Better Business 5th edition Solomon Solutions Manual

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Better Business, 5e **(Solomon/Poatsy/Martin)**
Chapter 2 Economics and Banking

1) The main function of economics is to study _____.
A) the exchange of goods and services between individuals, businesses, and nations
B) the exchange of cultural information in a diverse society
C) the stock exchange
D) the exchange of diplomatic relations between nations
E) the exchange of ideas about motivation and behavior in the workplace
Answer: A
Explanation: Economics is the study of how individuals and businesses make decisions to best satisfy wants, needs, and desires with limited resources. It is about businesses making goods or supplying services that we want or need to buy.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept

2) Celeste is interested in studying the effects that natural disasters have on the value of goods and services in the affected areas. Her area of study should be _____.
A) marketing
B) microeconomics
C) macroeconomics
D) sociology
E) sustainability
Answer: B
Explanation: Microeconomics is the study of how individuals, businesses, households, and consumers allocate their resources in exchange for goods and services. Marketing is the process or technique of selling goods to consumers. Macroeconomics is the study of the behavior of the economy as a whole. Sociology is the study of social relations and change. Sustainability is the use of resources without permanently depleting or damaging the resource.
Diff: 2
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Application

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3) Joseph took a class in macroeconomics, which means that he was studying the behavior of _____.
A) individual businesses
B) people with limited resources
C) the overall economy
D) corporate executives
E) Fortune 500 companies
Answer: C
Explanation: Macroeconomics is the study of the behavior of the economy as a whole. The study of behavior of individual businesses, people with limited resources, corporate executives, and Fortune 500 companies would fall under the area of microeconomics.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept

4) A free market economy is one in which _____.
A) the government or other centralized group determines what to produce
B) individuals determine what to produce with some level of government involvement
C) the government controls healthcare while privately owned businesses operate in other market sectors
D) individuals and private firms make decisions based on consumer needs and wants
E) privately owned, profit-seeking enterprises are converted to government-owned production and services
Answer: D
Explanation: A market economy is run entirely by individuals and businesses with no government involvement. The other responses refer to planned and mixed economies.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

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5) A mixed economy is one in which _____.
A) both resources and means of production are extremely limited and generally confined to agricultural produce
B) the government or other centralized group determines and controls all resources and means of production
C) both individuals and government control resources and determine production methods
D) either individuals or private firms, but not both, control resources and determine production methods
E) there is no government intervention whatsoever in industry
Answer: C
Explanation: A mixed economy is one in which individuals, businesses, and government share responsibility for determining allocation of resources and methods of production. The other responses refer to planned economies or market economies.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

6) A planned economy is one in which _____.
A) the government or other centralized group determines wages, sets prices, and distributes resources and products to the common group
B) individuals and businesses determine the production methods, with a focus on efficiency and productivity
C) individual income ultimately controls purchasing decisions
D) the government distributes some goods and services through selected social programs, and individual income determines purchasing decisions for other goods and services
E) the production and pricing of goods and services is determined through the operation of a market
Answer: A
Explanation: A planned economy is one in which the government controls the distribution of goods and resources. The other responses refer to market economies and mixed economies.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
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7) John is an employee at a car manufacturer. Today he has come into work to find that production has stopped because the government has determined that the steel used in the cars will be better used in the manufacture of a new railway line. John doesn't mind, because although his wages are low, he gets paid whether there is any work for him to do or not. John MOST likely lives in a _____ economy.
A) blended
B) planned
C) market
D) mixed
E) capitalist
Answer: B
Explanation: In a planned economy, the government determines what to produce, controls the resources and means of production, and determines wages. Resources and products are distributed to the common group.
Diff: 2
AACSB: Analytical Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Application
Learning Outcome: Compare and contrast different economic systems

8) Socialism is similar to communism in that _____.
A) the government provides all of the social services
B) the government fails under economic stress
C) the government distributes goods and services
D) the government does not charge taxes
E) the government does not intervene in industry
Answer: C
Explanation: In both socialist and communist states, the government is responsible for distributing both goods and services. However, in a communist state, the entire responsibility for the distribution is in the hands of the government, whereas in a socialist state, the government traditionally runs some of the social services and utilities but also allows for some private enterprise.
Diff: 1
AACSB: Analytical Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Application
Learning Outcome: Compare and contrast different economic systems

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9) Which of the following statements is NOT true of a market economy?
A) The pricing of goods is determined by what sellers wish to charge and buyers wish to pay.
B) The system encourages private ownership of resources.
C) The individual makes his or her own economic decisions.
D) The government may supply some goods or services.
E) The economy is defined by a freedom of choice for both buyers and sellers.
Answer: D
Explanation: In a free market economy, the government does not intervene in the production of goods or services. Most modern economies, including that of the United States, are mixed economies of privately owned businesses and some government control of social services.
Diff: 2
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

10) _____ is one of the countries closest to having a planned economy, and _____ is one of the countries closest to having a market economy.
A) Russia; Italy
B) India; Norway
C) Russia; Norway
D) Cuba; Singapore
E) Canada; China
Answer: D
Explanation: According to Figure 2.1: Cuba is at the end of the spectrum closest to a planned economy, and Singapore is at the end of the spectrum closest to a market economy.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

11) Microeconomics is the study of the behavior of the overall economies of small countries.
Answer: FALSE
Explanation: Microeconomics is the study of how individual businesses, households, and consumers make decisions to allocate their resources in the exchange of goods and services. Macroeconomics is the study of the behavior of the overall economy.
Diff: 1
AACSB: Analytical Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
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12) Macroeconomics is the study of how certain occurrences affect the economy as a whole.
Answer: TRUE
Explanation: Macroeconomics is the study of the behavior of the overall economy.
Diff: 1
AACSB: Analytical Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept

13) The supply of services is not part of the study of economics because it does not involve the exchange of goods.
Answer: FALSE
Explanation: The supply of services is part of the study of economics because services are exchanged for resources the same way goods are.
Diff: 1
AACSB: Analytical Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept

14) Economics is the study of how goods and services are exchanged between individuals, businesses, and governments.
Answer: TRUE
Explanation: Economics is the study of how individuals and businesses make decisions to best satisfy wants, needs, and desires.
Diff: 1
AACSB: Analytical Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept

15) Communism and socialism are examples of market economies.
Answer: FALSE
Explanation: These are examples of planned economic systems, in which the government plays a significant role in determining the goods and services produced and distributed.
Diff: 1
AACSB: Analytical Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

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16) In a planned economy, an individual's personal income dictates his or her spending choices.
Answer: FALSE
Explanation: In a planned economy, the government determines wages and sets prices, and resources are distributed throughout the group. In a market economy, the individual's personal income and preferences control their purchasing decisions.
Diff: 1
AACSB: Analytical Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

17) Although the United States comes close to being a capitalist economy, it is considered a mixed economy because there is some government intervention.
Answer: TRUE
Explanation: Capitalism is an economic system that allows freedom of choice for both buyers and sellers and encourages private ownership of resources. However, the United States is a mixed economy because its government does collect and distribute some resources under certain circumstances.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

18) Business managers do not need to be aware of the decisions of collective businesses outside their own industry.
Answer: FALSE
Explanation: Business managers need to be aware of any decisions by the government (e.g., a change in interest rates) or by collective businesses (e.g., the level of unemployment) that may impact the economy as a whole.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept

19) Define economics and explain the difference between microeconomics and macroeconomics.
Answer: Economics is the study of how governments, businesses, and individuals make decisions to best satisfy their wants and needs with limited resources. Microeconomics focuses on how individual businesses and consumers make decisions to allocate their resources. Macroeconomics focuses on the behavior of the overall economy.
Diff: 1
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept

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20) Explain the differences between how a market economy and a mixed economy decide what to produce, how to produce it, and for whom to produce it.
Answer: In a market economy, individuals and private firms make decisions about what to produce based on consumer needs and wants with no government involvement. Individuals and private firms determine production methods based on calculations of efficiency and profitability. Individual income ultimately controls purchasing decisions. In a mixed economy, individuals and private firms make decisions about what to produce, but the government is involved in providing services and regulating some aspects of conducting business. Individuals and private firms determine production methods, but may be influenced or regulated by the government. Government distributes some goods and services through social programs, but individual income informs most purchasing decisions.
Diff: 2
AACSB: Reflective Thinking
LO: 2.1: Define economics, and describe the different types of economic systems.
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

21) Which transaction BEST describes bartering?
A) an exchange of goods for currency, in which the price of something is determined by establishing its value against an underlying commodity
B) a transfer of goods without an exchange of currency, in which the price of something is determined by the seller, and the buyer agrees to pay at a later time
C) an exchange of goods without an exchange of currency, in which the price of something is determined by the needs and resources of each person involved in the exchange
D) an exchange of goods for currency, in which the price of something is determined by what buyers are willing to pay
E) an exchange of currency without an exchange of goods, in which the price of something is determined by what sellers demand
Answer: C
Explanation: The barter system involved a trading of goods without an exchange of money where the price was determined by the needs and resources of each person taking part in the exchange. Response A refers to the use of currency in a transaction in which the price of an item depends on its value relative to a consistent standard; Response B to a transaction involving credit; Response D to a transaction in which the price is set by the law of demand; and Response E mixes up aspects of several of the other responses.
Diff: 2
AACSB: Analytical Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

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22) Mae's Country Kitchen sells out of her cinnamon rolls every morning before 8:30 a.m., and her later customers ask her to make more. The next day, Mae makes an additional two dozen cinnamon rolls and raises the price of an individual cinnamon roll by 50¢. She sells all but one of them. Mae has found the _____ price of her cinnamon rolls.
A) market
B) supply
C) demand
D) determinant
E) surplus
Answer: A
Explanation: The market price is the price at which everyone who wants the item can get it without surplus or further demand.
Diff: 2
AACSB: Analytical Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Application
Learning Outcome: Discuss strategies for setting and adjusting prices

23) The amount of a product or service that is available for purchase at any given time is called _____.
A) commodity
B) surplus
C) supply
D) demand
E) shortage
Answer: C
Explanation: Supply is the amount of a product or service available; commodities are particular economic goods; a surplus is an amount of supply greater than the demand; demand is the need for an item; and shortage is not having enough of an item.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

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24) Prices become higher when a unique and highly desirable item is auctioned because the _____.
A) supply and demand are equal
B) demand is higher than the supply
C) supply is higher than the demand
D) supply and demand are kept unknown
E) demand is lower than the supply
Answer: B
Explanation: Prices increase depending on demand, therefore, the greater the demand the higher the price. If similar or identical items are offered for auction, there is less demand; therefore, the selling price is likely to be lower than for the unique and highly desirable item.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

25) According to the law of supply, the amount of a good or service supplied will increase as the price increases, and decrease as the price decreases. This direct relationship exists because supply is _____.
A) not dependent on the resources required to produce the product
B) derived from a producer's desire to maximize profit
C) affected by the number of suppliers
D) not affected by the quantity of similar or substitute products
E) affected by changes in technology
Answer: B
Explanation: All else held constant, supply is derived from a producer's desire to maximize profits. The more money a business can get for its good or service, the more of its product it is willing to supply.
Diff: 2
AACSB: Analytical Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Application

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26) A supply curve illustrates _____.
A) that as supply decreases, demand decreases
B) the effects of price on quantity supplied
C) the effects of price on quantity demanded
D) that as supply increases, the price stays the same
E) the effects of changes in resource prices on supply
Answer: B
Explanation: Supply curves illustrate that supply increases as the prices increases. The more a supplier can charge for a product, the more of that product he will want to supply.
Diff: 2
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

