PART 1 A FRAMEWORK FOR STUDY

Chapter 1

Exploring Canadian Business: A Critical Approach

What Are the Major Challenges Facing Business?

Is Canadian business headed for a dismal future, or one that is bright? How does one make sense of the current state of Canadian business? Assessing the prospects of organizations requires a careful examination of the contexts within which they operate. This chapter introduces the framework for this book—a critical examination of the internal and external forces that can critically impact the functioning and fate of business.

What factors play the strongest role in determining whether a business will prosper or fail? This question requires a closer examination of the environment the business is operating in and the factors that constitute the context of business—both internal and external. That is, to understand the forces that act on business, we need to look both inside and outside the organization. We can consider key issues that can be defined as existing within the boundaries of the organization, and we can also examine issues that are part of the organization's external environment. This chapter sets the stage for that examination.

Learning Objectives

After studying this chapter, you should be able to

1. Identify the key internal forces that shape any business.
2. Identify the forces that compose the specific and general environments of organizations.
3. Discuss the nature of the external forces confronting organizations.
4. Explain the importance of each of the external forces within the Canadian business context.

THE BUSINESS WORLD

Can Canadian Tire Flourish in a Rapidly Changing Business Context?

Canadian Tire has certainly become part of the fabric of Canadian society. It's been around since 1922 and has established itself as a solid Canadian retailer. Like the proverbial "underdog" Canadian hockey team, this Canadian retailer has managed quite well against a growing list of formidable US opponents. Over its 90-plus years, it has established approximately 500 stores across Canada, and with revenues close to $13 billion in 2012, this is no retail slouch.

However, as the expression goes, the times they are a changin'. And the question is, "Can Canadian Tire continue to flourish in these changing times amidst the onslaught of US retailers to Canada?"

US retailers have been invading our retail sector for many years now. It's an invasion welcomed by most Canadian consumers, but certainly not by Canadian retailers. Home Depot, Walmart, and Target are just a few of Canadian Tire's adversaries. And the competition continues to heat up.[1]

So what's a good ol' Canadian business to do? This is the question Canadian Tire is attempting to address. While the company clearly must have done something right to survive this long, some observers are puzzled by its success. In a recent *Maclean's* article, writer Chris Sorensen had this to say:

> Newer stores, located in towns and cities across the country, are brighter and more airy, but largely house the same eclectic inventory—none of it particularly cheap and none of it terribly aspirational either. Customer service, meanwhile, varies wildly from store to store, the result of the company's independent—and bureaucratic—dealer ownership model. It all seems like a recipe for retail disaster, particularly as an army of well-oiled U.S. big box chains—Wal-Mart, Home Depot and soon Target—continue their relentless march north of the border. Yet somehow, Canadian Tire remains standing, earning profits of $453 million on $10.3 billion in retail sales last year, which was up three per cent from a year earlier (Canadian Tire Corporation Ltd. also makes money through a banking operation, Canadian Tire Financial Services).[2]

How has Canadian Tire managed to retain its place among the top 20 Canadian brands over the past several years?

Experts believe that a big part of Canadian Tire's appeal is a combination of familiarity and convenience. But that doesn't tell the whole story. Obviously, Canadian Tire has succeeded by understanding its environment and responding to changing business contexts. The entrance of Target to the Canadian retail landscape has certainly made companies like Canadian Tire more vigilant and aware of the need to constantly evolve to best meet market demands. After feeling increased pressure from competitors, Canadian Tire has recently been revisiting its strategy. While not a direct competitor, Canadian

[1] Hulsman, N. (2013, March 7). Canadian Tire going small in fight against Target, Yahoo Finance. Retrieved from http://ca.finance.yahoo.com/blogs/insight/canadian-tire-going-small-fight-against-target-180021300.html.

[2] Sorenson, C. (2011, October 11). Canadian Tire's baffling strategy to sell you everything. *Maclean's*. Retrieved from http://www2.macleans.ca/2011/10/11/so-wrong-that-its-right.

Tire competes with Target on a number of product lines, including small appliances, and Canadian Tire's subsidiary Mark's Work Wearhouse competes for clothing sales.

In an effort to streamline its decision making, Canadian Tire cut several senior management positions in 2012. It has taken a systematic approach to analyzing the industry and adopting strategies to keep ahead of the game. For example, among recent changes was Canadian Tire's decision to spend less of its advertising budget on small, grassroots events and more on mainstream media. The aim is to build more brand awareness of Canadian Tire. The nature of advertising will also change, with a greater emphasis on the Canadian Tire image rather than on specific products. While some have suggested that Canadian Tire should play up its Canadian roots to appeal to loyal Canadians, others feel that a strategy based on national sentiment is a waste of time; they believe that other more tangible actions should be taken. As Susan Krashinsky of the *Globe and Mail* observed:

> Canadian Tire has survived past incursions by U.S. retailers such as Home Depot Inc. and Wal-Mart Stores Inc. The entry of Wal-Mart particularly caused the company to rethink the layout of its stores, change pricing policies and in more recent years, appeal to female shoppers more directly. It's efforts such as this, not Canadian roots, that proved most effective.[3]

In 2013, Canadian Tire announced plans to significantly improve its digital technology practices, including a partnership with Communitech, a technology company based in Kitchener, Ontario.[4] The aim is to develop apps, content, and other digital innovations to improve the shopping experience of Canadian Tire customers, both online and in the store. Canadian Tire also recently relaunched its online store after executives aborted a previous attempt in 2009. Among the items sold online are tires and wheels, which have to be picked up at Canadian Tire stores where many will also be installed. This effort was in response to a growing trend of Canadians buying their tires online through US-based websites and having them shipped directly to local mechanics.

Among other changes has been a renewed focus on its automotive roots. In 2013, Canadian Tire opened a number of automotive concept stores that feature drive-in reception areas, express oil and lube services, and auto detailing. Canadian Tire also owns 87 specialty automotive PartSource stores. This is part of its strategic emphasis on auto parts, tools, home supplies, and sporting goods to combat increased competition.

Another area of change is in the customer services offered by Canadian Tire. For example, it recently began offering home installation services for Canadian Tire garage door openers, followed by central vacuum installations and heating and cooling systems.

Canadian Tire has also ventured more deeply into the world of sports.[5] In 2013, it announced a host of deals with amateur sports organizations to strengthen its ties to a major market: up-and-coming athletes. Among the sponsorships is an eight-year agreement

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[3] Krashinsky, S. (2012, September 13). Pumping up the "Canada" in Canadian Tire. *Globe and Mail*. Retrieved from www.theglobeandmail.com/report-on-business/industry-news/marketing/pumping-up-the-canada-in-canadian-tire/article4543680.

[4] Boodoosingh, C. (2013, March 22). Canadian Tire steps up digital strategy, *Digital Home*. Retrieved from www.digitalhome.ca/2013/03/canadian-tire-steps-up-digital-strategy.

[5] McDiarmid, J. (2013, January 23). Canadian Tire digs deeper into amateur sport, *Toronto Star*. Retrieved from www.thestar.com/business/2013/01/23/canadian_tire_digs_deeper_into_amateur_sport.html.

with the Canadian Olympic Committee and new or expanded deals with other amateur organizations. These arrangements reflect Canadian Tire's shift to a greater presence in amateur sport following its 2011 acquisition of sports retailer Forzani Group Ltd. for $771 million. This move entrenched Canadian Tire's status in the sporting goods market as well as provided it with access to a younger demographic of Canadian consumers (who like to shop at malls). Forzani continues to serve as an independent unit, operating Sport Chek, Sport Mart, and Athletes World stores.

Some observers believe that a continuing challenge for Canadian Tire is to make it clear in consumers' minds that it offers more than automotive parts, tools, or sporting goods. On the other hand, marketing experts believe that Canadian Tire must also be cautious to not deviate far from its core business—that is, offering Canadians "everyday" household items rather than upscale home décor. As the old adage goes, you can't be all things to all people.

Sorensen sums it up nicely:

> Canadian Tire will need to stay on its toes as its territory is further invaded by big U.S. retailers. But despite its sometimes ungainly appearance, there's no reason to think the inverted orange triangle and green maple leaf will disappear from the Canadian landscape anytime soon. It may never be a chic proposition. But neither is weatherproofing windows or fixing a clogged toilet.[6]

In fact, in 2013 Canadian Tire announced that it would launch smaller stores in city centres, admitting that it needed to adopt a new approach to dealing with existing competitors like Walmart as well as combating new entrants like Target. Canadian Tire attempted the small-store concept in previous years. However, when Walmart began opening Supercentres across Canada (each about seven times the size of the new Canadian Tire format), it reconsidered that approach. Given that Walmart has recently begun toying with the "small box" concept (opening smaller, express versions of its big box stores) and with the entrance of Target, Canadian Tire has been open to revisiting just about anything, including a focus on smaller stores in core city shopping areas and malls. The plan is for these new "express" stores to be about 10,000 square feet.

Big or small, Canadian Tire has a lot to be proud of. It has been an iconic figure in the Canadian marketplace for many years. It has understood well the environmental forces that it must confront and address to survive. And for those patriotic Canadian consumers, let's hope this good ol' Canadian retailer sticks around for many more years. Way to go Canadian Tire—may the force(s) be with you, eh!

Objective 1 Identify the key internal forces that shape any business.

Leadership How people are managed within an organization.

Strategy The decisions made by business managers about how the company will address political, economic, global, societal, competitive, and technological forces.

THE INTERNAL CONTEXT OF BUSINESS

What goes on within the walls of an organization? That is, what comprises the internal context of organizations? In Part 2 of this book, we will consider more closely the internal context of organizations, focusing on four fundamental concepts: the employment relationship, **leadership**, organizational structure, and **strategy**. Looking inside organizations involves a consideration of how people within organizations are managed.

[6] Sorensen, 2011.

Chapter 2 explores the employment relationship; we will identify and examine the nature of responsibilities that employers have toward their workforce. Chapter 3 considers the notion of leadership and discusses perspectives on managing people, which is particularly important considering that organizations' fates are intrinsically bound to the quality of decisions that are generated inside the organization. Chapter 4 looks at how organizations are designed and why they sometimes decide to undergo dramatic **change**. Chapter 5 introduces the notion of business strategy and its relevance to organizational success or failure.

Exhibit 1.1 illustrates the framework we adopt in this book and also identifies the internal environment of business, which we discuss next.

Exhibit 1.1 Inside and Outside Organizations: The Framework for This Book

The Employment Relationship: Responsibilities Toward Labour

The ability to attract qualified workers and to extract maximum effort from them can be crucial to business success. However, navigating the **labour** relationship can be difficult and is fraught with risks. The context in which the labour relationship operates is a highly complex one. Workers are usually interested in maximizing the income they receive from the sale of their labour, whereas businesses usually desire to maximize profit. These two objectives can clash, creating conflicts that can have negative effects on productivity and profits, as well as the economy and society more generally. Chapter 2 considers the complexities associated with the legal context of managing labour. Societies and economies are influenced dramatically by how work is organized. We will discuss how debates about the best way to organize work are long-standing and influenced by perspectives on markets, power, and the role of the state in capitalist societies. The result is a complex web of rules and forces that businesses must learn and adapt to if they are to operate successfully. The next chapter considers some of these rules more closely, including rules and processes relating to unemployment and the loss of work, and rules that attempt to address Canada's diverse labour force.

Change A shift in how an organization operates.

Labour One of the five factors of production. Includes all workers in an organization who contribute their talents and strengths to create goods and services.

Sources to come

Leadership and Effectively Managing People

Chapter 3 considers the nature of the members who comprise an organization and how they manage and are managed. It does not matter whether we are talking about a nonprofit organization,

Sources to come

a small business, or a giant multinational corporation; any type of organization must be managed. Organizations are made up of people and, consequently, this factor is clearly one that we must carefully examine. How do we manage people within the organization? Regardless of your role in organizations, no doubt at some point in your career you will be required to apply some sort of management or leadership skills in the conduct of your job. Simply working in organizations is a reason to be familiar with how organizational life operates and to understand what exactly is involved in the art and science of management. Given the importance of this issue, we will take a closer look at it in more detail in Chapter 3.

Developing a Suitable Organizational Structure

Structure A deliberately planned network or pattern of relationships that exists among individuals within an organization. It determines such things as division of labour, span of control, level of formalization, and how centralized decision making is.

Chapter 4 considers the internal context of the organization with regard to how it is designed and the implications of organizational design and redesign. Organizational structure is a deliberately planned network or pattern of relationships that exists among individuals in various roles or positions. This includes the formal hierarchy of authority, the distribution or grouping of work (for example, into departments) and the rules or procedures that control and coordinate behaviour in the organization.

The **structure** of many organizations has been radically redesigned in recent years. Organizations in just about every industrialized nation have been undergoing change. (See Talking Business 1.1.) While some companies have reduced their levels of hierarchy or

TALKING BUSINESS 1.1

Changing GM's Organizational Structure

GM Global Design . . . announced a revised organizational structure and executive appointments that align it more closely with the company's brands across its network of 10 Design Centers around the world.

