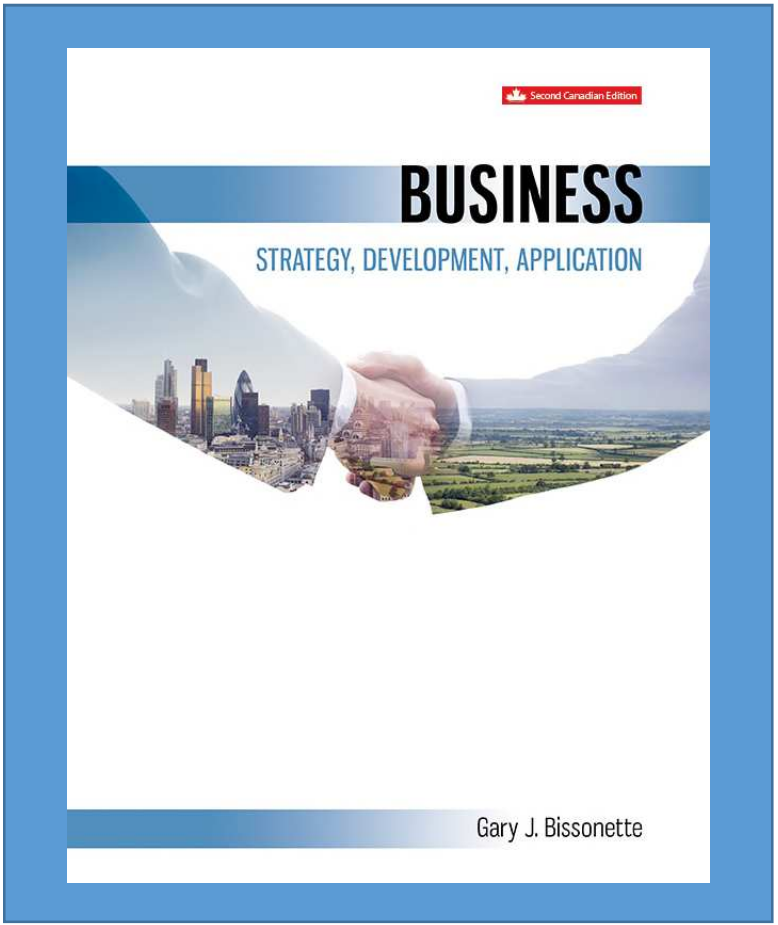
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Chapter 2

The Canadian Economic Environment

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Learning Objectives

1. The ability to identify the major contributing factors that impact overall economic development
2. Exposure to the core economic model that shapes Canada's economic growth and development
3. A base-level understanding of what constitutes economic activity and how economies grow and contract
4. The ability to recognize trends that will influence the future composition of economic development in Canada
5. Guidance on how managers use information on economic trends in today's marketplace to better manage their organizations and respond to the competitive challenges confronting them

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Canada & Its Economic System

- Canada possesses one of the most **fully developed** and **diversified economic systems** in the world.
- Abundance of **natural resources**, skilled labour, and sophisticated technology-based.
- Canada's economy has moved from being **primarily agricultural** to a diversified system.
- Productivity gains, strong business investment, technological innovation, moderate wage increases, and a favourable currency exchange rate create a resilient and competitive Canadian economy.

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Canada & Its Economic System

- Products **driving current trade performance** include oil and gas, canola, wheat, gold, nickel, potash, sulfur, telecommunications, aerospace, forestry-related, and automotive sector products.
- Canada is a member of the **G7/8**
- **Trading relationship** with the United States.

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Key Economic Influencers

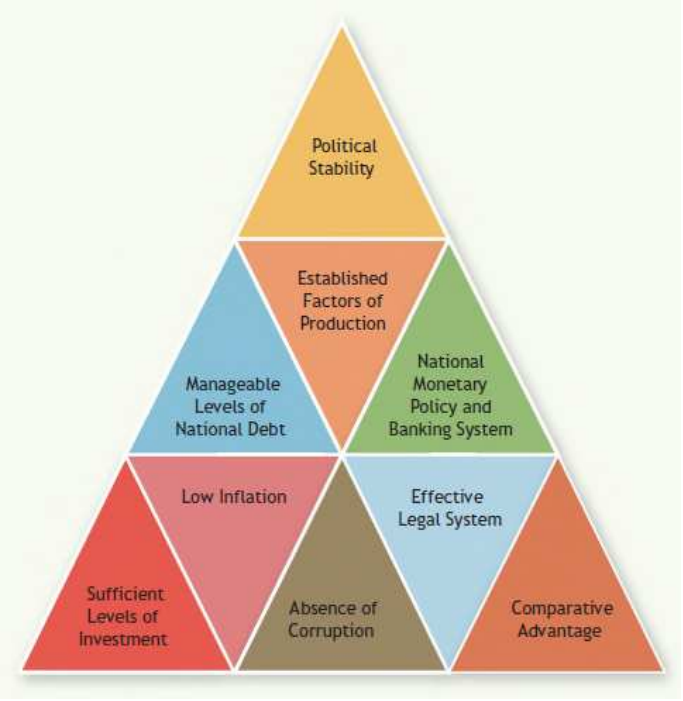
- Contributing factors to Canadian economic development include:
  - A stable political system
  - Necessary infrastructure - roads, ports, utility systems, educated workforce, technology-based business management systems
  - Manageable debt levels
  - Efficient / techno-savvy banking system
  - Well-managed inflation levels
  - Strong monetary policies and a central bank (Bank of Canada)
  - Strong natural resource base
- **Comparative Advantage**

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Contributing Factors to Economic Development



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Foreign Direct Investment (FDI)

- **Foreign direct investment**
  - FDI into Canada has been increasing; it topped $686.3 Billion in 2013
  - Just over half of FDI flowing into Canada comes from the US
  - Canada is viewed as a safe and lucrative place to do business
  - Both Europe and Asia/Oceania are active investors in Canada

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The Underlying Economic Model

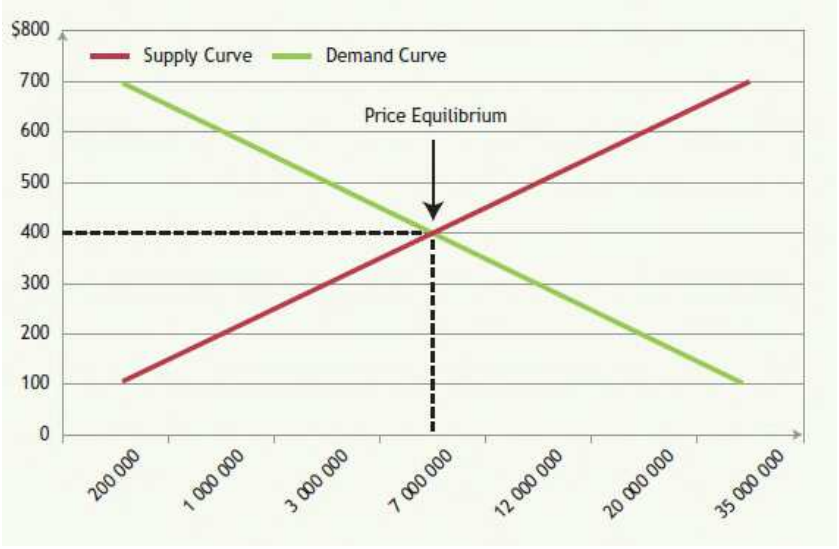
- **3 Fundamental Market Composition Principles**:
  1. The Law of Supply and Demand
  2. Allowance for private ownership, entrepreneurship, and wealth creation
  3. Extent of government in influencing economic activity and direction
- A **balanced relationship needs** to exist between the three fundamental market composition principles in order for an economic system to develop and grow.