27) _____ refers to how much of a product or service people want to buy at any given time.
A) Commodity
B) Surplus
C) Supply
D) Demand
E) Equilibrium
Answer: D
Explanation: Demand refers to how much of a product or service people want to buy at any given time. Commodities are particular economic goods. A surplus is the amount of supply that exceeds market demand; supply is the amount of the item available; equilibrium is the point at which supply meets with demand.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

28) A demand curve illustrates _____.
A) the effects of price on quantity demanded
B) that as price increases, demand stays the same
C) the effects of supply on quantity demanded
D) that demand decreases as price decreases
E) the effects on population changes on demand
Answer: A
Explanation: Demand curves illustrate that demand increases as price decreases by showing the relationship between price and quantity demanded.
Diff: 1
AACSB: Reflective Thinking
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Classification: Concept

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29) When the supply curve and the demand curve for a single product or service are shown on the same graph, the point at which the curves intersect identifies the _____.
A) total profit earned by the producers
B) market price of the good
C) quality of the good or service being purchased
D) amount of the surplus to be anticipated
E) number of substitute goods available
Answer: B
Explanation: The market price of an item is the price at which supply equals demand. Therefore, the market price is the point at which the supply curve and the demand curve intersect.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

30) Taken together, the iPod and iTunes are _____ goods.
A) substitute
B) complementary
C) competitive
D) monopolistic
E) intangible
Answer: B
Explanation: Products or services that go with each other and are consumed together, such as the iPod and iTunes, are considered complementary goods. The demand for iTunes is great as long as consumers are buying and using iPods and other portable media devices. These two products do not substitute for or compete with one another. Apple, their manufacturer, is successful in the market, but is not a monopoly, since there are substitute products that consumers may choose to purchase. An iPod is a physical item that can be touched, so it is not an intangible good.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Application

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31) Pilar's daughter wants a Betty the Builder doll for Christmas. When Pilar gets to the toy store they are sold out, so she goes to another store. There she is told that they have a limited quantity, which will go on special sale at 6 a.m. the next morning—and that she'd better get in line early. This is an example of which of the following determinants of demand?
A) complementary goods
B) population changes
C) substitute goods
D) consumer preference
E) changes in income levels
Answer: D
Explanation: Consumer preference drives demand by increasing popularity of the item.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Application

32) One example of complementary goods is _____.
A) cheese and crackers
B) cable television and Internet service
C) dog food and a dog bowl
D) a cell phone and wireless phone service
E) magazines and newspapers
Answer: D
Explanation: Complementary goods go with each other and are consumed together, and if new technology renders one obsolete, the demand for the other goes down. Although cable TV and Internet may be consumed at the same time and are often bundled together by service providers, neither is necessary to the operation of the other. The other choices are inaccurate because, though they describe items that go with each other and are consumed together, the obsolescence of one does not lead to less demand of the other.
Diff: 2
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Application

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33) What are substitute goods?
A) goods that can be used in place of others
B) goods that can be modified to replace others
C) goods that complement others
D) goods that can be used to repair others
E) goods that experience seasonal changes in demand
Answer: A
Explanation: Substitute goods can be used in place of others, such as the cola-type soft drinks Coke or Pepsi.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

34) Currency is a unit of exchange for the transfer of goods and services, and provides a consistent standard.
Answer: TRUE
Explanation: Initially the value of the standard was based on an underlying commodity, such as gold. Today, the U.S. currency isn't based on gold, but rather on a perceived value of its worth.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

35) The price of a product or service is based entirely on its actual value.
Answer: FALSE
Explanation: The price of a product or service is based ultimately on supply and demand, or how much of that product or service is available against the degree to which individuals or businesses need or want it.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

36) Supply refers to how much of a product or service is available for purchase at a given time.
Answer: TRUE
Explanation: Supply is the availability of a given item or service. It is dependent on a number of factors, including the resources required to produce or offer it.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

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37) The law of demand states that as the price for an item or service increases, so will the supply and that as the price decreases, the supply will also decrease.
Answer: FALSE
Explanation: This statement does not reflect the law of demand but rather the law of supply. The more money a business can get for its good or service, the more of its product it is willing to supply. In economic terms, the amount supplied will increase as the price increases; also, if the price is lower, less of the product is supplied.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

38) Mae bakes 100 cinnamon rolls each day to sell at her café, and each day she sells out before breakfast is over. Many of her customers ask for, but don't get one. Her customers ask that she bake more cinnamon rolls each day. This is an example of a shortage.
Answer: TRUE
Explanation: The need for an item is demand, and the availability of that item is supply. Because the number of people who want the cinnamon rolls is greater than the number of cinnamon rolls available, the supply does not meet the demand, and there is a shortage.
Diff: 1
AACSB: Analytical Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Application

39) Holding all other factors constant, prices are set slightly above the point where supply equals demand.
Answer: FALSE
Explanation: Holding all other factors constant, prices are set at a point where supply exactly equals demand. This is known as the market price.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept
Learning Outcome: Discuss strategies for setting and adjusting prices

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40) The price at which supply of an item or service equals the demand for that item is known as the market price.
Answer: TRUE
Explanation: Holding all other factors constant, prices are set at a point where supply equals demand.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept
Learning Outcome: Discuss strategies for setting and adjusting prices

41) Changes in the prices of resources do not help determine supply because those resources can be replaced by substitute goods.
Answer: FALSE
Explanation: Changes in resource prices help determine supply by altering the price of production. An increase in resource prices increases the cost of production and reduces profits, thus lowering the incentive to supply a product.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept
Learning Outcome: Discuss strategies for setting and adjusting prices

42) Population changes are a key determinant of demand for goods and services.
Answer: TRUE
Explanation: Population changes help determine demand by increasing or reducing the amount of goods and services a given location can supply and still maintain economic equilibrium.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Concept

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43) Mae is considering raising the price of her cinnamon rolls in order to maximize her profits. Describe the factors that will help her determine the best price for her cinnamon rolls.
Answer: Mae should take into consideration the basic conflict of price-setting, which is that the higher the price of an item, the more likely she is to supply the product, but that the lower the price, the more likely the product is to be purchased. Mae must consider whether the demand for her cinnamon rolls is high enough that customers will still want to buy them at a higher price. Holding all other factors constant, prices are set at a point where supply equals demand.
Diff: 2
AACSB: Analytical Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Application
Learning Outcome: Discuss strategies for setting and adjusting prices

44) How might a decrease in income levels lead to population changes?
Answer: A decrease in income levels might lead to population changes if it becomes necessary for people to sell their homes and/or move to another community in search of employment. Income losses also affect discretionary spending. For instance, people who have had a decrease in income are less likely to go on vacation and take part in seasonal rentals or activities. This might then negatively impact the economy in seasonal towns, leading to additional decreases of income in regions that rely on tourism.
Diff: 3
AACSB: Analytical Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Synthesis

45) How do consumer preferences for popular goods affect the demand curve? Give an example using a specific product.
Answer: When consumers show a high rate of preference for a particular product or service, the quantity of demand for that item increases and the demand curve shifts to the right (toward more demand). Examples will vary, but students should identify a product with high initial demand, or a demand that grew noticeably stronger over time such as Xbox One game systems, Apple iPad, and Tickle Me Elmo dolls.
Diff: 1
AACSB: Reflective Thinking
LO: 2.2: Explain the principles of supply and demand, and describe the factors that affect each principle.
Classification: Application

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46) What BEST determines the level of competition?
A) the degree of population change
B) the number of substitutes for a certain good or service
C) the degree of change in income levels
D) the number of complementary products or service
E) the existence of complementary goods
Answer: B
Explanation: Competition is driven by substitute goods and services, one of the factors of demand. The greater the number of substitute products, the more competition a product faces.
Diff: 2
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

47) _____ occurs when there is only one provider of a service or product and no substitutes for the service or product exist.
A) A duopoly
B) A monopoly
C) An oligopoly
D) Perfect competition
E) Monopolistic competition
Answer: B
Explanation: True monopolies are rare and in the United States the FTC regulates business mergers carefully to prevent the formation of monopolies. A duopoly exists when there are only two suppliers; an oligopoly exists when there are only a few suppliers and each has a fairly large share of the market. Perfect competition occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market. Monopolistic competition occurs when there are many buyers and sellers and the products are similar but not identical.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

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48) The _____ and the Department of Justice must review mergers between large competitors to determine whether the combined firm would be a monopolistic corporation.
A) Federal Trade Commission
B) Internal Revenue Service
C) Federal Reserve Bank
D) Federal Appeals Court
E) Securities and Exchange Commission
Answer: A
Explanation: The Federal Trade Commission and the Department of Justice review proposed mergers to ensure that such a merger would not be disadvantageous to consumers. The IRS, Federal Reserve Bank, the Federal Appeals Court, and the Securities and Exchange Commission are not charged with evaluating proposed mergers to determine the potential impact on consumers.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

49) The government allows some _____ companies to operate as regulated monopolies.
A) airline
B) mining
C) utility
D) timber
E) telecommunications
Answer: C
Explanation: Utility companies are often permitted to operate as regulated monopolies because they deal with limited supplies of resources like water. However, although they are allowed to run as monopolies, the government will regulate their prices to ensure that they do not inflate prices.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

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50) What is the MOST likely scenario in a monopoly, where only one seller supplies a product or service?
A) Demand may be low.
B) Demand may vary.
C) Supply may be abundant.
D) Supply may be limited.
E) Prices will be low.
Answer: D
Explanation: Supply may be limited, potentially increasing cost of products to consumers.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

51) _____ occurs when there are a few sellers in a given market and each seller has a fairly large share of that market.
A) Monopolistic competition
B) A monopoly
C) An oligopoly
D) Perfect competition
E) A duopoly
Answer: C
Explanation: An oligopoly is a competition in which only a few sellers exist. True monopolies are rare and in the United States the FTC regulates business mergers carefully to prevent the formation of monopolies. A duopoly exists when there are only two suppliers; an oligopoly exists when there are only a few suppliers and each has a fairly large share of the market. Perfect competition occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market. Monopolistic competition occurs when there are many buyers and sellers and the products are similar but not identical.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

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52) Which of the following industries is LEAST likely to form an oligopoly?
A) airline
B) automobile
C) tobacco
D) consulting
E) pharmaceutical
Answer: D
Explanation: Typically, oligopolies occur in industries in which there is a high investment to enter, so oligopolies are often major corporations in certain areas such as the airline, automobile, high-tech, pharmaceutical, and tobacco industries. Because consulting is knowledge intensive rather than resource intensive, it is least likely to become part of an oligopoly.
Diff: 2
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Application

53) _____ occurs when there are many buyers and sellers and little differentiation between products, but perceived differences between products among consumers.
A) Monopolistic competition
B) A monopoly
C) An oligopoly
D) Perfect competition
E) A duopoly
Answer: A
Explanation: Monopolistic competition occurs when there are many buyers and sellers and little differentiation between the products themselves (e.g., coffee versus coffee), but there is a perceived difference among consumers, who thereby favor one product offering over another. True monopolies are rare and in the United States the FTC regulates business mergers carefully to prevent the formation of monopolies. A duopoly exists when there are only two suppliers; an oligopoly exists when there are only a few suppliers and each has a fairly large share of the market. Perfect competition occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

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54) In what way does monopolistic competition favor consumers?
A) A limited number of sellers differentiate their products or services by offering better quality items and/or greater incentives to purchase them.
B) A large number of sellers providing virtually identical products means that no single seller can set the price.
C) A large number of sellers and products increases supply of similar, but not identical, products and services, so to increase demand sellers are likely to reduce prices.
D) A single seller or provider ensures consistency of product quality and regulated pricing.
E) A small number of sellers compete by differentiating their products from one another.
Answer: C
Explanation: Monopolistic competition is characterized by a market in which there are a large number of sellers providing similar goods to consumers whose purchasing choices are based on perceived differences between them. Price is often the distinction.
Diff: 2
AACSB: Analytical Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

