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Financial
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- Expansion of marketing management
- Reestablishment of relations with Cuba
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- New entrepreneurship feature: “Uber Takes on Taxi Industry”
- New Figures: Figure 1.3 “Average Annual Unemployment Rate, Civilian Labor Force 16 Years and Over” and Figure 1.4 “Growth in U.S. Gross Domestic Product”
- New information on deflation
- New Table 1.2 “Economic Indicators of Different Countries”
- New paragraph on standard of living
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- Link between diversity and financial performance

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- European antitrust investigation into Google
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the dynamics of business and economics



LEARNING OBJECTIVES

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After reading this chapter, you will be able to:

- | | |
|---|--|
| LO 1-1 Define basic concepts such as business, product, and profit. | LO 1-4 Describe the role of supply, demand, and competition in a free-enterprise system. |
| LO 1-2 Identify the main participants and activities of business and explain why studying business is important. | LO 1-5 Specify why and how the health of the economy is measured. |
| LO 1-3 Define economics and compare the four types of economic systems. | LO 1-6 Trace the evolution of the American economy and discuss the role of the entrepreneur in the economy. |

We begin our study of business in this chapter by examining the fundamentals of business and economics. First, we introduce the nature of business, including its goals, activities, and participants. Next, we describe

the basics of economics and apply them to the United States economy. Finally, we establish a framework for studying business in this text. ■

LO 1-1 Define basic concepts such as business, product, and profit.

THE NATURE OF BUSINESS

A **business** tries to earn a profit by providing products that satisfy people's needs and wants. The outcomes of its efforts are **products** that have both tangible and intangible characteristics that provide satisfaction and benefits. When you purchase a product, you are buying the benefits and satisfaction you think the product will provide. A Subway sandwich, for example, may be purchased to satisfy hunger, while a Honda Accord may be purchased to satisfy the need for transportation and the desire to present a certain image.

Most people associate the word *product* with tangible goods—an automobile, smartphone, coat, or some other tangible item. However, a product can also be a service, which occurs when people or machines provide or process something of value to customers. Dry cleaning, a checkup by a doctor, a movie or sports event—these are examples of services. Some services, such as Instagram, an online mobile photo and video sharing service, do not charge a fee for use but obtain revenue from ads on their sites. A product can also be an idea. Accountants and attorneys, for example, generate ideas for solving problems.

The Goal of Business

The primary goal of all businesses is to earn a **profit**, the difference between what it costs to make and sell a product and what a customer pays for it. If a company spends \$8 to manufacture, finance, promote, and distribute a product that it sells for \$10, the business earns a profit of \$2 on each product sold. Businesses have the right to keep and use their profits as they choose—within legal limits—because profit is the reward for the risks they take in providing products. Earning profits contributes to society by creating resources that support our social institutions and government. Businesses that create profits, pay taxes, and create jobs are the foundation of our economy. In addition, profits must be earned in a responsible manner. Not all organizations are businesses, however. **Nonprofit organizations**, such as National Public Radio (NPR), Habitat for Humanity, and other charities and social causes, do not have the fundamental purpose of earning profits, although they

may provide goods or services and engage in fundraising. Profits earned by businesses support nonprofit organizations through donations from employees.

To earn a profit, a person or organization needs management skills to plan, organize, and control the activities of the business and to find and develop employees so that it can make products consumers will buy. A business also needs marketing expertise to learn what products consumers need and want and to develop, manufacture, price, promote, and distribute those products. Additionally, a business needs financial resources and skills to fund, maintain, and expand its operations. Other challenges for businesspeople include abiding by laws and government regulations; acting in an ethical and socially responsible manner; and adapting to economic, technological, political, and social changes. Even nonprofit organizations engage in management, marketing, and finance activities to help reach their goals.

To achieve and maintain profitability, businesses have found that they must produce quality products, operate efficiently, and be socially responsible and ethical in dealing with customers, employees, investors, government regulators, and the community. Because these groups have a stake in the success and outcomes of a business, they are sometimes called **stakeholders**. Many businesses, for example, are concerned about how the production and distribution of their products affect the environment. New fuel requirements are forcing automakers to invest in smaller, lightweight cars. During times of low fuel prices, consumers tend to prefer bigger sport-utility vehicles (SUVs) and trucks, putting more of a strain on automakers to meet environmental requirements as well as consumer demands.¹ Others are

business individuals or organizations who try to earn a profit by providing products that satisfy people's needs.

product a good or service with tangible and intangible characteristics that provide satisfaction and benefits.

profit the difference between what it costs to make and sell a product and what a customer pays for it.

nonprofit organizations organizations that may provide goods or services but do not have the fundamental purpose of earning profits.

stakeholders groups that have a stake in the success and outcomes of a business.



