ECONOMICS

Distance Module II

GRADE 9

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Module Introduction

Dear distance learner, welcome to the module on Economics grade 9. As module writers, we are highly concerned about you. In preparing this course module, we have tried to consider your needs and knowledge you have acquired earlier, experience and previous learning. We organise this course into two modules. This is the second module "Module II", which contains four units, namely, introduction to production and cost; introduction to money; introduction to macroeconomics; and basic entrepreneurship. The objective of this module is to introduce you to these units. Each module of the subject consists of interrelated units. We divide the units into a number of sections. In some cases, we further divide the sections into sub-sections. We expect you to complete this module in a total of 60 hours. As you go through the module, you encounter unit and section outcomes stated at the beginning of each unit and section. Please read the module thoroughly in order to achieve the stated objectives after completing your study of the intended unit or section.

When you read the module, you will see questions. They provide you with the opportunities to apply your previous knowledge. These in text questions have also motivational value. Try to answer them in order to develop critical thinking. There are self-check tasks at the end of each section that allow you to assess your understanding of the topics covered in relation to the objectives shown at the beginning of the section. The final task of each section is a self-test. Try to respond to the self-test without consulting your notes. At the end of each unit, you will get the answers to all the tasks and the self-test. After completing the tasks and the self-test, compare your response to the answer key provided at the end of each unit. At the end of each module, you will have an assignment. Do it and submit your answers to your tutor.

Unit Learning Strategies

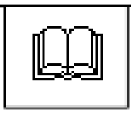
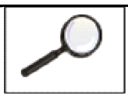
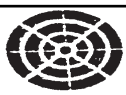
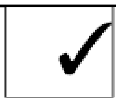
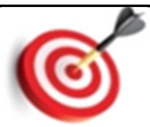
Dear distance learner, note that each unit has a self-study format. Pay attention to it consistently throughout your study in order to learn each unit effectively. The following learning strategies will help you study each unit.

- Topical Reading
- Doing varieties of activities
- Completing written exercises
- Activities based on the learner’s experience
- Extra-curricular learning
- Scenario-based activity
- Auto tutorial instruction

Table of Contents

Icons

Throughout each module, you will find the following icons or graphic symbols that alert you to a change in activity within the module. Onlythe icons that are required are used in each module.

 Text or Reading Material	provides information aboutthe topics that are covered.
 Self-check	requests that you double-check your comprehension. If you mark any box under the ‘No’ column, please look at the corresponding item to the left and go back to your text and read about it.
 Summary	highlights or provides an overview of the mostimportant points covered
 Overview	introduces you to focus on the content that will be discussed
 Suggested Answers	allows you to evaluate your learningby providing sample answers to assessments and activities
 Objective	indicates what you should know after completing a section or unit.
 Self-Assessment	enables you to check your understanding of what you have read and, in some cases, to apply the information presented in the unit to new situations.
	
 Recall for prior learning	requires you to focus on thecontent that will be discussed in a section or unit

Unit 5

Introduction to Production and Cost

Unit Introduction

The unit is divided into three sections, each of which covers various aspects and elements of production and cost in order to better understand the behavior of firms (producers) in the production of goods and services. The first section presents the definition of production, inputs, and outputs. The second section deals with periods of production, and the last section introduces the cost of production.

Unit Outcomes

At the end of this unit, you will be able to:

- Describe productivity
- Explain the types of inputs and outputs
- Analyse types of production costs.

Key Concepts

Inputs, outputs, production, short-run, long-run, production function, cost, fixed cost, variable cost, total cost, and marginal cost.

The Required Study Time: 12 hours

5.1. Definition of Production, Inputs, and Outputs

Overview

This section deals with definition of production, inputs, and outputs. It discusses the concepts of production and the production function. It also discusses the concepts of inputs and outputs.

Learning Outcomes

At the end of this section, you will be able to:

- Describe production
- Explain the types of inputs and outputs

5.1.1. Definition of production

Dear distance learner, how do you define production based on your life and work experiences so far? Have you ever engaged yourself in any production activity?

Production is the process of transforming inputs into outputs. For example, when we get wheat on a plot of land with the help of inputs like labour, capital, and seeds, it is termed as "the production of wheat". Similarly, when, in a cloth mill, inputs like labour, capital, and threads are transformed into cloth, it is called the "production of cloth". Similarly, services are also produced in an economy. For instance, in economics, the services of a teacher, a doctor, a singer, and servants are also called production. More importantly, the production function shows the relationship between various combinations of inputs and the maximum outputs obtainable from those combinations.

Activity 5.1

1. What do you mean by production?

5.1.2. Definition of inputs and outputs

Dear distance learner, can you define "inputs" and "outputs"? Also, try to mention the different types of inputs and outputs. Have you tried it? Good.

Inputs are economic resources that can be used in the production of goods and services. Inputs can be divided into two main groups: fixed and variable inputs. A fixed input is one whose quantity cannot be varied during the period under consideration. Buildings and machinery are examples fixed inputs. A variable input is one whose quantity can be changed during the period under consideration. Raw materials and labour inputs are examples of variable inputs.

Outputs are consequences of the production process. Outputs can be classified into tangible and intangible products. Tangible goods are physical products defined by their ability to be touched. They are different from intangible goods, which may have value but are not physical objects. Goods that are tangible play a large part in retail, though the purchasing of intangible goods is now widely available through the Internet (online shopping).

The main difference between tangible and intangible outputs is that tangible is something that a person can see, feel or touch. Thus, it has a physical existence. While the intangible is something which a person cannot see, feel, or touch. Hence, it does not have a physical existence.

Examples of tangible outputs include: building, machinery, equipment, car, etc. that have long term physical existence. Examples of intangible outputs include: insurance coverage, consultancy service, computer software, educational training, health care service, etc. that cannot often be tried out, inspected, or tested in advance.

Activity 5.2

1. How do you define inputs and outputs?
2. What is the difference between fixed and variable inputs?

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of production, the production function, inputs, and outputs. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain the concept of production?		
Are you able to define the concept of production function?		
Can you give examples of the different types of inputs and outputs?		

Dear distance learner, did you mark any boxes under the "No" column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 5.1

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Production is the act of converting inputs into outputs.
2. A production function is the minimum set of outputs that can be produced with a given set of inputs.
3. The consequences of the production process are known as outputs.
4. A variable input is an input whose quantity can be changed during the period under consideration.
5. Tangible asset is an asset that does not have a physical existence.

5.2. Periods of Production

Overview

This section deals with the periods of production function. It discusses the short-run and long-run periods of production. It also discusses the different forms in the productivity of variable inputs.

Learning Outcomes

At the end of this section, you will be able to:

- Describe the short-run and long-run production.
- Distinguish among total product, average product, and marginal product.

5.2.1 Classification of periods of production

Dear distance learner, from your previous study and practical experience, what do you know about production period? Did you think about it? Okay.

A "short-run" period of production is a period of production in which at least one of the inputs is fixed while the remaining is variable. This implies that increasing those inputs that can be varied--known as 'variable inputs'--can result in an increase in output in the short run. For example, if a producer wishes to increase output in the short run, she or he can do so by using more of the variable inputs like labour and raw material.

A "long-run" period of production is a period of production in which all inputs are variable or there is no fixed resource in general. A firm can install a new plant or construct a new factory building. Long-run is the period during which the plant size can be changed. Thus, all inputs are variable in the long run.

It must be understood that when we say "short run" and "long run," it does not necessarily mean a relatively short or long period of time, like one year or less than one year. It rather refers to the nature of the economic arrangement of the inputs in response to the changing economic environment.

5.2.2 Total Product, Average Product and Marginal Product in the Short Run

Dear distance learner, could you describe the different forms in the productivity of variable inputs? Did you attempt it? Good.

Total product (TP) is the total amount of output produced by the factors of production employed over a given period. It is the entire output by workers expressed in terms of quantity (Q). A firm obtains its total product in the short-run production function by combining variable inputs and some fixed inputs.

Average product (AP) is obtained by dividing the total output by the number of workers employed. This can be expressed as AP = TP/L, where AP = Average Product, TP = Total Product and L = Labour. Specifically, the average product of labour can be defined as

$$AP_L = \frac{TP}{L}$$

.

Where, TP shows total production and AP_L shows average product of labour.

The average product is a good indicator of the productivity of labour. Productivity is a measure of output per unit input (i.e., the ratio of each output level to the corresponding input level).

Marginal Product (MP): Ceteris paribus, the increase in output which results from using one additional unit of a single input is called the marginal physical product or simply marginal product. In other words, all other things being equal, the MP is the percentage change in total output resulting from a percentage change in variable input. Mathematically,

$$\mathrm{M}P_L = \frac{\Delta \mathrm{TP}}{\Delta \mathrm{L}}$$

Where, ΔTP is a change in total product, and ΔL is a change in labour input.

Both the MP and AP of the variable factor (labour) are derived from the TP of labour. Thus, the three returns, viz., total product (TP), average product (AP), and marginal product (MP) are interrelated.

Table 5.1 Production function with one variable input

Variable input (labour)	Fixed input (capital)	Total Product (TP) (In quintals)	Average product (AP)	Marginal Product (MP)	Stages of Production
0	10	0	-	-	Stage I
1	10	10	10	10	
2	10	28	14	18	
3	10	51	17	23	
4	10	76	19	25	
5	10	95	19	19	Stage II
6	10	108	18	13	
7	10	108	15.4	0	
8	10	96	12	-12	Stage III
9	10	80	8.89	-16	

The above schedule can also be expressed graphically by drawing TP, MP and AP curves. The following figure depicts the relationship among total product, average product, and marginal product.

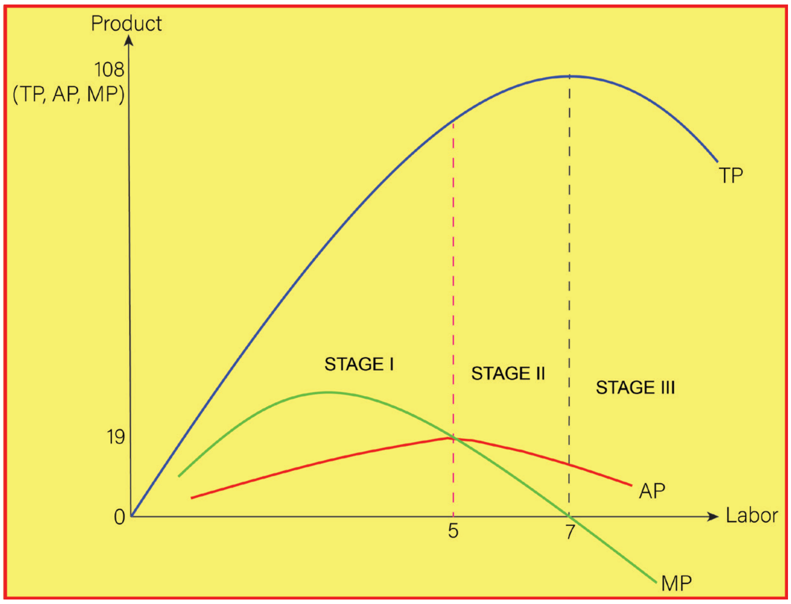


Figure 5.1 Stages of production

Activity 5.3

1. Explain the concepts of fixed and variable inputs in relation to short-run and long-run production functions.
2. Differentiate among Total Product, Average Product, and Marginal Product.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding about periods of production. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Are you able to describe the periods of production?		
Can you define the concepts of Total product, average product, and marginal product?		
Can you calculate the total product, average product, and marginal product?		

Dear distance learner, did you mark any boxes under the "No" column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 5.2

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Short-run and long-run do not necessarily mean a relatively short or long period of time.
2. Total product is the gross output produced by the factors of production employed over a given period.
3. Marginal product is the percentage change in total output resulting from a percentage change in variable input.
4. When the marginal product curve intersects the average product curve, average product is at its minimum.
5. If a producer wishes to increase output in the short run, she or he can do so by spending more on variables inputs like labour and raw materials.

