."[20]

CONCEPT CHECK

1. Why are small businesses becoming so popular?
2. Discuss the major advantages and disadvantages of small businesses.

5.7 The Small Business Administration

7. How does the Small Business Administration help small businesses?

Many small-business owners turn to the **Small Business Administration (SBA)** for assistance. The SBA's mission is to empower, advocate for, and assist small-business owners, and through its national network of local offices it helps people start and manage small businesses, advises them in the areas of finance and management, and helps them win federal contracts. Its toll-free number—1-800-U-ASK-SBA (1-800-827-5722)—provides general information, and its website at **https://www.sba.gov** offers details on all its programs.[21]

Financial Assistance Programs

The SBA offers financial assistance to qualified small businesses that cannot obtain financing on reasonable terms through normal lending channels. This assistance takes the form of guarantees on loans made by private lenders. These loans can be used for most business purposes, including purchasing real estate, equipment, and materials. The SBA has been responsible for a significant amount of small-business financing in the United States. In 2025, the SBA backed more than 84,000 small-business loans for $44.8 billion. About 30 percent of the loan approvals were for woman-owned firms and 11 percent were for minority-owned firms.[22]

Other SBA programs include assistance in finding investors, financing and assistance for firms that suffer economic harm after natural disasters, and government grants. The SBA also assists business owners in securing surety bonds, which are statements that guarantee that work will be completed. Some customers require such documentation before a contract is signed.

More than 300 SBA-licensed **Small Business Investment Companies (SBICs)** provided about $4 billion in long-term financing for small businesses in 2024. The SBA's website suggests seeking angel investors and using SBA-guaranteed loans as a way to fund the start-up. These privately owned and managed investment companies hope to earn a substantial return on their investments as the small businesses grow.

SCORE-ing with Management Assistance Programs

The SBA also provides a wide range of management advice. Its Business Guide section offers resources on most business topics, including information on how to start a wide variety of businesses—from ice-cream stores to fish farms.

Business development officers at the Office of Business Development and local Small Business Development Centers counsel many thousands of small-business owners each year, offering advice, training, and educational programs. The SBA also offers free management consulting through two volunteer groups: the

Service Corps of Retired Executives (SCORE), and the special resource hub through SCORE specifically for veterans. Executives in these programs use their own business backgrounds to help small-business owners. The SBA also has specialized programming through their network of partners to provide support and mentorship for woman-, minority-, and veteran-owned businesses. SCORE has expanded its outreach into new markets by offering email counseling in a variety of formats (such as email, video, phone) through its website (https://www.score.org). The SBA also offers free online resources and courses for small-business owners and aspiring entrepreneurs in its Learning Center, located on the SBA website under the "Learning Platform" tab.

Assistance for Women and Underrepresented Groups

The SBA has been committed to helping women and minorities increase their business participation. It has offered a minority small-business program, microloans, and the publication of Spanish-language informational materials. It has increased its responsiveness to small businesses by giving regional offices more decision authority and creating high-tech tools for grants, loan transactions, and eligibility reviews.

The SBA offers special programs and support services for socially and economically disadvantaged persons, including women, Native Americans, and Hispanic people through its Minority Business Development Agency. It also makes a special effort to help veterans go into business for themselves.

CONCEPT CHECK

1. What is the Small Business Administration (SBA)?
2. Describe the financial and management assistance programs offered by the SBA.

5.8 Trends in Entrepreneurship and Small-Business Ownership

8. What trends are shaping entrepreneurship and small-business ownership?

Entrepreneurship has changed since the heady days of the late 1990s, when starting a dot-com while still in college seemed a quick route to riches and stock options. Entrepreneurial opportunity comes from a variety of sources, including demographic changes, economic conditions, and technological advancements. Developments in areas such as AI and health tech represent a sector of growth potential for entrepreneurs. Additional emphasis is also being placed on ethics and sustainability. We have created a society in which we expect to have our problems taken care of, and the technological revolution stands ready with already-developed solutions. Evolving social and demographic trends, combined with the challenge of operating in a fast-paced technology-dominated business climate, are changing the face of entrepreneurship and small-business ownership.

Into the Future: Start-ups Drive the Economy

Do new business ventures drive the economic recovery from recent recessions and economic downturns, and are they continuing to make significant contributions to the U.S. economy? Data show that small businesses facilitate economic recovery. Small businesses significantly contribute to their local communities as well as to the overall economic health of the nation. Small businesses are responsible for job creation and are the foundation of economic resilience and growth. Numbers alone do not tell the whole story, however. Are these newly self-employed workers profiting from their ventures, or are they just biding their time during a period of unemployment?

U.S. small businesses employed over 60 million people in 2023, representing nearly 47 percent of the workforce. Small businesses were responsible for 70 percent of the net new jobs added to the economy since

2019.[23]

A significant rate of growth is coming from woman-owned firms, with nearly 50 percent of all businesses started in 2024 being launched by women. This was a 69 percent increase since 2019. There were an estimated 12.8 million woman-owned businesses employing over 9 million people in 2025, generating more than $1.9 trillion in annual revenue.[24]

Between 2019 and 2023, woman-owned firms increased at a rate twice that of firms owned by men. From 2022 to 2023 specifically, that rate increased to nearly 5 times. Even during the COVID-19 pandemic, woman-owned businesses thrived, creating 1.4 million jobs and boasting revenues of nearly $600 billion.[25]

These trends show that more workers are striking out on their own and earning money doing it. It has become very clear that encouraging small-business activity leads to continued strong overall economic growth.

Changing Demographics Create Entrepreneurial Diversity

The traditional view of retiring has evolved with individuals still being active in the workplace past the typical retirement age. The AARP predicts that older adult entrepreneurs will continue to rise in the coming years. As Baby Boomers look toward the future, many are likely to pursue selling the businesses they have spent years building. According to the SBA, there are over 12 million small businesses owned by Baby Boomers.[26] This represents a unique buying opportunity for other generations. The supply of existing small businesses is larger than the demand, so entrepreneurial Millennials and Gen Xers can take advantage of this position. Boomers are looking for someone to carry on the business legacy and could therefore be open to items such as seller financing. Gen Z leads the way in business startups, with nearly 25 percent of total entrepreneurial activity (TEA) attributed to individuals between the ages of 18 and 24.[27]

The growing numbers of Boomers working during retirement has prompted some forward-thinking companies to recognize business opportunities in technology. At one time there was a concern that the aging of the population would create a drag on the economy. Some Baby Boomers choose entrepreneurship to carry them through their retirement years. These businesses could be simply for fun or to pursue a passion they now have time for. The Boomer generation has built sizable wealth, and data indicate that some in this generation use that wealth to start businesses.

Minorities are also adding to the entrepreneurial mix. As we saw in **Table 5.3**, minority groups and women are increasing business ownership at a much faster rate than the national average. The increase in minority business ownership and the lack of funding through other sources prompted the SBA to help fill the gap. About one-third of all SBA-backed loans are with minority business owners.[28]

Data show that Latino-owned businesses surged by 35 percent between the years 2019 and 2024. Funding from venture capital firms for Latino-owned businesses was over $3 billion in 2024.[29]

Exhibit 5.6 Demographic and social trends have prompted women to move into sectors that have traditionally been dominated by men. Now, women entrepreneurs are launching ventures in fields such as health technology, finance, STEM areas, and gaming. Women now represent 25 percent of the game development sector. Keisha Howard, founder of Sugar Gamers, set out to create a space for underrepresented groups in the gaming industry. The company has grown to be a leader in gaming development with partnerships with HBO, Microsoft, and the NBA. *Why are many professional women leaving traditional workplaces to start entrepreneurial ventures online?* (Credit: TEDxTalks/ YouTube/ Creative Commons Attribution-NonCommercial-NoDerivatives 4.0 International license (CC BY-NC-ND 4.0))

How Far Will You Go to Get Rich?

With enough intelligence and determination, people can get rich almost anywhere in the United States. Whether you own chains of dry cleaners in Queens, car dealerships in Chicago, or oil wells in West Texas, fortunes have been made in every state in the Union. There are some places, however, where the chances of creating wealth are much greater than others. That is the reason why people who hope to strike it rich move to places such as Manhattan or Palo Alto. It's not because the cost of living is low or the quality of life as a struggling entrepreneur is fun. Whether starting a software or soft-drink company, entrepreneurs tend to follow the money.

But not all companies follow the herd. Guild (formerly Guild Education), founded in Denver in 2015 by Rachel Carlson and Brittany Stich, briefly moved to San Francisco, but quickly left due to the high cost of living that could slow down the company's growth. "We have a lot of women who are executives and department heads here, starting with myself and my cofounder," CEO Rachel Carlson said. "So when we left, we deliberately chose a place where you can have a family." Guild's original mission was to help large employers in offering education and tuition reimbursement as a benefit to working-age adults that lacked a college degree, but their vision has now evolved beyond just college education/tuition reimbursement to broader career mobility services.[30]

Since moving back to Denver, Guild has raised over $650 million with a company valuation of $4.4 billion. The firm now has approximately 850 employees.[31] "We were joking that we're the polar opposite of Apple," said Carlson. "Remember when the new 'mothership' came out? Every single parent noticed that it had a huge gym but not a day care."

According to Morningstar, the top regions in the United States for venture-backed deals in 2025 were the Bay Area ($94 billion), New York ($14.3 billion), and Los Angeles ($9.2 billion).[32]

Nontraditional funding sources are gaining traction with entrepreneurs. Options such as crowdfunding, grants, revenue-based financing, and community-backed investments offer entrepreneurs opportunities for access to funding without giving up part of their business as would be the case with equity funding. In 2024, nearly $350 million was raised through crowdfunding. The top U.S. industries with the most deals and funding are healthcare, manufacturing, e-commerce, financial technologies, and robotics.[33]

CONCEPT CHECK

1. What significant trends are occurring in the small-business arena?
2. How is entrepreneurial diversity impacting small business and the economy?
3. How do ethics impact decision-making with small-business owners?

Key Terms

angel investors Individual investors or groups of experienced investors who provide financing for start-up businesses by investing their own funds.

business plan A formal written statement that describes in detail the idea for a new business and how it will be carried out; includes a general description of the company, the qualifications of the owner(s), a description of the product or service, an analysis of the market, and a financial plan.

debt A form of business financing consisting of borrowed funds that must be repaid with interest over a stated time period.

entrepreneurs People with vision, drive, and creativity who are willing to take the risk of starting and managing a business to make a profit, or greatly changing the scope and direction of an existing firm.

equity A form of business financing consisting of funds raised through the sale of stock (i.e., ownership) in a business.

intrapreneurs Entrepreneurs who apply their creativity, vision, and risk-taking within a large corporation, rather than starting a company of their own.

small business A business with under 500 employees that is independently managed, is owned by an individual or a small group of investors, is based locally, and is not a dominant company in its industry.

Small Business Administration (SBA) A government agency that advocates for small business; specifically it helps people start and manage small businesses, advises them in the areas of finance and management, and helps them win federal contracts.

Small Business Investment Company (SBIC) Privately owned and managed investment companies that are licensed by the Small Business Administration and provide long-term financing for small businesses.

venture capital Financing obtained from venture capitalists, investment firms that specialize in financing small, high-growth companies and receive an ownership interest and a voice in management in return for their money.

Summary of Learning Outcomes

5.1 Entrepreneurship Today

1. Why do people become entrepreneurs, and what are the different types of entrepreneurs?

Entrepreneurs are innovators who take the risk of starting and managing a business to make a profit. Most want to develop a company that will grow into a major corporation. People become entrepreneurs for four main reasons: the opportunity for profit, independence, personal satisfaction, and lifestyle. Classic entrepreneurs may be micropreneurs, who plan to keep their businesses small, or growth-oriented entrepreneurs. Multipreneurs start multiple companies, while intrapreneurs work within large corporations.

5.2 Characteristics of Successful Entrepreneurs

2. What characteristics do successful entrepreneurs share?

Successful entrepreneurs are ambitious, independent, self-confident, creative, energetic, passionate, and committed. They have a high need for achievement and a willingness to take moderate risks. Good managerial, interpersonal, and communication skills are important for entrepreneurial success.

5.3 Small Business: Driving America's Growth

3. How do small businesses contribute to the U.S. economy?

Small businesses play an important role in the economy. They account for over 99 percent of all employer firms and produce about half of U.S. economic output. Most new private-sector jobs created in the United States over the past decade were in small firms. The Small Business Administration defines a small business as independently owned and operated, with a local base of operations, and not dominant in its field. It also defines small business by size, according to its industry. Small businesses are found in every field, but they

dominate the construction, leisure and hospitality, transportation, and financial services categories.

5.4 Ready, Set, Start Your Own Business

4. What are the first steps to take if you are starting your own business?

After finding an idea that satisfies a market need, the small-business owner should choose a form of business organization. Preparing a formal business plan helps the business owner analyze the feasibility of their idea. The written plan describes in detail the idea for the business and how it will be implemented and operated. The plan also helps the owner obtain both debt and equity financing for the new business.

5.5 Managing a Small Business

5. Why does managing a small business present special challenges for the owner?

At first, small-business owners are involved in all aspects of the firm's operations. Hiring and retaining key employees and the wise use of outside consultants can free up an owner's time to focus on planning, strategizing, and monitoring market conditions, in addition to overseeing day-to-day operations. Expanding into global markets can be a profitable growth strategy for a small business.

5.6 Small Business, Large Impact

6. What are the advantages and disadvantages facing owners of small businesses?

Because of their streamlined staffing and structure, small businesses can be efficiently operated. They have the flexibility to respond to changing market conditions. Small firms can serve specialized markets more profitably than large firms, and they provide a higher level of personal service. Disadvantages include limited managerial skill, difficulty in raising capital needed for start-up or expansion, the burden of complying with increasing levels of government regulation, and the major personal commitment that is required by the owner.

5.7 The Small Business Administration

7. How does the Small Business Administration help small businesses?

The Small Business Administration is the main federal agency serving small businesses. It provides guarantees of private-lender loans for small businesses. The SBA also offers a wide range of management assistance services, including courses, publications, and consulting. It has special programs for women, underrepresented groups, and veterans.

5.8 Trends in Entrepreneurship and Small-Business Ownership

8. What trends are shaping entrepreneurship and small-business ownership?

Changes in demographics, society, and technology are shaping the future of entrepreneurship and small business in America. More than ever, opportunities exist for entrepreneurs of all ages and backgrounds. Demographic and social shifts are changing the small-business landscape. Catering to the needs of an older population and a surge in web-based companies fuel continues technology growth. Entrepreneurs typically follow the money and set up shop in places where there is venture capital money easily available.

Preparing for Tomorrow's Workplace Skills

1. After working in software development with a major food company for 12 years, you are becoming impatient with corporate "red tape" (regulations and routines). You have an idea for a new snack product for nutrition-conscious consumers and are thinking of starting your own company. What entrepreneurial characteristics do you need to succeed? What other factors should you consider before quitting your job? Working with a partner, choose one to be the entrepreneurial employee and one to play the role of their current boss. Develop notes for a script. The employee will focus on why this is a good idea—reasons they will succeed—and the employer might negotiate to convince them that staying on at the large company is

a better idea. Then switch roles and repeat the discussion. (Information, Interpersonal)

2. What does it really take to become an entrepreneur? Find out by interviewing a local entrepreneur or researching an entrepreneur you've read about in this chapter or in the business press. Get answers to the following questions, as well as any others you'd like to ask:
   - How did you research the feasibility of your idea?
   - How did you develop your vision for the company?
   - How long did it take you to prepare your business plan?
   - Where did you obtain financing for the company?
   - Where did you learn the business skills you needed to run and grow the company?
   - What are the most important entrepreneurial characteristics that helped you succeed?
   - What were the biggest challenges you had to overcome?
   - What are the most important lessons you learned by starting this company?
   - What advice do you have for would-be entrepreneurs?

   (Information, Interpersonal, Systems)
3. A small catering business in your city is for sale for $250,000. The company specializes in business luncheons and small social events. The owner has been running the business for four years and now wants to sell. You will need outside investors to help you purchase the business. Develop questions to ask the owner about the business and its prospects, as well as a list of documents you want to see. What other types of information would you need before making a decision to buy this company? Summarize your findings in a memo to a potential investor that explains the appeal of the business for you and how you plan to investigate the feasibility of the purchase. (Information, Interpersonal)
4. Research various types of assistance available to women and minority business owners. Call or visit the nearest SBA office to find out what services and resources it offers. Contact trade associations such as the National Association of Women Business Owners (NAWBO), the U.S. Hispanic Chamber of Commerce (USHCC), and the U.S. Department of Commerce Minority Business Development Agency (MBDA). Call these groups or use the internet to develop a list of their resources and how a small-business owner could use them. (Information, Interpersonal, Technology)
5. Do you have what it takes to be an entrepreneur or small-business owner? You can find many online quizzes to help you figure this out. *Psychology Today* offers a quiz to determine whether you have an entrepreneurial mindset at **https://www.psychologytoday.com/us/tests/career/entrepreneurship-test**. What did your results tell you, and were you surprised by what you learned? (Information, Technology)
6. **Team Activity** Your class decides to participate in a local business plan competition. Divide the class into small groups, and choose one of the following ideas:

   - A new computer game based on the stock market
   - A company with an innovative design for a skateboard
   - Travel services for college and high school students

   Prepare a detailed outline for the business plan, including the objectives for the business and the types of information you would need to develop product, marketing, and financing strategies. Each group will then present its outline for the class to critique. (Information, Interpersonal, Systems)

Ethics Activity

As the owner of a small factory that makes plastic sheeting, you are constantly seeking ways to increase profits. As the new year begins, one of your goals is to find additional funds to offer annual productivity and/or merit bonuses to your loyal, hardworking employees.

Then a letter from a large national manufacturer of shower curtains seems to provide an answer. As part of a new "supplier diversity" program it is putting in place, the manufacturer is offering substantial purchase

contracts to minority-owned suppliers. Even though the letter clearly states that the business must be *minority owned* to qualify for the program, you convince yourself to apply for it based on the fact that all your employees are members of racial or ethnic minorities. You justify your decision by deciding they will benefit from the increased revenue a larger contract will bring, some of which you plan to pass on to them in the form of bonuses later in the year.

Using a web search tool, locate articles about this topic, and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Is it wrong for this business owner to apply for this program even though it will end up benefiting the employees as well as the business?

Working the Net

1. Visit the Business Plan Hub at **https://www.bplanhub.com/blog/** to review examples of all types of business plans. Select an idea for a company in a field that interests you and, using information from the site, prepare an outline for its business plan.
2. Find a business idea you like or dislike by searching the web. Explain why you think this is a good business idea or not. List additional information the entrepreneur should have to consider for this business, and research the industry on the web using a search engine.
3. Evaluate the export potential of your product idea at the Small Business Exporters Network website at **https://www.nsbaadvocate.org/sbea**. Explore three information areas, including market research, export readiness, and financing. Select a trade link site from government, university, or private categories. Compare them in terms of the information offered to small businesses that want to venture into overseas markets. Which is the most useful, and why?
4. Explore the SBA website at **https://www.sba.gov**. What resources are available to you locally? What classes does the Learning Platform offer? What about financing assistance? Do you think the website lives up to the SBA's goal of being a one-stop shopping resource for the small-business owner? Why or why not?
5. You want to buy a business but don't know much about valuing small companies. Using the BizBuySell site at **https://www.bizbuysell.com/**, develop a checklist of questions to ask when buying a business. Also summarize several ways that businesses arrive at their sale price ("Business for Sale" includes the price rationale for each profiled business).

Critical Thinking Case

Fostering Entrepreneurship in "Innovation Deserts"

You may have heard of food deserts or Internet deserts -- those places where groceries or online access are difficult to come by. But certain communities fall into similar "innovation deserts," where the population is cut off from educational, technical, and other resources connected to small business and entrepreneurial success. Often coinciding with economically distressed locations, innovation deserts force residents to look elsewhere for opportunities and support, causing a talent and economic drain that exacerbates the problem.

Felecia Hatcher has committed herself to ridding communities of these deserts. A self-described C-student in high school, she found creative ways to achieve and finance her education and early career. As a freshman at Lynn University, she launched a company focused on mentoring high school students. Upon graduating, she went on to lead social media campaigns for major brands such as Nintendo, Sony, Microsoft, and Little Debbie. Soon after, she landed a major position with the Minnesota Lynx of the WNBA. She left it to start an ice cream company.

That company, Feverish Gourmet Popsicles, went from a small food truck and cart operation to a venture capital-backed promotional partner to some of the biggest brands in the world. Her success -- and the financial resources it provided -- enabled Felecia to pivot once again.

In 2012, Hatcher started Code Fever, an organization focused on teaching Miami residents how to integrate technical knowledge into their skillset. Soon after, Hatcher and her partners brought Black Girls Code to Miami, and hosted numerous camps and events for local youth. In 2015, they started Black Tech Week to further the cause of creating inclusive innovation communities. The conference hosted several thousand attendees and some of the nation's top entrepreneurs, venture capitalists, educators, and tech professionals.

The following year, Hatcher's organizations further expanded their entrepreneurship programs. They began a VC-in-residence program to connect Black innovators with potential mentors and investors. Black Tech Week soon expanded from Miami to eight other cities.

Like many communities in South Florida, the Overton section of Miami was an innovation desert. Social mobility was relatively low, and potential entrepreneurs had few support networks or access to resources. Even though Miami was the nation's densest city for co-working spaces (seen as particularly helpful for start-ups), Overton didn't have one. Hatcher sought to directly fill the gap by opening a co-working space named a Space Called Tribe. The two-story hub offers individuals or small companies low-cost access to WiFi, office space, conference rooms, collaboration opportunities, and a wide array of workshops and guest speaker events. Even though members are from different companies serving different industries and customers, their shared experience can create networking and support relationships.

The Space Called Tribe was rebranded into The Center for Black Innovation by Hatcher and her group. Felecia Hatcher left the day-to-day operations of the organization in 2021 to pursue other ventures. Beyond the services and events described above, the Center works as a think tank and advocacy organization to further promote investment and innovation in the Black community, and better help all marginalized communities. During the COVID-19 pandemic, they launched a number of educational programs to help those affected launch "side hustles" to supplement their income. The Center also continues to serve as an incubator and capital investment networker to help people develop and scale their start-ups. And after helping thousands of business people, the Center frequently collaborates with past participants to mentor new ones and continue the cycle of innovation.

Critical Thinking Questions

1. What qualities or characteristics might lead to the emergence of an innovation desert? Is it always a geographical definition, or could it be defined in other ways?
2. In her efforts to help marginalized people gain technical and business experience, how was Felecia Hatcher's progression similar to business growth and grand expansion?
3. How might a Space Called Tribe and the larger efforts of the Center for Black Innovation lead to opportunity for local entrepreneurs?

Sources: Center for Black Innovation website, https://www.centerforblackinnovation.org/#what-we-do ; Felecia Hatcher-Pearson, "Ridding Communities of Innovation Deserts," Impakter, September 5, 2019, https://impakter.com/ridding-communities-of-innovation-deserts-how-corporations-and-governments-can-support-black-communities-innovation-potential/ ; Blair Levin and Larry Downes, "Cities, Not Rural Areas, Are The Real Internet Deserts," Washington Post, September 13, 2019, https://www.washingtonpost.com/technology/2019/09/13/cities-not-rural-areas-are-real-internet-deserts/ ; Rob Wile, "In a long-neglected Miami neighborhood, a new co-working space stirs to life," Miami Herald, May 30, 2018, https://www.miamiherald.com/news/business/technology/article212112389.html; "Felecia Hatcher / Feverish Gourmet Popsicles," https://www.chatchow.com, accessed March 3, 2026; Nancy Dahlberg, "Miami's Center for Black Innovation Draws $2.1 Million in Grants to Expand Mission," *Refresh Miami*, https://refreshmiami.com, November 12, 2020; Vanita Cooper, "Finding Your Genius with Felicia Hatcher," *Black Tech Weekly* (Season 1 Episode 8), https://www.buzzsprout.com, July 8, 2025.

Hot Links Address Book

1. Do you have a great business idea? Taking the quiz at **https://100steps2startup.com/startup-idea-quiz/**,

the 100 Steps to Startup website, will help you determine how feasible the idea is.

2. Do you have what it takes to become an entrepreneur? Take the quiz at **https://smallbizpulse.com/llc/llc-formation-management/how-to-know-if-your-business-idea-is-worth-pursuing/** to find out.
3. Before your business travels to foreign shores, pay a visit to the SBA's Office of Manufacturing and Trade to learn the best ways to enter global markets at **https://www.sba.gov/about-sba/sba-locations/headquarters-offices/office-manufacturing-trade**.
4. How can you find qualified overseas companies to buy your products? Find out how the International Trade Administration can help you become part of an e-marketplace at **https://www.trade.gov/find-buyers-and-partners**.
5. To learn about the services the U.S. Department of Commerce's Minority Business Development Agency provides for small-business owners, check out **https://www.mbda.gov**.

6

Management and Leadership in Today's Organizations

Exhibit 6.1 (Credit: Urs Rüegsegger / flickr / Public Domain Mark 1.0)

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What is the role of management?
2. What are the four types of planning?
3. What are the primary functions of managers in organizing activities?
4. How do leadership styles influence a corporate culture?
5. How do organizations control activities?
6. What roles do managers take on in different organizational settings?
7. What set of managerial skills is necessary for managerial success?
8. What trends will affect management in the future?

EXPLORING BUSINESS CAREERS

Jalem Getz, Costumes.com/Wantable, Inc.

You might ask, “How does one come to work in the world of online costume retail?” A passion for holiday make-believe and dress-up? A keen eye for business potential? The drive to capitalize on a competitive advantage? If you’re Jalem Getz, the answer is: all of these. Getz is the founder of Costumes.com, an online costume and accessories retailer (now run by Dan Haight) and, most recently, founder of Wantable, Inc.

As with most businesses, Costumes.com and Wantable, Inc., are the result of careful planning. Costumes.com was a response to what Getz saw as inherent flaws of resource allocation with the business model of brick-and-mortar costume retailers. The company experienced scale problems when they started over every year: "Because we only were in a mall four or five months a year, locations we had one year often were rented the next. So we had to find new stores to rent each year. Then we had to find management to run the stores, and train employees to staff them. We also had to shuffle the inventory

around each year to stock them. It's almost impossible to grow a business like that." By turning to the internet, however, Getz was able to bypass all of those issues. The virtual "space" was available year-round, and inventory and staff were centralized in a single warehouse location.

Getz grew Costumes.com to a multimillion-dollar business before selling it, with a staff of about 600 employees during its peak season. Before Getz sold the business, it carried over 10,000 Halloween items and had upwards of 20 million visitors each holiday season. In one year, it shipped over 1 million costumes across the world, including 45 countries outside the United States. "We say that our goal is to ensure that anytime anyone buys a costume anywhere in the world, it will be from Costumes.com. And, although to some extent we're kidding, we're also very serious."

To keep track of all this action, Getz mixed ideals of a strong work ethic, a willingness to take risks, and an interest in having fun while making a profit. Given the size of the company, Costumes.com organized its management to help keep the company focused on the corporate goal of continued growth. For Getz, his role in the management hierarchy was to "hire excellent people who have similar goals and who are motivated the same way I am and then put them in a position where they can succeed." Beyond that? "Inspect what you expect." This maxim is a concise way to say that, although he does not believe in constantly watching over his employees' shoulders, he does believe in periodically checking in with them to ensure that both he and they are on the same page. By considering the process of management a conversation between himself and his employees, he exhibits a strong participative leadership style.

Getz will joke that he wishes he could say that he spent his childhood dreaming of the day he could work with costumes. The truth, though, is that he saw an opportunity, grabbed it, and hasn't let go since. And sometimes, especially during Halloween, truth can be even more satisfying than fiction.

After selling Costumes.com, Getz experimented with other digital start-ups but quickly realized he worked best with retail. In 2012, he launched Wantable, Inc., an online personal shopping service. In its first four years, Getz led the company to exceed 28,000 percent annual revenue growth and to hire more than 100 employees. Wantable has around 400 employees with revenues of $50 million and two Milwaukee locations.

Sources: "About Wantable," https://blog.wantable.com, accessed October 27, 2017; "Wantable Surpasses 100 Employees," https://www.prweb.com, April 3, 2017; Jeff Engel, "Jalem Getz's Latest Retail Startup Wantable Targets Women, Fast Growth," https://www.xconomy.com, April 21, 2014; "Jalem Getz," *Wisconsin 275*, https://biztimes.com, accessed January 25, 2026.

Today's companies rely on managers to guide daily operations using human, technological, financial, and other resources to create a competitive advantage. For many beginning business students, being in "management" is an attractive but somewhat vague future goal. This vagueness is due in part to an incomplete understanding of what managers do and how they contribute to organizational success or failure. This chapter introduces the basic functions of management and the skills managers need to drive an organization toward its goals. We will also discuss how leadership styles influence a corporate culture and highlight the trends that are shaping the future role of managers.

6.1 The Role of Management

1. What is the role of management?

Management is the process of guiding the development, maintenance, and allocation of resources to attain organizational goals. Managers are the people in the organization responsible for developing and carrying out this management process. Management is dynamic by nature and evolves to meet needs and constraints in the organization's internal and external environments. In a global marketplace where the rate of change is

rapidly increasing, flexibility and adaptability are crucial to the managerial process. This process is based in four key functional areas of the organization: planning, organizing, leading, and controlling. Although these activities are discussed separately in the chapter, they actually form a tightly integrated cycle of processes and actions.

From this perspective, the managerial process can be described as (1) anticipating potential problems or opportunities and designing plans to deal with them, (2) coordinating and allocating the resources needed to implement plans, (3) guiding personnel through the implementation process, and (4) reviewing results and making any necessary changes. This last stage provides information to be used in ongoing planning efforts, and thus the cycle starts over again. The four functions are highly interdependent, with managers often performing more than one of them at a time and each of them many times over the course of a normal workday.

Exhibit 6.2 To encourage greater collaboration between employees, Apple invested $5 billion in the construction of its Cupertino, CA, headquarters, which replaced several buildings the company had outgrown. Most headquarters-based employees of Apple now share not only the same office space, but also the same technology tools and corporate culture. *How do Apple's planning and organizing decisions increase organizational efficiency and effectiveness?* (Credit: Tom Pavel / flickr/ Attribution 2.0 Generic (CC BY 2.0))

The four management functions can help managers increase organizational efficiency and effectiveness. **Efficiency** is using the least possible amount of resources to get work done, whereas **effectiveness** is the ability to produce a desired result. Managers need to be both efficient and effective in order to achieve organizational goals. For example, in 2025 Delta, one of the most efficient U.S. airlines, operated at revenue of 17.65 cents per seat-mile, which is the revenue the company makes on one seat (occupied or not) for the distance of one mile. No other airline came close to operating this efficiently, except American Airlines, which flew seats that produced 16.93 cents a mile.[1] There are many ways that airlines can manage to produce higher revenue per seat-mile. For instance, they can raise ticket prices, fill more of their seats, operate more efficient aircraft that utilize less fuel, or negotiate favorable salaries with their employees. While efficiency and effectiveness are sometimes lauded by investors, airlines also need to account for customer satisfaction, which can mean extra costs.[2]

The growth of AI has prompted many organizations to evaluate how this technology can improve their operations. For example, Unilever is utilizing AI to increase efficiencies in their recruitment and hiring processes. These efforts have resulted in significant cost savings by reducing the time to hire by 90 percent and reducing the interview time by a total of 50,000 hours. IBM is seeing similar results with a 30 percent decrease in costs related to recruitment, and as of 2024, nearly 4 million hours of employee time had been saved in the recruitment process by incorporating AI.[3]

As these examples and **Table 6.1** show, good management uses the four management functions to increase a company's efficiency and effectiveness, which leads to organizational efficiency and effectiveness, resulting in

achievement of the organizational mission and objectives. Let's look more closely at what each of the management functions entails.

What Managers Do and Why			
Planning	**Leading**	**Organizing**	**Controlling**
• Set objectives and state mission • Examine alternatives • Determine needed resources • Create strategies to reach objectives	• Lead and motivate employees to accomplish organizational goals • Communicate with employees • Resolve conflicts • Manage change	• Design jobs and specify tasks • Create organizational structure • Staff positions • Coordinate work activities • Set policies and procedures • Allocate resources	• Measure performance • Compare performance to standards • Take necessary action to improve performance

Table 6.1

CONCEPT CHECK

1. Define the term *management*.
2. What are the four key functions of managers?
3. What is the difference between efficiency and effectiveness?

6.2 Planning

2. What are the four types of planning?

Planning begins by anticipating potential problems or opportunities the organization may encounter. Managers then design strategies to solve current problems, prevent future problems, or take advantage of opportunities. These strategies serve as the foundation for goals, objectives, policies, and procedures. Put simply, planning is deciding what needs to be done to achieve organizational objectives, identifying when and how it will be done, and determining who should do it. Effective planning requires extensive information about the external business environment in which the firm competes, as well as its internal environment.

There are four basic types of planning: strategic, tactical, operational, and contingency. Most of us use these different types of planning in our own lives. Some plans are very broad and long term (more strategic in nature), such as planning to attend graduate school after earning a bachelor's degree. Some plans are much more specific and short term (more operational in nature), such as planning to spend a few hours in the library this weekend. Your short-term plans support your long-term plans. If you study now, you have a better chance of achieving some future goal, such as getting a job interview or attending graduate school. Like you,

organizations tailor their plans to meet the requirements of future situations or events. A summary of the four types of planning appears in Table 6.2.

Strategic planning involves creating long-range (one to five years), broad goals for the organization and determining what resources will be needed to accomplish those goals. An evaluation of external environmental factors such as economic, technological, and social issues is critical to successful strategic planning. Strategic plans, such as the organization's long-term mission, are formulated by top-level managers and put into action at lower levels in the organization. For example, when co-founders Brian Chesky and Joe Gebbia found themselves struggling with their rent expenses, they opened up their loft for guests to sleep on an air mattress as a way to generate income. That was the beginning of Airbnb. The team made the strategic decision to respond to current events, specifically the Democratic National Convention, to market their service for those who could not find hotel rooms for the event. Additional strategic decisions such as international acquisitions have launched their initiative into a global brand. Now a company valued at over $80 billion, the strategic vision of the co-founders has made a significant impact on the travel industry.[4]

Types of Planning						
Type of Planning	**Time Frame**	**Level of Management**	**Extent of coverage**	**Purpose and Goal**	**Breadth of Content**	**Accuracy and Predictability**
Strategic	1–5 years	Top management (CEO, vice presidents, directors, division heads)	External environment and entire organization	Establish mission and long-term goals	Broad and general	High degree of uncertainty
Tactical	Less than 1 year	Middle management	Strategic business units	Establish mid-range goals for implementation	More specific	Moderate degree of certainty
Operational	Current	Supervisory management	Geographic and functional divisions	Implement and activate specific objectives	Specific and concrete	Reasonable degree of certainty
Contingency	When an event occurs or a situation demands	Top and middle management	External environment and entire organization	Meet unforeseen challenges and opportunities	Both broad and detailed	Reasonable degree of certainty once event or situation occurs

Table 6.2

CATCHING THE ENTREPRENEURIAL SPIRIT

Changing Strategy Can Change Your Opportunities

Since 1949, Gordon Bernard, a customized fundraising printing company in Milford, Ohio, focused exclusively on printing fundraising calendars for a variety of clients, such as cities, schools, scout troops, and fire departments. The company's approximately 4,000 clients nationwide, 10 percent of which have been with the company for over 50 years, generated $4 million in revenue in 2006. In order to better serve customers, then-company-president Bob Sherman invested in the purchase of a top-end digital color printing machine so that the company could produce in-house parts of their products that they had been outsourcing. This purchase did more for the company than simply reduce costs, however.

The new press gave the company four-color printing capability for the first time in its history, and that led the management of Gordon Bernard to rethink the company's strategy. The machine excels at short runs, which means that small batches of an item can be printed at a much lower cost than on a traditional press. The press also has the capability to customize every piece that rolls off the machine. For example, if a pet store wants to print 3,000 direct mail pieces, every single postcard can have a personalized greeting and text. Pieces targeted to bird owners can feature pictures of birds, whereas the dog owners' brochure will contain dog pictures. Text and pictures can be personalized for owners of show dogs or overweight cats or iguanas.

Bob Sherman created a new division to oversee the implementation, training, marketing, and creative aspects of the new production process. The company even changed how it thinks of itself. No longer does Gordon Bernard consider itself a printing firm, but as a marketing services company with printing capabilities. That change in strategy prompted the company to seek more commercial work. For example, the company assists clients in developing customer databases and the collection of key information they need to know. Because calendar products are seasonal, these additional services provide revenue during the off-peak periods. This gives the company additional income-producing product/service areas to provide a suite of products to their clients and to diversify the company's revenue streams.

Critical Thinking Questions

1. What type of planning do you think Gordon Bernard is doing?
2. Because Gordon Bernard's strategy changed only after it purchased the iGEN3, does the shift constitute strategic planning? Why or why not?

Sources: GBC Fundraising Calendars, https://www.gordonbernard.com/, accessed September 15, 2017; Gordon Bernard Co Inc., https://www.manta.com, accessed September 15, 2017; Karen Bells, "Hot Off the Press; Milford Printer Spends Big to Fill New Niche," *Cincinnati Business Courier,* July 15, 2005, pp. 17–18; "About Us," https://ezo.gordonbernard.com/about.aspx, accessed January 25, 2026.

An organization's **mission** is formalized in its **mission statement**, a document that states the purpose of the organization and its reason for existing. For example, the mission statement for Whole Foods formalizes these concepts; see **Table 6.3**.

Whole Foods Mission, Values, and Declaration of Interdependence
Mission: Our purpose is to nourish people and the planet. We're a purpose-driven company that aims to set the standards of excellence for food retailers. Quality is a state of mind at Whole Foods Market.
Values: Whole Foods' Core Values consist of six elements that define what the company stands for and will not compromise regardless of the situation. • highest quality, all-natural and organic foods • customer satisfaction • promoting the growth and happiness of employees and stakeholders • win-win partnerships • profitability and prosperity for all • promoting community health, nutrition, and welfare
Declaration of Interdependence: Whole Foods Market acknowledges that it has come this far by depending on its customers, employees, suppliers, stakeholders, and the resources provided by Mother Earth.
Going forward, it will not attain its aspirations without their support again. Subsequently, it also recognizes its obligations and responsibility to all parties and stakeholders that depend on the company, promising to prioritize and advance their interests.

Table 6.3 S. K. Gupta, "Whole Foods Market Mission Statement | Vision | Values | Philosophy (2025 Analysis)," *Business Strategy Hub*, https://bstrategyhub.com, June 12, 2025.

In all organizations, plans and goals at the tactical and operational levels should clearly support the organization's mission statement.

Tactical planning begins the implementation of strategic plans. Tactical plans have a shorter (less than one year) time frame than strategic plans and more specific objectives designed to support the broader strategic goals. Tactical plans begin to address issues of coordinating and allocating resources to different parts of the organization.

Under co-founders Bebbia and Chesky's direction, new tactical plans were implemented to support Airbnb's new strategic direction. For example, the company's market shifted from merely home sharing to vacation/short-term rental options that included entire homes and luxury vacation options. In another strategic move to offer more value to customers, Airbnb acquired NabeWise in 2012. NabeWise is a city guide platform that helps individuals navigate neighborhoods and what they have to offer. This acquisition is an additional layer of service to offer to customers when they are booking spaces they are unfamiliar with. Other tactical plans included acquiring both a travel agency and a search engine that helped expand their networks. The company sought out partnerships to ensure the longevity of their service. For example, they signed a 9-year partnership, set to expire in 2028, with the International Olympic Committee to provide alternative housing for athletes.[5]

Operational planning creates specific standards, methods, policies, and procedures that are used in specific functional areas of the organization. Operational objectives are current, narrow, and resource focused. They are designed to help guide and control the implementation of tactical plans. In an industry where new versions of software have widely varying development cycles, Autodesk, a leading developer of design and engineering software used in architecture, manufacturing, construction, and media production, implemented new operational plans that dramatically increased profits. Former CEO Carol Bartz shifted the company away from the erratic release schedule it had been keeping to regular, annual software releases. By releasing upgrades on

a defined and predictable schedule, the company is able to use annual subscription pricing, which is more affordable for small and midsize companies. The predictability of software releases keeps Autodesk customers current with the most recent versions of the software and also allows the customers to more accurately budget and track expenses related to software adoption.[6]

The key to effective planning is anticipating future situations and events. Yet even the best-prepared organization must sometimes cope with unforeseen circumstances, such as a natural disaster, a cyberattack, or a radical new technology. Therefore, many companies have developed **contingency plans** that identify alternative courses of action for very unusual or crisis situations. The contingency plan typically stipulates the chain of command, standard operating procedures, and communication channels the organization will use during an emergency.

An effective contingency plan can make or break a company. Consider the example of Marriott Hotels in Puerto Rico. Anticipating Hurricane Erin in 2025, workers at the San Juan Marriott had to shift from their regular duties to handling the needs of not only customers, but everyone who needed assistance in the wake of the hurricane that devastated the island. A contingency plan and training for events such as this were a key part of managing this crisis.[7] The company achieved its goal of being able to cater to guest and general needs due to planning and training while having a contingency plan in place. One guest commented on TripAdvisor, "Could not believe how friendly, helpful & responsive staff were even during height of hurricane. Special thanks to Eydie, Juan, Jock, Ashley and security Luis. They kept us safe & were exemplary. Will always stay at Marriott from now on."[8] Within one month after Hurricane Maria hit, operations were back to normal at the San Juan Marriott.[9]

MANAGING CHANGE

Boeing Takes Off in New Direction

Boeing and Airbus have been locked in fierce competition for the world's airplane business for decades. What characterized most of that time period was a focus on designing larger and larger airplanes. Since its development in the 1970s, Boeing revamped its pioneering B747 numerous times and at one time boasted over 1,300 of the jumbo jets in operation around the world. As part of this head-to-head competition for bragging rights to the largest jet in the air, Boeing was working on a 747X, a super-jumbo jet designed to hold 525 passengers. In what seemed to be an abrupt change of strategy, Boeing conceded the super-jumbo segment of the market to its rival and killed plans for the 747X. Instead of trying to create a plane with more seats, Boeing engineers began developing planes to fly fewer people at higher speeds. Then, as the rising price of jet fuel surpassed the airlines' ability to easily absorb its increasing cost, Boeing again changed its strategy, this time focusing on developing jets that use less fuel. In the end, Boeing's strategy changed from plane capacity to jet efficiency.

The new strategy required new plans. Boeing managers identified gaps in Airbus's product line and immediately set out to develop planes to fill them. Boeing announced a new 787 "Dreamliner," which boasted better fuel efficiency thanks to lightweight composite materials and next-generation engine design. Even though the 787 has less than half the seating of the Airbus A380, Boeing's Dreamliner is a hit in the market. Orders for the plane have been stronger than anticipated, forcing Boeing to change its production plans to meet demand. The company decided to accelerate its planned 787 production rate buildup, rolling out a new jet every two days or so.

Airbus was not so lucky. The company spent so much time and energy on its super-jumbo that its A350 (the plane designed to compete with Boeing's 787) suffered. The 787 uses less fuel than the A350, and because it is a lighter aircraft, it can operate more efficiently.

The battle for airline supremacy continues to switch between the two global giants. Combined, the two companies hold over 75 percent of the global aircraft market. In 2025, Airbus beat Boeing on several measures including profits and aircraft orders. Airbus delivered nearly 800 jets in 2025, with Boeing delivering only 537. Boeing struggled with production and quality issues.

Critical Thinking Questions

1. What seems to be the difference in how Boeing and Airbus have approached planning?
2. Do you think Airbus should change its strategic plans to meet Boeing's or stick with its current plans? Explain.

Sources: Gillian Rich, "Why Boeing's Paris Air Show Orders Are 'Staggering'," https://www.investors.com, June 22, 2017; Jon Ostrower, "Boeing vs. Airbus: A New Winner Emerges at the Paris Air Show," *CNN,* https://money.cnn.com, June 22, 2017; Gillian Rich, "'Hybrid' Design for New Boeing Midrange Jet Could Hit This Sweet Spot," https://www.investors.com, June 20, 2017; Alex Taylor, III, "Boeing Finally Has a Flight Plan," *Fortune*, June 13, 2005, pp. 27–28; J. Lynn Lunsford and Rod Stone, "Boeing Net Falls, but Outlook Is Rosy," *The Wall Street Journal*, July 28, 2005, p. A3; Carol Matlack and Stanley Holmes, "Why Airbus Is Losing Altitude," *Business Week*, June 20, 2005, p. 20; J. Lynn Lunsford, "UPS to Buy 8 Boeing 747s, Lifting Jet's Prospects," *The Wall Street Journal*, September 18, 2005, p. A2; "Airbus to Launch A350 Jet in October," *Xinhua News Agency*, September 14, 2005, online; "Boeing Plans Major Change," *Performance Materials*, April 30, 2001, p. 5; Radu Balas, Christina Danilet, and Marius Stefan, "Boeing 787-10 vs Airbus A350-1000 (2026): The Widebody Battle – Range, Fuel Burn & Price Compared," *The Flying Engineer*, https://theflyingengineer.com, January 21, 2026; Erin Black, "How Airbus Surpassed Boeing to Become the World's Biggest Plane Maker," *CNBC*, https://www.cnbc.com, June 3, 2025; Marius Bujor, "Boeing Falls Further Behind as Airbus Dominates Aircraft Market with Record Deliveries," *Aeronautics Magazine*, https://aeronauticsmagazine.com, January 13, 2026.

CONCEPT CHECK

1. What is the purpose of planning, and what is needed to do it effectively?
2. Identify the unique characteristics of each type of planning.

6.3 Organizing

3. What are the primary functions of managers in organizing activities?

A second key function of managers is **organizing**, which is the process of coordinating and allocating a firm's resources in order to carry out its plans. Organizing includes developing a structure for the people, positions, departments, and activities within the firm. Managers can arrange the structural elements of the firm to maximize the flow of information and the efficiency of work processes. They accomplish this by doing the following:

- Dividing up tasks *(division of labor)*
- Grouping jobs and employees *(departmentalization)*
- Assigning authority and responsibilities *(delegation)*

These and other elements of organizational structure are discussed in detail elsewhere. In this chapter, however, you should understand the three levels of a managerial hierarchy. This hierarchy is often depicted as a pyramid, as in **Exhibit 6.3**. The fewest managers are found at the highest level of the pyramid. Called **top**

management, they are the small group of people at the head of the organization (such as the CEO, president, and vice president). Top-level managers develop *strategic plans* and address long-range issues such as which industries to compete in, how to capture market share, and what to do with profits. These managers design and approve the firm's basic policies and represent the firm to other organizations. They also define the company's values and ethics and thus set the tone for employee standards of behavior. For example, Jack Welch, former CEO of General Electric and often cited as a great leader, was a role model for his managers and executives. Admirers say that he had an extraordinary capacity to inspire hundreds of thousands of people in many countries and he could change the direction of a huge organization like General Electric as if it were a small firm. Following his leadership, General Electric's executives turned in impressive results. During his tenure, General Electric's market value increased from $14 billion to $600 billion, giving increased returns to GE shareholders.[10]

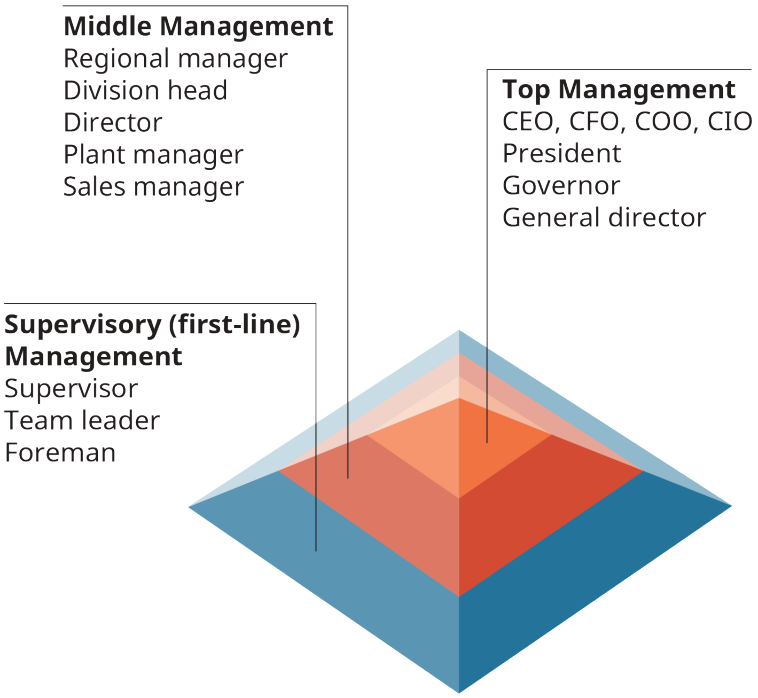

Exhibit 6.3 The Managerial Pyramid (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

The second and third tiers of the hierarchy are called **middle management** and **supervisory (first-line) management**, respectively. Middle managers (such as division heads, departmental managers, and regional sales managers) are responsible for implementing strategic plans. They design and carry out *tactical plans* in specific areas of the company. They begin the process of allocating resources to meet organizational goals, and they oversee supervisory managers throughout the firm. Supervisors, the most numerous of the managers, are at the bottom of the managerial pyramid. These managers design and carry out *operational plans* for the ongoing daily activities of the firm. They spend a great deal of their time guiding and motivating the employees who actually produce the goods and services.

CONCEPT CHECK

1. Explain the managerial function of organizing.
2. What is the managerial pyramid?

6.4 Leading, Guiding, and Motivating Others

4. How do leadership styles influence a corporate culture?

Leadership, the third key management function, is the process of guiding and motivating others toward the achievement of organizational goals. A leader can be anyone in an organization, regardless of position, able to influence others to act or follow, often by their own choice. Managers are designated leaders according to the organizational structure but may need to use negative consequences or coercion to achieve change. In the organization structure, top managers use leadership skills to set, share, and gain support for the company's direction and strategy—mission, vision, and values, such as Carole Tome does at UPS. Middle and supervisory management use leadership skills in the process of directing employees on a daily basis as the employees carry out the plans and work within the structure created by management. Tome demonstrates strong leadership and communication skills, such as those exhibited by Jack Welch while leading General Electric and led to many studies of his approach to leadership. Organizations, however, need strong effective leadership at all levels in order to meet goals and remain competitive.

To be effective leaders, managers must be able to influence others' behaviors. This ability to influence others to behave in a particular way is called **power**. Researchers have identified five primary sources, or bases, of power:

- **Legitimate power**, which is derived from an individual's position in an organization
- **Reward power**, which is derived from an individual's control over rewards
- **Coercive power**, which is derived from an individual's ability to threaten negative outcomes
- **Expert power**, which is derived from an individual's extensive knowledge in one or more areas
- **Referent power**, which is derived from an individual's personal charisma and the respect and/or admiration the individual inspires

Many leaders use a combination of all of these sources of power to influence individuals toward goal achievement. While CEO of Procter & Gamble, A. G. Lafley got his legitimate power from his then-position. His reward power came from reviving the company and making the stock more valuable. Also, raises and bonus for managers who met their goals was another form of reward power. Lafley also was not hesitant to use his coercive power. He eliminated thousands of jobs, sold underperforming brands, and killed weak product lines. With nearly 40 years of service to the company, Lafley had a unique authority when it came to P&G's products, markets, innovations, and customers. The company's sales doubled during his nine years as CEO, and its portfolio of brands increased from 10 to 23. He captained the purchase of Clairol, Wella AG, and IAMS, as well as the multibillion-dollar merger with Gillette. As a result, Lafley had a substantial amount of referent power. Lafley has been widely regarded in the global business community as one of the leading CEOs of his era, frequently cited for his consumer-centric strategy and turnaround of P&G. Ann Gillin Lefever, a managing director at Lehman Brothers, said, "Lafley is a leader who is liked. His directives are very simple. He sets a strategy that everybody understands, and that is more difficult than he gets credit for."[11]

Leadership Styles

Individuals in leadership positions tend to be relatively consistent in the way they attempt to influence the behavior of others, meaning that each individual has a tendency to react to people and situations in a particular way. This pattern of behavior is referred to as **leadership style**. As Table 6.4 shows, leadership styles can be placed on a continuum that encompasses three distinct styles: autocratic, participative, and free rein.

Autocratic leaders are directive leaders, allowing for very little input from subordinates. These leaders prefer to make decisions and solve problems on their own and expect subordinates to implement solutions according to very specific and detailed instructions. In this leadership style, information typically flows in one direction, from manager to subordinate. The military, by necessity, is generally autocratic. When autocratic leaders treat

employees with fairness and respect, they may be considered knowledgeable and decisive. But often autocrats are perceived as narrow-minded and heavy-handed in their unwillingness to share power, information, and decision-making in the organization. The trend in organizations today is away from the directive, controlling style of the autocratic leader.

Exhibit 6.4 Ranking near the top of the *Forbes* list of the world's most powerful women is Abigail Johnson, the CEO of Fidelity Investments. Johnson took over the leadership position from her father and saw a future in incorporating bitcoin into the business model by launching an interface for individual customers to trade bitcoin. Johnson also gives to many nonprofits including her alma mater, Harvard. *What are Abigail Johnson's primary sources of power?* (Credit: Village Global/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Instead, U.S. businesses are looking more and more for **participative leaders**, meaning leaders who share decision-making with group members and encourage discussion of issues and alternatives. Participative leaders use a democratic, consensual, consultative style. One CEO known for her participative leadership style is Mary Barra, CEO of General Motors. Berra creates a culture at GM where input from employees at any level is valued. She has enhanced leadership transparency and created a system where employees can report problems in the manufacturing process. Berra routinely seeks input from employees during town-hall style meetings. The input received is used to develop the overall company direction. Berra was the first woman CEO of a global automaker. She has stated that her vision is to make GM "the most inclusive employer in the world."[12]

Leadership Styles of Managers		
Autocratic Style	**Participative Style (Democratic, Consensual, Consultative)**	**Free-Rein (Laissez-Faire) Style**
• Leaders turn over most authority to subordinates. • Manager makes most decisions and acts in authoritative manner. • Manager is usually unconcerned about subordinates' attitudes toward decisions. • Emphasis is on getting task accomplished. • Approach is used mostly by military officers and some production line supervisors.	• Leaders hold most authority and allow subordinates very little authority. • Manager shares decision-making with group members and encourages teamwork. • Manager encourages discussion of issues and alternatives. • Manager is concerned about subordinates' ideas and attitudes. • Manager coaches subordinates and helps coordinate efforts. • Approach is found in many successful organizations.	• Leaders and subordinates collaboratively share authority. • Manager turns over virtually all authority and control to group. • Members of group are presented with task and given freedom to accomplish it. • Approach works well with highly motivated, experienced, educated personnel. • Approach is found in high-tech firms, labs, and colleges.

Table 6.4

ETHICS IN PRACTICE

Scott Stephenson: Balancing the Duality of Ethics

Whether it's defrauding investors, creating fake accounts, or using unfair pricing strategies, it seems like there is never a shortage of ethical issues being an important aspect of business. As shown by these examples, unethical decisions permeate different parts of the business and occur for different reasons.

For example, Bernie Madoff used a Ponzi scheme to defraud customers about the expected returns on investments with his company. The result was significant financial losses for thousands of customers. At Wells Fargo, pressure from managers to meet new account quotas prompted employees to create fictional accounts in the names of actual customers. These fake accounts bolstered the company's business portfolio to outside investors. The case of Mylan included the dramatic rise in the price of the EpiPen in a short time span and reports that CEO Heather Bresch and other executives received compensation that increased over 700 percent during the same time frame. Adding to the Mylan case was the fact that Bresch's father is West Virginia Senator Joseph Manchin, and prior to being appointed CEO at Mylan, Bresch served as Mylan's chief lobbyist and helped craft the Generic Drug User Fee Amendments and the School Access to Emergency Epinephrine Act.

Where does the responsibility of managing ethical behavior in organizations reside? The answer is *everyone* in the organization is responsible to act in an ethical manner. The primary responsibility resides, however, with the CEO and also with the chief financial officer, who has the responsibility to oversee financial compliance with laws and regulations. Scott Stephenson, the former CEO of Verisk Analytics, commented

on how he approached the duality of what he termed a "loose–tight" approach to leadership where he provided his employees with the discretion and responsibility to make critical decisions in crisis situations where ethics might be involved. That's the loose part. He also worked on communicating and building trust in his employees so that he had the confidence they would act responsibly and make the correct decisions in crisis situations. That's the tight part of his leadership duality.

Critical Thinking Questions

1. Do you think Verisk Analytics, a technology company that needs innovation breakthroughs, benefits from Stephenson's "loose–tight" approach? What if Stephenson had been an autocratic leader? Explain your reasoning.
2. What kind of participative leader (described below) does Stephenson seem to be? Explain your choice.

Sources: Scott Stephenson, "The Duality of Balanced Leadership," *Forbes*, https://www.forbes.com, November 29, 2017; Matt Egan, "Wells Fargo Uncovers Up to 1.4 Million More Fake Accounts," *CNN Money,* https://money.cnn.com, August 31, 2017; Jesse Heitz, "The EpiPen Scandal and the Perception of the Washington Establishment," *The Hill,* https://thehill.com, September 1, 2016; "Decade's Top 10 Ethics Scandals," *The Wall Street Journal*, https://www.wsj.com, August 9, 2010.

Participative leadership has three types: democratic, consensual, and consultative. **Democratic leaders** solicit input from all members of the group and then allow the group members to make the final decision through a voting process. This approach works well with highly trained professionals. The president of a physicians' clinic might use the democratic approach. **Consensual leaders** encourage discussion about issues and then require that all parties involved agree to the final decision. This is the general style used by labor mediators. **Consultative leaders** confer with subordinates before making a decision but retain the final decision-making authority. This technique has been used to dramatically increase the productivity of assembly-line workers.

The third leadership style, at the opposite end of the continuum from the autocratic style, is **free-rein** or **laissez-faire** (French for "leave it alone") **leadership**. Managers who use this style turn over all authority and control to subordinates. Employees are assigned a task and then given free rein to figure out the best way to accomplish it. The manager doesn't get involved unless asked. Under this approach, subordinates have unlimited freedom as long as they do not violate existing company policies. This approach is also sometimes used with highly trained professionals as in a research laboratory.

Although one might at first assume that subordinates would prefer the free-rein style, this approach can have several drawbacks. If free-rein leadership is accompanied by unclear expectations and lack of feedback from the manager, the experience can be frustrating for an employee. Employees may perceive the manager as being uninvolved and indifferent to what is happening or as unwilling or unable to provide the necessary structure, information, and expertise.

No leadership style is effective all the time. Effective leaders recognize employee growth and use **situational leadership**, selecting a leadership style that matches the maturity and competency levels of those completing the tasks. Newly hired employees may respond well to authoritative leadership until they understand the job requirements and show the ability to handle routine decisions. Once established, however, those same employees may start to feel undervalued and perform better under a participative or free-rein leadership style. Using situational leadership empowers employees as discussed next.

Employee Empowerment

Participative and free-rein leaders use a technique called empowerment to share decision-making authority with subordinates. **Empowerment** means giving employees increased autonomy and discretion to make their own decisions, as well as control over the resources needed to implement those decisions. When decision-making power is shared at all levels of the organization, employees feel a greater sense of ownership in, and

responsibility for, organizational outcomes.

Management use of employee empowerment is on the rise. This increased level of involvement comes from the realization that people at all levels in the organization possess unique knowledge, skills, and abilities that can be of great value to the company. For example, when Hurricane Katrina hit the Gulf Coast, five miles of railroad tracks were ripped off a bridge connecting New Orleans to Slidell, Louisiana. Without the tracks, which fell into Lake Pontchartrain, Norfolk Southern Railroad couldn't transport products between the East and West Coasts. Before the storm hit, however, Jeff McCracken, a chief engineer at the company, traveled to Birmingham with equipment he thought he might need and then to Slidell with 100 employees. After conferring with dozens of company engineers and three bridge companies, McCracken decided to try to rescue the miles of track from the lake. (Building new tracks would have taken several weeks at the least.) To do so, he gathered 365 engineers, machine operators, and other workers, who lined up eight huge cranes and, over the course of several hours, lifted the five miles of sunken tracks in one piece out of the lake and bolted it back on the bridge.[13] By giving employees the autonomy to make decisions and access to required resources, Norfolk Southern was able to avoid serious interruptions in its nationwide service.

Exhibit 6.5 CEO of HubSpot Yamini Rangan (center) has fully embraced the concept of employee empowerment. She instituted a "no inner circle" policy where there is open communication between all levels from the CEO down to interns. The company prioritizes employee needs and promotes autonomy by empowering employees to make decisions. *Should any one "school" of management predominate thinking, or should all approaches be considered?* (Credit: Rsuti/ Wikimedia Commons/ CC0 1.0 Universal Public Domain)

Corporate Culture

The leadership style of managers in an organization is usually indicative of the underlying philosophy, or values, of the organization. The set of *attitudes, values,* and *standards of behavior* that distinguishes one organization from another is called **corporate culture**. A corporate culture evolves over time and is based on the accumulated history of the organization, including the vision of the founders. It is also influenced by the dominant leadership style within the organization. Evidence of a company's culture is seen in its heroes (e.g., the late Andy Grove of Intel[14], myths (stories about the company passed from employee to employee), symbols (e.g., the Nike swoosh), and ceremonies. The culture at Google, working in teams and fostering innovation, sometimes is overlooked while its employee perks are drooled over. But both are important to the company's corporate culture. Alphabet (Google's parent company) ranked first on Fortune's "100 Best Companies to Work For" list eight times and appeared on the list every year from 2006 through 2018, based on employee surveys conducted by Great Place to Work®. [15] "We have never forgotten since our startup days that great things happen more frequently within the right culture and environment," a company spokesperson said in response to the company first taking over the top spot.[16]

Culture may be intangible, but it has a tremendous impact on employee morale and a company's success. Google approaches morale analytically. When it found that parents were leaving the company in higher rates than other employee groups, the company improved its parental-leave policies. The result was a reduction in attrition for working parents. An analytical approach along with culture-building activities such as town-hall style meetings with diverse groups of employees, support for underrepresented groups, and workshops for all employees around unconscious biases are some of the top reasons employees say Alphabet is a safe and

inclusive place to work.[17] Clearly Google leaders recognize culture is critical to the company's overall success.

CONCEPT CHECK

1. How do leaders influence other people's behavior?
2. How can managers empower employees?
3. What is corporate culture?

6.5 Controlling

5. How do organizations control activities?

The fourth key function that managers perform is **controlling**. Controlling is the process of assessing the organization's progress toward accomplishing its goals. It includes monitoring the implementation of a plan and correcting deviations from that plan. As Exhibit 6.6 shows, controlling can be visualized as a cyclical process made up of five stages:

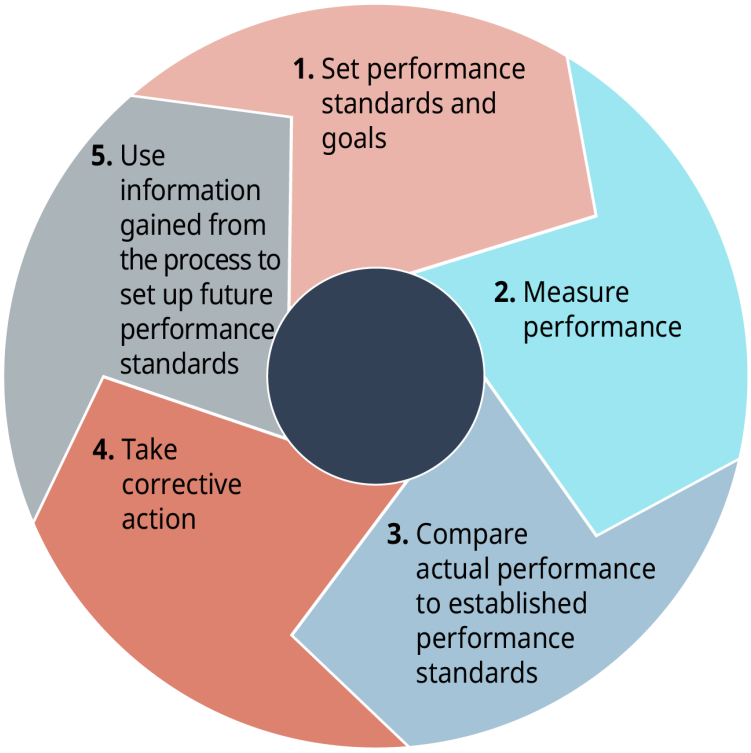

Exhibit 6.6 The Control Process (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Performance standards are the levels of performance the company wants to attain. These goals are based on its strategic, tactical, and operational plans. The most effective performance standards state a measurable behavioral objective that can be achieved in a specified time frame. For example, the performance objective for the sales division of a company could be stated as "$200,000 in gross sales for the month of January." Each individual employee in that division would also have a specified performance goal. Actual firm, division, or individual performance can be measured against desired performance standards to see if a gap exists between the desired level of performance and the actual level of performance. If a performance gap does exist, the reason for it must be determined and corrective action taken.

Feedback is essential to the process of control. Most companies have a reporting system that identifies areas

where performance standards are not being met. A feedback system helps managers detect problems before they get out of hand. If a problem exists, the managers take corrective action. General Motors uses a simple but effective control system in its manufacturing plants. Each employee is empowered to act as a quality control inspector and encouraged to report problems as they might arise. If a part is defective or not installed properly, any employee can report this inconsistency. Promoting a culture of employee participation in reporting problems helps ensure quality products while also promoting teamwork across the organization.

Why is controlling such an important part of a manager's job? First, it helps managers to determine the success of the other three functions: planning, organizing, and leading. Second, control systems direct employee behavior toward achieving organizational goals. Third, control systems provide a means of coordinating employee activities and integrating resources throughout the organization.

CONCEPT CHECK

1. Describe the control process.
2. Why is the control process important to the success of the organization?

6.6 Managerial Roles

6. What roles do managers take on in different organizational settings?

In carrying out the responsibilities of planning, organizing, leading, and controlling, managers take on many different roles. A role is a set of behavioral expectations, or a set of activities that a person is expected to perform. Managers' roles fall into three basic categories: *informational roles, interpersonal roles,* and *decisional roles.* These roles are summarized in Table 6.5. In an **informational role**, the manager may act as an information gatherer, an information distributor, or a spokesperson for the company. A manager's **interpersonal roles** are based on various interactions with other people. Depending on the situation, a manager may need to act as a figurehead, a company leader, or a liaison. When acting in a **decisional role**, a manager may have to think like an entrepreneur, make decisions about resource allocation, help resolve conflicts, or negotiate compromises.

Managerial Decision-Making

In every function performed, role taken on, and set of skills applied, a manager is a decision-maker. Decision-making means choosing among alternatives. Decision-making occurs in response to the identification of a problem or an opportunity. The decisions managers make fall into two basic categories: programmed and nonprogrammed. **Programmed decisions** are made in response to routine situations that occur frequently in a variety of settings throughout an organization. For example, the need to hire new personnel is a common situation for most organizations. Therefore, standard procedures for recruitment and selection are developed and followed in most companies.

The Many Roles Managers Play in an Organization		
Role	**Description**	**Example**
Information Roles		
Monitor	• Seeks out and gathers information relevant to the organization	• Finding out about legal restrictions on new product technology
Disseminator	• Provides information where it is needed in the organization	• Providing current production figures to workers on the assembly line
Spokesperson	• Transmits information to people outside the organization	• Representing the company at a shareholders' meeting
Interpersonal Roles		
Figurehead	• Represents the company in a symbolic way	• Cutting the ribbon at ceremony for the opening of a new building
Leader	• Guides and motivates employees to achieve organizational goals	• Helping subordinates to set monthly performance goals
Liaison	• Acts as a go-between among individuals inside and outside the organization	• Representing the retail sales division of the company at a regional sales meeting
Decisional Roles		
Entrepreneur	• Searches out new opportunities and initiates change	• Implementing a new production process using new technology
Disturbance handler	• Handles unexpected events and crises	• Handling a crisis situation such as a fire
Resource allocator	• Designates the use of financial, human, and other organizational resources	• Approving the funds necessary to purchase computer equipment and hire personnel
Negotiator	• Represents the company at negotiating processes	• Participating in salary negotiations with union representatives

Table 6.5

Infrequent, unforeseen, or very unusual problems and opportunities require **nonprogrammed decisions** by managers. Because these situations are unique and complex, the manager rarely has a precedent to follow. The earlier example of the Norfolk Southern employee, who had to decide the best way to salvage a five-mile-long piece of railroad track from the bottom of Lake Pontchartrain, is an example of a nonprogrammed decision. Likewise, when Hurricane Katrina was forecast to make landfall, Thomas Oreck, then CEO of the Oreck vacuum company that bears his family's name, had to make a series of nonprogrammed decisions. Oreck's corporate headquarters were in New Orleans, and its primary manufacturing facility was in Long Beach, Mississippi. Before the storm hit, Oreck transferred its computer systems and call-center operations to backup locations in Colorado and planned to move headquarters to Long Beach. The storm, however, brutally hit both locations. Oreck executives began searching for lost employees, tracking down generators, assembling temporary housing for workers, and making deals with UPS to begin distributing its product (UPS brought food and water to Oreck from Atlanta and took vacuums back to the company's distribution center there). All of these decisions were made in the middle of a very challenging crisis environment.

Whether a decision is programmed or nonprogrammed, managers typically follow five steps in the decision-making process, as illustrated in **Exhibit 6.7**:

1. Recognize or define the problem or opportunity. Although it is more common to focus on problems because of their obvious negative effects, managers who do not take advantage of new opportunities may lose competitive advantage to other firms.
2. Gather information so as to identify alternative solutions or actions.
3. Select one or more alternatives after evaluating the strengths and weaknesses of each possibility.
4. Put the chosen alternative into action.
5. Gather information to obtain feedback on the effectiveness of the chosen plan.

It can be easy (and dangerous) for managers to get stuck at any stage of the decision-making process. For example, entrepreneurs can become paralyzed evaluating the options. For Gabby Slome, the cofounder of natural pet food maker Ollie, the idea for starting the company came after her rescue dog began having trouble digesting store-bought pet food after living on scraps. Slome decided that the pet food industry, a $45 billion a year business in the United States, was ripe for a natural food alternative. She laments, however, that she let perfect be the enemy of the very good by indulging in "analysis paralysis."[18]

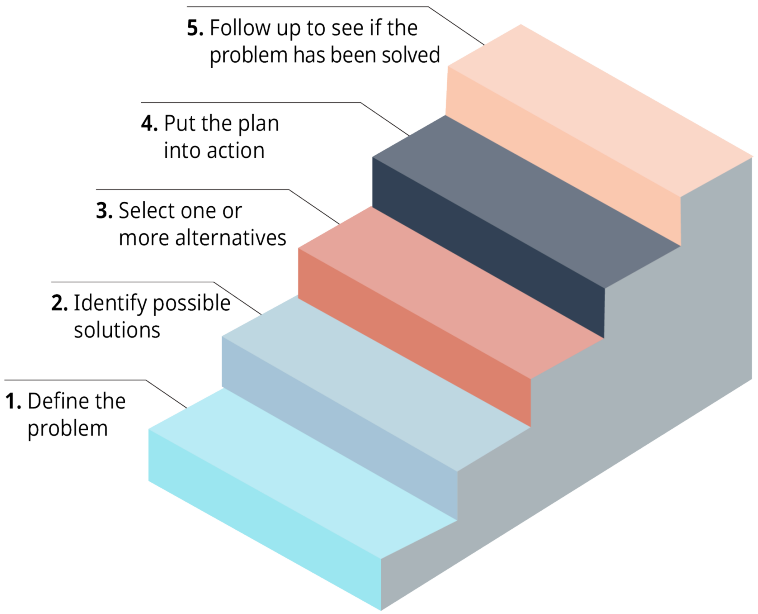

Exhibit 6.7 The Decision-Making Process (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

CONCEPT CHECK

1. What are the three types of managerial roles?
2. Give examples of things managers might do when acting in each of the different types of roles.
3. List the five steps in the decision-making process.

6.7 Managerial Skills

7. What set of managerial skills is necessary for managerial success?

In order to be successful in planning, organizing, leading, and controlling, managers must use a wide variety of skills. A *skill* is the ability to do something proficiently. Managerial skills fall into three basic categories: technical, human relations, and conceptual skills. The degree to which each type of skill is used depends upon the level of the manager's position as seen in Exhibit 6.8. Additionally, in an increasingly global marketplace, it pays for managers to develop a special set of skills to deal with global management issues.

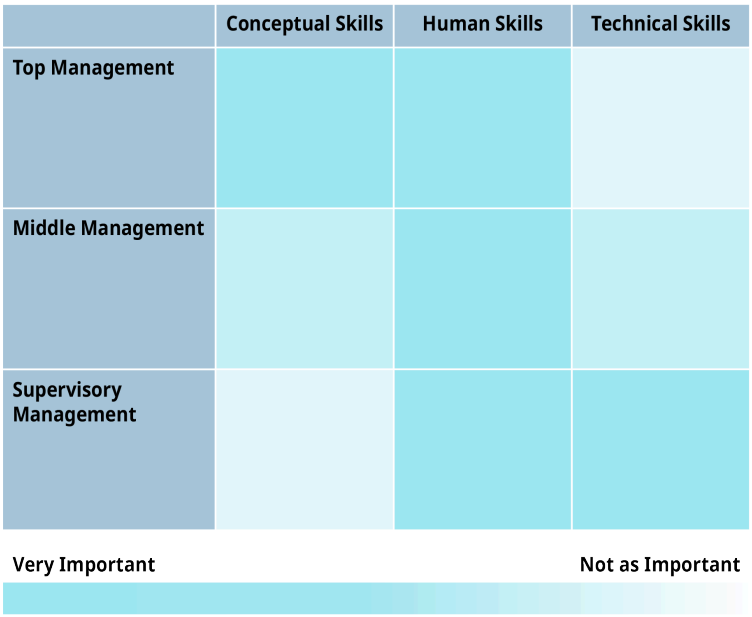

Exhibit 6.8 The Importance of Managerial Skills at Different Management Levels (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Technical Skills

Specialized areas of knowledge and expertise and the ability to apply that knowledge make up a manager's **technical skills**. Preparing a financial statement, programming a computer, designing an office building, and analyzing market research are all examples of technical skills. These types of skills are especially important for supervisory managers because they work closely with employees who are producing the goods and/or services of the firm.

Human Relations Skills

Human relations skills are the interpersonal skills managers use to accomplish goals through the use of human resources. This set of skills includes the ability to understand human behavior, to communicate effectively with others, and to motivate individuals to accomplish their objectives. Giving positive feedback to employees, being sensitive to their individual needs, and showing a willingness to empower subordinates are

all examples of good human relations skills. Identifying and promoting managers with human relations skills are important for companies. A manager with little or no people skills can end up using an authoritarian leadership style and alienating employees.

Conceptual Skills

Conceptual skills include the ability to view the organization as a whole, understand how the various parts are interdependent, and assess how the organization relates to its external environment. These skills allow managers to evaluate situations and develop alternative courses of action. Good conceptual skills are especially necessary for managers at the top of the management pyramid, where strategic planning takes place.

CONCEPT CHECK

1. Define the basic managerial skills.
2. How important is each of these skill sets at the different levels of the management pyramid?

6.8 Trends in Management and Leadership

8. What trends will affect management in the future?

Three key trends in management today are crisis management, technological advancements, and the increasing need for global management skills.

Crisis Management

Crises, both internal and external, can hit even the best-managed organization. Sometimes organizations can anticipate crises, in which case managers develop contingency plans, and sometimes they can't. Take, for example, the sudden death of McDonald's CEO Jim Cantalupo. The company had a solid succession plan in place and immediately named Charlie Bell as new CEO. Only a few months later, Bell announced that he had terminal cancer. Even though the company had prepared for the event of its leader's untimely death, surely it couldn't have anticipated that his successor would also be stricken by a terminal illness at almost the same time. Likewise, consider the devastation caused by the wildfires in Los Angeles in 2025 or the flooding and mudslides in North Carolina as a result of Tropical Storm Helene in 2024. Part of crisis management plans at hotels, for example, could include relaxing "no pets" policies to allow customers needing shelter as a result of a natural disaster to keep their pets with them in the hotel.[19]

Crises cannot be fully anticipated, but managers can develop contingency plans to help navigate through the aftermath of a disaster. For example, consider the challenges that faced Rajiv Joseph, the author of several plays including *Bengal Tiger at the Baghdad Zoo*, who was in Houston preparing to open his new play, *Describe the Night*, at the Alley Theatre when Hurricane Harvey hit and flooded the theater a few weeks prior to opening night. The six New York–based actors, the director, the stage manager, and Joseph decided to help in the relief efforts and made their way to the George Brown Convention Center, which had become the central location for relief efforts. When they arrived and the staffers discovered they were theater artists, they were deployed to handle the writing and deployment of public address announcements and manage the incoming crowds. What made the relief efforts successful was planning—matching the skill sets of volunteers with tasks they are best able to perform.[20] Even though those in charge of the relief efforts had contingency plans, they still needed to make dozens of nonprogrammed decisions to effectively manage the ever-changing situation.[21]

No manager or executive can be completely prepared for these types of unexpected crises. However, how a

manager responds to the situation can mean the difference between being able to survive the crisis or disaster versus not being able to recover from the event and the business eventually ceasing to operate. No matter the crisis, there are some basic guidelines managers should follow to minimize negative outcomes. Managers should not become immobilized by the problem or ignore it. Managers should face the problem head on. Managers should always tell the truth about the situation and then put the best people on the job to correct the problem. Managers should ask for help if they need it, and finally, managers must learn from the experience to avoid the same problem in the future.[22] **Table 6.6** describes what CEOs and other leaders learned about crisis management.

Managers and Advances in Technology

The second trend having a major impact on managers is the proliferation of data and analytics in information technology. An increasing number of organizations are selling technology, and an increasing number are looking for cutting-edge technology to make and market the products and services they sell. One particularly useful type of technology is AI (artificial intelligence). AI is being utilized across industries—from education, to healthcare, to manufacturing. Customer service "bots" are now used to solve many complaints from customers. AI assistance is used to screen résumés quickly and to facilitate onboarding activities to enhance recruiting efficiencies and reduce costs. The technology assists healthcare workers with routine administrative tasks such as billing and scheduling. AI tutors are assisting teachers and students alike. Overall, AI technologies are impacting employee productivity as tools continue to be developed to assist employees with work tasks.

Lessons Leaders Learned about Managing Crises	
Howard Schultz former chairman, Starbucks	Learn from one crisis at a time. After the Seattle earthquake of 2001, the company invested in a notification system that could handle text messaging. The night before Hurricane Katrina hit, Starbucks sent out 2,300 phone calls to associates in the region, telling them about available resources.
Mary Barra CEO, General Motors	Redirect efforts. During the COVID-19 pandemic, Barra was able to mobilize the company to redirect their options to producing much-needed hospital ventilators. This move was critical for the health care system, but also kept the company earning money.
J. W. Marriott former CEO, Marriott	Communicate for safety. Marriott moved its email system out of New Orleans before Katrina hit. As a result, employees were able to communicate with each other and vendors to get food and water to affected areas. A massive publicity campaign helped the company find 2,500 of its 2,800 people in the region.

Table 6.6 Sources: Susan Burns and David Hackett, "Business Lessons from Hurricane Irma," 941CEO, November-December 2017; "New Lessons to Learn," Fortune, October 3, 2005, pp. 87–88; "What Sets Female CEOs Apart in Crisis Leadership Scenarios," *The Women Leaders Magazine*, https://thewomenleaders.com, April 4, 2025; Jennifer Taylor, "Elon Musk, Marissa Mayer and 25 More CEOs That Have Saved or Sunk Major Corporations," *GoBankingRates*, https://www.gobankingrates.com, August 1, 2021; Lauren Wyatt, "Cynt Marshall's Legacy: Transforming the Dallas Mavericks and Inspiring a Community," *NBA*, https://www.nba.com, December 27, 2024; Energage, "10 Influential Female CEOs & Business Leaders," *Top Work Places*, https://topworkplaces.com, March 28, 2021.

Lessons Leaders Learned about Managing Crises	
Sonja Syngal former CEO, Gap	Listen to your people. To better understand employees in the retail sector of their business, Syngal started company-wide "listening tours" so that she could better understand the challenges they were facing during the COVID-19 pandemic.
Ann Mulcahy former CEO, Xerox	Forge a turnaround. Xerox was in serious debt and near bankruptcy when Ann Mulcahy was appointed CEO. She went to work to turn the company around by instituting cost-cutting measures and focusing on product innovations. Company net income went from around $90 million to over $850 million in one year.
Cynt Marshall former CEO, Dallas Mavericks	Make meaningful change. Marshall took over when the organization was under scrutiny for workplace harassment and sexual misconduct issues. Her mission was clear: transform the culture and rebuild the organization's image. She navigated the public image crises while maintaining profitability.

Table 6.6 Sources: Susan Burns and David Hackett, "Business Lessons from Hurricane Irma," 941CEO, November-December 2017; "New Lessons to Learn," Fortune, October 3, 2005, pp. 87–88; "What Sets Female CEOs Apart in Crisis Leadership Scenarios," *The Women Leaders Magazine*, https://thewomenleaders.com, April 4, 2025; Jennifer Taylor, "Elon Musk, Marissa Mayer and 25 More CEOs That Have Saved or Sunk Major Corporations," *GoBankingRates*, https://www.gobankingrates.com, August 1, 2021; Lauren Wyatt, "Cynt Marshall's Legacy: Transforming the Dallas Mavericks and Inspiring a Community," *NBA*, https://www.nba.com, December 27, 2024; Energage, "10 Influential Female CEOs & Business Leaders," *Top Work Places*, https://topworkplaces.com, March 28, 2021.

Such integrated functionality made dashboards extremely popular. A Gartner commentary suggests that companies put data and analytics at the heart of every company business decision.[23] Despite the increasing popularity of dashboard technology, the control tool has some drawbacks, such as focusing too intently on short-term results and ignoring the overall progress toward long-term goals. And some employees might bristle at being monitored as closely as dashboard tools allow.

Nonetheless, companies are seeing real results from implementing dashboard software. Robert Romanoff, an estate planning partner and past managing partner at the Chicago law firm Levenfeld Pearlstein, uses dashboards that aggregate client and firm data to guide decision-making.[24]

Exhibit 6.9 Marketing and sales professionals are increasingly turning to advanced data analytics tools to monitor business and evaluate performance. These computer tools use analytics and big data to help managers identify valuable customers, track sales,

and align plans with company objectives—all in real time. A typical dashboard might include sales and bookings forecasts, monthly close data, customer satisfaction data, and employee training schedules. This example tracks customers attending the Consumer Electronics Show so that the buzz created by influencers can be measured. *How does information technology affect managerial decision-making?* (Credit: Intel Free Press/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Managing Multinational Cultures

The increasing globalization of the world market has created a need for managers who have **global management skills**, that is, the ability to operate in diverse cultural environments. With more and more companies choosing to do business in multiple locations around the world, employees are often required to learn the geography, language, and social customs of other cultures. It is expensive to train employees for foreign assignments and pay their relocation costs; therefore, choosing the right person for the job is especially important. Individuals who are open minded, flexible, willing to try new things, and comfortable in a multicultural setting are good candidates for international management positions.

As companies expand around the globe, managers will continue to face the challenges of directing the behavior of employees around the world. They must recognize that because of cultural differences, people respond to similar situations in very different ways. The burden, therefore, falls on the manager to produce results while adapting to the differences among the employees they manage.

How a manager gets results, wins respect, and leads employees varies greatly among countries, cultures, and individuals. For example, different cultures have different approaches to time. Many western countries such as the United States and Germany view time in a linear pattern where the past leads to the future. There is an emphasis on goal setting and progress. Alternatively, some Indigenous cultures view time as more cyclical, with an eye toward the interconnectedness of events. The focus is on continuity and a sense of patience as time evolves through seasons. A U.S. manager with a linear view of time will approach scheduling planning with a different approach than colleagues with a multi-active or cyclic approach.[25] Despite differences such as these (examples of which can be cited for every country in the world), managing within a different culture is only an extension of what managers do every day: working with differences in employees, processes, and projects.

CONCEPT CHECK

1. How can information technology aid in decision-making?
2. What are three principles of managing multinational cultures?
3. Describe several guidelines for crisis management.

Key Terms

autocratic leaders Directive leaders who prefer to make decisions and solve problems on their own with little input from subordinates

coercive power Power that is derived from an individual's ability to threaten negative outcomes.

conceptual skills A manager's ability to view the organization as a whole, understand how the various parts are interdependent, and assess how the organization relates to its external environment.

consensual leaders Leaders who encourage discussion about issues and then require that all parties involved agree to the final decision.

consultative leaders Leaders who confer with subordinates before making a decision but who retain the final decision-making authority.

contingency plans Plans that identify alternative courses of action for very unusual or crisis situations; typically stipulate the chain of command, standard operating procedures, and communication channels the organization will use during an emergency.

controlling The process of assessing the organization's progress toward accomplishing its goals; includes monitoring the implementation of a plan and correcting deviations from the plan.

corporate culture The set of attitudes, values, and standards that distinguishes one organization from another.

decisional roles A manager's activities as an entrepreneur, resource allocator, conflict resolver, or negotiator.

democratic leaders Leaders who solicit input from all members of the group and then allow the members to make the final decision through a vote.

effectiveness The ability to produce the desired result or good.

efficiency Using the least amount of resources to accomplish the organization's goals.

empowerment The process of giving employees increased autonomy and discretion to make decisions, as well as control over the resources needed to implement those decisions.

expert power Power that is derived from an individual's extensive knowledge in one or more areas.

free-rein (laissez-faire) leadership A leadership style in which the leader turns over all authority and control to subordinates.

global management skills A manager's ability to operate in diverse cultural environments.

human relations skills A manager's interpersonal skills that are used to accomplish goals through the use of human resources.

informational roles A manager's activities as an information gatherer, an information disseminator, or a spokesperson for the company.

interpersonal roles A manager's activities as a figurehead, company leader, or liaison.

leadership The process of guiding and motivating others toward the achievement of organizational goals.

leadership style The relatively consistent way that individuals in leadership positions attempt to influence the behavior of others.

legitimate power Power that is derived from an individual's position in an organization.

management The process of guiding the development, maintenance, and allocation of resources to attain organizational goals.

middle management Managers who design and carry out tactical plans in specific areas of the company.

mission An organization's purpose and reason for existing; its long-term goals.

mission statement A statement that conveys an organization's purpose and reason for existing and describes its basic philosophy.

nonprogrammed decisions Responses to infrequent, unforeseen, or very unusual problems and opportunities where the manager does not have a precedent to follow in decision-making.

operational planning The process of creating specific standards, methods, policies, and procedures that are used in specific functional areas of the organization; helps guide and control the implementation of tactical plans.

organizing The process of coordinating and allocating a firm's resources in order to carry out its plans.

participative leaders Leaders who share decision-making with group members and encourage discussion of issues and alternatives; includes democratic, consensual, and consultative styles.
planning The process of deciding what needs to be done to achieve organizational objectives; identifying when and how it will be done; and determining who should do it.
power The ability to influence others to behave in a particular way.
programmed decisions Decisions made in response to frequently occurring routine situations.
referent power Power that is derived from an individual's personal charisma and the respect and/or admiration the individual inspires.
reward power Power that is derived from an individual's control over rewards.
situational leadership Selecting a leadership style based on the maturity and competency level of those who will complete the task.
strategic planning The process of creating long-range (one to five years), broad goals for the organization and determining what resources will be needed to accomplish those goals.
supervisory (first-line) management Managers who design and carry out operation plans for the ongoing daily activities of the firm.
tactical planning The process of beginning to implement a strategic plan by addressing issues of coordination and allocating resources to different parts of the organization; has a shorter time frame (less than one year) and more specific objectives than strategic planning.
technical skills A manager's specialized areas of knowledge and expertise, as well as the ability to apply that knowledge.
top management The highest level of managers; includes CEOs, presidents, and vice presidents, who develop strategic plans.

Summary of Learning Outcomes

6.1 The Role of Management

1. What is the role of management?

Management is the process of guiding the development, maintenance, and allocation of resources to attain organizational goals. Managers are the people in the organization responsible for developing and carrying out this management process. The four primary functions of managers are planning, organizing, leading, and controlling. By using the four functions, managers work to increase the efficiency and effectiveness of their employees, processes, projects, and organizations as a whole.

6.2 Planning

2. What are the four types of planning?

Planning is deciding what needs to be done, identifying when and how it will be done, and determining who should do it. Managers use four different types of planning: strategic, tactical, operational, and contingency planning. Strategic planning involves creating long-range (one to five years), broad goals and determining the necessary resources to accomplish those goals. Tactical planning has a shorter time frame (less than one year) and more specific objectives that support the broader strategic goals. Operational planning creates specific standards, methods, policies, and procedures that are used in specific functional areas of the organization. Contingency plans identify alternative courses of action for very unusual or crisis situations.

6.3 Organizing

3. What are the primary functions of managers in organizing activities?

Organizing involves coordinating and allocating a firm's resources in order to carry out its plans. It includes developing a structure for the people, positions, departments, and activities within the firm. This is accomplished by dividing up tasks (division of labor), grouping jobs and employees (departmentalization), and assigning authority and responsibilities (delegation).

6.4 Leading, Guiding, and Motivating Others

4. How do leadership styles influence a corporate culture?

Leading is the process of guiding and motivating others toward the achievement of organizational goals. Managers have unique leadership styles that range from autocratic to free-rein. The set of attitudes, values, and standards of behavior that distinguishes one organization from another is called corporate culture. A corporate culture evolves over time and is based on the accumulated history of the organization, including the vision of the founders.

6.5 Controlling

5. How do organizations control activities?

Controlling is the process of assessing the organization's progress toward accomplishing its goals. The control process is as follows: (1) set performance standards (goals), (2) measure performance, (3) compare actual performance to established performance standards, (4) take corrective action when necessary, and (5) use information gained from the process to set future performance standards.

6.6 Managerial Roles

6. What roles do managers take on in different organizational settings?

In an informational role, the manager may act as an information gatherer, an information distributor, or a spokesperson for the company. A manager's interpersonal roles are based on various interactions with other people. Depending on the situation, a manager may need to act as a figurehead, a company leader, or a liaison.

6.7 Managerial Skills

7. What set of managerial skills is necessary for managerial success?

Managerial skills fall into three basic categories: technical, human relations, and conceptual skills. Specialized areas of knowledge and expertise and the ability to apply that knowledge make up a manager's technical skills. Human relations skills include the ability to understand human behavior, to communicate effectively with others, and to motivate individuals to accomplish their objectives. Conceptual skills include the ability to view the organization as a whole, understand how the various parts are interdependent, and assess how the organization relates to its external environment.

6.8 Trends in Management and Leadership

8. What trends will affect management in the future?

Three important trends in management today are preparing for crisis management, advancing technologies, and the need to manage multinational cultures. Crisis management requires quick action, telling the truth about the situation, and putting the best people on the task to correct the situation. Finally, management must learn from the crisis in order to prevent it from happening again. Using the latest information technology, such as dashboard software, AI, and data analytics, managers can make quicker, better-informed decisions. As more companies "go global," the need for multinational cultural management skills is growing. Managers must set a good example, create personal involvement for all employees, and develop a culture of trust.

Preparing for Tomorrow's Workplace Skills

1. Would you be a good manager? Do a self-assessment that includes your current technical, human relations, and conceptual skills. What skills do you already possess, and which do you need to add? Where do your strengths lie? Based on this exercise, develop a description of an effective manager. (Resources, Information)
2. Successful managers map out what they want to do with their time (planning), determine the activities

and tasks they need to accomplish in that time frame (organizing), and make sure they stay on track (controlling). How well do you manage your time? Do you think ahead, or do you tend to procrastinate? Examine how you use your time, and identify at least three areas where you can improve your time management skills. (Resources)

3. Often researchers cast leadership in an inspirational role in a company and management in more of an administrative role. That tendency seems to put leadership and management in a hierarchy. Do you think one is more important than the other? Do you think a company can succeed if it has bad managers and good leaders? What about if it has good managers and bad leaders? Are managers and leaders actually the same? (Systems)
4. Today's managers must be comfortable using all kinds of technology. Do an inventory of your computer skills, and identify any gaps. After listing your areas of weakness, make a plan to increase your computer competency by enrolling in a computer class on or off campus. You may want to practice using common business applications such as a spreadsheet program to track your budget, creating presentation slides for your next class project, or utilizing a calendar program to manage your semester assignments. (Information, Technology)
5. **Team Activity** One of the most common types of planning that managers do is operational planning, or the creation of policies, procedures, and rules and regulations. Assemble a team of three classmates, and work together to draft an operational plan that addresses employee attendance (or absenteeism). (Interpersonal, Systems)

Ethics Activity

Are top executives paid too much? A study of CEO compensation raised many questions from investors and others. CEO pay for S&P 500 companies in 2024 was 285 to 1, as compared to the average worker. That is considerably larger than the ratio in the late 1980s, which was around 60 to 1. The Securities and Exchange Commission (SEC) now requires public companies to disclose full details of executive compensation, including salaries, bonuses, pensions, benefits, stock options, and severance and retirement packages.

Even some CEOs question the high levels of CEO pay. Edgar Woolard, Jr., former CEO and chairman of DuPont, thinks so. "CEO pay is driven today primarily by outside consultant surveys," he says. Companies all want their CEOs to be in the top half, and preferably the top quarter, of all CEOs. This leads to annual increases. He also criticizes the enormous severance packages that company boards give to CEOs that fail. For example, Carly Fiorina, former CEO of Hewlett-Packard, received roughly $21 million in cash severance—and about $40 million in total exit compensation including stock and pension—when she was forced out in 2005.

Using a web search tool, locate articles about this topic, and then write responses to the questions in the Ethical Dilemma section below. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Are CEOs entitled to increases in compensation when their company's financial situation worsens, because their job becomes more challenging? If they fail, are they entitled to huge severance packages for their efforts? Should companies be required to divulge all details of compensation for their highest top managers, and what effect is such disclosure likely to have on executive pay?

Sources: U.S. Securities and Exchange Commission, "SEC Adopts Rule for Pay Ratio Disclosure," https://www.sec.gov, accessed September 21, 2017; Irv Becker, "Why CEOs Aren't Overpaid," *Fortune,* https://fortune.com, June 11, 2017; "CEOs are Overpaid, Says Former DuPont CEO Edgar Woolard Jr.," *PR Newswire*, February 9, 2006, https://proquest.umi.com; Elizabeth Souder, "Firm Questions Exxon CEO's Pay," *Dallas Morning News*, December 15, 2005, https://galenet.thomsonlearning.com; "Weaker Company Performance Does Not Seem to Slow CEO Pay Increases," *Corporate Board*, September-October 2005, p. 27, https://galenet.thomsonlearning.com; "What Price CEO Pay?" *The Blade* (Toledo, Ohio), January 20, 2006, https://www.toledoblade.com; Kristin Tousaint, "The Gap between CEO and Worker Pay Keeps Increasing—and Trump's Policies Are Making It Grow Faster," *Fast Company*, https://www.fastcompany.com, July 24, 2025; Eric

Dash, "Fiorina Exiting Hewlett-Packard with More Than $42 Million," *The New York Times*, https://www.nytimes.com, February 12, 2005.

Working the Net

1. Are you leadership material? See how you measure up at Your Leadership Legacy, **https://www.yourleadershiplegacy.com/assessment.html**. Read the commentary, and take the test. Study the outcome, and provide an example of how you would put each item into action.
2. The Balanced Scorecard Institute, **https://balancedscorecard.org/**, offers many reasons why companies should develop strategic plans, as well as a strategy tip of the month, assessment tools, planning exercises, and resource links. Explore the site to learn the effect of strategic planning on financial performance, and present your evidence to the class. Then select a planning exercise, and with a group of classmates, perform it as it applies to your school.
3. Congratulations! You've just been promoted to your first supervisory position. However, you are at a loss as to how to actually manage your staff. This guide to general management, **https://resources-for-new-managers.com/**, brings together a variety of materials to help you. Check out Management Skills, as well as other resources. Develop a plan for yourself to follow.
4. How do entrepreneurs develop the corporate culture of their companies? Do a search of the term "corporate culture" on *Inc.* (**https://www.inc.com**), *Entrepreneur* (**https://www.entrepreneur.com**), or *Fast Company* (**https://www.fastcompany.com**). Prepare a short presentation for your class that explains the importance of corporate culture and how it is developed in young firms.
5. Good managers and leaders know how to empower their employees. The Forbes Business Council's "15 Ways to Empower Employees" (**https://www.forbes.com/councils/forbesbusinesscouncil/2021/10/12/15-ways-to-empower-your-employees/**) provides strategies to improve trust, satisfaction, and growth. After reviewing the information at this site, prepare a brief report on the benefits of employee empowerment. Include several ideas you would like a manager to use to empower you.
6. Get some leadership tips from 7 Steps to Closure at the Learning Center, **https://www.learningcenter.net/library/7steps.shtml**. Complete the Closure Planning Form to develop your own personal Success-Oriented Action Plan.

Critical Thinking Case

Managing an Extreme Makeover

Executives of Wipro Ltd. visited Toyota Kirloskar Motor's auto assembly plant in Bidadi, near their headquarters in Bengaluru, India, where models such as the Corolla were produced. There, they hit on a revolutionary idea—why not apply Toyota's successful manufacturing techniques to managing their software development and clients' back-office operations business?

"Toyota preaches continuous improvement, respect for employees, learning, and embracing change," says T. K. Kurien, former CEO of Wipro's IT business (and later CEO of Wipro Limited). "What we do is apply people, technology, and processes to solve a business problem."

Among the problems spotted early on by Kurien? Cubicles. They're normal for programmers but interrupt the flow for business-process employees. Deciding to position people side by side at long tables assembly-line style "was a roaring disaster," admits Kurien. "The factory idea concerned people." So based on feedback from his middle managers, Kurien arranged classes to explain his concepts and how they would ultimately make life easier for employees.

Wipro also adopted Toyota's *kaizen* system of soliciting employee suggestions. Priya, who has worked for Wipro for years, submitted several *kaizen* and was delighted when her bosses responded promptly to her suggestions. "Even though it's something small, it feels good. You're being considered," she says.

Kurien and his managers work hard at boosting employee morale, offering rewards—pens, caps, or shirts—to

employees who submit suggestions to *kaizen* boxes. And each week, a top-performing employee receives a cake. Murthy, an accountant who hopes to be Wipro's chief financial officer someday, spearheaded an effort to cut government import approval times from 30 to 15 days. He got a cake with his name written on it in honey. "I was surprised management knew what I was doing," he says. "Now I want to do more projects."

With over $3 billion in contracts, a market cap at nearly $31 billion, and over 230,000 employees, Wipro is celebrating 25 years of being listed on the New York Stock Exchange. The company's paperwork processing operations bear a clear resemblance to a Toyota plant. Two shifts of young people line long rows of tables. At the start of each shift, team leaders discuss the day's goals and divide up tasks. And just like in a Toyota factory, electronic displays mounted on the walls shift from green to red if things get bogged down.

This obsession with management efficiency has helped India become the back-office operation for hundreds of Western companies, resulting in the transfer of many thousands of jobs offshore. "If the Indians get this right, in addition to their low labor rates, they can become deadly competition," says Jeffrey K. Liker, Professor Emeritus of Industrial and Operations Engineering at the University of Michigan and author of *The Toyota Way*, a book about Toyota's lean manufacturing techniques. If Kurien's management initiatives succeed, experts may soon be extolling the Wipro way.

Critical Thinking Questions

1. What type of manager is T. K. Kurien? How would you characterize his leadership style?
2. What managerial role does T. K. Kurien assume in his approach to attaining his division's goal of improved customer service?
3. What management skill sets does he exhibit?

Sources: Steve Hamm, "Taking a Page from Toyota's Playbook," *Bloomberg Businessweek*, https://www.bloomberg.com, accessed November 17, 2017; Shilpa Phadnis, "T K Kurien to Leave Wipro This Month," *The Times of India*, https://timesofindia.indiatimes.com, January 23, 2017; Toyota Resumes Efficiency Drive," *BBC News*, https://www.bbc.com, March 26, 2015; "Toyota Kirloskar Motor Ltd," *Business Maps of India*, https://business.mapsofindia.com/, September 22, 2025; "Wipro Ltd. Company History and Annual Growth Details," *Good Returns*, https://www.goodreturns.in/, accessed January 25, 2026; "Wipro Ltd (WIT) Q3 2026 Earnings Call Highlights: Strong Revenue Growth amid Sector Challenges," *Guru Focus*, https://www.gurufocus.com, January 16, 2026; "Wipro Limited (WIT)," *Stock Analysis*, https://stockanalysis.com, accessed January 25, 2026; "Jeffrey Liker," Industrial & Operations Engineering/University of Michigan, https://ioe.engin.umich.edu/, accessed January 25, 2026.

Hot Links Address Book

1. Visit the International Business Leaders Forum (IBLF) at **https://www.iblfglobal.org** to discover what today's international business leaders are focusing on.
2. To learn more about how firms develop contingency plans for all sorts of crises, visit Indeed's guidance at **https://www.indeed.com/career-advice/career-development/contingency-plan**.
3. Who are the leaders of this year's *Inc*. 5000, and what do they have to say about their success? Find out at the *Inc*. 5000 site at **https://www.inc.com/inc5000**.
4. Want to learn more about Bill Gates's management style? Go to his personal website, **https://www.gatesnotes.com/Bio**, to read his official biography, books, and other information.
5. Most successful managers work hard at continually updating their managerial skills. One organization that offers many ongoing training and education programs is the American Management Association. Visit its site at **https://www.amanet.org**.
6. Search Questia's online library at **https://questia.librarika.com/** for leadership resources. You'll be able to preview a wide variety of books, journals, and other materials.

7

Designing Organizational Structures

Exhibit 7.1 (Credit: CDC/ Dawn Arlotta / US Government Works)

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What are the traditional forms of organizational structure?
2. What contemporary organizational structures are companies using?
3. Why are companies using team-based organizational structures?
4. What tools do companies use to establish relationships within their organizations?
5. How can the degree of centralization/decentralization be altered to make an organization more successful?
6. How do mechanistic and organic organizations differ?
7. How does the informal organization affect the performance of the company?
8. What trends are influencing the way businesses organize?

EXPLORING BUSINESS CAREERS

Elise Eberwein, EVP of People and Communications, American Airlines

As executive vice president of people and communications at American Airlines, Elise Eberwein's role within the structure of the organization might not be readily apparent. After all, you might ask, doesn't corporate communications typically involve marketing? And what does that have to do with organizational structure? As it turns out, quite a bit at the world's largest airline.

When American Airlines and US Airways finally got the U.S. government's approval to merge in late 2013, it was no longer business as usual for Eberwein and her colleagues at the "new" airline. Until the merger, which basically produced the world's largest airline with more than 6,000 daily flights and over 100,000 employees, Eberwein was head of communications at US Airways—a position she held for nine years after various other jobs in the airline industry.

Exhibit 7.2 American Airlines jet. (Credit: Joao Carlos Medau/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Communications and aviation are in Eberwein's DNA. She worked as a flight attendant at TWA before moving on to manage communications at Denver-based Frontier Airlines. Her next communications experience was at America West, which then merged with US Airways, where Eberwein served as executive vice president of people, communications, and public affairs before she took over the chief communications job at American Airlines, which she held until retiring from the role in 2022.

Corporation communications is no longer just about marketing. The importance of an effective communications strategy cannot be understated in today's 24/7 business environment. Corporate communication executives have taken on an expanded role in many organizations. According to data, more chief communications officers are reporting directly to the CEO, an increase of 34 percent over previous years. In addition, key leadership skills for communications professionals include having a strategic mindset that goes beyond day-to-day communications to include a vision for the future that can be translated into achievable corporate strategies at all levels of the organization.

In a company as large as American Airlines, even after the initial two-year integration plan, there are many departments, unions, and other employees to communicate with on a daily basis, not to mention the millions of customers they serve every day. For example, American's communications team focuses on social media and engagement, customer service, and social insights. The customer service group operates around the clock to address customers' issues, including missed flight connections and lost luggage, as well as quirky questions like why certain airplanes have a specific number of stripes on their tails. Reporting to Eberwein, the social media group was empowered to reach out to any company department directly to get answers for any customer.

Eberwein believed her role included working closely with the CEO and other managers across the globe to provide consistent, detailed information to all of its stakeholders. To accomplish this feat, Eberwein and other senior managers held a weekly Monday morning meeting to review the previous week's operations data, revenue results, and people engagement activities. Eberwein believes this type of regular contact with colleagues across the organization helps reinforce American's commitment to engagement and transparent communications, which ultimately shapes the customer's experience as well as the entire company.

Sources: "Leadership Bios: Elise Eberwein," https://www.aa.com, accessed July 24, 2017; "By the Numbers: Snapshot of the Airline," https://news.aa.com, accessed July 24, 2017; Richard Marshall, Beth Fowler, and Nels Olson, "The Chief Communications Officer: Survey and Findings among the Fortune 500," https://www.kornferry.com, accessed July 24, 2017; Elise Eberwein, "Why the Chief Communications Officer Is Pivotal to the CEO, Especially a New One," *Chief Executive*, https://chiefexecutive.net, September 11,

2016; Michael Slattery, "A Visit to American Airlines Social Media Hub," *Airways* magazine, https://airwaysmag.com, June 10, 2016; Diana Bradley, "American Airlines CEO Discusses Comms Strategy behind US Airways Merger," *PR Week,* https://www.prweek.com, May 27, 2015; Darlene Doyle, "The Growing CCO to CEO Pipeline," PAN, https://www.pancommunications.com/, accessed February 3, 2026.

This module focuses on the different types of organizational structure, the reasons an organization might prefer one structure over another, and how the choice of an organizational structure ultimately can impact that organization's success.

In today's dynamic business environment, organizational structures need to be designed so that the organization can quickly respond to new competitive threats and changing customer needs. Future success for companies will depend on their ability to be flexible and respond to the needs of customers. In this chapter, we'll look first at how companies build organizational structures by implementing traditional, contemporary, and team-based models. Then, we'll explore how managers establish the relationships within the structures they have designed, including determining lines of communication, authority, and power. Finally, we'll examine what managers need to consider when designing organizational structures and the trends that are changing the choices companies make about organizational design.

7.1 Building Organizational Structures

1. What are the traditional forms of organizational structure?

The key functions that managers perform include planning, organizing, leading, and controlling. This module focuses specifically on the organizing function. *Organizing* involves coordinating and allocating a firm's resources so that the firm can carry out its plans and achieve its goals. This organizing, or structuring, process is accomplished by:

- Determining work activities and dividing up tasks *(division of labor)*
- Grouping jobs and employees *(departmentalization)*
- Assigning authority and responsibilities *(delegation)*

The result of the organizing process is a formal structure within an organization. An **organization** is the order and design of relationships within a company or firm. It consists of two or more people working together with a common objective and clarity of purpose. Formal organizations also have well-defined lines of authority, channels for information flow, and means of control. Human, material, financial, and information resources are deliberately connected to form the business organization. Some connections are long-lasting, such as the links among people in the finance or marketing department. Others can be changed at almost any time—for example, when a committee is formed to study a problem.

Every organization has some kind of underlying structure. Typically, organizations base their frameworks on traditional, contemporary, or team-based approaches. Traditional structures are more rigid and group employees by function, products, processes, customers, or regions. Contemporary and team-based structures are more flexible and assemble employees to respond quickly to dynamic business environments. Regardless of the structural framework a company chooses to implement, all managers must first consider what kind of work needs to be done within the firm.

Exhibit 7.3 Founded in 1943, Sweden retailer IKEA has grown from a small mail-order operation to a global force in home furnishings with more than 500 stores in 63 different markets throughout Europe, North America, Africa, Australia, and Asia. Best known for its contemporary furniture designs, highly trafficked store openings, and quirky advertising, Ikea's organizational structure is separated into divisions corresponding to the core functions of the business that include retail, supply chain, sales, and design and manufacturing functions. *What factors likely influenced the development of IKEA's organizational structure as the company expanded over the years?* (Credit: JJBers/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Division of Labor

The process of dividing work into separate jobs and assigning tasks to workers is called **division of labor**. In a fast-food restaurant, for example, some employees take or fill orders, others prepare food, a few clean and maintain equipment, and at least one supervises all the others. In an auto assembly plant, some workers install rearview mirrors, while others mount bumpers on bumper brackets. The degree to which the tasks are subdivided into smaller jobs is called **specialization**. Employees who work at highly specialized jobs, such as assembly-line workers, perform a limited number and variety of tasks. Employees who become specialists at one task, or a small number of tasks, develop greater skill in doing that particular job. This can lead to greater efficiency and consistency in production and other work activities. However, a high degree of specialization can also result in employees who are disinterested or bored due to the lack of variety and challenge.

Traditional Structures

After a company divides the work it needs to do into specific jobs, managers then group the jobs together so that similar or associated tasks and activities can be coordinated. This grouping of people, tasks, and resources into organizational units is called **departmentalization**. It facilitates the planning, leading, and control processes.

An **organization chart** is a visual representation of the structured relationships among tasks and the people given the authority to do those tasks. In the organization chart in Exhibit 7.4, each figure represents a job, and each job includes several tasks. The sales manager, for instance, must hire salespeople, establish sales territories, motivate and train the salespeople, and control sales operations. The chart also indicates the general type of work done in each position. As Exhibit 7.5 shows, five basic types of departmentalization are commonly used in organizations:

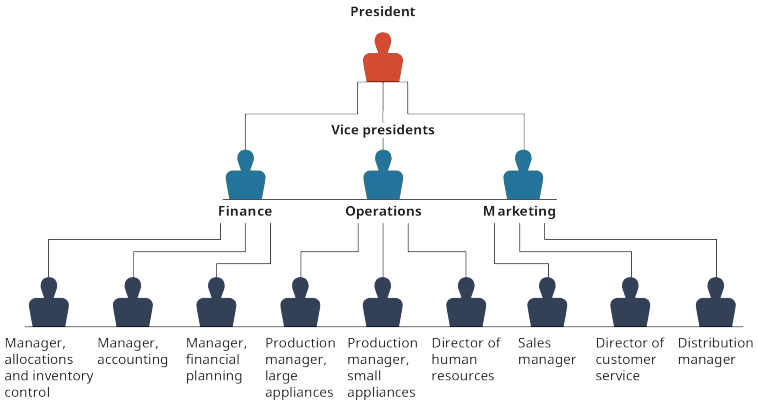

Exhibit 7.4 Organization Chart for a Typical Appliance Manufacturer Attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license

1. ***Functional departmentalization***, which is based on the primary functions performed within an organizational unit (marketing, finance, production, sales, and so on). Ethan Allen Interiors, a vertically integrated home furnishings company that designs, manufactures, and retails furniture and accessories, continues its successful departmentalization by function, including retail, manufacturing and sourcing, product design, logistics, and operations, which includes tight financial controls.[1]

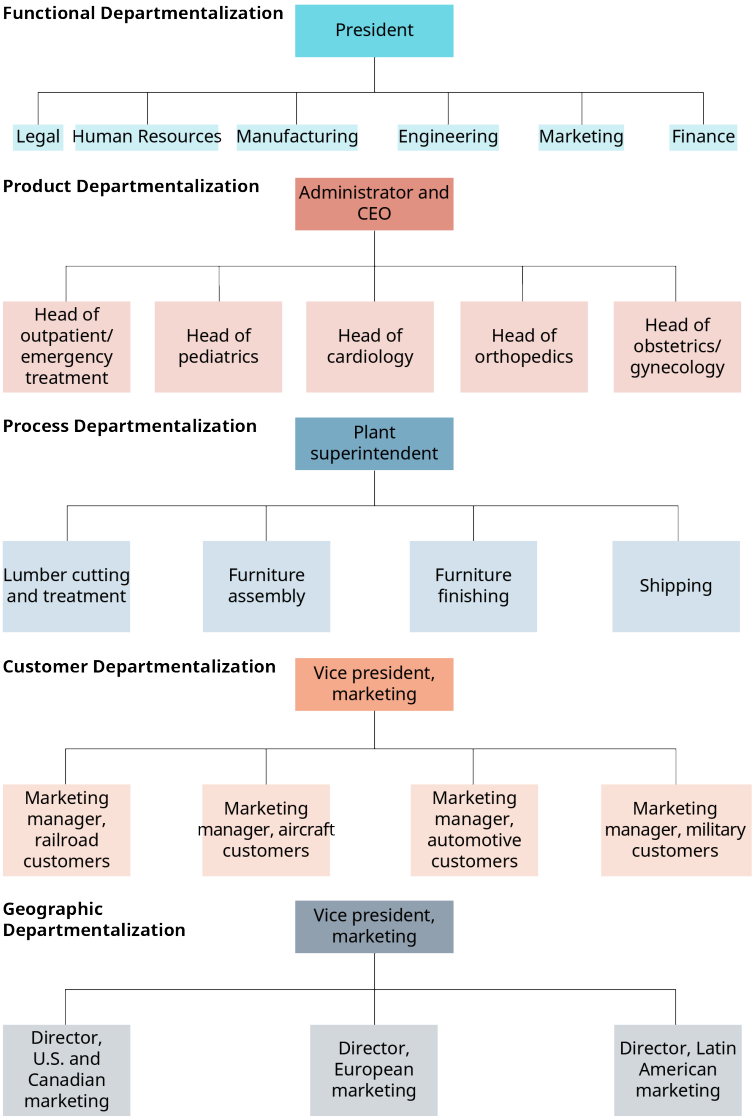

Exhibit 7.5 Five Traditional Ways to Organize (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

2. ***Product departmentalization***, which is based on the goods or services produced or sold by the organizational unit (such as outpatient/emergency services, pediatrics, cardiology, and orthopedics). For example, ITT is a diversified leading manufacturer of highly engineered components and customized technology solutions for the transportation, industrial, and oil and gas markets. The company is organized into four product divisions: Industrial Process (pumps, valves, and wastewater treatment equipment), Control Technologies (motion control and vibration isolation products), Motion Technologies (shock absorbers, brake pads, and friction materials), and Interconnect Solutions (connectors for a variety of markets).[2]
3. ***Process departmentalization***, which is based on the production process used by the organizational unit (such as lumber cutting and treatment, furniture finishing, and shipping). For example, the organization of Chevron, a major oil company, reflects the activities the company needs to perform to extract oil from the ground and turn it into a final product: exploration and research, production (drilling), refining, and marketing and distribution.[3] Pixar, the animated-movie company now part of Disney, is divided into three parallel yet interactive process-based groups: technology development, which delivers computer-graphics tools; creative development, which creates stories and characters and animates them; and production, which coordinates the film-making process.[4]
4. ***Customer departmentalization***, which is based on the primary type of customer served by the

organizational unit (such as wholesale or retail purchasers). The PNC Financial Services Group is a diversified financial institution offering a broad range of retail, commercial, corporate, and asset-management services to individuals, businesses, and institutions. It is structured by the type of consumer it serves: retail banking for consumers; the asset management group, with specific focus on individuals as well as corporations, unions, municipalities, and others; and corporate and institutional banking for middle-market companies nationwide.[5]

ETHICS IN PRACTICE

Panera's Menu Comes Clean

Making a strategic change to a company's overall philosophy and the way it does business affects every part of the organizational structure. And when that change pertains to sustainability and "clean food," Panera took on the challenge more than a decade ago. Panera Bread's U.S. food menu is marketed as "100% clean"—free from artificial preservatives, sweeteners, flavors, and colors from artificial sources, based on the company's published "No No" List.

In 2015, Ron Shaich, founder and now former CEO, announced Panera's "no-no" list of nearly 100 ingredients, which he vowed would be eliminated or never used again in menu items. Two years later, the company announced that its menu was "100 percent clean," but the process was not an easy one.

Panera used thousands of labor hours to review the 450 ingredients used in menu items, eventually reformulating more than 120 of them to eliminate artificial ingredients. Once the team identified the ingredients that were not "clean," they worked with the company's 300 vendors—and in some instances, a vendor's supplier—to reformulate an ingredient to make it preservative-free. For example, the recipe for the company's popular broccoli cheddar soup had to be revised 60 times to remove artificial ingredients without losing the soup's taste and texture. According to Shaich, the trial-and-error approach was about finding the right balance of milk, cream, and emulsifiers, like Dijon mustard, to replace sodium phosphate (a no-no item) while keeping the soup's texture creamy. Panera also created a new cheddar cheese to use in the soup and used a Dijon mustard that contained unpreserved vinegar as a substitute for the banned sodium phosphate.

Sara Burnett, former VP of food beliefs, sustainability, and PR at Panera (now executive director of ReFED), believes that the company's responsibility goes beyond just serving its customers. She believes that Panera can make a difference by using its voice and purchasing power to have a positive impact on the overall food system. In addition, the company's Herculean effort to remove artificial ingredients from its menu items also helped it take a close look at its supply chain and other processes that Panera could simplify by using better ingredients.

Panera is not yet satisfied with its commitment to clean food. Panera has committed to sourcing 100 percent cage-free eggs across its U.S. operations and reports steady progress toward achieving that goal by the end of 2025.

Critical Thinking Questions

1. How does Panera's approach to clean eating provide the company with a competitive advantage?
2. What kind of impact does this commitment to preservative-free food have on the company's organizational structure?
3. Does "clean food" put additional pressure on Panera and its vendors? Explain your reasoning.

Sources: "Our Food Policy," https://www.panerabread.com, accessed July 24, 2017; Emily Payne, "Panera Bread's Sara Burnett on Shifting Demand for a Better Food System," *Food Tank,* https://foodtank.com, accessed July 18, 2017; Julie Jargon, "What Panera Had to Change to Make Its Menu 'Clean,'" *The Wall Street*

Journal, https://www.wsj.com, February 20, 2017; Lani Furbank, "Seven Questions with Sara Burnett, Director of Wellness and Food Policy at Panera Bread," *Food Tank,* https://foodtank.com, April 12, 2016; "2023 Responsibility Update" and "Animal Health & Welfare," https://www.panerabread.com, accessed February 3, 2026.

5. ***Geographic departmentalization***, which is based on the geographic segmentation of organizational units (such as U.S. and Canadian marketing, European marketing, and Latin American marketing).

People are assigned to a particular organizational unit because they perform similar or related tasks, or because they are jointly responsible for a product, client, or market. Decisions about how to departmentalize affect the way management assigns authority, distributes resources, rewards performance, and sets up lines of communication. Many large organizations use several types of departmentalization. For example, Procter & Gamble (P&G), the multibillion-dollar consumer-products company, integrates four different types of departmentalization, which the company refers to as "four pillars." First, the Global Business Units (GBU) divide the company according to products (baby, feminine, and family care; beauty; fabric and home care; and health and grooming). Then, P&G uses a geographical approach, creating business units to market its products around the world. There are Selling and Market Operations (SMO) groups for North America; Latin America; Europe; Asia Pacific; Greater China; and India, the Middle East, and Africa. P&G's third pillar is Global Business Services division (GBS), which also uses geographic departmentalization. GBS provides technology processes and standard data tools to enable the GBUs and SMOs to better understand the business and to serve consumers and customers better. It supports P&G business units in areas such as accounting and financial reporting, information technology, purchases, payroll and benefits administration, and facilities management. Finally, the divisions of the Corporate Functions pillar provide a safety net to all the other pillars. These divisions are comprised of functional specialties such as customer business development; external relations; human resources; legal, marketing, consumer, and market knowledge; research and development; and workplace services.[6]

Line-and-Staff Organization

The **line organization** is designed with direct, clear lines of authority and communication flowing from the top managers downward. Managers have direct control over all activities, including administrative duties. An organization chart for this type of structure would show that all positions in the firm are directly connected via an imaginary line extending from the highest position in the organization to the lowest (where production of goods and services takes place). This structure, with its simple design and broad managerial control, is often well-suited to small, entrepreneurial firms.

As an organization grows and becomes more complex, the line organization can be enhanced by adding staff positions to the design. Staff positions provide specialized advisory and support services to line managers in the **line-and-staff organization**, shown in **Exhibit 7.6**. In daily operations, individuals in **line positions** are directly involved in the processes used to create goods and services. Individuals in **staff positions** provide the administrative and support services that line employees need to achieve the firm's goals. Line positions in organizations are typically in areas such as production, marketing, and finance. Staff positions are found in areas such as legal counseling, managerial consulting, public relations, and human resource management.

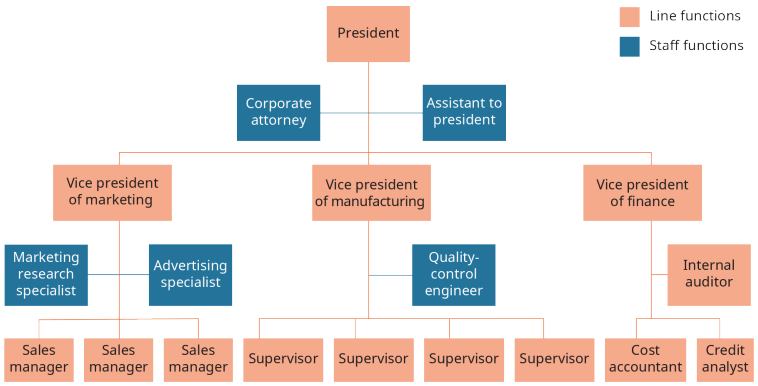

Exhibit 7.6 Line-and-Staff Organization (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

CONCEPT CHECK

1. How does specialization lead to greater efficiency and consistency in production?
2. What are the five types of departmentalization?

7.2 Contemporary Structures

2. What contemporary organizational structures are companies using?

Although traditional forms of organizational structures are still utilized by companies to structure their businesses, more flexible structures have emerged in response to changes in the workplace. Let's look at matrix and committee structures and how those two types of organizations are helping companies better leverage the diverse skills of their employees.

Matrix Structure

The **matrix structure** (also called the *project management* approach) is sometimes used in conjunction with the traditional line-and-staff structure in an organization. Essentially, this structure combines two different forms of departmentalization, functional and product, that have complementary strengths and weaknesses. The matrix structure brings together people from different functional areas of the organization (such as manufacturing, finance, and marketing) to work on a special project. Each employee has two direct supervisors: the line manager from her or his specific functional area and the project manager. Exhibit 7.7 shows a matrix organization with four special project groups (A, B, C, D), each with its own project manager. Because of the dual chain of command, the matrix structure presents some unique challenges for both managers and subordinates.

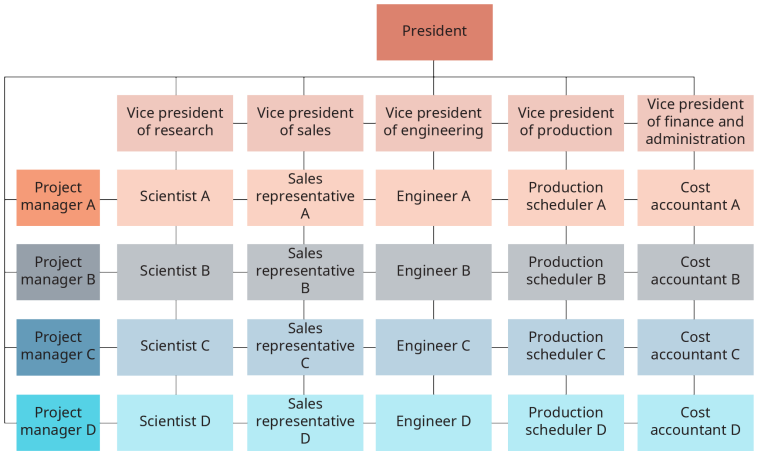

Exhibit 7.7 Matrix Organization (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Advantages of the matrix structure include:

- *Teamwork.* By pooling the skills and abilities of various specialists, the company can increase creativity and innovation and tackle more complex tasks.
- *Efficient use of resources.* Project managers use only the specialized staff they need to get the job done, instead of building large groups of underused personnel.
- *Flexibility.* The project structure is flexible and can adapt quickly to changes in the environment; the group can be disbanded quickly when it is no longer needed.
- *Ability to balance conflicting objectives.* The customer wants a quality product and predictable costs. The organization wants high profits and the development of technical capability for the future. These competing goals serve as a focal point for directing activities and overcoming conflict. The marketing representative can represent the customer, the finance representative can advocate high profits, and the engineers can push for technical capabilities.
- *Higher performance.* Employees working on special project teams may experience increased feelings of ownership, commitment, and motivation.
- *Opportunities for personal and professional development.* The project structure gives individuals the opportunity to develop and strengthen technical and interpersonal skills.

Disadvantages of the matrix structure include:

- *Power struggles.* Functional and product managers may have different goals and management styles.
- *Confusion among team members.* Reporting relationships and job responsibilities may be unclear.
- *Lack of cohesiveness.* Team members from different functional areas may have difficulty communicating effectively and working together as a team.

Although project-based matrix organizations can improve a company's flexibility and teamwork, some companies are trying to unravel complex matrix structures that create limited accountability and complicate day-to-day operations. Matrix structures can foster collaboration and encourage employees to develop new skills. However, the structure has been criticized because decision-making can take longer and employee performance can be difficult to measure.[7]

Committee Structure

In **committee structure**, authority and responsibility are held by a group rather than an individual. Committees are typically part of a larger line-and-staff organization. Often the committee's role is only advisory, but in some situations the committee has the power to make and implement decisions. Committees can make the coordination of tasks in the organization much easier. For example, Novartis, the huge Swiss pharmaceutical company, has a committee structure, which is chosen by and reports to the board of directors. The company's executive committee is responsible for overseeing the business operations of group companies

within the global organization and consists of the CEO, CFO, the chief people and organization officer, the chief legal and compliance officer, presidents of the U.S. and international operations, and a chief medical officer.[8]

Committees bring diverse viewpoints to a problem and expand the range of possible solutions, but there are some drawbacks. Committees can be slow to reach a decision and are sometimes dominated by a single individual. It is also more difficult to hold any one individual accountable for a decision made by a group. Committee meetings can sometimes go on for long periods of time with seemingly little being accomplished.

CONCEPT CHECK

1. Why does the matrix structure have a dual chain of command?
2. How does a matrix structure increase power struggles or reduce accountability?
3. What are advantages of a committee structure? Disadvantages?

7.3 Using Teams to Enhance Motivation and Performance

3. Why are companies using team-based organizational structures?

One of the most apparent trends in business today is the use of teams to accomplish organizational goals. Using a team-based structure can increase individual and group motivation and performance. This section gives a brief overview of group behavior, defines work teams as specific types of groups, and provides suggestions for creating high-performing teams.

Understanding Group Behavior

Teams are a specific type of organizational group. Every organization contains *groups,* social units of two or more people who share the same goals and cooperate to achieve those goals. Understanding some fundamental concepts related to group behavior and group processes provides a good foundation for understanding concepts about work teams. Groups can be formal or informal in nature. Formal groups are designated and sanctioned by the organization; their behavior is directed toward accomplishing organizational goals. Informal groups are based on social relationships and are not determined or sanctioned by the organization.

Formal organizational groups, like the sales department at Spectrum, must operate within the larger Spectrum organizational system. To some degree, elements of the larger Spectrum system, such as organizational strategy, company policies and procedures, available resources, and the highly motivated employee corporate culture, determine the behavior of smaller groups, such as the sales department, within the company. Other factors that affect the behavior of organizational groups are individual member characteristics (e.g., ability, training, personality), the roles and norms of group members, and the size and cohesiveness of the group. Norms are the implicit behavioral guidelines of the group, or the standards for acceptable and unacceptable behavior. For example, sales managers at Spectrum might be expected to work weekends as part of their job responsibilities. This may not be listed as a formal job requirement, but it is the expected norm in the organization.

Group cohesiveness refers to the degree to which group members want to stay in the group and tend to resist outside influences (such as a change in company policies). When group performance norms are high, group cohesiveness will have a positive impact on productivity. Cohesiveness tends to increase when the size of the group is small, individual and group goals are similar, the group has high status in the organization, rewards are group-based rather than individual-based, and the group competes with other groups within the organization. Work group cohesiveness can benefit the organization in several ways, including increased productivity, enhanced worker self-image because of group success, increased company loyalty, reduced

employee turnover, and reduced absenteeism. Zillow is known for its work group cohesiveness. On the other hand, cohesiveness can also lead to restricted output, resistance to change, and conflict with other work groups in the organization.

The opportunity to turn the decision-making process over to a group with diverse skills and abilities is one of the arguments for using work groups (and teams) in organizational settings. For group decision-making to be most effective, however, both managers and group members must understand its strengths and weaknesses (see Table 7.1).

Work Groups versus Work Teams

We have already noted that teams are a special type of organizational group, but we also need to differentiate between work groups and work teams. **Work groups** share resources and coordinate efforts to help members better perform their individual duties and responsibilities. The performance of the group can be evaluated by adding up the contributions of the individual group members. **Work teams** require not only coordination but also *collaboration,* the pooling of knowledge, skills, abilities, and resources in a collective effort to attain a common goal. A work team creates *synergy,* causing the performance of the team as a whole to be greater than the sum of team members' individual contributions. Simply assigning employees to groups and labeling them a team does not guarantee a positive outcome. Managers and team members must be committed to creating, developing, and maintaining high-performance work teams. Factors that contribute to their success are discussed later in this section.

Strengths and Weaknesses of Group Decision-Making

Strengths	Weaknesses
• Groups bring more information and knowledge to the decision-making process. • Groups offer a diversity of perspectives and, therefore, generate a greater number of creative solutions to problems. • Group decision-making results in a higher-quality decision than does individual decision-making. • Participation of group members increases the likelihood that a decision will be accepted.	• Groups typically take a longer time to reach a solution than an individual takes. • Group members may pressure others to conform, reducing the likelihood of alternatives. • The process may be dominated by one or a small number of participants. • Groups lack accountability, because it is difficult to assign responsibility for outcomes to any one individual.

Table 7.1

Types of Teams

The evolution of the team concept in organizations can be seen in three basic types of work teams: problem-solving, self-managed, and cross-functional. **Problem-solving teams** are typically made up of employees from the same department or area of expertise and from the same level of the organizational hierarchy. They meet on a regular basis to share information and discuss ways to improve processes and procedures in specific functional areas. Problem-solving teams generate ideas and alternatives and may recommend a specific course of action, but they typically do not make final decisions, allocate resources, or implement change.

Many organizations that experienced success using problem-solving teams were willing to expand the team concept to allow team members greater responsibility in making decisions, implementing solutions, and monitoring outcomes. These highly autonomous groups are called **self-managed work teams**. They manage themselves without any formal supervision, taking responsibility for setting goals, planning and scheduling

work activities, selecting team members, and evaluating team performance.

Today, an overwhelming majority of companies use self-managed teams in some capacity.[9] One example is Zappos's shift to self-managed work teams in 2014, where the traditional organizational structure was revised into a system called holacracy. Since the initial implementation, some managers have been put in place, but the company still largely embraces the concept. Job descriptions are focused on work duties and accountability rather than tasks tied to a specific title. Employees hold multiple roles and the teams (called "circles") act like small businesses governing themselves.[10] Another innovation from the company came when three employees invented Elixir guitar strings and used their spare time outside of work hours with a handful of other colleagues to improve the original design. After working three years *entirely* on their own—without asking for any supervisory or top management permission or being subjected to any kind of oversight—the team finally sought the support of the larger company, which they needed to take the strings to market. W. L. Gore's Elixir Strings, introduced in the late 1990s, grew into a major player in the acoustic guitar string market and are widely used by both amateur and professional musicians.[11]

An adaptation of the team concept is called a **cross-functional team**. These teams are made up of employees from about the same hierarchical level but different functional areas of the organization. Many task forces, organizational committees, and project teams are cross-functional. Often the team members work together only until they solve a given problem or complete a specific project. Cross-functional teams allow people with various levels and areas of expertise to pool their resources, develop new ideas, solve problems, and coordinate complex projects. Both problem-solving teams and self-managed teams may also be cross-functional teams.

CUSTOMER SATISFACTION AND QUALITY

Team Approach Flies High at GE Aerospace

“Teaming” is the term used at GE Aerospace manufacturing plants to describe how self-managed groups of employees are working together to make decisions to help them do their work efficiently, maintain quality, and meet critical deadlines in the global aviation supply chain.

This management concept is not new to GE Aerospace. The self-managed "teaming" model pioneered at GE's Bromont (Québec) and Durham (North Carolina) plants has been expanded across many of GE Aerospace's manufacturing sites worldwide and remains central to its supply chain culture.

The goal of teaming is to move decision-making and authority as close to the end-product as possible, which means front-line employees are accountable for meeting performance goals on a daily basis. For example, if there is some sort of delay in the manufacturing process, it is up to the team to figure out how to keep things moving—even if that means skipping breaks or changing their work schedules to overcome obstacles.

Under the self-managed teams model, employees at the manufacturing plants do not have supervisors that provide the direction for their work. Instead, they have coaches that give them specific goals, and they determine how to reach those goals within their teams. The typical functions performed by supervisors—such as planning, monitoring progress, and managing overtime and vacations—are managed by the teams themselves. In addition, members from each team work with management and HR representatives to provide input on decisions that impact overall plant operations, such as hiring and downsizing decisions and when to cut back on overtime hours.

This hands-on approach helps workers gain confidence and motivation to fix problems directly rather than sending a question up the chain of command and waiting for a directive. In addition, teaming allows the people who do the work on a daily basis to come up with the best ideas to resolve issues and perform

various jobs tasks in the most efficient way possible.

For GE Aerospace, implementing the teaming approach has been a successful venture, and the company finds the strategy easiest to implement when starting up a new manufacturing facility. In the mid-2010s, GE's aviation and power businesses opened several new plants, including a multi-modal "Brilliant Factory" in Welland, Ontario, Canada. That facility's hiring process—designed around GE's self-managed "teaming" concept—was notably more rigorous and team-oriented than typical manufacturing hiring practices at the time. With the team concept in mind, job candidates need to demonstrate not only required technical skills but also soft skills—for example, the ability to communicate clearly, accept feedback, and participate in discussions in a respectful manner.

Critical Thinking Questions

1. What challenges do you think HR recruiters face when hiring job candidates who need to have both technical and soft skills?
2. How can experienced team members help new employees be successful in the teaming structure? Provide some examples.

Sources: GE Reports Canada, "The Meaning of Teaming: Empowering New Hires at GE's Welland Brilliant Factory," https://gereports.ca, July 17, 2017; Sarah Kessler, "GE Has a Version of Self-Management That Is Much Like Zappos' Holacracy—and It Works," *Quartz,* https://qz.com, June 6, 2017; Gareth Phillips, "Look No Managers! Self-Managed Teams," *LinkedIn,* https://www.linkedin.com, June 9, 2016; Amy Alexander, "Step by Step: Train Employees to Take Charge," *Investor's Business Daily,* https://www.investors.com, June 18, 2014; Rasheedah Jones, "Teaming at GE Aviation," *Management Innovation eXchange,* https://www.managementexchange.com, July 14, 2013.

Building High-Performance Teams

A great team must possess certain characteristics, so selecting the appropriate employees for the team is vital. Employees who are more willing to work together to accomplish a common goal should be selected, rather than employees who are more interested in their own personal achievement. Team members should also possess a variety of skills. Diverse skills strengthen the overall effectiveness of the team, so teams should consciously recruit members to fill gaps in the collective skill set. To be effective, teams must also have clearly defined goals. Vague or unclear goals will not provide the necessary direction or allow employees to measure their performance against expectations.

Next, high-performing teams need to practice good communication. Team members need to communicate messages and give appropriate feedback that seeks to correct any misunderstandings. Feedback should also be detached; that is, team members should be careful to critique ideas rather than criticize the person who suggests them. Nothing can degrade the effectiveness of a team like personal attacks. Lastly, great teams have great leaders. Skilled team leaders divide work so that tasks are not repeated, help members set and track goals, monitor their team's performance, communicate openly, and remain flexible to adapt to changing goals or management demands.

CONCEPT CHECK

1. What is the difference between a work team and a work group?
2. Identify and describe three types of work teams.
3. What are some ways to build a high-performance team?

7.4 Authority—Establishing Organizational Relationships

4. What tools do companies use to establish relationships within their organizations?

Once companies choose a method of departmentalization, they must then establish the relationships within that structure. In other words, the company must decide how many layers of management it needs and who will report to whom. The company must also decide how much control to invest in each of its managers and where in the organization decisions will be made and implemented.

Managerial Hierarchy

Managerial hierarchy (also called the *management pyramid*) is defined by the levels of management within an organization. Generally, the management structure has three levels: top, middle, and supervisory management. In a managerial hierarchy, each organizational unit is controlled and supervised by a manager in a higher unit. The person with the most formal authority is at the top of the hierarchy. The higher a manager, the more power they have. Thus, the amount of power decreases as you move down the management pyramid. At the same time, the number of employees increases as you move down the hierarchy.

Not all companies today are using this traditional configuration. One company that has eliminated hierarchy altogether is The Morning Star Company, the largest tomato processor in the world. Based in Woodland, California, the company employs 600 permanent "colleagues" and an additional 4,000 workers during harvest season. Founder and sole owner Chris Rufer started the company and based its vision on the philosophy of self-management, in which professionals initiate communication and coordination of their activities with colleagues, customers, suppliers, and others, and take personal responsibility for helping the company achieve its corporate goals.[12]

An organization with a well-defined hierarchy has a clear **chain of command**, which is the line of authority that extends from one level of the organization to the next, from top to bottom, and makes clear who reports to whom. The chain of command is shown in the organization chart and can be traced from the CEO all the way down to the employees producing goods and services. Under the *unity of command* principle, everyone reports to and gets instructions from only one boss. Unity of command guarantees that everyone will have a direct supervisor and will not be taking orders from a number of different supervisors. Unity of command and chain of command give everyone in the organization clear directions and help coordinate people doing different jobs.