55) _____ occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market.
A) Monopolistic competition
B) A monopoly
C) An oligopoly
D) A duopoly
E) Perfect competition
Answer: E
Explanation: Perfect competition occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market. When these conditions exist, no single supplier can influence the price.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

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56) What is the purpose of the U.S. government's regulation of monopolies?
A) to ensure that there are as many opportunities for perfect competition as possible
B) to ensure that no single seller can drastically increase the price of a given product or service
C) to ensure that no one industry has control of the entire national economy
D) to ensure that local businesses are always the preferred provider of products consumers want
E) to ensure that companies have equal access to natural resources like water and natural gas
Answer: B
Explanation: Formation of monopolies is regulated so that a potential monopolistic supplier cannot charge an excessive price or be unresponsive to consumer needs. In the United States, as well as in other countries, large monopolies are rarely allowed. Natural monopolies are an exception. Utility companies, such as those that sell natural gas or water to consumers, may be permitted to hold monopolies in an effort to conserve natural resources.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

57) Mae's Restaurant is the only establishment in town that sells cinnamon rolls. Mae therefore has a monopoly on the cinnamon roll business in town.
Answer: TRUE
Explanation: A monopoly occurs when there is only one provider of a good or service and no substitutes for that good or service exist.
Diff: 1
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Application

58) Competition in an oligopoly is centered more on making one product stand out from another than it is on price.
Answer: TRUE
Explanation: Because there is little differentiation between products, competition in an oligopoly is strong and prices differ only slightly.
Diff: 2
AACSB: Reflective Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

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59) Describe how each of the four degrees of competition affect supply and demand.
Answer: (1) In a monopoly, there is only one supplier of a good or service. Supply is not as high as it would be in a different form of competition, but demand for that good or service will be very high. (2) In an oligopoly, there is more supply than in a monopoly and more competition. Prices tend to be very similar between products because the products themselves are similar. Competition is centered on product differentiation in order to capture a larger share of the market rather than on price. (3) In a monopolistic competition, there are many buyers and sellers and both supply and demand are high. Monopolistic competition is driven by the differences consumers perceive between similar products. This perceived distinction between products is often driven by differences in price. (4) In perfect competition, there are many buyers and sellers of virtually identical products. Supply and demand are both high, but because consumers do not differentiate between products and there are so many products available, no single seller can set the price.
Diff: 3
AACSB: Analytical Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Concept

60) Explain the relationship between monopoly as a form of economic competition and the failures of communism as an economic system.
Answer: A monopoly occurs when there is only one provider of a good or service and no substitutes for the good or service exist. Because there is only one supplier, there is less abundant supply in general and the supplier is more susceptible to changes in resource prices. In the communist system, the government is the sole supplier of all goods and services across the economic spectrum and is responsible as well for controlling prices and distributing those goods and services. The entire economy (rather than just a single product or service) is therefore in some sense a monopoly, and because competition is limited to nonexistent, motivation to produce goods can be limited and severe shortages of goods and services may result.
Diff: 3
AACSB: Analytical Thinking
LO: 2.3: Describe the various degrees of business competition.
Classification: Synthesis
Learning Outcome: Compare and contrast different economic systems

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61) What is an economic indicator?
A) a business expert who understands the economy and can advise managers how best to handle their companies
B) a formula used by accountants to determine their company's net profit
C) an aspect of the economy that can be measured in order to determine a country's overall economic health
D) a way of identifying whether a given market is an oligopoly or monopolistic competition
E) an action taken by the government to influence swings in the business cycle
Answer: C
Explanation: Economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—are used to determine how well businesses are performing overall.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

62) ArmiLiza, a popular United States-based brand of handbags, has built a second factory in Mexico. The majority of the new factory's employees are Mexican citizens or Honduran immigrants. On which country's gross domestic product will the second factory's goods be counted?
A) the United States
B) Mexico
C) Honduras
D) They will be split between the United States and Mexico.
E) They will be split among all three countries.
Answer: B
Explanation: GDP measures market value of all goods and services produced in a country, including goods and services produced by foreign-owned companies.
Diff: 2
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Application
Learning Outcome: Explain how economic performance is monitored

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63) The _____ is the most widely used indicator of economic growth in the world today.
A) gross national product
B) consumer price index
C) producer price index
D) gross domestic product
E) unemployment rate
Answer: D
Explanation: Most countries use the GDP to measure their economic health.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

64) A downward-moving GDP indicates that _____.
A) more goods and services are being produced and sold
B) fewer goods and services are being produced and sold
C) businesses are doing well
D) the number of unemployed people is decreasing
E) the number of products created in a country by non-domestic companies is increasing
Answer: B
Explanation: A rising GDP indicates that more goods and services are being produced and that businesses are doing well. A downward-moving GDP indicates that fewer goods are being produced, fewer services are being sold, and businesses are not doing as well.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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65) A rise in the general level of prices over time is called _____.
A) deflation
B) inflation
C) disinflation
D) deflection
E) equilibrium
Answer: B
Explanation: Inflation is a rise in the general level of prices over time. Deflation is a decrease in general level of prices over time. Disinflation is a decrease in the rate of inflation over time. Deflection is not an economic term. Equilibrium is when need and availability for an item are in balance.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept

66) _____ is a decrease in the rate of inflation.
A) Deflation
B) Inflation
C) Disinflation
D) Deflection
E) Depression
Answer: C
Explanation: By definition, disinflation is a decrease in the rate of inflation over time. Inflation is a rise in the general level of prices over time. Deflation is a decrease in general level of prices over time. Deflection is not an economic term. A depression is a very severe or long recession.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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67) A continuous decrease in the level of prices over time is called _____.
A) deflation
B) inflation
C) disinflation
D) deflection
E) depression
Answer: A
Explanation: By definition, deflation is a decrease in the general level of prices over time. Disinflation is a decrease in the rate of inflation over time. Inflation is a rise in the general level of prices over time. Deflection is not an economic term. A depression is a very severe or long recession.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

68) What does the monthly consumer price index (CPI) measure?
A) the changes in prices of goods and services as determined by the sellers
B) the amount of products and services manufactured domestically
C) the number of new products purchased by consumers
D) the changes in prices of goods and services purchased by households
E) the changes in prices of the resources used to create consumer goods
Answer: D
Explanation: CPI is a benchmark used to track changes over a period of time in the price of goods and services that consumers purchase. The CPI measures price changes by creating a "market basket" of a specified set of goods and services that represent the average buying pattern of urban households. The value of this market basket is determined by the combined prices of these goods and services and is compared to its value in a prior period (generally a month), and the change is noted.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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69) The value of the CPI's "market basket" is determined by _____.
A) the combined prices of a specified set of goods and services
B) the net profit earned by businesses selling a specified set of goods and services
C) the price of all goods and services purchased in a particular period
D) the cost of production for a specified set of goods and services in a given market
E) the difference between the prices of the raw materials used to create goods and the prices the consumer actually pays for these finished goods
Answer: A
Explanation: The value of the market basket is determined by the prices of a certain set of goods and services. The value of the market basket in a given period (e.g., a month) is then compared to its value in a prior period.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

70) Why does the U.S. Bureau of Labor Statistics evaluate the CPI's "market basket"?
A) to ensure that it reflects current trends in the production of goods and services
B) to ensure that it reflects current consumer spending habits
C) to ensure that it reflects current wholesale spending habits
D) to ensure that it reflects current consumer demand
E) to ensure that it reflects current wholesale resource costs
Answer: B
Explanation: The Bureau of Labor Statistics evaluates the market basket as a way to track spending habits of many different families and thus get a better idea of what people are spending money on. This helps determine how the economy is doing and how inflation rates are affecting spending habits in specific areas of the economy.
Diff: 2
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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71) The average total of goods and services required to maintain a particular standard of living is called _____.
A) the cost of living
B) total household expenditure
C) the cost of fundamental human needs
D) the cost/price index
E) quality of life
Answer: A
Explanation: The cost of living is the average monetary costs of the goods and services required to maintain a particular standard of living. It is closely related to the CPI. In fact, to keep up with inflation, the Social Security Administration calculates automatic cost of living adjustments to Social Security benefits based on annual percentage increases in the CPI. As you can imagine, the cost of living varies greatly by state and city. For example, the cost of living in New York City or San Francisco is much higher than in Topeka, Kansas, or Little Rock, Arkansas.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

72) The producer price index tracks the average change in prices from the _____ perspective.
A) government's
B) buyer's
C) seller's
D) economist's
E) marketer's
Answer: C
Explanation: The PPI tracks the prices of goods sellers use to create their products, such as raw materials, product components that require further processing, and finished goods sold to retailers. The PPI excludes energy prices and prices for services.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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73) Goods tracked by the PPI include _____ and _____.
A) education; medical care
B) recreation; apparel
C) transportation; communication
D) raw materials; finished goods sold to retailers
E) energy prices; prices for services
Answer: D
Explanation: PPI does not track consumer goods or services, but rather the cost of the resources, such as raw materials used to produce consumer goods. The PPI excludes energy prices and prices for services.
Diff: 2
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Application
Learning Outcome: Explain how economic performance is monitored

74) _____ is unemployment that occurs when workers are let go due to a downturn in the business cycle.
A) Seasonal
B) Frictional
C) Structural
D) Cyclical
E) Temporary
Answer: D
Explanation: Cyclical unemployment measures unemployment caused by a lack of demand for those who want to work. This generally follows the economy. Companies must cut back their workforce when there is a downturn in the business cycle. Once the demand for goods and services increases, companies begin to hire again.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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75) _____ unemployment measures those out of work during the off-season, such as those employed in snow- or beach-related industries, agriculture, and/or holiday activities.
A) Seasonal
B) Frictional
C) Structural
D) Cyclical
E) Temporary
Answer: A
Explanation: Seasonal unemployment occurs when workers get laid off during the off-season.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

76) _____ unemployment refers to a temporary state of unemployment in which workers move between jobs, careers, and locations.
A) Seasonal
B) Frictional
C) Structural
D) Cyclical
E) Circumstantial
Answer: B
Explanation: Frictional unemployment occurs because it simply takes a certain amount of time for workers to find the right jobs and employers to find the right workers.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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77) _____ unemployment measures permanent unemployment associated with massive industry-wide changes that lead to complete elimination of the positions formerly held.
A) Seasonal
B) Frictional
C) Structural
D) Cyclical
E) Circumstantial
Answer: C
Explanation: Structural unemployment measures permanent unemployment associated when an industry changes in such a way that jobs are terminated completely. For instance, many steel workers and miners lost their jobs when there was a decline in those industries. Likewise, robots have replaced many automobile workers, and computers have replaced many newspaper typesetters.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

78) An automobile assembly plant might measure _____ in terms of the number of cars created in a given period of time, per work-hours needed to create them.
A) productivity
B) demand
C) supply
D) price
E) unemployment
Answer: A
Explanation: In its broadest terms, productivity measures the quantity of goods and services that a firm's human and physical resources can produce in a given time period. It can be calculated as a physical measure or as a monetary measure.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Application
Learning Outcome: Explain how economic performance is monitored

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79) The gross domestic product (GDP) measures _____.
A) the overall market value of final goods and services produced in a country in a given year
B) the overall gross profit a country earns in a given year
C) a country's overall income resulting from production in a year
D) a country's overall expenditures in a given year
E) a country's overall increase in profitability from one year to the next
Answer: A
Explanation: GDP measures market value of all goods and services produced in a country, including goods and services produced by foreign-owned companies that operate in the country.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