"This new structure provides a foundation to build and grow the design language for each of our brands moving forward," said Ed Welburn, GM vice-president for Global Design. "It gives our design teams a greater opportunity to create products and brands that have an emotional connection with our customers and that continue to move our company forward."

The benefits of a more brand-focused design organization include:

- Drive stronger—and common—messaging across a brand's portfolio
- Allow designers to better understand—and design for—customers when they live the brand on a day-to-day basis
- Provide for greater parts sharing across brands
- Foster more creativity and provide a clear, single purpose for each design team member.

The revised structure also increases the role of GM's Advanced Design Centers, which are strategically located in the United States, Germany, Korea, China and Australia.

"Strengthening our Advanced Design organization will allow us to help the company develop innovative new technologies and strategies to meet the future transportation needs of the global marketplace," Welburn said. "One thing is clear: Success will require a variety of mobility solutions that are striking both in their execution and their efficiency."

Source: Excerpted from GM press release. (2012, June 18). GM Design announces changes to its global organization and leadership team; moves strengthen brand focus and advanced design capabilities. Available at www.autoblog.com/2012/06/18/general-motors-design-ranks-get-big-overhaul.

laid off employees at all levels, others have undergone a concurrent change in their whole business process, while others have simply closed down. To understand what is happening, and more importantly *why* it is happening, we need to understand more about the design or structure of organizations. This is the aim of Chapter 4—to offer insight into the anatomy of organizations and, ultimately, to explain why organizations are being redesigned.

Generating a Winning Business Strategy

Deciding what strategies the organization should pursue is a key task of managers. Managers are continually faced with making decisions, both minor and major, on a daily basis. The aim of Chapter 5 is to describe the nature and purpose of strategic management. The chapter examines issues that are of critical importance to strategic management. What are the key forces in determining an industry's structure, and what are the strategic implications? We will consider the roles of organizational resources and capabilities in firm performance. Our exploration will also include a discussion of corporate strategy and an identification of three generic strategies as well as how organizations go about implementing strategy. This examination reflects a central internal force that all organizations must contend with—the ability to generate a game plan to succeed.

THE EXTERNAL CONTEXT OF BUSINESS

Objective 3 Identify the forces that compose the specific and general environments of organizations.

We can refer to the external context of organizations as its *environment*. Management scholars have typically defined the environment of an organization along two dimensions: the organization's **specific or task environment** and the organization's **general environment**. Each factor in an organization's external environment can be considered as existing in two spheres: a specific sphere or environment within which the organization directly operates, and a general sphere or environment that would encompass the external environments of all organizations in a society. The *specific sphere* has been referred to as the environmental domain of the organization. For example, changes in the international environment may be a common factor for all organizations with, say, trade agreements affecting Canadian industry in general. However, some industries may be differentially affected by changes in the international environment via trade agreements. Not all organizations within an industry or within different industries are equally affected by changes in the environment. There are changes that affect all or some industries, and there are changes or factors that influence the direct sphere or environment of specific organizations.

specific or task environment The environment within which a particular organization operates, which is ultimately shaped by the general environment and includes stakeholders, customers, competitors, suppliers, and so on.

general environment The environment shared by all organizations in a society, such as the economic and political environments, and technological, societal, and global forces.

Specific or Task Environment

Any organization is surrounded by **external stakeholders**. These are parties or groups that have direct influence on the organization's ability to obtain resources and generate outputs. Stakeholders have some kind of *stake* or interest in the organization and could include such parties as the organization's customers or suppliers, the labour pool from within which the organization obtains employees, competitors, unions, distributors, creditors, the local public, and the government (see Exhibit 1.2). While not all of these stakeholders may exist or exert influence on every organization, they are the types of factors that potentially constitute the specific environment of an organization.

external stakeholders Individuals or groups who bear some kind of risk, whether financial, physical, or other, as a result of a corporation's actions. They include such parties as suppliers, the government, and society in general. There are ethical as well as practical reasons to attend to all of their interests, even when they conflict.

Exhibit 1.2 The External Context of Organizations

General Environment

The sphere surrounding the organization's specific environment is typically referred to as the *general environment*. The forces that make up the general environment ultimately shape the specific environment of the organization. Consequently, the general environment will also influence the organization's ability to obtain resources. General environmental factors typically include economic, competitive, technological, global, political, and societal forces. (See Exhibit 1.2.)

Objective 3 Discuss the nature of the external forces confronting organizations.

economic forces The economic influences on organizations, such as the state of the economy, unemployment, inflation, interest rates, and gross domestic product. For example, high unemployment numbers may indicate lower overall consumer spending, and business sales could be negatively affected. If sales go down significantly, businesses may need to reduce production, cut costs, or lay off workers.

competitive forces The domestic and foreign competitor influences on organizational decisions. Competitors are organizations operating in the same industry and selling similar products and services. However, competitors may compete in different ways.

Economic Forces

Whether the Canadian economy is experiencing a recession or strong economic health, **economic forces** act as a strong influence on the present and future prospects of any organization. Moreover, given the strong global ties in Canada, we can also consider the international economic environment as exerting an influence on Canadian organizations. Certainly, we understand the strong influence that the United States and its economy exert on Canadian business.

In considering how it will obtain resources from the environment, any organization must ask the question, "Is the economy healthy or weak?" Organizations are continuously forced to adapt to changing economic conditions. Downsizings are more likely to occur in lean times than in rich. For example, the development of a temporary workforce was partly an outcome of the recession that occurred in the 1990s and the consequent introduction of massive downsizings and layoffs of permanent members of the workforce. Economic changes have also facilitated changes to the nature of the employer–employee relationship. Lifetime employment appears to be a thing of the past. Consider the 1950s or the 1970s—those were times when employment actually meant security. In fact, the dominant model was long-term employment stability. However, a change to these implicit employment promises occurred sometime in the 1980s, when large, secure organizations beginning to layoff employees and the age of downsizing began. Today, part-time and temporary work arrangements have become much more common than in the past. The economic context of business will be explained in Chapter 6.

Competitive Forces

Competitive forces operate at two levels for any organization. As mentioned, an organization will have its own set of competitors, yet the force of competition can be viewed from a more general level as well. For example, globalization (which will be discussed elsewhere in this book) opens the floodgates for competitors in many industries. Clearly, the number of competitors and the nature of competition will dictate changes in organizational strategy. Competition, both domestic and foreign, certainly has demanded an acceleration in innovation among firms in many industries. To compete effectively, organizations must continually create new and better methods of serving customers. So while globalization has opened up larger markets for businesses, it has also facilitated much higher levels of competition. Chapter 7 examines the nature of competitive forces and includes a consideration of the different stages of the industry life cycle model. That chapter also identifies the key drivers of industry evolution and how competitive forces change during the life cycle of a business. What are the key success factors for firms at each stage of the life cycle?

Technological Forces Chapter 7's discussion of innovation acknowledges the importance of **technological forces** that surround organizations. Technology plays a central role in how an organization functions, how it obtains resources, and, ultimately, how effectively it competes. We will consequently examine different types of innovations and explore the relationship between technological evolution and industry evolution. Furthermore, we will discuss the impact of technology on competitive business practices and technology life-cycle models.

technological forces The technological environment that exerts influence across industries, playing a central role in how an organization functions, obtains resources, and competes. Changes in technology both permit and demand organizational change.

The technological environment exerts influence across industries. For example, in the case of Bell Canada, the increase in the number of competitors in the telecommunications industry was partly a consequence of the ability of smaller businesses to enter the industry. Technological advances led to reduced operating costs, which led to more competitors being able to enter the industry; formerly, the costly nature of the sophisticated technology required in this industry created a barrier to entry.

Change in technology is a constant force that permits and demands organizational change. One benefit of technology is increased flexibility in work arrangements. For instance, telework, or telecommuting, essentially means that an employee can work from home thanks to the technology available today. Technology has also facilitated business process redesign or "reengineering," an issue examined further in Chapter 7.

Global Forces **Global forces**, in many ways, are forces that could be considered part of general economic, political, technological, competitive, or societal forces, but are international in nature. For example, the tragic and devastating events of September 11, 2001, resulted in a chain reaction of international consequences, including changes in economic and political forces acting on organizations. Global events have an increasingly important impact on local organizations, too.

global forces The global influences on organizations that could be considered as part of the general economic, political, technological, competitive, or societal forces, but are international in nature.

While there is no universally agreed-upon definition of **globalization**, it is useful to consider this concept as a process—that is, a process involving the integration of world economies. The presence of trade blocs reflects the accelerating pace with which nations are integrating their economies. Globalization also includes the globalization of markets—the notion that consumer preferences are converging around the world. Whether it is for products made by McDonald's, Sony, Gap, or Nike, organizations are increasingly marketing their goods and services worldwide. On the other side, production is also increasingly becoming a global affair. Businesses will set up operations wherever it is least costly to do so.

globalization Although there is no universally agreed-upon definition, it may be considered as a process involving the integration of national economies and the worldwide convergence of consumer preferences; the process of generating a single world economic system.

Certainly, international trade agreements are global agreements among governments that are changing the nature and functions of many businesses. A Canadian organization may not simply consider consumers within the domestic borders, but may have a significant consumer market overseas; this demands a knowledge of global societies, global competitors, and other forces that exist on an international level.

The global forces of the general environment underscore the increasingly tangled web of players in the global business context: domestic and foreign competitors, workers, industry, government, national cultures, and economies. How business is conducted in light of trade agreements and global arrangements is a key issue for our entire society, and it is a theme we will explore more fully in Chapter 8.

political forces Governmental influences on an organization's decisions through laws, taxes, trade relationships, and other related political factors.

Political Forces

Political forces can exert influence at both the specific and general levels. The government's push toward deregulating many industries was designed to welcome more competitors into the Canadian business sector and facilitate freer trade between Canada and the United States. The reduction in trade barriers worldwide has also opened the doors for the increasing presence of foreign competition in many industries. Deregulation and privatization, discussed in Chapter 9, are clear examples of the importance of considering the effects of governmental changes on business strategy.

Are government regulations facilitating or restricting certain business strategies? The political environment can dictate changes in how a business competes or what services it offers and how they can be offered. As we will discuss in Chapter 9, the deregulation of protected industries in the 1980s and 1990s created competition for companies where no real competition had previously existed. Industries such as telecommunications, banking, energy, and aerospace were dramatically affected by these governmental/regulatory changes. As the dominant companies in these industries were forced to compete in an open market, some responded by downsizing their workforce.

In a general sense, the traditional relationship of government with business is clearly undergoing change. The trend toward increased government involvement after World War II seems to have reversed by about 1980. In fact, some observers have suggested that the massive disposal of government-owned assets and the reduction of government controls in the business sector indicate a minor revolution of sorts. We will examine this issue in more detail in Chapter 9.

societal forces A wide range of influences in society in general, including, for example, changes in public opinion on ethical issues like organizational justice (how employees are treated), that affect all organizations and to which businesses must respond.

Societal Forces

Societal forces have an important impact on organizations. The nature of a society certainly is an entrenched part of any organization's general environment. For example, we have witnessed an increasing concern for individual welfare in the workplace as societies become more cognizant of human rights and how people should be treated. Consequently, the workplace increasingly emphasizes organizational justice—that is, how employees are treated. This has translated into more laws governing fairness in the workplace. One such area that has been dramatically affected is compensation. Pay equity has been a key issue examined in redressing inconsistencies in pay treatment between men and women. We have also witnessed an increasing emphasis on merit-based pay and pay for performance, which attempt to more closely link actual effort to performance instead of seniority-based pay, which bases pay solely on the number of years an employee has been with the organization.

Businesses must respond to society. Consumer tastes change, for example, and businesses must adapt to such changes. Similarly, the types of organizations that serve societal demands can change. The aging population in Canada suggests that greater emphasis needs to be placed on industries such as the health care sector. In addition, society has a certain set of ethics or values, and these can influence the type of behaviour that organizations will manifest in that society. From a societal standpoint, it is not difficult to understand the importance of adequately addressing ethical behaviour of business organizations and their constituents. All sectors of society, including organizations themselves, are drastically affected by many forms of unethical behaviour. There is a growing belief that organizations are social actors responsible for the ethical and unethical behaviour of their employees.

Critics of business argue that organizational leaders must examine more closely the "moral sense-making" within organizations and responsibilities to external constituents. The tolerance of unethical behaviour in a society would seem to be a precursor to the acceptance of corporate unethical behaviour. This is an issue that we will more fully explore in Chapter 10, which also emphasizes the requirement for organizations to address stakeholders in the global context.

Sources to come

From the description of the external environment, it can be observed that there is overlap between the general environment and the specific environment. An organization may have a specific market niche or set of consumers, but demographic changes in the general environment, such as an aging society, will certainly translate into changes in consumer tastes at the specific level. Similarly, as noted above, the government's aim to reduce trade barriers at a national level can translate into regulatory changes or increased competition within an organization's specific environment. This underlines the importance of understanding the impact of both the general external environment and the specific environment of the organization.