Matrix organizations automatically violate the unity of command principle because employees report to more than one boss, if only for the duration of a project. For example, consider Unilever PLC, the consumer-products company that makes Dove soap, Ben & Jerry's ice cream, and Hellmann's mayonnaise. For many years, Unilever operated with a complex regional-product matrix, with powerful regional leaders in North America and Europe alongside global product heads. Employees in divisions that spanned both regions often experienced confusion about whose priorities took precedence—a common problem in matrix structures. In 2022, Unilever simplified its organization into five global product-based business groups (Beauty & Wellbeing, Personal Care, Home Care, Nutrition, and Ice Cream), shifting toward a product divisional structure.[13] Companies like Unilever tend to abandon matrix structures because of problems associated with unclear or duplicate reporting relationships, in other words, with a lack of unity of command.

Individuals who are part of the chain of command have authority over other persons in the organization. **Authority** is legitimate power, granted by the organization and acknowledged by employees, that allows an individual to request action and expect compliance. Exercising authority means making decisions and seeing that they are carried out. Most managers *delegate*, or assign, some degree of authority and responsibility to others below them in the chain of command. The **delegation of authority** makes the employees accountable to their supervisor. *Accountability* means responsibility for outcomes. Typically, authority and responsibility move downward through the organization as managers assign activities to, and share decision-making with,

their subordinates. Accountability moves upward in the organization as managers in each successively higher level are held accountable for the actions of their subordinates.

Span of Control

Each firm must decide how many managers are needed at each level of the management hierarchy to effectively supervise the work performed within organizational units. A manager's **span of control** (also called span of management or span of supervision) is the number of employees the manager has the ability to supervise or control. The number of employees can depend on several factors such as the size of the organization, the industry, or even the experience level of the manager. In general, the larger the span of control, the more efficient the organization. As Table 7.2 shows, however, both narrow and wide spans of control have benefits and drawbacks.

Narrow and Wide Spans of Control

	Advantages	Disadvantages
Narrow span of control	• This approach allows a high degree of control. • Fewer subordinates may mean the manager is more familiar with each individual. • Close supervision can provide immediate feedback.	• More levels of management mean that it is more expensive. • Decision-making is slower due to vertical layers. • Top management are isolated. • This approach discourages employee autonomy.
Wide span of control	• Fewer levels of management means increased efficiency and reduced costs. • Increased subordinate autonomy leads to quicker decision-making. • This approach allows for greater organizational flexibility. • This approach creates higher levels of job satisfaction due to employee empowerment.	• This approach allows for less control. • Managers may lack familiarity with their subordinates due to the large number. • Managers can be spread so thin that they can't provide necessary leadership or support. • There may be a lack of coordination or synchronization.

Table 7.2

If hundreds of employees perform the same job, one supervisor may be able to manage a very large number of employees. Such might be the case at a shipping warehouse where many employees perform similar tasks routinely. But if employees perform complex and dissimilar tasks, a manager can effectively supervise only a much smaller number. For instance, a supervisor in the research and development area of a pharmaceutical company might oversee just a few research chemists due to the highly complex nature of their jobs.

CONCEPT CHECK

1. How does the chain of command clarify reporting relationships?
2. What is the role of a staff position in a line-and-staff organization?
3. What factors determine the optimal span of control?

7.5 Degree of Centralization

5. How can the degree of centralization/decentralization be altered to make an organization more successful?

The optimal span of control is determined by the following five factors:

1. *Nature of the task*. The more complex the task, the narrower the span of control.
2. *Location of the workers*. The more locations, the narrower the span of control.
3. *Ability of the manager to delegate responsibility*. The greater the ability to delegate, the wider the span of control.
4. *Amount of interaction and feedback between the workers and the manager*. The more feedback and interaction required, the narrower the span of control.
5. *Level of skill and motivation of the workers*. The higher the skill level and motivation, the wider the span of control.

The final component in building an effective organizational structure is deciding at what level in the organization decisions should be made. **Centralization** is the degree to which formal authority is concentrated in one area or level of the organization. In a highly centralized structure, top management makes most of the key decisions in the organization, with very little input from lower-level employees. Centralization lets top managers develop a broad view of operations and exercise tight financial controls. It can also help to reduce costs by eliminating redundancy in the organization. But centralization may also mean that lower-level personnel don't get a chance to develop their decision-making and leadership skills and that the organization is less able to respond quickly to customer demands.

Decentralization is the process of pushing decision-making authority down the organizational hierarchy, giving lower-level personnel more responsibility and power to make and implement decisions. Benefits of decentralization can include quicker decision-making, increased levels of innovation and creativity, greater organizational flexibility, faster development of lower-level managers, and increased levels of job satisfaction and employee commitment. But decentralization can also be risky. If lower-level personnel don't have the necessary skills and training to perform effectively, they may make costly mistakes. Additionally, decentralization may increase the likelihood of inefficient lines of communication, competing objectives, and duplication of effort.

Several factors must be considered when deciding how much decision-making authority to delegate throughout the organization. These factors include the size of the organization, the speed of change in its environment, managers' willingness to give up authority, employees' willingness to accept more authority, and the organization's geographic dispersion.

Decentralization is usually desirable when the following conditions are met:

- The organization is very large, like Unilever, Costco, or Bank of America.
- The firm is in a dynamic environment where quick, local decisions must be made, as in many high-tech industries.
- Managers are willing to share power with their subordinates.
- Employees are willing and able to take more responsibility.
- The company is spread out geographically, such as Hilton Hotels & Resorts, Coca-Cola, or Samsung.

As organizations grow and change, they continually reevaluate their structure to determine whether it is helping the company to achieve its goals.

CONCEPT CHECK

1. What are the characteristics of a centralized organization?
2. What are the benefits of a decentralized organization?
3. What factors should be considered when choosing the degree of centralization?

7.6 Organizational Design Considerations

6. How do mechanistic and organic organizations differ?

You are now familiar with the different ways to structure an organization, but as a manager, how do you decide which design will work the best for your business? What works for one company may not work for another. In this section, we'll look at two generic models of organizational design and briefly examine a set of contingency factors that favors each.

Exhibit 7.8 The Walt Disney Company expanded its entertainment empire around 20 years ago by acquiring Pixar Studios, the animation powerhouse behind such blockbusters as *Toy Story, Finding Dory, Cars,* and *Up*. The $7.4 billion purchase absorbed Pixar into the Disney Studio Entertainment division, one of the company's four operating units, alongside Parks and Resorts, Media Networks, and Consumer Products and Interactive Media. Since the acquisition of Pixar, Disney has continued to make strategic decisions to expand the company including the purchase of Hulu in 2023 for nearly $9 billion. *Why do some analysts believe that Disney's gigantic organizational structure could engulf the smaller Pixar operation and stifle its creative output?* (Credit: Poi Beltran/ Flicker/ Attribution 2.0 Generic (CC BY 2.0))

Mechanistic versus Organic Structures

Structural design generally follows one of the two basic models described in Table 7.3: mechanistic or organic. A **mechanistic organization** is characterized by a relatively high degree of job specialization, rigid departmentalization, many layers of management (particularly middle management), narrow spans of control, centralized decision-making, and a long chain of command. This combination of elements results in what is called a tall organizational structure. Hospital and government organizations are typical mechanistic organizations.

In contrast, an **organic organization** is characterized by a relatively low degree of job specialization, loose departmentalization, few levels of management, wide spans of control, decentralized decision-making, and a short chain of command. This combination of elements results in what is called a flat organizational structure. Colleges and universities tend to have flat organizational structures, with only two or three levels of administration between the faculty and the president. Exhibit 7.9 shows examples of flat and tall organizational structures.

Factors Influencing the Choice between Mechanistic and Organic Structures

Although few organizations are purely mechanistic or purely organic, most organizations tend more toward one type or the other. The decision to create a more mechanistic or a more organic structural design is based on factors such as the firm's overall strategy, the size of the organization, and the stability of its external environment, among others.

A company's organizational structure should enable it to achieve its goals, and because setting corporate goals is part of a firm's overall strategy-making process, it follows that a company's structure depends on its *strategy*. That alignment can be challenging for struggling companies trying to accomplish multiple goals. For example, a company with an innovation strategy will need the flexibility and fluid movement of information that an organic organization provides. But a company using a cost-control strategy will require the efficiency and tight control of a mechanistic organization. Often, struggling companies try to simultaneously increase innovation and rein in costs, which can be organizational challenges for managers. Such is the case at Microsoft, where CEO Satya Nadella cut more than 18,000 jobs in 2014 after taking the helm at the technology giant. Most of the cuts were the result of the company's failed acquisition of a mobile phone business. The company eliminated additional jobs in sales and marketing (mostly overseas) as Microsoft shifts from a software developer to a cloud computing software delivery service. At the same time, Nadella also encourages employees and managers to break down barriers between divisions and increase the pace of innovation across the organization.[14]

Mechanistic versus Organic Structure		
Structural Characteristic	**Mechanistic**	**Organic**
Job specialization	High	Low
Departmentalization	Rigid	Loose
Managerial hierarchy (levels of management)	Tall (many levels)	Flat (few levels)
Span of control	Narrow	Wide
Decision-making authority	Centralized	Decentralization
Chain of command	Long	Short

Table 7.3

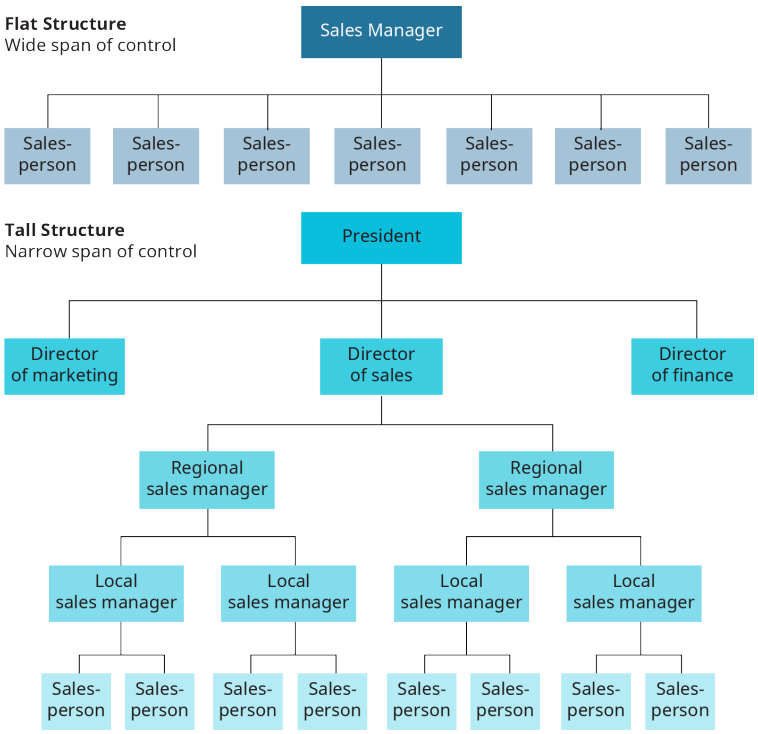

Exhibit 7.9 Flat versus Tall Organizational Structures (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Size is another factor that affects how mechanistic or organic a company's organizational structure is. Much research has been conducted that shows a company's size has a significant impact on its organizational structure. Smaller companies tend to follow the more organic model, in part because they can. It's much easier to be successful with decentralized decision-making, for example, if you have only 50 employees. A company with that few employees is also more likely, by virtue of its size, to have a lesser degree of employee specialization. That's because, when there are fewer people to do the work, those people tend to know more about the entire process. As a company grows, it becomes more mechanistic, as systems are put in place to manage the greater number of employees. Procedures, rules, and regulations replace flexibility, innovation, and independence. That isn't always the case, however. W. L. Gore & Associates is a global materials-science company with over 10,000 employees and roughly $4–5 billion in annual revenue, but, as noted earlier, uses an organic organizational structure. Employees self manage, participate on teams, and the organizational structure evolves organically as employees create roles for themselves to fill functional gaps within the company.[15]

Lastly, the business in which a company operates has a significant impact on its organizational structure. In complex, dynamic, and unstable environments, companies need to organize for flexibility and agility. For example, companies in technology or creative industries such as marketing agencies need the flexibility to foster innovative thinking and to evolve to meet the needs of their clients. That is, their organizational structures need to respond to rapid and unexpected changes in the business environment. For companies operating in stable environments, however, the demands for flexibility and agility are not so great. The environment is predictable. In a simple, stable environment, therefore, companies benefit from the efficiencies created by a mechanistic organizational structure.

MANAGING CHANGE

Google Learns the Alphabet

In the late 1990s, Larry Page and Sergey Brin built a search engine that used links to determine the importance of individual pages on the web. Today, Google has grown from two founders to more than 180,000 employees in dozens of different countries. While the company is routinely high on the lists of best places to work and companies with the best employee perks, its meteoric growth has not been without challenges.

Much has been written about Google's informal organizational structure, which has fueled a creative environment second to none. At one point, the founders shared an office that looked like a college dorm room, complete with skateboards, beanbag chairs, and remote-controlled airplanes. The company's offices around the world are designed to be the most productive workspaces imaginable, sometimes with meeting rooms designed as camping vans (Amsterdam) or hallways decorated with subway grates and fire hydrants (New York City).

As this creative environment expanded, Google relied on its innovative and competitive culture to produce some of the most popular products around the world including YouTube, Android, Pixel, and the Google Workplace suite of programs including Gmail, Sheets, and Google Docs. As Google grew, so did the strain on its informal structure. In the early days, while adding employees on a daily basis, the company needed to find the right balance between maintaining creativity and running a rapidly growing organization.

In 2001, Brin and Page hired an outside CEO, Eric Schmidt (who left the company in 2020 to pursue other ventures), who hired an HR manager and then divided employees into teams based on product or function. This structure seemed to work well until Google started to acquire companies or develop new products to add to its portfolio of business ventures, including Double Click and Nest. At the same time, Page and Brin never lost sight of their "moonshot" projects, potentially revolutionary innovations that could change lives, which may or may not become a profitable venture.

In 2015, as part of Google's reorganization into Alphabet, Sundar Pichai, who had successfully led Google Search and other product areas, became the new CEO of Google, while cofounder Larry Page became CEO of the new parent company, Alphabet, and Sergey Brin became its president, with former Google CEO Eric Schmidt serving as Alphabet's executive chair. In 2019, Page and Brinn stepped down from their executive roles, and Sundar Pichai became CEO of Alphabet as well as Google.

In 2015, Alphabet hired Ruth Porat as its new CFO (now president and chief investment officer). She has received praise for her guidance in helping company executives take a closer look at costs while still encouraging the innovation and creativity the Google founders seemingly invented. Although organizational change is not always easy, the new structure streamlined processes while allowing the various businesses room to grow on their own.

Critical Thinking Questions

1. If you were a long-time "Googler," how would feel about the change in organizational structure at the company?
2. Do you think the creative work environment fostered by company founders has taken a hit with the new Alphabet organizational structure? Why or why not?
3. What are some advantages and disadvantages of creating separate businesses for the company's moonshot projects?

Sources: "Our History," https://www.google.com, accessed July 24, 2017; Catherine Clifford, "Google Billionaire Eric Schmidt: These 2 Qualities Are the Best Predictors of Success," *CNBC,* https://www.cnbc.com,

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CONCEPT CHECK

1. Compare and contrast mechanistic and organic organizations.
2. What factors determine whether an organization should be mechanistic or organic?

7.7 The Informal Organization

7. How does the informal organization affect the performance of the company?

Up to this point, we have focused on formal organizational structures that can be seen in the boxes and lines of the organization chart. Yet many important relationships within an organization do not show up on an organization chart. Nevertheless, these relationships can affect the decisions and performance of employees at all levels of the organization.

The network of connections and channels of communication based on the informal relationships of individuals inside the organization is known as the **informal organization**. Informal relationships can be between people at the same hierarchical level or between people at different levels and in different departments. Some connections are work-related, such as those formed among people who carpool or ride the same train to work. Others are based on nonwork commonalties such as belonging to the same community center or health club or having children who attend the same school.

Functions of the Informal Organization

The informal organization has several important functions. First, it provides a source of friendships and social contact for organization members. Second, the interpersonal relationships and informal groups help employees feel better-informed about and connected with what is going on in their firm, thus giving them some sense of control over their work environment. Third, the informal organization can provide status and recognition that the formal organization cannot or will not provide employees. Fourth, the network of relationships can aid the socialization of new employees by informally passing along rules, responsibilities, basic objectives, and job expectations. Finally, the organizational grapevine helps employees to be more aware of what is happening in their workplace by transmitting information quickly and conveying it to places that the formal system does not reach.

Informal Communication Channels

The informal channels of communication used by the informal organization are often referred to as the

grapevine or the *rumor mill.* Managers need to pay attention to the grapevines in their organization, because their employees increasingly put a great deal of stock in the information that travels along it, especially in this era of social media. Research shows that many employees believe statements heard through the grapevine. This channel of communication is an important part of social connection in the workplace. Data also show that as much as 75 percent of the information channeled through the grapevine is at least in part true. "The grapevine may not be wholly accurate, but it is a very reliable indicator that something is going on," said one survey respondent.[16]

With this in mind, managers need to learn to use the existing informal organization as a tool that can potentially benefit the **formal organization**. An excellent way of putting the informal organization to work for the good of the company is to bring informal leaders into the decision-making process. That way, at least the people who use and nurture the grapevine will have more accurate information to send it.

Exhibit 7.10 Smart managers understand that not all of a company's influential relationships appear as part of the organization chart. A web of informal, personal connections exists between workers, and vital information and knowledge pass through this web constantly. Using social media analysis software and other tracking tools, managers can map and quantify the normally invisible relationships that form between employees at all levels of an organization. *How might identifying a company's informal organization help managers foster teamwork, motivate employees, and boost productivity?* (Credit: University of Exeter /flickr / Attribution 2.0 Generic (CC BY 2.0))

CONCEPT CHECK

1. What is the informal organization?
2. How can informal channels of communication be used to improve operational efficiency?

7.8 Trends in Organizational Structure

8. What trends are influencing the way businesses organize?

To improve organizational performance and achieve long-term objectives, some organizations seek to reengineer their business processes or adopt new technologies that open up a variety of organizational design options, such as virtual corporations and virtual teams. Other trends that have strong footholds in today's organizations include outsourcing and managing global businesses.

Reengineering Organizational Structure

Periodically, all businesses must reevaluate the way they do business. This includes assessing the effectiveness of the organizational structure. To meet the formidable challenges of the future, companies are increasingly

turning to **reengineering**—the complete redesign of business structures and processes in order to improve operations. An even simpler definition of reengineering is "starting over." In effect, top management asks, "If we were a new company, how would we run this place?" The purpose of reengineering is to identify and abandon the outdated rules and fundamental assumptions that guide current business operations. Every company has many formal and informal rules, based on assumptions about technology, people, and organizational goals, that no longer hold. Thus, the goal of reengineering is to redesign business processes to achieve improvements in cost control, product quality, customer service, and speed. The reengineering process should result in a more efficient and effective organizational structure that is better suited to the current (and future) competitive climate of the industry.

The Virtual Corporation

One of the biggest challenges for companies today is adapting to the technological changes that are affecting all industries. Organizations are struggling to find new organizational structures that will help them transform information technology into a competitive advantage. One alternative that gained momentum during the COVID-19 pandemic is the **virtual corporation**, which utilizes a network of independent companies (suppliers, customers, and even competitors) linked through technology to share skills, costs, and access to markets. This network structure allows companies to come together quickly to exploit rapidly changing opportunities. The key attributes of a virtual corporation are:

- *Technology.* Information technology helps geographically distant companies form alliances and work together.
- *Opportunism.* Alliances are less permanent, less formal, and more opportunistic than in traditional partnerships.
- *Excellence.* Each partner brings its core competencies to the alliance, so it is possible to create an organization with higher quality in every functional area and increase competitive advantage.
- *Trust.* The network structure makes companies more reliant on each other and forces them to strengthen relationships with partners.
- *No borders.* This structure expands the traditional boundaries of an organization.

In the concept's purest form, each company that links up with others to create a virtual corporation is stripped to its essence. Ideally, the virtual corporation has neither a central office nor an organization chart, no hierarchy, and no vertical integration. It contributes to an alliance only its core competencies, or key capabilities. It mixes and matches what it does best with the core competencies of other companies and entrepreneurs. For example, a manufacturer would only manufacture, while relying on a product design firm to decide what to make and a marketing company to sell the end result.

Although the preponderance of firms that are purely virtual can vary by geographic location and industry, many companies embrace some characteristics of the virtual structure. One example is Cisco Systems. Cisco uses many manufacturing plants to produce its products, but these plants are owned and operated by independent contract manufacturers. Cisco now relies on contract manufacturers for virtually all of its manufacturing needs. To the average customer, the interdependency of Cisco's suppliers and inventory systems makes it look like one huge, seamless company.

Virtual Teams

Technology is also enabling corporations to create virtual work teams. Geography is no longer a limitation when employees are considered for a work team. Virtual teams mean reduced travel time and costs, reduced relocation expenses, and utilization of specialized talent regardless of an employee's location.

When managers need to staff a project, all they need to do is make a list of required skills and a general list of employees who possess those skills. When the pool of employees is known, the manager simply chooses the best mix of people and creates the virtual team. Special challenges of virtual teams include keeping team members focused, motivated, and communicating positively despite their locations. If feasible, at least one

face-to-face meeting during the early stages of team formation will help with these potential problems.

Exhibit 7.11 In today's high-tech world, teams can exist any place where there is access to the internet. With globalization and outsourcing being common strategies in business operations today, companies of all shapes and sizes utilize virtual teams to coordinate people and projects halfway around the world. Unlike coworkers in traditional teams, virtual team members rarely meet in person, working from different locations and continents. *What practical benefits do virtual teams offer to businesses, employees, and other members?* (Credit: ThoroughlyReviewed/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Outsourcing

Another organizational trend that continues to influence today's managers is outsourcing. For decades, companies have outsourced various functions. For example, payroll functions such as recording hours, managing benefits and wage rates, and issuing paychecks have been handled for years by third-party providers. Outsourcing can include a wide array of business functions including customer service, production efforts, engineering, information technology, and marketing.

Historically, companies have outsourced for two main reasons: cost reduction and to focus on the core strengths of the business instead of functions that do not align. Outsourcing is a key component of many businesses' operations across all functions in the organization. Some of the insights highlighted in Deloitte's recent Global Outsourcing Survey bear this out. According to survey respondents from 280 global organizations, outsourcing continues to be successful because it is adapting to changing business environments. Outsourcing is prevalent for functions such as customer service, cybersecurity, and IT. Other functions such as purchasing, R&D, and finance functions are also being outsourced. Businesses view outsourcing as a way to manage costs, but also to enhance innovation to maintain a competitive advantage.[17]

Another form of outsourcing has become prevalent over the last several years, in part as the result of the slow economic recovery from the Great Recession in the early 2000s and the COVID-19 pandemic. As many U.S. businesses hesitated to hire full-time workers even as they began to experience gradual growth, some companies began to offer contract work to freelancers, who are not considered full-time employees with benefits. Known as the gig economy, this approach has advantages and disadvantages. Some individuals like the independence the gig economy offers, while others take on multiple projects when they are unable to find full-time employment with a company, especially during economic downturns as was the case during the COVID-19 pandemic. Still others, as full-time employees, may take on side projects as freelancers to pursue a hobby or passion, or simply to supplement their income. Estimates suggest that the gig economy will grow to nearly $500 million in gross volume and is expected to impact one-third of U.S. workers with over 60 million individuals now freelancing.[18]

Despite the challenges, outsourcing programs can be effective. To be successful in outsourcing efforts, managers must do the following:

- Identify a specific business problem.

- Consider all possible solutions.
- Decide whether outsourcing the work is the appropriate answer to the problem.
- Develop a strategic outsourcing partnership with vendors and a solid framework that promotes seamless collaboration and communication.
- Engage with outsourcing partners on a regular basis to instill trust between the two entities.
- Remain flexible when it comes to working with outsourcing providers in terms of accommodating requests or adjusting needs when necessary in an effort to build a long-term strategic partnership beneficial to both parties.[19]

Structuring for Global Mergers

Mergers creating mega-firms (such as Microsoft and LinkedIn, Amazon and Whole Foods, and Verizon and Yahoo) raise some important questions regarding corporate structure. How can managers hope to organize the global pieces of these huge, complex new firms into a cohesive, successful whole? Should decision-making be centralized or decentralized? Should the firm be organized around geographic markets or product lines? And how can managers consolidate distinctly different corporate cultures? These issues and many more must be resolved if mergers of global companies are to succeed.

Beyond designing a new organizational structure, one of the most difficult challenges when merging two large companies is uniting the cultures and creating a single business. The merger between Pfizer and Pharmacia, makers of Rogaine and Advil, is no exception. Failure to effectively merge cultures can have serious effects on organizational efficiency.

As part of its strategic plan for the giant merger, Pfizer put together 14 groups that would make recommendations concerning finances, human resources, operation support, capital improvements, warehousing, logistics, quality control, and information technology. An outside consultant was hired to facilitate the process. One of the first tasks for the groups was to deal with the conqueror (Pfizer) versus conquered (Pharmacia) attitudes. Company executives wanted to make sure all employees knew that their ideas were valuable and that senior management was listening.

As more and more global mergers take place, sometimes between the most unlikely suitors, companies must ensure that the integration plan includes strategies for dealing with cultural differences, establishing a logical leadership structure, implementing a strong two-way communications channel at all levels of the organization, and redefining the “new” organization’s vision, mission, values, and culture.[20]

CONCEPT CHECK

1. How does technology enable firms to organize as virtual corporations?
2. What effect could the gig economy have on a company’s decision to outsource?
3. What are some organizational issues that must be addressed when two firms merge?

Key Terms

authority Legitimate power, granted by the organization and acknowledged by employees, that allows an individual to request action and expect compliance.

centralization The degree to which formal authority is concentrated in one area or level of an organization. Top management makes most of the decisions.

chain of command The line of authority that extends from one level of an organization's hierarchy to the next, from top to bottom, and makes clear who reports to whom.

committee structure An organizational structure in which authority and responsibility are held by a group rather than an individual.

cross-functional team Members from the same organizational level but from different functional areas.

customer departmentalization Departmentalization that is based on the primary type of customer served by the organizational unit.

decentralization The process of pushing decision-making authority down the organizational hierarchy.

delegation of authority The assignment of some degree of authority and responsibility to persons lower in the chain of command.

departmentalization The process of grouping jobs together so that similar or associated tasks and activities can be coordinated.

division of labor The process of dividing work into separate jobs and assigning tasks to workers.

formal organization The order and design of relationships within a firm; consists of two or more people working together with a common objective and clarity of purpose.

functional departmentalization Departmentalization that is based on the primary functions performed within an organizational unit.

geographic departmentalization Departmentalization that is based on the geographic segmentation of the organizational units.

group cohesiveness The degree to which group members want to stay in the group and tend to resist outside influences.

informal organization The network of connections and channels of communication based on the informal relationships of individuals inside an organization.

line organization An organizational structure with direct, clear lines of authority and communication flowing from the top managers downward.

line positions All positions in the organization directly concerned with producing goods and services and that are directly connected from top to bottom.

line-and-staff organization An organizational structure that includes both line and staff positions.

managerial hierarchy The levels of management within an organization; typically includes top, middle, and supervisory management.

matrix structure (project management) An organizational structure that combines functional and product departmentalization by bringing together people from different functional areas of the organization to work on a special project.

mechanistic organization An organizational structure that is characterized by a relatively high degree of job specialization, rigid departmentalization, many layers of management, narrow spans of control, centralized decision-making, and a long chain of command.

organic organization An organizational structure that is characterized by a relatively low degree of job specialization, loose departmentalization, few levels of management, wide spans of control, decentralized decision-making, and a short chain of command.

organization The order and design of relationships within a firm; consists of two or more people working together with a common objective and clarity of purpose.

organization chart A visual representation of the structured relationships among tasks and the people given the authority to do those tasks.

problem-solving teams Usually members of the same department who meet regularly to suggest ways to

improve operations and solve specific problems.

process departmentalization Departmentalization that is based on the production process used by the organizational unit.

product departmentalization Departmentalization that is based on the goods or services produced or sold by the organizational unit.

reengineering The complete redesign of business structures and processes in order to improve operations.

self-managed work teams Teams without formal supervision that plan, select alternatives, and evaluate their own performance.

span of control The number of employees a manager directly supervises; also called span of management.

specialization The degree to which tasks are subdivided into smaller jobs.

staff positions Positions in an organization held by individuals who provide the administrative and support services that line employees need to achieve the firm's goals.

virtual corporation A network of independent companies linked by information technology to share skills, costs, and access to one another's markets; allows the companies to come together quickly to exploit rapidly changing opportunities.

work groups The groups that share resources and coordinate efforts to help members better perform their individual jobs.

work teams Like a work group but also requires the pooling of knowledge, skills, abilities, and resources to achieve a common goal.

Summary of Learning Outcomes

7.1 Building Organizational Structures

1. What are the traditional forms of organizational structure?

Firms typically use traditional, contemporary, or team-based approaches when designing their organizational structure. In the traditional approach, companies first divide the work into separate jobs and tasks. Managers then group related jobs and tasks together into departments. Five basic types of departmentalization are commonly used in organizations:

- *Functional:* Based on the primary functions performed within an organizational unit
- *Product:* Based on the goods or services produced or sold by the organizational unit
- *Process:* Based on the production process used by the organizational unit
- *Customer:* Based on the primary type of customer served by the organizational unit
- *Geographic:* Based on the geographic segmentation of organizational units

7.2 Contemporary Structures

2. What contemporary organizational structures are companies using?

In recent decades, companies have begun to expand beyond traditional departmentalization methods and use matrix, committee, and team-based structures. Matrix structures combine two types of traditional organizational structures (for example, geographic and functional). Matrix structures bring together people from different functional areas of the organization to work on a special project. As such, matrix organizations are more flexible, but because employees report to two direct supervisors, managing matrix structures can be extremely challenging. Committee structures give authority and responsibility to a group rather than to an individual. Committees are part of a line-and-staff organization and often fulfill only an advisory role. Team-based structures also involve assigning authority and responsibility to groups rather than individuals, but, different from committees, team-based structures give these groups autonomy to carry out their work.

7.3 Using Teams to Enhance Motivation and Performance

3. Why are companies using team-based organizational structures?

Work groups share resources and coordinate efforts to help members better perform their individual duties and responsibilities. The performance of the group can be evaluated by adding up the contributions of the individual group members. Work teams require not only coordination but also *collaboration,* the pooling of knowledge, skills, abilities, and resources in a collective effort to attain a common goal. Four types of work teams are used: problem solving, self-managed, cross-functional, and virtual teams. Companies are using teams to improve individual and group motivation and performance.

7.4 Authority—Establishing Organizational Relationships

4. What tools do companies use to establish relationships within their organizations?

The managerial hierarchy (or the *management pyramid*) comprises the levels of management within the organization, and the managerial span of control is the number of employees the manager directly supervises. In daily operations, individuals in line positions are directly involved in the processes used to create goods and services. Individuals in staff positions provide the administrative and support services that line employees need to achieve the firm's goals. Line positions in organizations are typically in areas such as production, marketing, and finance. Staff positions are found in areas such as legal counseling, managerial consulting, public relations, and human resource management.

7.5 Degree of Centralization

5. How can the degree of centralization/decentralization be altered to make an organization more successful?

In a highly centralized structure, top management makes most of the key decisions in the organization, with very little input from lower-level employees. Centralization lets top managers develop a broad view of operations and exercise tight financial controls. In a highly decentralized organization, decision-making authority is pushed down the organizational hierarchy, giving lower-level personnel more responsibility and power to make and implement decisions. Decentralization can result in faster decision-making and increased innovation and responsiveness to customer preferences.

7.6 Organizational Design Considerations

6. How do mechanistic and organic organizations differ?

A mechanistic organization is characterized by a relatively high degree of work specialization, rigid departmentalization, many layers of management (particularly middle management), narrow spans of control, centralized decision-making, and a long chain of command. This combination of elements results in a tall organizational structure. In contrast, an organic organization is characterized by a relatively low degree of work specialization, loose departmentalization, few levels of management, wide spans of control, decentralized decision-making, and a short chain of command. This combination of elements results in a flat organizational structure.

7.7 The Informal Organization

7. How does the informal organization affect the performance of a company?

The informal organization is the network of connections and channels of communication based on the informal relationships of individuals inside the organization. Informal relationships can be between people at the same hierarchical level or between people at different levels and in different departments. Informal organizations give employees more control over their work environment by delivering a continuous stream of company information throughout the organization, thereby helping employees stay informed.

7.8 Trends in Organizational Structure

8. What trends are influencing the way businesses organize?

Reengineering is a complete redesign of business structures and processes in order to improve operations.

The goal of reengineering is to redesign business processes to achieve improvements in cost control, product quality, customer service, and speed.

The virtual corporation is a network of independent companies (suppliers, customers, even competitors) linked by information technology to share skills, costs, and access to one another's markets. This network structure allows companies to come together quickly to exploit rapidly changing opportunities.

Many companies are now using technology to create virtual teams. Team members may be down the hall or across the ocean. Virtual teams mean that travel time and expenses are eliminated and the best people can be placed on the team regardless of where they live. Sometimes, however, it may be difficult to keep virtual team members focused and motivated.

Outsourcing business functions—both globally and domestically—continues to be a regular business practice for companies large and small. Companies choose to outsource either as a cost-saving measure or as a way to gain access to needed human resource talent and innovation. To be successful, outsourcing must solve a clearly articulated business problem. In addition, managers must use outsourcing providers that fit their company's actual needs and strive to engage these providers as strategic partners for the long term. After the impact of the COVID-19 pandemic, more people are working as freelancers on a per-project basis, either because they can't get hired as full-time employees or because they prefer to work as self-employed individuals.

Global mergers raise important issues in organizational structure and culture. The ultimate challenge for management is to take two organizations and create a single, successful, cohesive organization.

Preparing for Tomorrow's Workplace Skills

1. When people talk of climbing the corporate ladder, they are referring to moving vertically upward through the organizational structure. Many employees plot career paths that will take them to increasingly higher levels of management. Do you think you would be more interested in climbing higher in an organization, or being a middle-management bridge between the employees who do the work and the executives who set the strategy? Explain the reasons for your choice. (Resources, Interpersonal)
2. Teams are an increasingly popular method of organizing corporations, but not all people are suited for teamwork. As a manager, what do you do with employees who are talented but unapproachable? Can you think of a way to involve people who are uncomfortable in team settings so that your teams have the perspective of these employees as well? (Interpersonal)
3. Think about how gossip and rumors travel through a grapevine. Draw as many grapevines as you can think of that reflect the different ways rumors move through an organization. Can you think of information that a manager would want to disseminate through the grapevine? Is there information that is inappropriate to disseminate through informal channels? Provide examples. (Information)
4. Do you think companies that outsource will inevitably become virtual corporations? Why or why not? (Resources, Systems)
5. It used to be that only high-level executives and CEOs were able to work out of the office. Since the COVID-19 pandemic, work-from-home options have trickled down the organizational chart. Some positions remain remote even after pandemic concerns have subsided. In your opinion, is there a point in the organizational structure at which working remotely (at home, on the road) should stop? Should all employees in the hierarchy be allowed to work in a virtual environment, or should there be limits? Explain your reasoning. (Technology, Systems)
6. **Team Activity** Have you ever worked on a team with an underperforming member, such as a slacker, a complainer, or a critic? Assemble a team of three to five students and brainstorm a list of "bad" team members you have experience working with. Once you have a list of types, discuss how that person affected the work of the team and the outcome the team produced. Brainstorm ways to better manage and mitigate the negative effects of "bad" team members. Share your results with the class.

(Interpersonal, Systems)

Ethics Activity

Training IT Replacements

The University of California at San Francisco (UCSF) laid off more than 80 IT workers (a mix of full-time and contract employees) to outsource their operations to India in 2017. This change was part of a larger plan by UCSF to increase its technology outsourcing, which was projected to save the organization more than $30 million over time. A large part of UCSF's IT work focuses on its hospital services, and many other health care facilities had already outsourced these types of "back-end" jobs to foreign countries.

Working through a multinational contractor to manage the outsourcing process, UCSF also asked workers who would soon be out of a job to train their overseas replacements via videoconferencing calls to India. One such worker remarked, "I'm speechless. How can they do this to us?"

A UCSF spokesperson explained that the organization provides millions of dollars in charity care for low-income individuals, and that to continue providing those services, the school had to focus on more specialized tech work related to patients and medical research and send other IT work overseas.

UCSF is not alone in sending IT jobs overseas and making the laid-off workers train their Indian replacements. Companies such as American Express and United Health Group have outsourced IT operations abroad.

Using a web search tool, locate articles about this topic and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Are UCSF and other companies justified in outsourcing technology jobs to India? Do they have any obligation to find other jobs or provide training for displaced workers? Should organizations ask employees who are being laid off to train their replacements?

Sources: Sam Harnett, "Outsourced: In a Twist, Some San Francisco IT Jobs Are Moving to India," *All Tech Considered,* https://www.npr.org, accessed July 19, 2017; Dan Shafer, "Exclusive: ManpowerGroup HQ Workers Being Laid Off Required to Train Overseas Replacements," *Milwaukee Business Journal,* https://www.bizjournals.com, March 30, 2017; Bill Whitaker, "Are U.S. Jobs Vulnerable to Workers with H-1B Visas?" *60 Minutes,* https://www.cbsnews.com, March 19, 2017; Louis Hansen, "After Pink Slips, USCF Tech Workers Train Their Foreign Replacements," *The Mercury News,* https://www.mercurynews.com, November 3, 2016.

Working the Net

1. Using a search engine, look for the term "company organizational charts," and find at least three examples of organizational charts for corporations, not-for-profits, or government agencies. Analyze each entity's organizational structure. Is it organized by function, product/service, process, customer type, or geographic location?
2. Search the archives at the *Bloomberg Businessweek* (**https://www.bloomberg.com**), *Fortune* (**https://fortune.com**), or *Forbes* (**https://www.forbes.com**) website for stories about companies that have reorganized. Pick two examples, and prepare a summary of their reorganization efforts, including the underlying reasons the company chose to reorganize, the key elements of the reorganization plan, and if possible, how successful it has been.
3. Visit the *Inc.* magazine website, **https://www.inc.com**, and use the search engine to find articles about virtual corporations. Using a search engine, find the website of at least one virtual corporation, and look for information about how the company uses span of control, informal organization, and other concepts from this module.
4. FlexJobs (**https://www.flexjobs.com**) is an online company devoted to matching job hunters with flexible job experiences, whether they are telecommuting jobs, contract work, or part-time gigs. Read more on

how the company started and the void its services have filled over the past decade for people looking for a flexible job situation. Share your findings with classmates, and lead a discussion on the pros and cons of the flexible job movement.

5. Managing change in an organization is no easy task, as you've discovered in your new job with a consulting firm that specializes in change management. To get up to speed, go to the Change Management page of the Project Management Institute **(**https://www.pmi.org/learning/change-management**)**. Select three articles that discuss how companies approached the change process, and summarize their experiences.
6. After managing your first project team, you think you might enjoy a career in project management. The Project Management Institute is a professional organization for project managers. Its website, https://www.pmi.org, has many resources about this field. Start at the About PMI section, What We Do, to learn what project management is, and then go to the Learning and Resources pages. What are the requirements to earn the Project Management Professional designation? Explore other free areas of the site to learn more about the job of project manager. Prepare a brief report on the career and its opportunities. Does what you've learned make you want to follow this career path?
7. Many companies are outsourcing portions of their IT departments. Should they, and why? Develop a position on this issue by researching outsourcing trends on *Information Week,* (https://www.informationweek.com), or an IT website of your choosing. Then divide the class into two groups, those that support outsourcing and those that oppose it, and have a debate on this subject.

Critical Thinking Case

Gore's Flat Structure Works Well

Imagine an organization with more than 12,000 employees working in countries around the world—with no hierarchy structure. W. L. Gore & Associates, headquartered in Newark, Delaware, is a model of unusual business practices. Wilbert Gore, who left Dupont to explore new uses for Teflon, started the company in 1958. Best known for its breathable, weatherproof Gore-Tex fabric, Glide dental floss, and Elixir guitar strings, the company has no bosses, no titles, no departments, and no formal job descriptions. There is no managerial hierarchy at Gore, and top management treats employees, called associates, as peers.

In 2005, the company named 22-year associate Terri Kelly as its new chief executive officer. Unlike large public corporations, Gore's announcement was made without much fanfare. Kelly served as CEO for 13 years until her retirement in 2018, when Jason Field succeeded her.

The company focuses on its products and company values rather than on individuals. Committees, comprised of employees, make major decisions such as hiring, firing, and compensation. They even set top executives' compensation. Employees work on teams, which are switched around every few years. In fact, all employees are expected to make minor decisions instead of relying on the "boss" to make them. "We're committed to how we get things done," Kelly says. "That puts a tremendous burden on leaders because it's easier to say 'Just do it' than to explain the rationale. But in the long run, you'll get much better results because people are making a commitment."

Because no formal lines of authority exist, employees can speak to anyone in the company at any time. This arrangement also forces employees to spend considerable time developing relationships. As one employee described it, instead of trying to please just one "boss," you have to please everyone. Several years ago the company underwent a "strategy refresh," conducting surveys and discussions with employees about how they fit into the organization's culture. Not surprisingly, there was a cultural divide based on multiple generations of workers and length of service stature, which Kelly and her associates have worked hard to overcome. She realizes that not everyone will become a "lifer" at Gore, but recognizes the importance of younger employees who have helped the company become more tech-savvy in communications and stay well-connected in a fast-moving business world.

The informal organizational structure continues to work well. With revenues of $4–5 billion, the company produces thousands of advanced technology products for the electronics, industrial, fabrics, and medical markets. Its corporate structure fosters innovation and has been a significant contributor to associate satisfaction. Employee turnover is lower, and the company has a steady stream of applicants to choose from. In 2017, Gore was named one of the 12 legends on *Fortune's* "100 Best Companies to Work For." The company continues to be listed on the "Best" rankings since the list began in 1998.

Critical Thinking Questions

1. Given the lack of formal structure, how important do you think Gore's informal structure becomes?
2. Is W. L. Gore a mechanistic or an organic organization? Support your answer with examples from the case.
3. How do you think Gore's flat organizational structure affects innovation at the company?

Sources: "Our Story," https://www.gore.com, accessed July 18, 2017; Jeremy Hobson, "What It's Like to Lead a Non-Hierarchical Workplace," https://www.wbur.org, accessed July 18, 2017; Alan Deutschman, "The Un-CEO," *Fast Company,* https://www.fastcompany.com, accessed July 18, 2017; Claire Zillman, "Secrets from Best Companies All Stars," *Fortune,* https://fortune.com, March 9, 2017; Daniel Roberts, "At W.L. Gore, 57 Years of Authentic Culture," *Fortune,* https://fortune.com, March 5, 2015.

Hot Links Address Book

1. Like corporations, government agencies have organization charts, too. Learn how the Department of Health and Human Services is structured at **https://www.hhs.gov/about/agencies/orgchart/index.htm**.
2. Find team-building resources galore, from team-building activities and training exercises to guidance in solving team problems, at Team Builders Plus website, **https://teambuildersplus.com**.
3. To read articles on current best practices in outsourcing for both buyers and providers and find other outsourcing resources, search "outsourcing" on the Investopedia site at **https://www.investopedia.com**.
4. What benefits can a company gain by using web-based organizational charting software? Check out the features Organimi offers companies at **https://www.organimi.com**.
5. How can your organization develop better group skills? A good place to start is the Free Management Library at **https://management.org/aboutfml/index.html#title4**. Scroll down to the section "Working with Groups" for links to resources on many topics, including self-directed and self-managed work teams.

8

Managing Human Resources and Labor Relations

Exhibit 8.1 (Credit: Ludovic Bertron /flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What is the human resource management process, and how are human resource needs determined?
2. How do firms recruit applicants?
3. How do firms select qualified applicants?
4. What types of training and development do organizations offer their employees?
5. How are performance appraisals used to evaluate employee performance?
6. What are the types of compensation and methods for paying workers?
7. What is a labor union and how is it organized, what is collective bargaining, and what are some of the key negotiation issues?
8. How are grievances between management and labor resolved, and what tactics are used to force a contract settlement?
9. What are the key laws and federal agencies affecting human resource management and labor relations?
10. What trends and issues are affecting human resource management and labor relations?

EXPLORING BUSINESS CAREERS

Andrea Herran, Human Resources Consultant

In college, Andrea Herran studied business administration and minored in psychology. Always interested in a business career, she initially took psychology simply because it was interesting. Little did she know how applicable that minor would become. As a human resources (HR) consultant, she often benefits from her psychology background. “Studying human behavior really gave me the background necessary to put myself in the position of others, to see things from their point of view, which has definitely been helpful in my

career in human resources."

Herran started out as an administrative assistant in the HR department of a hotel, and her career has run the gamut of human resources in the years since she graduated from college. She has been an employment coordinator, focusing on employee recruitment and selection, and a personnel manager, where she learned the skills necessary to maintain and evaluate employees. As a training manager, she sharpened her talent for developing, coordinating, and even administering staff training. Eventually, she became the director of human resources for companies both in the United States and abroad. Indeed, beyond the United States, she has worked in Mexico, Argentina, and South Africa.

Andrea worked her way up in the corporate world, but entrepreneurship was more consistent with her desire for a fast-paced, changing environment, both in terms of what she does and who she works with, so she made the move to consulting. "Consulting allows me to draw upon all my human resources skills. I have opened five HR departments in my career, so I bring my full experience to bear on the challenges each company has."

Today, Andrea's passion is working with small businesses, entrepreneurs, managers, and owners as an advisor to "uncomplicate the people side of your business." As the principal of Focus HR Consulting, she advises firms how to set up human resource programs and ensure legal compliance. She also provides leadership coaching and training and mentors employees. She has worked in several industries, including hospitality (hotels and restaurants), advertising, professional services, logistics, technology, and manufacturing.

When Andrea was hired by Aquion Water Treatment Products, she was tasked with updating the company's HR policies and procedures. The company's performance reviews were very task-oriented versus behavior-oriented. Instead of determining whether a task was completed, behavior-oriented reviews seek to evaluate not only whether the person completed the task but also how they did so, especially examining the interactions involved in the task. Is an employee punctual at returning consumer request calls? How do they relate to customers? As a manager, do they express thoughts clearly? "By evaluating specific behaviors, you create an environment with clearly set qualifications for advancement and opportunities for targeted employee development. Without this, the *human* aspect of human resources can be overlooked."

Andrea has never looked back on her choice to become an entrepreneur, and she believes her varied employment history was a key to her success. "Anyone interested in this field should experience as many possibilities within human resources as possible. You leave school with the theory, but only through experience do you really get to see what the potential of such a career is."

Sources: "About Us," https://focushr.biz, accessed February 8, 2018; "Member Spotlight: Andrea Herran," https://www.centerforguiltfreesuccess.com, accessed February 8, 2018; Insureon blog, "5 HR Pros Reveal the Secret to Hiring the Right Employees the First Time," https://www.insureon.com, June 3, 2016.

This chapter looks at the role of human resources within an organization, from the general processes of developing and planning to the more specific tasks of employee evaluation and compensation.

Human resource management and labor relations involve acquisition, development, use, and maintenance of a human resource mix (people and positions) to achieve strategic organizational goals and objectives. Successful human resource management is based on a company's ability to attract and hire the best employees, equip them with the knowledge and skills they need to excel, compensate them fairly, and motivate them to reach their full potential and perform at high levels. Today's business environment presents numerous challenges to effectively managing employees:

- Technology continues to advance, such as the growth in artificial intelligence (AI), which places great importance on knowledge workers, especially when demand outstrips the supply of high-talent

individuals.
- Global business operations involve rapid data transfer and necessitate accelerated decision-making by executive and technical employees.
- The workforce is increasingly more diversified and multicultural, which places increased emphasis on communication and cultural understanding.
- Work, life, and family priorities are more difficult to balance as dual-worker families populate the labor force.
- Employment and labor laws continue to greatly influence employee recruitment and hiring, compensation decisions, and employee retention and turnover in both union and nonunion organizations.

Each day, human resource experts and front-line supervisors deal with these challenges while sharing responsibility for attracting and retaining skilled, motivated employees. Whether faced with a large or small human resources problem, supervisors need some understanding of difficult employee-relations issues, especially if there are legal implications.

In this chapter, you will learn about the elements of the human resource management process, including human resource planning and job analysis and design, employee recruitment and selection, training and development of employees, performance planning and evaluation, and compensation of the workforce. The chapter also describes labor unions and their representation of millions of U.S. workers in construction, manufacturing, transportation, and service-based industries.

8.1 Achieving High Performance through Human Resources Management

1. What is the human resource management process, and how are human resource needs determined?

Human resource (HR) management is the process of hiring, developing, motivating, and evaluating employees to achieve organizational goals. The goals and strategies of the firm's business model form the basis for making human resource management decisions. HR practices and systems comprise the firm's human resource decision support system that is intended to make employees a key element for gaining competitive advantage. To this end, the HR management process contains the following sequenced activities:

- Job analysis and design
- Human resource planning and forecasting
- Employee recruitment
- Employee selection
- Training and development
- Performance planning and evaluation
- Compensation and benefits

The human resource management process shown in **Exhibit 8.3** encourages the development of high-performance employees. The process is sequential because employees can't be trained and paid until selected and placed in jobs, which follows recruitment, which is preceded by human resource planning and job analysis and design. Good HR practices used along this sequence foster performance improvement, knowledge and skill development, and loyal employees who desire to remain with the organization.

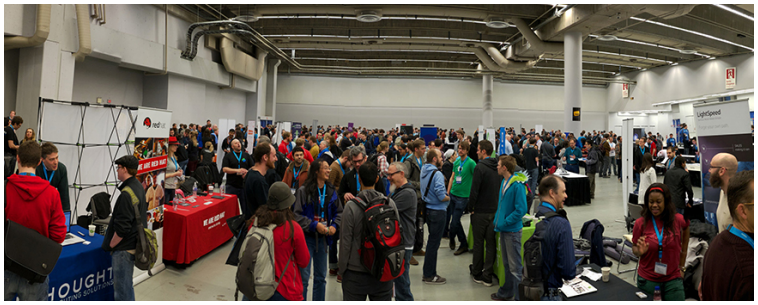

Exhibit 8.2 Job fairs and career expos are events in which employers, recruiters, and schools give information to potential employees and job seekers who attend hoping to make a good impression to potential employers. They also interact with potential coworkers by speaking face-to-face, exchanging résumés, and asking questions in attempt to get a good feel on the work needed. Likewise, online job fairs are held, giving job seekers another way to get in contact with probable employers using the internet. *How do you plan on using events like this in seeking your job? How can utilize the courses that you are taking to illustrate your skills that you can discuss at job fairs?* (Credit: Taavi Burns/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

HR Planning and Job Analysis and Design

Two important, and somewhat parallel, aspects of the human resource management process are determining employee needs of the firm and the jobs to be filled. When Alcon gained approval from the Food and Drug Administration for sales of a new contact lens disinfectant solution in its Opti-Free product line, it had to determine if additional sales representatives were needed and whether new sales positions with different knowledge and skill requirements should be established.[1] **Human resource planning** at Alcon means having the right number of people, with the right training, in the right jobs, to meet its sales goals for the new product. Once the need for sales representatives is determined, human resource specialists assess the skills of the firm's existing employees to see whether new people must be hired or current people can be trained. See Exhibit 8.3 for a representation of the human resource management process.

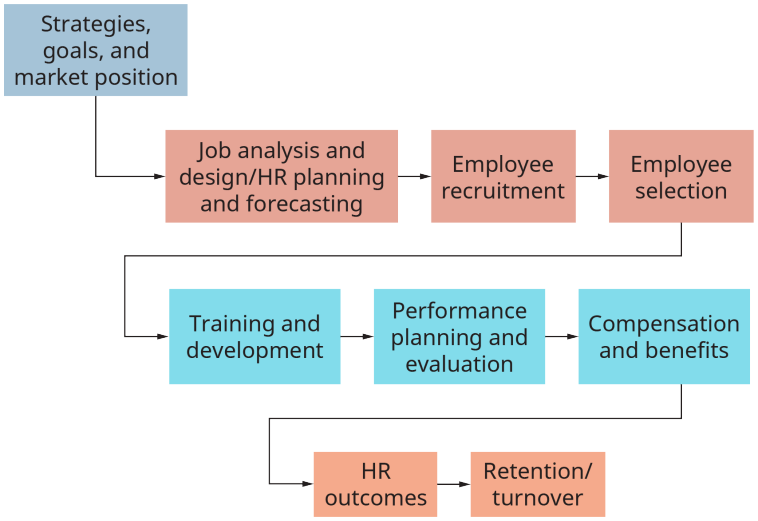

Exhibit 8.3 Human Resource Management Process (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Human resource planners must know what skills different jobs require. Information about a specific job typically begins with a **job analysis**, which is a study of the tasks required to do a job well. This information is used to specify the essential skills, knowledge, and abilities required for the job. When Hubert Joly started his former role as the CEO at Best Buy, the retailer was facing serious financial pressures. The threat of online competition from Amazon was real. Also facing a staffing issue with a lot of turnover, Joly's team instituted a plan to keep and promote staff as a core competency that would differentiate Best Buy from online retailers.[2] Also, a key HR responsibility is that jobs are examined to make any changes in job duty and task responsibilities. The tasks and responsibilities of a job are listed in a **job description**. The skills, knowledge, and abilities a person must have to fill a job are spelled out in a **job specification**. These two documents help human resource planners find the right people for specific jobs. A sample job description and specification is

shown in Table 8.1.

HR Planning and Forecasting

Forecasting an organization's human resource needs, known as an HR *demand forecast,* is an essential aspect of HR planning. This process involves two forecasts: (1) determining the number of people needed by some future time, such as one year, and (2) estimating the number of people currently employed by the organization who will be available to fill various jobs at some future time; this is an *internal supply forecast*.

Job Description and Specification	
Position: College Recruiter Reports to: Vice President of Human Resources	**Location: Corporate Offices Resources Classification: Salaried/Exempt**
Job Summary:	
Member of HR corporate team. Interacts with managers and department heads to determine hiring needs for college graduates. Visits 20 to 30 college and university campuses each year to conduct preliminary interviews of graduating students in all academic disciplines. Following initial interviews, works with corporate staffing specialists to determine persons who will be interviewed a second time. Makes recommendations to hiring managers concerning best-qualified applicants.	
Job Duties and Responsibilities:	
Estimated time spent and importance:	
15%	Working with managers and department heads, determines college recruiting needs.
10%	Determines colleges and universities with degree programs appropriate to hiring needs to be visited.
15%	Performs college relations activities with numerous colleges and universities.
25%	Visits campuses to conduct interviews of graduating seniors.
15%	Develops applicant files and performs initial applicant evaluations.
10%	Assists staffing specialists and line managers in determining who to schedule for second interviews.
5%	Prepares annual college recruiting report containing information and data about campuses, number interviewed, number hired, and related information.

Table 8.1

Job Description and Specification	
Position: College Recruiter Reports to: Vice President of Human Resources	**Location: Corporate Offices Resources Classification: Salaried/Exempt**
5%	Participates in tracking college graduates who are hired to aid in determining campuses that provide the most outstanding employees.
Job Specification (Qualifications):	
Bachelor's degree in human resource management or a related field. Minimum of two years of work experience in HR or department that annually hires college graduates. Ability to perform in a team environment, especially with line managers and department heads. Very effective oral and written communication skills. Reasonably proficient in Office products and familiar with PeopleSoft software.	

Table 8.1

The Advancement Planning process at Best Buy reduced the turnover that often occurs in the retail environment. The company then achieved a second-place ranking, behind Costco, with its general managers' tenure averaging around five years. The performance of managers at Best Buy is reviewed to identify people who can fill vacancies and be promoted, a process known as **succession planning**.[3] If Best Buy has a temporary shortage of sales professionals, at the holiday shopping season, for example, they can hire an experienced contractor or interim executive as a temporary or **contingent worker**, someone who wants to work but not on a permanent, continuous basis. Exhibit 8.4 summarizes the process of planning and forecasting an organization's personnel needs.

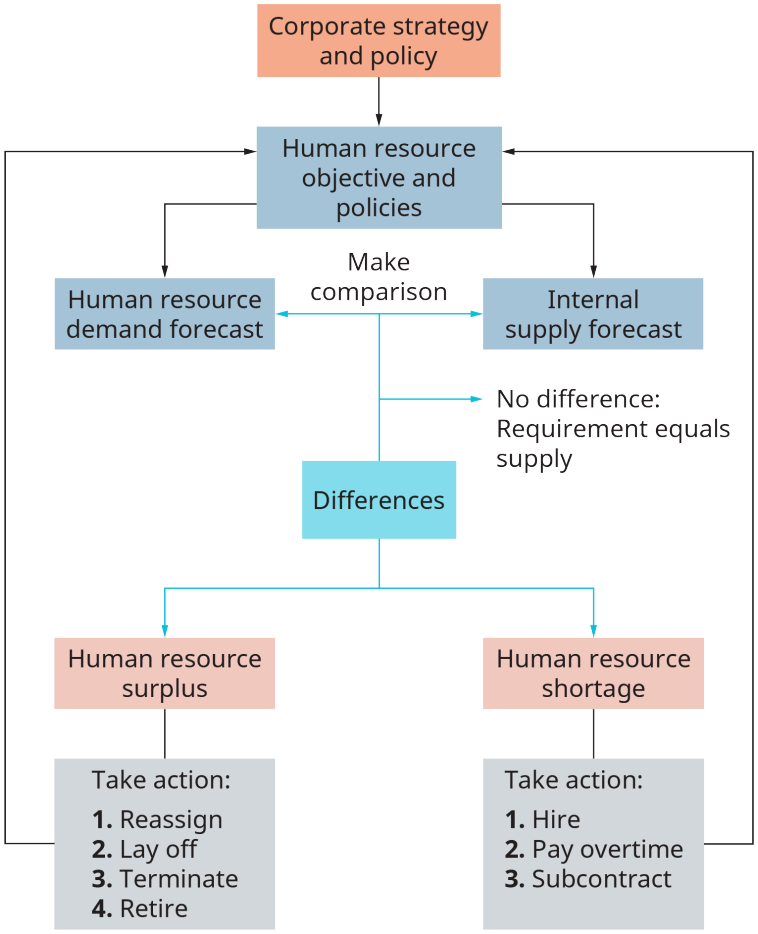

Exhibit 8.4 Human Resource Planning Process (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

CONCEPT CHECK

1. Define human resource management.
2. Distinguish between job analysis, job description, and the job specification.
3. Describe the human resource management process.

8.2 Employee Recruitment

2. How do firms recruit applicants?

When a firm creates a new position or an existing one becomes vacant, the firm starts looking for people with qualifications that meet the requirements of the job. Two sources of job applicants are the internal and external labor markets. The internal labor market consists of employees currently employed by the firm; the external labor market is the pool of potential applicants outside the firm.

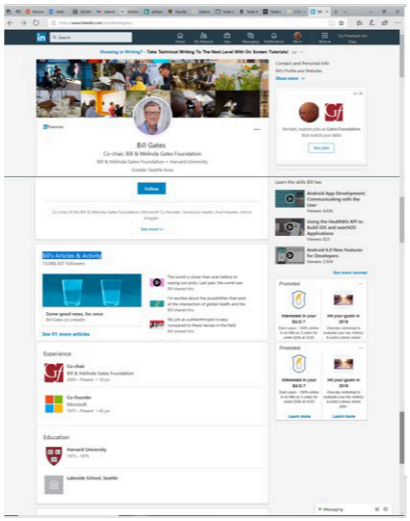

Exhibit 8.5 Online recruiting is among the top internet success stories of the past decade. LinkedIn, Monster, and CareerBuilder are hot spots for job hunters and recruiters seeking to establish a working relationship. *What are the advantages and disadvantages of online recruiting compared to traditional forms of recruitment?* (Credit: Bill Gates LinkedIn Profile screen capture, 3/23/2018)

Internal Labor Market

Internal recruitment can be greatly facilitated by using a human resource information system that contains an employee database with information about each employee's previous work experience, skills, education and certifications, job and career preferences, performance, and attendance. Promotions and job transfers are the most common results of internal recruiting. BNSF Railway, Walmart, Zappos, Ritz-Carlton Hotels, and most other firms, large and small, promote from within and manage the upward mobility of their employees.

External Labor Market

The external labor market consists of prospects to fill positions that cannot be filled from within the organization. **Recruitment** is the process of attracting qualified people to form an applicant pool. Numerous methods are used to attract applicants, including various channels such as web and social media advertising. Hospitality and entertainment firms, such as Ritz-Carlton Hotels and Six Flags, frequently use job fairs to attract applicants. A **job fair**, or *corporate open house*, is usually a one- or two-day event at which applicants are briefed about job opportunities, given tours, and encouraged to apply for jobs. For firms needing accountants, engineers, sales managers, and others for professional and scientific positions, college recruiting is very common. These firms (Deloitte, Cisco Systems, Salesforce.com, and thousands of others) schedule job fairs and on-campus interviews with graduating seniors.

Online Recruiting and Job Search

The internet, social media, and specialized software have completely changed the employee recruitment process. Dozens of companies such as Monster.com, Indeed, Handshake, and Glassdoor enable applicants to search for job openings, post their résumés, and apply for jobs that companies have posted. Most companies provide links to their company website and to the career page on their site so applicants can learn about the company culture, listen to or read testimonials from employees about what it is like to work for the company, and search for additional openings that may interest them.

Large firms may receive thousands of online applications per month. To review and evaluate thousands of online résumés and job applications, firms depend on software to scan and track applicant materials using key words to match skills or other requirements for a particular job. Social media has also changed how companies search for applicants and verify applicant information.

MANAGING CHANGE

Social Networking and Employee Recruitment

Referrals and professional networking are commonly used methods of identifying job prospects, particularity for managerial, professional, and technical positions. Several software applications and social networks facilitate employee referrals, reference checking, and hiring based on networks of personal relationships. ExecuNet is just one example of the many career sites that allow members to search for contacts and network with other professionals in their fields.

LinkedIn is the most popular social network for professionals. It is a giant database of contacts with profiles that provide an overview of a person's past and present professional experience, skills, professional referrals, and affiliations with business and professional associations. Individuals can search through an extended network of contacts based on a variety of factors, such as professional acquaintances, industry, or educational institutions. LinkedIn uses the concept that there are no more than six degrees of separation between two people, or one person can be linked to any other individual through no more than six other people. With more than 1 billion members worldwide, LinkedIn's extensive platform is an ideal network for both recruiters and those looking to make their next career move.

LinkedIn, like other social networks, is based on voluntary participation, and members consent to being networked. Nevertheless, important questions can be raised regarding privacy concerns and use of one's social network.

Critical Thinking Questions

1. Social networks can easily generate a name for an HR recruiting target, but how can the hiring firm convert the target into a candidate who is interested in the job?
2. A social network like LinkedIn is an excellent tool that can be used to build a personal brand and find a new job. In what ways could a job seeker potentially *harm* their career opportunities on a social networking site?

Sources: "About ExecuNet," https://www.execunet.com, accessed February 8, 2018; "Social Recruiting Tips," https://www.betterteam.com, January 24, 2018; Susan M. Heathfield, "Use LinkedIn for Recruiting Employees," *The Balance,* https://www.thebalance.com, April 7, 2017; Dilawar Malik, "100 Essential LinkedIn Statistics and Facts for 2025: Your Guide to the Professional Network," *LinkedIn*, https://www.linkedin.com, March 11, 2025.

Recruitment Branding

Recruitment branding involves presenting an accurate and positive image of the firm to those being recruited. Carbone Smolan Agency (CSA) was a New York-based, design-led branding agency creating visual identity and brand experience for major organizations. As part of that work, they have helped clients develop recruitment and employer-branding materials.[4] The materials developed by CSA comprise a *realistic job preview*, which informs job candidates about organizational realities of the job and the firm so they can more accurately evaluate jobs and firm expectations concerning work assignments, performance standards, promotional opportunities, company culture, and many other characteristics of the job.

CONCEPT CHECK

1. What are the two sources of job applicants?

2. What are some methods firms use to recruit applicants?
3. What is meant by recruitment branding?

8.3 Employee Selection

3. How do firms select qualified applicants?

After a firm has attracted enough job applicants, employment specialists begin the selection process. **Selection** is the process of determining which people in the applicant pool possess the qualifications necessary to be successful on the job. The steps in the employee selection process are shown in Exhibit 8.6. An applicant who can jump over each step, or hurdle, will very likely receive a job offer; thus, this is known as the successive hurdles approach to applicant screening. Alternatively, an applicant can be rejected at any step or hurdle. Selection steps or hurdles are described below:

1. *Initial screening*. During initial screening, an applicant completes an application form and/or submits a résumé, and has a brief interview of 30 minutes or less. The job application includes information about educational background, previous work experience, and job duties performed.
2. *Employment testing.* Following initial screening, the applicant may be asked to take one or more tests, such as the Wonderlic Assessments. Wonderlic offers a suite of pre-employment tests for each phase of the hiring process. Used individually or together, the tests can assess cognitive ability (ability to learn, adapt, and solve problems), motivation potential (attitude, behavior performance, and productivity), and knowledge and skills (math, verbal, data entry, software proficiency).[5]

   At the time, HR Senior Vice President Martha LaCroix of the Yankee Candle Company used personality assessments to make sure that prospective employees would fit the firm's culture. LaCroix was helped by The Predictive Index in determining Yankee Candle's best- and worst-performing store managers for developing a best practice behavioral profile of a top-performing store manager.[6] The profile was used for personality testing and to develop interview questions that reveal how an applicant may behave in certain work situations.

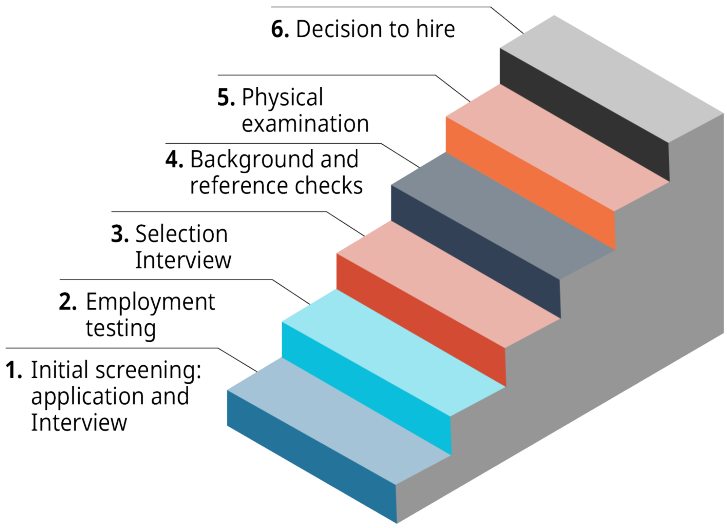

Exhibit 8.6 Steps of the Employee Selection Process (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

3. *Selection interview.* The tool most widely used in making hiring decisions is the **selection interview**, an in-depth discussion of an applicant's work experience, skills and abilities, education, and career interests. For managerial and professional positions, an applicant may be interviewed by several persons, including the

line manager for the position to be filled. This interview is designed to determine a person's communication skills and motivation. During the interview, the applicant may be presented with realistic job situations, such as dealing with a disgruntled customer, and asked to describe how they would handle the problem. Carolyn Murray of W.L. Gore & Associates (maker of Gore-Tex, among other products) listens for casual remarks that may reveal the reality behind applicant answers to her questions. Using a baseball analogy, Murray gives examples of how three job candidates struck out with her questions. See Table 8.2.[7]

Striking Out at the Interview Game		
The Pitch (Question to Applicant)	**The Swing (Applicant's Response)**	**The Miss (Interviewer's Reaction to Response)**
"Give me an example of a time when you had a conflict with a team member."	"Our leader asked me to handle all of the shipping for our team. I did it, but I thought that this responsibility was a waste of my time."	"At Gore, we work from a team concept. The applicant's answer shows that they won't exactly jump when a teammate needs help."
"Tell me how you solved a problem that was impeding your project."	"One of the engineers on my team wasn't pulling their weight, and we were closing in on a deadline. So I took on some of their work."	"The candidate may have resolved the issue for this particular deadline, but they did nothing to prevent the problem from happening again."
"What's the one thing that you would change about your current position?"	"My job as a salesperson has become boring. Now I want the responsibility of managing people."	"They are probably not maximizing their current territory and they are complaining. Will this employee find their next role 'boring' and complain about that role, too?"

Table 8.2

4. *Background and reference check.* If applicants pass the selection interview, most firms examine their background and check their references. In recent years, an increasing number of employers are carefully researching applicants' backgrounds, particularly their legal history, reasons for leaving previous jobs, and even creditworthiness.
5. *Physical exams and drug testing*. A firm may require an applicant to have a medical checkup to ensure they are physically able to perform job tasks. Drug testing is common in the transportation and health care industries. Southwest Airlines, BNSF Railway, Texas Health Resources, and the U.S. Postal Service use drug testing for reasons of workplace safety, productivity, and employee health.
6. *Decision to hire.* If an applicant progresses satisfactorily through all the selection steps (or jumps all of the selection hurdles), a decision to hire the person is made; however, the job offer may be contingent on passing a physical exam and/or drug test. The decision to hire is nearly always made by the manager of the new employee.

An important aspect of employee recruitment and selection involves treating job applicants as valued customers; in fact, some applicants may be customers of the firm.

CUSTOMER SATISFACTION AND QUALITY

Puttin' on the Ritz—For Potential Employees

Your meeting with a human resource representative is often your first exposure to the company you are applying to work for, and firms must provide good customer service to applicants if they expect to hire the most qualified employees.

Companies have several opportunities to create a positive impression of their organization during these key points in the employee selection process. These include a variety of communication channels, such as:

- In-person greetings at a job fair or at the interview itself
- Phone calls to a prospective employee from a human resource professional to set up the interview and any follow-up conversations between human resources and the applicant
- E-mail correspondence to acknowledge receipt of an application and to thank applicants for submitting their job application
- A thank-you note from the employer following the second interview

A company that is known to provide a personalized and welcoming recruitment process is Ritz-Carlton Hotels, a subsidiary of Marriott International. When the Washington D.C. Ritz-Carlton was recruiting employees to staff a new hotel, the goal was to provide applicants with a personal demonstration of the famous Ritz-Carlton service-oriented culture.

As applicants arrived, they experienced the Ritz-Carlton "warm welcome" from several employees who greeted them, wished them luck, and escorted them past a violinist and piano player to the waiting room, where beverages and snacks were available. Applicants went through a standardized screening questionnaire, and those who passed went on to a professionally developed structured interview. Individuals were then personally escorted to the "fond farewell," where they were thanked, given Ritz-Carlton chocolates, and escorted out of the hotel. The goal of Ritz-Carlton managers is to give applicants the same experience they would expect to receive as a customer staying in the hotel. Every applicant receives a personal, formal thank-you note for coming to the job fair, and those who are considered for positions but later rejected receive another note. Ritz-Carlton wants to make a good impression because an applicant could be a future Ritz-Carlton hotel guest, or the relative of a guest.

Ritz-Carlton continues to show exemplary service during the employee orientation process. Each employee is required to complete training before beginning work. The training includes a general orientation session as well as a session specific to Ritz-Carlton's values and philosophies. The goal is to create a training experience that evokes emotions in new employees for the first few days. For example, as new employees arrive for training on the first day, senior leaders in the company are lined up clapping and cheering to welcome them into the "family." The message is clear: *You are important and we will treat you exactly as we want you to treat customers.*

The leadership team is involved in facilitating the program, sending a powerful message about the importance of consensual commitment. "For these next few days, we will orient you to who we are—our heart, our soul, our goals, our vision, our dreams—so you can join us, and not just work for us."

Critical Thinking Questions

1. What are the benefits of an employer treating a job applicant like a customer? Are there costs associated with treating applicants poorly?
2. What is the Ritz-Carlton motto? How does it teach both applicants and employees about the company's values?

Sources: "Gold Standards," https://www.ritzcarlton.com, accessed February 8, 2018; "Lifetime Learning Opportunities," https://www.marriott.com, accessed February 8, 2018; Justin Hoffman, "Secrets of the Ritz-Carlton's 'Legendary' Customer Service," https://www.psafinancial.com, May 8, 2014; Sandra J. Sucher and Stacy McManus, "The Ritz-Carlton Hotel Company," Harvard Business School Case #601-163, March 2001; revised September 2005.

CONCEPT CHECK

1. Describe the employee selection process.
2. What are some of the ways that prospective employees are tested?

8.4 Employee Training and Development

4. What types of training and development do organizations offer their employees?

To ensure that both new and experienced employees have the knowledge and skills to perform their jobs successfully, organizations invest in training and development activities. **Training and development** involves learning situations in which the employee acquires additional knowledge or skills to increase job performance. Training objectives specify performance improvements, reductions in errors, job knowledge to be gained, and/or other positive organizational results. The process of creating and implementing training and development activities is shown in **Exhibit 8.8**. Training is done either on the job or off the job.

Exhibit 8.7 Here is the final assembly process on an Boeing 787-10 for Singapore Airlines. This plant is one of Boeing's largest and most technologically advanced manufacturing facilities, in Charleston, South Carolina. Boeing is investing heavily in expanding this facility to nearly double the current size to support growth. *How is technology helping companies develop skilled workers both on and off the job?* (Credit: https://upload.wikimedia.org/wikipedia/commons/thumb/c/c0/Singapore_Airlines_787-10_final_assembly_%2841008876271%29.jpg/220px-Singapore_Airlines_787-10_final_assembly_%2841008876271%29.jpg)

On-the-Job Training

New-employee training is essential and usually begins with **orientation**, which entails getting the new employee ready to perform on the job. Formal orientation (often a half-day classroom program) provides information about the company history, company values and expectations, policies, and the customers the company serves, as well as an overview of products and services. More important, however, is the specific job

orientation by the new employee's supervisor concerning work rules, equipment, and performance expectations. This second briefing tends to be more informal and may last for several days or even weeks.

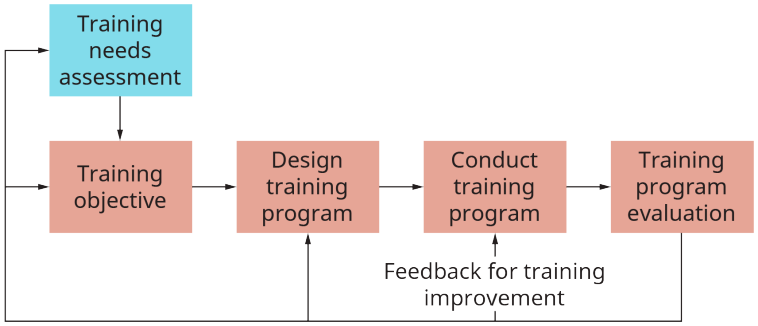

Exhibit 8.8 Employee Training and Development Process (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Beyond employee orientation, job training takes place at the job site or workstation and is directly related to the job. This training involves specific job instruction, coaching (guidance given to new employees by experienced ones), special project assignments, or job rotation. **Job rotation** is the reassignment of workers to several different jobs over time. At Cintas, management trainees rotate through every department in the business—such as sales, finance, and human resources—during the first year and a half.

Two other forms of on-the-job training are apprenticeship and mentoring. An **apprenticeship** usually combines specific on-the-job instruction with classroom training. It may last as long as four years and can be found in the skilled trades of carpentry, plumbing, and electrical work. **Mentoring** involves a senior manager or other experienced employee providing job- and career-related information to a mentee. Inexpensive and providing instantaneous feedback, mentoring is becoming increasingly popular with many firms, including FedEx, Merrill Lynch, Dow Chemical, and Bank of America. Whereas mentoring is typically conducted through ongoing face-to-face interactions between mentor and mentee, technology now allows for a long-distance mentoring relationship. Dow Chemical uses technology to facilitate mentoring sessions across borders. An employee whose first language is not English is encouraged to conduct all business in English from the beginning of their employment to build their fluency. English is the dominant language that Dow utilizes in their operations; therefore, it is important to allow employees time, support, and the resources necessary to sharpen those skills.[8]

EXPANDING AROUND THE GLOBE

Employees on the (International) Move

Working abroad at one of the thousands of U.S. or foreign multinational firms can be exciting and look good on your résumé. But is an international job assignment a step up the ladder to a more rewarding career path or a potential minefield of professional and family risk? The answer depends as much on an employee's family situation as their ambition, as well as how well the company supports and handles a transfer to an international location.

Global competencies are important in today's workplace and often viewed as essential leadership skills. Many companies utilize rotational programs designed to give individuals critical global experience. According to the BGRS 2016 Global Mobility Trends Survey, providing high levels of service to relocating employees and their families is a fundamental expectation.

SIRVA (formerly BGRS) is a talent mobility and relocation services firm that manages thousands of relocations in over 170 countries each year for its corporate and government clients. With over 60 offices around the world, the multilingual staff can tap into their network of trusted suppliers to help employees

and families acclimate to their new work and home environments.

Increasing numbers of recent college graduates and experienced professionals are offered opportunities for overseas work assignments ranging from a few days to 24 months or longer. But acclimating to a new country and culture, as well as a new work environment, can be daunting and involves some unique challenges.

Challenges face expatriates aside from the demands of work include:

- Choosing schools for children
- Securing housing
- Finding medical facilities
- Opening bank accounts
- Finding transportation and obtaining a driver's license
- Completing government forms
- Locating food stores
- Learning about community and entertainment offerings

With 276,000 worldwide staff and partners, KPMG International is one of the world's largest professional services firms, with a presence in nearly 140 countries. Through their Global Opportunities (GO) program, KPMG employees can explore international career options: short-term assignments, long-term assignments, and permanent international relocation options. The company's Career Mobility Guide allows employees to evaluate opportunities based on their interests and to seek guidance from a transition advisor on potential career opportunities.

KPMG has developed several programs and standards to guide employees and establish consistency, whether they work in the United States or abroad. One of the most important is the KPMG Code of Conduct, which defines the values and standards by which KPMG conducts business and is intended to help guide actions and behaviors of its global workforce.

All KPMG employees and partners are required to comply with the Code of Conduct. In addition, all partners and employees are required to complete mandatory training that reinforces the principles of the Code and further builds understanding of the firm's expectations.

Critical Thinking Questions

1. How is KPMG's Global Code of Conduct intended to influence and guide the personal values and behaviors of its employees and partners?
2. Why must the Code of Conduct be affirmed by employees and partners every year? Why does KPMG include their partners in this program?
3. What are the top four or five job qualifications an employee should have to be considered for an overseas assignment?

Sources: Corrine Purtill, "Expat Couples Do Best When They've Moved for the Woman's Job," *Quartz at Work*, December 6, 2017; https://work.qz.com/1134685/expat-couples-do-best-when-theyve-moved-for-the-womans-job/; Donald Murray, "The 7 Greatest Challenges of Moving Overseas and How to Resolve Them," *International Living*, March 15, 2018, https://internationalliving.com/the-7-greatest-challenges-of-moving-overseas-and-how-to-resolve-them/; "KPMG's Code of Conduct," Accessed March 15, 2018, https://home.kpmg.com/us/en/home/about/kpmgs-code-of-conduct.html; SIRVA Communications, "SIRVA and BGRS Agree to Combine to Create Global Leader in Relocation and Move Management," *SIRVA*, https://www.sirva.com, May 6, 2022; "About KPMG," https://kpmg.com, accessed February 24, 2026; "Global Opportunities," https://kpmg.com, accessed February 24, 2026; "KPMG Career Mobility Navigation Guide," https://careermobility-portal.kpmg.com, accessed February 24, 2026.

Off-the-Job Training

Even with the advantages of on-the-job training, many firms recognize that it is often necessary to train employees away from the workplace. With off-the-job training, employees learn the job away from the job. There are numerous popular methods of off-the-job training. It frequently takes place in a classroom, where cases, role-play exercises, films, videos, lectures, and computer demonstrations are used to develop workplace skills.

Web-based technology is increasingly being used along with more traditional off-the-job training methods. E-learning and e-training involve online computer presentation of information for learning new job tasks. BMW and Verizon utilize virtual reality (VR) trainings with thousands of employees widely dispersed geographically. These trainings can prepare front-line workers for crisis situations with customers or safety emergencies on the production floor. Providing training through this format saves time and travel costs, while enhancing the experience for employees over merely a video online training module. However, some required training can be delivered as **programmed instruction**, an online, self-paced, and highly structured training method that presents trainees with concepts and problems using a modular format. This is particularly helpful in some industries where training is legally required, such as through OSHA (Occupational Safety and Health Administration) mandates.[9]

Web-based training can also be done using a **simulation**, for example, a scaled-down version of a manufacturing process or even a mock cockpit of a jet airplane. American Airlines uses flight simulators embedded with AI technologies for pilots to practice hazardous flight maneuvers or learn the controls of a new aircraft in a safe, controlled environment with no passengers. The simulator allows for more direct transfer of learning to the job.

CONCEPT CHECK

1. Describe several types of on-the-job training.
2. What are the advantages of simulation training?
3. How is technology impacting off-the-job training?

8.5 Performance Planning and Evaluation

5. How are performance appraisals used to evaluate employee performance?

Along with employee orientation and training, new employees learn about performance expectations through performance planning and evaluation. Managers provide employees with expectations about the job. These are communicated as job objectives, schedules, deadlines, and product and/or service quality requirements. As an employee performs job tasks, the supervisor periodically evaluates the employee's efforts. A **performance appraisal** is a comparison of actual performance with expected performance to determine an employee's contributions to the organization and to make decisions about training, compensation, promotion, and other job changes. The performance planning and appraisal process is shown in **Exhibit 8.9** and described below.

1. The manager establishes performance standards.
2. The employee works to meet the standards and expectations.
3. The employee's supervisor evaluates the employee's work in terms of quality and quantity of output and various characteristics such as job knowledge, initiative, relationships with others, and attendance and punctuality.
4. Following the performance evaluation, reward (pay raise) and job change (promotion) decisions can be

made. If work is unsatisfactory, the employee may be put on a performance improvement plan, which outlines the behaviors or performance that must be improved, the milestones and time periods to improve performance, and what will occur if performance is not improved.

5. Rewards are positive feedback and provide reinforcement, or encouragement, for the employee to continue improving their performance.

It was once common practice for performance appraisals to be conducted annually, but many companies have moved away from that standard. Instead, managers are encouraged to provide employees with continuous real-time feedback so that skill development and job performance can be improved more rapidly.

Information for performance appraisals can be assembled from a variety of sources, such as colleagues or direct reports, and utilizing a variety of methods, including rating scales, and data about job performance indicators like production or sales statistics. Regardless of the source, performance information should be accurate and a record of the employee's job behavior and efforts. Table 8.3 illustrates a rating scale for one aspect of a college recruiter's job. A rating of "9" is considered outstanding job behavior and performance; a rating of "1" is viewed as very poor to unacceptable.

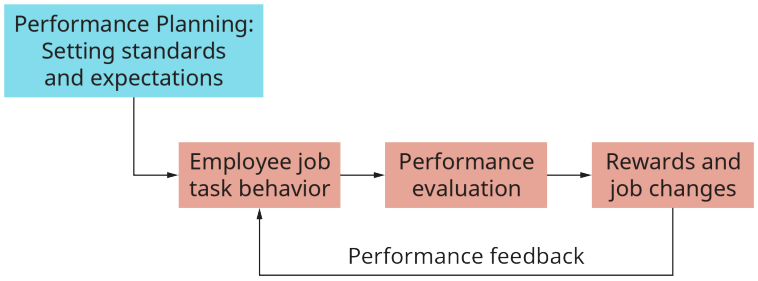

Exhibit 8.9 Performance Planning and Evaluation

Example of Behavior-Based Rating Scale (1–9) for Performance Appraisal Position: College Recruiter Job Description: Visits campuses and conducts interviews of graduating seniors		
Job Responsibility	**Rating**	**Comments**
Planning and organizing of spring semester college recruiting events	8	This recruiter plans and organizes spring-semester college-recruiting schedule to minimize travel expenses and maximize the number of colleges visited and students interviewed. Even with tight travel schedules between campuses, this recruiter completes each campus report before arrival at next campus.
Contact with faculty prior to visit to gain information about degree programs (goal is 2–3 contacts)	5	In making plans to visit a new campus, this recruiter had not identified two or three faculty members for obtaining pre-visit information about degree programs.

Table 8.3

Example of Behavior-Based Rating Scale (1–9) for Performance Appraisal		
Position: College Recruiter **Job Description: Visits campuses and conducts interviews of graduating seniors**		
Job Responsibility	**Rating**	**Comments**
Obtain student resumes prior to visit	6	This recruiter occasionally does not check with college placement office to request student resumes two days before arrival.
Resume and interview documentation	5	Sometimes this recruiter's notes are incomplete concerning a student's response to interview questions.
Punctuality and professionalism	2	This recruiter is often several minutes late in starting interviews.
Interview follow ups	1	This recruiter is frequently late in sending thank-you letters to students interviewed.
Summary reports	1	This recruiter is always late completing campus-recruiting reports.
Rating Scale: 7–9 meets or exceeds expectations 4–6 partially meets expectations 1–3 does not meet expectations		

Table 8.3

CONCEPT CHECK

1. What are the steps in the performance planning and appraisal process?
2. What purposes do performance appraisals serve?
3. Describe some sources of information for the performance appraisal.

8.6 Employee Compensation and Benefits

6. What are the types of compensation and methods for paying workers?

Compensation, which includes both pay and benefits, is closely connected to performance appraisals. Employees who perform better tend to get bigger pay raises. Several factors affect an employee's pay:

1. *Pay structure and internal influences.* Wages, salaries, and benefits are based on skills, experience, and the level of the job. The more important and demanding high-level positions such as president, chief information officer, and chief financial officer are compensated at the highest rates. Likewise, different entry-level jobs that require similar skills, education, or experience are compensated at similar rates. For

instance, if a drill-press operator and a lathe operator are considered to be of a similar skill and education level, they may both be paid $23 per hour.

2. *Pay level and external influences.* In deciding how much to pay workers, the firm must also be concerned with the salaries paid by competitors. If competitors are paying higher wages, a firm may lose its best employees. HR professionals regularly evaluate salaries by geography, job position, and competitor and market wages. Wage and salary surveys conducted by the U.S. Chamber of Commerce and the U.S. Department of Labor can also be useful. There are also several websites such as O*net for information about industries and regions, and Glassdoor, which posts information about salaries and work culture at specific companies.

An employer can decide to pay at, above, or below the going rate. Most firms try to offer competitive wages and salaries within a geographic area or an industry. If a company pays below-market wages, it may not be able to hire skilled people. The level of a firm's compensation is determined by the firm's financial condition (or profitability), efficiency, and employee productivity, as well as the going rates paid by competitors. For example, MillerCoors Brewing Co. is considered a high-paying firm ($29–$33 per hour for production employees).[10]

Types of Compensation or Pay

There are two basic types of compensation: direct and indirect. Direct pay is the wage or salary received by the employee; indirect pay consists of various employee benefits and services. Employees are usually paid directly on the basis of the amount of time they work, the amount they produce, the type of work performed, or some combination of skill, time, and output. An hourly rate of pay or a monthly salary is considered base pay, or an amount of pay received by the employee regardless of output level. In many jobs, such as sales and manufacturing, an employee can earn additional pay as a result of a commission or an **incentive pay** arrangement. The accelerated commission schedule for a salesperson shown below indicates that as sales increase the incentive becomes increasingly more attractive and rewarding; therefore, pay can function as a powerful motivator. In this example, a salesperson receives a base monthly salary of $1,000, then earns 3 percent on the first $50,000 of product sold, 4 percent on the next $30,000, and 5 percent on any sales beyond $80,000.

Pay type	Rate	Amount Sold in Tier	Realized for Month
Base pay	$1,000 per month	n/a	$1,000
Commission Tier A	3% of sales up to $50,000	$50,000	$1,500
Commission Tier B	4% of sales $50,000–$80,000	$30,000	$1,200
Commission Tier C	5% of sales over $80,000	$20,000	$1,000
			$4,700

Two other incentive pay arrangements are bonuses and profit-sharing. Employees may be paid bonuses for reaching certain monthly or annual performance goals or achieving a specific cost-saving objective. In this instance, employees are rewarded based on achieving certain goals.

In a profit-sharing plan, employees may receive some portion of the firm's profit. Employee profit shares are usually based on annual company financial performance and therefore are paid once a year. With either a bonus or a profit share, an important incentive pay consideration is whether the bonus or profit share is the same for all employees or whether it is differentiated by level in the organization, base pay, or some other

criterion. For example, a local company that specializes in building starter homes has 50 employees and pays an annual incentive share that is the same for everyone; the president receives the same profit share or bonus as the lowest-paid employee. In larger corporations, profit sharing can be restricted to certain levels in the company such as senior management and is often based on years of service and base salary. Southwest Airlines gives all employees, not just senior management, a share of the company's profits based on base salary and hours worked.

Indirect compensation includes pensions, health insurance, vacation time, employee perks, flexible work arrangements, and other related benefits. Other indirect compensation aspects are required by law, such as unemployment and worker's compensation, which are paid in part by employers. **Unemployment compensation** provides former employees with money for a certain period while they are unemployed. To be eligible, the employee must have worked a minimum number of weeks, be without a job through no fault of their own (i.e., they were not fired for performance issues), and be actively looking for another position. Some aspects vary by state, such as the number of weeks of work required to be eligible or recertification requirements. Some state laws permit payments to strikers. **Worker's compensation** pays employees for lost work time caused by work-related injuries and may also cover rehabilitation after a serious injury. Social Security is a government program that provides financial support to retired and disabled individuals. This program provides a guaranteed income stream that is passed on to surviving family members when the individual passes. Social Security is funded in part through required payroll deductions similar to how taxes are deducted from employee pay. Medicare (health care for older adults) and Medicaid (health care for people whose incomes are below an established level) are separate government programs with enrollment and other portions managed by the Social Security Administration.

Many employers also offer benefits not required by law. Among these are paid time off (vacations, holidays, sick days), health insurance (including dental and vision), supplemental benefits (disability, life, pet insurance, access to counseling services), 401K contributions, pensions and retirement savings accounts, and stock purchase options.

Some firms with numerous benefits allow employees to mix and match benefit items or select items based on individual needs. A younger employee with a family may desire to purchase medical, disability, and life insurance, whereas an older employee may want to put more benefit dollars into a retirement savings plan. Pay and benefits are obviously important elements of human resource management and are frequently studied as aspects of employee job satisfaction. Pay can be perceived as very satisfactory, or it can be a point of job dissatisfaction. Data indicate that direct compensation is a key element of job satisfaction across industries and job levels.[11] As economic conditions, societal changes, and workplace cultures have shifted, benefits have become increasingly important to employees.

CATCHING THE ENTREPRENEURIAL SPIRIT

Starbucks Perks More Than Coffee

At Starbucks, former CEO Howard Schultz understood that the single most important aspect of creating an enduring brand is its people. Schultz wanted to set Starbucks apart from other coffee shops and service businesses, and he did this by offering health benefits and stock ownership for employees who only worked part-time. That came with a cost. In addition to employee benefits, funding was funneled into operations to build the brand and create an experience that would enable Starbucks to endure and be profitable for many years to come.

This strategy was successful for the company for some time, and the brand quickly grew in customer loyalty and physical locations with over 40,000 locations worldwide. However, this tremendous growth also came with a cost. Customer complaints about product quality and consistency, long wait lines, and high prices

started to impact sales. Employees had concerns about workplace culture and pay. With the U.S. market saturated with locations on nearly every corner, opportunities for growth were limited. The stock price of the company dropped 5 percent in 2025, and investors expressed their concerns by demanding the company address the downfalls.

Keeping to its entrepreneurial roots, Starbucks management set out to reinvent the company. The long-range reinvention plan was designed to improve stores by helping with workflow, investing in technology upgrades, updating menu offerings, and improving employee wages and benefits. The new menu includes snacks and non-coffee-based options, while store improvements include updated equipment and more efficient layouts. Through their revamped digital platform that incorporates AI technologies, the company expects to expand mobile ordering.

These announced changes have repositioned the company for success in both creating that unique experience for customers and also creating a rewarding environment for employees. New CEO Brian Niccol has committed to getting firsthand feedback. He regularly conducts "listening tours" to garner this input. "In each conversation, two truths emerged: First, Starbucks is a beloved brand with wonderful people. We are woven into the fabric of people's lives and the communities we serve. Second, there's a shared sense that we have drifted from our core. We have an opportunity to make the store experience better for our partners and, in turn, for our customers." Recent data show that the reinvention is working. Sales and earnings have shown a modest increase which is a positive sign that their efforts are being recognized by customers.

Critical Thinking Questions

1. How can Starbucks rebuild employee trust and satisfaction while also managing customer expectations?
2. Can a firm give its employees too much in terms of benefits and services? Explain.

Sources: Carmine Gallo, "How Starbucks CEO Howard Schultz Inspired Us to Dream Bigger," *Forbes,* https://www.forbes.com, December 2, 2016; Tanza Loudenback, "The Story Behind the Rise of Starbucks' Howard Shultz, Who Just Gave a Raise to Every US Employee of His $82 Billion Coffee Company," *Business Insider,* https://www.businessinsider.com, July 11, 2016; Todd Campbell, "Starbucks' Problems May Be Too Big to Fix," *The Street*, https://www.thestreet.com, August 4, 2025; Joanna Fantozzi, "Starbucks' Reinvention Plan Includes Snacking and Tea Innovations, Rewards Partnerships, and More," *NRN*, https://www.nrn.com, November 3, 2023; FP Explainers, "Starbucks in Crisis: Is It the Coffee, the Menu, or the People?" *Firstpost*, https://www.firstpost.com, February 25, 2025; Amelia Lucas, "Starbucks Unveils Plan to Add 17,000 Locations by 2030, Cut $3 Billion in Costs," *CNBC*, https://www.cnbc.com, November 2, 2023.

CONCEPT CHECK

1. How does a firm establish a pay scale for its employees?
2. What is the difference between direct and indirect pay?
3. Why are health insurance and benefits so important to employees?

8.7 The Labor Relations Process

7. What is a labor union and how is it organized, what is collective bargaining, and what are some of the key negotiation issues?

Approximately 10 percent of workers in the U.S. belong to a union. Historically, the mining, manufacturing, construction, and transportation industries have been significantly unionized, but now service-based firms, health care organizations, and food and beverage companies have been unionizing.

A **labor union**, such as the International Brotherhood of Teamsters, is an organization that represents workers in dealing with management over disputes involving wages, hours, and working conditions. The labor relations process that produces a union-management relationship consists of three phases: union organizing, negotiating a labor agreement, and administering the agreement. In phase one, a group of employees within a firm may form a union on their own, or an established union (United Auto Workers, for example) may target an employer and organize many of the firm's workers into a local labor union. The second phase constitutes **collective bargaining**, which is the process of negotiating a labor agreement that provides for compensation and working arrangements mutually acceptable to the union and to management. Finally, the third phase of the labor relations process involves the daily administering of the labor agreement. This is done primarily through handling worker grievances and other workforce management problems that require interaction between managers and labor union officials.

The Modern Labor Movement

The basic structure of the modern labor movement consists of three parts: local unions, national and international unions, and union federations. There are nearly 10,000 unions in the United States, 64 national and international unions, and three federations. Union membership has been declining for some time from its peak in the 1950s when over 30 percent of employees were union members. The number of employed union members has declined by 3.4 million since 1983, the first year union statistics were reported. In 1983, union membership was 20.1 percent of workers with 17.7 million union workers. By 2024, membership had declined to around 10 percent of workers, with 14.3 million members.[12]

A **local union** is a branch or unit of a national union that represents workers at a specific plant or over a specific geographic area. Local 276 of the United Auto Workers represents assembly employees at the General Motors plant in Arlington, Texas. A local union (in conformance with its national union rules) determines the number of local union officers, procedures for electing officers, the schedule of local meetings, financial arrangements with the national organization, and the local's role in negotiating labor agreements.

The three main functions of the local union are collective bargaining, worker relations and membership services, and community and political activities. Collective bargaining takes place every three or four years. Local union officers and shop stewards in the plant oversee labor relations on a day-to-day basis. A **shop steward** is an elected union official who represents union members to management when workers have complaints. For most union members, their primary contact with the union is through union officials at the local level.

A national union can range in size from around 1,300 members (National Writers Union) to more than a million members (Teamsters). A national union may have a few to as many as several hundred local unions. The number of national unions has steadily declined since the early twentieth century. Much of this decline has resulted from union mergers. In 1999, for example, the United Papermakers International Union (UPICU) and the Oil, Chemical and Atomic Workers Union (OCAW) agreed to merge under the new name of PACE, or Paper, Allied-Industrial, Chemical and Energy International Union. Then in 2005, PACE merged with the United Steelworkers of America. The merged union, now simply known as the United Steelworkers, has over 850,000 members.

A trade union federation is another important group to consider. A **federation** is a collection of unions banded together to further organizing, public relations, political, and other agreed-upon purposes of the member unions. With a larger group working toward the same goal, they can make a greater impact. There are two major union federations in the U.S.: the American Federation of Labor–Congress of Industrial Organization (AFL-CIO) and the Strategic Organizing Center (SOC, formerly the Change to Win Coalition).[13] Membership in

these two organizations has changed, with some leaving the AFL-CIO to join SOC, only to come back to AFL-CIO. The AFL-CIO represents around 15 million workers and the SOC represents around 4 million workers. The federations utilize power in numbers to increase the bargaining power of employees through their larger collaborations because collective bargaining through the federation can impact a greater number of workers.[14]

Union Organizing

A nonunion employer becomes unionized through an organizing campaign. The campaign is started either from within, by unhappy employees, or from outside, by a union that has picked the employer for an organizing drive. Once workers and the union have made contact, a union organizer tries to convince all the workers to sign authorization cards. These cards prove the worker's interest in having the union represent them. In most cases, employers resist this card-signing campaign by speaking out against unions in letters, posters, and employee assemblies. However, it is illegal for employers to interfere directly with the card-signing campaign or to coerce employees into not joining the union.

Once the union gets signed authorization cards from at least 30 percent of the employees, it can ask National Labor Relations Board (NLRB) for a union certification election. This election, by secret ballot, determines whether the workers want to be represented by the union. The NLRB posts an election notice and defines the bargaining unit—employees who are eligible to vote and who will be represented by the particular union if it is certified. Supervisors and managers cannot vote. The union and the employer then engage in a pre-election campaign conducted through speeches, memos, and meetings. Both try to convince workers to vote in their favor. **Table 8.4** lists benefits usually emphasized by the union during a campaign and common arguments employers make to convince employees a union is unnecessary.

The election itself is conducted by the NLRB. If a majority vote for the union, the NLRB certifies the union as the exclusive bargaining agent for all employees who had been designated as eligible voters. The employer then has to bargain with the union over wages, hours, and other terms of employment. The complete organizing process is summarized in **Exhibit 8.10**.

In some situations, after one year, if the union and employer don't reach an agreement, the workers petition for a decertification election, which is similar to the certification election but allows workers to vote out the union. Decertification elections are also held when workers become dissatisfied with a union that has

represented them for a longer time. The number of decertification elections is several hundred per year.

Common Arguments for and against Unionization	
Arguments for Unionization	**Arguments against Unionization**
• Increased job security • Improved benefits • Higher pay • Stronger grievance procedures • More influence in decision-making • Better working conditions • Lobbying opportunities • Technical training • More job satisfaction	• No union dues • Employees can go directly to management with problems • Company pay and benefits already similar to leading firms in industry • Company already compliant with Federal Occupational Safety and Health Administration (OSHA) standards • Better to have pay closely tied to performance and productivity rather than union representation

Table 8.4

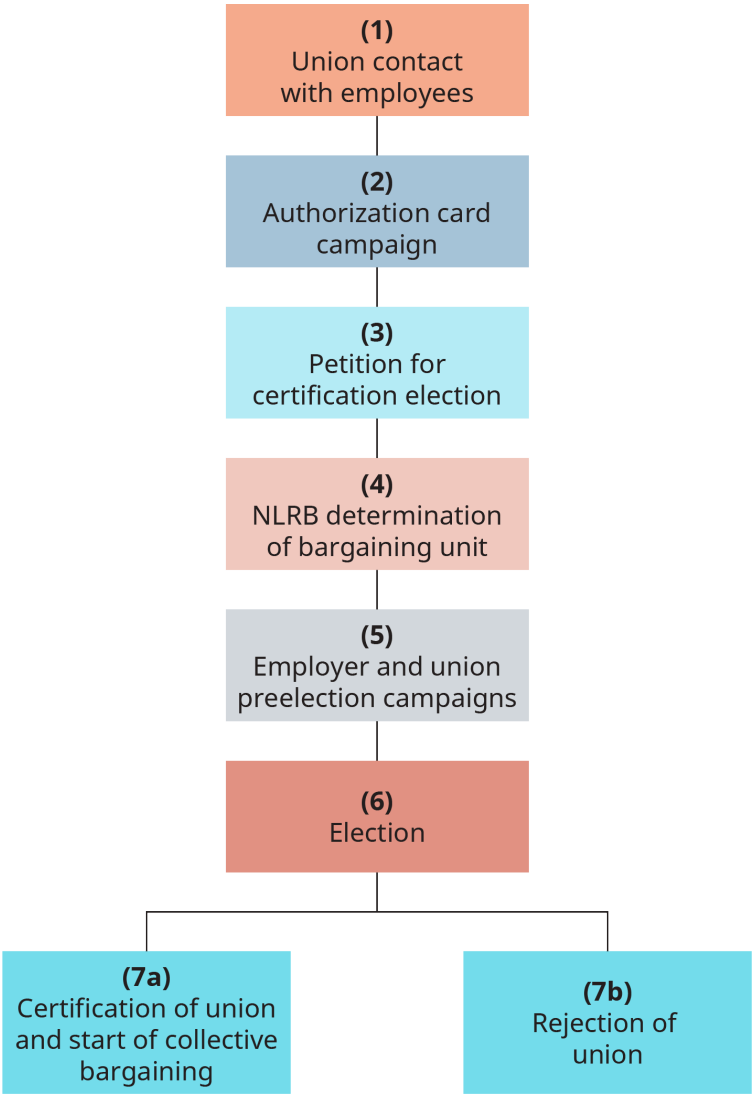

Exhibit 8.10 Union Organizing Process and Election (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Negotiating Union Contracts through Collective Bargaining

A labor agreement, or union contract, is created through *collective bargaining*. Typically, both management and union negotiation teams are made up of a few people. One person on each side is the chief spokesperson. Bargaining begins with union and management negotiators setting a list of contract issues that will be discussed. Much of the bargaining over specific details takes place through face-to-face meetings and the exchange of written proposals. Demands, proposals, and counterproposals are exchanged during several rounds of bargaining. The resulting contract must be approved by top management and ratified by the union members. Once both sides approve, the contract is a legally binding agreement that typically covers such issues as union security, management rights, wages, benefits, and job security. The collective bargaining process is shown in Exhibit 8.11. We will now explore some of the bargaining issues.

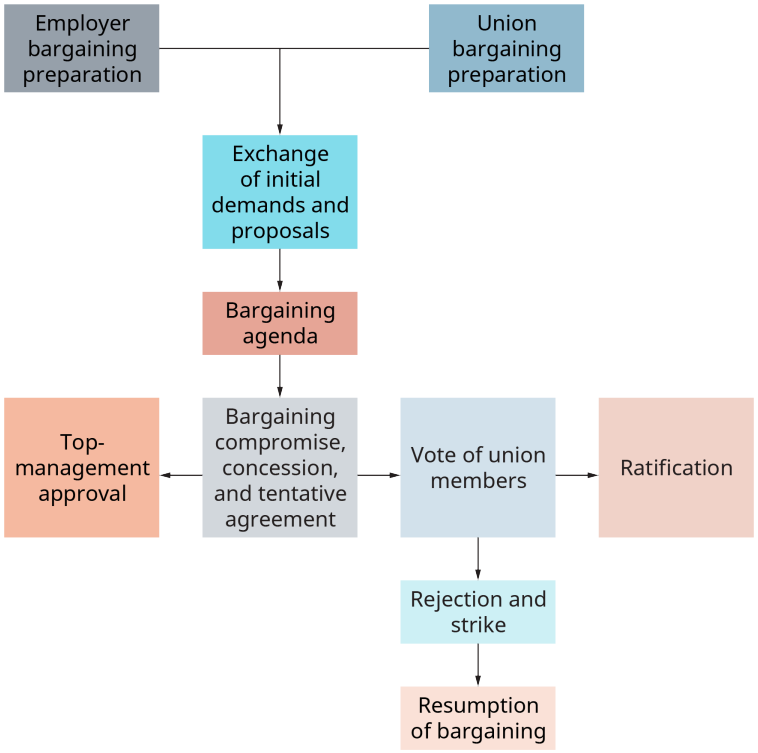

Exhibit 8.11 The Process of Negotiating Labor Agreements (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Union Security

A union wants all employees to be union members. This can be accomplished by negotiating a union security clause. The most common union security arrangement is the **union shop**, whereby nonunion workers can be hired by the firm, but then they must join the union, normally within 30 to 60 days. An **agency shop** does not require employees to join the union, but to remain employees, workers must pay the union a fee (known as the agency fee) to cover the union's expenses in representing them. The union must fairly represent all workers, including those in the bargaining unit who do not become members.

Under the Taft-Hartley Act of 1947, a state can make any and all forms of union security illegal by enacting a **right-to-work law**. In the 28 states that have these laws, employees can work at a unionized company without having to join the union. This arrangement is commonly known as an **open shop**. Workers don't have to join the union or pay dues or fees to the union.

Management Rights

When a company becomes unionized, management loses some of its decision-making abilities. But management still has certain rights that can be negotiated in collective bargaining. One way to resist union involvement in management matters is to put a **management rights clause** in the labor agreement. Most union contracts have one. A typical clause gives the employer all rights to manage the business except as specified in the contract. For instance, if the contract does not specify the criteria for promotions, with a management rights clause, managers will have the right to use any criteria they wish. Another way to preserve management rights is to list areas that are not subject to collective bargaining. This list might secure management's right to schedule work hours; hire and fire workers; set production standards; determine the number of supervisors in each department; and promote, demote, and transfer workers.

Wage and Benefits

Much bargaining effort focuses on wage adjustments and changes in benefits. Once agreed to, they remain in effect for the length of the contract. For example, in 2024 the Newark Teachers Union reached a 5-year

agreement with the school district that contained higher starting salaries for teachers, a 4.5 percent annual raise, and increased curriculum decision-making authority for district teachers.[15] Hourly rates of pay can also increase under some agreements when the cost of living increases above a certain level each year, say 4 percent.

In addition to requests for wage increases, unions usually want better benefits. In general, benefits are between 30 and 40 percent of the total cost of compensation, but this can vary by industry. Benefits may include higher wages for overtime work, holiday work, and less desirable shifts; insurance programs (life, health and hospitalization, dental care); payment for certain nonwork time (rest periods, vacations, holiday, sick time); pensions; and income-maintenance plans. Supplementary unemployment benefits such as income-maintenance can be provided by the employer in addition to the state unemployment given to laid-off workers. Unemployment pay is generally between 70 and 80 percent of an employee's normal pay.

Job Security and Seniority

Wage adjustments, cost-of-living increases, supplementary unemployment pay, and certain other benefits give employees under union contracts some financial security. But most financial security is directly related to job security—the assurance, to some degree, that workers will keep their jobs. Of course, job security depends primarily on the continued success and financial well-being of the company. For example, during the COVID-19 pandemic, thousands of employees across industries lost their jobs. Seniority, the length of an employee's time with a company, is significant in many labor contract negotiations and is often incorporated into salary determinations. Seniority is a factor in job security; usually, unions want the workers with the most seniority to have the most job security.

CONCEPT CHECK

1. Discuss the modern labor movement.
2. What are the various topics that may be covered during collective bargaining?
3. Explain the differences among a union shop, agency shop, and an open shop.

8.8 Managing Grievances and Conflicts

8. How are grievances between management and labor resolved, and what tactics are used to force a contract settlement?

In a unionized work environment, employees follow a step-by-step process for handling grievances or disputes between management and labor. Conflicts over contracts, however, are far more challenging to resolve and may result in the union or employer imposing economic pressure, as described in this section.

Grievance Handling and Arbitration

The union's main way of policing the contract is the grievance procedure. A **grievance** is a formal complaint by an employee or the union that management has violated some part of the contract. Under a typical contract, the employee starts by presenting the grievance to the supervisor, either in person or in writing. The typical grievance procedure is illustrated in **Exhibit 8.13**. An example grievance is when an employee is passed over for a promotion that went to a co-worker, and they feel that the promotion process and policies are unfair. The employee feels they have seniority and are more qualified than the co-worker that received the promotion. The employee can submit a grievance to have the incident evaluated for fairness and consistent application of company policies.

Exhibit 8.12 In 2017, Ezekiel Elliot was a star running back for the Dallas Cowboys who was suspended by the NFL commissioner for six games during that season. The controversial player, with the support of the NFL Players Association (NFLPA), appealed the decision several times and was able to delay the suspension, but eventually lost a highly publicized case in federal court. U.S. District Judge Katherine Polk Failla ruled that the NFL's decision to suspend Elliott did not violate the labor agreement. After losing the first case, he appealed to the Second Circuit, sought additional stays, but the suspension was ultimately enforced. *What options did Elliott and the NFLPA have during this process?* (Credit: grantlairdjr/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

If the problem isn't solved, the grievance is put in writing. The employee, one or more union officials, the supervisor, and perhaps the plant manager then discuss the grievance. If the matter still can't be resolved, another meeting takes place with higher-level representatives of both parties present. If top management and the local union president can't resolve the grievance, it goes to arbitration.

Arbitration is the process of settling a labor-management dispute by having a third party—a single arbitrator or a panel—make a decision. The decision is final and binding on the union and employer. The arbitrator reviews the grievance at a hearing and then makes the decision, which is presented in a document called the award. The arbitrator, after review of the information, might rule that the promotion was valid because the coworker had additional certifications that took precedence over seniority to better meet the job responsibilities needed in the new position.

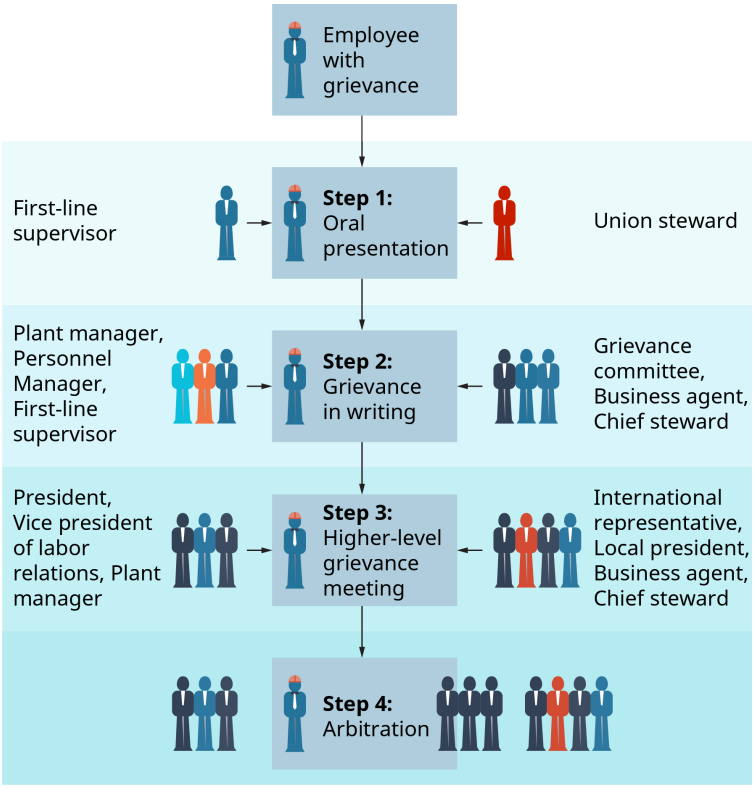

Exhibit 8.13 Typical Grievance Procedure (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Tactics for Pressuring a Contract Settlement

Virtually all labor agreements specify peaceful resolution of conflicts, usually through arbitration. However, when a contract expires and a new agreement has not been reached, the union is free to strike or engage in other efforts to exert economic pressure on the employer. A *strike* occurs when employees refuse to work. The United Auto Workers union used a **selective strike strategy**, a strategy of conducting a strike at a critical plant that supplies parts to other plants, against General Motors. The union conducted its strike at a stamping and parts facility in Flint, Michigan, that supplied critical parts to other plants. The 54-day strike caused the company to stop production at many of its assembly plants because parts were not available from the Flint plant. General Motors lost approximately $2.2 billion during that dispute. Likewise, the employer can put pressure on the union through a lockout or by hiring strike replacements if the union has called a strike. For example, in 2024, railway company CPKC locked out nearly 10,000 employees from working during contract negotiations that lasted nearly a year.[16] Table 8.5 provides a summary of union and employer pressure strategies for forcing a contract settlement.

Strategies of Unions and Employers			
Union Strategies		**Employer Strategies**	
Strike:	Employees refuse to work.	**Lockout:**	Employer refuses to let employees enter plant to work.
Boycott:	Employees try to keep customers and others from doing business with employer.	**Strike replacements:**	Employer uses nonunion employees to do jobs of striking union employees.

Table 8.5

Strategies of Unions and Employers			
Union Strategies		**Employer Strategies**	
Picketing:	Employees march near entrance of firm to publicize their view of dispute and discourage customers.	**Mutual-aid pact:**	Employer receives money from other companies in industry to cover some of income lost because of strikes.
Corporate campaign:	Union disrupts stockholder meetings or buys company stock to have more influence over management.	**Shift production:**	Employer moves production to nonunion plant or out of country.

Table 8.5

CONCEPT CHECK

1. Describe the grievance procedure.
2. In what ways do arbitrators act like judges?
3. What are some tactics for pressuring for a contract settlement?

8.9 Legal Environment of Human Resources and Labor Relations

9. What are the key laws and federal agencies affecting human resource management and labor relations?

Federal laws help ensure that job applicants and employees are treated fairly and not discriminated against. Hiring, training, and job placement must be unbiased. Promotion and compensation decisions must be based on performance. These laws help all Americans who have talent, training, and the desire to get ahead. The key laws that currently impact human resource management and labor relations are listed in Table 8.6.

Several laws govern wages, pensions, and unemployment compensation. For instance, the Fair Labor Standards Act sets the federal minimum wage, which is periodically raised by Congress. Minimum-wage jobs are found in many industries including service firms such as fast-food and retail stores. The 2025 Social Security Fairness Act protects the retirement income of employees and retirees who receive public pensions. Federal tax laws also affect compensation, including employee profit-sharing and stock purchase plans. To prohibit sex-based wage discrimination, John F. Kennedy signed the Equal Pay Act into law in 1963. The Act mandated that jobs requiring the same skill level and responsibility will be paid the same regardless of the employee's gender. At the time, women with full-time jobs earned between 59 and 64 cents for every dollar their men counterparts earned in the same jobs. Although this law has been in place for several decades, progress has been slow. During his tenure as President, Barack Obama established a National Equal Pay Day. In 2024, women earned 85 cents for every dollar their men counterparts made.[17]

Laws Impacting Human Resource Management		
Law	**Purpose**	**Agency of Enforcement**
Social Security Act (1935)	Provides for retirement income and old-age health care	Social Security Administration
Wagner Act (1935)	Gives workers the right to unionize and prohibits employer unfair labor practices	National Labor Relations Board
Fair Labor Standards Act (1938)	Sets minimum wage, restricts child labor, sets overtime pay	Wage and Hour Division, Department of Labor
Taft-Hartley Act (1947)	Obligates the union to bargain in good faith and prohibits union unfair labor practices	Federal Mediation and Conciliation Service
Equal Pay Act (1963)	Eliminates pay differentials based on sex	Equal Employment Opportunity Commission
Civil Rights Act (1964), Title VII	Prohibits employment discrimination based on race, color, religion, sex, or national origin	Equal Employment Opportunity Commission
Age Discrimination Act (1967)	Prohibits age discrimination against people age 40 and older	Equal Employment Opportunity Commission
Occupational Safety and Health Act (1970)	Protects worker health and safety, provides for hazard-free workplace	Occupational Safety and Health Administration
Vietnam Era Veteran's Readjustment Assistance Act (1974)	Requires affirmative employment of veterans of qualified war events	Veterans' Employment and Training Service, Department of Labor
Employee Retirement Income Security Act (1974)	Establishes minimum requirements for private pension plans	Internal Revenue Service, Department of Labor, and Pension Benefit Guaranty Corporation
Pregnancy Discrimination Act (1978)	Treats pregnancy as a temporary disability, prevents employment discrimination based on pregnancy	Equal Employment Opportunity Commission

Table 8.6

Laws Impacting Human Resource Management		
Law	**Purpose**	**Agency of Enforcement**
Immigration Reform and Control Act (1986)	Verifies employment eligibility, prevents employment of illegal immigrants	Department of Homeland Security, Department of Justice
Americans with Disabilities Act (1990)	Prohibits employment discrimination based on mental or physical disabilities	Department of Labor
Family and Medical Leave Act (1993)	Requires employers to provide 12 weeks of unpaid leave to employees with new children or those suffering from or caring for family with serious illness	Equal Employment Opportunity Commission

Table 8.6

Employers must also be aware of changes to laws concerning employee safety, health, and privacy. The Occupational Safety and Health Act requires employers to provide a workplace free of health and safety hazards. For instance, manufacturers must require their employees working on loading docks to wear steel-toed shoes so their feet won't be injured if materials are dropped. Employees working with chemicals are required to wear eye protection and other safety equipment such as gloves to protect their skin.

Another employee law that continues to affect the workplace is the Americans with Disabilities Act. To be considered disabled, a person must have a physical or mental impairment that greatly limits one or more major life activities. In 2021, there were about 42 million Americans with disabilities, or about 13 percent of the population, according to the U.S. Census Bureau.[18] Employers may not discriminate against people with disabilities. They must make "reasonable accommodations" so that qualified employees can perform the job, unless doing so would cause "undue hardship" for the business. Altering work schedules, modifying equipment so that individuals who have mobility issues can use it, and making buildings accessible by ramps and elevators are considered reasonable. Two companies often praised for their efforts to hire individuals with challenges are John Deere and PepsiCo.

The Family and Medical Leave Act went into effect in 1993. The law guarantees continuation of paid health benefits, plus a return to the same or equivalent job, and applies to employers with 50 or more employees. It requires these employers to provide unpaid leave of up to 12 weeks during any 12-month period to workers who have been employed for at least a year and worked at least 1,250 hours during the past year. The reasons for the leave include the birth or adoption of a child; the serious illness of a child, spouse, or parent; or a serious illness that prevents the worker from doing the job.

According to the Bureau of Labor Statistics, only 27 percent of all private industry workers have access to paid family leave. Only 6 percent of low wage earners get any paid parental leave, and nearly half will not take time off because they cannot afford to go without income. The United States is the most prominent nation globally that does not have guaranteed paid parental leave.[19]

The Wagner and Taft-Hartley Acts govern the relationship between an employer and union. Employees have the right to unionize and bargain collectively with the company. The employer must deal with the union fairly, bargain in good faith, and not discriminate against an employee who belongs to the union. The union must also represent all employees covered by a labor agreement fairly and deal with the employer in good faith.

Several federal agencies oversee employment, safety, compensation, and related areas. The **Occupational Safety and Health Administration** (OSHA) sets workplace safety and health standards, provides safety training, and inspects places of work (assembly plants, construction sites, and warehouse facilities, for example) to determine employer compliance with safety regulations.

Exhibit 8.14 For some occupations, danger is part of the job description. Tallies of work-related casualties routinely identify miners, loggers, pilots, steel workers, and those in the commercial fishing industry (pictured here) as holding the most deadly jobs. Job fatalities are often linked to the use of heavy or outdated equipment. *What laws and agencies are designated to improve occupational safety?* (Credit: Coast Guard News, MST2 Gerald Holle/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

The Wage and Hour division of the Department of Labor enforces the federal minimum-wage law and overtime provisions of the Fair Labor Standards Act. Employers are required to pay most hourly workers at least 1.5 times their rate of pay for each hour worked over 40 hours in one week.

The **Equal Employment Opportunity Commission** (EEOC) was created by the 1964 Civil Rights Act. It is one of the most influential agencies responsible for enforcing employment laws. The EEOC has three basic functions: processing discrimination complaints, issuing written regulations, and gathering and disseminating information. An employment discrimination complaint can be filed by an individual or a group of employees who work for a company. The group may comprise a **protected class**, that is, a group that is shielded from employment discrimination based on certain characteristics. There are several classes protected by the EEC and those include: race, national origin, disability, and religion, as a few examples. The protected group may pursue a class-action complaint that may eventually become a lawsuit. As a measure to prevent employment discrimination, many employers set up **affirmative action programs** to expand job opportunities for women and minorities.

In 2024, the EEOC received over 85,000 complaints from current or former employees. The monetary benefits that the EEOC wins for employees has grown over the last several years, despite the number of complaints declining since 2018. Large monetary settlements often occur when the EEOC files a class-action suit against an employer. For example, Diversified Maintenance Systems, LLC (a janitorial services provider) was ordered to pay $750,000 to several former employees for race discrimination and racial harassment in 2019. Also in 2019, Dollar General was ordered to pay $6 million for discriminatory practices in the way they conducted background checks for prospective employees.[20]

The NLRB was established to enforce the Wagner Act. Its five members are appointed by the president; the agency's main office is in Washington, DC, and regional and field offices are scattered throughout the United States. NLRB field agents investigate charges of employer and union wrongdoing (or unfair labor practices) and supervise elections held to decide union representation. Judges conduct hearings to determine whether employers and unions have violated the law.

The Federal Mediation and Conciliation Service helps unions and employers negotiate labor agreements. Agency specialists, who serve as impartial third parties between the union and company, use two processes: conciliation and mediation, both of which require expert communication and persuasion. In **conciliation**, the

specialist assists management and the union with focusing on the issues in dispute and acts as a go-between, or communication channel through which the union and employer send messages and share information with each other. The specialist takes a stronger role in **mediation** by suggesting compromises to the disputing organizations.

CONCEPT CHECK

1. Discuss the laws that govern wages, pensions, and employee compensation.
2. Describe the Americans with Disabilities Act.
3. How do the Wagner and Taft-Hartley Acts impact labor-management relations?

8.10 Trends in Human Resource Management and Labor Relations

10. What trends and issues are affecting human resource management and labor relations?

Some of today's most important trends in human resource management are using employee diversity as a competitive advantage, improving efficiency through outsourcing and technology, and hiring employees who fit the organizational culture. Although overall labor union enrollment continues to decline, a possible surge in membership in service unions is anticipated.

Employee Diversity and Competitive Advantage

American society and its workforce are becoming increasingly more diverse in terms of racial and ethnic status, age, educational background, work experience, and gender. A company with a demographic employee profile that looks like its customers may be in a position to gain a **competitive advantage**, which is a set of unique features of a company and its product or service that are perceived by the target market as superior to those of the competition. Competitive advantage is the factor that causes customers to patronize a firm and not the competition. Many things can be a source of competitive advantage: for Southwest Airlines it is its operational efficiencies and its hiring practices that focus on finding employees that fit their fun and friendly culture; for Ritz-Carlton hotels it is very high-quality guest services; for Toyota it is manufacturing efficiency and product durability; and for Patagonia it is its narrow market niche and its focus on environmentally sustainable business practices. For these firms, a competitive advantage is also created by their HR practices. Many firms are successful because of employee diversity, which can produce more effective problem-solving, a stronger reputation for hiring women and minorities, quicker adaptation to change, and more robust product solutions because a diverse team can generate more options for improvement.[21]

In order for an organization to use employee diversity for competitive advantage, top management must be fully committed to hiring and developing women and minority individuals. An organization that highly values employee diversity is Johnson & Johnson. The company hosts unconscious bias training for all employees and supports employee resource groups (ERGs) across its global locations to increase employee awareness of diversity both with coworkers and among their customer base. Over 35 percent of Johnson & Johnson's employees are minority persons, including over 16 percent Asian and 10 percent Latino/a. In addition, women make up nearly half of the organization's workforce.[22]

Outsourcing HR and Technology

The role of the HR professional has changed noticeably over the past 20 years. One significant change has been the use of technology in handling relatively routine HR tasks, such as payroll processing, initial screening of applicants, and benefits enrollments. Large firms such as FedEx and Procter & Gamble utilize specialized programs (WorkDay and PayCor, for example) to perform the information-processing aspects of many HR tasks. Other firms, such as Unilever, outsource—or contract out—these tasks to HR service providers such as

Accenture.

HR outsourcing is done when another firm can perform a task better and more efficiently, thus saving costs. Sometimes HR activities are outsourced because HR requirements involve legal compliance and can be overwhelming to execute in-house in a timely fashion. Frequently, HR activities are outsourced simply because a provider has greater expertise. For example, media conglomerate CBS Corp. uses Fidelity Investments to manage its 401(k) plan, which has more than $4 billion in assets.[23]

Today's HR managers are realizing the value of AI in their job functions. Not only can AI be useful in automating routine administrative tasks, but it can also have a place in more strategic initiatives such as workforce planning and identifying training gaps/needs. According to research conducted by the SHRM (Society for Human Resources Management), AI is being used in generating job descriptions, customizing job postings, initiating communication with candidates, and assisting with onboarding tasks. Looking to the future, HR professionals will have a key role in leading the distribution of AI adoption in the workplace. From hiring professionals with technological experience in AI to training existing employees on how to integrate the technology into their jobs, HR functions will shift from more administrative tasks to more strategic initiatives.[24]

Organizational Culture and Hiring for Fit

Regardless of general business and economic conditions, many firms are expanding operations and hiring additional employees. For many growing firms, corporate culture can be a key aspect of developing employees into a competitive advantage for the firm. Corporate culture refers to the core values and beliefs that support the mission and business model of the firm and guide employee behavior. Companies such as Trader Joe's, Patagonia, and Warby Parker place an emphasis on fit with the company culture during the recruitment and hiring process. This necessitates recruitment and selection of employees who exhibit the values of the firm. Companies can use carefully crafted applicant screeners early in the recruitment process to determine if the applicant's values and behaviors support the corporate culture. Additional tools such as behavioral-based interviewing questions centered on the company core values can also assist with finding a good fit for the company. Southwest Airlines has non-HR employees such as gate agents and pilots to screen for cultural fit as well as strong customer-service orientation.

In addition to cultural fit, firms are increasingly hiring for technical knowledge and skills fit to the job. Tech companies such as Dell, Alphabet, and Amazon receive thousands of résumés and job applications each year and continue to look for the best and the brightest when it comes to technical knowledge and skills. For example, Alphabet, Inc. focuses on a skills-based approach rather than a candidate's education level. Amazon is customer-centric and looks for employees who are innovative and data driven. Dell Technologies focuses on their "culture code" and actively seeks employees who have high integrity and a team-oriented mindset.[25]

More Service Workers Joining Labor Unions

Organized labor has faced tumultuous times during the last several decades due to declining union membership, loss of factory jobs, dwindling political clout, and the shifting of jobs outside the United States. With union membership around 10 percent of the U.S. workforce, some wonder if labor unions, who organize as a united front against poor working conditions, still have a place in the country. April Verritt, president of the Service Employees International Union (SEIU) is confident in the work of unions and the impact they can make. The SEIU is one of the fastest-growing unions in the nation, having jumped to 2 million members from 1.1 million a decade or more ago.[26]

Henry's goal is to focus on recruiting the country's millions of low-wage service workers, positions that are primarily filled by the working poor. These workers are disproportionately women, immigrants, and members of minority groups, which have all been traditionally more open to unionization. If these workers are successfully recruited into the SEIU, Henry believes that their wages and benefits would increase in much the same way unions brought factory workers into the middle class in the 1930s.

The SEIU believes that the service industry provides a target of opportunity given the size of the service sector in the United States, with nearly 80 percent of U.S. workers being employed in service-related fields:

Job	Projected Growth[27]
Home health aides	22%
Personal care aides	22%
Food preparation	2%
Janitorial	2%

Many believe that the future of labor lies primarily in the success of recruitment efforts and in enrolling the massive numbers of employees who are in fast-growing, low-wage service jobs. For example, the SEIU was successful in unionizing hundreds of workers who provide services to people with disabilities in California, with an eye toward raising standards for their work and increasing hourly wages and benefits. Reversing labor's decline will be challenging, but the SEIU looks positively toward the future under the leadership of Verrett.[28]

CONCEPT CHECK

1. How can employee diversity give a company a competitive advantage?
2. Explain the concept of hiring for fit.
3. Why does the service industry provide an opportunity for labor union growth?

Key Terms

affirmative action programs Programs established by organizations to expand job opportunities for women and minorities.
agency shop Workers don't have to join a union but must pay union dues.
apprenticeship A form of on-the-job training that combines specific job instruction with classroom instruction.
arbitration Settling labor-management disputes through a third party. The decision is final and binding.
collective bargaining Negotiating a labor agreement.
competitive advantage A set of unique features of an organization that are perceived by customers and potential customers as significant and superior to the competition.
conciliation Negotiation process in which a specialist in labor-management negotiations acts as a go-between for management and the unions and helps focus on the problems.
contingent worker Individual who has temporary employment, either full- or part-time, hired on a non-permanent basis.
Equal Employment Opportunity Commission (EEOC) Processes discrimination complaints, issues regulations regarding discrimination, and disseminates information.
federation A collection of unions banded together to achieve common goals.
grievance A formal complaint by a union worker that management has violated the contract.
human resource (HR) management The process of hiring, developing, motivating, and evaluating employees to achieve organizational goals.
human resource planning Creating a strategy for meeting current and future human resource needs.
incentive pay Additional pay for attaining a specific goal.
job analysis A study of the tasks required to do a particular job well.
job description The tasks and responsibilities of a job.
job fair An event, typically one or two days, held at a convention center to bring together job seekers and firms that are searching for employees.
job rotation Reassignment of workers to several different jobs over time so that they can learn the basics of each job.
job specification A list of the skills, knowledge, and abilities a person must have to fill a job.
labor union An organization that represents workers in dealing with management.
local union Branch of a national union that represents workers in a specific plant or geographic area.
management rights clause Clause in a labor agreement that gives management the right to manage the business except as specified in the contract.
mediation Negotiation process in which a specialist facilitates labor-management contract discussions and suggests compromises.
mentoring A form of on-the-job training in which a senior manager or other experienced employee provides job- and career-related information to a mentee.
Occupational Safety and Health Administration (OSHA) Sets workplace safety and health standards and assures compliance.
open shop Workers do not have to join the union or pay union dues.
orientation Presentation to get the new employee ready to perform their job.
performance appraisal A comparison of actual performance with expected performance to assess an employee's contributions to the organization.
programmed instruction A form of computer-assisted off-the-job training.
protected classes The specific groups who have legal protection against employment discrimination; include categories of race, national origin, disability, religion, and others.
recruitment The attempt to find and attract qualified applicants in the external labor market.
recruitment branding Presenting an accurate and positive image of the firm to those being recruited.
right-to-work law State laws that an employee does not have to join a union.

selection The process of determining which persons in the applicant pool possess the qualifications necessary to be successful on the job.
selection interview An in-depth discussion of an applicant's work experience, skills and abilities, education, and career interests.
selective strike strategy Strike at a critical plant that typically stops operations system-wide.
shop steward An elected union official that represents union members to management when workers have complaints.
simulation A scaled-down version or mock-up of equipment, processes, or a work environment.
succession planning Examination of current employees to identify people who can fill vacancies and be promoted.
training and development Activities that provide learning situations in which an employee acquires additional knowledge or skills to increase job performance.
unemployment compensation Government payment to unemployed former workers.
union shop Nonunion workers can be hired but must join the union later.
worker's compensation Pay for lost work time due to employment-related injuries.

Summary of Learning Outcomes

8.1 Achieving High Performance through Human Resources Management

1. What is the human resource management process, and how are human resource needs determined?

The human resource management process consists of a sequence of activities that begins with the job analysis and HR planning; progresses to employee recruitment and selection; then focuses on employee training, performance appraisal, and compensation; and ends when the employee leaves the organization.

Creating a strategy for meeting human resource needs is called human resource planning, which begins with the job analysis. Job analysis is a process of studying a job to determine its tasks and duties for setting pay, determining employee job performance, specifying hiring requirements, and designing training programs. Information from the job analysis is used to prepare a job description, which lists the tasks and responsibilities of the job. A job specification describes the skills, knowledge, and abilities a person needs to fill the job described in the job description. By examining the human resource demand forecast and the internal supply forecast, human resource professionals can determine if the company faces a personnel surplus or shortage.

8.2 Employee Recruitment

2. How do firms recruit applicants?

When a job vacancy occurs, most firms begin by trying to fill the job from within the ranks of their own employees, known as the internal labor market. If a suitable internal candidate is not available, the firm turns to the external labor market. Firms utilize a variety of outlets to recruit workers at all levels. To recruit more skilled candidates, employers can use college job fairs, executive search firms, and industry-specific websites to promote job openings. During the job search process, firms present an accurate and positive image of the company to those being recruited, called recruitment branding.

8.3 Employee Selection

3. How do firms select qualified applicants?

The selection process helps identify the candidates in the applicant pool who possess the best qualifications for the open position. Typically, an applicant submits an application or résumé and then receives a short, structured interview. If an applicant makes it past the initial screening, they may be asked to take an aptitude, personality, or skills test. The next step is the selection interview, which is an in-depth discussion of the applicant's work experience, skills and abilities, education, and career interests. If the applicant passes the

selection interview, most firms conduct background checks and talk with their references. Physical exams and drug testing may also be part of the selection process.

8.4 Employee Training and Development

4. What types of training and development do organizations offer their employees?

Training and development programs are designed to increase employees' knowledge, skills, and abilities in order to foster job performance improvements. Formal training (usually classroom in nature and off-the-job) takes place shortly after being hired. Development programs prepare employees to assume positions of increasing authority and responsibility. Job rotation, executive education programs, mentoring, and special-project assignments are examples of employee development programs.

8.5 Performance Planning and Evaluation

5. How are performance appraisals used to evaluate employee performance?

A performance appraisal compares an employee's actual performance with the expected performance. Performance appraisals serve several purposes, but are typically used to determine an employee's compensation, training needs, and advancement opportunities.

8.6 Employee Compensation and Benefits

6. What are the types of compensation and methods for paying workers?

Direct pay is the hourly wage or monthly salary paid to an employee. In addition to the base wage or salary, direct pay may include bonuses and profit shares. Indirect pay consists of various benefits and services. Some benefits are required by law and include unemployment compensation, worker's compensation, and Social Security. Many employers also offer benefits not required by law. These include paid vacations and holidays, pensions, health and other insurance, and employee wellness programs.

8.7 The Labor Relations Process

7. What is a labor union and how is it organized, what is collective bargaining, and what are some of the key negotiation issues?

A labor union is an organization that represents workers in dealing with management over disputes involving wages, hours, and working conditions. A company is unionized through an organizing drive that begins either inside, with a small group of existing employees, or outside, with an established union that targets the employer. When the union gets signed authorization cards from 30 percent of the firm's employees, the NLRB conducts a union certification election. A majority vote is needed to certify the union as the exclusive bargaining agent. The union and the employer then begin collective bargaining and have one year in which to reach an agreement.

Collective bargaining is the process of negotiating, administering, and interpreting labor agreements. Both union and management negotiators prepare a bargaining proposal. The two sides meet and exchange demands and ideas. Bargaining consists of compromises and concessions that lead to a tentative agreement. Top management then approves or disapproves the agreement for the management team. Union members vote to either approve or reject the contract. The key issues included in a union contract are wage increases, indirect compensation, and job security.

8.8 Managing Grievances and Conflicts

8. How are grievances between management and labor resolved, and what tactics are used to force a contract settlement?

In most labor agreements, the grievance procedure consists of three or four steps. In the initial step, the employee files a grievance; this is an oral and/or written presentation to the supervisor and may involve a

union steward as representative of the grievant. Steps two and three involve meetings of the employee, one or more union officials, the appropriate supervisor, and one or more management officials. If the grievance is not resolved at step three, either party (union or management) can request that an arbitrator, or neutral third party, hear and decide the grievance. The arbitrator reviews the grievance at a hearing and then makes the decision, which is presented in a document called the award.

When a union contract expires and a new agreement has not been reached, the union may impose economic pressure on the firm. These tactics may take the form of strikes, boycotts, picketing, or corporate campaigns. Similarly, employers may implement lockouts, hire replacements, or move production to another facility to place pressure on a union to accept a new contract.

8.9 Legal Environment of Human Resources and Labor Relations

9. What are the key laws and federal agencies affecting human resource management and labor relations?

A number of federal laws (listed in **Table 8.6**) affect human resource management. Federal law prohibits discrimination based on age, race, sex, color, national origin, religion, or disability. The Americans with Disabilities Act bans discrimination against disabled workers and requires employers to reasonably accommodate people with disabilities. The Family and Medical Leave Act requires employers, with certain exceptions, to provide employees up to 12 weeks of unpaid leave a year. The leave can be for the birth or adoption of a child or due to serious illness of the worker or a family member.