5.3. Cost of Production

Overview

This section deals with the cost of production. It discusses the concept cost of production and the different types of costs. It also discusses the different forms of the productivity of variable inputs in the short-run.

Learning Outcomes

At the end of this section, you will be able to:

- Define the cost of production.
- Differentiate among the different types of costs.

5.3.1. Definition of cost of production

Dear distant learner, what does the word "cost" mean to you? In our daily lives, we encounter everything that is not freely accessible. Did you think about it? Good.

To produce goods and services, we need factors of production. These factors of production (resources) are bought through monetary outlays from factor markets. Thus, cost is defined as the monetary value of inputs used in the production of goods.

Types of Cost of Production

1. Explicit and implicit costs

Explicit costs: These are the actual monetary payments or cash outlays that business firms make to outsiders who are suppliers of inputs or resources to them. For example, the rewards of labour, land, capital, and entrepreneurs are all costs for a business firm that employs them in certain production processes. In addition, there are other payments made for other raw materials, fuel, transport, power, and the like are all costs to a firm. Such costs are usually termed "accounting costs" because they are out-of-pocket costs. Thus, accounting cost refers to the cost of purchased inputs only, and this is only the explicit cost.

Implicit costs: These are costs that stand for the values of non-purchased resources owned and used by firms in their own production activities. They are said to be implicit costs. There are costs associated with firms' own and self-employed resources in carrying out activities like the salary of an owner-manager or the estimated rent of a building that belongs to the owner of a firm, etc. The values of these self-owned resources should be estimated based on what they could earn in their best alternative use.

2. Economic Cost and Accounting Cost

It is obvious that costs and profits are inseparable concepts of business. Here, the main idea is to understand the cost treatment differences and their consequence in cost analysis of business activities. Economists and Accountants define and treat costs differently. Economists define costs in terms of opportunity costs and they include these implicit costs in profit calculations. Thus,

Economic cost = Implicit costs + Explicit costs

Accounting cost is the monetary value of all purchased inputs used in production; it ignores the cost of non-purchased (self-owned) inputs. It considers only direct expenses such as wages/salaries, cost of raw materials, depreciation allowances, interest on borrowed funds and utility expenses (electricity, water, telephone, etc.). These costs are called explicit costs. They are out of pocket expenses for the purchased inputs.

3. Fixed and Variable Costs

Fixed costs are those costs that do not vary as the firm changes the level of output. These are costs that are always incurred even if the firm does not produce anything. These are also costs of fixed inputs. For example. rents on leased properties, interest on borrowed funds, the wear and tear of machineries, cost of administrative staff, etc. Variable costs are those costs of production that directly vary with the level of output of the firm. When output is zero variable costs are also zero. But as the firm expands its output these costs tend to rise. In short, variable costs of a firm are dependent on the level of output. Examples of variable costs are wage of workers excluding the administrative staff, cost of raw materials, etc. Total cost is the sum of total fixed cost and total variable cost. Or TC = TFC + TVC

Where, TC = Total Cost; TFC = Total Fixed Cost; and TVC = Total Variable Cost.

Activity 5.4

1. Define the cost of production.

5.3.2. Total Cost, Average Cost and Marginal Cost

Dear distance learner, what do you think about Total cost, Average cost, and Marginal cost? Did you think about it? Can you give practical examples in your area? Did you try it? Good.

In a production process, firms make a monetary payment to outsiders who are suppliers of inputs or resources to them. These cost outlays can be categorised as total cost, average cost, and marginal cost.

Fixed costs are those costs that do not vary as the firm changes its level of output. These are costs that are always incurred, even if the firm does not produce anything. These are also fixed-input costs. e.g., rents on leased properties, interest on borrowed funds, the wear and tear of machinery, the cost of administrative staff, etc.

Variable costs are production costs that vary directly with the firm's output level. When output is zero, variable costs are also zero. But as the firm expands its output, these costs tend to rise. In short, the variable costs of a firm are dependent on the level of output. Examples of variable costs are the wages of workers excluding the administrative staff, the cost of raw materials, etc.

The total cost is the sum of the total fixed cost and the total variable cost.

$$TC = TFC + TVC$$

where, TC = Total Cost; TFC = Total Fixed Cost; and TVC = Total Variable Cost.

Table 5.2 Short run costs of a firm

Q (output)	TFC (birr)	TVC (birr))	TC (birr))
0	60	0	60
1	60	20	80
2	60	40	100
3	60	60	120
4	60	65	125
5	60	75	135
6	60	120	180

We can also show the above data graphically, as follows:

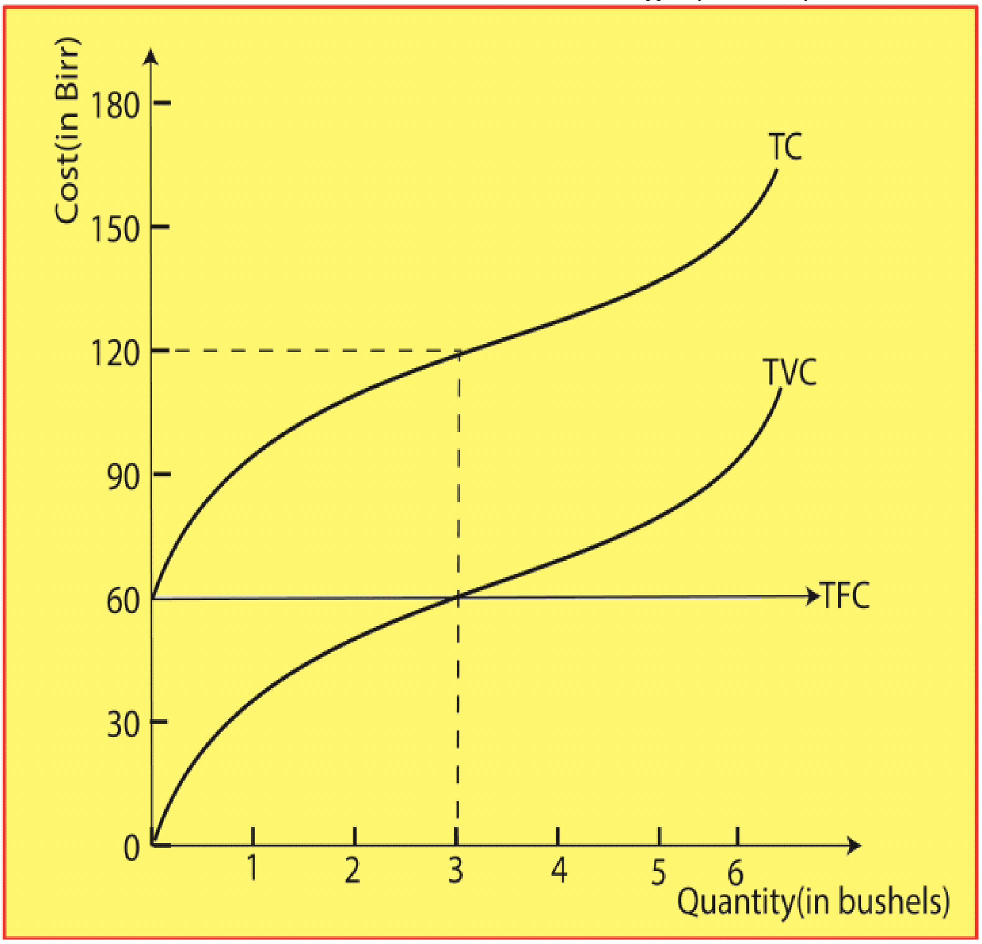


Figure 5.2 Cost curves

From table 5.2, we observe that TFC is at least 60 even if the output is zero. Moreover, the TFC curve is parallel to the quantity axis and is 60 birr above it. However, TVC is zero when output is zero and rises as output rises. The TVC initially rises at a decreasing rate, but later on it increases at an increasing rate. This is true because the firm initially uses few variable inputs and many fixed inputs, and at this point the TVC increases at a decreasing rate. Later on, as the firm employs more variable inputs with fixed inputs, its costs tend to rise at an increasing rate. The TC is the sum of the TVC and TFC at every output level. For this reason, the TC curve has the same shape as TVC.

Average Total Cost (ATC): This is the total cost per unit of output and is calculated by dividing the total cost by the quantity produced. So, ATC = TC/Q. It can also be divided into two parts, namely, the average variable cost (AVC) and the average fixed cost (AFC).
Thus, ATC = TFC/Q + TVC/Q, AFC = TFC/Q, and AVC = TVC/Q.

$$AFC + AVC = ATC$$

Marginal Cost (MC): it is the extra or additional cost that results from producing one more unit of output; or it is the change in total cost resulting from a percentage change in output, i.e.

$$MC = \Delta TC/\Delta Q \text{ or } \Delta TFC/\Delta Q + \Delta TVC/\Delta Q$$

$$\text{or } MC = \Delta TVC/\Delta Q, \text{ when } \Delta TFC=0 \text{ (in the short run)}$$

Activity 5.5

1. Outline the different types of costs for a wheat flour factory.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of the cost of production. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you define cost of production?		
Are you able to describe the types of cost of production?		

Dear distance learner, did you mark any boxes under the "No" column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 5.3

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Implicit cost refers to the cost of purchased inputs only, and this only refers to the explicit cost.
2. Economists define costs in terms of opportunity costs and they include these implicit costs in profit calculations.
3. The total cost is the sum of the total variable cost and total fixed cost.
4. Fixed cost is a cost that changes with the level of output produced.
5. Average total cost is calculated by dividing the total cost by the quantity produced.

Unit summary

The production function indicates the maximum amount of output that can be produced with the help of each possible combination of inputs. Outputs are the values of the production process.

A short-run period of production refers to a period of production in which at least one of the inputs is fixed while the remaining inputs are variable. A long-run period of production is a period of production in which all inputs are variable or there are no fixed resources in general. A fixed input is one whose quantity cannot be changed during the period under consideration. A variable input is an input whose quantity can be changed during the period under consideration.

Total product (TP) is the gross or entire output by workers and is expressed in terms of quantity (Q). Average product (AP) can be expressed as AP=TP/L. A marginal product (MP) is the percentage change in total output resulting from a percentage change in variable input.

Costs of production is the monetary outlays associated with production activity. Explicit costs are the actual monetary payments or cash outlays that business firms make to outsiders who are suppliers of inputs to them. Implicit costs are costs arising from the value of non-purchased resources owned and used by firms in their own production activities.

Fixed costs are costs that are always incurred, even if the firm does not produce anything. Variable costs are costs that vary directly with the firm's output level. Total cost is the sum of total fixed and total variable costs. Average total cost is the total cost per unit of output and is calculated by dividing the total cost by the quantity produced. Marginal cost is the change in total cost resulting from a unit change in output produced.

Unit Review Exercise

Part I: Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. The concepts of production and costs are independent facts.
2. Production function is the technical relationship between inputs and outputs.
3. An input whose quantity can be changed during the short period under consideration is known as a fixed input.
4. Economic cost is the sum total of explicit cost and implicit cost.
5. Accounting cost refers to the cost of purchased inputs only.
6. When total product increases at an increasing rate, marginal product increases.
7. When marginal product is greater than average product, average product is falling.
8. When marginal product equals average product, average product is minimum.
9. Fixed costs are those costs that vary as the firm changes the level of output.
10. MC is the additional cost that a firm incurs to produce all units of output.

Part II: Choose the best answer among the given alternatives for each of the following questions.