Consumers search for organic and locally grown vegetables to support sustainability.

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concerned with promoting science, engineering, and mathematics careers among women. Traditionally these careers have been male-dominated. The Association for Women in Science focuses on helping women reach their full potential in these underrepresented fields.² Other companies, such as Home Depot, have a long history of supporting natural disaster victims, relief efforts, and recovery.

LO 1-2 Identify the main participants and activities of business and explain why studying business is important.

The People and Activities of Business

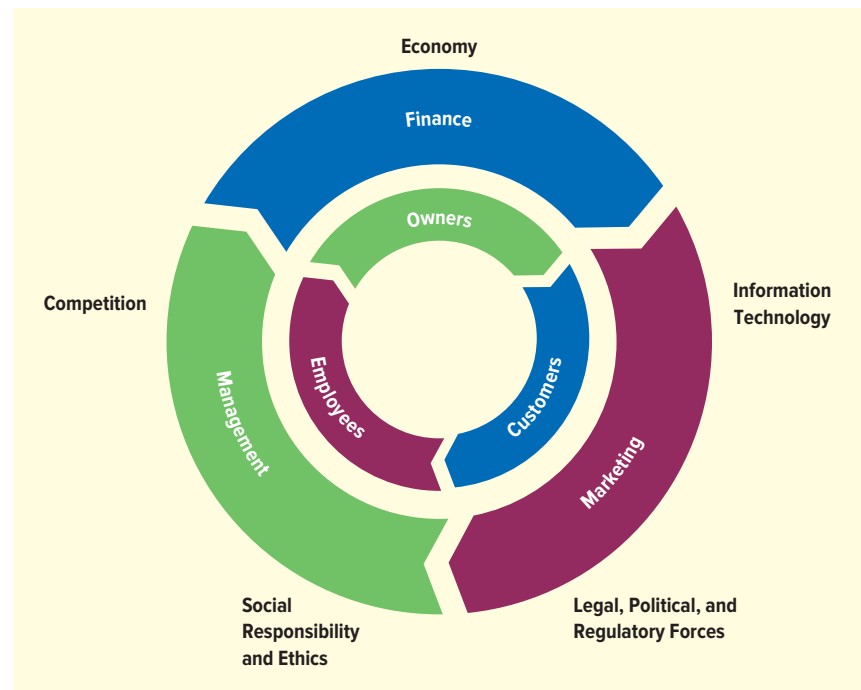
Figure 1.1 shows the people and activities involved in business. At the center of the figure are owners, employees, and customers; the outer circle includes the primary business activities—management, marketing, and finance. Owners have to put up resources—money or credit—to start a business. Employees are responsible for the work that goes on within a business. Owners can manage the business themselves or hire employees to accomplish this task. The president, CEO, and chair of the board of Procter & Gamble, David Taylor, does not own P&G, but is an employee who is responsible for managing all the other employees in a way that earns a profit for investors, who are the real owners. Finally, and most importantly, a business’s major role is to satisfy the customers who buy its goods or services. Note also that people and forces beyond an organization’s control—such as legal and regulatory forces, the economy, competition, technology, the political environment, and ethical and

social concerns—all have an impact on the daily operations of businesses. You will learn more about these participants in business activities throughout this book. Next, we will examine the major activities of business.

Management Notice that in Figure 1.1 management and employees are in the same segment of the circle. This is because management involves developing plans, coordinating employees’ actions to achieve the firm’s goals, organizing people to work efficiently, and motivating them to achieve the business’s goals. Management involves the functions of planning, organizing, leading, and controlling. Effective managers who are skilled in these functions display effective leadership, decision making, and implementation of work tasks. Management is also concerned with acquiring, developing, and using resources (including people) effectively and efficiently. Amazon enlists workers and suppliers through its Vendor Flex Program to make distribution more efficient.³

Operations is another element of management. Managers must oversee the firm’s operations to ensure that resources are successfully transformed into goods and services. Although most people associate operations with the development of goods, operations management applies just as strongly to services. Managers at the Ritz-Carlton, for instance, are concerned with transforming resources such as employee actions and hotel amenities into a quality customer service experience. In essence, managers plan, organize, staff, and control the tasks required to carry out the work of the company or nonprofit organization. We take a closer look at management activities in Parts 3 and 4 of this text.