Federal agencies that deal with human resource administration are the EEOC, OSHA, the Office of Federal Contract Compliance Programs (OFCCP), and the Wage and Hour Division of the Department of Labor. The EEOC and OFCCP are primary agencies for the enforcement of employment discrimination laws, OSHA enforces safety regulations, and the Wage and Hour Division enforces the minimum wage and related laws. Many companies employ affirmative action and safety officers to ensure compliance with antidiscrimination and workplace safety laws. The Wagner and Taft-Hartley Acts govern the union-management relationship, in part through the functions performed by the National Labor Relations Board. The law gives workers the right to form and join labor unions and obligates the employer to deal with the union fairly.

8.10 Trends in Human Resource Management and Labor Relations

10. What trends and issues are affecting human resource management and labor relations?

Human resource managers recognize that diverse workforces create an environment that nurtures creative decision-making, effective problem-solving, more agility in adapting to change, and a strong competitive advantage. Therefore, firms actively recruit and hire a diverse workforce. To maximize efficiency, many firms are outsourcing HR functions and using technology to reduce costs and improve efficiency. Firms are also striving to hire employees who possess qualities that match those of the corporate culture. Although labor union membership has declined, unions still play a vital role in improving working conditions, pay, and health benefits, specifically for low-wage earning industries.

Preparing for Tomorrow's Workplace Skills

1. Would an overseas job assignment be good for your career development? If you think so, what country would you prefer to live and work in for two or three years, and what type of job would you like to have in that country? (Resources)
2. The benefits package of many employers includes numerous items such as health insurance, life insurance, 401(k) plan, paid vacations, tuition reimbursement, employee price discounts on products of the firm, and paid sick leave. At your stage of life, what are the three or four most important benefits? Why? Twenty years from now, what do you think will be your three or four most important benefits? Why? (Resources)
3. Assume you have been asked to speak at a local meeting of human resource and labor relations professionals. The topic is whether union membership will increase or decline in the next 50 years. Take

either the increase or the decline position and outline your presentation. (Information)

4. Go to the Department of Labor (DOL) Bureau of Labor Statistics website at **https://stats.bls.gov**. Locate the following information for your state. (Information)
   - Number of persons in the workforce
   - Unemployment rate for last year
   - Demographic characteristics for the workers in your state: race, ethnic status, age, marital status, and gender
   - Occupations where there are projected shortages
   - Employment numbers by industry: manufacturing, banking and finance, health care, business and personal services, sports and entertainment, and any other area of interest to you
5. Assume you are a director of labor relations for a firm faced with a union certification election in 30 days. Draft a letter to be sent to your employees in which you urge them to vote "no union"; be persuasive in presenting your arguments against the union. (Information)
6. Using the internet, research articles featuring a recent strike or a labor contract settlement. Report to your class the specifics of the strike or settlement. (Technology, Resources)
7. **Team Activity** Select two teams of five. One team will take the position that employees are simply a business expense to be managed. The second team will argue that employees are an asset to be developed to enable the firm to gain a competitive advantage. The remainder of the class will judge which team provided the stronger argument. (Interpersonal)
8. Have you or a family member ever been a union member? If so, name the union and describe it in terms of membership size, membership characteristics, strike history, recent bargaining issues, and employers under union contracts. (Information)
9. **Team Activity** Divide the class into two groups. One group will take the position that workers should be required to join unions and pay dues. The other group will take the position that workers should not be required to join unions. Hold a debate in which a spokesperson from each group is given 10 minutes to present the group's arguments. (Interpersonal)

Ethics Activity

Tracking employee information through global positioning systems (GPS)—in particular, on company vehicles driven by employees—is becoming commonplace. Location information is transmitted to a server via the cell phone network (and sometimes via satellite phone service) and is then available to the company through the web or mobile apps.

As the cost of GPS drops and the number of mobile workers rises—by some accounts, to as much as 60 percent of the global workforce—companies are depending on GPS to monitor the movement of personnel and products to improve customer service and help with time management. "I wanted to see how much time was spent on each job," says one small business owner with a fleet of seven service vehicles. "We've had a few problems in the past—people weren't where they said they'd be. With GPS, we can defend ourselves to the customers. We know how fast the drivers drove, what route they took, and how long they spent on each job." GPS data can also be used for monitoring field employees who have positions that are not tied to working in an office. Additionally, for employees utilizing company vehicles, GPS tracking can ensure that company assets are being used appropriately.

Companies are not only tracking vehicles, but many now track employees through their mobile phones. Understandably, many employees don't like the idea of their employer following their every move. Many employees take their company vehicles home after their shifts, but even employees with company-owned phones may be tracked after hours, too.

Surveys show that many GPS-tracked employees have serious concerns about after-hours tracking, micromanagement, and privacy. Courts continue to uphold monitoring and tracking efforts of employers for

their employees during their work hours. In general, there is no expectation of privacy, and monitoring is permissible as long as the company "presents a legitimate business reason" for doing so.

Using a web search tool, locate articles about this topic, and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Do GPS devices constitute an invasion of employee privacy? Are there guidelines companies can develop for appropriate GPS use?

Sources: Kaveh Waddell, "Why Bosses Can Track Their Employees 24/7," *The Atlantic,* https://www.theatlantic.com, January 6, 2017; Andrew Burger, "IDC: Mobile Workers Will Make Up Nearly 75 Percent of U.S. Workforce," https://www.telecompetitor.com, June 23, 2015; "Mobile Workforce Trends," *ServicePower*, https://www.servicepower.com, October 14, 2024; Max Freedman, "Spying on Your Employees? Better Understand the Law First," *Business News Daily*, https://www.businessnewsdaily.com, January 5, 2026.

Working the Net

1. Go to the blog page of the College Recruiter website at **https://www.collegerecruiter.com/blog**, and read the relevant articles to learn how to prepare a résumé that will get results. Develop a list of rules for creating effective résumés. What tips were the most useful to you?
2. Working as a contingent employee can help you explore your career options. Visit the Manpower website at **https://www.manpower.com**, and use the Job Search feature to look for several types of jobs that interest you. Choose your current city and one where you would like to live, either in the United States or abroad. What are the advantages of being a temporary worker? What other services does Manpower offer job seekers?
3. As a corporate recruiter, you must know how to screen prospective employees. The Phyllo website at **https://www.getphyllo.com/post/pre-employment-screening-checklist-for-hr-professionals** offers a pre-employment screening checklist and related information. Prepare a short report that tells your assistant how to go about this process.
4. You've been asked to give a speech about the current status of affirmative action and equal employment to your company's managers. Starting with the website of the American Association for Access Equity and Diversity (**https://www.aaaed.org**) and its links to related sites, research the topic and prepare an outline for your talk. Include current legislation and recent court cases.
5. Web-based training is popular at many companies as a way to bring a wider variety of courses to more people at lower costs. The Web-Based Training Information Center site at **https://www.webbasedtraining.com** provides a good introduction. Learn about the basics of online training at its Primer page. Then link to the Resources section, try a demo, and explore other areas that interest you. Prepare a brief report on your findings, including the pros and cons of using the web for training, to present to your class.
6. What are the key issues facing labor unions today? Visit the AFL-CIO website, **https://www.aflcio.org**. Select three current topics and summarize the key points for the class.
7. Not everyone believes that unions are good for workers. The National Right to Work Legal Defense Foundation offers free legal aid to employees whose "human and civil rights have been violated by compulsory unionism abuses." Read the materials on its site (**https://www.nrtw.org**), and prepare a short report on its position regarding the disadvantages of labor unions.
8. Although we tend to think of labor unions as representing manufacturing employees, many office and service-industry employees, teachers, and professional belong to unions. Visit the websites of two of the following nonmanufacturing unions and discuss how they help their members: the Office and Professional Employees International Union (**https://www.opeiu.org**), the American Federation of State, County, and Municipal Employees (**https://www.afscme.org**), the National Education Association (**https://www.nea.org**), the Actor's Equity Association (**https://www.actorsequity.org**), and the American Federation of Musicians (**https://www.afm.org**). What are the differences, if any, between these unions

and those in other industries?

Critical Thinking Case

Discrimination in the Workplace Continues

Although we live in enlightened times, recent data show that over 90 percent of workers in the U.S. have experienced workplace discrimination.

The poll found that the two most frequently cited types of discrimination are retaliation (48 percent) and race/color discrimination (42 percent). Also mentioned were age, disability, sexual orientation, and religion. Work areas susceptible to discrimination are promotion and pay, and recruitment and hiring processes. Wage discrimination and sexual harassment are two big battles women continue to fight.

Thanks to Harvey Weinstein, the topic of sexual harassment was brought into the spotlight, setting off a call to action as women around the world reacted with their #MeToo stories. As the movement progressed from Hollywood, to media companies, to Capitol Hill, and finally into corporate America, the topic has developed a platform. From the boardroom to the factory floor, women who have been sexually harassed share their stories.

As companies rushed to put zero-tolerance policies into place and issue new training requirements, lawsuits and class-action cases were settled more quickly, some very publicly. In 2025, KFC was ordered to compensate two employees at an Orlando location for EEOC charges related to a sexually hostile work environment and retaliation as one of the employees was fired.

A new regulation that went in effect in 2018 was designed to combat the wage gap between men and women. The revised EEO-1 would have gone into effect March 31, 2018, and required companies with 100 or more employees and federal contractors with 50 or more employees to report W-2 wage information and total hours worked for all employees. The EEO-1 form already requires employers to report data on race/ethnicity and sex/gender.

The Office of Management and Budget (OMB) initiated a review and immediate stay to the U.S. EEOC "in accordance with its authority under the Paperwork Reduction Act (PRA)," reversing the regulation that had been revised on September 29, 2016.

Pay equity advocates who had supported expanded pay-data reporting were critical of the suspension. "We see through the Trump administration's call to halt the equal pay rule that requires employers to collect and submit pay data by gender, race, and ethnicity to the government," said Fatima Goss Graves, president and CEO of the National Women's Law Center in Washington, D.C. "Make no mistake—it's an all-out attack on equal pay. [It] sends a clear message to employers: if you want to ignore pay inequities and sweep them under the rug, this administration has your back."

How important is equal pay? According to the analyses of the 2014–2016 Annual Social and Economic supplement published by the Institute for Women's Policy Research, the United States economy would have produced additional income of $512.6 billion if women received equal pay; this represents 2.8 percent of 2016 gross domestic product (GDP).

In addition, poverty rates would drop from 10.8 percent to 4.4 percent, and the number of children with working mothers living in poverty would decrease significantly.

Critical Thinking Questions

1. Why is workplace diversity so important in today's business environment?
2. What are the major sources of workplace discrimination? Cite specific examples from the case.
3. What steps are companies taking to ensure that employees are not discriminated against?

Sources: "Statement of Acting Chair Victoria A. Lipnic about OMB Decision on EEO-1 Pay Data Collection,"

https://www.eeoc.gov, August 29, 2017; Stephen Miller, “White House Suspends Pay-Data Reporting on Revised EEO-1 Form,” https://www.shrm.org, August 31, 2017; Heidi Hartmann, Jeff Hayes, and Jennifer Clark, “How Equal Pay for Working Women Would Reduce Poverty and Grow the American Economy,” https://www.iwpr.org, January 13, 2014; Genevieve Carlton, "EEOC Data Reveals Most Common Types of Workplace Discrimination," *Working Now and Then*, https://www.workingnowandthen.com, April 15, 2025; U.S. Equal Employment Opportunity Commission, "Kentucky Fried Chicken to Pay $200,000 for EEOC Sexual Harassment and Retaliation Charge," https://www.eeoc.gov, January 6, 2026; Laura D. Windsor and Emily Kendall Chowhan, "Yes, EEO-1 Reporting Is Still A Thing," *Williams Mullen*, https://www.williamsmullen.com, May 27, 2025; "The Economic Impact of Equal Pay by State," https://statusofwomendata.org, accessed February 25, 2026.

Hot Links Address Book

1. Search the extensive job database of CareerBuilder.com (**https://www.careerbuilder.com**) for a job in a new city.
2. Get advice for brushing up your interview skills from Indeed at **https://www.indeed.com/career-advice/interviewing/improve-your-interviewing-skills**.
3. How does the Equal Employment Opportunity Commission promote equal opportunity in employment? Visit **https://www.eeoc.gov** to learn what the agency does.
4. For the latest news in the human resources field, visit the website of the Society for Human Resource Management at **https://www.shrm.org**.
5. Many companies are using the web to help manage employees. One example is ADP, **https://www.adp.com**, which you can visit to learn how online services can streamline their HR tasks.
6. At the NLRB website, **https://www.nlrb.gov**, you’ll learn about the agency’s many activities and how it protects workers’ rights.
7. Visit the Social Security Administration site to track the latest cost-of-living adjustment at **https://www.ssa.gov/OACT/COLA/colaseries.html**.

9

Motivating Employees

Exhibit 9.1 (Credit: Jeff Turner /flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What are the basic principles of Frederick Taylor's concept of scientific management?
2. What did Elton Mayo's Hawthorne studies reveal about worker motivation?
3. What is Maslow's hierarchy of needs, and how do these needs relate to employee motivation?
4. How are McGregor's Theories X and Y and Ouchi's Theory Z used to explain worker motivation?
5. What are the basic components of Herzberg's motivator-hygiene theory?
6. What four contemporary theories on employee motivation offer insights into improving employee performance?
7. How can managers redesign existing jobs to increase employee motivation and performance?
8. What initiatives are organizations using today to motivate and retain employees?

EXPLORING BUSINESS CAREERS

Chuck Kaplan, Ciena Corporation

Chuck Kaplan loves music and playing in a band, but he does not work in the music industry. He works for Ciena Corporation, a global supplier of telecommunications networking equipment, software, and services. Kaplan spends his days leading a team to help customers solve business problems by updating and creating revenue through their networks—the process of modernizing and monetizing networks. He also plays music with OTN Speedwagon, Ciena's all-employee band.

OTN Speedwagon was created after Kaplan thought the entertainment at a corporate function was "cheesy." He and three others took the idea of creating an employee band to their boss, and OTN Speedwagon was born. Its name comes from the networking technology Ciena implements, Optical Transport Network, and the rock band REO Speedwagon; its members are from all over the globe.

The band is made up of employees from multiple departments, time zones, and countries. Members included an executive administrative assistant in London, England; a CTO in Dallas, Texas; sales system engineers in Dallas, Texas, and St. Louis, Missouri; an account manager in Denver, Colorado; senior managers in Baltimore, Maryland, and New York, New York; a sales consultant in Atlanta, Georgia; vice presidents in Atlanta, Georgia, and Dallas, Texas; and a materials management leader in Ottawa, Canada. When playing with the band, they set aside their job titles and focus on producing award-winning music.

OTN Speedwagon performs songs in a variety of styles and enjoys performing whenever and wherever opportunity exists. A highlight was the opportunity to compete at the *Fortune* Battle of the Corporate Band, which was then a popular competition for all-employee bands. OTN Speedwagon won the event one year, beating seven other corporate bands. Two members also walked away with individual awards: best guitarist and best horns.

Producing great music together is not easy. Everyone knows one person being off-tempo or off-key can ruin a song. Because the band members have different job responsibilities and live in separate countries, they are rarely together. Scheduling live rehearsals is a major challenge, and they often happen only the day of or day before an event. The band is up to the challenge, though, and harnesses technology to solve the problem. The members discuss songs to sing (enough for a multi-hour show!) and pick a key for each song that fits the lead vocalist. One member makes an MP3 soundtrack for each song and shares it and lyrics with the others through a secure file-sharing system. Everyone spends hours practicing to the soundtracks—alone. But hard work and dedication pay off. When the band finally is together, often one time through is enough to perfect each song.

Opportunities and benefits such as being part of the band pay dividends for Ciena, certified as a "great place to work." Band members say trust in each other to do each person's part makes the band a success. Everyone knows what to do and does it, and that level of trust transfers back to the workplace. Members have built trust in coworkers, knocked down walls, and become more collaborative. The experience has brought the employees together, some meeting for the first time at rehearsal, and made the company seem more like a family. Bonus benefit? Corporate events are much more entertaining.

Sources: "About Chuck Kaplan," https://www.ciena.com, accessed January 19, 2018; "What Is Network Monetization?" https://www.ciena.com, accessed January 19, 2018; "OTN Speedwagon," https://www.ciena.com, accessed January 19, 2018; Great Place to Work, "Ciena Corporation," https://reviews.greatplacetowork.com, November 27, 2017; Jessica Stillman, "What This Remote Company Rock Band Can Teach You About Collaboration," *Inc.*, https://www.inc.com, March 10, 2017; Molly Winans, "Ciena's OTN Speedwagon Gears Up to Rock Out at OFC," https://www.ofcconference.org, March 17, 2017; Jane Hobbs, "Being a Great Place to Work Shouldn't Be a Mystery," https://www.ciena.com, October 24, 2016; "Ciena Takes Home National Title at 13th Annual FORTUNE Battle of the Corporate Bands," https://www.ciena.com, October 6, 2013; Bo Gowan, "Behind the Scenes with Ciena's Corporate Rock Band," https://www.ciena.com, September 16, 2013.

This chapter details motivational theory, both historically and currently, and applies that theory to the business world, where motivation, whether in the form of a rock band or not, is a key to success.

People can be a firm's most important resource. They can also be the most challenging resource to manage well. Employees who are motivated and work hard to achieve personal and organizational goals can become a crucial competitive advantage for a firm. The key then is understanding the process of motivation, *what* motivates individuals, and *how* an organization can create a workplace that allows people to perform to the best of their abilities.

Exhibit 9.2 LeBron James is on a roll. The U.S. basketball player began receiving national attention as a high school player in Ohio. By the time he was graduating from high school, he was touted as the consensus first pick in the NBA draft. James was determined to make it in professional basketball. Across successful stints in Cleveland, Miami, and Los Angeles, James is an NBA standout as the all-time leading scorer. *What motivates people to achieve their personal best?* (Credit: Erik Drost/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

9.1 Early Theories of Motivation

1. What are the basic principles of Frederick Taylor's concept of scientific management?

Motivation is the set of forces that prompt a person to release energy in a certain direction. As such, motivation is essentially a need- and want-satisfying process. A **need** is best defined as the gap between what is and what is *required*. Similarly, a **want** is the gap between what is and what is *desired*. Unsatisfied needs and wants create a state of tension that pushes (motivates) individuals to practice behavior that will result in the need being met or the want being fulfilled. That is, motivation is what pushes us to move from where we are to where we want to be, because expending that effort will result in some kind of reward.

Rewards can be divided into two basic categories: intrinsic and extrinsic. Intrinsic rewards come from within the individual—things like satisfaction, contentment, sense of accomplishment, confidence, and pride. By contrast, extrinsic rewards come from outside the individual and include things like pay raises, promotions, bonuses, prestigious assignments, and so forth. Exhibit 9.3 illustrates the motivation process.

Successful managers are able to marshal the forces to motivate employees to achieve organizational goals. And just as there are many types of gaps between where organizations are and where they want to be, there are many motivational theories from which managers can draw to inspire employees to bridge those gaps. In this chapter, we will first examine motivational theories that grew out of the industrial revolution and early ideas of organizational psychology. Then we will examine needs-based theories and more contemporary ideas about employee motivation like equity, expectancy, goals, and reinforcement theories. Finally, we will show you how managers are applying these theories in real-world situations.

How can managers and organizations promote enthusiastic job performance, high productivity, and job satisfaction? Many studies of human behavior in organizations have contributed to our current understanding of these issues. A look at the evolution of management theory and research shows how managers have arrived at the practices used today to manage human behavior in the workplace. A sampling of the most influential of these theorists and research studies are discussed in this section.

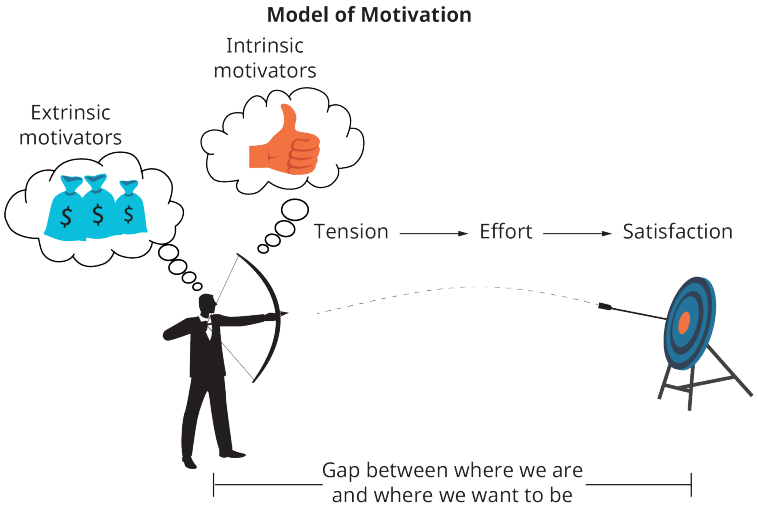

Exhibit 9.3 Model of Motivation (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Frederick Taylor's Scientific Management

One of the most influential figures of the *classical era* of management, which lasted from about 1900 to the mid-1930s, was Frederick W. Taylor, a mechanical engineer sometimes called the "father of **scientific management**." Taylor's approach to improved performance was based on economic incentives and the premise that there is "one best way" to perform any job. As a manager at the Midvale and Bethlehem Steel companies in Philadelphia in the early 1900s, Taylor was frustrated at the inefficiency of the laborers working in the mills.

Convinced that productivity could be improved, Taylor studied the individual jobs in the mill and redesigned the equipment and the methods used by workers. Taylor timed each job with a stopwatch and broke down every task into separate movements. He then prepared an instruction sheet telling exactly how each job should be done, how much time it should take, and what motions and tools should be used. Taylor's ideas led to dramatic increases in productivity in the steel mills and resulted in the development of four key principles of scientific management:

1. Use a scientific approach to allocate each task.
2. Scientifically select, train, and develop employees.
3. Require collaboration between employees and managers.
4. Divide work tasks among employees according to who is better suited to perform the task.

Taylor published his ideas in *The Principles of Scientific Management.* His pioneering work vastly increased production efficiency and contributed to the specialization of labor and the assembly-line method of production. Taylor's approach is still being used a century later in companies such as UPS, where industrial engineers maximize efficiency by carefully studying every step of the delivery process looking for the quickest possible way to deliver packages to customers. Though Taylor's work was a giant step forward in the evolution of management, it had a fundamental flaw in that it assumed that all people are primarily motivated by economic means. Taylor's successors in the study of management found that motivation is much more complex than he envisioned.

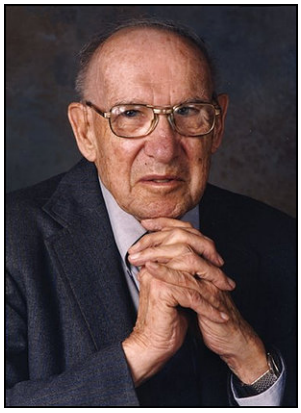

Exhibit 9.4 Management thought leader Peter Drucker (1909–2005) was the author of more than three dozen books, translated into almost as many languages. Most management scholars have remarked that although he was firmly associated with the human relations school of management—along with Douglas McGregor and Warren Bennis, for example—the thought leader Drucker most admired was Frederick Winslow Taylor, the father of "scientific" management. *Should any one "school" of management predominate thinking, or should all approaches be considered?* (Credit: IsaacMao/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

CONCEPT CHECK

1. How did Frederic Taylor's studies contribute to the early understanding of human motivation?
2. How are Taylor's insights still seen in today's management practices?

9.2 The Hawthorne Studies

2. What did Elton Mayo's Hawthorne studies reveal about worker motivation?

The classical era of management was followed by the *human relations era,* which began in the 1930s and focused primarily on how human behavior and relations affect organizational performance. The new era was ushered in by the Hawthorne studies, which changed the way many managers thought about motivation, job productivity, and employee satisfaction. The studies began when engineers at the Hawthorne Western Electric plant decided to examine the effects of varying levels of light on worker productivity—an experiment that might have interested Frederick Taylor. The engineers expected brighter light to lead to increased productivity, but the results showed that varying the level of light in either direction (brighter or dimmer) led to increased output from the experimental group. In 1927, the Hawthorne engineers asked Harvard professor Elton Mayo and a team of researchers to join them in their investigation.

From 1927 to 1932, Mayo and his colleagues conducted experiments on job redesign, length of workday and workweek, length of break times, and incentive plans. The results of the studies indicated that increases in performance were tied to a complex set of employee attitudes. Mayo claimed that both experimental and control groups from the plant had developed a sense of group pride because they had been selected to participate in the studies. The pride that came from this special attention motivated the workers to increase their productivity. Supervisors who allowed the employees to have some control over their situation appeared to further increase the workers' motivation. These findings gave rise to what is now known as the **Hawthorne effect**, which suggests that employees will have higher productivity when they receive attention from management as to their welfare. The attention paid to employees' needs has a motivational effect on job performance. Further studies also revealed that the social relationships of employees working in groups can impact productivity. The results of the Hawthorne studies enhanced our understanding of what motivates individuals in the workplace. They indicate that in addition to the personal economic needs emphasized in the classical era, social needs play an important role in influencing work-related attitudes and behaviors.

CONCEPT CHECK

1. How did Mayo's studies at the Hawthorne plant contribute to the understanding of human motivation?
2. What is the Hawthorne effect?
3. Was the practice of dimming and brightening the lights ethical?

9.3 Maslow's Hierarchy of Needs

3. What is Maslow's hierarchy of needs, and how do these needs relate to employee motivation?

Another well-known theorist from the behavioral era of management history, psychologist Abraham Maslow, proposed a theory of motivation based on universal human needs. Maslow believed that each individual has a hierarchy of needs, consisting of physiological, safety, social, esteem, and self-actualization needs, as shown in Exhibit 9.5.

Maslow's theory of motivation contends that people act to satisfy their unmet needs. When you're hungry, for instance, you look for and eat food, thus satisfying a basic physiological need. Once a need is satisfied, its importance to the individual diminishes, and a higher-level need is more likely to motivate the person.

According to **Maslow's hierarchy of needs**, the most basic human needs are physiological needs, that is, the needs for food, shelter, and clothing. In large part, it is the physiological needs that motivate a person to find a job. People need to earn money to provide food, shelter, and clothing for themselves and their families. Once people have met these basic needs, they reach the second level in Maslow's hierarchy, which is safety needs. People need to feel secure, to be protected from physical harm, and to avoid the unexpected. In work terms, they need job security and protection from work hazards.

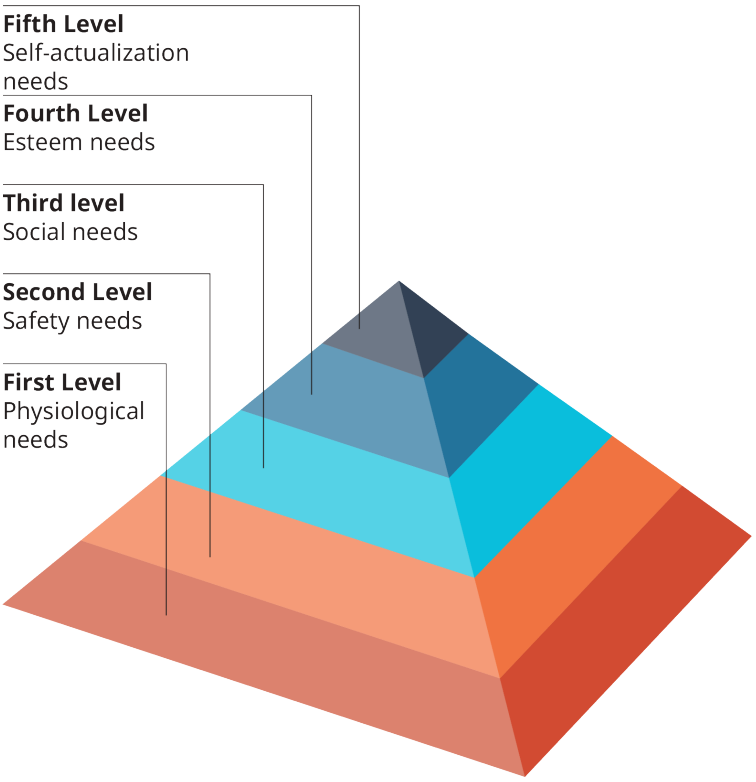

Exhibit 9.5 Maslow's Hierarchy of Needs (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Physiological needs and safety are physical needs. Once these are satisfied, individuals focus on needs that involve relationships with other people. At Maslow's third level are social needs, or needs for belonging (acceptance by others) and for giving and receiving friendship and love. Informal social groups on and off the job help people satisfy these needs. At the fourth level in Maslow's hierarchy are esteem needs, which are needs for the respect of others and for a sense of accomplishment and achievement. Satisfaction of these needs is reflected in feelings of self-worth. Praise and recognition from managers and others in the firm contribute to the sense of self-worth. Finally, at the highest level in Maslow's hierarchy are self-actualization needs, or needs for fulfillment, for living up to one's potential, and for using one's abilities to the utmost. In order to give you a better understanding of how Maslow's hierarchy applies in the real business world, let's look at a detailed example about Wegmans supermarkets. When you think of your first-choice job, you probably aren't thinking about working in a supermarket. With a lack of flexibility, lower pay, limited opportunities for development, and an annual turnover around 50 to 70 percent, supermarkets are generally not considered the best places to work—unless you work at Wegmans. Wegmans has been named to the *Fortune* 100 Best Companies to Work For list for 28 consecutive years, which also earned Wegmans' designation as a Great Place to Work Legend.

Part of what makes Wegmans successful is the company's attention to its employees' needs at all levels of Maslow's hierarchy. The company pays above-market wages (the sous chef at a Pittsburgh store used to work for Thomas Keller's French Laundry in Napa Valley, and talent like that doesn't come cheap), and provides generous comprehensive benefits to both full-time and part-time employees (*physiological needs*). Wegmans workers retain at a higher rate, with 60 percent of employees saying that they would stay with the company even if offered a position with higher pay. Furthermore, two-thirds of employees feel that the company is doing what they need to do to retain them (*safety needs*).

Because employees stay so long, the Wegmans culture has become stronger and more ingrained over time. Edward McLaughlin, director of Cornell's Food Industry Management Program, says, "When you're a 16-year-old kid, the last thing you want to do is wear a geeky shirt and work for a supermarket. But at Wegmans, it's a badge of honor. You are not a geeky cashier. You are part of the social fabric," (*social needs*).[1] Sara Goggins, a 19-year-old college student, was complimented on the display she helped prepare for the store's French-inspired patisserie—by Danny Wegman himself (*esteem needs*). Sara keeps a photo of her and Danny Wegman behind the counter. Maria Benjamin used to bake "chocolate meatball cookies" to celebrate coworkers' birthdays. They were so popular that she asked Danny Wegman if the store would sell them in the bakery department. He said yes, and it did. Employees like Sara and Maria are routinely recognized for their contributions to the company (*esteem needs*). Wegmans has spent $150 million for college scholarships for nearly 50,000 employees since 1984. Investing in employee development is a core focus of Wegmans as evidenced by spending $50 million annually in employee training and development. These growth opportunities are varied across positions in the company, even developing employees into culinary experts (*self-actualization needs*).[2] As you can see from this extended example, Wegmans works hard to meet its employees' needs at all levels.

Maslow's theory is not without criticism, however. Maslow claimed that a higher-level need was not activated until a lower-level need was met. He also claimed that a satisfied need is not a motivator. A farmer who has plenty to eat is not motivated by more food (the physiological hunger need). Research has not verified these principles in any strict sense. The theory also concentrates on moving up the hierarchy without fully addressing moving back down the hierarchy. Despite these limitations, Maslow's ideas are very helpful for understanding the needs of people at work and for determining what can be done to satisfy them.

CONCEPT CHECK

1. What is Maslow's hierarchy of needs, and how does it help in understanding human motivation?

2. What are some criticisms of Maslow's hierarchy?

9.4 McGregor's Theories X and Y

4. How are McGregor's Theories X and Y and Ouchi's Theory Z used to explain worker motivation?

Douglas McGregor, one of Maslow's students, influenced the study of motivation with his formulation of two contrasting sets of assumptions about human nature—Theory X and Theory Y.

The **Theory X** management style is based on a pessimistic view of human nature and assumes the following:

- The average person dislikes work and will avoid it if possible.
- Because people don't like to work, they must be controlled, directed, or threatened with punishment to get them to make an effort.
- The average person prefers to be directed, avoids responsibility, is relatively unambitious, and wants security above all else.

This view of people suggests that managers must constantly prod workers to perform and must closely control their on-the-job behavior. Theory X managers tell people what to do, are very directive, like to be in control, and show little confidence in employees. They often foster dependent, passive, and resentful subordinates.

In contrast, a **Theory Y** management style is based on a more optimistic view of human nature and assumes the following:

- Work is as natural as play or rest. People want to and can be self-directed and self-controlled and will try to achieve organizational goals they believe in.
- Workers can be motivated using positive incentives and will try hard to accomplish organizational goals if they believe they will be rewarded for doing so.
- Under proper conditions, the average person not only accepts responsibility but seeks it out. Most workers have a relatively high degree of imagination and creativity and are willing to help solve problems.

Managers who operate on Theory Y assumptions recognize individual differences and encourage workers to learn and develop their skills. An administrative assistant might be given the responsibility for generating a monthly report. The reward for doing so might be recognition at a meeting, a special training class to enhance computer skills, or a pay increase. In short, the Theory Y approach builds on the idea that worker and organizational interests are the same. It is not difficult to find companies that have created successful corporate cultures based on Theory Y assumptions. In fact, *Fortune*'s list of "100 Best Companies to Work For" and the Society for Human Resource Management's list of "Great Places to Work" are full of companies that operate using a Theory Y management style. Delta Airlines, Sheetz Inc., Publix Supermarkets, and Bank of America are all examples of companies that encourage and support their workers. In the early 2000s, Genencor—an industrial biotechnology company later acquired and integrated into larger firms—was recognized multiple times as a top workplace, having a culture that celebrates success in all aspects of its business. Employees can reward colleagues with on-the-spot awards for extraordinary effort. According to the company's former CEO, Robert Mayer, "Genencor is truly unique among U.S. companies of any size. It is a model for innovation, teamwork, and productivity—and a direct result of our 'work hard, play hard, change the world' philosophy. Investing in our employees has always been good business for Genencor."[3]

Theory Z

William Ouchi (pronounced O Chee), Distinguished Professor Emeritus of Management and Organizations at the University of California, Los Angeles, has proposed a theory that combines U.S. and Japanese business practices. He calls it **Theory Z**. Table 9.1 compares the traditional U.S. and Japanese management styles with the Theory Z approach. Theory Z emphasizes long-term employment, slow career development, moderate

specialization, group decision-making, individual responsibility, relatively informal control over the employee, and concern for workers. Theory Z has many Japanese elements. But it reflects U.S. cultural values.

In the past decade, admiration for Japanese management philosophy that centers on creating long-term relationships has declined. The cultural beliefs of groupthink, not taking risks, and employees not thinking for themselves are passé. Such conformity has limited Japanese competitiveness in the global marketplace. Today there is a realization that Japanese firms need to be more proactive and nimble in order to prosper. It was that realization that led Japanese conglomerate Sony to name a foreigner as the CEO of Japan's most famous company. Over the years, Sony's performance has declined, until in April 2005, the company posted its biggest loss ever. Nobuki Idei, the former CEO who inherited Sony's massive debts and stagnant product lines, realized his strategy wasn't working, so he became determined to appoint a successor who would be able to transform Sony from the lumbering giant it had become back into the forward-thinking company it had been. Idei tapped Sir Howard Stringer, a Welsh-born American who had been running Sony's U.S. operations. In doing so, Idei hoped to shock company insiders and industry analysts alike. "It's funny, 100 percent of the people around here agree we need to change, but 90 percent of them don't really want to change themselves," he says. "So I finally concluded that we needed our top management to quite literally speak another language."[4]

Differences in Management Approaches			
Factor	**Traditional U.S. Management**	**Japanese Management**	**Theory Z (Combination of U.S. and Japanese Management)**
Length of employment	Relatively short-term; workers subject to layoffs if business is bad	Lifetime; layoffs never used to reduce costs	Long-term but not necessarily lifetime; layoffs "inappropriate"; stable, loyal workforce; improved business conditions don't require new hiring and training
Rate of evaluation and promotion	Relatively rapid	Relatively slow	Slow by design; managers thoroughly trained and evaluated
Specialization in a functional area	Considerable; worker acquires expertise in single functional area	Minimal; worker acquires expertise in organization instead of functional areas	Moderate; all experience various functions of the organization and have a sense of what's good for the firm rather than for a single area
Decision-making	On individual basis	Input from all concerned parties	Group decision-making for better decisions and easier implementation
Responsibility for success or failure	Assigned to individual	Shared by group	Assigned to individual

Table 9.1 Sources: Comparison of traditional U.S. and Japanese management styles with the Theory Z approach. Based on information from Jerry D. Johnson, Austin College. Dr. Johnson was a research assistant for William Ouchi. William Ouchi, *Theory Z*, Avon, 1982.

Differences in Management Approaches			
Factor	**Traditional U.S. Management**	**Japanese Management**	**Theory Z (Combination of U.S. and Japanese Management)**
Control by manager	Very explicit and formal	More implicit and informal	Relatively informal but with explicit performance measures
Concern for workers	Focuses on work-related aspects of worker's life	Extends to whole life of worker	Is relatively concerned with worker's whole life, including the family

Table 9.1 Sources: Comparison of traditional U.S. and Japanese management styles with the Theory Z approach. Based on information from Jerry D. Johnson, Austin College. Dr. Johnson was a research assistant for William Ouchi. William Ouchi, *Theory Z*, Avon, 1982.

CONCEPT CHECK

1. How do the Theory X, Theory Y, and Theory Z management styles differ?

9.5 Herzberg's Motivator-Hygiene Theory

5. What are the basic components of Herzberg's motivator-hygiene theory?

Another important contribution to our understanding of individual motivation came from Frederick Herzberg's studies, which addressed the question, "What do people really want from their work experience?" In the late 1950s, Herzberg surveyed numerous employees to find out what particular work elements made them feel exceptionally good or bad about their jobs. The results indicated that certain job factors are consistently related to employee job satisfaction, while others can create job dissatisfaction. According to Herzberg, **motivating factors** (also called *job satisfiers*) are primarily intrinsic job elements that lead to satisfaction. **Hygiene factors** (also called *job dissatisfiers*) are extrinsic elements of the work environment. A summary of motivating and hygiene factors appears in Table 9.2.

One of the most interesting results of Herzberg's studies was the implication that the opposite of satisfaction is not dissatisfaction. Herzberg believed that proper management of hygiene factors could prevent employee dissatisfaction, but that these factors could not serve as a source of satisfaction or motivation. Good working conditions, for instance, will keep employees at a job but won't make them work harder. But poor working conditions, which are job dissatisfiers, may make employees quit. According to Herzberg, a manager who wants to increase employee satisfaction needs to focus on the motivating factors, or satisfiers. A job with many satisfiers will usually motivate workers, provide job satisfaction, and prompt effective performance. But a lack of job satisfiers doesn't always lead to dissatisfaction and poor performance; instead, a lack of job satisfiers may merely lead to workers doing an adequate job, rather than their best.

Exhibit 9.6 Flexibility has been a competitive advantage for ride-sharing companies like Uber and Lyft. Companies' adaptable work hours have been appealing to many workers who appreciate the flexibility that these jobs provide, either as a full-time job or a way to make supplemental income. *According to Herzberg's motivator-hygiene theory, what effect might Uber and Lyft's work environment have on employee?* (Credit: Alfredo Mendez/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Although Herzberg's ideas have been widely read and his recommendations implemented at numerous companies over the years, there are some very legitimate concerns about Herzberg's work. Although his findings have been used to explain employee motivation, in fact his studies focused on job satisfaction, a different (though related) concept from motivation. Other criticisms focus on the unreliability of Herzberg's methodology, the fact that the theory ignores the impact of situational variables, and the assumed relationship between satisfaction and productivity. Nevertheless, the questions raised by Herzberg about the nature of job satisfaction and the effects of intrinsic and extrinsic factors on employee behavior have proved a valuable contribution to the evolution of theories of motivation and job satisfaction.

Herzberg's Motivating and Hygiene Factors	
Motivating Factors	**Hygiene Factors**
Achievement	Company policy
Recognition	Supervision
Work itself	Working conditions
Responsibility	Interpersonal relationships at work
Advancement	Salary and benefits
Growth	Job security

Table 9.2

CONCEPT CHECK

1. What is Herzberg's theory, and how does it relate to an understanding of motivation?

2. How can a manager use an understanding of Herzberg's theory to motivate employees?
3. What are the limitations of Herzberg's theory?

9.6 Contemporary Views on Motivation

6. What four contemporary theories on employee motivation offer insights into improving employee performance?

The early management scholars laid a foundation that enabled managers to better understand their workers and how best to motivate them. Since then, new theories have given us an even better understanding of worker motivation. Four of these theories are explained in this section: the expectancy theory, the equity theory, the goal-setting theory, and reinforcement theory.

Expectancy Theory

One of the best-supported and most widely accepted theories of motivation is expectancy theory, which focuses on the link between motivation and behavior. According to **expectancy theory**, the probability of an individual acting in a particular way depends on the strength of that individual's belief that the act will have a particular outcome and on whether the individual values that outcome. The degree to which an employee is motivated depends on three important relationships, shown in Exhibit 9.7.

1. The link between *effort and performance,* or the strength of the individual's expectation that a certain amount of effort will lead to a certain level of performance
2. The link between *performance and outcome,* or the strength of the expectation that a certain level of performance will lead to a particular outcome
3. The link between *outcomes and individual needs,* or the degree to which the individual expects the anticipated outcome to satisfy personal needs. Some outcomes have more valence, or value, for individuals than others do.

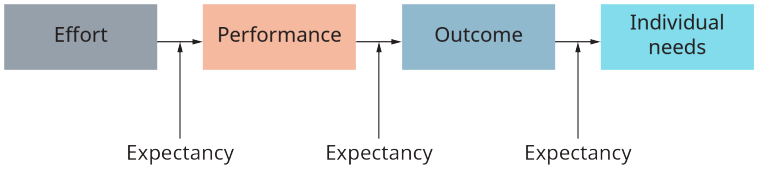

Exhibit 9.7 How Expectations Can Lead to Motivation (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Equity Theory

Another contemporary explanation of motivation, **equity theory** is based on individuals' perceptions about how fairly they are treated compared with their coworkers. In this context, equity means justice or fairness, and in the workplace it refers to employees' perceived fairness of the way they are treated and the rewards they earn. For example, imagine that after graduation you were offered a job that paid $55,000 a year and had great benefits. You'd probably be ecstatic, even more so if you discovered that the coworker in the next cubicle was making $45,000 for the same job. But what if that same colleague were making $59,000 for the same job? You'd probably think it unfair, particularly if the coworker had the same qualifications and started at the same time as you did. Your determination of the fairness of the situation would depend on how you felt you compared to the other person, or referent. Employees evaluate their own *outcomes* (e.g., salary, benefits) in relation to their *inputs* (e.g., number of hours worked, education, and training) and then compare the outcomes-to-inputs ratio to one of the following: (1) the employee's own past experience in a different position in the current organization, (2) the employee's own past experience in a different organization, (3) another employee's experience inside the current organization, or (4) another employee's experience outside the organization.

According to equity theory, if employees perceive that an inequity exists, they will make one of the following choices:

- *Change their work habits* (exert less effort on the job)
- *Change their job benefits and income* (ask for a raise, steal from the employer)
- *Distort their perception of themselves* ("I always thought I was smart, but now I realize I'm a lot smarter than my coworkers.")
- *Distort their perceptions of others* ("Cameron's position is really much less flexible than mine.")
- *Look at the situation from a different perspective* ("I don't make as much as the other department heads, but I make a lot more than most graphic artists.")
- *Leave the situation* (quit the job)

Managers can use equity theory to improve worker satisfaction. Knowing that every employee seeks equitable and fair treatment, managers can make an effort to understand an employee's perceptions of fairness and take steps to reduce concerns about inequity.

Exhibit 9.8 Ben & Jerry's founders Ben Cohen and Jerry Greenfield firmly believe the maxim that companies "do well by doing good." This idealism led the founders to once famously swear that no Ben & Jerry's executive would ever make more than seven times the lowliest worker's wage. But when growth required attracting exceptional top-level management, the company eventually abandoned its self-imposed ratio between its lowest and highest compensation rates. *How might perceived inequities in pay affect worker satisfaction and motivation?* (Credit: Mike Mozart/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Goal-Setting Theory

Goal-setting theory is based on the premise that an individual's intention to work toward a goal is a primary source of motivation. Once set, the goal clarifies for the employee what needs to be accomplished and how much effort will be required for completion. The theory has three main components: (1) specific goals lead to a higher level of performance than do more generalized goals ("do your best"); (2) more difficult goals lead to better performance than do easy goals (provided the individual accepts the goal); and (3) feedback on progress toward the goal enhances performance. Feedback is particularly important because it helps the individual identify the gap between the *real* (the actual performance) and the *ideal* (the desired outcome defined by the goal). Given the trend toward employee empowerment in the workplace, more and more employees are participating in the goal-setting process.

To help employees during peak holiday delivery seasons, UPS, FedEx and the U.S. Postal Service often pay additional overtime to help achieve their goals. These companies strategically plan for the peak by hiring seasonal workers. For example, UPS hires over 100,000 seasonal employees to meet its team goals of on-time delivery. This strategy seems to work, with UPS reporting an on-time delivery rate of around 96 percent for the peak holiday season.[5]

Reinforcement Theory

Reinforcement theory says that behavior is a function of its consequences. In other words, people do things because they know other things will follow. So, depending on what type of consequences follows, people will either practice a behavior or refrain from it. There are three basic types of consequences: positive, negative, and none. In general, we think of positive consequences as rewards, but a **reward** is anything that increases the particular behavior. By contrast, **punishment** is anything that decreases the behavior.

Motivating with the reinforcement theory can be tricky because the theory is functional. All of its components are defined by their function rather than their structure. That is, consequences can operate differently for different people and in different situations. What is considered a punishment by one person may, in fact, be a reward for another. Nonetheless, managers can successfully use reinforcement theory to motivate workers to practice certain behaviors and avoid others. Often, managers use both rewards and punishment to achieve the desired results.

For example, retailers have long needed additional help during peak selling days like Black Friday and Cyber Monday. To help meet these needs, Urban Outfitters recruited salaried workers for a six-hour shift at its new fulfillment facility to help out some of their colleagues and sold the idea to salaried employees as a team-building activity. The workers were offered transportation and paid lunches and asked to wear comfortable shoes. Although it was not mandatory, an Urban Outfitters spokesperson commented: "After successfully opening our new fulfillment center in June, we asked salaried employees at our home office to volunteer for shifts that would help support the new center through a busy month of October. Unsurprisingly, we received a tremendous response, including many of our senior management."[6]

EXPANDING AROUND THE GLOBE

Motivation Is Culture Bound

Most motivation theories in use today were developed in the United States by Americans and about Americans. Of those that were not, many have been strongly influenced by American theories. But several motivation theories do not apply to all cultures. For example, Maslow's theory does not often hold outside the United States. In countries higher on uncertainty avoidance (such as Greece, Portugal, and Belgium) as compared with those lower on uncertainty avoidance (such as Denmark and Singapore), security motivates employees more strongly than does self-actualization. Employees in high-uncertainty-avoidance countries often consider job security and lifetime employment more important than holding a more interesting or challenging job. Also contrasting with the American pattern, social needs often dominate the motivation of workers in countries such as Luxembourg, Denmark, and the Netherlands that stress the quality of life over materialism and productivity.

When researchers tested Herzberg's theory outside the United States, they encountered different results. In New Zealand, for example, supervision and interpersonal relationships appear to contribute significantly to satisfaction and not merely to reducing dissatisfaction. Similarly, researchers found that individuals in Asia, Canada, and Latin America cited certain extrinsic factors as being satisfying at a greater frequency than did their U.S. counterparts. In other words, the factors that motivate U.S. employees may not spark the same motivation in employees in other cultures. Some of the major differences among the cultural groups include the following:

1. Individualistic countries such as the United States and many Western European countries rank personal achievement high and supportive management lower in terms of motivators.
2. Collectivist countries such as France, Japan, and Brazil give greater importance to security and less importance to personal recognition.

3. Northern European countries such as Sweden have less interest in getting ahead and work towards recognition goals and place more emphasis on job accomplishment. In addition, they have more concern for people and less for the organization as a whole (it is important that their jobs not interfere with their personal lives).
4. Latin American and Southern European countries find individual achievement somewhat less important; Southern Europeans place the highest emphasis on job security, whereas both groups of countries emphasize fringe benefits.
5. Germany ranks high on security and fringe benefits and among the highest on getting ahead.
6. Japan, although low on advancement, also ranks second-highest on challenge and lowest on autonomy, with a strong emphasis on good working conditions and a friendly working environment.

Critical Thinking Questions

1. In today's global business environment, with its diversity of perspectives, can a manager ever successfully use equity theory? Why or why not?
2. What impact, if any, do these cultural differences have on managers managing an entirely American workforce? Explain.

Sources: Adapted from Nancy J. Adler and Allison Gunderson, *International Dimensions of Organizational Behavior*, 5th ed. (Cengage Learning, 2008), pp. 174–181; "Motivation across Cultures: Same Value-Different Approach," *Authentic Journeys*, https://blog.authenticjourneys.info, July 10, 2014; "Uncertainty Avoidance," https://clearlycultural.com, accessed February 9, 2026; "Power Distance Index," https://clearlycultural.com, accessed February 9, 2026; Marcus Lu, "Ranked: The Top 30 Countries by Quality of Life," *Visual Capitalist*, https://www.visualcapitalist.com, November 1, 2025; G. H. Hines, "Cross-Cultural Differences in Two-Factor Motivation Theory," *Journal of Applied Psychology*, Volume 58, Issue 3, pp. 375–377, https://doi.org/10.1037/h0036299, 1973; Prince Kumar, " Understanding Herzberg's Two-Factor Theory in Different Cultures," *The MBA Institute*, https://themba.institute, January 15, 2024.

CONCEPT CHECK

1. Discuss the three relationships central to expectancy theory.
2. Explain the comparison process that is a part of equity theory.
3. How does goal-setting theory contribute to our understanding of motivation?
4. What are the main elements of reinforcement theory?

9.7 From Motivation Theory to Application

7. How can managers redesign existing jobs to increase employee motivation and performance?

The material presented thus far in this chapter demonstrates the wide variety of theorists and research studies that have contributed to our current understanding of employee motivation. Now we turn our attention to more practical matters, to ways that these concepts can be applied in the workplace to meet organizational goals and improve individual performance.

Motivational Job Design

How might managers redesign or modify existing jobs to increase employee motivation and performance? The following three options have been used extensively in the workplace:

- *Job enlargement*. The horizontal expansion of a job, increasing the number and variety of tasks that a

person performs, is called **job enlargement**. Increasing task diversity can enhance job satisfaction, particularly when the job is mundane and repetitive in nature. A potential drawback to job enlargement is that employees may perceive that they are being asked to work harder and do more with no change in their level of responsibility or compensation. This can cause resentment and lead to dissatisfaction.

- *Job enrichment*. **Job enrichment** is the vertical expansion of an employee's job. Whereas job enlargement addresses the breadth or scope of a job, enrichment attempts to increase job depth by providing the employee with more autonomy, responsibility, and decision-making authority. In an enriched job, the employee can use a variety of talents and skills and has more control over the planning, execution, and evaluation of the required tasks. In general, job enrichment has been found to increase job satisfaction and reduce absenteeism and turnover.
- *Job rotation*. Also called *cross-training,* **job rotation** is the shifting of workers from one job to another. This may be done to broaden an employee's skill base or because an employee has ceased to be interested in or challenged by a particular job. The organization may benefit from job rotation because it increases flexibility in scheduling and production and because employees can be shifted to cover for absent workers or changes in production or operations. It is also a valuable tool for training lower-level managers in a variety of functional areas. Drawbacks of job rotation include an increase in training costs and decreased productivity while employees are getting "up to speed" in new task areas.

Work-Scheduling Options

As companies try to meet the needs of a diverse workforce and retain quality employees while remaining competitive and financially prosperous, managers are challenged to find new ways to keep workers motivated and satisfied. Today, there are many alternatives to the traditional work schedule, such as flexible hours, a compressed work week, remote options, and job sharing.

One option for employees who want a work schedule that can change as their life needs change is a flexible work arrangement (FWA), in use at nearly 70 percent of U.S. companies.[7] Flextime allows employees to decide what their work hours will be. Employees are generally expected to work a certain number of hours per week but have some discretion as to when they arrive at work and when they leave for the day.

Another option for employees who want to maximize their leisure hours, indulge in three-day weekends, and avoid commuting during morning and evening rush hours is the *compressed workweek.* Employees work the traditional 40 hours, but fit those hours into a shorter workweek. Most common is the 4-40 schedule, where employees work four 10-hour days a week. Organizations that offer this option claim benefits ranging from increased motivation and productivity to reduced absenteeism and turnover. SHRM's Employee Benefits Survey has shown that compressed workweeks are offered by a minority of employers and have fluctuated over time; for example, the share of companies providing a compressed workweek fell from 35 percent in 2013 to 29 percent in 2017. One of the reasons for the downward trend may be the increasing popularity of a four-day workweek.[8]

A four-day workweek, where employees work 32 hours or less, has also gained popularity. Data today show that nearly 60 percent of companies are open to a compressed or four-day workweek. In 2016, Amazon announced a pilot project that allowed some tech teams in their human resources department to work fewer hours for 75 percent of pay but retain the same benefits as full-time employees. In contrast, Tower Paddle Boards routinely offers reduced workday hours as an incentive a few months annually for any years when business increased over the previous year. Employees retain the same pay and obligations as before so are challenged to be more productive in less time.[9]

Telecommuting is a work-scheduling option that allows employees to work from home via a computer that is linked with their office, headquarters, or colleagues. During the COVID-19 pandemic, telecommuting became a necessity. With mandated shutdowns, companies had to pivot to alternative work arrangements. Telecommuting coupled with video conferencing technologies allowed companies to continue to operate despite the shutdowns. The remote working option is still utilized by many organizations post-pandemic. Often

employers will use a mix of these scheduling options depending on the situation. Jacquelyn Pawela-Crew was a group leader in Intel's management engineering unit who worked a compressed schedule. She worked Monday through Thursday, and on two of those days she telecommuted from her home. On the other two days, she worked a flexible schedule, sometimes getting to the office at 6 a.m., so she could be home when her children came home from school. Her former manager, Dan Enloe, was a U.S. Navy reservist and divorced dad, so he also used Intel's flexible schedule to meet his military and family needs.[10] He saw the flexible scheduling as a key motivator for Intel's employees. "I've had workers tell me flat out, they were going to leave Intel if they didn't have the option of some flexibility with their schedules," he says.[11] Ricardo Semler, CEO of Semco, a Brazilian conglomerate, sums up flexible work schedules this way: "The essence to us [at Semco] was that people who are free people, who [can act] based on self-interest, who can balance their own lives, are much happier, more productive people. If you take a business call on a Sunday afternoon, for instance, why not go to the movies on a Monday?" Semco's employees not only choose their own schedules, they often choose which part of the business to work for and even how much they'll be paid.[12]

Job sharing is a scheduling option that allows two individuals to split the tasks, responsibilities, and work hours of one 40-hour-per-week job. Though used less frequently than flextime and the compressed workweek, this option can also provide employees with job flexibility. The primary benefit to the company is that it gets "two for the price of one"—the company can draw on two sets of skills and abilities to accomplish one set of job objectives. Mary Kaye Stuart is an account executive at a broadcasting company in Austin, Texas. After her doctor warned her that the stress of her 100-mile commute could shorten her life, she pursued job sharing. She teamed up with a former coworker, and each works three days a week, working together on Wednesdays. "Job sharing is a great solution to keeping people from burning out and preventing turnover," says Melissa Nicholson. She believes in the power of job sharing so much that, after years of doing it herself, she founded Work Muse to help companies set up job-share arrangements. Not all partnerships have been successful, she admits, but when they are, she loves having the ability to be flexible and for the workers to cover each other and support each other. "I'm able to just not think about email or work for four days a week," she said. "That's just an impossibility for most people."[13]

Although each of these work-scheduling options may have some drawbacks for the sponsoring organizations, the benefits far outweigh the problems. In 2025, 33 percent of the U.S. workforce engaged in flexible work arrangements, and this is expected to increase.

Recognition and Empowerment

All employees have unique needs that they seek to fulfill through their jobs. Organizations must devise a wide array of incentives to ensure that a broad spectrum of employee needs can be addressed in the work environment, thus increasing the likelihood of motivated employees. A sampling of these motivational tools is discussed here.

Formal recognition of superior effort by individuals or groups in the workplace is one way to enhance employee motivation. Recognition serves as positive feedback and reinforcement, letting employees know what they have done well and that their contribution is valued by the organization. Recognition can take many forms, both formal and informal. Some companies use formal awards ceremonies to acknowledge and celebrate their employees' accomplishments. Others take advantage of informal interaction to congratulate employees on a job well done and offer encouragement for the future. Recognition can take the form of a monetary reward, a day off, a congratulatory e-mail, or a verbal "pat on the back." Recognition does not have to come from superiors to be meaningful, however. At The Motley Fool, a financial services company dedicated to helping people invest better, employees use a workplace app to recognize the contributions of coworkers. In the app, employees are given "gold" to spend by thanking or complimenting one other along with a statement of what the recipient did to earn it. The recipients cash in the gold for real prizes or gift cards. Employees say this type of recognition may be better than management recognition.[14]

Employee empowerment, sometimes called employee involvement or participative management, involves

delegating decision-making authority to employees at all levels of the organization, trusting employees to make the right decision. Employees are given greater responsibility for planning, implementing, and evaluating the results of decisions. Empowerment is based on the premise that human resources, especially at lower levels in the firm, are an underutilized asset. Employees are capable of contributing much more of their skills and abilities to organizational success if they are allowed to participate in the decision-making process and are given access to the resources needed to implement their decisions. Netflix removes obstacles by utilizing a "No Rules" HR policy that eliminates most policies and procedures to show its trust in employee decision-making, including in decisions about expenses and vacations. Netflix hires “fully formed adults” and tells them to use their best judgment to act in the company’s best interest. The company believes employees will be more productive if not bound by processes. These practices play a significant role in Netflix's success. The company is the leader for streaming services with over 260 million subscribers and is in the top 5 percent of companies for employee retention.[15]

Economic Incentives

Any discussion of motivation has to include the use of monetary incentives to enhance performance. Currently, companies are using a variety of variable-pay programs such as piece-rate plans, profit sharing, gain sharing, stock options, and bonuses to encourage employees to be more productive. Unlike the standard salary or hourly wage, variable pay means that a portion of an employee’s pay is directly linked to an individual or organizational performance measure. In *piece-rate pay plans,* for example, employees are paid a given amount for each unit they produce, directly linking the amount they earn to their productivity. *Profit-sharing plans* are based on overall company profitability. Using an established formula, management distributes some portion of company profits to all employees. *Gain-sharing plans* are incentive programs based on group productivity. Employees share in the financial gains attributed to the increased productivity of their group. This encourages employees to increase productivity within their specific work area regardless of the overall profit picture for the organization as a whole.

One well-known approach to monetary incentives is the award of *stock options*, or giving employees the right to purchase a given amount of stock at below-market prices. Stock can be a strong motivator because those who receive the options have the chance to make a lot of money. Tax incentive changes can impact how much equity (stock) companies offer, but in 2025, over 40 percent of companies offered employee stock options.[16]

One popular incentive is the bonus. A *bonus* is simply a one-time lump-sum monetary award. In many cases, employees receive bonuses for achieving a particular performance level, such as meeting or exceeding a sales quota, and it is not uncommon for bonuses to be substantial. Google created a Founders’ Award and gave millions in restricted stock to the winners when the award was active, a huge spot bonus for great work on a project. On average, yearly bonuses for employees range between 15 and 25 percent, determined by employee performance.

That’s not to say that small bonuses aren’t good motivators. Google discovered the large range in values for the award created jealousy instead of fostering better teamwork. Based on employee input, Google added non-monetary awards such as gifts and trips into their awards structure.[17] “Spot” bonuses allow companies to target employees that impact the bottom line and can help motivate average employees. Sarah Clausen received her first bonus from Dallas-based Associa, a property management company, for overseeing the rollout of video-based town halls. “It really creates a feeling that your work is being valued and appreciated,” she says. “It definitely leads me to want to stay here and do a good job.”[18]

Regardless of their size, bonuses can be an additional way companies recognize employees for a job well done and motivate them to perform at even higher levels. That is because bonuses can vary according to outcomes. Financial incentives that allow variability in compensation to reflect an individual employee’s contribution are generally known as *pay-for-performance* programs. One of the many companies that use pay-for-performance programs is Allstate, which evaluates employees' individual performance on a scale. The size of the employee's bonus depends on their rating. For example, one employee might receive a bonus of $3,200, but another with

the same job title with a higher performance rating might receive $4,000. The pay-for-performance approach can also be used for CEOs. Jane Fraser of Citigroup was the first woman to lead a major U.S. bank when she became CEO in 2021. Her compensation is over $25 million, which includes a base salary and annual bonuses that are tied to the company's performance. Bonuses are a combination of monetary awards as well as equity (stock).[19] Data indicate that over three-quarters of businesses utilize some kind of pay-for-performance structure in their compensation packages. The percentage fluctuates widely by industry with the finance and banking industries offering the highest percentages, as much as 50 percent of the employee's base salary, and retail being the lowest around 2 to 5 percent. The average across all industries is approximately 10 percent.[20]

CONCEPT CHECK

1. Explain the difference between job enlargement and job enrichment.
2. What are the four work-scheduling options that can enhance employee performance?
3. Are all employees motivated by the same economic incentives? Explain.

9.8 Trends in Employee Motivation

8. What initiatives are organizations using today to motivate and retain employees?

This chapter has focused on understanding what motivates people and how employee motivation and satisfaction affect productivity and organizational performance. Organizations can improve performance by investing in people. There are several ways to invest in employees, including: (1) development opportunities through education and training, (2) employee ownership, (3) work-life benefits to help employees outside of the workplace, and (4) nurturing knowledge workers and their increasing significance. All of the companies making *Fortune*'s annual list of the "100 Best Companies to Work For" know the importance of treating employees right. They all have programs that allow them to invest in their employees through programs such as these and many more. This section discusses each of these trends in motivating employees.

Education and Training

Companies that provide educational and training opportunities for their employees reap the benefits of a more motivated, as well as a more skilled, workforce. Employees who are properly trained in new technologies are more productive and less resistant to job change. Education and training provide additional benefits by increasing employees' feelings of competence and self-worth. When companies spend money to upgrade employee knowledge and skills, they convey the message "we value you and are committed to your growth and development as an employee."

CATCHING THE ENTREPRENEURIAL SPIRIT

Everyone's a CFO

Andrew Levine, chairman of DCI (Development Counsellors International), a New York-based place-marketing and public relations firm, wanted to implement a more open management style at his company, so he added a financial segment to monthly staff meetings, during which he would share results and trends with his employees. Much to his surprise, employees seemed bored. During one staff meeting he asked his employees how to calculate a profit, and only one employee knew how. Levine was astounded, both at his employees' general deficit in math concepts and at Barrios' knack for figures. Levine then decided to require employees to present the financial reports themselves.

For the next staff meeting, Levine appointed Barrios the chief financial officer (CFO) of the day. Barrios explained the terminology in ways the average person could understand. Since the changes, employees have become well versed in financial concepts. The employee assigned as "CFO for the day" meets with DCI's actual CFO prior to their scheduled presentation day. In this meeting, they review income, expenses, and other relevant financial information and statements. They discuss the revenue projections and general financial trends. The "CFO of the day" then prepares a presentation to share at the staff meeting. Employees at all levels think the training is beneficial for the company, stating that employees are trained not only in their job position, but also as a business executive. When an employee's turn comes around, they stand before their colleagues and deliver the financial numbers and trends. Employees presenting are encouraged to involve their co-workers in the discussion by asking questions of the audience and collaborating toward a mutual understanding of what the numbers are indicating about the company performance.

“CFO of the day” has definitely been a good thing for DCI, which remains profitable. Employee and customer retention remain high.

Levine has embraced the lessons of open management, or participative management. Participative management practices, such as open-book management, were popularized by Jack Stack and Springfield Remanufacturing Corporation (SRC). Whether the term is CFO for a day, participative or open-book management, or great game of business, the goal is to teach employees about business, thereby engaging them in the business. Companies that embrace these practices believe employees will be more productive if they understand financials and feel like owners. And in the example of DCI, employees are no longer bored during the financial review section of the monthly meeting.

Sources: Peter Carbonara, “Small Business Guide: What Owners Need to Know about Open-Book Management,” *Forbes*, https://www.forbes.com, accessed January 19, 2018; Peter Carbonara, “Gaming the System: How a Traditional Manufacturer Opened Its Books and Turned Employees into Millionaires,” *Forbes*, https://www.forbes.com, accessed January 19, 2018; Nadine Heintz, “Everyone’s a CFO,” *Inc.,* https://www.inc.com, accessed January 15, 2018; Bill Fotsch and John Case, “The Business Case for Open-Book Management,” *Forbes*, https://www.forbes.com, accessed January 19, 2018; Louis Mosca, “The Dangers of Opening Your Books to Employees,” *Forbes*, https://www.forbes.com, accessed January 19, 2018; "DCI's Team," https://aboutdci.com, accessed February 9, 2026.

Critical Thinking Questions

1. Do you think a CFO-of-the-day program is a good idea for all companies? Why or why not?
2. How comfortable would you be leading the financial discussion at a monthly staff meeting? What could you do to improve your skills in this area?

Employee Ownership

A trend that continues in many compensation and benefits plans is employee ownership, most commonly implemented as employee stock ownership plans, or *ESOPs*. ESOPs are not the same as stock options, however. In an ESOP, employees receive compensation in the form of company stock. Recall that stock options give employees the opportunity to purchase company stock at a set price, even if the market price of the stock increases above that point. Because ESOP employees are compensated with stock, over time they can become the owners of the company, which is attractive because if they leave the company they retain their stock ownership. Behind employee ownership programs is the belief that employees who think like owners are more motivated to take care of customers’ needs, reduce unnecessary expenses, make operations smoother, and stay with the company longer.

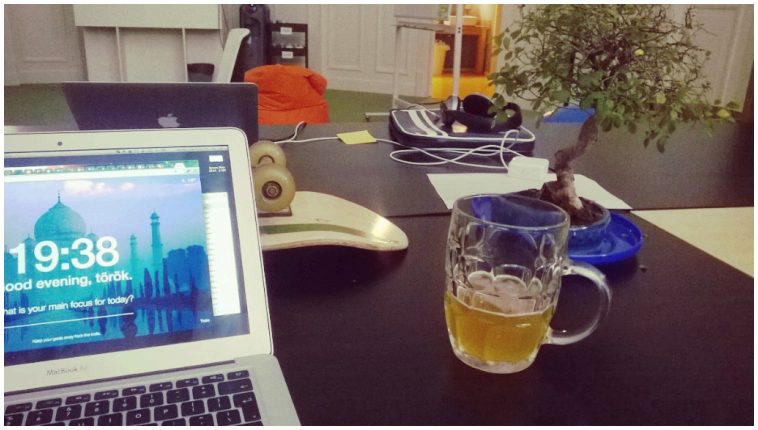

Exhibit 9.9 Companies sometimes create unusual perks to help attract and retain talented workers. Duolingo employees receive a fully paid sabbatical after 10 years and assistance toward back-up childcare. Worthington Industries offers workers on-site haircuts and fitness centers at some of their work locations. SC Johnson provides benefits for employees' families, including adoption leave, family volunteer events, and scholarships for students. One company even has a beer tap that it offers after 3 p.m. every Friday to get workers off to a relaxing weekend. *What trends are emerging in the ways companies seek to motivate workers and keep them happy on the job?* (Credit: nyuhuhuu/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

According to the National Center for Employee Ownership, there are over 6,000 ESOPs in the United States, with a total of 15 million participants.[21] Changes in tax laws can impact ESOPs; however, the amount of stock held by ESOPs in 2023 was over $2.1 trillion and is expected to increase.[22] Employee ownership plans continue to be a powerful competitive tool in employee recruitment and retention.[23]

ESOPs, however, also have drawbacks. The biggest concern is that some employees have so much of their retirement savings tied to their company's ESOP. If the company's performance starts to decline, they risk losing a significant portion of their wealth. This is what happened at former grocery store chain Piggly Wiggly Carolina. Business started to decline. Employee and retirees watched as senior management made decisions to raise prices and then sell stores. The share value started to decline in the early 2000s, losing significant value, until employees received notice that they would not get their distributions. Company executives stated they planned to make future payments when financial conditions improved. Employees filed a lawsuit in 2018 alleging senior management violated their duties by not acting as the stock value lost 90 percent of its value. The case was settled for nearly $9 million, with employees receiving a payout of approximately $1,000.[24]

Still, many companies successfully implement ESOPs. Axia Home Loans, a national residential mortgage lender based in Seattle, experienced record-breaking production and was able to attract top talent in the first year after creating its ESOP. After taking questions from non-managing shareholders about exit strategies, Gellert Dornay, president and CEO, looked into an ESOP and thought it would fit with the company's innovative and forward-thinking culture. "Studies show that employee-owned companies experience increased employee satisfaction, retention, and productivity gains," Dornay said, adding, "an ESOP rewards employees who contribute to the company's success by allowing them to share in the company's future increase in value."[25]

So what enables one company with an ESOP, such as Axia Home Loans, to be more successful than another, such as Piggly Wiggly? It has a lot to do with the way companies treat employees. You can't just call an employee an owner and expect them to respond positively. You have to do something to make them feel like an owner and then involve them as owners. Piggly Wiggly illustrates that employee ownership is not a magic elixir. "When employees run the company, our decision methodology is different. Everything is in the primary best interest of the shareholders, who are the employees," Dornay said.[26]

Work-Life Benefits

In recognition of the numerous and sometimes competing demands on employees' time, companies are looking for ways to help. Organizations are taking an active role in helping employees achieve a balance between their work responsibilities and their personal obligations. The desired result is employees who are less stressed, better able to focus on their jobs, and, therefore, more productive. One tool companies can use

to help their employees is extended leave through sabbaticals. Sabbaticals can be traced back to ancient times and Hebrew Sabbath practices. Modern sabbaticals are rooted in higher education, first being offered at Harvard to faculty to conduct research in the late 1800s. Today, corporations have adopted the practice to assist with work-life balance and employee burnout. Sabbaticals offer employees extended time away from work, that can be paid or unpaid depending on company policies. In today's business environment, companies are juggling cutting costs and increasing profits while simultaneously battling to keep employees motivated and positive about work. Sabbaticals can be an important tool to help managers achieve this balancing act.

Reports vary on the percentage of companies that offer sabbaticals; however, offering employees this option can be an innovative tool to both recruit and retain employees.[27] One benefit is that employees return refreshed and recharged. Morris Financial Concepts, Inc., a small financial planning firm, offers all full-time employees a paid, month-long sabbatical every five years. Kyra Morris, president and owner, says employees were working during vacations, even when discouraged not to. They are required to unplug during sabbaticals. Morris says sabbaticals work for both millennials and older employees and are a great recruiting tool.[28] Zillow, the online real estate giant, offers six-week half-paid sabbaticals to employees at all levels of the organization after six years. Amy Bohutinsky, Zillow Group's former chief operating officer and now board director, says the company wants to reward long-term employees, encourage them to have a life outside of work, and have them come back recharged.[29] Another benefit is the opportunity to learn new skills, which can be an alternative to layoffs. Buffer, a social media management platform, has offered various sabbatical programs, including ones to help employees learn new skills to successfully transition into another department. Learning sabbaticals fit the company's value of self-improvement.[30]

Nurturing Knowledge and Learning Workers

Most organizations have specialized workers, and managing them all effectively is a big challenge. In many companies, knowledge workers may have a supervisor, but they are not "subordinates." They are "associates." Within their area of knowledge, they are supposed to do the telling. Because knowledge is effective only if specialized, knowledge workers are not homogeneous, particularly the fast-growing group of knowledge technologists such as data analytic specialists, programmers, and AI engineers. The rapidly growing AI industry is shaping workplace needs, especially for knowledge workers, many of whom are freelancers (about 25 percent). Companies need employees with both technical skills as well as critical thinking and problem-solving abilities. AI engineers, developers, and consultants are working with companies of all sizes to assist with integrating this technology into their businesses. Because of the pace of change with AI, companies are looking to freelancers for this work as they are often nearly 40 percent more efficient than their full-time employee counterparts with these skills.[31]

A knowledge-based workforce is qualitatively different from a less-skilled workforce. Increasingly, the success—indeed, the survival—of every business will depend on the performance of its knowledge workforce. The challenging part of managing knowledge workers is finding ways to motivate proud, skilled professionals to share expertise and cooperate in such a way that they advance the frontiers of their knowledge to the benefit of the shareholders and society in general. To achieve that auspicious goal, several companies have created what they call "communities of practice."

Exhibit 9.10 Employers seeking to stem the rising tide of absenteeism are developing innovative, flexible benefits for their employees. SC Johnson offers workers both child and adult care, along with financial coaching and an emotional wellbeing program. Prudential allows employees to take time off to care for sick children and elderly parents. Hewlett-Packard boasts a range of hybrid and flexible work options along with many programs for employee wellbeing. *Do flexible options and benefits adequately address the root causes of absenteeism?* (Credit: MarylandGovPics/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Coping with the Rising Costs of Absenteeism

With today's companies trying to do more work with fewer employees, managers must be attentive to the impact morale and employee performance have on absenteeism and turnover. According to the Bureau of Labor Statistics, the absence rate remains relatively steady around 2 to 4 percent for a variety of causes, including illness, childcare challenges, family care obligations, mental health needs, and transportation issues.[32] It is estimated that employee absences cost companies as much as $575 billion annually.[33] However, not all reasons for unscheduled absences are genuine. Although data show that around 2 percent of workplace absences are because of illness, there is some concern that employees are not really sick when they call in for an unscheduled absence. There are various reasons for an employee calling in sick when they are not really ill, including work burnout, mental health needs, home or family obligations, or lack of motivation to go into the workplace.[34]

While some employees are taking a day off, employees covering for unscheduled absences are pushed to do more. The result is lower productivity and lower morale, especially if chronic absenteeism is not addressed. In addition to an attendance policy, offering incentives for attendance, wellness programs, employee assistance programs, and other benefits that show care for employees can lower absenteeism rates.[35]

MANAGING CHANGE

Using Communities of Practice to Motivate Knowledge Workers

Communities of practice (CoP) have been so named since the early 1990s as a way to motivate and engage employees. One company that has experienced tremendous success with CoPs is Schlumberger Limited, an oil-field-services company with over $35 billion in annual revenue. As with all CoPs, what Schlumberger calls Eureka groups are comprised of similar professional employees from across the entire organization. Employees participate in one or more of 284 Eureka groups ranging from chemistry to oil-well engineering.

Before the establishment of the communities, Schlumberger's engineers, physicists, and geologists worked

well on individual projects, but the company was ignorant of how to help its employees develop the professional sides of their lives. Since the company sells services and expertise, motivating and cultivating its knowledge workers was a critical success factor. Former CEO Euan Baird felt he had tried everything to manage and motivate the company's technical professionals—and failed. That's when he decided to let them manage themselves. He ordered Schlumberger veteran Henry Edmundson to implement communities of practice.

Schlumberger's Eureka communities have been a tremendous success and helped the company leverage its knowledge assets. Today, self-created CVs are posted on the company's internal website, allowing employees across the 85 countries where the company operates to consult the résumé of nearly every company employee to find someone with a particular area of knowledge or expertise. Another reason the Eureka groups are so successful is that they are completely democratic. Participating employees vote on who will lead each community. An employee who is backed by his or her manager and at least one other community member can run for a term of office that lasts one year. At the time, the elected leaders of Schlumberger's Eureka communities cost the company about $1 million a year. "Compared with other knowledge initiatives, it's a cheapie," said Edmundson.

John Afilaka, a geological engineer who was a Schlumberger business-development manager in Nigeria, stood for election to the head of the company's rock-characterization community, a group of more than 1,000 people who are experts in determining what might be in an underground reservoir. He beat an opponent and spent 15 to 20 percent of his time organizing the group's annual conference and occasional workshops, overseeing the group's website, coordinating subgroups, and so forth.

Retired CEO Andrew Gould says the self-governing feature is crucial to the Eureka communities' success. Technical professionals are often motivated by peer review and peer esteem, he says, implying that stock options and corner offices aren't sufficient. The election of leaders, he says, "ensures the integrity of peer judgments."

Schlumberger's use of CoPs is known worldwide. The company has been a 12-time European MAKE (Most Admired Knowledge Enterprises) winner, and declared the overall winner three times, most recently in 2017.

Critical Thinking Questions

1. How do you think communities of practice help companies like Schlumberger manage in dynamic business environments?
2. Although communities of practice are commonly thought of in regard to knowledge workers, could they successfully motivate other employees as well? Why do you think as you do?

Sources: Rory L. Chase, "2017 European Most Admired Knowledge Enterprises MAKE Report," *Teleos—The KNOW Network*, https://www.theknowledgebusiness.com, accessed January 24, 2018; "Schlumberger Cited for Knowledge Management," https://www.slb.com, accessed January 24, 2018; "2016 Annual Report," Schlumberger Limited, 2017; "John Afilaka," https://www.zoominfo.com, accessed January 24, 2018; "RezFlo Services Company Limited," https://www.rezflo.com/, accessed January 24, 2018; Olivia Pulsinelli, "Reemerged Energy Co. Hires Halliburton Exec, Names Former Energy CEOs to Board," *Houston Business Journal*, https://www.bizjournals.com, accessed January 24, 2018; Chris J. Collison, Paul J. Corney, and Patricia Lee Eng, "Knowledge Management in Schlumberger: 'Eureka!'" In: *The KM Cookbook: Stories and Strategies for Organisations Exploring Knowledge Management Standard ISO30401* (Cambridge University Press, 2019), pp. 111–120; "Eureka Moments," *SLB*, https://careers.slb.com, 2019.

Another trend related to employee morale and absenteeism is turnover. The number of employees who are job-searching is on the rise. A recent Gallup survey found that 51 percent of current employees are looking to leave their current job, but *Newsweek* reports that 92 percent are actively seeking new employment.[36] Both figures are great cause for concern. A high rate of turnover can be expensive and dampen the morale of other

employees who watch their colleagues leave the company. The top reasons cited for employee turnover are career opportunities, discontent with wages and benefits, and poor leadership.[37]

High rates of turnover (or absenteeism) at the management level can be destabilizing for employees, who need to develop specific strategies to manage a steady flow of new bosses. High rates of turnover (or absenteeism) at the employee level compromises the company's ability to perform at its highest levels. In order to stay competitive, companies need to have programs in place to motivate employees to come to work each day and to stay with the company year after year.

CONCEPT CHECK

1. What benefits can an organization derive from training and educational opportunities and stock ownership programs?
2. Why are sabbaticals growing in popularity as work-life balance tools?
3. How are knowledge workers different from traditional employees?
4. Why are absenteeism and turnover rates increasing, and what is the impact on companies?

Key Terms

equity theory A theory of motivation that holds that worker satisfaction is influenced by employees' perceptions about how fairly they are treated compared with their coworkers.

expectancy theory A theory of motivation that holds that the probability of an individual acting in a particular way depends on the strength of that individual's belief that the act will have a particular outcome and on whether the individual values that outcome.

goal-setting theory A theory of motivation based on the premise that an individual's intention to work toward a goal is a primary source of motivation.

Hawthorne effect The phenomenon that employees perform better when they feel singled out for attention or feel that management is concerned about their welfare.

hygiene factors Extrinsic elements of the work environment that do not serve as a source of employee satisfaction or motivation.

job enlargement The horizontal expansion of a job by increasing the number and variety of tasks that a person performs.

job enrichment The vertical expansion of a job by increasing the employee's autonomy, responsibility, and decision-making authority.

job rotation The shifting of workers from one job to another; also called cross-training.

job sharing A scheduling option that allows two individuals to split the tasks, responsibilities, and work hours of one 40-hour-per-week job.

Maslow's hierarchy of needs A theory of motivation developed by Abraham Maslow; holds that humans have five levels of needs and act to satisfy their unmet needs. At the base of the hierarchy are fundamental physiological needs, followed in order by safety, social, esteem, and self-actualization needs.

motivating factors Intrinsic job elements that lead to worker satisfaction.

motivation Something that prompts a person to release his or her energy in a certain direction.

need The gap between what is and what is required.

punishment Anything that decreases a specific behavior.

reinforcement theory A theory of motivation that holds that people do things because they know that certain consequences will follow.

reward Anything that increases a specific behavior.

scientific management A system of management developed by Frederick W. Taylor and based on four principles: developing a scientific approach for each element of a job, scientifically selecting and training workers, encouraging cooperation between workers and managers, and dividing work and responsibility between management and workers according to who can better perform a particular task.

Theory X A management style, formulated by Douglas McGregor, that is based on a pessimistic view of human nature and assumes that the average person dislikes work, will avoid it if possible, prefers to be directed, avoids responsibility, and wants security above all.

Theory Y A management style, formulated by Douglas McGregor, that is based on a relatively optimistic view of human nature; assumes that the average person wants to work, accepts responsibility, is willing to help solve problems, and can be self-directed and self-controlled.

Theory Z A theory developed by William Ouchi that combines U.S. and Japanese business practices by emphasizing long-term employment, slow career development, moderate specialization, group decision-making, individual responsibility, relatively informal control over the employee, and concern for workers.

want The gap between what is and what is desired.

Summary of Learning Outcomes

9.1 Early Theories of Motivation

1. What are the basic principles of Frederick Taylor's concept of scientific management?

Scientific management is based on the belief that employees are motivated by economic incentives and that

there is “one best way” to perform any job. The four basic principles of scientific management developed by Taylor are as follows:

1. Develop a scientific approach for each element of a person’s job.
2. Scientifically select, train, teach, and develop workers.
3. Encourage cooperation between workers and managers so that each job can be accomplished in a standard, scientifically determined way.
4. Divide work and responsibility between management and workers according to who is better suited to each task.

9.2 The Hawthorne Studies

2. What did Elton Mayo’s Hawthorne studies reveal about worker motivation?

The pride that comes from special attention motivates workers to increase their productivity. Supervisors who allow employees to have some control over their situation appeared to further increase the workers’ motivation. The Hawthorne effect suggests that employees will perform better when they feel singled out for special attention or feel that management is concerned about employee welfare.

9.3 Maslow's Hierarchy of Needs

3. What is Maslow’s hierarchy of needs, and how do these needs relate to employee motivation?

Maslow believed that each individual has a hierarchy of needs, consisting of physiological, safety, social, esteem, and self-actualization needs. Managers who accept Maslow’s ideas attempt to increase employee motivation by modifying organizational and managerial practices to increase the likelihood that employees will meet all levels of needs. Maslow’s theory has also helped managers understand that it is hard to motivate people by appealing to already-satisfied needs.

9.4 McGregor's Theories X and Y

4. How are McGregor’s Theories X and Y and Ouchi’s Theory Z used to explain worker motivation?

Douglas McGregor influenced the study of motivation with his formulation of two contrasting sets of assumptions about human nature—designated Theory X and Theory Y. Theory X says people don’t like to work and will avoid it if they can. Because people don’t like to work, they must be controlled, directed, or threatened to get them to make an effort. Theory Y says that people want to be self-directed and will try to accomplish goals that they believe in. Workers can be motivated with positive incentives. McGregor personally believed that Theory Y assumptions describe most employees and that managers seeking to motivate subordinates should develop management practices based on those assumptions.

William Ouchi’s Theory Z combines U.S. and Japanese business practices. Theory Z emphasizes long-term employment, slow career development, and group decision-making. By combining elements of both business practices, organizations can enhance employee engagement and appeal to the different motivating factors in a diverse workforce.

9.5 Herzberg's Motivator-Hygiene Theory

5. What are the basic components of Herzberg’s motivator-hygiene theory?

Frederick Herzberg’s studies indicated that certain job factors are consistently related to employee job satisfaction whereas others can create job dissatisfaction. According to Herzberg, motivating factors (also called satisfiers) are primarily intrinsic job elements that lead to satisfaction, such as achievement, recognition, the (nature of) work itself, responsibility, advancement, and growth. What Herzberg termed hygiene factors (also called dissatisfiers) are extrinsic elements of the work environment such as company policy, relationships with supervisors, working conditions, relationships with peers and subordinates, salary and benefits, and job security. These are factors that can result in job dissatisfaction if not well managed. One of the most

interesting results of Herzberg's studies was the implication that the opposite of satisfaction is not dissatisfaction. Herzberg believed that proper management of hygiene factors could prevent employee dissatisfaction, but that these factors could not serve as a source of satisfaction or motivation.

9.6 Contemporary Views on Motivation

6. What four contemporary theories on employee motivation offer insights into improving employee performance?

According to expectancy theory, the probability of an individual acting in a particular way depends on the strength of that individual's belief that the act will have a particular outcome and on whether the individual values that outcome. Equity theory is based on individuals' perceptions about how fairly they are treated compared with their coworkers. Goal-setting theory states that employees are highly motivated to perform when specific goals are established and feedback on progress is offered. Reinforcement theory states that behavior is a function of consequences; that is, people do things because they know other things will follow.

9.7 From Motivation Theory to Application

7. How can managers redesign existing jobs to increase employee motivation and performance?

The horizontal expansion of a job, which involves increasing the number and variety of tasks that a person performs, is called job enlargement. Increasing task diversity can enhance job satisfaction, particularly when the job is mundane and repetitive in nature. Job enrichment is the vertical expansion of an employee's job to provide the employee with more autonomy, responsibility, and decision-making authority. Other popular motivational tools include work-scheduling options, employee-recognition programs, empowerment, and variable-pay programs.

9.8 Trends in Employee Motivation

8. What initiatives are organizations using today to motivate and retain employees?

Today firms are using several key tactics to motivate and retain workers. First, companies are investing more in employee education and training, which makes employees more productive and confident in their jobs. Second, managers are giving employees the opportunity to participate in the ownership of the company, which can strongly increase employee commitment. Employers are providing more work-life benefits to employees, and a small but growing percentage of companies is offering employees paid sabbaticals in addition to regular vacation and sick time. As the composition of the workforce changes, it is becoming increasingly important for companies to understand how to manage knowledge workers. One method of doing this is establishing communities of practice that enable workers to share expertise across the organization. Finally, managers in today's business environment need to pay special attention to managing absence rates and employee (and management) turnover.

Preparing for Tomorrow's Workplace Skills

1. Are you motivated more by intrinsic rewards (satisfaction, sense of accomplishment, etc.) or by extrinsic rewards (money, bonuses, etc.)? Interview some friends and classmates to find out what motivates them. Discuss your differences in perspective. (Interpersonal, Information)
2. Think of a task or project you have completed recently that required a great deal of effort. What motivated you to exert so much energy to complete the task or project? Describe your motivation in terms of the theories presented in the chapter. (Systems)
3. Not all jobs are intrinsically motivating. For example, many entry-level jobs often involve repetitive and simple tasks that can become rapidly boring. (You may have worked a job that fits that description.) How can managers motivate frontline employees (such as package handlers, hotel front desk workers, supermarket cashiers, etc.) to perform at high levels? (Systems, Interpersonal)
4. If you were offered the opportunity to job-share, would you need to have a partner who was motivated by

the same things as you are? Why or why not? (Interpersonal)

5. **Team Activity** Assemble a team of three to five students. Imagine that you are the management team for a start-up business with limited resources but a need for a highly motivated, skilled workforce. Brainstorm ways you could motivate your employees other than large bonuses and high salaries. (Resources)

Ethics Activity

You join a large bank that encourages and promotes employee volunteerism, allowing employees one day a month, or up to 12 days a year, to volunteer for a cause of their choosing. Shortly after you start working there as a junior teller, your boss's spouse is diagnosed with a particularly aggressive form of breast cancer that carries a very poor prognosis. Realizing it will win you kudos with your boss, you choose the local chapter of the Susan G. Komen for the Cure foundation—a breast cancer charity that sponsors an annual Race for the Cure—for your company-sponsored volunteer work.

In addition to working at the foundation's office one day a month, you spend your own time actively soliciting other staffers at your firm to sign up for the charity walk in a few months' time. Impressed with your qualities of tireless dedication, your boss puts your name forward for promotion to junior bank officer, well before the customary two years of service normally required for being considered for promotion.

Using a web search tool, locate articles about this topic and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Your company is generous in its approach to employee volunteerism. It gives you paid time off, and you acquire enhanced job skills through your volunteer activities. Have you just been smart in recognizing the value of volunteering for a charity that you know will earn your boss's personal appreciation? Or are you taking unfair advantage of your boss's vulnerability and manipulating the situation?

Working the Net

1. Looking for 1,001 ways to motivate or reward your employees? Review this advice from Indeed (**https://www.indeed.com/career-advice/career-development/reward-employees**) and Bonusly (**https://bonusly.com/post/creative-employee-reward-ideas**) to get some ideas you can put to use to help you do a better job, either as a manager or as an employee.
2. Some companies offer their employees stock ownership plans. To learn the differences between an ESOP and stock options, visit the National Center for Employee Ownership (NCEO) at **https://www.nceo.org** and the Beyster Foundation for Enterprise Development at **https://beyster.com**. Which stock plan would you rather have? Why?
3. Open-book management is one of the better-known ways to create a participatory work environment. Over 2,000 companies have adopted this practice, which involves sharing financial information with nonmanagement employees and training them to understand financial information. Does it really motivate employees and improve productivity? The NCEO website, **https://www.nceo.org**, has a number of articles on open-book management. Search open-book management articles on their site to get more insight into this practice, and then develop your answers to this question.
4. You've been asked to develop a staff recognition program for your company but don't have a clue where to start. Two sites with articles and other useful information are *Incentive* magazine's "Their Strategy" page, **https://www.northstarmeetingsgroup.com/Incentive**, the Education Page of the National Association for Employee Recognition, **https://www.recognition.org**. Using the material you'll find there, outline the plan you would recommend for your company.
5. You have two great job opportunities. Both are equally attractive in terms of job content and offer the same salary. However, one offers year-end bonuses, whereas the other includes stock options for employees. How do you compare the offers? Learn how to evaluate stock options through a Secfi financial advisor's insights at **https://secfi.com/learn/how-to-negotiate-a-job-offer-stock-options**. Prepare a comparison of bonuses versus stock options, and determine which appeals to you more. Explain your

reasons.

6. Use a search engine to find companies that offer "work-life benefits." Link to several companies and review their employee programs in this area. How do they compare? Which benefits would be most important to you if you were job hunting, and why?

Critical Thinking Case

Motivating Employees: A Changing Landscape

As mentioned earlier, U.S. businesses will face a changing workforce and modest growth in numbers with employees from several different generations as individuals choose to work past the traditional retirement age. And with advances in technology, business needs are expected to evolve. Societal shifts, in part due to the COVID-19 pandemic, have employees thinking beyond their salary to aspects such as work-life balance, flexible work arrangements, and more engaging/meaningful work experiences. "Our study reveals that recruiters and hiring managers are not only cognizant of the issue but are concerned about its current and future impact on organizational growth," said Dr. Jesse Harriott, former vice president of research at monster.com (**https://www.monster.com**), one of the leading global online career and recruitment resources. "Businesses of all sizes and across all industries must develop and implement creative programs and strategies to attract and hire top candidates while retaining and motivating current employees. As the talent pool shrinks, it is imperative that immediate action is taken to ensure businesses are properly prepared and staffed for the future."

In a sampling of 1,000 individuals, McKinsey & Company's survey showed that employees are motivated by clear, consistent expectations, with 72 percent of those surveyed indicating goal-setting as a key motivator. The survey further found that opportunities for development through training and non-financial rewards were also sources of motivation to drive performance.

While compensation is clearly a significant issue, not all companies can offer this advantage. Other strategies that motivate employee loyalty and commitment are necessary.

Some of these include:

- encouraging work-life balance through creative benefit programs
- clearly articulating expectations and holding both employees and management accountable
- offering training and development opportunities for those interested in advancement
- considering a promote-from-within program
- employee/peer mentoring programs
- regular assessment of employee satisfaction
- regular and consistent performance feedback with rewards
- creating an engaging workplace that is not only designed to retain employees, but also to attract new talent

Diana Pohly, who led The Pohly Company (a Boston-based custom publishing firm), keeps vigilant watch over the morale of the office, ensuring that employees are satisfied. "Business owners of growing companies must possess strong leadership and management skills in order to solidify the foundation of their business," said Pohly. "Effective team leadership is imperative to sustain efficient team workflows and contribute to employee morale." Improving employee morale with creative and effective management tactics ultimately boosts employee productivity, and that goes straight to the bottom line.

Critical Thinking Questions

1. How are social and economic factors influencing companies' approach to hiring, motivating, and retaining employees?
2. What are some of the nonmonetary strategies companies must develop to attract and reward employees and keep them motivated?

3. What "reward factors" would be important to you when working for a company? List at least five in order of importance, and list your reasons for each.

Sources: "Company Overview of Globoforce Group plc," https://www.bloomberg.com, accessed January 24, 2018; "Diana Pohly," The Pohly Company, https://www.pohlyco.com, accessed January 24, 2018; "Poll Says Top-Performing Workers Motivated By Money," *Nation's Restaurant News,* April 25, 2005, https://www.findarticles.com; "Team Motivation: Women Business Owners Increase Productivity Through Effective Leadership," *Business Wire,* Oct 27, 2005, https://www.findarticles.com; Stephanie Ferguson Melhorn, Jenna Shrove, and Isabella Lucy, "Data Deep Dive: The Workforce of the Future," *U.S. Chamber of Commerce*, https://www.uschamber.com, October 4, 2023; Asmus Komm, Brooke Weddle, and Dana Maor, "What Employees Say Matters Most to Motivate Performance," *McKinsey & Company*, https://www.mckinsey.com, August 21, 2024.

Hot Links Address Book

1. What makes a company a good place to work? Find out by reading about the companies on *Fortune* magazine's "100 Best Companies to Work For" at **https://www.fortune.com**.
2. Expand your knowledge about motivation in the workplace through the lens of Positive Psychology, **https://positivepsychology.com/improving-motivation-at-work/**.
3. How do you keep employees satisfied? The Business Research Lab has a series of tips and articles, which you'll find at **https://www.nbrii.com/about/**.
4. Wish you could have flexible hours? For advice on making this wish come true, visit this Career Planning page on flextime, **https://www.thebalance.com/flextime-hours-and-benefits-1177979**.
5. Association for Talent Development is a professional association and leading resource on workplace learning and performance issues. Visit its site, **https://www.td.org/**, to learn more about it and these topics.

10

Achieving World-Class Operations Management

Exhibit 10.1 (Credit: U.S. Geological Survey / flickr/ Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. Why is production and operations management important in both manufacturing and service firms?
2. What types of production processes do manufacturers and service firms use?
3. How do organizations decide where to put their production facilities? What choices must be made in designing the facility?
4. Why are resource-planning tasks such as inventory management and supplier relations critical to production?
5. How do operations managers schedule and control production?
6. How can quality-management and lean-manufacturing techniques help firms improve production and operations management?
7. What roles do technology and automation play in manufacturing and service-industry operations management?
8. What key trends are affecting the way companies manage production and operations?

EXPLORING BUSINESS CAREERS

Deborah Butler, Caterpillar

Deborah Butler is a certified Master Black Belt, but don't expect to see her working with Jet Li anytime soon. In fact, her job has little to do with martial arts. Employed by Caterpillar—a global leader in the manufacture of equipment for construction, mining, and engineering—Butler's Master Black Belt status reflects her expertise in Six Sigma, the process Caterpillar employees use to continually manage, improve, and create processes, products, and services. "Sigma" refers to the standard deviation of the number of defects and is used to determine the defect tolerance levels in production or service delivery. "Six Sigma" is the highest level of quality control, which refers to three standard deviations above the average and three

standard deviations below the average to set the defect tolerance levels. That means if you were to use Six Sigma in your college career, you would miss only *one half of a single question* in over four years of test-taking!

In 2001, Caterpillar deployed Six Sigma globally by implementing the program not only to its then nearly 300 facilities, but also eventually to every dealer and more than 850 key suppliers throughout the world. The corporation hails the process as a key element of its overall operations management, attributing increased profits, improved customer service, and supply-chain efficiency to Six Sigma.

Caterpillar continues to maintain an extensive Six Sigma program with Master Black Belts leading projects and training Black Belts throughout the organization. *Our Values in Action: Caterpillar's Worldwide Code of Conduct* outlines five core values of integrity, excellence, teamwork, commitment, and sustainability—which embody two important aspects of the company's philosophy on Lean Six Sigma.

Sigma is a Greek letter that represents a statistical unit of measurement and defines standard deviation. Caterpillar uses this standard deviation for the number of errors in a product, which equates to 3.4 errors per million. Six Sigma is designed to reduce the number of errors in a process by a step-by-step approach. Caterpillar uses the Six Sigma methodology that utilizes the process of gathering information, analyzing the data, and then making decisions based on the facts. This process ensures that Caterpillar is meeting the requirements of the customer.

Caterpillar recognizes that employees are the heart of any operation. Therefore, Caterpillar employees use Six Sigma to improve as people and as workers as much as to improve the products they produce. The core values, reflected in a series of action statements such as "We put Integrity in action when we compete fairly," are the product of a yearlong development process involving Butler's global team. As part of the project research, the team interviewed thousands of Caterpillar employees, from officers of the company to production and hourly workers, for the purpose of, as Butler says, "bringing to the surface the values that have made Caterpillar a successful enterprise, enhancing behavioral expectations, and accurately expressing Caterpillar's corporate culture."

Caterpillar is not content simply to produce *Our Values in Action* and leave it at that, however, and the second aspect of its Six Sigma philosophy is that employees must bring the process to their lives. The company strives to inject the code of conduct's values into employees' day-to-day work. If an employee writes about safety-related changes, for example, she would not just list the changes. Instead, she might write first: "According to Our Values In Action, we put Commitment in action when we protect the health and safety of others and ourselves. As such, we are implementing the following changes. . . ." In this way, the code becomes a living part of corporate culture, a critical component of operations management.

Sources: Heather McBroom, "6 Sigma: Foundation for Quality at Caterpillar," *Peoria Magazine*, https://www.peoriamagazines.com, accessed February 20, 2018; John Gillett, Ross Fink, and Nick Bevington, "How Caterpillar Uses 6 Sigma to Execute Strategy," *Strategic Finance Magazine,* https://sfmagazine.com, accessed February 20, 2018; "Christopher Six Sigma Black Belt," https://www.caterpillar.com, accessed February 20, 2018; "Code of Conduct," https://www.caterpillar.com, accessed February 9, 2026.

Nearly every type of business organization needs to find the most efficient and effective methods of producing the goods or services it sells to its customers. Technological advances, ongoing competition, and consumer expectations force companies to rethink where, when, and how they will produce products or services.

Manufacturers have discovered that it is no longer enough to simply push products through the factory and onto the market. Consumers demand high quality at reasonable prices. They also expect manufacturers to deliver products in a timely manner. Firms that can't meet these expectations often face strong competition from businesses that can. To compete, many manufacturers are streamlining how they make their

products—by automating their factories, developing new production processes, focusing on quality-control techniques, and improving relationships with suppliers.

Service organizations also face challenges. Their customers are demanding better service, shorter waiting periods, and more individualized attention. Like manufacturers, service companies are using new methods to deliver what their customers need and want. Banking services are made more accessible to customers through apps and online banking. You can obtain a degree or certification for your career completely online. Most grocery stores offer online shopping with either pickup or delivery options.

This chapter examines how manufacturers and service firms manage and control the creation of products and services. We'll discuss production planning, including the choices firms must make concerning the type of production process they will use; the location where production will occur; the design of the facility; and the management of resources needed in production. Next, we'll explain routing and scheduling, two critical tasks for controlling production and operations efficiency. Then we will look at how firms can improve production and operations by employing quality management and lean-manufacturing techniques. Finally, we will review some of the trends affecting production and operations management.

10.1 Production and Operations Management—An Overview

1. Why is production and operations management important in both manufacturing and service firms?

Production, the creation of products and services, is an essential function in every firm. Production turns inputs, such as natural resources, raw materials, human resources, and capital, into outputs, which are products and services. This process is shown in **Exhibit 10.3**. Managing this conversion process is the role of **operations management**.

Exhibit 10.2 Building an overpass or road bridge is a complex and multidimensional process involving equipment and materials from dozens of entities. Earth movers, cranes, drainage and sewers, safety components, gravel, cement, and large objects such as steel girders must all be transported to the site according to a tight schedule and specific budget. And then the workers, engineers, and inspectors must be sourced, scheduled, and compensated. This work is done at multiple locations, all at once, in every state in the country. Operations managers are core to making it happen. *What are the key inputs in the road construction process?* (Credit: Mark Dixon/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

The goal of customer satisfaction is an important part of effective production and operations. In the past, the manufacturing function in most companies was inwardly focused. Manufacturing had little contact with customers and didn't always understand their needs and desires. In the 1980s, many U.S. industries, such as automotive, steel, and electronics, lost customers to foreign competitors because their production systems could not provide the quality at the price point that customers demanded. As a result, today most U.S. companies, both large and small, consider a focus on quality to be a central component of effective operations management.

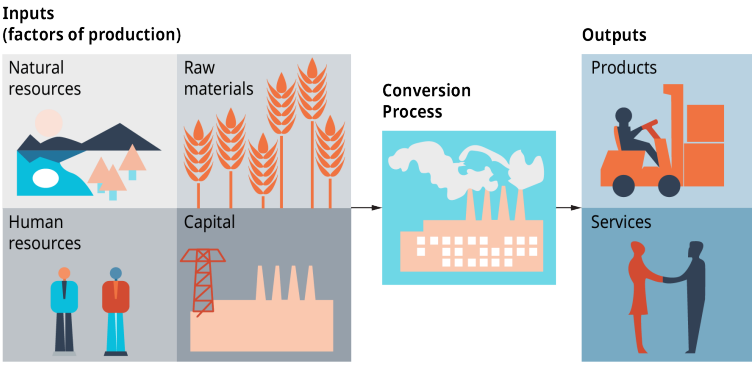

Exhibit 10.3 Production Process for Products and Services (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Stronger links between marketing and manufacturing also encourage production managers to be more outwardly focused and to consider decisions in light of their effect on customer satisfaction. Service companies find that making operating decisions with customer satisfaction in mind can be a competitive advantage.

Operations managers, the people charged with managing and supervising the conversion process, play a vital role in today's firm. They control a large portion of a firm's assets, including inventories, wages, and benefits. They also work closely with other major divisions of the firm, such as marketing, finance, accounting, and human resources, to ensure that the firm produces its goods profitably and satisfies its customers. Marketing personnel help them decide which products to make or which services to offer. Accounting and human resources help them face the challenge of combining people and resources to produce high-quality goods on time and at reasonable cost. They are involved in the development and design of goods and determine what production processes will be most effective.

Operations management involves decisions made at different stages during the production process.

1. *Production planning.* The first decisions facing operations managers come at the *planning stage.* At this stage, managers decide where, when, and how production will occur. They determine site locations and obtain the necessary resources.
2. *Production control.* At this stage, the decision-making process focuses on controlling quality and costs, scheduling, and the actual day-to-day operations of running a manufacturing site or service facility.
3. *Improving production and operations*. The final stage of operations management focuses on developing more efficient methods of producing the firm's goods or services.

All three decisions are ongoing and may occur simultaneously. In the following sections, we will take a closer look at the decisions and considerations firms face in each stage of production and operations management.

Gearing Up: Production Planning

An important part of operations management is **production planning**. Production planning allows the firm to consider the competitive environment and its own strategic goals to find the best production methods. Good production planning has to balance goals that may conflict, such as providing high-quality service while keeping operating costs low, or keeping profits high while maintaining adequate inventories of finished products. Sometimes accomplishing all these goals is difficult.

Exhibit 10.4 Frustrated with how contemporary music was heard through existing devices, Dr. Dre and Jimmy Iovine set out to create headphones that would give customers a studio-quality experience. In 2008, the first model of Beats Studio headphones hit the market. The brand not only focused on the functionality of the product but also positioned Beats as a fashion accessory. Through innovative designs and high-level technological elements, the brand quickly grew. In just a few years, the product held a majority of the global market for premium headphones. *What important planning decisions does the company need to make as it considers expanding their product lines into new markets?* (Credit: Ajay Suresh/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Production planning involves several key phases. Long-term planning has a time frame of three to five years. It focuses on which goods to produce, how many to produce, and where they should be produced. Medium-term planning decisions cover about two years. They concern the layout of factory or service facilities, where and how to obtain the resources needed for production, and labor issues. Short-term planning, within a one-year time frame, converts these broader goals into specific production plans and materials management strategies.

Important decisions must be made in production. They include issues such as the type of production processes that will be used, where the production will be located through strategic site selections, the layout of the facilities, and planning for the needed resources.

CONCEPT CHECK

1. What are the three types of decisions that must be made in production planning?
2. What are the three phases of production planning?

10.2 The Production Process: How Do We Make It?

2. What types of production processes do manufacturers and service firms use?

In production planning, the first decision involves which type of **production process**—the way a good or service is created—best fits with company goals and customer demand. An important consideration is the type of good or service being produced, because different goods may require different production processes. In general, there are three types of production: mass production, mass customization, and customization. In addition to production type, operations managers also classify production processes by how inputs are converted into outputs and the process timing.

One for All: Mass Production

Mass production, manufacturing many identical goods at once, was a product of the Industrial Revolution. The Model-T automobile developed by Henry Ford in the early 1900s is a good example of early mass production. Each car turned out by Ford's factory was identical, right down to its color. If you wanted a car in any color except black, you were out of luck. Electronics, clothing, processed food products, and appliances are

other examples of goods that are mass-produced. The emphasis in mass production is on keeping manufacturing costs low by producing uniform products using repetitive and standardized processes. As products became more complicated to produce, mass production also became more complex. Appliance manufacturers, such as Whirlpool, must now incorporate sophisticated technologies like smart phone integration into their designs. As a result, the types of assembly stations and training needed have evolved.

Just for You: Customizing Goods

In **mass customization**, goods are produced using mass-production techniques, but only up to a point. At that point, the product or service is custom-tailored to the needs or desires of individual customers. For example, American Leather, a Dallas-based furniture manufacturer, uses mass customization to produce couches and chairs to customer specifications within 30 days. The basic frames in the furniture are the same, but automated cutting machinery precuts the color and type of leather ordered by each customer. Using mass-production techniques, they are then added to each frame.

Customization is the opposite of mass production. In customization, the firm produces goods or services one at a time according to the specific needs or wants of individual customers. Unlike mass customization, each product or service produced is unique. For example, a local jewelry store may specially design and produce jewelry for their customers. This could include rings, necklaces, cuff links, watches, and earrings. Each customer order varies based on the design of the piece, quantity needed, and the materials used to produce the item. A manufacturing firm that produces goods in response to customer orders is called a **job shop**.

Exhibit 10.5 Classification of Production Types (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Mass Production	Mass Customization	Customization
Highly uniform products or services Many products made sequentially	Uniform standardized production to a point, then unique features added to each product	Each product or service produced according to individual customer requirements
Examples: Breakfast cereals, soft drinks, and computer keyboards	**Examples:** Dell Computers, tract homes, and Taylor Made golf clubs	**Examples:** Custom homes, legal services, and haircuts

Some types of service businesses also deliver customized services. Doctors, for instance, must consider the illnesses and circumstances of each individual patient before developing a customized treatment plan. Real estate agents may develop a customized service plan for each customer based on the type of house the person is selling or wants to buy. The differences between mass production, mass customization, and customization are summarized in **Exhibit 10.5**.

Converting Inputs to Outputs

As previously stated, production involves converting *inputs* (natural resources, raw materials, human resources, capital) into *outputs* (products or services). In a manufacturing company, the inputs, the production process, and the final outputs are usually obvious. Harley-Davidson, for instance, converts steel, rubber, paint, and other inputs into motorcycles. But the production process in a service company involves a less obvious

conversion. For example, a medical center converts the knowledge and skills of its medical personnel, along with equipment and supplies from a variety of sources, into health care services for patients. Table 10.1 provides examples of the inputs and outputs used by various other businesses.

There are two basic processes for converting inputs into outputs. In **process manufacturing**, the basic inputs (natural resources, raw materials) are broken down into one or more outputs (products). For instance, wood pulp (the input) is processed to make paper products such as paper towels or tissues (the output). The **assembly process** is just the opposite. The basic inputs, like natural resources, raw materials, or human resources, are either *combined* to create the output or *transformed* into the output. A cellphone, for example, is created by assembling thousands of parts, which are its raw material inputs. Steel manufacturers use heat to transform iron and other materials into steel. In services, customers may play a role in the transformation process. For example, a financial advisor combines their knowledge and expertise with the client's information about their personal finances in order to assist the client with retirement investments.

Production Timing

A second consideration in choosing a production process is timing. A **continuous process** uses long production runs that may last days, weeks, or months without equipment shutdowns. This is best for high-volume, low-variety products with standardized parts, such as paper towels, personal care items, and office supplies. Some services also use a continuous process. Household utility companies that deliver gas, electricity, water, and internet are examples. Per-unit costs are low, and production is easy to schedule.

Converting Inputs to Outputs		
Type of Organization	**Input**	**Output**
Airline	Pilots, flight attendants, reservations system, ticketing agents, customers, airplanes, maintenance crews, ground facilities	Movement of customers and freight
Grocery store	Merchandise, building, clerks, supervisors, store fixtures, shopping carts, customers	Groceries for customers
High school	Faculty, curriculum, buildings, classrooms, library, auditorium, gymnasium, students, staff, supplies	Graduates, public service
Manufacturer	Machinery, raw materials, plant, workers, managers	Finished products for consumers and other firms
Restaurant	Food, cooking equipment, servers, chefs, dishwashers, host, patrons, furniture, fixtures	Meals for patrons

Table 10.1

In an **intermittent process**, short production runs are used to make batches of different products. Machines are shut down to change them to make different products at different times. This process is best for low-volume, high-variety products such as those produced by mass customization or customization. The jewelry store discussed previously is an example of a firm using an intermittent process. Based on the product they are producing, they may utilize different equipment and materials at different times.

Although some service companies use continuous processes, most service firms rely on intermittent

processes. For instance, a salon providing a variety of services to clients such as coloring or styling, surgeons performing medical procedures, and financial advisors offering different investment products to suit each customer utilize an intermittent process. Note that their "production runs" may be very short—one grilled salmon or one physical exam at a time.

CONCEPT CHECK

1. Describe the different types of production processes.
2. How are inputs transformed into outputs in a variety of industries?

10.3 Location, Location, Location: Where Do We Make It?

3. How do organizations decide where to put their production facilities? What choices must be made in designing the facility?

A big decision that managers must make early in production and operations planning is where to put the facility, be it a factory or a service office. The facility's location affects operating and shipping costs and, ultimately, the price of the product or service and the company's ability to compete. Mistakes made at this stage can be expensive, because moving a factory or service facility once production begins is difficult and costly. Firms must weigh a number of factors to make the right decision.

Exhibit 10.6 Facing stiff competition from rival automobile companies and sagging demand among German consumers, Germany's BMW opened a factory in Spartansburg, South Carolina. Opened in 1994, the U.S. plant has produced over 7 million vehicles and now employs more than 12,000 employees at its ten-million-square-foot plant. *What factors determine where auto companies locate their operations?* (Credit: Chris Favero/ Flickr/ Attribution-Share Alike 2.0 Generic (CC BY-SA 2.0))

Availability of Production Inputs

As we discussed earlier, organizations need certain resources to produce products and services for sale. Access to these resources, or inputs, is a huge consideration in site selection. Executives must assess the availability of raw materials, parts, equipment, and available labor for each site under consideration. The cost of shipping raw materials and finished goods can be as much as 25 percent of a manufacturer's total cost, so locating a factory where these and other costs are as low as possible can make a major contribution to a firm's success.

Companies that use heavy or bulky raw materials, for example, may choose to be located close to their suppliers. Mining companies want to be near ore deposits, oil refiners near oil fields, paper mills near forests, and food processors near farms. Bottlers are discovering that rural western communities in need of an economic boost make rich water sources. Niagara Purified Drinking Water operates a 160,000-square-foot facility in Los Lunas, New Mexico, to produce purified bottled water. The business helps diversify the town's economy and created 40 new, much-needed jobs.[1]

The availability and cost of labor are also critical to both manufacturing and service businesses, and the unionization of local labor is another point to consider in many industries. Payroll costs can vary widely from one location to another due to differences in the cost of living; the number of jobs available; and the size, skills, and productivity of the local workforce. In the case of the water-bottling company, a ready pool of relatively inexpensive labor was available due to high unemployment in the areas.

Marketing Factors

Businesses must evaluate how their facility location will affect their ability to serve their customers. For some firms it may not be necessary to be located near customers. Instead, the firm will need to assess the difficulty and costs of distributing its goods to customers from its chosen location. Other firms may find that locating near customers can provide marketing advantages. When a factory or service center is close to customers, the firm can often offer better service at a lower cost. Other firms may gain a competitive advantage by locating their facilities so that customers can easily buy their products or services. The location of competitors may also be a consideration. And businesses with more than one facility may need to consider how far to spread their locations in order to maximize market coverage.

Manufacturing Environment

Another factor to consider is the manufacturing environment in a potential location. Some localities have a strong existing manufacturing base. When a large number of manufacturers in a certain industry are already located in an area, that area is likely to offer greater availability of resources, such as manufacturing workers, better accessibility to suppliers and transportation, and other factors that can increase a plant's operating efficiency.

In 2025, bakery franchise Paris Baguette broke ground on its inaugural bakery manufacturing plant in Texas. The facility is 267,00 square feet, and the investment was nearly $200 million. The facility created over 400 new jobs in the town of Burleson. The project is expected to be completed by the end of 2027.[2]

Local Incentives

Incentives offered by countries, states, or cities may also influence site selection. Tax breaks are a common incentive. A locality may reduce the amount of taxes a firm must pay on income, real estate, utilities, or payroll. Local governments may offer financial assistance and/or exemptions from certain regulations to attract or keep production facilities in their area. For example, many U.S. cities are competing to attract the construction of a data center in their communities because of the economic benefits such as job creation and investments in local infrastructure. Incentives offered by the cities include tax abatements and less restrictive zoning and permit policies.[3]

International Location Considerations

There are often sound financial reasons for considering a foreign location. Labor costs can be more affordable in countries such as Brazil, Mexico, Hungary, or Bangladesh. Foreign countries may also have fewer regulations governing how factories operate. A foreign location may also move production closer to new markets. Automobile manufacturers such as Honda, Toyota, and Volkswagen are among those that build facilities in the United States to reduce shipping costs for their end-market product.

Designing the Facility

After the site location decision has been made, the next focus in production planning is the facility's layout. The goal is to determine the most efficient and effective design for the particular production process. A manufacturer might opt for production activities to be split between two adjacent buildings, for example, rather than housing all activities in one larger facility.

Service organizations must also consider layout, but they are more concerned with how it affects customer behavior. It may be more convenient for a school cafeteria to have its delivery dock in the front of the school with easy access to the parking area, but doing so would interfere with school activities such as student pick up and recess times.

There are three main types of facility layouts: process, product, and fixed-position. All three layouts are illustrated in **Exhibit 10.7**. Cellular manufacturing is another type of facility layout.

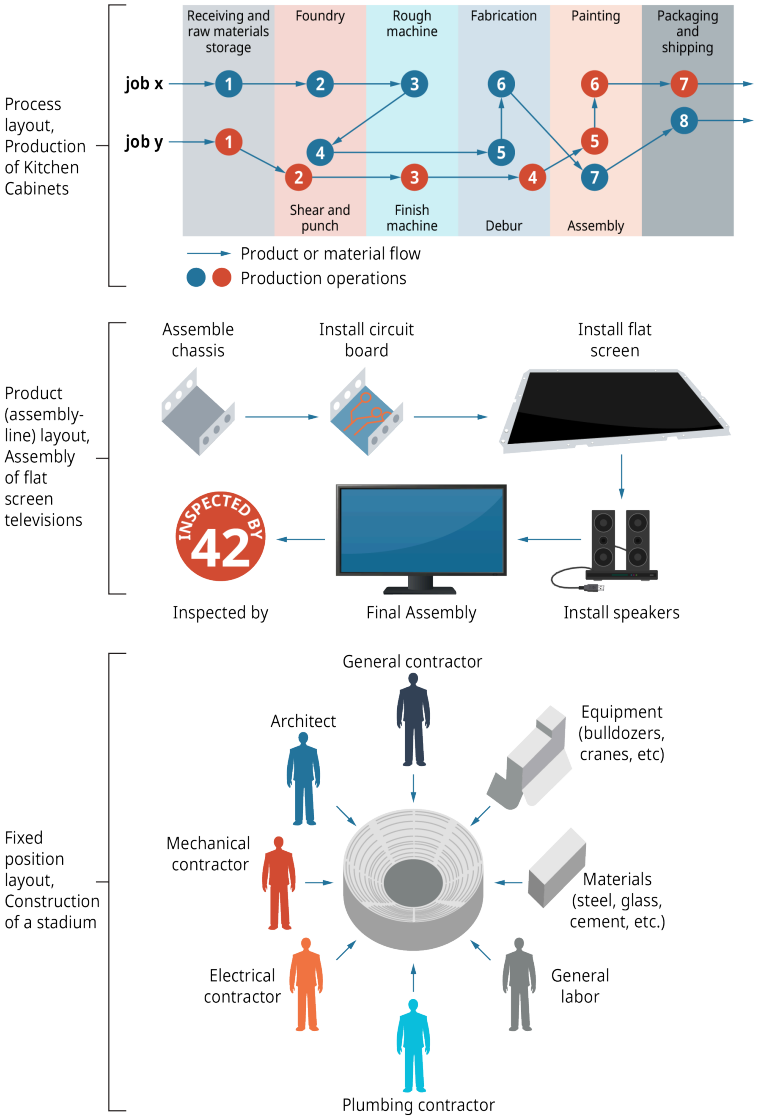

Exhibit 10.7 Types of Facility Layouts Source: Adapted from *Operations Management*, 9th edition, by Gaither/Frazier.

Process Layout: All Welders Stand Here

The **process layout** arranges workflow around the production process. All workers performing similar tasks are grouped together. Products pass from one workstation to another (but not necessarily to every workstation). For example, all grinding would be done in one area, all assembling in another, and all inspection in yet another. The process layout is best for firms that produce small numbers of a wide variety of products, typically using general-purpose machines that can be changed rapidly to new operations for different product designs. For example, a manufacturer that builds custom automated medical equipment would use a process layout.

Product Layout: Moving Down the Line

Products that require a continuous or repetitive production process use the **product** (or **assembly-line**) **layout**. When large quantities of a product must be processed on an ongoing basis, the workstations or departments are arranged in a line with products moving along the line. Automobile and appliance manufacturers, as well as food-processing plants, usually use a product layout. Service companies may also use a product layout for routine processing operations.

Fixed-Position Layout: Staying Put

Some products cannot be put on an assembly line or moved about in a plant. A **fixed-position layout** lets the product stay in one place while workers and machinery move to it as needed. Products that are challenging to move—ships, aircraft, and large agricultural equipment—are typically produced using a fixed-position layout. Limited space at the project site often means that parts of the product must be assembled at other sites, transported to the fixed site, and then assembled. The fixed-position layout is also common for on-site services such as housecleaning services, pest control, and landscaping.

Cellular Manufacturing: A Start-to-Finish Focus

Cellular manufacturing combines some aspects of both product and fixed-position layouts. Work cells are small, self-contained production units that include several machines and workers arranged in a compact, sequential order. Each work cell performs all or most of the tasks necessary to complete a manufacturing order. Employees working in the cell are cross-trained so that they are able to do any of the steps in the production process. The goal is to create a team environment wherein team members are involved in production from beginning to end.

CONCEPT CHECK

1. What factors does a firm consider when making a site-selection decision?
2. What should be considered when deciding on a production approach?

10.4 Pulling It Together: Resource Planning

4. Why are resource-planning tasks such as inventory management and supplier relations critical to production?

As part of the production-planning process, firms must ensure that the resources needed for production—such as raw materials, parts, equipment, and labor—will be available at strategic moments in the production process. This can be a huge challenge. The components used to build just one airplane, for instance, number in the millions. Cost is also an important factor. The cost of materials and supplies used in the production process can vary widely by industry but generally represents between one-third and up to 70 percent of the total cost to produce the products. Resource planning is therefore a big part of any firm's production strategy.

Resource planning begins by specifying which raw materials, parts, and components will be required, and when, to produce finished goods. To determine the amount of each item needed, the expected quantity of finished goods must be forecast. A **bill of material** is then drawn up that lists the items and the number of each required to make the product. **Purchasing**, or *procurement,* is the process of buying production inputs from various sources.

Make or Buy?

The firm must decide whether to make its own production materials or buy them from outside sources. This is the **make-or-buy decision**. The quantity of items needed is one consideration. If a part is used in only one of many products, buying the part may be more cost-effective than making it. Buying standard items, such as screws, bolts, rivets, and nails, is usually cheaper and easier than producing them internally. Purchasing larger components from another manufacturer can be cost-effective as well. When items are purchased from an outside source instead of being made internally, it is called **outsourcing**. Harley-Davidson, for example, purchases its tires, brake systems, and other motorcycle components from manufacturers that make them to

Harley's specifications. However, if a product has special design features that need to be kept secret to protect a competitive advantage, a firm may decide to produce all parts internally.

In deciding whether to make or buy, a firm must also consider whether outside sources can provide the high-quality supplies it needs in a reliable manner. Having to shut down production because vital parts aren't delivered on time can be a costly disaster. Just as bad are inferior parts or materials, which can damage a firm's reputation for producing high-quality goods. Therefore, firms that buy some or all of their production materials from outside sources should make building strong relationships with quality suppliers a priority.

Inventory Management: Not Just Parts

A firm's **inventory** is the supply of goods it holds for use in production or for sale to customers. Deciding how much inventory to keep on hand is one of the biggest challenges facing operations managers. On the one hand, with large inventories, the firm can meet most production and customer demands. Buying in large quantities can also allow a company to take advantage of quantity discounts. On the other hand, large inventories can tie up the firm's money, are expensive to store, and can become obsolete.

Inventory management involves deciding how much of each type of inventory to keep on hand and the ordering, receiving, storing, and tracking of it. The goal of inventory management is to keep down the costs of ordering and holding inventories while maintaining enough on hand for production and sales. Good inventory management enhances product quality, makes operations more efficient, and increases profits. Poor inventory management can result in dissatisfied customers, financial difficulties, and even bankruptcy.

To better analyze inventory levels and their cost implications, managers should evaluate holding inventory, reorder frequency, and inventory on hand.

To control inventory levels, managers often track the use of certain inventory items. Most companies keep a **perpetual inventory**, a continuously updated list of inventory levels, orders, sales, and receipts, for all major items. Today, companies mostly use computers to track inventory levels, calculate order quantities, and issue purchase orders at the right times.

Computerized Resource Planning

Many manufacturing companies have adopted computerized systems to control the flow of resources and inventory. **Materials requirement planning (MRP)** is one such system. MRP uses a comprehensive schedule to ensure that the materials, labor, and equipment needed for production are at the right places in the right amounts at the right times. The schedule is based on forecasts of demand for the company's products. It says exactly what will be manufactured during the next few weeks or months and when the work will take place. Sophisticated computer programs coordinate all the elements of MRP. The computer comes up with materials requirements by comparing production needs to the materials the company already has on hand. Orders are placed so items will be on hand when they are needed for production. MRP helps ensure a smooth flow of finished products.

Manufacturing resource planning II (MRPII) was developed to expand on MRP. It uses a complex computerized system to integrate data from many departments, including finance, marketing, accounting, engineering, and manufacturing. MRPII can generate a production plan for the firm, as well as management reports, forecasts, and financial statements. The system lets managers make more accurate forecasts and assess the impact of production plans on profitability. If one department's plans change, the effects of these changes on other departments are transmitted throughout the company.

Whereas MRP and MRPII systems are focused internally, **enterprise resource planning (ERP)** systems go a step further and incorporate information about the firm's suppliers and customers into the flow of data. ERP consolidates a firm's data from the various functional departments (such as marketing and production) into a unified platform. For instance, production can call up sales information and know immediately how many units must be produced to meet customer orders. By providing information about the availability of resources,

including both the human resources and materials needed for production, the system allows for better cost control and eliminates production delays. The system automatically notes any changes, such as the closure of a plant for maintenance and repairs on a certain date or a supplier's inability to meet a delivery date, so that all functions adjust accordingly. Both large and small organizations use ERP to improve operations.

Keeping the Goods Flowing: Supply-Chain Management

In the past, the relationship between purchasers and suppliers was often competitive and antagonistic. Businesses used many suppliers and switched among them frequently. During contract negotiations, each side would try to get better terms at the expense of the other. Communication between purchasers and suppliers was often limited to purchase orders and billing statements.

Today, however, many firms are moving toward a new concept in supplier relationships. The emphasis is increasingly on developing a strong **supply chain**. The supply chain can be thought of as the entire sequence of securing inputs, producing goods, and delivering goods to customers. If any links in this process are weak, chances are customers—the end point of the supply chain—will end up dissatisfied.

Effective supply-chain strategies reduce costs. For example, integration of the shipper and customer's supply chains allows companies to automate more processes and save time. Technology also improves supply-chain efficiency by tracking goods through the various supply-chain stages and helping with logistics. With better information about production and inventory, companies can order and receive goods at the optimal point to keep inventory holding costs low.

Companies also need contingency plans for supply-chain disruptions. Is there an alternative source of supply if weather events cause plane delays or crop failures and other related disruptions? By thinking ahead, companies can avert major losses. The length and distance involved in a supply line is also a consideration. Importing parts from or outsourcing manufacturing globally can create extended supply chains for firms in the United States, as an example. Perhaps there are closer suppliers or manufacturers who can meet a company's needs at a lower overall cost. Companies should also reevaluate outsourcing decisions periodically.

Strategies for Supply-Chain Management

Ensuring a strong supply chain requires that firms implement supply-chain management strategies. **Supply-chain management** focuses on smoothing transitions along the supply chain, with the ultimate goal of satisfying customers with quality products and services. A critical element of effective supply-chain management is to develop tight bonds with suppliers. This may mean reducing the number of suppliers used and asking them to offer more services or better prices in return for an ongoing relationship.

Exhibit 10.8 Managing an efficient supply chain is critical for businesses, especially when the product being delivered is a bouquet of fresh-cut flowers. To ensure that only the freshest, most colorful floral arrangement arrives for that special someone, 1-800 Flowers.com serves customers by utilizing their network of local florists that can deliver the same day. Customers place orders through the 1-800 Flowers website, and the firm then coordinates delivery from reputable local florists through various carriers. *What strategies help businesses create and maintain an effective supply chain?* (Credit: Direct 2 Florist www.direct2florist.co.uk/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Manufacturers plan to reduce the number of global suppliers to give more long-term contracts to domestic strategic partners. Many firms are reconsidering utilizing suppliers that extend their supply chain across borders. Global networks have been used to cut costs, but more companies are concluding they're a risky bet due to political shifts, protectionist measures, and natural disasters.

Instead of being viewed as "outsiders" in the production process, many suppliers play an important role in supporting the operations of their customers. They are expected to meet high quality standards, offer suggestions that can help reduce production costs, and even contribute to the design of new products.

EXPANDING AROUND THE GLOBE

Sophisticated Supply-Chain Strategies Keep Products on the Move

Headquartered in Tokyo but with offices around the world, shipping company MOL (Mitsui O.S.K. Lines, Ltd.) has taken integrating with its customers to new levels. It is joining its customers in a series of joint ventures to build and operate dedicated vessels for as long as 25 years. One such joint venture teamed MOL with a Chinese steel mill to build and sail ships bringing Brazilian iron ore and coal across the Pacific Ocean for processing.

Sophisticated supply-chain systems that control every aspect of production and transportation are the key to making offshore manufacturing work. Supply-chain software that monitors operations and continually makes adjustments ensures that all processes are running at peak efficiency. By tightly mapping an entire sequence—from order to final delivery—and by automating it as much as possible, supply-chain management can deliver products from across the world while at the same time cutting costs. Companies that can optimize how much inventory they carry and have customers that pay in a timely manner can improve their cash flow and profitability.

Acer, an $8+ billion Taiwanese computer and electronics maker, brings components from around the world and assembles them into everything from PC notebooks to TVs at factories in several Asian countries including Taiwan and mainland China. It then reverses the flow by shipping these products to international buyers.

The synchronizing of trade is essential. If goods don't get into the stores in time, sales might be lost or the company might have to carry larger inventories to avoid sellouts, which would cut into its profits. Companies need to continually monitor demand and react quickly by adjusting production. "This gets increasingly difficult when the supply chain stretches across thousands of miles and a dozen time zones," says David Bovet, senior supply chain consultant at Hawk Partners, a Boston-based firm that advises on business tactics. "There are strategies that smart companies are using to bring costs down to earth. Getting the most of lower labor costs overseas requires an emphasis on transportation, and supply-chain skills are a required core competency," he says. His advice to global manufacturers: cooperate with shippers, and integrate supply chains into one cohesive system.

An important aspect of a solid supply chain is the availability of inventory, as the needs of the customer cannot be met without an in-stock supply of products. Inventory can refer to components such as the goods and materials on hand. In international global supply, some things to consider are the availability of labor, geography, and local regulations.

There needs to be a well-developed strategy in order to have a successful supply chain. Strategies include knowing your customers and their needs and planning what you want to achieve and how you are going to make it happen.

Dell is widely recognized for its innovative supply chain designed to manage the costs associated with

carrying inventory while still providing quick delivery to customers. With the integration of technology, Dell is a leader in just-in-time delivery (JIT). Alongside Dell executives are representatives of its logistics suppliers for guidance and quick action if anything goes wrong.

There is risk associated with international trade including the impact of tariffs, political unrest, and transportation issues, and companies need to decide whether to play it safe with extra inventory or scramble if a disaster like a port strike occurs. Either way, they need to have contingency plans and be ready to react, and solid supply-chain strategies will ensure they are prepared for any eventuality.

Sources: "About MOL," https://www.mol.co.jp, accessed February 20, 2018; "Supply Chain," https://www.dell.com, accessed February 20, 2018; "Our Supply Chain," https://www.acer-group.com, accessed February 20, 2018; Muddassir Ahmed, "How to Create a Supply Chain Strategic Plan That Will Work for (Nearly) Any Business," https://muddassirism.com, December 4, 2016; Pamela Hyatt, "The 5 Essential Stages in Developing a Successful Supply Chain," *Trade Ready,* https://www.tradeready.ca, February 12, 2016; Crystal Gilliam, "7 Tips for Effective Inventory Management in a Global Supply Chain," *Trade Gecko*, https://www.tradegecko.com, October 19, 2015; "Acer Reports FY2024 Net Income of NT$5.54 Billion and NT$1.7 Cash Dividend Per Share," https://news.acer.com/, March 13, 2025; "What Is the Dell Supply Chain Model and Its Advantages," Faster Capital, https://fastercapital.com, accessed February 9, 2026.

Critical Thinking Questions

1. Why are solid supply-chain strategies so important?
2. What problems is a company likely to experience without such strategies in place?

E-Procurement, Electronic Data Interchange, and Blockchain

Effective supply chain management depends on strong communications with suppliers. Technology, particularly cloud computing and the emergence of AI, is providing new ways to do this. E-procurement, the process of purchasing supplies and materials online, has become commonplace for companies. Many manufacturing firms use the internet to keep key suppliers informed about their requirements. Intel, for example, has set up a special website for its suppliers and potential suppliers. Would-be suppliers can visit the site to get information about doing business with Intel; once they are approved, they can access a secure area to make bids on Intel's current and future resource needs.

The internet also streamlines purchasing by providing firms with quick access to a huge database of information about the products and services of hundreds of potential suppliers. Some large companies participate in reverse auctions online, which can lower procurement costs. In a reverse auction, the manufacturer posts its specifications for the materials it requires. Potential suppliers then bid against each other to get the job. However, there are risks with reverse auctions. It can be difficult to establish and build ongoing relationships with specific suppliers using reverse auctions because the job ultimately goes to the lowest bidder. Therefore, reverse auctions may not be an effective procurement process for critical production materials. Other types of corporations can use these auctions as well. The U.S. Army utilizes reverse auctions to leverage technology, become more efficient, and manage procurement costs. In 2005 the U.S. Army began to partner with FedBid, Inc., the largest commercial marketplace for reverse auctions, for a variety of products from paper to computers to helicopters. Costs dropped by $388 million according to independent government cost estimates over the past decade. A decade ago, the General Services Administration found that government agencies had 31 suppliers that were charging between $9.76 and $48.77 for the same hammer.[4]

Another communications tool is **electronic data interchange (EDI)**, in which two trading partners exchange information electronically. EDI can be conducted via a linked computer system or over a secured, private network. The advantages of exchanging information with suppliers electronically include speed, accuracy, and lowered communication costs. EDI plays a critical role in Ford Motor Company's efforts to produce and distribute vehicles worldwide. With the emergence of **blockchain technology**, Ford has been able to create a

streamlined process that is automated and connects suppliers and other partners.[5]

CONCEPT CHECK

1. What are the approaches to inventory that businesses can consider?
2. How is technology being used in resource planning?

10.5 Production and Operations Control

5. How do operations managers schedule and control production?

Every company needs to have systems in place to see that production and operations are carried out as planned and to correct errors when they are not. The coordination of materials, equipment, and human resources to achieve production and operating efficiencies is called *production control*. Two of its key aspects are routing and scheduling.

Routing: Where to Next?

Routing is the first step in production control. It sets out a work flow, the sequence of machines and operations through which a product or service progresses from start to finish. Routing depends on the type of goods being produced and the facility layout. Good routing procedures increase productivity and cut unnecessary costs.

One useful tool for routing is **value-stream mapping**, whereby production managers "map" the flow from suppliers through the factory to customers. A visual representation using icons is created to represent the flow of both materials and information. Value-stream mapping can help identify where bottlenecks may occur in the production process and is a valuable tool for visualizing how to improve production routing.

Awning manufacturer Rader Awning & Upholstery used value-stream mapping to automate some of its operations. With the assistance of New Mexico Manufacturing Extension Partnership (MEP), the company evaluated how orders were processed from sales to manufacturing over two days. With the implementation of the processes suggested by MEP, productivity per salesperson improved, production defects decreased, and there was drop in installation corrections needed.[6]

Scheduling: When Do We Do It?

Closely related to routing is scheduling. **Scheduling** involves specifying and controlling the time required for each step in the production process. The operations manager prepares timetables showing the most efficient sequence of production and then tries to ensure that the necessary materials and labor are in the right place at the right time.

Scheduling is important to both manufacturing and service firms. The production manager in a factory schedules material deliveries, work shifts, and production processes. Trucking companies schedule drivers, clerks, truck maintenance, and repairs in accordance with customer transportation needs. Scheduling at a college entails deciding when to offer which courses, in which learning environments, and with which instructors. A museum must schedule special exhibits, transport works to be displayed, market its offerings, and conduct educational programs and tours. Scheduling can range from simple to complex. Giving numbers to customers waiting to be served in a bakery and making interview appointments with job applicants are examples of simple scheduling. Organizations that must produce large quantities of products or services or service a diverse customer base face more complex scheduling problems.

Some scheduling tools and methods that can be used for complex situations are Gantt charts, the critical path

method, and PERT.

Tracking Progress with Gantt Charts

Named after their originator, Henry Gantt, **Gantt charts** are bar graphs plotted on a time line that show the relationship between scheduled and actual production.

In the example shown in **Exhibit 10.9**, the left side of the chart lists the activities required to complete the job or project. Both the scheduled time and the actual time required for each activity are shown, so the manager can easily judge progress.

Gantt charts are most helpful when only a few tasks are involved, when task times are relatively long (days or weeks rather than hours), and when job routes are short and simple. Gannt charts are static, and this can be a disadvantage for projects that require frequent modifications. Also, the linear nature of the charts do not always show the interdependencies of tasks. These problems can be solved, however, by using two other scheduling techniques, the critical path method and PERT.

The Big Picture: Critical Path Method and PERT

To control large projects, operations managers need to closely monitor resources, costs, quality, and budgets. They also must be able to see the "big picture"—the interrelationships of the many different tasks necessary to complete the project. Finally, they must be able to revise scheduling and divert resources quickly if any tasks fall behind schedule. The critical path method (CPM) and the program evaluation and review technique (PERT) are related project management tools that were developed to help managers accomplish this.

In the **critical path method (CPM)**, the manager identifies all of the activities required to complete the project, the relationships between these activities, and the order in which they need to be completed. Then, the manager develops a diagram that uses arrows to show how the tasks are dependent on each other. The longest path through these linked activities is called the **critical path**. If the tasks on the critical path are not completed on time, the entire project will fall behind schedule.

To better understand how CPM works, look at **Exhibit 10.10**, which shows a CPM diagram for constructing a house. All of the tasks required to finish the house and an estimated time for each have been identified. The arrows indicate the links between the various steps and their required sequence. As you can see, most of the jobs to be done can't be started until the house's foundation and frame are completed. It will take five days to finish the foundation and another seven days to erect the house frame. The activities linked by brown arrows form the critical path for this project. It tells us that the fastest possible time the house can be built is 38 days, the total time needed for all of the critical path tasks. The noncritical path jobs, those connected with black arrows, can be delayed a bit or done early. Short delays in installing appliances or roofing won't delay construction of the house because these activities don't lie on the critical path.

