

SOLUTIONS MANUAL



better business



solomon | poatsy | martin

Chapter 2
Small Business and the Entrepreneur
Better Business, 1e
End Of Chapter Answers

SELF TEST

Multiple Choice

1. d

2. b

3. a

4. c

5. a

6. a

7. b

8. d

9. b

10. c

True/False

1. False

2. True

3. True

4. False

5. False

CRITICAL THINKING Suggested Answers

1. Technology changes in the printing industry have resulted in lower costs of production and higher levels of productivity. Technology advances have also opened the door for more companies to enter the print publishing business. These factors increase the supply of printed material. An increase in supply (shown graphically as a rightward shift of the supply curve) puts downward pressure on the price of printed materials and increases the quantity bought and sold. However, at the same time, the Internet and the availability of immediate news via web-based products has decreased the demand for printed materials. A decrease in demand (reflected graphically as a leftward shift of the demand curve) puts downward pressure on the price of printed materials and decreases the quantity bought and sold. The combined effects of a simultaneous increase in supply, and a decrease in the demand for printed materials unequivocally decreases the price charged for printed materials (because both put downward pressure on the price). However, we are uncertain about the impact on the quantity traded. This would depend on the magnitude of the increase in supply and the decrease in the demand for printed materials as a result of technological advances.

2. It is possible that we could experience an increase in the number of jobs, or people employed, but still experience an increase in the unemployment rate. This can happen because as population grows, more people seek jobs in the labor market. Many of these new job-seekers may find work increasing the absolute number of people employed. However, the *percent* of people seeking a job *and* finding employment may not rise. Therefore the unemployment rate can rise even though there are a greater number of people employed. The unemployment rate is a better measure of economic performance because it is a *relative* measure of economic activity. That is, a falling unemployment rate

means the economy is performing better because a greater *percentage* of a growing labor force is able to find work. The trick is to get the economy to grow (increase in GDP over time) at least fast enough to absorb the growing labor force. If it doesn't grow fast enough then the unemployment rate (the percent of people seeking and unable to find work) can rise even though the absolute number of people working rises.

3. Results will vary depending on the phase of the business cycle currently underway.

Although economic indicators are closely watched by many people, the driving force behind changes in all of them is the amount of overall demand, or total spending, on products. If total spending (the demand for products) rises then businesses will produce more products to satisfy this increase in demand. More production generates a greater demand for workers and pushes the unemployment rate down. A greater percentage of the labor force employed translates into a higher overall income level for households and people go shopping. This increased spending generates still more sales, more production, more jobs and more income to spend. This is what happens during an expansionary phase of the business cycle. On the other hand, a decrease in total spending in the national economy results in fewer business sales. Businesses respond by cutting back on their rate of production, lay off workers and the unemployment rate rises. As unemployment rises people have less income to spend. Spending and sales fall. Businesses produce less and production falls further generating still more unemployment and less income to spend, etc. This is what happens during a recession. Economic indicators try to forecast changes in total spending in an economy in an attempt to forecast changes in the business cycle.

4. Capitalism has the advantages of efficiency and freedom. The capitalist system is extremely efficient in allocating scarce resources into the production of those goods and

services most desired by society. Competition among businesses ensures this. Business must first produce products people want or they will fail. Moreover, they must produce these goods and services efficiently in order to minimize their costs to remain price competitive. There is also a lot of economic freedom of enterprise and choice. That is, there is a minimal role for government. Business people and consumers are largely free from government influence to pursue their own self-interests.

A few disadvantages emerge from capitalism (sometimes called market failures because the market mechanism inherent within capitalism fails to promote the general well-being of society). These include monopoly power (monopolies produce less and charge higher prices), the over- or underproduction of some products (society may want more or less of some goods and services because of their social consequences—we would want fewer products that may damage the environment for example; but more education because of its social benefits), the lack of public goods and services (some goods and services may be so beneficial to society that they are so grossly under-produced by private companies that people call on government to provide for them—examples roads, bridges, police departments and national defense), an inequitable or unfair distribution of income (some people may argue that the distribution of income is not fair and government ought to intervene to redistribute income), and macroeconomic instability (we have a business cycle that creates problems like unemployment and inflation that hurts people).

Advocates for socialism point to a more fair distribution of income and the opportunity for government to address many of the other shortcomings or market failures associated with capitalism. However, just as the market system can fail, so too can

government fail. Government failure, failure to improve the well being of society, often results from corruption, ignorance or succumbing to special interest group political pressure. The major disadvantage associated with socialism is that it is inefficient in producing a combination of products most desired by society and doing it in a cost-effective manner. State-run economies determine what they think ought to be produced and are wrought with bureaucratic inefficiency and significantly higher costs. After all, there are no competitive pressures to produce what the people want and to keep costs down. Critics of socialism also point to a reduced degree of freedom for individuals to pursue their own self-interests.

5. Although GDP is often used to indicate the economic well-being of a country, it really measures only how much we *spend and therefore produce*. It really doesn't indicate the *well-being* of a society or economy. It's a subtle distinction, but critics point out that what is included in the GDP are expenditures toward some of the negative aspects of the economy, such as cleaning up the environment after a bad oil spill, the costs associated with fighting crime, treating illnesses associated with smoking, to name a few. These expenditures increase GDP and we may be better off. On the other hand, the GDP does not include the economic activity associated with goods produced at home but not sold (cooking, gardening, crafts), the sale of used goods, or charitable donations and volunteerism. A case in point is national disaster incurred by weather, such as Hurricane Katrina in 2005. Oddly, factoring in the increases in the construction, equipment, service, and industrial supply industries used to rebuild New Orleans and the other regions severely damaged by the hurricane, the disaster will end up having a more positive impact on the nation's GDP than negative, even though the *well-being* of that region will

be hurt for a long time. What also are not tallied into the GDP are the massive amounts of donations of money, supplies and volunteer time. The positive impact of the volunteer efforts, the significant amounts of donations and grants attributed to Hurricane Katrina and other disasters do not show in the GDP and do not reflect the activity of our society since these volunteer and donated activities do not produce a final good or service that are purchased. But since these variations are difficult to measure domestically, and to compare internationally, the current method of computing GDP is adequate and still a good economic measure.

TEAM TIME

Responses will vary for each group.

ETHICS AND CORPORATE SOCIAL RESPONSIBILITY

Economic Inequality

Responses will vary for each group.

WEB EXERCISES

Responses to Web Exercises will vary.