FIGURE 1.1
Overview of the Business World



Marketing Marketing and consumers are in the same segment of Figure 1.1 because the focus of all marketing activities is satisfying customers. Marketing includes all the activities designed to provide goods and services that satisfy consumers' needs and wants. Marketers gather information and conduct research to determine what customers want. Using information gathered from marketing research, marketers plan and develop products and make decisions about how much to charge for their products and when and where to make them available. They also analyze the marketing environment to see if products need to be modified. Marketing focuses on the 4 Ps—product, price, place (or distribution), and promotion—also known as the marketing mix. Product management involves such key management decisions as product adoption or deletion, branding, and product positioning. Selecting the right price for the product is essential to the organization as it relates directly to profitability. Distribution is an important management concern because it involves making sure products are available to consumers in the right place at the right time. Marketers use promotion—advertising, personal selling, sales promotion (coupons, games, sweepstakes, movie tie-ins), and publicity—to communicate the benefits and advantages of their products to consumers and increase sales.



Mars, Inc. uses humorous advertising featuring its M&M's® spokescharacters to stimulate interest in M&M's® Chocolate Candies and Starburst® Jellybeans.

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Nonprofit organizations also use promotion. For example, the National Fluid Milk Processor Promotion Board's "milk mustache" advertising campaign has featured Brooke Shields, Beyoncé Knowles, Sheryl Crow, Elizabeth Hurley, Serena Williams, and even animated "celebrities" such as Garfield.⁴ We will examine marketing activities in Part 5 of this text.

Finance Owners and finance are in the same part of Figure 1.1 because, although management and marketing have to deal with financial considerations, it is the primary responsibility of the owners to provide financial resources for the operation of the business. Moreover, the owners have the most to lose if the business fails to make a profit. Finance refers to all activities concerned with obtaining money and using it effectively. People who work as accountants, stockbrokers, investment advisors, or bankers are all part of the financial world. Owners sometimes have to borrow money from banks to get started or attract additional investors who become partners or stockholders. Owners of small businesses in particular often rely on bank loans for funding. Financial management is discussed later in the text.

Why Study Business?

Studying business can help you develop skills and acquire knowledge to prepare for your future career, regardless of whether you plan to work for a multinational Fortune 500 firm, start your own business, work for a government agency, or manage or volunteer at a nonprofit organization. The field of business offers a variety of interesting and challenging career opportunities throughout the world, such as marketing, human resources management, information technology, finance, production and operations, wholesaling and retailing, and many more.

Studying business can also help you better understand the many business activities that are necessary to provide satisfying goods and services—and that these activities carry a price tag. For example, if you buy a DVD or Blu-ray disc, about half of the price goes toward activities related to distribution and the retailer's expenses and profit margins. The production (pressing) of the disc represents about \$1, or a small percentage of its price. Most businesses charge a reasonable price for their products to ensure that they cover their production costs, pay their employees, provide their owners with a return on their investment, and perhaps give something back to their local communities and societies. Bill Daniels founded Cablevision, building his first cable TV system in Casper, Wyoming, in 1953, and is now considered "the father of cable television." Prior to Daniels's passing in 2000, he had established a foundation that currently has funding of \$1.1 billion and supports a diversity of causes from education to business ethics. During his career, Daniels created the Young Americans Bank, where children could create bank accounts and learn about financial responsibility, and this remains the world's only charter bank for young people. He named the Daniels College of Business through a donation of \$20 million to the University of Denver. During his life, he affected many individuals and organizations, and his business success has allowed his legacy to be one of giving and impacting communities throughout the United States.⁵ Most

economics the study of how resources are distributed for the production of goods and services within a social system.

natural resources land, forests, minerals, water, and other things that are not made by people.

human resources the physical and mental abilities that people use to produce goods and services; also called labor.

financial resources the funds used to acquire the natural and human resources needed to provide products; also called capital.

capital the funds used to acquire the natural and human resources needed to provide products; also called financial resources.

of the profits he earned in business continue to support nonprofit organizations and society. Thus, learning about business can help you become a well-informed consumer and member of society.

Business activities help generate the profits that are essential not only to individual businesses and local economies but also to the health of the global economy. Without profits, businesses find it difficult, if not impossible, to buy more raw materials, hire more employees, attract more capital, and create additional products that in turn make more profits and fuel the world economy. Understanding how our free-enterprise economic system allocates resources and provides incentives for industry and the workplace is important to everyone.