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Law of Supply and Demand

- **Demand**
  - Inelastic demand
  - Elastic demand
- **Supply**
- **Price Equilibrium**



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Allowance for Private Ownership, Entrepreneurship, and Wealth Creation

- **Private Enterprise** includes:
  - **Personal Ownership**
  - **Entrepreneurship**
  - **Wealth Creation**
- Some economies like Canada and the US fully support these concepts in a climate of risk versus return.
- Developing economies such as China and India are allowing greater access to these capitalistic principles, while others like North Korea, are not.

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Government Involvement in Influencing Economic Activity and Direction

- **Government:**
  - Customer, regulator, manager, taxation agent, economic stimulation agent, and competitor.
- **Open system -** adheres to the principles of economic freedom: the law of supply and demand, full and open access to the principles of private ownership, entrepreneurship, and wealth creation, and an absence of regulation on the part of the government.
- **Controlled system -** the fundamentals of the law of supply and demand, private ownership, entrepreneurship, and wealth creation are **largely restricted or absent**, and the government fully controls the economic direction and activity.

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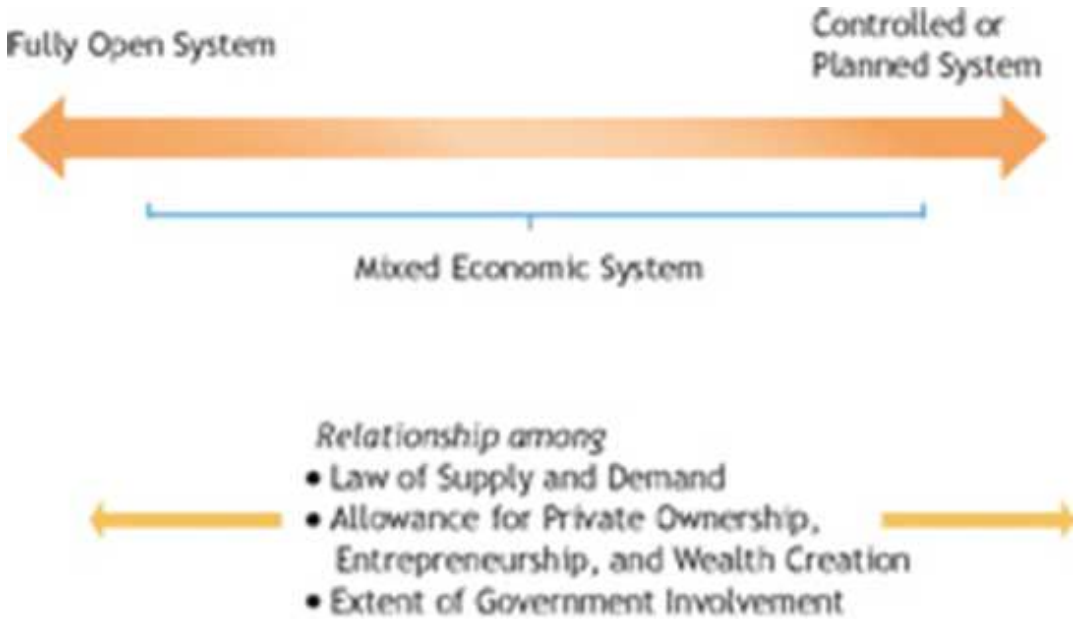
Canada: A Mixed Economic System

- The Canadian economy allows the **law of supply and demand** to significantly influence the market.
- The principles of **private ownership, entrepreneurship, wealth creation** and their corresponding risk and return opportunities are present and supported.
- The Canadian government is an active participant in the economy but attempts to manage economic activity through a cooperative/competitive model using its powers of taxation, regulation, national debt targets, provincial transfers, and monetary policy control.

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Canada: A Mixed Economic System



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Business in Action: Role of the Bank of Canada

- Canada's central bank
- Created in 1934; became a **Crown corporation** in 1938
- Develop and manage the monetary policies and financial systems
- Has the following **core areas of responsibility**:
  - Managing inflation and currency supply
  - Developing and managing financial systems and safeguards
  - Providing fund management services to chartered banks
- Interest rate adjustment controls inflation

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The Economy in Simple Terms

Four fundamental Factors:

1. **Expenditures** – purchases made in support of daily economic activity
2. **Savings** – dollars set aside to support economic activity and wealth creation in/for the future
3. **Capital Asset Investments** – investments made today to expand productivity and overall economic capacity
4. **Credit** – the borrowing of dollars to support expenditures or investments being made

Economic Activity = Expenditures + Savings + Investment + Credit

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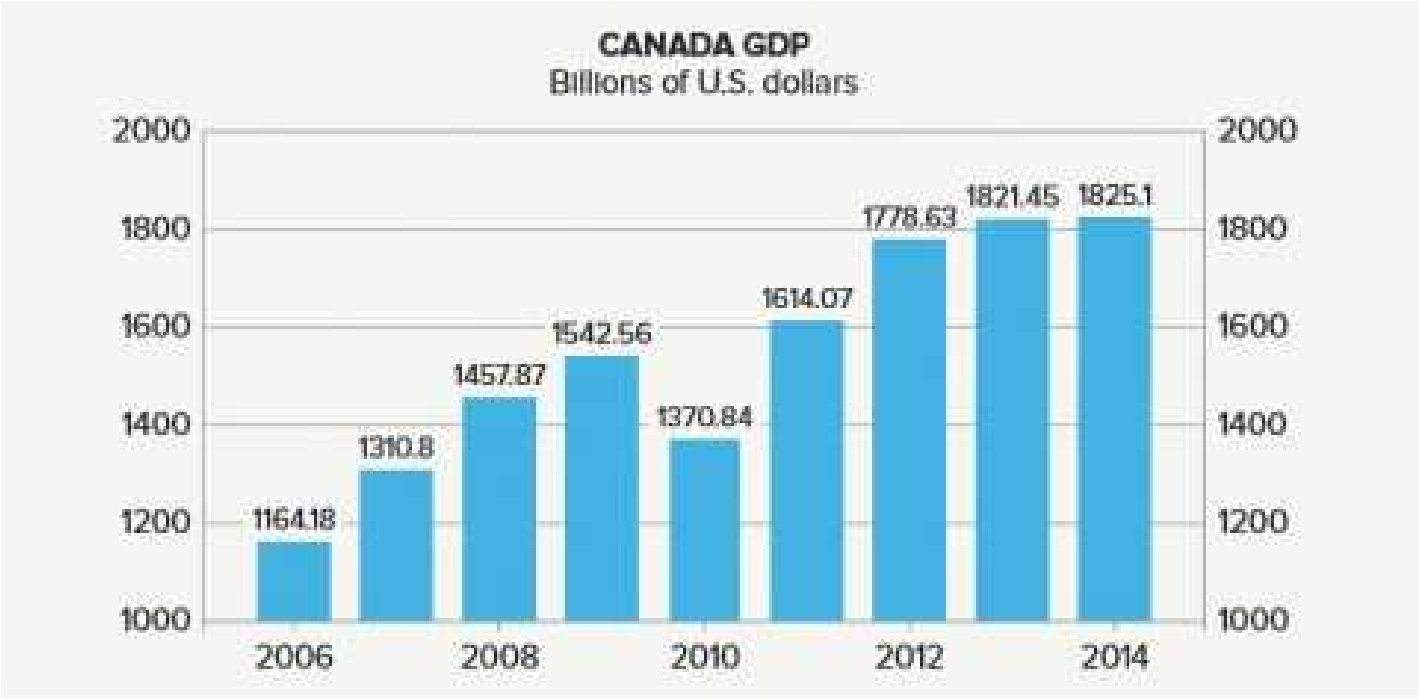
The Economic Growth Cycle