80) Products manufactured in foreign countries by U.S. companies are included in the U.S.'s gross domestic product (GDP).
Answer: FALSE
Explanation: The GDP is based on products manufactured domestically, that is, within the country. All goods manufactured in a country are included in that country's GDP, no matter the nationality of the parent company.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

81) The consumer price index (CPI) tracks changes in prices at the wholesale level.
Answer: FALSE
Explanation: The consumer price index (CPI) tracks changes in price at the consumer level. The producer price index (PPI) tracks changes in price at the wholesale level.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
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82) Change in prices is an important economic indicator because it is a measurement of consumers' purchasing power.
Answer: TRUE
Explanation: When prices increase, the purchasing power of the dollar decreases. This eventually leads to an increase in wages in order to compensate. Businesses must then increase the prices of their goods and services in order to cover the higher cost of labor.
Diff: 2
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

83) Cyclical unemployment measures those out of work during the off-season, such as those employed in agriculture and snow-, beach-, or holiday-related industries.
Answer: FALSE
Explanation: Cyclical unemployment measures unemployment caused by lack of demand for those who want to work. It generally follows the economy. Seasonal unemployment measures those out of work due to their being employed in seasonal industries like landscaping or agricultural harvesting.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

84) Higher productivity results in higher costs and higher prices, resulting in lower income and lower profitability.
Answer: FALSE
Explanation: Higher productivity results in lower costs and lower prices because higher productivity indicates that workers are producing more goods and services in a certain amount of time than previously. Higher productivity thus generates more business income and profitability.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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85) Divya owns a small boutique in a busy neighborhood. She has been thinking of expanding her business hours and hiring a sales associate to work evenings and weekends. She sees on the news that the GDP is down and decides to hold off on expanding her business for the time being. Why?
Answer: A downward-moving GDP indicates problems with the economy. The GDP moves down because fewer goods are being produced and fewer services being sold. This means that the businesses that produce these goods and services will have less profit and may need to lay off workers. The change in income for these workers means that they will spend less money overall, which means she may not have enough customers to make the expansion worthwhile.
Diff: 2
AACSB: Analytical Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Application
Learning Outcome: Explain how economic performance is monitored

86) Describe how the consumer price index (CPI) uses the "market basket" to measure price changes.
Answer: The CPI measures price changes by creating a "market basket" of a specified set of goods and services that represent the average buying pattern of urban households. The value of this market basket, as determined by the combined prices of these goods and services, is compared to its value in a prior period (generally a month) and the change is noted.
Diff: 2
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

87) What does the consumer price index (CPI) tell us about the purchasing power of the dollar? How does it function as an economic indicator?
Answer: During periods of increasing prices as reflected by the CPI, the purchasing power of the dollar decreases, meaning that less can be bought with a dollar today than yesterday. This functions as an economic indicator by showing that inflation is on the rise and that businesses should prepare for increases in the cost of labor and production.
Diff: 3
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
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88) What are some consequences of a high unemployment rate? What are some consequences of a low unemployment rate?
Answer: High unemployment results in an increase in government spending on unemployment benefits and social services. It can also bring about increases in stress, mental illness, and crime throughout a population. Also, it is costly for businesses to lay off workers and then, as the economy improves eventually, hire and train new employees. Low unemployment means that workers have increased buying power and spend more, which can lead to a higher inflation rate. The challenge is to try to keep both inflation and unemployment low.
Diff: 1
AACSB: Reflective Thinking
LO: 2.4: Explain how the various economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity-reflect the health of an economy.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

89) The term "business cycle" refers to the _____.
A) periodic increases and decreases of the economy
B) periodic purchases of goods and services by the government
C) increases and decreases in the rate of inflation
D) periodic growth of the Federal Reserve system
E) periodic increases and decreases in the GDP due to seasonal factors
Answer: A
Explanation: Over time, the economy naturally goes through periodic increases and decreases in what is known as the business cycle.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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90) The government determines the appropriate level of taxes and spending through its _____ policy.
A) monetary
B) domestic
C) foreign
D) fiscal
E) currency
Answer: D
Explanation: Fiscal policy involves raising and spending money; monetary policy involves managing the supply of money.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

91) Decreasing taxes can stimulate the economy by _____.
A) allowing consumers more money to spend
B) decreasing the amount of money the government is able to spend
C) directly influencing the consumer price index
D) controlling the money supply
E) helping to contain an economy that is growing too quickly
Answer: A
Explanation: Decreasing taxes means that consumers have more money to spend. However, consumers may save money that accrues as a result of tax decreases. This would not stimulate the economy, which relies on consumer spending.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

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92) What is the money supply?
A) the total amount of money held in the Federal Reserve Bank
B) the combined amount of money available in privately owned accounts
C) the combined amount of money available within the economy
D) the amount of money the government is allowed to spend to stimulate economic growth
E) all the coins and bills held by people, businesses, and banks
Answer: C
Explanation: The money supply is defined as all available money within the economy. It includes not only currency, but also personal savings and checking accounts as well as the deposit accounts from large institutions.
Diff: 2
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

93) The government manages the supply of money through its _____ policy.
A) monetary
B) domestic
C) foreign
D) fiscal
E) stimulus
Answer: A
Explanation: Monetary policy involves managing the supply of money; fiscal policy involves raising and spending money.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

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94) The Federal Reserve System (the Fed) manages the country's money supply through its monetary policy to control inflation by doing all of the following EXCEPT _____.
A) buying and selling government securities
B) trading in foreign exchange markets
C) changing certain interest rates
D) increasing taxes
E) manipulating reserve requirements
Answer: D
Explanation: Increasing taxes is not within the power of the Federal Reserve System, nor does it fall under monetary policy. It is a fiscal decision, not a monetary one.
Diff: 2
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

95) All of the following statements about open market operations are true EXCEPT _____.
A) they are used by the Federal Reserve to change the federal funds rate
B) they are used by the Federal Reserve to change the discount rate
C) they are used by the Federal Reserve to buy and sell mutual funds
D) they are used by the Federal Reserve to transact with securities dealers
E) they are probably the most influential tool the Federal Reserve has to alter money supply
Answer: B
Explanation: The primary tool the Fed uses in its monetary policy is open market operations—buying and selling U.S. Treasury and federal agency bonds on the "open market." When the Fed buys securities, it adds reserves to the system, money is said to be "easy," and interest rates drop. Lower interest rates help stimulate the economy by decreasing the desire to save and increasing the demand for loans such as home mortgages. Open market operations would not change the discount rate, the interest rate charged by the Fed to banks in order to maintain their reserve funds.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

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96) In which part of the business cycle would the Federal Reserve be most likely to increase the discount rate to discourage banks from borrowing?
A) trough
B) expansion
C) peak
D) recession
E) depression
Answer: B
Explanation: During expansion, banks are discouraged from seeking loans from the Federal Reserve at higher discount rates, thereby slowing the addition of funds into the economy, which keeps the economy from expanding too rapidly. If the money supply were allowed to continually expand, eventually there might not be enough goods and services to satisfy demand, and when demand is high, prices will rise. Inflation results from an increase in overall prices.
Diff: 3
AACSB: Analytical Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Synthesis
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

97) The reserve requirement is defined as _____.
A) the maximum amount of money banks can borrow from the Federal Reserve
B) the maximum amount of money banks can borrow from one another
C) the minimum amount of money banks hold in reserve to cover deposits
D) the minimum amount of money that can be deposited by banks in the Federal Reserve
E) the maximum amount of money that is insured by the Federal Deposit Insurance Corporation
Answer: C
Explanation: By definition, the reserve requirement is the minimum amount of money banks must hold in reserve to cover deposits. The Federal Reserve can raise or lower the reserve requirement to ensure that banks have enough money to cover deposits.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

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98) A recession is an increase in the unemployment rate over two or more consecutive quarters of a year.
Answer: FALSE
Explanation: A recession is a decline in the gross domestic product (GDP) over two or more consecutive quarters of a year.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

99) The government can influence the economy through its fiscal policy by making changes in the money supply.
Answer: FALSE
Explanation: A government's fiscal policy determines the appropriate level of taxes and spending but does not directly influence changes in the money supply. A government's monetary policy, on the other hand, is the medium through which it may make changes in the money supply.
Diff: 2
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

100) When the Federal Reserve Bank buys or sells U.S. securities, it changes the level of reserves in the banking system which has an effect on interest rates.
Answer: TRUE
Explanation: When the Fed buys securities, it adds reserves to the system, making it easier to obtain money through loans, etc., and interest rates drop. When the Fed sells securities, it removes money from the system, money becomes harder to obtain, and interest rates rise.
Diff: 2
AACSB: Analytical Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

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101) The discount rate is the interest rate banks are charged when they borrow money from the Fed.
Answer: TRUE
Explanation: By definition, the discount rate is the interest rate banks are charged when they borrow money from the Federal Reserve Bank. The discount rate should not be confused with the federal funds rate, which is the interest rate that banks charge other banks when they borrow funds overnight from each other in order to maintain their reserves.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

102) The Fed relies primarily on changes in the reserve requirement (the minimum amount of money banks must hold in reserve to cover deposits) to ease or tighten the money supply.
Answer: FALSE
Explanation: The Fed only rarely makes changes in the reserve requirement as a means of monetary policy, as these actions would be very disruptive to the banking industry. When they do, they lower the reserve requirement to increase the money supply and increase it to decrease the money supply.
Diff: 1
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

103) Name the four parts of the business cycle and describe how they relate to each other.
Answer: The *peak* of a business cycle occurs when the economy is at its strongest. A *recession* is a decline in GDP for two or more consecutive quarters and is characterized by a decline in corporate profits and a rise in unemployment. The *trough* is the point in the cycle at which the economy is at its weakest. The trough occurs when recession ends and recovery begins. *Recovery*, or expansion, is a growth in GDP and is characterized by rising profits and reduced unemployment.
Diff: 2
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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104) Define open market operations and describe how the Federal Reserve Bank uses them to control the money supply.
Answer: Open market operations are the buying and selling by the Federal Reserve Bank of U.S. Treasury and federal agency bonds on the open market. Securities dealers compete in these transactions to get the best deal. When the Fed buys or sells U.S. securities, it is changing the level of monetary reserves in the banking system. When it buys securities, it adds reserves to the banking system, thereby increasing the money supply and lowering interest rates. When it sells securities, it decreases the amount of reserves in the system, thereby reducing the money supply and causing interest rates to rise.
Diff: 2
AACSB: Reflective Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

105) What are the possible consequences of a continual expansion in the money supply?
Answer: If the money supply continues to expand, eventually there may not be enough goods and services to satisfy demand. When demand is high, prices will rise. An overall rise in price results in inflation, which leads to a decrease in the purchasing power of the dollar. To compensate, businesses increase wages to compensate for the price increases and eventually increase prices to compensate for the expanded costs of production.
Diff: 3
AACSB: Analytical Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Application
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

106) How does lowering the discount rate enable the Fed to stimulate the economy? How does raising the discount rate enable the Fed to control an economy that is too robust?
Answer: The Fed lowers the discount rate on loans to banks to stimulate the economy by making it easier for banks to obtain additional reserves. The banks can then lend this money out to businesses, thereby stimulating the economy by adding funds into the economy. When the economy is too robust, the Fed can increase the discount rate, making it harder for banks to get loans. Businesses are then discouraged from taking out loans at the higher interest rate, thereby slowing the addition of funds to the economy.
Diff: 2
AACSB: Analytical Thinking
LO: 2.5: Describe the four stages of the business cycle, and explain how the government uses both fiscal policy and monetary policy to control swings in the business cycle.
Classification: Application
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

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CHAPTER 2: ECONOMICS AND BANKING

CHAPTER OPENER

Chapter 2 covers the fundamentals of economics—how business decisions are shaped by supply and demand and the degrees of competition.