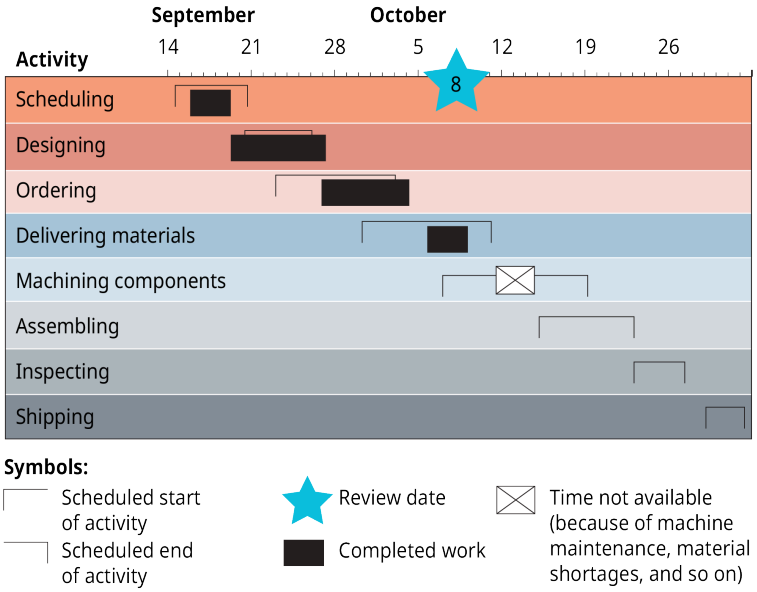

Exhibit 10.9 A Typical Gantt Chart (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

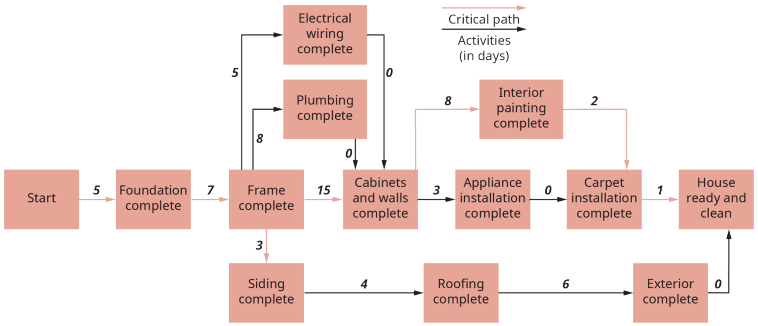

Exhibit 10.10 A CPM Network for Building a House (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Like CPM, the **program evaluation and review technique (PERT)** helps managers identify critical tasks and assess how delays in certain activities will affect operations or production. In both methods, managers use diagrams to see how operations and production will flow. PERT differs from CPM in one important respect. CPM assumes that the amount of time needed to finish a task is known with certainty; therefore, the CPM diagram shows only one number for the time needed to complete each activity. In contrast, PERT assigns three time estimates for each activity: an optimistic time for completion, the most probable time, and a pessimistic time. These estimates allow managers to anticipate delays and potential problems and schedule accordingly.

CONCEPT CHECK

1. What is production control, and what are its key aspects?
2. How can value-stream mapping improve routing efficiency?
3. Identify and describe three commonly used scheduling tools.

10.6 Looking for a Better Way: Improving Production and Operations

6. How can quality-management and lean-manufacturing techniques help firms improve production and operations management?

Competing in today's business world is challenging. To compete effectively, firms must keep production costs

down. At the same time, it's becoming increasingly complex to produce and deliver the high-quality goods and services customers demand. Methods to help meet these challenges include quality-management techniques, lean manufacturing, and technology and automation.

Putting Quality First

Successful businesses recognize that quality and productivity must go hand in hand. **Quality** goods and services meet customer expectations by providing reliable performance. Defective products waste materials and time, increasing costs. Worse, poor quality causes customer dissatisfaction, which usually results in lost sales.

A consumer measures quality by how well a product serves its purpose. From the manufacturer's point of view, quality is the degree to which the product conforms to a set of predetermined standards. **Quality control** involves creating quality standards, producing goods that meet them, and measuring finished goods and services against them. It takes more than just inspecting goods at the end of the assembly line to ensure quality control, however. Quality control requires a company-wide dedication to managing and working in a way that builds excellence into every facet of operations.

W. Edwards Deming was a respected American business theorist and management consultant who was the first to say that quality control should be a company-wide goal. Deming believed that quality control starts with top management, who must foster a company-wide culture dedicated to producing quality.

Deming's concept of **Total Quality Management (TQM)** emphasizes the use of quality principles in all aspects of a company's production and operations. It recognizes that all employees involved with bringing a product or service to customers—marketing, purchasing, accounting, shipping, manufacturing—contribute to its quality. TQM focuses on **continuous improvement**, a commitment to constantly seek better ways of doing things in order to achieve greater efficiency and improve quality. Company-wide teams work together to prevent problems and systematically improve key processes instead of troubleshooting problems only as they arise. Continuous improvement continually measures performance using statistical techniques and looks for ways to apply new technologies and innovative production methods.

Another quality-control method is the **Six Sigma** quality program. Six Sigma is a company-wide process that focuses on measuring the number of defects that occur and systematically eliminating them in order to get as close to "zero defects" as possible. In fact, Six Sigma quality aims to have every process produce no more than 3.4 defects per million. Six Sigma focuses on designing products that not only have fewer defects but that also satisfy customer needs. A key process of Six Sigma is called *DMAIC*. This stands for Define, Measure, Analyze, Improve, and Control. Employees at all levels define what needs to be done to ensure quality, then measure and analyze production results using statistics to see if standards are met. They are also charged with finding ways to improve and control quality.

General Electric was one of the first companies to institute Six Sigma throughout the organization. GE employees are trained in Six Sigma concepts, and many analysts believe this has given GE a competitive manufacturing advantage. Service firms and government entities have applied Six Sigma to their quality initiatives as well.

Malcolm Baldrige National Quality Award

Named for a former secretary of commerce, the **Malcolm Baldrige National Quality Award** was established by the U.S. Congress to recognize U.S. companies that offer goods and services of world-class quality. The award promotes awareness of quality and allows the business community to assess which quality control programs are most effective.

Administered by the U.S. Department of Commerce's National Institute of Standards and Technologies (NIST), the award's most important criterion is a firm's effectiveness at meeting customer expectations, as well as demonstrating that it offers quality goods and services. To qualify for the award, a company must also show

continuous improvement in internal operations. Company leaders and employees must be active participants in the firm's quality program, and they must respond quickly to data and analysis.

Organizations in a wide variety of industries have won the Baldrige Award since it was first presented in 1987. In 2024, for example, the Baldrige Award winners included Alamo Colleges District in Texas that provides affordable or tuition-free education to eligible students; Freese and Nichols Inc., a private engineering planning and consulting firm based in Texas; and Northwest Delta Dental, which provides prepaid dental insurance.[7]

Worldwide Excellence: International Quality Standards

The International Organization for Standardization (ISO), located in Geneva, Switzerland, is an industry organization that has developed standards of quality that are used by businesses around the world. **ISO 9000** is a family of international standards designed to offer a uniform way of determining whether manufacturing plants and service organizations conform to sound quality control procedures. The family currently consists of three main standards, with ISO 9001 being the certifiable requirements standard. To register, a company must go through an audit of its manufacturing and customer service processes, covering everything from how it designs, produces, and installs its products, to how it inspects, packages, and markets them. As of 2024, over 1.4 million organizations worldwide have met ISO 9000 standards.

ISO 14000, launched after ISO 9000, was designed in response to environmental issues such as global warming and water pollution and promotes clean production processes. To meet ISO 14001 standards, a company must commit to continually improving environmental management and preventing pollution through systematic environmental management practices.

Lean Manufacturing Trims the Fat

Manufacturers are discovering that they can better respond to rapidly changing customer demands, while keeping inventory and production costs down, by adopting lean-manufacturing techniques. **Lean manufacturing** streamlines production by eliminating steps in the production process that do not add benefits customers want. In other words, *non-value-added production processes* are cut so that the company can concentrate its production and operations resources on items essential to satisfying customers. Toyota was a pioneer in developing these techniques, but today manufacturers in many industries have adopted the lean-manufacturing philosophy.

Another business concept, **just-in-time (JIT)**, goes hand in hand with lean manufacturing. JIT is based on the belief that materials should arrive exactly when they are needed for production, rather than being stored on-site. Relying closely on computerized systems such as MRP, MRPII, and ERP, manufacturers determine what parts will be needed and when and then order them from suppliers so they arrive "just in time." Under the JIT system, inventory and products are "pulled" through the production process in response to customer demand. JIT requires close teamwork between vendors and purchasing and production personnel because any delays in deliveries of supplies could bring JIT production to a halt.

Unexpected events like the September 11 terrorist attacks or natural disasters can cause chaos in the supply chains of manufacturers, resulting in problems for firms relying on JIT. But if employed properly, and in spite of these risks, a JIT system can greatly reduce inventory-holding costs and smooth production highs and lows.

CONCEPT CHECK

1. How can managers use techniques to improve efficiency?
2. Define Six Sigma.
3. What was Edward Demming's contribution to operations management?

10.7 Transforming the Factory Floor with Technology

7. What roles do technology and automation play in manufacturing and service-industry operations management?

Technology is helping many firms improve their operating efficiency and ability to compete. Computer systems in particular are enabling manufacturers to automate factories in ways never before possible. Among the technologies used to automate manufacturing are computer-aided design, robotics, flexible manufacturing systems, computer integrated manufacturing, and AI.

Computer-Aided Design and Manufacturing Systems

Computers have transformed the design and manufacturing processes in many industries. In **computer-aided design (CAD)**, computers are used to design and test new products and modify existing ones. Engineers use these systems to draw products and look at them from different angles. They can analyze the products, make changes, and test prototypes before manufacturing a single item. **Computer-aided manufacturing (CAM)** uses computers to develop and control the production process. These systems analyze the steps required to make the product, then automatically send instructions to the machines that do the work. **CAD/CAM systems** combine the advantages of CAD and CAM by integrating design, testing, and manufacturing control into one linked computer system. The system helps design the product, control the flow of resources needed to produce the product, and operate the production process. Companies can further improve the design and manufacturing processes through the use of AI and 3D printing. 3D printing can be used to create parts or early prototypes, and in some industries, 3D printing can be used to print certain components on site rather than shipping them.

Cardianove Inc., a former Montreal-based manufacturer of medical and surgical equipment, used CAD software to develop cardiac assist devices, including mixed-flow blood pumps. The company says using computer-aided design shaved two years off the normal design time for cardiac devices. The company's CAD program ran complex three-dimensional simulations to confirm that the design would function properly inside the human body. Using CAD software, Cardianove tested over 100 virtual prototypes before the top three designs were produced for real-life testing.

Robotics

Robots are computer-controlled machines that can perform tasks independently. **Robotics** is the technology involved in designing, constructing, and operating robots. The first robot, or "steel-collar worker," was used by General Motors in 1961. Robots can be mobile or fixed in one place. Fixed robots have an arm that moves and does what the computer instructs. Some robots are quite simple, with limited movement for a few tasks such as cutting sheet metal and spot welding. The robotics technology used can also be very complex, using AI and generative technology to learn movements that require extreme precision. Other robots can be used with sensing devices to detect defects in products, as just an example of the capabilities of robotics in manufacturing.

Robots usually operate with little or no human intervention. Replacing human effort with robots is most effective for tasks requiring accuracy, speed, or strength. Although manufacturers such as Frigidaire are most likely to use robots, some service firms are also finding them useful. Medical facilities, for example, can use robotic technology to sort and process samples or to assist with some surgical procedures. This can allow medical personnel more time for other necessary tasks.

AI

More firms are embracing the emergence of artificial intelligence (AI) and the benefits it can bring to the manufacturing environment. AI can be utilized to enhance current technologies such as computer-aided design and robotics, and it offers additional applications and capabilities. AI can be used at many points in the

production process from the development stage to quality control. AI can be used to assist engineers and product developers in the design stage by aiding with new ideas, product modifications, and visual mockups of new products to garner customer feedback early in the product development life cycle. AstraZeneca, a pharmaceutical company, has utilized AI technologies to aid in drug development for optimizing the performance of drugs. Additionally, they have integrated AI into the approval phase to facilitate creating and filing regulatory documents that have cut the time to create the filings by as much as 70 percent. This is just one example of how AI is transforming how manufacturers do their work. Through a technology called "digital twin" technology, virtual representations of processes, manufacturing production lines, and supply chains can be created to evaluate existing operations, investigate the impact of potential adjustments to the processes, and monitor the operations as a whole.

The integration of AI into the manufacturing facility can be seen in several key areas: predictive maintenance, performance optimization, human/robot collaborations, and quality control. The use of AI can be effective in managing and analyzing vast amounts of data from the equipment used in a manufacturing facility. Through the analysis provided, managers can better predict when equipment needs repair or even replacement. This high-level analysis through AI can reduce downtime and maintenance costs. As with the AstraZeneca example, AI can be used to optimize performance of both the products produced and the usage of raw materials and equipment. Again, with sophisticated data analytics possible through AI, machine operation can be optimized, raw material usage can be closely tracked, and discrepancies can be quickly identified. As previously discussed, the cost of raw materials has a significant impact on profitability. Better management of raw materials to reduce waste and overuse can reduce overall costs and in turn increase profits. Product quality can be closely monitored with AI to quickly identify defects or potential issues in the manufacturing process. Early detection of defects can lead to better management of product quality for the end customer.

Robotics already have a stronghold in manufacturing facilities. However, AI "cobots" are becoming more commonplace. Cobots (collaborative robots), utilizing generative AI technologies, work with human employees to enhance capabilities. For example, in a process that requires precise measurements to several decimal places (such as in the pharmaceutical industry), cobots can greatly assist the employee with this task. Cobots can be programmed to learn from their human counterparts to quickly identify defects or place items in precise positions for the next stage of the production process. Manufacturers are finding new ways to utilize AI in their operations to lower costs, reduce time to market, and increase efficiency.[8]

Adaptable Factories: Flexible and Computer-Integrated Manufacturing Systems

A **flexible manufacturing system (FMS)** automates a factory by utilizing technology and specialized equipment to design the space to allow the production line to be easily adapted based on the product. This reduces downtime and improves production efficiency. These systems combine integrated workstations that allow the product to follow different routes or for the machines to move based on production needs.

ETHICS IN PRACTICE

Can Technology Save Your Life?

Using robots to perform surgery once seemed like a futuristic fantasy, but not anymore. Over 20 million patients have benefited from da Vinci surgery globally according to its creator, Intuitive Surgical.

So what accounts for the surge in robotic surgeries? Some preliminary studies suggest improved outcomes for patients. Surgeons who use the da Vinci Surgical System find that patients have less blood loss and pain, lower risks of complications, shorter hospital stays, and quicker recovery times than those who have open surgery—or even, in some cases, laparoscopic procedures that are also performed through multiple small

incisions.

In October 2005, Dr. Francis Sutter, chief of cardiology at the Heart Center at Lankenau Hospital near Philadelphia, did the first da Vinci double bypass. His patient had a single incision and had a rapid recovery period compared to traditional methods. Tests show his heart function to be normal again.

So what are the downsides? The price point of equipment can be a barrier. Often insurance companies have standardized benefits for procedures, regardless of the method used. This may leave a large balance that the patient will have to pay or the hospital must subsidize for some of the more expensive procedures utilizing robotic technologies. Sutter's center held fundraisers to help pay for the da Vinci Surgical System. Surgeons need additional training for the new technologies and on the benefits to patients. There is also a concern that once a hospital invests in such an expensive system, surgeons may feel pressured to use it and steer patients toward surgery over other treatment options.

Other types of technology also improve health care. At Advocate Aurora Health in Oakbrook Terrace, Illinois, intensive care nurses can check a patient coming out of heart-bypass surgery remotely. This is the Aurora eICU, from which a team of doctors and nurses keep constant watch on all 246 ICU beds across the Aurora Health Care system, spanning multiple hospitals across the region. "The idea is not to make care more remote," says David Rein, the unit's medical director, "but to bring expertise to the patient's bedside faster than we ever could before."

Monitors display vital signs and the patient's electronic chart, with details on medications, lab tests and X-ray results, and notes on the patient's condition. Cameras can zoom in so closely that monitoring staff can see the capillaries in a patient's eyes.

Of course, robotic surgery raises some ethical issues. Recent developments suggest ethical issues that may arise when implementing technology into health care practices. Dr. Bertalan Meskó, who wrote the book *The Guide to the Future of Medicine,* identified such issues, including cybercrime related to medical devices, privacy of medical information, reliance on at-home diagnosis without medical guidance, societal changes, and bioterrorism concerns.

Critical Thinking Questions

1. How is technology being used to streamline hospital operations, improve the quality of patient care, and provide better outcomes for patients?
2. What criteria should hospitals use to evaluate whether these expensive technologies are worthwhile investments?

Sources: Bertalan Meskó, "Ethical Issues of the Future of Medicine: The Top 10," *Medical Futurist,* https://medicalfuturist.com, accessed February 20, 2018; Thomas Macaulay, "Could the 'World's Smallest Surgical Robot' Make Keyhole Surgery Mainstream?" *Tech World,* https://www.techworld.com, December 28, 2017; Greg Adamson, "Ethics and Technology," *IEEE Standards University*, https://www.standardsuniversity.org, March 13, 2017; Nayef Al-Rodhan, "The Many Ethical Implications of Emerging Technologies," *Scientific* American, https://www.scientificamerican.com, March 13, 2015; Nick Glass and Matthew Knight, "Would You Have Surgery at the Hands of a Robot?" *CNN*, https://www.cnn.com, August 5, 2013; Josh Fishman, "Can High Tech Save Your Life?" *U.S. News & World Report*, August 1, 2005, p. 45–52; "20 Million Patients Benefit from da Vinci Surgery Globally," *Intuitive*, https://isrg.intuitive.com, January 23, 2026; "Advocate Aurora Health – Electronic ICU," https://healthcaresnapshots.com, accessed February 9, 2026; "Virtual Health Remote Monitoring for Home Health Services," https://www.aurorahealthcare.org, accessed February 9, 2026.

Flexible manufacturing systems are expensive. But once in place, a system requires little labor to operate and provides consistent product quality. It can also be adjusted easily and inexpensively. FMS equipment can

quickly be reprogrammed to perform a variety of jobs. These systems work well when small batches of a variety of products are required or when each product is made to individual customer specifications.

Computer-integrated manufacturing (CIM) combines computerized manufacturing processes (such as robots and flexible manufacturing systems) with other computerized systems that control design, inventory, production, and purchasing. With CIM, when a part is redesigned in the CAD system, the changes are quickly transmitted both to the machines producing the part and to all other departments that need to know about and plan for the change.

Technology and Automation at Your Service

Manufacturers are not the only businesses benefiting from technology. Nonmanufacturing firms are also using automation to improve customer service and productivity. Most financial institutions such as banks and credit cards offer services to customers through various channels such as apps, ATMs, or websites. Retail stores of all kinds use point-of-sale (POS) terminals that track inventories, identify items that need to be reordered, and tell which products are selling well. Walmart, a leader in retailing automation, has its own satellite system connecting POS terminals directly to its distribution centers and headquarters.

CONCEPT CHECK

1. Describe total quality management and the role that Six Sigma, ISO 9000, and ISO14000 play in it.
2. How can lean manufacturing and just-in-time inventory management help a firm improve its production and operations?
3. How are both manufacturing and nonmanufacturing firms using technology and automation to improve operations?

10.8 Trends in Production and Operations Management

8. What key trends are affecting the way companies manage production and operations?

What trends will impact U.S. production and operations management both now and in the future? Manufacturing employment has fluctuated since the Great Recession and with the impact of the COVID-19 pandemic, but by the end of 2024 there were nearly 13 million people employed in the manufacturing sector. U.S exports have increased to nearly $300 billion and the integration of technology into manufacturing processes has made U.S. firms more competitive.[9]

Yet rapid changes in technology and intense global competition create anxiety about the future. Is technology replacing too many jobs? Or, with qualified workers predicted to be in short supply, is the integration of technology imperative to the United States' ability to compete in a global marketplace? Will the United States start to lag behind other economies for leadership in innovation? And what should it be doing to ensure that today’s students are tomorrow’s innovators and scientists?

Workforce development and finding skilled employees is a concern facing U.S. firms today. If the United States is to maintain its competitive edge, more emphasis is needed on science, education and workforce development, research, and entrepreneurial ventures. And what about the crucial role of technology? These are some of the trends facing companies today that we will examine.

U.S. employees compete for positions with workers across the world and are no longer simply competing against one another. This is particularly true for manufacturers who account for over 60 percent of U.S. exports. Today's integrated global economy with more competition and export opportunities brings new challenges and new possibilities to the United States and its workforce. To compete in the global economy,

emphasis on innovation and workforce development are critical success factors for countries to consider.

Looming Workforce Crisis Threatens U.S. Competitiveness

According to the latest National Association of Manufacturers Skills Gap Report, manufacturing executives rank a "high-performing workforce" as the most important factor in their firms' future success. This finding concurs with data from the U.S. Department of Labor, which conclude that over 70 percent of future jobs will require education and training beyond a high school diploma.

But the National Association of Manufacturers predicts that 3.8 million new jobs will be filled over the coming years, but nearly two million jobs will go unfilled due to a skills gap. When asked to identify the most serious problem for their company, 65 percent of survey respondents indicated that attracting and retaining employees is their biggest business challenge.

As demand for better-educated and more highly skilled workers begins to grow, trends project this shortage of skilled workers will increase. Firms are investigating innovative ways to develop their current workforce to keep up with the skills needed in technology and AI. For example, businesses are partnering with trade schools, high school career centers, and economic development organizations to both train the existing workforce and to recruit new employees. Governments and business leaders alike recognize the importance of education and workforce development activities.[10]

American Innovation Leadership at Risk

Recent research shows the United States in competition for its global leadership position in science and innovation. The report was prepared by the Task Force of the Vision for American Science and Technology (VAST), a coalition of industry leaders, scientists, and academics. Although the United States has historically been a leader in innovation, competing countries are narrowing the gap. In response, according to the Task Force report, the United States needs to focus on strengthening and building an adaptable workforce.

The task force indicated a need for a renewed focus on investment in science and research. Federally funded research as a share of GDP has been on the decline since a high in the 1960s. Federally funded research and development represented less than one percent (0.63 percent) of GDP in 2022.[11] The U.S. share of worldwide high-tech exports has fluctuated over time after the Great Recession and COVID-19 pandemic, from around $220 billion in 2008 to the latest data showing U.S. high-tech exports at $385.3 billion. However, graduate science and engineering enrollment is on the rise in the United States as it is in competing countries worldwide. In addition, the changing workforce in the United States in these fields could lead to a critical shortage of the talent needed by firms.[12]

So what needs to be done to reverse this alarming trend? Continued investment in research at all levels—federally funded, business funded, and privately funded—is a key success factor to fostering innovation and technological development. Historically, such funding has helped bring to market products such as lasers, MRI machines, fiber optics, and even the internet. National Association of Manufacturers President Jay Timmons noted that, "Modern manufacturing offers high-paying, long-term careers. It's a high-tech, sleek industry. It's time to close the skills gap and develop the next generation of the manufacturing workforce."[13]

Business Process Management (BPM)—The Next Big Thing?

Today's firms have a wide span across borders with an assortment of partners and an array of suppliers often spread across thousands of miles. Some companies can find themselves unprepared for this global design. Many firms today see the benefit of collaboration across borders and are making strides to acclimate to the global nature of doing business.[14]

"**Business Process Management** is the glue to bind it all together," says Eric Austvold, chief revenue officer at ToolsGroup (formerly research director at AMR Research). "It provides a unified system for business." This technology has the power to integrate and optimize a company's sprawling functions by automating much of

what it does. The results speak for themselves. Implementing BPM can provide significant savings on inventory costs and material expenses. Defense contractor Lockheed Martin uses a BPM system to eliminate waste and improve process efficiency, allowing them to realize considerable savings each year.

BPM is the key to the success of such corporate high-flyers as Walmart and Dell, which collect, digest, and utilize all sorts of production, sales, and shipping data to continually hone their operations. So how does BPM actually work? When a Dell product is ordered online through an integrated BPM system, electronic transactions flow between suppliers so that each part arrives quickly and the product assembly including software installation and testing is scheduled. Because of the efficiency of the process and the just-in-time delivery, Dell bills customers when the products are shipped. A well-thought-through BPM system can even reschedule production runs, reroute deliveries, or shift work to alternate plants.[15]

The amount of available data—business intelligence (BI), enterprise resource planning (ERP), customer relationship management (CRM), and other systems—is staggering. "Every organization has hundreds of processes that require decisions," says Paul Harmon, executive editor and founder of Business Process Trends. "If you could improve each of those decisions so that the average employee consistently did as well as the best employee, your organization would be making a lot more money," according to Harmon. BPM can drive growth through the automation of business processes and decision-making, particularly those processes that integrate organizations. Companies that have good collaborative processes through the adoption of business process management programs experience savings in inventory costs, stronger order fulfillment practices, fewer stock outs, increases in sales, and as a result of the cost savings, increased revenues.[16]

AI, specifically the data analytic capabilities made possible through artificial intelligence, is having a significant impact on operations management. The goal of operations management is maximizing efficiency in all aspects of production—from design, to sourcing raw materials, to supply chain, to delivery to the end customer. AI technology is proving to be instrumental in assisting leaders with this goal. Data gathered by Deloitte found that 94 percent of business leaders surveyed contend that AI will be critical to their firm's success in the coming years. Through the high-level data analysis provided through AI technologies, managers can make real-time decisions to increase production or reduce waste, and ultimately reduce costs. AI technologies can be integrated into existing systems to manage inventory more efficiently, address customer concerns in a more timely manner, optimize supply chain activities, and automate processes that have typically been manual operations. AI can gather and analyze large data sets and make recommendations based on this analysis for business leaders to evaluate and implement. By "partnering" with AI, employees can enhance their critical thinking and problem-solving capabilities to make improvements to production processes.[17]

CONCEPT CHECK

1. Describe the impact of the anticipated worker shortage on U.S. business.
2. How are today's educational trends affecting the future of manufacturing?
3. What is business process management (BPM), and how do businesses use it to improve operations management?

Key Terms

assembly process A production process in which the basic inputs are either combined to create the output or transformed into the output.

bill of material A list of the items and the number of each required to make a given product.

blockchain technology Refers to a decentralized "public ledger" of all transactions that have ever been executed. It is constantly expanding, as "completed" blocks are added to the ledger with each new transaction.

business process management (BPM) A unified system that has the power to integrate and optimize a company's sprawling functions by automating much of what it does.

CAD/CAM systems Linked computer systems that combine the advantages of computer-aided design and computer-aided manufacturing. The system helps design the product, control the flow of resources needed to produce the product, and operate the production process.

cellular manufacturing Production technique that uses small, self-contained production units, each performing all or most of the tasks necessary to complete a manufacturing order.

computer-aided design (CAD) The use of computers to design and test new products and modify existing ones.

computer-aided manufacturing (CAM) The use of computers to develop and control the production process.

computer-integrated manufacturing (CIM) The combination of computerized manufacturing processes (such as robots and flexible manufacturing systems) with other computerized systems that control design, inventory, production, and purchasing.

continuous improvement A commitment to constantly seek better ways of doing things in order to achieve greater efficiency and improve quality.

continuous process A production process that uses long production runs lasting days, weeks, or months without equipment shutdowns; generally used for high-volume, low-variety products with standardized parts.

critical path In a critical path method network, the longest path through the linked activities.

critical path method (CPM) A scheduling tool that enables a manager to determine the critical path of activities for a project—the activities that will cause the entire project to fall behind schedule if they are not completed on time.

customization The production of goods or services one at a time according to the specific needs or wants of individual customers.

electronic data interchange (EDI) The electronic exchange of information between two trading partners.

enterprise resource planning (ERP) A computerized resource-planning system that incorporates information about the firm's suppliers and customers with its internally generated data.

fixed-position layout A facility arrangement in which the product stays in one place and workers and machinery move to it as needed.

flexible manufacturing system (FMS) A system that combines automated workstations with computer-controlled transportation devices—automatic guided vehicles (AGV)—that move materials between workstations and into and out of the system.

Gantt charts Bar graphs plotted on a time line that show the relationship between scheduled and actual production.

intermittent process A production process that uses short production runs to make batches of different products; generally used for low-volume, high-variety products.

inventory The supply of goods that a firm holds for use in production or for sale to customers.

inventory management The determination of how much of each type of inventory a firm will keep on hand and the ordering, receiving, storing, and tracking of inventory.

ISO 14000 A set of technical standards designed by the International Organization for Standardization to promote clean production processes to protect the environment.

ISO 9000 A set of five technical standards of quality management created by the International Organization for Standardization to provide a uniform way of determining whether manufacturing plants and service organizations conform to sound quality procedures.

job shop A manufacturing firm that produces goods in response to customer orders.

just-in-time (JIT) A system in which materials arrive exactly when they are needed for production, rather than being stored on-site.

lean manufacturing Streamlining production by eliminating steps in the production process that do not add benefits that customers want.

make-or-buy decision The determination by a firm of whether to make its own production materials or to buy them from outside sources.

Malcolm Baldrige National Quality Award An award given to recognize U.S. companies that offer goods and services of world-class quality; established by Congress and named for a former secretary of commerce.

manufacturing resource planning II (MRPII) A complex computerized system that integrates data from many departments to allow managers to more accurately forecast and assess the impact of production plans on profitability.

mass customization A manufacturing process in which goods are mass-produced up to a point and then custom-tailored to the needs or desires of individual customers.

mass production The manufacture of many identical goods at once.

materials requirement planning (MRP) A computerized system of controlling the flow of resources and inventory. A compehensive schedule is used to ensure that the materials, labor, and equipment needed for production are at the right places in the right amounts at the right times.

operations management Management of the production process.

outsourcing The purchase of items from an outside source rather than making them internally.

perpetual inventory A continuously updated list of inventory levels, orders, sales, and receipts.

process layout A facility arrangement in which work flows according to the production process. All workers performing similar tasks are grouped together, and products pass from one workstation to another.

process manufacturing A production process in which the basic input is broken down into one or more outputs (products).

product (or assembly-line) layout A facility arrangement in which workstations or departments are arranged in a line with products moving along the line.

production The creation of products and services by turning inputs, such as natural resources, raw materials, human resources, and capital, into outputs, which are products and services.

production planning The aspect of operations management in which the firm considers the competitive environment and its own strategic goals in an effort to find the best production methods.

production process The way a good or service is created.

program evaluation and review technique (PERT) A scheduling tool that is similar to the CPM method but assigns three time estimates for each activity (optimistic, most probable, and pessimistic); allows managers to anticipate delays and potential problems and schedule accordingly.

purchasing The process of buying production inputs from various sources; also called *procurement.*

quality Goods and services that meet customer expectations by providing reliable performance.

quality control The process of creating quality standards, producing goods that meet them, and measuring finished goods and services against them.

robotics The technology involved in designing, constructing, and operating computer-controlled machines that can perform tasks independently.

routing The aspect of production control that involves setting out the work flow—the sequence of machines and operations through which the product or service progresses from start to finish.

scheduling The aspect of production control that involves specifying and controlling the time required for each step in the production process.

Six Sigma A quality-control process that relies on defining what needs to be done to ensure quality,

measuring and analyzing production results statistically, and finding ways to improve and control quality.

supply chain The entire sequence of securing inputs, producing goods, and delivering goods to customers.

supply-chain management The process of smoothing transitions along the supply chain so that the firm can satisfy its customers with quality products and services; focuses on developing tight bonds with suppliers.

Total Quality Management (TQM) The use of quality principles in all aspects of a company's production and operations.

value-stream mapping Routing technique that uses simple icons to visually represent the flow of materials and information from suppliers through the factory to customers.

Summary of Learning Outcomes

10.1 Production and Operations Management—An Overview

1. Why is production and operations management important in both manufacturing and service firms?

In the past, some U.S. manufacturers lost customers to foreign competitors because their production and operations management systems did not support the high-quality, reasonably priced products consumers demanded. Service organizations also rely on effective operations management in order to satisfy consumers. Operations managers, the personnel charged with managing and supervising the conversion of inputs into outputs, work closely with other functions in organizations to help ensure quality, customer satisfaction, and financial success.

10.2 The Production Process: How Do We Make It?

2. What types of production processes do manufacturers and service firms use?

Products are made using one of three types of production processes. In mass production, many identical goods are produced at once, keeping production costs low. Mass production, therefore, relies heavily on standardization, mechanization, and specialization. When mass customization is used, goods are produced using mass-production techniques up to a point, after which the product or service is custom-tailored to individual customers by adding special features. When a firm's production process is built around customization, the firm makes many products one at a time according to the very specific needs or wants of individual customers.

10.3 Location, Location, Location: Where Do We Make It?

3. How do organizations decide where to put their production facilities? What choices must be made in designing the facility?

Site selection affects operating costs, the price of the product or service, and the company's ability to compete. In choosing a production site, firms must weigh the availability of resources—raw materials, labor, and even capital—needed for production, as well as the ability to serve customers and take advantage of marketing opportunities. Other factors include the availability of local incentives and the manufacturing environment. Once a site is selected, the firm must choose an appropriate design for the facility. The three main production facility designs are process, product, and fixed-position layouts. Cellular manufacturing is another type of facility layout.

10.4 Pulling It Together: Resource Planning

4. Why are resource-planning tasks such as inventory management and supplier relations critical to production?

Production converts input resources, such as raw materials and labor, into outputs, finished products and services. Firms must ensure that the resources needed for production will be available at strategic moments in the production process. If they are not, productivity, customer satisfaction, and quality may suffer. Carefully

managing inventory can help cut production costs while maintaining enough supply for production and sales. Through good relationships with suppliers, firms can get better prices, reliable resources, and support services that can improve production efficiency.

10.5 Production and Operations Control

5. How do operations managers schedule and control production?

Routing is the first step in scheduling and controlling production. Routing analyzes the steps needed in production and sets out a workflow, the sequence of machines and operations through which a product or service progresses from start to finish. Good routing increases productivity and can eliminate unnecessary cost. Scheduling involves specifying and controlling the time and resources required for each step in the production process. Operations managers use three methods to schedule production: Gantt charts, the critical path method, and PERT.

10.6 Looking for a Better Way: Improving Production and Operations

6. How can quality-management and lean-manufacturing techniques help firms improve production and operations management?

Quality and productivity go hand in hand. Defective products waste materials and time, increasing costs. Poor quality also leads to dissatisfied customers. By implementing quality-control methods, firms can reduce these problems and streamline production. Lean manufacturing also helps streamline production by eliminating unnecessary steps in the production process. When activities that don't add value for customers are eliminated, manufacturers can respond to changing market conditions with greater flexibility and ease.

10.7 Transforming the Factory Floor with Technology

7. What roles do technology and automation play in manufacturing and service-industry operations management?

Many firms are improving their operational efficiency by using technology to automate parts of production. Computer-aided design and manufacturing systems, for example, help design new products, control the flow of resources needed for production, and even operate much of the production process. By using robotics, human time and effort can be minimized. Factories are being automated by blending computers, robots, and machinery into flexible manufacturing systems that require less labor to operate. Service firms are automating operations too, using technology to cut labor costs and control quality.

10.8 Trends in Production and Operations Management

8. What key trends are affecting the way companies manage production and operations?

The U.S. economy is strong with steady growth, but dramatic advances in technology, predicted worker shortages, and global competition create challenges for the future. How will companies balance their technology and workforce needs? Can the United States retain its competitive advantage for leadership in innovation? And what should it be doing to convert today's students into tomorrow's innovators and scientists? Workforce development is a challenge facing U.S. firms today. To address this concern, investment in research and science can help the United States compete globally in this arena. And what of the increasingly crucial role of technology? These are some of the trends facing companies today.

Preparing for Tomorrow's Workplace Skills

1. LeShaun and Casey are co-owners of L-Z Marketing, an advertising agency. Last week, they landed a major aerospace manufacturer as a client. The company wants the agency to create its annual report. LeShaun, who develops the art for the agency, needs about a week to develop the preliminary report design, another two weeks to develop the graphical elements, and three weeks to proof and edit the report for final copy. Casey writes the material for the report and doesn't need as much time: two days to meet with

the client to review the company's financial information, and about three weeks to compile the information into a format ready to be included in the final report document. Of course, LeShaun can't develop the necessary graphical elements until the text for the report has been completed. Casey also needs to proof the final copy before publishing the annual report, and that will take three days. Develop either a Gannt chart or a critical path diagram for the team to use in scheduling the project. Explain why you chose the method you did. How long will it take LeShaun and Casey to finish the project if there are no unforeseen delays? (Resources, Systems)

2. Look for ways that technology and automation are used at your school, in your mode of transportation, or at a local retailer. As a class, discuss how automation affects the service you receive from each of these organizations. Does one organization use any types of automation that might be effectively used by one of the others? Explain. (Interpersonal, Information)
3. Pick a small business in your community. Make a list of the resources critical to the firm’s production and operations. What would happen if the business suddenly couldn’t acquire any of these resources? Divide the class into small groups and discuss strategies that small businesses can use to manage their supply chain. (Resources, Information, Interpersonal)
4. Broadway Fashions is a manufacturer of dresses. The company’s factory has 50 employees. Production begins when the fabric is cut according to specified patterns. After being cut, the pieces for each dress style are placed into bundles, which then move through the factory from worker to worker. Each worker opens each bundle and does one assembly task, such as sewing on collars, hemming dresses, or adding decorative items such as appliqués. Then, the worker puts the bundle back together and passes it on to the next person in the production process. Finished dresses are pressed and packaged for shipment. Draw a diagram showing the production process layout in Broadway Fashions’ factory. What type of factory layout and process is Broadway using? Discuss the pros and cons of this choice. Could Broadway improve production efficiency by using a different production process or factory layout? How? Draw a diagram to explain how this might look. (Resources, Systems)
5. As discussed in this chapter, some firms choose to move their manufacturing operations overseas. Although there can be sound financial benefits to this choice, moving production overseas can also raise new challenges for operations managers. Identify several of these challenges, and offer suggestions for how operations managers can use the concepts in this chapter to minimize or solve them. (Resources, Information)
6. **Team Exercise** Reliance Systems, headquartered in Oklahoma City, is a manufacturer of computer keyboards. The company plans to build a new factory and hopes to find a location with access to low-cost but skilled workers, national and international transportation, and favorable government incentives. Working in teams, assign tasks, and research possible site locations, both domestic and international. Choose a location you feel would best meet the company’s needs. Make a group presentation to the class explaining why you have chosen this location. Include information about the location’s labor force, similar manufacturing facilities already located there, availability of resources and materials, possible local incentives, political and economic environment in the location, and any other factors you feel make this an attractive location. After all teams have presented their proposed locations, as a class rank all of the locations and decide the top two Reliance should investigate further. (Interpersonal, Information)
7. Your teacher has just announced a huge assignment, due in three weeks. Develop a Gantt chart to plan and schedule more effectively.
    - Break the assignment down into smaller tasks: pick a topic; conduct research, organize your information, develop an outline, write, revise, and proofread.
    - Estimate how much time each task will take.
    - Across the page, list all the days until the assignment is due. Along the side, list all the tasks you've identified in the order that they need to be done. To facilitate the organization of the information, you might consider using a Gantt chart or a spreadsheet template.
    - Starting with the first task, block out the number of days you estimate each task will take. Include days that you won’t be able to work on the project.

- Track the actual time spent on each task.

After you complete and submit your assignment, compare your time estimates to the actual time each task took. How can these findings help you with future assignments? (Resources, Systems)

Ethics Activity

A spate of mine disasters that caused numerous fatalities refocused national attention on the question: is management doing enough to protect employees on the job? Serious OSHA (Occupational Safety and Health Administration) violations that resulted in serious injuries to workers because of the lack of appropriate safety equipment suggest there is still a long way to go.

Companies are responsible for providing a safe workplace for employees. So why do accidents like these continue to happen? In a word—money. It takes money to purchase the necessary safety equipment, such as harnesses, install guardrails, and otherwise ensure a safe and healthy work environment. And even more is needed to employ the staff necessary to enforce company safety policies. It can be less costly for the firm to pay the fines for the violations.

As a supervisor at a company with frequent violations of OSHA regulations, you worry about your employees' safety. But each time your company needs to implement a new safety feature, end-of-year employee bonuses get smaller. The money has to come from somewhere, management claims.

Conduct research to locate articles about this topic, and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Do you report safety violations to management in the hope they will be corrected before someone gets hurt, or do you stage a total work stoppage to force management's hand, knowing that either way you risk losing popularity at every level, and very possibly your job? Or, of course, you could say nothing and hope for the best. It is not a problem you created, and you're just there to do a job, after all.

Sources: George Avalos, "PG&E Violated Safety Rules, Was Late on Thousands of Wine Country Electricity Inspections and Work Orders," *The Mercury News*, https://www.mercurynews.com, October 25, 2017; Barry Meier and Danielle Ivory, "Worker Safety Rules Are Among Those Under Fire in Trump Era," *The New York Times*, https://www.nytimes.com, March 13, 2017; Kenneth Cheng, "Senior Managers Could Be Taken to Task for Workplace Safety Violations," *Today Online*, https://www.todayonline.com, March 7, 2017.

Working the Net

1. Conduct a web search for "supplier information," and visit the websites of several firms (for example, Walmart, Home Depot, Verizon, etc.). Compare the requirements companies set for their suppliers. How do they differ? How are they similar?
2. Visit *Site Selection* magazine, **https://www.siteselection.com**. Review the State & Area Guides for information about the manufacturing environment in various U.S. locations. Pick three to four areas to read about. Using this information, what locations would you recommend for firms in the following industries: data centers, agriculture equipment manufacturing, or clothing manufacturing? Explain.
3. Manufacturers face many federal, state, and local regulations. Visit the National Association of Manufacturers at **https://www.nam.org**. Pick two or three legislative or regulatory issues discussed under their Issues sections, and use a search engine to find more information.
4. Use a search engine to research information about technologies such as ERP, CAD/CAM systems, or robotics. Find at least three suppliers for one of these technologies. Visit their websites, and discuss how their clients are using their products to automate production.
5. Research either the Malcolm Baldrige National Quality Award or the ISO 14000 Quality Standards program on the internet. Write an executive summary that explains the basic requirements and costs of participating. What are the benefits of participating? Include a brief example of a company that has

participated and their experiences. Include a list of relevant website links for further reading.

Critical Thinking Case

Innovation and Employee Involvement

This chapter provides insights into how manufacturing and service organizations can implement processes and controls to increase efficiency, manage expenditures, and increase profits for the organization. For companies such as Dell that need to manage suppliers and make sure that all components are procured on time and at the best costs to ensure the final assembly runs efficiently, and for service organizations such as Hilton Hotels, which wants to have clean rooms and an efficient check-in process when guests arrive, the main lessons of this chapter are readily apparent.

All companies, however, need to innovate continuously to improve their products and services. Automobile companies such as Ford have to constantly measure customer tastes and needs and provide products that meet and exceed their expectations. Likewise, Marriott needs to cater to the needs of business and leisure travelers in a variety of locations.

Procter & Gamble, a leader in the consumer goods industry, has a long history of innovation and employee empowerment. In 2022, the company embarked upon a project partnering with Microsoft to integrate AI technologies into their manufacturing processes. These technologies increased productivity and quality, reduced waste, automated processes, and put a focus on sustainable usage of energy and water. Through the data management power of AI, P&G was able to integrate data from manufacturing facilities worldwide to facilitate improved efficiencies.

At the heart of implementing a change of this scale was employee buy-in. To facilitate this, the company created IT-embedded teams in all business categories and global markets. These embedded teams were a part of the larger IT group responsible for the AI integration, but because they were embedded into the various business units and markets, they worked with employees in those units to develop solutions specific to their area. Another key strategy was P&G's "insourcing" approach where they recruit from within their current workforce for key positions in the areas of data analytics and computer engineering.

Critical Thinking Questions

1. What is the business value to P&G as a result of their approach to garnering employee buy-in?
2. What are the potential problems that could arise out of this approach?
3. Can you think of alternative ways that P&G could have secured employee support through the transition to AI supported processes?

Sources: Thor Olavsrud, "P&G Turns to AI to Create Digital Manufacturing of the Future," *CIO*, https://www.cio.com, September 30, 2022.

Hot Links Address Book

1. See how Nike brings it all together to create customized shoes at **https://www.nike.com/nike-by-you**.
2. What characteristics contribute to a city's manufacturing climate? Find out by reading more at *Industry Week*'s website: **https://www.industryweek.com**.
3. How do companies decide whether to make or buy? Find out more at the Outsourcing Institute, a professional association where buyers and sellers network and connect: **https://www.outsourcing.com**.
4. Learn how to build your own Gantt chart at **https://www.gantttool.com/en**.
5. What does it take to win the Malcolm Baldrige National Quality Award? Get the details at **https://www.nist.gov/baldrige/baldrige-award**.
6. Want to know more about how robots work? Find out at **https://science.howstuffworks.com/robot.htm**.

11

Creating Products and Pricing Strategies to Meet Customers' Needs

Exhibit 11.1 (Credit: Hamza Butt / flickr / Attribution Generic 2.0 (CC BY))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What is the marketing concept and relationship-building?
2. How do managers create a marketing strategy?
3. What is the marketing mix?
4. How do consumers and organizations make buying decisions?
5. What are the five basic forms of consumer and business market segmentation?
6. What is a product, and how is it classified?
7. How do organizations create new products?
8. What are the stages of the product life cycle?
9. What strategies are used for pricing products, and what are the future trends?
10. What trends are occurring in products and pricing?

EXPLORING BUSINESS CAREERS

Rachel Kuhr Conn: Mark Cuban's Shark Tank Empire

Rachel Kuhr Conn previously led product and innovation work supporting Mark Cuban's portfolio of companies, including investments in the ABC show *Shark Tank*. After watching an early episode, Kuhr e-mailed Mark Cuban and attached a resume that highlighted her mechanical engineering and product development expertise. Her approach appealed to Cuban, and she was contacted the next day by Abe Minkara, founding partner at Legacy Knight and former managing director at Mark Cuban Companies. After a Skype interview in which Minkara was impressed with Kuhr's skill set of both creativity and attention to process, she was hired to fill that role and work with several start-ups that Cuban acquired an investment in through the show. Today, Kuhr coaches and collaborates with companies on product and innovation

through the firm she founded, Productable.

Rather than start out with detailed plans and building sophisticated prototypes, Kuhr preferred to first sketch out basic ideas using items such as whiteboards and post-it notes instead of electronic tools. Such an approach uses the best practices from brainstorming to steer the direction of product development before spending lots of resources, both human and financial, on a single idea for too long. This approach also allows the product development team to incorporate the user experience, which is sometimes overlooked when the focus is squarely on the product.

One of the companies that Kuhr worked with created Chapul Cricket Bars. Chapul, founded by Pat Crowley, popularized cricket-flour protein bars after appearing on Shark Tank and receiving an investment from Mark Cuban. The company used flavor-forward naming as it worked to broaden appeal. Chapul later pivoted away from consumer protein bars and refocused on insect agriculture (Chapul Farms).

Another Cuban investment was the Austin, Texas–based BeatBox Beverages. To better understand how typical consumers would relate to boxed flavored cocktails, Kuhr attended several fraternity parties at Southern Methodist University and off-campus bars. She asked questions that addressed how a variety of consumers decide on what to drink on different occasions and in different settings. Since securing a $1 million dollar investment from Cuban, and working with Rachel Kuhr, online and in-store sales have significantly increased, according to Justin Fenchel, BeatBox Beverages' CEO.

Sources: Cheryl Hall, "Why Rachel Kuhr Is the Innovator for Mark Cuban's Shark Tank Startups," *Dallas News*, https://www.dallasnews.com, accessed October 1, 2017; "About Us," https://chapul.com, accessed October 1, 2017; "The Story," https://www.beatboxbeverages.com, accessed October 1, 2017; Teddy Nykiel, "Shark Tank's Biggest Deals and How They Panned Out," *NerdWallet*, https://www.nerdwallet.com, January 9, 2015; "About Us," https://www.beproductable.com, accessed March 4, 2026; Khyati Dand, "Chapul: Here's What Happened After Shark Tank," *Food Republic*, https://www.foodrepublic.com, December 7, 2023.

Marketing plays a key role in the success of businesses. It is the task of marketing to generate sales for the firm. Sales revenue, in turn, pays workers' salaries, buys supplies, covers the costs of new buildings and equipment, and hopefully enables the company to earn a profit. This chapter looks at the nature of marketing and the creation of product and pricing strategies to meet customers' needs. In this chapter, you will learn about the marketing concept, marketing strategies, and consumer and business buying decisions. You will also see how the marketing mix is used to create sales opportunities. We discuss how new products are created and how they go through periods of sales growth and then decline. Next you will discover how managers set prices to reach organizational goals.

11.1 The Marketing Concept

1. What is the marketing concept and relationship-building?

Marketing is the process of getting the right goods or services or ideas to the right people at the right place, time, and price, using the right promotion techniques and utilizing the appropriate people to provide the customer service associated with those goods, services, or ideas. This concept is referred to as the *"right" principle* and is the basis of all marketing strategy. We can say that **marketing** is finding out the needs and wants of potential buyers (whether organizations or consumers) and then providing goods and services that meet or exceed the expectations of those buyers. Marketing is about creating exchanges. An **exchange** takes place when two parties give something of value to each other to satisfy their respective needs or wants. In a typical exchange, a consumer trades money for a good or service. In some exchanges, nonmonetary things are exchanged, such as when a person who volunteers for the company charity receives a T-shirt in exchange for time spent. One common misconception is that some people see no difference between marketing and

sales. They are two different things that are both part of a company's strategy. Sales incorporates actually selling the company's products or service to its customers, while marketing is the process of communicating the value of a product or service to customers so that the product or service sells.

To encourage exchanges, marketers follow the "right" principle. If a local boutique does not have the right clothing size for a potential customer when the customer wants it, at the price they are willing to pay, the potential customer will not purchase the new clothing item. Think about the last exchange (purchase) you made: What if the price had been 30 percent higher? What if the store or other source had been less accessible? Would you have bought anything? The "right" principle tells us that marketers control many factors that determine marketing success.

Most successful organizations have adopted the **marketing concept**. The marketing concept is based on the "right" principle. The marketing concept is the use of marketing data to focus on the needs and wants of customers in order to develop marketing strategies that not only satisfy the needs of the customers but also accomplish the goals of the organization. An organization uses the marketing concept when it identifies the buyer's needs and then produces the goods, services, or ideas that will satisfy them (using the "right" principle). The marketing concept is oriented toward pleasing customers (be those customers organizations or consumers) by offering value. Specifically, the marketing concept involves the following:

- Focusing on the needs and wants of the customers so the organization can distinguish its product(s) from competitors' offerings. Products can be goods, services, or ideas.
- Integrating all of the organization's activities, including production and promotion, to satisfy these wants and needs
- Achieving long-term goals for the organization by satisfying customer wants and needs legally and responsibly

Today, companies of every size in all industries are applying the marketing concept. Enterprise Rent-A-Car found that its customers didn't want to have to drive to its offices. Therefore, Enterprise began delivering vehicles to customers' homes or places of work. Disney found that some of its patrons really disliked waiting in lines. In response, the company originally introduced FastPass as a free way to reduce perceived waiting. Today, Disney monetizes that benefit through paid Lightning Lane passes. One important key to understanding the marketing concept is to know that using the marketing concept means the product is created *after* market research is used to identify the needs and wants of the customers. Products are not just created by production departments and then marketing departments are expected to identify ways to sell them based on the research. An organization that truly utilizes the marketing concept uses the data about potential customers from the very inception of the product to create the best good, service, or idea possible, as well as other marketing strategies to support it.

Customer Value

Customer value is the ratio of benefits for the customer (organization or consumer) to the sacrifice necessary to obtain those benefits. The customer determines the value of both the benefits and the sacrifices. Creating customer value is a core business strategy of many successful firms. Customer value is rooted in the belief that price is not the only thing that matters. A business that focuses on the cost of production and price to the customer will be managed as though it were providing a commodity differentiated only by price. In contrast, businesses that provide customer value believe that many customers will pay a premium for superior customer service or accept fewer services for a value price. It is important not to base value on price (instead of service or quality) because customers who only value price will buy from the competition as soon as a competitor can offer a lower price. It is much better to use marketing strategies based on customer relationships and service, which are harder for the competition to replicate. Southwest Airlines historically differentiated itself with simple service and (formerly) open seating. Today it offers assigned seating, and while it typically does not provide complimentary full meals, it does offer snacks/beverages and in-flight entertainment (often via streaming to personal devices). Southwest emphasizes operational reliability, and its

on-time performance is competitive with other major U.S. carriers. In 2025, Southwest was ranked the highest in customer satisfaction for economy airlines for the fourth year in a row, beating out Jet Blue and Delta Airlines.

Customer Satisfaction

Customer satisfaction is a theme stressed throughout this text. **Customer satisfaction** is the customer's feeling that a product has met or exceeded expectations. Expectations are often the result of communication, especially promotion. Utilizing marketing research to identify specific expectations and then crafting marketing strategy to meet or exceed those expectations is a major contributor to success for an organization. Lexus consistently wins awards for its outstanding customer satisfaction. Lexus frequently ranks highly in J.D. Power studies, which measure different aspects of ownership at different times—such as initial quality shortly after purchase and dependability based on reported problems in 3-year-old vehicles. Lexus continues to lead the industry and has been America's top-ranked vehicle for three years in a row based on the 2025 survey.[1]

Exhibit 11.2 Geico—the major auto insurer with the scaly mascot—famously boasts a 97 percent customer-satisfaction rating. Although the firm's claim may be exaggerated a bit, consumers get the message that Geico delivers quality insurance coverage at low prices. *In what way does the company's quirky and ubiquitous advertising—in which customers claim to have saved a bunch of money on car insurance by switching to Geico—influence customers' service expectations?* (Credit: Mike Mozart/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Building Relationships

Relationship marketing is a strategy that focuses on forging long-term partnerships with customers. Companies build relationships with customers by offering value and providing customer satisfaction. Once relationships are built with customers, customers tend to continue to purchase from the same company, even if the prices of the competitors are less or if the competition offers sales promotions or incentives. Customers (both organizations and consumers) tend to buy products from suppliers whom they trust and feel a kinship with, regardless of offerings of unknown competitors. Companies benefit from repeat sales and referrals that lead to increases in sales, market share, and profits. Costs fall because it is less expensive to serve existing customers than to attract new ones. Focusing on customer retention can be a winning tactic; studies show that increasing customer retention rates by 5 percent increases profits by anywhere from 25 to 95 percent.[2]

Customers also benefit from stable relationships with suppliers. Business buyers have found that partnerships with their suppliers are essential to producing high-quality products while cutting costs. Customers remain loyal to firms that provide them greater value and satisfaction than they expect from competing firms.

Frequent-buyer clubs are an excellent way to build long-term relationships. Most major airlines have frequent-flyer programs. Members earn points or miles, often based on ticket spending and other activity, and can redeem them for award travel with some restrictions. Now, cruise lines, hotels, car rental agencies, credit-card companies, and even mortgage companies give away "airline miles" with purchases. Consumers patronize the airline and its partners because they want the free tickets. Thus, the program helps to create a long-term relationship with (and ongoing benefits for) the customer. Southwest's Rapid Rewards loyalty program offers member perks such as points that can be redeemed for flights and partner rewards, plus tier-based benefits

for frequent flyers.

CONCEPT CHECK

1. Explain the marketing concept.
2. Explain the difference between customer value and customer satisfaction.
3. What is meant by relationship marketing?

11.2 Creating a Marketing Strategy

2. How do managers create a marketing strategy?

What Is Marketing Strategy?

Marketers use a number of different “tools” to develop the products or services that meet the needs and wants of their customers, provide excellent value for the customers, and satisfy those customers. Marketing strategy is really five different components of marketing. These components are traditionally called “the Four Ps” of marketing; however, this chapter includes an additional component "People" to create a new total of **Five Ps**. They are the methods, tools, and processes used by marketers to develop and market products. In Chapter 12, we will analyze an additional P, "Packaging" but will continue to refer to these components as "Five Ps." These five tools are also called “the marketing mix.” These are the 5Ps:

- **Product:** Something offered in exchange and for which marketing actions are taken and marketing decisions made. Products can be goods (physical things such as smartphones) or services (such as the telecommunications that must be used for a smartphone to work) or ideas (such as the thought that being constantly connected through telecommunications is absolutely crucial in today’s society). All products have both tangible and intangible aspects.
- **Price:** Something given in exchange for a product. Price may be monetary or nonmonetary (such as waiting in long lines for a restaurant or giving blood at the local blood bank). Price has many names, such as rent, fees, charges, and others.
- **Place:** Some method of getting the product from the creator of the product to the customer. Place includes a myriad of important tasks: transportation, location, supply chain management (managing each entity that deals with the product in its route to the buyer), online presence, inventory, and atmospherics (how the office, store, or website looks).
- **Promotion:** Methods for informing and influencing customers to buy the product. Promotion includes several different components: traditional advertising, sales promotion, public relations, personal selling, social media, and e-commerce. Promotion is often mistaken for marketing because it is the most visible part of marketing; however, marketing encompasses much more than just promotion.
- **People:** Methods of utilizing organization employees to support the marketing strategies of the company. All products have both tangible and intangible aspects. People (as a marketing strategy) are crucial to the development of the product’s intangible aspects.

Marketers utilize the tools of marketing strategy to develop new products and sell them in the marketplace. But marketers cannot create products in isolation. Marketers must understand and consider all aspects of the external environment in order to create marketing programs (plans) that will be successful in the current market and in future markets. Thus, many organizations assemble a team of specialists to continually collect and evaluate environmental information, a process called **environmental scanning**. The goal in gathering the environmental data is to identify current and future market opportunities and threats.

Companies in high-tech industries understand the importance of environmental scanning to monitor rapidly

changing consumer interests. After the emergence of PCs, processor speeds have grown exponentially alongside a convergence of technologies. The digital industry (manufacturers of computers and smartphones, as examples) has converged with the entertainment industry (such as radio, streaming, and the internet). This convergence is already creating great opportunities for new products—more wearable technologies such as fitness rings or home appliances with smartphone integration—that are not affiliated with companies in the digital or tech industries.

One clear winner in this new world so far is Apple, which has leveraged its computer platform to make it easy and fashionable for consumers to become experts in the digital age. Apple has capitalized on this through the development of iPhones, iPads, and the Apple Watch. Apple sells more iPads per year than it does Macbooks, and over 200 million iPhones. Microsoft is a top competitor in this business, as is HP (Hewlett-Packard). Both companies offer strong competition to Apple and are investing in AI and how it is transforming the industry. Another competitor to watch is Samsung. Samsung's advantage over Apple is its diverse business model in providing products to consumers but also participating in business-to-business relationships by selling components to other companies, with Apple being one of them. Finally, the device-free streaming services such as Amazon Music, Pandora, and Spotify have provided competition to Apple while helping to restore profitability to the music industry.[3]

In general, six categories of environmental data shape most marketing decisions:

- *Cultural/social forces:* Includes such factors as the buying behaviors of specific cultures and subcultures, the values of potential customers, the changing roles of families, and other societal trends such as employees working from home and flexible work hours
- *Demographic forces:* Includes such factors as changes in the ages of potential customers (e.g., baby boomers, millennials, Gen Z), birth and death rates, and locations of various groups of people
- *Economic forces:* Includes such factors as changing incomes, unemployment levels, inflation, and recession
- *Technological forces:* Includes such factors as advances in AI and computer technology
- *Political and legal forces:* Includes such factors as changes in laws, regulatory agency activities, and political movements
- *Competitive forces:* Includes such factors as new and shifting competition from domestic and foreign-based firms

Defining the Target Market

Marketers develop the information about the environment to get a clear picture of the total market for the product, including environmental factors. Once the marketers understand the various environmental factors, specific target markets must then be chosen from the total market. Marketers focus on providing value for a well-defined target market or target markets. The **target market** is the specific group of customers (which could be organizations or individual consumers) toward which a firm directs its marketing efforts. Monster Energy Drinks targets people 18 to 34 years old and those interested in gaming, extreme sports, or fitness. Williams Sonoma has several different brands, each geared toward a distinct target market: Pottery Barn for upscale home furnishings; its specialty stores, West Elm, Mark and Graham, and Rejuvenation, that specialize in jewelry and other accessories; and home improvement and furnishings that are affordable and sustainable. These target markets are all part of the overall retail market for housewares and lifestyle. Identifying a target market helps a company focus its marketing efforts on those who are most likely to buy its products or services. Concentrating on potential customers lets the firm use its resources efficiently. Examples of the target markets for Marriott Hotel Brands' lodging alternatives are shown in **Table 11.1**.

Examples of Target Markets for Marriott Hotel Brands		
	Offering	**Target Market**
Fairfield Inn	Budget-conscious lodgings	Economizing business and leisure travelers
Towne Place Suites	Cost-sensitive extended stay	Moderate-tier travelers who stay three to four weeks
SpringHill Suites	Spacious suites	Business and leisure travelers looking for more space and amenities
Courtyard	Business conveniences	Travelers seeking quality and affordable accommodations designed for the road warrior
Residence Inn	Extended stay suites with kitchens	Travelers seeking a residential-style hotel
Marriott Hotels, Resorts, and Suites	Full-service amenities for business or leisure	Grounded achievers who desire consistent quality
Renaissance Hotels and Resorts	Premium lifestyle stays	Discerning business and leisure travelers who seek creative attention to detail
Ritz-Carlton	Executive travel and affluent leisure with high-touch service	Senior executives and entrepreneurs looking for a unique, luxury, personalized experience

Table 11.1

Creating a Competitive Advantage

A **competitive advantage**, also called a *differential advantage*, is a set of unique features of a company and its products that are perceived by the target market(s) as significant and superior to those of the competition. Competitive advantage is the factor that causes customers to patronize a specific firm and not the competition. There are four types of competitive advantage: cost, product differentiation, service differentiation, and niche.

Cost Competitive Advantage

A firm that has a **cost competitive advantage** can produce a product or service at a lower cost than all its competitors while maintaining satisfactory profit margins. Firms become cost leaders by effectively managing raw material costs, optimizing plant operations for efficiency, making strategic product design choices, and controlling overhead costs.

Over time, the cost competitive advantage may fail. Typically, if one firm is using an innovative technology to reduce its costs, then other firms in the industry will adopt this technology and reduce their costs as well. For example, in the 1980s, Bell Labs invented fiber-optic communication systems that not only reduced the cost of voice and data transmission, but also increased the speed of transmission considerably, to almost instantaneous. Within five years, however, fiber-optic technology had spread through the industry, and Bell

Labs lost its cost competitive advantage. Firms may also lose their cost competitive advantage if competing firms match their low costs by using the same lower-cost suppliers. Therefore, a cost competitive advantage may not offer a long-term competitive advantage.

Product Differentiation Competitive Advantage

Because cost competitive advantages are subject to continual erosion, other types of competitive advantage tend to provide a longer-lasting competitive advantage. The durability of a **differential competitive advantage** can be more successful for the long-term viability of the company. Common differential advantages are brand names Airpods, a strong dealer network (Caterpillar for construction equipment), product reliability (Subaru vehicles), image (Coach in retailing), and service (FedEx). Brand names can also convey quality, such as Chanel, BMW, or Patagonia. Through continual product and marketing innovations and attention to quality and value, marketers at these organizations have created enduring competitive advantages.

Service Differentiation Competitive Advantage

In today's world of instant connection and social media, services are crucial for both tangible and nontangible products. Almost every day, news outlets report the consequences of poor service that went "viral" on social media because the service interaction was recorded and posted online. Customers now demand a higher level of service for all kinds of products, and if the service level does not meet customer expectations, it is likely that the customer will post negative comments on a review site or upload the interaction to various social media platforms. Some small companies have had to close their doors on the basis of one poor service interaction that went viral. Service levels that delight customers are even more important for intangible products such as engineering and accounting. Nearly 50 percent of the U.S. GDP is based on services. The ability to create the service product, continually refine the service process, and interact with customers (co-creators of the service) is crucial. Higher-level services require more planning, better execution, and constant evolution through the relationships with the customers. The use of service differentiation as a competitive advantage can be one of the most enduring and viable types of advantage.

Niche Competitive Advantage

A company with a **niche competitive advantage** targets and effectively serves a single segment of the market. For small companies with limited resources that potentially face giant competitors, utilizing a niche competitive advantage may be the only viable option. A market segment that has good growth potential but is not crucial to the success of major competitors is a good candidate for a niche strategy. Once a potential segment has been identified, the firm needs to make certain it can defend against challengers through its superior ability to serve buyers in the segment. For example, Regions Bank's Music Row office in Nashville follows a niche strategy, serving music and entertainment industry clients. The office is located in the heart of the Music Row district. Music Row Private Bank has decided to expand its niche strategy to Miami, the "epicenter" of Latin music, and to Atlanta. The latter is a longtime rhythm-and-blues capital and now is the center of contemporary "urban" music. Both new markets have the kinds of music professionals—entertainers, record executives, producers, agents, and others—that have made Regions Bank–Music Row Private Bank so successful in Nashville.

CONCEPT CHECK

1. What is environmental scanning?
2. What is a target market, and why should a company have one?
3. Explain the four types of competitive advantages and provide examples of each.

11.3 Developing a Marketing Mix

3. What is the marketing mix?

Once a firm has defined its target market and identified its competitive advantage, it can create the **marketing mix**, which is based on the 5Ps discussed earlier, that brings a specific group of consumers a product with superior value. Every target market requires a unique marketing mix to satisfy the needs of the target customers and meet the firm's goals. A strategy must be constructed for each of the 5Ps, and all strategies must be blended with the strategies of the other elements. Thus, the marketing mix is only as good as its weakest part. For example, an excellent product with a poor distribution system could be doomed to failure. An excellent product with an excellent distribution system but an inappropriate price is also doomed to failure. A successful marketing mix requires careful tailoring. For instance, at first glance you might think that McDonald's and Wendy's have roughly the same marketing mix. After all, they are both in the fast-food business. But McDonald's targets children through Happy Meals with connections to popular children's programs or toys and with in-store playgrounds. Wendy's is geared more to an adult crowd. Wendy's restaurants do not have playgrounds, have decor more oriented towards adults, and offer a menu with items geared more toward adult tastes.

Product Strategy

Marketing strategy typically starts with the product. Marketers can't plan a distribution system or set a price if they don't know exactly what product will be offered to the market. Marketers use the term *product* to refer to *goods, services*, or even *ideas.* Examples of goods include tires, gaming systems, and clothing. Goods can be divided into business goods (commercial or industrial) or consumer goods. Examples of services would be hotels, hair salons, food delivery services, and accounting firms. Services can be divided into consumer services, such as lawn care and hair styling, or professional services, such as engineering, accounting, or consultancy. In addition, marketing is often used to "market" ideas that benefit companies or industries, such as the idea to "go green" or to "give blood." Businesses often use marketing to improve the long-term viability of their industries, such as the insurance industry or processed food industry, which run strategic advertising campaigns and social media messaging to encourage consumers to view their industries favorably. Thus, the heart of the marketing mix is the good, service, or idea. Creating a **product strategy** involves choosing a brand name, packaging, colors, a warranty, accessories, and a service program.

Marketers view products in a much larger context than is often thought. They include not only the item itself but also the brand name and the company image. The names Ralph Lauren and Gucci, for instance, create extra value for everything from cosmetics to bath towels. That is, products with those names sell at higher prices than identical products without the names. Consumers buy things not only for what they do, but also for what they mean.

Exhibit 11.3 With their computerized profile-matching capabilities, online dating services are a high-tech way to make a love connection. Today's date-seeking singles want more than automated personals, however. They want advice from experts. Bumble offers in-app dating and relationship advice content from multiple experts—articles and videos covering topics like self-love, first dates, and connecting with others. Dr. Neil Clark Warren, founder of eHarmony, helped popularize online compatibility matching aimed at long-term relationships. *How do internet dating services use various elements of the marketing mix to bolster the effectiveness of their product strategies?* (Credit: Cityswift/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Pricing Strategy

Pricing strategy is based on demand for the product and the cost of producing that product. However, price

can have a major impact on the success of a product if the price is not in balance with the other components of the 5Ps. For some products (especially service products), having a price that is too low may actually hurt sales. In services, a higher price is often equated with higher value. For some types of specialty products, a high price is expected, such as prices for designer clothes or luxury cars. For example, designer shoes are often marked up over 300 percent above the cost to produce because of the image factor associated with the higher price and the brand name. Special considerations can also influence the price. Sometimes an introductory price is used to get people to try a new product. Some firms enter the market with low prices and keep them low, such as Carnival Cruise Lines and Mitsubishi cars. Others enter a market with very high prices and then lower them over time, such as producers of smart TVs and tablets.

Place (Distribution) Strategy

Place (distribution) strategy is creating the means (the channel) by which a product flows from the producer to the consumer. Place includes many parts of the marketing endeavor. It includes the physical location and physical attributes of the business, as well as inventory and control systems, transportation, supply chain management, and even presence on the web. One aspect of distribution strategy is deciding how many stores and which specific wholesalers and retailers will handle the product in a geographic area. Cosmetics, for instance, are distributed in many different ways. Online retailers offer customers a variety of products for skin care and cosmetics at all price points. Urban Decay and Clinique are distributed through stores like Ulta and Sephora. Cover Girl and e.l.f. use mostly chain drugstores like CVS and other mass merchandisers such as Target. Redken products sell primarily through hair salons. L'Oréal uses several of these distribution channels. Birchbox, an online subscription box service, allows customers to try new and premium products. For services, place often becomes synonymous with both physical location (and attributes of that location such as atmospherics) and online presence. For example, an engineering firm would develop offices with modern, high-end interiors (to denote success). Place strategy for services also includes such items as supply chain management. For instance, that same engineering firm would be managing the supplies for ongoing operations and projects and sourcing those through various supply channels to deliver to their customers.

Promotion Strategy

Many people feel that promotion is the most exciting part of the marketing mix. **Promotion strategy** involves the tools and channels that a firm uses to generate awareness, and more importantly, demand for their product or services. These tools can include traditional advertising, public relations, fostering word of mouth through social media channels, sales promotions, and an online presence including e-commerce. These elements are called the promotional mix. Each element is coordinated with the others to create a promotional blend. An advertisement, for instance, helps a buyer get to know the company and paves the way for a sales call. A good promotional strategy can dramatically increase a firm’s sales.

Public relations plays a special role in promotion. It is used to create a good image of the company and its products. Bad publicity costs nothing to send out, but it can cost a firm a great deal in lost business. Good publicity includes tools such as announcements to build excitement about a firm's new product or news about the firm's most philanthropic endeavor. The impact is the result of much time, money, and effort spent by a public-relations department. Public-relations efforts are the least “controllable” of all the tools of promotion, and a great deal of effort and relationship-building is required to develop the ongoing goodwill and networking that is needed to enhance the image of a company.

Sales promotion is directed towards stimulating sales. It can include celebrity endorsements, trade shows, catalogs, contests, games, premiums, coupons, and special offers. It is a direct incentive for the customer to purchase the product immediately. It takes many forms and must adhere to strict laws and regulations. For example, some types of contests and giveaways are not allowed in all the states within the United States. Domino's pizza offers discount coupons and McDonald's has its annual "monopoly" game offering money and food prizes as examples of sales promotions in the fast-food industry.

Social media is a major element of the promotion mix in today's world. Most businesses have a social media presence on various platforms, such as Facebook, Instagram, and TikTok. Social media is more powerful as a channel for getting the company's message out to the target market (or general public) than traditional advertising, especially for some target markets. Companies (and even individuals) can use social media to create instant branding. Influencers play an important role in both sales promotion and public relations activities for companies. Through social media, influencers promote specific products, brands, or companies in general. They can also work against the promotion efforts of firms and direct customers to the competition. Consumers have come to rely on influencer opinions as they make purchasing decisions in nearly every category—from clothing to cars to travel destinations. E-commerce is the use of the company website to support and expand the marketing strategies of the 5Ps. It can include actual "order online" capabilities, create online communities, and be used to collect data from both existing and potential customers. Some e-commerce websites offer free games and other interactive options for their customers. All of this activity helps to build and strengthen the long-term relationships of customers with the company.

Not-for-Profit Marketing

Profit-oriented companies are not the only ones that analyze the marketing environment, find a competitive advantage, and create a marketing mix. The application of marketing principles and techniques is also vital to not-for-profit organizations. Marketing helps not-for-profit groups identify target markets and develop effective marketing mixes. In some cases, marketing has kept local theaters, museums, and other sites of cultural significance from having to close their doors. In other organizations, such as United Way, marketing ideas and techniques have helped managers do their jobs better. In the private sector, the profit motive is both an objective for guiding decisions and a criterion for evaluating results. Not-for-profit organizations do not seek to make a profit for redistribution to owners or shareholders. Rather, their focus is often on generating enough funds to cover expenses or generating enough funds to expand their services to assist more people. For example, a religious organization does not gauge it success by the amount of money that its members donate. The Museum of Science and Industry does not base its performance evaluations on the dollar value of the t-shirts sold in the gift shop. An organization such as the American Red Cross raises funds to provide basic services, but if enough funds are raised (beyond just the amount to cover expenses), those funds are used to expand services or improve current services.

CONCEPT CHECK

1. What is meant by the marketing mix?
2. What are the components of the marketing mix?
3. How can marketing techniques help not-for-profit organizations?

11.4 Buyer Behavior

4. How do consumers and organizations make buying decisions?

An organization that wants to be successful must consider buyer behavior when developing the marketing mix. **Buyer behavior** is the actions people take with regard to buying and using products. Marketers must understand buyer behavior, such as how raising or lowering a price will affect the buyer's perception of the product and therefore create a fluctuation in sales, or how a specific review on social media can create an entirely new direction for the marketing mix based on the comments (buyer behavior/input) of the target market.

To understand buyer behavior, marketers must understand how customers make buying decisions. Consumers and businesses have processes for making decisions about purchases. These decision-making

processes are affected by cultural, social, individual, and psychological factors. The consumer decision-making process has several steps, which are shown in Exhibit 11.4.

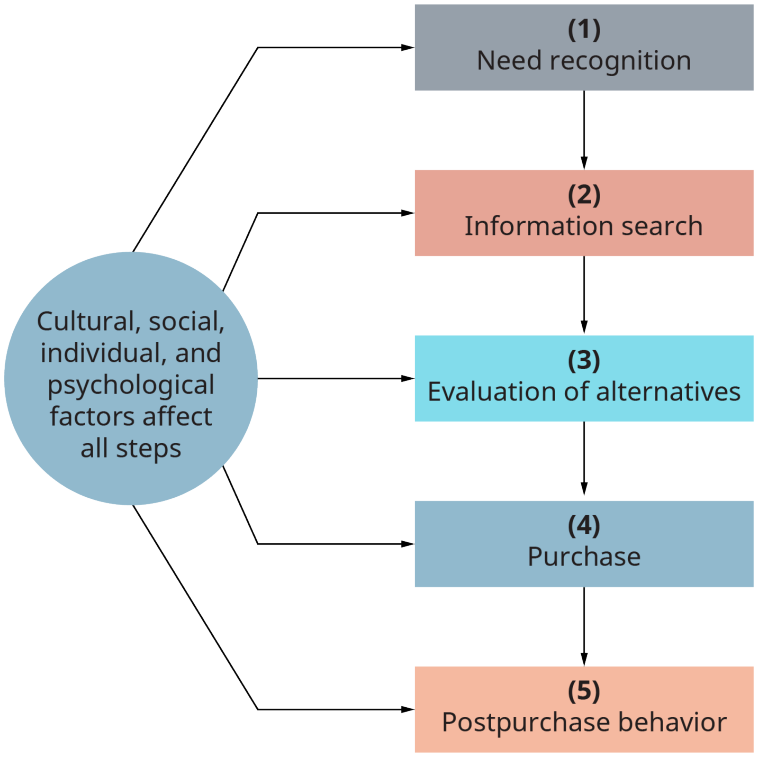

Exhibit 11.4 Consumer Purchase Decision-Making Process (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

The process starts with need recognition. Need recognition could be as simple as running out of shampoo. Need recognition could also take place over several months, such as when repeated car repairs influence a consumer to make a decision to buy a new car. (Step 1 in Exhibit 11.4).

Next, the buyer gathers information. If the consumer is making a decision to purchase a home, they might research information about financing, available housing, styles, locations, and so forth (Step 2). Once the consumer has gathered the information, they must evaluate alternatives (Step 3). For example, a consumer might eliminate all homes that are over a certain price point or over a certain distance from work. After evaluating the alternatives, the consumer will make a decision based on those alternatives. Then the consumer makes the purchase decision, the decision to buy or not to buy (Step 4). Finally, the consumer assesses the decision itself and their satisfaction with the purchase, which would include not only the home, but the buying experience as well (Step 5).

Influences on Consumer Decision-Making

Cultural, social, individual, and psychological factors have an impact on consumer decision-making from the time a person recognizes a need through post-purchase behavior. We will examine each of these factors in more detail. It is important to understand the relevance of these influences on consumer decision-making.

Culture

Consumer decision-making is influenced by culture. **Culture** is the set of values, ideas, attitudes, and symbols created to shape human behavior. Culture is the part of customs and traditions of a group of people that is transformed into its art, food, costumes/clothing, architecture, and language, as well as other unique manifestations of a specific group of related individuals.

Culture by definition is social in nature. It is human interaction that creates values and prescribes acceptable

behavior. Culture gives order to society by creating common expectations. Sometimes these expectations are codified into law; for example, if you come to a red light, you stop the car. In some cultures, a young person undergoes a special rite of passage from youth into adulthood (such as a bar mitzvah in Jewish culture or a quinceañera in Hispanic culture). As long as a value or belief meets the needs of society, it will remain part of the culture. If it is no longer functional, the value or belief fades away. For example, the value that very large families are ideal is no longer held by a majority of people in the U.S. whose daily lives are less dependent on a large household for survival. The impact of culture on consumer decision-making can be found, for instance, in food tastes and traditions, gift-giving practices, and personal care preferences. Beyond products themselves, the aesthetics of a retail space or the way salespeople interact with potential customers, for example, can appeal to certain cultural values.

Social Factors

Most consumers are likely to seek out the opinions of others to reduce their search and evaluation effort or uncertainty, especially as the perceived risk of the decision increases. Consumers may also seek out others' opinions for guidance on new products or services, products with image-related attributes, or products where attribute information is lacking or uninformative. Specifically, consumers interact socially with reference groups, opinion leaders, and family members to obtain product information and decision approval. All the formal and informal groups that influence the buying behavior of an individual are considered that person's **reference groups**. Consumers may use products or brands to identify with or become a member of a group. They learn from observing how members of their reference groups consume, and they use the same criteria to make their own consumer decisions. A reference group might be an age cohort, coworkers in your field, or an interest group to which you belong.

Individual Influences

Consumers have different behaviors when it comes to shopping and what they are shopping for, such as convenience items, specialty items, or unsought items. A person's buying decisions are also influenced by personal characteristics unique to each individual, such as gender and personality. Physiological differences between men and women result in different needs, such as health and beauty products. Just as important are the distinct cultural, social, and economic roles played by individuals and the effects that these have on their decision-making processes. Studies show that spending habits among single men and women are similar. For example, research indicates that the percentage of spending single females expend on entertainment is 41 percent, whereas for men it is around 38 percent. There are, however, some distinct differences when it comes to household purchases and online shopping. A vast majority of the grocery shopping is by women (80 percent). Over half of men, around 60 percent, prefer to make purchases in-store compared to online or through an app. Generational differences can also be seen in shopping habits. Millennial men are reported to spend nearly 60 percent more money on clothing and shoes than females.[4]

Each consumer has a unique personality. **Personality** is a broad concept that can be thought of as a way of organizing and grouping how an individual typically reacts to situations. Thus, personality combines psychological makeup and environmental forces. It includes people's underlying dispositions, especially their most dominant characteristics. Although personality is one of the least useful concepts in the study of consumer behavior, some marketers believe that personality influences the types and brands of products purchased. For instance, the car, electronics, or clothing a consumer buys may reflect one or more personality traits.

Psychological Influences

An individual's buying decisions are further influenced by psychological factors such as perception, beliefs, and attitudes. These factors are what consumers use to interact with their world. They are the tools consumers use to recognize their feelings, gather and analyze information, formulate thoughts and opinions, and take action. Unlike the other three influences on consumer behavior, psychological influences can be affected by a person's

environment because they are applied on specific occasions. For example, individuals will perceive different stimuli and process these stimuli in different ways depending on whether the individual is sitting in class, chatting with friends, or out to dinner with family.

B2B Purchase Decision-Making

Business-to-business (B2B) buyer behavior and business markets are different from consumer markets. Business markets include institutions such as hospitals and schools, manufacturers, wholesalers and retailers, and various branches of government. The key difference between a consumer product and a business product is the intended use. For example, if a consumer purchases a certain brand of computer for use at home, it is considered a consumer good. If a purchasing agent for a local university buys the same exact product for a faculty member at the university, it is considered a business good. This is because the university is a business consumer and the computer will be used in that context.

The Decision-Making Process

The purchases that organizations make often involve greater risk than purchases made by individual consumers. For this reason, businesses (and other organizations) tend to base purchase decisions on more data and make purchase decisions based on rational decision-making so purchases will optimize value for the organization and minimize risk. For this reason, the business purchase decision-making process differs from the consumer process. The steps are similar: need recognition, setting specifications, information search (including identification of suppliers), evaluation (including evaluation of suppliers), purchase ("go or no-go"), and post-purchase evaluation. The major difference between the two processes is that businesses decide beforehand what exactly is needed on the purchase (setting specifications) and then seek information regarding products that meet those specifications. In this way, the purchases are more likely to satisfy the needs of the overall organization, thus reducing the risk.

Characteristics of the B2B Market

The main differences between consumer markets and business markets include the following:

1. *Purchase volume:* Business customers buy in much larger quantities than consumers. Mars must purchase many truckloads of raw materials to make one day's output of M&Ms. Home Depot buys thousands of boxes of screws and nails each day for resale to consumers. The federal government must use (and purchase) millions of office supplies each day.
2. *Number of customers:* Business marketers usually have far fewer customers than consumer marketers. As a result, it is much easier to identify prospective buyers and monitor current needs. For example, there are far fewer customers for industrial equipment than there are for consumer goods like paper towels. There are more than 125 million consumer households in the United States.
3. *Location of buyers:* Business customers tend to be much more geographically concentrated than consumers. The tech industry is concentrated in areas such as California and Texas. Aircraft manufacturing is found in Seattle, Washington; St. Louis, Missouri; and Dallas/Fort Worth, Texas. Suppliers to these manufacturers often locate close to the manufacturers to lower distribution costs and facilitate communication.
4. *Direct distribution:* Business sales tend to be made directly to the buyer because such sales frequently involve large quantities or custom-made items such as heavy machinery. Consumer goods are more likely to be sold through intermediaries such as wholesalers and retailers.

CONCEPT CHECK

1. Explain the consumer purchase decision-making process.
2. Explain the differences between the business purchase decision-making process and the consumer

purchase decision-making process.
3. How do business markets differ from consumer markets?

11.5 Market Segmentation

5. What are the five basic forms of consumer and business market segmentation?

Most organizations cannot target the total market for a specific product. For each separate part of the market that an organization wants to target, a marketing mix (a set of 5Ps) must be created. It would be very expensive to try to create a marketing mix for every part of the target market. Instead, companies cut up those targets into specific "segments" of the market that the organization is more strategically positioned to be successful in targeting. Segmentation also varies based on the target market being a consumer market or a business market.

The study of buyer behavior helps marketing managers better understand why people make purchases. To identify the target markets that may be most profitable for the firm, marketers use **market segmentation**, which is the process of separating, identifying, and evaluating the layers of a market to identify a target market. For instance, a target market might be segmented into two groups: single-parent families and families with no children. Single-parent families might look for on-the-go breakfast items such as fruit or those in convenient packaging. Families with no children might be more likely to buy health-oriented items or breakfast foods that require more preparation and cooking. Cereal companies plan their marketing mixes with this difference in mind. A business market may be segmented by large customers and small customers or by geographic area.

The five basic forms of consumer market segmentation are demographic, geographic, psychographic, benefit, and volume. Their characteristics are summarized in Table 11.2 and discussed in the following sections.

Demographic Segmentation

Demographic segmentation uses categories such as age, education, gender, income, and household size to differentiate among markets. This form of market segmentation is the most common because demographic information is easy to obtain. The U.S. Census Bureau provides a great deal of demographic data, especially about metropolitan areas. For example, marketing researchers can use census data to find areas within cities that contain high concentrations of high-income consumers, single individuals, or those employed in certain trades. However, even though demographic information is easier to obtain than other types of information, it may not always be the best approach to segmentation because it is limited on what it can reveal about consumers.

Forms of Consumer Market Segmentation	
Form General	**Characteristics**
Demographic segmentation	Age, education, gender, income, race, social class, household size
Geographic segmentation	Regional location (e.g., New England, Mid-Atlantic, Southeast, Great Lakes, Plains States, Northwest, Central, Southwest, Rocky Mountains, Far West), population density (urban, suburban, rural), city or county size, climate

Table 11.2

Forms of Consumer Market Segmentation	
Form General	**Characteristics**
Psychographic segmentation	Lifestyle, personality, interests, values, attitudes
Benefit segmentation	Benefits provided by the good or service
Volume segmentation	Amount of use (light versus heavy)

Table 11.2

Age Segmentation for Fritos, Doritos, and Tostitos				
	Year Introduced	**Main Ingredients**	**Demographic**	**Niche, According to Frito Lay**
Fritos	1932	Corn, vegetable oil, salt	33- to 51-year-old men	“Hunger satisfaction”
Doritos	1964	Corn, vegetable oil, cheddar cheese, salt	Teens, mostly young men	“Bold and daring snacking”
Tostitos	1981	White corn, vegetable oil, salt	Upscale consumers born between 1946 and 1964	“Casual interaction through friends and family . . . a social food that brings people together”

Table 11.3 Sources: "About Us," https://www.fritos.com, accessed March 4, 2026; "Doritos," https://www.pepsico.com, accessed March 4, 2026; "Tostitos," https://www.pepsico.com, accessed March 4, 2026.

Many products are targeted to various age groups. Much of the music industry, movies, clothing trends, and thousands of other products are targeted towards Gen Z. In contrast, cruises, medicinal products, fine jewelry, hybrid vehicles, and anti-aging skin care products are targeted toward older generations. An example of how Frito Lay targets various age groups for three of its most popular products is shown in **Table 11.3**.

Income is another popular way to segment markets. Income level influences consumers’ wants and determines their buying power. Electronics, clothing, cars, and some food and beverage products are among the many markets segmented by income. Processed food items are often targeted to lower-income groups, whereas products found at Trader Joe's or Whole Foods are aimed at higher-income consumers.

Geographic Segmentation

Geographic segmentation means segmenting markets by region of the country, city or county size, market density, or climate. *Market density* is the number of people or businesses within a certain area. Many companies segment their markets geographically to meet regional preferences and buying habits. A national restaurant chain, for instance, might adjust their menu offerings for specific markets, such as extra cheese on items for urban locations or additional flavor profiles in more ethnically diverse areas. Automobile firms sell

more pickup trucks and truck parts in the middle of the country than on either coast. More pickup truck sales happen in the Midwest, from Wyoming and South Dakota in the northern parts to Texas in the southern region.

Psychographic Segmentation

Race, income, occupation, and other demographic variables help in developing strategies but often do not paint the entire picture of consumer needs. Demographics provide basic data that can be observed about individuals, but psychographics provide vital information that is often much more useful in crafting the marketing message. Demographics provide the framework, and psychographics expand upon it. **Psychographic segmentation** is market segmentation by personality or lifestyle. People with common activities, interests, and opinions are grouped together and given a “lifestyle name.” For example, Harley-Davidson divides its customers into lifestyle segments from "freedom-seeking" customers who like open-road adventures to brand-loyal "traditionalists" for whom riding a Harley product is part of their identity. Two managers could both be categorized by the same demographics, such as the same age, similar income, and comparable education levels. If only looking at these variables, a marketer might create one advertisement to appeal to both managers. However, if the marketer added the psychographic variables that one manager was involved in city politics and coached their child's soccer team, whereas the other was a hobbyist farmer and had no children, the messages might be designed very differently in order to be more successful.

Benefit Segmentation

Benefit segmentation is based on what a product will do rather than on consumer characteristics. For years Crest toothpaste was targeted toward consumers concerned with preventing cavities. Now Crest's market is subdivided, offering specialized products such as Crest Kids, Crest Densify, and Crest 3D White. Sensodyne toothpaste is firstly aimed at consumers with sensitive teeth, but has also expanded its offerings to include whitening and enamel-building toothpastes based on the benefit segmentation concept.

Volume Segmentation

The fifth main type of segmentation is **volume segmentation**, which is based on the amount of the product purchased. Just about every product has heavy, moderate, and light users, as well as nonusers. Heavy users often account for a very large portion of a product’s sales. Thus, a firm might want to target its marketing mix to the heavy-user segment. For example, in the fast-food industry, the heavy user (a young, single man) accounts for over 60 percent of all visits to fast-food restaurants.

Retailers are aware that heavy shoppers not only spend more, but also visit each outlet more frequently than other shoppers. Average shoppers visit the grocery store about every five days, which is around 75 days per year. Heavy shoppers would be those that exceed this benchmark. This behavior can translate to other types of shopping such as online purchasing. On each trip, they typically spend more than their medium-shopping counterparts.

Business Market Segmentation

Business markets are segmented differently than consumer markets. Business markets may segment based on geography, volume, and benefits, just as consumer markets are. However, organizations might also segment based on use of the product (such as an insurance firm having one market segment for purchasers who need insurance for a new business and one for purchasers for nonprofits that need coverage for a special event), characteristics of purchasing function (such as purchasing committees, purchasing managers, or purchasing departments), size of the client (one segment for large customers who have different needs than smaller customers), or industry (such as segmenting food systems into restaurants or government agencies such as schools or military bases), as well as other considerations related to characteristics of business customers.

Using Marketing Research to Serve Existing Customers and Find New Customers

How do successful companies learn what their customers value? Through marketing research, companies can be sure they are listening to the voice of the customer. **Marketing research** is the process of planning, collecting, and analyzing data relevant to a marketing decision. The results of this analysis are then communicated to management. The information collected through marketing research includes the preferences of customers, the perceived benefits of products, and consumer lifestyles. Research helps companies make better use of their marketing budgets. Marketing research has a range of uses, from fine-tuning existing products to discovering whole new marketing concepts.

For example, everything at the Olive Garden restaurant chain, from the décor to the wine list, is based on marketing research. Each new menu item is put through a series of consumer taste tests before being added to the menu. Otterbox uses marketing research to test product features, color choices, and even which phone models to make products for in its line of phone cases and accessories. Otterbox's experts know which designs and features will sell best in which places, not only geographically, but also in which types of stores. For example, cases with waterproof features might sell better in an outdoor equipment store than in a supermarket.

Marketing research can use either primary data (where the organization actually gets the data to then analyze) or secondary data (where the organization uses data that have already been developed and published by another entity and the organization is able to utilize the data for its own purposes). There are three basic research methods used for gathering primary data: survey, observation, and experiment.

With **survey research**, data are gathered from respondents—through analyzing electronic data such as purchasing habits, through the internet, and sometimes in person. New product development teams may bring in customers from their target market to conduct interviews in order to get input on new product offerings, or may even gather the data in the respondent's home to see how they are using the products. AI is utilized to create virtual environments for product testing to get feedback or to test out new product ideas without having to create a physical prototype.

AI can also be used to automate survey research to expand the reach to consumers as well as to speed up the data collection process. Furthermore, with the power of AI technology, survey-type research can be garnered from multiple sources by scanning online reviews, social media posts, blogs, and other consumer opinion data and then consolidated to reveal market trends. With the power of AI, what historically might have been the effort of a single corporation conducting a survey about a particular product category or new-to-the-market product idea can now be collected and analyzed from multiple sources to compound the information, giving decision makers more depth of knowledge before making strategic business decisions.[5]

Observation research is research that monitors respondents' actions without direct interaction. In the fastest-growing form of observation research, researchers utilize purchase data collected by most companies to observe trends that can be further divided by demographic and even psychographic variables. Technological advances are rapidly expanding the future of observation research. Nielsen Audio uses a wearable device called a portable people meter (PPM) to capture participants' habits surrounding media consumption. The PPM captures TV viewing habits, music listening habits including source and duration, streaming activities, and any other electronic media that the participant encounters throughout the day.[6]

In the third research method, **experiment**, the investigator changes one or more variables—price, package, design, shelf space, advertising theme, or advertising expenditures—while observing the effects of those changes on another variable (usually sales). The objective of experiments is to measure causality. For example, an experiment may reveal the impact that a change in package design has on sales.

CONCEPT CHECK

1. Define market segmentation.
2. List and discuss the five basic forms of consumer market segmentation.
3. What are some additional forms of business segmentation?
4. How does marketing research help companies make better use of their marketing budgets?

11.6 What Is a Product?

6. What is a product, and how is it classified?

The goal of marketing research is to create products that are desired by the target market(s) chosen as strategic markets in line with the organization's goals. In marketing, a **product** (a good, service, or idea), along with its perceived attributes and benefits, creates value for the customer. Attributes can be tangible or intangible. Among the tangible attributes are packaging and warranties as illustrated in Exhibit 11.5. Intangible attributes are symbolic, such as brand image. Intangible attributes can include things like image as well as the depth of the relationship between a service provider and a customer. People make decisions about which products to buy after considering both tangible and intangible attributes of a product. For example, when a consumer buys a pair of jeans, they consider price, brand, store image, and style before making the purchase. These factors are all part of the marketing mix.

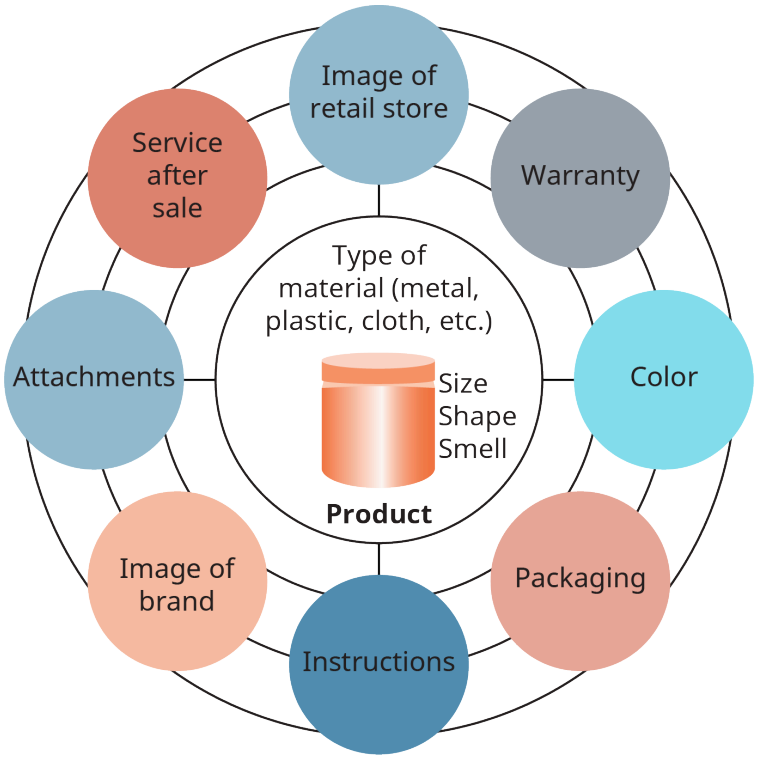

Exhibit 11.5 Tangible and Intangible Attributes of a Product Create Value (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Classifying Consumer Products

Consumers are really buying packages of benefits that deliver value, which always includes some tangible aspects and some intangible aspects. The person who flies with a regional airline is looking for a quick way to get from one city to another relatively close by (the benefit). Providing this benefit requires a tangible part of

the product (the plane) and the intangible part of the service (accessibility, convenience, on-time arrival). A firm that purchases accounting services buys the benefit of having their taxes completed correctly (tangible benefit) and having the expertise of the accounting professional offering recommendation to reduce the firm's costs and taxes the following year (intangible benefit).

Marketers must know how consumers view the types of products their companies sell so that they can design the marketing mix to appeal to the selected target market. To help them define target markets, marketers have devised product categories. Products that are bought by the end user are called *consumer products*. They include personal care items, food, cars, clothing, furniture, and electronics. Purchasing habits differ significantly based on demographic factors such as generation and/or gender. For example, globally, women account for $40 trillion in spending on consumer goods. Women are the leading purchaser of health-related items such as vitamins and gym memberships, whereas men gravitate toward high-tech electronics and gadgets at a much greater rate than women. Consumer products that get used up—such as soaps and shampoos, snack items like chips and pretzels, or paper products like towels or tissues—are called *consumer nondurables*. Those that last for a long time, such as laundry machines, laptops, or furniture, are *consumer durables.*

Another way to classify consumer products is by the amount of effort consumers are willing to make to acquire them. The four major categories of consumer products are unsought products, convenience products, shopping products, and specialty products, as summarized in Table 11.4. **Unsought products** are products unplanned by the potential buyer or known products that the buyer does not actively seek.

Convenience products are relatively inexpensive items that require little shopping effort. Energy drinks, candy, snacks, and small hardware items are examples. Consumers buy them routinely without much planning. This does not mean that such products are unimportant or obscure. Many, in fact, are well known by their brand names—such as Celsius Energy drinks, Irish Spring deodorant, and 3M Command Strips.

In contrast to convenience products, **shopping products** are bought only after some deliberation and thought including comparing brands or prices. Examples are furniture, cars, vacation destinations, or even some high-end clothing items. Convenience products are bought with little planning, but shopping products may be purchased after months or even years of search and evaluation.

Specialty products are products for which consumers search long and hard and for which they refuse to accept substitutes. Custom-designed jewelery, high-end electronics, limited-release products, and five-star restaurants fall into this category. Because consumers are willing to spend much time and effort to find specialty products, distribution is often offered within a limited distribution network that could include online exclusive sales, or one or two sellers in a given region, such a Porsche dealer or a Prada store.

Classification of Consumer Products by the Effort Expended to Buy Them

Consumer	Product Examples	Degree of Effort Expended by Consumer
Unsought products	Life insurance	Minimum effort
	Burial plots	Some to considerable effort
	Specialized medical supplies	Some to considerable effort
Convenience products	Soft drinks	Very little or minimum effort
	Bread	Very little or minimum effort

Table 11.4

Classification of Consumer Products by the Effort Expended to Buy Them		
Consumer	**Product Examples**	**Degree of Effort Expended by Consumer**
	Milk	Very little or minimum effort
	Coffee	Very little or minimum effort
Shopping products	Automobiles	Considerable effort
	Homes	Considerable effort
	Vacations	Considerable effort
Specialty products	Expensive jewelry	Maximum effort
	Gourmet restaurants	Maximum effort
	Limited-production automobiles	Maximum effort

Table 11.4

CUSTOMER SATISFACTION AND QUALITY

Ferrari Targets Successful Consumers

Kevin Crowder walked onto the famed Monza, Italy, race track, climbed into a Ferrari F2000 racer, and circled the course with a Grand Prix champion. Crowder, founding partner of Intelis Capital, who earned millions when he sold a software company he cofounded, isn't himself a professional driver. He's a customer of one of Ferrari's marketing programs: the F-1 Clienti program, through which Ferrari maintains and preserves historic F1 cars. Then, it sells them for $1 million or more, along with the chance to drive them with a professional pit crew's help.

Ferrari limits production to maintain exclusivity, delivering approximately 13,500–14,000 cars annually, with models starting around $240,000 and ranging well into the hundreds of thousands of dollars. Some customers purchase purpose-built Ferrari Challenge race cars and pay entry fees to compete against fellow owners at company-sponsored Ferrari Challenge racing events held worldwide. The F-1 Clienti program adds a super-premium service by giving people a chance to drive the same Ferraris used in Formula One, a premier global racing series with particularly strong followings in Europe, the Americas, and Asia.

The program gives customers "an experience they can't get elsewhere," says Ferrari regional executive (CEO/president of Ferrari Far East and Middle East) Dieter Knechtel. Mr. Knechtel says that the "brand experience is very much related to the ownership experience: It's about driving and the experience of the car while doing it in a community of like-minded people. This is why, we organise track days and tours in Italy with road tours in different countries, we can organise almost any experience with the car—what we offer to our customers is often a 'money can't buy' experience."

Critical Thinking Questions

1. For Crowder, the Ferrari is a specialty good. What kind of product would it be for you? Why?

2. Do you think that Ferrari has done a good job of building brand loyalty? Could another automaker do the same thing?

Sources: "Corse Clienti: Overview," https://races.ferrari.com, accessed October 8, 2017; James Allen, "Ferrari's F1 Clienti Is the World's Ultimate Used Car Buying Program," *Car Buzz,* https://www.carbuzz.com, accessed October 8, 2017; Jonathan Ho, "Ferrari Celebrates 70 Years," *Luxuo,* https://www.luxuo.com, July 13, 2017; Jonathan Welsh, "Checkered-Flag Past Helps Ferrari Unload a Fleet of Used Cars," *The Wall Street Journal,* January 11, 2005, pp. A1, A10.

Classifying Business Products

Products bought by businesses or institutions for use in making other products are called *business products.* These products can be commercial, industrial, or services products. A commercial product would be industrial equipment, such as a crane or software used for inventory management. An industrial product is used in the manufacturing process of goods, such as robotic equipment in an automotive plant. A services product (for business) might be a networking consulting firm helping a large corporation set up offices abroad. Business products are classified as either capital products or expense items. **Capital products** are usually large, expensive items with a long life span. Examples are buildings, large machines, and airplanes. **Expense items** are typically smaller, less expensive items that usually have a life span of less than a year. Examples are general office supplies and cleaning products. Industrial products are sometimes further classified in the following categories:

1. *Installations:* These are large, expensive capital items that determine the nature, scope, and efficiency of a company. Capital products such as General Motors' truck assembly plant in Fort Wayne, Indiana, represent a big commitment against future earnings and profitability. Buying an installation requires longer negotiations, more planning, and the judgments of more people than buying any other type of product.
2. *Accessories:* Accessories do not have the same long-run impact on the firm as installations, and they are less expensive and more standardized. But they are still capital products. Projectors for virtual meetings, tablets, and smaller machines such as tools are typical accessories. Marketers of accessories often rely on well-known brand names and extensive advertising as well as personal selling.
3. *Component parts and materials:* These are expense items that are built into the end product. Some component parts are custom-made, such as navigation equipment in cars, an external keyboard for a tablet, or custom artwork for product packaging; others are standardized for sale to many industrial users. Microprocessors for electronics and insulation in the construction industry are examples of standardized component parts and materials.
4. *Raw materials:* Raw materials are expense items that have undergone little or no processing and are used to create a final product. Examples include lumber, water, chemicals, and metals.
5. *Supplies:* Supplies do not become part of the final product. They are bought routinely and in fairly large quantities. Supply items can vary but include items such as office supplies, cleaning products, and gasoline. Supplies, if not managed properly, can have an impact on the firm's long-run profits.
6. *Services.* These are expense items used to plan or support company operations—for example, janitorial cleaning and management consulting services.

CONCEPT CHECK

1. What is a product?
2. What are the classes of consumer products?
3. Explain how business products are classified.

11.7 Creating Products That Deliver Value

7. How do organizations create new products?

New products pump life into company sales, enabling the firm not only to survive but also to grow. Companies like ATI (specialty steel and materials), Dow (chemicals), Samsung (electronics), Campbell Soup (foods), and Stryker (medical products) get most of their profits from new products. Companies that lead their industries in profitability and sales growth get a large percentage of their revenues from products developed within the last five years. A McKinsey survey found that 70 percent of the top global companies have innovated growth for the company by creating new markets.[7]

Marketers have several different terms for new products, depending on how the product fits into a company's existing product line. When a firm introduces a product that has a new brand name and is in a product category new to the organization, it is classified as a new product.

A new flavor, size, or model using an existing brand name in an existing category is called a **line extension**. Coke Zero and Cherry Coke are line extensions. The strategy of expanding the line by adding new models has enabled companies like Garmin (watches), Sargento (cheeses), Oscar Mayer (lunch meats), and Sony (consumer electronics) to tie up a large amount of shelf space and brand recognition in a product category. Crayola offers branded bath products geared toward children. Services companies also develop new products—new services based on market research—or make changes in ongoing services. Services companies can often introduce and adapt their products faster than companies that manufacture goods because service delivery can be more flexible and changes can often be made immediately. Due to this, customers often expect and require immediate improvements to services.

How New Products Are Developed

Developing new products is both costly and risky, especially for companies that sell products that are goods. New-product failure rates for household and grocery products can approach 80 percent. Overall, companies report that only 3 percent of new products exceed the typical benchmark of success of $50 million in sales the first year. Even companies such as Facebook (now Meta), which launched Facebook Home in 2013 at an initial price of $99 per year, have experienced new product failures.[8] Industrial goods failure rates tend to be lower than those for consumer goods. To increase their chances for success, most firms use the following product development process, which is also summarized in **Exhibit 11.6**.

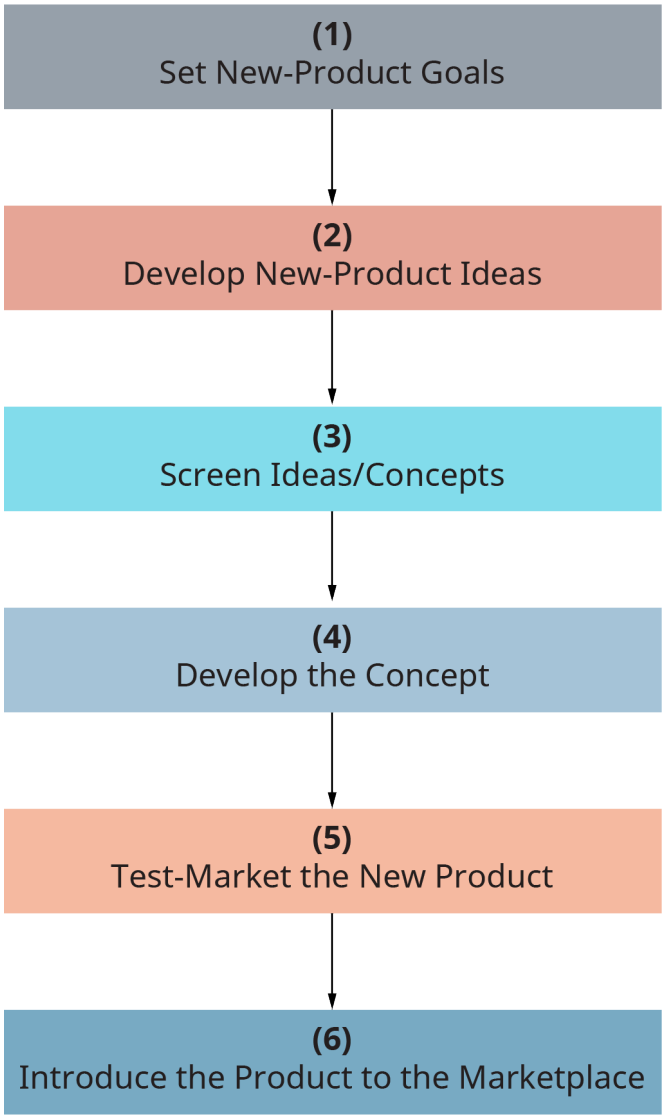

Exhibit 11.6 Steps to Develop New Products That Satisfy Customers (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

1. *Set new-product goals:* New-product goals are usually stated as financial objectives. For example, a company may want to recover its investment in three years or less. Or it may want to earn at least a 15 percent return on the investment. Nonfinancial goals may include using existing equipment or facilities.
2. *Develop new-product ideas:* Smaller firms usually depend on employees, customers, investors, and distributors for new ideas. Larger companies use these sources and more-structured marketing research techniques, such as focus groups and brainstorming. A **focus group** consists of eight to 12 participants led by a moderator in an in-depth discussion on one particular topic or concept. The goal of focus group research is to learn and understand what people have to say and why. The emphasis is on getting people to speak at length and in detail about the subject at hand. The intent is to find out how they feel about a product, concept, idea, or organization; how it fits into their lives; and their emotional involvement with it. Focus groups often generate excellent product ideas. A few examples of focus group–influenced products are the Procter & Gamble Swiffer, Twitter (now X), and Airbnb's service enhancements. Focus groups have been key for designing all kinds of business products, from tools to keyboards to aircraft interiors.

   Brainstorming is also used to generate new-product ideas. With **brainstorming**, the members of a group think of as many ways to vary a product or solve a problem as possible. Criticism is avoided, no matter how ridiculous an idea seems at the time. The emphasis is on sheer numbers of ideas. Evaluation of these

ideas is postponed to later steps of development.

3. *Screen ideas and concepts:* As ideas emerge, they are checked against the firm's new-product goals and its long-range strategies. Many product concepts are rejected because they don't fit well with existing products, needed technology is not available, the company doesn't have enough resources, or the sales potential is low.

4. *Develop the concept:* Developing the new-product concept involves creating a prototype of the product, testing the prototype, and building the marketing strategy. Building the marketing strategy means developing a test set of 5Ps. The type and amount of product testing varies, depending on such factors as the company's experience with similar products, how easy it is to make the item, and how easy it will be for consumers to use it. If Kraft wanted to develop a new salad dressing flavor, the company would benefit from the fact that the company already has a lot of experience in this area. The new dressing will go directly into advanced taste tests and perhaps home-use tests. To develop a new line of soft drinks, however, Kraft would most likely do a great deal of testing. It would study many aspects of the new product before actually making it.

   While the product is tested, the marketing strategy is refined. Channels of distribution are selected, pricing policies are developed and tested, the target market is further defined, and demand for the product is estimated. Management also continually updates the profit plan.

   As the marketing strategy and prototype tests mature, a communication strategy is developed. A logo and package wording are created. As part of the communication strategy, promotion themes are developed, and the product is introduced to the sales force.

5. *Test-market the new product:* **Test-marketing** is testing the product among potential users. It allows management to evaluate various strategies and to see how well the parts of the marketing mix fit together. Few new-product concepts reach this stage. For those that pass this stage, the firm must decide where to introduce the product—regionally, nationally, or globally.

   Companies that don't test-market their products run a strong risk of product failure. In essence, test-marketing is the "acid test" of new-product development. The product is put into the marketplace, and then the manufacturer can see how it performs against the competition.

6. *Introduce the product:* A product that passes test-marketing is ready for market introduction, called *rollout,* which requires a lot of logistical coordination. Various divisions of the company must be encouraged to give the new item the attention it deserves. Packaging and labeling in a different language may be required. Sales training sessions must be scheduled, spare parts inventoried, service personnel trained, advertising and promotion campaigns readied, and wholesalers and retailers informed about the new item. If the new product is to be sold internationally, it may have to be altered to meet the requirements of the target countries. For instance, electrical products may have different plugs and run on different electrical currents.

For services companies, the new product develop process is similar, but developing the prototype can take less time and resources. It will mean developing the service and training service personnel on the new service in order to test it in the market.

The Role of the Product Manager

When a new product enters the marketplace in large organizations, it is often placed under the control of a product or brand manager. A **product manager** develops and implements a complete strategy and marketing program for a specific product or brand of product. Some companies may have numerous brands of the same type of product, such as many versions of hair care products, each with different target markets, brand names, and product attributes. The concept of product management was pioneered by Procter & Gamble in 1929. A new soap product was not doing well, and a P&G executive was assigned to develop and promote the brand.

Using this model, the company added other brand and product managers. Since then, many companies use a similar model.

CONCEPT CHECK

1. How do companies organize for new-product development?
2. What are the steps in the new-product development process?
3. How does new-product development differ for services companies?
4. Explain the role of the product manager.

11.8 The Product Life Cycle

8. What are the stages of the product life cycle?

Product managers create marketing mixes for their products as they move through the life cycle. The **product life cycle** is a pattern of sales and profits over time for a product (Dawn dishwashing soap) or a product category (liquid detergents). As the product moves through the stages of the life cycle, the firm must keep revising the marketing mix to stay competitive and meet the needs of target customers.

Stages of the Life Cycle

As illustrated in Exhibit 11.7, the product life cycle consists of the following stages:

1. *Introduction:* When a product enters the life cycle, it faces many obstacles. Although competition may be light, the *introductory stage* usually features frequent product modifications, limited distribution, and heavy promotion. The failure rate is high. Production and marketing costs are also high, and sales volume is low. Hence, profits are usually small or negative.
2. *Growth:* If a product survives the introductory stage, it advances to the *growth stage* of the life cycle. In this stage, sales grow at an increasing rate, profits are healthy, and many competitors enter the market. Large companies may start to acquire small pioneering firms that have reached this stage. Emphasis switches from primary demand promotion to aggressive brand advertising and communicating the differences between brands. For example, the goal changes from convincing people to buy flat-screen TVs to convincing them to buy Sony versus Panasonic or Sharp.

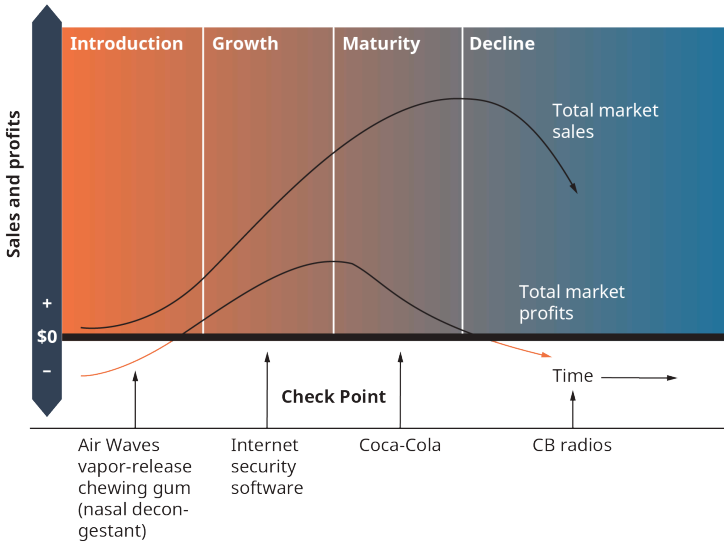

Exhibit 11.7 Sales and Profits during the Product Life Cycle (Attribution: Copyright Rice University, OpenStax, under CC BY

4.0 license.)

Distribution becomes a major key to success during the growth stage, as well as in later stages. Manufacturers scramble to acquire dealers and distributors and to build long-term relationships. Without adequate distribution, it is impossible to establish a strong market position.

Toward the end of the growth phase, prices normally begin falling, and profits peak. Price reductions result from increased competition and from cost reductions from producing larger quantities of items (economies of scale). Also, most firms have recovered their development costs by now, and their priority is in increasing or retaining market share and enhancing profits.

3. *Maturity:* After the growth stage, sales continue to mount—but at a decreasing rate. This is the *maturity stage*. Most products that have been on the market for a long time are in this stage. Thus, most marketing strategies are designed for mature products. One such strategy is to bring out several variations of a basic product (line extension). Kool-Aid, for instance, was originally offered in six flavors. Today there are more than 20 flavors of the traditional powder product, as well as sweetened and unsweetened varieties.

4. *Decline (and death):* When sales and profits fall, the product has reached the *decline stage*. The rate of decline is governed by two factors: the rate of change in consumer tastes and the rate at which new products enter the market. Traditional desktop computers are an example of a product line in the decline stage. The demand for desktops has been surpassed by the demand for tablets and laptops. Sometimes companies can improve a product by implementing changes to the product, such as new ingredients or new services. If the changes are accepted by customers, it can lead to a product moving out of the decline stage and back into the introduction stage.

Exhibit 11.8 Coca-Cola regularly adds new drinks to its product portfolio. While some of these new beverages are close relatives of the original Coca-Cola Classic, others, such as Vitaminwater, constitute entirely new categories of soft drink. *What challenges do new products such as Vitaminwater face during the introduction phase of the product life cycle? (Credit: kobakou/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))*

The Product Life Cycle as a Management Tool

The product life cycle may be used in planning. Marketers who understand the cycle concept are better able to forecast future sales and plan new marketing strategies. **Table 11.5** is a brief summary of strategic needs at various stages of the product life cycle. Marketers must be sure that a product has moved from one stage to the next before changing its marketing strategy. A temporary sales decline should not be interpreted as a sign that the product is dying. Pulling back marketing support can become a self-fulfilling prophecy that brings about the early death of a healthy product.

Strategies for Success at Each Stage of the Product Life Cycle				
Category	**Introduction**	**Growth**	**Maturity**	**Decline**
Marketing objectives	Encourage trial, establish distribution	Get triers to repurchase, attract new users	Seek new user or users	Reduce marketing expenses, used to keep loyal users
Product	Establish competitive advantage	Maintain product quality	Modify product	Maintain product
Distribution	Establish distribution network	Solidify distribution relationships	Provide additional incentives to ensure support	Eliminate trade allowances
Promotion	Build brand awareness	Provide information	Reposition product	Eliminate most advertising and sales promotions
Pricing	Set introductory price (skimming or penetration pricing)	Maintain prices	Reduce prices to meet competition	Maintain prices

Table 11.5

CONCEPT CHECK

1. What is the product life cycle?
2. Describe each stage of the product life cycle.
3. What are the marketing strategies for each stage of the product life cycle?

11.9 Pricing Strategies and Future Trends

9. What strategies are used for pricing products, and what are the future trends?

An important part of the marketing planning process is setting the right price. Price is the perceived value that is exchanged for something else. Value in our society is most commonly expressed in dollars and cents. Thus, price is typically the amount of money exchanged for a product. Note that *perceived value* refers to the perception of the product's value at the time of the transaction. After a consumer has used a product, the consumer may decide that its actual value was less than its perceived value at the time it was purchased. The price paid for a product is based on the *expected satisfaction* that the customer will receive and not necessarily the *actual satisfaction of the customer.*

Although price is usually a dollar amount, it can be anything with perceived value. When products are exchanged for each other, the trade is called *barter*. For example, if your car needs a repair, you might offer to do the house chores for your mechanic roommate in exchange for their service repairing your car. You have engaged in a barter exchange.

Pricing Objectives

Price is important in determining how much a firm earns. The price charged customers times the number of units sold equals the *gross revenue* for the firm. Revenue is what pays for every activity of the company (production, finance, sales, distribution, and so forth). The money that is left over (if any) is profit. Managers strive to charge a price that will allow the firm to earn a fair return on its investment and will maximize return on investment to the highest extent while still maintaining a fair return.

The chosen price must be neither too high nor too low, and the price must equal the perceived value to target consumers. If consumers think the price is too high, sales opportunities will be lost. Lost sales mean lost revenue. If the price is too low, consumers may view the product as a great value, but the company may not meet its profit goals. Sometimes, as in the case of services, a price that is too low will cause the product to be viewed as less than credible and lose sales for the company.

Product Pricing

Managers use various pricing strategies when determining the price of a product, as this section explains. Price skimming and penetration pricing are strategies used in pricing new products; other strategies such as leader pricing and bundling may be used for established products as well.

Price Skimming

The practice of introducing a new product on the market with a high price and then lowering the price over time is called **price skimming**. As the product moves through its life cycle, the price usually is lowered because competitors are entering the market. As the price falls, more and more consumers can buy the product. Examples include gaming systems and flat-screen TVs. When a new gaming system comes out, they are often priced around $500, and flat-screen TVs were originally released at over $1000. Over time, the price of the gaming system decreases to a lower price point to encourage more sales, and the same is true for TVs. You can purchase a flat-screen TV for around $100, although prices vary by size and features.

Price skimming has four important advantages. First, a high initial price can be a way to find out what buyers are willing to pay. Second, if consumers find the introductory price too high, it can be lowered. Third, a high introductory price can create an image of quality and prestige. Fourth, when the price is lowered later, consumers may think they are getting a bargain. The disadvantage is that high prices attract competition.

Price skimming can be used to price virtually any new products, such as high tech electronics, pharmaceutical drugs, and cars. For example, The Republic of Tea offers Emperor's White Tea, which it says is among the rarest of teas. Because it is minimally processed, white tea is said to retain the highest level of antioxidants and has a lower caffeine content than black and green teas. The company says the tea is picked only a few days each year, right before the leaf opens, yielding a small harvest. The product retails for approximately $18.50 per tin. Products don’t have to cost hundreds of dollars to use a skimming strategy.

Penetration Pricing

A company that doesn’t use price skimming will probably use **penetration pricing**. With this strategy, the company offers new products at low prices in the hope of achieving a large sales volume. Procter & Gamble did this with its Oral-B electric toothbrushes. Penetration pricing requires more extensive planning than skimming does because the company must gear up for mass production and marketing. When Ford invested nearly $4 billion in its facility in Michigan to produce lower cost EV car batteries, it produced enough batteries to supply 400,000 cars per year. If the company had been wrong about demand, its losses would have been huge.

Penetration pricing has two advantages. First, the low initial price may induce consumers to switch brands or companies. Using penetration pricing on its wines, Yellow Tail has lured customers away from more well-known brands. Second, penetration pricing may discourage competitors from entering the market. Their costs would tend to be higher, so they would need to sell more at the same price to break even.

Leader Pricing

Pricing products below the normal markup or even below cost to attract customers to a store where they wouldn't otherwise shop is **leader pricing**. A product priced below cost is referred to as a **loss leader**. Retailers hope that this type of pricing will increase their overall sales volume and thus their profit.

Items that are leader priced are usually well known and priced low enough to appeal to many customers. They also are items that consumers will buy at a lower price, even if they have to switch brands. Supermarkets may use leader pricing on products like rotisserie chickens, milk, or eggs to attract customers, pricing them at or near cost while earning profits on other purchases. Department stores and specialty stores also rely heavily on leader pricing.

Pricing of Services

Pricing of services tends to be more complex than pricing of products that are goods. Services may be priced as standard services, such as the price for a cheeseburger value meal at a fast food restaurant, or pricing may be based on tailored services designed for a specific buyer, such as the prices charged for hair stylist services, which vary by the types of services desired.

ETHICS IN PRACTICE

Pricing Before, During, and After Hurricanes

The late summer of 2017 brought several devastating hurricanes that impacted large areas of Texas, Florida, Puerto Rico, and the Virgin Islands. As often happens during events like these, there were several reports of stores, hotels, and service stations engaging in price gouging. Many states have laws against price gouging during natural disasters, but a photo on social media of an electronics retailer charging over $40 for a case of water was widely circulated. A case of water typically costs under $10, so the price was thought to be an instance of price gouging. The retailer quickly addressed the exorbitant price and issued an apology, stating they normally do not sell cases of water, and that an employee wanting to provide a service in advance of the storms simply multiplied the price of a single bottle they normally sell by 24 to arrive at the per-case total. The retailer's response was aimed at deflecting a negative public perception with regard to the pricing "error."

Another example of how companies might be accused of price gouging occurs with companies that use "**dynamic pricing**," which uses computer algorithms to analyze demand and automatically raises prices as demand increases. Amazon uses dynamic pricing, and consumers saw an increase in the price of things like generators and water in the days prior to hurricanes Harvey, Irma, and Juan in 2017.

Some economists believe that price increases during natural disasters are a good thing. They state that letting the market forces work to regulate prices discourages hoarding during disasters such as hurricanes, with buyers purchasing more than they need when the prices are kept low. With the increased demand and lower prices in place, firms do not see the incentive to maintain supply because they are making less money. This leads to shortages for critical items needed during natural disasters, such as water. For example, let's say a retailer decides to raise the price of an essential good such as toilet tissue during a disaster such as the COVID-19 pandemic. A customer might not purchase more than they think they need, thus leaving product for other customers. The higher price, thus higher return to the business, encourages the retailer to restock the product when needed rather than letting the shelves go empty.

Critical Thinking Questions

1. What risks do companies face when selling a product that they normally don't sell and then are accused of price gouging, or when they using dynamic pricing?

2. Why is the use of dynamic pricing deemed acceptable for selling tickets to sporting events but not during a natural disaster?
3. Do you agree with the arguments in support of higher prices put forth by free-market economists?

Sources: Andrew Ross Sorkin, “Hurricane Price Gouging Is Despicable Right? Not to Some Economists,” *The New York Times*, https://www.nytimes.com, September 11, 2017; Tom Popomaronis, “Amid Preparations for Hurricane Irma, Amazon Draws Scrutiny for Price Increases,” *Forbes*, https://www.forbes.com, September 6, 2017; Dennis Green, “Best Buy Explains Why It Charges $42 for a Case of Water in Texas During the Hurricane in ‘a Big Mistake,’” *Business Insider*, https://www.businessinsider.com, August 29, 2017; Matt Zwolinski, “The Ethics of Price Gouging,” *Business Ethics Quarterly,* 18(3): 347–378, 2008, https://facpub.stjohns.edu; Lili Carneglia, "Price Gouging During Disasters Is Actually a Good Thing," *Foundation for Economic Education*, https://fee.org, October 15, 2018; "Price-Gouging Laws and Consumer Welfare: An Economic Analysis," *Northeastern University*, https://econ.sites.northeastern.edu, January 18, 2024.

Bundling

Bundling means grouping two or more related products together and pricing them as a single product. For example, a local restaurant might bundle menu items with a bottle of wine and flowers for a Valentine's Day weekend special. Appliance stores may offer a washer and dryer together for a price lower than if the units were bought separately.

The idea behind bundling is to reach a segment of the market that the products sold separately would not reach as effectively. Some buyers are more than willing to buy one product but have much less use for the second. Bundling the second product to the first at a slightly reduced price thus creates some sales that otherwise would not be made. For example, Aussie Miracle Moist Shampoo is typically bundled with its conditioner because many people use shampoo more than conditioner, so they don’t need a new bottle of conditioner.

Odd-Even Pricing

Psychology often plays a big role in how consumers view prices and what prices they will pay. **Odd-even pricing** (or **psychological pricing**) is the strategy of setting a price at an odd number to connote a bargain and at an even number to imply quality. For years, many retailers have priced their products in odd numbers—for example, $99.95 or $49.95—to make consumers feel that they are paying a lower price for the product.

Prestige Pricing

The strategy of raising the price of a product so consumers will perceive it as being of higher quality, status, or value is called **prestige pricing**. This type of pricing is common where high prices indicate high status. In high-end shops located in places such as Chicago or New York City, products that would sell elsewhere for less are often marked up because of the prestige of the shop and the perception of higher quality. If the price were lower, customers would perceive them as being of low quality. Prestige pricing is also very prevalent in services because services providers with reputations for excellent service are more in demand, often with a waiting list. This is due to the fact that services are tied directly to the people who provide them and those people have only so much time in a week in which to provide services. Once the calendar fills up, the demand goes up, and the prices become prestige prices.

CONCEPT CHECK

1. What is the difference between penetration pricing and price skimming?
2. Explain the concept of price bundling.
3. Describe odd-even pricing and prestige pricing.
4. Why is prestige pricing prevalent in services?

11.10 Trends in Developing Products and Pricing

10. What trends are occurring in products and pricing?

As customer expectations increase and competition becomes fiercer, perceptive managers will find innovative strategies to satisfy demanding consumers and establish unique products in the market. Satisfying customers requires the right prices. The proliferation of e-commerce across industries has delivered pricing power to both buyers and sellers. Through AI and electronic data gathering from multiple devices, firms can use one-to-one marketing strategies to create a customized marketing mix and even customized messaging for each consumer.

These customized, hyper-personalized marketing messages can be crafted to individual consumers based on real-time data gathering from the customer's online activity. AI and machine learning technologies can offer fast feedback to marketers on pricing changes or consumer product preferences. By gathering sales and feedback data from multiple e-commerce sites and social media outlets, firms can quickly see the impact of changes in the marketing mix to their sales numbers. This data can then be utilized to automate adjustments to budget allocations by shifting funds to more lucrative marketing channels. Finally, maybe the most beneficial aspect of the impact of AI on the marketing mix is the speed and accuracy of data collection. Accurate data delivered to marketers in real-time can have substantial impacts on the performance of the business overall.

Impact of the Internet on Pricing

The internet, corporate networks, and wireless setups are linking people, machines, and companies around the globe—and connecting sellers and buyers as never before. This link is enabling buyers to quickly and easily compare products and prices, putting them in a better bargaining position. At the same time, the technology enables sellers to collect detailed data about customers' buying habits, preferences, and even spending limits so that they can tailor their products and prices. Advances in technology and the significant growth of e-commerce from even traditional retailers has drastically changed the retail landscape. Amazon's Prime membership, which offers free shipping for most items along with other features for an annual fee, has taken some market share from traditional low-cost retailers such as Costco.[9]

Online price-comparison engines, known as shopbots, are continuing to add new features. Price comparison sites like CamelCamelCamel (for Amazon price tracking) and Google Shopping help consumers find the best prices, often highlighting available coupons and discounts. In the past, consumers had to click deep into a retailer's site to find out about these additional savings. Capital One Shopping is a browser extension that compares prices across retailers and alerts users when lower prices are available elsewhere. BuySAFE provides shopping guarantees for purchases made through participating online merchants. When shoppers buy from BuySAFE-verified merchants, they receive purchase protection up to $1,000 if the seller fails to deliver as promised.

Use of these sites has increased as people have become more reliant on the web both as a research tool and as a place to shop. According to reports, more than 60 percent of consumers use their phones to comparison-

shop while in stores.[10] Much of the growth has come from the more-established sites such as Shopify, Bizrate, and PriceGrabber, as well as the shopping sections of Microsoft's MSN, Google, and Capital One. The big attraction with shopping comparison services, of course, is the hunt for a better bargain. Merchants like the sites because they help drive consumer spending. Consumers who use comparison-shopping sites for product information or in-store discount coupons spend more than those who don't.[11]

One-to-One Marketing

One-to-one marketing is creating a unique marketing mix for every consumer. The key to creating one-to-one marketing is a good marketing database. The information contained in a marketing database helps managers know and understand customers, and potential customers, on an individual basis. A **marketing database** is a computerized file of customers' and potential customers' profiles and purchase patterns.

Database marketing can get a customized, individual message to everyone simultaneously through targeted ads on social media sites or through email campaigns. This is why database marketing is sometimes called micromarketing. Database marketing can be used to create a virtual "relationship" between customers and businesses that parallels the relationships people used to have with in-store merchants. "A database is sort of a collective memory," says Richard G. Barlow, president of Frequency Marketing, Inc., a Cincinnati-based consulting firm. "It deals with you in the same personalized way as a mom-and-pop grocery store, where they knew customers by name and stocked what they wanted."

You have also probably heard the term **big data**. Companies such as Meta and Alphabet can process information and then tailor information to provide marketers with higher-probability targets. For instance, imagine that you and some friends are discussing a vacation and you are searching for possible beach locations. That search data can be combined with demographic data and sold to companies that provide travel services to beach destinations. You and your friends then are likely to see travel ads in your social media feeds. Likewise, imagine you are searching for the newest streaming movies to watch on a long flight. You have also recently searched for ways to remove clothing stains. Now when you go to Amazon or social media sites, you see several ads for new movies and laundry cleaning products. All of this was done through the use of big data and analytics to provide consumers solutions they are looking for as well as products that they don't even know that they want. Exhibit 11.9 contrasts the differences in approaches in traditional advertising versus targeted marketing using big data.

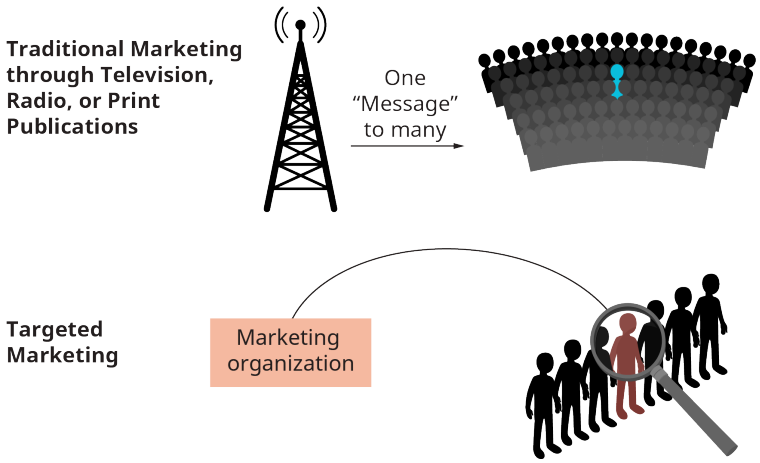

Exhibit 11.9 Traditional Advertising and Targeted Marketing Using Big Data (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Companies such as Ford, Kimberly Clark, and Citicorp have databases of tens of millions of names. The information contained in these databases can be quite detailed. For example, a credit card company can pull from its database all customers who made purchases during the last month at Lowe's, who have also attended a concert, who have traveled outside the U.S. in the past year, and who have children.

Companies are using their marketing databases to implement one-to-one marketing. For example, John Deere uses precision agriculture data and digital tools for customized recommendations. Climate FieldView (Bayer/BASF) offers personalized agronomic insights. Various other agri-tech companies use data-driven personalization for seed/input recommendations for their customers.

CONCEPT CHECK

1. How have online price-comparison engines helped consumers shop for the best price?
2. Describe one-to-one marketing and the role of marketing databases.

Key Terms

benefit segmentation The differentiation of markets based on what a product will do rather than on customer characteristics.

big data Large data sets and systems and solutions developed to manage large accumulations of data.

brainstorming A method of generating ideas in which group members suggest as many possibilities as they can without criticizing or evaluating any of the suggestions.

bundling The strategy of grouping two or more related products together and pricing them as a single product.

buyer behavior The actions people take in buying and using goods and services.

capital products Large, expensive items with a long life span that are purchased by businesses for use in making other products or providing a service.

competitive advantage A set of unique features of a company and its products that are perceived by the target market as significant and superior to those of the competition; also called differential advantage.

convenience products Relatively inexpensive items that require little shopping effort and are purchased routinely without planning.

cost competitive advantage A firm's ability to produce a product or service at a lower cost than all other competitors in an industry while maintaining satisfactory profit margins.

culture The set of values, ideas, attitudes, and other symbols created to shape human behavior.

customer satisfaction The customer's feeling that a product has met or exceeded expectations.

customer value The ratio of benefits to the sacrifice necessary to obtain those benefits, as determined by the customer; reflects the willingness of customers to actually buy a product.

demographic segmentation The differentiation of markets through the use of categories such as age, education, gender, income, and household size.

differential competitive advantage A firm's ability to provide a unique product or service with a set of features that the target market perceives as important and better than the competitor's.

distribution strategy Creating the means by which products flow from the producer to the consumer.

dynamic pricing Computer algorithms that allow for prices to change based on demand.

environmental scanning The process in which a firm continually collects and evaluates information about its external environment.

exchange The process in which two parties give something of value to each other to satisfy their respective needs.

expense items Items (purchased by businesses) that are smaller and less expensive than capital products and usually have a life span of less than one year.

experiment A marketing research method in which the investigator changes one or more variables—price, packaging, design, shelf space, advertising theme, or advertising expenditures—while observing the effects of these changes on another variable (usually sales).

five Ps The traditional 4Ps of marketing: product, price, promotion, place (distribution), now with people added as a key marketing component, which together make up the marketing mix.

focus group A group of eight to 12 participants led by a moderator in an in-depth discussion on one particular topic or concept.

geographic segmentation The differentiation of markets by region of the country, city or county size, market density, or climate.

leader pricing The strategy of pricing products below the normal markup or even below cost to attract customers to a store where they would not otherwise shop.

line extension A new flavor, size, or model using an existing brand name in an existing category.

loss leader A product priced below cost as part of a leader-pricing strategy.

market segmentation The process of separating, identifying, and evaluating the layers of a market in order to identify a target market.

marketing The process of discovering the needs and wants of potential buyers and customers and then

providing goods and services that meet or exceed their expectations.

marketing concept Identifying consumer needs and then producing the goods or services that will satisfy them while making a profit for the organization.

marketing database Computerized file of customers' and potential customers' profiles and purchase patterns.

marketing mix The blend of product offering, pricing, promotional methods, distribution system, and strategies for utilizing people that creates an offering that brings a specific group of consumers superior value.

marketing research The process of planning, collecting, and analyzing data relevant to a marketing decision.

niche competitive advantage A firm's ability to target and effectively serve a single segment of the market, often within a limited geographic area.

observation research A marketing research method in which the investigator monitors respondents' actions without interacting directly with the respondents; for example, by using cash registers with scanners.

odd-even (psychological) pricing The strategy of setting a price at an odd number to connote a bargain and at an even number to suggest quality.

one-to-one marketing Creating a unique marketing mix for every customer.

penetration pricing The strategy of selling new products at low prices in the hope of achieving a large sales volume.

personality A way of organizing and grouping how an individual reacts to situations.

prestige pricing The strategy of increasing the price of a product so that consumers will perceive it as being of higher quality, status, or value.

price skimming The strategy of introducing a product with a high initial price and lowering the price over time as the product moves through its life cycle.

pricing strategy Setting a price based upon the demand for and cost of a good or service.

product In marketing, a good, service or idea, along with its perceived attributes and benefits, that creates value for the customer.

product life cycle The pattern of sales and profits over time for a product or product category; consists of an introductory stage, growth stage, maturity, and decline (and death).

product manager The person who develops and implements a complete strategy and marketing program for a specific product or brand.

product strategy Taking the good or service and selecting a brand name, packaging, colors, a warranty, accessories, and a service program.

promotion strategy The tools and channels that a firm uses to generate awareness demand for their product or services, including traditional advertising, public relations, social media, sales promotions, and online presence. Sometimes referred to as the promotion mix.

psychographic segmentation The differentiation of markets by personality or lifestyle.

reference groups Formal and informal groups that influence buyer behavior.

relationship marketing A strategy that focuses on forging long-term partnerships with customers by offering value and providing customer satisfaction.

shopping products Items that are bought after considerable planning, including brand-to-brand and store-to-store comparisons of price, suitability, and style.

specialty products Items for which consumers search long and hard and for which they refuse to accept substitutes.

survey research A marketing research method in which data are gathered from respondents, either in person, by telephone, by mail, at a mall, or through the internet to obtain facts, opinions, and attitudes.

target market The specific group of consumers toward which a firm could direct its marketing efforts. It is often divided into segments so that marketing strategies can be directed to a more specific target.

test marketing The process of testing a new product among potential users.

unsought products Products that either are not planned as a purchase by a potential buyer or are known

but the buyer does not actively seek them, such as funeral services.

volume segmentation The differentiation of markets based on the amount of the product purchased.