- **Gross Domestic Product (GDP)** - market value of all goods and services a nation produces domestically over a year.
- GDP includes all the economic activity including:
  - Goods and services produced and purchased domestically for **consumption**
  - Business **investments** within the economy
  - Goods produced for **export** purposes
  - **Government spending**
- **Recession –** two or more consecutive quarters of decline in GD{

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Canada's GDP Growth



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Key Economic Drivers

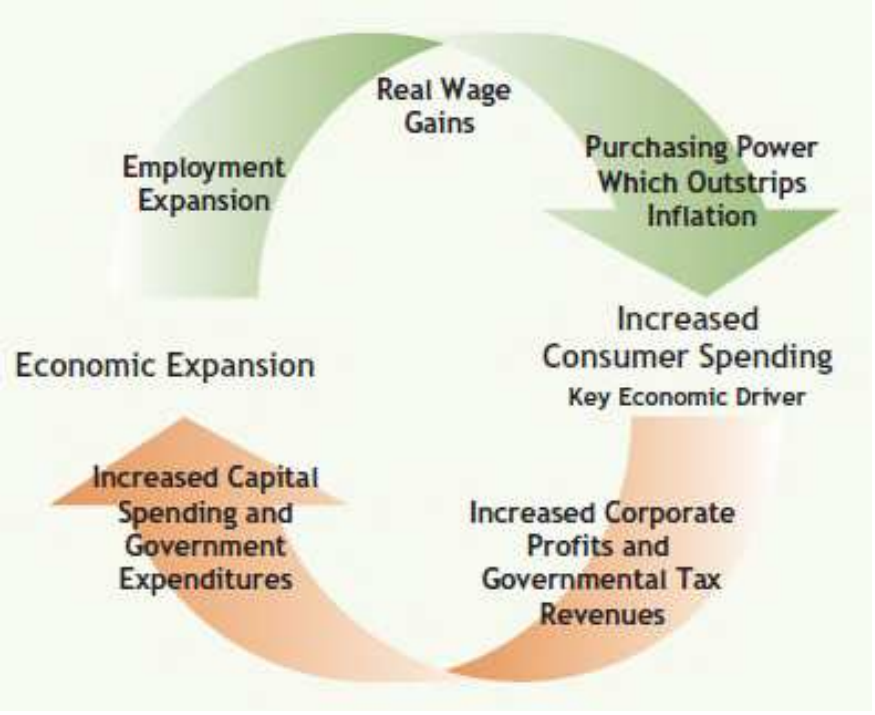
- Varies from country to country:
  - For China, the current key economic driver is the production of goods and services and the underlying capital investments.
  - For the US, it is consumer spending; the US is one of the leading purchasers of goods and services.
- The US economy is $17 Trillion (2014 estimate) – **the largest in the world** and is considered to be the engine that drives the global economy.
- 60% of GDP activity in Canada is driven by **consumer spending**; 79% of Canada's exports go to the US.
- Other activities that influence Canada's GDP movement **include natural resources, technology, and energy production.**

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Economic Growth Cycle, North America: Economic Expansion



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The Canadian Banking System

- The World Economic Forum, annually identifies **Canada as the most sound banking system in the world** (2009-2014).

  - Best-managed and well-capitalized banking operations.
  - Well-develop and organized regulatory system
  - Governed by the *Bank Act*
  - A strong track record for risk assessment and control, and a stable and secure operational environment

- **Chartered Banks** are financial institutions regulated under the *Canada Bank Act*.

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Managing the Movement in the Economy

- **Economic growth** needs to be managed in a way that stimulates investment yet maintains control of inflation and other inefficient economic influencers.
- **Inflation -** A rise in the level of prices of goods and services within an economy over a period of time.
- Growth that is taking place needs to be **real growth** not masked by inflation.

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Managing the Movement in the Economy

- Given the geographic distribution of Canada's economic clusters, **regional disparity** exists in growth rates and economic potential.
- Alberta, Saskatchewan, BC, and Newfoundland/Labrador have experienced **tremendous growth** due to the increasing demand for natural resources, agricultural based products, and energy.
- Growth needs to be **stimulated** in Central and Eastern Canada without compromising the growth rates of the Western provinces.

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Trends Impacting the Canadian Market

- Consumer Debt Loads
- Inflation
- Geographic Clustering & Economic Imbalance
- Currency Exchange Rate Impact
- Branch Market Impact: Purchasing Power Parity & Takeovers
- Sustainability and Green Initiatives
- Aging Workforce, Immigration, and Multiculturalism
- Long-Term Competitiveness
- Small Business Emphasis:
- Globalization & potential geopolitical instability
- Threat of cyber attacks

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Managing in Challenging Times

- **3 Fundamental Questions:**

1. What are the general indicators saying about the current economy and the relationships among the key variables governing our mixed economic system?
2. What broad-level changes (political, economic, social, technological, environmental, and legal) are occurring which might directly impact future growth and market position?
3. What specific current competitive actions and market forces may disrupt the way in which business is done within an organization's particular market sector?