1. The process of using different factors of production in order to make goods and services available is known as:
   A . Investment   C . Consumption
   B . Production   D . Resource
2. Any good or service that comes out of a production process, is known as:
   A . Output   C . Labour
   B . Input   D . Economic resource
3. When the short-run, marginal product of labour is negative:
   A . Total product is also negative
   B . Total product is rising but at a diminishing rate
   C . Total product is rising at an increasing rate
   D . Total product is declining
4. Suppose the average product of 6 workers is 150 units of a good and that of 7 workers is 170 units. The MP of the seventh worker equals:
   A . 200   B. 270   C. 290   D. 220
5. The supply of economic resources in the short run production that cannot change is
   A . Fixed inputs   C . Labour and raw materials
   B . Variable input   D . Average variable cost
6. Which of the following is/are not a good indicator or measure of output per unit input?
   A . Total product   C . Marginal Product
   B . Average product   D . Both A and C
7. A specific type of costs that are always incurred even if the firm does not produce anything.
   A . Accounting costs   C . Total cost
   B . Variable costs   D . Fixed costs

8. In the short-run,

   A . All costs are fixed
   B . All costs are marginal
   C . Some costs are fixed
   D . All costs are variable

9. Suppose output increases from 50 to 51 units and total cost increases from birr 260 to birr 293. The MC of the extra output is birr,

   A . 553 B. 226.5 C. 33 D. 29

Part III: Answer the following questions briefly and to the point.

1. Define production function.
2. Explain two types of production function based on periods of production.
3. Describe the relationship between the average product and the marginal product with the help of graph.
4. Describe the relationship between marginal product and total product with the help of graph
5. Explain the explicit and implicit cost.

Answer Key

✓ **Suggested Answers for Activities**

Activity 5.1

1. Production is the process of transforming inputs into outputs.

Activity 5.2

1. We can define inputs and outputs as follows:
    - Inputs are economic resources that can be used in the production of goods and services. Inputs are divided into fixed and variable.
    - Outputs are consequences of the production process. Outputs are classified into tangible and intangible products.
2. The difference between fixed and variable inputs is
    - A fixed input is an input whose quantity cannot be changed during the period under consideration.
    - In contrast, a variable input is one whose quantity can be changed during the period under consideration.

Activity 5.3

1. We can explain the concepts of fixed and variable inputs in relation to short-run and long-run production functions as follows.
    - A short-run period of production is one in which at least one of the inputs is fixed while the other is variable. This suggests that increasing the variable inputs can result in an increase in output in the short run.
    - A long-run period of production is one in which all inputs are variable. Long-run is the period during which the plant size can be changed. Therefore, all inputs are variable in the long run.
2. We can differentiate among Total Product, Average Product, and Marginal Product as follows.
    - **Total product** is the total amount of output produced by the factors of production used over a given period. It is the entire output by workers expressed in terms of quantity.
    - **Average product** is obtained by dividing the total output by the number of workers employed. It is a good indicator of the productivity of labour.
    - **Marginal product** is the increase in output which results from using one additional unit of a variable input, all other things being equal. It is the percentage change in the total output resulting from a percentage change in the variable input.

Activity 5.4

1. In general, cost of production refers to the monetary outlays associated with production activity. It is the total expenditures and sacrifices made in the entire process of production and distribution of goods and services. Consequently, cost of production is defined as the monetary value of inputs used in the production of goods and services.

Activity 5.5

1. We can outline the different types of costs for a wheat flour factory as: Cost of machineries, labour, wheat grains and other raw materials, utilities, etc.

✓ **Suggested Answers for Self-test exercises**

Self-test Exercise 5.1

1. True 2. False 3. True 4. True 5. False

Self-test Exercise 5.2

1. True 2. False 3. True 4. False 5. True

Self-test Exercise 5.3

1. False 2. True 3. True 4. False 5. True

✓ **Suggested Answers for Unit Review Exercises**

Part I

1. True 2. True 3. False 4. True 5. True

6. True 7. False 8. False 9. False 10. False

Part II

1. B 2. A 3. D 4. C. 5. A 6. D 7. D 8.C 9.C

Part III

1. The production function is purely a technological relationship that expresses the relationship between the output of a good and the different combinations of inputs

used in its production.

2. A "*Short run*" refers to a period of time in which the quantity of at least one of the inputs or resources is fixed.

   On the other hand, the term "long run" refers to a period of time in which all inputs are variable or there are no fixed resources in general.

3. The relationships between the MP curve and AP curve are as follows:

   So long as the MP curve lies above the AP curve, the AP curve is a positively sloping curve, AP rises

   When the MP curve intersects the AP curve, AP is at its maximum

   When the MP curve lies below the AP curve, the AP curve slopes downward

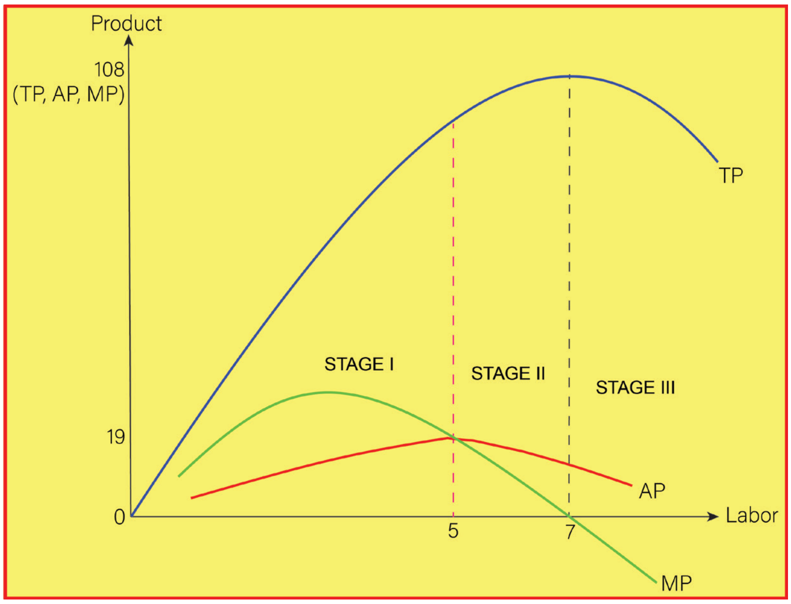
4. The relationship between TP and MP:

   When TP increases at an increasing rate, marginal product increases

   While TP increases at a diminishing rate, MP declines

   When the total product reaches its maximum, the marginal product becomes zero

   When TP begins to decline, MP becomes negative.



5. *Explicit costs* are the actual monetary payments or cash outlays that business firms make to outsiders who are suppliers of inputs or resources to them.

   Implicit costs are those costs stand for the values of non-purchased resources owned and used by firms in their own production activities. They are said to be implicit costs.

Unit 6

Introduction to Money

Unit Introduction

This unit introduces the nature of money—what it is, how it works, and its critical role in the functioning of the economic system. We discuss the efficient resource allocating role that money plays in the economy and its basic functions.

The unit is divided into five sections, each of which covers various aspects and functions of money in order to better understand the significance of inventing money. The first section presents the definition of money; the second section explains the evolution of money, followed by functions of money, demand and supply of money, and money and electronic money.

Unit Outcomes

At the end of this unit, you will be able to:

- Describe the concept of money.
- Describe the evolution of money in Ethiopia and globally.
- Discuss the functions of money.
- Enumerate the factors affecting the demand and supply of money.
- Explain the role of money and electronic money in an economy.

Key Concepts

Customarily, debt, money, precious metal, barter system, medium of exchange, standardization, portability, durability, transactions, precautionary, speculative, stock, automatic teller machine (ATM), and electronic fund transfers.

The Required Study Time: 18 hours

6.1. Definition of Money

Overview

This section deals with the definition of money. It discusses the concept of money. It also discusses the characteristics of commodity money.

Dear learner, in this section you will learn about the term "money". You will also look at the technical definition of money, and relationship payment for outputs.

Learning Outcomes

At the end of this section, you will be able to:

- Explain the meaning of money
- Identify the criteria for a commodity to be accepted as money

6.1.1 Meaning of money

Dear distance learner, how do you define money based on your life and work experiences so far?

Economists define money as generally accepted in payment for goods or services or in the repayment of debts. When most people talk about money, they are talking about currency. If, for example, someone comes up to you and shouts loudly, "Your money or your life," you should quickly hand over all your currency rather than risk your life. You would not ask, "What exactly do you mean by money?"

Money is any good that is widely used and accepted in transactions involving the transfer of goods and services from one person to another. Money is a commodity accepted by general consent as a medium of economic exchange. It serves as the medium for expressing prices and values; as currency, it circulates anonymously from person to person and country to country, facilitating trade and serving as the primary measure of wealth.

An essential characteristic that money has is that it is immediately exchangeable for all kinds of marketable assets, such as goods and services, real estate, etc. Each person accepts money as a means of payment because he or she is confident that others will accept it as payment for him/her. The social convention could either be established through legal or other means.

Activity 6.1

1. What do you mean by money?

1.1.2 Characteristics of commodity money

Dear distance learner, what do you think about Characteristics of commodity money? Did you attempt it? It is good.

Money may be any commodity chosen by common consent as a medium of exchange. All other commodities are thus expressed and valued in terms of that commodity regarded as money. Such a commodity should be recognisable and acceptable to all who use it as a medium of exchange. It is a commodity that is accepted customarily without any special test of quality.

For a commodity to be accepted as money, it must meet the following criteria.

- **Standardization:** it must be easily standardized, making it simple to ascertain its value.
- **Acceptability:** It must be widely accepted as a medium of exchange.
- **Divisibility:** It must be divisible so that it is easy to make a change.
- **Portability:** It must be easy to carry.
- **Durability:** It should not degrade quickly.

In general, money is an economic unit that serves as a widely accepted medium of exchange in an economy for transactional purposes. Money begins as a commodity with a physical property that market participants can use as a medium of exchange.

Activity 6.2

1. Describe the criteria for a commodity to be accepted as money.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of the definition of money. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	*Yes*	*No*
Can you define money?		
Can you describe the criteria for a commodity to be accepted as money?		
Does the Ethiopian money meet all these criteria?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 6.1

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Money is a commodity accepted by general consent as a medium of economic exchange.
2. Money has the characteristic of being immediately exchangeable for few marketable assets.
3. Money is a commodity that is accepted customarily without any special test of quality.

6.2. Evolution of Money

Overview

This section deals with the evolution of money. It discusses how money has evolved over time. It also discusses the concept of bartering.

Learning Outcomes

At the end of this section, you will be able to:

- Define bartering.
- Describe how money has evolved overtime in Ethiopia and globally.

The invention of money and bartering

Dear distance learner, from your previous study and experience, what do you understand about the invention of money? Did you think about it? Good.

Life among ancient humans was not as complex as it is today. Human needs were simple, and almost everybody satisfied them by producing whatever the individual required. The individual provided the bare necessities of life. The individual was self-sufficient in the sense that everybody engaged in hunting and gathering for food, made their own clothing, and had their own dwelling. Economic activities were, therefore, confined to production and consumption.

In the course of time, humans gained knowledge through learning by doing, formed families, and their individual needs increased. Human beings realize now it is not possible for them to satisfy their rising needs by producing everything for themselves. As a result, self-sufficiency came to an end, and the process of exchange started.

Bartering

Initially, the exchange was direct. That is, it was an exchange of goods for goods. Such an exchange is known as "barter." Under the barter system, an individual produces goods in greater quantities than they could be consumed, so as to exchange the surplus with another person for something the producer needs in return. The economy based on this system of exchange is called the barter economy.

Limitations of the barter system: A direct exchange of one good for another without the mediation of money has a number of difficulties associated with it. These are:

- **Lack of double coincidence of wants:** The barter system requires that a person with a surplus of one commodity needs to find another person who wants that commodity and has something acceptable to offer in exchange.

- **Lack of a common measure of value:** There is no common value under the barter system. For example, if a sheep is to be exchanged for wheat, it is difficult to decide in what proportion the two goods are to be exchanged. Thus, it is difficult to settle the terms of exchange.

- **Indivisibility of commodities:** If someone wants to exchange a horse for a pair of shoes, they will have to part with a portion of the horse based on the exchange ratio. In this process, the horse loses its identity and value as a horse. Hence, the exchange is unthinkable.