The Challenge of Change

We are a society of organizations—from our hospitals to our schools to our multinational organizations, it is hard to imagine life without organizations. And, for better or worse, those very institutions and organizations that we have grown up with are continuing to undergo dramatic change. In fact, the last two decades have witnessed tremendous change and turmoil across our organizational landscape—from bankruptcies of once great Canadian companies like Nortel, to massive reductions in the workforce of many well-known organizations such as GM and Bell Canada, to the rise (and possible fall) of successful Canadian companies like Research In Motion (now known as BlackBerry). What is going on?

While predicting the next big change may be futile, sensible questions that can be addressed include, "What are the sources of change directed at organizations?" "How do these changes affect the nature of organizations and work?" In every chapter in this book, from management through to globalization, we recognize that just about every important area of business is undergoing some kind of change. Chapter 11 considers how organizations respond (or fail to respond) to these shifts in the environment of business. It's all about adaption and change.

Organizations that effectively change or adapt to their environment are ones that have first "learned" —they have learned how to recognize the need for change, and they have learned what actions are necessary to adapt. Some management scholars have suggested that organizational learning represents the collective experience of individuals within the organization and happens when organizational procedures change as a result of what has been learned. **Organizational learning**, in this sense, involves a three-stage evolution in which the highest stage incorporates three aspects of learning: adapting to the environment, learning from employees, and contributing to the learning of the wider community or context. This idea will be explored more fully in Chapter 11.

organizational learning The detection and correction of error, or the collective experience of individuals within the organization that results in changes in organizational procedure. Three aspects of learning are adapting to the environment, learning from employees, and contributing to the learning of the wider community or context. Two types of learning are single-loop learning and double-loop learning.

The ability of organizations to adapt to and change with a changing environment is dependent on the ability of their members to change and adapt. The best business leaders are essentially facilitators of change. Such facilitators are individuals with vision who can encourage others to leap into a new paradigm—a concept we will also examine in Chapter 12.

Sustainability

What is the most critical issue in the world today that needs to be solved? The answer will likely depend on whom you ask and where you live. For example, there is less fresh water to drink and less viable farmland to grow food on than there was 100 years ago. Sources of oil continue to be extracted worldwide as the number of cars increase. And the climate is getting steadily warmer across the globe. Preserving the environment for future generations to enjoy and for the economy to prosper is clearly an important issue. What currently threatens the planet? Two key concerns are the depletion of natural resources by overconsumption and the ongoing release of greenhouse gas emissions. As a society, how do we continue to grow and prosper while also ensuring that our way of life is sustainable now and in the future?

Traditionally, growing the economy and protecting the environment were viewed as two separate goals, often conflicting with one another. Why should businesses want to be sustainable? What are the motivating factors for businesses to implement sustainable practices? While the primary goal of a business is to make a profit, sustainable practices can contribute to this goal and help create value on a number of levels. Business leaders now recognize that society, the economy, and the environment are interrelated systems that have an important effect on one another; one system cannot survive without the others.

Today, sustainable development can be viewed as a long-term approach to balancing the needs of people while growing the economy and preserving the environment. In a general sense, **sustainability** involves the relationship between the three Ps: people, profits, and the planet (also referred to as the three Es: social equity, the economy, and the environment). This accounting framework is known as the **triple bottom line**. However, since the movement toward sustainability is still relatively new, the development of a common standard of global measures is still underway. What measures currently exist and how can businesses implement more sustainable practices? There are a number of indicators of sustainable development that measure changes on a national or global basis that can be examined.

Sustainability In business, the relationship between the three Ps: people, profits, and the planet.

triple bottom line An accounting framework that can be voluntarily used by organizations to report performance on social, economic, and environmental results for a project or reporting period.

Implementing sustainable business practices is a new challenge many managers face. Time, money, and lack of knowledge are a few obstacles. Yet sustainable businesses that achieve their economic, social, and environmental goals can expect to receive many benefits. Sustainable business practices have proven to help businesses in the long term by reducing costs, reducing risks, and improving consumer relations. Clearly, environmental degradation cannot quickly be fixed, and businesses need to continue to consider their impact on the environment and society now and in the future. All of these issues will be addressed in Chapter 12.

Objective 4 Explain the importance of each of the external forces within the Canadian business context.

THE CANADIAN CONTEXT: HOW'S BUSINESS IN CANADA, EH?

How is business doing in Canada? Some economists believe we are doing well; others believe Canada's economy is slowly contracting and losing its competitive edge in the growing global economy. Some factors that are important to a country's success in the global marketplace identified by economists include a country's need for strong trading partners, low corporate taxes, an educated and skilled workforce, a stable financial and banking system, and a sustainable competitive advantage. Let's consider how business is doing in Canada in these terms by revisiting each of the external environmental forces with regard to the Canadian context.

Economic Forces in Canada

What are some of the indicators of the current state of health of the Canadian economic scene? One indicator of the health of the economy is **gross domestic product (GDP)**: the total value of a country's output of goods and services in a given year. The money that is earned from producing goods and services goes to the employees who produce them, to the people who own businesses, and to the governments in the form of taxes. The general trend of governments worldwide is to reduce their share of GDP. Obviously, it is good for GDP to grow: from 1979–1989 Canada's GDP grew about 3.2% annually. The compound annual growth of GDP between 2002 and 2011 was 2.6%. Currently, Canada's economy is expected to see compounded annual growth of 2.5% until 2025. (See Exhibit 1.3 for GDP growth between 2002 and 2011.) Canada experienced solid economic growth between 1993 and 2007. However, it went into a severe recession in 2008–2009, but has since emerged strong after this global financial crisis ended.

gross domestic product (GDP) The total value of a country's output of goods and services in a given year.

The future health of the Canadian economy, as in most economies, is continually the subject of speculation. It appears that economists are not necessarily more accurate in their predictions of economic well-being than are those looking into the proverbial crystal ball. Nonetheless, it is crucial to understand what underlying forces are ultimately shaping the state of our business system in Canada. This amounts to distinguishing between short-term changes in the domestic economy and ongoing trends in the nature of the business enterprise system. It may be more manageable for us to consider what has been going on around us in recent years and assess what conditions will continue to persist in the coming years.

One important economic factor is the unemployment rate. In Canada, the unemployment rate increased sharply in the early part of the 1990s because of the severe 1991–1992 recession and the steepest drop in economic activity since the Great Depression of the 1930s. While much of the 1990s was not bright for employment, we have witnessed vast

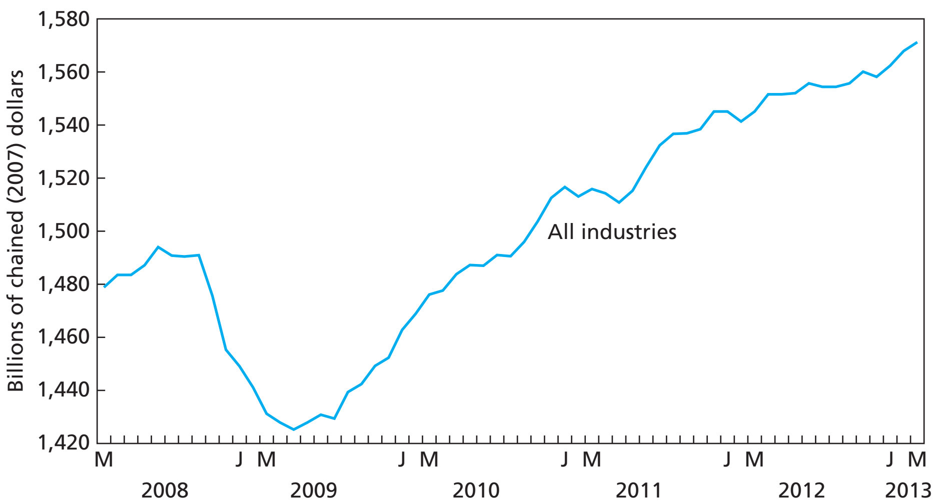


Exhibit 1.3 Gross Domestic Product (GDP) and GDP Growth

Between 2002 and 2011, GDP for all industries in the Canadian economy increased from $1,068 billion to $1,266 billion. In each year during this time period, GDP growth has been positive with the exception of 2009. The compound annual growth rate of GDP between 2002 and 2011 measured 2.6%.

Source: Statistics Canada. (2013, May 31). Canadian economic accounts, first quarter 2013 and March 2013. *The Daily.* Retrieved from www.statcan.gc.ca/daily-quotidien/130531/dq130531a-eng.htm?HPA.

Sources to come

improvements in recent years. By 1999, the unemployment rate dropped to 7.6%; in 2005 it dropped to 6.7%, which was the lowest level achieved in three decades. This decrease in unemployment continued to drop in 2007, reaching a low of about 6%. (See Exhibit 1.4.)

The soundness of Canada's banking system is another important economic factor for Canada's economy. In 2010, the World Economic Forum ranked Canada's banking system as the world's soundest for the third year in a row.[7] This type of international recognition is good for Canada because it gives businesses, investors, and consumers the confidence that Canada is a safe and stable place to conduct business.

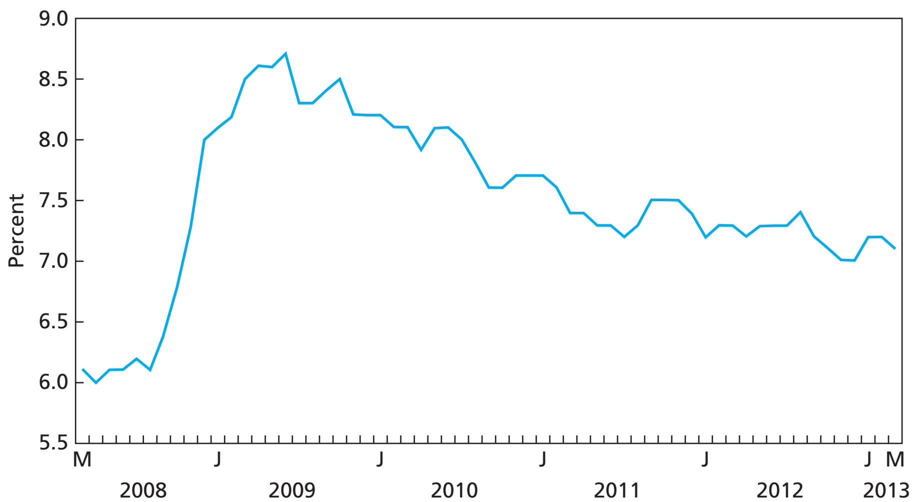
Why are Canadian banks more secure than banks in other countries? The Canadian Bankers Association attributes this financial stability to three key factors: Canada's banks are well regulated, well capitalized, and well managed.[8]

Canada's Banks Are Well Regulated Under the federal government, two primary regulatory bodies oversee banking activities in Canada: the Office of the Superintendent of Financial Institutions (OSFI) for prudential regulation, and the Financial Consumer Agency of Canada (FCAC) for consumer issues. The Canadian Bank Act is also reviewed and updated every five years to reflect changes in the industry. In comparison, the United States has a much more complex arrangement of regulators, but with less stringent rules. After the US economic collapse in 2009, the US federal government had to bail out many of its banks with billions of dollars to prevent bankruptcies and a potential economic depression. Similar

Exhibit 1.4 **The Unemployment Rate in Canada, 2008–2013 (percent of labour force)**

In 2009, the unemployment rate was 8.3%. Between 1976 and 2009, the unemployment rate reached its highest levels in 1983 (12.0%) and 1993 (11.4%), following two major recessions. In 2007, Canada recorded its lowest unemployment rate (6.0%) since the mid-1970s. By May 2013, the unemployment rate was 7.1%.

Source: Statistics Canada. (2013, June 7). Labour Force Survey, May 2013. *The Daily*. Retrieved from www.statcan.gc.ca/daily-quotidien/130607/dq130607a-eng.htm.



[7] Canadian Bankers Association. (2010, September 9). Good news for all Canadians: World Economic Forum again ranks Canada's banks as the world's soundest. Retrieved from www.cba.ca/en/media-room/65-news-releases/536-good-news-for-all-canadians-world-economic-forum-again-ranks-canadas-banks-as-the-worlds-soundest.

[8] Canadian Bankers Association. (2010, May 14). Canada's strong banking system: Benefiting Canadians. Retrieved from http://cba.stage6.industrialmedia.ca/en/media-room/50-backgrounders-on-banking-issues/469-canadas-strong-banking-system-benefiting-canadians.

bank bailouts occurred across Europe. Canadian banks, however, did not require any government assistance and kept doing business as usual throughout the crisis.

Some economists blamed the US mortgage lending system for the collapse. There were many high-risk mortgage products in the United States, which Canadian regulators did not allow. Canadian bank mortgages also require at least a 20% down payment for a home or the mortgage would need to be insured; this requirement was not mandatory in the United States. Today, the US government is seeking bank regulation reform and is looking to Canadian models to help improve its system.