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Primary Economic Indicators

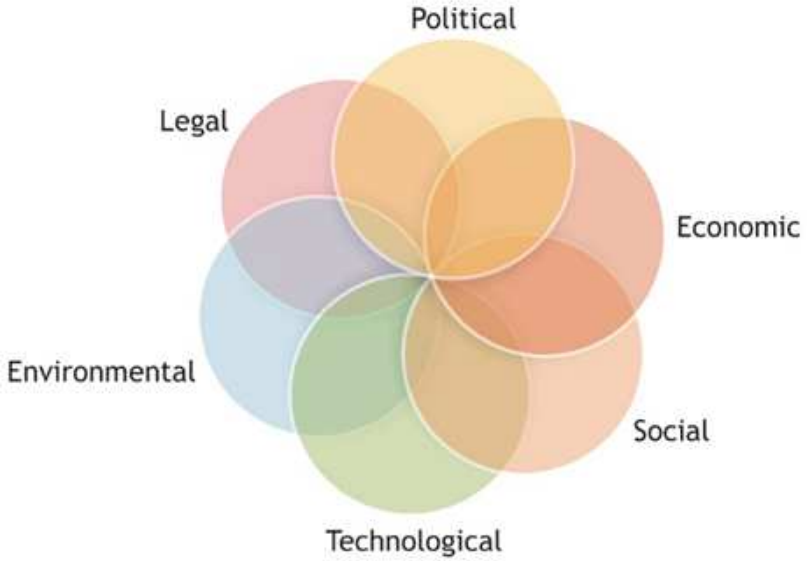
- Unemployment rate
- Inflation Rate
- Consumer Price Index (CPI)
- New Housing Starts
- Manufacturing Inventory
- Consumer Confidence Index
- Price per Barrel of Crude Oil
- Stock Market Indexes (TSX, S&P 500, Dow Jones)
- Currency Exchange Rate
- Monthly Retail Sales
- Industry-Specific Indexes

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Macro-Level Analysis PESTEL Analysis



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Macro-Level Analysis

- **Managers look for trends in:**
  - Government intervention or regulation such as ***protectionism***
  - Demographic and cultural shifts / behavioural changes
  - Changes to laws that could impact overall business risk
  - Changes in environmental compliance regulations
  - Speed and direction of technology shifts that could render products, services and/or processes obsolete
- Managers must constantly look to see where and how their markets are changing in light of competitive influences

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Understanding Competitive Models



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Sensing Market Change

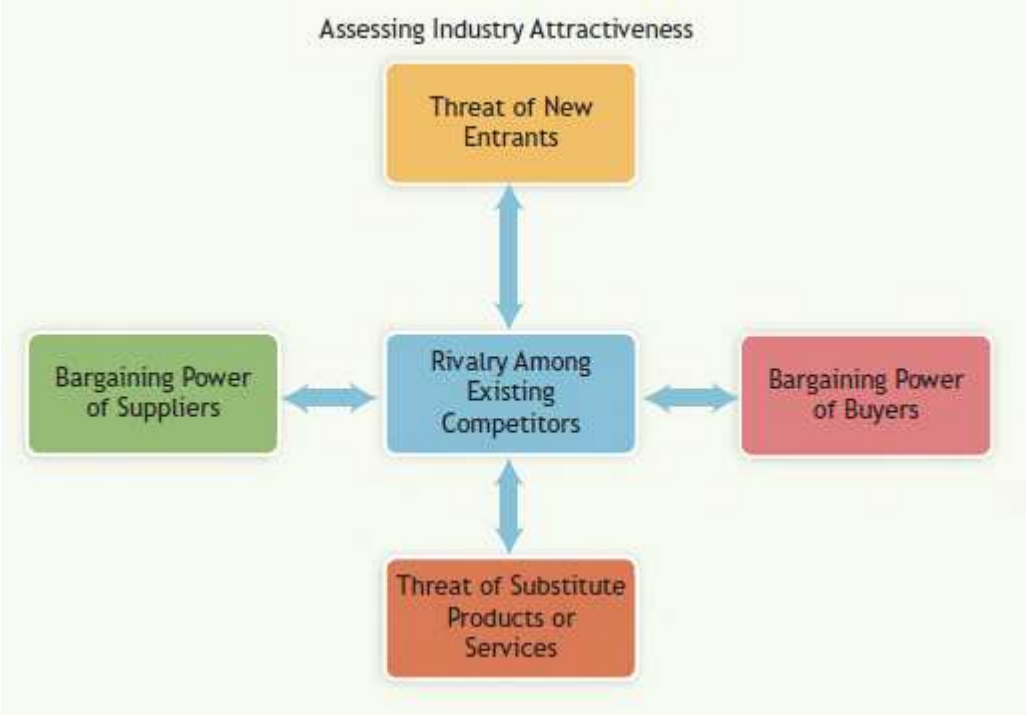
- One of the most often used business tools for assessing changes in market sectors is the **Porter's Five Forces Model**
- Michael Porter suggests that managers can keep their finger on the pulse of the industry in which they operate by assessing changes in 5 key areas:

1. **Rivalry Among Existing Competitors**
2. **Threat of New Entrants**
3. **Threat of Substitute Products/Services**
4. **Bargaining Power of Suppliers**
5. **Bargaining Power of Buyers**

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Porter's Five Forces Model



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Management Reflection: Analyzing Market Trends

- Managers need to recognize the importance of understanding the **economic platform** that governs the Canadian economy.
- This requires a constant analysis of **economic trends**, economic indicators, governmental actions and shifts in global competitiveness.
- Managers need to assess social, cultural, legal, environmental, and technological trends.
- Managers need to recognize and respond to **disruptive innovations** that will impact the specific markets and industries within which they compete: changes that could render their products/services obsolete or negatively impact the customer base.
- Use of business models such as **PESTEL** Analysis and **Porter's Five Forces** assist managers in sensing trends, both positive and negative, and enable redirection of business efforts to ensure long term business success.

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Chapter Summary

- Canada and its Mixed Economic System
- Key Economic Influencers
  - ➢ Contributing Factors to Economic Development
  - ➢ The Underlying Economic Model: Supply & Demand
- The Economy in Simple Terms
  - ➢ Expenditures, Savings, Capital Asset Investments & Credit

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Chapter Summary

- The Economic Growth Cycle/Managing Economy Movement
  - Gross Domestic Product (GDP)
  - Economic Expansion and Contraction, Inflation, Recession
- Trends Impacting the Canadian Market
- Managing in Challenging Times
  - Key Economic Indicators
  - Competitive Models: Purely Competitive, Monopolistic, Oligopoly, Monopoly
  - Sensing Market Change: PESTEL Analysis & Porter's Five Forces
- Management Reflection – Analyzing Market Trends

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Chapter 2: The Canadian Economic Environment

Chapter Summary

In this chapter, we have described the current composition of the Canadian economy and the key contributing factors that influence its growth and overall direction. In addition to identifying the core fundamentals necessary for economic development, we also focus on describing the market composition principles that govern our economic activity and the nature of Canada's mixed economic system. A considerable emphasis is placed on describing how economic activity is generated and how economies are stimulated or contracted on the basis of movement in their key economic drivers. The discussion associated with the economic growth cycle is fundamental to this overall process. With the basics of the economy having been identified, we shift our focus toward understanding how we attempt to manage our overall economic activity and some of the key trends that will influence our marketplace evolution going forward. We close off our chapter discussing how managers use this information to better understand how changes within the economy and the marketplace in which they operate will impact their organizations. We also provide a brief glimpse as to how the nature of competition within markets can change, and how managers, via such models as Porter's Five Forces, can seek to better understand and respond to trends and market changes through proactive analysis.