Summary of Learning Outcomes

11.1 The Marketing Concept

1. What is the marketing concept and relationship-building?

Marketing includes those business activities that are designed to satisfy consumer needs and wants through the exchange process. Marketing managers use the "right" principle—getting the right goods or services to the right people at the right place, time, and price, using the right promotional techniques. Today, many firms have adopted the marketing concept. The marketing concept involves identifying consumer needs and wants and then producing products (which can be goods, services, or ideas) that will satisfy them while making a profit. Relationship marketing entails forging long-term relationships with customers, which can lead to repeat sales, reduced costs, and stable relationships.

11.2 Creating a Marketing Strategy

2. How do managers create a marketing strategy?

A firm creates a marketing strategy by understanding the external environment, defining the target market, determining a competitive advantage, and developing a marketing mix. Environmental scanning enables companies to understand the external environment. The target market is the specific group of consumers toward which a firm directs its marketing efforts. A competitive advantage is a set of unique features of a company and its products that are perceived by the target market as significant and superior to those of the competition.

11.3 Developing a Marketing Mix

3. What is the marketing mix?

To carry out the marketing strategy, firms create a marketing mix—a blend of products, distribution (place) systems, prices, promotion, and people. Marketing managers use this mix to satisfy target consumers. The mix can be applied to nonbusiness as well as business situations.

11.4 Buyer Behavior

4. How do consumers and organizations make buying decisions?

Buyer behavior is what consumers and businesses do in order to buy and use products. The consumer purchase decision-making process consists of the following steps: recognizing a need, seeking information, evaluating alternatives, purchasing the product, judging the purchase outcome, and engaging in post-purchase behavior. A number of factors influence the process. Cultural, social, individual, and psychological factors have an impact on consumer decision-making. The business purchase decision-making model includes the following steps: need recognition, setting specifications, information search, evaluation of alternatives against specifications, purchase, and post-purchase behavior. The main differences between consumer and business markets are purchase volume, number of customers, location of buyers, direct distribution, and rational purchase decisions. Companies learn more about their target markets by conducting marketing research—the process of planning, collecting, and analyzing data relevant to a marketing decision.

11.5 Market Segmentation

5. What are the five basic forms of consumer and business market segmentation?

Success in marketing depends on understanding the target market. One technique used to identify a target market is market segmentation. The five basic forms of segmentation are demographic (population statistics), geographic (location), psychographic (personality or lifestyle), benefit (product features), and volume (amount

purchased).

Business markets may segment based on geography, volume, and benefits, just as consumer markets are. However, organizations might also segment based on use of the product, characteristics of purchasing function, and size of the client or industry, as well as other considerations related to characteristics of business customers.

11.6 What Is a Product?

6. What is a product, and how is it classified?

A product can be a good, service, or idea, along with its perceived attributes and benefits, that creates customer value. Tangible attributes include the good itself, packaging, and warranties. Intangible attributes can include the brand's image or relational attributes such as the credibility of its service providers. Products are categorized as either consumer products or business-to-business products, which can be commercial, industrial, or services products. Consumer products are bought and used by the end user, sometimes called "the ultimate consumer." They can be classified as unsought products, convenience products, shopping products, or specialty products, depending on how much effort consumers are willing to exert to get them.

Business-to-business products are those bought by organizations for use in making other products or in rendering services to other organizations and include capital products and expense items.

11.7 Creating Products That Deliver Value

7. How do organizations create new products?

To succeed, most firms must continue to design new products to satisfy changing customer demands. But new-product development can be risky. Many new products fail. The steps in new-product development are setting new-product goals, exploring ideas, screening ideas, developing the concept (creating a prototype and building the marketing strategy), test-marketing, and introducing the product. When the product enters the marketplace, it is often managed by a product manager.

11.8 The Product Life Cycle

8. What are the stages of the product life cycle?

After a product reaches the marketplace, it enters the product life cycle. This cycle typically has four stages: introduction, growth, maturity, and decline (and possibly death). Profit margins are usually small in the introductory phase, reach a peak at the end of the growth phase, and then decline.

Price indicates value, helps position a product in the marketplace, and is the means for earning a fair return on investment. If a price is too high, the product won't sell well and the firm will lose money. If the price is too low, the firm may lose money even if the product sells well. Prices are set according to pricing objectives.

11.9 Pricing Strategies and Future Trends

9. What strategies are used for pricing products, and what are the future trends?

The two main strategies for pricing a new product are price skimming and penetration pricing. Price skimming involves charging a high introductory price and then, usually, lowering the price as the product moves through its life cycle. Penetration pricing involves selling a new product at a low price in the hope of achieving a large sales volume.

Pricing tactics are used to fine-tune the base prices of products. Sellers that use leader pricing set the prices of some of their products below the normal markup or even below cost to attract customers who might otherwise not shop at those stores. Bundling is grouping two or more products together and pricing them as one. Psychology often plays a role in how consumers view products and in determining what they will pay. Setting a price at an odd number tends to create a perception that the item is cheaper than the actual price.

Prices in even numbers denote quality or status. Raising the price so an item will be perceived as having high quality and status is called prestige pricing. Pricing for services is more complicated and is often tailored to specific services for a specific customer.

11.10 Trends in Developing Products and Pricing

10. What trends are occurring in products and pricing?

The proliferation of e-commerce has given pricing power to both buyers and sellers. Enhanced data collection abilities fostered by technology have allowed firms to use this data to create detailed databases for one-to-one marketing strategies. The large amount of data that is available to marketers is being mined and analyzed to target specific customers with personalized messages rather than creating one message that is aimed at a broad audience.

Preparing for Tomorrow's Workplace Skills

1. Can the marketing concept be applied effectively by a sole proprietorship, or is it more appropriate for larger businesses with more managers? Explain. (Information)
2. Before starting your own business, you should develop a marketing strategy to guide your efforts. Choose one of the business ideas listed below, and develop a marketing strategy for the business. Include the type of market research you will perform and how you will define your target market. (Information, Systems)
    - Crafts retailer to capitalize on the renewed interest in knitting and other crafts
    - Online corporate-training company
    - Ethnic restaurant near your campus
    - Another business opportunity that interests you
3. “Market segmentation is the most important concept in marketing.” Why do you think some marketing professionals make this statement? Give an example of each form of segmentation. (Systems)
4. Pick a specific product that you use frequently, such as a skin or personal care item, snack food, article of clothing, app, or game. What is the target market for this product, and does the company’s marketing strategy reflect this? Now consider the broader category of your product. How can this product be changed and/or the marketing strategy adjusted to appeal to other market segments? (Systems)
5. Under what circumstances would a company that designs and sells jeans market the product as a convenience product? A shopping product? A specialty product? (Information)
6. Conduct research to find examples of price skimming, penetration pricing, and value pricing. Write a summary report outlining the examples and how they represent the pricing strategies. (Information)
7. Explain how something as obvious as a retail price can have a psychological dimension. (Information)
8. **Team Activity** Divide the class into teams. Create a single market list of products. Each team should visit a different retailer's website and collect pricing information about the goods selected. Report your findings to the class. (Interpersonal)
9. How does the stage of a product’s life cycle affect price? Give some examples. (Informational)

Ethics Activity

As cosmetics companies roll out line after line of products to satisfy consumers’ quest for beauty and a healthy appearance, the shelves are getting crowded. How can a company stand out? Products such as Thrive Causemetics and Method IQ promote their science-backed products and biotech approach to product design to distinguish them from the competition. Other companies in the healthy living market also claim science-backed products, including Herbalife Nutrition, Juice Plus+, and BODi.

The practice of multi-level marketing by companies like Herbalife and Plexus can be a controversial business model. In fact, some companies that previously used the approach have switched to a direct-to-consumer selling model. Basically, multi-level marketing enlists a new salesperson by making the individual purchase training and inventory of the company product at a discount and begin selling the product at retail prices,

while also recruiting new salespeople as their "downline" salespeople. The idea is that eventually you will make most of your income via the results of your downline salespeople—the people you brought into the business.

There are numerous critiques of multi-level marketing, the most notable being investor Bill Ackman's accusation that weight loss company Herbalife was engaging in a pyramid scheme. A pyramid scheme is an arrangement whose entire whole purpose is the enrichment of the top of the pyramid at the expense of new recruits. Herbalife was able to refute Ackman's accusations in a lawsuit brought against them by showing that their results were based on product sales rather than recruitment and that they offered money-back guarantees if the recruits were unable to sell the product. Herbalife continues to face legal and regulatory challenges, including foreign bribery charges and distributor lawsuits.

Ethical Dilemma: Is the practice of multi-level marketing ethical? How can companies that use the approach conduct business fairly for both their sellers and for customers who buy their products?

Sources: "Multi-Level Marketing," *Investopedia,* https://www.investopedia.com, accessed October 1, 2017; "METHODIQ," https://www.methodiq.com, accessed March 4, 2026; "About Us," https://thrivecausemetics.com, accessed March 4, 2026; "BODi to Transition from Multi-Level Marketing to Single-Level Affiliate Model," *DSN*, https://www.directsellingnews.com, October 1, 2024; "Beachbody Shifts to Affiliate Model, Cuts Workforce by 33%," *Investing.com*, https://www.investing.com, September 30, 2024; "All About Plexus Worldwide," https://helpcenter.plexusworldwide.com, accessed March 4, 2026; Lesley Fair, "It's No Longer Business as Usual at Herbalife: An Inside Look at the $200 Million FTC Settlement," Federal Trade Commission, https://www.ftc.gov, July 15, 2016; Hank Schultz, "Herbalife to Pay $12.5 Million to Settle Class Action Suit Over Event Costs," *Supply Side Supplement Journal*, https://www.supplysidesj.com, May 10, 2023.

Working the Net

1. You are considering starting a job with a multi-level marketing company. Do research to get information about this type of work. You might consider resources such as **https://ismelguerrero.com/blog/mlm-companies/** or **https://moneymasterpiece.com/multi-level-marketing/**. Find two potential firms that interest you and compare and contrast their approach, compensation, and benefits. Summarize your findings.
2. Visit Viola Marketing at **https://violamarketingblog.wordpress.com/2025/01/30/do-you-know-what-your-vals-type-is/** and read about the VALS survey. Consider how marketers might use it and what value it brings. Then take the survey to find out which psychographic segment you're in. Do you agree or disagree with the results? Why or why not?
3. How good was the marketing strategy you developed in Question 2 of Preparing for Tomorrow's Workplace? Using advice from the Grow Your Business section of *Entrepreneur* on How to Create a Marketing Plan (**https://www.entrepreneur.com/growing-a-business/how-to-create-a-marketing-plan-entrepreneurcom/43018**), revisit your marketing strategy for the business you selected, and revise the plan accordingly. What did you overlook? (If you didn't do this exercise, pick one of the businesses and draft a marketing strategy using online resources to guide you.)
4. Visit an online retailer such as Amazon.com **(https://www.amazon.com)**, Wayfair **(https://www.wayfair.com)**, or cvs.com **(https://www.cvs.com/)**. At the site, try to identify examples of leader pricing, bundling, odd-even pricing, and other pricing strategies. Do online retailers have different pricing considerations than brick-and-mortar or traditional retailers? Explain.
5. Do a search for online auctions for a product you are interested in buying. Visit several auctions, and get an idea of how the product is priced. How do these prices compare with the price you might find in a local store? What pricing advantages or disadvantages do companies face in selling their products through online auctions? How do online auctions affect the pricing strategies of other companies? Why?
6. Pick a new consumer electronic product such as a fitness ring or the latest GoPro camera. Then go to shopping bot **https://shop.app/**. Compare prices, information, and ease-of-use of the site. Report your findings to the class.

Critical Thinking Case

Celebrity Brand Endorsements

Coca-Cola now distributes Monster Energy drinks as part of its partnership with Monster Beverage, PepsiCo markets energy drinks under its Rockstar brand (acquired in 2020) and Mountain Dew Amp Energy, and smaller companies are challenging the soft drink giants with products such as Bang Energy, Bloom Energy Drinks, and Liquid IV. With concerns about the amount of sugar in soft drinks and the negative health effects that can cause, brands such as Vitaminwater and Bai have garnered significant market share and have been acquired by soft drink companies such as Coca-Cola (Vitaminwater, 2007) and Keurig Dr Pepper (Bai, 2017).

The person behind the success of Powerade, Vitaminwater, and Bai is Rohan Oza, now co-founder and managing partner of CAVU Consumer Partners. After graduating from the University of Michigan's business school, Oza began working at Coca Cola, where he worked on brands such as Sprite and Powerade. After Oza left Coca Cola for more entrepreneurial challenges, he scored a coup with Smartwater, where he was able to approach Jennifer Aniston to become the endorser of the product. Rapper 50 Cent was an early endorser of Vitaminwater (2004–2009), taking equity instead of cash and earning an estimated $100 million when Coca-Cola acquired the brand in 2007.

Oza did not stop after the Vitaminwater success. Ben Weiss founded Bai in 2009, building it into one of the fastest-growing beverage brands. Marketing executive Oza helped orchestrate celebrity partnerships, including bringing in Justin Timberlake as an investor and Chief Flavor Officer in 2016, shortly before Dr Pepper Snapple acquired the company for $1.7 billion. Just as he did with Jennifer Aniston and Smartwater, and with 50 Cent and Vitaminwater, Oza works on making sure that he has the correct strategy to match the features and benefits of the brand with just the right celebrity endorser. With Bai, a sparkling drink that features antioxidants as a product benefit, Oza was able to convince Timberlake, an entrepreneur in his own right, to invest in Bai. So Timberlake was not only an endorser but a part owner, and he has been intimately involved in the brand strategy. This partnership worked as well, because Bai was sold to the Dr Pepper Snapple Group for $1.7 billion in 2016.

Critical Thinking Questions

- Oza has established several successful products in the competitive beverage industry. Why has he been able to achieve this success when large organizations with more resources, such as Coca Cola and Pepsi, are forced to buy these new successful brands?
- What types of unique marketing support helped to sustain Vitaminwater and Bai's tremendous growth?
- Suggest a celebrity endorsement with a beverage brand, and tell why that pairing would lead to success. What are the brand attributes and the reputation of the endorser that would resonate with specific consumer segments?

Sources: John Lynch, "Hollywood's 'Brandfather' Talks About His New Role on 'Shark Tank,' Working with 50 Cent and Justin Timberlake," *Business Insider*, https://www.businessinsider.com, October 1, 2017; Heidi Parker, "She Has Great Ideas and Is Savvy," *The Daily Mail,* https://www.dailymail.co.uk, September 17, 2017; Katie Benner, "He'd Like to Buy the World Something Other Than a Coke," *The New York Times*, https://www.nytimes.com, January 6, 2017; "smartwater® and Jennifer Aniston Reunite for 2025 Campaign," The Coca-Cola Company, https://www.coca-colacompany.com, June 17, 2025; Kimberly Wilson, "From Rap Icon To Mogul: How 50 Cent Became One Of Hollywood's Most Strategic Power Players," *Essence*, https://www.essence.com, December 8, 2025.

Hot Links Address Book

1. What's the latest in customer loyalty programs? For the answer, do a search for "loyalty programs" at Tech Target, **https://www.techtarget.com/**.
2. Considering a career in marketing? Read articles about different marketing topics of interest and visit the

Marketing Job Board and Collegiate Hub areas at the American Marketing Association site, **https://www.ama.org/**.

3. What's different about business-to-business marketing? Find out at the ANA B2B Practice site, **https://www.ana.net/b2b**.
4. How satisfied are American consumers today? The American Customer Satisfaction Index (ACSI) is an economic indicator based on modeling of customer evaluations. Find the latest survey results at **https://theacsi.org/**.
5. So what's so important about branding? Learn more about branding products at **https://www.allaboutbrands.com**.
6. See how one consulting firm helps clients pick the right name by pointing your web browser to **https://www.namebase.com**.
7. At Interbrand.com, a leading global branding consultancy, you'll find branding insights, best practices, case studies, and research: **https://interbrand.com**.
8. Companies are turning to smart-pricing software to improve margins on products. Find out how one company's software works at Zilliant's website, **https://www.zilliant.com**.
9. If you have ever wondered how manufacturers make certain types of products, this is the site for you! At How Products Are Made, you can find the details on everything from accordions and action figures to zippers, and everything in between: **https://www.madehow.com**.

12

Distributing and Promoting Products and Services

Exhibit 12.1 (Credit: OIST / flickr/ Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What is the nature and function of distribution (place)?
2. What is wholesaling, and what are the types of wholesalers?
3. What are the different kinds of retail operations?
4. How can supply-chain management increase efficiency and customer satisfaction?
5. What is promotion, and what are the key elements of a promotional mix?
6. How are advertising media selected?
7. What is personal selling?
8. What are the goals of a sales promotion, and what are several types of sales promotion?
9. How does public relations fit into the promotional mix?
10. What is social media, and how has it changed promotion?
11. What is e-commerce, and how does it affect promotion?

EXPLORING BUSINESS CAREERS

Steve Piehl, Harley-Davidson

A road not taken is the next adventure waiting. Live to ride; ride to live. These are just a few of the creeds that Harley riders live by. Whether it's the vision of the open road, the shine of chrome, or the smell of dust mixed with exhaust, people are drawn to Harley-Davidson motorcycles. How often do you see someone with "Honda" tattooed on their arm? Harleys are the stuff that dreams and identities are made of.

Matt Ryan, the chief marketing and technology officer at Harley-Davidson, helps to shape people's dreams. He helps the company use traditional marketing channels and also advertise in the digital age. Harley also, understandably, approaches marketing nontraditionally.

The experience that Harley sells is what has given them success. They do not define the experience for the customer; instead, they leave it up to the individual to make their own experience with their Harley-Davidson product. For some, the experience is freedom, for others, it is a ride to work, and for some riders, it's an entire lifestyle. Harley's promotion of accessories, branded clothing, and gear supports this approach. No two Harleys are the same, nor are the customers. At many Harley-Davidson dealerships, customers can work with a "chrome consultant"—a specialist who helps with customizing and accessorizing their bike with parts and accessories. This is one of the ways in which Harley makes each bike part of a customer's identity.

Part of Harley's focus on experience is its support of motorcycle riding as a sport. On its website and at the dealerships, it provides tips and classes for rider improvement. Through the Harley Owners Group (H.O.G.), a membership group of Harley owners, Harley promotes events and rallies where owners can get together and ride.

It is with this focus on the "sport" that Harley creates its most powerful marketing tool: the motorcycle mentor. Through the nature of the Harley community, previous owners coach new owners on buying a more advanced bike, taking an overnight trip, or packing for long-distance rides. Former director of customer experience Steve Piehl says, "We would be doing a disservice if we said we reach everyone with our product announcements. But when we put it out, it works its way through the customer base. Our owners sell our products. They encourage people to get more involved in the sport." Tools such as online communities (like HDForums.com) and the magazine *The Enthusiast* (the official Harley-Davidson lifestyle publication for H.O.G. members, relaunched in 2020) facilitate that sharing.

So how does Harley-Davidson measure its marketing success? It measures customer satisfaction through internal surveys, dealer feedback programs, and participation in industry studies to understand the ownership experience of new motorcycle buyers. Historically, Harley-Davidson has enjoyed exceptional customer loyalty, with studies from the 1990s–2000s showing that over 90 percent of Harley owners would repurchase a Harley. This remarkable brand loyalty helped make Harley-Davidson one of the most recognizable brands in the world.

It is just another part of Harley's creed: We believe life is what you make it, and we make it one heck of a ride.

Sources: Interview with Steve Piehl, "Sturgis Motorcycle Rally Is Tamer, Still not a family Affair," *Hagerty*, https://www.hagerty.com, August 29, 2016; "What Is Harley Davidson's Marketing Strategy?" https://marketrealist.com, March 31, 2016; "Steve Piehl Is Retiring from Harley Davidson," Cyrilhuzblog.com, July 23, 2015, https://cyrilhuzeblog.com/2015/06/23/steve-piehl-is-retiring-from-harley-davidson; Paul Ziobro, "Harley-Davidson Makes Executive Changes Under New CEO," *The Wall Street Journal*, https://www.wsj.com, December 10, 2025; "Welcome to the Enthusiast," https://www.harley-davidson.com, accessed March 9, 2026; "Harley-Davidson Delivers Fourth Quarter and Full Year Financial Results and 2026 Outlook," *Harley Davidson*, https://investor.harley-davidson.com, February 10, 2026.

This chapter continues to reveal the role of marketing, starting with a discussion of the distribution system and concluding with a look at traditional and nontraditional marketing channels. It explores how organizations use a distribution system to enhance the value of a product and examines the methods used to move products to locations where consumers wish to buy them. Distribution is also known as "place" in terms of the **5Ps**, key components of the marketing mix. It is important to have an understanding of the members of a distribution system and to explore the role of wholesalers and retailers in delivering products to customers. In addition to understanding how the supply chain works to increase efficiency and customer satisfaction, marketers must also develop tactics for promotion, the last element of the marketing mix. Promotion is multi-faceted and includes traditional advertising, sales promotion, personal selling, public relations, social media, and e-

commerce. It can also include sponsorships, general publicity, and participating in industry events such as trade shows.

12.1 The Nature and Functions of Distribution (Place)

1. What is the nature and function of distribution (place)?

Distribution is efficiently managing the acquisition of raw materials by the factory and the movement of products from the producer or **manufacturer** to business-to-business (B2B) users and consumers. It includes many facets, such as location, hours, website presence, logistics, atmospherics, inventory management, supply-chain management, and others. Logistics activities are usually the responsibility of the marketing department and are part of the large series of activities included in the supply chain. A supply chain is the system through which an organization acquires raw material, produces products, and delivers the products and services to its customers. Exhibit 12.2 illustrates a typical supply chain. Supply chain management helps increase the efficiency of logistics service by minimizing inventory and moving goods efficiently from producers to the ultimate users.

On their way from producers to end users and consumers, products pass through a series of marketing entities known as a **distribution channel**. We will look first at the entities that make up a distribution channel and then examine the functions that channels serve.

Marketing Intermediaries in the Distribution Channel

A distribution channel is made up of **marketing intermediaries**, or organizations that assist in moving goods and services from producers to end users and consumers. Marketing intermediaries are in the middle of the distribution process, between the producer and the end user. The following marketing intermediaries most often appear in the distribution channel:

- *Agents and brokers:* **Agents** are sales representatives of manufacturers and wholesalers, and **brokers** are entities that bring buyers and sellers together. Both agents and brokers are usually hired on commission basis by either a buyer or a seller. Agents and brokers are go-betweens whose job is to make deals. They do not own or take possession of goods.
- *Industrial distributors:* **Industrial distributors** are independent wholesalers that buy related product lines from many manufacturers and sell them to industrial users. They often have a sales force to call on purchasing agents, make deliveries, extend credit, and provide information. Industrial distributors are used in such industries as large equipment manufacturing, consumer goods production, and agriculture.
- *Wholesalers:* **Wholesalers** are firms that sell finished goods to retailers, manufacturers, and institutions (such as educational institutions, local government departments, and hospitals). Historically, their function has been to buy from manufacturers and sell to retailers.
- *Retailers:* **Retailers** are firms that sell goods to consumers and to industrial users for their own consumption.

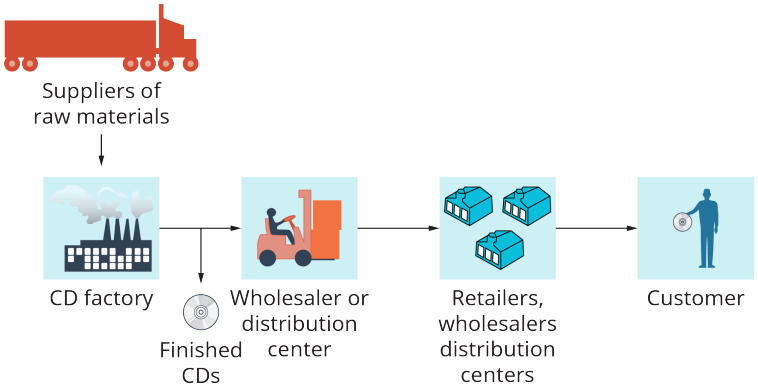

Exhibit 12.2 A Typical Supply Chain (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

At the end of the distribution channel are final consumers and industrial users. Industrial users are firms that buy products for internal use or for producing other products or services. They include manufacturers, electronics firms, airlines, and service institutions such as hotels, hospitals, and schools.

Exhibit 12.3 shows various ways marketing intermediaries can be linked. For instance, a manufacturer may sell to a wholesaler that sells to a retailer that in turn sells to a customer. In any of these distribution systems, goods and services are physically transferred from one organization to the next. As each takes possession of the products, it may take legal ownership of them. As the exhibit indicates, distribution channels can handle either consumer products or industrial products.

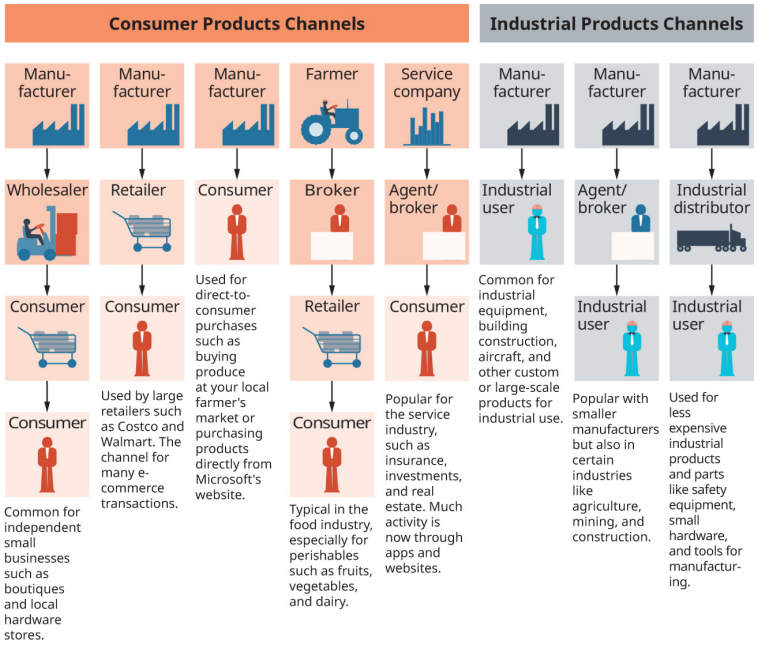

Exhibit 12.3 Channels of Distribution for B2B and Consumer Products (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

The Functions of Distribution Channels

Why do distribution channels exist? Why can't every firm sell its products directly to the end user or consumer? Why are go-betweens needed? Channels serve a number of functions.

Channels Reduce the Number of Transactions

Channels make distribution simpler by reducing the number of transactions required to get a product from the manufacturer to the consumer. For example, if there are four students in a course and a professor requires five textbooks (each from a different publisher), a total of 20 transactions would be necessary to accomplish the

sale of the books. If the bookstore serves as a go-between, the number of transactions is reduced to nine. Each publisher sells to one bookstore rather than to four students. Each student buys from one bookstore instead of from five publishers (see **Exhibit 12.4**).

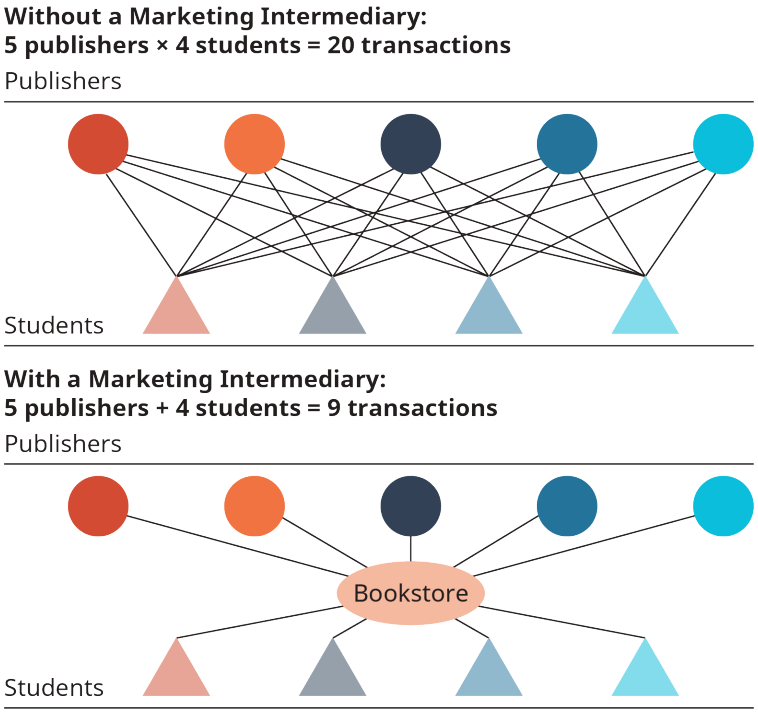

Exhibit 12.4 How Distribution Channels Reduce the Number of Transactions (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Dealing with channel intermediaries frees producers from many of the details of distribution activity. Producers are traditionally not as efficient nor as willing to sell products directly to end users as channel members are. First, producers may wish to focus on production. They may feel that they cannot both produce and distribute in a competitive way. On the other hand, manufacturers are interested in dealing directly with giant retailers, such as Target, which offer huge sales opportunities to producers.

Channels Ease the Flow of Goods

Channels make distribution easier in several ways. The first is by *sorting,* which consists of the following:

- *Sorting out:* Breaking many different items into separate stocks that are similar. Shampoos, for instance, are sorted by type such as volumizing, hydrating, or deep cleaning. Another example would be different lines of clothing—designer, moderate, and economy lines.
- *Accumulating:* Bringing similar stocks together into a larger quantity. A case of hydrating shampoo could be paired with hydrating conditioner and shipped together to the retailer in a bulk quantity. Another example would be to merge several lines of pants from different designers together.
- *Allocating:* Breaking similar products into smaller and smaller lots. (Allocating at the wholesale level is called **breaking bulk**.) For instance, a large order of flowers delivered to a local florist can be broken down into small bouquets, or a tank-car load of milk could be broken down into gallon jugs. The process of allocating generally is done when the goods are dispersed by region and as ownership of the goods changes.

The processes of sorting, accumulating, and allocating are essential tasks for the distribution of goods. These processes serve not only the individual consumer, but also the larger industrial consumers with higher levels of consumption.

A second way channels ease the flow of goods is by locating buyers for merchandise. A wholesaler must find

the right retailers to sell a profitable volume of merchandise. A wholesaler of sporting goods, for instance, needs to find retailers for their products to sell to consumers interested in sporting goods. Retailers have to understand the buying habits of consumers and put stores where consumers want and expect to find the merchandise. Every member of a distribution channel must locate buyers for the products it is trying to sell.

Channel members also store merchandise so that goods are available when consumers want to buy them. The high cost of retail space often means many goods are stored by the wholesaler or manufacturer.

CONCEPT CHECK

1. List and define the marketing intermediaries that make up a distribution channel.
2. Provide an example of a strategic channel alliance.
3. How do channels reduce the number of transactions?

12.2 Wholesaling

2. What is wholesaling, and what are the types of wholesalers?

Wholesalers are channel members that buy finished products from manufacturers and sell them to retailers. Retailers in turn sell the products to consumers.

Wholesalers also sell products to institutions, such as government entities, educational institutions, and hospitals, for use in performing their own missions. A manufacturer, for instance, might buy computer paper from Veritiv, a major paper and packaging wholesaler. A hospital might buy its cleaning supplies from wholesalers such as Imperial Dade or through brands like Lagasse (now part of Staples' distribution network).

Sometimes wholesalers sell products to manufacturers for use in the manufacturing process. A contractor who builds outdoor sheds might buy lumber from one wholesaler and electrical components from another. Some wholesalers even sell to other wholesalers, creating yet another stage in the distribution channel.

Types of Wholesaler Intermediaries

The two main types of wholesalers are merchant wholesalers and agents and brokers. Merchant wholesalers take title to the product (ownership rights); agents and brokers simply facilitate the sale of a product from producer to end user.

Merchant Wholesalers

Merchant wholesalers make up the majority of all wholesaling establishments and more than 60 percent of all wholesale sales. A **merchant wholesaler** is an institution that buys goods from manufacturers and resells them to businesses, government agencies, other wholesalers, or retailers. All merchant wholesalers take title to the goods they sell.

Agents and Brokers

As mentioned earlier, agents represent manufacturers and wholesalers. **Manufacturers' representatives** (also called **manufacturers' agents**) represent noncompeting manufacturers. These salespeople function as independent agents rather than as salaried employees of manufacturers. They do not take title to or possession of merchandise. They get commissions if they make sales—and nothing if they don't. They are found in a variety of industries, including aerospace and defense, consumer electronics, heating and electrical, and safety equipment.

Exhibit 12.5 At both Sam's and Costco, high-end jewelry, including diamonds, is priced well below its market value. *Why do cash-and-carry wholesalers offer jewelry for considerably lower prices than those offered by high-end jewelers?* (Credit: Phillip Pressard/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Brokers bring buyers and sellers together. Like agents, brokers do not take title to merchandise, they receive commissions on sales, and they have little say over company sales policies. Their job is to connect buyers and sellers who might not otherwise know each other. These markets include real estate, agriculture, insurance, and commodities.

CONCEPT CHECK

1. Define wholesaling, and describe what wholesalers do.
2. Describe merchant wholesalers.
3. Explain the difference between agents and brokers.

12.3 The Competitive World of Retailing

3. What are the different kinds of retail operations?

Over 15 million Americans are engaged in retailing. Of this number, over half work in service businesses such as hair care establishments, attorney's offices, or recreational facilities such as amusement parks. Although most retailers are involved in small businesses, most sales are made by the giant retail organizations, such as Target, Home Depot, or Kohl's. These large retailers carry the majority of retail sales annually, and the retail sector as a whole accounts for nearly 30 percent of U.S. employment. Retailers feel the impact of changes in the economy more than many other types of businesses. Survival depends on keeping up with changing lifestyles and customer shopping patterns. In recent years, online retailing trends have significantly impacted retailing organizations, providing more opportunity for smaller retailers and more competition for larger retailers.

Types of Retail Operations

There is a great deal of variety in retail operations. The major types of retailers are described in Table 12.1. There are several ways that retailers can position themselves in the marketplace. For example, they can be a convenience retailer or a specialty retailer. How they define their business impacts all aspects of the company. Most retailers today also have e-commerce stores available through their websites, extending their reach

beyond a physical store location.

Retailing Takes Many Forms		
Type of Retailing	**Description**	**Examples**
Department store	Houses many departments under one roof with each treated as a separate buying center to achieve economies of buying, promotion, and control	Macy's, Nordstrom, Bloomingdale's, Kohl's
Specialty store	Specializes in a category of merchandise and carries a complete assortment	Toys "R" Us, Zales Jewelers
Convenience store	Offers convenience goods with long store hours and quick checkout	7-Eleven, Circle K
Supermarket	Specializes in a wide assortment of food, with self-service	Safeway, Kroger, Winn-Dixie
Big box retailer	Competes on the basis of low prices and high turnover; offers few services	Walmart, Target, Ikea
Off-price retailer	Sells at prices 25 percent or more below traditional department store prices in a spartan environment	TJ Maxx, HomeGoods
Factory outlet	Owned by manufacturer; sells closeouts, factory seconds, and canceled orders	Levi Strauss, Dansk
Vending machine	Sells merchandise by machine	Canteen
Direct selling	Personal sales via multi-level marketing	Herbalife
Online-only retailer	Selling over the internet	Wayfair, Chewy

Table 12.1

Atmosphere and Retail Image

In considering retailing as a distribution strategy (place in the 5Ps), it is important to understand that place includes more than channel members or logistics. It also includes atmospherics—the image of the actual retailing store (or, in the case of nonstore retailing, the platform from which the product is offered, such as their website or social media accounts). An important task in retailing is to create this image. Marketers combine the store's merchandise mix, service level, and atmosphere to make up a retail image. *Atmosphere* refers to the physical layout and décor of the store. They can create a relaxed or busy feeling, a sense of luxury, a friendly or cold attitude, and a sense of organization or clutter.

These are the most influential factors in creating a store's atmosphere:

- *Employee type and density:* Employee type refers to an employee's general characteristics—for instance, approachable, knowledgeable, or service-oriented. Density is the number of employees per 1,000 square feet of selling space. A discount retailer might have a low employee density, especially if it utilizes self-checkout stations to create an atmosphere with less pressure on the customer to make a purchase. In contrast, a car dealership or furniture store might have a high employee density so that the customer can have one-on-one attention, increasing the chances of making a sale.
- *Merchandise type and density:* The type of merchandise carried and how it is displayed add to the atmosphere the retailer is trying to create. Often, high-end retailers such as Nordstrom carry more expensive brand names and have more organized and creative merchandise displays. Other retailers, such as Dollar Tree, display goods in a typical aisle-and-shelf set up with the goal of displaying as many products as possible because they are targeting value-conscious buyers who are more motivated by price than brand.

Exhibit 12.6 Whether peering through department store windows, buying holiday gifts, or going on a spending spree, consumers have varied shopping habits. Research indicates that shopping can activate key areas of the brain, impacting a person's mood. Feelings of pleasure and satisfaction can result from making a purchase, and the perception of getting a good deal can produce what researchers call a "shopper's high." *How might retailers use atmosphere to stimulate consumers' shopping behavior?* (Montgomery County Planning Commission/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

- *Fixture type and density:* Fixtures can be elegant (rich woods) or modern (contemporary colors and finishes), or they can be old, beat-up tables, as in an antique store. The fixtures should be consistent with the general atmosphere the store is trying to create. By displaying its merchandise on tables and shelves rather than on traditional pipe racks, retailers like the Gap and Banana Republic create a relaxed and organized atmosphere. In addition to traditional display racks, Cabela's retail stores may feature giant aquariums stocked with carp, trout, and other fish or dioramas featuring elephants, lions, zebras, hyenas, and other animals. Cabela's flagship stores can attract millions of visitors annually, functioning as tourist destinations. For example, one Michigan location drew 6 million visitors per year and became the state's largest tourist attraction. Across all Bass Pro Shops and Cabela's locations (which merged in 2017), the combined chain attracts over 200 million visitors annually. It is not unusual for someone to drive many miles to get to a Cabela's, where you can often see license plates from many U.S. states and Canadian provinces. These stores function as destination retail experiences rather than just shopping locations.[1]
- *Sound:* Sound can be pleasant or unpleasant for a customer. Classical music at an upscale restaurant helps create ambiance, just as more upbeat music does at a sports bar or casual dining establishment. Music can also entice customers to stay in the store longer and buy more, or it can encourage them to eat quickly and leave a table for others.
- *Odors:* Smell can either stimulate or detract from sales. The smell of pastries and breads entices bakery customers, as does the smell of freshly brewed coffee at a local breakfast cafe. Conversely, customers can be repulsed by off-putting odors, such as cigarette smoke, cleaning chemicals, musty smells, or strong room deodorizers.

EXPANDING AROUND THE GLOBE

Creative Retailing at Selfridges

To steer traffic to its flagship store in London, Selfridges sought divine intervention—that is, a 50-foot statue of Jesus. The small-scale replica of Rio de Janeiro's famous monument gazed down on shoppers during a month-long Brazilian-themed promotion.

Combined with a radical redesign of the retail space that makes each of Selfridges' four outlets feel more like a collection of quirky boutiques than one gargantuan marketplace, stunts like the Brazil 40° celebration have transformed the once-staid 95-year-old British retail chain into a premier arbiter of hip. Selfridges' success has spurred retailers worldwide to take a closer look. "A department store chief who has not made his way to Selfridges to study its operation," says Arnold Aronson, former CEO of Saks Fifth Avenue, "is an executive not doing his job."

Typically, department stores develop their own merchandising strategies, resulting in a retail space crowded with Tommy Hilfiger, Ralph Lauren, and other recognizable brands arranged in displays that rarely vary from one chain to the next. Selfridges combines traditional department store organization with innovative experiential retail. While maintaining conventional product departments (Beauty, Women's, Men's, etc.), the store features dedicated brand spaces where designers and vendors create their own displays. Selfridges also incorporates lifestyle-focused pop-ups and themed installations, such as The Corner Shop (which rotates concepts like Harry Styles' Pleasing brand) and Sportopia (a sports lifestyle experience). The recently renovated Beauty Hall (2024) features over 300 brands, each with its own counter and display space, alongside experiential elements like the Beauty Spot for brand residencies. This helps expose customers to merchandise they might not otherwise see.

Selfridges asked a tattoo and body-piercing parlor called Metal Morphosis to set up shop next to some women's fashion vendors. Metal Morphosis, a tattoo and body-piercing studio, was such a hit when it opened in Selfridges Oxford Street in 2003 that it expanded to Selfridges Manchester in 2004, demonstrating how department stores were evolving to include non-traditional retail concepts.

Selfridges is also known for its "happenings." In 2017, Selfridges hosted a temporary interfaith charity shop within their Oxford Street store as an art installation curated by filmmaker Miranda July. The pop-up ran for two months and sold low-cost secondhand goods alongside luxury merchandise, partnering with Islamic Relief, Jewish charity Norwood, and other faith-based organizations. The project demonstrated how luxury retailers experiment with unconventional retail concepts.

Critical Thinking Questions

1. Discuss whether Selfridges' store design and approach to retail can stand the test of time and not become outdated quickly. Do you think they are too far outside of the norm for retail firms? How might this impact sales?
2. Would Selfridges be successful in the United States? Why or why not?

Sources: "The Secrets Behind Our House," https://www.selfridges.com/US/en, accessed September 27, 2017; Barry Toberman, "Norwood Delight as Interfaith Shop at Selfridges Brings in the Punters," *The Jewish Chronicle,* https://www.thejc.com, September 1, 2017; Hannah Ellis-Petersen, "Miranda July Curates Interfaith Charity Shop Opening up in Selfridges," *The Guardian,* https://www.theguardian.com, August 30, 2017; "Store Information," https://www.selfridges.com, accessed March 9, 2026; Tianwei Zhang, "Selfridges Unveils Revamped Beauty Hall in London Flagship," *Women's Wear Daily*, https://wwd.com, May 24, 2024; Simar Deol, "Brand Innovation Debrief: Selfridges," *LS:N Global*, https://www.lsnglobal.com, August 16, 2024; "Central Group and Turkish Airlines Invite You to Experience "Selfridges" A World-Class Department

Store and Social Destination," *Central Group*, https://www.centralgroup.com, January 6, 2026.

CONCEPT CHECK

1. Describe at least five types of in-store retailing and four forms of nonstore retailing.
2. What factors most influence a retail store's atmosphere?

12.4 Using Supply Chain Management to Increase Efficiency and Customer Satisfaction

4. How can supply-chain management increase efficiency and customer satisfaction?

Distribution (place) is an important part of the marketing mix. Retailers don't sell products they can't deliver, and salespeople don't (or shouldn't) promise deliveries they can't make. Late deliveries and broken promises may mean the loss of a customer. Accurate order filling and billing, timely delivery, and arrival in good condition are important to the success of the product.

The goal of supply-chain management is to create a satisfied customer by coordinating all of the activities of the supply-chain members into a seamless process. An important aspect of supply-chain management is to acknowledge that it is customer driven, and therefore, customer needs often have a primary role in decision-making. Some mass-produced products are successful. However, consumers often expect product and service customization and configurations that match their unique needs. For example, Dell builds computers according to customer specifications for amount of memory, hard drive space, and other options. Dell works with contract manufacturers (ODMs) who build products to Dell's specifications. Final assembly occurs at facilities around the world—including in China, Vietnam, Malaysia, Ireland, Mexico, India, Poland—where microprocessors, software, and other key components are added. In recent years, Dell has been diversifying its supply chain to reduce dependence on any single country, particularly China, due to geopolitical tensions. Finished products are then sent to Dell-operated distribution centers where they are packaged and shipped to customers.

Through the channel partnership of suppliers, manufacturers, wholesalers, and retailers along the entire supply chain who work together toward the common goal of creating customer value, supply-chain management allows companies to respond with the unique product configuration demanded by the customer. Today, supply-chain management plays a dual role: first, as a *communicator* of customer demand that extends from the point of sale all the way back to the supplier, and second, as a *physical flow process* that engineers the timely and cost-effective movement of goods through the entire supply pipeline.

Accordingly, supply-chain managers are responsible for making channel strategy decisions, coordinating the sourcing and procurement of raw materials, scheduling production, processing orders, managing inventory, transporting and storing supplies and finished goods, and coordinating customer-service activities. Supply-chain managers are also responsible for the management of information that flows through the supply chain. Coordinating the relationships between the company and its external partners, such as vendors, carriers, and third-party companies, is also a critical function of supply-chain management. Because supply-chain managers play such a major role in both cost control and customer satisfaction, they are more valuable than ever.

For products that are services, the distribution channel is based primarily on location of the services, such as where the company has its headquarters; the layout of the area in which the service is provided (for example, the interior of a hair salon); alternative locations for the presentation of services, such as an accounting firm visiting a client's site location; and elements of atmosphere, such as furniture and decor selections in a

doctor's office waiting area, which can influence consumers. Services companies also utilize the traditional entities of distribution for any actual goods they sell or supplies they must purchase.

CONCEPT CHECK

1. What is the goal of supply-chain management?
2. What does it mean for a supply chain to be customer driven?
3. How does distribution (place) differ for services products?

12.5 Promotion Strategy

5. What is promotion, and what are the key elements of a promotional mix?

Promotion is an attempt by marketers to inform, persuade, or remind consumers and B2B users to influence their opinion or elicit a response. Most firms use some form of promotion. Because company goals vary widely, so do promotional strategies. The goal is to stimulate action from the people or organizations of a target market. In a profit-oriented firm, the desired action is for the consumer to buy the promoted item. Mrs. Smith's, for instance, wants people to buy more frozen pies. Not-for-profit organizations seek a variety of actions with their promotions. Promotions such as anti-littering initiatives, driver safety messages, and donation campaigns are geared toward influencing people's behaviors. (These are examples of products that are ideas marketed to specific target markets.)

Promotional goals include creating awareness, getting people to try products, providing information, retaining loyal customers, increasing the use of products, and identifying potential customers, as well as teaching potential service clients what is needed to "co-create" the services provided. Any promotional campaign may seek to achieve one or more of these goals:

1. *Creating awareness:* All too often, firms go out of business because people don't know they exist or what they do. This can sometimes be the case for small businesses. Simply putting up a sign and opening the door is rarely enough. Promotion through social media platforms, local sponsorship opportunities, and joining groups such as the chamber of commerce, can create awareness of a new business or product.

   Large companies often use catchy slogans to build brand awareness. For example, Liberty Mutual uses the team of Doug and LiMu Emu to market their products. Clever ads with memorable scenarios, such as a streaker at the Super Bowl, have brought awareness to the brand plus a fan following on social media enhancing customer engagement.

2. *Getting consumers to try products:* Promotion is almost always used to get people to try a new product or to get nonusers to try an existing product. Sometimes free samples are given away. For instance, often in membership stores such as Sam's or Costco, as you wander through the food section, new products are available to sample at in-store kiosks. Coupons and trial-size containers of products are also common tactics used to tempt people to try a product. Celebrities are also used to get people to try products. Selena Gomez, for example, partnered with Oreo to launch "Selena's Signature Oreo," a campaign that also integrates social media and technology to give access to exclusive music and content when purchased. Kate Murphy, director of strategic partnerships at the social marketing platform Crowdtap, weighed in on the strategy. "Celebrity endorsements can provide immense value to a product/brand when done right," Murphy said. "If a celebrity aligns with a product, they bring a level of trust and familiarity to the table."[2]

3. *Providing information:* Informative promotion is more common in the early stages of the product life cycle. An informative promotion may explain what ingredients (for example, fiber) will do for a consumer's

health, describe why the product is better (for example, 5G versus lower-speed networks), inform the customer of a new low price, or explain where the item may be purchased.

People typically will not buy a product or support a not-for-profit organization until they know what it will do and how it may benefit them. Thus, an informative ad may stimulate interest in a product. Consumer watchdogs and social critics applaud the informative function of promotion because it helps consumers make more intelligent purchase decisions. StarKist, for instance, lets customers know that its tuna is "dolphin safe" and ethically sourced.

4. *Keeping loyal customers:* Promotion is also used to keep people from switching brands. Slogans such as Campbell's soups are "M'm! M'm! Good!" and "Intel Inside" remind consumers about the brand. Marketers also remind users that the brand is better than the competition. For years, Pepsi has claimed it has the taste that consumers prefer. Geico insurance brags that "15 minutes could save you 15 percent or more" on insurance. Such **advertising** reminds customers about the quality of the product or service.

   Firms can also help keep customers loyal by telling them when a product or service is improved. Domino's aired candid advertisements about the quality of their product and revamped their delivery operations to improve service. Their advertisements highlight quality ingredients and the use of their online and app ordering to facilitate order accuracy and quick delivery. According to University of Maryland marketing professor Roland Rust, "delivery" stands out in how Domino's has broadly improved its quality, and "the customized delivery vehicles are a competitive advantage."[3]

5. *Increasing the amount and frequency of use:* Promotion is often used to get people to use more of a product and to use it more often. The National Cattlemen's Beef Association reminds consumers: "Beef. It's what's for dinner." The most popular promotion to increase the use of a product may be frequent-flyer or -user programs. The Marriott Bonvoy Member program awards points for each dollar spent at a Marriott property. At the highest levels, members receive upgrades to select suites and expanded breakfast offerings, and a variety of other benefits.[4]

6. *Identifying target customers:* Promotion helps find customers. One way to do this is to list a website as part of the promotion. For instance, promotions in *The Wall Street Journal* and *Bloomberg Businessweek* regularly include web addresses on businesses they feature or topics they address in their stories to target interested consumers. Through analytics of data such as ad clicks and video plays, combined with demographic information gathered from social media sites, companies can better define their target market. Fidelity Investments ads pose a call-to-action to their customers by stating, "Be Invested"—encouraging consumers to take ownership of their financial future. These ads are shown through multiple channels and direct consumers to the company website. Pop up, banner, and sidebar ads on websites (such as a Spectrum banner on the Wall Street Journal site) encourage consumers to visit the website to receive the most recent promotion offered by the company for high-speed wireless connections. These websites typically will ask for your e-mail address when you seek additional information.

7. *Teaching the customer:* For service products, it is often imperative to actually teach the potential client the reasons for certain parts of a service. In services, the service providers work with customers to perform the service. This is called "co-creation." For example, an engineer will need to spend extensive time with team members from a client company and actually teach the team members what the design process will be, how the interaction of getting information for the design will work, and at what points each part of the service will be delivered so that ongoing changes can be made to the design. For services products, this is more involved than just providing information—it is actually teaching the client.

The Promotional Mix

The combination of traditional advertising, personal selling, sales promotion, public relations, social media, and e-commerce used to promote a product is called the **promotional mix**. Each firm creates a unique

promotional mix for each product. But the goal is always to deliver the firm's message efficiently and effectively to the target audience. These are the elements of the promotional mix:

- *Traditional advertising:* Any paid form of company or organization promotion, which may be delivered in a variety of ways and formats. For example, outdoor advertising, broadcast advertising, or printed promotional pieces are traditional forms of advertising.
- *Personal selling:* A face-to-face presentation to a prospective buyer.
- *Sales promotion:* Marketing activities (other than personal selling, traditional advertising, public relations, social media, and e-commerce) that stimulate consumer buying, including coupons and samples, displays, shows and exhibitions, demonstrations, and other types of selling efforts.
- *Public relations:* The linking of organizational goals with key aspects of the public interest and the development of programs designed to earn public understanding and acceptance. Public relations can include lobbying, publicity, special events, internal publications, and media such as a company's internal communication network.
- *Online advertising and promotion:* There are several opportunities for businesses and organizations to advertise online. The majority have dedicated company websites that can be promoted through search engine optimization. Many also have companion social media sites, including accounts on Facebook, X, Instagram, and TikTok that can promote the company and specific products or services. Through these social media platforms, firms can develop and pay for pop-up ads, ads in feeds, banner ads, and sidebar ads. With the data available, these ads can be targeted to specific demographic, psychographic, and geographic groups. Finally, through virtual "word of mouth" and influencer support, advertising and promotion can happen organically.
- *E-commerce:* The use of a company's website to generate sales through online ordering, information, interactive components such as games, and other elements of the website. Website development is mandatory is today's business world. Understanding how to develop and utilize a website to generate sales is imperative for any marketer.

Ideally, marketing communications from each promotional-mix element (personal selling, traditional advertising, sales promotion, public relations, social media, and e-commerce) should be integrated. That is, the communication reaching the customer should be similar in context and message regardless of whether it comes from a print ad, a salesperson, a social media posting, or an influencer endorsement.

Integrated Marketing Communications

The complex task of managing the ever-increasing promotion channels and opportunities has propelled many companies to adopt the concept of **integrated marketing communications (IMC)**. IMC involves carefully coordinating all promotional activities—traditional advertising, sales promotion, public relations, online advertising and promotion, e-commerce, packaging, and other forms of promotion—to produce a consistent, unified message that is customer focused. Following the concept of IMC, marketing managers carefully work out the roles the various promotional elements will play in the marketing mix. Timing of promotional activities is coordinated, and the results of each campaign are carefully monitored to improve future use of the promotional mix tools. Typically, a company appoints a marketing communications director who has overall responsibility for integrating the company's marketing communications.

Exhibit 12.7 When Martha Stewart and Snoop Dogg went "public" with their friendship, marketers took notice. Although they have been friends since the early 2000s, it wasn't until they both starred in a Comedy Central program in 2015 that their friendship gained public attraction. Since then, the duo has appeared in several ads together and promoted the Olympics. Their friendship is promoted through their individual social media sites as well as with the companies that they promote. *What challenges and payoffs are associated with integrated marketing communications?* (Credit "Martha Stewart": Gage Skidmore/ Flickr/ Attribution Share-Alike 2.0 Generic (CC BY-SA 2.0); Credit "Snoop Dogg": Glenn Francis/"Toglenn" of www.PacificProDigital.com / Wikimedia Commons/ Attribution-Share Alike 4.0 International (CC BY-SA 4.0))

GoPro relies on IMC to build their brand and a community centered on user-generated content. Through their campaign to turn customers into creators, they have essentially turned marketing over to their customers. GoPro's advertising and promotion activities center on adventure and feature content from their users. This is integrated across multiple marketing channels. The company created a YouTube channel to highlight the best videos from users, and it is connected to other social media sites such as Instagram and Facebook. GoPro regularly runs contests through the platform to generate high-quality content. The message extends to broadcast media and in-store signage and displays showing user-created content. Through strategic IMC, GoPro has created a sustainable, cost-effective marketing campaign to promote their brand and image.[5]

The sections that follow examine the elements of the promotional mix in more detail.

CONCEPT CHECK

1. What is the objective of a promotional campaign?
2. What is the promotional mix?
3. What are the features of an integrated marketing communications campaign?

12.6 The Huge Impact of Advertising

6. How are advertising media selected?

Most Americans are bombarded daily with advertisements to buy things. **Traditional advertising** is any paid form of company or organization promotion that is delivered in a variety of ways and formats. For example, outdoor advertising, broadcast advertising, or printed promotional pieces are traditional forms of advertising. In the United States, children are exposed to more than 20,000 ads each year. Adults are exposed to between 4,000 and 10,000 ads each day, which is more than two million advertisements yearly.[6]

The money that big corporations spend on advertising is in the billions of dollars. Total advertising expenses in the U.S. were estimated at nearly $400 billion in 2025.[7] Global advertising expenditures are over $1 trillion annually.[8] Amazon has been the largest advertiser in the U.S. annually in the 2020s, with $21.4 billion in spending in 2024. It is also the largest global spender at over $20 billion in 2023.[9]

Samsung was a sponsor of the 2026 Olympics in Milan and provided special edition phones to the athletes.

Ads for the 2026 Super Bowl cost between $8 and $10 million for a 30-second commercial. Apple secured exclusive rights to advertise with Major League Soccer (MLS) for the next 10 years at a cost of $2.5 billion.

The Impact of Technology and the Internet on Traditional Advertising

Digital technology is delivering content anytime, anywhere. Audiences are fragmented and their attention is spread across multiple channels and devices, making them tougher than ever to reach. Each year, the Super Bowl captures millions of viewers. But events such as the World Cup and the Olympic games are capturing over 2 billion viewers each.

Entertainment is widely digitized. Magazines, books, movies, games, and many other forms of entertainment can all be accessed through a device. In 2025, 94 percent of the U.S. population has access to broadband connections. That percentage is lower in rural areas at 72 percent.[10]

Technology is driving many of the changes in advertising, but so is consumer behavior. Advertiser questions abound. How do you adjust your marketing strategy to reach younger consumers through their devices? How do you optimize your TV advertising when users often have the ability to skip ads? How can you leverage social media platforms to promote your product or service and extend your reach to new audiences? How do you control the message across social media platforms? What role do influencers play in promoting your business? How do you create a website that fosters sales, is informative, and engaging? Do you consider other forms of promotion such as product placement or podcasts? We will touch on each of these later in the chapter.

Choosing Advertising Media

The channels through which advertising is carried to prospective customers are the **advertising media**. Both product and institutional ads appear in all the major advertising media. Each company must decide which media are best for its products. Two of the main factors in making that choice are the cost of the medium and the audience reached by it.

Advertising Costs and Market Penetration

Cost per contact is the cost of reaching one member of the target market. Naturally, as the size of the audience increases, so does the total cost. Cost per contact enables an advertiser to compare media vehicles, such as broadcast media versus print media. An advertiser debating whether to spend local advertising dollars for media spots such as at local sporting events or through sponsorship of a youth sports team could consider the cost per contact of each. The advertiser might then pick the vehicle with the lowest cost per contact to maximize advertising punch for the money spent. Often costs are expressed on a **cost per thousand (CPM)** contacts basis.

Reach is the number of different target consumers who are exposed to a commercial at least once during a specific period. Media plans for product introductions and attempts at increasing brand awareness usually emphasize reach. For example, an advertiser might try to reach 70 percent of the target audience during the first three months of the campaign. Because the typical ad is short-lived and often only a small portion of an ad may be perceived at one time, advertisers repeat their ads so consumers will remember the message. **Frequency** is the number of times an individual is exposed to a message. Average frequency is used by advertisers to measure the intensity of a specific medium's coverage.

Media selection is also a matter of matching the advertising medium with the product's target market. If marketers are trying to reach teenagers, they might select TikTok or Instagram. If they are trying to reach older consumers, they might consider print media rather than online targeted ads. A medium's ability to reach a precisely defined market is its **audience selectivity**. Some media vehicles, such as broadcast media and local advertising might appeal to a wide cross section of the population. Others—such as interest-specific websites or genre-specific radio stations—appeal to very specific groups. Marketers must also consider utilizing various social media platforms and which platforms are most likely to reach the targeted market.

CONCEPT CHECK

1. How is technology impacting the way advertisers reach their markets?
2. What are the two main factors that should be considered when selecting advertising media?

12.7 The Importance of Personal Selling

7. What is personal selling?

Advertising acquaints potential customers with a product and thereby makes personal selling easier. **Personal selling** is a face-to-face sales presentation to a prospective customer. Sales jobs are found in a variety of industries—from retail establishments, to engineering firms, to the financial industry. Over 2.3 million people in the United States are employed in a sales job. Slightly under 30 percent of them are women. The number of people employed in advertising is around 1.4 million in the United States. Personal selling offers several advantages over other forms of promotion:

- Personal selling provides a detailed explanation or demonstration of the product. This capability is especially desirable for complex or new goods and services.
- The sales message can be varied according to the motivations and interests of each prospective customer. Moreover, when the prospect has questions or raises objections, the salesperson is there to provide explanations. In contrast, advertising and sales promotion do not have the customer in front of them to respond to objections or questions.
- Personal selling can be directed only to qualified prospects. Other forms of promotion include some unavoidable waste because many people in the audience are not prospective customers.
- Personal selling costs can be controlled by adjusting the size of the sales force (and resulting expenses) in one-person increments. In contrast, advertising and sales promotion must often be purchased in fairly large amounts.
- Perhaps the most important advantage is that personal selling is more effective than other forms of promotion in building relationships with customers to increase the probability of obtaining a sale and a loyal customer.

The Selling Process

Selling is a process that can be learned. Experts have spelled out the steps of the selling process, shown in Exhibit 12.8, and professional salespeople use them all the time. These steps are as follows:

1. *Prospecting and qualifying:* To start the process, the salesperson looks for **sales prospects**, those companies and people who are most likely to buy the seller's offerings. This activity is called **prospecting**. Often, many methods are used to find prospects.

   For many companies, the inquiries generated by advertising and promotion are the most likely source of prospects. Inquiries are also known as sales leads. Leads usually come via networking, social media sites, or through purchasing leads. Some companies supply salespeople with prospect lists compiled from external sources, such as directories, public records, membership lists, or data gathered from online sources. Meetings, such as industry-specific conventions and trade shows, are another good source of leads. Sales representatives attend such meetings to display and demonstrate their company's products and to answer the questions of those attending. The firm's files and records can be another source of prospects. Customer records and purchase history can be helpful. For example, car service records can help identify customers who might be prospects for a new vehicle purchase. Finally, personal connections of the salesperson can be a source of leads.

One guideline is that not all prospects are "true" opportunities for a sale. Just because someone has been referred or has made an inquiry does not mean that the person is a genuine prospect. Salespeople can avoid wasting time and increase their productivity by qualifying all prospects. **Qualifying questions** are used to separate prospects from those who do not have the potential to buy. The following three questions help determine who is a real prospect and who is not:

- Does the prospect have a need for our product?
- Can the prospect make the buying decision?
- Can the prospect afford our product?

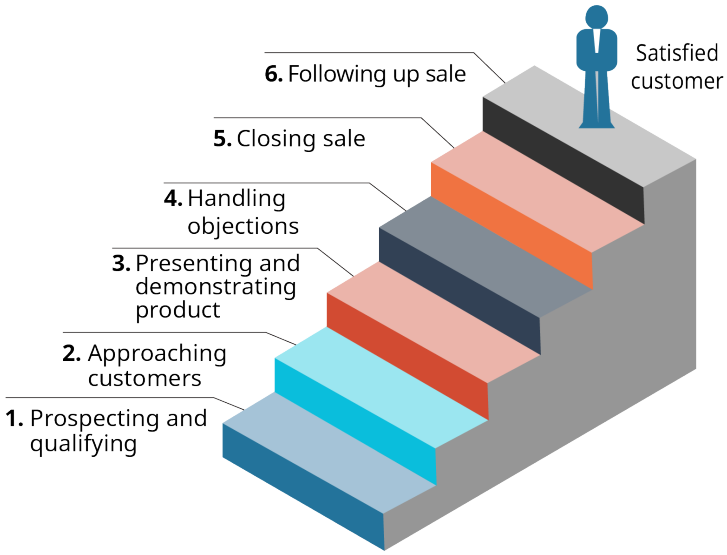

Exhibit 12.8 Steps in Making a Successful Sale (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

2. *Approaching customers:* After identifying a prospect, the salesperson makes contact with the prospect. At this point, the goal is for the salesperson to present the product or service. This contact could be in person or through virtual means. At the same time, the salesperson tries to build interest in the coming meeting. One good way to do this is to impart an interesting or important piece of information—for instance, "I think my product can cut your shipping and delivery time by two days."

3. *Presenting and demonstrating the product:* The presentation can take a variety of forms. It can be a structured digital presentation, or it could be a more unstructured casual conversation. It will depend on the product or service being sold and the individual salesperson's preferred approach. In a structured presentation, the salesperson presents the product or service outlining the benefits and features being sold. Questions can be addressed either as they arise or at the end of the presentation. In today's business world, in which relationships are most important for long-term sales, canned or structured presentations are not well received, nor do they support the idea of building a great bond with the customer. A completely unstructured presentation that has no set format is a much more successful approach. It may be a casual conversation, with the salesperson presenting product benefits and assisting the customer in solving their problems (like a partner on the client company's team) in a way that might interest the potential buyer.

4. *Handling objections:* Almost every sales presentation, structured or unstructured, meets with some objection. Rarely does a customer say, "I'll buy it," without asking questions or voicing concerns. The professional salesperson tries to anticipate objections so they can be countered quickly and with assurance. The best way to counter objections is to have a thorough knowledge of the product offering so that a solution can be found that overcomes the objection.

   Often employed in business, the "higher authority" objection is frequently used when one of the parties says, "This agreement looks good, but I'll have to run it by my committee" (or spouse or partner or any

other "higher authority"). The result is that sales presentation turns out to be just a preliminary, nonbinding round. After the higher authority responds, often disapproving the agreement, the sale goes into round two or starts all over again.

For example, when a customer wants to buy a house, car, or anything expensive, the salesperson will say, "If we find the house (or car) that you really like, is there any reason you could not make the purchase today?" Once they get the green light, the salesperson will spend whatever time it takes to find the right product for the customer. However, if the client says their family member has to give the final approval as they will be loaning the money, the salesperson might consider bringing the family member into the conversation.

5. *Closing the sale:* After all the objections have been dealt with, it's time to close the sale. Even experienced salespeople sometimes find this part of the sales process awkward. Perhaps the easiest way to close a sale is to ask for it: "May I write up your order?" One of the best techniques is to act as though the deal has been concluded: "We'll have this equipment in and working for you in two weeks." If Mr. Bateson doesn't object, the salesperson can assume that the sale has been made.
6. *Following up on the sale:* The salesperson's job isn't over when the sale is made. In fact, the sale is just the start. The salesperson must write up the order properly and turn it in promptly. This part of the job may be easy for many consumer products, but for B2B products or services, it may be more complex. An order for a complex piece of equipment may include a good deal of documentation. Each detail must be carefully checked to ensure that the equipment is exactly what was ordered.

   After the product is delivered to the customer, it is good practice for the salesperson to make a routine visit to see that the customer is satisfied. This follow-up call may also be a chance to make another sale. But even if it isn't, it will build goodwill for the salesperson's company and may bring future business. Repeat sales over many years are the goal of professional salespeople.

CONCEPT CHECK

1. What are the advantages of personal selling?
2. Explain the selling process.

12.8 Sales Promotion

8. What are the goals of sales promotion, and what are several types of sales promotion?

Sales promotion helps make personal selling and advertising more effective. **Sales promotions** are marketing events or sales efforts—not including traditional advertising, personal selling, and public relations—that stimulate buying. Sales promotion can be developed as part of the social media or e-commerce effort just as advertising can, but the methods and tactics are much different. Sales promotion is usually targeted toward either of two distinctly different markets. Consumer sales promotion is targeted to the ultimate consumer market. Trade sales promotion is directed to members of the marketing channel, such as wholesalers and retailers.

The goal of many promotion tactics is immediate purchase. Therefore, it makes sense when planning a sales-promotion campaign to target customers according to their general behavior. For instance, is the consumer loyal to the marketer's product or to the competitor's? Does the consumer switch brands readily in favor of the best deal? Does the consumer buy only the least expensive product, no matter what? Does the consumer buy any products in your category at all?

Procter & Gamble believes consumers make up their mind about a purchase nearly instantaneously. The "first moment of truth," as P&G calls it, is the three to seven seconds when someone notices an item and makes their purchasing decision. Despite spending on traditional and online advertising, the consumer-products leader thinks this instant is one of the most critical marketing opportunities. The presentation and packaging of the product is at the forefront of this first impression. In the mid-2000s, P&G created a position entitled Director of First Moment of Truth (FMOT) to focus on in-store displays, recognizing the critical 3 to 7 seconds when shoppers encounter products on store shelves. The company established a 15-person FMOT department at headquarters and stationed 50 FMOT leaders globally. This represented P&G's strategic focus on point-of-purchase marketing during an era before digital commerce transformed consumer behavior.[11]

Exhibit 12.9 Pet owners want to choose the proper diet to keep their beloved animals healthy. There is a market for specialized food choices, which is why many dog food companies are creating specific size- and age- appropriate diets. *What promotional objectives underlie these practices?* (Credit: Berkshirehumane/ Wikimedia Commons/ Attribution-Share Alike 4.0 International (CC BY-SA 4.0))

In addition to a distinct focus on innovation and new product development, P&G developed a coupon and savings program to bolster engagement. The program, P&G BrandSAVER, gives participants online coupons and points for purchasing the company products that can be redeemed for rewards. Additionally, the company will make a donation to a nonprofit organization of the customer's choosing to further their philanthropic efforts and to strengthen the relationship with the customer.

The objectives of a promotion depend on the general behavior of target consumers, as described in **Table 12.2**. For example, marketers who are targeting loyal users of their product don't want to change behavior. Instead, they want to reinforce existing behavior or increase product usage. Frequent-buyer programs that reward consumers for repeat purchases can be effective in strengthening brand loyalty. Other types of promotions are more effective with customers prone to brand switching or with those who are loyal to a competitor's product. Digital coupons, free samples, or an end-cap display in a store can entice shoppers to try a different brand.

The use of sales promotion for services products depends on the type of services. Consumer services, such as insurance, utilize sales promotions such as multi-policy discounts or discounts for good driving habits. Professional services utilize different promotional tactics. Doctors, for example, will approach sales promotion through more intangible means such as their patient relations, additional care and services provided by the office staff, or even through the decor in the waiting area. Professional service organizations such as medical offices or attorneys benefit from advertising and promotion. Word-of-mouth promotion can be especially helpful. But advertising services through broadcast media, online, and print can also be effective.

Types of Consumers and Sales Promotion Goals		
Type of Behavior	**Desired Results**	**Sales Promotion Examples**
Loyal customers: People who buy your product most or all of the time	Reinforce behavior, increase consumption, change purchase timing	Loyalty marketing programs, such as frequent-purchaser programs Programs that encourage customers to purchase the company's brand in exchange for points that can be exchanged for rewards
Competitor's customers: People who buy a competitor's product most or all of the time	Break loyalty, persuade to switch to your brand	Discounts, digital coupons, or added features that create interest in the product
Brand switchers: People who buy a variety of products in the category	Persuade to buy your brand more often	Promotions that are high enough to encourage a purchase; for example, buy one and get a second half price
Price buyers: People who consistently buy the least expensive brand	Appeal with low prices or supply added value that makes price less important	Arrangements with retailers to make the product more readily available than competing products, such as end-cap displays or increased shelf space Discounts and coupons that reduce the price of the brand to match that of the brand that would have been purchased

Table 12.2

Two additional areas of sales promotion are couponing and product placement. U.S. consumers redeemed 871 billion coupons in 2024. Over 465 million digital coupons were redeemed and over 355 million paper coupons were redeemed. Revenues from digital coupons was nearly $11 billion in the last year. A vast majority of coupons distributed (87 percent) are paper, but over two-thirds of the coupons that are redeemed are digital.[12] Paper coupons are coming back into the marketplace. Retailers are responding to customers' need to save money and their preference for the ease of paper coupons. The coupons are available through various sources including in-store, online, and email campaigns. The use of digital coupons is growing, but the older segment of shoppers have expressed frustration with the digital options. Coupons for household goods are most frequently redeemed. The savings from consumer packaged goods is estimated at nearly $4 billion. Data indicate that 55 percent of customers express frustration when they cannot use coupons when grocery shopping. About one-third of shoppers purchase more than they intend when they use coupons, and two-thirds of customers have made impulse purchases because of a digital coupon.[13]

Product placement is paid inclusion of brands in mass media programming. This includes movies, TV, sporting events, social media content, and video games. So when you see all the Dodge Ram trucks in the show *Yellowstone* or Tom Cruise wearing Ray-Ban sunglasses in the *Top Gun* films, that is product placement. Product placement has become a huge business. In 2023, companies paid more than $20 billion in the United States to have their products placed prominently in a film or TV program; that figure is expected to reach more than $74 billion globally by 2033.[14] It is easy to go overboard with this trend and be portrayed as a parody,

however. In some cases, viewers have a negative reaction to blatant product placement. The placement can be so out of place or noticeable that it distracts the viewer from the scene. For example, in *The Walking Dead* series about a zombie apocalypse, the characters are often seen getting into abandoned vehicles as they fight zombies. These vehicles are predominately near perfect Hyundai models of the current year. Fans of the show found the cars to be a distraction given the condition of the rest of society in the show.[15] Also, some have suggested that product placement might doom the products and companies. Despite the cost and the potential customer response, product placements continue to dominate the promotion landscape. In 2024, there were nearly 15,000 placements in TV shows and nearly 5,000 in movies. In the *Challengers* movie of 2024, there are 121 product placements. The most frequent brands using this strategy are Apple, Microsoft, Nike, and Coca-Cola.[16] Many large companies are cutting their advertising budgets to spend more on product placements.

Exhibit 12.10 The sports industry is a lucrative option for product placement. NASCAR drivers' uniforms, cars, equipment, and tracks are filled with corporate brands and sponsors. Video games have product placement, such as Fortnite including products from high-end designer Balenciaga. And Nike shoes are forever immortalized in the movie *Forrest Gump. Does product placement blur the lines between advertising and content, and should viewers be concerned?* (Credit: roger blake/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

ETHICS IN PRACTICE

Influencer Marketing and Product Placement: Are They Always Ethical?

Traditional marketing vehicles such as advertising have been regulated to include limitations on promotions for such products as tobacco and alcohol. One area that has not had the same type of regulatory oversight has been the practice of product placement and companies working with "influencers" to market their products.

In a classic scene from *Forrest Gump,* actor Tom Hanks, who plays Gump, meets President Kennedy and says, "The best thing about visiting the president is the food! Now, since it was all free, and I wasn't hungry but thirsty, I must have drank me 15 Dr Peppers." Since *Forrest Gump* was a family film, this scene could be viewed as influencing kids to drink large quantities of soda, and that doing so might even give them the energy needed to run like Forrest Gump. Unlike other forms of advertising, product placement has not been regulated for as long. However, because of the proliferation of the practice, there are regulations in place in the United States and globally. For instance, in Australia, the Alcohol Beverages Advertising Code (ABAC) has instituted expanded regulation of advertising and product placement for new, nontraditional

media that had not been regulated previously.

Companies are also enlisting influencers to help them reach customers. Influencers might be people who have achieved recognition as an expert in a certain area, or someone who has amassed a large number of followers on platforms such as TikTok or Instagram. The use of influencers has raised concern about the ethics of companies such as Amazon, Apple, and Google when they enlist teachers such as Kayla Delzer, who has her own brand, Top Dog Teacher (**https://www.topdogteaching.com**), that touts her teaching approaches through workshops. Since Delzer incorporates technology into her classroom, she has attracted the attention of both small start-ups such as Seesaw and large companies such as Apple, which provide her with products and services in the hope that disseminating her experiences through blogs, tweets, and workshops will encourage her followers to adopt their technologies. Because there is little research-based evidence that these technologies actually improve student outcomes, this situation presents an ethical dilemma for school administrators.

Another ethical dilemma is that some influencers use fake followers to increase the appearance of extended media reach, thus being able to command larger sums of money from various companies for their services. For example, in 2021, half of Instagram influencers used fake followers to inflate their numbers. In a 2017 case, Moscow had about 20 vending-type machines across the city where patrons could purchase Instagram likes and followers. No longer operational, this example still highlights the fact that social media stats can be fictional.

Critical Thinking Questions

1. What is the role of industry trade groups, government agencies, and marketers to self-regulate ethical practices?
2. Do you think it's unethical to pay people to use products and services that influence consumer purchases? Explain your reasoning.

Sources: Natasha Singer, "Silicon Valley Courts Name-Brand Teachers Raising Ethical Issues," *The New York Times*, https://www.nytimes.com, September 2, 2017; Natalie Koltun, "Insta-Fakers: When Fraud Hits Influencer Marketing," *Mobile Marketer*, https://www.mobilemarketer.com, August 14, 2017; Rosie Baker, "New Rules on Placement of Alcohol Ads Loom Large," *AdNews*, https://www.adnews.com, August 9, 2017; Yvette Tan, "There's a Vending Machine Selling Fake Instagram Likes, Because This Is What We've Become," *Mashable*, https://mashable.com, June 7, 2017; Louise Matsakis, "This Russian Vending Machine Will Sell You Fake Instagram Likes," *Vice*, https://www.vice.com, June 6, 2017; "Product Placement Laws: How to Comply with the Legal and Regulatory Aspects of Product Placement," *FasterCapital*, https://fastercapital.com, April 6, 2025; "Top 20 Influencer Fraud Statistics 2026 Reveal Shocking Fake Follower Crisis," https://www.amraandelma.com, accessed March 9, 2026.

CONCEPT CHECK

1. How does sales promotion differ from advertising?
2. Describe several types of sales promotion.

12.9 Public Relations Helps Build Goodwill

9. How does public relations fit into the promotional mix?

Like sales promotion, public relations can be a vital part of the promotional mix. **Public relations** is any

communication or activity designed to win goodwill or prestige for a company or person. This could include **publicity**, information about a company or product that appears in the news media and is not directly paid for by the company. Publicity can be good or bad. Reports of financial scandal in a nonprofit organization is an example of negative publicity. Public relations includes many other activities, such as lobbying, event planning, managing social media presence, acting as representative speaker for the organization, managing internal communication, and coordinating crisis management for communications.

Naturally, firms' public relations departments try to create as much good publicity as possible. They furnish company speakers for business and civic clubs, write speeches for corporate officers, and encourage employees to take active roles in such civic groups as the United Way and the Chamber of Commerce. One of the tools of the public relations department is the *press release,* a formal announcement of some newsworthy event connected with the company, such as the start of a new program, the introduction of a new product, or the opening of a new plant. Public relations departments may perform any or all of the functions described in Table 12.3.

The Functions of a Public Relations Department	
Public Relations	**Function Description**
Press relations	Placing positive, newsworthy information in the news media to attract attention to a product, a service, or a person associated with the firm or institution
Product publicity	Publicizing specific products or services
Corporate communications	Creating internal and external messages to promote a positive image of the firm or institution
Public affairs	Building and maintaining national or local community relations
Lobbying	Influencing legislators and government officials to promote or defeat legislation and regulation
Employee and investor relations	Maintaining positive relationships with employees, shareholders, and others in the financial community
Crisis management	Responding to unfavorable publicity or a negative event

Table 12.3

Much of sales promotion and publicity is about creating buzz. Buzz marketing (or viral marketing) is elevated word-of-mouth marketing. Word-of-mouth can be a snowball process where information is quickly disseminated through various channels. And this has become even more the case with social media. This can apply to both positive and negative messages. Often the marketer does not have a good deal of control over the buzz. When it works well, marketers feel they get more from viral marketing than other forms of promotion.

CONCEPT CHECK

1. How does public relations differ from advertising?
2. Describe several types of publicity.

12.10 Trends in Social Media

10. What is social media, and how has it changed promotion?

Advances in technology continue to change the marketing landscape. As you will see in the following sections, marketers are harnessing new technology to hone their marketing message and reach more customers.

The business world now relies on the internet for much of its communications, marketing or otherwise. Almost all companies have a strong social media presence and leaders of these organizations also have separate accounts on professional social media sites such as LinkedIn. A presence on social media has become almost a necessity for businesses today. The phenomenon of social media has created a business climate in which thousands of impressions can be made with one social media post. That impression could be positive or negative. Within social media, there are “stars” of social media—individuals who have developed audiences in the millions who follow their posts every day. **Social media** is a hugely powerful tool for marketers. It has it challenges, though, because the platforms are constantly changing and evolving. Also, there is a good deal of misinformation that can quickly spread through social media platforms. A social media post with inaccurate information, if it goes "viral," can have a significant impact on a business, despite the post not being true. That’s what makes social media the newest challenge/opportunity for marketers. Companies that want to retain market share and build their image must develop tactics for the use of social media and for defending against problems created by the use of this powerful marketing tool.

Promotion through Blogs

Blogs provide marketers with a real-time dialogue with customers and an avenue to promote their products or services. A *blog* is an online journal with regularly updated content. The content, which can allow for response and discussion, can be pushed out via RSS (really simple syndication) or email, or it can be accessed through websites, social media platforms, or apps. RSS enables users to automatically gather updates from various websites, especially news sites and blogs, and display headlines and a brief summary of those updates in a single location. If a blog is not sponsored by the company or hosted on their website, it can be considered a form of social media.

Well-run marketing blogs usually focus tightly on one niche area, product line, or vertical market segment. The aim is to provide the blog’s readers with a constantly renewing source of news and insight about that topic. In the United States, there are approximately 600 million blogs hosted on a variety of sites, with more than 7.5 million posts daily. This is approximately 3 billion items of content created annually.[17]

Many companies have set up their own blogs, including Ikea, Home Depot, IBM, and Progressive Insurance, to name a few. These companies blog because they: (1) get real-time input from customers and prospects; (2) create and maintain relationships; (3) can have a continuing dialogue with loyal customers and prospective clients; and (4) can zero in on specific marketing goals. For example, Johnson & Johnson sponsors a company website dedicated to all things parenting, called BabyCenter. The site contains a variety of information in addition to a community section where registered users can post content, ask questions, and interact with other parents.[18]

Firms can also use search tools such as HootSuite, BrandMentions, and Mentionlytics to monitor conversations about their company and brands. A public relations department might then decide to feed new-product

information to bloggers who are loyal to or potential influencers for their brand.

Advertisers Jump on Podcasts and Videos

Podcasts are essentially verbal blogs that are arranged by episode. There are many platforms and technologies available today for people to create their own podcasts and post them for easy access by the public. There are an estimated 4.4 million podcasts available globally producing over 70 million episodes annually. Besides individuals, companies are beginning to do their own podcasts as well as posting videos from the company as another marketing channel. For listeners, the advantage of a podcast is convenience. Through streaming apps, customers can download videos and podcasts to their devices or they can watch live and listen in real time. Many news programs have the digital version of their content readily available through their website and/or app. These downloads are generally free of charge and allow users to access the content when it is most convenient for them. Podcasts and videos offer another revenue-generating opportunity as they can sell ad "space" in the content. Often these ads interrupt the podcast or video for a short period of time (30 seconds or less) to share an advertisement. Some are designed where the user cannot skip the ad, whereas others give the user the ability to skip the content forward after a certain time period (such as after 15 seconds).

iHeartMedia operates one of the nation's largest podcast networks, offering thousands of podcasts across multiple genres. The company produces original content and also distributes podcasts from its 860+ radio stations nationwide. Another podcast production firm, Wondery (owned by Amazon), is one of the largest podcast production companies, creating original investigative journalism, true crime, and narrative podcasts that reach millions of listeners monthly.[19]

Podcasts are often targeted to specific interest groups such as parents, those involved in a certain sport or hobby, or with content related to specific celebrities or shows. For example, pet owners can go to https://www.petliferadio.com/ to find a collection of podcasts and information about pets and owning pets. The site has been active since the early 2000s and is a network of pet-related content. The resource shares weekly talk show and podcast content and often has celebrity guests. Globally, Pet Life Radio boasts over 250 million subscribers. Their service is accessible on demand through various platforms such as Amazon, Spotify, and Audible.[20]

Videos have become another important promotions channel. Billions of videos can be viewed on YouTube, the world's largest video-hosting platform. As of 2025, YouTube hosts approximately 29 billion videos and has 2.7+ billion monthly active users who collectively watch nearly 5 billion videos daily. The platform continues to dominate video content consumption globally. Many people now log in to YouTube to watch videos on a particular product and how the product can be used. Entrepreneurs and other small-business owners have made extensive use of YouTube to provide value to their customers by creating and uploading informational videos that highlight their products.

CONCEPT CHECK

1. How are companies embracing social media as a way to connect with customers?
2. What has been the effect of social media on traditional advertising?

12.11 Trends in E-Commerce

11. What is e-commerce, and how has it affected the retail sector?

E-commerce is related to social media and other new online platforms because it utilizes the internet for marketing communication. **E-commerce** refers to the development and maintenance of a company's website

and the facilitation of commerce on the website, such as the ability for customers to order products online, to get questions answered about products, and for the company to introduce new products and ideas. E-commerce can include special components designed specifically for separate target market segments. Anything associated with an actual company website related to marketing can be considered e-commerce.

E-commerce was nearly 20 percent of all retail sales in 2024, and globally it is projected to increase to over 22 percent by 2028.[21] Why? One reason is the economics of shopping. The convenience of shopping online is a key driver of this trend. The time to make a purchase in a traditional brick-and-mortar store includes factors such as the commute to the store, the cost of that commute, finding the product(s) you want, comparison shopping in-store, and other related activities that take time and money. Through e-commerce, purchases can be made more efficiently, saving the shopper both time and money by facilitating instant access to product information of both the product of interest and similar products for comparison shopping.

Countless small businesses have taken the plunge to serve the growing population of online shoppers. Many e-commerce businesses, including e-jeweler Blue Nile, luggage site Away (direct-to-consumer brand), and Zappos (owned by Amazon) are relying on e-commerce, with reports indicating that 35 percent of small businesses in the United States use e-commerce as their primary sales channel. The increasing sophistication of search technology and comparison-shopping sites have allowed online businesses to market their products to millions of potential customers cheaply and effectively. Often, these innovations are bringing less-well-known brands and merchants to consumers' attention.

Online merchants can offer a far broader array of merchandise than specialty brick-and-mortar retailers because they don't have to keep the products on store shelves. In response to this challenge from online-only retailers, firms are turning to technology to gain an advantage by equipping their in-store sales associates with tools to more efficiently assist customers, such as tablets to check stock availability at other locations and pricing options online versus in-store.[22]

After a slow start, the world's largest retailer, Walmart, has begun moving into e-retailing in a big way. It is now in almost every major category of web-related consumer commerce. It is estimated that Walmart has approximately 200 million items across all of its outlets, compared to 600 million items available through Amazon. The company has taken some innovative steps to leverage the web to drive people to its stores. In 2016, Walmart CEO Doug McMillon (who led the company until January 2026) acquired Jet.com for $3.3 billion and appointed Jet.com's CEO Marc Lore to run Walmart's online business. Lore led Walmart's e-commerce division until January 2021, helping jumpstart the retailer's digital transformation. A case in point is the company's online tire service, which allows you to order automobile tires to be picked up and mounted at a Walmart tire center. Customers can order prescription refills for delivery by mail or for pickup at a Walmart pharmacy department. Walmart's online photo service, in addition to providing a way to store pictures on the web, allows customers to send digital pictures to be printed in a Walmart store of their choice, with a one-hour turnaround.[23]

CONCEPT CHECK

1. How can brick-and-mortar stores use technology to compete with online giants such as Amazon?
2. What factors contribute to the internet's soaring growth in retailing?

Key Terms

5Ps The traditional 4Ps of marketing: product, price, promotion, and place (distribution), now with packaging added as a key marketing component.

advertising Any paid form of nonpersonal presentation by an identified sponsor.

advertising media The channels through which advertising is carried to prospective customers; includes print media, broadcast media, outdoor advertising, and online advertising including social media.

agents Sales representatives of manufacturers and wholesalers.

audience selectivity An advertising medium's ability to reach a precisely defined market.

breaking bulk The process of breaking large shipments of similar products into smaller, more usable lots.

brokers Go-betweens that bring buyers and sellers together.

cost per thousand (CPM) Cost per thousand contacts is a term used in expressing advertising costs; refers to the cost of reaching 1,000 members of the target market.

distribution (logistics) Efficiently managing the acquisition of raw materials by the factory and the movement of products from the producer to industrial users and consumers.

distribution channel The series of marketing entities through which goods and services pass on their way from producers to end users.

e-commerce E-commerce refers to the development and maintenance of a company's website and the facilitation of commerce on the website, such as the ability for customers to order products online and other activities.

frequency The number of times an individual is exposed to an advertising message.

industrial distributors Independent wholesalers that buy related product lines from many manufacturers and sell them to industrial users.

integrated marketing communications (IMC) The careful coordination of all promotional activities—media advertising, sales promotion, personal selling, and public relations, as well as direct marketing, packaging, and other forms of promotion—to produce a consistent, unified message that is customer focused.

manufacturer A producer; an organization that converts raw materials to finished products.

manufacturers' representatives Salespeople who represent noncompeting manufacturers; function as independent agents rather than as salaried employees of the manufacturers.

marketing intermediaries Organizations that assist in moving goods and services from producers to end users.

merchant wholesaler An institution that buys goods from manufacturers (takes ownership) and resells them to businesses, government agencies, other wholesalers, or retailers.

personal selling A face-to-face sales presentation to a prospective customer.

promotion The attempt by marketers to inform, persuade, or remind consumers and industrial users to engage in the exchange process.

promotional mix The combination of advertising, personal selling, sales promotion, and public relations used to promote a product.

prospecting The process of looking for sales prospects.

public relations Any communication or activity designed to win goodwill or prestige for a company or person.

publicity Information about a company or product that appears in the news media and is not directly paid for by the company.

qualifying questions Inquiries used by salespeople to separate prospects from those who do not have the potential to buy.

reach The number of different target consumers who are exposed to a commercial at least once during a specific period, usually four weeks.

retailers Firms that sell goods to consumers and to industrial users for their own consumption.

sales promotion Marketing events or sales efforts—not including advertising, personal selling, and public relations—that stimulate buying.

sales prospects The companies and people who are most likely to buy a seller's offerings.
social media A marketing channel that includes platforms such as Facebook, TikTok, and Instagram.
wholesalers Firms that sell finished goods to retailers, manufacturers, and institutions.

Summary of Learning Outcomes

12.1 The Nature and Functions of Distribution (Place)

1. What is the nature and function of distribution (place)?

Distribution (place) includes the efficient managing of the acquisition of raw materials by the factory and the movement of products from the producer or manufacturer to business-to-business users and consumers. Place includes such activities as location selection, store layout, atmosphere and image-building for the location, inventory, transportation, and logistics. Logistics activities are usually the responsibility of the marketing department and are part of the large series of activities included in the supply chain.

Distribution channels are the series of marketing entities through which goods and services pass on their way from producers to end users. Distribution systems focus on the physical transfer of goods and services and on their legal ownership at each stage of the distribution process. Channels reduce the number of transactions and ease the flow of goods.

12.2 Wholesaling

2. What is wholesaling, and what are the types of wholesalers?

Wholesalers typically sell finished products to retailers and to other institutions, such as manufacturers, schools, and hospitals. The two main types of wholesalers are merchant wholesalers and agents and brokers. Merchant wholesalers buy from manufacturers and sell to other businesses. Agents and brokers are essentially independents who provide buying and selling services. They receive commissions according to their sales and don't take title (ownership) of the merchandise.

12.3 The Competitive World of Retailing

3. What are the different kinds of retail operations?

Over 15 million Americans are engaged in retailing. Retailing operations include department stores, specialty stores, factory outlets, vending machines, direct sales, and internet retailing. Some important factors in creating an in-store experience include employee type and density, merchandise displays, sound, and smell.

12.4 Using Supply Chain Management to Increase Efficiency and Customer Satisfaction

4. How can supply-chain management increase efficiency and customer satisfaction?

The goal of supply-chain management is to coordinate all of the activities of the supply-chain members into a seamless process, thereby increasing customer satisfaction. Supply-chain managers have responsibility for main channel strategy decisions, coordinating the sourcing and procurement of raw materials, scheduling production, processing orders, managing inventory, transporting and storing supplies and finished goods, and coordinating customer-service activities.

12.5 Promotion Strategy

5. What is promotion, and what are the key elements of a promotional mix?

Promotion aims to stimulate demand for a company's goods or services. Promotional strategy is designed to inform, persuade, or remind target audiences about those products. The goals of promotion are to create awareness, get people to try products, provide information, keep loyal customers, increase use of a product, identify potential customers, and even teach clients about potential services.

The unique combination of public relations, online advertising and promotion, and e-commerce used to promote a product is called the promotional mix. Advertising is any paid form of nonpersonal promotion by an identified sponsor. Personal selling consists of a face-to-face presentation in a conversation with a prospective purchaser. Sales promotion consists of marketing activities—other than personal selling, advertising, and public relations—that stimulate consumers to buy. These activities include digital coupons, discounts, loyalty programs, influencers, and other selling efforts. Public relations is the marketing function that links the policies of the organization with the public interest and develops programs designed to earn public understanding and acceptance. IMC is being used by more and more organizations. It is the careful coordination of all of the elements of the promotional mix to produce a consistent, unified message that is customer focused.

12.6 The Huge Impact of Advertising

6. How are traditional advertising media selected?

Cost per contact is the cost of reaching one member of the target market. Often costs are expressed on a cost per thousand basis. Reach is the number of different target customers who are exposed to a commercial at least once during a specific period. Frequency is the number of times an individual is exposed to a message. Media selection is a matter of matching the advertising medium with the target audience. Technology continues to drive many of the changes to traditional advertising strategies.

12.7 The Importance of Personal Selling

7. What is personal selling?

Over 2.3 million people in the United States are employed in a sales job. Personal selling enables a salesperson to demonstrate a product and tailor the message to the prospect; it is effective in closing a sale. Professional salespeople are knowledgeable and creative. They also are familiar with the selling process, which consists of prospecting and qualifying, approaching customers, presenting and demonstrating the product, handling objections, closing the sale, and following up on the sale.

12.8 Sales Promotion

8. What are the goals of sales promotion, and what are several types of sales promotion?

Immediate purchase is the goal of most sales promotion, whether it is aimed at consumers or the trade (wholesalers and retailers). The most popular sales promotions are digital coupons, discounts, product placements, contests, and premiums. Trade shows and in-store or online ads are other types of sales promotion.

12.9 Public Relations Helps Build Goodwill

9. How does public relations fit into the promotional mix?

Public relations is mostly concerned with getting good publicity for companies and other organizations. Publicity is any information about a company or product that appears in the news media and is not directly paid for by the company. Public relations departments furnish company speakers for business and civic clubs, write speeches for corporate officers, and encourage employees to take active roles in civic groups. These activities help build a positive image for an organization and create awareness, which if positive can be a good support for selling its products.

12.10 Trends in Social Media

10. What is social media, and how does it affect promotion?

Social media is a marketing channel that includes platforms such as Facebook, LinkedIn, Instagram, and TikTok. Social media has created a business climate in which thousands of impressions (marketing messages) can be achieved with one creative social media post. Social media is a hugely powerful tool for marketers. It

has it challenges, though, because a social media post that goes viral can close down a business, even if it is not true. That's what makes social media the newest challenge/opportunity for marketers. The internet and new technology are having a major impact on promotion and promotion expenditures. Broadcast and print media are not used as frequently because of the cost and ease of using online advertising and promotion. Many companies have created blogs and a strong social media presence to strengthen customer relationships and to reach new consumers. Podcasts offer advertisers an additional medium to interact with their target market. Videos—through company websites, social media, and influencer content—are also important advertising and promotion channels.

12.11 Trends in E-Commerce

11. What is e-commerce, and how does it affect promotion?

E-commerce refers to the development and maintenance of a company's website and the facilitation of commerce on the website, such as the ability for customers to order products on line, to get questions answered about products, and for the company to introduce new products and ideas. E-commerce can include special components designed specifically for separate target market segments.

The ease of use and ability to comparison-shop is driving millions of people to the internet to purchase goods and services. Major retailers such as Walmart continue to cultivate their web presence in an effort to stay relevant in this ever-changing business environment and to attract even more loyal customers who have made the switch to doing most of their shopping on line.

Preparing for Tomorrow's Workplace Skills

1. **Team Activity** Divide the class into two groups with one taking the "pro" position and the other the "con" position on the following issue: "The only thing marketing intermediaries really do is increase prices for consumers. It is always best to buy direct from the producer." (Interpersonal)
2. Trace the distribution channel for some familiar product. Write a summary that explains why the channel has evolved as it has and how it is likely to change in the future. (Systems)
3. You work for a small chain of department stores (six stores total) located within a single state. Summarize your findings to the leadership of the company explaining how e-retailing may affect the chain's business. (Technology)
4. How does supply-chain management increase customer value? (Systems)
5. Think of a product that you use regularly. Find several examples of how the manufacturer markets this product, such as ads in different media, sales promotions, and publicity. Assess each example for effectiveness in meeting one or more of the six promotional goals described in the chapter. Then analyze them for effectiveness in reaching you as a target consumer. Consider such factors as the media used, the style of the ad, and ad content. Present your findings to the class. (Information)
6. Go to the blogging search sites listed in the text and find personal blogs, both positive and negative, for a brand. Also report on a consumer good manufacturer's blogging site. Was it appealing? Why or why not? (Technology)
7. *The internet and technology has changed the world of promotion forever.* Explain the meaning of this sentence. (Technology)
8. What advantages does personal selling offer over types of promotion? (Information)
9. Choose a current advertising campaign for a beverage product. Describe how the campaign uses different media to promote the product. Which media is used the most, and why? What other promotional strategies does the company use for the product? Evaluate the effectiveness of the campaign. Present your results to the class. (Information)
10. The Promotional Products Association International is a trade association of the promotional-products industry that provides an introduction to promotional products and how they are used in marketing. Read about its Golden Pyramid competition at **https://www.ppai.org/media/awards/pyramid-awards/** and

recent winners at **https://www.ppai.org/media-hub/53-industry-companies-win-2025-ppai-pyramid-awards/**. Choose three to four winners from different categories. Now prepare a short report on the role of promotional products in the promotional mix. Include the examples you selected, and explain how the products helped the company reach its objective. (Technology)

Ethics Activity

After working really hard to distinguish yourself, you've finally been promoted to senior account executive at a major advertising agency and placed in charge of the agency's newest account, a nationally known cereal company. Their product is one you know contains excessive amounts of sugar as well as artificial colorings and lacks any nutritional value whatsoever. In fact, you have never allowed your own children to eat it.

Your boss has indicated that the cereal company would like to use the slogan "It's good for you" in their new television and print advertising campaign. You know that a billion-dollar lawsuit has been filed against a cereal manufacturer and a broadcast corporation for marketing practices targeting young children. The suit asserts that "alluring product packaging, toy giveaways, contests, collectibles, kid-oriented games and apps, and branded toys and clothes" are used to promote unhealthy habits in young children and that the advertising is a deliberate attempt to increase sales by influencing children. In addition, two consumer groups have joined the suit citing "unfair and deceptive marketing" for unhealthy food and habits directed towards children.

Your new role at the agency will be tested with this campaign. Doing a good job on it will cement your position and put you in line for a promotion to vice president. But as a responsible parent, you have strong feelings about misleading advertising targeted at susceptible children.

Using a web search tool, locate articles about this topic and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Do you follow your principles and ask to be transferred to another account? Or do you help promote a cereal you know may be harmful to children in order to secure your career?

Sources: James Schroeder, "To the Heart of the Matter: We Are What We Eat," *Evansville Courier & Press,* https://www.courierpress.com, September 11, 2017; Lizzie Parry, "Popular Cereals Contain Up to a Third of Your Kids' Sugar Intake," *The Sun*, https://www.thesun.co.uk, February 8, 2017; Stephanie Thompson, "Kellogg Co. Might as Well Have Painted a Bull's-eye on Itself," *Advertising Age,* January 23, 2006; and Abbey Klaassen, "Viacom Gets Nicked," *Advertising Age,* January 23, 2006.

Working the Net

1. Visit *Industry Week*'s website at **https://www.industryweek.com**. Go to the Supply Chain section and choose an article from the results that describes how a company has used supply-chain management to improve customer satisfaction, performance, or profitability. Give a brief presentation to your class on your findings.
2. What are some of the logistics problems facing firms that operate internationally? Visit the *Logistics Management* magazine website at **https://www.logisticsmgmt.com**, and see if you can find information about how firms manage global logistics. Summarize the results.
3. Go to **https://www.woot.com**. Why do you think that this e-retailer has such a strong position in the market?
4. A competitive advantage of the internet is the ability to comparison-shop like never before. To compare brands, features, and prices of products, go to two of these sites: **https://www.pricegrabber.com** **https://www.overstock.com**, **https://www.smartbargains.com**, **https://www.bluefly.com**, or **https://www.shopzilla.com**. Which is the easiest site to use? The most difficult? Which site provides the most information?
5. The Zenith Media site at **https://www.zenithmedia.com** is a good place to find links to internet resources on advertising. Research the leading brands listed on the site. Pick three of the company sites listed, and

review them using the concepts in this chapter.

6. Go to the *Sales and Marketing* magazine site at **https://www.salesandmarketing.com**. Read several of the free recent articles from the magazine as well as online exclusives, and prepare a brief report on current trends in one of the following topics: sales strategies, marketing strategies, customer relationships, or training. Also check out their podcast. What is your opinion of this podcast?
7. Entrepreneurs and small businesses don't always have big sales promotion budgets. Learn more about the strategy of guerrilla marketing at **https://www.investopedia.com/terms/g/guerrilla-marketing.asp** and **https://sendpulse.com/support/glossary/guerrilla-marketing**. After exploring the sites, explain the concept of guerrilla marketing in your own words. Then list five ideas or tips that appeal to you, and summarize why they are good marketing strategies.
8. Press releases are a way to get free publicity for your company and products. Visit the following site to learn how to write a press release: **https://www.contentgrip.com/how-to-write-a-press-release-examples/**. Was this helpful, and why? Develop a short "how-to" guide on press releases for your classmates. Then write a press release that announces the opening of your new health food restaurant, Zen Foods, located just two blocks from campus.

Critical Thinking Case

Advertisers Score with the Super Bowl

What sporting event is televised globally in over 130 countries worldwide and has created a quasi–national holiday in the United States? The Super Bowl is considered by football fans as the ultimate game and known as the largest advertising opportunity for media companies that broadcast the game and companies that want to reach a large audience. The history of impactful advertising shown as part of Super Bowl viewing includes the 2019 ad with Bud Light and the *Game of Thrones* jousting battle. The ad was only shown once, but it is recognized as one of the most iconic moments in the history of advertising.

In recent years companies have used football's popularity and the Super Bowl as a global program to get their message out to a worldwide audience. While the high cost of advertising during the Super Bowl may deter some advertisers, the impact of ads during this and other major sporting events continues to be effective with viewers and create buzz that ads running in other spots do not generate.

One additional thing that advertisers have to consider is the impact of the current political climate and other aspects of players' lives that could create a diversion and affect campaigns. These issues could impact the amount that the networks pay for the rights to air the events and the decision of whether a firm wants to be associated with the event because of certain players or political issues. NFL games, and the Super Bowl in particular, provide a platform for players to communicate their stance on current issues or political concerns because of the large viewership. Likewise, a controversy can occur in relation to the halftime show or by protesters in the stands, both of which have happened in previous years. A large-scale live event always provides the possibility of something happening that could not be anticipated. Companies with creative and adept social media departments can, however, make a positive impact by reacting to events as they occur. For example, during the 2013 Super Bowl in New Orleans, a faulty transformer caused a power outage just before halftime, which caused a 30-minute delay. An employee in Oreo's social media department sent out a Tweet saying, "Power out? No problem. You can still dunk in the dark," with a picture of an Oreo cookie on a dark background.

Critical Thinking Questions

1. Name some of the challenges marketers encounter when developing advertising and promotional campaigns. How does the type of product affect the promotional strategies?
2. You work for an ad agency that has a Super Bowl sponsor as a client. What approach would you recommend for your agency as it develops a campaign—universal, customized for each geographical region, or something else, and why?

3. What types of companies could benefit from placing ads on the NFL website, and how can they use the internet effectively to promote their products?

Sources: Benjamin Hoffman, Victor Mather, and Jacey Fortin, “After Trump Blasts N.F.L., Players Kneel and Lock Arms in Solidarity,” *The New York Times*, https://www.nytimes.com, September 25, 2017; Jason Notte, “How NFL Sponsors Get Ambushed at the Super Bowl," *The Street*, https://www.thestreet.com, January 24, 2017; Rochelle Olsen and Andrew Krammer, **“**Two Pipeline Protesters Arrested after Hanging Banner in U.S. Bank Stadium during Vikings Game," *Star Tribune*, https://www.startribune.com, January 2, 2017; Angele Watercutter, “How Oreo Won the Marketing Super Bowl with a Timely Blackout Ad on Twitter,” *Wired*, https://www.wired.com, February 4, 2013; "Super Bowl LX second most-watched all time with nearly 125M viewers," *NFL*, https://www.nfl.com, February 10, 2026; Brittaney Kiefer, "The 26 Best Super Bowl Ads of the Past 26 Years," *Adweek*, https://www.adweek.com, February 6, 2026.

Hot Links Address Book

1. Consumers can now comparison-shop like never before. To compare brands, features, and prices of products, go to one of these sites: **https://www.pricegrabber.com**, **https://www.mysimon.com**, or **https://www.compare.net**.**https://www.bottomdollar.com**
2. At the National Retail Federation’s website, you’ll find current retail statistics, links to retailing resources, and information about retailing careers: **https://www.nrf.com**.
3. The Convenience Distribution Association is an international trade organization for distributors of convenience products in the United States. Visit its website to browse the latest issue of *Convenience Distribution* magazine and learn more about this field: **https://www.cdaweb.net/**.
4. Beyond Retail Industry offers hundreds of ideas for putting together a successful retail strategy: **https://www.beyondretailindustry.com/retail-strategy/retail-strategy-all-you-need-to-know/**.
5. The Intermodal Association of North America offers detailed information on various modes of transportation and links to transportation companies: **https://www.intermodal.org/what-intermodal#gsc.tab=0**.
6. For articles on supply-chain management along with information on the latest technology in the field, check out *Supply Chain Management Review:* **https://scmr.com**.
7. A good site for the latest on interactive and internet marketing is ClickZ network, where you’ll find news, advice from experts, statistics, feature articles, and more: **https://www.clickz.com**.
8. How can you find the right magazine in which to advertise? The FeedSpot website has a searchable database of thousands of magazines: **https://magazine.feedspot.com/**.
9. What should a communication for the press include? Prezly provides the answer, along with other good information about getting publicity for your company: **https://www.prezly.com/academy/public-relations-101**.
10. *Advertising Age* magazine has a wealth of information about the latest in advertising, including videos and ratings of new ads: **https://www.adage.com**.

13

Using Technology to Manage Information

Exhibit 13.1 (Credit: OIST / flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. How has information technology transformed business and managerial decision-making?
2. Why are computer networks an important part of today's information technology systems?
3. What types of systems make up a typical company's management information system?
4. How can technology management and planning help companies optimize their information technology systems?
5. What are the best ways to protect computers and the information they contain?
6. What are the leading trends in information technology?

EXPLORING BUSINESS CAREERS

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When meeting with a Daly Investment (**https://www.dalyinvestment.com**) financial consultant, most likely you are thinking about money, *your* money. Whether you seek a short-term investment or a retirement nest egg, money will be your focus. You probably will not be thinking about the technological infrastructure required to transmit information throughout a multibillion dollar, nationwide institution such as TD Ameritrade (acquired by Charles Schwab in 2020)—information that often is private and financial in nature. Luckily for you, however, the company is led by financial advisor John Daly, who works with TD Ameritrade to support the company's technology needs.

After successful careers at Charles Schwab and Morgan Stanley, Daly knew when starting up that the firm would need IT support to ensure the security of the funds managed for customers while focusing on the financial aspects of managing their finances. In addition to providing a financial trading platform for individual investors, TD Ameritrade had a robust set of software as a service cloud-based tools that allow

Daly to focus on his core competencies rather than having to hire, train, and maintain a complex set of IT resources that his clients can trust.

Given the size of the assets it manages, TD Ameritrade's management information system (MIS) is necessarily large. TD Ameritrade's open architecture environment enables financial advisors like John Daly to select the technology they want to use. The lesson is that Daly could act as an entrepreneur and start a firm while providing information technology with the scale that customers expect and providing the personal service that is often missing when dealing with larger organizations.

Sources: "Innovative Technologies," *TD Ameritrade Institutional*, https://www.tdainstitutional.com, accessed February 21, 2018; Daly Investment Management website, https://www.dalyinvestment.com, accessed February 21, 2018; Daly Investment Management Facebook page, https://www.facebook.com/dalyinvestment, accessed February 21, 2018.

This chapter focuses on the role of information technology (IT) in business, examining the details of MIS organization, as well as the challenges companies encounter in an increasingly technological world. As John Daly learned, harnessing the power of information technology gives a company a significant competitive advantage.

13.1 Transforming Businesses through Information

1. How has information technology transformed business and managerial decision-making?

Information technology (IT) includes the equipment and techniques used to manage and process information. Information is at the heart of all organizations. Without information about the processes of and participants in an organization—including orders, products, inventory, scheduling, shipping, customers, suppliers, and employees—a business cannot operate.

Over several decades, we have shifted from an industrial society to a knowledge-based economy driven by information. Businesses depend on information technology for everything from running daily operations to making strategic decisions. Computers are the tools of this information age, performing extremely complex operations as well as everyday jobs such as creating documents and spreadsheets. The pace of change has been rapid since the personal computer became a fixture on most office desks. Individual units became part of small networks, followed by more sophisticated enterprise-wide networks. **Table 13.1** and **Table 13.2** summarize the types of computer equipment and software, respectively, most commonly used in business management information systems today.

Business Computing Equipment		
Computer Type	**Description**	**Comments**
Tablets	Self-contained computers in which applications (apps) can reside. These devices can also be linked into a network over which other programs can be accessed.	Increasing power, speed, and memory accessed via the cloud make these tablets the dominant computer for many business processes.
Desktop personal computers (PC)	Self-contained computers on which software can reside. These PCs can also be linked into a network over which other programs can be accessed.	Increasing power, speed, memory, and storage make these commonly used for many business processes. Can handle text, audio, video, and complex graphics.
Laptop computers	Portable computers similar in power to desktop computers.	Smaller size and weight make mobile computing easier for workers.
Minicomputers	Medium-sized computers with multiple processors, able to support from four to about 200 users at once.	Although the description is technically correct, the term is largely obsolete as the distinction between larger microcomputers and smaller mainframes has diminished.
Mainframe computers	Powerful machines, often much larger than typical personal computers, that can simultaneously run many different programs and support hundreds or thousands of users.	Extremely reliable and stable, these are used by companies and governments to process large amounts of data. They are more secure than PCs.
Servers	Greatest storage capacity and processing speeds.	These are not subject to crashes and can be upgraded and repaired while operating.
Supercomputers	Most powerful computers, now capable of operating at exaflop scale.	Companies can rent time to run projects from special supercomputer centers.

Table 13.1

Application Type	Description
Word processing software	Used to write, edit, and format documents such as reports and contracts. Editing functions and tools to integrate information from other software programs simplify document preparation.
Spreadsheet software	Used for preparation and analysis of financial statements, sales forecasts, budgets, and similar numerical and statistical data. Once the mathematical formulas are keyed into the spreadsheet, the data can be changed and the solution will be recalculated instantaneously.
Database management programs	Serve as electronic filing cabinets for records such as customer lists, employee data, and inventory information. Can sort data based on various criteria to create different reports.
Graphics and presentation programs	Create tables, graphs, and slides for customer presentations and reports. Can add images, video, animation, and sound effects.
Desktop publishing software	Combines word processing, graphics, and page layout software to create various files. Allows companies to design and produce eye-catching graphical materials for print and online publication. Examples include sales brochures, advertisements, and company newsletters.
Communications programs	Translate data into a form for transmission and transfer it across a network to other computers. Used to send and retrieve data and files.
Integrated software suites	Combine several popular types of programs, such as word processing, spreadsheet, database, graphics presentation, and communications programs. Component programs are designed to work together.
Groupware	Facilitates collaborative efforts of workgroups so that several people in different locations can work on one project. Supports online meetings and project management (scheduling, resource allocation, document and e-mail distribution, etc.).
Financial software	Used to compile accounting and financial data and create financial statements and reports.

Table 13.2

Although most workers spend their days at powerful desktop computers, other groups tackle massive computational problems at specialized supercomputer centers. Tasks that would take years on a PC can be completed in just hours on a supercomputer. With their ability to perform complex calculations quickly, supercomputers play a critical role in national security research, such as analysis of defense intelligence; scientific research, from biomedical experiments and drug development to simulations of earthquakes and star formations; demographic studies such as analyzing and predicting voting patterns; and weather and environmental studies. Businesses, too, put supercomputers to work by analyzing big data to gain insights into customer behavior, improving inventory and production management and for product design.[1] The speed

of these special machines has been rising steadily to meet increasing demands for greater computational capabilities. Achieving these incredible speeds is critical to future scientific, medical, and business discoveries. Many countries, including the United States, China, France, and Japan, have made enhancing computational power a priority.[2]

In addition to a business's own computers and internal networks, the internet makes it effortless to connect quickly to almost anyplace in the world. As Thomas Friedman points out in his book *The World Is Flat,* "We are now connecting all of the knowledge centers on the planet together into a single global network, which . . . could usher in an amazing era of prosperity and innovation."[3] Collaboration on a global scale is easier than ever. Managers can share information to a broad audience across the world just as easily as with a colleague in the same office complex. The internet and the web have become indispensable business tools that facilitate communication within companies as well as with customers.

The rise of electronic trading hubs is just one example of how technology is facilitating the global economy. Electronic trading hubs are not reserved for large companies of developed economies, however. Alibaba launched an e-hub called eWTP in Malaysia that provides access to small businesses. As Jack Ma, Alibaba co-founder, said at eWTP's launch, "There are a lot of free-trade zones for efficient trade facilitation, but only for big companies. There is no free-trade zone designed for small companies. I have been shouting everywhere, screaming, that every government should do it."[4]

Many companies entrust an executive called the **chief information officer (CIO)** with the responsibility of managing all information resources. The importance of this responsibility is immense. In addition to the massive expansion of information gathered by today's businesses, most of us are **knowledge workers** who develop or use knowledge. Knowledge workers contribute to and benefit from information they use to perform planning, acquiring, searching, analyzing, organizing, storing, programming, producing, distributing, marketing, or selling functions. We must know how to gather and use information from the many resources available to us.

Exhibit 13.2 In today's high-tech world, CIOs must possess not only the technical smarts to implement global IT infrastructures, integrate communications systems with partners, and protect customer data from insidious hackers, but they must also have strong business acumen. Fumbi Chima, consultant and former CIO of organizations such as Adidas, Fox Networks Group, and Burberry, has led strategic efforts for transforming and adopting digital technologies to generate business growth. She utilizes traditional leadership skills combined with innovative digital solutions to drive strategic initiatives for companies and organizations across the world. *Why is it important for CIOs to possess both technological and business expertise?* (Credit: Richter Frank-Jurgen/ Flickr/ Attribution-Share Alike 2.0 Generic (CC BY-SA 2.0))

EXPANDING AROUND THE GLOBE

E-Hubs Integrate Global Commerce

Thanks to the wonders of technological advancement, global electronic trading now goes far beyond the internet retailing and trading that we are all familiar with. Special websites known as trading hubs, or eMarketplaces, facilitate electronic commerce between businesses in specific industries such as automotive manufacturing, retailing, telecom provisioning, aerospace, financial products and services, and more. Virtually all Forex (Foreign Exchange) is done via trading hubs that provide an open market for trading of a variety of currencies. Because there are a large number of trades involving currencies, the price is discoverable and there is transparency in the market.

The trading hub functions as a means of integrating the electronic collaboration of business services. Each hub provides standard formats for the electronic trading of documents used in a particular industry, as well as an array of services to sustain e-commerce between businesses in that industry. Services include demand forecasting, inventory management, partner directories, and transaction settlement services. And the payoff is significant—lowered costs, decreased inventory levels, and shorter time to market—resulting in bigger profits and enhanced competitiveness. For example, large-scale manufacturing procurement can amount to billions of dollars. Changing to "just-in-time purchasing" on the e-hub can save a considerable percentage of these costs.

Electronic trading across a hub can range from the collaborative integration of individual business processes to auctions and exchanges of goods (electronic barter). Global content management is an essential factor in promoting electronic trading agreements on the hub. A globally consistent view of the "content" of the hub must be available to all. Each participating company handles its own content, and applications such as *content managers* keep a continuously updated central catalog of the inventories of all members of the hub. The *transaction manager* application automates trading arrangements between companies, allowing the hub to provide aggregation and settlement services.

Ultimately, trading hubs for numerous industries could be linked together in a global e-commerce web—an inclusive "*hub of all hubs*." One creative thinker puts it this way: "The traditional linear, one step at a time, supply chain is dead. It will be replaced by parallel, asynchronous, real-time marketplace decision-making. Take manufacturing capacity as an example. Enterprises can bid their excess production capacity on the world e-commerce hub. Offers to buy capacity trigger requests from the seller for parts bids to suppliers who in turn put out requests to other suppliers, and this whole process will all converge in a matter of minutes."

Sources: "Asian Companies Count Losses—Hatch Ways to Cope with Weak Dollar," *Reuters*, https://www.reuters.com, January 24, 2018; Rob Verger, "This Is What Determines the Price of Bitcoin," *Popular Science*, https://www.popsci.com, January 22, 2018; Bhavan Jaipragas, "Alibaba's Electronic Trading Hub to Help Small and Medium-sized Enterprises Goes Live in Malaysia," *This Week in Asia*, https://www.scmp.com, November 3, 2017.

Critical Thinking Questions

1. How do companies benefit from participating in an electronic trading hub?
2. What impact does electronic trading have on the global economy?

Because most jobs today depend on information—obtaining, using, creating, managing, and sharing it—this chapter begins with the role of information in decision-making and goes on to discuss computer networks and management information systems. The management of information technology—planning and protection—follows. Finally, we'll look at the latest trends in information technology. Throughout the chapter,

examples show how managers and their companies are using computers to make better decisions in a highly competitive world.

Data and Information Systems

Information systems and the computers that support them are so much a part of our lives that we almost take them for granted. These **management information systems** methods and equipment that provide information about all aspects of a firm's operations provide managers with the information they need to make decisions. They help managers properly categorize and identify ideas that result in substantial operational and cost benefits.

Businesses collect a great deal of *data*—raw, unorganized facts that can be moved and stored—in their daily operations. Only through well-designed IT systems and the power of computers can managers process these data into meaningful and useful *information* and use it for specific purposes, such as making business decisions. One such form of business information is the **database**, an electronic filing system that collects and organizes data and information. Using software called a *database management system (DBMS),* you can quickly and easily enter, store, organize, select, and retrieve data in a database. These data are then turned into information to run the business and to perform business analysis.

Databases are at the core of business information systems. For example, a customer database containing name, address, payment method, products ordered, price, order history, and similar data provides information to many departments. Marketing can track new orders and determine what products are selling best; sales can identify high-volume customers or contact customers about new or related products; operations managers use order information to obtain inventory and schedule production of the ordered products; and finance uses sales data to prepare financial statements. Later in the chapter, we will see how companies use very large databases called data warehouses and data marts.

Companies are discovering that they can't operate well with a series of separate information systems geared to solving specific departmental problems. It takes a team effort to integrate the systems described and involves employees throughout the firm. Company-wide *enterprise resource planning (ERP)* systems that bring together human resources, operations, and technology are an integral part of business strategy. So is managing the collective knowledge contained in an organization, using data warehouses and other technology tools. Technology experts are learning more about the way the business operates, and business managers are learning to use information systems technology effectively to create new opportunities and reach their goals.

CONCEPT CHECK

1. What are management information systems, and what challenges face the CIO in developing the company's MIS?
2. Distinguish between data and information. How are they related? Why are data considered a valuable asset for a firm?
3. How does systems integration benefit a company?

13.2 Linking Up: Computer Networks

2. Why are computer networks an important part of today's information technology systems?

Today most businesses use networks to deliver information to employees, suppliers, and customers. A **computer network** is a group of two or more computer systems linked together by communications channels to share data and information. Today's networks often link thousands of users and can transmit audio and

video as well as data.

Networks include clients and servers. The *client* is the application that runs on a personal computer or workstation. It relies on a *server* that manages network resources or performs special tasks such as storing files, managing one or more printers, or processing database queries. Any user on the network can access the server's capabilities.

By making it easy and fast to share information, networks have created new ways to work and increase productivity. They provide more efficient use of resources, permitting communication and collaboration across distance and time. With file-sharing, all employees, regardless of location, have access to the same information. Shared databases also eliminate duplication of effort. Employees at different sites can "screen-share" computer files, working on data as if they were in the same room. Because their computers are connected on the network, they all see the same thing on their display, and anyone can make changes that are seen by the other participants. The employees can also use the networks for videoconferencing.

Networks make it possible for companies to run enterprise software, large programs with integrated modules that manage all of the corporation's internal operations. Enterprise resource planning systems run on networks. Typical subsystems include finance, human resources, engineering, sales and order distribution, and order management and procurement. These modules work independently and then automatically exchange information, creating a company-wide system that includes current delivery dates, inventory status, quality control, and other critical information. Let's now look at the basic types of networks companies use to transmit data—local area networks and wide area networks—and popular networking applications such as intranets and virtual private networks.

Connecting Near and Far with Networks

Two basic types of networks are distinguished by the area they cover. A **local area network (LAN)** lets people at one site exchange data and share the use of hardware and software from a variety of computer manufacturers. LANs offer companies a cost-effective way to link computers for business efficiency. The most common uses of LANs at small businesses, for example, are office automation, accounting, and information management. LANs can help companies reduce staff, streamline operations, and cut processing costs. LANs can be set up with wired or wireless connections.

A **wide area network (WAN)** connects computers at different sites by linking multiple LANs through connections often leased from a large provider with many routers and switches. Modems convert signals from telephone lines into digital data that devices use to connect to the internet. The internet is essentially a worldwide WAN. Communications companies, such as AT&T, Verizon, and Sprint, operate very large WANs. Companies also connect LANs at various locations into WANs. WANs make it possible for companies to work on critical projects around the clock by using teams in different time zones.

Several forms of WANs—intranets, virtual private networks (VPN), and extranets—use internet technology. Here we'll look at intranets, internal corporate networks that are widely available in the corporate world, and VPNs. Although wireless networks have been around for more than a decade, they are increasing in use because of falling costs, faster and more reliable technology, and improved standards. They are similar to their wired LAN and WAN cousins, except they use radio frequency signals to transmit data. You use a wireless WAN (WWAN) regularly when you use your cellular phone. WANs' coverage can span several countries. Telecommunications carriers operate using wireless WANs.

Wireless LANs (WLAN) that transmit data at one site offer an alternative to traditional wired systems. WLANs' reach can vary depending on the equipment being used, interference from other devices, and physical obstacles such as buildings. The range can be extended with antennas, transmitters, and optimal router placement. The wireless devices communicate with a wired access point into the wired network. WLANs are convenient for specialized applications where wires are in the way or when employees are in different locations in a building. Hotels, airports, restaurants, hospitals, retail establishments, universities, and

warehouses are among the largest users of WLANs, also known as Wi-Fi. For example, the Veterans Administration Hospital in West Haven, Connecticut, added Wi-Fi access in all patient rooms to upgrade its existing WLAN to improve patient access, quality, and reliability. The new WLAN supports many different functions, from better on-site communication among doctors and nurses through both data transmission and voice-over-internet phone systems to data-centric applications such as its Meditech clinical information system and pharmacy management.[5]

CATCHING THE ENTREPRENEURIAL SPIRIT

Documenting the Future

Potential customers of OpenText Capture (formerly Captiva Software) didn't share company cofounder and chief executive Reynolds Bish's belief that traditional paper files would still be essential in business. They held to the idea that personal computers and the internet would make paper disappear, and they weren't going to invest in software to organize their documents. That almost caused Captiva to go under. "We really were afraid we weren't going to make it," said Jim Berglund, an early investor in Captiva and a former board member.

But Bish asked investors for another $4 million commitment—on a bet that paper was here to stay. Bish recalls a board member telling him, "Five years from now people are going to either think you're a genius or a complete idiot."

That conversation took place 20 years ago. Captiva Software was named one of the fastest-growing technology companies in San Diego in the early 2000s for its 172 percent increase in revenues. The company was then acquired by EMC Corp.—the sixth-largest software company in the world and top maker of corporate data-storage equipment, with projected annual revenues of more than $9 billion—for $275 million in cash, rewarding embattled early Captiva investors with 10 times their money back. After EMC sold Captiva to Dell in 2016, it was then sold to OpenText in 2017, which rebranded it as OpenText Capture.

Captiva began its journey to the big time in 1989 in Park City, Utah, as TextWare Corp., a small data-entry company. Cofounder Steven Burton's technical expertise, Bish's business background, and a credit card helped them get the business going. "It was pure bootstrapping," Bish said. "We did everything from going without a salary for a year or more to using up our credit cards."

Bish and Burton quickly saw the need for employees to enter data more directly and accurately. The software they developed still required clerks to type information from a paper document, but it could check for inaccuracies, matching zip codes to cities, for instance. In 1996, TextWare produced software that could "read" typewritten words on a scanned piece of paper, which significantly reduced the number of data-entry clerks needed. It found popularity with credit-card processors, insurance companies, shipping companies, and other corporations that handled thousands of forms every day.

TextWare acquired or merged with five firms, went public, changed its name twice, and in 1998 set up its headquarters in San Diego, California, after buying Wheb Systems, which is based there. In 2002, the company merged with publicly held ActionPoint, a San Jose, California, document-processing company, and changed its name to Captiva.

As of 2024, organizations report that, on average, over 45 percent of business processes are still paper-based, according to market research firm Deep Analysis. OpenText Capture processes, extracts, and sorts incoming files to automatically deliver data into business content management systems. Although traditional paper documents still have a role in business operations today, software solutions are utilized to reduce errors and enhance efficient file storage and management systems.

Continuing with the entrepreneurial spirit, OpenText Capture is embracing AI and machine learning to deliver quality services to their customers. With continuous machine learning technology, the firm can offer a variety of services for automation such as accounts payable and onboarding processes. Their offerings can bring increased accuracy as well as services that help firms prepare for audits. The power of AI allows their products to utilize information from a wide variety of sources including emails, images, and mobile device data.

Sources: "Why Captiva?" https://www.emc.com, accessed February 21, 2018; EMC corporate website, "About Us," https://dellemc.com, accessed February 21, 2018; "Lucera Uses Connectivity Routes of Chicago, New York, London and Tokyo as a Trading Hub in Trading Increases," *BSO*, https://www.bsonetwork.com, October 19, 2017; Ron Miller, "$67 Billion Dell–EMC Deal Closes Today," *Tech Crunch,* https://techcrunch.com, September 7, 2016; Brian Sherman, "Input Management and Opportunities for the Reseller Channel: An Interview with Wayne Ford, VP of Partner Alliances at Captiva," *ECM Connection*, https://www.ecmconnection.com, December 27, 2005; Kathryn Balint, "Captiva's Paper Chase Paying Off," *San Diego Union-Tribune,* December 9, 2005, pp. C1, C5; "45% of Business Processes are Paper Based," Deep Analysis, https://www.deep-analysis.net, October 30, 2024; "OpenText Signs Definitive Agreement to Acquire Dell EMC's Enterprise Content Division, including Documentum," https://www.opentext.com, September 12, 2016; "Captiva thrives as Intelligent Capture," https://www.opentext.com, September 8, 2022; "OpenText Capture," https://www.opentext.com, accessed March 11, 2026.

Critical Thinking Questions

1. What role did co-founders Reynolds Bish and Steven Burton play in the evolution of tiny TextWare into hugely successful Captiva?
2. What other unique factors were responsible for the company's remarkable growth?

An Inside Job: Intranets

Like LANs, **intranets** are private corporate networks. Many companies use both types of internal networks. However, because they use internet technology to connect computers, intranets are WANs that link employees in many locations and with different types of computers. Essentially mini-internets that serve only the company's employees, intranets operate behind a *firewall* that prevents unauthorized access. Employees navigate using a standard web browser, which makes the intranet easy to use. They are also considerably less expensive to install and maintain than other network types and take advantage of the internet's interactive features such as chat rooms and team workspaces. Many software providers now offer off-the-shelf intranet packages so that companies of all sizes can benefit from the increased access to and distribution of information.

Companies now recognize the power of intranets to connect employers and employees in many ways, promoting teamwork and knowledge-sharing. Intranets have many applications, from human resource (HR) administration to logistics. For instance, a benefits administration intranet can become a favorite with employees. Instead of having to contact an HR representative to make any changes in personnel records or retirement plan contributions or to submit time sheets, staff members simply log on to the intranet and update the information themselves. Managers can also process staffing updates, performance reviews, and incentive payments without filing paperwork with human resources. Employees can regularly check an online job board for new positions. Shifting routine administrative tasks to the intranet can bring additional benefits by allowing HR staff members to turn their attention to more substantive projects such as employee training programs and benefit negotiations.[6]

Enterprise Portals Open the Door to Productivity

Intranets that take a broader view serve as sophisticated knowledge management tools.

One such intranet is the **enterprise portal**, an internal website that provides proprietary corporate information to a defined user group. Portals can take one of three forms: business to employee (B2E), business to business (B2B), and business to consumer (B2C). Unlike a standard intranet, enterprise portals allow individuals or user groups to customize the portal home page to gather just the information they need for their particular job situations and deliver it through a single web page. Because of their complexity, enterprise portals are typically the result of a collaborative project that brings together designs developed and perfected through the effort of HR, corporate communications, and information technology departments.

More companies use portal technology to provide:

- A consistent, simple user interface across the company
- Integration of disparate systems and multiple sets of data and information
- A single source for accurate and timely information that integrates internal and external information
- A shorter time to perform tasks and processes
- Cost savings through the elimination of information intermediaries
- Improved communications within the company and with customers, suppliers, dealers, and distributors

No More Tangles: Wireless Technologies

Wireless technology has become commonplace today. We routinely use devices such as cellular phones, mobile devices, garage door openers, and home security systems—without thinking of them as examples of wireless technology. Businesses use wireless technologies to improve communications with customers, suppliers, and employees.

Companies in the package delivery industry, such as UPS and FedEx, were among the first users of wireless technology. Delivery personnel use scanner devices to send immediate confirmation of package arrival. You may also have seen meter readers and repair personnel from utility and energy companies send data from remote locations back to central computers.

Bluetooth short-range wireless technology is a global standard that improves personal connectivity for users of mobile phones, portable computers, and stereo headsets, and Bluetooth wirelessly connects keyboards and mice to computers and headsets to phones and music players. A Bluetooth-enabled mobile phone, for example, provides safer hands-free phone use while driving. The technology is finding many applications in the auto industry as well and is now standard in many vehicles today. Bluetooth hands-free solutions are standard features in a wide variety of products, and aftermarket adapters are available to add this functionality to older technology.[7]

Exhibit 13.3 Although designing a true mobile replacement for the desktop PC has proved elusive for computer manufacturers, ultramobile PCs offer wireless functions many professionals want—web browsing, e-mail, Microsoft Office, and telephony. The newest iPad Pro with a touchscreen and stylus, provides the power of a desktop PC in a tablet. *What impact might ultramobile*

computing have on business? (Credit: Tinh t? Photo/ flickr/ Public Domain)

Private Lines: Virtual Private Networks

Many companies use **virtual private networks** to connect two or more private networks (such as LANs) over a public network, such as the internet. VPNs include strong security measures to allow only authorized users to access the network and its sensitive corporate information. Companies with widespread offices may find that a VPN is a more cost-effective option than creating a network using purchased networking equipment and leasing expensive private lines. Unlike creating a network with networking equipment and private lines, a VPN connects over public networks and allows authorized users access when they are not physically in the office.

As Exhibit 13.4 shows, the VPN uses existing internet infrastructure and equipment to connect remote users and offices almost anywhere in the world. In addition to saving on telecommunications costs, companies using VPNs don't have to buy or maintain special networking equipment and can outsource management of remote access equipment. VPNs are useful for remote workers who can access the company's network as if they were on-site at the company's office. On the downside, the VPN's availability and performance, especially when it uses the internet, depends on factors largely outside of an organization's control.

VPNs are popular with many different types of organizations. Why? Security is one of the main reasons to always use a VPN to access the internet. Because all your data are encrypted once tunneled, if a hacker were trying to intercept your browsing activity, say, while you were entering your credit card number to make an online purchase, the encryption would stymie their efforts. That's why it's a particularly good idea to use VPNs in public settings such as coffee shops and airports.[8]

Software on Demand: Application Service Providers

As software developers release new types of application programs and updated versions of existing ones every year or two, companies have to analyze whether they can justify buying or upgrading to the new software—in terms of both cost and implementation time. **Application service providers (ASP)** offer a different approach to this problem. Companies subscribe, usually on a monthly basis, to an ASP and use the applications much like you'd use telephone voice mail, the technology for which resides at the phone company. Other names for ASPs include on-demand software, hosted applications, and software-as-a-service. Exhibit 13.5 shows how the ASP interfaces with software and hardware vendors and developers, the IT department, and users.

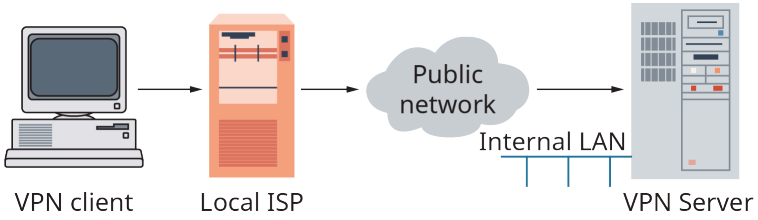

Exhibit 13.4 Virtual Private Networks (VPNs) (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

The simplest ASP applications are automated—for example, a user might use one to build a simple e-commerce site. ASPs provide three major categories of applications to users:

- Enterprise applications, including customer relationship management (CRM), enterprise resource planning, e-commerce, and data warehousing
- Collaborative applications for internal communications, e-mail, groupware, file creation, and management messaging
- Applications for personal use—for example, games, entertainment software, and home-office applications

Based on survey data, more companies are currently using an ASP, and even moving their legacy systems to the cloud. Estimates suggest revenues from subscriptions to on-demand cloud services are projected to reach $2 trillion by 2030. This sector is growing much more rapidly than traditional hardware and software.[9] As this market grows, more companies are adding on-demand offerings to their traditional software packages. IBM

Cloud, Salesforce Marketing Cloud, and Microsoft Azure are among the leading cloud service providers.[10]

Initially, many companies were reluctant to outsource critical enterprise applications to third-party providers. As ASPs improved their technologies and proved to be reliable and cost-effective, attitudes have changed. Companies, both large and small, seek cost advantages such as the convenience ASPs provide. The basic idea behind subscribing to an ASP is compelling. Users can access any of their applications and data from any computer, and IT can avoid purchasing, installing, supporting, and upgrading expensive software applications. ASPs buy and maintain the software on their servers and distribute it through high-speed networks. Subscribers rent the applications they want for a set period of time and price. The savings in licensing fees, infrastructure, time, and staff are significant.

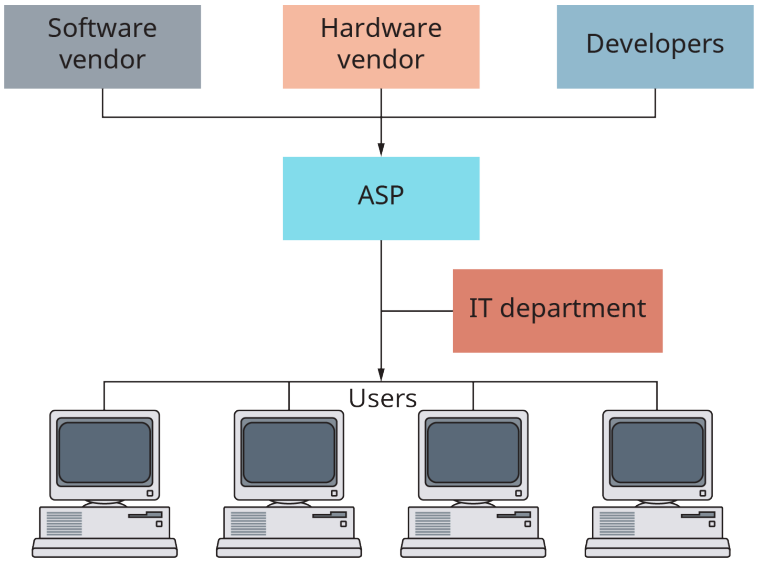

Exhibit 13.5 Structure of an ASP Relationship (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Managed service providers (MSP) represent the next generation of ASPs, offering greater customization and expanded capabilities that include business processes and complete management of the network servers. The global market for managed IT services reached $149.1 billion in 2016. This market is estimated to reach nearly $800 billion by 2033, from under $200 billion in 2017, at a compound annual growth rate of approximately 11 percent.[11]

CONCEPT CHECK

1. What is a computer network? What benefits do companies gain by using networks?
2. How do a LAN and a WAN differ? Why would a company use a wireless network?
3. What advantages do VPNs offer a company? What about the cloud, ASPs, and MSPs?

13.3 Management Information Systems

3. What types of systems make up a typical company's management information system?

Whereas individuals use business productivity software such as word processing, spreadsheet, and graphics programs to accomplish a variety of tasks, the job of managing a company's information needs falls to *management information systems:* users, hardware, and software that support decision-making. Information systems collect and store the company's key data and produce the information managers need for analysis, control, and decision-making.