Canadian Banks Are Well Capitalized Canada has also been commended for the fact that its banks are well capitalized. This means that banks hold sufficient reserves to cover potential defaults on loans and other losses. According to Erik Heinrich, "the average capital reserves for Canada's Big Six banks—defined as Tier 1 capital (common shares, retained earnings, and non-cumulative preferred shares) to risk-adjusted assets—is 9.8%, several percentage points above the 7% required by Canada's federal bank regulators."[9] Canada even exceeds international norms and surpasses the Bank for International Settlement's requirements.[10]

Canadian Banks Are Well Managed Although Canadian banks may not have the same level of competition (as US banks) to motivate them to succeed, they have remained well managed. Canada's six largest banks (known collectively as the "**Big Six**") include the Canadian Imperial Bank of Commerce (CIBC), Scotiabank, TD Canada Trust, Bank of Montreal (BMO), Royal Bank of Canada (RBC), and National Bank of Canada. Investment advisers frequently refer to these companies as Canada's blue-chip stocks. Historically, these companies have proven to be safe and conservative investments that usually profit year after year.

Big Six Canada's six largest banks, including CIBC, Scotiabank, TD Canada Trust, BMO, RBC, and National Bank.

Why can the Big Six banks be relied upon to be consistently profitable? Stringent lending requirements constitute one factor that has proven effective in preventing huge losses. According to the Canadian Bankers Association, "in a survey by the Strategic Counsel, 81% of respondents believe that prudent lending is a key reason why Canadian banks have performed better than their international peers."[11] But are Canadian banks as competitive as they can be? Can they compete on a global scale? Here are three challenges industry analysts point to that Canada's banking industry needs to overcome to become successful global competitors.

1. *Canadian banks are less competitive:* Some analysts believe that Canada's banks pay a cost for being safe. They tend to take fewer risks and, therefore, are not high-growth companies. In Canada, the banking industry is more stable, but it does not have the same competition that other countries do. The Canadian financial market is dominated by a few large players—the Big Six. Although consumers have begun to see smaller players enter the market, there have been few so far. President's Choice Financial (PCF), for example, offers many of the same banking services as the Big Six, but it does not have the same number of in-person branches that many of the traditional banks have. PCF provides mainly phone and online services so it can reduce overhead expenses and offer customers greater benefits. With lower

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[9] Heinrich, E. (2008, November 10). Why Canada's banks don't need help. *Time*. Retrieved from www.time.com/time/business/article/0,8599,1855317,00.html.

[10] Canadian Bankers Association (2010, May 14).

[11] Canadian Bankers Association (2010, May 14).

administrative costs, this bank has typically offered customers higher interest rates on deposits and lower (sometimes zero) banking fees.

2. *Too small to compete globally:* Many banks would like to be more competitive but have faced some limitations. Some Canadian banks would need to double in size to compete as international players. A couple of the Big Six banks have attempted to merge in the past, but government approval was denied. Many opponents argue that merged banks would be too powerful, and consumers would have less choice and potentially face higher fees.
3. *Too much regulation:* In addition, many argue that our banking system is too regulated. For example, stringent bank loan policies can make it difficult for small businesses to gain the funds needed to invest and to expand. This can impact Canada's economic growth, since the majority of new jobs are created by small businesses. For banks, this means more of the same slow and stable growth and less opportunity for high-growth results. Nonetheless, media attention promoting the fiscal well-being of Canadian banks has helped give them international recognition and, perhaps, a competitive advantage.

Competitive Forces in Canada

Imagine a situation where there is only one provider of an important good. If you require this good, then you must be willing to accept whatever price the provider demands. There is also no assurance regarding the quality of the good. There is little incentive for the provider of this good to be efficient in operations—any high costs can simply be passed on to the consumer in the form of higher prices. Similarly, there is little need to innovate or produce higher quality products for the consumer, given that there is no risk of losing this captive market. Consequently, competition is considered to be an important element: This entails firms competing with each other to provide better products at lower prices if they want to increase sales and profits.

Our economic system is based on the assumption that sufficient competition exists. Competition is the "invisible hand" that ensures the market works in this manner. However, if an industry is relatively concentrated then businesses can act as price setters, not price takers. Of course, with extreme concentration, as is the case with a monopoly, then businesses can set whatever price they want or collude with other businesses. Observers suggest that Canada has not taken as strict a stance on this issue as the United States, where legislation has been aimed at preventing industry concentration.

Now, when you think "Canadian business," what picture do you conjure in your mind? Looking back over Canada's past, it has been argued that we established a certain pattern for ourselves in terms of the types of business activities we emphasized here. During most of our existence, we have developed as a largely open economy, trading internationally primarily in resources. It has been suggested that our emphasis on the export of our natural resources, typically in a relatively unprocessed state, has made us more akin to a simple supplier of raw materials, whether it has been logs and lumber, pulp and newsprint, unrefined minerals, agricultural crops, and so on. But is that resource industry Canada's competitive advantage?

competitive advantage Achieved when an organization excels in one or more attributes that allow it to outperform its competitors.

attribute A business advantage of some kind, which might include having a highly skilled staff, a patented technology, a unique marketing strategy, a well-known brand, or something else that makes the company a leader in its field.

First of all, what is a competitive advantage? A **competitive advantage** is achieved when an organization excels in one or more attributes that allow it to outperform its competitors. An **attribute** might be having a highly skilled staff, a patented technology, a unique marketing strategy, a well-known brand, or something else that makes the company a leader in its field.

In the global economic environment, countries compete through trade and strive for a competitive advantage based on the goods and services they sell. Some countries are recognized for their superior products. The United States, for example, is known for producing world-class Hollywood movies. Belgium is known for crafting decadent chocolates. And England is recognized for its fine bone china. But what is Canada known for?

When people think of Canada's economy, they often think of its natural resources. These are Canada's forests, farms, fisheries, mines, and oil and gas sectors. Traditionally, Canada's economy was built on extracting and exporting these raw materials. As early as the 1600s, companies began selling Canadian resources abroad. In 1670, for example, the Hudson's Bay Company was formed and began trading fur with European countries.[12]

By the early 1900s, significant industry had developed in Canada. Numerous mining companies began extracting minerals and coal from Alberta's landscape. Similarly, other companies saw great opportunity to extract and manufacture forestry products. In 1909, for example, a pulp and paper mill was established in Grand Falls, Newfoundland. Similarly, the Maritime provinces had flourishing fishing industries with easy access to the Atlantic Ocean and other bodies of water.

Across Canada, individuals moved to places of employment, and towns grew around industry leaders. The resource sector became the foundation of Canada's economy and economic growth for the next century, creating jobs and prosperity for many. Today, the resource sector is still an important part of Canada's economy, but faces a number of challenges:

- *Depleting resources:* Over the last century, many renewable and nonrenewable resources have been significantly depleted. Mining companies have had to rely on lower-grade ores; in the forestry industry, depletion of high-quality fibre has led companies to exploit second- and third-growth timber in less accessible areas; and in the fishing sector, the Newfoundland cod fishery had been essentially exhausted by the late 1980s.[13]
- *New technology and equipment:* Costs have increased significantly for improved technology and extraction equipment. New equipment has been required to improve production efficiency, to extract resources requiring advanced extraction systems, to gain greater value from production inputs, and to sustain Canada's competitive position in the global commodities marketplace.[14]
- *Foreign competition:* Foreign competition presents another challenge to Canada's natural resource industries. The US softwood lumber producers, for example, have been a major competitor to Canada, resulting in several legal battles over unfair competition practices. Inexpensive labour costs have also been a competitive advantage for foreign producers. In 2009, AbitibiBowater Inc. (now known as Resolute Forest Products), closed its Grand Falls' pulp and paper mill because of reduced demand for paper and increasing labour costs.
- *Pressure from environmental groups:* Similarly, environmental concerns have resulted in new regulations for Canadian companies, to which foreign producers are not subject. The high rate of extraction of natural resources has led environmental groups to lobby governments to protect wilderness areas, reduce yields extracted, and require

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[12] Canadiana.org. (2001–2002). The Hudson's Bay Company Is Formed. Retrieved from www.canadiana.ca/hbc/hist/hist6_e.html.

[13] Howlett, M., & Brownsey, K. (2008). *Canada's resource economy in transition* (p. 43). Toronto, ON: Edmond Montgomery Publications Limited.

[14] Howlett & Brownsey, 2008, 44.

higher standards for extraction processes. Substitute products that are more sustainable, like bamboo, have also been encouraged. As the fastest growing wood in the world, bamboo has advantages over traditional woods such as cherry, maple, and walnut. Bamboo is highly renewable and, therefore, environmentally friendly.[15]

Clean energy consumption presents another environmental concern. Increased demand for cleaner energy sources means lower demand for dirtier energy like coal. Subsequently, many coal mines across Canada have faced closures. Some have even become tourist attractions that serve as historical sites, such as the Bellevue coal mine in Crowsnest Pass, Alberta.

Animal protection organizations have had a similar impact. Today, many consumers opposing cruelty to animals have stopped purchasing fur products and refrain from shopping at stores that sell them. Hudson's Bay was one of these stores, and after 300 years of selling furs the company finally ended its fur trade business in 1991 because of societal pressures.

Many economists will agree that Canada's resources sector is in transition. But is the sector still important to the Canadian economy? Some business leaders contend that mining and natural resources is still Canada's competitive advantage. Other business leaders argue that Canada needs to diversify into other areas, so that when our non-renewable resources run out we will still have a thriving economy. In fact, it has been argued that Canadian corporations are much more involved in the extraction and processing of natural resources than most other countries at comparable stages of economic development. This pattern has led critics to suggest that we have not developed the entrepreneurial and technological expertise of other nations—nations that have used our "raw materials" and added value through their own technological resources. However, it would be unfair to suggest that this is the whole picture. The fact is we have witnessed major changes in the nature of our economic sector, and we continue to see a major transformation in our economy and in the types of business competitors we have created. As with any capitalist-based system, Canada views competition as an important part of the business enterprise system.

Technological Forces in Canada

Traditionally, Canada's economy has been resource based. This refers to our emphasis on industries like agriculture, mining, forestry, fisheries, minerals, and energy. Natural resources have constituted the bulk of Canada's exports. Given the nature of our primary industries, one important implication for businesses in these industries is that prices for the output are very much influenced by the world market. That is, these natural resource industries are highly affected by any fluctuations in the global supply and demand for these commodities, suggesting that many of our industries are highly sensitive to changes in the global or world market. A general criticism that has been levelled at the Canadian business environment is that we need to catch up in the area of technology and innovation rather than relying on our natural resources (which are exported mostly in an unprocessed form).

However, the Canadian economy has been transforming. While much of Canada's economic strength lies in the diversity of its natural resource industries that supply ore, oil and gas, lumber, and other commodities internationally, our rapidly growing high-tech sectors are earning high marks for leading-edge research and development. This includes such

[15] Howlett & Brownsey, 2008, 46.

areas as information and communications technology (ICT), biotechnology, nanotechnology, advanced manufacturing, electronics, aeronautics, pharmaceuticals, and agri-food.

We have already seen significant changes in the sectoral composition of Canada's economy throughout the 20th century. At the beginning of the 20th century, there was a balance between employment in the primary sectors of the economy and the industrial and service sectors. The *primary sector* consists of agriculture, mining, logging, fishing, hunting, and trapping. The *industrial sector* is akin to the manufacturing or goods-producing sectors, while the *service sector* can include things like the hotel or restaurant industry. At the beginning of the 20th century, we had an abundance of employment in the primary sector, with most of this coming from the agricultural sector. However, even early in the century Canada witnessed a steady decline in agricultural employment right up until World War II—after which time this decline was more rapid.

Canada's employment has clearly shifted away from the agricultural sector. Why? A number of reasons have been offered. Perhaps one of the most obvious reasons for the decline in agricultural employment is a reduced need for human capital; that is, technological advances have helped many agricultural practices become increasingly mechanized and, consequently, fewer workers are required to achieve the same level of output. Concurrent with this decline has been the increasing urbanization of the Canadian population. Increasing numbers of Canadians continue to flock to cities from rural areas in search of employment, and it is the cities that attract the largest share of new immigrants.

If there has been a significant shift in employment away from the agriculture sector, the question is, "Where has it shifted to?" What we have seen happening in conjunction with agricultural employment decline in Canada is an increase in the number of Canadians employed in goods-producing and service industries. The manufacturing sector produces tangible goods, such as clothes, oil, food, machines, and automobiles. The service sector includes things like banking, insurance, information, marketing, accounting, hospitality and food services, recreation, and so on.

The shift to the manufacturing and service sectors was particularly striking in the first 15 years following World War II, after which growth in these areas slowed, although it certainly continued throughout the 1960s, 1970s, and 1980s. However, what is particularly striking in the later postwar period is the simultaneous rise in service-sector employment and, at least since the 1950s, the rapid decline in goods-producing industries. We continue to witness this trend, albeit at a reduced rate. Consider this: In 1950, only 42% of Canadians were employed in service-producing industries; by 1993, the figure had risen to over 72%. Whereas at the turn of the 20th century we shifted from an agricultural to an industrial economy, the second shift has been the transition from a goods-producing to a service-oriented economy.

Why are we moving away from the natural resources and the manufacturing sector to the service sector? What is driving this shift? Well, there is not really one accepted reason for this transformation to a service economy. But probably the most oft-cited reason is technology: just as mechanization of agricultural production decreased the need for human capital, the increasing mechanization of manufacturing facilities has similarly reduced the need for human labour in this sector. We can produce comparable levels of output with far less labour than we did in the past. But productivity still remains a challenge across Canada. (See Talking Business 1.2 and Exhibit 1.5.)