Learning Objectives

This chapter is designed to provide students with:

- The ability to identify the major contributing factors that impact overall economic development
- Exposure to the core economic model that shapes Canada's economic growth and development
- A base-level understanding of what constitutes economic activity and how economies grow and contract
- The ability to recognize trends that will influence the future composition of economic development in Canada
- Guidance on how managers use information on economic trends in today's marketplace to better manage their organizations and respond to the competitive challenges confronting them

Management Reflection – Analyzing Market Trends

Managers, regardless of whether they are overseeing a for-profit business or a not-for-profit organization, a large business or a small business, need to recognize the importance of understanding the economic platform that governs our economy. This requires a constant analysis of economic trends through the review and assessment of economic indicators, governmental actions, and shifts that are occurring in global competitiveness. In addition to analyzing economic data, managers need to assess social, cultural, legal, environmental, and technological trends as well, and seek to recognize and respond to disruptive innovations that will impact the specific markets and industries within which they compete. The marketplace is not static. The situation changes daily. These changes are influenced by both controllable and non-controllable factors. In

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some cases, these changes can be the result of broader macroeconomic forces beyond a specific industry. In others it can be gradual or sudden shift in industry-specific forces which totally disrupt the status quo. As managers, we need to continuously assess what is happening at the macro and industry levels via business models such as a PESTEL analysis and Michael Porter's Five Forces. Our focus is on sensing trends, both positive and negative, which will enable us to redirect our business efforts in order to ensure our long-term business success. To be successful we not only have to develop viable business models, but we must also actively assess their ongoing relevance, as markets evolve and consumer wants, desires, and behaviours change. This requires knowing the underlying fundamentals of economic growth, as well as the key critical influences driving future demand and our overall relevance.

Business Updates

- Toronto Stock Exchange (Page 36)
- Bank of Canada (Page 38, 46, 54-59)
- Apple, Google, LG, Lenovo (Page 40, 67, 71-73)
-
- Heritage Foundation, The Wall Street Journal (Page 44)
- Government of Alberta (Page 52)
- World Economic Forum, The Financial Consumer Agency of Canada (FCAC), The Office of the Superintendent of Financial Institutions (OFSI), Canadian Banker's Association, (Page 53)
- Canadian Banks (Royal Bank of Canada (RBC), Bank of Montreal (BMO), Toronto-Dominion (TD), Canadian Imperial Bank of Commerce (CIBC), Scotiabank, the National Bank of Canada (Page 53)
- TD Economics, Bank of Canada, Food Institute of the University of Guelph (Page 57)
- TransCanada's Keystone XL, Canadian Government, Bank of Canada (Page 58)
- Inco, Vale of Brazil, Falconbridge, Xstrata, BHP Billiton, Potash Corporation,
- London Stock Exchange, Toronto Stock Exchange, Rona, Lowes, Blackberry, Lenovo, Ontario Teachers' Pension Plan, British Columbia Investment Management Corporation (Page 59)
- Conference Board of Canada, Ipsos Reid, Globe and Mail (Page 60)
- Petroleum Human Resources Council of Canada (Page 60)
- Royal Bank, Manulife, Bombardier, Research In Motion, GM of Canada (Page 61)
- Target Corporation, Home Depot, Sony (Page 62)
- TSX, S&P 500, Dow Jones (Page 63)
- Nokia, Emerson, Samsung, Lenovo, Apple, Xiaomi, Blackberry (Page 67)
- Boeing, EADS Airbus, Bombardier Inc. and Embraer (Page 68)
- General Motors, Ford Motor Company, Chrysler Motors, American Motors (Page 52)
- Sony, Warner, HMV, Music World, Sam the Record Man, Walmart, Napster, Kazaa Apple iTunes, Amazon.com's Inc., Spotify, undergroundhiphop.com, GhostTunes (Page 71)
- Amazon, Google, Apple, Chapters, Barnes and Noble, Samsung, Google's Android, Lenovo, Xiamoi, LG, Huawei (Page 71-72)

Log onto the Bank of Canada website at http://www.bankofcanada.ca/rates/interest-rates/selected-historical-interest-rates/. Illustrate to the class how interest rate modifications are the Bank of Canada's primary tool to control inflation and ensure that credit is available (one of the drivers of economic activity). It is clearly visible that in times of recession, the Bank of Canada lowers the

prime rate to induce borrowing, which stimulates consumer spending, and can help to remedy the economic contraction feedback.

Selected Statistics:

Prime Lending Rate
In August 2003, the prime lending rate was 4.25%, rising to 6% in July 2011, before falling to a recent low of 2.25% in April 2009. The current prime lending rate is 2.70% (September 2015).

Bank of Canada's Key Lending Rate
In October 2008, in response to the financial crisis, the Bank of Canada decreased interest rates from 3.25% to 2.50%, and interest rates have continued to fall since then, bottoming out at 0.50% through 2009 and half of 2010. The current overnight lending rate, also known as the Bank's Key Lending Rate is 0.50% (September 2015).

Key Takeaways (Chapter Highlights)

Page 38
Productivity gains, strong business investment, technological innovation, moderate wage increases, and a favourable currency exchange rate are all key factors that are deemed to be critical in ensuring that our economy remains resilient and competitive now and in the future.

Page 39
A core requirement to the stability and growth of any economic system lies in its ability to service and promote both the current and future economic activity taking place.

Page 43
Government involvement in the economy relates to the varying roles government can play within ongoing day-to-day economic activities.

Page 46
Canada, like most fully developed economies, is considered to be a mixed economic system.

Page 48
The economy as a whole operates on four principles. Economic Activity = Expenditures + Savings + Investment + Credit

Page 49
Economists track the movement of GDP (upward or downward) over a period of time to determine whether an economy is growing or contracting.

Page 51
Our broad base of economic activity enables our Canadian economy to withstand an economic downturn in one sector, thereby preventing it from having a detrimental influence on economic activity as a whole.

Page 55
Economic growth needs to be managed in a way that stimulates investment yet maintains control of inflation and other inefficient economic influencers.

Page 63

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As managers, it is fundamentally important that we understand what is happening in both our domestic economy and within those global economies that influence our overall economic activity and prosperity.

Page 65
Managers must constantly look to see where and how their markets are changing in light of competitive influences.

Page 66
Understanding the type of competitive environment a business is facing is fundamental to creating a strategy for competing and understanding where and how to allocate resources in support of product/service positioning and overall marketing effort.
Page 69
In addition to recognizing the current status of the competitive market (environment), managers must recognize that market configuration and composition are not static.

Page 73
The lesson learned is that we must constantly assess our industry and its markets for potential disruptive changes that will render our products obsolete or negatively impact our customer base.

Chapter Exercise

Exercise 1:

This exercise will demonstrate how the law of supply and demand works, how different levels of economic openness influence private ownership and entrepreneurship, and how government involvement can change economic activity.

This exercise requires lots of chocolate bars.

Auction off a chocolate bar to the individual in the class who is willing to pay the most. Let this individual consume the chocolate bar, and then ask how much he/ she would pay for a second chocolate bar. If necessary, sell the individual the second chocolate bar. Allow them to eat the chocolate bar. Continue this exercise until the individual reduces his bid. This illustrates the notion of diminishing marginal benefit from consuming a good/ service, and explains why the demand curve is negatively sloped.