Factories use computer-based information systems to automate production processes and order and monitor inventory. Most companies use them to process customer orders and handle billing and vendor payments. Banks use a variety of information systems to process transactions such as deposits, ATM withdrawals, and loan payments. Most consumer transactions also involve information systems. When you check out at the supermarket, book a hotel room online, or download music over the internet, information systems record and track the transaction and transmit the data to the necessary places.

Companies typically have several types of information systems, starting with systems to process transactions. Management support systems are dynamic systems that allow users to analyze data to make forecasts, identify business trends, and model business strategies. Office automation systems improve the flow of communication throughout the organization. Each type of information system serves a particular level of decision-making: operational, tactical, and strategic. **Exhibit 13.6** shows the relationship between transaction processing and management support systems as well as the management levels they serve. Let's take a more detailed look at how companies and managers use transaction processing and management support systems to manage information.

Transaction Processing Systems

A firm's integrated information system starts with its **transaction processing system (TPS)**. The TPS receives information from both internal and external sources to collect, process, and store transactional data in an accessible database. In fact, all the company's key data are stored in a single huge database that becomes the company's central information resource. As noted earlier, the *database management system* tracks the data and allows users to query the database for the information they need.

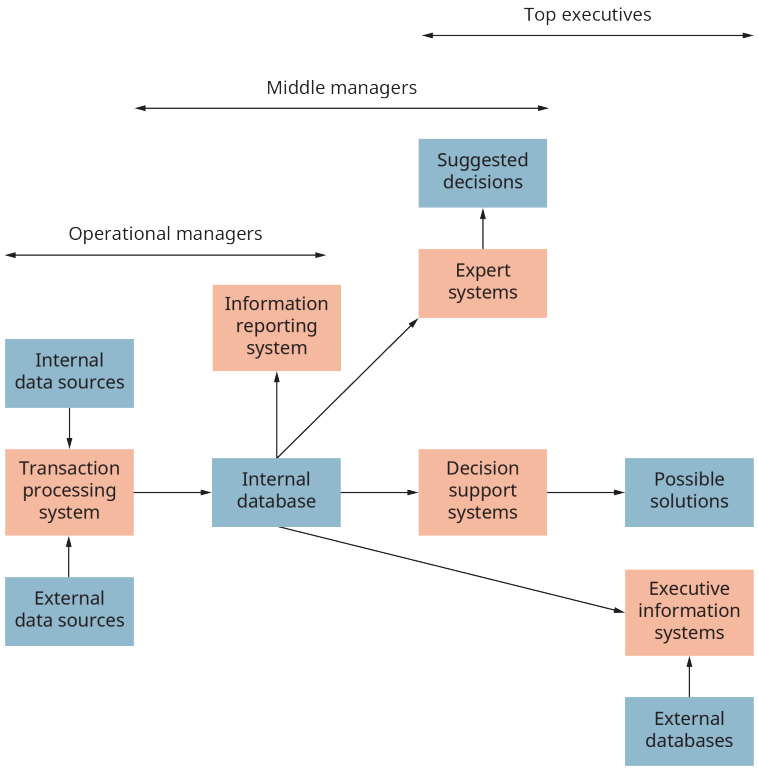

Exhibit 13.6 A Company's Integrated Information System (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

The database can be updated in two ways: **batch processing**, where data are collected over some time period and processed together, and **online**, or **real-time**, **processing**, which processes data as they become available. Batch processing uses computer resources very efficiently and is well-suited to applications such as payroll processing that require periodic rather than continuous processing. Online processing keeps the company's data current. When you make an airline reservation, the information is entered into the airline's information

system, and you quickly receive confirmation of the details electronically. Online processing is more expensive than batch processing, so companies must weigh the cost versus the benefit. For example, a factory that operates around the clock may use real-time processing for inventory and other time-sensitive requirements but process accounting data in batches overnight.

Decisions, Decisions: Management Support Systems

Transaction processing systems automate routine and tedious back-office processes such as accounting, order processing, and financial reporting. They reduce clerical expenses and provide basic operational information quickly. **Management support systems (MSS)** use the internal primary database to perform high-level analyses that help managers make better decisions.

Information technologies such as data warehousing are part of more advanced MSSs. A **data warehouse** combines many databases across the whole company into one central database that supports management decision-making. With a data warehouse, managers can easily access and share data across the enterprise to get a broad overview rather than just isolated segments of information. Data warehouses include software to extract data from operational databases, maintain the data in the warehouse, and provide data to users. They can analyze data much faster than transaction-processing systems. Data warehouses may contain many **data marts**, special subsets of a data warehouse that each deal with a single area of data. Data marts are organized for quick analysis.

Companies use data warehouses to gather, secure, and analyze data for many purposes, including customer relationship management systems, fraud detection, product-line analysis, and corporate asset management. Retailers might wish to identify customer demographic characteristics and shopping patterns to improve targeted marketing responses. Banks can more easily spot credit-card fraud, as well as analyze customer usage patterns.

Over 60 percent of large corporations use data warehouses as a management tool. Union Pacific (UP), a $24 billion railroad, turned to data warehouse technology to streamline its business operations. By consolidating multiple separate systems, UP achieved a unified supply-chain system that also enhanced its customer service. “Before our data warehouse came into being we had stovepipe systems,” says Roger Bresnahan, principal engineer. “None of them talked to each other. . . . We couldn’t get a whole picture of the railroad.”

UP’s data warehouse system took many years and the involvement of 26 departments to create. The results were well worth the effort: UP can now make more accurate forecasts, identify the best traffic routes, and determine the most profitable market segments. The ability to predict seasonal patterns and manage fuel costs more closely has saved UP millions of dollars by optimizing locomotive and other asset utilization and through more efficient crew management. In just three years, Bresnahan reports, the data warehouse system had paid for itself.[12]

At the first level of an MSS is an *information-reporting system,* which uses summary data collected by the TPS to produce both regularly scheduled and special reports. The level of detail would depend on the user. A company’s payroll personnel might get a weekly payroll report showing how each employee’s paycheck was determined. Higher-level mangers might receive a payroll summary report that shows total labor cost and overtime by department and a comparison of current labor costs with those in the prior year. Exception reports show cases that fail to meet some standard. An accounts receivable exception report that lists all customers with overdue accounts would help collection personnel focus their work. Special reports are generated only when a manager requests them; for example, a report showing sales by region and type of customer can highlight reasons for a sales decline.

Decision Support Systems

A **decision support system (DSS)** helps managers make decisions using interactive computer models that describe real-world processes. The DSS also uses data from the internal database but looks for specific data

that relate to the problems at hand. It is a tool for answering "what if" questions about what would happen if the manager made certain changes. In simple cases, a manager can create a spreadsheet and try changing some of the numbers. For instance, a manager could create a spreadsheet to show the amount of overtime required if the number of workers increases or decreases. With interactive computer models, managers can evaluate different scenarios by changing input values to determine the best course of action. Marketing executives at a furniture company could run DSS models that use sales data and demographic assumptions to develop forecasts of the types of furniture that would appeal to the fastest-growing population groups.

Companies can use a predictive analytics program to improve their inventory management system and use big data to target customer segments for new products and line extensions.

Exhibit 13.7 Decision support systems help businesses by providing quantitative data and predictive models that aid problem-solving and decision-making. Now the health-care industry wants this technology in hospitals to improve the practice of medicine. Some leaders in the industry believe national DSS could help physicians with diagnosing and treating illnesses. *What are the pros and cons to having medical professionals rely on a DSS for help in treating patients?* (Credit: Axelle Geelen/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Executive Information Systems

Although similar to a DSS, an **executive information system (EIS)** is customized for an individual executive. These systems provide specific information for strategic decisions. For example, a CEO's EIS may include special spreadsheets that present financial data comparing the company to its principal competitors and graphs showing current economic and industry trends.

Expert Systems

An **expert system** gives managers advice similar to what they would get from a human consultant. Expert systems are an application of AI that combines computer science with expertise provided by humans to help a

manager solve problems. Artificial intelligence enables computers to reason and learn to solve problems in much the same way humans do, using what-if reasoning. Although they are expensive and difficult to create, expert systems are finding their way into more companies as more applications are found. Lower-end expert systems can even run on mobile devices. Top-of-the-line systems help airlines appropriately deploy aircraft and crews, critical to the carriers' efficient operations. The cost of hiring enough people to do these ongoing analytical tasks would be prohibitively expensive. Expert systems have also been used to help explore for oil, schedule employee work shifts, and diagnose illnesses. Some expert systems take the place of human experts, whereas others assist them.

Through machine learning technology called chaining, the system can take facts that have been added by experts and synthesize the information for usage by a non-expert. The chaining can be used in a forward direction to predict what will happen next, such as sales targets for the next fiscal year. Conversely, an expert system can use backward chaining to provide insight into why something occurred. For example, the system can analyze data and facts to isolate why sales targets were not met last year.[13]

CONCEPT CHECK

1. What are the main types of management information systems, and what does each do?
2. Differentiate between the types of management support systems, and give examples of how companies use each.

13.4 Technology Management and Planning

4. How can technology management and planning help companies optimize their information technology systems?

With the help of computers, people have produced more data in the last 30 years than in the previous 5,000 years combined. Companies today make sizable investments in information technology to help them manage this overwhelming amount of data, convert the data into knowledge, and deliver it to the people who need it. In many cases, however, the companies do not reap the desired benefits from these expenditures. Among the typical complaints from senior executives are that the company is spending too much and not getting adequate performance and payoff from IT investments, these investments do not relate to business strategy, the firm seems to be buying the latest technology for technology's sake, and communications between IT specialists and IT users are poor.

Optimize IT!

Managing a company's enterprise-wide IT operations, especially when those often stretch across multiple locations, software applications, and systems, is no easy task. IT managers must deal not only with on-site systems; they must also oversee the networks and other technology, such as mobile devices that handle e-mail messaging, that connect staff working at locations ranging from the next town to another continent. At the same time, IT managers face time constraints and budget restrictions, making their jobs even more challenging.

Growing companies may find themselves with a decentralized IT structure that includes many separate systems and duplication of efforts. A company that wants to enter or expand into e-commerce needs systems flexible enough to adapt to this changing marketplace. Security for equipment and data is another critical area, which we will cover later in the chapter.

The goal is to develop an integrated, company-wide technology plan that balances business judgment, technology expertise, and technology investment. IT planning requires a coordinated effort among a firm's top

executives, IT managers, and business-unit managers to develop a comprehensive plan. Such plans must take into account the company's strategic objectives and how the right technology will help managers reach those goals.

Technology management and planning go beyond buying new technology. Today companies are cutting IT budgets so that managers are being asked to do more with less. They are implementing projects that leverage their investment in the technology they already have, finding ways to maximize efficiency and optimize utilization.

Managing Knowledge Resources

As a result of the proliferation of information, we are also seeing a major shift from information management to a broader view that focuses on finding opportunities in and unlocking the value of intellectual rather than physical assets. Whereas *information management* involves collecting, processing, and condensing information, the more difficult task of **knowledge management (KM)** focuses on researching, gathering, organizing, and sharing an organization's collective knowledge to improve productivity, foster innovation, and gain competitive advantage. Many companies have a position, *chief knowledge officer,* to head up this effort.[14]

Companies use their IT systems to facilitate the physical sharing of knowledge. But better hardware and software are not the answer to KM. KM is not technology-based, but rather a business practice that uses technology. Technology alone does not constitute KM, nor is it the solution to KM. Rather, it facilitates KM. Executives with successful KM initiatives understand that KM is not a matter of buying a major software application that serves as a data depository and coordinates all of a company's intellectual capital. According to Melinda Bickerstaff, Certified Master Executive Coach and former vice president of knowledge management at Bristol-Myers Squibb (BMS), any such "leading with technology" approach is a sure path to failure. "Knowledge management has to be perceived as a business problem solver, not as an abstract concept," Bickerstaff explains.

Effective KM calls for an interdisciplinary approach that coordinates all aspects of an organization's knowledge. It requires a major change in behavior as well as technology to leverage the power of information systems, especially the internet, and a company's human capital resources. The first step is creating an information culture through organizational structure and rewards that promotes a more flexible, collaborative way of working and communicating. Moving an organization toward KM is no easy task, but it is well worth the effort in terms of creating a more collaborative environment, reducing duplication of effort, and increasing shared knowledge. The benefits can be significant in terms of growth, time, and money.

At Bristol-Meyers Squibb, a major pharmaceutical company, Bickerstaff began the KM implementation by looking for specific information-related problems to solve so that the company would save time and/or money. For example, she learned that company scientists were spending about 18 percent of their time searching multiple databases to find patents and other information. Simply integrating the relevant databases gave researchers the ability to perform faster searches. A more complex project involved compiling the best practices of drug-development teams with the best FDA approval rates so that other groups could benefit. Rather than send forms that could be easily set aside, Bickenstaff collected information from these high-performing teams through interviews and then used that knowledge to create engaging materials to share the best practices with others.[15]

Technology Planning

A good technology plan provides employees with the tools they need to perform their jobs at the highest levels of efficiency. The first step is a general needs assessment, followed by ranking of projects and the specific choices of hardware and software. **Table 13.3** poses some basic questions departmental managers

and IT specialists should ask when planning technology purchases.

Questions for IT Project Planning
• What are the company's overall objectives? • What problems does the company want to solve? • How can technology help meet those goals and solve the problems? • What are the company's IT priorities, both short- and long-term? • What type of technology infrastructure (centralized or decentralized) best serves the company's needs? • Which technologies meet the company's requirements? • Are additional hardware and software required? If so, will they integrate with the company's existing systems? • Does the system design and implementation include the people and process changes, in addition to the technological ones? • Do you have the in-house capabilities to develop and implement the proposed applications, or should you bring in an outside specialist?

Table 13.3

Once managers identify the projects that make business sense, they can choose the best products for the company's needs. The final step is to evaluate the potential benefits of the technology in terms of efficiency and effectiveness. For a successful project, you must evaluate and restructure business processes, choose technology, develop and implement the system, and manage the change processes to best serve your organizational needs. Installing a new IT system on top of inefficient business processes is a waste of time and money!

CONCEPT CHECK

1. What are some ways a company can manage its technology assets to its advantage?
2. Differentiate between information management and knowledge management. What steps can companies take to manage knowledge?
3. List the key questions managers need to ask when planning technology purchases.

13.5 Protecting Computers and Information

5. What are the best ways to protect computers and the information they contain?

Have you ever lost an important assignment that you worked on for weeks because of a technological mishap? You were likely angry and frustrated. Multiply that lost time and effort and your feelings hundreds of times over, and you can understand why companies must protect computers, networks, and the information they store and transmit from a variety of potential threats. For example, security breaches of corporate information systems—from human hackers or electronic versions such as viruses and worms—are increasing at an alarming rate. The ever-increasing dependence on computers requires plans that cover human error, power outages, equipment failure, hacking, and terrorist attacks. To withstand natural disasters such as major fires, earthquakes, and floods, many companies install specialized fault-tolerant computer systems.

Disasters are not the only threat to data. A great deal of data, much of it confidential, can easily be tapped or destroyed by anyone who knows about computers. Keeping your networks secure from unauthorized

access—from internal as well as external sources—requires formal security policies and enforcement procedures. The increasing popularity of mobile devices—laptops, tablets, and cell phones—and wireless networks requires new types of security provisions.

In response to mounting security concerns, companies have increased spending on technology to protect their IT infrastructure and data. Along with specialized hardware and software, companies need to develop specific security strategies that take a proactive approach to prevent security and technical problems before they start. However, CIO has noted the lack of basic security policies that companies only implement after a hack or data crisis.[16]

Data Security Issues

Unauthorized access into a company's computer systems can be expensive, and not just in monetary terms. Experts estimate that cybercrime will cost businesses well over $10 trillion by 2029 compared to just $2 trillion in 2019. The most costly categories of threats include investment fraud, personal and business data breaches, and compromised networks. Reports indicate that almost all U.S. businesses report at least one security issue across most industries.[17]

Computer crooks are becoming more sophisticated all the time, finding new ways to get into ultra-secure sites. "There's very little you can do to guarantee you're not a victim, but there are a lot of things you can do to be more secure that aren't being done," says Stuart Madnick, Professor of Information Technology at MIT.[18] Whereas early cybercrooks were typically amateur hackers working alone, cybercriminals now are more sophisticated, often working collaboratively to commit large-scale internet crimes for large financial rewards. The internet, where criminals can hide behind anonymous screen names, has increased the stakes and expanded the realm of opportunities to commit identity theft and similar crimes. Catching such cybercriminals is difficult, and fewer than 5 percent are caught.[19]

Exhibit 13.8 In 2021, cybercriminals penetrated LinkedIn and posted data for 700 million users on the dark web. *What impact do identity theft and other data-security issues have on global networking and e-commerce?* (Credit: Blogtrepreneur/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Firms are taking steps to prevent these costly computer crimes and problems, which fall into several major categories:

- *Unauthorized access and security breaches.* Whether from internal or external sources, unauthorized access and security breaches are a top concern of IT managers. These can create havoc with a company's systems and damage customer relationships. Unauthorized access also includes employees, who can copy confidential new-product information and provide it to competitors or use company systems for personal

business that may interfere with systems operation. Networking links also make it easier for someone outside the organization to gain access to a company's computers.
With enhancements in AI technology and more remote workplaces, there are greater opportunities for cybercriminals to utilize ransomware to access personal data, with financial gain often the primary motivator. This software then copies and transmits a user's keystrokes—passwords, PINs, and other personal information—from selected sites, such as banking and credit card sites, to thieves. Additionally, AI tools are more accessible so that even a novice user can pose a risk for creating sophisticated attacks. Phishing schemes appear more authentic and go well beyond simple emails to include voice impersonations. Through machine learning technologies, malware can adapt and "learn" to circumvent security measures that have historically been effective at blocking attacks.

- *Computer viruses, worms, and Trojan horses.* Computer viruses and related security problems such as worms and Trojan horses are among the top threats to business and personal computer security. A computer program that copies itself into other software and can spread to other computer systems, a **computer virus** can destroy the contents of a computer's hard drive or damage files. Another form is called a *worm* because it spreads itself automatically from computer to computer. Unlike a virus, a worm doesn't require e-mail to replicate and transmit itself into other systems. It can enter through valid access points.
  Trojan horses are programs that appear to be harmless and from legitimate sources but trick the user into installing them. When run, they damage the user's computer. For example, a Trojan horse may claim to get rid of viruses but instead infects the computer. Other forms of Trojan horses provide a "trapdoor" that allows undocumented access to a computer, unbeknownst to the user. Trojan horses do not, however, infect other files or self-replicate.

  Viruses can hide for weeks, months, or even years before starting to damage information. A virus that "infects" one computer or network can be spread to another computer by sharing disks or by downloading infected files over the internet. To protect data from virus damage, virus protection software automatically monitors computers to detect and remove viruses. Program developers make regular updates available to guard against newly created viruses. In addition, experts are becoming more proficient at tracking down virus authors, who are subject to criminal charges.

- *Deliberate damage to equipment or information.* For example, an unhappy employee in the purchasing department could get into the company's computer system and delete information on past orders and future inventory needs. The sabotage could severely disrupt production and the accounts payable system. Willful acts to destroy or change the data in computers are hard to prevent. To lessen the damage, companies should back up critical information.
- *Spam.* Although you might think that *spam,* or unsolicited and unwanted e-mail, is just a nuisance, it also poses a security threat to companies. Viruses spread through e-mail attachments that can accompany spam e-mails. Spam is now clogging blogs, instant messages, and cell phone text messages as well as e-mail inboxes. Spam presents other threats to a corporation: lost productivity and expenses from dealing with spam, such as opening the messages and searching for legitimate messages that special spam filters keep out.
- *Software and media piracy.* The copying of copyrighted software programs, games, and movies by people who haven't paid for them is another form of unauthorized use. Piracy, defined as using software without a license, takes revenue away from the company that developed the program—usually at great cost.

Preventing Problems

Creating formal written information security policies to set standards and provide the basis for enforcement is the first step in a company's security strategy. Unfortunately, research shows that over two-thirds of IT executives worldwide expect a cyberattack in the near future. Stephanie Ewing, a data security expert, states, "Having a documented, tested process brings order to chaotic situations and keeps everyone focused on

solving the most pressing issues." Without information security strategies in place, companies spend too much time in a reactive mode—responding to crises—and don't focus enough on prevention.[20]

Security plans should have the support of top management, and then follow with procedures to implement the security policies. Because IT is a dynamic field with ongoing changes to equipment and processes, it's important to review security policies often. Some security policies can be handled automatically, by technical measures, whereas others involve administrative policies that rely on humans to perform them. Examples of administrative policies are "Users must change their passwords every 90 days" and "End users will update their virus signatures at least once a week." **Table 13.4** shows the types of security measures companies use to protect data.

Five Areas of Concern Regarding the Protection of Data	
Percentage	Concern for Protecting Data
52	Aren't sure how to secure connected devices and apps
40	Don't immediately change default passwords
33	Don't think they can control how companies collect personal information
33	Parents admit they don't know the risks well enough to explain to children
37	Use credit-monitoring services

Table 13.4 Source: Adapted from Tony Bradley, "Top 5 Concerns to Focus on for Privacy Day," *Forbes*, https://forbes.com, January 27, 2017.

Preventing costly problems can be as simple as regularly backing up applications and data. Companies should have systems in place that automatically back up the company's data every day and store copies of the backups off-site. In addition, employees should back up their own work regularly. Another good policy is to maintain a complete and current database of all IT hardware, software, and user details to make it easier to manage software licenses and updates and diagnose problems. In many cases, IT staff can use remote access technology to automatically monitor and fix problems, as well as update applications and services.

Companies should never overlook the human factor in the security equation. One of the most common ways that outsiders get into company systems is by posing as an employee, first getting the staffer's full name and username from an e-mail message and then requesting to update a forgotten password. Crooks can also get passwords by viewing them on notes attached to a desk or computer monitor, using machines that employees leave logged on when they leave their desks, and leaving laptop computers with sensitive information unsecured in public places.

Portable devices, from handheld computers to tiny plug-and-play flash drives and other storage devices (including mobile phones), pose security risks as well. They are often used to store sensitive data such as passwords, bank details, and calendars. Mobile devices can spread viruses when users download virus-infected documents to their company computers.

Imagine the problems that could arise if an employee saw a calendar entry on a mobile device like "meeting re: layoffs," an outsider saw "meeting about merger with ABC Company," or an employee lost a flash drive containing files about marketing plans for a new product. Manufacturers are responding to IT managers' concerns about security by adding additional layers of protection such as multi-factor authentication. Companies can also use flash drive monitoring software that prevents unauthorized access on PCs and

laptops.

Companies have many ways to avoid an IT meltdown, as Table 13.5 describes.

Procedures to Protect IT Assets
• Develop a comprehensive plan and policies that include portable as well as fixed equipment. • Protect the equipment itself with stringent physical security measures to the premises. • Protect data using special *encryption* technology to encode confidential information so only the recipient can decipher it. • Stop unwanted access from inside or outside with special authorization systems. These can be as simple as a password or as sophisticated as fingerprint or voice identification. • Install *firewalls*, hardware or software designed to prevent unauthorized access to or from a private network. • Monitor network activity with intrusion-detection systems that signal possible unauthorized access, and document suspicious events. • Conduct periodic IT audits to catalog all attached storage devices as well as computers. • Use technology that monitors ports for unauthorized attached devices and turn off those that are not approved for business use. • Train employees to troubleshoot problems in advance, rather than just react to them. • Hold frequent staff-training sessions to teach correct security procedures, such as logging out of networks when they go to lunch and changing passwords often. • Make sure employees choose sensible passwords, at least eight characters long, containing numbers, letters, and punctuation marks. Avoid dictionary words and personal information. • Establish a database of useful information and FAQ (frequently asked questions) for employees so they can solve problems themselves. • Develop a healthy communications atmosphere.

Table 13.5

Keep IT Confidential: Privacy Concerns

The very existence of huge electronic file cabinets full of personal information presents a threat to our personal privacy. Until recently, our financial, medical, tax, and other records were stored in separate computer systems. Computer networks make it easy to pool these data into data warehouses. Companies also sell the information they collect about you from sources like warranty registration cards, credit-card records, registration at websites, personal data forms required to purchase online, and grocery store discount club cards. Telemarketers can combine data from different sources to create fairly detailed profiles of consumers.

The September 11, 2001, tragedy and other massive security breaches have raised additional privacy concerns. As a result, the government began looking for ways to improve domestic-intelligence collection and analyze terrorist threats within the United States. Sophisticated database applications that look for hidden patterns in a group of data, a process called **data mining**, increase the potential for tracking and predicting people's daily activities. Legislators and privacy activists worry that such programs as this and ones that eavesdrop electronically could lead to excessive government surveillance that encroaches on personal privacy. The stakes are much higher as well: errors in data mining by companies in business may result in a consumer being targeted with inappropriate advertising, whereas a governmental mistake in tracking suspected terrorists could do untold damage to an unjustly targeted person.

Increasingly, consumers are fighting to regain control of personal data and how that information is used. Privacy advocates are working to block sales of information collected by governments and corporations. For

example, they want to prevent state governments from selling driver's license information and supermarkets from collecting and selling information gathered when shoppers use customer loyalty programs. With information about their buying habits, advertisers can target consumers for specific marketing programs.

The challenge to companies is to find a balance between collecting the information they need while at the same time protecting individual consumer rights. Most registration and warranty forms that ask questions about income and interests have a box for consumers to check to prevent the company from selling their names. Many companies now state in their privacy policies that they will not abuse the information they collect. Regulators are taking action against companies that fail to respect consumer privacy.

CONCEPT CHECK

1. Describe the different threats to data security.
2. How can companies protect information from destruction and unauthorized use?
3. Why are privacy rights advocates alarmed over the use of techniques such as data warehouses and data mining?

13.6 Trends in Information Technology

6. What are the leading trends in information technology?

Information technology is a continually evolving field. The fast pace and amount of change, coupled with IT's broad reach, make it especially challenging to isolate industry trends. Month over month, and year over year, new trends appear, and those that seemed important may fade. However, some trends that are reshaping today's IT landscape are cloud-based solutions, the inclusion of AI within IT operations, and sustainability concerns with large data centers becoming more prolific.

The proliferation of AI technologies is changing how IT departments operate and support their organizations. AI is part of how nearly all software programs are built and deployed across business functions. However, one of the more important benefits of AI integration into IT operations is system reliability through real-time monitoring and automated fixes for network issues when they arise. This can be critical to the day-to-day functioning of the firm overall as IT is integrated across most business functions in nearly all companies and industries. IT professionals are utilizing AI and machine learning technologies to solve user issues more quickly, deliver a more reliable and secure network for the firm, and elevate productivity of employees with strategic integration of AI tools in the workplace.[21]

Cyber Sleuthing: A New Style of Crime Busting

What helped investigators bring suit against Enron, Merck's Vioxx medication, and the BTK serial killer? Digital evidence taken from an individual's computer or corporate network—web pages, pictures, documents, and e-mails are part of a relatively new science called *digital forensics.* Digital-forensics software safeguards electronic evidence used in investigations by creating a duplicate of a hard drive that an investigator can search by keyword, file type, or access date. Digital forensics is also evolving into areas such as cloud computing and blockchain technology. For instance, it is estimated that as much as 14 percent of the original 21 million bitcoins are "lost" due to various issues such as discarded hardware or lost passwords.[22]

But nowadays digital sleuthing is not limited to law enforcement. Companies such as Walmart and Target, and in industries including insurance and healthcare organizations, have their own in-house digital forensics teams. And what if you're in New York and need to seize a hard drive in Hong Kong? No problem. With advancements in digital forensic tools, users can now search hard drives remotely. Digital forensics makes it possible to track down those who steal corporate data and intellectual property. Broadcom, a semiconductor

chip designer, used computer forensics to investigate and apprehend former employees who were attempting to steal trade secrets. In the process, Broadcom gathered incriminating e-mails, including deleted documents, that gave it solid evidence to use existing legislation as support to stop the former employees from starting up a rival firm.[23]

However, there is a downside to having these advanced capabilities. If this kind of software falls into the wrong hands, sophisticated hackers could access corporate networks and individual computers as easily as taking candy from a baby—and the victims would not even know it was happening. In an age of corporate wrongdoing, sexual predators, and computer porn, your hard drive will tell investigators everything they need to know about your behavior and interests, good and bad. Cybersleuthing means we are all potential targets of digital forensics. As evidenced by the huge increase in identity theft, personal privacy—once an unassailable right—is no longer as protected as it once was.

ETHICS IN PRACTICE

Unearthing Your Secrets

Cybercrimes in our technologically driven world are on the increase—identity theft, pornography, and sexual predator victim access, to name a few. The FBI's computer analysis response team confirms their caseload includes hundreds of cases per day. To keep up with the changing world we live in, law enforcement, corporations, and government agencies have turned to new crime-fighting tools, one of the most effective being digital forensics.

The leader in this technology is OpenText, which acquired Guidance Software that developed solutions to identify, recover, and deliver digital information in a forensically sound and cost-effective manner. The company employs people at offices and training facilities across the world. Its high-profile clients include leading police agencies, government investigation and law enforcement agencies, and Fortune 1000 corporations in the financial service, insurance, high-tech and consulting, health care, and utility industries.

OpenText's software suite of OpenText EnCase® solutions is the first computer forensics tool able to provide world-class electronic investigative capabilities for large-scale complex investigations. Law enforcement officers, government/corporate investigators, and consultants around the world can now benefit from computer forensics that exceed anything previously available. The software offers an investigative infrastructure that provides network-enabled investigations, enterprise-wide integration with other security technologies, and powerful search and collection tools. With EnCase, clients can conduct digital investigations, handle large-scale data collection needs, and respond to external attacks.

Notably, forensic tools such as EnCase have been used by law enforcement to solve murder cases that have gone cold, major security breaches, and even to examine data retrieved in military operations.

Guidance Software also helps reduce corporate and personal liability when investigating computer-related fraud, intellectual property theft, and employee misconduct. It protects against network threats such as hackers, worms, and viruses and hidden threats such as malicious code.

In response to increases in the number and scope of discovery requests, new solutions have been developed such as OpenText eDiscovery. The software package dramatically improves the practice of large-scale discovery—the identification, collection, cataloging, and saving of evidence—required in almost every major legal case these days. eDiscovery integrates with other litigation-support software to significantly decrease the time for corporations to accomplish these tasks. At the same time, it improves regulatory compliance and reduces disruption. The result is many millions of dollars in cost savings.

Sources: FBI website, https://www.fbi.gov, accessed January 15, 2018; Guidance Software website,

https://www.guidancesoftware.com, accessed January 15, 2018; OpenText website, https://www.opentext.com, accessed January 15, 2018; "7 Real-Life Cases Solved Using Digital Forensics [References]," https://www.ticktechtold.com, April 16, 2023.

Critical Thinking Questions

1. How is Guidance Software responding to and helping to manage changes in our technology-driven world?
2. What other types of forensics software do you foresee a need for in the future? Do you think there are ethical issues in using forensics software, and why?
3. What are the benefits and risks of Guidance Software being acquired by a larger company?

The Distributed Workforce

Insurance company Aetna (now part of CVS Health) shuttered 2.7 million square feet of office space, saving the company $78 million, while American Express estimates it saved between $10 to $15 million dollars per year by expanding its distributed workforce. Was this a sign that these company were in trouble? Far from it. Instead of maintaining expensive offices in multiple locations, they sent employees home to work and adopted a new model for employees: the distributed workforce. Employees have no permanent office space and work from home or on the road. The shift to virtual workers has been a huge success, and not only do companies save on their personnel and related costs, but they also have happier, more productive employees.

Aetna and American Express are not alone in recognizing the benefits of distributed workers, especially in companies that depend on knowledge workers. Estimates show that over 20 percent of Americans work remotely, but this can vary by industry and geographic location. The World Economic Forum estimates that nearly 100 million jobs globally will be remote by 2030. Long commutes, high gas costs, and better connecting tools and technologies make this an attractive option for many workers who like the flexibility of not working in an office.[24] Already, employees use the internet to conduct video-conferenced meetings and collaborate on teams that span the globe. On the downside, working from home can also mean being available 24/7—although most workers consider the trade-off well worth it.

According to current statistics, over 30 million U.S. workers work from home at least half of the time. Remote workers continue to be recruited by companies of all sizes, including Allstate, Humana, Pinterest, and others.[25] At Allstate, thousands of employees participate in the virtual-work program, and it has been a critical factor in attracting and retaining younger workers. Almost half of the employees at Sun Microsystems (now part of Oracle) are “location-independent,” reducing real estate costs by $300 million. Additional benefits for Sun are higher productivity from these workers and the ability to hire the best talent. “Our people working these remote schedules are the happiest employees we have, and they have the lowest attrition rates,” says Bill MacGowan, senior vice president for human resources at Sun. “Would I rather settle on someone mediocre in the Bay Area, or get the best person in the country who is willing to work remotely?”[26]

Grid and Cloud Computing Offer Powerful Solutions

How can smaller companies that occasionally need to perform difficult and large-scale computational tasks find a way to accomplish their projects? They can turn to *grid* or **cloud computing**, also called *utility computing* or *peer-to-peer computing.* Cloud and grid technology provides a way to divide the job into many smaller tasks and distribute them to a virtual supercomputer consisting of many small computers linked into a common network. Combining multiple desktop machines results in computing power that exceeds supercomputer speeds. A hardware and software infrastructure clusters and integrates computers and applications from multiple sources, harnessing unused power in existing PCs and networks. This structure distributes computational resources but maintains central control of the process. A central server acts as a team leader and traffic monitor. The controlling cluster server divides a task into subtasks, assigns the work to computers on the grid with surplus processing power, combines the results, and moves on to the next task

until the job is finished. **Exhibit 13.9** shows how typical grid and cloud setups work, and the differences between the two.

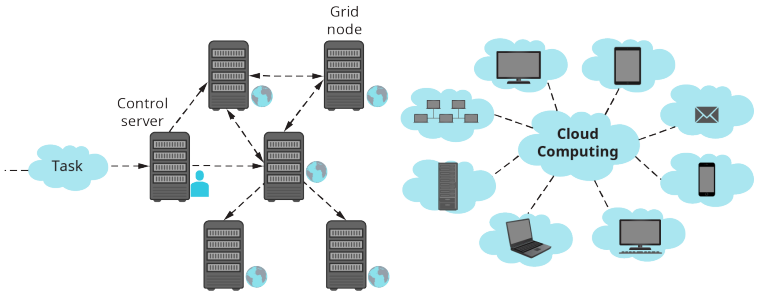

Exhibit 13.9 How Grid and Cloud Computing Work (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

With utility computing, any company—large or small—can access the software and computer capacity on an as-needed basis. One of the big advantages of cloud computing is that companies can update their inventory in real time across their entire organization. For example, suppose you are an appliance retailer and have several outlets throughout the Midwest. If you have one model of a Whirlpool washing machine in your Des Moines, Iowa, store, and a salesperson in your Chicago location can sell that model in Chicago, the sale can be accomplished pretty easily. They can finalize the sale, create the shipping instructions, and update the inventory record automatically—and the Chicago consumer's needs will be met.[27]

Amazon Web Service (AWS), Microsoft Azure, and Oracle Cloud are among the companies providing as-needed cloud and grid services. Although cloud and grid computing appears similar to outsourcing or on-demand software from ASPs, it has two key differences:

- Pricing is set per-use, whereas outsourcing involves fixed-price contracts.
- Cloud and grid computing goes beyond hosted software and includes computer and networking equipment as well as services.

The cloud and grids provide a very cost-effective way to provide computing power for complex projects in areas such as weather research and financial and biomedical modeling. Because the computing infrastructure already exists—they tap into computer capacity that is otherwise unused—the cost is quite low. The increased interest in cloud and grid technology will continue to contribute to high growth.

CONCEPT CHECK

1. How are companies and other organizations using digital forensics to obtain critical information?
2. Why do companies find that productivity rises when they offer employees the option of joining the virtual workforce?
3. What advantages do grid and cloud computing offer a company? What are some of the downsides to using this method?

Key Terms

application service providers (ASP) A service company that buys and maintains software on its servers and distributes it through high-speed networks to subscribers for a set period and price.

batch processing A method of updating a database in which data are collected over some time period and processed together.

chief information officer (CIO) An executive with responsibility for managing all information resources in an organization.

cloud computing A general term for the delivery of hosted services over the internet.

computer network A group of two or more computer systems linked together by communications channels to share data and information.

computer virus A computer program that copies itself into other software and can spread to other computer systems.

data mart Special subset of a data warehouse that deals with a single area of data and is organized for quick analysis.

data mining Sophisticated database applications that look for hidden patterns in a group of data to help track and predict future behavior.

data warehouse An information technology that combines many databases across a whole company into one central database that supports management decision-making.

database An electronic filing system that collects and organizes data and information.

decision support system (DSS) A management support system that helps managers make decisions using interactive computer models that describe real-world processes.

enterprise portal A customizable internal website that provides proprietary corporate information to a defined user group, such as employees, supply-chain partners, or customers.

executive information system (EIS) A management support system that is customized for an individual executive; provides specific information for strategic decisions.

expert system A management support system that gives managers advice similar to what they would get from a human consultant; it uses artificial intelligence to enable computers to reason and learn to solve problems in much the same way humans do.

information technology (IT) The equipment and techniques used to manage and process information.

intranet An internal corporate-wide area network that uses internet technology to connect computers and link employees in many locations and with different types of computers.

knowledge management (KM) The process of researching, gathering, organizing, and sharing an organization's collective knowledge to improve productivity, foster innovation, and gain competitive advantage.

knowledge worker A worker who develops or uses knowledge, contributing to and benefiting from information used to perform planning, acquiring, searching, analyzing, organizing, storing, programming, producing, distributing, marketing, or selling functions.

local area network (LAN) A network that connects computers at one site, enabling the computer users to exchange data and share the use of hardware and software from a variety of computer manufacturers.

managed service providers (MSP) Next generation of ASPs, offering customization and expanded capabilities such as business processes and complete management of the network servers.

management information system (MIS) The methods and equipment that provide information about all aspects of a firm's operations.

management support system (MSS) An information system that uses the internal primary database to perform high-level analyses that help managers make better decisions.

online (real-time) processing A method of updating a database in which data are processed as they become available.

transaction processing system (TPS) An information system that handles the daily business operations of a firm. The system receives and organizes raw data from internal and external sources for storage in a

database using either batch or online processing.

virtual private networks (VPN) Private corporate networks connected over a public network, such as the internet. VPNs include strong security measures to allow only authorized users to access the network.

wide area network (WAN) A network that connects computers at different sites via telecommunications media such as phone lines, satellites, and microwaves.

Summary of Learning Outcomes

13.1 Transforming Businesses through Information

1. How has information technology transformed business and managerial decision-making?

Businesses depend on information technology for everything from running daily operations to making strategic decisions. Companies must have management information systems that gather, analyze, and distribute information to the appropriate parties, including employees, suppliers, and customers. These systems are comprised of different types of computers that collect data and process it into usable information for decision-making. Managers tap into databases to access the information they need, whether for placing inventory orders, scheduling production, or preparing long-range forecasts. They can compare information about the company's current status to its goals and standards. Company-wide enterprise resource planning systems that bring together human resources, operations, and technology are becoming an integral part of business strategy.

13.2 Linking Up: Computer Networks

2. Why are computer networks an important part of today's information technology systems?

Today companies use networks of linked computers that share data and expensive hardware to improve operating efficiency. Types of networks include local area networks, wide area networks, and wireless local area networks. Intranets are private WANs that allow a company's employees to communicate quickly with one other and work on joint projects, regardless of their location. Companies are finding new uses for wireless technologies such as tablets, cell phones, and other mobile devices. Virtual private networks give companies a cost-effective secure connection between remote locations by using public networks such as the internet.

13.3 Management Information Systems

3. What types of systems make up a typical company's management information system?

A management information system consists of a transaction processing system, management support systems, and an office automation system. The transaction processing system collects and organizes operational data on the firm's activities. Management support systems help managers make better decisions. They include an information-reporting system that provides information based on the data collected by the TPS to the managers who need it; decision support systems that use models to assist in answering "what if" types of questions; and expert systems that give managers advice similar to what they would get from a human consultant. Executive information systems are customized to the needs of top management.

13.4 Technology Management and Planning

4. How can technology management and planning help companies optimize their information technology systems?

To get the most value from IT, companies must go beyond simply collecting and summarizing information. Technology planning involves evaluating the company's goals and objectives and using the right technology to reach them. IT managers must also evaluate the existing infrastructure to get the best return on the company's investment in IT assets. Knowledge management focuses on sharing an organization's collective knowledge to improve productivity and foster innovation. Some companies establish the position of chief knowledge officer to head up KM activities.

13.5 Protecting Computers and Information

5. What are the best ways to protect computers and the information they contain?

Because companies are more dependent on computers than ever before, they need to protect data and equipment from natural disasters and computer crime. Types of computer crime include unauthorized use and access, software piracy, malicious damage, and computer viruses. To protect IT assets, companies should prepare written security policies. They can use technology such as virus protection, firewalls, and employee training in proper security procedures. They must also take steps to protect customers' personal privacy rights.

13.6 Trends in Information Technology

6. What are the leading trends in information technology?

IT is a dynamic industry, and companies must stay current on the latest trends to identify ones that help them maintain their competitive edge, such as digital forensics, the distributed workforce, and grid computing. With digital forensics techniques, corporations, government agencies, attorneys, and lawmakers can obtain evidence from computers and corporate networks—web pages, pictures, documents, and e-mails. Many knowledge workers now work remotely rather than from an office. Companies adopting the distributed workforce model gain many benefits, such as cost savings, more satisfied and productive employees, and increased employee retention. Cloud computing harnesses the power of computers, online software, and data storage to create a virtual computing environment that is invisible to the user. A company can access the cloud on an as-needed basis instead of investing in its own supercomputer equipment. Outsourcing a portion of the company's computing needs provides additional flexibility and cost advantages. Companies can also set up internal grids.

Preparing for Tomorrow's Workplace Skills

1. How has information technology changed your life? Describe at least three areas (both personal and school- or work-related) where having access to better information has improved your decisions. Are there any negative effects? What steps can you take to manage information better? (Information, Technology)
2. Visit or conduct a phone interview with a local small-business owner about the different ways their firm uses information technology. Prepare a brief report on your findings that includes the hardware and software used, how it was selected, benefits of technology for the company, and any problems in implementing or using it. (Interpersonal, Information)
3. Your school wants to automate the class-registration process. Prepare a memo to the dean of information systems describing an integrated information system that would help a student choose and register for courses. Make a list of the different groups that should be involved and questions to ask during the planning process. Include a graphic representation of the system that shows how the data become useful information. Indicate the information a student needs to choose courses and its sources. Explain how several types of management support systems could help students make better course decisions. Include ways the school could use the information it collects from this system. Have several students present their plans to the class, which will take the role of university management in evaluating them. (Resources, Systems, Technology)
4. You recently joined the IT staff of a midsized consumer products firm. After a malicious virus destroys some critical files, you realize that the company lacks a security strategy and policies. Outline the steps you'd take to develop a program to protect data and the types of policies you'd recommend. How would you present the plan to management and employees to encourage acceptance? (Resources, Technology)
5. **Team Activity** Should companies outsource IT? Some executives believe that IT is too important to outsource and that application service providers don't have a future. Yet spending for hosted software programs through subscriptions, third party IT management services and other forms of IT outsourcing such as cloud computing continue to grow. What's your position? Divide the class into groups designated "for" or "against" outsourcing and/or ASPs. Have them research the current status of ASPs using

publications such as *CIO* and *Computerworld* and websites such as Enterprise Apps Today, https://www.enterpriseappstoday.com. (Interpersonal, Information)

Ethics Activity

As the owner of a small but growing business, you are concerned about employees misusing company computers for personal matters. Not only does this cost the company in terms of employee productivity, but it also ties up bandwidth that may be required for company operations and exposes the firm's networks to increased risks of attacks from viruses, spyware, and other malicious programs. Installing e-mail monitoring and web security and filtering software programs would allow you to track e-mail and internet use, develop use policies, block access to inappropriate sites, and limit the time employees can conduct personal online business. At the same time, the software will protect your IT networks from many types of security concerns, from viruses to internet fraud. You are concerned, however, that employees will take offense and consider such software an invasion of privacy.

Using a web search tool, locate articles about this topic and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Should you purchase employee-monitoring software for your company, and on what do you base your decision? If you install the software, do you have an obligation to tell employees about it? Explain your answers and suggest ways to help employees understand your rationale.

Sources: KC Agu, "6 Software Tools for Monitoring Employee Productivity," *Huffington Post*, https://www.huffingtonpost.com, December 6, 2017; Marissa Lang, "Electronic Tracking Spurs Workplace Privacy Debate," *Government Technology*, https://www.govtech.com, October 18, 2017; Mike Rogoway, "Jive's Buyer Responds to Employee Anxiety over Workplace Monitoring Tool," *The Oregonian,* https://www.oregonlive.com.

Working the Net

1. Enterprise resource planning is a major category of business software. Visit the site of one of the following companies: SAP (**https://www.sap.com**), or Oracle (**https://www.oracle.com**). Prepare a short presentation for the class about the company's ERP product offerings and capabilities. Include examples of how companies use the ERP software. What are the latest trends in ERP?
2. What can intranets and enterprise portals accomplish for a company? Find out by using such resources as Brint.com's Intranet Portal, **https://www.brint.com/Intranets.htm**. Look for case studies that show how companies apply this technology. Summarize the different features an intranet or enterprise portal provides.
3. Learn more about the CERT Coordination Center (CERT/CC), which serves as a center of internet security expertise. Explore its website, **https://www.cert.org/index.cfm**. What are the latest statistics on incidents reported, vulnerabilities, security alerts, security notes, mail messages, and hotline calls? What other useful information does the site provide to help a company protect IT assets?
4. Research the latest developments in computer security at *Computerworld*'s site, **https://computerworld.com/**. What types of information can you find here? Pick a category based on the concepts in the chapter such as cybercrime, privacy, or VPNs and search the content on the site for information. Summarize your findings.
5. How can someone steal your identity? Using information at the Federal Trade Commission's central website for information about identity theft, https://www.consumer.ftc.gov/features/feature-0014-identity-theft, compile a list of the ways thieves can access key information to use your identity. What steps should you take if you've been a victim of identity theft? Summarize key provisions of federal laws dealing with this crime and the laws in your state.

Critical Thinking Case

Novartis's Prescription for Invoice Processing

What do you do when you have a presence in about 60 countries with products sold in 155 countries around the world—processing complex invoices in various languages and currencies? You seek out the best technology solution to make the job easier.

At global pharmaceutical giant Novartis, the IT department is a strategic resource critical to the company's overall strategy of a streamlined global footprint. Because most of the company's invoices come from international suppliers, they have differences in design, language, taxes, and currency. Consequently, many ended up as "query items" requiring manual resolution by Novartis accounting staff—which delayed payments and made those invoices extremely costly to process. In fact, finance personnel spent so much of their time resolving queried invoices that other work suffered. A solution was badly needed.

To maximize its investment, Novartis needed a flexible solution that would meet its current and future needs and function in other business departments in a variety of geographic locations. It should provide fast, accurate document capture and multi-language support, and should extend to other types of information—such as sales metrics and electronic customer data—in addition to traditional company files. Finally, in order to obtain financing for the project, return on investment (ROI) was required within nine months of project implementation.

OpenText Intelligent Capture for Invoices from OpenText was the answer. The software extracts data from paper documents, applies intelligent document recognition (IDR) technology to convert them to digital images, and sends relevant data to enterprise resource planning, accounts payable (A/P), and other back-end management systems. The specialized Input*Accel* server manages output by recognizing and avoiding holdups in the workflow process. It also ensures if a server goes offline, others will carry on functioning, thus avoiding downtime.

Now Novartis scans incoming invoices at a centrally located site, and the images are transmitted to the Input*Accel* for Invoices server for image improvement. Invoice data are then extracted and validated against supplier information. Most invoices are transferred directly for payment, with relatively few invoices requiring transfer to one of three accounts payable clerks who deal with queries manually. Novartis is a global leader in research and development of products that improve health issues. Input*Accel* was selected by Novartis to be part of its accounting system.

Thanks to IT, overall efficiency has increased, processing errors are reduced, and accounting personnel can use their time and expert knowledge for more meaningful tasks than resolving invoice errors. For Novartis, it is "mission accomplished."

Critical Thinking Questions

1. What factors contributed to Novartis's invoice processing being so complex?
2. How did IT help the company solve that problem?
3. What other uses and functions does Input*Accel* serve, and how will this be useful to Novartis over the long term? (You may want to visit the OpenText website, **https://opentext.com**, for more information on the capabilities of OpenText Intelligent Capture for Invoices)

Sources: "OpenText Acquires EMC Enterprise Division," *MetaSource*, https://www.metasource.com, September 20, 2016; Novartis corporate website, https://www.novartis.com, March 20, 2006; "Processing Invoices From Around the World," *ECM Connection,* https://www.ecmconnection, February 2, 2006; Kathryn Balint, "Captiva's Paper Chase Paying Off," *San Diego Union-Tribune,* December 9, 2005, pp. C1, C5.

Hot Links Address Book

1. If you want to know the definition of a computer term or more about a particular topic, Webopedia has

the answer: **https://www.webopedia.com**.

2. Can't tell a LAN from a WAN? Learn more about networking at Lifewire's Internet & Networking pages, **https://www.lifewire.com**.
3. To find out if that e-mail alerting you to another virus threat is real or a hoax, check out the latest information at **https://www.snopes.com**.
4. How can you "inoculate" your computer against viruses? Symantec's Security Center has the latest details on virus threats and security issues: **https://www.symantec.com**.
5. The CIO digital magazine offers helpful articles that provide a good introduction to key IT topics: **https://www.cio.com**.
6. Curious about how companies are using on-demand grid computing? Read more at IBM's site, **https://www.ibm.com/think/topics/grid-computing**, and then check out some of the many links to other resources.

14

Using Financial Information and Accounting

Exhibit 14.1 (Credit: Matt Madd /flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. Why are financial reports and accounting information important, and who uses them?
2. What are the differences between public and private accountants, and how has federal legislation affected their work?
3. What are the six steps in the accounting cycle?
4. In what terms does the balance sheet describe the financial condition of an organization?
5. How does the income statement report a firm's profitability?
6. Why is the statement of cash flows an important source of information?
7. How can ratio analysis be used to identify a firm's financial strengths and weaknesses?
8. What major trends affect the accounting industry today?

EXPLORING BUSINESS CAREERS

Theresa Lee, Future Glory

Theresa Lee always knew she would start her own business; it was just a matter of time. In 2013, after working as a designer in the Bay Area for more than a decade, Lee cofounded Future Glory, which specializes in handmade leather bags and accessories, now made in a small studio in the Dogpatch neighborhood of San Francisco.

Lee would be the first to tell you that she is a creative person and not so great with numbers and other business details. But the business details, including financial statements and cash flow, are key to any company. That's where accounting software comes in handy. Companies use a variety of accounting tools, including software from providers like QuickBooks (QB), Oracle NetSuite, Sage, and Xero. Smaller firms and entrepreneurs often use tools like QB because of the ease of use and affordability, while larger companies

utilize platforms like Oracle and SAP.

Intuit, the leading provider of small business accounting software, has revolutionized the approach taken by small businesses with its products, including QuickBooks and TurboTax, programs that can be used by new businesses, independent contractors, product sellers, accountants, and other types of businesses. The company estimates more than seven million global customers are currently using the online version of QuickBooks. Intuit provides online support that includes expert help, a resource blog, accounting advice, and other features utilized by QuickBooks users and those wanting more information about how to track typical business accounting functions.

As Lee points out, using a cloud-based accounting program has helped her gain control over company finances and provided insight into key business components such as profit and loss, cost of goods sold, and labor. In addition, QuickBooks' ability to work with other apps has helped her manage e-commerce sales efficiently. Lee uses Shopify as an e-commerce platform and PayPal as a payment system. By using a version of these apps designed to work with QuickBooks, Lee can import sales data (line items, fees, and taxes) as well as customer information into the accounting program. In addition, Shopify e-commerce data automatically sync with QuickBooks, allowing her to keep bookkeeping activities to a minimum and giving her more time to focus on designing and creating new products and fulfilling the social goals of her business.

Future Glory employs local community members at living wages and donates a portion of proceeds to local non-profits focused on supporting women, reflecting the company's social mission. The firm also supports various social causes, donating a portion of revenue to organizations that assist women in need, including Project Bayview, Because Justice Matters, Freedom House, and New Story.

Keeping a close eye on financial and accounting information is an important part of any business, whether it's a startup or a global conglomerate. The continuing revolution in technology has enabled bookkeeping and accounting activities to be done more efficiently while giving business owners, particularly small businesses like Future Glory, the time to spend expanding their business and giving back to their local communities.

Sources: "Corporate Profile," https://www.intuit.com, accessed August 11, 2017; "QuickBooks Online," https://quickbooks.intuit.com, accessed August 11, 2017; "Our Story," https://futureglory.co, accessed August 10, 2017; "It's in the Bag—Future Glory Blends Apps with QuickBooks to Craft Fine Leather Goods," https://quickbooks.intuit.com, accessed August 10, 2017; Jordan Kushins, "Guide to Dogpatch's Flourishing Design Shops," *San Francisco Chronicle,* https://www.sfchronicle.com, March 1, 2017; David Leøng Photography blog, "November—Theresa Lee," https://www.davidleongphoto.com, November 30, 2016; Present Company, "Thankful Thursday — Theresa Lee, Founder of Future Glory," *Medium*, https://blog.present.co, October 19, 2017; Joseph D'Souza, "QuickBooks Statistics By Market Share, Online and Desktop (2025)," *Electro IQ*, https://electroiq.com, July 2, 2025; "Intuit: The Fintech Giant Powering Small Businesses," *StockOpine*, https://www.stockopine.com, April 29, 2025.

Financial information is central to every organization. To operate effectively, businesses must have a way to track income, expenses, assets, and liabilities in an organized manner. Financial information is also essential for decision-making. Managers prepare financial reports using accounting, a set of procedures and guidelines for companies to follow when preparing financial reports. Unless you understand basic accounting concepts, you will not be able to "speak" the standard financial language of businesses. This module examines the role of accounting in business, how accounting contributes to a company's overall success, the three primary financial statements, and careers in accounting.

14.1 Accounting: More than Numbers

1. Why are financial reports and accounting information important, and who uses them?

Prior to 2001, accounting topics rarely made the news. That changed when Enron Corporation's manipulation of accounting rules to improve its financial statements hit the front pages of newspapers. The company filed bankruptcy in 2001, and its former top executives were charged with multiple counts of conspiracy and fraud. Arthur Andersen, LLP, Enron's auditor, was indicted and convicted of obstruction of justice, and in 2002, the once-respected firm went out of business. Soon financial abuses at other companies—among them Tyco Theranos, WorldCom, and FTX (cryptocurrency exchange), and more recently Luckin Coffee (coffee chain based in China) and Macy's—surfaced. Top executives at these and other companies were accused of knowingly flouting accepted accounting standards to inflate current profits and increase their compensation. Many were subsequently convicted:

- Investment securities broker Bernard Madoff and his accountant bilked investors out of more than $65 billion; Madoff died in 2021 while serving a 150-year prison term.
- Andrew Fastow, Enron's former chief financial officer, and Ben Glisan Jr., its former treasurer, pleaded guilty and received prison terms of six and five years, respectively. The company's former CEO, Jeffrey Skilling, served 12 years in prison after being convicted of multiple charges.
- Bernard Ebbers, WorldCom's CEO, was sentenced to 25 years in prison for conspiracy, securities fraud, and filing false reports with regulatory agencies—crimes that totaled $11 billion in accounting fraud. He was released due to poor health in 2019 after serving 13 years of his sentence and died shortly after his release.
- Tyco's CEO L. Dennis Kozlowski was fined $70 million and sentenced to 8 to 25 years. He was released from prison in 2014.[1]

These and other cases raised critical concerns about the independence of those who audit a company's financial statements, questions of integrity and public trust, and issues with current financial reporting standards. Investors suffered as a result because the crisis in confidence sent stock prices tumbling, and companies lost billions in value.

So it's no surprise that more people are paying attention to accounting topics. We now recognize that accounting is the backbone of any business, providing a framework to understand the firm's financial condition. Reading about accounting irregularities, fraud, audit (financial statement review) shortcomings, out-of-control business executives, and bankruptcies, we have become very aware of the importance of accurate financial information and sound financial procedures.

All of us—whether we are self-employed, work for a local small business or a multinational Fortune 100 firm, or are not currently in the workforce—benefit from knowing the basics of accounting and financial statements. We can use this information to educate ourselves about companies before interviewing for a job or buying a company's stock or bonds. Employees at all levels of an organization use accounting information to monitor operations. They also must decide which financial information is important for their company or business unit, what those numbers mean, and how to use them to make decisions.

Exhibit 14.2 This advertisement by the U.S. Marshals Service illustrates the impact Bernie Madoff's actions had. His personal belongings were seized and auctioned off to help pay for the $65 billion lost by his customers. *What should be the lessons learned by executives and accounting professionals about Madoff's behavior?* (Credit: P K /Flickr/ Attribution 2.0 Generic (CC BY 2.0))

This chapter starts by discussing why accounting is important for businesses and for users of financial information. Then it provides a brief overview of the accounting profession and today's regulatory environment. Next it presents an overview of basic accounting procedures, followed by a description of the three main financial statements—the balance sheet, the income statement, and the statement of cash flows. Using these statements, we then demonstrate how ratio analysis of financial statements can provide valuable information about a company's financial condition. Finally, the chapter explores current trends affecting the accounting profession.

Accounting Basics

Accounting is the process of collecting, recording, classifying, summarizing, reporting, and analyzing financial activities. It results in reports that describe the financial condition of an organization. All types of organizations—businesses, hospitals, schools, government agencies, and civic groups—use accounting procedures. Accounting provides a framework for looking at past performance, current financial health, and possible future performance. It also provides a framework for comparing the financial positions and financial performances of different firms. Understanding how to prepare and interpret financial reports will enable you to evaluate two companies and choose the one that is more likely to be a good investment.

The accounting system shown in Exhibit 14.3 converts the details of financial transactions (sales, payments, purchases, and so on) into a format that people can use to evaluate the firm and make decisions. Data become information, which in turn becomes reports. These reports describe a firm's financial position at one point in time and its financial performance during a specified period. Financial reports include *financial statements,* such as balance sheets and income statements, and special reports, such as sales and expense breakdowns by product line.

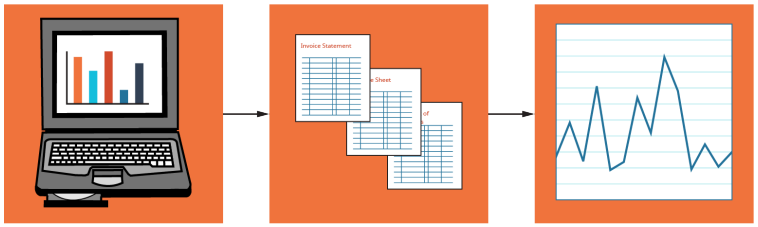

Exhibit 14.3 The Accounting System (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Who Uses Financial Reports?

The accounting system generates two types of financial reports, as shown in Exhibit 14.4: internal and external. Internal reports are used within the organization. As the term implies, **managerial accounting**

provides financial information that managers inside the organization can use to evaluate and make decisions about current and future operations. For instance, the sales reports prepared by managerial accountants show how well marketing strategies are working, as well as the number of units sold in a specific period of time. This information can be used by a variety of managers within the company in operations as well as in production or manufacturing to plan future work based on current financial data. Production cost reports can help departments track and control costs, as well as determine the amount of labor needed to produce goods or services. In addition, managers may prepare very detailed financial reports for their own use and provide summary reports to top management, providing key executives with a "snapshot" of business operations in a specific timeframe.

Financial accounting focuses on preparing external financial reports that are used by outsiders; that is, people who have an interest in the business but are not part of the company's management. Although they provide useful information for managers, these reports are used primarily by lenders, suppliers, investors, government agencies, and others to assess the financial strength of a business.

To ensure accuracy and consistency in the way financial information is reported, accountants in the United States follow **generally accepted accounting principles (GAAP)** when preparing, presenting, and reporting financial statements. These rules are issued and revised by the **Financial Accounting Standards Board (FASB)**, which is an independent nonprofit organization that is responsible for establishing financial accounting standards used in the United States.

The widely accepted rules across the world for financial reporting are the International Financial Reporting Standards (IFRS). Because accounting practices vary from country to country, a multinational company must make sure that its financial statements conform to both its own country's accounting standards and those of the parent company's country. Often another country's standards are quite different from U.S. GAAP. The U.S. Financial Accounting Standards Board and the International Accounting Standards Board (IASB, based in London) worked together to develop global accounting standards that would make it easier to compare financial statements of foreign-based companies.

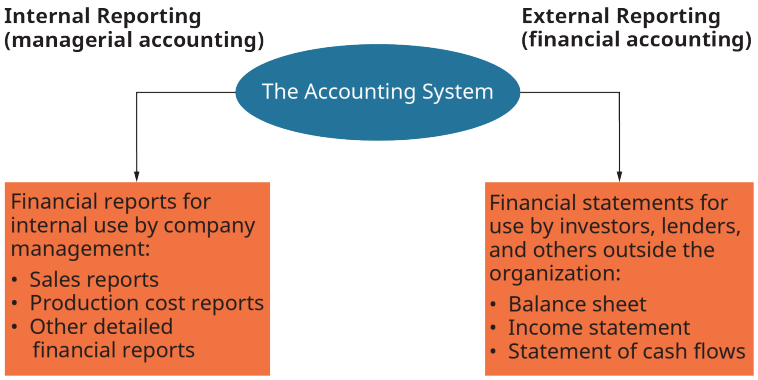

Exhibit 14.4 Reports Provided by the Accounting System (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

EXPANDING AROUND THE GLOBE

Global Accounting Standards Unlikely to Happen

Imagine being a CFO of a major multinational company with significant operations in 10 other countries. Because the accounting rules in those countries don't conform to GAAP, your staff has to prepare nine sets of financial reports that comply with the host country's rules—and also translate the figures to GAAP for consolidation into the parent company's statements in the United States. It's a massive undertaking for anyone.

The U.S. FASB and the IASB have tried to make this task easier since the early 2000s. These groups have worked to develop international accounting standards that remove disparities between national and international standards, improve the quality of financial information worldwide, and simplify comparisons of financial statements across borders for both corporations and investors. To date, although many jurisdictions follow the IFRS standards, not all do, including the United States.

In the years 2006–2009, the FASB and the IASB jointly published and updated a memorandum of understanding (MOU) reaffirming the two organizations' desire to create uniform global accounting standards. "This document underscores our strong commitment to continue to work together with the IASB to bring about a common set of accounting standards that will enhance the quality, comparability, and consistency of global financial reporting, enabling the world's capital markets to operate more effectively," said Robert Herz, FASB's former chairman. Sir David Tweedie, then chairman of the IASB, agreed: "The pragmatic approach described in the MOU enables us to provide much-needed stability for companies using IFRS [the IASB's International Financial Reporting Standards] in the near term," he commented. (About 169 countries worldwide currently use IFRS.)

As they worked toward convergence, the board members decided to develop a new set of common standards rather than try to reconcile the two standards. These new standards had to be better than existing ones, not simply eliminate differences. Unfortunately, merging GAAP and IFRS into a consistent set of international accounting standards has proven to be very difficult because of different approaches used in the two sets. The IFRS is viewed more as a set of principles to follow, whereas GAAP provides specific rules and procedures to follow. In the United States, preparers of financial statements rely on very detailed rules in all areas of accounting to remain compliant with regulations. In contrast, the IASB's approach is instead setting principles or guidelines that allow the preparers to apply them to individual situations as they see appropriate. Moving toward global accounting standards could be costly and time consuming for companies doing business in the United States. It would likely involve new software, additional training, and other business-related practices such as restructuring accounting and finance departments.

For now, the two organizations continue to collaborate to determine if they can converge GAAP and IFRS into a unified global set of standards. They continue to evaluate upcoming changes in standards that may impact accounting practices worldwide.

Critical Thinking Questions

1. Is it important to have a single set of international accounting standards for at least publicly owned companies? Defend your answer.
2. Do you think the two organizations will ever come close to uniform global accounting standards? Use a search engine and the archives of *CFO* magazine, **https://www.cfo.com**, to research this topic, and summarize your findings.

Sources: "Who Uses IFRS Standards?" https://www.ifrs.org, accessed August 10, 2017; "FASB and IASB Reaffirm Commitment to Enhance Consistency, Comparability and Efficiency in Global Capital Markets," (press release), https://www.fasb.org, accessed August 10, 2017; Bruce Cowie, "Insights: IFRS/US GAAP Convergence and Global Accounting Standards—Where Are We Now?" https://kaplan.co.uk, September 26, 2016; Michael Cohn, "IASB and FASB Look Beyond Convergence," https://www.accountingtoday.com, December 9, 2014; David M. Katz, "The Split over Convergence," *CFO,* https://ww2.cfo.com, October 17, 2014; "Comparability in International Accounting Standards—A Brief History," https://fasb.org, accessed February 11, 2026; "Converting from US GAAP to IFRS," https://kpmg.com, accessed February 11, 2026; "Convergence with the International Accounting Standards Board (IASB)," https://web.archive.org/web/20190731160358/https://www.fasb.org/intl/convergence_iasb.shtml, accessed February 11, 2026; Chair Mary Jo White, "A U.S. Imperative: High-Quality, Globally Accepted Accounting Standards," (statement), U.S. Securities and Exchange Commission, https://www.sec.gov, January 5, 2017; Remi Forgeas, "Is IFRS That

Different from U.S. GAAP?" *IFRS*, https://web.archive.org/web/20190731160345/https://www.ifrs.com/overview/General/differences.html, June 16, 2008.

Financial statements are the chief element of the **annual report**, a yearly document that describes a firm's financial status. Annual reports usually discuss the firm's activities during the past year and its prospects for the future. Three primary financial statements included in the annual report are discussed and shown later in this chapter:

- The balance sheet
- The income statement
- The statement of cash flows

CONCEPT CHECK

1. Explain who uses financial information.
2. Differentiate between financial accounting and managerial accounting.
3. How do GAAP, the FASB, and the IASB influence the accounting industry?

14.2 The Accounting Profession

2. What are the differences between public and private accountants, and how has federal legislation affected their work?

When you think of accountants, do you picture someone who works in a back room, hunched over a desk, working with a calculator and scrutinizing pages and pages of numbers? Although today's accountants still must love working with numbers, they now work closely with their clients to not only prepare financial reports but also help them develop good financial practices. Advances in technology have taken the tedium out of the number-crunching and data-gathering parts of the job and now offer powerful analytical tools as well. Therefore, accountants must keep up with information technology trends. The accounting profession has grown due to the increased complexity, size, and number of businesses and the frequent changes in the tax laws. Accounting is now a $640+ billion global industry. The more than 1.4 million accountants in the United States are classified as either public accountants or private (corporate) accountants. They work in public accounting firms, private industry, education, and government, and about 5 percent of US accountants are self-employed. The job outlook for accountants over the next decade is positive; the Bureau of Labor Statistics projects that accounting and auditing jobs will increase 5 percent, which is faster than the average for all occupations.[2]

Public Accountants

Independent accountants who serve organizations and individuals on a fee basis are called **public accountants**. Public accountants offer a wide range of services, including preparation of financial statements and tax returns, independent auditing of financial records and accounting methods, and management consulting. **Auditing**, the process of reviewing the records used to prepare financial statements, is an important responsibility of public accountants. They issue a formal *auditor's opinion* indicating whether the statements have been prepared in accordance with accepted accounting rules. This written opinion is an important part of a company's annual report.

The largest public accounting firms, called the Big Four, operate worldwide and offer a variety of business consulting services in addition to accounting services. In order of size, they are Deloitte, PwC

(PricewaterhouseCoopers), EY (Ernst & Young), and KPMG International.[3]

To become a **certified public accountant (CPA)**, generally an individual must have at least 150 college credit hours with a bachelor's degree with specific accounting courses, one year of accounting work experience, and achieve a passing score on the CPA certification exam. State requirements vary, such as years of on-the-job experience, credit hour requirements, and continuing education. Only CPAs can issue the auditor's opinion on a firm's financial statements. Most CPAs first work for public accounting firms and later may become private accountants or financial managers. Of the 397,000 accountants who belong to the AICPA, they are divided between working in public accounting firms, and in business and industry.[4]

Private Accountants

Accountants employed to serve one particular organization are **private accountants**. Their activities include preparing financial statements, auditing company records to be sure employees follow accounting policies and procedures, developing accounting systems, preparing tax returns, and providing financial information for management decision-making. Whereas some private accountants hold the CPA designation, managerial accountants also have a professional certification program. Requirements to become a **certified management accountant (CMA)** include passing an examination.

Reshaping the Accounting Environment

Although our attention was focused on big-name accounting scandals, an epidemic of accounting irregularities was also taking place in the wider corporate arena. The number of companies restating annual financial statements grew at an alarming rate, tripling from 1997 to 2002. In the wake of the numerous corporate financial scandals, Congress and the accounting profession took major steps to prevent future accounting irregularities. These measures targeted the basic ways, cited by a report from the AICPA, that companies massaged financial reports through creative, aggressive, or inappropriate accounting techniques, including:

- Committing fraudulent financial reporting
- Stretching accounting rules to significantly enhance financial results
- Following appropriate accounting rules but using loopholes to manage financial results

Why did companies willfully push accounting to the edge—and over it—to artificially pump up revenues and profits? Looking at the companies involved in the scandals, some basic similarities have emerged:

- A company culture of arrogance and above-average tolerance for risk
- Interpretation of accounting policies to their advantage and manipulation of the rules to get to a predetermined result and conceal negative financial information
- Compensation packages tied to financial or operating targets, making executives and managers greedy and pressuring them to find sometimes-questionable ways to meet what may have been overly optimistic goals
- Ineffective checks and balances, such as audit committees, boards of directors, and financial control procedures, that were not independent from management
- Centralized financial reporting that was tightly controlled by top management, increasing the opportunity for fraud
- Financial performance benchmarks that were often out of line with the industry standards
- Complicated business structures that clouded how the company made its profits
- Cash flow from operations that seemed out of line with reported earnings (You'll learn about this important difference between cash and reported earnings in the sections on the income statement and statement of cash flows.)
- Acquisitions made quickly, often to show growth rather than for sound business reasons; management focused more on buying new companies than making the existing operations more profitable[5]

Companies focused on making themselves look good in the short term, doing whatever was necessary to top past performance and to meet the expectations of investment analysts, who project earnings, and investors, who panic when a company misses the analysts' forecasts. Executives who benefited when stock prices rose had no incentive to question the earnings increases that led to the price gains.

These number games raised serious concerns about the quality of earnings and questions about the validity of financial reports. Investors discovered to their dismay that they could neither assume that auditors were adequately monitoring their clients' accounting methods nor depend on the integrity of published financial information.

Better Numbers Ahead

Over the past few decades, a number of accounting reforms have been put in place to set better standards for accounting, auditing, and financial reporting. Investors, now aware of the possibility of various accounting discrepancies, are avoiding companies that use complicated financial structures and off-the-books financing.

In 2002, the **Sarbanes-Oxley Act** (commonly referred to as SOX) went into effect. This law, one of the most extensive pieces of business legislation passed by Congress, was designed to address the investing public's lack of trust in corporate America. It redefines the public corporation–auditor relationship and restricts the types of services auditors can provide to clients. The Act clarifies auditor-independence issues, places increased accountability on a company's senior executives and management, strengthens disclosure of insider transactions (an employee selling stock based on information not known by the public), and prohibits loans to executives.

An independent five-member Public Company Accounting Oversight Board (PCAOB) was given the authority to set and amend auditing, quality control, ethics, independence, and other standards for audit reports. The Act specifies that all PCAOB members be financially literate. Two members must have their CPA designation, and the other three cannot be or have been CPAs. Appointed and overseen by the Securities and Exchange Commission (SEC), the PCAOB can also inspect accounting firms; investigate breaches of securities law, standards, competency, and conduct; and take disciplinary action. The corporate Board registers public accounting firms, as the Act now requires. Altering or destroying key audit documents now carries felony charges and increased penalties.

Additional provisions in the Act cover the following areas:

- *Auditing standards:* The Board must include in its standards several requirements, such as maintaining audit work papers and other documentation for audit reports for seven years, the review and approval of audit reports by a second partner, and audit standards for quality control and review of internal control procedures.
- *Financial disclosure:* Companies must clearly disclose all transactions that may have a material current or future effect on their financial condition, including those that are off the books or with unconsolidated entities (related companies whose results the company is not required to combine with its own financial statements under current accounting rules). Management and major stockholders must disclose transactions such as sales of company stock within two days of the transaction. The company must disclose its code of ethics for senior financial executives. Any significant changes in a company's operations or financial condition must be disclosed "on a rapid and current basis."
- *Financial statement certification:* Chief executive officers and chief financial officers must certify company financial statements, with severe criminal and civil penalties for false certification. If securities fraud results in restatement of financial reports, these executives will lose any stock-related profits and bonuses they received prior to the restatement.
- *Internal controls:* Each company must have appropriate internal control procedures in place for financial reporting, and its annual report must include a report on implementation of those controls to assure the integrity of financial reports.

- *Consulting work:* The Act restricts the non-auditing work auditors may perform for a client. In the past, the large accounting firms had expanded their role to include a wide range of advisory services that went beyond their traditional task of validating a company's financial information. Conflicts of interest arose when the same firm earned lucrative fees for both audit and consulting work for the same client.[6]

Other regulatory organizations also took steps to prevent future abuses. In September 2002, the AICPA Auditing Standards Board (ASB) issued expanded guidelines to help auditors uncover fraud while conducting audits. The New York Stock Exchange stiffened its listing requirements so that the majority of directors at listed companies must be independent and not employees of the corporation. Nor can lead auditors serve on clients' boards for five years. Companies listed in the Nasdaq marketplace cannot hire former auditors, specifically for high-level roles or board positions, for three years.

In response to the passage of Sarbanes-Oxley and other regulations, companies implemented new control measures and improved existing ones. The burdens in both cost and time have been considerable. Many companies had to redesign and restructure financial systems to improve efficiency. Some finance executives believe that their investment in increased controls has improved shareholder perceptions of their company's ethics. Others, however, reported that costs depressed earnings and negatively affected stock prices. Despite the changes and costs associated with SOX compliance, the results and impact on businesses have been positive since the law's implementation. Not only did it help fine-tune financial activities and reporting, it also prompted a recognition of the value of corporate compliance and ethical behavior. Because of the personal accountability required through the Act, company executives and board members are more involved in the reporting process to ensure accuracy and transparency.[7]

CONCEPT CHECK

1. Compare the responsibilities of public and private accountants. How are they certified?
2. Summarize the major changes affecting accounting and corporate reporting and the reasons for them.

14.3 Basic Accounting Procedures

3. What are the six steps in the accounting cycle?

Using generally accepted accounting principles, accountants record and report financial data in similar ways for all firms. They report their findings in financial statements that summarize a company's business transactions over a specified time period. As mentioned earlier, the three major financial statements are the balance sheet, income statement, and statement of cash flows.

People sometimes confuse accounting with bookkeeping. Accounting is a much broader concept. *Bookkeeping,* the system used to record a firm's financial transactions, is a routine, clerical process. Accountants take bookkeepers' transactions, classify and summarize the financial information, and then prepare and analyze financial reports. Accountants also develop and manage financial systems and help plan the firm's financial strategy.

The Accounting Equation

The accounting procedures used today are based on those developed in the late 15th century by an Italian monk, Brother Luca Pacioli. He defined the three main accounting elements as assets, liabilities, and owners' equity. **Assets** are things of value owned by a firm. They may be *tangible,* such as cash, equipment, and buildings, or *intangible,* such as a patent or trademarked name. **Liabilities**—also called *debts*—are what a firm owes to its creditors. **Owners' equity** is the total amount of investment in the firm minus any liabilities. Another term for owners' equity is *net worth.*

The relationship among these three elements is expressed in the accounting equation:

$$\text{Assets} - \text{Liabilities} = \text{Owners' equity}$$

The accounting equation must always be in balance (that is, the total of the elements on one side of the equals sign must equal the total on the other side).

Suppose you start a coffee shop and put $10,000 in cash into the business. At that point, the business has assets of $10,000 and no liabilities. This would be the accounting equation:

$$\begin{array}{lcllcl} \text{Assets} & = & \text{Liabilities} & + & \text{Owners' equity} \\ \$10,000 & = & \$0 & + & \$10,000 \end{array}$$

The liabilities are zero and owners' equity (the amount of your investment in the business) is $10,000. The equation balances.

To keep the accounting equation in balance, every transaction must be recorded as two entries. As each transaction is recorded, there is an equal and opposite event so that two accounts or records are changed. This method is called **double-entry bookkeeping**.

Suppose that after starting your business with $10,000 cash, you borrow another $10,000 from the bank. The accounting equation will change as follows:

Assets	=	Liabilities	+	Owners' equity	
$10,000	=	$0	+	$10,000	Initial equation
$10,000	=	$10,000	+	$0	Borrowing transaction
$20,000	=	$10,000	+	$10,000	Equation after borrowing

Now you have $20,000 in assets—your $10,000 in cash and the $10,000 loan proceeds from the bank. The bank loan is also recorded as a liability of $10,000 because it's a debt you must repay. Making two entries keeps the equation in balance.

The Accounting Cycle

The *accounting cycle* refers to the process of generating financial statements, beginning with a business transaction and ending with the preparation of the report. **Exhibit 14.5** shows the six steps in the accounting cycle. The first step in the cycle is to analyze the data collected from many sources. All transactions that have a financial impact on the firm—sales, payments to employees and suppliers, interest and tax payments, purchases of inventory, and the like—must be documented. The accountant must review the documents to make sure they're complete.

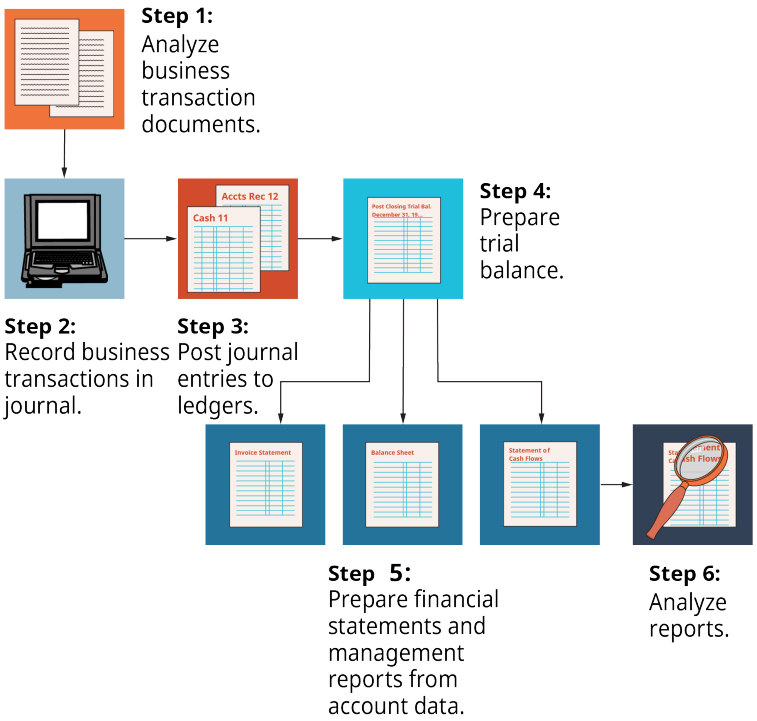

Exhibit 14.5 The Accounting Cycle (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Next, each transaction is recorded in a *journal,* a listing of financial transactions in chronological order. The journal entries are then recorded in *ledgers,* which show increases and decreases in specific asset, liability, and owners' equity accounts. The ledger totals for each account are summarized in a *trial balance,* which is used to confirm the accuracy of the figures. These values are used to prepare financial statements and management reports. Finally, individuals analyze these reports and make decisions based on the information in them.

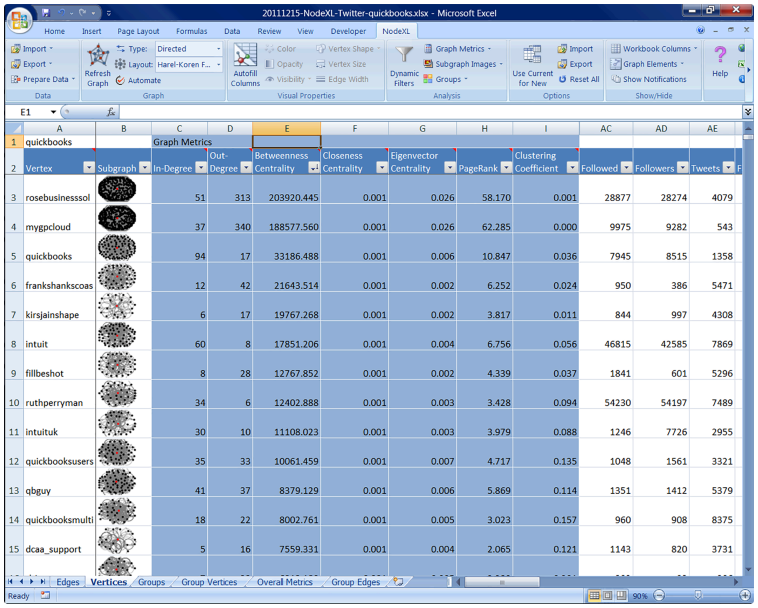

Exhibit 14.6 QuickBooks is a well-known accounting software program that provides business-management solutions to businesses of all sizes, but is especially used by many small businesses. The company's tools benefit professionals by automating a broad range of accounting and other business tasks. Its user-friendly interface allows the non-accountant user to also utilize the platform for financial management and accounting tasks. QB has become a leader in small businesses by assisting in managerial decision-making and streamlining bookkeeping and accounting processes. *What accounting functions are typically incorporated into basic accounting software programs?* (Credit: Marc Smith/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Technological Advances

Over the past decade, technology has had a significant impact on the accounting industry. Computerized and online accounting programs now do many different things to make business operations and financial reporting more efficient. For example, most accounting packages offer basic modules that handle general ledger, sales order, accounts receivable, purchase order, accounts payable, and inventory control functions. Tax programs use accounting data to prepare tax returns and tax plans. Point-of-sale terminals used by many retail firms automatically record sales and do some of the bookkeeping. The Big Four and many other large public accounting firms develop accounting software for themselves and for clients.

Accounting and financial software can be a large investment for a company. Accounting software ranges from ready-made programs for small businesses to full-scale customized enterprise resource planning systems for major corporations. Although these technological advances in accounting applications have made the financial aspects of running a small business much easier, entrepreneurs and other small-business owners should take to time to understand underlying accounting principles, which play an important role in evaluating just how financially sound a business enterprise really is.

MANAGING CHANGE

Data Analytics Become Effective CPA Tool

Knowledge is power, and understanding what your customers want and how your company can provide it often differentiates you from the competition. As the accounting field continues to take advantage of technological advances, it is important that data analytics become a key element of any accounting professional's toolbox.

Historically described as "paper pushers" who track financial information, today's accountants need to learn about big data and data analytics as part of their continuing education. Not long ago, an accountant's work finished when business financial statements were finalized and tax forms were ready to be filed with federal, state, and local governing bodies. Not anymore. With the revolution of technology, automation, and data collection from a myriad of sources, accountants can use data analytics to provide a clearer picture of the overall business environment for their companies and clients on an ongoing basis.

Data analytics can be defined as the process of examining numerous data sets (sometimes called big data) to draw conclusions about the information they contain, with the assistance of specialized systems and software. Using data analytics effectively can help businesses increase revenue, expand operations, maximize customer service, and more. Accountants can use data analytics to make more accurate and detailed forecasts; help companies link diverse financial and nonfinancial data sets, which provides a more comprehensive reporting of their overall performance to shareholders and others; assess and manage risk across the entire organization; and identify possible fraud.

Data analytics can also improve and enhance the auditing process because more information is collected, which allows for analysis of *full* data sets in situations where only samples were audited previously. In addition, continuous monitoring is easier to accomplish using data sets that are comprehensive.

Accounting professionals who can adapt to quickly changing technology such as data analytics will not only expand the scope of their expertise but also provide financial guidance that will give their companies and clients a strong strategic advantage over competitors.

Critical Thinking Questions

1. How can accountants use data analytics to enhance the services they provide to their clients?
2. Is the seismic shift in technology a good thing for professional accountants? Explain your reasoning.

Sources: "Data Analytics," https://searchdatamanagement.techtarget.com, accessed August 11, 2017; Jiali Tang and Khondkar E. Karim, "Big Data in Business Analytics: Implications for the Audit Profession," *The CPA Journal,* https://www.cpajournal.com, June 2017 issue; Clarence Goh, "Are You Ready? Data Analytics Is Reshaping the Work of Accountants," https://www.cfoinnovation.com, February 28, 2017; Norbert Tschakert, Julia Kokina, Stephen Kozlowski, and Miklos Vasarhelyi, "The Next Frontier in Data Analytics," *Journal of Accountancy,* https://www.journalofaccountancy.com, August 1, 2016.

CONCEPT CHECK

1. Explain the accounting equation.
2. Describe the six-step accounting cycle.
3. What role do computers and other technology play in accounting?

14.4 The Balance Sheet

4. In what terms does the balance sheet describe the financial condition of an organization?

The **balance sheet**, one of three financial statements generated from the accounting system, summarizes a firm's financial position at a specific point in time. It reports the resources of a company (assets), the company's obligations (liabilities), and the difference between what is owned (assets) and what is owed (liabilities), or owners' equity.

The assets are listed in order of their **liquidity**, the speed with which they can be converted to cash. The most liquid assets come first, and the least liquid are last. Because cash is the most liquid asset, it is listed first. Buildings, on the other hand, have to be sold to be converted to cash, so they are listed after cash. Liabilities are arranged similarly: liabilities due in the short term are listed before those due in the long term.

The balance sheet as of December 31, 20XX, for Delicious Desserts, Inc., a fictitious bakery, is illustrated in **Table 14.1.** The basic accounting equation is reflected in the three totals highlighted on the balance sheet: assets of $148,900 equal the sum of liabilities and owners' equity ($70,150 + $78,750). The three main categories of accounts on the balance sheet are explained below.

Balance Sheet for Delicious Desserts			
Delicious Desserts, Inc. **Balance Sheet as of December 31, 20XX**			
Assets			
Current assets:			
Cash		$15,000	
Marketable securities		4,500	
Accounts receivable			
Less: Allowance for doubtful accounts	$45,000	43,700	
Notes receivable	1,300	5,000	
Inventory		15,000	
Total current assets			83,200
Fixed assets:			
Bakery equipment		$40,000	
Less: Accumulated depreciation			
Furniture and fixtures	$56,000		
Less: Accumulated depreciation	16,000		
Total fixed assets		14,200	54,200
Intangible assets:			
Trademark	$18,450		
Goodwill	4,250		
		$ 4,500	
Total intangible assets		7,000	11,500
Total assets			$148,900
Liabilities and owners' equity			
Current liabilities:			
Accounts payable	$30,650		
Notes payable	15,000		
Accrued expenses	4,500		
Income taxes payable	5,000		
Current portion of long-term debt	5,000		
Total current liabilities		$60,150	

Table 14.1

Balance Sheet for Delicious Desserts			
Delicious Desserts, Inc. **Balance Sheet as of December 31, 20XX**			
Long-term liabilities: Bank loan for bakery equipment Total long-term liabilities Total liabilities	$10,000	10,000	$ 70,150
Owners' equity: Common stock (10,000 shares outstanding) Retained earnings Total owners' equity Total liabilities and owners' equity		$30,000 48,750	78,750 $148,900

Table 14.1

Assets

Assets can be divided into three broad categories: current assets, fixed assets, and intangible assets. **Current assets** are assets that can or will be converted to cash within the next 12 months. They are important because they provide the funds used to pay the firm's current bills. They also represent the amount of money the firm can quickly raise. Current assets include:

- *Cash:* Funds on hand or in a bank
- *Marketable securities:* Temporary investments of excess cash that can readily be converted to cash
- *Accounts receivable:* Amounts owed to the firm by customers who bought goods or services on credit
- *Notes receivable:* Amounts owed to the firm by customers or others to whom it lent money
- *Inventory:* Stock of goods being held for production or for sale to customers

Fixed assets are long-term assets used by the firm for more than a year. They tend to be used in production and include land, buildings, machinery, equipment, furniture, and fixtures. Most fixed assets generally wear out and become dated over time, with the exception of land. Thus, they decrease in value every year. This declining value is accounted for through depreciation. **Depreciation** is the allocation of the asset's original cost to the years in which it is expected to produce revenues. A portion of the cost of a depreciable asset—a building or piece of equipment, for instance—is charged to each of the years in which it is expected to provide benefits. This practice helps match the asset's cost against the revenues it provides. Because it is impossible to know exactly how long an asset will last, estimates are used. They are based on past experience with similar items or IRS guidelines for assets of that type. Notice that, through 20XX, Delicious Desserts has taken a total of $16,000 in depreciation on its bakery equipment.

Intangible assets are long-term assets with no physical existence. Common examples are patents, copyrights, trademarks, and goodwill. *Patents* and *copyrights* shield the firm from direct competition, so their benefits are more protective than productive. For instance, no one can use more than a small amount of copyrighted material without permission from the copyright holder. *Trademarks* are registered names that can be sold or licensed to others. One of Delicious Desserts' intangible assets is a trademark valued at $4,500. *Goodwill* is what the company pays for intangible assets such as brand recognition, intellectual property, or customer loyalty. It is the difference between the tangible value of the assets of the acquired firm and what the company

actually paid for the firm. Delicious Desserts' other tangible asset is goodwill of $7,000.

Liabilities

Liabilities are the amounts a firm owes to creditors. Those liabilities coming due sooner—current liabilities—are listed first on the balance sheet, followed by long-term liabilities.

Current liabilities are those due within a year of the date of the balance sheet. These short-term claims may strain the firm's current assets because they must be paid in the near future. Current liabilities include:

- *Accounts payable:* Amounts the firm owes for credit purchases due within a year. This account is the liability counterpart of accounts receivable.
- *Notes payable:* Short-term loans from banks, suppliers, or others that must be repaid within a year. For example, Delicious Desserts has a six-month, $15,000 loan from its bank that is a note payable.
- *Accrued expenses:* Expenses, typically for wages and taxes, that have accumulated and must be paid at a specified future date within the year although the firm has not received a bill
- *Income taxes payable:* Taxes owed for the current operating period but not yet paid. Taxes are often shown separately when they are a large amount.
- *Current portion of long-term debt:* Any repayment on long-term debt due within the year. Delicious Desserts is scheduled to repay $5,000 on its equipment loan in the coming year.

Long-term liabilities come due more than one year after the date of the balance sheet. They include bank loans (such as Delicious Desserts' $10,000 loan for bakery equipment), mortgages on buildings, and the company's bonds sold to others.

Owners' Equity

Owners' equity is the owners' total investment in the business after all liabilities have been paid. For sole proprietorships and partnerships, amounts put in by the owners are recorded as capital. In a corporation, the owners provide capital by buying the firm's common stock. For Delicious Desserts, the total common stock investment is $30,000. **Retained earnings** are the amounts left over from profitable operations since the firm's beginning. They are total profits minus all dividends (distributions of profits) paid to stockholders. Delicious Desserts has $48,750 in retained earnings.

CONCEPT CHECK

1. What is a balance sheet?
2. What are the three main categories of accounts on the balance sheet, and how do they relate to the accounting equation?
3. How do retained earnings relate to owners' equity?

14.5 The Income Statement

5. How does the income statement report a firm's profitability?

The balance sheet shows the firm's financial position at a certain point in time. The **income statement** summarizes the firm's revenues and expenses and shows its total profit or loss over a period of time. Most companies prepare monthly income statements for management and quarterly and annual statements for use by investors, creditors, and other outsiders. The primary elements of the income statement are revenues, expenses, and net income (or net loss). The income statement for Delicious Desserts for the year ended December 31, 20XX, is shown in Table 14.2.

Income Statement for Delicious Desserts			
Delicious Desserts, Inc. **Income Statement for the Year Ending December 31, 20XX**			
Revenues			
Gross sales		$275,000	
Less: Sales discounts		2,500	
Less: Returns and allowances		2,000	
Net sales			$270,500
Cost of Goods Sold			
Beginning inventory, January 1		$ 18,000	
Cost of goods manufactured		109,500	
Total cost of goods available for sale		$127,500	
Less: Ending inventory December 31		15,000	
Cost of goods sold			112,500
Gross profit			**$158,000**
Operating Expenses			
Selling expenses			
Sales salaries	$31,000		
Advertising	16,000		
Other selling expenses	18,000		
Total selling expenses		$ 65,000	
General and administrative expenses			
Professional and office salaries	$20,500		
Utilities	5,000		

Table 14.2

Income Statement for Delicious Desserts			
Delicious Desserts, Inc. **Income Statement for the Year Ending December 31, 20XX**			
Office supplies	1,500		
Interest	3,600		
Insurance	2,500		
Rent	17,000		
Total general and administrative expenses		50,100	
Total operating expenses			115,100
Net profit before taxes			**$ 42,900**
Less: Income taxes			10,725
Net profit			**$ 32,175**

Table 14.2

Revenues

Revenues are the dollar amount of sales plus any other income received from sources such as interest, dividends, and rents. The revenues of Delicious Desserts arise from sales of its bakery products. Revenues are determined starting with **gross sales**, the total dollar amount of a company's sales. Delicious Desserts had two deductions from gross sales. *Sales discounts* are price reductions given to customers that pay their bills early. For example, Delicious Desserts gives sales discounts to restaurants that buy in bulk and pay at delivery. *Returns and allowances* is the dollar amount of merchandise returned by customers because they didn't like a product or because it was damaged or defective. **Net sales** is the amount left after deducting sales discounts and returns and allowances from gross sales. Delicious Desserts' gross sales were reduced by $4,500, leaving net sales of $270,500.

Expenses

Expenses are the costs of generating revenues. Two types are recorded on the income statement: cost of goods sold and operating expenses.

The **cost of goods sold** is the total expense of buying or producing the firm's goods or services. For manufacturers, cost of goods sold includes all costs directly related to production: purchases of raw materials and parts, labor, and factory overhead (utilities, factory maintenance, machinery repair). For wholesalers and retailers, it is the cost of goods bought for resale. For all sellers, cost of goods sold includes all the expenses of preparing the goods for sale, such as shipping and packaging.

Delicious Desserts' cost of goods sold is based on the value of inventory on hand at the beginning of the accounting period, $18,000. During the year, the company spent $109,500 to produce its baked goods. This figure includes the cost of raw materials, labor costs for bakery workers, and the cost of operating the bakery

area. Adding the cost of goods manufactured to the value of beginning inventory, we get the total cost of goods available for sale, $127,500. To determine the cost of goods sold for the year, we subtract the cost of inventory at the end of the period:

$$\$127{,}500 - \$15{,}000 = \$112{,}500$$

The amount a company earns after paying to produce or buy its products but before deducting operating expenses is the **gross profit**. It is the difference between net sales and cost of goods sold. Because service firms do not produce goods, their gross profit equals net sales. Gross profit is a critical number for a company because it is the source of funds to cover all the firm's other expenses.

The other major expense category is **operating expenses**. These are the expenses of running the business that are not related directly to producing or buying its products. The two main types of operating expenses are selling expenses and general and administrative expenses. *Selling expenses* are those related to marketing and distributing the company's products. They include salaries and commissions paid to salespeople and the costs of advertising, sales supplies, delivery, and other items that can be linked to sales activity, such as insurance, telephone and other utilities, and shipping expenses. *General and administrative expenses* are the business expenses that cannot be linked to either cost of goods sold or sales. Examples of general and administrative expenses are salaries of top managers and office support staff; utilities; office supplies; interest expense; fees for accounting, consulting, and legal services; insurance; and rent. Delicious Desserts' operating expenses totaled $115,100.

Net Profit or Loss

The final figure—or bottom line—on an income statement is the **net profit** (or **net income**) or **net loss**. It is calculated by subtracting all expenses from revenues. If revenues are more than expenses, the result is a net profit. If expenses exceed revenues, a net loss results.

Several steps are involved in finding net profit or loss. (These are shown in the right-hand column of **Table 14.2**.) First, cost of goods sold is deducted from net sales to get the gross profit. Then total operating expenses are subtracted from gross profit to get the net profit before taxes. Finally, income taxes are deducted to get the net profit. As shown in **Table 14.2**, Delicious Desserts earned a net profit of $32,175 in 20XX.

It is very important to recognize that profit does not represent cash. The income statement is a summary of the firm's operating results during some time period. It does not present the firm's actual cash flows during the period. Those are summarized in the statement of cash flows, which is discussed briefly in the next section.

CONCEPT CHECK

1. What is an income statement? How does it differ from the balance sheet?
2. Describe the key parts of the income statement. Distinguish between gross sales and net sales.
3. How is net profit or loss calculated?

14.6 The Statement of Cash Flows

6. Why is the statement of cash flows an important source of information?

Net profit or loss is one measure of a company's financial performance. However, creditors and investors are also keenly interested in how much cash a business generates and how it is used. The **statement of cash flows**, a summary of the money flowing into and out of a firm, is the financial statement used to assess the sources and uses of cash during a certain period, typically one year. All publicly traded firms must include a statement of cash flows in their financial reports to shareholders. The statement of cash flows tracks the firm's

cash receipts and cash payments. It gives financial managers and analysts a way to identify cash flow problems and assess the firm's financial viability.

Exhibit 14.7 Coinstar is a cash cow—literally. The company established a niche counting loose change at the exits of supermarkets and other retailers everywhere. For a small fee, Coinstar's coin-counting machines turn penny jars and piggy banks into cash vouchers, a no-fee eGift card, or a charity donation. *What does the statement of cash flows indicate about a company's financial status?* (Credit: Mike Mozart/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Using income statement and balance sheet data, the statement of cash flows divides the firm's cash flows into three groups:

- *Cash flow from operating activities:* Those related to the production of the firm's goods or services
- *Cash flow from investment activities:* Those related to the purchase and sale of fixed assets
- *Cash flow from financing activities:* Those related to debt and equity financing

Delicious Desserts' statement of cash flows for 20XX is presented in Table 14.3. It shows that the company's cash and marketable securities have increased over the last year. And during the year the company generated enough cash flow to increase inventory and fixed assets and to reduce accounts payable, accruals, notes payable, and long-term debt.

Statement of Cash Flows for Delicious Desserts		
Delicious Desserts, Inc. **Statement of Cash Flows for 20XX**		
Cash Flow from Operating Activities		
Net profit after taxes	$32,175	
Depreciation	1,500	
Decrease in accounts receivable	3,140	
Increase in inventory	(4,500)	

Table 14.3

Statement of Cash Flows for Delicious Desserts		
Delicious Desserts, Inc. **Statement of Cash Flows for 20XX**		
Decrease in accounts payable	(2,065)	
Decrease in accruals	(1,035)	
Cash provided by operating activities		$29,215
Cash Flow from Investment Activities		
Increase in gross fixed assets	($ 5,000)	
Cash used in investment activities		($5,000)
Cash Flow from Financing Activities		
Decrease in notes payable	($ 3,000)	
Decrease in long-term debt	(1,000)	
Cash used by financing activities		($4,000)
Net increase in cash and marketable securities		**$20,215**

Table 14.3

CONCEPT CHECK

1. What is the purpose of the statement of cash flows?
2. Why is cash flow such an important measure of a firm's financial condition?
3. What situations can you cite from the chapter that support your answers?

14.7 Analyzing Financial Statements

7. How can ratio analysis be used to identify a firm's financial strengths and weaknesses?

Individually, the balance sheet, income statement, and statement of cash flows provide insight into the firm's operations, profitability, and overall financial condition. By studying the relationships among the financial statements, however, one can gain even more insight into a firm's financial condition and performance. A good way to think about analyzing financial statements is to compare it to a fitness trainer putting clients through various well-established assessments and metrics to determine whether a specialized fitness program is paying dividends for the person in terms of better strength, endurance, and overall health. Financial statements at any given time can provide a snapshot of a company's overall health. Company management

must use certain standards and measurements to determine whether they need to implement additional strategies to keep the company fit and profitable.

Ratio analysis involves calculating and interpreting financial ratios using data taken from the firm's financial statements in order to assess its condition and performance. A financial ratio states the relationship between financial data on a percentage basis. For instance, current assets might be viewed relative to current liabilities or sales relative to assets. The ratios can then be compared over time, typically three to five years. A firm's ratios can also be compared to industry averages or to those of another company in the same industry. Period-to-period and industry ratios provide a meaningful basis for comparison, so that we can answer questions such as, "Is this particular ratio good or bad?"

It's important to remember that ratio analysis is based on historical data and may not indicate future financial performance. Ratio analysis merely highlights potential problems; it does not prove that they exist. However, ratios can help managers monitor the firm's performance from period to period to understand operations better and identify trouble spots.

Ratios are also important to a firm's present and prospective creditors (lenders), who want to see if the firm can repay what it borrows and assess the firm's financial health. Often loan agreements require firms to maintain minimum levels of specific ratios. Both present and prospective shareholders use ratio analysis to look at the company's historical performance and trends over time.

Ratios can be classified by what they measure: liquidity, profitability, activity, and debt. Using Delicious Desserts' 20XX balance sheet and income statement (Table 14.1 and Table 14.2), we can calculate and interpret the key ratios in each group. Table 14.4 summarizes the calculations of these ratios for Delicious Desserts. We'll now discuss how to calculate the ratios and, more important, how to interpret the ratio value.

Liquidity Ratios

Liquidity ratios measure the firm's ability to pay its short-term debts as they come due. These ratios are of special interest to the firm's creditors. The three main measures of liquidity are the current ratio, the acid-test (quick) ratio, and net working capital.

The **current ratio** is the ratio of total current assets to total current liabilities. Traditionally, a current ratio of 2 ($2 of current assets for every $1 of current liabilities) has been considered good. Whether it is sufficient depends on the industry in which the firm operates. Utilities such as gas and water companies, which have a very steady cash flow, operate quite well with a current ratio well below 2, whereas a current ratio of 2 might not be adequate for manufacturers and merchandisers that carry high inventories and have lots of receivables. The current ratio for Delicious Desserts for 20XX is 1.4, as shown in Table 14.4. This means little without a basis for comparison. If the analyst found that the industry average was 2.4 for small bakeries, Delicious Desserts would appear to have low liquidity.

The **acid-test (quick) ratio** is like the current ratio except that it excludes inventory, which is the least-liquid current asset. The acid-test ratio is used to measure the firm's ability to pay its current liabilities without selling inventory. The name *acid-test* implies that this ratio is a crucial test of the firm's liquidity. An acid-test ratio of at least 1 is preferred. But again, what is an acceptable value varies by industry. The acid-test ratio is a good measure of liquidity when inventory cannot easily be converted to cash (for instance, if it consists of very specialized goods with a limited market). If inventory is liquid, the current ratio is better. Delicious Desserts' acid-test ratio is 1.1 for 20XX. Because the bakery's products are perishable, it does not carry large inventories. Thus, the values of its acid-test and current ratios are fairly close. At a manufacturing company, however, inventory typically makes up a large portion of current assets, so the acid-test ratio will be lower than the current ratio.

Ratio Analysis for Delicious Desserts at Year-End 20XX			
Ratio	**Formula**	**Calculation**	**Result**
Liquidity Ratios			
Current ratio	$\frac{\text{Total current assets}}{\text{Total current liabilities}}$	$\frac{\$83,200}{\$60,150}$	1.4
Acid-test (quick) ratio	$\frac{\text{Total current assets–inventory}}{\text{Total current liabilities}}$	$\frac{\$83,200–\$15,000}{\$60,150}$	1.1
Net working capital	Total current assets– Total current liabilities	$\$83,200 – \$60,150$	$23,050
Profitability Ratios			
Net profit margin	$\frac{\text{Net profit}}{\text{Net sales}}$	$\frac{\$32,175}{\$270,500}$	11.9%
Return on equity	$\frac{\text{Net profit}}{\text{Total owners' equity}}$	$\frac{\$32,175}{\$78,750}$	40.9%
Earnings per share	$\frac{\text{Net profit}}{\text{Number of shares of common stock outstanding}}$	$\frac{\$32,175}{10,000}$	$3.22
Activity Ratio			
Inventory turnover	$\frac{\text{Cost of goods sold}}{\text{Average inventory}}$		
	$\frac{\text{Cost of goods sold}}{(\text{Beginning inventory}+\text{Ending inventory})/2}$	$\frac{\$112,500}{(\$18,000+\$15,000)/2}$	
		$\frac{\$112,500}{\$16,500}$	6.8 times
Debt Ratio			
Debt-to-equity ratio	$\frac{\text{Total liabilities}}{\text{Owners' equity}}$	$\frac{\$70,150}{\$78,750}$	89.1%

Table 14.4

Net working capital, though not really a ratio, is often used to measure a firm's overall liquidity. It is calculated by subtracting total current liabilities from total current assets. Delicious Desserts' net working capital for 20XX is $23,050. Comparisons of net working capital over time often help in assessing a firm's liquidity.

Profitability Ratios

To measure profitability, a firm's profits can be related to its sales, equity, or stock value. **Profitability ratios** measure how well the firm is using its resources to generate profit and how efficiently it is being managed. The main profitability ratios are net profit margin, return on equity, and earnings per share.

The ratio of net profit to net sales is the **net profit margin**, also called *return on sales.* It measures the percentage of each sales dollar remaining after all expenses, including taxes, have been deducted. Higher net

profit margins are better than lower ones. The net profit margin is often used to measure the firm's earning power. "Good" net profit margins differ quite a bit from industry to industry. A supermarket usually has a very low net profit margin, perhaps below 1 percent, whereas a software company's net profit margin would probably exceed 10 percent. Delicious Desserts' net profit margin for 20XX is 11.9 percent. In other words, Delicious Desserts is earning 11.9 cents on each dollar of sales.

Exhibit 14.8 For giant retailers such as Macy's, the expenses of operating a physical location counters the markup on the merchandise, resulting in low profit margins. Because competition forces marketers to keep prices low, it is often a retailer's management of other costs, not sales volume, that determines whether a business will be profitable. *What expenses other than payroll and the cost of merchandise affect a retailer's net profit margin?* (Credit: Mike Mozart/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

The ratio of net profit to total owners' equity is called **return on equity (ROE)**. It measures the return that owners receive on their investment in the firm, a major reason for investing in a company's stock. Delicious Desserts has a 40.9 percent ROE for 20XX. On the surface, a 40.9 percent ROE seems quite good. But the level of risk in the business and the ROE of other firms in the same industry must also be considered. The higher the risk, the greater the ROE investors look for. A firm's ROE can also be compared to past values to see how the company is performing over time.

Earnings per share (EPS) is the ratio of net profit to the number of shares of common stock outstanding. It measures the number of dollars earned by each share of stock. EPS values are closely watched by investors and are considered an important sign of success. EPS also indicates a firm's ability to pay dividends. Note that EPS is the dollar amount earned by each share, not the actual amount given to stockholders in the form of dividends. Some earnings may be put back into the firm. Delicious Desserts' EPS for 20XX is $3.22.

Activity Ratios

Activity ratios measure how well a firm uses its assets. They reflect the speed with which resources are converted to cash or sales. A frequently used activity ratio is inventory turnover. The **inventory turnover ratio** measures the speed with which inventory moves through the firm and is turned into sales. It is calculated by dividing cost of goods sold by the average inventory. (Average inventory is estimated by adding the beginning and ending inventories for the year and dividing by 2.) Based on its 20XX financial data, Delicious Desserts' inventory, on average, is turned into sales 6.8 times each year, or about once every 54 days (365 days ÷ 6.8). The acceptable turnover ratio depends on the line of business. A supermarket would have a high turnover ratio, maybe 20 times a year, whereas the turnover for an industrial equipment manufacturer might be only three times a year.

Debt Ratios

Debt ratios measure the degree and effect of the firm's use of borrowed funds (debt) to finance its operations. These ratios are especially important to lenders and investors. They want to make sure the firm has a healthy mix of debt and equity. If the firm relies too much on debt, it may have trouble meeting interest payments and repaying loans. The most important debt ratio is the debt-to-equity ratio.

The **debt-to-equity ratio** measures the relationship between the amount of debt financing (borrowing) and the amount of equity financing (owners' funds). It is calculated by dividing total liabilities by owners' equity. In general, the lower the ratio, the better. But it is important to assess the debt-to-equity ratio against both past values and industry averages. Delicious Desserts' ratio for 20XX is 89.1 percent. The ratio indicates that the company has 89 cents of debt for every dollar the owners have provided. A ratio above 100 percent means the firm has more debt than equity. In such a case, the lenders are providing more financing than the owners.

CONCEPT CHECK

1. How can ratio analysis be used to interpret financial statements?
2. Name the main liquidity and profitability ratios, and explain what they indicate.
3. What kinds of information do activity ratios give? Why are debt ratios of concern to lenders and investors?

14.8 Trends in Accounting

8. What major trends affect the accounting industry today?

The post-SOX business environment has brought many changes to the accounting profession. When the public accounting industry could no longer regulate itself back in the late 1990s and early 2000s, it became subject to formal regulation for the first time. This regulatory environment set higher standards for audit procedures, which actually helped public companies fine-tune their financial reporting procedures, despite the added costs and labor hours needed to comply with SOX. Once again the core auditing business, rather than financial advisory and management consulting services, became the primary focus of public accounting firms. The relationship between accountants and their clients has also changed, and the role of chief audit executive has taken on more visibility in many large organizations. In addition, the FASB has made slow but steady progress in making changes related to GAAP, including a separate decision-making framework for users and preparers of private company financial statements.[8] There are several other important trends that may affect the accounting industry over the next several years, including increased cloud computing services, advances in AI, further automation, and staffing challenges.

Cloud-Based Services

The internet and cloud technology continue to transform many industries, including accounting, and clients expect their accountants to be up to speed on how financial data and other accounting information can be entered, accessed, and discussed in a very short period of time. For the most part, gone are the days when accountants and their support staff spend hours manually inputting data that gets "re-hydrated" into standardized accounting and financial statements, and reams of paper generate a company's weekly, monthly, or yearly reports.

In 2023, three quarters of cloud-based accounting firms saw increases in profit due to more clients and the rollout of new services through cloud computing, whereas only about 50 percent of traditional accounting firms saw increases in profit. In addition, with an estimated 90 percent of small- and medium-sized companies using cloud-based accounting software, this "trend" has become a permanent fixture in the industry and is

quickly becoming the norm.[9]

Automation and AI

In addition to cloud-based services, automation will continue to play an important role in the accounting industry, particularly in auditing services, where the manual gathering and inputting of information can be an inefficient and sometimes inaccurate process. Being able to automate this process will help generate complete sets of data that will improve the overall details of the auditing process. In addition, accountants who can use a client's data files from their business operations and import this information into a tax or accounting software package will streamline the overall accounting process and lessen the tedious work of data entry.[10]

The emergence of AI has had a significant impact on the accounting industry. From the automation of tasks and through machine learning, accountants can use their expertise for more strategic initiatives rather than traditional bookkeeping activities like recording income and expenses. Technologies such as NLP (natural language processing) allow the accountant to interact with the financial software using conversations. This technology can also assist with extracting data from different sources to put in a format suitable for analysis. OCR, or optical character recognition, has been invaluable, allowing scanning of documents such as receipts or invoices and automatically extracting the data into the appropriate accounting lines. These tools can also be used to check for accuracy in reporting by cross referencing different documents for inconsistencies. Through automated invoices and bank reconciliations, companies can reduce the time it takes for payments to arrive from their customers, which improves cash flow. Other key benefits include fraud detection and automated auditing tools.

Many accounting software packages include options such as tax filing, payroll processing, and financial forecasting. Through the use of AI and its sophisticated data analysis capabilities, these functions can be easily automated. The overall financial health of the business can be improved with AI data analytics to evaluate costs, profit margins, and tax implications of various strategic decisions. The industry has seen AI assist the accountant with their responsibilities rather than replace them. The accountant works with the technology to provide the information needed in a more efficient manner, which allows the accountant to shift their focus to strategic tasks and ensure compliance with GAAP. With the global nature of business today, utilizing AI can help the accountant navigate the differences between countries and their financial practices and requirements.[11]

Staffing Challenges

There is a significant staffing shortage in the accounting industry. Nearly 90 percent of managers in the industry recognize this shortage. In just one year, the open positions in the field increased by 150 percent. It is taking more than 60 days to fill positions. As these and other disruptive technologies change the focus of accounting work, the challenge of hiring the right staff with the skills and knowledge to learn how to adapt to new tools such as those provided through AI technologies intensifies. With accounting processes becoming automated and less time-intensive, some accounting firms are becoming more connected to their clients and increasing their advisory services when it comes to daily business operations. This change in approach will likely have an impact on the type of experienced employees accountants hire in the future. In addition, because most services are now cloud-based and financial data is available rather quickly, businesses are apt to change accounting firms faster than in the past if they are unsatisfied with the services they receive. Accountants have a great opportunity to expand their business portfolios and increase their client list by leveraging technology as part of their overall corporate strategies.[12]

MANAGING CHANGE

Attracting Gen Z and Retaining Millennial CPAs

Much has been written about millennials, the population segment born between the early 1980s and the end of the twentieth century. As the older baby boomer generation continues to retire, millennials now make up the largest group in the U.S. labor force. This group will continue to shape the workplace over the next few decades.

Businesses and other organizations cannot ignore this group and their expectations about employment. To be successful, today's accounting firms—whether Big 4 firms or small and mid-sized businesses—need to understand what makes millennials tick, what is important to them, what makes them look for new opportunities both within and outside the organization—and how to retain them.

Global accounting services company PricewaterhouseCoopers (PwC) partners with several other institutions to conduct a two-year generational study about the attitudes of millennial employees. Key findings suggest that millennials want flexibility in their work lives that leads to an enjoyable work-life balance, appreciation for the work they accomplish, collaborative environments in which to thrive, challenges that will help them grow in their careers, and continued support from employers. As a result of this study, PwC made several changes to its own work environment to attract and retain millennial workers, including flexible schedules, relaxed dress codes, greater communication at all levels of the company, and a renewed commitment to transparency within the organization.

In contrast, Gen Z employees enjoy teamwork less, prioritize diversity, often have additional income sources, thrive with new technology, and have a focus on overall well-being. To attract Gen Z employees, companies can provide clear paths for career development connected to larger company goals, embrace technological advances and give employees space to incorporate technology into their work, help them develop relationships and improve collaboration skills, and provide work arrangements that allow employees to focus on their physical and mental well-being.

PwC is not alone in shifting its organizational culture to address some of the issues millennials say are important factors for them within the work environment. For example, KMPG, another top accounting firm, recognizes that a significant portion of its workforce consists of millennials who have helped shape the company's approach to work. The themes of flexibility and trust permeate the company's culture, which reinforces employees' motivation to be engaged in work that is meaningful, satisfying, and helps them develop as individuals.

Here are some other strategies accounting firms might employ to keep their 30-something employees from jumping ship:

- *Initiate onboarding activities quickly:* Although training accounting professionals takes time, companies should engage and train new employees quickly to immerse them in organizational culture and assign them work they view as meaningful.
- *Assign mentors from the start:* Millennials want to know their work makes a difference, so what better way to get them involved right from the start than to make sure they are connected to mentors who can guide their work and career path.
- *Support a flexible approach to work:* Some millennials are in the prime of their career, and many may also be juggling a family life that requires a lot of their time. Companies need to remember that millennials like being productive, although they may not think a long workday equates to a productive one. The use of cloud-based technology encourages employees to do their work in a productive atmosphere that may not take place in the office.

Recognizing generational traits of millennials not only demonstrates commitment on the part of the company, but also helps keep these employees engaged and involved in their work.

Critical Thinking Questions

1. Do you think a shift in thinking when it comes to managing millennials is a smart strategy? Why or why not?
2. Will accounting firms be required to rethink their hiring and retention strategies to address the needs of Gen Z? Explain your reasoning.

Sources: “Workforce of the Future: The Competing Forces Shaping 2030,” https://www.pwc.com, accessed August 11, 2017; Hitendra Patil, “The 7 Experiences Millennials Want from Your Firm,” https://www.cpatrendlines.com, accessed August 11, 2017; “Millennial Accountants Don’t Want a Corner Office with a View,” https://www.rogercpareview.com, April 24, 2017; David Isaacs, “Voices: Confessions of a Millennial CPA: The Most Productive Generation,” https://www.accountingtoday.com, April 20, 2017; Teri Saylor, “How CPA Firms Are Evolving to Meet Millennials’ Desires,” https://www.journalofaccountancy.com, March 6, 2017; "Key Statistics about Millennials in the Workplace," *Firstup*, https://firstup.io, October 27, 2021; "The Interplay of Generations in the Workforce: A Comprehensive Analysis for 2025," https://kaplan.com, accessed February 11, 2026; Preeta Ghoshal, "How to Attract, Engage and Retain Gen Z Talent," *FDM*, https://www.fdmgroup.com, October 20, 2025; Tracy Brower, "How To Attract And Retain Gen Z Talent With 8 Proven Strategies," *Forbes*, https://www.forbes.com, September 21, 2025.

CONCEPT CHECK

1. How has the relationship between public accounting firms and their clients changed since SOX became law?
2. Describe how cloud computing and automation are changing the accounting industry.
3. What are some of the challenges encountered by accounting firms when introducing new technologies into their workflow process?

Key Terms

accounting The process of collecting, recording, classifying, summarizing, reporting, and analyzing financial activities.

acid-test (quick) ratio The ratio of total current assets excluding inventory to total current liabilities; used to measure a firm's liquidity.

activity ratios Ratios that measure how well a firm uses its assets.

annual report A yearly document that describes a firm's financial status and usually discusses the firm's activities during the past year and its prospects for the future.

assets Things of value owned by a firm.

auditing The process of reviewing the records used to prepare financial statements and issuing a formal auditor's opinion indicating whether the statements have been prepared in accordance with accepted accounting rules.

balance sheet A financial statement that summarizes a firm's financial position at a specific point in time.

certified management accountant (CMA) A managerial accountant who has completed a professional certification program, including passing an examination.

certified public accountant (CPA) An accountant who has completed an approved bachelor's degree program, passed a test prepared by the American Institute of CPAs, and met state requirements. Only a CPA can issue an auditor's opinion on a firm's financial statements.

cost of goods sold The total expense of buying or producing a firm's goods or services.

current assets Assets that can or will be converted to cash within the next 12 months.

current liabilities Short-term claims that are due within a year of the date of the balance sheet.

current ratio The ratio of total current assets to total current liabilities; used to measure a firm's liquidity.

debt ratios Ratios that measure the degree and effect of a firm's use of borrowed funds (debt) to finance its operations.

debt-to-equity ratio The ratio of total liabilities to owners' equity; measures the relationship between the amount of debt financing (borrowing) and the amount of equity financing (owner's funds).

depreciation The allocation of an asset's original cost to the years in which it is expected to produce revenues.

double-entry bookkeeping A method of accounting in which each transaction is recorded as two entries so that two accounts or records are changed.

earnings per share (EPS) The ratio of net profit to the number of shares of common stock outstanding; measures the number of dollars earned by each share of stock.

expenses The costs of generating revenues.

financial accounting Accounting that focuses on preparing external financial reports that are used by outsiders such as lenders, suppliers, investors, and government agencies to assess the financial strength of a business.

Financial Accounting Standards Board (FASB) The private organization that is responsible for establishing financial accounting standards in the United States.

fixed assets Long-term assets used by a firm for more than a year such as land, buildings, and machinery.

generally accepted accounting principles (GAAP) The financial accounting standards followed by accountants in the United States when preparing financial statements.

gross profit The amount a company earns after paying to produce or buy its products but before deducting operating expenses.

gross sales The total dollar amount of a company's sales.

income statement A financial statement that summarizes a firm's revenues and expenses and shows its total profit or loss over a period of time.

intangible assets Long-term assets with no physical existence, such as patents, copyrights, trademarks, and goodwill.

inventory turnover ratio The ratio of cost of goods sold to average inventory; measures the speed with

which inventory moves through a firm and is turned into sales.

liabilities What a firm owes to its creditors; also called debts.

liquidity The speed with which an asset can be converted to cash.

liquidity ratios Ratios that measure a firm's ability to pay its short-term debts as they come due.

long-term liabilities Claims that come due more than one year after the date of the balance sheet.

managerial accounting Accounting that provides financial information that managers inside the organization can use to evaluate and make decisions about current and future operations.

net loss The amount obtained by subtracting all of a firm's expenses from its revenues, when the expenses are more than the revenues.

net profit (net income) The amount obtained by subtracting all of a firm's expenses from its revenues, when the revenues are more than the expenses.

net profit margin The ratio of net profit to net sales; also called return on sales. It measures the percentage of each sales dollar remaining after all expenses, including taxes, have been deducted.

net sales The amount left after deducting sales discounts and returns and allowances from gross sales.

net working capital The amount obtained by subtracting total current liabilities from total current assets; used to measure a firm's liquidity.

operating expenses The expenses of running a business that are not directly related to producing or buying its products.

owners' equity The total amount of investment in the firm minus any liabilities; also called net worth.

private accountants Accountants who are employed to serve one particular organization.

profitability ratios Ratios that measure how well a firm is using its resources to generate profit and how efficiently it is being managed.

public accountants Independent accountants who serve organizations and individuals on a fee basis.

ratio analysis The calculation and interpretation of financial ratios using data taken from the firm's financial statements in order to assess its condition and performance.

retained earnings The amounts left over from profitable operations since the firm's beginning; equal to total profits minus all dividends paid to stockholders.

return on equity (ROE) The ratio of net profit to total owners' equity; measures the return that owners receive on their investment in the firm.

revenues The dollar amount of a firm's sales plus any other income it received from sources such as interest, dividends, and rents.

Sarbanes-Oxley Act (SOX) Legislation passed in 2002 that sets new standards for auditor independence, financial disclosure and reporting, and internal controls; establishes an independent oversight board; and restricts the types of non-audit services auditors can provide audit clients.

statement of cash flows A financial statement that provides a summary of the money flowing into and out of a firm during a certain period, typically one year.

Summary of Learning Outcomes

14.1 Accounting: More than Numbers

1. Why are financial reports and accounting information important, and who uses them?

Accounting involves collecting, recording, classifying, summarizing, reporting, and analyzing a firm's financial activities according to a standard set of procedures. The financial reports resulting from the accounting process give managers, employees, investors, customers, suppliers, creditors, and government agencies a way to analyze a company's past, current, and future performance. Financial accounting is concerned with the preparation of financial reports using generally accepted accounting principles. Managerial accounting provides financial information that management can use to make decisions about the firm's operations.

14.2 The Accounting Profession

2. What are the differences between public and private accountants, and how has federal legislation affected their work?

Public accountants work for independent firms that provide accounting services—such as financial report preparation and auditing, tax return preparation, and management consulting—to other organizations on a fee basis. Private accountants are employed to serve one particular organization and may prepare financial statements, tax returns, and management reports.

The bankruptcies of companies such as Enron and Theranos, plus widespread abuses of accounting practices, raised critical issues of auditor independence and the integrity and reliability of financial reports. To set better standards for accounting, auditing, and financial reporting and prevent future accounting irregularities, Congress passed the Sarbanes-Oxley Act in 2002. This Act created an independent board to oversee the accounting profession, set stricter auditing and financial disclosure standards, and placed increased accountability on a company's senior executives and management. In addition, the law restricts auditors from providing certain types of consulting services to clients. Other organizations such as the SEC, the New York Stock Exchange, and accounting industry professional associations issued regulations and guidelines related to compliance with the Act.

14.3 Basic Accounting Procedures

3. What are the six steps in the accounting cycle?

The accounting cycle refers to the process of generating financial statements. It begins with analyzing business transactions, recording them in journals, and posting them to ledgers. Ledger totals are then summarized in a trial balance that confirms the accuracy of the figures. Next the accountant prepares the financial statements and reports. The final step involves analyzing these reports and making decisions.

14.4 The Balance Sheet

4. In what terms does the balance sheet describe the financial condition of an organization?

The balance sheet represents the financial condition of a firm at one moment in time, in terms of assets, liabilities, and owners' equity. The key categories of assets are current assets, fixed assets, and intangible assets. Liabilities are divided into current and long-term liabilities. Owners' equity, the amount of the owners' investment in the firm after all liabilities have been paid, is the third major category.

14.5 The Income Statement

5. How does the income statement report a firm's profitability?

The income statement is a summary of the firm's operations over a stated period of time. The main parts of the statement are revenues (gross and net sales), cost of goods sold, operating expenses (selling and general and administrative expenses), taxes, and net profit or loss.

14.6 The Statement of Cash Flows

6. Why is the statement of cash flows an important source of information?

The statement of cash flows summarizes the firm's sources and uses of cash during a financial-reporting period. It breaks the firm's cash flows into those from operating, investment, and financing activities. It shows the net change during the period in the firm's cash and marketable securities.

14.7 Analyzing Financial Statements

7. How can ratio analysis be used to identify a firm's financial strengths and weaknesses?

Ratio analysis is a way to use financial statements to gain insight into a firm's operations, profitability, and

overall financial condition. The four main types of ratios are liquidity ratios, profitability ratios, activity ratios, and debt ratios. Comparing a firm's ratios over several years and comparing them to ratios of other firms in the same industry or to industry averages can indicate trends and highlight financial strengths and weaknesses.

14.8 Trends in Accounting

8. What major trends affect the accounting industry today?

The post-SOX business environment has brought many changes to the accounting profession, including higher standards for audit procedures. The FASB continues to collaborate in efforts to align GAAP and international accounting standards, but the implementation of global accounting standards is not projected to occur in the near future. Several important trends will continue to impact the accounting industry going forward, including in cloud-based services, further AI integration, and staffing shortages.

Preparing for Tomorrow's Workplace Skills

1. Your firm has been hired to help several small businesses with their year-end financial statements.
    a. Based on the following account balances, prepare the Marbella Design Enterprises balance sheet as of December 31, 20XX:

Cash	$30,250
Accounts payable	28,500
Fixtures and furnishings	85,000
Notes payable	15,000
Retained earnings	64,450
Accounts receivable	24,050
Inventory	15,600
Equipment	42,750
Accumulated depreciation on fixtures and furnishings	12,500
Common shares (50,000 shares at $1)	50,000
Long-term debt	25,000
Accumulated depreciation on equipment	7,800
Marketable securities	13,000
Income taxes payable	7,500

    b. The following are the account balances for the revenues and expenses of the Windsor Gift Shop for the year ending December 31, 20XX. Prepare the income statement for the shop. (Resources,

Information)

Rent	$ 15,000
Salaries	23,500
Cost of goods sold	98,000
Utilities	8,000
Supplies	3,500
Sales	195,000
Advertising	3,600
Interest	3,000
Taxes	12,120

2. During the year ended December 31, 20XX, Lawrence Industries sold $2 million worth of merchandise on credit. A total of $1.4 million was collected during the year. The cost of this merchandise was $1.3 million. Of this amount, $1 million has been paid, and $300,000 is not yet due. Operating expenses and income taxes totaling $500,000 were paid in cash during the year. Assume that all accounts had a zero balance at the beginning of the year (January 1, 20XX). Write a brief report for the company controller that includes calculation of the firm's (a) net profit and (b) cash flow during the year. Explain why there is a difference between net profit and cash flow. (Information, Systems)
3. A friend has been offered a sales position at Draper Media, Inc., a small publisher of computer-related publications, but wants to know more about the company. Because of your expertise in financial analysis, you offer to help analyze Draper's financial health. Draper has provided the following selected financial information:

Account balances on December 31, 20XX:	
Inventory	$ 72,000
Net sales	450,000
Current assets	150,000
Cost of goods sold	290,000
Total liabilities	180,000
Net profit	35,400
Total assets	385,000

Current liabilities	75,000
Other information	
Number of common shares outstanding	25,000
Inventory at January 1, 20XX	48,000

Calculate the following ratios for 20XX: acid-test (quick) ratio, inventory turnover ratio, net profit margin, return on equity, debt-to-equity ratio, and earnings per share. Summarize your assessment of the company's financial performance, based on these ratios, in a report for your friend. What other information would you like to have to complete your evaluation? (Information, Systems)

4. Research how companies and accounting firms adhere to the provisions of SOX. What processes do they have in place to be compliant with the Act. What rules have other organizations issued that relate to Act compliance? Summarize your findings. (Information)
5. **Team Activity** Two years ago, Riley Mardon started a computer consulting business, Mardon Consulting Associates. Until now, they have been the only employee, but business has grown enough to support hiring an administrative assistant and another consultant this year. Before adding staff, however, they want to hire an accountant and migrate their financial recordkeeping to an electronic system. Divide the class into small groups, assigning one person to be Riley and the others to represent members of a medium-sized accounting firm. Riley should think about the type of financial information systems their firm requires and develop a list of questions for the firm. The accountants will prepare a presentation making recommendations to Riley as well as explaining why their firm should win the account. (Resources, Interpersonal)
6. One of the best ways to learn about financial statements is to prepare them. Put together your personal balance sheet and income statement, using Table 14.1 and Table 14.2 as samples. You will have to adjust the account categories to fit your needs. Here are some suggestions:
   - Current assets—cash on hand, balances in savings and checking accounts
   - Investments—stocks and bonds, retirement funds
   - Fixed assets—real estate, personal property (cars, furniture, electronics, etc.)
   - Current liabilities—charge-card balances, loan payments due in one year
   - Long-term liabilities—auto loan balance, mortgage on real estate, other loan balances that will not come due until after one year
   - Income—employment income, investment income (interest, dividends)
   - Expenses—housing, utilities, food, educational expenses, transportation, medical, clothing, insurance, loan payments, taxes, personal care, recreation and entertainment, and miscellaneous expenses

   After you complete your personal financial statements, use them to see how well you are managing your finances. Consider the following questions:

   a. Should you be concerned about your debt ratio?
   b. Would a potential creditor conclude that it is safe or risky to lend you money?
   c. If you were a company, would people want to invest in you? Why or why not? What could you do to improve your financial condition? (Information)

Ethics Activity

As the controller of a medium-sized financial services company, you take pride in the accounting and internal

control systems you have developed for the company. You and your staff have kept up with changes in the accounting industry and been diligent in updating the systems to meet current accounting standards. Your outside auditor, which has been reviewing the company's books for 15 years, routinely complimented you on your thorough procedures.

Current regulations require testing internal control systems to remain compliant. You have researched the requirements and made adjustments to be compliant with regulations, even though that created additional work. Your auditors, however, interpret the regulations very aggressively—too much so in your opinion. As such, they have recommended changes to your system that will be costly and also widen the scope of the audit process, raising their fees. When you question the partner in charge, they explain that the complexity of the law means that it is open to interpretation and it is better to err on the side of caution than risk noncompliance. You are not pleased with this answer, as you believe that your company is in compliance with SOX, and consider changing auditors.

Using a web search tool, locate articles about this topic and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Should you change auditors because your current one is too stringent in applying the Sarbanes-Oxley Act? What other steps could you take to resolve this situation?

Sources: Loren Kasuske, "The 4 Biggest Pros and Cons of the Sarbanes-Oxley Act," https://ktconnections.com, June 8, 2017; Terry Sheridan, "Financial Services Spend More than $1M Annually on SOX," https://www.accountingweb.com, August 2, 2016; "Sarbanes-Oxley Is Paying Off for Companies Despite Increased Costs and Hours, Protiviti Survey Finds," https://www.prnewswire.com, June 2, 2016; Daniel Kim, "Top 3 Ways to Reduce SOX Compliance Costs," https://www.soxhub.com, December 14, 2015.

Working the Net

1. Visit the website of one of the following major U.S. public accounting firms: Deloitte (**https://www.deloitte.com**), EY (**https://www.ey.com**), KPMG (**https://www.kpmg.com**), PwC (**https://www.pwc.com**), Grant Thornton (**https://www.grantthornton.com**), or BDO (**https://www.bdo.com**). Explore the site to learn the services the firm offers. What other types of resources does the firm have on its website? How well does the firm communicate via the website with existing and prospective clients? Summarize your findings in a brief report.
2. Do annual reports confuse you? Many websites can take the mystery out of this important document. See Investopedia's "How to Read an Annual Report" at **https://www.investopedia.com/articles/basics/10/guide-to-reading-annual-reports.asp** and the SEC's 'How to Read an Annual Report" at **https://www.sec.gov/investor/pubs/readan.htm**. Which site was more helpful to you, and why?
3. Corporate reports filed with the SEC are now available on the web at the EDGAR (Electronic Data Gathering, Analysis, and Retrieval system) website, **https://www.sec.gov/edgar**. First, read about the EDGAR system; then go to the search page. To see the type of information that companies must file with the SEC, use the search feature to locate a recent filing by Microsoft. What types of reports did you find, and what was the purpose of each report?

Critical Thinking Case

Accountingfly Changes How CPAs Get Hired

Filling accounting positions, especially at the CPA level, can be a challenge. Until a few years ago, businesses other than the Big 4 firms basically had two options: post openings on general job platforms such as Monster and Indeed, or go through a staffing agency that charged a hefty fee for finding just the right accounting professional.

Jeff Phillips, CEO of Accountingfly and former Monster.com recruiter, saw the opportunity to create a job site

that caters strictly to accounting and bookkeeping jobs and started Accountingfly.com with siblings John and James Hosman. After studying various industries, the founders decided to focus on accounting because of the "massive imbalance" when it came to recruiting for private and public accountants. In their research, the trio found that most of the talent was snapped up by Big 4 accounting firms, leaving other accounting businesses struggling to find the right experienced people to fill key positions.

Despite the number of students majoring in accounting at that time, Phillips discovered the number of graduates taking the CPA exam was declining rapidly, signaling to him that people were losing interest in public accounting jobs. He sees Accountingfly as a way to alert job seekers (and companies) about the good jobs available for new and experienced CPAs outside of the four major players in the accounting field.

As the accounting talent pool evolves, millennials and Gen Zers are looking for challenging work with competitive salaries, work-life balance flexibility, and long-term career development. The needs of both generations are different, and organizations need to adjust in order to both attract and retain the talent needed for the positions. Accountingfly.com provides job boards, recruiting services, and career resources, processing thousands of applications annually and serving hundreds of accounting firms. In 2015, Accountingfly acquired Going Concern, a leading accounting news website that features original content and an insider's perspective on the people, firms, and culture that shape the accounting profession in this country. According to Phillips, Going Concern has a large, well-informed, highly engaged audience of early-career accountants who could benefit from connecting with accounting firms seeking exceptional talent.

Critical Thinking Questions

1. How does the company's focus on recruiting accountants and related services give Accountingfly a competitive advantage?
2. Do you think Accountingfly's approach can compete with the Big 4's expensive and comprehensive recruiting efforts for new accountants? Explain your reasoning.
3. How can Accountingfly use its acquisition of Going Concern as a recruiting tool for experienced CPAs who desire a different career track? Provide some examples to support your answer.

Sources: "Who We Are," https://accountingfly.com, accessed August 11, 2017; Ian Welham, "How Accountingfly Is Revolutionizing the Way CPAs Are Hired," https://cpatrendlines.com, August 5, 2017; "Millennial Businesses to Accounting Firms: Diversify Services, Go Digital and Embrace the Cloud," https://www.bill.com, May 30, 2017; Carlos Gieseken, "Accountingfly Gains Influence in Industry," https://www.pnj.com, October 5, 2015; Sherman G. Mohr, Jr., "Meet Jeff Phillips, CEO of Accountingfly. Tech Is Thriving in the Florida Panhandle," *LinkedIn,* https://www.linkedin.com, August 24, 2015; "Accountingfly Acquires Going Concern, a Leading Accounting News Publication," https://www.prweb.com, August 20, 2015.

Hot Links Address Book

1. What issues is the FASB working on now? Check it out at **https://www.fasb.org**.
2. Two good sites to learn about the latest news in the accounting industry are Accounting Today, **https://www.accountingtoday.com**, and AccountingWEB, **https://www.accountingweb.co.uk**.
3. To find free information about business statistics and financial ratios, go to the BizStats website at **https://www.bizstats.com**. There you will find industry financial ratios for corporations in around 9,000 markets and over 10 million companies.
4. To find out more about the accounting profession and becoming a CPA, visit the American Institute of CPAs' website at **https://www.aicpa-cima.com**, and click on the Careers tab to explore various career paths in the accounting industry.
5. Forensic accountants combine their accounting knowledge with investigative skills in various legal and investigative settings, looking for fraud in various accounting transactions. To learn more about this accounting specialty, go to the website of the Association of Certified Fraud Examiners at **https://www.acfe.com**.

6. A comprehensive site with information about careers in accounting, certification programs, internships, and links to many related websites can be found at **https://www.accounting.com/careers/overview**.

15

Understanding Money and Financial Institutions

Exhibit 15.1 (Credit: The Fed/US Government Works)

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What is money, what are its characteristics and functions, and what are the three parts of the U.S. money supply?
2. How does the Federal Reserve manage the money supply?
3. What are the key financial institutions, and what role do they play in the process of financial intermediation?
4. How does the Federal Deposit Insurance Corporation (FDIC) protect depositors' funds?
5. What roles do U.S. banks play in the international marketplace?
6. What trends are reshaping financial institutions?