LO 1-3 Define economics and compare the four types of economic systems.

THE ECONOMIC FOUNDATIONS OF BUSINESS

To continue our introduction to business, it is useful to explore the economic environment in which business is conducted. In this section, we examine economic systems, the free-enterprise system, the concepts of supply and demand, and the role of competition. These concepts play important roles in determining how businesses operate in a particular society.

Economics is the study of how resources are distributed for the production of goods and services within a social system. You are already familiar with the types of resources available. Land, forests, minerals, water, and other things that are not made by people are **natural resources**. **Human resources**, or labor, refer to the physical and mental abilities that people use to produce goods and services. **Financial resources**, or **capital**, are the funds used to acquire the natural and human resources needed to provide products. These resources are related to the *factors of production*, consisting of land, labor, capital, and enterprise used to produce goods and services. The firm can also have intangible resources such as a good reputation for quality products or being socially responsible. The goal is to turn the factors of production and intangible resources into a competitive advantage.

Economic Systems

An **economic system** describes how a particular society distributes its resources to produce goods and services. A central issue of economics is how to fulfill an unlimited demand



The Young Americans Bank in Denver was created by cable magnate Bill Daniels. It is the only chartered bank in the world that makes loans to children.

Courtesy of Young Americans Center for Financial Education

for goods and services in a world with a limited supply of resources. Different economic systems attempt to resolve this central issue in numerous ways, as we shall see.

Although economic systems handle the distribution of resources in different ways, all economic systems must address three important issues:

1. What goods and services, and how much of each, will satisfy consumers' needs?
2. How will goods and services be produced, who will produce them, and with what resources will they be produced?
3. How are the goods and services to be distributed to consumers?

Communism, socialism, and capitalism, the basic economic systems found in the world today (Table 1.1), have fundamental differences in the way they address these issues. The factors of production in command economies are controlled by government planning. In many cases, the government owns or controls the production of goods and services. Communism and socialism are, therefore, considered command economies.

Communism Karl Marx (1818–1883) first described **communism** as a society in which the people, without regard to

class, own all the nation's resources. In his ideal political-economic system, everyone contributes according to ability and receives benefits according to need. In a communist economy, the people (through the government) own and operate all businesses and factors of production. Central government planning determines what goods and services satisfy citizens' needs, how the goods and services are produced, and how they are distributed. However, no true communist economy exists today that satisfies Marx's ideal.

On paper, communism appears to be efficient and equitable, producing less of a gap between rich and poor. In practice, however, communist economies have been marked by low standards of living, critical shortages of consumer goods, high prices, corruption, and little freedom. Russia, Poland, Hungary, and other eastern European nations have turned away from communism and toward economic systems governed by supply and demand rather than by central planning. However, their experiments with alternative economic systems have been fraught with difficulty and hardship. Cuba continues to apply communist principles to its economy, but Cuba is also experiencing economic and political change. Countries such as Venezuela have tried to incorporate communist economic principles. However, Venezuela has experienced economic failures even with large oil resources. Other communist countries have encountered similar difficulties. As a result of these economic challenges, communism is declining and its future as an economic system is uncertain. Even Cuba is experiencing changes to its predominately communist system. Massive government layoffs required many Cubans to turn toward the private sector, opening up more opportunities for entrepreneurship. President Obama has called for the reestablishment of relations with Cuba and an end to the embargo. Americans have more opportunities to visit Cuba than they have had for the past 50 years, although they still must apply for licenses and have one of 12 approved reasons for traveling there.⁶ Similarly, China has become the first communist country

economic system a description of how a particular society distributes its resources to produce goods and services.

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socialism an economic system in which the government owns and operates basic industries but individuals own most businesses.

to make strong economic gains by adopting capitalist approaches to business. The Chinese state is the largest shareholder among China's 150 largest companies and influences thousands of other businesses.⁷ Economic prosperity has advanced in China with the government claiming to ensure market openness, equality, and fairness through state capitalism.⁸

Socialism Socialism is an economic system in which the government owns and operates basic industries—postal service, telephone, utilities, transportation, health care, banking, and some manufacturing—but individuals own most businesses. For example, in France the postal service industry La Poste is fully owned by the French government and makes a profit. Central planning determines what basic goods and services are produced, how they are produced, and how they are distributed. Individuals and small businesses provide other goods and services based on consumer demand and the availability of resources. Citizens are dependent on the government for many goods and services.