Next, give a stock of chocolate bars to another individual in the class. Allow this individual to sell a few bars to eager members of the class (stimulating entrepreneurship). Next, discuss how this individual's fortunes would change if another supplier existed (anti-trust regulation). Demonstrate how an equilibrium is reached when more suppliers enter the market (supplier power reduces) and a homogenized product is offered (selling all Mars bars versus an array of chocolate varying in quality). This will illustrate that as competition increases, markets become more efficient, and an equilibrium price will be reached. This exercise could be extended to involve supplier strategies to increase their profits through collusion, and the regulatory response that we could expect from this action.

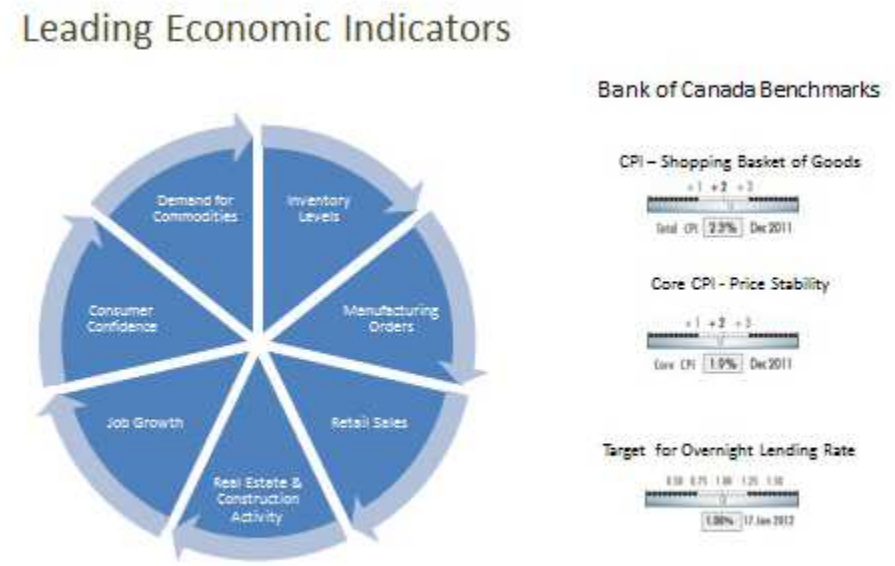
Furthermore, we could tie in Porter's Five Forces, discussing how each party in this transaction (supplier, buyer, regulator) could improve their fortune by shaping one of the forces. For example, supplies would benefit from collusion or restricted trade through tariffs or import

quotas, while buyers could lobby the government to place a price ceiling on the price of chocolate bars, and governments could tax each transaction by taking a portion of each bar sold.

This exercise is intended to introduce the three fundamental market composition principles, and introduce some concepts and tools from this chapter (Porter's Five Forces, PESTEL- what sorts of changes could affect each party to the transaction).

Exercise 2:

Ask students to comment on what they feel are the leading economic indicators which give businesses and managers a sense as to the overall strength of the economy. Ask them how these tie in to the Economic Growth Cycle. Follow up on this with a discussion as to how the Bank of Canada attempts to manage economic activity in terms of stimulation and/or putting on the brakes in the case the economy gets overheated. The chart below offers some guidance in formulating this discussion.



Exercise 3:

Lead a discussion about Canada's current economic fortunes. Where do the risk factors lie? (dependence on U.S. consumption and European Credit Crisis, as examples). What tools are available to dig the economy out of the cycle of economic contraction? What insights do PESTEL and Porter's Five Forces provide? How can we manage the risks that we have identified?

Questions for Discussion

1. Identify the major contributing factors that influence the economic development of a region or nation. Are there any additional factors not mentioned that you feel are significant contributors to whether a country's economy develops?

Answered on page 39 of the text.

In brief, a core requirement to the stability and growth of any economic system lies in its ability to support and promote both current and future activity. A country needs a well-developed support network in order to develop. The chart to the right, pictured on page 29, outlines several factors that are critical precursors for economic development to occur. We can see that Canada has been highly fortunate in that it surpasses requirements for each of these factors. For example, Canada's factor endowments have enabled it to develop a comparative advantage in resource extraction and trade; in the face of increasing energy costs and demand from the industrialization of countries like China and India, Canada's resource base will increasingly contribute to national income and economic growth.

One factor that is not mentioned in this figure that has a significant influence on economic development is the availability of/ ability to obtain foreign aid. It could be argued that effective legal systems, absence of corruption, manageable levels of national debt, and political stability are requirements to receive foreign aid, but historically, this has not been the case. Rather, foreign aid is often allocated to developing nations on a conditional basis; if aid is given, policy reform must be undertaken. In the past, foreign aid has been largely ineffective in promoting economic development, however, aid distribution practices are constantly evolving. For example, tied aid, which was prominent between 1950 and 1980, required the beneficiary country to purchase services from the donor country, negating the effect of aid.

Some countries do not have access to established factors of production or trading infrastructure, and as a result, they do not receive investment. If we look to Africa as an example, Swaziland, Uganda, Burkina Faso, Ethiopia, Burundi, and Malawi are all land locked nations in which less than 1% of GDP comes from the export of natural resources. These countries are not attractive to FDI. As such, aid is essential toward developing national infrastructure and averting health or hunger crises. The nine factors pictured above are all critically important to developing an economy, but if certain features are not in place, foreign aid can be essential to kick starting an economy.

Some recent research suggests that aid should be allocated to good policy environments. Allocating aid has also been shown to restore investor confidence, encouraging FDI.

Some sources to consider:

Paul Collier and David Dollar, "Aid Allocation and Poverty Reduction," *European Economic Review* 46 (2001): , accessed November 21 2010, http://www.sciencedirect.com/science/article/pii/S0014292101001878.

"Missing the Point," *The Economist*, March 14 2002, accessed November 16 2011, http://www.economist.com/node/1034243.

David Dollar and William Easterly, "The search for the key: aid, investment and policies in Africa," *Journal of African Economies* 8 (1999): , accessed November 22, 2011, http://journals2.scholarsportal.info.proxy.queensu.ca/tmp/8456260250283761337.pdf.

Calderisi, Robert. "Turning on the Lights: A Short History of Foreign Aid in Africa." In *The Trouble with Africa: Why Foreign Aid Isn't Working.* (New York: Palgrave Macmillan, 2006), 1-17.

2. What are three fundamental principles that influence a mixed economic system? Discuss the differences between the relationship of these three principles with respect to the current structure of the Canadian economy and that of a developing nation such as China or India.