This chapter will introduce students to concepts such as:

- the different types of economic systems throughout the world
- how economic indicators such as the gross domestic product (GDP), price indices, the unemployment rate, and productivity reflect the health of an economy
- the four stages of the business cycle
- how the government uses fiscal policy to smooth swings in the business cycle

Finally, students will learn about the money supply, the Federal Reserve Bank, and the tools it uses to stabilize the economy through monetary policy.

DETAILED LECTURE OUTLINE

I. The Basics of Economics

A. Economics Defined
   1. So what is economics?
      a. **Economics** is the study of how individuals and businesses make decisions to best satisfy wants, needs, and desires with limited resources.
      b. There are two basic studies of economics: *microeconomics* and *macroeconomics.*
         i. **Microeconomics** is the study of how individual businesses, households, and consumers make decisions to allocate their limited resources in the exchange of goods and services.
         ii. **Macroeconomics** is the study of the behavior of the overall economy.

B. Economic Systems.
   1. What are the different types of economic systems?
      a. An **economy** is a system that tries to balance the available resources of a country, such as land, capital, and labor, against the wants and needs of consumers.
      b. An economy is defined by:
         i. What is produced
         ii. How it is produced
         iii. Who gets the finished product
      c. The world's different economies are classified into three basic economic systems: planned (or controlled) economies, free market economies, and mixed economies (Table 2.1).

C. Planned Economic Systems
   1. In a **planned economic system,** the government plays a significant role in determining the goods and services produced and distributed.

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2. **Communism** is an economic system in which a state's government makes all economic decisions and controls all social services, as well as many of the major resources required for the production of goods and services.
3. **Socialism** is a system whereby the government owns or controls many basic businesses and services, and the profits from them are distributed evenly among the people.
    a. The government charges high tax rates to pay for the services it provides.
    b. This economic system may tend to reduce people's motivation to work as hard as they might otherwise.
    c. Many socialist and communist countries are beginning to change their economies into free market economies through **privatization**—the conversion of government-owned production and services to privately owned, profit-seeking enterprises.

D. Market Economies
1. In a **market economy,** individuals are more able to make their own economic decisions.
2. **Capitalism** is an economic system that allows freedom of choice and encourages private ownership of resources required to make and provide goods and services.
3. The production and pricing of goods and services is determined through the operation of a **market**—the mechanism by which buyers and sellers exchange goods and services.

E. Mixed Economies
1. Most economic systems are **mixed economies**—a blend of market and planned economies. See Figure 2.1.

F. Business and Economics
1. Why do business managers need to be concerned with economics?
    a. Businesses need to know how much of their goods to produce or services to offer, as well as how much to charge.
    b. They need to be aware of the potential impact that government decisions and the decisions of collective businesses can have on their individual business.

II. Determining Price: Supply and Demand

A. Definitions
1. **Currency** is a unit of exchange for the transfer of goods and services and provides a consistent standard.
2. The **market price** for a good or service is the price at which everyone who wants the item can get it—without wanting more or without any of the items being left over.

B. Supply
1. What is supply?
    a. **Supply** refers to how much of a product or service is available. It is derived from a producer's desire to maximize profits.
    b. The **law of supply** states that the amount supplied will increase as the price increases; if the price is lower, then less of the product is supplied.

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c. A **supply curve** shows the relationship between supply and price.

C. Demand
1. What is demand?
   a. **Demand** refers to how much people want to buy at any given time.
   b. The amount demanded increases as price declines.
   c. A **demand curve** illustrates the relationship between demand and price.

D. Factors That Determine Price
1. What factors determine price?
   a. As a price of a product increases, more of it is likely to be supplied.
   b. As the price of the produce decreases, more of it is likely to be demanded by customers.
   c. If supply exceeds demand, there is a **surplus.**
   d. If demand exceeds supply, there is a **shortage.**
   e. The price at which supply equals demand is the *market price* or the **equilibrium price** and is illustrated in a supply-and-demand curve.

E. Factors That Affect Demand
1. What other factors besides price affect demand?
   a. **Determinants of demand** include:
      i. Changes in income levels
         a.) When income levels increase, people are able to buy more products.
         b.) When income levels decrease, people cut back on spending and buy fewer products.
      ii. Population changes
         a.) Increases in population create greater demand.
         b.) Demographic changes also affect demand for certain goods and services.
      iii. Consumer preferences
         a.) Demand for a product can change based on what is popular at any given moment.
      iv. Complementary goods
         a.) Products or services that go with each other and are consumed together, such as apps and iPhones, are considered **complementary goods.**
      v. Substitute goods
         a.) Goods that can be used in place of other goods, such as Coke for Pepsi, are **substitute goods.**
   b. A positive change in any of these shifts the demand curve to the right.
   c. A negative change in any of these shifts the demand curve to the left.

F. Factors That Shift Supply
1. What makes supply change?
   a. Factors that can create a change in supply are known as **determinants of supply** and include:
      i. Technology changes

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a.) Improvements in technology enable suppliers to produce goods or services more efficiently and with fewer costs, thus increasing their ability to supply more.

ii. Changes in resource prices
   a.) Increases and decreases in the price of the resources used to produce a good or a service affect the cost of their production.
      i.) An increase in resource prices increases the cost of production and reduces profits, thus lowering the incentive to supply a product.

iii. Price expectations
   a.) The expected future price of a product will affect how much of it producers are willing to supply.
      i.) If prices are expected to increase in the future, a supplier might stockpile the product and supply more at a later time when prices are higher.
      ii.) If prices are expected to decrease, the supplier might attempt to sell its supply while prices are high.

iv. The number of suppliers
   a.) The supply of a good or a service increases as the number of competitors increases.

v. The price of substitute goods
   a.) If there are equally comparable goods available at a lower price, the supply of the more expensive good will be affected.

b. Changes in any of these factors can shift the supply curve to the left (negative impact on supply) or to the right (positive impact on supply).

III. Degrees of Competition

A. Monopolies
   1. What is a monopoly?
      a. A **monopoly** occurs when a provider of a good or service has control of all or nearly all of its market.
   2. Why aren't there many monopolies?
      a. Without competition, a firm that has a monopoly can charge a higher price and may be less responsive to consumer needs.
      b. The U.S. Federal Trade Commission (FTC) and the Department of Justice must review mergers between large competitors to determine whether the combined firm would result in a monopoly that would thwart competition.
      c. Natural monopolies (such as utility companies that sell natural gas or water) may be permitted in the United States to conserve natural resources but the government regulates the prices, preventing the companies from overcharging.

B. Duopolies and Oligopolies
   1. What happens when one or two other companies enter a monopolistic market?
      a. A **duopoly** is where only two suppliers exist, or only two firms dominate a market.

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b. An **oligopoly** is a form of competition in which only a few sellers exist and each seller has a fairly large share of the market.

C. Monopolistic Competition
1. What happens when there isn't much differentiation between products?
a. **Monopolistic competition** occurs when there are many buyers and sellers and the products are similar but not identical.
b. Often there is a *perceived* difference among consumers so the products are not perfectly substitutable products.

D. Perfect Competition
1. What happens when products are almost identical?
a. **Perfect competition** occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market.
b. No single supplier can influence the price.

IV. Economic Indicators

A. Definitions
1. Business managers need to be aware of certain statistics about economic activities, called **economic indicators.**
a. *Leading indicators* are statistics that can be used to help predict how the economy will do in the near future.
b. *Coincident indicators* are statistics that reflect how the economy is currently doing.
c. *Lagging indicators* are statistics that change only after the economy as a whole changes.
2. The gross domestic product, consumer and producer price indices, and the unemployment rate are three economic indicators closely watched by businesspeople.

B. The Gross Domestic Product
1. How do we determine the health of an economy?
a. The broadest measure of the health of any country's economy is its **gross domestic product (GDP),** which measures how productive a nation is; that is, the overall market value of final goods and services produced in a country in a year.
b. Only those goods that are actually *produced* in the country are counted in the country's GDP.
2. How does the GDP act as an economic indicator?
a. A rising GDP indicates that more goods and services are being produced and that businesses are doing well.
b. A downward-moving GDP indicates that fewer goods are being produced, fewer services are being sold, and businesses are not doing as well.
c. A nation's GDP is often viewed in tandem with the country's debt level.
i. A low debt-to-GDP ratio indicates an economy that is healthy.
ii. A high debt-to-GDP ratio indicates a country that is spending beyond its means.

C. Consumer and Producer Price Indices

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1. What else is used to gauge the health of an economy?
    a. There are two price indices used as economic indicators: the consumer price index and the producer price index.
    b. A consistent increase in either indicator indicates inflation.
        i. **Inflation** is a rise in the general level of prices over time.
        ii. A decrease in the rate of inflation is **disinflation.**
        iii. A continuous decrease in prices over time is **deflation.**
2. How are changes in the price of consumer products measured?
    a. The **consumer price index (CPI)** tracks changes in prices over time by measuring changes in prices of goods in services that consumers purchase.
    b. It is a lagging indicator, so it shifts after the economy changes.
    c. The CPI measures price changes by creating a "market basket" of a specific set of goods and services that represent the average buying pattern of urban households.
3. What goods and services are included in the CPI?
    a. The expenditure items fall into eight major groups: apparel, education and communication, food and beverages, housing, medical care, recreation, transportation, and other goods and services (Figure 2.8).
4. Does the CPI measure the change in price of all goods?
    a. The CPI measures the change in prices of consumer goods only.
    b. The **producer price index (PPI)** tracks the average change in prices at the wholesale level.
        i. It tracks the prices of goods sellers use to create products, such as raw materials, product components that require further processing, and finished goods sold to retailers.
5. Why are price indices important?
    a. They measure purchasing power and consequently trigger business decisions.
    b. During periods of increasing prices, consumers' purchasing power decreases.
        i. As a result, wages increase to compensate for the higher cost of living, and businesses must eventually increase the prices of their products to offset higher labor costs, again decreasing the consumer's purchasing power.

D. The Unemployment Rate
1. What other indicators are used to measure the economy?
    a. The **unemployment rate** measures the number of workers who are at least 16 years old, are not working, and who have tried to find jobs within the past four weeks.
    b. There are different measurements of unemployment:
        i. **Frictional unemployment** is temporary unemployment that results when workers move among jobs, careers, and locations.
        ii. **Structural unemployment** is permanent unemployment that occurs when an industry changes and jobs are terminated completely.
        iii. **Cyclical unemployment** occurs when firms must cut back their workforces when there is a downturn in the business cycle.

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iv. **Seasonal unemployment** occurs when workers get laid off during the off-season or after the holiday shopping season ends.

2. Why is unemployment an important economic measure?
   a. High unemployment results in an increase in unemployment benefits and government spending on social programs such as welfare.
   b. If the unemployment drops too low, more workers have increased buying power and spend more, causing prices to rise and resulting in inflation.

E. Productivity of Firms
1. How is the productivity of a firm's workforce measured?
   a. **Productivity** measures the quantity of goods and services that a firm's human and physical resources can produce in a given time period.
2. Why is measuring productivity important to businesses?
   a. An increase in productivity indicates that workers are producing more goods or services in the same amount of time, often resulting in lower costs and lower prices.