- **Difficulty in storing and transferring wealth:** Most goods, such as rice, wheat, cattle, skins, and so on, lose their value over time or involve high storage costs. Further, the transfer of these goods from one place to another involves a huge transportation cost.

- **Difficulty in in differing payments:** Payment is not always made right away, but rather after some time has passed. Because there is an absence of stability in the prices of goods. Besides, there is an absence of quality and general acceptability in goods. In this way, it is very difficult to make different payments in the form of goods.

The history of money (in Ethiopia and the global context)

Dear distance learner, have you ever read about the history of money? Now, please read the text below.

When the barter system gave way to the monetary system, primitive money in the form of commodity money was being used. The particular commodity chosen to be used as money was determined by factors such as the community's location and economic development.

The problem with a payment system based exclusively on commodity money-a precious metal or any other valuable commodity-is that such a form of money is very heavy and is hard to transport from one place to another.

The next development in the payments system was paper currency. Initially, paper currency embodied the promise that it was convertible into coins or into a quantity of precious metal.

In most countries, however, currency has evolved into fiat money, paper currency decreed by governments as legal tender, but not convertible into coins or precious metal. Paper currency has the advantage of being much lighter than coins or precious metal. Yet, it can be accepted as a medium of exchange only if there is some trust in the authorities who issue it. However, printing has reached a sufficiently advanced stage that fabricating is extremely difficult.

Paper currency and coins have the major drawbacks of being easily stolen and being expensive to transport because of their bulk if there are large amounts. To address this issue, another step in the evolution of the payments system occurred with the development of modern banking. This was the invention of checks. In this case, someone will have a checking account at a bank and can write checks whenever they wanted to make payment. The holder of the check can change it to cash at the bank.

Checks are payable on demand. This allows transactions to take place without the need to carry large amounts of currency. The introduction of checks was a major innovation. It improved the efficiency of the payment system. Thus, the use of checks reduces transportation costs associated with the payment system and improves economic efficiency. Another advantage of checks is that they can be written for any amount up to the balance in the account. This makes transactions for large amounts much easier. Checks are advantageous in that loss from theft is greatly reduced. Hence, they provide convenient receipts for purchases.

According to official records, it was since the third century A.D. (during the reign of King Endybis and Aphilas) that the Axumite kingdom began using its own coins for both internal and external trading, although coins might have existed many years before. With the fall of the kingdom, however, the coins disappeared from circulation and, since then, in Ethiopia, various commodities like a bar of salt (amole), cloth, beads, etc., have been used as money. The most important and widely spread one, however, was salt. Until, the emergence of Maria Theresa, salt was the most popular medium of exchange. Even after the introduction of Maria Theresa to Ethiopia, salt continued to exist as one of the popular mediums of exchange. In addition to commodity money, metallic money like Maria Theresa, the coins of Menelik II, Haileselassie I, the Lire, the East African shilling, and the present type of coins have been serving as a medium of exchange before modern money came into being.

The Maria Theresa Dollar has had a long history in Ethiopia and has had an important place in the monetary evolution of the country. The coin was first minted in Vienna in 1751 to commemorate the coronation of Maria Theresa as empress of Austria. Interestingly enough, this coin was not used as a legal currency in its country of origin. It is believed that Maria Theresa was introduced into Ethiopia by traders between the late 18th and early 19th century. Maria Theresa served as a medium of exchange until 1945. Although it was not as popular as Maria Theresa, the first national coin was minted by Emperor Menelik II, in 1893.

Menelik's coins were replaced by the new metallic coins issued in July 1933 bearing the image of the Emperor Haileselassie. Paper money was issued by the Bank of Abyssinia for the first time in 1914. However, it was unusual in society, and it failed to gain acceptance because most people were only familiar with metallic coins.

Paper money was again issued by the Bank of Ethiopia (the successor of the Bank of Abyssinia) in 1932. These notes were 100 percent backed by gold deposits and thus served as a medium of exchange alongside the salt bar and the Maria Theresa until the Italian occupation in 1936. In 1941, when the country was liberated from the brief Italian occupation, it had no national currency and no financial institutions. Following the restoration of independence in 1941, many foreign currencies started to be used as mediums of exchange, including the Italian Lire, the Maria Theresa Dollar, the East African Shilling, the Indian Rupee, and the Egyptian Pound, circulating as a medium of exchange. While the lire was a holdover from the Italian occupation and the Maria Theresa Dollar was a carryover from earlier periods, the rest of the currencies were introduced by British military forces who helped liberate the country and took over administration. It was only in July 1945 that the Ethiopian government issued the new national currency, the Birr. With the development of the banking system, checks have also started to be used as money, though there have been some developments in that regard in recent years.

Activity 6.3

1. Discuss the various stages of development the world has been passing through to come up with the current use of money.
2. Describe the concept of bartering. How did an individual produce goods under the barter system?

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of the evolution of money. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you define the word "bartering"?		
Can you list the limitations of the barter system?		
Can you describe the specific stages of evolution of money?		
Can you state these stages in the Ethiopian context?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 6.2

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. The economy based upon the exchange of goods for goods is called the barter economy.
2. In the barter exchange system, payment is always made right away.
3. Primitive money was first used in the form of commodity money after the barter system.
4. Coins or precious metals have the advantage of being much lighter than paper currency.
5. Paper currency is decreed by governments as legal tender.

6.3. Functions of Money

Overview

This section deals with the functions of money. It discusses the four basic functions of money.

Learning Outcomes

At the end of this section, you will be able to:

- Explain the basic functions of money.

Dear distance learner, what is the function of money? Did you try it? Good.

Basic functions of money

In every society, money performs four basic functions. All of these functions play significant roles in the operation of the economy.

1. The medium of exchange functions

The most basic function of money is to serve as a medium of exchange. In almost all market transactions in our economy, money in the form of currency or checks is a medium of exchange. It is used to pay for goods and services.

Money has power to purchase those things that have utility and satisfy human wants. Using money as a medium of exchange promotes economic efficiency by reducing the time spent exchanging goods and services. The time spent trying to exchange goods or a service is called a "transaction cost." In a barter economy, transaction costs are high because people have to satisfy a "double coincidence of wants". In other words, they have to find someone who has a good they want and who also wants the goods they have to offer.

Thus, money is a lubricant that allows the economy to run more smoothly by lowering transaction costs and encouraging specialisation and the division of labour.

2. Money as a unit of account

The second role of money is to provide a unit of account. It is used to measure value in the economy. We measure the value of goods and services in terms of money just as we measure weight in pounds or distance in miles.

Imagine how hard it would be to shop in a supermarket with a thousand different items on its shelves. To make sure that you can compare the prices of all items, the price tags of each item would have to list up to 999 different prices. The time spent reading them would result in a very high transaction cost.

The solution to the problem is to introduce money into the economy. Money serves as a unit of account in terms of which the values of goods and services exchanged in the economy are measured. Money enables an orderly pricing system. This is essential for rational economic calculation and choice. It is also essential for transmitting economic information among individuals.

3. Money as a store of value

Money also serves as a store of value. It is a source of purchasing power over time. A store of value is used to save purchasing power from the time income is received until it is spent. This function of money is useful because most of us do not want to immediately spend our income on receiving it. We would rather wait until we have the time or the desire to shop.

Money is not unique as a store of value; any asset, be it money, stocks, bonds, land, houses, art, or jewelry, can be used to store wealth. Many such assets have an advantage over money as a store of value: they often pay the owner a higher interest rate than money, maintain their value, and provide service as a house. If these assets are more desirable stores of value than money, why do people hold money at all? The answer to this question relates to the important economic concept of liquidity, or the relative ease and speed with which an asset can be converted into a medium of exchange.

4. Money as a standard of deferred payments

Money lets you buy now and pay later. Or it lets you lend now and collect later. When people save money, that money can be borrowed and channeled into investments. It is the deferred payment function of money that permits this transfer of spending power from earner—savers to borrower—spenders. It permits the easy transfer of resources from less desired uses to more desired uses.

Activity 6.4

1. Why is money a poor means of holding wealth?

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of the functions of money. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Questions	Yes	No
Can you outline the basic functions of money?		
Can you explain why people hold money at all?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 6.3

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Money is a lubricant that allows the economy to run more smoothly.
2. When using money, transaction costs are high because people have to satisfy a "double coincidence of wants".
3. Money lets you buy now and pay later.

6.4. Demand and Supply of Money

Overview

This section deals with the demand and supply of money. It discusses about the demand for money. It also discusses about the supply of money.

Learning Outcomes

At the end of this section, you will be able to:

- Explain the motives for holding money.
- Describe what constitutes the supply of money.

6.4.1. Demand for Money

Dear distance learner, why do people hold money? Did you try it? Good.

Demand for Money

The old idea about the demand for money was that money was demanded to complete business transactions. In other words, the demand for money depends on the volume of trade or transactions. As a result, demand for money increased during a boom period or when trade was erratic, and decreased during a depression or a calm in trade.

The modern idea about the demand for money was put forward by John Maynard Keynes, the famous English economist, who gave birth to what has been called the Keynesian Economics. According to Keynes, the demand for money, or liquidity preference, means the demand for money to hold.

People want money for three main motives:

(i) Transactional motive
(ii) Precautionary motive
(iii) Speculative motive

Each one of them could be explained as follows.

(i) Transactional motive

This motive can be looked at from the:

a) perspective of consumers seeking income to meet their household expenditures, also known as the income motive, and
b) point of view of businessmen, who require money and want to hold it in order to carry on their business, i.e., the business motive.

a) Income motive:

The transaction motive relates to the demand for money for the current transactions of individual and business exchanges. Individuals hold cash in order "to bridge the interval between the receipt of income and its expenditure." This is called the "income motive." Most people receive their income by the week or the month, whereas the expenditure is on a day-to-day basis. A certain amount of money, therefore, is kept on hand to make current payments. This amount will depend upon the size of the individual's income, the interval at which the income is received, and the methods of payment in the locality.

b) Business motive:

Businessmen and entrepreneurs also have to keep a proportion of their resources in cash in order to meet current needs of various kinds. They need money all the time to pay for raw materials and transport, wages and salaries, and meet all other current expenses incurred by any business.

It is clear that the amount of money held, under this business motive, will depend to a very large extent on the turnover (i.e., the volume of trade of the firm in question). The larger the turnover, the greater, in general, the amount of money needed to cover current expenses.

(ii) Precautionary motive:

The precautionary motive for holding money refers to the desire of people to hold cash balances for unforeseen contingencies. People hold a certain amount of money to provide for the risk of unemployment, sickness, accidents, and other more uncertain losses. The amount of money held under this motive will depend on the nature of the individual and on the conditions in which he or she lives.

(iii) Speculative motive:

The speculative motive relates to the desire to hold one's resources in liquid form in order to take advantage of market movements regarding future changes in the rate of interest (or bond-prices). Money held under the speculative motive serves as a store of value, just as money held under the precautionary motive does. But it is a store of money meant for a different purpose.

Thus, the amount of money required to be held under the various motives constitutes the demand for money.

Activity 6.5

1. What are the motives for holding money?

6.4.2. Supply of money

Dear distance learner, what do you think about the supply of money?

Just as the demand for money is the demand for money to hold, similarly, the supply of money is the supply of money to hold. Someone must always hold money; otherwise, it cannot exist. Hence, the supply of money means the sum total of all the forms of money held by a community at any given moment.

The money supply consists of (a) metallic money or coins, (b) currency notes issued by the currency authority of the country, whether it be the central bank or the government, and (c) cheque able bank deposits. In old times, coins formed the bulk of the country's money supply. Later, currency notes eclipsed metallic currency, and now the bank deposits in current accounts withdrawable by check have overwhelmed all other forms of money.

Hence, "money supply" refers to the total amount of money that is available to the public for use in connection with national economic activity. Broadly speaking, the money supply in a country is composed of two main elements:

(a) currency with the public; and (b) deposit money with the public.