EXPLORING BUSINESS CAREERS

Michelle Moore, Bank of America

Technology continues to change every facet of daily life, including how consumers interact with banks and other financial institutions. Whether large or small, banks have to stay one step ahead of the competition when it comes to providing top-notch service to their customers, including digital and mobile channels. Michelle Moore, former head of digital banking at Bank of America, and now EVP of Digital, Data, and AI at Wells Fargo, has worked in various parts of the company for more than 14 years. Regardless of her role within the organization, Moore has consistently demonstrated her obsession with exceptional service and how best to make sure the bank is providing customers with products and features that will make their lives easier, keep them loyal to the organization, and ultimately increase sales.

Exhibit 15.2 Michelle Moore is the head of digital banking at Bank of America. (Credit: Mike Mozart/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

While overseeing the bank's call center operations, Moore was asked to take on the bank's mobile initiatives, a request that befuddled her. Moore is the first to tell you she is no techie—she admits she kept her beloved flip phone too long before opting for a smartphone. Yet, her people skills and her drive to provide the best customer service made her the perfect person to take on the bank's digital and mobile efforts.

Like other major financial institutions, Bank of America did not have a stellar reputation when it came to digital or mobile banking. Although customers used the bank's digital offerings, the services were basic, even as the smartphone revolution changed many of life's daily activities. Once Moore and her digital team got the bank's mobile app up to speed, they began to figure out how to make it better. The team started to add features to the app, making sure that nearly everything customers can do at a bank branch they can do on the new and improved app. In addition, Moore and her group created a digital assistant feature that uses artificial intelligence and predictive analytics to provide customers with the same level of advice and expertise that previously would have been reserved for customers with high-end wealth-management accounts.

A play on the word "America," the app called Erica debuted to the public in 2018, and customer reaction has been positive. But Moore is never satisfied with the status quo. She encourages her team to constantly ask how customers will use the app and what will it take to make and keep them happy with the digital assistant's features. For example, after Moore read an article on the success of Apple's Siri and Amazon's Alexa, she wondered, "Why can't our banking app talk to clients?" She pushed her team to add a voice feature to Erica, which gave the digital assistant a competitive edge over other banking mobile apps at the time.

Moore knows that customer sentiment is critical to the bank's success, especially in mobile banking. She continues to be obsessed by customer reviews and how the bank can increase customer satisfaction quickly and efficiently, and she knows that agility is critical in an ever-changing bank environment. Her efforts are paying off. When entering the mobile banking era, Bank of America had 6 million mobile banking users; today, that number has jumped to about 30 million. Mobile banking customers logged into their accounts nearly 15 billion times in 2025, representing a 16 percent increase over the previous year—much more than the number of desktop logins. And when customers need to visit a local bank branch, they are often booking appointments via the mobile app. Although she knows there is more work to do, Moore's common-sense approach to listening to customers while leveraging technology has helped Bank of America increase sales and stay ahead of the competition.

Sources: Robert Barba, "Digital Banker of the Year: B of A's Michelle Moore," *American Banker,* https://www.americanbanker.com, May 31, 2017; Robert Barba, "Mom, Marathoner, App Maker: B of A's

Michelle Moore," *American Banker,* https://www.americanbanker.com, May 31, 2017; Ayoub Aouad and Jaime Toplin, "Bank of America Boosts Digital Banking Segment," *Business Insider,* https://www.businessinsider.com, April 19, 2017; Michelle Moore, "Leading the Way in Digital Banking," *The Financial Brand,* https://the financial brand.com, February 20, 2017; Hilary Burns, "Michelle Moore on the Latest for BofA's Digital Operations," *Charlotte Business Journal,* https://www.bizjournals.com, December 21, 2016; "Erica®, the Guide by Your Side, Is Here for You," https://info.bankofamerica.com, accessed February 16, 2026; "Digital Interactions by BofA Clients Surge to Over 26 Billion, up 12% Year-Over-Year," Bank of America, February 24, 2025, https://newsroom.bankofamerica.com; CIO Visionaries, "5 Key Facts About Bank of America Mobile Banking App in 2025 Latest," https://ciovisionaries.com, accessed February 16, 2026.

Advanced technology, globalization of markets, and the relaxation of regulatory restrictions continue to accelerate the pace of change in the financial services industry. These changes are giving businesses and consumers new options for conducting their financial transactions. The competitive landscape for financial institutions is also changing, creating new ways for these firms to increase their market share and boost profits.

This chapter focuses on the role of financial institutions in U.S. and international economies. It discusses different types of financial institutions, how they are set up and how they function internally, and government oversight of their operations. Because financial institutions connect people with money, this chapter begins with a discussion of money, its characteristics and functions, and the components of the U.S. money supply. Next, it explains the role of the Federal Reserve System in managing the money supply. Then it describes different types of financial institutions and their services and the organizations that insure customer deposits. The chapter ends with a discussion of international banking and trends in financial institutions.

15.1 Show Me the Money

1. What is money, what are its characteristics and functions, and what are the three parts of the U.S. money supply?

Money is anything that is acceptable as payment for goods and services. It affects our lives in many ways. We earn it, spend it, save it, invest it—making decisions on how to best plan for the future. Businesses and government use money in similar ways. Both require money to finance their operations. By controlling the amount of money in circulation, the federal government can promote economic growth and stability. For this reason, money has been called the oil that keeps our economic system running smoothly. Our banking system was developed to ease the handling of money.

Characteristics of Money

For money to be a suitable means of exchange, it should have these key characteristics:

- *Scarcity:* Money should be scarce enough to have some value but not so scarce as to be unavailable. Small rocks as currency, for example, which meet some of the other criteria, would not work well as money because they are widely available. Too much money in circulation increases prices and inflation. Governments control the scarcity of money by limiting the quantity of money in circulation.
- *Durability:* Any item used as money must be durable. A perishable item such as a fruit or vegetable becomes useless as money when it spoils. Even early societies used durable forms of money, such as metal coins and paper money, which lasted for a long time.
- *Portability:* Money must be easily moved around. Large or bulky items, such as heavy rocks or heavy pieces of metal, cannot be transported easily from place to place.
- *Divisibility:* Money must be capable of being divided into smaller parts. Divisible forms of money help

make transactions of all sizes and amounts possible.

Table 15.1 provides some interesting facts about our money.

Functions of Money

Using a variety of items as money would be confusing. Thus, societies develop a uniform money system to measure the value of goods and services. For money to be acceptable, it must function as a medium of exchange, as a standard of value, and as a store of value.

As a *medium of exchange,* money makes transactions easier. Having a common form of payment is much less complicated than having a barter system, wherein goods and services are exchanged for other goods and services. Money allows the exchange of products to be a consistent and manageable process.

Money also serves as a *standard of value.* With a form of money whose value is accepted by all, goods and services can be priced in standard units. This makes it easy to measure the value of products and allows transactions to be recorded in consistent terms.

As a *store of value,* money is used to hold wealth. It retains its value over time, although it may lose some of its purchasing power due to inflation. Individuals may choose to keep their money for future use rather than exchange it today for other types of products or assets.

Interesting Facts about U.S. Currency

Did you know . . .

- Currency paper is composed of 25% linen and 75% cotton.
- About 4,000 double folds (first forward and then backwards) are required before a note will tear.
- As of December 2024, there was over $2.3 trillion in U.S. currency in circulation.
- Over 70% of the notes printed each year are used to replace notes already in circulation.
- The largest note ever printed by the Bureau of Engraving and Printing was the $100,000 Gold Certificate, Series 1934.
- During fiscal year 2025, it cost between 4.1 and 7.3 cents to produce the main U.S. bills in circulation.
- A stack of currency one mile high would contain over 14 million notes.
- If you had 10 billion $1 notes and spent one every second of every day, it would require 317 years for you to go broke.

Table 15.1 Sources: U.S. Currency Education Program, "Currency Facts," https://www.uscurrency.gov, accessed February 16, 2026; U.S. Currency Education Program, "U.S. Currency in Circulation," https://www.uscurrency.gov, accessed February 16, 2026; U.S. Currency Education Program, "The Life Cycle of a Federal Reserve Note," https://www.uscurrency.gov, accessed February 16, 2026; Federal Reserve Bank of St. Louis (FRED), "Monetary Base: Currency in Circulation," https://fred.stlouisfed.org, January 27, 2026; "How Much Does It Cost to Produce Currency and Coin?" https://www.federalreserve.gov, accessed February 16, 2026; The Bureau of Engraving & Printing, "$1 Note," https://www.bep.gov, accessed February 16, 2026

The U.S. Money Supply

The U.S. money supply is composed of currency, demand deposits, and time deposits. **Currency** is cash held in the form of coins and paper money. Other forms of currency include travelers' checks, cashier's checks, and money orders. The amount of currency in circulation depends on public demand. Domestic demand is influenced primarily by prices for goods and services, income levels, and the availability of alternative payment methods such as credit cards. Until the mid-1980s, nearly all U.S. currency circulated only domestically. Today domestic circulation totals less than half of the total amount of U.S. currency in circulation.

Over the past decade, the amount of U.S. currency has grown to over $2.3 trillion and is held both inside and outside the country.[1] Foreign demand is influenced by the political and economic uncertainties associated with some foreign currencies, and estimates suggest that over half of the value of currency in circulation is held

abroad. Some residents of foreign countries hold dollars as a store of value, whereas others use it as a medium of exchange.

Federal Reserve notes make up more than 99 percent of all U.S. currency in circulation. Each year the Federal Reserve Board determines new currency demand and submits a print order to the Treasury's Bureau of Engraving and Printing (BEP). The order represents the Federal Reserve System's estimate of the amount of currency the public will need in the upcoming year and reflects estimated changes in currency usage and destruction rates of unfit currency. Table 15.2 shows how long we can expect our money to last on average.

How Long Will Your Money Last?	
Have you ever wondered how quickly money wears out from being handled or damaged? Not surprisingly, smaller denominations have a shorter life span.	
$1 bill	7.2 years
$5 bill	5.8 years
$10 bill	5.7 years
$20 bill	11.1 years
$50 bill	14.9 years
$100 bill	24.0 years

Table 15.2 Source: U.S. Currency Education Program, "Lifespan Data," https://www.uscurrency.gov, accessed February 16, 2026.

Demand deposits consist of money kept in checking accounts that can be withdrawn by depositors on demand. Demand deposits include regular checking accounts as well as interest-bearing and other special types of checking accounts. **Time deposits** are deposits at a bank or other financial institution that pay interest but cannot be withdrawn on demand. Examples are certain savings accounts, money market deposit accounts, and certificates of deposit. Economists use two terms to report on and discuss trends in the U.S. monetary system: M1 and M2. **M1** (the *M* stands for money) is used to describe the total amount of readily available money in the system and includes currency and demand deposits. As of December 2025, the M1 monetary supply was $19.1 trillion. M2 includes all of M1 plus time deposits and other money that is not immediately accessible. At the end of 2025, the M2 monetary supply was $22.4 trillion.[2] Credit cards, sometimes referred to as "plastic money," are routinely used as a substitute for cash and checks. Credit cards are not money; they are a form of borrowing. When a bank issues a credit card to a consumer, it gives a short-term loan to the consumer by directly paying the seller for the consumer's purchases. The consumer pays the credit card company after receiving the monthly statement. Credit cards do not replace money; they simply defer payment.

CONCEPT CHECK

1. What is money, and what are its characteristics?
2. What are the main functions of money?
3. What are the three main components of the U.S. money supply? How do they relate to M1 and M2?

15.2 The Federal Reserve System

2. How does the Federal Reserve manage the money supply?

Before the twentieth century, there was very little government regulation of the U.S. financial or monetary systems. In 1907, however, several large banks failed, creating a public panic that led worried depositors to withdraw their money from other banks. Soon many other banks had failed, and the U.S. banking system was near collapse. The panic of 1907 was so severe that Congress created the Federal Reserve System in 1913 to provide the nation with a more stable monetary and banking system.

The **Federal Reserve System** (commonly called the **Fed**) is the central bank of the United States. The Fed's primary mission is to oversee the nation's monetary and credit system and to support the ongoing operation of America's private-banking system. The Fed's actions affect the interest rates banks charge businesses and consumers, help keep inflation under control, and ultimately stabilize the U.S. financial system. The Fed operates as an independent government entity. It derives its authority from Congress but its decisions do not have to be approved by the president, Congress, or any other government branch. However, Congress does periodically review the Fed's activities, and the Fed must work within the economic framework established by the government.

The Fed consists of 12 district banks, each covering a specific geographic area. **Exhibit 15.3** shows the 12 districts of the Federal Reserve. Each district has its own bank president who oversees operations within that district.

Originally, the Federal Reserve System was created to control the money supply, act as a borrowing source for banks, hold the deposits of member banks, and supervise banking practices. Its activities have since broadened, making it the most powerful financial institution in the United States. Today, four of the Federal Reserve System's most important responsibilities are carrying out monetary policy, setting rules on credit, distributing currency, and overseeing payment systems including digital transactions.

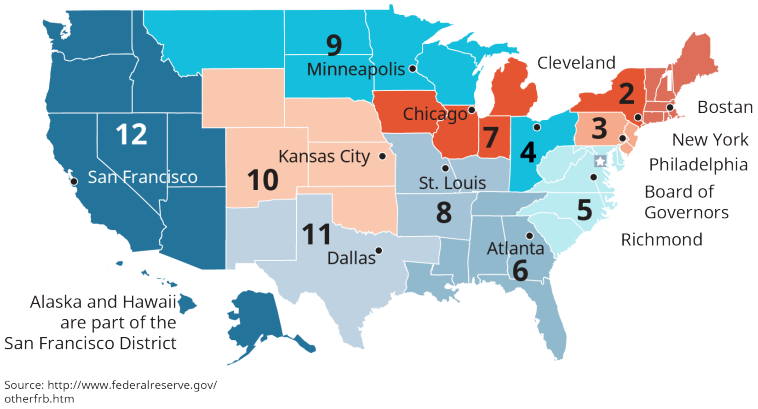

Exhibit 15.3 Federal Reserve Districts and Banks Source: "Federal Reserve Banks," https://www.richmondfed.org, accessed September 7, 2017.

Carrying Out Monetary Policy

The most important function of the Federal Reserve System is carrying out monetary policy. The Federal Open Market Committee (FOMC) is the Fed policy-making body that typically meets eight times a year to make monetary policy decisions. It uses its power to change the money supply in order to control inflation and interest rates, increase employment, and influence economic activity. Three tools used by the Federal Reserve System in managing the money supply are open market operations, reserve requirements, and the discount rate. **Table 15.3** summarizes the short-term effects of these tools on the economy.

Open market operations—a key function of the Federal Reserve—involve the purchase or sale of U.S. government bonds. The U.S. Treasury issues bonds to obtain the extra money needed to run the government

(if taxes and other revenues aren't enough). In effect, Treasury bonds are long-term loans (20 to 30 years) made by businesses and individuals to the government. The Federal Reserve buys and sells these bonds for the Treasury. When the Federal Reserve buys bonds, it puts money into the economy. Banks have more money to lend, so they reduce interest rates, which generally stimulates economic activity. The opposite occurs when the Federal Reserve sells government bonds.

The Federal Reserve System's Monetary Tools and Their Effects

Tool	Action	Effect on Money Supply	Effect on Interest Rates	Effect on Economic Activity
Open market operations	Buy government bonds	Increases	Lowers	Stimulates
	Sell government bonds	Decreases	Raises	Slows Down
Discount rate	Raise discount rate	Decreases	Raises	Slows Down
	Lower discount rate	Increases	Lowers	Stimulates

Table 15.3

The Federal Reserve is called "the banker's bank" because it lends money to banks that need it. The interest rate that the Federal Reserve charges its member banks is called the **discount rate**. When the discount rate is less than the cost of other sources of funds (such as certificates of deposit), commercial banks borrow from the Federal Reserve and then lend the funds at a higher rate to customers. The banks profit from the *spread,* or difference, between the rate they charge their customers and the rate paid to the Federal Reserve. Changes in the discount rate usually produce changes in the interest rate that banks charge their customers. The Federal Reserve raises the discount rate to slow down economic growth and lowers it to stimulate growth.

Setting Rules on Credit

Another activity of the Federal Reserve System is setting rules on credit. It controls the credit terms on some loans made by banks and other lending institutions. This power, called **selective credit controls**, includes consumer credit rules and margin requirements. *Consumer credit rules* establish the minimum down payments and maximum repayment periods for consumer loans. The Federal Reserve uses credit rules to slow or stimulate consumer credit purchases. *Margin requirements* specify the minimum amount of cash an investor must put up to buy securities or investment certificates issued by corporations or governments. The balance of the purchase cost can be financed through borrowing from a bank or brokerage firm. By lowering the margin requirement, the Federal Reserve stimulates securities trading. Raising the margin requirement slows trading.

Distributing Currency: Keeping the Cash Flowing

The Federal Reserve distributes the coins minted and the paper money printed by the U.S. Treasury to banks. Most paper money is in the form of Federal Reserve notes. Look at a dollar bill and you'll see "Federal Reserve Note" at the top. The large letter seal on the left indicates which Federal Reserve Bank issued it. For example, bills bearing a *D* seal are issued by the Federal Reserve Bank of Cleveland, and those with an *L* seal are issued by the San Francisco district bank.

Making Check Clearing Easier

Another important activity of the Federal Reserve is processing and clearing checks between financial institutions. When a check is cashed at a financial institution other than the one holding the account on which the check is drawn, the Federal Reserve's system lets that financial institution—even if distant from the institution holding the account on which the check is drawn—quickly convert the check into cash. Transactions, through various means such as checks or ACH, drawn on banks within the same Federal Reserve district are handled through the local Federal Reserve Bank using a series of entries (often electronic) to transfer funds between the financial institutions. The process is more complex for transactions between different Federal Reserve districts.

The time between when the transaction is initiated and when the funds are deducted from the originator's account provides float. With ACH transactions, the float is greatly reduced (almost instantaneous) from what you would expect with a paper check. Float benefits the originator by allowing it to retain the funds until the transaction clears—that is, when the funds are actually withdrawn from its accounts. Check usage declined over the last decade from 6 percent to just 2.5 percent of customer transactions. It is projected that the number of check payments will continue to decline as more people exclusively use online banking and other electronic payment systems. In fact, some countries are planning to phase out checks in the coming years entirely, and the U.S. government no longer accepts or issues checks for items such as tax payments or social security benefits as of September 2025.[3]

Managing the Great Recession

Much has been written about the global financial crisis that occurred between 2007 and 2009. Some suggest that without the Fed's intervention, the U.S. economy would have slipped deeper into a financial depression that could have lasted years. The Great Recession was caused by several factors including weak regulation of the mortgage market, lenders taking excess risk, and lending practices that put borrowers at risk of default. These actions, along with other economic factors, put the U.S. economy into a financial crisis.[4]

In the early 2000s, the housing industry was booming. Mortgage lenders were signing up consumers for mortgages that "on paper" they could afford. In many instances, lenders told consumers that based on their credit rating and other financial data, they could easily take the next step and buy a bigger house or maybe a vacation home because of the availability of mortgage money and low interest rates. This prompted a situation in which borrowers could no longer afford to pay their mortgages, and they started to default on their home loans in late 2007. The value of real estate declined, and many borrowers owed more on their loans than the home was worth, which left their investment "underwater." Many consumers were unable to keep their homes and even had to file for personal bankruptcy. At this same time, the U.S. economy was struggling, and unemployment was on the rise as companies were responding to the declining economic conditions.[5]

In addition, several leading financial investment firms, particularly those that managed and sold the high-risk, mortgage-backed financial products, failed quickly because they had not set aside enough money to cover the billions of dollars they lost on mortgages then going into default. For example, Bear Sterns, a large investment bank in operation since 1923, had a large portion of investments that were secured by mortgages that were going unpaid by consumers. The firm could not survive the impact and was sold to JP Morgan Chase for less than $10 per share in 2008.[6]

After the collapse of Bear Stearns and other firms such as Countrywide Financial and Merrill Lynch, the Fed set up a special loan program to stabilize the banking system and to keep the U.S. bond markets trading at a normal pace. The Federal Reserve made more than $9 trillion in loans to financial firms during the Great Recession. Additionally, the Federal Reserve provided emergency funding for firms in the auto industry as a "bail out" to help support the U.S. stock market.[7]

As a result of this financial meltdown, Congress passed legislation in the years that followed to establish more regulations in the financial industry both to protect consumers and to help prevent another recession because

of risky lending practices. Among its provisions, the Dodd-Frank Wall Street Reform and Consumer Protection Act (known as Dodd-Frank) created oversight councils to track the stability of major firms in the financial industry and regulate insurance companies. The councils were given the powers to require changes, liquidate, or restructure the firms to protect the stability of the U.S. economy. Risky investments by financial firms are now also restricted. Consumers are more protected as a result of the Act with the Consumer Financial Protection Bureau. Finally, the Act established a whistle-blower provision to protect individuals who come forward to report security and financial violations.[8]

Another provision of Dodd-Frank legislation requires major U.S. banks to submit to annual stress tests conducted by the Federal Reserve. These annual checkups determine whether banks have enough capital to survive economic turbulence in the financial system and whether the institutions can identify and measure risk as part of their capital plan to pay dividends or buy back shares. And today this has grown to all banks, although the number of banks required to meet the standards was decreased in 2018 with the passing of the Economic Growth, Regulatory Relief and Consumer Protection Act.[9]

Exhibit 15.4 The Federal Reserve kept short-term interest rates close to 0 percent for more than seven years, from 2009 to December 2015, as a result of the global financial crisis. During the COVID-19 pandemic, they lowered the interest rate to nearly zero to prompt economic recovery. Following the pandemic, the U.S. experienced higher-than-normal inflation rates and that caused the Fed to make further adjustments to the interest rate. Now that the economy seems to be recovering from the pandemic, the interest rates have increased to 3.5 percent. *What effect do higher interest rates have on the U.S. economy?* (Credit: ./ Pexels/ CC0 License/✓ Free for personal and commercial use/✓ No attribution required)

CONCEPT CHECK

1. What are the four key functions of the Federal Reserve System?
2. What three tools does the Federal Reserve System use to manage the money supply, and how does each affect economic activity?
3. What was the Fed's role in supporting the U.S. financial markets to recovery during the Great Recession?

15.3 U.S. Financial Institutions

3. What are the key financial institutions, and what role do they play in the process of financial intermediation?

The well-developed financial system in the United States supports our high standard of living. The system allows those who wish to borrow money to do so with relative ease. It also gives savers a variety of ways to earn interest on their savings. For example, a small business wants to build a new facility in Atlanta. They would like to take out a loan from a financial institution to finance the new facility. The financial institution also has customers in San Diego with savings accounts. The institution can use the savings funds to give the loan to the business in Atlanta. The interest paid on the loan covers the cost to the bank for providing the funding and also allows the bank to give interest to the customers with savings accounts and for the bank to make a profit. The transfer of funds from savers to investors enables businesses to expand and the economy to grow.

Households are important participants in the U.S. financial system. Although many households borrow money to finance purchases, they supply funds to the financial system through their purchases and savings. Overall, businesses and governments are users of funds. They borrow more money than they save.

Sometimes those who have funds deal directly with those who want them. A family member may have the ability to lend money to another family member to purchase a house. Most often, financial institutions act as intermediaries—or go-betweens—between the suppliers and demanders of funds. The institutions accept savers' deposits and invest them in financial products (such as loans) that are expected to produce a return. This process, called **financial intermediation,** is shown in **Exhibit 15.5.** Households are shown as suppliers of funds, and businesses and governments are shown as demanders. However, a single household, business, or government can be either a supplier or a demander, depending on the circumstances.

Financial institutions are the heart of the financial system. They are convenient vehicles for financial intermediation. They can be divided into two broad groups: depository institutions (those that accept deposits) and nondepository institutions (those that do not accept deposits).

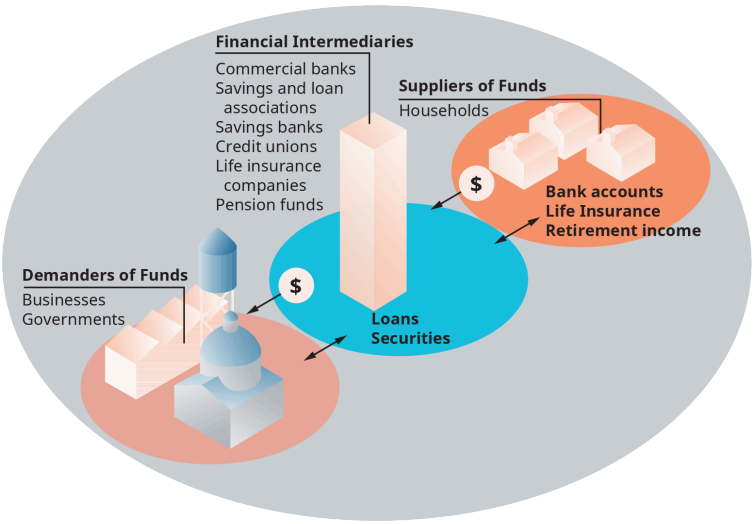

Exhibit 15.5 The Financial Intermediation Process Only the dominant suppliers and demanders are shown here. Clearly, a single household, business, or government can be either a supplier or demander, depending on circumstances. (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Depository Financial Institutions

Not all depository financial institutions are alike. Most people call the place where they save their money a "bank." Some of those places are indeed banks, but other depository institutions include thrift institutions and credit unions.

Commercial Banks

A **commercial bank** is a profit-oriented financial institution that accepts deposits, makes business and consumer loans, invests in government and corporate securities, and provides other financial services. Commercial banks vary greatly in size, from the "money center" banks located in the nation's financial centers

to smaller regional and local community banks. As a result of consolidations, small banks are decreasing in number. There are approximately 3,900 commercial banks in the United States, accounting for $24.5 trillion in assets.[10] Banks hold a variety of assets, as shown in the diagram in **Exhibit 15.6**.

Table 15.4 lists the top 10 insured U.S.-chartered commercial banks, based on their consolidated assets.

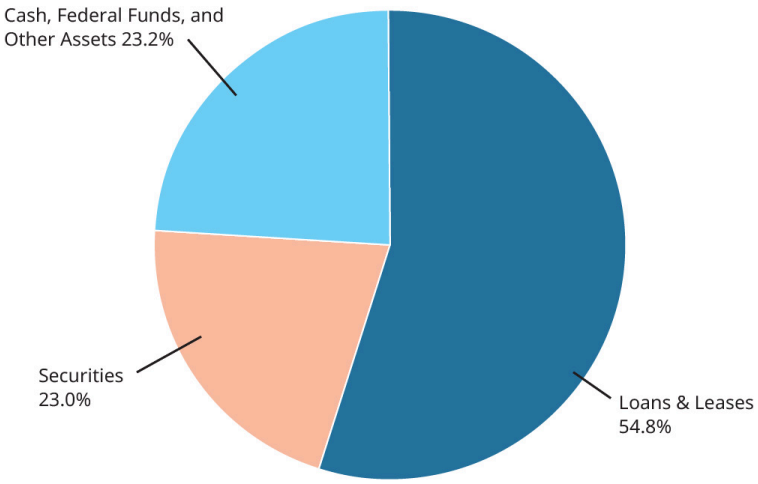

Exhibit 15.6 Assets of FDIC-Insured Commercial Banks, 2026 Source: "Assets and Liabilities of Commercial Banks in the United States - H.8," https://www.federalreserve.gov, accessed February 16, 2026.

Customers' deposits are a commercial bank's major source of funds, the main use for which is loans. The difference between the interest the bank earns on loans and the interest it pays on deposits, plus fees it earns from other financial services, pays the bank's costs and provides a profit.

Commercial banks are corporations owned and operated by individuals or other corporations. They can be either national or state banks, and to do business, they must get a **bank charter**—an operating license—from a state or federal government. *National banks* are chartered by the Comptroller of the Currency, who is part of the U.S. Treasury Department. These banks must belong to the Federal Reserve System and must carry insurance on their deposits from the Federal Deposit Insurance Corporation. *State banks* are chartered by the state in which they are based. Generally, state banks are smaller than national banks, are less closely regulated than national banks, and are not required to belong to the Federal Reserve System.

Thrift Institutions

A **thrift institution** is a depository institution formed specifically to encourage household saving and to make home mortgage loans. Thrift institutions include *savings and loan associations (S&Ls)* and *savings banks.* S&Ls keep large percentages of their assets in home mortgages. Compared with S&Ls, savings banks focus less on mortgage loans and more on stock and bond investments. Thrifts are declining in number. At their peak in the late 1960s, there were more than 4,800. But a combination of factors, including sharp increases in interest rates in the late 1970s and increased loan defaults during the recession of the early 1980s, has reduced their ranks significantly. In 2020, due to acquisitions by or conversions to commercial banks or other savings banks, the number of thrifts had fallen to just over 600.[11]

Top Ten Insured U.S.-Chartered Commercial Banks, Based on Total Assets, 2026	
Bank	**Assets**
JPMorgan Chase Bank	$3,813,431,000
Bank of America	$2,651,090,000
Citibank	$1,844,189,000
Wells Fargo Bank	$1,767,105,000
U.S. Bank	$679,293,260
Capital One	$652,138,082
Goldman Sachs Bank	$644,020,000
PNC Bank	$563,953,196
Truist Bank	$535,540,000
The Bank of New York Mellon	$366,502,000

Table 15.4 Sources: "BankFind Suite: Financial/Regulatory Search & Reporting," https://banks.data.fdic.gov, accessed February 16, 2026; "Largest U.S. Banks by Asset Size (2025)," *MX Blog*, https://www.mx.com, July 30, 2025.

CUSTOMER SATISFACTION AND QUALITY

Rating Banks: Mobile and Branch Banking a Must

Which banks provide the best customer satisfaction? J.D. Power (JDP), based in Costa Mesa, California, ranked nine national banks in the United States based on responses from more than 11,500 retail banking customers. In the research company's 2025 study, top performers received high ratings in trust, people, account offerings, allowing customers to bank how and when they want, saving time and money, digital channels, and resolving problems or complaints.

While specific banks took the top spots in various areas of the country, the overall customer sentiment in the JDP survey was clear: consumers wants banks that offer a digital experience and, as needed, personal interaction at a local branch. Findings also suggest that banks that provide a user-friendly digital experience will have higher customer satisfaction. This is especially important as customers utilize the full range of banking services such as mortgages and wealth management products. Other key survey findings include:

- Overall satisfaction increased 8 points over 2024's score
- Credit unions scored on average 74 points higher on satisfaction than banks
- Customers better understand the fees assessed, with one-third of credit union customers under 40 years of age indicating they are going to close their accounts because of fees
- Customers indicated more confidence in banks supporting them during hard times

- Fraud, debit cards, and interest earned on deposits were noted as areas of improvement.

Assessing customer satisfaction is also the goal of the American Customer Satisfaction Index (ACSI), which granted Bank of America the top spot in the national bank category in its 2025 survey, with a 1 percent decline in its overall score. Other top super regional banks in the ACSI study include Regions Bank, TD Bank, PNC Bank, and Capital One. Overall, national banks' customer service experience declined 1 percent from ACSI's previous survey.

Sources: "U.S. National Banking Satisfaction Study," https://www.jdpower.com, accessed February 16, 2026; Matthew Goldberg, "J.D. Power Study: Customer Satisfaction Increasing at Banks but More So at Credit Unions," *Bankrate*, https://www.bankrate.com, April 28, 2025; "Keep Pace with Digitally Engaged Customers through Meaningful Metrics," https://theacsi.org, accessed February 16, 2026.

Critical Thinking Questions

1. What can banks and financial institutions do to retain their customers and make them feel valued?
2. Is there a cost involved in not making customer service a priority? Explain your answer.

Credit Unions

A **credit union** is a not-for-profit, member-owned financial cooperative. Credit union members typically have something in common: they may, for example, work for the same employer, belong to the same union or professional group, or attend the same church or school. The credit union pools their assets, or savings, in order to make loans and offer other services to members. The not-for-profit status of credit unions makes them tax-exempt, so they can pay good interest rates on deposits and offer loans at favorable interest rates. Like banks, credit unions can have either a state or federal charter.

The approximately 4,300 credit unions in the United States have more than 143 million members and over $2.3 trillion in assets. The five largest credit unions in the United States are shown in **Table 15.5**. Although the U.S. credit union system remained strong during the 2007–2009 financial crisis, consumer-owned credit unions in several regions weakened as a result of home foreclosures, business failures, and unemployment rates. Today, the credit union system demonstrates resilience because of its member-oriented structure and greater stability with lower risk.[12]

Services Offered

Commercial banks, thrift institutions, and credit unions offer a wide range of financial services for businesses and consumers. Typical services offered by depository financial institutions are listed in **Table 15.6**. Some financial institutions specialize in providing financial services to a particular type of customer, such as consumer banking services or business banking services.

MANAGING CHANGE

Banks Take on P2P Payments

Person-to-person (P2P) payment systems are big business, and U.S. banks are now working together to compete in this billion-dollar industry. P2P transfers made through apps such as Venmo, PayPal, Cash App, and others globally accounted for nearly $6 billion in 2023 with expected growth to over $30 billion by 2032.

The simplicity of P2P apps has made them a part of everyday life for millions, especially millennials and young adults who use their smartphones for many daily activities. Venmo, for example, requires a phone number and a bank account or debit card. You must also be at least 18 years of age and be located in the

United States. Social media sites also encourage their members to transfer money via mobile apps, such as Google Wallet and Facebook Messenger.

Banks have been successful allowing their own customers to transfer money via apps; however, P2P transfers have been limited to other customers of the same bank—until now. More than 1,600 financial institutions utilize Zelle, which can be used to transfer funds to customers across these banking institutions. Over 80 percent of people in the United States can connect to Zelle via their bank's app.

A downside of using Venmo is that it may take a day or two for money to arrive in a recipient's account because the money flows through an intermediary; however, for a fee, you can get the funds instantly. With Zelle, for enrolled users, the transfer of money between two accounts will occur within minutes. Typically, customers using Zelle through their banks are not charged a fee to accept or send money.

Is a cashless society imminent now that major banks have gotten on board with P2P payments? Probably not, but the Consumer Financial Protection Bureau has put rules in place to protect customers. As of the end of 2024, P2P systems will be supervised in the same way that banks and credit unions are. This oversight includes document reviews and employee interviews to make sure they are maintaining consumer privacy and protecting against fraudulent activities.

Critical Thinking Questions

1. Does working together on a P2P system help banks stay competitive? Explain your reasoning.
2. Do you think P2P payment systems will eventually eliminate the use of cash in our society? Why or why not?

Sources: "Sending & Requesting Money," https://help.venmo.com, accessed February 16, 2026; "Peer to Peer Lending Market Size, Share & Segmentation By Type, By Loan Type, By Purpose Type, By End-User, By Region and Global Forecast 2024-2032," *S&S Insider*, https://www.snsinsider.com, November 2024, p. 125; Adriana Nunez, "Zelle Carries Momentum Thanks to Network and Capability Expansions," *EMarketer*, https://www.emarketer.com, September 9, 2022; "Zelle® Help Center," https://www.zelle.com, accessed February 16, 2026; Diccon Hyatt, "CFPB Will Treat Payment Apps Like Banks," *Investopedia*, https://www.investopedia.com, November 21, 2024.

Five Largest U.S. Credit Unions
1. Navy Federal Credit Union, Vienna, Virginia
2. State Employees Credit Union, Raleigh, North Carolina
3. Schoolfirst Federal Credit Union, Santa Ana, California
4. PenFed Credit Union, Alexandria, Virginia
5. Boeing Employees Credit Union, Tukwila, Washington

Table 15.5 Source: Sebastian Oliveira, "20 Largest Credit Unions in America," *U.S. News & World Report*, https://www.usnews.com, October 23, 2025.

Nondepository Financial Institutions

Some financial institutions provide certain banking services but do not accept deposits. These nondepository financial institutions include insurance companies, pension funds, brokerage firms, and finance companies. They serve both individuals and businesses.

Insurance Companies

Insurance companies are major suppliers of funds. Policyholders make payments (called *premiums*) to buy financial protection from the insurance company. Insurance companies invest the premiums in stocks, bonds, real estate, business loans, and real estate loans for large projects.

Exhibit 15.7 Insurance companies, hurt by billions of dollars in unforeseen payouts during natural disasters such as Hurricane Milton in 2024, are rethinking their reliance on catastrophe-risk modelers, whose risk estimates failed to anticipate cataclysmic storms such as tornadoes, tropical storms, blizzards, and other weather-related events. Cat-risk businesses forecast potential weather-related expenses for insurers through sophisticated computer modeling that analyzes historical meteorological data. *How do frequent natural disasters affect insurance companies and their policyholders?* (Credit: Cayobo/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Services Offered by Depository Financial Institutions	
Service	**Description**
Savings accounts	Deposits gain interest, and it is expected that the money will remain in the account for some time
Checking accounts	Transactional accounts where depositors can deposit or withdraw funds at any time up to the amount in the account
Money market deposit accounts	Accounts that have features of both a savings and checking account with higher interest rates based on market rates
Certificates of deposit (CD)	Similar to savings accounts, but pay a fixed interest rate over a certain time period during which you cannot withdraw the funds
Consumer loans	Loans to individuals to finance purchases such as homes or cars
Business loans	Loans to businesses or organizations to finance their operations

Table 15.6

Services Offered by Depository Financial Institutions	
Service	**Description**
Electronic funds transfer	Use of computers and mobile devices to conduct financial transactions
Automated teller machine (ATM)	Self-service kiosk where customers can conduct a variety of transactions including withdraws and deposits
Debit cards	Electronic transfer of funds from a checking or savings account to be used for purchases
Online banking	Allows customers to conduct financial transactions online or via a mobile app
Mobile apps	Technology that allows consumers to download programs to mobile devices that enable them to take care of banking, financial, and other transactions
Direct deposit of paychecks	Enabled through employers and payroll service vendors; allows financial institutions to accept direct deposits of payroll checks to consumers' checking and/or savings accounts on a regular basis

Table 15.6

Pension Funds

Corporations, unions, and governments set aside large pools of money for later use in paying retirement benefits to their employees or members. These **pension funds** are managed by the employers or unions themselves or by outside managers, such as life insurance firms, commercial banks, and private investment firms. Pension plan members receive a specified monthly payment when they reach a given age. After setting aside enough money to pay near-term benefits, pension funds invest the rest in business loans, stocks, bonds, or real estate. They often invest large sums in the stock of the employer. U.S. pension fund assets total nearly $30 trillion.[13]

Brokerage Firms

A *brokerage firm* buys and sells securities (stocks and bonds) for its clients and gives them related advice. Many brokerage firms offer some banking services. They may offer clients a combined checking and savings account with a high interest rate and also make loans, backed by securities, to them.

Finance Companies

A *finance company* makes short-term loans for which the borrower puts up tangible assets (such as an automobile, inventory, machinery, or property) as security. Finance companies often make loans to individuals or businesses that cannot get credit elsewhere. Promising new businesses with no track record and firms that can't get more credit from a bank often obtain loans from *commercial finance companies. Consumer finance companies* make loans to individuals, often to cover the lease or purchase of large consumer goods such as automobiles or major household appliances. To compensate for the extra risk, finance companies usually charge higher interest rates than banks.

CONCEPT CHECK

1. What is the financial intermediation process?
2. Differentiate between the three types of depository financial institutions and the services they offer.
3. What are the four main types of nondepository financial institutions?

15.4 Insuring Bank Deposits

4. How does the Federal Deposit Insurance Corporation (FDIC) protect depositors' funds?

The U.S. banking system worked fairly well from when the Federal Reserve System was established in 1913 until the stock market crash of 1929 and the Great Depression that followed. Business failures caused by these events resulted in major cash shortages as people rushed to withdraw their money from banks. Many cash-starved banks failed because the Federal Reserve did not, as expected, lend money to them. The government's efforts to prevent bank failures were ineffective. Over the next two years, 5,000 banks—about 20 percent of the total number—failed.

President Franklin D. Roosevelt made strengthening the banking system his first priority. After taking office in 1933, Roosevelt declared a bank holiday, closing all banks for a week so he could take corrective action. Congress passed the Banking Act of 1933, which empowered the Federal Reserve System to regulate banks and reform the banking system. The act's most important provision was the creation of the **Federal Deposit Insurance Corporation (FDIC)** to insure deposits in commercial banks. The 1933 act also gave the Federal Reserve authority to set reserve requirements, ban interest on demand deposits, regulate the interest rates on time deposits, and prohibit banks from investing in specified types of securities. In 1934 the Federal Savings and Loan Insurance Corporation (FSLIC) was formed to insure deposits at S&Ls. When the FSLIC went bankrupt in the 1980s, the FDIC took over responsibility for administering the fund that insures deposits at thrift institutions.

Today, the major deposit insurance funds include the following:

- *The Deposit Insurance Fund (DIF):* Administered by the FDIC, this fund provides deposit insurance to commercial banks and thrift institutions.
- *The National Credit Union Share Insurance Fund:* Administered by the National Credit Union Administration, this fund provides deposit insurance to credit unions.

Role of the FDIC

The FDIC is an independent, quasi-public corporation backed by the full faith and credit of the U.S. government. It examines and supervises over 4,300 banks and savings banks, more than half the institutions in the banking system. It insures trillions of dollars of deposits in U.S. banks and thrift institutions against loss if the financial institution fails.[14] The FDIC insures all member banks in the Federal Reserve System. The ceiling on insured deposits is $250,000 per account. Each insured bank pays the insurance premiums, which are a fixed percentage of the bank's domestic deposits. In 1993, the FDIC switched from a flat rate for deposit insurance to a risk-based premium system because of the large number of bank and thrift failures during the 1980s and early 1990s. Some experts argue that certain banks take too much risk because they view deposit insurance as a safety net for their depositors—a view many believe contributed to earlier bank failures.

Enforcement by the FDIC

To ensure that banks operate fairly and profitably, the FDIC sets guidelines for banks and then reviews the financial records and management practices of member banks at least once a year. Bank examiners perform

these reviews during unannounced visits, rating banks on their compliance with banking regulations—for example, the Equal Credit Opportunity Act, which states that a bank cannot refuse to lend money to people because of their color, religion, or national origin. Examiners also rate a bank's overall financial condition, focusing on loan quality, management practices, earnings, liquidity, and whether the bank has enough capital (equity) to safely support its activities.

When bank examiners conclude that a bank has serious financial problems, the FDIC can take several actions. It can lend money to the bank, recommend that the bank merge with a stronger bank, require the bank to use new management practices or replace its managers, buy loans from the bank, or provide extra equity capital to the bank. The FDIC may even cover all deposits at a troubled bank, including those over $250,000, to restore the public's confidence in the financial system.

CONCEPT CHECK

1. What is the FDIC, and what are its responsibilities?
2. What are the major deposit insurance funds?
3. What can the FDIC do to help financially troubled banks?

15.5 International Banking

5. What roles do U.S. banks play in the international marketplace?

The financial marketplace spans the globe, with money routinely flowing across international borders. U.S. banks play an important role in global business by providing loans to foreign governments and businesses. Multinational corporations need many special banking services, such as foreign-currency exchange and funding for overseas investments. U.S. banks also offer trade-related services, such as global cash management, that help firms manage their cash flows, improve their payment efficiency, and reduce their exposure to operational risks. Sometimes consumers in other nations have a need for banking services that banks in their own countries don't provide. Therefore, large banks often look beyond their national borders for profitable banking opportunities.

Many U.S. banks have offices across the world. They can have additional services and access to more sources of funding. Citibank, for example, was the first bank to enter the existing Japanese ATM network, providing direct competition to the domestic Japanese banks.

For U.S. banks, expanding internationally can be difficult. Banks in other nations might be subject to fewer regulations than U.S. banks, making it easier for them to undercut American banks on the pricing of loans and services. Some governments also protect their banks against foreign competition. For example, China imposes higher fees and may limit the amount of deposits that foreign banks can accept from customers. Interest rates also vary to place some restrictions on borrowing from foreign banks. [15]

International banks operating within the United States also have a substantial impact on the economy through job creation (they employ over 200,000 U.S. citizens as of 2024), operating and capital expenditures, taxes, and other contributions. According to December 2025 Federal Reserve data, the combined banking and non-banking assets of the U.S. operations of foreign banks total more than $3.3 trillion.[16]

The World's Biggest Banks, 2026
Industrial and Commercial Bank of China
China Agricultural Bank
China Construction Bank
Bank of China
JPMorgan Chase (USA)
Bank of America Corp. (USA)
HSBC (UK)
BNP Paribas (France)
Crédit Agricole (France)
Mitsubishi UFJ Financial Group (Japan)

Table 15.7 Source: Adrian Jimenea, John Wu, Harry Terris, Yuvraj Singh, and Cheska Lozano, "The World's Largest Banks by Assets, 2025," *S&P Global*, https://www.spglobal.com, April 15, 2025.

The United States has two banks listed in the top 10 world's biggest banks, as shown in **Table 15.7**.

Political and economic uncertainty in other countries can make international banking a high-risk venture. European and Asian banks were not immune to the financial crisis of 2007–2009. In fact, several countries, including Greece, Portugal, Spain, and Ireland, have rebounded from the near-collapse of their economic and financial systems they experienced at that time. Financial bailouts spearheaded by the European Union and the International Monetary Fund have helped stabilize the European and global economy. The impact of "Brexit," with the United Kingdom leaving the European Union, affected international banking. Many overseas banks were based in London and utilized the benefits of being part of the EU to have access to the other 27 member countries. With the UK leaving the EU, new authorizations to conduct business in those countries was required. This impacts their businesses today as they try to navigate the additional compliance issues.[17]

CONCEPT CHECK

1. What is the role of U.S. banks in international banking?
2. What challenges do U.S. banks face in foreign markets?

15.6 Trends in Financial Institutions

6. What trends are reshaping financial institutions?

What factors will influence financial institutions in the coming years? The latest reports suggest there will be a

continued focus on regulatory and compliance issues (especially after financial crisis of the Great Recession), as well as on operational efficiency and technological advances.

Banks will continue to tackle customer engagement and technology initiatives over the next few years. According to a 2025 report by Evolution Partners, a global consultant firm that forecasts banking trends, technology continues to empower consumers to control their banking experiences. Additionally, the inclusion of AI and cybersecurity concerns are at the forefront in the coming years. The term "responsive resilience" is identified as a key trend as financial institutions navigate the opportunities and challenges of new technologies and ever-changing regulations.[18]

Financial technology (or “fintech” services) will continue to disrupt the banking industry and provide opportunities for banks and other institutions to work closely with fintech companies that can help them innovate and streamline their business practices. Data indicate that fintech firms are estimated to reach $1.5 trillion in revenues by 2030, which represents 25 percent of banking across the globe. Services offered by fintech firms include digital payments, P2P lending, online money transfers, and personal finance management.[19]

Mobile financial apps will continue to be a strategic advantage that separates traditional banking approaches from innovative companies that can offer their clients a connected, digital experience when it comes to their money and investments. Consumers will expect personalization of bank products and services as part of their routine interaction with financial institutions. Otherwise, they will look elsewhere for a competitive platform to meet all of their financial and banking needs.[20]

Many banks continue to offer local branch offices, but online and mobile services will continue to grow in popularity. Most banking institutions offer apps that give customers the convenience of moving money between accounts and mobile check deposits that expedite when money is available in their account. In addition, online payment platforms such as PayPal, Cash App, Square, and Venmo continue to make both personal and business transactions seamless. Customers expect access to banking needs to be quick, efficient, and readily accessible when needed.[21]

Exhibit 15.8 Online payment platforms such as Square and others continue to make personal and business transactions seamless and efficient. *How can companies continue to leverage technology to make financial transactions as easy as tapping your phone or debit card?* (Credit: "mybloodtypeiscoffee"/ Flickr/ Attribution 4.0 International (CC BY 4.0))

MANAGING CHANGE

Chatbots Help Banks Connect with Customers

Computer software using artificial intelligence (AI) to simulate conversation with humans, chatbots have become an integral part of the banking industry’s push to connect with customers while keeping operations and costs in line. They can be an effective tool in what banks call “conversational commerce”—interacting with customers via messaging and digital platforms.

Typically banks engage their customers through various channels, including human channels (in-person transactions or service calls with a live agent) and digital channels (websites, mobile apps, e-mail, and online ads). Although customers may have a favorite way to interact with their bank, these channels can cost banks a substantial amount of money, and financial institutions are constantly looking for ways to reduce costs while maintaining quality customer service.

It is not surprising that in-person transactions are the most expensive service provided by banks; however, not every transaction with a customer requires human intervention. As technology continues to evolve, more banks have figured out they can leverage their services to fit the everyday activities of their tech-savvy customers by using chatbots as the next step in customer service.

For example, as mentioned in the opening feature in this module, Bank of America introduced Erica, a voice- and text-enabled chatbot that helps customers make smarter banking decisions. Erica sends customers notifications, points out areas where they can save money, updates credit ratings, and can help facilitate bill payments within the bank's mobile app.

Capital One, another player in the U.S. banking industry, launched Eno, a text-enabled chatbot that helps customers manage their money via smartphone. Customers can ask Eno questions about account balances, credit history, recent transactions, payment history, etc. via text messaging. Eno is the second virtual assistant created by Capital One; it already has in place Alex Skill which allows customers to conduct their banking business through voice in conversations with Alexa.

AI chatbots provide benefits to both banks and customers. Banks are using them to streamline operations, automate customer support, and provide a convenient and positive customer experience. Customers rely on this type of digital assistant to make their lives easier and keep them current on personal and business transactions without having to wait on hold for a person to respond to questions that can easily be answered by chatbots. A report by Deloitte in 2025 found that 63 percent of customers have interacted with banking chatbots. The data collected indicate that more than half of the usage was for technical support (60 percent) and inquiries about their accounts (53 percent). A large majority, nearly three-quarters of customers, prefer human interaction, even for routine transactions. With nearly 4 billion users of mobile banking worldwide, chatbots can be an effective tool to help banks become more efficient, more proactive in anticipating customer needs, and more sensitive to their bottom line.

Critical Thinking Questions

1. Do you think chatbots will eventually replace customer service representatives at U.S. banks? Explain your reasoning.
2. What are some advantages and disadvantages of using a digital assistant as part of your banking routine?

Sources: Yue Cathy Chang and Cindi Thompson, "Chatbots in Banking," *Silicon Valley Data Science,* https://svds.com, accessed September 11, 2017; Maruti Techlabs, "Banking Chatbots," https://chatbotmagazine.com, accessed September 11, 2017; Blake Morgan, "5 Ways Chatbots Can Improve Customer Experience in Banking," *Forbes,* https://www.forbes.com, August 6, 2017; Elizabeth Mills, "How 10 Big Banks Are Using Chatbots to Boost Their Business," https://www.abe.ai, March 13, 2017; Kristin Korzekwa, Val Srinivas, and Shivalik Srivastav, "AI Banking Chatbots: From Frustration to Delight," *The Wall Street Journal*, https://deloitte.wsj.com, August 19, 2025; Joseph D'Souza, "Mobile Banking Statistics and Facts (2025)," *Sci-Tech Today*, https://www.sci-tech-today.com, November 28, 2025.

CONCEPT CHECK

1. How will fintech services enhance the overall banking experience?
2. What challenges do banks face when it comes to offering local branch services to customers?

Key Terms

bank charter An operating license issued to a bank by the federal government or a state government; required for a commercial bank to do business.
commercial banks Profit-oriented financial institutions that accept deposits, make business and consumer loans, invest in government and corporate securities, and provide other financial services.
credit unions Not-for-profit, member-owned financial cooperatives.
currency Cash held in the form of coins and paper money.
demand deposits Money kept in accounts that can be withdrawn by depositors on demand.
discount rate The interest rate that the Federal Reserve charges its member banks.
Federal Deposit Insurance Corporation (FDIC) An independent, quasi-public corporation backed by the full faith and credit of the U.S. government that insures deposits in commercial banks and thrift institutions for up to a ceiling of $250,000 per account.
Federal Reserve System (Fed) The central bank of the United States; consists of 12 district banks, each located in a major U.S. city.
financial intermediation The process in which financial institutions act as intermediaries between the suppliers and demanders of funds.
M1 The total amount of readily available money in the system; includes currency and demand deposits.
M2 A term used by economists to describe the U.S. monetary supply. Includes all M1 monies plus time deposits and other money that is not immediately accessible.
money Anything that is acceptable as payment for goods and services.
open market operations The purchase or sale of U.S. government bonds by the Federal Reserve to stimulate or slow down the economy.
pension funds Large pools of money set aside by corporations, unions, and governments for later use in paying retirement benefits to their employees or members.
reserve requirement Requires banks that are members of the Federal Reserve System to hold some of their deposits in cash in their vaults or in an account at a district bank.
selective credit controls The power of the Federal Reserve to control consumer credit rules and margin requirements.
thrift institutions Depository institutions formed specifically to encourage household saving and to make home mortgage loans.
time deposits Deposits at a bank or other financial institution that pay interest but cannot be withdrawn on demand.

Summary of Learning Outcomes

15.1 Show Me the Money

1. What is money, what are its characteristics and functions, and what are the three parts of the U.S. money supply?

Money is anything accepted as payment for goods and services. For money to be a suitable means of exchange, it should be scarce, durable, portable, and divisible. Money functions as a medium of exchange, a standard of value, and a store of value. The U.S. money supply consists of currency (coins and paper money), demand deposits (checking accounts), and time deposits (interest-bearing deposits that cannot be withdrawn on demand).

15.2 The Federal Reserve System

2. How does the Federal Reserve manage the money supply?

The Federal Reserve System (the Fed) is an independent government agency that performs four main functions: carrying out monetary policy, setting rules on credit, and managing the money supply. The three

tools it uses in managing the money supply are open market operations, reserve requirements, and the discount rate. The Fed played a major role in keeping the U.S. financial system solvent during the Great Recession and during the COVID-19 pandemic. Through loans, bailouts, legislation, and interest rate adjustments, the Federal Reserve works to bring stability to the economy through the financial system.

15.3 U.S. Financial Institutions

3. What are the key financial institutions, and what role do they play in the process of financial intermediation?

Financial institutions can be divided into two main groups: depository institutions and nondepository institutions. Depository institutions include commercial banks, thrift institutions, and credit unions. Nondepository institutions include insurance companies, pension funds, brokerage firms, and finance companies. Financial institutions ease the transfer of funds between suppliers and demanders of funds.

15.4 Insuring Bank Deposits

4. How does the Federal Deposit Insurance Corporation (FDIC) protect depositors' funds?

The Federal Deposit Insurance Corporation insures deposits in commercial banks through the Bank Insurance Fund and deposits in thrift institutions through the Savings Association Insurance Fund. Deposits in credit unions are insured by the National Credit Union Share Insurance Fund, which is administered by the National Credit Union Administration. The FDIC sets banking policies and practices and reviews banks annually to ensure that they operate fairly and profitably.

15.5 International Banking

5. What role do U.S. banks play in the international marketplace?

U.S. banks provide loans and trade-related services to foreign governments and businesses. They also offer specialized services such as cash management and foreign-currency exchange.

15.6 Trends in Financial Institutions

6. What trends are reshaping financial institutions?

There will be a continued focus on regulatory and compliance issues, especially as technology plays a larger role in the industry and cybersecurity concerns come to the forefront. Banks will continue to tackle customer engagement and technology initiatives, as consumers will demand more accessibility and convenience with their relationships with banks and other financial institutions. Fintech services and their continued innovation streamline banking operations. Mobile apps are evolving to give a more personalized experience and enable firms to collect and utilize customer data to enhance their services to customers. Finally, online payment platforms continue to grow and are an integral player in the banking and financial sector, as consumers' expectations drive innovation in the industry.

Preparing for Tomorrow's Workplace Skills

1. How much does a bank account cost? Call or visit websites of several local banks and weigh fees and services. Take into consideration how you will use your account, how many transactions a month you will have, and the average balance you expect to keep. On the internet, BankRate.com (**https://www.bankrate.com**) lets you digitally compare bank products, including those banking institutions that are strictly internet-based. Could you pay lower fees elsewhere? Could you earn interest on your checking account at a credit union? Would you be better off paying a monthly fee with unlimited check-writing privileges? Crunch the numbers to find the best deal. (Resources, Information)
2. You are starting a small business selling collectible books over the internet and need to establish a business banking account that will provide the following services: business checking, credit-card processing, a business savings account, and perhaps a line of credit. Research at least three banks,

including an online-only bank, to gather information about their business banking services, including data about fees, service options, and other features of interest to entrepreneurs. Write a short summary of each bank's offerings and benefits and make a recommendation about which bank you would choose for your new business. (Interpersonal, Information)

3. If you watch the news, you've undoubtedly heard mention that the Fed is going to raise or lower interest rates. What exactly does this mean? Explain how the Fed's decision to raise and lower its discount rate might affect (a) a large manufacturer of household appliances, (b) a mid-sized software firm, (c) a small restaurant, (d) a family hoping to purchase their first home, and (e) a college student. (Information)
4. Research the banking system of another country, and write a report on your findings by answering these questions: Is there a central banking system similar to the U.S. Federal Reserve System in place? Which government agency or department controls it, and how does it operate? How stable is the country's central banking system? How does it compare in structure and operation to the Federal Reserve System? How much control does the government have over banks operating in the country? Are there any barriers to entry specifically facing foreign banks? What would this mean to a foreign business attempting to do business in this country? (Information)
5. Banks use databases to identify profitable and unprofitable customers. Data indicate that banks will lose money on customers with balances under $1,000 and those that frequently utilize banking services. The more profitable customers are those that keep several thousand dollars in their accounts and have limited usage of banking services. To turn unprofitable customers into profitable ones, banks assess fees on many of their services, but some of the fees are reduced or waived for customers who maintain high account balances. Bankers justify the fees by saying they're in business to earn a profit. Discuss whether banks are justified in treating profitable and unprofitable customers differently. Defend your answers. (Information, Systems)
6. **Team Activity** During its regular meetings, the Federal Open Market Committee, the Federal Reserve's monetary policy-making body, considers a number of economic indicators and reports before making decisions. The decisions made by the Fed include whether to sell or purchase Federal treasury bonds, whether to raise or lower interest rates, and whether to raise or lower the Federal Reserve discount rate. Divide your class into groups (if possible, try to use seven members, the size of the FOMC), and assign each group one of these decisions. As a group, identify the types of information used by the Fed in making their assigned decision and how that information is used. Find the most current information (sources may include news sites, business publications, online databases, etc.) and analyze it. Based on this information and your group's analysis, what should the Fed do now? Present your findings and recommendations to the class. (Interpersonal, Information)

Ethics Activity

You are a loan officer with a financial company that specializes in auto loans. The senior vice president in charge of your area sets new loan quotas for your group and suggests that courting more subprime borrowers would make the new quotas easier to meet. They remind you that the company can justifiably charge higher interest rates, loan fees, and servicing costs for these higher-risk loans. They also point out that the loans will earn you and your team larger commissions as well. "Everyone wins," they tell you. "We help people who might otherwise not be able to get the financing they need, the company makes money, and so do you."

But you are uneasy about the company's focus on subprime borrowers, low-income applicants with weak or limited credit histories, many of whom are also minorities. You suspect the company's tactics could be considered "predatory lending" or "reverse redlining." You are also convinced that the cost of the company's subprime loans aren't tied to the increased risk factor at all, but to how much profit the company can squeeze from a group of unsophisticated borrowers with few other options.

Using a web search tool, locate articles about the topic of subprime auto loans, and then write responses to

the following question. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Should you seek out subprime loans, knowing that you will have to charge borrowers the high fees your company demands, while believing they may not be totally justified?

Sources: Adam Tempkin, "'Deep' Subprime Car Loans Hit Crisis-Era Milestone," *Bloomberg Markets,* https://www.bloomberg.com, August 15, 2017; Shannara Johnson, "Subprime Auto Loans Up, Car Sales Down: Why This Could Be Good for Gold," *Forbes,* https://www.forbes.com, July 13, 2017; Mark Huffman, "Santander Settles Subprime Auto Loan Suit with Massachusetts," *Consumer Affairs,* https://www.consumeraffairs.com, March 31, 2017; Michael Corkery and Jessica Silver-Greenberg, "Prosecutors Scrutinize Minority Borrowers' Auto Loans," *The New York Times,* https://www.nytimes.com, March 30, 2015.

Working the Net

1. Banking on a great career? Go to **https://www.careerbank.com** to explore what positions are available in banking, finance, and accounting. Make a presentation on the type of job you might choose and its location.
2. Visit the United Nations Office on Drugs and Crime (**https://www.unodc.org/cld/st/home.html**) for the latest information on what organizations are doing regarding transnational organized crime. Go to the Databases tab, then Education for Universities, to find information about organized crime and cybercrime and how they pertain to the banking industry. Summarize your findings.
3. Find out everything you want to know about financial institutions and banking careers from the latest edition of the Bureau of Labor Statistics' *Occupational Outlook Handbook.* Visit the OOH's website at **https://www.bls.gov/ooh**, and click on the A–Z Index to explore banking and other financial occupations, including the forecast for these careers in the coming decade. Explain why this information should be important to you.
4. Using an internet search engine, research information on digital banking branches used around the country by companies such as JPMorgan Chase. Make a presentation describing the merits of this trend to your class.
5. The 2016 Wells Fargo scandal in which bank employees created more than three million fake customer accounts as a result of pressure from their managers to meet sales quotas is one of the more well-known examples of ethics violations and fraudulent practices in the banking industry. Research what happened at Wells Fargo and how it has impacted their business today. Summarize your findings, and provide recommendations on what banking executives and employees could have done differently.
6. What are your rights to privacy when dealing with financial institutions? Use the internet to research the specific privacy provisions related to banking and financial services, and write a paper on how you can use this information to protect your privacy and financial identity.

Critical Thinking Case

Stripe Revolutionizes Digital Payments

Raised in Ireland, Patrick and John Collison were precocious, inquisitive youngsters who taught themselves computer coding at an early age. By the time they were teenagers, the brothers were developing iPhone apps and eventually became college dropouts after a few semesters at MIT (Patrick) and Harvard (John). During this time they started a company called Auctomatic Inc., which created an online marketplace management system for companies such as eBay, and then sold the company for $5 million in 2008.

After selling the business, they continued to work on simplifying the payment process for startup businesses that use the internet to sell goods and services. As the internet entered its second decade and more and more entrepreneurs were using the web to do business, the Collisons recognized that the payment transaction process for online purchases needed an overhaul. In 2011, they opened their new company, Stripe, after testing their service and building relationships with banks, credit card companies, and regulators, so clients

could focus their energies on building their businesses—and not building a payment infrastructure from scratch.

Using Stripe, businesses only need to add seven lines of coding to their websites to handle payments—a process that previously could have taken weeks to perfect. Word spread quickly among developers that the Collison brothers' simple coding architecture could indeed disrupt the payment processing industry. As more and more marketplace companies and other online services needed to divvy up payments between vendors and consumers, Stripe became the go-to company to figure out how to move money online quickly and to get people (and companies) paid. The company's engineers determined how to separate payments for some of the internet's startups such as Lyft, which needed consumers to pay for rides and drivers to be compensated quickly. Stripe engineers worked their magic to bypass typical banking protocol and linked payments to Lyft drivers via their debit cards, which allowed them to be paid promptly.

After over 25 years in business, Stripe is now the financial "back office" for more than 100,000 businesses that take mobile payments—some of them startups and some of them big businesses such as Amazon, Microsoft, BMW, and Toyota. The company charges a fee on credit card payments in exchange for its services. Although Stripe's sales data are confidential, the company has a valuation at over $100 billion and handled more than $1.4 trillion in payment volume processing in 2024.

With around 8,000 employees, Stripe continues to expand its product offerings in an effort to give customers and potential clients new tools they can use to help grow their business. For example, Radar, Stripe's fraud detection service, uses artificial intelligence to analyze payments on its extensive network to identify suspicious activity. By looking at such a large data set on its own network, Stripe can spot patterns better than a single company reviewing its own transactions. The company has rolled out another tool called Atlas, which can help a local or overseas startup incorporate, get a taxpayer ID number and U.S. bank account, and receive legal and tax advice on forming a company—for a fee of $500 and a few simple clicks. Typically this process would take months, many visits to the United States (if a foreign business), and large legal fees.

Stripe continues to disrupt the payment processing industry, and its Irish cofounders believe they have what it takes to continue building a simple internet infrastructure that will allow startups across the globe to do business and handle mobile payments efficiently—giving entrepreneurs more time to focus on growing successful businesses.

Critical Thinking Questions

1. Do you think Stripe's strategy of keeping things simple is a sound business plan? Explain your reasoning.
2. What impact do you think the company's Atlas product offering has on Stripe's global expansion?
3. Do you think Stripe's agility in working with so many different businesses provides the company with a competitive advantage over big banks and credit card companies? Justify your answer.

Sources: "About Us," https://stripe.com, accessed September 12, 2017; Matt Weinberger, "$9 Billion Stripe Has a Master Plan to Take Over the World—or at Least, Open It Up for Business," *Business Insider,* https://www.businessinsider.com, August 10, 2017; Ashlee Vance, "How Two Brothers Turned Seven Lines of Code into a $9.2 Billion Startup," *Bloomberg Businessweek,* https://www.businessweek.com, August 1, 2017; "Stripe CEO Patrick Collison on Recode Decode (Podcast transcript)," *Recode,* https://www.recode.net, June 13, 2017; Marguerite Ward, "Meet the 20-Something Stripe Founders Who Are Now Worth More Than $1 Billion Each," *CNBC,* https://www.cnbc.com, March 20, 2017; Rolfe Winkler and Telis Demos, "Stripe's Valuation Nearly Doubles to $9.2 Billion," *The Wall Street Journal,* https://www.wsj.com, November 25, 2016; Jacqueline Corba, "Stripe's Valuation Climbs to $91.5 Billion in Secondary Stock Offer," *CNBC*, https://www.cnbc.com, February 27, 2025; "Stripe Valuation Reaches Record $106 Billion," *PYMNTS*, https://www.pymnts.com, September 24, 2025; Jyoti Mann, "Leaked Memo: Stripe Lays Off 300 Employees, Mostly in Product, Engineering, and Operations," *Business Insider*, https://www.businessinsider.com, January 21, 2025; "Stripe Atlas," https://support.stripe.com, accessed February 16, 2026.

Hot Links Address Book

1. Tour the Museum of American Finance to learn the history of our nation's money at **https://www.moaf.org/exhibits/america_circulation**.
2. The website of the Federal Reserve Bank of St. Louis offers an easy-to-understand explanation of how the Federal Reserve System works, called "In Plain English": **https://www.stlouisfed.org/in-plain-english/**.
3. The FDIC gets so many requests about banks' insurance status that it added an option to determine "Is my account fully insured?" on its website. Visit **https://www.fdic.gov/resources/deposit-insurance/financial-products-insured**.
4. What goes on at a Federal Open Market Committee meeting? Find out by reading the minutes of the Committee's latest meeting at **https://www.federalreserve.gov/monetarypolicy/fomc.htm**.
5. Find out what other services the Federal Reserve provides to financial institutions at **https://www.frbservices.org**.
6. How did Abraham Lincoln do his banking? Take a cybertour of U.S. banking history by clicking on the About tab and going to the History section at **https://www.occ.treas.gov**.
7. To find out if you're eligible to join a credit union, visit the National Credit Union Administration's credit union locator at **https://mapping.ncua.gov**.

16

Understanding Financial Management and Securities Markets

Exhibit 16.1 (Credit: skys the limit2 / flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. How do finance and the financial manager affect a firm's overall strategy?
2. What types of short-term and long-term expenditures does a firm make?
3. What are the main sources and costs of unsecured and secured short-term financing?
4. What are the key differences between debt and equity, and what are the major types and features of long-term debt?
5. When and how do firms issue equity, and what are the costs?
6. How do securities markets help firms raise funding, and what securities trade in the capital markets?
7. Where can investors buy and sell securities, and how are securities markets regulated?
8. What are the current developments in financial management and the securities markets?

EXPLORING BUSINESS CAREERS

Vicki Saunders, Venture Capitalist & Entrepreneur

Many women dream of starting their own business. But this involves a large investment of time, dedication, creativity—and money. Even the best ideas fall flat without strong financial backing and fiscal management. Most start-ups don't have a chief financial officer, let alone an unlimited amount of cash to fund their owners' dreams.

According to recent reports, there are more than 14 million woman-owned businesses in the United States that employ over 12 million people and generate more than $2.7 trillion in revenues. And growth has increased for these businesses over man-owned businesses by nearly 60 percent between 2022 and 2023. Despite these impressive statistics, less than 4 percent of venture capital funding goes to this group of entrepreneurs. That's where Vicki Saunders and her venture capital start-up Coralus (formerly SheEO) come

into the picture.

Saunders, who describes herself as a serial entrepreneur, previously cofounded and ran four different business ventures. She believes that the funding universe for women entrepreneurs needs to be fixed and offers her plan via Coralus, a platform to enlist women "activators" to invest money to create a pool of capital distributed to select woman-owned businesses in the form of zero-percent-interest loans that are paid back within five years. The activators are more than just investors, however. Saunders envisions these women as being a crucial part of the businesses in which they invest, by providing operational support, resources for suppliers and other vendors, and a solid networking opportunity for everything from legal support to cultivating new customers. In a recent campaign called Radical Generosity, $1,000 was raised from each of 500 women, and that pool of $500,000 was split among five woman-led businesses.

In year three of the funding venture in 2017, Coralus funded 15 companies and invested $1.5 million. Coralus has funded entrepreneurs working on a variety of businesses, including artificial intelligence, hardware for people with disabilities, food, and education. Coralus currently operates in the United States, Australia, New Zealand, and the UK, and Saunders's goals for funding woman-led businesses are lofty. The company has distributed nearly $20 million to about 200 woman-led businesses. But her ultimate goal is to change the culture around how investors support businesses—all businesses. According to Saunders, activating women on behalf of other women will change the world.

Sources: Company website, "About Us," https://sheeo.world, accessed November 5, 2017; Emma Hinchliffe, "SheEO Has a Plan to Build a $1 Billion Fund for Female Founders," *Mashable,* https://mashable.com, October 24, 2017; Catherine McIntyre, "How Vicki Saunders Plans to Get a Million Women Involved in Venture Capital," *Canadian Business,* https://www.canadianbusiness.com, accessed October 24, 2017; Kimberly Weisul, "Venture Capital Is Broken. These Women Are Trying to Fix It," *Inc.,* https://www.inc.com, accessed October 24, 2017; Geri Stengel, "Women Become Financiers to Disrupt the Funding Landscape for Entrepreneurs," *Forbes,* https://www.forbes.com, October 18, 2017; Kathleen Chaykowski, "Meet the Top Women Investors in VC in 2017," *Forbes,* https://www.forbes.com, April 18, 2017; Jill Richmond, "Everything May Be Broken But This CEO's Glasses Are a Rose Hue," *Forbes,* https://www.forbes.com, December 16, 2016; "2024 Impact of Women-Owned Businesses," https://www.wippeducationinstitute.org, accessed February 18, 2026; Wells Fargo, "The 2024 Impact of Women-Owned Businesses," https://590304bc-30be-46aa-9413-98f54baa7cfa.filesusr.com/ugd/5cba3e_96b999d23fb04d8eb488192a179781d4.pdf, accessed February 18, 2026; Founders Forum Group, "Women in VC & Startup Funding: Statistics & Trends (2025 Report)," https://ff.co, May 23, 2025; "Venture Capital and Entrepreneurship," https://www.hks.harvard.edu, accessed February 18, 2026; "About Coralus," https://www.coralus.world, accessed February 18, 2026.

In today's fast-paced global economy, managing a firm's finances is more complex than ever. For financial managers, a thorough command of traditional finance activities—financial planning, investing money, and raising funds—is only part of the job. Financial managers are more than number crunchers. As part of the top management team, chief financial officers (CFOs) need a broad understanding of their firm's business and industry, as well as leadership ability and creativity. They must never lose sight of the primary goal of the financial manager: to maximize the value of the firm to its owners.

Financial management—spending and raising a firm's money—is both a science and an art. The science part is analyzing numbers and flows of cash through the firm. The art is answering questions such as these: Is the firm using its financial resources in the best way? Aside from costs, why choose a particular form of financing? How risky is each option? Another important concern for both business managers and investors is understanding the basics of securities markets and the securities traded on them, which affect both corporate plans and investor pocketbooks. About 62 percent of adult Americans now own stocks, compared to 52 percent in 2017 and only 25 percent in 1981.[1]

This chapter focuses on the financial management of a firm and the securities markets in which firms raise funds. We'll start with an overview of the role of finance and of the financial manager in the firm's overall business strategy. Discussions of short- and long-term uses of funds and investment decisions follow. Next, we'll examine key sources of short- and long-term financing. Then we'll review the function, operation, and regulation of securities markets. Finally, we'll look at key trends affecting financial management and securities markets.

16.1 The Role of Finance and the Financial Manager

1. How do finance and the financial manager affect the firm's overall strategy?

Any company, whether it's a small-town bakery or Whole Foods Market, needs money to operate. To make money, it must first spend money—on inventory and supplies, equipment and facilities, and employee wages and salaries. Therefore, finance is critical to the success of all companies. It may not be as visible as marketing or production, but management of a firm's finances is just as much a key to the firm's success.

Financial management—the art and science of managing a firm's money so that it can meet its goals—is not just the responsibility of the finance department. All business decisions have financial consequences. Managers in all departments must work closely with financial personnel. If you are a sales representative, for example, the company's credit and collection policies will affect your ability to make sales. The head of the IT department will need to justify any requests for new computer systems or employee laptops.

Revenues from sales of the firm's products should be the chief source of funding. But money from sales doesn't always come in when it's needed to pay the bills. Financial managers must track how money is flowing into and out of the firm (see **Exhibit 16.2**). They work with the firm's other department managers to determine how available funds will be used and how much money is needed. Then they choose the best sources to obtain the required funding.

For example, a financial manager will track day-to-day operational data such as cash collections and disbursements to ensure that the company has enough cash to meet its obligations. Over a longer time horizon, the manager will thoroughly study whether and when the company should open a new manufacturing facility. The manager will also suggest the most appropriate way to finance the project, raise the funds, and then monitor the project's implementation and operation.

Financial management is closely related to accounting. Many organizations will have an executive position such as the VP of finance or the chief financial officer that is responsible for the financial management of the firm. But the accountant's main function is to collect and present financial data. Financial managers use financial statements and other information prepared by accountants to make financial decisions. Financial managers focus on **cash flows**, the inflows and outflows of cash. They plan and monitor the firm's cash flows to ensure that cash is available when needed.

The Financial Manager's Responsibilities and Activities

Financial managers have a complex and challenging job. They analyze financial data prepared by accountants, monitor the firm's financial status, and prepare and implement financial plans. One day they may be developing a better way to automate cash collections, and the next they may be analyzing a proposed acquisition. The key activities of the financial manager are:

- *Financial planning*: Creating financial plans, including forecasting and budgeting.
- *Cost control*: Analyzing and monitoring costs and, when appropriate, implementing measures to cut costs.
- *Investing*: Using the firm's resources to fund projects, weighing the costs and risks versus the potential returns.
- *Financing*: Securing funding for the firm's operations and investments through the balance between debt (funds borrowed) and equity (funds raised through the sale of ownership in the business).

The Goal of the Financial Manager

How can financial managers make wise planning, investment, and financing decisions? The main goal of the financial manager is to maximize the value of the firm to its owners. The value of a publicly owned corporation is measured by the share price of its stock. A private company's value is the price at which it could be sold.

To maximize the firm's value, the financial manager has to consider both short- and long-term consequences of the firm's actions. Maximizing profits is one approach, but it should not be the only one. Such an approach favors making short-term gains over achieving long-term goals. What if a high-tech firm in a competitive industry, such as Panasonic, chose not to invest in research and the development of new products? In the short run, profits might be higher because the company was not investing in research and development, which can be expensive. But in the long run, the firm is likely to lose market share and competitiveness, and therefore profits, because of its lack of new products.

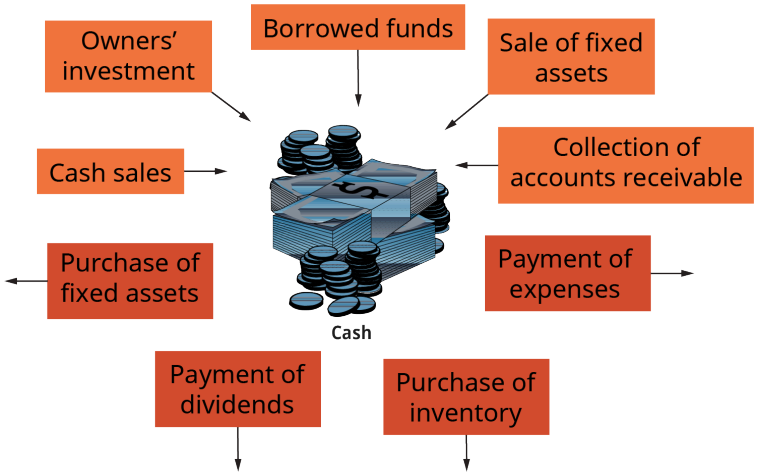

Exhibit 16.2 How Cash Flows through a Business (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

This is true regardless of a company's size or point in its life cycle. At Corning, a company founded almost 200 years ago, management believes in taking the long-term view and not managing for quarterly earnings to satisfy Wall Street's expectations. The company, once known to consumers mostly for kitchen products such as Corelle dinnerware and Pyrex heat-resistant glass cookware, is today a technology company that manufactures specialized glass and ceramic products. It is a leading supplier of Gorilla Glass, a special type of glass used for the screens of mobile devices, including popular Apple and Android products and other digital display panels. The company was also the inventor of optical fiber and cable for the telecommunications industry. These product lines require large investments during their long research and development (R&D) cycles and for plant and equipment once they go into production.[2]

This can be risky in the short term, but staying the course can pay off. In fact, Corning announced plans to develop a separate company division for Gorilla Glass, which now has more than 70 percent of the phone screen market—with over 8 billion devices sold. In addition, its fiber-optic cable business is thriving as providers such as Verizon have doubled down on upgrading the fiber-optic network across the United States. This growth is largely due to the increased 5G network and the construction of data centers. In early 2026, Corning entered into a multi-year agreement with Meta to facilitate their AI data center expansion. The company's revenues were up nearly 14 percent in 2025.[3]

As the Corning situation demonstrates, financial managers constantly strive for a balance between the opportunity for profit and the potential for loss. In finance, the opportunity for profit is termed **return**; the potential for loss, or the chance that an investment will not achieve the expected level of return, is **risk**. A basic principle in finance is that the higher the risk, the greater the return that is required. This widely accepted concept is called the **risk-return trade-off**. Financial managers consider many risk and return factors when making investment and financing decisions. Among them are changing patterns of market demand, interest

rates, general economic conditions, market conditions, and social issues (such as environmental effects and equal employment opportunity policies).

CONCEPT CHECK

1. What is the role of financial management in a firm?
2. How do the three key activities of the financial manager relate?
3. What is the main goal of the financial manager? How does the risk-return trade-off relate to the financial manager's main goal?

16.2 How Organizations Use Funds

2. What types of short-term and long-term expenditures does a firm make?

To grow and prosper, a firm must keep investing money in its operations. The financial manager decides how best to use the firm's money. Short-term expenses support the firm's day-to-day activities. For instance, athletic-apparel maker Nike regularly spends money to buy such raw materials as fabric and foams and to pay employee salaries. Long-term expenses are typically for fixed assets. For Nike, these would include outlays to build a new factory, buy automated manufacturing equipment, or acquire a small manufacturer of sports apparel.

Short-Term Expenses

Short-term expenses, often called operating expenses, are outlays used to support current production and selling activities. They typically result in current assets, which include cash and any other assets (accounts receivable and inventory) that can be converted to cash within a year. The financial manager's goal is to manage current assets so the firm has enough cash to pay its bills and to support its accounts receivable and inventory.

Cash Management: Assuring Liquidity

Cash is the lifeblood of business. Without it, a firm could not operate. An important duty of the financial manager is **cash management**, or making sure that enough cash is on hand to pay bills as they come due and to meet unexpected expenses.

Businesses estimate their cash requirements for a specific period. Many companies keep a minimum cash balance to cover unexpected expenses or changes in projected cash flows. The financial manager arranges loans to cover any shortfalls. If the size and timing of cash inflows closely match the size and timing of cash outflows, the company needs to keep only a small amount of cash on hand. A company whose sales and receipts are fairly predictable and regular throughout the year needs less cash than a company with a seasonal pattern of sales and receipts. A landscaping company, for instance, whose sales are concentrated in the spring and summer months, spends a great deal of cash during the fall and winter to build inventory of supplies and repair equipment. It has excess cash during the fall and winter when it collects on sales from its peak season.

Because cash held in checking accounts earns little, if any, interest, the financial manager tries to keep cash balances low and to invest the surplus cash. Surpluses are invested temporarily in **marketable securities**, short-term investments that are easily converted into cash. The financial manager looks for low-risk investments that offer high returns. Some of the most popular marketable securities are stocks, bonds, ETFs, and commercial paper. (**Commercial paper** is a promissory note—an IOU—a short-term debt to finance short-term needs issued typically by large corporations.) Today's financial managers have new tools to help them

find the best short-term investments, such as online trading platforms that save time and provide access to more types of investments. These have been especially useful for smaller companies who don't have large finance staffs.

Firms with operations overseas may have different and additional cash management challenges. Developing the systems for international cash management may sound simple in theory, but in practice it's extremely complex. In addition to exchange rate fluctuations when dealing with foreign currencies, other countries have different legal, banking, regulatory, and tax requirements that need to be considered. Financial and accounting procedures need to be tailored to the requirements in the country. Local managers need to be trained on the differences and how to facilitate cross-border compliance. Financial managers should also be sensitive to local customs and business practices and adjust their approach as needed.

In addition to seeking the right balance between cash and marketable securities, the financial manager tries to shorten the time between the purchase of inventory or services (cash outflows) and the collection of cash from sales (cash inflows). The three key strategies are to collect money owed to the firm (accounts receivable) as quickly as possible, to pay money owed to others (accounts payable) as late as possible without damaging the firm's credit reputation, and to minimize the funds tied up in inventory.

Managing Accounts Receivable

Accounts receivable represent sales for which the firm has not yet been paid. Because the product has been sold but cash has not yet been received, an account receivable amounts to a use of funds. For manufacturing firms, for example, accounts receivable represent between 12 and 18 percent of revenue.

The financial manager's goal is to collect money owed to the firm as quickly as possible, while offering customers credit terms attractive enough to increase sales. Accounts receivable management involves setting credit policies, guidelines on offering credit, credit terms, and specific repayment conditions, including how long customers have to pay their bills and whether a cash discount is given for quicker payment. Another aspect of accounts receivable management is deciding on collection policies, the procedures for collecting overdue accounts.

Setting up credit and collection policies is a balancing act for financial managers. On the one hand, easier credit policies or generous credit terms (a longer repayment period or larger cash discount) result in increased sales. On the other hand, the firm has to finance more accounts receivable. The risk of uncollectible accounts receivable also rises. Businesses consider the impact on sales, timing of cash flow, experience with bad debt, customer profiles, and industry standards when developing their credit and collection policies.

Companies that want to speed up collections actively manage their accounts receivable, rather than passively letting customers pay when they want to. According to reports, more than 90 percent of businesses experience late payments from customers, and some companies write off a percentage of their bad debt, which can be expensive.[4]

Technology plays a big role in helping companies improve their credit and collections performance. For example, technologies such as AI integration to aid with decision-making and ERP systems can help companies make strategic decisions when it comes to credit and collection processes.[5]

Some companies choose to outsource financial and accounting processes, rather than to invest in their own systems. Because of the pace of change in technology, it can be more cost effective to outsource. There is still a need for a CFO even though some control over the processes shifts to a third party. There is some risk associated with this approach as confidential corporate data are housed on an outside network. Cybersecurity concerns are a consideration when outsourcing these functions. Another outsourcing area that firms utilize is in the international trade arena. Regulations can differ from country to country, so having an expert assist with navigating tasks such as customs clearance, trade compliance for imports and exports, and shipping logistics can be very beneficial and cost effective. Processing costs for imported goods are often higher than those of

domestic goods, so managing international commerce activities through a third party can make the transactions more efficient from both a time and money perspective.[6]

Inventory

Another use of funds is to buy inventory needed by the firm. In a typical manufacturing firm, inventory is between 20 and 25 percent of total assets. The cost of inventory includes not only its purchase price, but also ordering, handling, storage, interest, and insurance costs.

Production, marketing, and finance managers usually have differing views about inventory. Production managers want lots of raw materials on hand to avoid production delays. Marketing managers want lots of finished goods on hand so customer orders can be filled quickly. But financial managers want the least inventory possible without harming production efficiency or sales. Financial managers must work closely with production and marketing to balance these conflicting goals. Techniques for reducing the investment in inventory are inventory management, the just-in-time system, and materials requirement planning.

For retail firms, inventory management is a critical area for financial managers, who closely monitor inventory turnover ratios. This ratio shows how quickly inventory moves through the firm and is turned into sales. If the inventory number is too high, it will typically affect the amount of working capital a company has on hand, forcing the company to borrow money to cover the excess inventory. If the turnover ratio number is too high, it means the company does not have enough inventory of products on hand to satisfy customer needs, which means they could take their business elsewhere.[7]

Long-Term Expenditures

A firm also invests funds in physical assets such as land, buildings, machinery, equipment, and information systems. These are called **capital expenditures**. Unlike operating expenses, which produce benefits within a year, the benefits from capital expenditures extend beyond one year. For instance, a printer's purchase of a new printing press with a usable life of seven years is a capital expenditure and appears as a fixed asset on the firm's balance sheet. Paper, ink, and other supplies, however, are expenses. Mergers and acquisitions are also considered capital expenditures.

Firms make capital expenditures for many reasons. The most common are to expand, to replace or renew fixed assets, and to develop new products. Most manufacturing firms have a big investment in long-term assets. Boeing, for instance, puts billions of dollars a year into airplane-manufacturing facilities. Because capital expenditures tend to be costly and have a major effect on the firm's future, the financial manager uses a process called **capital budgeting** to analyze long-term projects and select those that offer the best returns while maximizing the firm's value. Decisions involving new products or the acquisition of another business are especially important. Managers look at project costs and forecast the future benefits the project will bring to calculate the firm's estimated return on the investment.

CONCEPT CHECK

1. Distinguish between short- and long-term expenses.
2. What is the financial manager's goal in cash management? List the three key cash management strategies.
3. Describe a firm's main motives in making capital expenditures.

16.3 Obtaining Short-Term Financing

3. What are the main sources and costs of unsecured and secured short-term financing?

How do firms raise the funding they need? They borrow money (debt), sell ownership shares (equity), and retain earnings (profits). The financial manager must assess all these sources and choose the combination most likely to help maximize the firm's value.

Like expenses, borrowed funds can be divided into short- and long-term loans. A short-term loan comes due within one year; a long-term loan has a maturity greater than one year. Short-term financing is shown as a current liability on the balance sheet and is used to finance current assets and support operations. Short-term loans can be unsecured or secured.

Unsecured Short-Term Loans

Unsecured loans are made on the basis of the firm's creditworthiness and the lender's previous experience with the firm. An unsecured borrower does not have to pledge specific assets as security. The three main types of unsecured short-term loans are trade credit, bank loans, and commercial paper.

Trade Credit: Accounts Payable

When Goodyear sells tires to General Motors, GM does not have to pay cash on delivery. Instead, Goodyear regularly bills GM for its tire purchases, and GM pays at a later date. This is an example of **trade credit**: the seller extends credit to the buyer between the time the buyer receives the goods or services and when it pays for them. Trade credit is a major source of short-term business financing. The buyer enters the credit on its books as an **account payable**. In effect, the credit is a short-term loan from the seller to the buyer of the goods and services. Until GM pays Goodyear, Goodyear has an account receivable from GM, and GM has an account payable to Goodyear.

Bank Loans

Unsecured bank loans are another source of short-term business financing. Companies often use these loans to finance seasonal (cyclical) businesses. Unsecured bank loans include lines of credit and revolving credit agreements. A **line of credit** specifies the maximum amount of unsecured short-term borrowing the bank will allow the firm over a given period, typically one year. The firm is charged a fee in the form of interest that is based on the balance owed. Another bank loan, the **revolving credit agreement**, is basically a guaranteed line of credit that carries an extra fee in addition to interest. Revolving credit agreements are often arranged for a period of two to five years.

Commercial Paper

As noted earlier, commercial paper is an unsecured short-term debt—an IOU—issued by a financially strong corporation. Thus, it is both a short-term investment and a financing option for major corporations. Corporations issue commercial paper in multiples of $100,000 for periods ranging from 3 to 270 days. Many big companies use commercial paper instead of short-term bank loans because the interest rate on commercial paper is usually 1 to 3 percent below bank rates.

Secured Short-Term Loans

Secured loans require the borrower to pledge specific assets as collateral, or security. The secured lender can legally take the collateral if the borrower doesn't repay the loan. Commercial banks and commercial finance companies are the main sources of secured short-term loans to business. Borrowers whose credit is not strong enough to qualify for unsecured loans use these loans. Typically, the collateral for secured short-term loans is accounts receivable or inventory. Because accounts receivable are normally quite liquid (easily converted to cash), they are an attractive form of collateral. The appeal of inventory—raw materials or finished goods—as collateral depends on how easily it can be sold at a fair price.

Another form of short-term financing using accounts receivable is **factoring**. A firm sells its accounts receivable outright to a factor, a financial institution (often a commercial bank or commercial finance company) that buys accounts receivable at a discount. Factoring is widely used in the clothing, furniture, and

appliance industries. Factoring is more expensive than a bank loan, however, because the factor buys the receivables at a discount from their actual value.

Exhibit 16.3 For businesses with steady orders but a lack of cash to make payroll or other immediate payments, factoring is a popular way to obtain financing. In factoring, a company sells its invoices to a third-party funding source for cash. The factor purchasing the invoices then collects on the due payments over time. Transportation companies with large accounts receivables balances in the form of freight bills are good candidates for the use of short-term financing such as factoring. *Why might firms choose factoring instead of loans?* (Credit: Mike's Photos/ flickr/ Creative Commons Zero (CC0) license)

CONCEPT CHECK

1. Distinguish between unsecured and secured short-term loans.
2. Briefly describe the three main types of unsecured short-term loans.
3. Discuss the two ways that accounts receivable can be used to obtain short-term financing.

16.4 Raising Long-Term Financing

4. What are the key differences between debt and equity, and what are the major types and features of long-term debt?

A basic principle of finance is to match the term of the financing to the period over which benefits are expected to be received from the associated outlay. Short-term items should be financed with short-term funds, and long-term items should be financed with long-term funds. Long-term financing sources include both debt (borrowing) and equity (ownership). Equity financing comes either from selling new ownership interests or from retaining earnings. Financial managers try to select the mix of long-term debt and equity that results in the best balance between cost and risk.

Debt versus Equity Financing

Say that Boeing plans to spend $2 billion over the next four years to build and equip new factories to make jet aircraft. Boeing's top management will assess the pros and cons of both debt and equity and then consider several possible sources of the desired form of long-term financing.

The major advantage of debt financing is the deductibility of interest expense for income tax purposes, which lowers its overall cost. In addition, there is no loss of ownership. The major drawback is **financial risk**: the chance that the firm will be unable to make scheduled interest and principal payments. The lender can force a borrower that fails to make scheduled debt payments into bankruptcy. Most loan agreements have restrictions to ensure that the borrower operates efficiently.

Equity, on the other hand, is a form of permanent financing that places few restrictions on the firm. The firm is

not required to pay dividends or repay the investment. However, equity financing gives common stockholders voting rights that provide them with a voice in management. Equity is more costly than debt. Unlike the interest on debt, dividends to owners are not tax-deductible expenses. Table 16.1 summarizes the major differences between debt and equity financing.

Debt Financing

Long-term debt is used to finance long-term (capital) expenditures. Debt maturity for long-term debt can range from more than a year to as long as 30 years depending on the type of debt. Three forms of long-term debt utilized by corporations include term loans, bonds, and mortgage loans.

Major Differences between Debt and Equity Financing

	Debt Financing	Equity Financing
Have a say in management	Creditors typically have none, unless the borrower defaults on payments. Creditors may be able to place restraints on management in event of default.	Common stockholders have voting rights.
Have a right to income and assets	Debt holders rank ahead of equity holders. Payment of interest and principal is a contractual obligation of the firm.	Equity owners have a residual claim on income (dividends are paid only after paying interest and any scheduled principal) and no obligation to pay dividends.
Maturity (date when debt needs to be paid back)	Debt has a stated maturity and requires repayment of principal by a specified date.	The company is not required to repay equity, which has no maturity date.
Tax treatment	Interest is a tax-deductible expense.	Dividends are not tax-deductible and are paid from after-tax income.

Table 16.1

A **term loan** is a business loan with a maturity of more than one year. Term loan maturities can vary between 3 to 25 years and can be unsecured or secured. They are available from commercial banks, insurance companies, pension funds, commercial finance companies, and manufacturers' financing subsidiaries. A contract between the borrower and the lender spells out the amount and maturity of the loan, the interest rate, payment dates, the purpose of the loan, and other provisions such as operating and financial restrictions on the borrower to control the risk of default. The payments include both interest and principal, so the loan balance declines over time. Borrowers try to arrange a repayment schedule that matches the forecast cash flow from the project being financed.

Bonds are long-term debt obligations (liabilities) of corporations and governments. A bond certificate is issued as proof of the obligation. The issuer of a bond must pay the buyer a fixed amount of money—called **interest**, stated as the *coupon rate*—on a regular schedule, typically every six months. The issuer must also pay the bondholder the amount borrowed—called the **principal**, or *par value*—at the bond's maturity date (due date). Bonds are usually issued in units of $1,000—for instance, $1,000, $5,000, or $10,000—and typically have an initial maturity length of 10 to 30 years. They may be secured or unsecured, include special provisions for early

retirement, or be convertible to common stock.

A **mortgage loan** is a long-term loan made against real estate as collateral. The lender takes a mortgage on the property, which lets the lender seize the property, sell it, and use the proceeds to pay off the loan if the borrower fails to make the scheduled payments. Long-term mortgage loans are often used to finance office buildings, factories, and warehouses. Life insurance companies are an important source of these loans. They make billions of dollars' worth of mortgage loans to businesses each year.

CONCEPT CHECK

1. Distinguish between debt and equity.
2. Identify the major types and features of long term debt.

16.5 Equity Financing

5. When and how do firms issue equity, and what are the costs?

Equity refers to the owners' investment in the business. In corporations, the preferred and common stockholders are the owners. A firm obtains equity financing by selling new ownership shares (external financing), by retaining earnings (internal financing), or for small and growing, typically high-tech, companies, through venture capital (external financing).

Selling New Issues of Common Stock

Common stock is a security that represents an ownership interest in a corporation. A company's first sale of stock to the public is called an *initial public offering (IPO)*. An IPO often enables existing stockholders, usually employees, family, and friends who bought the stock privately, to earn big profits on their investment. (Companies that are already public can issue and sell additional shares of common stock to raise equity funds.)

But going public has some drawbacks. For one thing, there is no guarantee an IPO will sell. It is also expensive. Big fees must be paid to investment bankers, brokers, attorneys, and accountants. Once the company is public, it is closely watched by regulators, stockholders, and securities analysts. The firm must reveal such information as operating and financial data, product details, financing plans, and operating strategies. Providing this information is often costly.

Going public is the dream of many small company founders and early investors, who hope to recoup their investments and have their company become profitable. Intuitive Surgical went public in 2000 trading at just $2 per share. Now, over two decades later, the stock is trading at nearly $500 per share. The company specializes in robotic systems for minimally invasive surgeries, and as the technology has been adopted at over 6,000 hospitals in the United States, the stock has steadily grown.

The number of IPOs can vary based on economic and political conditions, and the decision requires planning and strategic moves, despite the expected lucrative rewards for both investors and entrepreneurs. For example, in 2014, King Digital Entertainment, a mobile game creator, had its IPO with the stock opening at $20.50. By the end of the first day of trading, the stock had dropped over 15 percent and by the end of the first year, it was down 23 percent. The business was eventually acquired by Activision Blizzard in 2016. The decline was attributed to the decreasing popularity of its key game—Candy Crush Saga—and investors became skeptical that the company was too reliant on a single product.[8]

Some companies choose to remain private. Cargill, Publix Super Markets, Mars, and Fidelity Investments are among the largest U.S. private companies.

Exhibit 16.4 Snap Inc., the parent company of Snapchat, went public in 2017 under the ticker symbol "SNAP." The much-anticipated IPO was popular at an opening price of $17 per share and rose that same day by more than 40 percent, which initially put the company's market capitalization at about $30 billion. *What are the pros and cons of going public?* (Credit: Tim Savage/ pexels/ Creative Commons Zero (CC0) license)

Dividends and Retained Earnings

Dividends are payments to stockholders from a corporation's profits. Dividends can be paid in cash or in stock. **Stock dividends** are payments in the form of more stock. Stock dividends may replace or supplement cash dividends. After a stock dividend has been paid, more shares have a claim on the same company, so the value of each share often declines. A company does not have to pay dividends to stockholders. But if investors buy the stock expecting to get dividends and the firm does not pay them, the investors may sell their stocks.

At their meetings, a company's board of directors will review proposals from the firm's management to determine how much to distribute as dividends. A firm's basic approach to paying dividends can greatly affect its share price. A stable history of dividend payments indicates good financial health. For example, pharmaceutical company Eli Lilly and Co has increased its dividend for the last 11 years with a growth rate of over 15 percent, giving shareholders a solid return on their investment.[9]

If a firm that has been making regular dividend payments cuts or skips a dividend, investors start thinking it has serious financial problems. The increased uncertainty often results in lower stock prices. Thus, most firms set dividends at a level they can keep paying. They start with a relatively low dividend payout ratio so that they can maintain a steady or slightly increasing dividend over time.

Retained earnings, profits that have been reinvested in the firm, have a big advantage over other sources of equity capital: They do not incur underwriting costs. Financial managers strive to balance dividends and retained earnings to maximize the value of the firm. Often the balance reflects the nature of the firm and its industry. Mature firms with management confidence for positive earnings in the future—such as construction materials firms, companies in the oil and gas sector, consumer goods businesses, and financial services companies—typically pay out a good portion of their earnings in dividends. For example, in the 2025 fiscal year, ExxonMobil paid dividends of $4.12 per share, Altria Group paid $4.24 per share, Apple paid $1.04 per share, and Costco paid $5.20 per share.

Some high-growth companies or those yet to have a profit, such as those in technology-related sectors, finance their company growth through their retained earnings and do not pay out dividends. As the firm matures, some then decide to begin paying dividends, as Dell decided to do in 2022 after being publicly traded for 34 years.[10]

Preferred Stock

Another form of equity is **preferred stock**. Unlike common stock, preferred stock usually has a dividend

amount that is set at the time the stock is issued. These dividends must be paid before the company can pay any dividends to common stockholders. Also, if the firm goes bankrupt and sells its assets, preferred stockholders get their money back before common stockholders do.

Like debt, preferred stock increases the firm's financial risk because it obligates the firm to make a fixed payment. But preferred stock is more flexible. The firm can miss a dividend payment without suffering the serious results of failing to pay back a debt.

Preferred stock is more expensive than debt financing, however, because preferred dividends are not tax-deductible. Also, because the claims of preferred stockholders on income and assets are second to those of debtholders, preferred stockholders require higher returns to compensate for the greater risk.

Venture Capital

Venture capital is another source of equity capital. It is most often used by small and growing firms that aren't big enough to sell securities to the public. This type of financing is especially popular among high-tech firms in sectors such as fintech, biotechnology, and robotics, that need significant seed money to finance their operations.

Venture capitalists invest in new businesses in return for part of the ownership, typically between 20 and 40 percent. They look for business with high return-on-investment potential. The time frame required for the venture capitalist to see a return varies by the industry and the stage of the business; however, typically returns are realized in 12 to 14 years. By getting in on the ground floor, venture capitalists buy stock at a very low price. They earn profits by selling the stock at a much higher price when the company goes public. Venture capitalists generally get a voice in management through seats on the board of directors. Getting venture capital is difficult, even though there are hundreds of private venture-capital firms in this country. Only about one percent of companies that apply for venture capital funding are financed. Venture-capital investors are strategic when deciding which firms to finance, weighing the risks of the business and economic risks against the probability of getting a large enough return to justify the risk level. In addition to venture capital, other sources of funding, including private foundations, states, and wealthy individuals (called *angel investors*), are helping start-up firms find equity capital. These private investors are motivated by the potential to earn a high return on their investment.

CONCEPT CHECK

1. Compare the advantages and disadvantages of debt and equity financing.
2. Discuss the costs involved in issuing common stock.
3. Briefly describe these sources of equity: retained earnings, preferred stock, venture capital.

16.6 Securities Markets

6. How do securities markets help firms raise funding, and what securities trade in the capital markets?

Stocks, bonds, and other securities trade in securities markets. These markets streamline the purchase and sales activities of investors by allowing transactions to be made quickly and at a fair price. **Securities** are investment certificates that represent either *equity* (ownership in the issuing organization) or *debt* (a loan to the issuer). Corporations and governments raise capital to finance operations and expansion by selling securities to investors, who in turn take on a certain amount of risk with the hope of receiving a profit from their investment.

Securities markets are busy places. On an average day, individual and institutional investors trade billions of

shares of stock in more than 10,000 companies through securities markets. *Individual investors* invest their own money to achieve their personal financial goals. **Institutional investors** are investment professionals who are paid to manage other people's money. Most of these professional money managers work for financial institutions, such as banks, mutual funds, insurance companies, and pension funds. Institutional investors control very large sums of money, often buying stock in 10,000-share blocks. They aim to meet the investment goals of their clients. Institutional investors are a major force in the securities markets, accounting for about half of the dollar volume of equities traded.

Types of Markets

Securities markets can be divided into primary and secondary markets. The **primary market** is where *new* securities are sold to the public, usually with the help of investment bankers. In the primary market, the issuer of the security gets the proceeds from the transaction. A security is sold in the primary market just once—when the corporation or government first issues it. King Digital Entertainment is an example of a primary market offering.

Later transactions take place in the **secondary market**, where *old* (already issued) securities are bought and sold, or traded, among investors. The issuers generally are not involved in these transactions. The vast majority of securities transactions take place in secondary markets, which include broker markets, dealer markets, the over-the-counter market, and the commodities exchanges. You'll see *tombstones,* announcements of both primary and secondary stock and bond offerings, in the *Wall Street Journal* and other news sources.

The Role of Investment Bankers and Stockbrokers

Two types of investment specialists play key roles in the functioning of the securities markets. **Investment bankers** help companies raise long-term financing. These firms act as intermediaries, buying securities from corporations and governments and reselling them to the public. This process, called **underwriting**, is the main activity of the investment banker, which acquires the security for an agreed-upon price and hopes to be able to resell it at a higher price to make a profit. Investment bankers advise clients on the pricing and structure of new securities offerings, as well as on mergers, acquisitions, and other types of financing. Well-known investment banking firms include Goldman Sachs, Morgan Stanley, JP Morgan, Bank of America Merrill Lynch, and Citigroup.

A **stockbroker** is a person who is licensed to buy and sell securities on behalf of clients. Also called *account executives,* these investment professionals work for brokerage firms and execute the orders customers place for stocks, bonds, mutual funds, and other securities. Investors are wise to seek a broker who understands their investment goals and can help them pursue their objectives.

Brokerage firms are paid commissions for executing clients' transactions. Typically, most brokerage firms have fixed commission schedules for transactions. These commissions usually depend on the value of the transaction and the number of shares involved.

Online Investing

Technological advances have made it commonplace for investors to research, analyze, and trade securities online. Today almost all brokerage firms offer online trading capabilities. Online brokerages are popular with "do-it-yourself" investors who choose their own stocks and don't want to pay a full-service broker for these services. Lower transaction costs are a major benefit. Fees at online or app brokerages are often low and many offer zero trading fees for standard stock transactions, with some minimal fees for more complex services. Although there are many online brokerage firms, the four largest—Charles Schwab, Fidelity, Vanguard, and JPMorgan Chase—have digital customers that account for nearly 70 percent of all brokerage clients and trillions in assets.[11] The internet also offers investors access to a wealth of investment information.

MANAGING CHANGE

Competition Causes Online Fees to Drop

With the U.S. stock market routinely setting new all-time record highs, private investors are increasingly interested in getting into the market on their own. Historically, trading stocks meant high fees paid to brokers to execute the transactions. Technological advances have provided private investors an alternative through online or app-based trading platforms. These platforms are offered by traditional brick-and-mortar firms such as Fidelity, Charles Schwab, TD Ameritrade, and E*Trade, and through independent apps such as Robinhood. With advances in technology, including the use of artificial intelligence, the costs associated with handling stock trades has dropped dramatically over the last decade, and investors are looking for the best possible deal.

With competition from companies such as Robinhood, a start-up app that offers $0 fees for stock trades, online trading firms have rushed to reduce their fees to attract more overall business. Fidelity, Charles Schwab, TD Ameritrade, and E*trade eliminated their fees for many transactions in order to compete with apps like Robinhood.

So how will these firms continue to make money? They believe that lowering the price of entry for trading stocks will allow them to "sweep up" customer assets—meaning firms have an opportunity to attract new customers who not only will take advantage of low trading fees but will be interested in other financial products offered by these investment companies. Other services offered by online trading firms include providing loans to purchase stock and selling customers additional features such as wealth management or stock research services.

According to some industry analysts, one downside to matching competitors' low fees could be a strategy of consolidation within the online trading industry. Unless firms can increase their overall business by reaching out to current customers and potential ones, some may be forced to join up with competitors.

Critical Thinking Questions

1. From a business standpoint, do you think the "almost-free" trading fees make sense? Explain.
2. What can online trading firms do to increase their overall business, particularly when it comes to attracting new investors?

Sources: Simone Foxman, "The Future Price of Investing: Zilch," *Bloomberg Businessweek,* https://www.bloomberg.com, October 31, 2017; Evelyn Chang, "Robinhood, Trading App for Millennials, Still Betting on Stocks over Bitcoin," *CNBC,* https://www.cnbc.com, October 10, 2017; Taylor Tepper, "You Probably Have the Wrong Idea When It Comes to Investments. Let's Fix That," https://www.bankrate.com, July 19, 2017; Trevor Hunnicutt and Tim McLaughlin, "Brokerages' Race to Zero Fees Points to a Bigger War to Come," *Reuters,* https://www.reuters.com, February 27, 2017; Akhilesh Ganti, "Understanding Brokerage Fees: Types, Structures, and How They Work," *Investopedia*, https://www.investopedia.com, December 6, 2025; "Compare Us to Our Competitors," https://www.schwab.com, accessed February 18, 2026.

Investing in Bonds

When many people think of financial markets, they picture the equity markets. However, the bond markets are huge—the International Capital Markets Association (ICMA) estimates that the global bond market was over $123 trillion in 2020. The global bond market had grown to approximately $141 trillion in 2024. Average daily trading volume exceeded $1.07 trillion in 2024, with the U.S. Treasury securities accounting for over 40 percent of the total.[12]

Bonds can be bought and sold in the securities markets. However, the price of a bond changes over its life as

market interest rates fluctuate. When the market interest rate drops below the fixed interest rate on a bond, it becomes more valuable, and the price rises. If interest rates rise, the bond's price will fall. *Corporate bonds,* as the name implies, are issued by corporations. They usually have a par value of $1,000. They may be secured or unsecured (called *debentures*), include special provisions for early retirement, or be convertible to common stock. Corporations can also issue *mortgage bonds*, bonds secured by property such as land, buildings, or equipment. Approximately $1.5 trillion in new corporate bonds were issued in 2025.[13]

In addition to regular corporate debt issues, investors can buy *high-yield bonds* (also called *junk bonds*)—high-risk, high-return bonds often used by companies whose credit characteristics would not otherwise allow them access to the debt markets. They generally earn 4 to 5 percent above the returns on high-quality corporate bonds. Corporate bonds may also be issued with an option for the bondholder to convert them into common stock. These *convertible bonds* generally allow the bondholder to exchange each bond for a specified number of shares of common stock.

Exhibit 16.5 In 2018, Netflix sold junk bonds valued at nearly $2 billion to support the growth in subscribers at that time and to finance new programming. The company continued this strategy of issuing high-yield bonds to finance its growth, but for the first time in 2024, the company sold high-quality bonds valued at $19 billion. *What are the risks and rewards of buying junk bonds?* (Credit: "Simple FX"/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

U.S. Government Securities and Municipal Bonds

Both the federal government and local government agencies also issue bonds. The U.S. Treasury sells three major types of federal debt securities: Treasury bills, Treasury notes, and Treasury bonds. All three are viewed as default-risk-free because they are backed by the U.S. government. Treasury bills mature in one year or less. Treasury notes have maturities of 2 to 10 years, and Treasury bonds have maturities as long as 20 or 30 years. All three are sold in increments of $100 with a minimum purchase of $100. The interest earned on government securities is subject to federal income tax but is free from state and local income taxes. According to SIFMA, just under $30 trillion U.S. Treasuries were issued in 2025, up nearly 30 percent from 2023.[14]

Municipal bonds are issued by states, cities, counties, and other state and local government agencies. Over $580 billion in municipal bonds were issued in 2025.[15] These bonds typically have a par value of $5,000 and are either general obligation or revenue bonds. *General obligation bonds* are backed by the full faith and credit (and taxing power) of the issuing government. *Revenue bonds*, on the other hand, are repaid only from income generated by the specific project being financed. Examples of revenue bond projects include toll highways and bridges, stadiums, and parking structures. Because the issuer of revenue bonds has no legal obligation to back the bonds if the project's revenues are inadequate, they are considered more risky and therefore have higher interest rates than general obligation bonds.

Municipal bonds are attractive to investors because interest earned on them is typically exempt from federal income tax. For the same reason, the coupon interest rate for a municipal bond is lower than for a similar-quality corporate bond. In addition, interest earned on municipal bonds issued by governments within the taxpayer's home state is exempt from state income tax as well. In contrast, all interest earned on corporate

bonds is fully taxable.

Bond Ratings

Bonds vary in quality, depending on the financial strength of the issuer. Because the claims of bondholders come before those of stockholders, bonds are generally considered less risky than stocks. However, some bonds are in fact quite risky. Companies can default—fail to make scheduled interest or principal payments—on their bonds. Investors can use **bond ratings**, letter grades assigned to bond issues to indicate their quality or level of risk. Ratings for corporate bonds are easy to find. The most well-known rating agencies are Moody's, Standard & Poor's (S&P), and Fitch, whose publications with ratings are found readily online. Table 16.2 lists the letter grades assigned by the agencies. A bond's rating may change if a company's financial condition changes.

Other Popular Securities

In addition to stocks and bonds, investors can buy mutual funds, a very popular investment category, or exchange-traded funds (ETFs). Futures contracts and options are more complex investments for experienced investors.

Mutual Funds

Suppose that you have $1,000 to invest but don't know which stocks or bonds to buy, when to buy them, or when to sell them. By investing in a mutual fund, you can buy shares in a large, professionally managed portfolio, or group, of stocks and bonds. A **mutual fund** is a financial-service company that pools its investors' funds to buy a selection of securities—marketable securities, stocks, bonds, or a combination of securities—that meet its stated investment goals. Each mutual fund focuses on one of a wide variety of possible investment goals, such as growth or income. Many large financial-service companies, such as Fidelity and Vanguard, sell a wide variety of mutual funds, each with a different investment goal. Investors can pick and choose funds that match their particular interests. Some mutual funds are invested in a certain type of company, industry, geographical region or asset. For example, there are mutual funds in one industry such as health care or real estate. Others might be comprised on all international funds or on only stocks that offer high dividends.

Mutual funds are one of the most popular investments for individuals today: they can choose from over 8,000 different funds. Investments in mutual funds are more than $69 trillion worldwide, of which U.S. mutual funds hold more than $28 trillion. About 125 million individuals, representing over half of all U.S. households, own mutual funds.[16] Mutual funds appeal to investors for three main reasons:

Moody's and Standard & Poor's Bond Ratings		
Moody's Ratings	**S & P and Fitch Ratings**	**Description**
Aaa	AAA	**Prime-quality investment bonds:** Highest rating assigned; indicates extremely strong capacity to pay.
Aa, A	AA, A	**High-grade investment bonds:** Also considered very safe bonds, although not quite as safe as Aaa/AAA issues; Aa/AA bonds are safer (have less risk of default) than single As.

Table 16.2

Moody's and Standard & Poor's Bond Ratings		
Moody's Ratings	**S & P and Fitch Ratings**	**Description**
Baa	BBB	**Medium-grade investment bonds:** Lowest of investment-grade issues; seen as lacking protection against adverse economic conditions.
Ba B	BB B	**Junk bonds:** Provide little protection against default; viewed as highly speculative.
Caa Ca C	CCC CC C D	**Poor-quality bonds:** Either in default or very close to it.

Table 16.2

- They are a good way to hold a diversified, and thus less risky, portfolio. Investors with only $500 or $1,000 to invest cannot diversify much on their own. Buying shares in a mutual fund lets them own part of a portfolio that may contain 100 or more securities.
- Mutual funds are professionally managed.
- Mutual funds may offer higher returns than individual investors could achieve on their own.

Exchange-Traded Funds

Another type of investment, the **exchange-traded fund (ETF)**, has become very popular with investors. ETFs are similar to mutual funds because they hold a broad basket of stocks with a common theme, giving investors instant diversification. ETFs trade on stock exchanges (most trade on the New York Stock Exchange, NYSE), so their prices change throughout the day, whereas mutual fund share prices, called net asset values (NAVs), are calculated once a day, at the end of trading. Worldwide, ETF assets in 2025 were almost $20 trillion, with the U.S. ETF market accounting for nearly 70 percent of the global market.[17]

Investors can choose from more than 12,000 global and about 3,500 EFTs in the United States that track almost any market sector, from a broad market index such as the S&P 500 (described later in this chapter), industry sectors such as health care or energy, and geographical areas such as a particular country (Japan) or region (Southeast Asia). ETFs have very low expense ratios. However, because they trade as stocks, investors pay commissions to buy and sell these shares.

Futures Contracts and Options

Futures contracts are legally binding obligations to buy or sell specified quantities of commodities (agricultural or mining products) or financial instruments (securities or currencies) at an agreed-on price at a future date. An investor can buy commodity futures contracts in corn, soybeans, coffee, wheat, oil, or lumber, as just a few examples. Financial futures include Treasury securities and foreign currencies, such as the euro or Japanese yen. Futures contracts do not pay interest or dividends. The return depends solely on favorable price changes. These are very risky investments because the prices can vary a great deal.

Options are contracts that entitle holders to buy or sell specified quantities of common stocks or other financial instruments at a set price during a specified time. As with futures contracts, investors must correctly guess future price movements in the underlying financial instrument to earn a positive return. Unlike futures

contracts, options do not legally obligate the holder to buy or sell, and the price paid for an option is the maximum amount that can be lost. However, options have very short maturities, so it is easy to quickly lose a lot of money with them.

CONCEPT CHECK

1. Distinguish between primary and secondary securities markets. How does an investment banker work with companies to issue securities?
2. Describe the types of bonds available to investors and the advantages and disadvantages they offer.
3. Why do mutual funds and exchange-traded funds appeal to investors? Discuss why futures contracts and options are risky investments.

16.7 Buying and Selling at Securities Exchanges

7. Where can investors buy and sell securities, and how are securities markets regulated?

When we think of stock markets, we are typically referring to secondary markets, which handle most of the securities trading activity. The two segments of the secondary markets are broker markets and dealer markets, as Exhibit 16.6 shows. The primary difference between broker and dealer markets is the way each executes securities trades. Securities trades can also take place in alternative market systems and on non-U.S. securities exchanges.

The securities markets both in the United States and around the world are in flux and undergoing tremendous changes. We present the basics of securities exchanges in this section and discuss the latest trends in the global securities markets later in the chapter.

Broker Markets

The **broker market** consists of national and regional securities exchanges that bring buyers and sellers together through brokers on a centralized trading floor. In the broker market, the buyer purchases the securities directly from the seller through the broker. Broker markets account for about 60 percent of the total dollar volume of all shares traded in the U.S. securities markets.

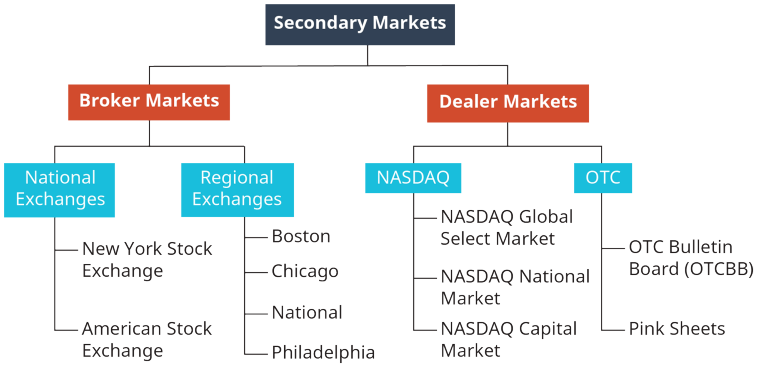

Exhibit 16.6 The Secondary Markets: Broker and Dealer Markets (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

New York Stock Exchange

The oldest and most prestigious broker market is the *New York Stock Exchange (NYSE),* which has existed since 1792. Often called the Big Board, it is located on Wall Street in downtown New York City. The NYSE, which lists the shares of 2,800 companies, had a total market capitalization (domestic and foreign companies) of $44 trillion in January 2026. On a typical day, more than 1.46 billion shares of stock are traded on the NYSE.[18] It

represents about half of the trading volume in the U.S. broker marketplace. Major companies such as Verizon, Home Depot, Procter & Gamble, Reddit, Uber, and Nike list their shares on the NYSE. Companies that list on the NYSE must meet stringent listing requirements and annual maintenance requirements, which give them creditability.

The NYSE is also popular with non-U.S. companies. More than 520 international companies with a market value in the trillions now list their securities on the NYSE. [19]

In the past, all NYSE transactions occurred on the vast NYSE trading floor. Each of the companies traded at the NYSE is assigned to a trading post on the floor. When an exchange member receives an order to buy or sell a particular stock, the order is transmitted to a floor broker at the company's trading post. The floor brokers then compete with other brokers on the trading floor to get the best price for their customers.

In response to competitive pressures from electronic exchanges, the NYSE created a hybrid market that combines features of the floor auction market and automated trading. Its customers now have a choice of how they execute trades. Trends and changes to the NYSE as technology has advanced will be discussed later in the chapter.

Another national stock exchange, NYSE American (formerly the American Stock Exchange, AMEX), lists the securities of 238 corporations in an electronic platform. Because the rules of this exchange are less strict than those of the NYSE, many listed firms are new, entrepreneurial ventures less well known than the NYSE-listed corporations. The firms typically are smaller cap stocks that trade at much lower volumes. Some firms choose to move up to the NYSE once they qualify, but they can choose to remain listed on the NYSE American. The NYSE American exchange has become a major exchange for EFTs and small cap companies.[20]

Exhibit 16.7 The New York Stock Exchange (NYSE) is the largest securities market in the world. Its market capitalization dwarfs both foreign and domestic markets. Unlike other financial markets, the NYSE trades mostly through specialists, financial professionals who match up buyers and sellers of securities, while pocketing the spread between the bid and ask price on market orders. *How have the NYSE's trading processes evolved with technological advances?* (Credit: Kevin Hutchison/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Dealer Markets

Unlike broker markets, **dealer markets** do not operate on centralized trading floors but instead use sophisticated telecommunications networks that link dealers throughout the United States. Buyers and sellers do not trade securities directly, as they do in broker markets. They work through securities dealers called *market makers*, who make markets in one or more securities and offer to buy or sell securities at stated prices. A security transaction in the dealer market has two parts: the selling investor sells their securities to one dealer, and the buyer purchases the securities from another dealer (or in some cases, the same dealer).

Exhibit 16.8 The New York Stock Exchange (NYSE) named Stacy Cunningham the first woman to head the exchange in its 226-year history, and it is currently overseen by president Lynn Martin. Outside the exchange, the statue "Fearless Girl" by Kristen Virbal stared down the "bull" statue and represented the need for more representation of women on the world's most important exchange. *How does the naming of two consecutive women as head of the NYSE demonstrate that the glass ceiling has been shattered?* (Anthony Quintano/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

NASDAQ

The largest dealer market is the **National Association of Securities Dealers Automated Quotation system**, commonly referred to as NASDAQ. The first electronic-based stock market, the NASDAQ is a global, sophisticated electronic marketplace that links dealers throughout the United States. Founded in 1971 with origins in the over-the-counter (OTC) market, today NASDAQ is a separate securities exchange that is no longer part of the OTC market. The NASDAQ lists more companies than the NYSE, but the NYSE still leads in total market capitalization. Between 8 billion to over 10 billion shares are exchanged daily in 2026 through NASDAQ, and it is the world's largest electronic exchange.[21] It provides up-to-date bid and ask prices on about 3,500 of the most active OTC securities. Its sophisticated electronic communication system provides faster transaction speeds than traditional floor markets and is the main reason for the popularity and growth of the OTC market.

In January 2006, the SEC approved NASDAQ's application to operate as a national securities exchange. As a result, the NASDAQ Stock Market LLC began operating independently in August 2006.[22] The securities of many well-known companies, some of which could be listed on the organized exchanges, trade on the NASDAQ. Examples include Amazon, Alphabet, Costco, Comcast, Honeywell, and Starbucks. The stocks of most commercial banks and insurance companies also trade in this market, as do most government and corporate bonds. More than 1,400 foreign companies also trade on the NASDAQ.

More than a decade ago, the NASDAQ changed its structure to a three-tier market:

- The NASDAQ Global Select Market, a new tier with "financial and liquidity requirements that are higher than those of any other market," according to NASDAQ. More than 1,300 NASDAQ companies qualify for this group.
- The NASDAQ Global Market (formerly the NASDAQ National Market), which will list about 1,350 companies.
- The NASDAQ Capital Market will replace the NASDAQ Small Cap Market and list about 1,300 companies.

All three market tiers adhere to NASDAQ's rigorous listing and corporate governance standards.[23]

The Over-the-Counter Market

The **over-the-counter (OTC) markets** refer to those other than the organized exchanges described above. There are three OTC markets: Pink Sheets, OTCQX, and OTCQB. These markets generally list small companies and have no listing or maintenance standards, making them attractive to young companies looking for

funding. OTC companies do not have to file with the SEC or follow the costly provisions of Sarbanes-Oxley. Investing in OTC companies is therefore highly risky and should be for experienced investors only.

Alternative Trading Systems

In addition to broker and dealer markets, alternative trading systems such as **electronic communications networks (ECNs)** make securities transactions. ECNs are private trading networks that allow institutional traders and some individuals to make direct transactions in what is called the *fourth market*. ECNs bypass brokers and dealers to automatically match electronic buy and sell orders. They are most effective for high-volume, actively traded stocks. Money managers and institutions such as pension funds and mutual funds with large amounts of money to invest like ECNs because they cost far less than other trading venues.

Global Trading and Foreign Exchanges

Improved communications and the elimination of many legal barriers are helping the securities markets go global. The number of securities listed on exchanges in more than one country is growing. Foreign securities are now traded in the United States. Likewise, foreign investors can easily buy U.S. securities.

Stock markets also exist in foreign countries: over 70 major countries operate their own securities exchanges. NASDAQ ranks second to the NYSE, followed by Shanghai and the Japan/Tokyo Stock exchange. Other important foreign stock exchanges include Euronext (which merged with the NYSE but operates separately), Toronto, London, National (India), Shenzen (China), and Korea.[24] The number of big U.S. corporations with listings on foreign exchanges is growing steadily, especially in Europe. For example, significant activity in NYSE-listed stocks also occurs on the LSE. The LSE also is getting a growing share of the world's IPOs. Emerging markets such as India, whose economy has been growing 6 percent or more a year, continue to attract investor attention. The Sensex, the benchmark index of the Bombay Stock Exchange, increased nearly 80 percent since 2020 as foreign investors continue to put money into Indian stocks and the world's economies recover from the COVID-19 pandemic.[25]

Why should U.S. investors pay attention to international stock markets? Because the world's economies are increasingly interdependent, businesses must look beyond their own national borders to find materials to make their goods and markets for foreign goods and services. The same is true for investors, who may find that they can earn higher returns in international markets.

Regulation of Securities Markets

Both state and federal governments regulate the securities markets. The states were the first to pass laws aimed at preventing securities fraud. But most securities transactions occur across state lines, so federal securities laws are more effective. In addition to legislation, the industry has self-regulatory groups and measures.

Securities Legislation

Congress passed the Securities Act of 1933 in response to the 1929 stock market crash and subsequent problems during the Great Depression. It protects investors by requiring full disclosure of information about new securities issues. The issuer must file a *registration statement* with the SEC, which must be approved by the SEC before the security can be sold.

The *Securities Exchange Act of 1934* formally gave the SEC power to regulate securities exchanges. The act was amended in 1964 to give the SEC authority over the dealer markets as well. The amendment included rules for operating the stock exchanges and granted the SEC control over all participants (exchange members, brokers, dealers) and the securities traded in these markets.

The 1934 act also banned **insider trading**, the use of information that is not available to the general public to make profits on securities transactions. Because of lax enforcement, however, several big insider trading scandals occurred during the late 1980s. The *Insider Trading and Fraud Act of 1988* greatly increased the

penalties for illegal insider trading and gave the SEC more power to investigate and prosecute claims of illegal actions. The meaning of *insider* was expanded beyond a company's directors, employees, and their relatives to include anyone who gets private information about a company.

Other important legislation includes the *Investment Company Act of 1940,* which gives the SEC the right to regulate the practices of investment companies (such as mutual funds managed by financial institutions), and the *Investment Advisers Act of 1940,* which requires investment advisers to disclose information about their background. The *Securities Investor Protection Corporation (SIPC)* was established in 1970 to protect customers if a brokerage firm fails, by insuring each customer's account for up to $500,000.

In response to corporate scandals that hurt thousands of investors, the SEC passed new regulations designed to restore public trust in the securities industry. It issued *Regulation FD* (for "fair disclosure") in October 2000. Regulation FD requires public companies to share information with all investors at the same time, leveling the information playing field. The *Sarbanes-Oxley Act of 2002* has given the SEC more power when it comes to regulating how securities are offered, sold, and marketed.

Self-Regulation

The investment community also regulates itself, developing and enforcing ethical standards to reduce the potential for abuses in the financial marketplace. The Financial Industry Regulatory Authority (FINRA) oversees the nation's approximately 3,500 brokerage firms and 620,000 registered brokers. It develops rules and regulations, provides a dispute resolution forum, and conducts regulatory reviews of member activities for the protection and benefit of investors.

In response to "Black Monday"—October 19, 1987, when the Dow Jones Industrial Average plunged 508 points and the trading activity severely overloaded the exchange's computers—the securities markets instituted corrective measures to prevent a repeat of the crisis. Now, under certain conditions, **circuit breakers** stop trading for a 15-minute cooling-off period to limit the amount the market can drop in one day. Under revised rules approved in 2012 by the SEC, market-wide circuit breakers kick in when the S&P 500 Index drops 7 percent (level 1), 13 percent (level 2), and 20 percent (level 3) from the prior day's closing numbers.[26]

ETHICS IN PRACTICE

Blowing the Whistle on Financial Fraud

As part of the 2010 Dodd-Frank legislation passed by Congress in response to the 2008 financial crisis, the Securities and Exchange Commission (SEC) established a whistleblower-rewards program to provide employees and other individuals with the opportunity to report financial securities misconduct. More than seven years after starting the Office of the Whistleblower, the SEC reports that the rewards program has recovered $37 billion in financial penalties from companies that have done things to damage their own reputation as well as those of employees and other stakeholders.

According to the SEC, 2025 saw a sharp decline for individuals reporting financial wrongdoings and whistleblowers being rewarded for what they discovered. In 2025, around $60 million was awarded to whistleblowers—an amount far less than the $255 million awarded in 2024 and $600 million in 2023. Since its inception in 2011, nearly $7 billion has been awarded to individuals for their information.

The whistleblower program is based on three key components: monetary awards, prohibition of employer retaliation, and protection of the whistleblower's identity. The program requires the SEC to pay out monetary awards to eligible individuals who voluntarily provide original information about a violation of federal securities laws that has occurred, is ongoing, or is about to take place. The information supplied must lead to a successful enforcement action or monetary sanctions exceeding $1 million. No awards are

paid out until the sanctions are collected from the offending firm.

A whistleblower must be an individual (not a company), and that individual does not need to be employed by a company to submit information about that specific organization. A typical award to a whistleblower is between 10 and 30 percent of the monetary sanctions the SEC and others (for example, the U.S. attorney general) are able to collect from the company in question.

In 2024, the whistleblower program received nearly 25,000 tips, nearly double the tips that were received in 2022. The program is not limited to U.S. citizens or residents; foreign persons living abroad may submit tips and are eligible to receive a monetary award. In fact, in 2015, the SEC gave $104 million to a foreign national for information regarding international tax fraud. In 2020, there were about 100 whistleblowers from outside the United States.

Despite criticisms from some financial institutions, the whistleblower-rewards program continues to be a success—reinforcing the point that financial fraud will not go unnoticed by the SEC, employees, and others individuals.

Critical Thinking Questions

1. Despite assurances that companies involved in financial fraud are not allowed to retaliate against their accusers, would you blow the whistle on your employer? Why or why not?
2. What can companies do to make sure their employees are aware of the consequences of financial securities fraud? Provide several examples.

Sources: “Office of the Whistleblower,” https://www.sec.gov, accessed November 1, 2017; Erika A. Kelton, “Four Important Dodd-Frank Whistleblower Program Developments to Watch for in 2017,” https://wp.nyu.edu, accessed November 1, 2017; Jason Zuckerman and Matt Stock, “One Billion Reasons Why the SEC Whistleblower-Reward Program Is Effective,” *Forbes,* https://www.forbes.com, July 18, 2017; John Maxfield, “The Dodd-Frank Act Explained,” *USA Today,* https://www.usatoday.com, February 3, 2017; Eduardo Singerman and Paul Hugel, “The Tremendous Impact of the Dodd-Frank Whistleblower Program in 2016,” *Accounting Today,* https://www.accountingtoday.com, December 28, 2016; Samuel Rubenfeld, “Dodd-Frank Rollback to Spare SEC Whistleblower Program, Experts Say,” *The Wall Street Journal,* https://www.blogs.wsj.com, November 15, 2016; Daniel M. Hawke and Christian D. H. Schultz, "Top Takeaways From the Annual Report on the SEC’s Whistleblower Program," *Arnold & Porter*, https://www.arnoldporter.com, November 26, 2024; "Whistleblower Rewards: Award Payouts and How They Work," https://www.phillipsandcohen.com, accessed February 18, 2026; "Whistleblower Rewards FAQ," https://www.whistleblowers.org, June 6, 2020; Agnes Jonsson and Jaiden Wick, "SEC Whistleblower Program Sees Dramatic Drop in 2025 Award Payouts," *Whistleblower Network News*, https://whistleblowersblog.org, October 12, 2025; "Rewards for Non-U.S. Whistleblowers," https://www.whistleblowers.org, accessed February 18, 2026.

CONCEPT CHECK

1. How do the broker markets differ from dealer markets, and what organizations compose each of these two markets?
2. Why is the globalization of the securities markets important to U.S. investors? What are some of the other exchanges where U.S companies can list their securities?
3. Briefly describe the key provisions of the main federal laws designed to protect securities investors. What is insider trading, and how can it be harmful? How does the securities industry regulate itself?

16.8 Trends in Financial Management and Securities Markets

8. What are the current developments in financial management and the securities markets?

Many of the key trends shaping the practice of financial management echo those in other disciplines. For example, technology is improving the efficiency with which financial managers run their operations. In the wake of a slowing economy and corporate scandals, the SEC assumed a stronger role and implemented additional regulations to protect investors from fraud and misinformation. A wave of merger mania hit the global securities markets as the securities exchanges themselves have begun to consolidate to capture larger shares of the world's trading volume in multiple types of securities. Online brokerage firms are seeking new ways to capture and keep their customers by broadening the services they offer and keeping the fees they charge highly competitive. Two key areas where technology is playing a role is with overseeing corporate compliance required as a result of the Sarbanes-Oxley Act and advances in electronic trading platforms and niche markets.

Finance Looks Outward

No longer does finance operate in its own little world of spreadsheets and banking relationships. Most CFOs want the finance function to be viewed by their company's business units as a strategic partner who can contribute to their success. Finance professionals therefore need a broad view of company operations to communicate effectively with business unit managers, board members, creditors, and investors. The goal is productive cooperation and teamwork between finance and the business units to meet corporate objectives. CFOs are more highly visible and active in company management than ever before. They serve as both business partner to the chief executive and a fiduciary to the board.

As a result of accounting scandals and the Great Recession, CFOs consider accuracy of financial reporting their top priority, and they also must now provide more detailed explanations of what's behind the numbers to board members and other stakeholders. Rather than showering the board with financial reports and statistics, CFOs are crafting more focused presentations that deal with the company's overall financial health and future prospects.[27] They must also educate board members about the implications of Sarbanes-Oxley and other legislation, such as Dodd-Frank, and what the company is doing to comply with federal regulations.

Vying for the Crown

The NYSE and the NASDAQ continue to compete for the top spot in the global securities markets. The NYSE fell behind because the NSADAQ already had an electronic platform. This prompted the NYSE to respond with their hybrid market, in addition to changes to their organizational structure and merger with Archipelago, a major ECN. NASDAQ responded by expanding their reach by acquiring Instinet's INET. The NYSE made the strategic move to merge with Euronext to create the first cross-border exchange. That prompted the NASDAQ to increase its ownership of shares in the London Stock Exchange. These changes by both exchanges reduced the divide and eliminated many of the differentiating factors.

CONCEPT CHECK

1. How has the role of CFO changed as a result of the passage of the Sarbanes-Oxley Act?
2. Describe the major changes taking place in the U.S. securities markets. What trends are driving these changes?

Key Terms

accounts payable Purchases for which a buyer has not yet paid the seller.
accounts receivable Sales for which a firm has not yet been paid.
bond ratings Letter grades assigned to bond issues to indicate their quality or level of risk; assigned by rating agencies such as Moody's and Standard & Poor's (S&P).
bonds Long-term debt obligations (liabilities) issued by corporations and governments.
broker markets National and regional securities exchanges that bring buyers and sellers together through brokers on a centralized trading floor.
capital budgeting The process of analyzing long-term projects and selecting those that offer the best returns while maximizing the firm's value.
capital expenditures Investments in long-lived assets, such as land, buildings, machinery, equipment, and information services, that are expected to provide benefits over a period longer than one year.
cash flows The inflow and outflow of cash for a firm.
cash management The process of making sure that a firm has enough cash on hand to pay bills as they come due and to meet unexpected expenses.
circuit breakers Corrective measures that, under certain conditions, stop trading in the securities markets for a short cooling-off period to limit the amount the market can drop in one day.
commercial paper Unsecured short-term debt—an IOU—issued by a financially strong corporation.
common stock A security that represents an ownership interest in a corporation.
dealer markets Securities markets where buy and sell orders are executed through dealers, or "market makers," linked by telecommunications networks.
dividends Payments to stockholders from a corporation's profits.
electronic communications networks (ECNs) Private trading networks that allow institutional traders and some individuals to make direct transactions in the fourth market.
exchange traded fund (ETF) A security similar to a mutual fund; holds a broad basket of stocks with a common theme but trades on a stock exchange so that its price changes throughout the day.
factoring A form of short-term financing in which a firm sells its accounts receivable outright at a discount to a factor.
financial management The art and science of managing a firm's money so that it can meet its goals.
financial risk The chance that a firm will be unable to make scheduled interest and principal payments on its debt.
futures contracts Legally binding obligations to buy or sell specified quantities of commodities or financial instruments at an agreed-on price at a future date.
insider trading The use of information that is not available to the general public to make profits on securities transactions.
institutional investors Investment professionals who are paid to manage other people's money.
interest A fixed amount of money paid by the issuer of a bond to the bondholder on a regular schedule, typically every six months; stated as the coupon rate.
investment bankers Firms that act as intermediaries, buying securities from corporations and governments and reselling them to the public.
line of credit An agreement between a bank and a business that specifies the maximum amount of unsecured short-term borrowing the bank will allow the firm over a given period, typically one year.
marketable securities Short-term investments that are easily converted into cash.
mortgage loan A long-term loan made against real estate as collateral.
municipal bonds Bonds issued by states, cities, counties, and other state and local government agencies.
mutual fund A financial-service company that pools investors' funds to buy a selection of securities that meet its stated investment goals.
National Association of Securities Dealers Automated Quotation (NASDAQ) system The first and largest electronic stock market, which is a sophisticated telecommunications network that links dealers throughout

the United States.

options Contracts that entitle holders to buy or sell specified quantities of common stocks or other financial instruments at a set price during a specified time.

over-the-counter (OTC) market Markets, other than the exchanges, on which small companies trade; includes the Over-the-Counter Bulletin Board (OTCBB) and the Pink Sheets.

preferred stock An equity security for which the dividend amount is set at the time the stock is issued and the dividend must be paid before the company can pay dividends to common stockholders.

primary market The securities market where new securities are sold to the public.

principal The amount borrowed by the issuer of a bond; also called par value.

retained earnings Profits that have been reinvested in a firm.

return The opportunity for profit.

revolving credit agreement A guaranteed line of credit whereby a bank agrees that a certain amount of funds will be available for a business to borrow over a given period, typically two to five years.

risk The potential for loss or the chance that an investment will not achieve the expected level of return.

risk-return trade-off A basic principle in finance that holds that the higher the risk, the greater the return that is required.

secondary market The securities market where old (already issued) securities are bought and sold, or traded, among investors; includes broker markets, dealer markets, the over-the-counter market, and the commodities exchanges.

secured loans Loans for which the borrower is required to pledge specific assets as collateral, or security.

securities Investment certificates issued by corporations or governments that represent either equity or debt.

stock dividends Payments to stockholders in the form of more stock; may replace or supplement cash dividends.

stockbroker A person who is licensed to buy and sell securities on behalf of clients.

term loan A business loan with a maturity of more than one year; can be unsecured or secured.

trade credit The extension of credit by the seller to the buyer between the time the buyer receives the goods or services and when it pays for them.

underwriting The process of buying securities from corporations and governments and reselling them to the public; the main activity of investment bankers.

unsecured loans Loans for which the borrower does not have to pledge specific assets as security.