V. Government and the Economy

A. Economic Policies
1. Why does the state of the economy change?
   a. Over time, the economy naturally goes through periodic increases and decreases, called the **business cycle.** There are four stages (Figure 2.9):
      i. **Peak** occurs when an economic expansion is at its most robust point.
      ii. **Recession** is a decline in the GDP for two or more successive quarters. A very severe or long recession is a **depression.**
      iii. A **trough** occurs when the recession hits bottom and the economy begins to expand again.
      iv. **Expansion** or **recovery** refers to the phase when the economy begins to grow again and enters into an expansionary or recovery phase. Eventually the recovery will hit a peak and the cycle begins again.
2. How does the government control swings in the business cycle?
   a. To smooth out the swings in the business cycle, lawmakers use **fiscal policy** to determine the appropriate level of taxes and government spending.

B. Fiscal Policy
1. Why does the government increase taxes to influence the economy?
   a. Tax increases mean consumers spend less, which slows down the growth of businesses and the economy by reducing the amount of money in the system, and this lowers inflation.
   b. Decreasing taxes does not have the opposite effect because the amount of money entering the system depends on how much of the reduction in taxes consumers spend and how much they save.
2. How does government spending help stimulate the economy?
   a. The government spends money on a wide variety of projects, such as infrastructure improvements and projects that benefit the military, education, and health.

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b. This increases the cash flow in the economy faster than decreasing taxes does and also creates additional jobs, which also helps stimulate the economy.

C. Monetary Policy
   1. What else can be done to control the economy?
      a. The second tool to manage the economy is **monetary policy,** which is exercised by the **Federal Reserve System (the Fed),** the central banking system of the United States.
         i. It includes 12 regional Federal Reserve Banks, a Board of Governors, and the **Federal Open Market Committee,** which sets the policies of the Fed.
         ii. Through its monetary policy, the Fed affects the nation's money supply and helps shape the direction of the economy.
   2. What is the money supply?
      a. The **money supply** is the combined amount of money available within an economy.
      b. There are different components to the money supply (see Figure 2.11):
         i. **M-1:** Coins and bills (currency), traveler's checks, and checking accounts. These are the most liquid assets.
         ii. **M-2:** M-1 plus savings deposits, money market accounts, and certificates of deposit (CDs) less than $100,000.
         iii. **M-3:** M-1, M-2, and less liquid funds such as larger CDs, money market accounts held by large banks and corporations, and U.S. dollars deposited in banks outside the United States.
   3. Why is the money supply important?
      a. The more money we have, the more we tend to spend.
      b. As consumers spend more, businesses do better, increasing demand for resources, labor, and capital, and the economy improves.
      c. However, when the money supply continues to expand, there may not be enough goods and services to satisfy demand and it may result in inflation.
      d. When the economy begins to slow down due to decreased spending, either disinflation or deflation results.
      e. The Fed uses three tools to affect money supply: reserve requirements, short-term interest rates, and open market operations.

D. Reserve Requirements
   1. What are reserve requirements?
      a. The **reserve requirement,** determined by the Fed, is the minimum amount of money banks must hold in reserve to cover deposits.
      b. The Fed can ease or tighten the money supply by increasing or decreasing the reserve requirement.
         i. If the Fed increases the reserve requirement, it forces banks to hold on to more money rather than lending it out, slowing down economic activity.
      c. The Fed rarely uses the reserve requirement as a means of monetary policy.

E. Short-Term Interest Rates

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1. What is the discount rate?
    a. When commercial banks borrow funds from the Fed, they are charged an interest rate called the **discount rate.**
    b. The Fed has the power to increase or decrease the discount rate in its efforts to control money supply.
        i. When the Fed lowers the discount rate, commercial banks are encouraged to obtain additional reserves by borrowing funds from the Fed and then lending those reserves to businesses, thereby stimulating the economy.
        ii. When the Fed increases the discount rate, it discourages banks from borrowing additional reserves and lending to businesses.
2. Is the discount rate the same as the federal funds rate?
    a. The **federal funds rate** is the interest rate that banks charge other banks when they borrow funds overnight from one another.
    b. The Fed does not control the federal funds rate directly. The rate is the equilibrium price created through the Fed's open market operations and the exchange of securities.
        i. The excess reserves that are available to lend among banks come from securities that the Fed buys and sells through its open market operations.
            a.) To increase the federal funds rate, the Fed sells bonds in the open market, and banks buy the securities, reducing their excess reserves available for loans.
            b.) To decrease the federal funds rate, the Fed buys bonds in the open market, increasing banks' excess reserves and making more money available.

F. Open Market Operations
1. What are open market operations?
    a. The primary tools the Fed uses in its monetary policy are **open market operations,** buying and selling U.S. Treasury and federal agency bonds on the "open market".
    b. When the Fed buys or sells U.S. securities, it is changing the level of monetary reserves in the banking system by adding or taking away money from the system.

NOTE: End the lecture by asking students to write down the muddiest points or main points of the lecture. This will allow you to know what might need to be reviewed during the next lecture.

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SUPPLEMENTAL ACTIVITIES

Supplemental In-Class Activity
Comparing Economic Systems

Activity Overview: This activity gets students talking about how similar and different the U.S. economic system is to other systems.

Time Limit: 30 minutes

What to Do:

1. Divide the class into small groups. Ask the groups to assume they have just overheard a classmate say, "The United States is becoming more socialist every day—with all the government control." Have each group list reasons why the statement could be true and reasons why the statement could be false. (15 minutes)

2. Reassemble the class and discuss each group's thoughts. (15 minutes)

Don't Forget: Remind students that a government's level of control distinguishes capitalism from socialism. If you have foreign students in your class, you may want them to say a bit about the economic system in their native country.

Wrap-Up: Wrap up the discussion by reminding students that the U.S. economic system and a socialist system share some similarities and many differences. For example, workers in socialist economies often work fewer hours, have longer vacations, and receive more health, education, and child-care benefits than do workers in capitalist economies. On the other hand, the federal government does control some basic services in the United States as well as various aspects of the market through agencies, such as the Food and Drug Administration (FDA) and the Federal Communication Commission (FCC).

Supplemental Homework Activity
Let's Go Shopping!

Homework Assignment: Visit a local shopping mall or shopping area. List each store that you see and determine what degree of competition it faces in its immediate environment. For example, if there is only one store in the mall that sells shoes, that store represents a monopoly. Note those businesses with direct competitors (e.g., two jewelry stores) and show how they compete with one another.

Deliverable: A brief paper reporting on degrees of competition and the tactics stores use to compete with one another. Answers will vary, but students should recognize different levels of competition and how stores respond to competition by advertising, reducing prices, and so on.

At-Home Completion Time: 1 to 2 hours.

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ENHANCING THE ONLINE COURSE

Online Lecture: Define the terms *microeconomics* and *macroeconomics* and use examples to distinguish between the two disciplines. Video tape yourself giving the short "mini-lecture". Many institutions have video cameras for your use in the library or you can use a digital camera with the help of another professor. Load the short video online (using procedures as specified by your online platform). Have your students watch the short video and do a quiz afterward.

Economics Model Search: Ask students to search the Internet to illustrate each of the boxes in Table 2.1. Require students to develop and send in a table with graphics and examples in each of the cells to illustrate the differences among the systems of economics.

Create a Model: Ask your students to use photos or other graphics to show the relationship of supply and demand. Limit the written discussion (in words) to one page to be e-mailed back to the discussion board. Ask the students to relate the content of their responses to current events posted on the Internet.

Price Points: Require your students to check the prices of products for three weeks in a row (suggested products: bread, eggs, chicken, tomatoes, milk, oranges, coffee, potato chips, gasoline). What could account for the changes in price? Ask your students to report back on the findings of their "study", to analyze the price differences, and, using the information in the text, to develop some ideas about what has caused the price differences. Students can post the reports via the discussion board.

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ANSWERS TO END-OF-CHAPTER MATERIALS

Self Test

Multiple Choice *You can find the answers on the last page of this book.*

2-1 Which of the following is a good example of microeconomics?
a. How a specific company would maximize its production and capacity so it could better compete in its industry
Learning Objective 2-1: The Basics of Economics
ACSB: Analytical thinking

2-2 There are four coffee shops in your town. All of them claim to have the "freshest tasting coffee." Each shop advertises the unique benefits of its coffee and prices. This is an example of
d. an oligopoly.
Learning Objective 2-3: Degrees of Competition
AACSB: Analytical thinking

2-3 Jeannette has a successful organic spa business in which she gives massages, facials, and organic body treatments. Last summer, another organic spa opened up in town. The supply curve for Jeanette's business would shift in which direction?
a. To the right
Learning Objective 2-2: Determining Price: Supply and Demand
AACSB: Application of knowledge

2-4 Which of the following is a determinant of demand?
c. Price of substitute goods
Learning Objective 2-2: Determining Price: Supply and Demand
AACSB: Application of knowledge

2-5 Racerback Swimwear, an Australian company, opens a factory near Tallahassee, Florida. The value of the swimsuits produced in the new Florida factory is included in which country's GDP?
b. United States
Learning Objective 2-4: Economic Indicators
AACSB: Application of knowledge

2-6 Which of the following tracks the prices of goods and resources sellers use to create their products?
b. CPI
Learning Objective 2-4: Economic Indicators
AACSB: Application of knowledge

2-7 Jackson Paulson works as a waterskiing instructor at Migis Lodge on Sebago

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Lake. He claims unemployment from October through April. Jackson experiences which type of unemployment?
b. Seasonal
Learning Objective 2-4: Economic Indicators
AACSB: Application of knowledge

2-8 Which of the following is an example of the government's fiscal policy to stimulate an economy?
a. Increased government spending
Learning Objective 2-5 Government and the Economy
AACSB: Application of knowledge

2-9 What results when there is an increase in overall prices?
a. Inflation
Learning Objective 2-4: Economic Indicators
AACSB: Application of knowledge

2-10 At which point in the business cycle is the economy when GDP declines for two or more successive quarters?
b. Recession
Learning Objective 2-5: Government and the Economy
AACSB: Analytical thinking

True/False *You can find the answers on the last page of this book.*

2-11 Microeconomics is the study of the behavior of the overall economy.
☐ **False**
Learning Objective 2-1: The Basics of Economics
AACSB: Analytical thinking

2-12 The discount rate is what is charged when banks borrow emergency funds from each other.
☐ **False**
Learning Objective 2-6: Government and the Economy
AACSB: Analytical thinking

2-13 Sweden, with its high taxes and widespread government programs, is a good example of a market economy.
☐ **False**
Learning Objective 2-1: The Basics of Economics
AACSB: Analytical thinking

2-14 To celebrate the first day of summer, an ice cream shop dropped the price of its cones to 10 cents and sold out of them within two hours. This created a shortage of ice cream cones.
☐ **True**
Learning Objective 2-2: Determining Price: Supply and Demand

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AACSB: Application of knowledge

2-15 The M-1 money supply measure consists of currency, traveler's checks, and checking accounts.
☐ True
Learning Objective 2-6: Government and the Economy
AACSB: Analytical thinking

Critical Thinking Questions: Suggested Answers

2-16 Both monetary and fiscal policy are used to stimulate economic growth or control inflation.

Monetary policy is carried out by the Federal Reserve System (the Fed), and it involves controlling the supply of money. The Fed has three tools with which it can do this:

- The reserve requirement involves raising or lowering the percentage of commercial bank's checking and savings accounts that they must keep in the bank as cash.
  - To increase the money supply, the Fed would lower the reserve requirement.
  - To decrease the money supply, the Fed would increase the reserve requirement.
- Open market operations consist of the buying and selling of government bonds.
  - To increase the money supply, the Fed buys government bonds from individuals, corporations, or organizations that are willing to sell.
  - To decrease the money supply, the Fed sells government bonds.
- The discount rate is the interest rate that the Fed charges for loans to its member banks.
  - To increase the money supply, the Fed would lower the discount rate, encouraging banks to borrow money and thereby increasing the funds they have available for loans.
  - To decrease the money supply, the Fed would increase the discount rate, discouraging banks from borrowing money and thereby reducing the funds they have available for loans.