In order to arrive at the total amount of currency with the public, we add:

(i) currency notes in circulation; (ii) circulation of birr notes and coins; and

(iii) circulation of small coins; and from the total, deduct: "Cash in hand with banks. The bulk of the currency in the hands of the public is in the form of currency notes issued by the National Bank of Ethiopia.

Besides currency, the money supply of the public includes deposit money, i.e., the bank balances held in current accounts of the banks. Currency, rather than bank deposits, has a dominant position in developing countries because the majority of commercial transactions are conducted in cash as a medium of exchange, rather than through cheques as in advanced countries.

Thus, the supply of money in a country depends, by and large, on the credit control policies pursued by the country's banking system.

Activity 6.6

1. What constitutes the supply of money?

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding about the demand and supply of money. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you define the demand for money?		
Can you outline the motives for holding money?		
Can you define the supply of money?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 6.4

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. The motivation to keep cash on hand for unanticipated emergencies is referred to as the "transaction reason" for holding money.
2. In business, money demand will depend to a very large extent on turnover.
3. The amount of money required to be held under the various motives constitutes the demand for money.
4. The supply of money in a country depends on the banking system of the country.
5. Money supply refers to the total amount of money that is available to the public for use in connection with national economic activity.

6.5. Money and Electronic Money (e-money)

Overview

This section deals with money and electronic money in modern businesses. It discusses the concept of money and electronic money. It also describes the advantages and disadvantages of e-money.

Learning Outcomes

At the end of this section, you will be able to:

- Explain the meaning of electronic money

Dear distance learner, what do you understand about money and electronic money? Did you attempt it? Good.

Money and Electronic Money

Electronic money is an electronic store of monetary value on a technical device that may be used widely for making payments. For example, payments can be performed in a number of ways such as debit card, prepaid cards, and credit cards. These make paying at a point-of-sale terminals quick and simple.

However, for many people, electronic money means a 24-hour access to cash through an automated teller machine (ATM) or Direct Deposit of pay-checks into checking or savings accounts. Broadly speaking, electronic money involves different types of transactions, rights, responsibilities and sometimes fees.

Electronic money is also known as electronic fund transfer (EFT). It uses computer and electronic technology in place of checks and other paper transactions. EFT is started using tools, such as cards or codes, that provide you or other people you have given permission to access your account. Many financial institutions use ATM or debit cards and Personal Identification Numbers (PINs) for this purpose. Some people use other types of debit cards that require your signature or a scan. In the context of Ethiopia, ATMs are electronic terminals that let you bank almost virtually any time.

Advantages of e-money:

- the ability to move money quickly
- better recordkeeping
- global money transfers
- the ability to move large sums of money without any physical burden

Disadvantages of e-money

- cybercrime and new digital forms of money laundering (crime)
- users must have a minimum level of training and knowledge, especially with more complicated forms of electronic transfers
- some types of e-money, most notably crypto currencies, are closely linked to criminal activity
- requires hardware and software to perform transfer of electronic cash

Activity 6.7

1. Define electronic money.
2. Visit banks in your area and ask people why they prefer to use ATMs.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of the money and electronic money. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain the term "electronic money"?		
Can you describe the use of electronic money?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 6.5

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. **Using** electronic money can make the transaction much easier.
2. **An ATM** is an electronic terminal that lets you withdraw money at any time.
3. The ability to move large sums of money without any physical burden becomes impossible using e-money.

Unit summary

Money is defined as anything that is generally accepted as payment for goods or services or in the repayment of debts. Barter means the exchange of goods for goods before invention of money. Money serves as: medium of exchange, measure of value, standard of deferred payment, and store of value.

In Ethiopia, various commodities like a bar of salt (amole), cloth, beads, etc., have been used as money. The most important and widely spread one, however, was salt. Until, the emergence of Maria Theresa, salt was the most popular medium of exchange. Even after the introduction of Maria Theresa to Ethiopia, salt continued to exist as one of the popular mediums of exchange.

Money is often defined in terms of the basic functions that it provides. Money serves as a medium of exchange, a store of value, a standard for different types of payment. Money's most important function is as a medium of exchange to facilitate transactions. Without money, all transactions would have to be conducted by barter, which involves the direct exchange of one good or service for another.

Money was simply in demand since it was necessary to complete commercial transactions and the number of transactions or trades required money to complete. There are three main motives on account of which money is wanted by the people, namely, (i) the transaction motive, (ii) the precautionary motive, and (iii) the speculative motive.

The money supply is the total amount of cash, coins, and balances in bank accounts in circulation. The money supply is commonly defined as a group of safe assets that households and businesses can use to make payments or hold as short-term investments.

Electronic money involves many different types of transactions, rights, responsibilities, and sometimes fees.

Unit Review Exercise

Part I: Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Checks are payable on demand that allows transaction to take place without the need to carry a large amount of currency.
2. The acceptance of money as a medium of exchange is a matter of social convention.
3. Transaction motive for holding money refers to the desire of the people to hold cash balances for unforeseen contingencies.
4. The supply of money in a country, by and large, depends not on the credit control policies pursued by the banking system of the country.
5. It was exchange of goods for goods, known as barter.
6. One of the limitations of the barter system entails the nature of divisibility of commodities on the basis of the exchange ratio.
7. Money as legal tender meaning that legally it must be accepted as payment for debts.
8. Money enables rational economic calculation and choice
9. Money held under the speculative motive serves as a store of value as money held under the transaction motive does.
10. One of the advantages of e-money is the ability to move money quickly.

Part II: Choose the best answer among the given alternatives for each the following questions.

1. For a commodity to be accepted as money, which criteria it must meet?
   A. Standardization C. Portability
   B. Divisibility D. All of the above
2. Which of the following refers to anything that is generally accepted in payment for goods and services?
   A. Checks C. Checking account deposits
   B. Money D. All of the above
3. Major drawbacks of paper currency and coins are
   A. they are easily stolen
   B. they can be expensive to transport
   C. they have a problem of common measure of value
   D. both A and B
4. Examples of e-money include,
   A. visa card C. mobile banking
   B. credit card D. all of the above
5. For a commodity to be accepted as money, it must meet the following criteria.
   A. Unit of account C. Measure of value
   B. Standardization D. Differed payment
6. Payments through electronic money can be performed in a number of ways such as
   A. debit card C. credit cards
   B. prepaid cards D. all of the above

7. The bulk of the currency with the public is in the form of currency notes issued by,
   A. National Bank of Ethiopia
   B. Commercial Bank of Ethiopia
   C. Private Commercial Banks
   D. all of the above
8. The money supply consists of,
   A. metallic money
   B. coins
   C. currency notes
   D. all of the above
9. It relates to the desire to hold one's resources in liquid form in order to take advantage of market movements in the future,
   A. the speculative motive
   B. the precautionary motive
   C. the transaction motive
   D. both A and C
10. When the barter system was replaced by monetary system, the primitive money was first used,
    A. paper currency
    B. checks
    C. commodity money
    D. e-money

Part III. Answer the following questions briefly and to the point.

1. How was the barter system used before the advent of money?
2. Define what money is.
3. What are the major drawbacks of paper currency and coins?
4. What criteria must meet for a commodity to be accepted as money?
5. Explain the three main motives of holding money.

Answer Key

✓ **Suggested Answers for Activities**

Activity 6.1

1. Money means an economic unit that functions as a generally recognised medium of exchange for transaction purposes in an economy.

Activity 6.2

1. A commodity is accepted as money if it satisfies the following criteria.
   i. Standardization – it must be easily standardized, making it simple to ascertain its value.

   ii. Acceptability - It must be widely accepted as a medium of exchange.

   iii. Divisibility – It must be divisible so that it is easy to make a change.

   iv. Portability – it must be easy to carry.

   v. Durability – it should not deteriorate quickly.

Activity 6.3

1. Initially, there was a direct exchange of goods for goods. Such an exchange was known as barter. When the barter system was replaced by the monetary system, the primitive money was first used in the form of commodity money. The next development in the payments system was paper currency though it had drawbacks in that it could easily be stolen. Further, it could be expensive to transport because of its bulk if there were large amounts. This situation had led to the invention of checks. With the development of computer and advanced communications technology, it would seem to be a better way to use an electronic means of payment.
2. Bartering was exchange of goods for goods. Such an exchange was called barter. Under the barter system, an individual produces goods in large quantity than it could be consumed. It was intended to exchange the surplus with another person for something the producer wanted in return.

Activity 6.4

1. Money is a poor means of holding wealth because the purchasing power of money is subjected to change over time. As a result of this, money is not a perfect means of holding wealth.

Activity 6.5

1. The motives for holding money are: Transaction motive, Precautionary motive and Speculative motive.

Activity 6.6

1. The total volume of monetary media of exchange available to the community for use in relation to the economic activity of a country constitutes the supply money. In a broader sense, money supply in a country is composed of two main elements, namely, the currency with the public and the deposit money with the public.

Activity 6.7

1. Electronic money is an electronic store of monetary value on a technical device that may be used widely for making payments. Electronic money is also known as electronic fund transfer. It uses computer and electronic technology in place of checks and other paper transactions.
2. People prefer to use ATMs electronic terminals because it lets them bank almost virtually any time.

✓ Suggested Answers for Self-test Exercises

Self-test Exercise 6.1

1. True 2. False 3. True

Self-test Exercise 6.2

1. True 2. False 3. True 4. False 5. True

Self-test Exercise 6.3

1. True 2. False 3. True

Self-test Exercise 6.4

1. False 2. True 3. True 4. False 5. True

Self-test Exercise 6.5

2. True 2. True 3. False

✓ Suggested Answers for Unit Review Exercises

Part I

1. True 2. True 3. False 4. False 5. True
2. 6. False 7. True 8. True 9. False 10. True

Part II

1. D 2. B 3. A 4. D 5. B 6. D 7.A 8. D 9. A 10. C

Part III

1. The barter system was an exchange of goods for goods to ease transactions. Under the barter system, an individual produces some goods in greater quantity than he could consume, so as to exchange the surplus with another person for something he needs in return.
2. Money is anything that is generally acceptable as a means of exchange (i.e. as a means to settle debt) and that at the same time acts as a measure and as a store of value.
3. Paper currency and coins have the major drawbacks of being easily stolen and being expensive to transport because of their bulk if there are large amounts.
4. "Anything that is habitually and widely used as a means of payment and generally accepted in the settlement of debt" and " anything that is commonly used and generally accepted as a medium of exchange or as a standard of value" respectively.
5. Transaction, precautionary, and speculative motives.

Unit 7

Introduction to Macroeconomics

Unit Introduction

Macroeconomics (from the Greek prefix macro- meaning "large") is a branch of economics dealing with the performance, structure, behaviour, and decision-making of an economy as a whole. For example, using interest rates, taxes, and government spending to regulate an economy's growth and stability are the mandates of macroeconomics.

This unit deals with introduction to macroeconomics. It is divided into three sections. The first section presents definition of macroeconomic variables. The second section focuses on macroeconomic goals and the third section deals with macroeconomic problems.

Unit Outcomes

At the end of this unit, you will be able to:

- Explain the meaning of macroeconomics.
- Identify the basic macroeconomic variables.
- Describe the relationship among unemployment, inflation and growth.

Key Concepts

National Income, gross domestic product, gross national product, per capita Income, employment, inflation, deflation, and unemployment.

The Required Study Time: 12 hours

7.1. Definition of Macroeconomic Variables

Overview

This section deals with the definition of macroeconomic variables. It discusses the gross domestic product. It also discusses the gross national product.

Learning Outcomes

At the end of this section, you will be able to:

- Define the concept of macroeconomics.
- Explain the basic macroeconomic variables.

Dear distance learner, does everything that is produced in Ethiopia belong to the country? How do you think national income would be measured?

Macroeconomics focuses on the economic behaviour and policies that affect consumption and investment, trade balance, and other determinants of various macroeconomic variables. Examples of macroeconomic variables include economic outputs, unemployment rates, and inflation. These indicators of economic performance are closely monitored by governments, businesses and consumers alike.