Most socialist nations, such as Sweden, India, and Israel, are democratic and recognize basic individual freedoms. Citizens can vote for political offices, but central government planners usually make decisions about what is best for the nation. People are free to go into the occupation of their choice, but they often work in government-operated organizations. Socialists believe their system permits a higher standard of living than other economic systems, but the difference often applies to the nation as a whole rather than to its individual citizens. Socialist economies profess egalitarianism—equal distribution of income and social services. They believe their economies are more stable than those of other nations. Although this may be true, taxes and unemployment are generally higher in socialist countries.

▼ **TABLE 1.1** Comparison of Communism, Socialism, and Capitalism

	Communism	Socialism	Capitalism
Business ownership	Most businesses are owned and operated by the government.	The government owns and operates some major industries; individuals own small businesses.	Individuals own and operate all businesses.
Competition	Government controls competition and regulates the economy.	Restricted in major industries; encouraged in small business.	Encouraged by market forces and government regulations.
Profits	Excess income goes to the government. The government supports economic and political institutions.	Profits earned by small businesses may be reinvested in the business; profits from government-owned industries go to the government.	Individuals and businesses are free to keep profits and use them as they wish after paying taxes.
Product availability and price	Consumers have a limited choice of goods and services; prices are usually high.	Consumers have some choice of goods and services; prices are determined by supply and demand.	Consumers have a wide choice of goods and services; prices are determined by supply and demand.
Employment options	Little choice in choosing a career; most people work for government-owned industries or farms.	More choice of careers; many people work in government jobs.	Unlimited choice of careers.

capitalism (free enterprise) an economic system in which individuals own and operate the majority of businesses that provide goods and services.

free-market system pure capitalism, in which all economic decisions are made without government intervention.

mixed economies economies made up of elements from more than one economic system.

demand the number of goods and services that consumers are willing to buy at different prices at a specific time.

of the ways in which the United States and Canadian governments regulate business is through laws.



The Federal Trade Commission enforces anti-trust laws and monitors businesses to ensure fair competition.
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Laws such as the Federal Trade Commission Act, which created the Federal Trade Commission to enforce antitrust laws, illustrate the importance of the government's role in the economy. In the last recession, the government provided loans and took ownership positions in banks such as Citigroup, AIG (an insurance company), and General Motors. These actions were thought necessary to keep these firms from going out of business and creating a financial disaster for the economy.

Mixed Economies No country practices a pure form of communism, socialism, or capitalism, although most tend to favor one system over the others. Most nations operate as **mixed economies**, which have elements from more than one economic system. In socialist Sweden, most businesses are owned and operated by private individuals. In capitalist United States, an independent federal agency operates the postal service and another independent agency operates the Tennessee Valley Authority, an electric utility. In Great Britain and Mexico, the governments are attempting to sell many state-run businesses to private individuals and companies. In Germany, the Deutsche Post is privatized and trades on the stock market. In once-communist Russia, Hungary, Poland, and other eastern European nations, capitalist ideas have been implemented, including private ownership of businesses.

Perhaps as a result, many socialist countries have also experienced economic difficulties.

Capitalism **Capitalism**, or **free enterprise**, is an economic system in which individuals own and operate the majority of businesses that provide goods and services. Competition, supply, and demand determine which goods and services are produced, how they are produced, and how they are distributed. The United States, Canada, Japan, and Australia are examples of economic systems based on capitalism.

There are two forms of capitalism: pure capitalism and modified capitalism. In pure capitalism, also called a **free-market system**, all economic decisions are made without government intervention. This economic system was first described by Adam Smith in *The Wealth of Nations* (1776). Smith, often called the “father of capitalism,” believed that the “invisible hand of competition” best regulates the economy. He argued that competition should determine what goods and services people need. Smith’s system is also called *laissez-faire* (“let it be”) **capitalism** because the government does not interfere in business.

Modified capitalism differs from pure capitalism in that the government intervenes and regulates business to some extent. One

“Free enterprise provides an opportunity for a business to succeed or fail on the basis of market demand.”