And as far as productivity is concerned, what we have seen is labour productivity growth in manufacturing outpacing productivity growth in services. Why? Consider the

TALKING BUSINESS 1.2

Growth in Provincial Labour Productivity: A Problem from Coast to Coast

Over the next two decades, Canada and its regions will have to contend with the challenges of more and more aging baby boomers leaving the workforce. The result will be slower growth in our economy while simultaneously adding to demand and expenditures for health care. One part of the solution to slower growth would be to lift our productivity—a sure fire way to boost income per capita and help us pay for those public services we want and need.

While we're hopeful for the future, our past performance on the productivity front has not been strong. Numerous past studies have highlighted our poor labour productivity performance relative to the United States but few have looked at the issue from a regional perspective. Productivity is not just a federal issue. Here, we look at productivity among the provinces and find that with just one exception, poor productivity growth is a problem that exists from coast-to-coast. With the baby boomers contributing to slower economic growth and to rising health care expenditures across all regions, it's vital that all provinces develop an agenda to boost their productivity growth.

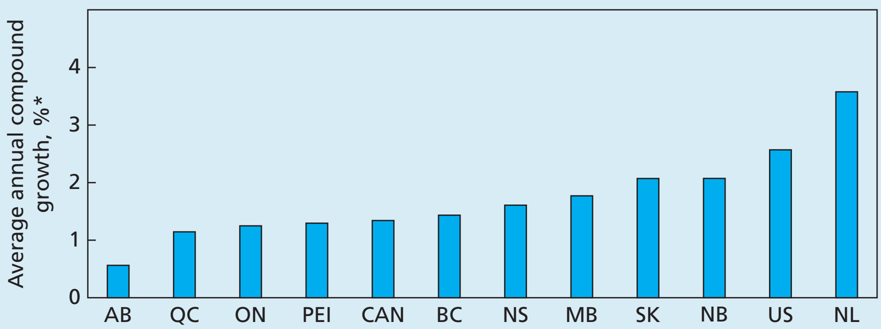
Over the 1998 to 2011 time period, the U.S. posted average annual compound growth in labour productivity of 2.5 percent while Canada posted average growth of 1.3 percent. But it's no wonder that productivity growth for Canada as a whole has been so low when its three biggest provinces are productivity growth laggards. Quebec and Ontario, for instance, posted gains of 1.1 and 1.2 percent respectively, and in Alberta, the headline number is even worse, with growth of just 0.5 percent. (See chart "Business Sector Labour Productivity Growth.")

Only one province posted stronger business sector labour productivity growth than the United States and that was Newfoundland and Labrador. While Newfoundland and Labrador does have programs to promote productivity, the primary reason behind its productivity miracle was a structural shift in its economy where an oil boom increased the contribution of the highly productive mineral fuels industry from an estimated 1.5 percent of real GDP in 1997 to 19.4 percent in 2011. Therefore, its success cannot be benchmarked by the other provinces. Moreover, looking only at the headline productivity growth rates does not tell the whole story. For example, Alberta has the weakest growth among the provinces, but it also has the highest level of labour productivity in the country.

Nevertheless, the data clearly shows that labour productivity *growth* is a problem across the country. By embracing a productivity strategy, provinces would have the ability to make themselves more competitive, increase the standard of living for their residents and experience faster economic growth. So how can provinces boost their productivity growth?

There are three main factors that drive labour productivity growth: the composition of labour, capital intensity and multifactor productivity (MFP) growth. Labour composition basically refers to the skill set of the working population, and all provinces perform fairly well on this metric. This is not to suggest that there is no room for improving the quality of the labour force, but it is not the driving force behind weak productivity growth.

When it comes to capital intensity (the amount of capital per worker), the provincial performance has been mixed. Half the provinces experienced larger increases in capital intensity over the 1998 to 2010 period than the U.S., led by the resource intensive economies of Saskatchewan



*Canadian data are based on 2002 $; US data are based on 2005 $.
Sources: Statistics Canada; U.S Bureau of Labor Statistics; The Conference Board of Canada.

and Alberta. But that leaves half the provinces still trailing in capital investment. Policies such as adopting a harmonized sales tax (where it is not already in place), investment tax credits and reducing corporate tax rates and regulatory burdens are steps provinces can take to boost investment and, subsequently, productivity.

MFP, the final component, captures increases in labour productivity not attributable to increases in capital or labour composition. MFP is essentially the efficiency with which capital and labour mix to create output. This captures a wide range of factors from the industrial structure of an economy to its innovation performance. With the exception of Newfoundland and Labrador (which as noted above benefited from a structural economic shift), all provinces posted sub-par MFP growth relative to the U.S. That is the main reason why labour productivity growth in the provinces (and for Canada as a whole) is so much weaker than in the U.S. While there is no easy answer to improving MFP growth, research has shown that initiatives such as credits and programs that encourage business spending on research and development; investments in public infrastructure; and a reduction in barriers to interprovincial trade and labour mobility can help provinces boost their MFP growth.

Governments at a variety of levels have understood for years the need to address lagging productivity performance, but the data show that we have not made nearly enough progress. With every province facing an aging population and budget challenges, the time is now to develop and implement productivity strategies with a focus on improving MFP growth.

Source: Excerpted from Macdonald, E. (2013, February 20). Growth in provincial labour productivity: A problem from coast to coast. Conference Board of Canada. Retrieved from www.conferenceboard.ca/economics/hot_eco_topics/default/13-02-20/growth_in_provincial_labour_productivity_a_problem_from_coast_to_coast.aspx.

nature of many service-oriented jobs: Social workers who counsel youths, waiters who serve customers, and medical caregivers who treat patients are not easily replaced by machinery. Productivity growth in this sector is thus much slower than in the manufacturing sector. The result of this difference in productivity growth rates is that more Canadians need to be employed in services to maintain the relative levels of service and manufacturing output.

Whatever the source, there is little question that services are playing a much greater role in our economy than they have in the past. However, one final question that we can ask related to all this has to do with whether this shift is a good thing. Let's consider several implications of this transition.

On an individual level, anyone planning on entering the job market or remaining employable must consider his or her skill set. Obviously, our workforce must be better educated and capable of attaining the relatively higher skill levels required in the well-paying service-sector jobs (in comparison to the manufacturing sector). The notion of the **knowledge worker**, a relatively recent buzzword, underscores the increasing importance of higher education and the value of transferable skills.

knowledge workers People employed in knowledge-intensive industries, such as the high-tech industries, where specialized and frequently changing knowledge is required. Knowledge work is thus harder to routinize than, for instance, service work.

But in broader terms, is the service sector better for our economy? Or is manufacturing still a critical element? A number of observers suggest that we should say "good riddance" to the old, outdated manufacturing sector and welcome the growing service sector with open arms. For example, economist Nuala Beck, in her popular book *Shifting Gears: Thriving in the New Economy*, referred to a "new knowledge economy" that is quickly replacing the old mass-manufacturing economy. Beck observed that these "knowledge workers" now make up 30% of North America's workforce, while only 10% are actually involved in production. Further, it is the more knowledge-intensive industries (like the high-tech industries) that are creating most of the jobs and driving the economy.

Exhibit 1.5 Canadian Employment by Industry (in thousands)

	2008	2009	2010	2011	2012
Total, all industries	17,087.4	16,813.1	17,041.0	17,306.2	17,507.7
Goods-producing sector	4,013.4	3,724.3	3,740.0	3,804.9	3,872.0
Agriculture	323.6	316.1	300.7	305.6	309.2
Forestry, fishing, mining, quarrying, oil and gas	344.6	317.9	329.4	337.2	369.1
Forestry and logging with support activities	54.4	46.2	51.4	46.5	51.8
Fishing, hunting, and trapping	21.6	20.7	20.6	19.4	18.4
Mining, quarrying, and oil and gas	268.6	251.1	257.5	271.3	298.8
Utilities	151.5	147.6	148.3	139.8	140.7
Construction	1,231.0	1,160.8	1,217.2	1,262.2	1,267.5
Manufacturing	1,962.7	1,781.8	1,744.3	1,760.2	1,785.5
Durables	1,168.4	1,037.0	1,019.4	1,042.9	1,083.4
Nondurables	794.3	744.8	724.9	717.3	702.1
Services-producing sector	13,074.0	13,088.8	13,301.0	13,501.3	13,635.7
Trade	2,684.9	2,652.2	2,677.8	2,669.9	2,643.8
Wholesale trade	632.0	631.8	628.9	632.8	611.9
Retail trade	2,052.9	2,020.4	2,048.9	2,037.1	2,031.9
Transportation and warehousing	848.9	816.2	805.7	843.4	849.4
Finance, insurance, real estate, and leasing	1,073.6	1,092.1	1,095.7	1,083.4	1,093.2
Finance and insurance	776.4	769.9	783.5	758.0	783.2
Real estate and leasing	297.2	322.3	312.2	325.4	309.9
Professional, scientific, and technical services	1,189.3	1,191.9	1,266.7	1,309.2	1,299.3
Business, building and other support services	685.0	654.9	672.2	677.0	690.5
Educational services	1,186.3	1,188.8	1,217.8	1,219.4	1,287.7
Health care and social assistance	1,893.0	1,949.2	2,030.7	2,091.5	2,128.0
Information, culture, and recreation	758.4	769.6	766.0	784.2	790.4
Accommodation and food services	1,080.6	1,056.6	1,058.4	1,093.4	1,102.4
Other services	748.3	787.0	753.5	758.7	795.3
Public administration	925.7	930.3	956.4	971.2	955.9

Source: Statistics Canada. (2013). Labour Force Survey estimates (LFS), by North American Industry Classification System (NAICS), sex and age group, annual (persons unless otherwise noted). CANSIM Table 282-0008. Retrieved from http://www5.statcan.gc.ca/cansim/a26?lang=eng&retrLang=eng&id=2820008&paSer=&pattern=&stByVal=1&p1=1&p2=37&tabMode=dataTable&csid=.

Global Forces in Canada

Clearly, our proximity to the United States is an element that influences the nature of our business environment. Keep in mind that the United States has a population that is approximately 10 times that of Canada. And though we possess one of the largest countries in terms of land mass, the bulk of our population lives within 200 kilometres of the Canada–US border. In fact, the US presence in the Canadian business sector is a defining characteristic of our environment. Moreover, the trade agreements we have entered into with the United States have critical implications for our business sector (an issue we will deal with later in this book).

It is hard to imagine Canada's economy without the United States. With a market of over 300 million people, the United States has always been a significant player when Canada's economy grows or contracts. After all, 75% of Canadian exports go to the United States,[16] and of those exports 85% of the goods are Canadian.[17] These numbers make sense, though, when you consider the contributing factors. Canada and the United States share an adjacent border, a similar culture, and a common language. The United States also makes an efficient and effective trading partner. The Canada–US trade relationship is supported by accessible railways, trucking, air services, and oceans linking the two nations to shipped goods.

Although trade had existed for many years, in 1988 the partnership became formalized under the Canada–US Free Trade Agreement (FTA). By 1994, the countries expanded their trading relationship to include Mexico. Subsequently, the agreement became known as the North American Free Trade Agreement (NAFTA).

Today, the Canada–US trade relationship remains unique. It represents the largest cross-border trading relationship between any two countries globally.[18] But what does this really mean? According to the Government of Canada, goods and services traded between the two countries totalled $740 billion in 2008—that's about $1.4 million in trade per minute.[19] Canada's exports to the United States make up about $306.6 billion,[20] an important part of our GDP, which was approximately $1.5 trillion in 2009.[21]

But what does Canada trade with the United States, and what are the dominant industries? Over half of Canada's food exports go to the United States, making our southern neighbour Canada's leading agricultural export market. In recent years, Canada's main exports to the United States were automobiles, machinery, mineral fuels, and oils. According to the Government of Canada, "Canadians and Americans share the closest energy relationship in the world. Energy infrastructure—including oil and gas pipeline networks and electricity grids—is tightly integrated. Canada is the United States' largest and most secure supplier of oil, natural gas, electricity, and uranium."[22]

Currently, Canada exports over 40% of its total annual production (GDP), compared to 25% a decade ago. This underscores the fact that Canada is considered to be a major trading nation. A key concern regarding our international business activity is whether we are selling more to other countries (exporting) than we are importing (buying from other countries).

A number of issues regarding our trade status have received much attention in the last decade or so: the FTA and NAFTA and the consequent increase in the degree of openness to international trade. As mentioned earlier, Canada's traditional reliance on trade in unprocessed natural resources has received much criticism, and its reliance on US trade has been scrutinized.

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[16] Lam, E. (2011, October 3). Canada weaning itself off exports to U.S. *Financial Post.* Retrieved from http://business.financialpost.com/2011/10/03/is-canada-weaning-itself-off-the-u-s.

[17] Mandal-Campbell, A. (2007). *Why Mexicans don't drink Molson*, p. 25. Toronto, ON: Douglas and McIntyre.