Gross Domestic Product (GDP): It is the total value of currently produced final goods and services that are produced within a country's boundaries during a given period of time, usually one year.

In order to understand the meaning of GDP, note the following points:

- It measures the current production only.
- It takes into account final goods and services only, or we do not include the intermediate products in our GDP calculations. i.e., intermediate goods are goods that are completely used up in the production of other products in the same period that they themselves are produced.
- It measures the values of final goods and services produced within the boundaries of a country irrespective of who produced them.

In measuring it we take the market values of goods and services ($GDP = \sum P_i \times Q_i$)

Where, P_i = the prices of outputs produced in different sectors of an economy in a certain period,

Q_i = the quantity of final goods and services produced in an economy.

Gross National Product (GNP): - is the total value of goods and services currently produced by domestically owned factors of production in a given period of time, (usually one year) irrespective of their geographical locations.

$$GNP = GDP + NFI$$

Where NFI = Net Factor Income received from abroad

On the other hand, NFI = (factor income received from abroad by a country's citizens) – (factor income paid for foreigners to abroad).

Depending on the amount of factor income received by the two parties, NFI could be negative, positive or zero.

When NFI > 0, then GNP > GDP

NFI < 0, then GNP < GDP

NFI = 0, GNP = GDP

=> If the economy is closed or a country has no interaction with the rest of the world.

Per Capita Income: - the ratio of the GDP of a country to its total population. It determines the average income of individual citizens of the country under consideration. This enables one to evaluate the living standard of the country's population.

Activity 7.1

1. Describe the essential issues in macroeconomics.
2. Compare Ethiopia's GDP with the GDP of other developing countries.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of definition of macroeconomic variables. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain the term "macroeconomics"?		
Can you describe the macroeconomic variables?		
Can you calculate Gross National Product (GNP)?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 7.1

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Macroeconomics studies the individual economic units of an economy.
2. National income, savings, and general price levels are examples of macroeconomic variables.
3. If the economy is closed, GNP is equal to GDP.

7.2. Macroeconomic Goals

Overview

This section deals with the macroeconomic goals of a country. It discusses the various macroeconomic goals that a country needs to achieve.

Learning Outcomes

At the end of this section, you will be able to:

- Identify the macroeconomic goals of a country.

Dear distance learner, from your previous study and experience, what do you understand about the major macroeconomic goals of a country? Did you think about it? Good.

We know that macroeconomic analysis deals with the behaviour of the economy as a whole with respect to output, income, employment, general price level and other aggregate economic variables. With a view to bringing about desirable changes in such variables, nations (both developed and developing) need to achieve various macroeconomic goals.

The major macroeconomic goals of a country are:

- Economic growth: It is the persistence increase in national income.
- Full employment: It means the maximum possible utilisation of factors of production in the production process.
- Stable balance of payments: It is the statistical record of all economic transactions between domestic residents and the rest of the world that reaches equilibrium.
- Price stability: It is the stable level of prices in an economy that avoids long periods of inflation or deflation. It sustains the value of money over time. Price stability is important for savers.
- Fair distribution of income and wealth: It means distribution of the benefits based on presupposed criteria of being just and unbiased.

Activity 7.2

1. What are the macroeconomic goals of a country?

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of the goals of macroeconomics. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain the major goals of macroeconomics?		
Can you list the goals of macroeconomics for a country?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 7.2

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Full employment is the optimum utilisation of factors of production.
2. Price stability is the stable level of money supply in an economy.
3. Fair distribution of income and wealth means the distribution of benefits based on presupposed criteria of being just and unbiased.

7.3. Macroeconomic problems

Overview

This section deals with the macroeconomic problems of a country. It discusses the causes and types of inflation. It also discusses the types of unemployment, trade balance deficit and balance of payments deficit.

Learning Outcomes

At the end of this section, you will be able to:

- Identify the problems of macroeconomics.
- Explain the meanings of inflation and unemployment.
- Mention the types of unemployment.

Dear distance learner, can you describe the macroeconomic problems of a country? Did you think about it? Wonderful!

The economy does not always work smoothly. There are often fluctuations in the level of economic activity. At times the economy finds itself in the grip of recession when levels of national income, output and employment are far below their full potential levels. During a recession, there is a lot of idle or unutilized productive capacity, that is, available factors of production are not working to their full capacity. Some of the key questions addressed by macroeconomics include: What causes inflation? What causes unemployment?

1. Inflation

Inflation is a sustained increase in the general price level. It may be noted thus:

- a small rise in prices or an irregular price rise cannot be called inflation. It is a persistent and appreciable rise in prices which is called inflation.
- during inflation, all costs and prices do not rise together and in the same proportion. It is an increase in the general level of prices measured by a price index, which is an average of consumer or producer prices.

Inflation occurs when the prices of goods and services rise, while deflation occurs when those prices fall. The balance between these two economic conditions, opposite sides of the same coin, is delicate and an economy can quickly fluctuate from one condition to the other.

Causes of inflation

- increase the money supply
- increase in the input costs
- imported inflation
- weaker exchange rate
- decline in productivity

Types of inflation

Depending on the specific causes, two types of inflation have been distinguished: (1) Demand-pull inflation (2) Cost-push inflation.

1. Demand-pull inflation: inflation resulting from an increase in aggregate demand when the economy is producing at or near full capacity. This demand grows faster than the economy's productive capacity at full employment. This is a situation where "too much money" chases "too few goods."
2. Cost-push inflation, or supply-side inflation, arises due to a continuous decline in aggregate supply. This may be due to bad weather, increase in wages, or the prices of other inputs. Setbacks in agricultural and industrial production due to various reasons –shortage of raw materials, power breakdowns, strikes and lockouts, bad weather conditions, increase in input prices, etc. – lead to a decreased supply of goods in comparison to their demand, which further leads to price rise.

2. Unemployment

Unemployment refers to individuals who are employable and actively seeking a job but are unable to find any. Included in this group are those people in the workforce who are working but do not have an appropriate job.

Interestingly, people who have not looked for a job in the past four weeks but have been actively seeking one in the last 12 months are put into a category called "marginally attached to the labour force." Within this category is another one called "discouraged workers," which refers to people who have given up looking for a job.

The labour force consists of all those who are fit for work and are willing and available to work. In other words, if we exclude children, old persons, individuals who are unable to work, etc., from the population of a country, we get the number of those who are able to work. We further deduct from this those who are not willing or are not available to work. This gives us the labour force.

The labour force includes group of people in a specified age bracket (15 -64), who are actually employed and those who are without a job but are actively searching for a job.

Labour force = employed + unemployed

Unemployment, therefore, refers to that portion of the labour force that is without a job but is actively searching for one. Thus, for a person to be categorized as unemployed, two conditions must be fulfilled the person:

- is without a job and able to work
- wants to have a job and is willing to work at the current market wage.

The unemployment rate is usually found by dividing the number of unemployed people by the total number of people in the workforce. Unemployment serves as one of the indicators of a country's economic status.

Types of Unemployment

a. **Frictional unemployment:** refers to a brief period of unemployment experienced by people due to

    - Seasonality of work e.g., construction workers
    - Voluntary switching of jobs in search of better jobs
    - Entrance to the labour force, e.g., a student immediately after graduation
    - Re-entering the labor force

b. **Structural unemployment:** results from a mismatch between the skills or locations of job seekers and the requirements or locations of the vacancies. It refers to a situation in which workers become jobless due to a loss of demand in particular regions or industries. For example, an agricultural graduate looking for a job at a construction site. Thus, structural unemployment refers to unemployment that occurs as a result of a change in the pattern of demand, which causes changes in the structure of production in the economy. Hence, structural unemployment signifies a mismatch between the demand and supply of labour.

c. **Cyclical unemployment:** is generated due to absence of vacancies. This usually happens due to a deficiency in demand for commodities. Thus, unemployment that arises due to inadequate overall demand during the downswing, recession, or depression period of a trade cycle is called cyclical unemployment.

Disguised unemployment in the Ethiopian economy

Disguised unemployment is unemployment that does not affect aggregate economic output. It occurs when productivity is low and too many workers are filling too few jobs. It can refer to any part of the population that is not employed at full capacity.

Disguised unemployment, or hidden unemployment, is an economic term used to refer to the portion of the labour force that is involved in redundant work, which creates minimal to no productivity. Disguised unemployment is very common in developing countries, which are still have large populations. This is known as a labour surplus.

3. Trade Balance Deficit

The trade balance is sometimes referred to as the visible balance because it represents the difference between receipts for exports of goods and expenditure on imports of goods, which can be seen crossing frontiers.

Trade Balance = receipts for exported goods – payments on imported goods

When the trade balance is in surplus, this means that a country has earned more from its exports of goods than when it is in disequilibrium, which means that the condition is either deficit or surplus.

A deficit in balance of trade occurs when the total receipts fall short of the total payments for imports of goods. For example, the Ethiopian economy has a trade deficit because the country's export receipts fall short of import expenditure.

4. Balance of Payments Deficit

The balance of payments is a statistical record of all the economic transactions between residents of the reporting country and residents of the rest of the world during a given period. The usual reporting period for all the statistics included in the accounts is a year. However, some of the statistics that make up the balance of payments are published on a more regular monthly and quarterly basis. Clearly, the balance of payments is one of the most important statistical statements for any country.

It reveals how many goods and services the country has been exporting and importing, and whether the country has been borrowing from or lending money to the rest of the world. In addition, whether or not the central monetary authority (usually the central bank) has added to or reduced its reserves of foreign currency is reported in the statistics.

Though the credit and debit are written balanced in the balance of the payment account, it may not remain balanced always. Very often, debit exceeds credit or the credit exceeds credit, or credit exceeds debit, causing an imbalance in the balance of the payment account. Such an imbalance is called disequilibrium. Disequilibrium may take place either in the form of a deficit or in the form of a surplus. For example, the same reflection from a trade deficit goes to the country's balance of payments.

Activity 7.3

1. What is meant by inflation? Explain its causes and types.
2. Define the concepts of unemployment and disguised unemployment.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of macroeconomic problems. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you define inflation?		
Are able to describe the types of inflation?		
Can you define unemployment?		
Can you mention the types of unemployment?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 7.3

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. The economy does not always work smoothly.
2. Cost-push inflation is a situation where "too much money chases too few goods."
3. Labor force includes both employed and unemployed people.

Unit summary

National income is broadly defined as the aggregate monetary value of all the final goods and services produced in a country during a year. GDP is one of the national income accounting measures; it is the sum of four categories of expenditure in consumption, investment, government purchases, and net exports.

The economy does not always work smoothly. At times the economy finds itself in the grip of recession when levels of national income, output and employment are far below their full potential levels. During a recession, there is a lot of idle or unutilized productive capacity, that is, available factors of production are not working to their full capacity.

Inflation is a persistent rise in the general price level of all goods. Inflation occurs when the prices of goods and services rise, while deflation occurs when those prices fall. The balance between these two economic conditions, opposite sides of the same coin, is delicate and an economy can quickly fluctuate from one condition to the other.

The unemployment rate shows what fraction of those who would like to work do not have a job. The trade balance deficit occurs when there is a difference between receipts from exports of goods and expenditures on imports of goods. The balance of payments deficit occurs when there is a difference between residents of the reporting country and residents of the rest of the world during a given time period.

Unit Review Exercises

Part I: Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Frictional unemployment is temporary unemployment.
2. Unemployment leads to the exploitation of labour.
3. During inflation, the prices of all goods and services rise together.
4. The economy does always work smoothly without fluctuations.
5. During inflation, all costs and prices do not rise together and in the same proportion.
6. Unemployment refers to individuals who are employable, but are actively not seeking a job.
7. Disguised unemployment is very common in third world countries.
8. The labour force includes groups of people within a specified age bracket (15-64) who are without a job but are actively searching for a job.