Fiscal policy refers to the federal government's efforts to stabilize the economy. The government can do this in one of two ways:

- Taxation
  - When the government wants to slow down inflation, it can increase taxes. A tax increase means that consumers have less money to spend. This in turn slows the growth of businesses, because they have to produce less, and consequently slows down the economy.

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- Although decreasing taxes conceptually gives consumers more money to spend, it does not have the same direct effect because consumers may choose to save the money rather than spend it.

- Fiscal spending
  - To simulate the economy, the government spends money on a wide variety of projects, such as infrastructure improvements (highways, bridges, etc.) and other projects that benefit the military, education, and health care. This creates additional jobs, puts money into consumers' hands, and stimulates spending.

    Learning Objective 2-5: Government and the Economy
    AACSB: Application of knowledge

2-17 Answers will vary regarding the privatization of the U.S. Postal Service and Amtrak. Some of the points the students should consider are:

Pros
1. Privatization can be an effective way to fund critical infrastructure needs.
2. Privatization can provide a source of immediate revenue for strained public budgets.
3. Private infrastructure funds are an attractive investment vehicle for certain investors, making infrastructure privatization appealing to potential bidders.
4. Historically low interest rates enable private firms to make highly leveraged infrastructure investments.
5. Because the private sector can often deliver greater efficiencies than government, privatization can result in better service at lower cost
6. Privatization can be a politically expedient solution to public problems.

Cons
1. Privatization constrains future options.
2. Privatization may have social implications, adversely affecting certain groups.
3. Stealing from the future? Privatization deals typically generate huge cash windfalls in the present in exchange for revenue streams that would otherwise accrue to citizens in the future.
4. Privatization may result in an undervalued deal.
5. Private entities may fail to fulfill contractual obligations.
6. A lack of public input.

1.1.1 The Pros & Cons of Privatization | Government Finance Officers ...
www.gfoa.org/**pros-cons-privatization** Date Published**:** June 2011

Learning Objective 2-5: Government and the Economy
AACSB: Application of knowledge

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2-18. Answers will vary with some students arguing that the definition of GDP should be changed but most students will probably argue that the current definition is sufficient recognizing that whatever definition that is used will be criticized by somebody. The value of the current definition is the consistency when comparing various economies.

Learning Objective 2-4: Economic Indicators
AACSB: Application of knowledge

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Team Time
The Great Debate

2-19 Answers will vary. However, the point of the exercise is to help students understand the process of monetary regulation and to discuss who has a right to regulate how money flows in the U.S. economy.

Learning Objective 2-5: Government and the Economy
AACSB: Application of knowledge

2-20 Answers will vary. However, the point of the exercise is to help students understand the process of monetary regulation and to discuss who has a right to regulate how money flows into the U.S. economy.

Learning Objective 2-5: Government and the Economy
AACSB: Application of knowledge

2-21 Answers will vary. However, the point of the exercise is to help students understand the process of monetary regulation and to discuss who has a right to regulate how money flows into the U.S. economy.

Learning Objective 2-5: Government and the Economy
AACSB: Application of knowledge

Ethics and Corporate Social Responsibility
Economic Inequality

Answers to questions 2-22, 2-23, 2-24, and 2-25 will vary. However, be sure to have students consider how the type of economy in which they are currently living (capitalism) influences their answers to this question. Would students living in a planned economy, such as communism or socialism, answer the questions in the same way?

Learning Objective 2-1: The Basics of Economics
AACSB: Application of knowledge

Web Exercises
2-26 Getting Acquainted with Your Local Federal Reserve Bank
The Federal Reserve Banks are: Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis Minneapolis, Kansas City, Dallas, and San Francisco. Students' answers will vary, depending upon the Federal Reserve Bank selected and the latest news/policies on its website.

Learning Objective 2-5: Government and the Economy
AACSB: Application of knowledge

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2-27 AT&T and Antitrust Regulations
Students' answers will vary, depending on their personal experience with the communications industry and their opinions regarding the government's intervention in breaking up the AT&T monopoly.

Learning Objective 2-3: Degrees of Competition
AACSB: Application of knowledge

2-28 Learning More About Supply and Demand
Students' answers will vary, depending on their experience with the game. The game puts students in the position of being the inventor of a new product and walks them through decisions such as determining demand and supply, plotting demand and supply curves, whether shortages or surpluses exist at certain price points, if other goods are complementary or substitute, and how certain factors will cause shifts in the demand and supply curve. Answers should reflect these concepts.

Learning Objective 2-2: Determining Price: Supply and Demand
AACSB: Application of knowledge

2-29 Pro Sports and the Economy
Students' answers will vary, depending on their experience with the game. The game is divided into nine "innings" and each inning examines a different issue, such as how the pro sports market evolved, how leagues gained market power, why athletes earn as much as they do, the sources of pro sports revenue, why tickets cost so much, why there is such a high level of economic conflict in modern pro sports, and the globalization of pro sports. Reference the Teacher's Guide for the game at
http://www.bostonfed.org/peanuts/teacher/guide.htm

Learning Objective 2-2: Determining Price: Supply and Demand
AACSB: Application of knowledge

5. Monetary Policy: You're in Control
Students' answers will vary, depending on their experience with the game. The game asks students to take charge of a simulated economy and make decisions about adjusting the federal funds rate every three months for the next four years. As they make decisions, they will see the resulting effects on inflation and unemployment, and they will also be asked to react to other events (such as oil shortages) that affect the economy.

Learning Objective 2-5: Government and the Economy
AACSB: Application of knowledge

Suggested Answers MyBizLab

2-31 Answers will vary but students should focus on the shift in the supply curve based on an increase in the number of competitors.

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Learning Objective 2-2: Determining Price: Supply and Demand
AACSB: Application of knowledge

2-32 Answers will vary. This question gives students and opportunity to focus on macroeconomic outcomes and the role that government plays in the economy.

Learning Objective 2-5: AACSB: Application of knowledge
AACSB: Application of knowledge

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Better Business, 5e **(Solomon/Poatsy/Martin)**
Mini-Chapter 2 Constructing an Effective Business Plan

1) Which of the following statements is MOST correct about the writing of business plans?
A) Smart entrepreneurs always write business plans before they start businesses.
B) Smart entrepreneurs tend to write business plans one month after staring businesses.
C) Smart entrepreneurs do not write business plans.
D) Smart entrepreneurs may potentially write business plans at different times.
E) Smart entrepreneurs don't need business plans.
Answer: D
Explanation: Smart entrepreneurs write business plans at different times. Traditionally, a potential business owner writes a business plan *before* a business is launched, but it can be written after a business has been established. In some instances, and especially in industries in which change occurs rapidly, a business opportunity might be lost if you do not start operations immediately; you may not have time to take the weeks or months often required to write a business plan.
Diff: 2
Classification: Concept

2) Which of the following entrepreneurs would MOST likely start their business as quickly as possible, spending little time on a business plan?
A) Madison is starting a business to provide makeshift shelters to natural disaster victims.
B) Stacia is starting a housecleaning business for working couples with children.
C) Danisha is starting a personal coaching business for senior high school girls wanting to be computer software developers.
D) Luke is starting a café business that will operate from 11pm to 3am Monday through Thursday.
E) Domenica is starting an interior design firm specializing in restaurant interiors.
Answer: A
Explanation: In industries that change very quickly, the business opportunity could be lost if operations are not started immediately. In this instance, taking weeks to write a plan may not be feasible. Businesses such as housecleaning, personal coaching, cafés, and interior design are consistently stable. Natural disaster victims need shelter quickly so Madison would need to write a business plan rapidly, if she was to write one at all.
Diff: 2
AACSB: Analytical Thinking
Classification: Application

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3) Which of the following statements is TRUE about the components of a business plan?
A) Potential business owners can use a common template to write a business plan because all plans share the same components.
B) Business plans all have the same key components; however, some may be included in a different order.
C) All business plans discuss the specific product before analyzing how the product fits the market.
D) All business plans are different depending on the business; however, most have a few components in common.
E) All business plans are unique and share no common characteristics or components.
Answer: D
Explanation: Each business is unique, so business plans can be drawn up in a variety of ways. Still, most business plans share a few basic components. A typical business plan for a start-up company is about 35–60 pages in length and contains eight key elements: cover sheet/TOC; executive summary; company and management team; market analysis; product; sales and promotions; financials; and appendices.
Diff: 2
Classification: Concept

4) What should a potential owner do BEFORE writing a business plan?
A) determine whether personal goals and business goals are aligned
B) ensure that the key components of the plan will be addressed
C) determine the best location and pricing structure for the business
D) make sure there is enough information to prepare financial statements
E) decide which appendices to include in the final pages
Answer: A
Explanation: Before writing a business plan, potential owners should evaluate their personal goals and objectives. By doing so, potential owners can crystallize their focus and realize what their priorities are for the business.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

5) The following are all components of a business plan EXCEPT _____.
A) the chapter summary
B) product descriptions
C) sales and promotion details
D) the table of contents
E) the executive summary
Answer: A
Explanation: A chapter summary is not necessary because the business plan's content will be organized in the table of contents and the executive summary highlights the main points of the plan. Descriptions of the product or service and details about sales and promotion are all crucial components of the business plan.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

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6) When investors read an executive summary, they usually look for all of the following EXCEPT _____.
A) the business's purpose
B) details about the pricing of company products
C) information about the business's operating methods
D) anticipated profitability of the business
E) the business's value
Answer: B
Explanation: An executive summary contains only a broad overview of the business, enough information to get a potential investor interested in the company. Details such as pricing strategies are discussed in the product section of the business plan. After reading the executive summary, someone should have an understanding of the business's purpose, value, operating methods, and profitability.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

7) The order in which the key elements of a business plan are organized _____.
A) is random
B) does not matter
C) should always put a complete product description first
D) must prioritize the elements of utmost importance to the business owner
E) should be the order of importance to the person reading the document
Answer: E
Explanation: The order in which the key elements are included is not random; they should be in the order of importance to the person reading the document. Therefore, although a complete description of your product may be of utmost importance to you, your investors and key contributors first need to know about the market before the specifics of your product.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

8) Rick's business plan cover sheet includes basic company information, the month and year of the business plan, and the names of the people who prepared his plan. What key information did Rick NOT include on the cover sheet?
A) brief description of the business
B) unique record number
C) brief description of the owner(s)
D) the mission statement
E) anticipated challenges and planned responses
Answer: B
Explanation: A unique record number should be included so that you can track who received which copy so you can easily follow up with him or her.
Diff: 1
Classification: Concept

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9) Lucia is working on her executive summary. Which information will she NOT include here?
A) expected growth rate
B) predicted future profits
C) projected yearly sales
D) amount of and uses for capital
E) social media strategy
Answer: E
Explanation: This is included in the sales and promotion section. The executive summary should contain information about the company's unique competitive advantage and projections for future sales, growth, and profits.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

10) Robyn's business has an expiring patent that could negatively affect her ability to secure investors. In which section of the business plan should Robyn disclose the expiring patent information?
A) Robyn should include it in the executive summary.
B) Robyn should include it in the company and management team section.
C) Robyn should include it in the sales and promotion section.
D) Robyn should include it in the market analysis section.
E) Robyn should not mention the expiring patent because it hasn't expired yet.
Answer: B
Explanation: Within the company and management team section, there is a subsection called, "Anticipated Challenges and Planned Responses." This is where potential vulnerabilities, like an expiring patent, would be listed. A business plan gives the potential investor the full picture of the business including risks and challenges. It is very important to address the risks and available options and resources to mitigate problems.
Diff: 2
AACSB: Analytical Thinking
Classification: Application