[18] Mandal-Campbell, 2007, 19.

[19] Government of Canada. (2011). NAFTA Advantage. Retrieved from http://investincanada.gc.ca/eng/advantage-canada/nafta-advantage.aspx.

[20] Prime Minister of Canada. (2011, February 4). Canada/U.S. trade and investment. Retrieved from http://pm.gc.ca/eng/media.asp?id=3935.

[21] Statistics Canada. (2010). Gross domestic product, expenditure-based. Retrieved from http://www40.statcan.gc.ca/l01/cst01/econ04-eng.htm.

[22] Prime Minister of Canada, 2011.

So how "Canadian" is Canadian business? In other words, what proportion of the corporations doing business in Canada are actually controlled by Canadian sources? While the level of foreign ownership varies among different industries (for example, about 67% of chemical product and textile manufacturers are foreign owned, while only about 9% of communications companies are), the average level of foreign ownership is relatively high by world standards. *Annual foreign investment* in Canadian companies refers to ownership of assets like factories, land, buildings, machinery, equipment, and companies themselves.

So we have a pretty high level of foreign ownership, largely US-based, in Canadian corporations—but what difference does that make to the nature of business in Canada? That is, what are the implications of foreign investment? There is much debate about this topic. In fact, Canadians have traditionally been ambivalent when it comes to the issue of foreign investment. For some, interest in the Canadian economy is a good thing. On the other, We want to attract investors to our country to generate more business and more jobs. The source of ownership shouldn't make a difference when the results are the same—more jobs for Canadians and more money invested in the Canadian economy.

What impact does foreign ownership have on the personality of our corporate sector? Keep in mind that these foreign-owned corporations are largely subsidiaries of US-based "parent" companies. One important consideration are the activities the corporation carries out to conduct its business—that is, strategic planning, research and development, marketing, and so on. Many foreign-owned firms, like the car manufacturers or the multinational oil companies, operate Canadian subsidiaries largely to produce or simply market the product. These products are typically designed outside Canada, usually using imported components. These Canadian subsidiaries, then, do not perform the complete range of functions necessary to offer a product in the marketplace. These are the traditional so-called **branch plants**.

branch plants Subsidiaries (of companies in another country) that do not perform the complete range of functions necessary to offer a product in the marketplace. Typically, subsidiaries defer responsibility of higher-level strategic functions to the parent company.

Some observers believe that we will continue to see the rapid spread of branch plants in Canada, with progressively less important activities being allocated to the Canadian subsidiary. This has led many critics to suggest that these subsidiaries are nothing more than "sales offices" for the US parent company. Mel Hurtig made the following critical observation regarding the significance of foreign ownership in Canada:

> In . . . just over 20 years, there were 11,380 companies in Canada taken over by non-resident controlled corporations . . . 569 companies a year on average. Or you can think of it as 3 companies every two days, and an average of 47 a month, EVERY month for the last 20 years![23]

Some critics argue that we have built up a dependence on foreign capital to supply us with the funds for business development. While this financial assistance was welcome, it brought a major cost with it—the establishment of these branch plants and an economy that is approximately 30% foreign owned. It has been suggested that this branch-plant economy has impeded the development of an innovative or entrepreneurial spirit in Canadian business. In other words, there is a sense that, historically, Canadian managers have not been challenged to do the strategic planning, to engage in the research and

[23] Hurtig, M. (2005, October 19). Foreign investment? No. Foreign ownership and control? Yes! Canadian Democratic Movement. Retrieved from www.canadiandemocraticmovement.ca/index.php?name=News&file=article&sid=757.

development, and to develop the technological expertise to add value to the present supply of products or services. However, we are witnessing the increasing presence of Canadian-owned and global competitors, and it is expected that Canada will continue to move beyond its history and carve a bigger niche in the global environment.

Political Forces in Canada

The Canadian economic system has been described as a **mixed system**. This refers to the notion that while we possess a capitalist economy, government nonetheless plays an important role. In fact, government has historically played a critical role in the Canadian economy. (See Talking Business 1.3.) In Canada, we have a long history of government involvement in business in the sense of promoting and protecting our industries. Tariffs

mixed system An economic system that involves a capitalist economy with an important government role. Most economies today are considered mixed systems.

TALKING BUSINESS 1.3

Jobs, Productivity, and Innovation: How Health Care Drives the Economy

As one of the biggest recipients of public revenues, health care plays a major role within Canada's economic performance. While most people are generally aware of the sector's high costs (over $200 billion, or about 11.7 percent of gross domestic product in 2011), there is less understanding of its economic benefits. The health care sector delivers economic benefits on three levels: jobs, productivity and innovation.

First, the health care sector is a major employer. The sector directly employs about 1.4 million physicians, nurses, and other health care providers and clerical and administrative staff, which represent about nine percent of total jobs in Canada. Indirectly, the sector also supports thousands of additional jobs through its supply chain: the purchase of medical supplies, clinical equipment, and professional services. About 45,000 Canadians are employed in pharmaceutical, medicine, medical equipment, and medical supplies manufacturing in Canada. Therefore, directly or indirectly, the sector has a major influence on the careers of thousands of Canadians, many of whom are highly qualified professionals who pay taxes and purchase goods and services from all sectors of the economy.

Second, the health care sector contributes to a more productive and engaged workforce. Productivity, how efficiently goods and services are produced, is the single most important determinant of a country's per capita income over the longer term. Countries with high productivity have a superior standard of living. Unfortunately, this is an area where Canada has faced challenges. In 2012, Canada's level of labour productivity (that is, the dollar value of output per hour worked) was US$42, much lower than that of the United States, at US$52. More worrisome is that despite a broad and growing consensus that Canadian productivity needs to be improved, the gap with the U.S. is widening, not narrowing. Canada's productivity level has fallen to 80 percent of the U.S. level from a high of 90 percent in the mid-1980s. Efforts to improve labour productivity are needed to sustain or improve Canada's standard of living.

How does this relate to Canada's health care systems? According to Statistics Canada, Canadian workers lost an average of 7.7 days from work in 2011 due to illness or disability. Direct and indirect costs of disease and injury in 2000 were estimated at around $188 billion, a figure that is likely to be higher now. Disease outbreaks are very costly too. The Severe Acute Respiratory Syndrome (SARS) drained billions of dollars from Canada's economy in 2003. Because health care services touch the life of every Canadian, the sector plays a key role in decreasing employee absence due to illness, stress, and disability, which bring significant economic burden to Canada. Put simply, healthier workers are more productive workers.

Third, the health care sector is a major pillar of science and technology research. It also is a leader in putting the result of research to work. Advancements in life sciences have resulted in additional economic output of trillions of dollars that exceeds health research and health care costs over the same

(continued)

TALKING BUSINESS 1.2 *(continued)*

period by orders of magnitude. For example, at the turn of the 20th century, an individual had a life expectancy of 50 years. In 1961, the average Canadian could expect to live to age 71, and in 2006, the estimated average life expectancy in Canada was 80 years. This represents an impressive gain of 30 years of life over one century. These health gains represent the benefits of improvements in determinants of health (e.g., education, income) but also health advancements which were the product of research and innovation that was properly translated into health care services. In the United States, 1970–2000 life expectancy gains have been estimated to be worth US$95 trillion (US$3.2 trillion per year). Further improvements in the treatment of cancer and cardiovascular diseases are estimated to bring additional value in the magnitude of billions of dollars to the United States. (See Table 1.)

Current Value of a 10 Percent Reduction in Mortality from Major Diseases (2004 US$ billions)

Major Cause of Death	Males	Females	Total
All causes	$10,651	$7,885	$18,536
Cardiovascular diseases	$3,254	$2,471	$5,725
Cancer	$2,415	$2,261	$2,676
Diabetes	$237	$249	$486
Infectious diseases	$500	$148	$648
Accidents and adverse effects	$977	$421	$1,398

A 2008 report from the United Kingdom also highlighted the value of advancements resulting from medical research. It found that public investments in cardiovascular research in the U.K.—conducted from 1975 to 1992—yielded returns of about 39 percent. In other words, for each £1 invested in public cardiovascular research, the U.K. earned £0.39 per year in perpetuity. This demonstrates that when health research and development leads to health innovations that are appropriately and timely integrated into health and health care systems, it results in healthier and longer lives, which creates more value than the investments they require. Combined with the shift over the past century from physical labour to knowledge work, this means that Canadians have the ability to remain in the labour force for longer and hence make a greater contribution to wealth creation as well as consumption. The returns on research, therefore, also contribute to productivity growth.

Despite its escalating costs, the health care sector may be creating more value than it consumes. It is no exaggeration to say that the Canadian health care system lies at the heart of Canada's national economy and innovation system, both as a contributor of inputs and as an attractor or demander of its outputs.

Source: Prada. G. (2013, April 2). Jobs, productivity and innovation: How health care drives the economy. Conference Board of Canada. Retrieved from www.conferenceboard.ca/commentaries/healthinnovation/default/13-04-02/jobs_productivity_and_innovation_how_health_care_drives_the_economy.aspx.

on imported goods were designed to protect our domestic business by making the cost of foreign goods more expensive relative to those of Canadian goods. It can be argued that a large portion of Canada's industrial development is due to protectionism through tariffs first imposed in 1879 by Sir John A. Macdonald's National Policy.

Eventually, the government also offered direct incentives for industrial and resource development. *Incentive programs* were established to encourage managers to conduct business in a manner desired by the government. Managers may decide to, say, invest in new product development, engage in greater export activities, or locate in an underdeveloped region. Government incentives will be offered to engage in such activities. Receiving government financial support or reward for such activities would influence decisions to engage in these activities.

In Canada, an ongoing concern is the degree to which government can or should help businesses compete—whether in the form of direct subsidies, tax incentives, or some other form of protectionism. For example, one recurring controversy in recent years is the level of government subsidies to businesses operating in the global marketplace and government support for research and development programs. For example, one controversy involved a dispute regarding government subsidies to Canada's aerospace giant Bombardier and its main competitor in the jet market, Embraer SA (Empresa Brasileira de Aeronáutica S.A.) of Brazil.

Taxation The government's ability to levy taxes on corporations is another aspect of political forces acting on businesses. All profits earned by a Canadian resident corporation are subject to Canadian corporate income taxes, which are calculated on the basis of the company's net profits. But how much tax should corporations pay?

Canada is often admired by other countries for its low corporate tax rate. Over the past five years, Canada has gone from having the highest tax rate to the lowest of the G7 countries. In 2012, the federal tax rate was further reduced to 15%, which is closer to Ireland's 12.5%, one of the lowest tax rates in the world. When provincial tax rates are added, the combined corporate tax rate jumps to between 26 and 32%.

What are the benefits of low corporate income taxes? Clearly, businesses benefit by keeping more of their profits, but what are the benefits to the economy and the rest of society?

- *Long-term economic growth:* Many economists and business leaders agree: Reduce the expenses of companies and the economy will grow. According to Jeff Brownlee, vice-president of public affairs and partnerships for Canadian Manufacturers and Exporters, "to increase after-tax cash flow, leave more money in the hands of business to invest."[24] In other words, if you give businesses money by reducing taxes, they will be able to purchase efficient machinery or expand a product line. Either way, it is a step in the right direction toward higher productivity and a better economy.

  In 2008, the Organisation for Economic Co-operation and Development (OECD) researched the relationship between different types of taxes and economic growth. The OECD study concluded that corporate income tax was the most harmful tax out of personal income taxes, sales taxes, and property taxes because of the impact it has on long-term economic growth. One finding, for example, was that corporate income taxes had a negative impact on GDP per capita.[25]
- *Improved competitiveness:* Another benefit of low corporate taxes is improved competitiveness. Lower corporate tax rates generally mean lower costs for businesses. In turn, lower costs turn into lower prices for consumers. Lower costs also help businesses be more competitive not only domestically but globally as well.
- *Increased wages and improved living standards:* Economists today recognize that the corporate tax burden is ultimately passed on to other stakeholders in society. In a February 2011 paper, the Canadian Chamber of Commerce stated, "Business taxes are borne directly or indirectly by people—workers through lower wages, consumers in the form of higher prices for goods and services, and shareholders through lower returns."[26] In one research study, the Oxford University Centre for Business Taxation examined over 55,000 European companies in nine countries and found that for every $1 increase in corporate taxes, a reduction in real wages occurred by 75%.[27]

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[24] *CBC News*. (2011, April 15). Canada's corporate income tax fight. Retrieved from www.cbc.ca/news/business/story/2011/04/14/f-corporate-tax-cuts-for-against.html.

[25] Hodge, S. (2011, May). Special report: Ten benefits of cutting the U.S. corporate tax rate. Tax Foundation, *192*, 2. www.taxfoundation.org/files/sr192.pdf.

[26] *CBC News*, 2011.

[27] Hodge, 2011.

Exhibit 1.6 Country Comparison of Education and Skills

REPORT CARD		
Education and Skills		
1	Finland	A
2	Canada	A
3	Japan	B
4	Switzerland	B
5	Sweden	B
6	Australia	B
7	Germany	B
8	Netherlands	B
9	Belgium	B
10	United Kingdom	C
11	Denmark	C
12	Austria	C
13	Ireland	C
14	France	C
15	Norway	C
16	United States	C
17	Italy	D

Note: Data for the most recent year available were used.
Source: The Conference Board of Canada.