Part II: Choose the best answer among the given alternatives for each of the following questions.

1. The labour force consists of all those:
   A . who are fit for work
   B . who are willing to work
   C . who are available for work
   D . all of the above
2. The general goals of a macroeconomic policy,
   A . high rate of economic growth
   B . rule of law
   C . price instability
   D . all
3. If the national economy is closed, i.e. a country has no interaction with the rest of the world then
   A . GNP > GDP
   B . GNP < GDP
   C . GNP = GDP
   D . all
4. Which of the following describes structural unemployment?
   A . A civil engineering graduate looking for a job at a clinic
   B . A student immediately after graduation
   C . An agricultural graduate looking for a job at "Piassa"
   D . A and C
5. Which one of the following is wrong about gross domestic product (GDP)?
   A . It measures the current production of goods and services only
   B . It is less than GNP if the net factor income received from abroad is negative
   C . It measures the values of final goods and services produced within the territory of a country irrespective of who owns that output.
   D . When the net factor income received from abroad is zero, GDP is equal to GNP
6. The general objectives of a macroeconomic policy are to achieve:
   A . Economic growth
   B . Full employment
   C . Stable balance of payment
   D . all
7. A situation where "too much money" chases "too few goods."
   A . cost push inflation
   B . demand pull inflation
   C . supply side inflation
   D . both A and C

8. A situation of voluntary switching of jobs in search of better jobs.

   A . Frictional unemployment
   B . Structural unemployment
   C . Cyclical unemployment
   D . all

9. It represents the difference between receipts for exports of goods and expenditure on imports of goods.

   A . Balance of Payments
   B . Visible balance
   C . Trade Balance
   D . both B and C

Part III. Answer the following questions briefly and to the point.

1. Define macroeconomics
2. Explain the general goals of a macroeconomic policy
3. Discuss the difference between GDP and GNP.
4. Do you think, in a closed economy, GDP and GNP are equal? Justify.
5. Discuss the concepts of frictional, structural and cyclical unemployment with the help of examples.

Answer Key

✓ **Suggested Answers for Activities**

Activity 7.1

1. The essential issues in macroeconomics emanate from its focus on the economic behaviour and policies that affect consumption and investment, trade balance, and other determinants of various macroeconomic variables.
2. Ethiopia is a least developed country, which the lowest figure of GDP compared to that of other developing countries. For example, Botswana is one the developing countries in Africa with a higher GDP a fair distribution of income among its citizens.

Activity 7.2

1. The macroeconomic goals of a country are: Economic growth, full employment, stable balance of payments, price stability, and fair distribution of income and wealth.

Activity 7.3

1. Inflation means a situation in which there is a sustained increase in the general price level.
   - Causes of inflation are: increase the money supply, increase in the input prices, imported inflation, weaker exchange rate and a fall in productivity
   - Two types of inflation are: Demand–pull inflation and Cost-push inflation.
2. Unemployment refers to those individuals who are unemployed and actively seeking for a job but are unable to find any.
   - Disguised unemployment is unemployment, which does not affect the aggregate economic output. It can refer to any part of the population that is not employed at full capacity.

✓ **Suggested Answers for Self-test Exercises**

Self-test Exercise 7.1

1. False 2. True 3. True

Self-test Exercise 7.2

1. True 2. False 3. True

Self-test Exercise 7.3

1. True 2. False 3. True

✓ Suggested Answers for Unit Review Exercises

Part I

1. True	2. True	3. False	4. False
5. True	6.False	7.True	8.False

Part II

1. D 2. A 3. C 4. C 5. B 6. D 7. D 8. A 9. D

Part III

1. Macroeconomics is a branch of economics dealing with the performance, structure, behavior, and decision-making of an economy as a whole. For example, using interest rates, taxes, and government spending to regulate an economy's growth and stability is one example. This includes regional, national, and global economies.
2. The general goals of a macroeconomic policy are to achieve:
   - The maximum feasible output
   - high rate of economic growth
   - full employment
   - price stability
   - equality in the distribution of income and wealth
3. **Gross Domestic Product (GDP):** -It is the total value of currently produced final goods and services that are produced within a country's boundary during a given period of time, usually one year.
4. **Gross National Product (GNP):** the total value of goods and services produced by domestically owned factors of production in a given time period (usually one year), regardless of their geographical location.
5. Yes, GNP = GDP. Because if the economy is closed, i.e., a country has no interaction with the rest of the world, GDP = GNP.
6. **Frictional unemployment:-** refers to a brief period of unemployment experienced people due to,

   Seasonality of work, e.g., construction workers

   Voluntary switching of jobs in search of better jobs

   Entrance to the labor force, e.g., a student immediately after graduation

   Re-entering the labor force

   Structural unemployment results from a mismatch between the skills or locations of job seekers and the requirements or locations of the vacancies.

   Cyclical unemployment is generated due to the absence of vacancies. This usually happens due to a deficiency in demand for commodities.

Unit 8

Basic Entrepreneurship

Unit Introduction

This unit deals with the basic entrepreneurship. It is divided into six sections. The first section presents Definition of Enterprise, Entrepreneur and Entrepreneurship. The second section deals with Creativity and Innovation in Solving Local Problems. The third section focuses on Entrepreneurial Attitudes, Behaviour and Mind-set. The fourth section presents Windows of Entrepreneurial Opportunities. The fifth section deals with Entrepreneurial Success, Teamwork and Diversity. While the last section focuses on Finance and Promotion of Entrepreneurship.

Unit Outcomes

At the end of this unit, you will be able to:

- Elaborate the concepts of enterprise, entrepreneur and entrepreneurship.
- Discuss the role of entrepreneurs in economic development.
- Analyse entrepreneurial attitudes and behaviour.
- Explain the relationship between entrepreneurial success and alertness to opportunities, teamwork, and diversity.

Key Concepts

Entrepreneurship, enterprise, entrepreneurs, teamwork, diversity, attitudes, behavior, and mindset

The Required Study Time: 18 hours

8.1. Definition of Enterprise, Entrepreneur and Entrepreneurship

Overview

This section deals with the definition of enterprise, entrepreneur and entrepreneurship. It discusses the role an entrepreneur in a business organisation. It also discusses entrepreneurship as a practice and a process that results in creativity, innovation, and enterprise development and growth in an economy.

Learning Outcomes

At the end of this section, you will be able to:

- Define concepts of entrepreneurship, enterprise and entrepreneur.
- Explain social entrepreneurship.

Dear distance learner, can you explain the differences among 'enterprise', 'entrepreneur' and 'entrepreneurship'?

An enterprise is defined as a legal entity possessing the right to conduct business on its own, for example, to enter into contracts, own property, incur liabilities, and establish bank accounts.

An entrepreneur is any person who creates and develops a business idea and takes the risk of setting up an enterprise to produce a product or service that satisfies customer needs.

Entrepreneurship is the process of identifying opportunities in the market, arranging the resources required to pursue those opportunities, and investing resources in order to exploit the opportunities for long-term gains. It involves creating incremental wealth by bringing together resources in new ways to start and operate an enterprise. Entrepreneurship is a practice and a process that results in creativity, innovation, and enterprise development and growth. Engaging in entrepreneurship shifts people from being "job seekers" to "job creators", which is critical in countries with high rates of unemployment like Ethiopia. However, it requires a lot of creativity as the driving force behind innovation.

Bethlehem Tilahun Alemu is an Ethiopian entrepreneur. When she was 25, she started a business immediately after graduating from college. She founded Sole Rebels, a shoe company that uses recycled tyres. In 2014, she was named the fastest growing brand in Africa by Forbes.

Briefly, the process of entrepreneurship includes five critical elements. These are:

1) The ability to perceive an opportunity.
2) The ability to commercialise the perceived opportunity through innovation.
3) The ability to pursue it on a sustainable basis.
4) The ability to pursue it through systematic means.
5) The acceptance of risk of failure.

What is social entrepreneurship?

Social entrepreneurship is attracting growing amounts of talent, money, and attention, but with its increasing popularity has come less certain about what exactly a social entrepreneur is and does.

The emerging field of social entrepreneurship is growing rapidly and attracting increased attention from many sectors. There are several reasons behind the popularity of social entrepreneurship. Basically, there is something interesting and appealing about entrepreneurs and the stories of why and how they do their jobs. People, like Muhammad Yunus and Steve Jobs, were attracted to social entrepreneurship for many reasons. These extraordinary people come up with brilliant ideas for creating new products and services that dramatically improve people's lives.

Social entrepreneurship indicates a commanding role to drive social change and a potential payoff with its benefits to society. The potential benefits of social entrepreneurship are clear to many of those promoting and funding these activities. However, the actual definition of social entrepreneurs is less clear. In fact, we would argue that the definition of social entrepreneurship today is anything but clear. As a result, social entrepreneurship has become so inclusive that it now has a home that embraces all manner of socially beneficial activities.

Activity 8.1

1. Give the definitions of entrepreneurship, enterprise, and entrepreneur.
2. Describe social entrepreneurship.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of definition of enterprise, entrepreneur and entrepreneurship. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain the term "entrepreneurship"?		
Are able to define an entrepreneur?		
Can you describe entrepreneurship?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-Test exercise 8.1

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. An entrepreneur is a person who sets up a business or businesses, taking on financial risks in the hope of profit.
2. Entrepreneurship is the activity of setting up a business or businesses, taking on financial risks in the hope of profit.
3. A single-location restaurant that aims to make profit would be an example of social entrepreneurship.

8.2. Creativity and Innovation in Solving Local Problems

Overview

This section deals with creativity and innovation in solving local Problems. It discusses the contributions of creativity, innovation and entrepreneurship in a nation's economic growth. It also discusses the move from creativity to entrepreneurship.

Learning Outcomes

At the end of this section, you will be able to:

- Indicate the possibility of creativity and innovation leading to entrepreneurship.
- Describe the relationship among creativity, innovation, and entrepreneurship.

Dear distance learner, from your previous study and experience, what do you understand about the possibility and relationship between creativity and innovation towards entrepreneurship?

Creativity, innovation and entrepreneurship, have been recognised as important contributors to a nation's economic growth. These three terminologies are chronologically interrelated, and it is very important to look into them to get their full picture.

A. Creativity

Creativity is defined as the tendency to generate ideas, alternatives, or possibilities that may be useful in solving problems, communicating with others, and entertaining ourselves and others. Creativity is the ability to come up with new ideas and to identify new and different ways of looking at problems and opportunities. It is a process of assembling ideas by recombining elements already known but wrongly assumed to be unrelated to each other. This definition has three key elements that are worth considering:

- Process: creativity is a process.
- Ideas: creativity results in ideas that have potential value.
- Recombining: The creative process is one of putting things together in unexpected ways.

In order to be creative, you need to be able to view things from different perspectives. Thus, creativity is the development of ideas about products, practices, services, or procedures that are original and potentially useful to the organisation.

B. Innovation

Innovation lies at the heart of the entrepreneurial process and is a means to the exploitation of opportunities. It is the implementation of new ideas at the individual, group or organisational level.

There are four distinct types of innovation, namely,

- Invention – described as the creation of a new product, service or process.
- Extension – the expansion of a product, service or process.
- Duplication – the replication of an already existing product, service, etc.
- Synthesis – the combination of existing concepts and factors into a new formulation.

C. From Creativity to Entrepreneurship

Creativity is the ability to develop new ideas and discover new ways of looking at problems and opportunities. Innovation is the ability to apply creative solutions to those problems and opportunities in order to improve people's lives or enrich society.

Creativity leads to the generation of novel and innovative ways of doing business. Exploring new niches and generating new ideas lead to efficiency and eventually give an entrepreneur the edge over the competition.

Activity 8.2

1. How do we move from creativity and innovation towards entrepreneurship?
2. Explain the relationship among creativity, innovation, and entrepreneurship?