Countries such as China and Russia have used state capitalism to advance the economy. State capitalism tries to integrate the powers of the state with the advantages of capitalism. It is led by the government but uses capitalistic tools such as listing state-owned companies on the stock market and embracing globalization.⁹ State capitalism includes some of the world’s largest companies such as Russia’s Gazprom, which is the largest natural gas company. China’s ability to make huge investments to the point of creating entirely new industries puts many private industries at a disadvantage.¹⁰ However, economists believe that state-run capitalism can contribute only so much to growth because officials cannot distribute resources as well as the market can.¹¹

The Free-Enterprise System

Many economies—including those of the United States, Canada, and Japan—are based on free enterprise, and many communist and socialist countries, such as China and Russia, are

applying more principles of free enterprise to their own economic systems. Free enterprise provides an opportunity for a business to succeed or fail on the basis of market demand. In a free-enterprise system, companies that can efficiently manufacture and sell products that consumers desire will probably succeed. Inefficient businesses and those that sell products that do not offer needed benefits will likely fail as consumers take their business to firms that have more competitive products.

A number of basic individual and business rights must exist for free enterprise to work. These rights are the goals of many countries that have recently embraced free enterprise.

1. Individuals must have the right to own property and to pass this property on to their heirs. This right motivates people to work hard and save to buy property.
2. Individuals and businesses must have the right to earn profits and to use the profits as they wish, within the constraints of their society's laws, principles, and values.
3. Individuals and businesses must have the right to make decisions that determine the way the business operates. Although there is government regulation, the philosophy in countries like the United States and Australia is to permit maximum freedom within a set of rules of fairness.
4. Individuals must have the right to choose what career to pursue, where to live, what goods and services to purchase, and more. Businesses must have the right to choose where to locate, what goods and services to produce, what resources to use in the production process, and so on.

Without these rights, businesses cannot function effectively because they are not motivated to succeed. Thus, these rights make possible the open exchange of goods and services. In the countries that favor free enterprise, such as the United States, citizens have the freedom to make many decisions about the employment they choose and create their own productivity systems. Many entrepreneurs are more productive in free-enterprise societies because personal and financial incentives are available that can aid in entrepreneurial success. For many entrepreneurs, their work becomes a part of their system of goals, values, and lifestyle. Consider the panelists (“sharks”) on the ABC program *Shark Tank*. Panelists on *Shark Tank* give entrepreneurs a chance to receive funding to realize their dreams by deciding whether to invest in their projects. They include Barbara Corcoran, who built one of New York’s largest real estate companies; Mark Cuban, founder of Broadcast.com and MicroSolutions; and Daymond John, founder of clothing company FUBU.¹²

LO 1-4 Describe the role of supply, demand, and competition in a free-enterprise system.

The Forces of Supply and Demand

In the United States and in other free-enterprise systems, the distribution of resources and products is determined by supply and demand. **Demand** is the number of goods and services that

SUPPLY AND DEMAND IN ACTION: RUSSIA’S BAN OF EU FOOD TRIGGERS LOWER PRICES

Conflicts with other countries can impact the equilibrium price of certain products, which in turn can lead to changes in the economic cycle. Many Western powers—including the United States and the European Union (EU)—placed economic sanctions on Russia due to the conflicts in the Ukraine. Russia struck back, imposing a one-year embargo on a number of agricultural imports from any country sanctioning Russia. This had an immediate impact on the EU, where exports to Russia comprise a significant portion of the fruit, vegetable, dairy, and meat markets. Suddenly, a \$6.5 billion export market halted.

A visible effect of the embargo included lower food prices across Europe. Considering the perishable nature of agricultural products, many producers have been forced to immediately switch to selling their surplus within

the EU. This influx of supply, without any corresponding increase in consumer demand, provided a real-world demonstration of the classic supply and demand chart—prices plummeted. For example, in 2014 the cost of Dutch cucumbers and tomatoes had dropped 80 percent; in the Czech Republic, apple prices were down 70 percent; and Spanish, Italian, and Greek peaches and nectarines were selling at 30–50 percent cheaper.

While these price drops seem wonderful for consumers, producers facing lower prices were unable to turn a profit, which harmed their future viability and the long-term health of major European industries. The EU acknowledged this and called special meetings and provided emergency support measures for the worst-affected markets. This situation demonstrates how major

changes in supply and demand brought about by trading conflicts can have an immediate impact on a nation’s (or trade bloc’s) economy.¹³

Discussion Questions

1. Analyze the EU’s food price deflation using the theories of supply and demand, and chart what has happened on a supply and demand graph.
2. How important to business is the surrounding political and regulatory environment? How can businesses best deal with volatile political situations that might end up affecting them?
3. What are some ways the EU and its agricultural producers can deal with their oversupply and deflation issues?