Source: Conference Board of Canada. (2013). Education and skills. *How Canada performs: A report card on Canada.* Retrieved from www.conferenceboard.ca/hcp/details/education.aspx.

But who actually pays the tax? Opponents of lower corporate taxes argue that if corporations pay less taxes then individuals will have to pay more. When individuals pay more tax, they have less disposable income to spend on goods and services; businesses will therefore profit less. Clearly, the debate on who should pay the tax is far from over.

Societal Forces in Canada

There is much to be proud of with regard to Canadian society. In an OECD study, Canada ranked second out of 17 peer countries in education and skills (see Exhibit 1.6). What does this mean? Canada has a good public education system that provides the basic skills necessary for adults to enter the workplace. With one of the highest high school and college completion rates in the world, Canada is a leader in education.

Given our strengths in educating our population, Canadian society has the potential to create a productive and innovative business environment. Recent studies suggest that countries with more educated and skilled workers have a higher chance of economy prosperity. According to the OECD Secretary-General, Angel Gurria, "better educational outcomes are a stronger predictor for future economic growth."[28] Why? Generally, earnings will increase with each level of education achieved, giving individuals more income to spend on goods and services. Individuals are also better equipped as employees to contribute more knowledge to their organizations. In comparing education to earnings, Americans with a university degree earned $180 for every $100 earned by Americans with a high school diploma. Similarly, a worker with a college degree earned $114, whereas non–high school graduates earned only $65 for every $100 earned by high school graduates.[29] Indeed, Canada is poised to earn a distinguished reputation on the world scene.

At the same time, it is important to consider how we can maintain and strengthen such a reputation. Perhaps central among the factors to consider is the manner in which we conduct business in this country—that is, the integrity of our business environment. Unfortunately, we have witnessed that Canada, like any other country, is not immune to scandal and corruption. In recent years, both the private and public sectors have been forced to confront a host of misdeeds that speak to the issue of corporate governance, social responsibility, and business ethics. The challenge for Canadian business leaders is to ensure that along with our industrial development comes an equally well-developed sense of corporate ethics and social responsibility.

In a recent article for the *Ottawa Citizen*, journalist Derek Abma[30] observed that Canadian business is at risk of losing its "clean cut" image if scandals continue to accumulate. Abma cites a number of recent scandals, including a Vancouver-based mining company. Bear Creek Mining sought to open a silver mine in Peru, which sparked a violent protest by local citizens who were concerned that the company's activities would pollute

[28] OECD. (2010, July 12). Education: Korea and Finland top OECD's latest PISA survey of educational performance. Retrieved from www.oecd.org/newsroom/koreaandfinlandtopoecdslatestpisasurveyofeducationperformance.htm.

[29] Conference Board of Canada. (2013). Education and skills. *How Canada performs: A report card on Canada*. Retrieved from www.conferenceboard.ca/hcp/details/education.aspx.

[30] Abma, D. (2011, July 2). Scandals pile up in world of Canadian business. *Ottawa Citizen*.

local water sources while providing few economic benefits. Five people died and about a dozen were wounded in clashes in 2011.

Sadly, Canadian companies have increasingly been appearing in the news in a less than flattering light. Calgary-based Niko Resources was found guilty in 2011 of bribing a government official in Bangladesh. The RCMP had been investigating the case against Niko for six years, along with at least 22 other ongoing investigations involving Canadian companies suspected of bribery. Elsewhere, an engineering firm based in Montreal (SNC-Lavalin Group) was recently exposed in the media as playing a role in building prisons for the Lybian regime of Muammar Gaddafi. In 2009, Toronto-based Barrick Gold (among the work's largest gold miners) faced public embarrassment after Norway's government pension fund sold off about $230 million worth of Barrick stock because of what it saw as irresponsible environmental practices of the mining company in Papua New Guinea.

Other socially irresponsible practices have been occurring in a host of industries and for many years in Canada. The Canadian oil sands industry in general has been criticized globally for its production of "dirty oil." In terms of criticism, Canada has also been pointed out by the anti-corruption group Transparency International for being the only G7 country that continually provides "little or no enforcement" of the OECD's Anti-Bribery Convention.[31]

All those scandals may be "exceptions to the rule," in that business in Canada normally operates with integrity and with a social conscience. These scandals do not detract from the fact that we do have a lot to be proud of in terms of our Canadian business practices. However, it would be foolish to ignore these events and to assume that they will never reappear. We need to better recognize that the societal context witin which business operates must be fully addressed to ensure continued prosperity and success in our business sector.

CHAPTER SUMMARY

Understanding the environment of business is the only way to get a sense of where we are headed in terms of future economic prospects. Whether you are currently a full-time student or are already in the workforce, an understanding of the context of organizations is a critical part of any intelligent person's portfolio. The aim of the upcoming chapters is to shed more light on the environment of organizations and to consider the implications for the future of organizations. What are the prospects for business, and what are the challenges we most confront? No organization operates in a vacuum, so the real world surrounding the organization must be addressed.

Indeed, within each external and internal force there are many factors that can positively or negatively impact business, as seen in Exhibits 1.7 and 1.8.

[31] Norton Rose Group. (2012, March). *Global anti-corruption developments: Annual review 2011*, p. 18. Retrieved from www.nortonrosefulbright.com/files/download-the-anti-corruption-annual-review-2011-65076.pdf.

Exhibit 1.7 The External Forces Framework: Considerations for Analysis

External Force	
Economic	**Examples**

a. State of the economy	• Is the economy growing or slowing down?
	• What stage of the business cycle is the economy in?
	  ○ expansionary (slow, moderate, high growth)
	  ○ peak
	  ○ contractionary (recession)
	  ○ trough
	• How is the economy affecting business? Are businesses expanding operations or downsizing?

b. Interest rates	• What are the lending interest rates?
	  ○ Are they low, moderate, or high?
	• How are interest rates affecting business?
	  ○ low interest rates = lower financing costs
	  ○ high interest rates = higher financing costs

c. Currency rate	• What is the domestic currency rate compared to other countries?
	• Is the currency rate appreciating or depreciating?
	• How is the currency rate affecting business?
	  ○ If the domestic currency is appreciating,
	    ■ = more expensive for foreign countries to buy Canadian goods (exports)
	    ■ = less expensive for Canadians to buy foreign goods (imports)
	  ○ If the foreign currency is appreciating,
	    ■ = more expensive for Canadians to buy foreign goods (imports)
	    ■ = less expensive for foreign countries to buy Canadian goods (exports)

d. Unemployment rate	• What is the unemployment rate?
	• How is the unemployment rate affecting business?
	  ○ low unemployment = more people working = increased spending power
	  ○ high unemployment = less people working = decreased spending power

e. Inflation rate	• What is the inflation rate?
	• How is inflation affecting business?
	  ○ low inflation = price level increasing at a slow pace
	  ○ high inflation = price level increasing at a rapid pace

f. National debt	• What is the national debt? • Is a country's debt so high that it is creating economic instability in the country?
Competitive	

a. Type of competition	• What type of competition exists in your industry?
	  ○ perfect competition
	  ○ monopoly
	  ○ oligopoly
	  ○ monopolistic competition

b. Phase of the industry in industry life-cycle model	• What phase of the industry life-cycle model is your industry in?
	  ○ introduction
	  ○ growth
	  ○ mature
	  ○ decline

External Force	
Economic	**Examples**
c. Intra-industry competition	• How competitive is your industry? (low, moderate, or high?) • How large is your company compared to your competitors? • Does your company dominate the industry? • Did your company create an industry standard? • Who are your competitors? • How many competitors do you have? • Do you have domestic and foreign competition? • What opportunities and threats exist in your industry that can affect your company being more competitive or less competitive?
Technological	

a. Type of technology	• What types of technology are used in your company's industry?
	• How is technology impacting or changing business?
	  ○ Work approaches
	    ■ Videoconferencing versus in-person meetings
	    ■ Tablets versus desktop computers
	  ○ Equipment
	    ■ Manufacturing assembly line
	    ■ Special computer-aided tools
	  ○ Electronics
	    ■ Smartphones, tablets, robotics, etc.
	  ○ Telecommunications
	    ■ Internet, phone service, etc.
	  ○ Processing systems
	    ■ Computers, data processing systems, etc.

Political/Legal	
a. Country stability	• Are there wars, natural disasters, national debt, civil unrest, or other issues that threaten the government and businesses being able to function?
b. Laws and regulations	• How do municipal, provincial, federal, or international laws and regulations affect business operations, projects, and activities?
c. Taxes	• What taxes does your organization have to pay? For example, corporate tax, property tax, sales tax, land transfer tax, tariffs on imported goods, etc.
d. Trade relationships	• How is a country's trade relationship with another country affecting business? • Is there a free trade agreement (e.g., NAFTA) or trade barriers (e.g., quotas and tariffs)? • Does the relationship protect domestic business or open the market up to foreign competition?

(continued)

Exhibit 1.7 The External Forces Framework: Considerations for Analysis *(continued)*

External Force	
Economic	**Examples**
e. Environmental fees	• Are there environment fees that businesses need to collect and remit? For example, are there recycling fees on designated electronic products or garbage collection fees?
f. Business incentives	• What incentives does the government give businesses to encourage them to operate in a particular region, create jobs, increase profitability, or increase competitiveness? • For example, in Canada, the Scientific Research and Experimental Development (SR&ED) tax credit for eligible companies encourages research and innovation; subsidies (e.g., free cash or loans by government) also support certain industries.
g. Crown corporations	• Are there certain industries the government has control over that affects how your business operates and competes? (For example, the Liquor Control Board of Ontario (LCBO), Canada Post, etc.)
h. Deregulation/ privatization	• Are there certain industries the government is releasing control over that may affect how your business operates and competes?
Societal	
a. Societal customs, attitudes, values, ethics	• What does society think about certain issues? (the environment, foreign-made goods, workers' rights, health and safety issues, etc.) • What demands are consumers requiring businesses to adhere to that are driven by values, customs, attitudes, and ethics? (corporate social responsibility, fair reporting, sustainability, etc.)
b. Demographics	• Is the majority of the population young or old? • How is the age of the population affecting consumer spending and demand for certain products and services? • How are demographics affecting or changing business?
c. Consumer preferences	• What products and services are customers preferring and willing to pay for? • Are consumer preferences changing? If so, why? • How are consumers' changing tastes affecting business?
Global	
Includes all of the forces described above in an international context.	
a. Political	• Are political issues and events in foreign countries affecting how domestic companies do business? (country stability, laws, taxes, trade relationships, etc.)
b. Economic	• How are foreign economic conditions affecting domestic businesses? (e.g., will the debt problems of Europe affect the economy in Canada and the global economy?)
c. Technological	• How do foreign technological innovations affect competition for Canadian firms? (e.g., iPhone technology versus Blackberry technology?)
d. Societal	• How do Canadian societal values, attitudes, and expectations affect business operations in other countries? • How do foreign societal values, attitudes, and expectations affect businesses in Canada?
e. Competitive	• How do foreign companies impact how domestic firms operate and compete?

Exhibit 1.8 The Internal Forces Framework: Considerations for Analysis

Internal Forces	Examples
1. People	
a. Employment relationship (responsibilities toward labour)	
i. Labour relationship • employee or contractor	• Are you hiring employees or contractors?
ii. Legal compliance • Canadian Charter of Rights and Freedoms • human rights laws • employment equity legislation	• Are you abiding by all employment-related laws?
iii. Work perspective • neoclassical perspective • managerial perspective • industrial pluralist perspective • critical perspective	• What is your perspective on the governance of work?
b. Leadership and managing people	
i. Classical • Frederick Taylor • Henri Foyal • Max Weber ii. Behavioural • Elton Mayo • Mary Parker Follet • Chester Barnard • modern behavioural science iii. Contingency theory • size • technology • environmental uncertainty • individual differences iv. Modern behavioural science	• What management approach is best suited to manage people in your organization and in your industry?
2. Strategy	
a. Business-level strategies	
i. Cost leadership • efficient-scale facilities • cost reduction on overhead, marginal customer accounts, R&D, marketing, general administration, etc. ii. Product differentiation • product features • links functions • location	• How should a company compete in a given market?

(continued)

Exhibit 1.8 The Internal Forces Framework: Considerations for Analysis *(continued)*

Internal Forces	Examples
• product mix • links with other firms • service iii. Focus • a particular buyer group • a segment of the product line • a narrow geographic market	
b. Corporate-level strategies	
Types of diversification • related • unrelated • vertical integration • backward integration • forward integration	• What businesses or markets should a firm compete in? • How should these businesses or markets be managed so they create synergies?
Michael Porter's Five Forces Model	
i. Threat of new entrants • economies of scale • capital requirements • switching costs • access to distribution channels • cost disadvantages independent of scale ii. Bargaining power of suppliers iii. Bargaining power of customers • switching costs • undifferentiated products • importance of incumbents' products to buyers • the number of incumbents relative to the number of buyers iv. Threat of substitutes v. Threat of existing rivalry • lack of differentiation or switching costs • numerous or equally balanced competitors • high exit barriers	• What is the state of the industry? • How competitive is the industry? • How easy or difficult is it going to be to compete and be successful?
The VRIO Model • value • rareness • imitability • organization	• How strong is the company compared to its competitors? • Are your company's resources, products, and services more valuable, rare, difficult to imitate, or better managed?
SWOT Analysis • strengths • weaknesses • opportunities • threats	• What are the internal and external forces affecting the company? • What are the company's strengths, weaknesses, opportunities, and threats?