Summary of Learning Outcomes

16.1 The Role of Finance and the Financial Manager

1. How do finance and the financial manager affect the firm's overall strategy?

Finance involves managing the firm's money. The financial manager must decide how much money is needed and when, how best to use the available funds, and how to get the required financing. The financial manager's responsibilities include financial planning, investing (spending money), and financing (raising money). Maximizing the value of the firm is the main goal of the financial manager, whose decisions often have long-term effects.

16.2 How Organizations Use Funds

2. What types of short-term and long-term expenditures does a firm make?

A firm incurs short-term expenses—supplies, inventory, and wages—to support current production, marketing, and sales activities. The financial manager manages the firm's investment in current assets so that the company has enough cash to pay its bills and support accounts receivable and inventory. Long-term expenditures (capital expenditures) are made for fixed assets such as land, buildings, equipment and information systems. Because of the large outlays required for capital expenditures, financial managers

carefully analyze proposed projects to determine which offer the best returns.

16.3 Obtaining Short-Term Financing

3. What are the main sources and costs of unsecured and secured short-term financing?

Short-term financing comes due within one year. The main sources of unsecured short-term financing are trade credit, bank loans, and commercial paper. Secured loans require a pledge of certain assets, such as accounts receivable or inventory, as security for the loan. Factoring, or selling accounts receivable outright at a discount, is another form of short-term financing.

16.4 Raising Long-Term Financing

4. What are the key differences between debt and equity, and what are the major types and features of long-term debt?

Financial managers must choose the best mix of debt and equity for their firm. The main advantage of debt financing is the tax-deductibility of interest. But debt involves financial risk because it requires the payment of interest and principal on specified dates. Equity—common and preferred stock—is considered a permanent form of financing on which the firm may or may not pay dividends. Dividends are not tax-deductible.

The main types of long-term debt are term loans, bonds, and mortgage loans. Term loans can be unsecured or secured and can have maturities between 3 and 25 years. Bonds typically have an initial maturity length of 10 to 30 years. Mortgage loans are secured by real estate. Long-term debt usually costs more than short-term financing because of the greater uncertainty that the borrower will be able to make the scheduled loan payments.

16.5 Equity Financing

5. When and how do firms issue equity, and what are the costs?

The chief sources of equity financing are common stock, retained earnings, and preferred stock. The cost of selling stock includes issuing costs and potential dividend payments. Retained earnings are profits reinvested in the firm. For the issuing firm, preferred stock is more expensive than debt because its dividends are not tax-deductible and its claims are secondary to those of debtholders but less expensive than common stock. Venture capital is often a source of equity financing for young companies.

16.6 Securities Markets

6. How do securities markets help firms raise funding, and what securities trade in the capital markets?

Securities markets allow stocks, bonds, and other securities to be bought and sold quickly and at a fair price. New issues are sold in the primary market. After that, securities are traded in the secondary market. Investment bankers specialize in issuing and selling new security issues. Stockbrokers are licensed professionals who buy and sell securities on behalf of their clients.

In addition to corporate securities, investors can trade U.S. government Treasury securities and municipal bonds, mutual funds, futures, and options. Mutual funds are managed by financial-service companies that pool the funds of many investors to buy a diversified portfolio of securities. Investors choose mutual funds because they offer a convenient way to diversify and are professionally managed. Exchange-traded funds (ETFs) are similar to mutual funds but trade on stock exchanges similar to common stock. Futures contracts are legally binding obligations to buy or sell specified quantities of commodities or financial instruments at an agreed-on price at a future date. They are very risky investments because the price of the commodity or financial instrument may change drastically. Options are contracts that entitle the holder the right to buy or sell specified quantities of common stock or other financial instruments at a set price during a specified time. They, too, are high-risk investments.

16.7 Buying and Selling at Securities Exchanges

7. Where can investors buy and sell securities, and how are securities markets regulated?

Securities are resold in secondary markets, which include both broker markets and dealer markets. The broker market consists of national and regional securities exchanges, such as the New York Stock Exchange, that bring buyers and sellers together through brokers. Dealer markets use sophisticated electronic platforms that link dealers throughout the United States. The NASDAQ and over-the-counter markets are examples of dealer markets. In addition to broker and dealer markets, electronic communications networks (ECNs) can be used to make securities transactions. In addition to the U.S. markets, more than 70 countries have securities exchanges. The largest non-U.S. exchanges are Shanghai and the Japan/Tokyo Stock, Toronto, London, National (India), Shenzen (China), and Korea.

The Securities Act of 1933 requires disclosure of important information regarding new securities issues. The Securities Exchange Act of 1934 and its 1964 amendment formally empowered the Securities and Exchange Commission and granted it broad powers to regulate the securities exchanges and the dealer markets. The Investment Company Act of 1940 places investment companies such as companies that issue mutual funds under SEC control. The securities markets also have self-regulatory groups such as the Financial Industry Regulatory Authority (FINRA) and measures such as “circuit breakers” to halt trading if the S&P 500 Index drops rapidly.

16.8 Trends in Financial Management and Securities Markets

8. What are the current developments in financial management and the securities markets?

The role of the CFO has continued to expand since the passage of the Sarbanes-Oxley Act, with CFOs taking the central role in overseeing corporate compliance with the act and reestablishing public trust. CFOs must look outward and be business focused. Most CFOs are promoting strategic finance and encouraging finance staff to be team players who work closely with business units to achieve corporate goals.

Competition among the world’s major securities exchanges has changed the composition of the financial marketplace. The NYSE and NASDAQ compete for the top spot in the United States. The NYSE became a for-profit company, acquired Archipelago, an electronic exchange, and merged with Euronext to form the first transatlantic exchange. NASDAQ also expanded by acquiring its own ECN and buying a 25 percent stake in the London Stock Exchange, which continues to look for a potential buyer.

Preparing for Tomorrow's Workplace Skills

1. The head of your school’s finance department has asked you to address a group of incoming business students about the importance of finance to their overall business education. Develop an outline with the key points you would cover in your speech. (Information)
2. You are the chief financial officer of Discovery Labs, a privately held biotechnology company that needs to raise $3 million to fund the development of a new drug. Prepare a report for the board of directors that discusses the types of long-term financing available to the firm, their pros and cons, and the key factors to consider in choosing a financing strategy. (Information)
3. **Team Activity** Does paying dividends enhance the value of a company? Some financial experts caution companies to look long and hard before beginning to pay dividends. They believe that committing to a regular dividend curtails financial flexibility and reduces debt capacity. Dividends might also signal that the company doesn’t have good growth opportunities in which to invest its excess cash. Others counter that dividends can help a company’s stock by making it less volatile. Standard & Poor’s data supports this; typically, dividend-paying stocks in the S&P 500 outperform nonpayers. Divide the class into two teams to debate whether dividends add value to a company’s stock. (Interpersonal, Information)
4. Research the trends in the IPO marketplace from 2019 through 2025. Then select two IPO success stories and two failures. Prepare a report for the class on their performance. What lessons about the securities

markets can you learn from their stories? (Information)

5. While having dinner at a Manhattan restaurant, you overhear two investment bankers at the next table. They are discussing the takeover of Bellamco Industries by Gildmart Corp., a deal that has not yet been announced. You have been thinking about buying Bellamco stock for a while, so the next day you buy 500 shares for $30 each. Two weeks later, Gildmart announces its acquisition of Bellamco at a price of $45 per share. Have you fairly earned a profit, or are you guilty of insider trading? What's wrong with insider trading? (Information)
6. **Team Activity** Is joining an investment club a good way to learn about investing in the stock market? Divide the class into groups of five to eight students to develop a strategy to form their own investment club. Use the National Association of Investors Corporation (NAIC) website at **https://www.betterinvesting.org** to learn how investment clubs operate and the investment strategy the organization teaches. Each group should then set up guidelines for their investment club and present their plan to the class. After the presentations, the class members should discuss whether they would prefer to start investing through an investment club or on their own. (Resources, Interpersonal, Information)

Ethics Activity

In late July 2017, senior management at Equifax, a U.S. credit-reporting company, discovered that hackers had stolen the personal data of more than 145 million U.S. customers, including names, birthdates, Social Security numbers, and driver's license information. In addition, the hackers stole credit card information for more than 200,000 Equifax customers.

If that weren't bad enough, reports soon surfaced that three top executives, including Equifax's chief financial officer, sold close to $2 million in shares of company stock days after learning about the breach and more than a month before the company announced the data hack publicly. In a company statement, Equifax says the executives "had no knowledge that an intrusion had occurred at the time they sold their shares." The day after the company's announcement about the breach, Equifax's stock dropped by double digits, and the Department of Justice opened a criminal investigation.

Less than three weeks after the public announcement, Equifax announced its CEO, Richard Smith, would retire, taking a multimillion-dollar payout with him—even after shareholders lost more than $5 *billion* in stock value after the data breach was acknowledged.

Ethical Dilemma: Is it legal for company executives to sell stock shares for financial gain when they know impending bad news will cause the stock price to plummet? Does this constitute insider trading?

Sources: Verne Kopytoff, "Equifax Board Reviews Executive Stock Sales after Data Breach," *Fortune,* https://fortune.com, September 29, 2017; Jen Wieczner, "Equifax CEO Richard Smith Who Oversaw Breach to Collect $90 Million," *Fortune,* https://www.fortune.com, September 26, 2017; Tom Schoenberg, Anders Melin, and Matt Robinson, "Equifax Stock Sales Are the Focus of U.S. Criminal Probe," *Bloomberg Markets,* https://www.bloomberg.com, September 18, 2017; Liz Moyer, "Suspect Trading in Equifax Options before Breach Might Have Generated Millions in Profit," *CNBC,* https://www.cnbc.com, September 8, 2017; Alina Selyukh, "3 Equifax Executives Sold Stock Days after Hack That Wasn't Disclosed for a Month," *NPR,* https://www.npr.org, September 8, 2017; Anders Melin, "Three Equifax Managers Sold Stock Before Cyber Hack Revealed," *Bloomberg News,* https://www.bloomberg.com, September 7, 2017.

Working the Net

1. If factoring accounts receivable is still a mystery to you, visit the 21st Financial Solutions site, **https://www.21stfinancialsolutions.com**. Follow the links on the home page to answer these questions: What are factoring's advantages? What are the additional benefits, and what types of companies can use factoring to their advantage? Then summarize the factoring process.

2. Go to the Eqvista website at **https://eqvista.com/best-100-active-venture-capitalist-firms-for-startup-funding/**, and link to three different venture capital firms listed in the website's "best" list. Compare the firms' investment strategies (industry specialization, age of companies in which they invest, etc.). Also do a web search to check out two angel investor firms. How do their requirements differ from the venture firms?
3. Compare the listing requirements of the NYSE and NASDAQ, using the information at their websites: **https://www.nyse.com** and **https://www.nasdaq.com**. Search the sites for listing requirements. What types of companies qualify for listing on each exchange? Why does NASDAQ offer alternative listing standards?
4. Choose a company currently traded on the NYSE (**https://www.nyse.com**). Find the company's website using a search engine such as Google. At the website, find the firm's investor relations information. Review the information, including, if available, the most recent online annual report. Follow up by researching if any SEC actions have been taken against the firm at the SEC website, **https://www.sec.gov**. Summarize your findings in a brief report that discusses whether you would recommend this company's stock as an investment.
5. Using the information and links available at the Securities Industry and Financial Markets Association's (SIFMA) website, **https://www.sifma.org**, write a brief paper explaining the pros and cons of investing in corporate bonds. In your paper, provide at least three examples of currently available corporate bonds from a site such as **https://public.com/bonds/screener**, and explain why they would be good investments.
6. Research the job responsibilities of a corporate investor relations officer (IRO). If possible, try to interview an IRO, by either phone or email. The National Investor Relations Institute (**https://www.niri.org**), a trade association for IROs, is an alternate source of information. What types of experience and education does an IRO need in order to perform effectively? How are their roles changing? Write a paper summarizing your findings. (Interpersonal, Information)

Critical Thinking Case

Blue Apron IPO Leaves a Bad Taste

Blue Apron was once one of the top meal-kit delivery services doing business in the United States. Started by three cofounders—Matt Salzberg, Matt Wadiak, and Ilia Pappas—Blue Apron provides preportioned ingredients (and recipes) for a meal, delivered to consumers' front doors.

Today, the U.S. meal-kit delivery industry is a nearly $20 billion business that is expected to reach over $50 billion by 2035 as more and more consumers struggle to find time to go grocery shopping, make meals, and spend time with family and friends in their hectic daily lives.

As word spread among foodies about the quality and innovative meals put together by Blue Apron, the company's popularity took off, supported by millions in start-up funding. Costs to scale the business have not been cheap—estimates suggest that Blue Apron's marketing costs have been high.

Despite the challenges, by early 2017 the company was selling more than 8 million meal kits a month and decided to go public in an effort to raise more money and scale its operations, including a new fulfillment facility in New Jersey. According to IPO paperwork filed with the SEC, the company had net revenues of $84 million in 2014, which increased to $795 million in 2016. However, those ambitious numbers were not without warnings: company losses increased in the same time period from $33 million to $55 million.

Even with those larges losses on its balance sheet, Blue Apron decided to go ahead with the IPO and hired Goldman Sachs and Morgan Stanley, two top stock underwriters, to figure out the right price for the initial offering. While Blue Apron and its underwriters were finalizing stock prices, Amazon announced plans to acquire Whole Foods—a move that could negatively affect Blue Apron's business going forward.

Even after Amazon's announcement, Blue Apron and its financial advisors priced the initial offering at $15 to

$17 a share and met with investors across the country to inform them about the IPO, which would value the company on paper at more than $3 billion. As part of the IPO strategy, Blue Apron executives needed to communicate a strong financial picture while providing potential investors with an honest assessment of investor demand, especially for institutional investors, who typically are repeat buyers when it comes to IPOs.

According to sources close to the IPO experience, Blue Apron's bankers told investors late in the IPO pricing process that they were "closing their order books early," which meant there was a heightened demand for the stock—a signal that the stock would be priced in the original $15–$17 range.

A day later, however, Blue Apron amended its prospectus with a price range between $10 and $11 a share, which shocked potential investors—a move greeted with criticism that Blue Apron's messaging now lacked credibility in the eyes of the investment community if the company priced the IPO $5 lower per share than originally estimated. With that sudden change in the IPO offering, investors walked away, and the $10 initial offering for Blue Apron stock actually declined on its first day of trading. The stock declined to a low of $4.70 in August of 2023, prompting the company to consider its options.

With continued consolidation in the meal-kit delivery sector inevitable, Blue Apron was at a crossroads when it comes to generating revenue and stabilizing costs while trying to sign up more subscribers. Market competitor Plated was acquired by the Albertson's grocery chain in 2017, and Amazon trademarked the phrase, "We do the prep. You be the chef," as it rolled out prepared food kits in that same year through its AmazonFresh delivery service. The strong competition in the industry, high costs related to gaining customers, and an overall weak competitive advantage prompted Blue Apron to be acquired by The Wonder Group at the end of 2023. Since the acquisition, the service has been rebranded to offer more meal options, additional features such as family-friendly meals and one-pan meals, and enhanced customization options.

Critical Thinking Questions

1. What issues should executives of a company such as Blue Apron consider before deciding to go public? In your opinion, was the company ready for an IPO? Why or why not?
2. How else could Blue Apron have raised funds to continue to grow? Compare the risks of raising private funding to going public.
3. Research the history of the company to learn about the factors that led to Blue Apron's acquisition. Prepare a brief summary, including how the acquisition by the Wonder Group could help Blue Apron survive.

Sources: Wolf Richter, "Blue Apron's Cash Burn Is a Threat Just 3 Months after Its IPO," *Business Insider,* https://www.businessinsider.com, October 19, 2017; Graham Rapier, "Blue Apron CEO: Amazon and Whole Foods Aren't the Competition," *Business Insider,* https://markets.businessinsider.com, September 13, 2017; Matthew Lynley, "Where Does Blue Apron Go after Amazon Wraps Up Its Whole Foods Deal?" *Tech Crunch,* https://techcrunch.com, August 27, 2017; Leslie Picker, "Inside Blue Apron's IPO: Communication Lapse Chased Away Investors," *CNBC,* https://www.cnbc.com, August 23, 2017; Phil Lempert, "Understanding Blue Apron's IPO and the Future of Meal Kits," *Forbes,* https://www.forbes.com, June 2, 2017; "Meal Kit Delivery Services Market Summary," https://www.grandviewresearch.com, accessed February 18, 2026; "Blue Apron Holdings Inc (APRN)," https://www.investing.com, accessed February 18, 2026; Allee Manning, "Amazon Is Launching a Meal Kit Delivery Service," *Self,* https://www.self.com, July 18, 2017; Brooke Bajgrowicz, "Everything You Need To Know About Blue Apron's Rebrand," *Forbes*, https://www.forbes.com, September 23, 2025.

Hot Links Address Book

1. What challenges do today's financial managers face? To find out, browse through current issues of *CFO* magazine at **https://www.cfo.com**.
2. Find an introduction to the types of cash management services banks offer their customers at the Royal Bank of Canada website, **https://www.rbcroyalbank.com**.
3. Start your online exploring at Yahoo! Finance, **https://finance.yahoo.com,** which offers everything from

breaking business and world news to stock research, portfolio tracking tools, and educational articles.

4. For small businesses just starting out or entrepreneurs who have invented the next great product but need some financial assistance, several crowdfunding platforms can help. Both Kiva (**https://www.kiva.org**) and IndieGoGo (**https://www.indiegogo.com**) offer loans or financial backing to help people start up new businesses or match potential investors with entrepreneurs looking for some financial backing.
5. The Motley Fool, **https://www.fool.com**, is a favorite site for both novice and experienced investors. In addition to the latest stock picks, the website offers detailed information on a variety of topics, such as how to invest, retirement, and personal finance.
6. You'll find dozens of minicourses, including several on bonds, when you select "Courses" at the top of the page at **https://www.interactivebrokers.com/campus/**.
7. Moneychimp (**https://www.moneychimp.com**) strives to educate investors by offering clear, practical articles on a complete range of finance and investing topics, including investment basics, understanding annual reports, stock valuation, and more.
8. Thinking of investing in a particular company? Go to the SEC's website to access the EDGAR database of the financial reports filed by all public companies with the SEC: **https://www.sec.gov**.

17

Your Career in Business

Exhibit 17.1 (Credit: public Information Office / flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. How can you enhance your interpersonal skills?
2. Why is learning to plan so important in your education and in the real world?
3. What skills should you develop that can transfer easily to your professional life and make it a success?
4. What are some strategies that will help you find, keep, and advance in your career?
5. What key attributes do employers look for when interviewing job candidates?

What makes someone successful in life? For many, it means going through the various stages of life satisfied in knowing that they have done their best: their best at work and home, in health and mind, in self and relationships, and in all pursuits of life. A big part of having a happy life is pursuing a career that offers job satisfaction. And for many, an education helps to unlock opportunities that can lead to professional and personal fulfillment. An education can help you to:

- **Get and keep a better job.** Because the world is changing rapidly and many jobs rely on new technology, more jobs require education beyond high school. With a college education, you will have more jobs from which to choose.
- **Earn more money.** People who go to college usually earn more than those who do not. Education beyond a high school diploma is worth between $5,000 and $10,000 a year. That salary increase grows with the more education you attain, whether in the form of advanced degrees, certifications, or licenses.[1]
- **Get a good start in life.** A business education helps you acquire a wide range of knowledge in many subjects as well as a deeper understanding of your specialized area of business.

Simply stated, an education in business gives you the chance to pursue and achieve the satisfaction in life you deserve. The knowledge, experience, networking connections, and additional purchasing power of a degree won't guarantee a satisfying life and career, but it can put you well onto the road to finding it.

17.1 Learn the Basics of Business

You might want to pursue a career as a physician, small business owner, financial analyst, information technology professional, or any of a thousand other opportunities. One thing that many careers have in common is that you need to have a basic understanding of business. Regardless of the career field you choose, having solid business skills will be of benefit. The concepts covered in this text give you a good foundation of the business environment to take into your career—whatever that may be.

Exhibit 17.2 Finding one's dream job requires combing through job descriptions, researching salary information, taking career-assessment tests, and shadowing others in the workplace. But sometimes people need some career advice or mentorship to "pivot" to a new career or to fine-tune their current job skills. That's where Pivot comes in—the company provides mentorship, résumé assistance, social media advice, mock interview practice, and more with a paid subscription. *How can this type of advice and mentorship help individuals longing to change their career paths?* (Credit: U.S. Fish and Wildlife Service Southeast Region/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Choose a Career

Because this introductory business course gives you a detailed overview of all the major areas of business, it will guide you in selecting a major should you elect to get a degree in business. Choosing a career path is an important decision. Your career and the education needed to be successful in that field can have an impact on your life choices moving forward. For example, a marketing professional might have a career in sales, marketing research, or advertising. But they also could start out in one area of marketing and pivot as they develop in their field. Someone in the accounting field may determine mid-career that they wish to pursue a different path and shift to cybersecurity or information technology. Over your lifetime, you will likely put in about 90,000 work hours in your career field. Your path might go in various directions based on your stage of life and changing interests. The key is doing something that you can find rewarding and satisfying.

17.2 Developing Interpersonal Skills Is Key to Your Success

A degree in business can offer you many great career opportunities. Once you take your first job, how rapidly you move up the ladder is up to you. People with strong interpersonal skills can do better both on and off the job. It has been estimated that 85 percent of workplace success is based on interpersonal skills.[2] If you aspire to be in a leadership position in your career, here are some ways to enhance your interpersonal skills to help get you there:

1. **Build your people skills.** Learn to build alliances in a group and foster an environment of collaboration. That is not to say that you have to be friends with all of your coworkers, but taking the time to get to know them and to build a strong rapport can go a long way toward establishing strong team collaboration and effectiveness. Make a concerted effort to know what is happening in the lives of your colleagues. Skills such as being open to constructive criticism, listening, problem-solving, collaboration, empathy, being trustworthy, and reliability are all useful abilities in the workplace. Offering praise and thanks are also important aspects of strong interpersonal skills.

   Become a good listener. When you listen well, you are in effect telling the other person that they are worth listening to. Listening well includes listening to both what is said and what is not said. Learn to read unspoken gestures and expressions. When giving feedback, plan what you will say in advance. Be positive and specific. Ask the person receiving the feedback if they would like to discuss your comments further.

2. **Understand how to persuade others.** Remember: we all must sell ourselves and our ideas to get ahead in life and in business. Influencing others means overcoming objections, igniting passions, or changing minds. First, help establish a culture of shared enthusiasm and buy-in to the company or group goals. Using strong communication and listening skills can build a culture where everyone is working toward shared goals, while recognizing the unique contributions that each member brings to the table. Recognize team members for their contributions and celebrate successes.

   Persuasion rests on trust. You can build trust by being honest, fulfilling your commitments, being concerned about others, and minimizing problems and pain for others whenever possible. In short, if you have integrity, building trust becomes a simple task.

   When people raise objections to your plans or ideas, try to fully understand their comments and the motivation for making them. For example, if there is an objection to an idea presented, you can follow up with rationale based on facts and data to support your position. Be willing to compromise, realizing that your ideas might not be the only solution to achieving the goal. Determine your persuasion skills by taking the quiz in **Table 17.1**.

3. **Learn to think on your feet.** Top executives say that thinking and speaking well on your feet while under pressure is the best thing that you can do for your career. An important skill to practice is being able to clearly express yourself with confidence, even when under pressure. If you display confidence in tense situations, you will be more likely to get others to listen to your perspective. [3]

Self-Test—Can You Persuade Others?				
Rate your level of agreement with the statements below using the following scale:				
Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
1. I prefer to work in a team rather than individually. 2. I enjoy motivating others to help accomplish objectives. 3. I avoid working with difficult people or trying to resolve group differences. 4. I can learn more working in a team rather than working by myself. 5. I would prefer to work with individuals I have known previously. 6. I give up if my team members do not agree with me. 7. I may not always convince my team members to agree with my opinions, but I will go ahead and do what I feel is correct. 8. I think people who can persuade others always possess sound judgment. 9. I will do the work myself if others do not agree to do it. 10. To get the work done, I will listen to a person to understand how they want it to be done. 11. I can get people to voluntarily make commitments and get the work done.[4]				
See the scoring guidelines at the end of this chapter to obtain your score.				

Table 17.1

It will not happen overnight, but you can become a skilled and confident thinker and speaker. Consider practicing your public speaking skills with a friend. You could ask this person to speak on a topic for a few minutes. During this time, you should be carefully listening to understand the concept they are discussing. When they are finished, the challenge for you is to use their main topic to set the stage for your speech. Another technique is to have someone "interview" you asking you specific questions about yourself and your experiences. You might also consider recording yourself during these activities. We often are unaware of habits such as certain body language or speech patterns until we see ourselves on video. Replaying the recording can reveal areas in which you can improve your communication skills.

4. **Empower yourself.** No matter who you are, what position you will hold, or where you work, you probably will have to report to somebody. If you are fortunate enough to work in a culture of empowerment, you are allowed control over your job (not complete control, but enough control to make you feel your opinion matters). Having the ability to provide input in the workplace is a key aspect of job satisfaction and motivation. When empowered, you have the confidence to do something to alter your circumstances. On the job, empowerment means that you can make decisions to benefit the organization and its customers.

   If you want to gain empowerment in your life and work, here are a few tips: be confident and do not be afraid to speak up, present your ideas to the group and your supervisors with solid rationale, link your personal goals to the goals of the organization, develop your leadership skills, seek out learning opportunities, reflect on bad situations and how you can manage or change them, give yourself grace when you fail, and celebrate your successes.

5. **Understand office politics.** Politics is often an integrated part of organizations, including schools and workplaces, and can have an influence on the inner workings and interpersonal relationships of the business environment. You should learn to navigate office politics to understand what is going on behind the scenes. At times, you may need to form alliances with key players in the organization to facilitate getting a job accomplished. For example, sometimes those employees that are not in a defined leadership

position can have key information or skills that you will need to be successful. Collaborating with those coworkers can be invaluable to your career and overall the success of your work projects. Being political means getting along with others in order to move them toward accomplishing a specific goal. It does not mean maneuvering for selfish purposes, manipulating in order to deceive, or scheming so others lose while you win.

Here are some tips and techniques to be effective at navigating office politics:

- *Think about what you say.* Understand the effect your words will have on others before you say or write them.
- *Empathize.* Try to think of a situation from the other person's perspective.
- *Suggest a trial period if you meet opposition to an idea you're proposing.* If you are as successful as you are confident, you can then ask to have the trial period extended.
- *Learn about the political climate in which you are working.* This means knowing, among other things, what actions have led to failure for others, knowing who is "in" and why, determining who is "out" and why, and learning what behaviors lead to promotion.
- *Volunteer to do the jobs no one else wants to do.* Occasionally pitching in shows your willingness to get the job done, and being a team player goes a long way to building your credibility in an organization. However, care should be taken to not over volunteer for tasks far outside of your work duties. This could take away from the job you were hired to perform and that could reflect poorly on your evaluations.
- *Work hard to meet the needs of those in authority.* Make certain you fully understand management's requirements; then go out of your way to meet them. If in time you do not think you are getting the recognition or respect you deserve, make your own needs known.
- *Give credit to others.* You never know who may be in a position to help you in the future, regardless of their position in the firm. Consequently, the best policy is to treat everyone with respect and dignity. Show your appreciation to everyone who has helped you. Do not steal credit that belongs to someone else.
- *Learn your supervisor's preferences.* The more you are aware of your supervisor's style, wishes, and preferences, the better you can work together. However, try not to simply mimic your supervisor's style. Instead, understand how to work with the manager while maintaining your style and voicing your ideas and/or concerns.
- *Maintain confidentiality and privacy.* Resist the temptation to spread rumors or share overly personal information in the workplace. Not only do you run the risk of sharing false information about others, but you also risk others viewing you in a negative light for spreading rumors. If you are revealing information told to you in confidence about a coworker or even the company itself, you risk losing the trust and respect of your colleagues. Try to avoid sharing too much about your personal life in the workplace and consider setting your social media profiles to private. Negative public information about your private life can reflect poorly on you in the workplace or possibly even on your employer.

Find out how well you play the political game by taking the quiz in **Table 17.3**.

6. **Become a team builder.** Throughout your college and business career, you will participate on teams. You can expect some level of teamwork in nearly all organizations. An effective team is one that meets its goals on time and, if a budget is involved, within budget. It is important that the team have good communication skills, a culture of collaboration, and clear goals that are tied to the larger organizational goals. **Table 17.2** lists the questions that teams should answer to ensure their success.

Key Questions That Teams Should Answer before Starting a Project
1. What are the goals? 2. Who provides the mission statement? 3. What are our limits? 4. Where will support come from? Who will be our sponsor? 5. Who will be team leader? How is that person selected? 6. What are the deadlines we face? 7. What resources are available? 8. What data will we need to collect? 9. For how long will our team exist? 10. Who are the customers for our team results? What do they expect of us? 11. Will our team responsibilities conflict with our regular jobs? 12. What is the reward for success? 13. How will decisions be made? 14. How will our efforts be measured? 15. Will our intended success be replicated? If so, how and by whom?[5]
See the scoring guidelines at the end of this chapter to obtain your score.

Table 17.2

Self-Test—Are You Good at Office Politics?
Answer "yes" or "no" to the following questions:
1. To be successful, you should have a strong relationship with your boss, peers, and subordinates. 2. Office politics is not very challenging. 3. Tough people give you a tough time but also teach you tough lessons. 4. Networking and observation play a major role in being good at office politics. 5. There are no ethics or morals in office politics. 6. Corporate politics is not about the individuals; it is about the survival of the corporation. 7. Office politics is the only way; you gain real access to your boss's ear. 8. Those who avoid being political at work may not move forward in their careers, may find themselves resentful and frustrated, and run the risk of being isolated. 9. If you do all of the work on a project, you won't tell the boss because you don't want your coworkers to get in trouble. 10. When faced with gossip and rumors, you prefer to be silent but aware. 11. To succeed in office politics, you should seek a win-lose situation. 12. If a person in authority is out to get rid of you, a good tactic would be to establish allies and position yourself for another job in the company. 13. If you have made any significant contribution to a project, you always make sure that others know about it, which, in turn, adds to your reputation.[6]
See the scoring guidelines at the end of this chapter to obtain your score.

Table 17.3

7. **Handle conflict well.** The world is not a perfect place, and there are no perfect people living in it. The best we can hope for is people's willingness to improve life's circumstances. If we are truly committed to the idea of reducing conflict in organizations, there is much we can do to inspire such willingness in others. Bringing conflict into the open has its advantages. Talking about conflict often helps to clear the air, and thinking about the possibility of conflict often helps to avoid it.

   When conflicts occur, try the K-I-N-D technique. The letters stand for:

   K = Kind
   I = Informed
   N = New
   D = Definite

   The technique involves your requesting a meeting with the difficult person, whether they are is having a conflict with you or with others. Start off with kind words, words that encourage cooperation, words that show your determination to make the conflict situation better. Next, demonstrate that you have taken the time to learn more about the person, what is important to them, what they prefers in terms of work. Show by your words that you have taken the time to become informed about the individual.

   The third step requires you to do something novel, something you have not tried before. Put your creativity to work, and discover a plan to which you can both subscribe (for example, document the main issues and possible solutions in a shared file).

   Finally, do not permit the exchange to conclude until you have made a definite overture to ensure future success. What can you promise the other person you will do differently? What are you asking them to do differently? Set a time to meet again and review your individual attempts to achieve collective improvement.

17.3 Make Your Future Happen: Learn to Plan

There is a natural conflict between planning and being impulsive, between pursuing a long-range goal and doing what you feel like doing right now. If you have ever had to study while the rest of the family was enjoying a show, you know what that conflict feels like. If you have ever been invited out to dinner with friends but stayed home to work on a class assignment, you know that sticking to a plan is not easy.[7]

Of course, planning and being impulsive both have a place in your life. You need to balance them. Having a plan does not mean that you can't act on the spur of the moment and do something that was not planned. Spontaneous events can produce some of the happiest, most meaningful times of your life. Problems arise when you consistently substitute impulsive actions for goal-oriented planning. Success in life requires a balance between the two.

If you do not engage in long-range planning and lack the discipline for it, you may limit your opportunities to be impulsive. For example, if you have not planned for the expense associated with a weekend trip out of town with friends, you may not be able to go. In the short run, planning involves sacrifice, but in the long run, it gives you more options.

Exhibit 17.3 Life requires planning, and the more important one's goals, the more important planning is to achieve these goals. Whether the objective is to obtain a degree, attain a leadership position in your professional career, or serve the community through serving on a nonprofit board of directors, personal success depends on a good plan. *How can the six steps of the planning process help individuals achieve their educational, personal, and career dreams?* (Credit: Urban Promise/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

What Is a Plan?

A **plan** is a method or process worked out in advance that leads to the achievement of some goal. A plan is systematic, which means it relies on using a step-by-step procedure. A plan also needs to be flexible so that it may be adapted to gradual changes in your goal.

The Planning Process

Whether choosing a career path or where to apply for a job, you should understand how the planning process helps you accomplish your goals. The following steps outline the planning process.

Step 1: Set a Goal. Identify something you want to achieve or obtain, your **goal**. The goal, which is usually longer term in nature, will require planning, patience, and discipline to achieve.

Step 2: Acquire Knowledge. Gain an understanding of your goal and what will be required to achieve it. Gather information about your goal through research, conversation, and thought.

Step 3: Compare Alternatives. Weigh your options, which are the different paths you might take to achieve your goal. Analyze the pluses and minuses of each—the costs, the demands, the likelihood of success.

Step 4: Choose a Strategy. Select one option as the best plan of action. The choice is based on sound information, the experience of others, and your own interests and abilities.

Step 5: Make a Commitment. Resolve to proceed step-by-step toward achieving your goal. Keep your eyes on the prize.

Step 6: Stay Flexible. Evaluate your progress, and when necessary, revise your plan to deal with changing circumstances and new opportunities.

An Example of Planning

The following example illustrates the process of buying new bluetooth earbuds using this planning process.

Step 1: Set a Goal. Purchase a pair of wireless headphones.

Step 2: Acquire Knowledge. Ask friends if you can try out their headphones. Study standards and specifications. Check on retailers, brands, models, and prices. Research brands through trusted online sources.

Step 3: Compare Alternatives.

Alternative 1: Purchase a pair of headphones from a website such as eBay or Poshmark.

- *Pro:* Affordable high-end equipment. Can buy right now.
- *Con:* Uncertain condition of equipment. Limited warranty.

Alternative 2: Buy earbuds for $70.
- *Pro:* Can afford now; new equipment with warranty.
- *Con:* Not the best sound quality.

Alternative 3: Buy a high-quality pair of earbuds for $300.
- *Pro:* Excellent sound; new equipment with warranty.
- *Con:* Costs more than prepared to pay now.

Step 4: Choose a Strategy. Decide to buy the high-quality product, but rather than using a credit card that charges interest, choose a no-interest payment option (buy now, pay later) such as Affirm or Afterpay that splits the total cost into smaller payments. You could also delay the purchase for six months to save for them.

Step 5: Make a Commitment. Give up going out for trivia night or buying coffee at the local cafe for the six-month period, eat meals at home, and place the savings in a designated headphones fund.

Step 6: Stay Flexible. Four months into the plan, a sale on the model you want provides an opportunity to buy it for a discount. Make the purchase, paying cash.

Planning for Your Life

Using the planning process to make a buying decision is a simple exercise. Making a decision about major parts of your life is far more complex. You will see that no part of life is exempt from the need for planning. It is important to apply thought, creativity, and discipline to all the interrelated phases of our lives. These phases include the following:

- **Career:** Choosing a field of work and developing the knowledge and skills needed to enter and move ahead in that field. We will offer you some tips to get started on a career later in this chapter.
- **Self:** Deciding who you are and what kind of person you want to be, working to develop your strengths and overcome your weaknesses, refining your values.
- **Lifestyle:** Expressing yourself in the nature and quality of your everyday life, your recreation and hobbies, how you use your time, money, and other resources.
- **Relationships:** Developing friendships and learning to get along with people in a variety of contexts. Building family and community ties.
- **Finances:** Building the financial resources and the economic security needed to pursue all the other dimensions of your life.
- **Physical and mental well-being:** Incorporating the necessary breaks, habits, and activities to support your physical and mental health.

Dreams and Plans

People like to dream about what lies ahead. Dreams help you frame plans for the future. For example, if your dream job is to work in a large city, then your plans and choices surrounding your career can be built around that dream. You have a right to your dreams, and they can encourage you—even if dreams feel out of reach, they can be a strong source of motivation.

Planning is not the same as dreaming, but it uses dreams as raw materials. It translates them into specific goals. It tests them. It lays out a course of action that moves you toward realizing these goals and sets up milestones you need to achieve. Planning brings dreams down to earth and turns them into something real and attainable. For example, assume you have a dream to visit Spain. To translate this dream into a specific goal, you will need to follow the planning process—gather information about the places you want to visit in Spain, maybe seek out a tour company offering a package deal, discuss the dream with your friends and family, and work to improve your Spanish-language skills.

Directions for Your Life

One of the best things about pursuing our dreams is that, even when you fall short of attaining the dream, the

effort spent can be viewed as a growth opportunity and could lead you down another path. The person who trains as a musician may not achieve the dream of making a career of playing music, but they may use that passion instead to work as a director of a musical arts organization or as a music teacher. Your team might have come in second place in the tournament last year, but with practice and more skill development, you can find yourselves able to win the state title this year. Without a plan, dreams are seldom realized. With a plan, they give shape and direction to our lives.

Planning involves a lot of thinking and finding answers to lots of questions. The answers and even the plan will change over time as you gain more knowledge and experience. Planning is a skill that can be useful in many areas of your life. It is something you have to pursue consciously and thoughtfully. When you plan, you translate your goals and dreams into step-by-step strategies, specific things you can do to test your goals and bring them to reality. You often have to revise your plans, but even when your plans are not fulfilled, planning will have a positive effect on the course of your life.

17.4 Optimize Your Education

You have already had one of your dreams come true—you are pursuing an education. In the United States, around 60 percent of high school graduates enroll in college, with fewer than 40 percent graduating. So make the best of it by putting in effort, working hard in your studies, and learning the following skills.[8]

Learn to Concentrate

Concentration is the art of being focused, the ability to pay attention. Concentration can help you better remember what you hear, see, and read. Concentration is a frame of mind that enables you to stay centered on the activity or work you are doing. You know when you're concentrating when you are able to tune out distractions and are able to focus your energies on the task at hand.

There are strategies to enhance your ability to concentrate. Here are some ways to make it happen:

- *Choose a workplace*. Avoid the bed—many people associate it with relaxing or sleeping. Consider an alternate location to work such as a desk or a table. This will give you a change of scenery and a space that is more conducive to work. Be sure to have good lighting.
- *Pay attention to nutrition needs.* What you eat plays an important role in how well or how poorly you concentrate. Vegetables and protein foods (such as eggs, dairy, beans, fish, lean meats, and nuts), keep the mind alert, while carbohydrates (such as white bread, pasta, baked goods, rice, and sugary foods) make you sleepy.
- *Listen to your own thoughts.* Minimizing distractions can facilitate your concentration efforts. Things such as music, videos, or cell phones can interrupt your concentration. Consider putting your phone on silent and maybe even across to the room to reduce the temptation to look at the screen.
- *Make a to-do list.* If you are trying to study but get distracted by all of the things you need to do, take time to make a to-do list. Jotting down a list and referring to it from time to time can be very effective for clearing your mind and focusing on your task.
- *Take short, frequent breaks.* Research indicates that you can concentrate effectively for about 15 to 20 minutes before your concentration begins to fade. Therefore, it makes sense to capitalize on your natural body rhythms and take a short break every 20 to 30 minutes. If you feel you are fully concentrating and involved in a task, then work until a natural break occurs.

Learn to Manage Your Time

There are two ways to make sure you have more time in a day. *The first and most important way to gain more time is to plan it.* Think about planning a group outing with your friends. You need to know where you are going and have a plan to get there. Without a plan, you will waste your time and take longer to get to your destination—if you get there at all!

Find a way to keep track of your weekly tasks and assignments. This could be a physical planner or it could be a calendar/planner app on your phone or computer. Using a method to record your tasks is an effective way to plan your week or day. Also, by capturing the information by writing it down or adding it to your virtual calendar, you do not have to expend the mental energy trying to remember it all.

A second way to gain more time in a day is to do more in less time. This can be as simple as doubling up on activities. For example, if you have several errands, consider the most efficient way to tackle all three. Can you combine trips? Can you map your route to make the most of your time and travel distance? If you commute, you could use this time to study or work on other tasks. You might utilize your lunch break to organize your notes for a class. Use your imagination as to how you can get more done in less time.

Exhibit 17.4 We have digital assistants basically built into our phones. With the vast number of apps available to help with time management, finances, shared family calendars, reminders of important appointments and dates, and workout plans, many facets of life can be managed with technology. We can integrate these apps across devices to make managing life's demands easier. *How might technology help you accomplish more and make better use of your time when it comes to everyday activities and your educational responsibilities?* (Credit: Nappy/ Nappy.co/ Universal Public Domain (CC0 1.0))

Here are some ideas to help you better manage your time:

- *Prepare for the morning the night before.* Put out your clothes; make lunches; grab your laptop and any other materials you need for the day.
- *Get up 15 minutes earlier in the morning.* Use the time to plan your day, review your assignments, or scroll through the top stories of the day.
- *Schedule a realistic day.* Avoid planning for every minute. Leave extra time in your day for breaks and travel time.
- *Leave room in your day for the unexpected.* This will allow you to do what you need to do, regardless of what happens. If the unexpected never happens, you will have more time for yourself.
- *Do one thing at a time.* Try to avoid doing too many things at a time. We can multi-task to a certain degree but often become inefficient by trying to do too many tasks at one time. Concentrate on the here and now.
- *Learn to say "No."* Saying no helps you establish healthy boundaries that protect your time and your mental health. Choosing to skip events or activities when you just don't have the time or energy can preserve that energy and time for other tasks.

How well do you manage your time? Take the quiz in **Table 17.4** to find out.

Use Your Money Wisely

You may be funding your education through several different sources, including the following.

- **Grants and Scholarships.** This refers to aid you do not have to repay. Grants are usually based on need while scholarships are frequently based on academic merit or other qualifying factors.
- **Educational Loans.** These are usually subsidized by federal and state governments, private lenders, or the colleges themselves. Generally, the loans carry lower interest rates than commercial loans, and you do not have to pay them off until after graduation.
- **Work Study.** This is federal financial aid to assist with your living expenses while in school. You typically

work on campus part time.

There are many ways to cut the cost of going to college. Consider these:

- Going a community college can often save you money in the long-run. You could take core, transferable courses at the community college before finishing at a four-year institution.
- Attending a nearby college and living off campus, rather than in campus-provided housing.
- Enrolling in one of hundreds of colleges and universities with cooperative educational programs that alternate between full-time studies and full-time employment.
- Taking a full-time job at a company that offers tuition reimbursement or assistance.

Self-Test—How Well Do You Manage Your Time?				
Rate your level of agreement with the following statements using the scale below:				
Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
1. I rarely feel driven by the urgencies that come my way. 2. I keep track of each task to be performed in a day. I prioritize them accordingly. 3. I prioritize not by the importance of the work but by the effort needed to complete the task. 4. I can manage my schedule without preparing a weekly plan that includes specific activities. 5. I always want to do all the work myself, thinking I can do it better than anyone else. 6. I use the weekends for social time with others. 7. I can delegate work to people so that the work gets done on time and the people feel they are a part of the team. 8. I allow time for the unexpected things I cannot control. 9. If something doesn't happen as per my schedule, it doesn't get done. 10. To accomplish a set of objectives doesn't mean to avoid other unexpected problems. 11. I seldom work outside of my assigned hours. 12. I would rather have technology complete a task if it can be done faster than if I performed it manually. 13. I feel it is easier and time-saving to try new ways of doing things. 14. I always find time to do what I want to do and what I should do.[9]				
See the scoring guidelines at the end of this chapter to obtain your score.				

Table 17.4

To learn about college costs and financial aid, consider visiting the website of The College Board, a not-for-profit organization that connects students to college success and opportunity. Some of the important topics covered at **https://www.collegeboard.org** include explaining financial aid, facilitating the application process, and finding colleges that fit. There are other websites that also offer information on financial aid:

- **https://www.fastweb.com:** Fastweb has a database of more than 1.5 million private-sector scholarships, grants, and loans.
- **https://www.ed.gov:** This is the U.S. Department of Education information site for federal aid programs, including student loans and grants.

Gain some insight into your money management skills by taking the quiz in **Table 17.5**.

Study Well

To set yourself up for success in any course, complete your assignments on time. Assignments given by the

instructor are often used to reinforce key concepts covered. Reading the textbook or other course materials is also good practice to help you be successful in mastering content in a class. If you don't complete an assignment when it is due, not only will you be at a disadvantage in the class, you will have additional work to add to your schedule, your final course grade could be impacted, and you might miss getting feedback from your instructor that is needed to do well on future assignments.

Second, know what material to study. This may sound simple, but all too often students do not ask what material they should study and find out too late that they studied the wrong information. The easiest and most accurate way to learn what will be covered on a test is to take good notes when in class or when studying the material. If you have questions about what might be on a particular test, often you can reach out to the instructor for some guidance.

Tests are one tool used to evaluate your knowledge of particular concepts. Tests can be designed to not only ask you to memorize or recall specific information, but also to give you the opportunity to think critically about a topic or apply a concept to a real-life scenario through extended response questions. To help yourself remember items such as dates, definitions, or terms, you can use memory devices that have been proven to work:

Self-Test—Are You Good at Managing Money?				
Rate your level of agreement with the following statements, using the scale below:				
Strongly Agree	**Agree**	**Neither Agree nor Disagree**	**Disagree**	**Strongly Disagree**
1. I eagerly wait for the day I get my paycheck, because my bank balance is generally below the minimum. 2. I have set my savings and spending priorities and have a budget. 3. When I go shopping, I don't buy anything unless it is on sale or is required. 4. I can easily spend money when I am in school. 5. I can differentiate between what I want and what I truly need. 6. I always utilize all the credit available on my credit cards. 7. I don't need to plan for my or my family's future education needs because there are financial support programs available. 8. I do not have an account for saving money. 9. I was raised where I always felt that money was tight. 10. Credit cards have been useful to me during times of emergency. 11. It is easy for me to resist buying on credit.[10]				
See the scoring guidelines at the end of this chapter to obtain your score.				

Table 17.5

- *Recite information using your own words.* You will learn more when you reinforce your learning in as many ways as possible. You can reinforce your learning through hearing, writing, reading, reviewing, and reciting.
- *Develop acronyms.* Acronyms are words or names formed from the first letters or groups of letters in a phrase. Acronyms help you remember because they organize information according to the way you need or want to learn it. For example, COD means "cash on delivery," and GDP refers to "gross domestic product." When you study for a test, be creative and make up your own acronyms.

- *Try mnemonic sentences, rhymes, or jingles.* Mnemonic sentences are similar to acronyms; they help you organize your ideas. But instead of creating a word, you make up a sentence. Creating a rhyme, song, or poem can make the information even easier to remember. The more creative and unique the sentence or poem, the easier it can be to remember. Take, for example, the nine planets listed in order according to their distance from the sun:

  Mercury Venus Earth Mars Jupiter Saturn Uranus Neptune

  The first letters of these words are: M V E M J S U N .

  An acronym using these letters would be difficult to remember. But if you create a sentence using the letters in order, you will remember the sequence better. For example: My Very Easy Method Just Speeds Up Naming.

- *Visualize.* Visualization refers to creating or recalling mental pictures related to what you are learning. Have you ever tried to remember something while taking a test and visualized the page the information was on? This is your visual memory at work. Visualization is important for memory because it engages multiple areas of the brain at the same time. Research indicates that using visualization when studying can increase test scores by more than 10 percent.

Table 17.6 helps you evaluate your study skills.

Become a Pro at Taking Tests

Test taking skills involve developing strategies to efficiently pull key terms from the question and using those to formulate your answer. Time management is also important while taking a test. You need to be sure to pace yourself so that you can answer all questions fully in the time allowed. Tests are evaluations of what you know and what you can do with what you know. Here are the rules of the test-taking game:

Tip 1: Act As If You Will Succeed. Thought is powerful. When you think negative thoughts, your stress level rises. Your confidence level may drop, which often leads to feelings of failure. When this happens, think about success. Smile and take deep, slow breaths. Close your eyes, and imagine getting the test back with a good grade.

Self-Test—Do You Have Good Study Habits?
Answer "yes" or "no" to the following questions:
1. Do you usually spend too much time studying for the amount you are learning? 2. Do you spend hours cramming the night before an exam? 3. Do you find it easy to balance your social life with your study schedule? 4. Do you prefer to study with sound around you? 5. Can you sit for long periods and study for several hours without getting distracted? 6. Do you always borrow notes/materials from your friends before the exam? 7. Do you review your class notes periodically throughout the semester while preparing for tests? 8. Is it easy for you to recall what you studied at the beginning of the semester? 9. Do you need to change your reading/learning style in response to the difficulty level of the course? 10. Do you normally write your papers or prepare for your presentations the night before they are due? 11. Do you feel comfortable contacting the instructor and asking questions or for help whenever you need it? 12. Do you prefer to study lying relaxed or sitting in a more formal setting like at a workspace or table?[11]
See the scoring guidelines at the end of this chapter to obtain your score.

Table 17.6

Tip 2: Arrive Ahead of Time. Arriving to a test a bit early can help ease some anxiety and give you an opportunity to get prepared. If your test is in an online format, give yourself time before you begin the test to get your physical and mental space prepared. You will have a better chance focusing, relaxing, and preparing yourself for the test if you have ample time.

Tip 3: Bring the Essential Testing Tools. Don't forget to bring the necessary testing tools along with you, including materials that you may need such as your laptop (charged!), calculator, or writing instruments if necessary. If you are taking an exam online, be sure you have the items required for monitoring such as having your laptop camera operational.

Tip 4: Preview the Test before Beginning. Here's how to do a preview:

- Listen to instructions, and read directions carefully.
- Look at the total number of questions and the point value of each. Decide how much time you can spend on each question and still finish the test on time.
- Budget your time. If you budget your time and stick to your time limits, you will be more likely to complete the test in the amount of time given.
- Use the test as an information tool. Be on the lookout for clues that answer other questions. Frequently, instructors will test you on a single topic in more than one way.

Tip 5: Make Notes. Before beginning the test, write down key terms, formulas, dates, and other important information in the white space on the test paper.

Tip 6: Complete the Easy Questions First. Answering easy questions first helps build your confidence. If you come across a tough question, mark it so you can come back to it later. Avoid spending so much time on a challenging question that you might run out of time to answer the questions you do know.

Tip 7: Know If There Is a Guessing Penalty. Chances are your tests will carry no penalty for guessing. If your time is about to run out and there is no penalty, take a wild guess. On the other hand, if your test carries a penalty for guessing, choose your answers wisely, and leave blank the answers you do not know.

Tip 8: Avoid Looking for Patterns. Have you ever changed your answer because it seemed there were too many "B" answers, only to learn that "B" was correct? Try to refrain from detecting patterns in your

answers. Rarely are there distinct patterns to answers that you can discern. Use your knowledge and choose the best answer.

Tip 9: Be Clear in Responses. If you are taking a written test, make sure your handwriting is legible. This increases the likelihood that the instructor will correctly interpret your responses.

Here are some websites to help you learn more about how to succeed with test-taking:

- Improve study habits across the board at https://learningcenter.unc.edu/tips-and-tools/studying-101-study-smarter-not-harder/
- Learn strategies to apply to different types of tests, like essay or multiple choice exams, at https://www.brainscape.com/academy/best-test-taking-strategies/
- Get tips on test prep, test taking, and ways to cope with test-taking anxiety at https://summer.harvard.edu/blog/14-tips-for-test-taking-success/#Four-Ways-to-Cope-with-TestTaking-Anxiety

17.5 Get Your Career Off on the Right Track

Keep this section in mind as you might want to refer back to it during the remainder of your educational journey. This section will give you advice and tactics that can help you to find, keep, and advance in that job that is perfect for you.

Think Positively

Positive affect, which is described as "pleasurable engagement with the environment," has been linked to social connections, lower depression, and emotional support. It is making a conscious effort to think with an optimistic attitude and to anticipate positive outcomes. Positive behavior means acting with happiness, enthusiasm, alertness, and excitement. When you think and behave positively, you guide your mind toward your goals and generate energy toward meeting those goals.

Positive thinking and behavior can be factors in exhibiting confidence in the workplace, during a interview for a promotion, or whatever career step you are targeting. That's because positive thinking can help things come to fruition because of your motivation to work toward that goal is enhanced with a positive outlook. Follow these steps to form the habit of positive thinking and to boost your success:

1. **Deliberately motivate yourself every day.** Think of yourself as successful, and expect positive outcomes for everything you attempt.
2. **Project energy and enthusiasm.** Employers may recognize and reward positive energy and enthusiasm. Develop the habit of speaking, moving, and acting with these qualities.
3. **Practice this positive-expectation mindset until it becomes a habit.** Enthusiasm and positive behavior are qualities that many hiring managers desire. Hiring decisions are influenced largely by this positive energy. The habit will help you reach your peak potential.
4. **Dwell on past successes.** Focusing on past successes to remind yourself of your abilities helps in attaining goals. For example, you may not have all of the skills needed for a particular position or career field. Through training, practice, and trial and error, you gain new abilities. During the trial-and-error phases of development, remind yourself of past successes; look at mistakes as part of the natural learning curve. Continue until you achieve the result you want, and remind yourself that you have succeeded in the past and can do so again. You fail only when you quit trying![12]

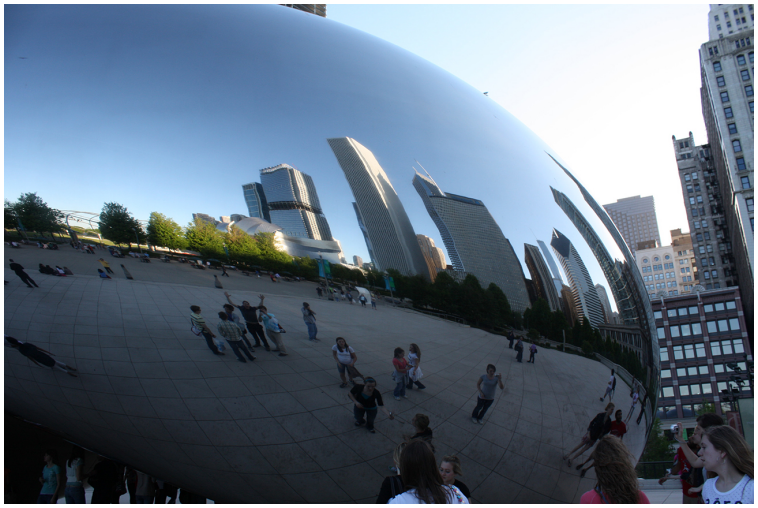

Exhibit 17.5 Aligning one's lifestyle interests with one's career trajectory is essential to long-term career satisfaction. If the idea of working in a big city is appealing, this can guide which regions you look into for job opportunities. If one is motivated to work with animals, then animal welfare organizations or zoos might be a good place to look. *What jobs do you visualize yourself doing, and how can that vision guide your career search?* (Credit: Rich Bowen/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Take a Good Look at Yourself

Once you've developed a positive, "can do" attitude, the next step is to better understand yourself. Ask yourself two basic questions: "Who am I?" and "What can I do?"

Who Am I? This question is the start of *self-assessment*, examining your likes and dislikes and basic values. You may want to ask yourself the following questions:

- Do I want to help society?
- Do I want to help make the world a better place?
- Do I want to help other people directly?
- Is it important for me to be seen as part of a big corporation? Or do I prefer to be part of a smaller organization?
- Do I prefer working indoors or outdoors?
- Do I like to meet new people?
- Do I prefer working alone?

Are you assertive? Assess your assertiveness by taking the quiz in **Table 17.7**.

What Can I Do? After determining what your values are, take the second step in career planning by asking, "What can I do?" This question is the start of *skill assessment*, evaluating your key abilities and characteristics for dealing successfully with problems, tasks, and interactions with other people. Many skills—for instance, strong communication skills—are valuable in many occupations.

Be sure to consider past work experiences such as summer jobs, volunteer activities, or internships. These jobs teach you skills and make you more attractive to potential employers. It's never too early or too late to take a part-time job in your chosen field. For instance, someone with an interest in accounting might consider shadowing a CPA at an accounting firm or working a part-time job with a tax preparer.

Self-Test—How Assertive Are You?				
Rate your level of agreement with the following statements using the scale below:				
Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
1. I don't easily agree to work for others. 2. There are some people who make jokes about the way I communicate and put me down repeatedly. 3. I speak up without fear of what others will think of me. 4. I rarely have to repeat my thoughts to make people understand. 5. I sound like I am asking a question when I am making a statement. 6. I'm more reluctant to speak up on the job than in other situations. 7. I can always think of something to say when faced with rude remarks. 8. I tend to suffer in silence when unfairly criticized or insulted. 9. I tend to respond aggressively when criticized unfairly. 10. People don't listen when I am speaking. 11. If I say "no," I feel guilty. 12. When I have a conflict with someone, the results seem to always go their way. 13. When I speak, people listen.[13]				
See the scoring guidelines at the end of this chapter to obtain your score.				

Table 17.7

In addition to examining your job-related skills, you should also look at your leisure activities. Some possible questions: Are there leisure activities that I enjoy? These could be hobbies such as golf or participating in community theater programs, as just two examples. In some businesses, transactions can occur while participating in activities with coworkers or clients outside of normal work hours. In that case, participating in such activities can be important as you navigate politics in the workplace.

It's hard to like your job if you don't like the field that you're in. Most career counselors agree that finding work you're passionate about is one of the critical factors behind career success. That's why so many career counselors use all those diagnostic tools that measure your personality traits, skill levels, professional interests, and job potential.

The internet is virtually exploding with tests and assessments that you can take. Try, for example, **https://riasectest.com/tests**. This test is based on the theory that people and work environments can be classified into six basic types: realistic, investigative, artistic, social, enterprising, and conventional. The test determines which three types best describe you, and it suggests occupations that could be a good match. The **Keirsey Character Sorter (https://www.keirsey.com)** is like the widely used personality assessment test know as Myers-Briggs. It sorts people into four temperaments: idealists, rationals, artisans, and guardians. Like Myers-Briggs, it not only places you in an overall category, but it also offers a more detailed evaluation of your personality traits. You are likely to find many other personality tests with a quick online search.

Understand What Employers Want

Employers want to hire people who will make their businesses more successful. The most desirable employees have the specific skills, transferable career competencies, work values, and personal qualities necessary to be successful in the employers' organizations. The more clearly you convey your skills as they relate to your job target, the greater your chance of landing your ideal job.[14]

Job-Specific Skills. Employers seek job-specific skills (skills and technical abilities that relate specifically to a particular job). Two examples of job-specific skills are being proficient in the Microsoft Suite or having a certification to use specialized equipment.

Transferable Skills and Attitudes. Change is a constant in today's business world. Strong transferable career skills are the keys to success in managing your career through change. Some of the more influential skills and attitudes are the abilities to:

- Work well with people.
- Plan and manage multiple tasks.
- Maintain a positive attitude.
- Show willingness to learn.

Employers need workers who have transferable career competencies—basic skills and attitudes that are important for all types of work. These skills make you highly marketable because they're needed for a wide variety of jobs and can be transferred from one task, job, or workplace to another. Some examples of these skills include:

- Time management
- Research
- Communication
- Interpersonal
- Critical thinking
- Leadership
- Project management

Take, for example, a supervisor at a building site and an accountant. Both must work well with others, manage time and specific tasks, solve problems, read, and communicate effectively—all transferable competencies. They both must be competent in these areas even though constructing a building and preparing financial statements (job-specific skills for each industry, respectively) are not related. In every occupation, transferable competencies are as important as technical expertise and job-specific skills.

Find Your Career Path

The next step is landing the job that fits your skills and desires. You need to consider not only a general type of work but also work-life balance and your personal goals. If you cannot see yourself in an office-type setting, you might be unhappy with a position that requires that type of work. If you prefer to live in smaller towns, you may not be comfortable working in an urban, downtown environment. Some areas have higher projected job growth and these might be areas in which to focus your job search. You should consider whether you are willing to relocate or would prefer to stay where you are. If you are willing to relocate, take into account the moving expenses and perhaps cost of living differences.

According to 2025 data on unemployment rate, labor force growth, and earnings growth, the top cities for jobs are:

1. Raleigh, NC
2. Nashville, TN
3. Austin, TX
4. Salt Lake City, UT
5. Portland, ME
6. Denver, CO
7. Omaha, NE
8. Charlotte, NC
9. Charleston, SC

10. Indianapolis, IN[15]

You might start answering the question "What will I do?" by studying the *Occupational Outlook Handbook*, regularly published by the U.S. Department of Labor **(https://www.bls.gov/ooh)**. The most recent *Handbook* edition projects job opportunities by industry through the year 2034. The *Handbook* is divided into 25 occupational clusters describing 325 job profiles (with a section on military careers). Among the clusters are education, sales, transportation and logistics, health care, and social services. Each job description tells about the nature of the work, working conditions, required training, other qualifications, chances for advancement, employment outlook, earnings, related occupations, and sources of more information. Another good source of job information is the website for the National Association of Colleges and Employers **(https://www.naceweb.org)**. If you are a member of a minority group, you might want to check out **https://www.blackcareernetwork.com** or **https://www.saludos.com**.

Use the Internet to Find a Job

Today, many job searches begin online. You might also consider your network of friends, family, former coworkers, or professors as a source of job leads. You may still be supplying a paper copy of your résumé to a potential employer, but often those submissions are online. You will need to research best practices when it comes to creating a résumé and where to post it, as well as submitting it through a company's website. Consider creating or updating your LinkedIn profile to reflect that you are currently seeking a new job opportunity. LinkedIn is a great resource to utilize during your job search activities. Through the site, you can search for specific job titles, companies, or even employees of your dream firm. You could reach out to connect with individuals through the site and ask questions that you may have about a job in that company or the industry as a whole. LinkedIn can greatly expand your network and possibly open up opportunities that you would not have found otherwise.

Let's start with the résumé. There are thousands of job-related sites and millions of résumés on the internet. To break through the clutter, you must start with a great résumé—a written description of your education, work experience, personal data, and interests. There are plenty of online resources that can provide you with tips and actual templates to use when creating your résumé. For example, CollegeGrad (**https://collegegrad.com**) provides more than 100 preformatted templates for over 30 college majors on its website that you can use to tailor your résumé and highlight your specific skills and talents.[16] Of course, there are many other sources for creating a résumé, including templates on other job search websites and in Microsoft Word or Google Docs.

Once you have created a résumé, you have several options when it comes to your job search. First, you can target specific companies where you would like to work. Then go to their corporate websites and look for a careers page on the website. For example, Dell has an extensive careers section on its website that provides detailed information on how to apply, along with a section about the work culture, how they hire, and career development opportunities.[17]

You can also try posting your résumé on some of the top job websites. They are a great place to check out first. They tend to have a large variety of jobs and companies listed, so they can be a good starting point to help narrow your search. Many even give you the opportunity to apply directly to a specific firm through the site.[18]

- Indeed **(https://www.indeed.com)**
- Monster **(https://www.monster.com)**
- Glassdoor **(https://www.glassdoor.com)**
- CareerBuilder **(https://www.careerbuilder.com)**
- SimplyHired **(https://www.simplyhired.com)**
- JobDiagnosis **(https://www.jobdiagnosis.com)**
- Nexxt **(https://www.nexxt.com)**
- ZipRecruiter **(https://www.ziprecruiter.com)**

- USAJobs (**https://www.usajobs.gov**)

Your Online Presence

As you begin the job search process, consider your field. If you are going to enter a highly technical or creative field such as programming, web development, graphic design, animation, modeling, or any other field that would benefit from sharing a portfolio of work, sound, or movement, a multimedia résumé might be a good choice. You might also consider creating a professional website to showcase your talents and have that same feel reflected in your LinkedIn page. For other fields, keeping your LinkedIn profile current with a professional headshot, accurate credentials, and up-to-date contact information is key. You might not need a professional webpage, but think of your LinkedIn profile as serving that function: a space to showcase your skills, abilities, work experience, and references from trusted contacts. Finally, you should audit your personal social media sites. You do not necessarily have to delete photos, but consider what you are posting and sharing. Even better, set all of your personal social media profiles to private to help reduce the risk that something in your personal online presence will show you in a negative light. Research indicates that over 90 percent of employers check applicants' social media accounts.[19]

Getting Your Résumé into the Short Pile

Applicant tracking systems (ATSs) screen for keywords, which either reject your résumé or move it on to the short list. Utilize keywords that are central to the field or listed in the specific job description so that your résumé is selected through algorithm. Keywords tend to be more of the noun or noun phrase type (total quality management , Walmart, sales manager) as opposed to power action verbs often found in traditional résumés (developed, coordinated, organized). Every occupation and career field has its own jargon, acronyms, and buzzwords. There are also general keywords that apply to transferable skills important in many jobs, such as teamwork, writing, and planning.

Use these tips for adding effective keywords to your résumé:

- The best source of keywords is the actual job listing, which is likely to contain many, if not all, of the keywords that an employer will use to search the résumé database.
- Include plenty of keyword nouns and noun phrases throughout your résumé. If you have a “Summary of Qualifications” section at the beginning of your résumé, try not to repeat verbatim the contents of this section.
- If you are applying for technical positions, you can list your skills, separating each noun or phrase by a comma.
- In some fields, a simple list of skills does not sufficiently describe the job seeker’s background. Where appropriate, include accomplishments, as well, but be sure to include enough keywords to satisfy the ATS searches.[20]

There are several ways to determine what keywords are appropriate for your industry and job.

- Look through recent job postings online. Certain words will reappear consistently. Those are your “key” words.
- Make sure your résumé contains the keywords and concepts used in the *particular job listing* you are applying to.
- Talk to people in the career field you are targeting, and ask them what keywords are appropriate to the positions you are applying to.
- Research specific company websites that appeal to you in terms of getting a job with that specific organization, and review the “About Us” section. Try to use some of the key words the company uses to describe its corporate environment as part of your résumé descriptions.[21]
- Visit professional association websites, and read the content carefully. Many of these are loaded with industry-related vocabulary that may be appropriate for your résumé.

You should try to get experience or insight into the career field you are targeting. This could be through a formal internship, a job, a mentorship, or even through a job shadowing opportunity. Even if the experience is short in duration, this will give you a valuable glimpse into the field and help you build the verbiage to include on your résumé. Moreover, you will gain valuable experience that you can highlight on your résumé to catch the attention of hiring professionals.[22]

I've Landed a Job Interview

If some of the companies you contacted want to speak with you, your résumé achieved its goal of getting you a job interview. Look at the interview as a chance to describe your knowledge and skills and interpret them in terms of the employer's specific needs. To make this kind of presentation, you need to do some research on the company. A great place to start is the company's own corporate website.

As you do your search, build your knowledge in the following areas. This information will help you during the interview and give you items to build questions around to ask the hiring manager. Keep in mind that you shouldn't ask questions for which answers can be readily found on the company website. This shows a lack of preparation on your part. Instead, use the information to formulate more in-depth questions that connect to the knowledge you've gathered through your research.

1. **General Information about the Occupational Field.** Learn about the current and predicted industry trends, general educational requirements, job descriptions, growth outlook, and salary ranges in the industry.
2. **Information about Prospective Employers.** Learn whether the organization is publicly or privately owned. Verify company names, addresses, products, or services (current and predicted, as well as trends); history; culture; reputation; performance; divisions and subsidiaries; locations (U.S. and global); predicted growth indicators; number of employees; company philosophies and procedures; predicted job openings; salary ranges; and listings of managers of your targeted department within the organization. Also learn about the competitors and customers.
3. **Information about Specific Jobs.** Obtain job descriptions; identify the required education and experience; and determine prevalent working conditions, salary, and fringe benefits.

Interview Like a Pro

An interview tends to have three phases: introductions where the interviewer and the candidate get to know each other a bit; questioning by the interviewer; and questioning by the applicant. Interviewers often will try to rate you in several different areas that are core to the position. The questions are designed to assess your skills and your fit with the organization.

Many firms start with a *screening interview*, a rather short interview (about 30 minutes) to decide whether to invite you back for a second interview. Sometimes screening interviews will take place over the phone or virtually. These interviews may not be with the hiring manager but instead with a representative from the HR department. Less than 10 percent of job applicants are invited back for another interview. The second interview is generally an hour or so in length. This too can be virtual, but would likely include the hiring manager and maybe others in the department to which you are applying. After the meetings, someone from the human resource department will discuss other application materials with you and tell you when an offer of acceptance or rejection is likely to be sent. (The wait may be weeks or even months.) Many applicants send follow-up letters in the meantime to show they are still interested in the firm.

For the interview, you should dress professionally, appropriate to the industry. Plan to arrive about 10 to 15 minutes ahead of time. Try to relax. Smile and make eye contact with (but do not stare at) the interviewer. Body language is an important communicator. The placement of your hands and feet and your overall posture say a good deal about you. Here are some other tips for interviewing like a pro:

1. **Concentrate on being likable.** As simplistic as it seems, research proves that one of the most essential

goals in successful interviewing is to be liked by the interviewer. Interviewers want to hire pleasant people others will like working with on a daily basis. Pay attention to the following areas to project that you are highly likable:

- Be friendly, courteous, and enthusiastic.
- Speak positively.
- Smile.
- Use positive body language.
- Make certain your appearance is appropriate.
- Make eye contact when you speak.

2. **Project an air of confidence and pride.** Act as though you want and deserve the job, not as though you are desperate.
3. **Demonstrate enthusiasm.** The applicant's level of enthusiasm often influences employers as much as any other interviewing factor. The applicant who demonstrates little enthusiasm for a job will never be selected for the position.
4. **Demonstrate knowledge of and interest in the employer.** "I really want this job" is not convincing enough. Explain why you want the position and how the position fits your career plans. You can cite opportunities that may be unique to a firm or emphasize your skills and education that are highly relevant to the position.
5. **State your name and the position you're seeking.** When you enter the interviewer's office, begin with a friendly greeting and state the position you're interviewing for: "Hello, Ms. Levine, I'm Bella Reyna. I'm here to interview for the accounting position." If someone has already introduced you to the interviewer, simply say, "Good morning, Ms. Levine." Identifying the position is important because interviewers often interview for many different positions.
6. **Focus on how you fit the job.** Near the beginning of your interview, as soon as it seems appropriate, ask a question similar to this: "Could you describe the scope of the job and tell me what capabilities are most important in filling the position?" The interviewer's response will help you focus on emphasizing your qualifications that best match the needs of the employer.
7. **Speak correctly.** Grammatical errors can cost applicants the job. Use correct grammar, word choice, and a businesslike vocabulary, not an informal, chatty one. Avoid slang. When under stress, people often use pet phrases (such as *you know*) too often. This does not project the most professional demeanor and could be distracting during the interview. Some level of nervousness is expected, and hiring professionals understand that. However, being too informal and using filler phrases (such as "like") or generational words or phrases can impact the outcome of the interview. Using the word "probably" in response to a question can show doubt in your abilities or a lack of confidence. Try not to use "just" or "only" when discussing past work experiences. For example, saying "I just worked as a server" gives the impression that you did not value the experience gained in that job. You could instead rephrase and say "My experience as a server helped me develop strong communication skills and the ability to work through conflict." Saying phrases such as "I guess" or even "I don't know" can give a negative impression of not being prepared or confident. Ask a friend or family member to help you identify any speech weaknesses you have. Begin eliminating these speech habits now.

Also, you should avoid the following "disqualifiers" at all costs. Any one of these blunders could cost you the job opportunity:

1. Don't sit down until the interviewer invites you to; waiting is courteous.
2. Don't bring anyone else to the interview; it can give an impression of immaturity or lack of confidence.
3. Don't use tobacco products or chewing gum, and consider not bringing a beverage with you; often, they may offer you water during the interview.
4. Don't put anything on or read anything on the interviewer's desk; it's considered an invasion of personal space.

5. Make sure your breath is fresh. Having a mint before you begin the interview might be a good idea.
6. If you are invited to a business meal, consider what you order and follow the lead of the hiring manager. If you order alcohol, be certain to not overindulge. When ordering, choose food that's easy to eat while carrying on a conversation.
7. Don't offer a weak handshake; it projects weakness. Use a firm handshake.[23]

Select the Right Job for You

Hard work and a little luck may pay off with multiple job offers. Your happy dilemma is deciding which one is best for you. Start by considering the "FACTS":

- *Fit:* Do the job and the employer fit your skills, interests, and lifestyle?
- *Advancement and growth*: Will you have the chance to develop your talents and move up within the organization?
- *Compensation*: Is the employer offering a competitive salary and benefits package?
- *Training:* Will the employer provide you with the tools needed to be successful on the job?
- *Site:* Is the job location a good match for your lifestyle and your budget?

A great way to evaluate a new location is through Zillow **(https://www.zillow.com/)** or Realtor.com **(https://www.realtor.com/)**. Sites such as these offer tools to help estimate the cost of moving, cost of living, and other aspects of your new location. Many offer calculators to determine how much it will cost to ship your possessions. Crime rates, demographic, economic, and climate information is also available on many sites. You can often find resources for both home purchasing and rentals through these resources.

Start Your New Job

No time is more crucial, and possibly nerve-racking, than the first few months at a new job. During this probationary period, the employer decides whether a new employee is valuable enough to keep and, if so, in what capacity. Sometimes the employee's whole future with the company rides on the efforts of the first few weeks or months. You can expect an orientation process at the new job. There will be some formalized trainings and meetings to attend. You may be expected to complete other trainings or orientation modules on your own. You will be expected to become familiar with the firm's goals; its organization, including your place in the company; and basic personnel policies, such as lunch breaks, phone usage, and parking.

Here are a few tips on making your first job rewarding and productive:

- *Listen and learn:* When you first walk into your new job, let your senses take everything in. Do people refer to one another by first names, or is the company more formal? How do people dress? Do the people you work with drop into one another's open offices for informal chats about business matters? Or have you entered a culture where important matters are documented in emails and and meetings with coworkers are scheduled through administrative assistants? Size up where the power lies. Who seems to most often assume a leadership role? Who is the person others turn to for advice? Why has that person achieved that position? What traits have made this person a "political leader"? Don't be misled by what others say, but also don't dismiss their evaluations. Make your own judgments based on what you see and hear. Effective listening skills help you learn your new job responsibilities quickly. Take the quiz in **Table 17.8** to see if you are a good listener.
- *Do unto others:* Be nice. Nice people are usually the last to be fired and among the first to be promoted. Don't be pleasant only with those who can help you in the company. Be nice to everyone. You never know who can help you or give you information that will turn out to be useful. Genuinely nice people make routine job assignments, and especially pressure-filled ones, more pleasant. And people who are dealt with pleasantly usually respond in kind.
- *Don't start out as a rule breaker:* If every new employee tried to change tried-and-true methods to suit their whims, the firm would quickly be in chaos. Individual needs must adhere to established procedures. Devote yourself to getting things done within the system. Every manager realizes that it takes time for a

new person to adjust. But the faster you start accomplishing things, the faster the boss will decide that you were the right person to hire.

- *Find a great mentor:* Poor leadership can lead to lower job satisfaction. Good jobs can easily be ruined by supervisors who hold you back. In contrast, your career will soar when you have a great mentor helping you along the way. If you find a job with a super mentor, jump at the chance to take it.

Self-Test—Are You a Good Listener?				
Rate your level of agreement with the statements below using the following scale:				
Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree

1. A person who takes time to ask for clarification about something that might be unclear is not a good listener.
2. While listening, I am distracted by the sounds around me.
3. I try to not only understand what is being said but also analyze the strength of any ideas that are being presented.
4. I ask questions, make observations, or give opinion when necessary for clarifications.
5. While I am listening, I avoid eye contact but am polite.
6. I am tempted to judge a person whether or not they are a good speaker.
7. I feel more comfortable when someone talks to me about a topic that I find interesting.
8. I always make a mental note of key phrases/points that strike me as important points of concern that require a response.
9. The amount of focus I have on a speaker is impacted by their style of communication.
10. A good listener requires a good speaker.[24]

See the scoring guidelines at the end of this chapter to obtain your score.

Table 17.8

Moving Up

Once you have been on the job for a while, you might be thinking of the position as a long-term endeavor and may be considering how to be promoted or get ahead in the firm. **Table 17.9** offers several suggestions for improving your chances of promotion. The first item might seem a bit strange, yet it's there for a practical reason. If you don't really like what you do, you won't be committed enough to compete with those who do. The passionate people are the ones who go the extra mile, do the extra work, and come up with fresh out-of-the-box ideas.

So there you have it. Remember: it's never too early to begin planning your career—the future is now.

How to Move Up
• Love what you do, which entails first figuring out who you are. • Never stop learning about new technologies and new skills that will help you build a successful career. • Often volunteering for an international experience can be viewed in a favorable light if you are trying to move up in an organization. • Create new business opportunities—they could lead to a promotion. • Be really terrific at what you're doing now, this week, this month.

Table 17.9

17.6 Self-Test Scoring Guidelines

After you answer the questions in each of the self-tests that appear in this chapter, determine your score and evaluate your skills using the following scoring guidelines.

Table 1 Fun Self-Test: Can You Persuade Others?

For questions 1, 2, 4, 8, 10, and 11, use the following to calculate your score:

Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
5 points	4 point	0 points	0 points	0 points

For questions 3, 5, 6, 7, and 9 use the following to calculate your score:

Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
0 points	0 points	0 points	4 points	5 points

If your score is between 40 and 55, you have an excellent ability to persuade others. A score between 30 and 39 means you have reasonably good persuasion skills. However, you may need to improve your listening and communicating skills. A score below 30 means that you might need to work on your persuasion skills. Consider researching how to improve this skill set.

Table 2 Self-Test: Are You Good at Office Politics?

For questions 1, 3, 4, 7, 8, 10, 12, and 13, give yourself 1 point if you said "true." For questions 2, 5, 6, 9, and 11, give yourself 1 point if you said "false." If your score is 9 or below, you may be good at managing your work, but you need to improve your political skills. Navigating office politics means working through interpersonal relationships and sometimes even conflicts to accomplish goals. It might also mean forming alliances with coworkers or employees in other departments who might help you in the workplace. If your score is low, consider researching ways to better navigate office politics and review the tips offered in the chapter.

Table 4 Self-Test: How Well Do You Manage Your Time?

For questions 2, 6, 8, 9, 11, 13, 14, and 15, use the following to calculate your score:

Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
0 points	0 points	0 points	4 points	5 points

For questions 1, 3, 4, 5, 7, 10, and 12, use the following to calculate your score:

Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
5 points	4 points	0 points	0 points	0 points

If your score is 60 or higher, you have excellent time management skills. Congratulations—you use your time well! If your score is below 60, consider finding ways to better manage your time. You can utilize online resources to find ways to help with your time management or find a time-management tool that fits your needs as a starting point. The chapter has additional tips that may be useful in improving your time-management skills.

Table 5 Self-Test: Are You Good at Managing Money?

For questions 2, 3, 5, 6, 10, and 11, use the following to calculate your score:

Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
0 points	0 points	0 points	4 points	5 points

For questions 1, 4, 7, 8, and 9, use the following to calculate your score:

Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
5 points	4 points	0 points	0 points	0 points

If your score is 44 or higher, you are able to manage money while balancing your expenses and income. You will be ready to handle financial emergencies without turning to friends or relatives. If your score is between 36 and 43, your savings habits may be inconsistent. To achieve better savings, control your expenses and avoid unnecessary purchases. If your score is 35 or below, you should consider evaluating your spending habits. You can get better control of your finances by reviewing your spending activities, reducing your credit card debt, and creating a budget. Meeting with a financial advisor can help as you look forward to planning for the future such as making a home purchase or saving for retirement.

Table 6 Self-Test: Do You Have Good Study Habits?

If you answered “yes” to questions 3, 5, 7, 8, and 11, give yourself 1 point for each answer.

If you answered “no” to questions 1, 2, 4, 6, 9, 10, and 12, give yourself 1 point for each answer.

If your score is 10 or above, congratulations! You have good study habits. If your score is below 10, read the tips offered in the chapter on improving your study skills. You may also meet with someone at your school to

help maximize your study time.

Table 7 Self-Test: How Assertive Are You?

For questions 1, 3, 4, 7, 9, and 13, use the following to calculate your score:

Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
5 points	4 points	0 points	0 points	0 points

For questions 2, 5, 6, 8, 10, 11, and 12, use the following to calculate your score:

Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
0 points	0 points	0 points	4 points	5 points

If your score is 44 or higher, you stand up for your rights while showing respect for others. You quickly respond to unfair criticism. You should be able to fare well in office politics. If your score is 43 or lower, you may want to consider ways to become more comfortable communicating your ideas and opinions and managing your relationships with others.

Table 8 Self-Test: Are You a Good Listener?

For questions 3, 4, 8, and 9, use the following to calculate your score:

Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
5 points	4 points	0 points	0 points	0 points

For questions 1, 2, 5, 6, 7, and 10, use the following to calculate your score:

Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
0 points	0 points	0 points	4 points	5 points

Listening is an important communication skill that will help you succeed in your career. By becoming an effective listener, you gain respect from your colleagues, pick up insights and ideas on improving your job performance, and develop a skill that is important in managing others. If you have a score of 32 or above, then you are a good listener. If your score falls below 32, you need to improve your listening skills. Search the internet for articles and ideas on becoming a better listener, and begin practicing your new skills with your friends and coworkers.

A Understanding the Legal and Tax Environment

Learning Outcomes

After reading this appendix, you should be able to answer these questions:

1. How does the legal system govern business transactions and settle disputes?
2. What are the required elements of a valid contract, and what are the key types of business law?
3. What are the most common taxes paid by businesses?

Understanding the Legal Environment

1. How does the legal system govern business transactions and settle disputes?

Our legal system affects everyone who lives and does business in the United States. The smooth functioning of society depends on the law, which protects the rights of people and businesses. The purpose of law is to keep the system stable while allowing orderly change. The law defines which actions are allowed or banned and regulates some practices. It also helps settle disputes. The legal system both shapes and is shaped by political, economic, and social systems. As Judge Learned Hand wrote in *The Spirit of Liberty,* "Without [the law] we cannot live; only with it can we insure the future which by right is ours."

In any society, **laws** are the rules of conduct created and enforced by a controlling authority, usually the government. They develop over time in response to the changing needs of people, property, and business. The legal system of the United States is thus the result of a long and continuing process. In each generation, new social problems occur, and new laws are created to solve them. For instance, in the late 1800s corporations in certain industries, such as steel and oil, merged and became dominant. The Sherman Antitrust Act was passed in 1890 to control these powerful firms. Eighty years later, in 1970, Congress passed the National Environmental Policy Act. This law dealt with pollution problems, which no one had thought about in 1890. Today new areas of law are developing to deal with the internet and the recent financial scandals.

The Main Sources of Law

Common law is the body of unwritten law that has evolved out of judicial (court) decisions rather than being enacted by legislatures. It is also called case law. It developed in England and came to America with the colonists. All states except Louisiana, which follows the Napoleonic Code inherited from French settlers, follow the English system. Common law is based on community customs that were recognized and enforced by the courts.

Statutory law is written law enacted by legislatures at all levels, from city and state governments to the federal government. Examples of statutory law are the federal and state constitutions, bills passed by Congress, and ordinances, which are laws enacted by local governments. Statutory law is the chief source of new laws in the United States. Among the business activities governed by statutory law are securities regulation, incorporation, sales, bankruptcy, and antitrust.

Related to statutory law is **administrative law**, or the rules, regulations, and orders passed by boards, commissions, and agencies of federal, state, and local governments. The scope and influence of administrative law have expanded as the number of these government bodies has grown. Federal agencies issue more rulings and settle more disputes than all the courts and legislatures combined. Some federal agencies that issue rules are the Civil Aeronautics Board, the Internal Revenue Service, the Securities and Exchange Commission, the Federal Trade Commission, and the National Labor Relations Board.

Business law is the body of law that governs commercial dealings. These laws provide a protective environment within which businesses can operate. They serve as guidelines for business decisions. Every businessperson should be familiar with the laws governing his or her field. Some laws, such as the Internal Revenue Code, apply to all businesses. Other types of business laws may apply to a specific industry, such as

Federal Communications Commission laws that regulate radio and TV stations.

In 1952 the United States grouped many business laws into a model that could be used by all the states. The **Uniform Commercial Code (UCC)** sets forth the rules that apply to commercial transactions between businesses and between individuals and businesses. It has been adopted by 49 states; Louisiana uses only part of it. By standardizing laws, the UCC simplifies the process of doing business across state lines. It covers the sale of goods, bank deposits and collections, letters of credit, documents of title, and investment securities.

The Court System

The United States has a highly developed court system. This branch of government, the **judiciary**, is responsible for settling disputes by applying and interpreting points of law. Although court decisions are the basis for common law, the courts also answer questions left unanswered by statutes and administrative rulings. They have the power to assure that these laws do not violate the federal or state constitutions.

Trial Courts

Most court cases start in the **trial courts**, also called courts of general jurisdiction. The main federal trial courts are the U.S. district courts. There is at least one federal district court in each state. These courts hear cases involving serious federal crimes, immigration, postal regulations, disputes between citizens of different states, patents, copyrights, and bankruptcy. Specialized federal courts handle tax matters, international trade, and claims against the United States.

Appellate Courts

The losing party in a civil (noncriminal) case and a losing defendant in a criminal case may appeal the trial court's decision to the next level in the judicial system, the **appellate courts (courts of appeals)**. There are 12 U.S. circuit courts of appeals. Cases that begin in a federal district court are appealed to the court of appeals for that district. These courts may also review orders from administrative agencies. Likewise, the states have appellate courts and supreme courts for cases tried in state district or superior courts.

No cases start in appellate courts. Their purpose is to review decisions of the lower courts and affirm, reverse, or modify the rulings.

The Supreme Court

The U.S. Supreme Court is the highest court in the nation. It is the only court specifically established by the U.S. Constitution. Any cases involving a state or in which an ambassador, public minister, or consul is a party are heard directly by the Supreme Court. Its main function is to review decisions by the U.S. circuit courts of appeals. Parties not satisfied with a decision of a state supreme court can appeal to the U.S. Supreme Court. But the Supreme Court accepts only those cases that it believes will have the greatest effect on the country, only about 200 of the thousands of appeals it gets each year.

Administrative Agencies

Administrative agencies have limited judicial powers to regulate their special areas. These agencies exist at the federal, state, and local levels. For example, in 2017, the Federal Trade Commission (FTC) ordered satellite TV provider Dish Network to pay a fine of $280 million for violating the Do Not Call Registry, a clearinghouse for consumers who do not want to be contacted by telemarketers. A federal judge ruled that Dish Network was liable for more than 66 million calls that violated the FTC's Telemarketing Sales Rule.[1] A list of selected federal agencies is shown in **Table A1**.

1 Lesley Fair, "Court Orders $280 Million from Dish Network, Largest Ever Do Not Call Penalty," https://www.ftc.gov, accessed June 23, 2017.

Federal Regulatory Agencies	
Agency	**Function**
Federal Trade Commission (FTC)	Enforces laws and guidelines regarding unfair business practices and acts to stop false and deceptive advertising and labeling.
Food and Drug Administration (FDA)	Enforces laws and regulations to prevent distribution of adulterated or misbranded foods, drugs, medical devices, cosmetics, veterinary products, and hazardous consumer products.
Consumer Products Safety Commission	Ensures compliance with the Consumer Product Safety Act and seeks to protect the public from unreasonable risk of injury from any consumer product not covered by other regulatory agencies.
Federal Communications Commission (FCC)	Regulates wire, radio, and TV communication in interstate and foreign commerce.
Environmental Protection Agency (EPA)	Develops and enforces environmental protection standards and researches the effects of pollution.
Federal Energy Regulatory Commission (FERC)	Regulates rates and sales of natural gas products, thereby affecting the supply and price of gas available to consumers; also regulates wholesale rates for electricity and gas, pipeline construction, and U.S. imports and exports of natural gas and electricity.
Federal Aviation Administration (FAA)	Oversees the policies and regulations of the airline industry.
Federal Highway Administration (FHA)	Regulates vehicle safety requirements.

Table A1

Nonjudicial Methods of Settling Disputes

Settling disputes by going to court is both expensive and time-consuming. Even if the case is settled prior to the actual trial, sizable legal expenses can be incurred in preparing for trial. Therefore, many companies now use private arbitration and mediation firms as alternatives to litigation. Private firms offer these services, which are a high growth area within the legal profession.

With **arbitration**, the parties agree to present their case to an impartial third party and are required to accept the arbitrator's decision. **Mediation** is similar, but the parties are not bound by the mediator's decision. The mediator suggests alternative solutions and helps the parties negotiate a settlement. Mediation is more

flexible than arbitration and allows for compromise. If the parties cannot reach a settlement, they can then go to court, an option not available in most arbitration cases.

In addition to saving time and money, corporations like the confidentiality of testimony and settlement terms in these proceedings. Arbitration and mediation also allow businesses and medical professionals to avoid jury trials, which can result in large settlements in certain types of lawsuits, such as personal injury, discrimination, medical malpractice, and product liability.

Contract Law

2. What are the required elements of a valid contract, and what are the key types of business law?

Linda Price, a 22-year-old college student, is looking at a car with a sticker price of $18,000. After some negotiating, she and the salesperson agree on a price of $17,000, and the salesperson writes up a contract, which they both sign. Has Linda legally bought the car for $17,000? The answer is yes, because the transaction meets all the requirements for a valid contract.

A **contract** is an agreement that sets forth the relationship between parties regarding the performance of a specified action. The contract creates a legal obligation and is enforceable in a court of law. Contracts are an important part of business law. Contract law is also incorporated into other fields of business law, such as property and agency law. Some of the business transactions that involve contracts are buying materials and property, selling goods, leasing equipment, and hiring consultants.

A contract can be an *express contract,* which specifies the terms of the agreement in either written or spoken words, or an *implied contract*, which depends on the acts and conduct of the parties to show agreement. An example of an express contract is the written sales contract for Linda Price's new car. An implied contract exists when you order and receive a sandwich at Jason's Grill. You and the restaurant have an implied contract that you will pay the price shown on the restaurant's menu in exchange for an edible sandwich.

Contract Requirements

Businesses deal with contracts all the time, so it's important to know the requirements of a valid contract. For a contract to be legally enforceable, all of the following elements must be present:

- *Mutual assent.* Voluntary agreement by both parties to the terms of the contract. Each party to the contract must have entered into it freely, without duress. Using physical or economic harm to force the signing of the contract—threatening injury or refusing to place another large order, for instance—invalidates a contract. Likewise, fraud—misrepresenting the facts of a transaction—makes a contract unenforceable. Telling a prospective used-car buyer that the brakes are new when in fact they have not been replaced makes the contract of sale invalid.
- *Capacity.* Legal ability of a party to enter into contracts. Under the law, minors (those under 18), mental incompetents, drug and alcohol addicts, and convicts cannot enter into contracts.
- *Consideration.* Exchange of some legal value or benefit between the parties. Consideration can be in the form of money, goods, or a legal right given up. Suppose that an electronics manufacturer agrees to rent an industrial building for a year at a monthly rent of $1,500. Its consideration is the rent payment of $1,500, and the building owner's consideration is permission to occupy the space. But if you offer to type a term paper for a friend for free and your offer is accepted, there is no contract. Your friend has not given up anything, so you are not legally bound to honor the deal.
- *Legal purpose.* Absence of illegality. The purpose of the contract must be legal for it to be valid. A contract cannot require performance of an illegal act. A contract to smuggle drugs into a state for a specified amount of money would not be legally enforceable.
- *Legal form.* Oral or written form, as required. Many contracts can be oral. For instance, an oral contract exists when Bridge Corp. orders office supplies by phone from Ace Stationery Store and Ace delivers the requested goods. Written contracts include leases, sales contracts, and property deeds. Some types of

contracts must be in writing to be legally binding. In most states, written contracts are required for the sale of goods costing more than $500, for the sale of land, for contract performance that cannot be carried out within a year, and for guarantees to pay the debts of someone else.

As you can see, Linda Price's car purchase meets all the requirements for a valid contract. Both parties have freely agreed to the terms of the contract. Linda is not a minor and presumably does not fit any of the other categories of incapacity. Both parties are giving consideration, Linda by paying the money and the salesperson by turning over the car to her. The purchase of the car is a legal activity. And the written contract is the correct form because the cost of the car is over $500.

Breach of Contract

A **breach of contract** occurs when one party to a contract fails (without legal excuse) to fulfill the terms of the agreement. The other party then has the right to seek a remedy in the courts. There are three legal remedies for breach of contract:

- *Payment of damages.* Money awarded to the party who was harmed by the breach of contract, to cover losses incurred because the contract wasn't fulfilled. Suppose that Ajax Roofing contracts with Fred Wellman to fix the large hole in the roof of his factory within three days. But the roofing crew doesn't show up as promised. When a thunderstorm four days later causes $45,000 in damage to Wellman's machinery, Wellman can sue for damages to cover the costs of the water damage because Ajax breached the contract.
- *Specific performance of the contract.* A court order requiring the breaching party to perform the duties under the terms of the contract. Specific performance is the most common method of settling a breach of contract. Wellman might ask the court to direct Ajax to fix the roof at the price and conditions in the contract.
- *Restitution.* Canceling the contract and returning to the situation that existed before the contract. If one party fails to perform under the contract, neither party has any further obligation to the other. Because Ajax failed to fix Wellman's roof under the terms of the contract, Wellman does not owe Ajax any money. Ajax must return the 50 percent deposit it received when Wellman signed the contract.

Warranties

Express warranties are specific statements of fact or promises about a product by the seller. This form of warranty is considered part of the sales transaction that influences the buyer. Express warranties appear in the form of statements that can be interpreted as fact. The statement "This machine will process 1,000 gallons of paint per hour" is an express warranty, as is the printed warranty that comes with a computer or a telephone answering machine.

Implied warranties are neither written nor oral. These guarantees are imposed on sales transactions by statute or court decision. They promise that the product will perform up to expected standards. For instance, a man bought a used car from a dealer, and the next day the transmission fell out as he was driving on the highway. The dealer fixed the car, but a week later the brakes failed. The man sued the car dealer. The court ruled in favor of the car owner because any car without a working transmission or brakes is not fit for the ordinary purpose of driving. Similarly, if a customer asks to buy a copier to handle 5,000 copies per month, she relies on the salesperson to sell her a copier that meets those needs. The salesperson implicitly warrants that the copier purchased is appropriate for that volume.

Patents, Copyrights, and Trademarks

The U.S. Constitution protects authors, inventors, and creators of other intellectual property by giving them the rights to their creative works. Patents, copyrights, and registration of trademarks and servicemarks are legal protection for key business assets.

A **patent** gives an inventor the exclusive right to manufacture, use, and sell an invention for 20 years. The U.S. Patent Office, a government agency, grants patents for ideas that meet its requirements of being new, unique,

and useful. The physical process, machine, or formula is what is patented. Patent rights—pharmaceutical companies' rights to produce drugs they discover, for example—are considered intangible personal property.

The government also grants copyrights. A **copyright** is an exclusive right, shown by the symbol ©, given to a writer, artist, composer, or playwright to use, produce, and sell her or his creation. Works protected by copyright include printed materials (books, magazine articles, lectures), works of art, photographs, and movies. Under current copyright law, the copyright is issued for the life of the creator plus 70 years after the creator's death. Patents and copyrights, which are considered intellectual property, are the subject of many lawsuits today.

A **trademark** is a design, name, or other distinctive mark that a manufacturer uses to identify its goods in the marketplace. Apple's "bitten apple" logo (symbol) is an example of a trademark. A **servicemark** is a symbol, name, or design that identifies a service rather than a tangible object. The Travelers Insurance umbrella logo is an example of a servicemark.

Most companies identify their trademark with the ® symbol in company ads. This symbol shows that the trademark is registered with the Register of Copyrights, Copyright Office, Library of Congress. The trademark is followed by a generic description: Fritos corn chips, Xerox copiers, Scotch brand tape, Kleenex tissues.

Trademarks are valuable because they create uniqueness in the minds of customers. At the same time, companies don't want a trademark to become so well known that it is used to describe all similar types of products. For instance, Coke is often used to refer to any cola soft drink, not just those produced by The Coca-Cola Company. Companies spend millions of dollars each year to keep their trademarks from becoming *generic words,* terms used to identify a product class rather than the specific product. The Coca-Cola Company employs many investigators and files many lawsuits each year to prevent its trademarks from becoming generic words.

Once a trademark becomes generic (which a court decides), it is public property and can be used by any person or company. Names that were once trademarked but are now generic include *aspirin, thermos, linoleum,* and *toll house cookies.*

Tort Law

A **tort** is a civil, or private, act that harms other people or their property. The harm may involve physical injury, emotional distress, invasion of privacy, or *defamation* (injuring a person's character by publication of false statements). The injured party may sue the wrongdoer to recover damages for the harm or loss. A tort is not the result of a breach of contract, which would be settled under contract law. Torts are part of common law. Examples of tort cases are medical malpractice, *slander* (an untrue oral statement that damages a person's reputation), *libel* (an untrue written statement that damages a person's reputation), product liability (discussed in the next section), and fraud.

A tort is generally not a crime, although some acts can be both torts and crimes. (Assault and battery, for instance, is a criminal act that would be prosecuted by the state and also a tort because of the injury to the person.) Torts are private wrongs and are settled in civil courts. *Crimes* are violations of public law punishable by the state or county in the criminal courts. The purpose of criminal law is to punish the person who committed the crime. The purpose of tort law is to provide remedies to the injured party.

For a tort to exist and damages to be recovered, the harm must be done through either negligence or deliberate intent. *Negligence* occurs when reasonable care is not taken for the safety of others. For instance, a woman attending a New York Mets baseball game was struck on the head by a foul ball that came through a hole in the screen behind home plate. The court ruled that a sports team charging admission has an obligation to provide structures free from defects and seating that protects spectators from danger. The Mets were found negligent. Negligence does not apply when an injury is caused by an unavoidable accident, an event that was not intended and could not have been prevented even if the person used reasonable care. This area of tort law

is quite controversial, because the definition of negligence leaves much room for interpretation.

Product-Liability Law

Product liability refers to manufacturers' and sellers' responsibility for defects in the products they make and sell. It has become a specialized area of law combining aspects of contracts, warranties, torts, and statutory law (at both the state and federal levels). A product-liability suit may be based on negligence or strict liability (both of which are torts) or misrepresentation or breach of warranty (part of contract law).

An important concept in product-liability law is **strict liability**. A manufacturer or seller is liable for any personal injury or property damage caused by defective products or packaging—even if all possible care was used to prevent such defects. The definition of defective is quite broad. It includes manufacturing and design defects and inadequate instructions on product use or warnings of danger.

Product-liability suits are very costly. More than 100,000 product-liability suits were filed against hundreds of companies that made or used asbestos, a substance that causes lung disease and cancer but was once used widely in insulation, brake linings, textiles, and other products. Scores of companies were forced into bankruptcy as a result of asbestos-related lawsuits, and the total cost of asbestos cases to defendants and their insurers exceeds $70 billion (most of which was paid not to the victims but to lawyers and experts).

Bankruptcy Law

Congress has given financially distressed firms and individuals a way to make a fresh start. **Bankruptcy** is the legal procedure by which individuals or businesses that cannot meet their financial obligations are relieved of their debts. A bankruptcy court distributes any assets to the creditors.

Bankruptcy can be either voluntary or involuntary. In a *voluntary bankruptcy,* the debtor files a petition with the court, stating that debts exceed assets and asking the court to declare the debtor bankrupt. In an *involuntary bankruptcy,* the creditors file the bankruptcy petition.

The *Bankruptcy Reform Act* of 1978, amended in 1984 and 1986, provides for the resolution of bankruptcy cases. Under this act, two types of bankruptcy proceedings are available to businesses: *Chapter 7* (liquidation) and *Chapter 11* (reorganization). Most bankruptcies, an estimated 70 percent, use Chapter 7. After the sale of any assets, the cash proceeds are given first to secured creditors and then to unsecured creditors. A firm that opts to reorganize under Chapter 11 works with its creditors to develop a plan for paying part of its debts and writing off the rest.

The Bankruptcy Abuse Prevention and Consumer Protection Act went into effect October 17, 2005. Under this law, Americans with heavy debt will find it difficult to avoid meeting their financial obligations. Many debtors will have to work out repayment plans instead of having their obligations erased in bankruptcy court.[2]

The law requires people with incomes above a certain level to pay some or all of their credit-card charges, medical bills, and other obligations under a court-ordered bankruptcy plan. Supporters of the 2005 law argue that bankruptcy frequently is the last refuge of gamblers, impulsive shoppers, the divorced or separated, and fathers avoiding child support. Now there is an objective, needs-based bankruptcy test to determine whether filers should be allowed to cancel their debts or be required to enter a repayment plan. Generally, people with incomes above the state median income would be required to use a plan to repay their debts. People with special circumstances, such as serious medical conditions, would be allowed to cancel debts despite this income level.

Also, companies will need a lot more cash to enter into a bankruptcy than in the past. Before the 2005 law, utilities could not discontinue service as a result of a bankruptcy filing. But under the new act, the filing company must post a cash deposit or equivalent in order to continue their service. Sellers also have priority over other claims with regard to merchandise distributed to the debtor within 20 days prior to the bankruptcy

2 "Changes in Bankruptcy Laws—Credit Counseling, Means Test," https://www.creditinfocenter.com, May 10, 2016.

filing.

The act limits the debtor's exclusivity period, which was a real boon of filing for bankruptcy. Past law allowed for indefinite extensions, which served to drag out the time before bondholders and other creditors get any money. But now that period is capped at 18 months, with no room for extension. For large corporations with complicated bankruptcies, such a quick turnaround may not be possible, and if a plan is not filed at the end of 18 months, the company must put itself at the mercy of creditors.

Laws to Promote Fair Competition

Many measures have been taken to try to keep the marketplace free from influences that would restrict competition. These efforts include **antitrust regulation**, laws that prevent companies from entering into agreements to control trade through a monopoly. The first act regulating competition was the *Sherman Antitrust Act*, passed in 1890 to prevent large companies from dominating an industry and making it hard for smaller firms to compete. This broad act banned monopolies and contracts, mergers, or conspiracies in restraint of trade. In 1914 the *Clayton Act* added to the more general provisions of the Sherman Antitrust Act. It outlawed the following:

- *Price discrimination.* Offering a customer discounts that are not offered to all other purchasers buying on similar terms
- *Exclusive dealing.* Refusing to let the buyer purchase a competitor's products for resale
- *Tying contracts.* Requiring buyers to purchase merchandise they may not want in order to get the products they do want
- *Purchase of stock in competing corporations so as to lessen competition.* Buying competitors' stock in such quantity that competition is reduced

The 1950 *Celler-Kefauver Act* amended the Clayton Act. It bans the purchase of one firm by another if the resulting merger decreases competition within the industry. As a result, all corporate acquisitions are subject to regulatory approval before they can be finalized. Most antitrust actions are taken by the U.S. Department of Justice, based on federal law. Violations of the antitrust acts are punishable by fines, imprisonment, or civil damage payments that can be as high as three times the actual damage amount. These outcomes give defendants an incentive to resolve cases.

The *Federal Trade Commission Act,* also passed in 1914, bans unfair trade practices. This act created the Federal Trade Commission (FTC), an independent five-member board with the power to define and monitor unfair trade practices, such as those prohibited by the Sherman and Clayton Acts. The FTC investigates complaints and can issue rulings called *cease-and-desist orders* to force companies to stop unfair business practices. Its powers have grown over the years. Today the FTC is one of the most important agencies regulating the competitive practices of business.

Regulation of Advertising and Pricing

A number of federal laws directly affect the promotion and pricing of products. The *Wheeler-Lea Act* of 1938 amended the Federal Trade Commission Act and gave the FTC authority to regulate advertising. The FTC monitors companies' advertisements for false or misleading claims.

The most important law in the area of pricing is the *Robinson-Patman Act,* a federal law passed in 1936 that tightened the Clayton Act's prohibitions against price discrimination. An exception is made for circumstances like discounts for quantity purchases, as long as the discounts do not lessen competition. But a manufacturer cannot sell at a lower price to one company just because that company buys all its merchandise from the manufacturer. Also, if one firm is offered quantity discounts, all firms buying that quantity of goods must get the discounts. The FTC and the antitrust division of the Justice Department monitor pricing.

Consumer Protection Laws

Consumerism reflects the struggle for power between buyers and sellers. Specifically, it is a social movement

seeking to increase the rights and powers of buyers vis-à-vis sellers. Sellers' rights and powers include the following:

- To introduce into the marketplace any product, in any size and style, that is not hazardous to personal health or safety, or if it is hazardous, to introduce it with the proper warnings and controls
- To price the product at any level they wish, provided they do not discriminate among similar classes of buyers
- To spend any amount of money they wish to promote the product, so long as the promotion does not constitute unfair competition
- To formulate any message they wish about the product, provided that it is not misleading or dishonest in content or execution
- To introduce any buying incentives they wish

Meanwhile, buyers have the following rights and powers:

- To refuse to buy any product that is offered to them
- To expect products to be safe
- To expect a product to be essentially as the seller represents it
- To receive adequate information about the product

Many laws have been passed to protect consumer rights. **Table A2** lists the major consumer protection laws.

Key Consumer Protection Laws	
Mail Fraud Act (1872)	Makes it a federal crime to defraud consumers through use of the mail.
Pure Food and Drug Act (1906)	Created the Food and Drug Administration (FDA); protects consumers against the interstate sale of unsafe and adulterated foods and drugs.
Food, Drug, and Cosmetic Act (1938)	Expanded the power of the FDA to cover cosmetics and therapeutic devices and to establish standards for food products.
Flammable Fabrics Act (1953)	Prohibits sale or manufacture of clothing made of dangerously flammable fabric.
Child Protection Act (1966)	Prohibits sale of harmful toys and gives the FDA the right to remove dangerous products from the marketplace.
Cigarette Labeling Act (1965)	Requires cigarette manufacturers to put labels warning consumers about health hazards on cigarette packages.

Table A2

Key Consumer Protection Laws	
Fair Packaging and Labeling Act (1966)	Regulates labeling and packaging of consumer products.
Consumer Credit Protection Act (Truth-in-Lending Act) (1968)	Requires lenders to fully disclose to borrowers the loan terms and the costs of borrowing (interest rate, application fees, etc.).
Fair Credit Reporting Act (1971)	Requires consumers denied credit on the basis of reports from credit agencies to be given access to their reports and to be allowed to correct inaccurate information.
Consumer Product Safety Act (1972)	Created the Consumer Product Safety Commission, an independent federal agency, to establish and enforce consumer product safety standards.
Equal Credit Opportunity Act (1975)	Prohibits denial of credit on the basis of gender, marital status, race, religion, age, or national origin.
Magnuson-Moss Warranty Act (1975)	Requires that warranties be written in clear language and that terms be fully disclosed.
Fair Debt Collection Practice Act (1978)	Makes it illegal to harass or abuse any person, to make false statements, or to use unfair methods when collecting a debt.
Alcohol Labeling Legislation (1988)	Provides for warning labels on liquor saying that women shouldn't drink when pregnant and that alcohol impairs our abilities.
Nutrition Labeling and Education Act (1990)	Requires truthful and uniform nutritional labeling on every food the FDA regulates.

Table A2

Key Consumer Protection Laws	
Children's Television Act (1990)	Limits the amount of advertising to be shown during children's television programs to not more than 10.5 minutes per hour on weekends and not more than 12.0 minutes per hour on weekdays.
Americans with Disabilities Act (ADA) (1990)	Protects the rights of people with disabilities; makes discrimination against the disabled illegal in public accommodations, transportation, and telecommunications.
Brady Law (1998)	Imposes a 5-day waiting period and a background check before a gun purchaser can take possession of the gun.
Children's Online Privacy Protection Act (2002)	Regulates the collection of personally identifiable information (name, address, e-mail address, phone number, hobbies, interests, or other information collected through cookies) online from children under age 13.
Can-Spam Anti-Spam Law (2004)	Requires marketers to remove customers from their lists when requested, and provide automated opt-out methods as well as complete contact information (address and phone) with alternate means of removal. It also bans common practices such as false headers and e-mail harvesting (the use of software that spies on Web sites to collect e-mail addresses). Subject lines must be truthful and contain a notice that the message is an ad.
Credit Card Accountability and Disclosure Act (2009)	Amends the Truth in Lending Act to prescribe open-end credit lending procedures and enhanced disclosures to consumers, limit related fees and charges to consumers, increase related penalties, and establish constraints and protections for issuance of credit cards to minors and students.
Dodd Frank Wall Street Reform and Consumer Protection Act (2010)	The act established after the financial crisis of 2008 created a number of new government agencies tasked with overseeing various components of the act and by extension various aspects of the banking system. In May, 2018, Congress and President Trump passed a law to roll back significant pieces of Dodd-Frank.

Table A2

Deregulation of Industries

During the 1980s and 1990s, the U.S. government actively promoted **deregulation**, the removal of rules and regulations governing business competition. Deregulation drastically changed some once-regulated industries (especially the transportation, telecommunications, and financial services industries) and created many new competitors. The result has been entries into and exits from some industries. One of the latest industries to deregulate is the electric power industry. With almost 200 investor-owned electric utilities, it is the largest industry to be deregulated so far.

Consumers typically benefit from deregulation. Increased competition often means lower prices. Businesses also benefit because they have more freedom to operate and can avoid the costs associated with government regulations. But more competition can also make it hard for small or weak firms to survive.

Regulation of the Internet

Use of the internet has exploded over the past decade. Recent estimates suggest that more than half of the world's population use the web to purchase goods and services, book travel plans, conduct banking and pay bills, stream original content, read the latest news and sports information, look up facts and figures, and keep up with friends, family, and business associates via Skype, FaceTime, Twitter, Facebook, and other platforms.[3]

Internet access and regulation continue to be a concern for many interest groups, including privacy advocates, internet providers, private citizens, technology companies, and the government, to name a few. In 2017, President Trump signed legislation overturning the internet privacy protections originally put in place by the Obama administration. Under the new legislation, internet providers will now be able to collect, store, share, and sell certain types of customer information without their consent. Under previous legislation, sharing this type of data would have required consumers' permission. With this new law, companies such as Verizon and Comcast will be able to mine user data and use that information to compete in the $83 billion digital advertising market with companies such as Google and Facebook.[4] The internet environment is extremely dynamic, so consumers and other interest groups should monitor how regulations and other policies will continue to change the ground rules for internet use.

Understanding the Tax Environment of Business

3. What are the most common taxes paid by businesses?

Taxes are sometimes seen as the price we pay to live in this country. Taxes are assessed by all levels of government on both business and individuals, and they are used to pay for the services provided by government. The federal government is the largest collector of taxes, accounting for 52 percent of all tax dollars. States are next, followed closely by local government taxes. The average American family pays about 37 percent of its income for taxes, 28 percent to the federal government and 9 percent to state and local governments.

Income Taxes

Income taxes are based on the income received by businesses and individuals. The income taxes paid to the federal government are set by Congress, regulated by the Internal Revenue Code, and collected by the Internal Revenue Service. These taxes are *progressive*, meaning that rates increase as income increases. Most of the states and some large cities also collect income taxes from individuals and businesses. The state and local governments establish their own rules and tax rates.

Other Types of Taxes

Besides income taxes, individuals and businesses pay a number of other taxes. The four main types are property taxes, payroll taxes, sales taxes, and excise taxes.

Property taxes are assessed on real and personal property, based on the assessed value of the property. They raise quite a bit of revenue for state and local governments. Most states tax land and buildings. Property taxes may be based on fair market value (what a buyer would pay), a percentage of fair market value, or replacement value (what it would cost today to rebuild or buy something like the original). The value on which the taxes are based is the assessed value.

Any business that has employees and meets a payroll must pay **payroll taxes**, the employer's share of Social

3 "Digital in 2017: Global Overview," *The Next Web,* https://thenextweb.com, accessed June 23, 2017.
4 Brian Fung, "Trump Has Signed Repeal of FCC's Internet Privacy Rule. Here's What Happens Next," *Los Angeles Times,* https://www.latimes.com, April 4, 2017.

Security taxes and federal and state unemployment taxes. These taxes must be paid on wages, salaries, and commissions. State unemployment taxes are based on the number of employees in a firm who have become eligible for unemployment benefits. A firm that has never had an employee become eligible for unemployment will pay a low rate of state unemployment taxes. The firm's experience with employment benefits does not affect federal unemployment tax rates.

Sales taxes are levied on goods when they are sold and are a percentage of the sales price. These taxes are imposed by states, counties, and cities. They vary in amount and in what is considered taxable. Some states have no sales tax. Others tax some categories (such as appliances) but not others (such as clothes). Still others tax all retail products except food, magazines, and prescription drugs. Sales taxes increase the cost of goods to the consumer. Businesses bear the burden of collecting sales taxes and sending them to the government.

Excise taxes are placed on specific items, such as gasoline, alcoholic beverages, cigarettes, airline tickets, cars, and guns. They can be assessed by federal, state, and local governments. In many cases, these taxes help pay for services related to the item taxed. For instance, gasoline excise taxes are often used to build and repair highways. Other excise taxes—such as those on alcoholic beverages, cigarettes, and guns—are used to control practices that may cause harm.

Index

Symbols

1996 Telecommunications Act 40
5Ps 404

A

Abbott 67
Absolut 103
absolute advantage 82
account payable 544
Accounting 474
Accounts receivable 542
Ace Hardware 130, 130
acid-test (quick) ratio 493
acquisition 138
Activity ratios 495
administrative law 599
advertising 415
advertising media 418
Aetna 462, 462
affirmative action programs 283
agency shop 276
Agents 405
AICPA Auditing Standards Board 480
Airbus 40, 194, 194, 194, 194
Albertson's 105, 106, 106
Alcoa 67
Alcon 254
Alibaba 441
Alibaba.com 139
Altria Group 138, 548
Amazon 14, 139, 139, 242, 310, 429, 557
Amazon Music 366
American Bar Association 124
American Building Restoration Products 92
American Express 67, 67, 462, 462
American Leather 332
American Red Cross 12, 67, 371
Americans with Disabilities Act 282
Angel investors 169
annual report 477
antitrust regulation 606
appellate courts (courts of appeals) 600
Apple 12, 56, 366, 366, 366, 548
Application service providers (ASP) 448
apprenticeship 264
Arbitration 278, 601
Arthur Andersen 473
assembly process 333
assembly-line 336
Assets 480
Associa 312
AT&T 40, 444
audience selectivity 418
Auditing 477
Authority 231
Autocratic leaders 197
Autodesk 193
Axia Home Loans 315, 315

B

B Corps 66
B Lab 65
balance of payments 81
balance of trade 81
balance sheet 484
bank charter 519
Bank of America 264
Bank of America Merrill Lynch 550
Bank of New York 104
Bankruptcy 605
barriers to entry 39
batch processing 450
Bayer 67
Bear Stearns 516
Bell Labs 367
Benefit segmentation 377
Best Buy 256, 256
Bethlehem Steel 298
big data 393
bill of material 337
Bissell 103
blockchain technology 341
Bloomberg Businessweek 415
Blue Diamond 130
BNSF Railway 258, 261
board of directors 125
Boeing 40, 194, 194, 194, 194, 194, 194, 194, 194, 545
Bolthouse Farms 60
bond ratings 553
Bonds 546
Bosch 103
brainstorming 384
breach of contract 603
breaking bulk 407
Bristol-Meyers Squibb 454
Bristol-Myers Squibb 454
Broadcom 460, 461
broker market 555
brokers 405
Bundling 391
Bureau of Labor Statistics 26, 282, 317, 477
business 12
business cycles 26
Business law 599
business plan 166, 166
Business Process Management 351
buy-national regulations 85
Buyer behavior 371
Buyer cooperatives 130

C

C corporation 127
Cabela's 411
Cacharel 93
CAD/CAM systems 347
Calavo 130
CAMI Automotive 94
Campbell Soup 383
Campbell Soup Company 60
Campbell's soups 415
capital 14
capital budgeting 543
capital expenditures 543
Capital products 382
Capitalism 22
Carbone Smolan Agency 259
Cardianove 347, 347
Cargill 547
Carnival Cruise Lines 370
cash flows 539
cash management 541

Caterpillar 93, 368
CBS 285
Cellular manufacturing 337
Centralization 233
certified management accountant (CMA) 478
certified public accountant 173
certified public accountant (CPA) 478
chain of command 231
Chamber of Commerce 426
Charles Schwab 550
chief information officer (CIO) 441
Chili's 136
CHS 130
circuit breakers 559
circular flow 24
Cisco Systems 104, 240, 258
Citibank 526
Citigroup 104, 550
Civil Rights Act 283
Clairol 197
cloud computing 462
CNN 25
Coca-Cola 91, 97, 100
code of ethics 59
Coercive power 197
Coke 92
collective bargaining 272
commercial bank 518
Commercial paper 541
committee structure 226
Common law 599
Common stock 547
communism 23
competitive advantage 284, 367
computer network 443
computer virus 457
computer-aided design (CAD) 347
Computer-aided manufacturing (CAM) 347
Computer-integrated manufacturing (CIM) 350
Conceptual skills 207
conciliation 283
conglomerate merger 138
Consensual leaders 200
Consultative leaders 200
consumer price index (CPI) 28
Consumerism 606
contingency plans 194
contingent worker 256
continuous improvement 345
continuous process 333
contract 602
contract manufacturing 93
contractionary policy 30
controlling 202
Convenience products 380
cooperative 129
copyright 604
Corning 540, 540
corporate culture 201
Corporate philanthropy 67
corporate social responsibility (CSR) 62
corporation 122
cost competitive advantage 367
cost per thousand (CPM) 418
Cost-push inflation 28
Costco 59, 548
Costs 12
countertrade 96
CPA 173
credit union 521
Crest 377
critical path 343
critical path method (CPM) 343
cross-functional team 229
crowding out 31
Culture 372
Currency 512
Current assets 486
Current liabilities 487
current ratio 493
Customer departmentalization 222
Customer satisfaction 364
Customer value 363
Customization 332
Cyclical unemployment 27

D

data marts 451
data mining 459
data warehouse 451
database 443
dealer markets 556
DeBeers Consolidated Mines Ltd. 39
debt 168
Debt ratios 496
debt-to-equity ratio 496
Decentralization 233
decision support system (DSS) 451
decisional role 203
Deepwater Horizon 16
delegation of authority 231
Dell 67, 352
Deloitte 62, 241, 258, 477
Delphi 89
Demand 33
demand curve 33
Demand deposits 513
Demand-pull inflation 28
Deming 345
Democratic leaders 200
Demographic segmentation 375
Demography 18
deontology 57
Department of Commerce 174
Department of Labor 29, 29, 283
departmentalization 220
Depreciation 486
deregulation 609
devaluation 82
differential competitive advantage 368
direct foreign investment 94
discount rate 515
Disney 67, 222, 363
Distribution 405
distribution channel 405
Dividends 548
division of labor 220
Dodd-Frank Wall Street Reform and Consumer Protection Act 517
Domino's 77, 77, 77, 78
Domino's 77, 78, 78, 78, 78
double-entry bookkeeping 481
Dow 383
Dow Chemical 264

Drucker 62
Dumping 86
Dunkin' 136
dynamic pricing 390

E

E-commerce 428
E-procurement 341
Eagle Global Logistics 161
Earnings per share (EPS) 495
economic growth 26
economic system 20
Economics 20
effectiveness 189
Efficiency 189
electronic communications networks (ECNs) 558
electronic data interchange (EDI) 341
embargo 85
Empowerment 200
Enron 460, 473, 473
enterprise portal 447
Enterprise Rent-A-Car 363
enterprise resource planning (ERP) 338
Entrepreneur 135, 135, 137, 141
Entrepreneur's 131
Entrepreneurs 14, 155
environmental scanning 365
Equal Employment Opportunity Commission 283
equilibrium 34
equity 168
equity theory 306
Ernst & Young 478
Ethan Allen 221
ethical issue 55
Ethics 55
Ethics Resource Center 58
European integration 90
European Union 527
European Union (EU) 90
exchange 362
Exchange controls 85
exchange-traded fund (ETF) 554
Excise taxes 611
executive information system (EIS) 452
expansionary policy 30
expectancy theory 306
Expense items 382
experiment 378
Expert power 197
expert system 452
Export Assistance Centers 92
Export Working Capital Program 92
exporting 92
Exports 80
ExxonMobil 548
EY 41, 42, 42, 42, 42, 42, 42, 478

F

Facebook 61, 383
factoring 544
factors of production 14
Fair Labor Standards Act 280, 283
Family and Medical Leave Act 282
FedBid 341
federal budget deficit 31
Federal Deposit Insurance Corporation (FDIC) 525
Federal Mediation and Conciliation Service 283
Federal Open Market Committee 514
Federal Reserve 513
Federal Reserve Board 513
Federal Reserve System 514
Federal Reserve System (the Fed) 29
Federal Trade Commission 137
federation 272
FedEx 264, 447
Fidelity 550
Fidelity Investments 285
Financial accounting 475
Financial Accounting Standards Board (FASB) 475
financial intermediation, 518
Financial management 539
financial risk 545
fiscal policy 30
Fishpeople Seafood 66
Fitness 135
Five Ps 365
Fixed assets 486
fixed-position layout 337
flexible manufacturing system (FMS) 348
floating exchange rates 81
focus group 384
Food and Drug Administration 17, 18, 254
Forbes 14
Ford 331
formal organization 239
Fortune 123, 473
Fortune 500 130
franchise agreement 134
Franchise Business Review 131
Franchise Gator 131, 135, 135
franchisee 133
Franchising 133
Franchising World 137
franchisor 133
Free trade 83
free-rein 200
free-trade zone 88
Frequency 418
Frictional unemployment 27
Friedman 441
Fruit of the Loom 93
full employment 26
Functional departmentalization 221
Futures contracts 554

G

G20 84
Gaggenau 103
Gantt charts 343
Gartner 209
Gates 105, 155
Geeks on Call 135
Genencor 302
General Electric 197, 345
General Foods 138
General Motors 272, 279, 279, 347, 382
general partners 120
general partnership 119
General Services Administration 341
generally accepted accounting principles (GAAP) 475

Geographic departmentalization 224
Geographic segmentation 376
Gillette 100, 197
Glassdoor 258
global management skills 210
global vision 79
Goal-setting theory 307
Goldman Sachs 550
Goods 12
Google 104, 201, 201, 202, 312, 312
Gore-Tex 34
grievance 277
gross domestic product (GDP) 26
Group cohesiveness 227
Gucci 369

H

H-E-B 19
H&R Block 19, 19, 19, 19
Haier 103
Handshake 258
Harley-Davidson 332, 337, 377
Hasbro 53, 54, 54, 54, 54, 54, 54, 54, 54
Hawthorne 299, 299
Hawthorne effect 299
Herzberg 304, 304, 305, 305, 305
Hewlett-Packard 104
Home Depot 374
Home Instead Senior Care 140, 141, 141
Honda 79, 104
Hoover 103
horizontal merger 138
Human relations skills 206
Human resource (HR) management 253
Human resource planning 254
Hurricane Katrina 16, 36, 55, 67
Hygiene factors 304
Hyundai 103

I

IAMS 197
IBM 94, 158
Ikea 103
import quota 85
Imports 80
In-N-Out Burger 19
Inc. 137
incentive pay 269
Income taxes 610
Indeed 258
Industrial distributors 405
inflation 27
informal organization 238
Information technology (IT) 438
informational role 203
Infrastructure 98
insider trading 558
Institutional investors 550
Intangible assets 486
integrated marketing communications (IMC) 416
Intel 67, 158, 311, 311, 311, 311, 341, 341, 341, 415
interest 546
intermittent process 333
International Franchise Association 137
International Monetary Fund 527
International Monetary Fund (IMF) 88
International Organization for Standardization 346
interpersonal roles 203
intranets 446
intrapreneurs 158
inventory 338
Inventory management 338
inventory turnover ratio 495
Investment bankers 550
ISO 14000 346
ISO 9000 346
ITT 222

J

Jamba Juice 133
Jana Brands 136, 136
Jiffy Lube 131, 133
job analysis 254
job description 254
job enlargement 310
Job enrichment 310
job fair 258
Job rotation 264, 310
Job sharing 311
job shop 332
job specification 254
Johnson Controls 138
joint venture 94, 130
JP Morgan 550
judiciary 600
just-in-time (JIT) 346
justice 56

K

Kaiser Permanente 19
Kauffman Foundation 162, 162, 162
Kellogg 92, 100
Kimberly Clark 105
Knowledge 15
knowledge management (KM) 454
knowledge workers 15, 441
Kodak 39, 39
KPMG International 478
Kraft 385
Kraft Foods 138

L

labor union 272
laissez-faire 200
Land O'Lakes 130
laws 599
layout 336
leader pricing 390
leadership 200
leadership style 197
Lean manufacturing 346
Legitimate power 197
Lending Club 58
leveraged buyout (LBO) 138
Levi Strauss 93
LG 103
Li Ning 103
Liabilities 480
Licensing 93
limited liability company (LLC) 127
limited partners 120
limited partnership 120
line extension 383
line of credit 544

line organization 224
line positions 224
line-and-staff organization 224
LinkedIn 242
liquidity 484
Liquidity ratios 493
local area network (LAN) 444
local union 272
Lockheed Martin 352
Long-term liabilities 487
loss leader 390

M

M1 513
Ma 441
Macroeconomics 24
Madoff 58, 473
make-or-buy decision 337
Malcolm Baldrige National Quality Award 345
Managed service providers (MSP) 449
Management 188
management information systems 443
management rights clause 276
Management support systems (MSS) 451
managerial accounting 474
Managerial hierarchy 231
Manufacturers' representatives 408
Manufacturing resource planning II (MRPII) 338
market segmentation 375
market structure 38
marketable securities 541
marketing 362
marketing concept 363
marketing database 393
marketing intermediaries 405
marketing mix 369
Marketing research 378
Marriott 194, 194, 194, 194, 366, 415, 415
Mars 374
Mars Inc 26
Maslow 300, 300, 300, 300, 301, 301, 301, 301, 301, 301, 302
Maslow's hierarchy of needs 300
mass customization 332
Mass production 331
Materials requirement planning (MRP) 338
matrix structure 225
Mayo 299, 299
McDonald's 79, 131, 136, 207, 369
McGregor 302
mechanistic organization 234
mediation 284, 601
Mentoring 264
merchant wholesaler 408
Merck 460
Mercosur 89
merger 138
Merrill Lynch 264
microeconomics 24
Microsoft 235, 235, 242
middle management 196
Miller Brewing Company 138
MillerCoors Brewing 269
mission 192
mission statement 192
mixed economies 24
Model Business Corporation Act 124
Monetary policy 29
Money 511
monopolistic competition 39
Monster.com 258
Morgan Stanley 550
Morris Financial Concepts 316
mortgage loan 547
motivating factors 304
Motivation 297
Motley Fool 311
multinational corporations 100
Municipal bonds 552
Music Row Private Bank 368, 368
mutual fund 553

N

Nabisco 138
Nadella 235, 235
NAICS 162
Nasdaq 480
National Association of Manufacturers 351, 351
National Association of Manufacturers Skills Gap Report 351
National Association of Securities Dealers Automated Quotation system 557
national debt 31
National Institute of Standards and Technologies 345
National Labor Relations Board 273
Nationalism 96
need 297
Nescafe 100
Nestlé 104, 104
net profit margin 494
Net working capital 494
Netflix 312
Network Capital Funding Corporation 19
New Mexico Manufacturing Extension Partnership 342
New York Stock Exchange 480
niche competitive advantage 368
Nike 40, 43, 103, 104, 201
NLRB 283
nonprogrammed decisions 205
Norfolk Southern 205
Norfolk Southern Railroad 201
North American Free Trade Agreement (NAFTA) 88
North American Industry Classification System 162
not-for-profit organization 13

O

Observation research 378
Occupational Safety and Health Act 282
Occupational Safety and Health Administration 283
Ocean Spray 130
Odd-even pricing 391
Office of International Trade 174
Oil, Chemical and Atomic Workers Union 272
oligopoly 40

Olive Garden 378
One-to-one marketing 393
online 450
Open market operations 514
open shop 276
Operational planning 193
operations management 329
Options 554
OrangeTheory Fitness 135
Oreck 205, 205, 205, 205
organic organization 234
organization 219
organization chart 220
organizing 195
orientation 263
Otis Elevator 103
Ouchi 302
outsourcing 83, 337
over-the-counter (OTC) markets 557
Overnite 138
Owners' equity 480

P

Pampers 100
Panasonic 386
Pandora 366
Paper, Allied-Industrial, Chemical and Energy International Union 272
participative leaders 198
partnerships 119
patent 603
payroll taxes 610
Pearl Paradise 117
penetration pricing 389
pension funds 524
Pepsi 100
perfect (pure) competition 38
performance appraisal 266
perpetual inventory 338
Personal selling 419
Personality 373
Pew Research 141
Pfizer 242, 242, 242
Pharmacia 242, 242
Philip Morris 100, 138
Piggly Wiggly 315, 315
Piggly Wiggly Carolina 315
Pizza Hut 135
Place (distribution) strategy 370
Planning 190
PNC Financial Services Group 223
Polaroid 39, 39
power 197
PPG 96
preferential tariff 88
preferred stock 548
prestige pricing 391
price skimming 389
PricewaterhouseCoopers 478
Pricing strategy 369
primary market 550
principal 546
principle of comparative advantage 82
private accountants 478
Problem-solving teams 228
Process departmentalization 222
process layout 336
process manufacturing 333
processing 450
Procter & Gamble 197, 224, 389
producer price index (PPI) 29
product 336, 379
Product departmentalization 222
Product liability 605
product life cycle 386
product manager 385
product strategy 369
Production 329
production planning 330
production process 331
Productivity 19
profit 12
Profitability Ratios 494
program evaluation and review technique (PERT) 344
Programmed decisions 203
programmed instruction 266
Promotion 414
Promotion strategy 370
promotional mix 415
Property taxes 610
prospecting 419
protected class 283
protectionism 83
Protective tariffs 85
Psychographic segmentation 377
psychological pricing 391
public accountants 477
Public Company Accounting Oversight Board 479
Public relations 425
publicity 426
punishment 308
Purchasing 337
purchasing power 27
pure monopoly 39
PwC 477

Q

Qualifying questions 420
Quality 345
Quality control 345
Quality Imaging Products 161
Quality of life 12
Quiznos 131

R

Rader Awning & Upholstery 342
Ralph Lauren 369
Ratio analysis 493
Reach 418
real-time 450
recession 26
Recruitment 258
Recruitment branding 259
Red Bull 103
reengineering 240
reference groups 373
Referent power 197
Regions Bank 368
REI 65
Reinforcement theory 308
relationship management 43
Relationship marketing 364
Retailers 405
Retained earnings 487, 548
return 540
return on equity (ROE) 495
Revenue 12
revolving credit agreement 544
reward 308
Reward power 197

right-to-work law 276
Risk 12, 540
risk-return trade-off 540
Ritz-Carlton 258, 258, 284
Robotics 347
Rolex 85, 85
Routing 342

S

S corporation 127
Sales promotions 421
sales prospects 419
Sales taxes 611
Salesforce 62
Salesforce.com 158, 258
Samsung 103, 383
Sarah Adult Day Services 141
Sarbanes-Oxley Act 479
savings bonds 32
SBA 92
Scheduling 342
scientific management 298
seasonal unemployment 27
secondary market 550
Secured loans 544
Securities 549
Securities and Exchange Commission 18, 479
Selection 260
selection interview 260
selective credit controls 515
selective strike strategy 279
self-managed work teams 228
Seller cooperatives 130
Semco 311, 311
servicemark 604
Services 12
Sharp 386
Shkreli 55
shop steward 272
Shopify 393
shopping products 380
Siemens 105
simulation 266
situational leadership 200
Six Flags 258
Six Sigma 345
small business 155
Small Business Administration 92, 155, 162
Small Business Administration (SBA) 176
Small Business Association 174
Small Business Investment Companies (SBICs) 176
social investing 68
Social media 427
Socialism 23
sole proprietorship 117
Sony 12, 303, 303, 303, 386
Southwest Airlines 261, 285
Spalding Company 93
span of control 232
specialization 220
Specialty products 380
Spotify 366
Sprint 40, 444
staff positions 224
Stakeholders 65
standard of living 12
Starbucks 62, 557
StarKist 415
Startups 137
statement of cash flows 490
Statutory law 599
StickerGiant 15, 15, 15, 15, 15
Stock dividends 548
stockbroker 550
Stockholders (or shareholders) 125
strategic alliances 43
strategic giving 68
Strategic planning 191
strict liability 605
Structural unemployment 27
Stryker 383
Subway 135, 136, 136, 136, 136, 136, 136, 136
Success 137
succession planning 256
Sunkist 130
supervisory (first-line) management 196
supply 34
supply chain 339
supply curve 34
Supply-chain management 339
survey research 378
Suzuki 94

T

Tactical planning 193
Taft-Hartley Act of 1947 276
Target 43, 43, 43, 43, 43
target market 366
tariff 84
Taylor 298, 298, 298, 298
Team Rubicon 10, 10, 10, 10, 10, 11, 11
Teamsters 272
technical skills 206
Technology 19
Telecommunications Act of 1996 18
term loan 546
Test-marketing 385
Texas Health Resources 261
Texas Instruments 158
The Federal Trade Commission 18
The Morning Star Company 231
The NonProfit Times 11
The Wall Street Journal 415
The World Is Flat 441
Theory X 302, 302, 302
Theory Y 302, 302, 302, 302, 302, 302
Theory Z 302, 302, 302, 303
thrift institution 519
Time deposits 513
top management 195
tort 604
Total Quality Management (TQM) 345
Tower Paddle Boards 310
Toyota 79, 81, 81, 81, 97, 284
trade credit 544
trade deficit 81
trade surplus 81
trademark 604
Training and development 263
transaction processing system (TPS) 450
Treasury's Bureau of Engraving and Printing 513
trial courts 600
TripAdvisor 194
Turing Pharmaceuticals 55
Tyco 473, 473
Tyco International 138

Tylenol 40

U

U.S. Army 341
U.S. Census Bureau 18, 41, 375
U.S. Chamber of Commerce 269
U.S. Constitution 57
U.S. Department of Commerce 345
U.S. Department of Labor 27, 269, 590
U.S. Postal Service 261
underwriting 550
Unemployment compensation 270
unemployment rate 27
Uniform Commercial Code (UCC) 600
Unilever 105, 231
Union Pacific 451
union shop 276
United Auto Workers 272, 279
United Nations Sustainability Development Goals 105
United Papermakers International Union 272
United Way 426
Unsecured loans 544
Unsought products 380
UPS 67, 133, 138, 298, 447
Urban Outfitters 308, 308
Uruguay Round 86
utilitarianism 57

V

value-stream mapping 342
Venture capital 170
Verizon 242, 444
vertical merger 138
Veterans Administration Hospital 445
VF Corporation 154
Virgin 103
virtual corporation 240
virtual private networks 448
volume segmentation 377

W

W. L. Gore 236
W.L. Gore 261
Wagner Act 283
Wagner and Taft-Hartley Acts 282
Walgreens 67
Walmart 67, 94, 97, 258, 350, 352, 429
want 297
Wegmans 301, 301, 301, 301, 301, 301
Welch 197
Wella AG 197
Wells Fargo 58
Wendy's 369
Whirlpool 463
Whole Food 242
Wholesalers 405
Wicks 'n' Sticks 133
wide area network (WAN) 444
Williams Sonoma 366
Wing Zone 141
Work groups 228
Work teams 228
Worker's compensation 270
World Bank 87
World Oceans Day 106
World Trade Organization 86
WorldCom 473

Y

Yahoo 139, 242
Yankee Candle Company 260

Z

Zappos 258
Zillow 316, 316
Zuckerberg 14

References

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24. The Are You a Good Listener scale was originally created by the authors and from the following sources: *American Management Association – Self-Test: Are You a Good Listener,* https://www.amanet.org/arc_center/archive/quiz_aug2003.htm; *How To Be an Active Listener,* https://techrepublic.com/5102-10878-5054191.html; *Are You a Good Listener?,* https://www.nidoqubein.com/article15.html; *Are You a Good Listener?,* https://www.lwvohio.org/members/postboard/june2004/Are_You_a_Good_Listener.pdf; *Productivity – Are You a Good Listener?,* https://www.effectivemeetings.com/productivity/communication/listener.asp; *Are You a Good Listener?—Listen and Profit,* Mike Kelly, https://www.simplysolo.com/kelly.htm; *Joan Lloyd at Work,* https://www.joanlloyd.com/articles/open.asp?art=026.htm; and *Humanities 2000—Listening Skills,* https://www.h2000.utoledo.edu/hs/clay/ListenSkills.html.