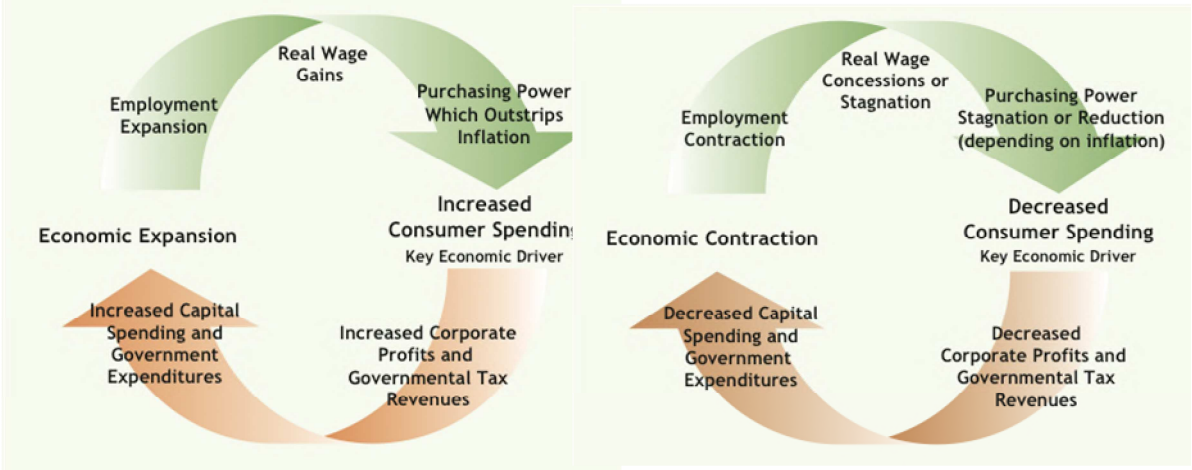
Answered on pages 43-46 of the text.
The three fundamental principles that influence a mixed economic system are: 1) the law of supply and demand; 2) government involvement; and 3) the allowance for private ownership, entrepreneurship, and wealth creation.

In Canada, markets are normally allowed to operate without intervention; prices and quantities of goods and services reflect the market equilibrium, where the economically efficient output is realized. However, Canada does not allow markets to operate without intervention, as evidenced by the existence of competition legislation. Markets also support, encourage, and promote the concepts of private enterprise, personal ownership, and entrepreneurship. Finally, government plays a variety of roles in the Canadian economy, ranging from regulator to taxation agent to manager of enterprise. The government acts through a cooperative/competitive mode, participating in the economy where it feels it is of benefit to the market as a whole.

An economy like that of China represents a controlled system, whereby the fundamentals of the law of supply and demand, private ownership, entrepreneurship, and wealth creation are largely restricted. In China, domestic enterprises are largely state-owned, and government-controlled industries account for approximately 1/3 of the country's sizeable GDP.

3. Describe the economic growth cycle. How does the cycle change between an expanding and contracting economy?

The economic growth cycle describes a positive feedback system in which GDP growth influences various facets of the economy, resulting in further growth. The reverse holds true for a contracting economy. The figures below show this cycle.



The Economic Expansion Cycle (Left, Figure 2.13, Page 51) and The Economic Contraction Cycle (Right, Figure 2.14, Page 52)

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The economic contraction cycle describes the features/ causes of a stalling economy. Consumer spending falls because people increase their savings rate. This is especially important in North American economies where consumer spending is a key driver of economic growth. This lower spending leads to lower corporate profits, and lower tax revenue for the government. As a result, investment decreases, and fewer workers are needed to support the economy. This leads to a labour supply that exceeds demand (surplus), which puts downward pressure on wages. Wage stagnation reduces or limits purchasing power, which in turn decreases consumer spending.

This cycle is a positive feedback, which begs the question: how do we overcome recessionary pressures? In the recent economic crisis, governments and central banks made significant capital infusions to ensure the liquidity of the financial sector, and to develop mechanisms for job creation with the purpose of ending this self-perpetuating cycle. This infusion was largely debt-financed and should be viewed as an abnormal, although highly necessary, response.

4. Do you think the Canadian government should modify the Canadian Investment Act and/or the Competition Act to incorporate a national security test to assess the impact a potential acquisition of a Canadian company by a foreign entity could have on our economy? Why?

Answered on page 59 of the text.

Globally, the price of energy (oil, natural gas, coal) is on the rise, as is the price of food. The nature of scarcity and differential factor endowments between nations promotes the acceptance of a realist trade perspective; nations will continue to attempt to secure the necessary resources to support their economy.

In the past 5 years, the number of Canadian-owned companies purchased by foreign firms has increase dramatically. The danger of these acquisitions: Canada is in danger of losing control of its economic base, and runs the risk of becoming a branch market economy. The decision to include a national security test in the Investment Canada Act has both costs and benefits.

The benefits of including a security test would be that industries essential to national defense (energy sector, steel manufacturing etc.) would be protected from acquisition. Canadian citizens and businesses would maintain sovereignty over critical sectors.

From an international perspective, these benefits would come at significant costs. First, as a member of the WTO, Canada's domestic policy is subject to WTO review, and amending the Investment Canada Act could justify retaliatory trade practices from trading partners. In addition, economic welfare would be reduced because this action would restrict free trade, and prevent Canada and its trading partners from specializing in the industries in which they possess a comparative advantage.

5. What is meant by a PESTEL analysis? How does it assist managers in better understanding changes that are occurring within the market sector in which their companies compete?

Answered on page 64 of the text.

A PESTEL analysis considers macro level Political, Economic, Social, Technological Environmental, and Legal changes that could influence the business' operations. For example, an analysis of political factors might involve looking for trends in government legislation or activity that could alter the management of the economy, such as interest rate changes, more strict anti-trust (monopoly) legislation, or trade policy.

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A PESTEL analysis forces managers to look outside of their business or their narrowly defined industry, and consider larger scale market and non-market risk factors that could stand to influence its future growth, profitability, or sustainability. A thorough understanding of market risk factors allows managers to prepare communication and contingency plans, and in the event of change, respond rapidly and effectively.

Additional Discussion Questions

Briefly describe the four competitive models. Provide examples of industries that fit into each of these categories.

Answer on pages 55-56 in the text.

Explain why a low, stable inflation rate is essential for an economy to prosper. What mechanisms are in place for the government to regulate inflation?

Answer on pages 46-47 of the text.

This chapter presents a number of trends that stand to impact the Canadian market in the coming years. Prioritize these trends based on their potential to influence future economic welfare in Canada. Explain your thought process.

Answer with reference to pages 56-63.

Case for Discussion – McDonald's Corporation – How to Restore the Golden Arches

This chapter presents a number of industries (music, books) that are in flux as a result of changing market conditions. The Quick Service Restaurant (QSR) sector is no different, and the reigning champion, McDonald's Corporation, is facing significant headwinds as it tries to establish a foothold in a rapidly changing industry. Sales are down worldwide as a result of food safety issues, supply chain issues, expense creep, and changing consumer tastes. Factor in political, economic, and legal factors, and McDonald's has reason for concern. The purpose of this discussion is to discuss how McDonald's, under their new CEO Steve Easterbrook, can weather the QSR storm.

1. Using the PESTEL and Market Structure business models, identify the key macro-level shifts/changes that McDonald's management must respond to as they reestablish their position in the North American marketplace?