Internal Forces	Examples
3. Structure	
a. Mechanistic • narrow division of labour • centralized decision making • narrow span of control • high formalization b. Organic • wide division of labour • decentralized decision making • wide span of control • low formalization c. Contingency theory • strategy • size • technology • environment	• What structure will best suit your organization? • Do you need to be cost efficient or innovative? • Is your company in a new industry or a mature one?

CHAPTER LEARNING TOOLS

Key Terms

attribute 16
Big Six 15
branch plant 24
Change 5
competitive advantage 16
competitive forces 8
economic forces 8
external stakeholders 7
general environment 7
global forces 9
globalization 9
gross domestic product (GDP) 13
Labour 5
Leadership 4
knowledge worker 21
mixed system 25
Organizational learning 11
Political forces 10
societal forces 10
specific or task environment 7
Strategy 4
Structure 6
Sustainability 12
technological forces 9
triple bottom line 12

Multiple-Choice Questions

Select the *best* answer for each of the following questions. Solutions are located in the back of your textbook.

1. The internal challenges of business consist of all of the following *except*
   a. labour
   b. unions
   c. leadership
   d. structure

2. An organizational structure involves
   a. a pattern of relationships between individuals in various roles or positions
   b. a formal hierarchy of authority
   c. rules and procedures
   d. all of the above

3. Outside the organization, challenges that exist include all of the following *except*
   a. political forces
   b. strategic forces
   c. competitive forces
   d. societal forces

4. The general environment involves
   a. strategic forces
   b. labour forces
   c. economic forces
   d. structure forces

5. An example of an external stakeholder is a(n)
   a. creditor
   b. employee union
   c. customer
   d. all of the above

6. The availability of telework is primarily the result of
   a. societal forces
   b. political forces
   c. competitive forces
   d. technological forces
7. All of the following belong to the specific environment *except* a
   a. customer
   b. city government
   c. newly formed union
   d. political force
8. An example of a component of the general environment is the
   a. political force
   b. economic force
   c. environmental force
   d. both a and b
9. Globalization can be defined as
   a. the integration of world economies
   b. the process of creating and negotiating trade agreements
   c. the globalization of markets
   d. both a and c
10. Changing consumer tastes is an example of the
    a. technological force
    b. societal force
    c. economic force
    d. competitive force
11. The "invisible hand" to ensure the market works effectively is also known as
    a. competition
    b. economic forces
    c. government policies and regulations
    d. all of the above
12. Organizational learning involves
    a. adapting to the environment
    b. learning from the organization's people
    c. contributing to the learning of the wider community
    d. all of the above
13. A worker with specialized education, skills, and training is sometimes called a
    a. high school graduate
    b. knowledge worker
    c. professional
    d. both b and c
14. Canada's exports to the United States make up approximately ____ of its total exports.
    a. 30%
    b. 50%
    c. 75%
    d. 10%
15. Canada's economic system has been described as a
    a. free market system
    b. mixed system
    c. socialist system
    d. communist system

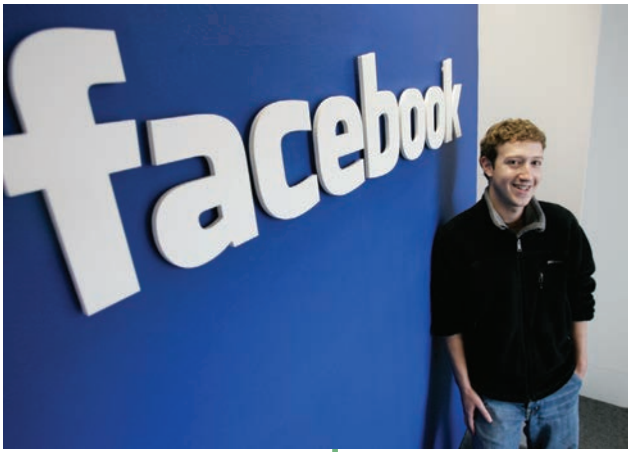
Discussion Questions

1. Identify and explain four internal challenges for business.
2. Describe the difference between the general environment and the specific environment.
3. Identify and describe the six external challenges for business.
4. Provide five examples of an external stakeholder.
5. How can the political force influence business?
6. How can the societal force influence business?
7. Compare and contrast the competitive force and technological force. How do they relate to one another?
8. Why is organizational learning important to a company's success?
9. How is the resource industry impacting Canada's economy?
10. Does Canada have a competitive advantage?

CONCEPT APPLICATION FACEBOOK: WHEN YOUR FRIENDS ARE WORTH A BILLION!

By September 2012, Facebook accomplished a major milestone: it had reached 1 billion users worldwide. Put another way, one seventh of the world's population has a Facebook account. Since Facebook was first launched in 2004, critics have doubted whether Mark Zuckerberg, a 21-year-old Harvard dropout, could make any money by providing a free networking service on the Internet. After all, Facebook began in a Harvard dorm room and became successful because of the exclusivity it offered. It was a network built for just college students; therefore, a certain amount of privacy was already built in.

Although Facebook has typically earned only a fraction of its principal rival, Google, the company took in an impressive $5 billion in revenue in 2012 (one tenth of what Google earned). How did Facebook get to be so rich?



The vast majority of Facebook's revenues comes from advertising. What is so appealing to advertisers? It's simple—they can tailor ads for each user based on all the personal information a user is willing to share. In addition, Facebook allows advertisers to target users' friends, who are more likely to respond favourably to an ad when they know that their friend has endorsed that brand or simply "checked in" at a store.

If you've used Facebook you'll know that advertisements appear on the border of the screen. Information is gathered about you from your "likes" and your activity on the site. This information is used to tailor advertisements for you whenever you visit the site. The obvious question is, "So what?" How effective are these tailored ads for the advertiser? There is something called a click-through rate, or CTR, which is the number of times a user clicks on an ad for every 1 million times it's seen. What is the CTR rate for Facebook? It is about 400—that is, about 400 users are clicking ads for every 1 million page views. This is much lower than many other websites, so why bother paying to advertise on Facebook? The answer is because Facebook generates high traffic and offers a powerful venue for ads. Even if most users don't click on the ads, brand awareness will be built.

Another source of revenue for Facebook is through online games supplied by companies like Zynga. These games have attracted millions of users who pay real money for in-game items. Supplier companies like Zynga earn their revenue though these in-game purchases, and Facebook gets a percentage of the profits.

Today, some observers call Zuckerberg a genius with a little bit of luck, but many critics argue that Facebook is simply a virtual space that doesn't have anything to sell except information about its customers.

Facebook's leadership team, however, sees things differently. The average age of its executives is under 45, and Facebook recently increased its global workforce to over 4,600—still a lean company for its revenue size.

Since the company went public in May 2012, the share price dropped from US$38 to less than US$20,[32] leading shareholders to question whether the company can continue to grow. Some disgruntled shareholders have even filed lawsuits against Facebook, questioning the validity of its initial public offering (IPO) valuation. But how do you grow a company that already has a billion customers?

Keeping members interested and coming back is critical to maintaining market share. Certainly, clicking "like" or "poke" was interesting at the beginning, but like all technology features, these too get outdated fast.

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[32] Vance, A. (2012, October 4). Facebook: The making of 1 billion users. *Businessweek*. Retrieved from www.businessweek.com/articles/2012-10-04/facebook-the-making-of-1-billion-users; Lee, D. (2012, October 5). Facebook surpasses one billion users as it tempts new markets. *BBC News*. Retrieved from www.bbc.co.uk/news/technology-19816709

Case Continued >

Unlike other tech companies, Facebook doesn't do controlled testing of its technologies. According to a *Businessweek* article,

> engineers race to put up new features, see if they work, and make tweeks to fix them if they don't. Even trainees who haven't finished their six-week indoctrination program are asked to work on the live site . . . [however], the learn on-the-go philosophy regularly blows up in Zuckerberg's face. He and his team periodically revamp Facebook's privacy policy, triggering a predictable chain reaction: consumer outrage, company walkback, adjusted policy, re-release, lessened outrage, and so forth until the furor dies down. . . . [But], these iterations are apt to leave lasting damage to Facebook's reputation."[33]

So far, Facebook has tried to minimize this. In fact, Facebook has slowly started charging customers for one service (sending messages to new people, or "nonfriends"), but the social networking site doesn't want to lose customers to similar companies such as Google+, Twitter, and LinkedIn.[34]

In addition, gaining new regular members is no easy task. Privacy concerns are still a big issue for many users. Many parents of young teens are either monitoring or limiting their children's social media usage because of cyberbullying, privacy, and other safety and security concerns. And corporations are using Facebook to do background checks on potential new employees. Certainly, there have been numerous newspaper stories of people being fired for their inappropriate photos, status updates, and other public activity on Facebook.[35]

So where do Facebook's next 1 billion members come from? Indeed, growth in North America and Europe has started to level off. According to CNN Money, "less than 20% of Facebook's users live in the U.S. and Canada, but those users account for 48% of advertising revenue that Facebook took in last quarter."[36] Zuckerberg is hoping this will change, but there are still challenges ahead. Facebook has been unable to prosper in one of the world's largest markets, China, because of government censor restrictions. Instead, China's 1.3 billion citizens use local social media sites such as Sina Weibo, Renren, and Tencent.[37]

Russia is another market where local sites are still the choice for its users. VKontakte is one Russian network with over 100 million users, compared to Facebook's mere 7 million users in the same region.[38]

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[33] Vance, 2012.

[34] Shaughnessy, H. (2013, April 8). Facebook extends charging for messages. Great move! *Forbes*. Retrieved from www.forbes.com/sites/haydnshaughnessy/2013/04/08/facebook-extends-charging-and-that-is-good.

[35] Ramirez, A. (2010, May 28). What Facebook learned from Apple and what we can learn from Facebook. *Executive Street*. Retrieved from http://blog.vistage.com/business-innovation/what-facebook-learned-from-apple-and-what-we-can-learn-from-facebook

[36] Smith, A., Segall, L., & Cowley, S. (2012, October 4). Facebook reaches one billion users. *CNN* Money. Retrieved from http://money.cnn.com/2012/10/04/technology/facebook-billion-users/index.html

[37] Smith, Segall, & Cowley, 2012.

[38] Lee, 2012.

Given these challenges, how is Facebook trying to change? In 2013, Facebook significantly increased its mobile ad presence, which earned close to $1 billion in mobile ad revenue. The company also recently entered the mobile phone market itself by introducing its first smartphone, the HTC First. While Zuckerberg was attempting to build a better mobile experience, he recognized that an increasing number of Facebook users access the site from their mobile phones and tablets, where ads need to be targeted.[39] "We're picking these big investments because I think these are important areas for us to focus on," said Zuckerberg.[40]

David Ebersman, Facebook's chief financial officer, explained, "We're pleased with our progress in product development and with our financial results as well. Mobile has the opportunity to be huge for Facebook if we execute well and continue to attract mobile users and develop valuable mobile monetization products."[41]

What else is Facebook doing right? It is still the top choice amongst business users as well. According to one survey, Facebook is still the preferred platform among 85% of social media professionals.[42]

Since social networking is a relatively new industry, many organizations are still learning how Facebook and other social media sites can best achieve their goals. Clearly, Facebook is also being used to advertise products, organize protests, and provide awareness on social issues—and now it is selling products, too. Academics of different disciplines are closely watching how social media is beginning to change life in North America as we know it. "It's really humbling to get a billion people to do anything," Zuckerberg says.[43]

Questions

1. What elements of the external and internal environment do you think contributed to Facebook's success?
2. Which elements of the external and internal environment are beginning to create challenges for Facebook?
3. Which force must Facebook work the hardest to address to continue to prosper? Why?

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[39] Metz, R. (2013, April 10). The first Facebook phone: A little too much information. *MIT Technology Review*. April 10, 2013. Retrieved from www.technologyreview.com/news/513566/the-first-facebook-phone-a-little-too-much-information

[40] Womack, B. (2013, May 2). Facebook revenue exceeds estimates on mobile advertising. *Bloomberg*. www.bloomberg.com/news/print/2013-05-01/facebook-revenue-exceeds-estimates-on-mobile-advertising.html

[41] Womack, 2013.

[42] Shaughnessy, H. (2012, October 4). Facebook's 1 Billion Users: Why the Sky is Still the Limit. *Forbes*. Retrieved from www.forbes.com/sites/haydnshaughnessy/2012/10/04/facebooks-1-billion-users-why-the-sky-is-still-the-limit

[43] Vance, 2012.