11) The following are all key elements in the company and management team section of the business plan EXCEPT _____.
A) description of which companies will provide the materials to manufacture the product
B) explanation of what economic trends are emerging and how they will affect future growth
C) description, if applicable, of the board members for the business
D) explanation of why the business has the unique opportunity to impact the industry
E) the mission and vision statements
Answer: A
Explanation: A description of which companies or vendors will be supplying materials to produce the items is included in the product and service section. Economic trends, board member names, industry impact, and mission and vision statements are included in the company and management team section.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

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12) When writing a market analysis for your business plan, you should include all of the following EXCEPT _____.
A) explanation of the advantage of using your business's product or service
B) identification of age and location of potential customers
C) description of methods that will be used to promote the business
D) description of the potential growth for the good or service
E) a clear understanding of your competition
Answer: C
Explanation: The market analysis includes the necessary research to determine if there will be enough customers for the business and what the competitive advantages are in the field. Through the analysis, the business owner should be able to identify how customers will benefit, the demographics of customers (e.g., where do they live, ages), and the condition of the market. Is it expanding or shrinking? Strategies for promoting the business are included in the sales and promotion section.
Diff: 3
AACSB: Analytical Thinking
Classification: Concept

13) Which section contains an analysis of whether there will be enough customers to purchase the product in the future?
A) market research
B) market investment
C) competitive assessment
D) promotional plan
E) financials
Answer: A
Explanation: The market research section of a business plan contains necessary information to help the business owner decide how large the customer base is and the future potential for the product.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

14) Which section of a business plan lists what a company thinks customers would be willing to pay for the merchandise?
A) financials
B) sales and promotion
C) product
D) market analysis
E) executive summary
Answer: C
Explanation: The product section discusses customer pricing. After doing research, the business owner has a better understanding of what customers would be willing to pay for the product. This is not discussed in the financials, sales and promotion, or market analysis sections.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

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15) In which section of a business plan would you find a statement that another company charges more money for a similar product?
A) executive summary
B) company and management team
C) product
D) sales and promotion
E) financials
Answer: C
Explanation: The product section should cover your pricing strategy. In your pricing discussion, detail any aspects of the product that require a higher price, such as using premium materials. Additionally, you must conduct a thorough analysis of what the competition is charging for a similar product, noting the differences in their product or your product that justify a price differential.
Diff: 3
AACSB: Analytical Thinking
Classification: Concept

16) A potential investor wants to know if the proposed auto body shop will be offering warranties on its service. In which section of the business plan should the investor look?
A) product
B) appendices
C) sales and promotion
D) company profile and strategy
E) market analysis
Answer: A
Explanation: The product section describes the product and all its pertinent details. It is also important to discuss ongoing service aspects that are provided with the product, such as warranties and repairs.
Diff: 1
AACSB: Analytical Thinking
Classification: Application

17) Eva is planning to buy raw materials from an international supplier for her educational toy company. Where would she include this information in her business plan?
A) company profile
B) product
C) appendix
D) sales and promotion
E) This information does not have to be included in the plan.
Answer: B
Explanation: The product section includes all information about producing the product, which includes who the suppliers are going to be for the business. These details are important so potential investors can make an informed decision whether to fund the business or not.
Diff: 1
AACSB: Analytical Thinking
Classification: Application

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18) Zach plans to promote his fly fishing business through an aggressive Internet marketing campaign by utilizing search engine optimization strategies. How should he incorporate this information in his business plan?
A) Zach should include the details in the market analysis section.
B) Zach should describe the campaign in the executive summary.
C) Zach should add this to the sales and promotion section.
D) Zach should mention this strategy in the appendices.
E) Zach should not include this information in the business plan.
Answer: C
Explanation: The sales and promotion section describes which marketing strategies the business owner will do to reach the target markets. Internet marketing is a strategy and would be included in the sales and promotion section. The market analysis does not list specific strategies and neither does the executive summary.
Diff: 2
AACSB: Analytical Thinking
Classification: Application

19) Companies should put their financials through a _____ by showing how they expect the business to perform in different situations.
A) budget query
B) cash flow analysis
C) dry run
D) stress test
E) reality check
Answer: D
Explanation: A stress test is very important because it identifies how the business will operate financially given worst case, expected case, and best case scenarios.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

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20) Dwayne is seeking financial assistance for his business and needs to include a statement of funding requirements in the business plan. The statement of funding requirement should include all of the following EXCEPT _____.
A) term of the loan
B) personal credit history
C) type of funding needed
D) amount of capital needed
E) an exit strategy
Answer: B
Explanation: If one of the primary purposes of a business plan is to seek outside financing, another component of the financial section is a statement of funding requirements that indicates information such as the amount of capital needed, the type of funding, the loan's terms, and how the funds will be used. Investors will also want to see how you intend to pay them back—the timing, the return on investment, and an exit strategy that you might want to suggest to investors. Since the statement of funding is based on the business, personal credit is not included in this section.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

21) What should NOT be stated in the financials section of the business plan?
A) length of time before investors receive revenue
B) amount of revenue to be paid to investors
C) balance sheet
D) price differential between your products and your competitor's products
E) cash flow statement
Answer: D
Explanation: The business plan should include a thorough analysis of what the competition is charging for a similar product, noting the differences in their product or your product that justify a price differential. This is included in the product section of the business plan, not in the financials section.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

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22) What is the purpose of the appendices in a business plan?
A) to provide additional information that adds to the credibility of your business plan
B) to summarize your business plan and to remind investors of the key points of the plan
C) to provide a summary of the projected income that has not been adequately provided within the plan
D) to provide key definitions for industry terms used in the plan as it will be read by non-industry experts
E) to provide a clear and concise (abbreviated) form of the entire business plan
Answer: A
Explanation: Appendices provide additional information that adds to the credibility of the business plan. Summarizing key points and the projected income as well as definitions would not be found in the appendices.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

23) All of the following are included within the business plan BEFORE the appendices EXCEPT _____.
A) marketing strategy
B) professional references
C) core production strategy
D) table of contents
E) company profile and strategy
Answer: B
Explanation: The appendices of a business plan contain extra information added to the plan, not core information. A listing of personal references would be contained in the appendices.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

24) Business plan competitions at universities are simply the culmination of an academic exercise.
Answer: FALSE
Explanation: Business plan competitions, once deemed as the culmination of an academic exercise, are now sources of serious money.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

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25) Entrepreneurs must write business plans before beginning their businesses.
Answer: FALSE
Explanation: Not all entrepreneurs write business plans before starting their businesses. There is no rule as to when business plans must be written. In some instances, and especially in industries in which change occurs rapidly, a business opportunity might be lost if you do not start operations immediately. You may not have time to take the weeks or months often required to write a business plan.
Diff: 1
Classification: Concept

26) Once a business has been operating for more than a year, it makes little sense to write a business plan if one has not been previously written.
Answer: FALSE
Explanation: It is never too late to write a business plan. Business plans help business owners consider their business's processes, procedures, and products. It is never too late to do this.
Diff: 3
AACSB: Analytical Thinking
Classification: Concept

27) The executive summary is so crucial that if it does not meet a potential investor's expectation, he or she might stop reading the plan and discard it.
Answer: TRUE
Explanation: Potential investors may frequently be asked to read and evaluate business plans, which is time consuming. The investor's goal is to minimize risk and make a profit. If entrepreneurs can not properly articulate their business operations, then an investor may question their ability to effectively run a business. Many investors stop reading rather than potentially waste their time.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

28) Customer benefits are those things that do something better for the customer.
Answer: TRUE
Explanation: They affect a person's feelings, pocketbook, or both.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

29) Information on personnel recruitment for a service oriented business belongs in the management team section of the business plan.
Answer: FALSE
Explanation: The product section details how you will find qualified workers and how they will be trained. The management team section lists the names and pertinent experience of the management personnel and board of directors, if applicable.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

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30) Entrepreneurs should ALWAYS prepare their own financial statements and NEVER use financial software because they need to fully understand how the numbers were generated.
Answer: FALSE
Explanation: It is acceptable to use financial software to generate statements; however, the entrepreneur must be able to explain every number used. Understanding and defending financial statements builds investor confidence.
Diff: 2
AACSB: Analytical Thinking
Classification: Concept

31) An exit strategy is often included in the financial section of a business plan.
Answer: TRUE
Explanation: Investors want to see how you intend to pay them back–the timing, the return on investment, and an exit strategy that you might want to suggest to investors.
Diff: 3
AACSB: Analytical Thinking
Classification: Concept

32) Even though it is a professional document filled with details and financial statements, it is important to capture the investor's attention by making the business plan interesting to read.
Answer: TRUE
Explanation: Just because the business plan includes a thorough analysis of a business with financial statements and projections, it does not mean it has to be dry and bland. In fact, the opposite is true. Business plans should capture investors' interest and make them really want to back a business and help it succeed.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

33) Business plans must be lengthy, formal documents.
Answer: TRUE
Explanation: While some business plans are lengthy, formal documents that can take weeks or months to pre-pare, others are short, informal outlines. Regardless of when or how it is written, a business plan is a crucial part of a successful business operation.
Diff: 1
AACSB: Analytical Thinking
Classification: Concept

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34) First describe a potential business you would like to start. Then describe three ways a business plan could help you be more successful.
Answer: Student answers will vary. However, they should include a business description and then a few sentences about how a business plan can increase the chances of success. For example, a business plan a) helps identify the company's goals and objectives, b) helps identify a potential need, and c) explains how the business can be profitable.
Diff: 3
AACSB: Written and Oral Communication
Classification: Application

35) Describe in a paragraph why a well-defined business plan may attract high-quality employees.
Answer: Answers may include: In order to recruit high-quality employees, a business owner must understand the company's operation, product, and direction toward profitability. Quality workers are in demand and search for top-notch companies who have a very clear direction and purpose. A well-defined business plan forces an entrepreneur to think and evaluate all the aspects of the business from its mission and management team to operations and sales and marketing.
Diff: 3
AACSB: Reflective Thinking
Classification: Concept

36) Steven wants to buy ten acres of land and start an organic farm near his home. He does not think that he has time to write a business plan. Describe three potential consequences of NOT writing a business plan.
Answer: Answers may include: If Steven does not write a business plan, then 1) he probably will not attract investors to help buy the land, equipment, etc., 2) the market research probably will not be complete and there would be missed opportunities for reaching different customers, and 3) he may not know how much revenue he needs to generate to cover his expenses and make a profit.
Diff: 2
AACSB: Reflective Thinking
Classification: Application

37) You recently graduated from business school and you want to open up a small pizzeria in a large college town. There is a perfect space to lease for the pizzeria; however, a few doors down is a very well-established Italian restaurant that has been around since 1964. Their food has been legendary for all of those years. How would a market analysis help you decide if opening up the pizzeria near the restaurant would be a good idea or not?
Answer: A market analysis would identify how large the customer base is in the town, how many tourists eat at restaurants, and if there is enough of a market to support another eatery. Also, a market analysis would identify the strengths and weaknesses of the other food establishments and what your competitive advantages would be over those businesses.
Diff: 3
AACSB: Analytical Thinking
Classification: Application

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38) Imagine you just started a landscaping business in an area that gets very little rain each year. Your market research indicated that the homeowners would pay top dollar to beautify their lawns. Besides advertising in the newspaper or on the radio, name three ways you could promote the business.
Answer: Answers might include distributing your business flyer throughout the town, sending an email to everyone you know in the area and letting them know about the service, and attending the Chamber of Commerce meetings.
Diff: 3
AACSB: Reflective Thinking
Classification: Application

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