- **Political**: Pending minimum wage legislation will affect how much McDonald's must pay their staff, eroding margins in the process.
- **Economic**: Price sensitivity. Average Sales per Customer are down, revealing a trend that may indicate consumers are feeling the cash pinch of increasing debt load. Expense creep will continue to erode margins as well.
- **Social**: Demographic shifts and changing consumer tastes. Consumers prefer what they perceive to be healthier options (e.g. Chipotle). Family tastes are changing as well, as demonstrated by a decline in the share of "family with kids under 12" market. Food safety and supplier scandals in international markets also influence how consumers perceive McDonald's

- **Technological**: New application-based delivery services (e.g. UberFresh) may impact how consumers perceive and consume McDonald's. Are there any appliance innovations that may improve McDonald's prep time?
- **Environmental**: This coincides with changing consumer tastes, as there is a growing awareness of how carbon intensive farming meat protein can be. Consumers are continuing to seek out organizations that pledge to be environmentally conscious in their operations. McDonald's must consider addressing these concerns.
- **Legal**: Labour relations and workers rights violations. This must be addressed because it can result in poor publicity in addition to costly legal disputes that erode profit margins.

2. Now focus on the industry and the QSR and Fast Casual sectors. Use Porter's Five Forces model to identify issues/challenges

- **Rivalry among existing competitors**: there are a number of existing competitors such as Burger King and Wendy's who have been around for years. However, changing consumer tastes threaten all of these existing competitors, as they tend to be perceived as unhealthy, environmentally destructive organizations. These competitors are continually tweaking their menus and improving their products to try and regain deserting consumers, and this is a challenge for McDonald's
- **Threat of new entrants**: Fast casual and gourmet burger chains seem to be popping up all the time, and seriously threaten McDonald's customer base. For example, The Burger's Priest, a chain based in Toronto, has seen its number of stores climb from 1 to 9 in just four years. Shake Shack, a chain based in New York, recently launched its IPO with the plans to expand westward across the United States and around the globe
- **Threat of substitute products**: This is a big challenge, and is related to the threat of new entrants because they offer what consumers perceive as tastier, healthier, and more environmentally friendly products. Subway led the way with this, but new players such as Chipotle Mexican Grill and Panera Bread are taking significant consumer portions away from McDonald's customer base
- **Bargaining power of suppliers**: As one of the world's largest organizations, McDonald's has a lot of power over its suppliers. However, recent supplier scares in China and Japan mean that McDonald's is likely searching for new suppliers, which may impact how suppliers bargain with McDonald's (e.g. changing premiums to guarantee quality control, capitalizing on McDonald's need to guarantee quality to its customers and stabilize its tarnished image)
- **Bargaining power of buyers**: With new entrants joining the market, buyers have never had more bargaining power over McDonald's. With so many QSR restaurants to choose from, consumers are voting with their dollar every chance they get.

3. If you were advising the McDonald's management team, what are the three "high priority items you would recommend they tackle first?

- There is no correct solution here. This question is meant to stimulate discussion and debate. Changing consumer tastes is definitely a priority, as it is the main influence in a customer's choice of restaurant. McDonald's should consider trimming its vast menu size and focus on their core menu items that brought them success (Big Mac, nuggets fries, etc.). Improving consumer perception is another challenge, as McDonald's must address food quality, sanitation, and, legal, and environmental issues all at once. Focusing on Average Sales per Customer could be a priority as well.

Quiz Questions

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1. Which of the following are critical factors that will ensure our economy remains resilient and competitive now and in the future?

a) Productivity gains
b) Technological innovation
c) Lower wages
d) An exchange rate fixed to the US dollar
e) Two of the above

2. Which of the following are contributing factors to economic development?

a) Absence of corruption
b) A trade surplus
c) Low inflation
d) A and C
e) B and C

3. What is NOT one of the fundamental principles that influences an economic system? Choose all that apply (there might be more than one answer).

a) The law of supply and demand
b) Extent of government regulation
c) Trade policy
d) Allowance for private ownership, entrepreneurship, and wealth creation
e) Foreign Direct Investment

4. The primary weapon the Bank of Canada uses to control inflationary pressures in the short run is:

a) Printing less currency
b) Buying/ selling foreign currency reserves
c) Interest rate adjustments
d) Lending less money to chartered banks
e) None of the above

5. Economic activity can be understood based on which of the following factors?

a) Savings
b) Credit
c) Expenditures
d) Two of the above
e) All of the above

6. Choose the definition that best describes GDP (gross domestic product).

a) The total value of goods and services produced in a country and sold to other countries
b) The total market value of the goods and services a nation produces domestically over a period of time
c) The total market value of goods and services produced by a country's nationals over a period of time

d) The total market value of goods and services produced in a country, adjusted for inflation
e) The best way to measure economic development

7. Which of the following factors would cause Canada's GDP to decrease?

a) Decreased government spending
b) A decline in net exports (the value of exports minus the value of imports)
c) Lower levels of investment in the economy
d) An increase in the price of oil (assume that Canada is a net exporter of oil)
e) A and C

8. Choose the step that does NOT correspond to economic expansion.

a) Increased consumer spending
b) Purchasing power gains exceed inflation
c) Increased levels of government and consumer savings
d) Employment expansion
e) Increased tax revenue

9. Which of the following are chartered banks in Canada?

a) BMO
b) The Bank of Canada
c) National Bank
d) Goldman Sachs
e) A and C

10. Which of the following trends stand to impact the complexion of the Canadian economy in coming years?

a) Branch market impact
b) Geographic clustering
c) Sustainability and Green Initiatives
d) An aging workforce
e) All of the above

11. Which of the following are NOT critical indicators that reflect the general direction of the economy? (Choose one or more options)

a) Stock Market Indices (S&P 500, Dow Jones etc.)
b) Consumer Price Index
c) Crime rates
d) Consumer Confidence Index
e) Empowerment of women or minority groups

12. The acronym PESTEL refers to what six macro level factors?

a) Political, Economic, Scientific, Technological, Environmental, Legal
b) Earnings, Sales, Profitability, Targets, Equity, Liability
c) Political, Legal, Social, Environmental, Economic, Technological
d) Parliament, Legislation, Senate, Taxation, Economy, Export Balance

e) None of the above

13. Which of the following statements best describes monopolistic competition?

a) Markets with similar products in which no single competitor has a dominant position. Differentiation is absent, and there are few barriers to entry.
b) Markets served by a single supplier.
c) Markets that contain a small number of suppliers that control a large percentage of market share, and offer differentiated products.
d) Markets that possess a number of different suppliers of products and services but the nature of the product or service and the associated marketing effort has enabled true differentiation to set in.
e) None of the above

14. Choose the statement that is TRUE.

a) The telecom industry in Canada is best described as an oligopoly based market
b) The wheat farming sector is monopolistically competitive
c) The delivery of Utilities like energy and natural gas is generally achieved through an oligopolistic market structure
d) The automotive industry in the 1970s was an oligopoly – based market
e) None of the above are true

15. A Porter's Five Forces analysis can help managers ascertain:

a) The probability that our product or service could be rendered obsolete by substitutes
b) The level of competitive rivalry that prevails in an industry
c) The profit potential of an industry
d) Two of the above
e) All of the above