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of creativity and innovation in solving local problems. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain the concept of innovation?		
Can you explain the relationship among creativity, innovation and entrepreneurship?		
Can you describe the role of creativity and innovation in solving problems in your area?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 8.2

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Innovation is the implementation of new idea at the individual, group or organisational level.
2. Invention is the combination of existing concepts and factors into a new formulation.
3. Creativity leads to the generation of novel and innovative ways of doing business.

8.3. Entrepreneurial Attitude, Behaviour and Mind-set

Overview

This section deals with entrepreneurial attitude, behaviour and mind-set. It discusses the characteristics that help make up an entrepreneurial mind-set important. a nation's economic growth. It also discusses the key attitudes an entrepreneur must have to a business project.

Learning Outcomes

At the end of this section, you will be able to:

- Describe the key attitudes every entrepreneur must have.
- Identify your skills and attributes to be more innovative.

Dear distance learner, how do you relate entrepreneurship with entrepreneurial attitude, behaviour and mind-set?

An entrepreneurial mind-set is a state of mind that an individual possesses. The way people think and their attitude towards the pursuit of their goals is an important tool that enables them to undertake entrepreneurial activities.

Entrepreneurs are innovators and creator who, due to their way of thinking and mind-set, give their businesses the best chance of surviving. Effectively, it means that they are brave in the decisions they make. They will actively seek clients and take risks. Further, they possess a range of other characteristics that help make an entrepreneurial mindset so important. Not all entrepreneurs succeed in every business activity. A successful entrepreneur fails at least once. What matter is how entrepreneurs learn from their failures and utilise them.

Key attitudes every entrepreneur must have to a business project:

1. Passion

Entrepreneurs should be passionate about their ideas, goals, and companies. This passion is what drives them to do their business. Whatever drives an individual to try to succeed is where his or her passion lies, and that passion is essential to the entrepreneurial life.

2. Bravery

Entrepreneurs are fearful that they will not succeed in the sense that a well-conceived idea cannot be executed. However, they do not let these fears of failure inhibit them. Since they are brave, they learn from their failures. They utilise their fear of failing to push them to work hard and strive to correct the mistakes that have caused them to fail. Thus, it is bravery that drives them to pursue successful businesses.

3. Flexibility

Entrepreneurs usually experience obstacles. There are some difficulties to overcome in any business. However, entrepreneurs must possess flexible mindsets so they can change a way of thinking that seems to lead towards failure. Flexible entrepreneurs should modify the route towards their established goal in order to achieve it successfully.

4. Strong Work Ethics

It is not easy to start from the scratch and become a successful business owner. Many hours of hard work, frustration, creativity and supervision are devoted to a new business. Entrepreneurs are always working-establishing new ideas, creating new products, designing new processes, and hiring clever and brilliant people.

5. Integrity

Entrepreneurs must demonstrate to others that they are trustworthy and honest. Regardless of the type of business they plan to establish, colleagues, sellers, customers and investors must trust them. Suppliers need to know that payments for goods they have shipped will arrive on time. Customers need to know that whatever product or service they have ordered will be delivered as promised. Colleagues need to know that they are a valued part of the company's success. Investors need to know that a company has the potential to grow.

Skills and attributes to be more innovative

A skill is simply knowledge that is demonstrated through action. It is the ability to perform in a certain way. An entrepreneur is someone who has a good business idea and can turn that idea into reality.

Turning an idea into reality requires two kinds of skills. These are general management skills and people management skills.

i) General Management Skills: These are skills required to organize the physical and financial resources required to run the business. Some of the most important general management skills are:

a) Strategy skills refers to the ability to consider the business as a whole, to understand how it fits within its market, how it can organise itself to deliver value to its customers, and the ways in which it does this better than its competitors.

b) Planning skills refer to the ability to consider what the future might offer, how it will influence the business and what needs to be done to prepare for it now.

c) Marketing skills refer to the ability to see beyond the firm's contributions and its features to understand how they satisfy the customer's needs and why the customer finds them attractive.

d) Financial skills refer to the ability to manage money, to keep track of expenditures and to monitor cash flow, and to assess investments in terms of their potential risks.

e) Project management skills refer to the ability to organise projects in order to set specific objectives and schedules to ensure that the necessary resources are in the right place at the right time.

f) Time management skills refer to the ability to use time productively to prioritise important jobs and to get things done on schedule.

ii) People Management Skills: A business can be successful only if the people who run it are properly guided and committed to making efforts on its behalf. An entrepreneurial undertaking also needs the support of people from outside the organisation, such as customers, suppliers, and investors. To be effective, an entrepreneur should demonstrate a variety of skills while dealing with other people. Some of the most important people management skills are:

a) Communication Skills – the ability to use spoken and written language to express ideas and inform to others.

b) **Leadership Skills** – the ability to inspire people to work in a specific way and to undertake the tasks that are necessary for the success of the business.

c) **Motivation Skill**s – the ability to induce people and make them fully committed to their tasks. Motivation requires an understanding of what drives people and what they expect from their jobs.

d) **Delegation Skills** – the ability to allocate tasks to different people. Effective delegation involves more than instructing. It requires an understanding of the skills that people possess and how they use them to achieve the future needs of the business.

e) **Negotiation Skills** – the ability to understand what is needed from a situation, what is motivating others in that situation and recognise the possibilities of maximising the outcomes for all parties.

All these different people's skills are interrelated. Here, entrepreneurial performance results from a combination of business knowledge, general management skills; people management skills and personal motivation. The successful entrepreneur must use and learn to use these skills. Entrepreneurs should constantly improve their abilities in these areas, recognise their strengths and weaknesses, and plan how to develop these skills in the future.

Activity 8.3

1. What are the key attitudes every entrepreneur must have?
2. Describe skills and attributes of an entrepreneur to be more innovative.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of entrepreneurial attitude, behaviour and mind-set. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you outline the key attitudes every entrepreneur must have towards business projects?		
Can you list down the skills and attributes needed to be more innovative?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 8.3

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. An entrepreneurial mindset is a state of mind that an individual possesses.
2. The negotiation skill is the ability to allocate tasks to different people.
3. Financial skills refer to ability to manage money and to keep track of expenditures.

8.4. Windows of Entrepreneurial Opportunities

Overview

This section deals with windows of entrepreneurial opportunities. It discusses the criteria that must be met to change an idea into an opportunity. It also describes the methods that Schumpeter identified for finding new business opportunities.

Learning Outcomes

At the end of this section, you will be able to:

- Identify methods for finding new business opportunities.

Dear distance learner, from your previous study and experience, what do you understand about the windows of entrepreneurial opportunities?

Aspiring entrepreneurs can come up with ideas all day long, but not every idea is necessarily a good one. For an idea to be worth pursuing, we must first determine whether it can be converted into an entrepreneurial opportunity. Entrepreneurial opportunity is the point at which identifiable consumer demand meets the possibility of satisfying the requested product or service. In the field of entrepreneurship, specific criteria need to be met to change an idea into an opportunity. It begins with developing the right mindset—a mindset where the aspiring entrepreneur sharpens his or her senses to consumer needs, and conducts research to determine whether the idea can become a successful new project.

In some cases, opportunities are found through a deliberate search, especially when developing new technologies. In other instances, opportunities emerge unintentionally by chance. But in most cases, an entrepreneurial opportunity comes from recognising a problem and making a deliberate attempt to solve it.

In the 20th century, economist Joseph Schumpeter stated that entrepreneurial innovation is the disruptive force that creates and sustains economic growth. But in the process, it can also destroy established companies, reshape businesses, and interrupt employment. He termed this force creative destruction. Schumpeter described business processes, including the concept of reduction as designed to increase company efficiency. The change in businesses development in the economy improves our lifestyle, but it can make other activities or products outdated.

Schumpeter identified the following methods for finding new business opportunities:

1. Develop a new market for an existing product.
2. Find a new supply of resources that would enable the entrepreneur to produce the product at lowest possible cost.
3. Use existing technology to produce an old product in a new way.
4. Use an existing technology to produce a new product.
5. Finally, use new technology to produce a new product.

We can understand theories of opportunity as related to supply or demand, or as approaches to innovations in the use of technology. The first situation is a demand opportunity, whereas the second one is a supply situation. The last three are technological innovations.

Activity 8.4

1. Describe the entrepreneurial opportunities in your surroundings.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of windows of entrepreneurial opportunity. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain the windows of entrepreneurial opportunity?		
Can you explain the methods for finding new business opportunities?		
Can you give examples of business opportunities that are available in your area?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 8.4

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. In the field of entrepreneurship, specific criteria need to be met to change an idea into an opportunity.
2. In all cases, opportunities are found through a deliberate search, especially when developing new technologies.
3. We can understand theories of opportunity as related to supply or demand, or as approaches to innovations in the use of technology.

8.5. Entrepreneurial Success, Teamwork, and Diversity

Overview

This section deals with entrepreneurial success, teamwork and diversity. It discusses the benefits of teamwork to companies.

Learning Outcomes

At the end of this section, you will be able to:

- Explain the importance of teamwork to the success of a business.

Dear distance learner, from your previous study and experience, what do you understand about the importance of teamwork to entrepreneurial successes? Did you think about it? Good.

Many companies nowadays emphasise the importance of ability. They are encouraging the idea that a few top employees are responsible for most of the overall success. However, most recent productivity studies have shown that even successful leaders need the help of a strong team in order to succeed. Therefore, the importance of teamwork is emphasised more and more, with companies spending millions on team building strategies.

Why does teamwork matter to the business success?

Teamwork brings numerous benefits to companies:

1) Teamwork fosters cooperation.

Cooperation among teammates is one of the key elements of success. Football teams in which players choose to pass the ball to teammates with better chances to score win championships more often than teams with successful leaders trying to keep their hero status and take the shot on their own even when others might have had better chances.

The same is true for every team that is supposed to achieve a common goal. Working together by sharing experience and ideas, instead of keeping them to themselves can bring better results for all parties involved, and the whole company.

2) Teamwork broadens horizons.

When working alone, you only have a one perspective on things. While that is not essentially wrong, it can be very restricting. On the other hand, working with a team offers different perspectives and ideas, which might end up bringing much better results.

Studies have shown that teams with members coming from diverse backgrounds (gender, age, ethnicity, etc.) are more creative and perform better by up to 35 per cent, compared to non-diverse teams. That shows the importance of having different perspectives to work with: instead of viewing a single side of things, teamwork offers a three-dimensional picture.

3) Teamwork increases productivity.

In a team, the workload is shared among team members with different knowledge and skills. Members coordinate efforts to do a better job, in a shorter time than a single person does.

Different people have different problem-solving methods. They generate new ideas and solutions that would be difficult for an individual. Effective brainstorming sessions help teams in their search to innovate. They also enable them to find solutions by building on each other's ideas.

4) Teamwork provides learning opportunities.

Having people with different skills, levels of experience, and abilities work together does not only mean that they will work better and faster. While interacting over work issues, they are also sharing their knowledge with each other. They are growing together and improving their abilities.

5) Teamwork frames the company culture.

A team that works well together will foster a spirit of friendship, loyalty, and cooperation that will shape the company's culture. Working in a positive environment increases morale and overall happiness and satisfaction, creating a sense of belonging to something bigger. Eventually, the team becomes a community, in which everyone understands their role and plays their part towards the common goal.

By supporting each other, team members build relationships based on trust and mutual respect. Positive team relationships make employees more reliable, effective, and productive. All these qualities are ultimately contributing to the success of the company.

Activity 8.5

1. What are the benefits of teamwork for making business successful?

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of entrepreneurial success, teamwork, and diversity. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain how the teamwork brings numerous benefits to companies?		
Can you give examples of the benefits you got due to teamwork?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 8.5

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Most recent productivity studies have shown that even successful leaders need the help of a strong team in order to succeed.
2. Instead of viewing a single side of things, teamwork offers a two-dimensional picture.
3. Positive team relationships make employees more reliable, effective, and productive.

8.6. Finance and Promotion of Entrepreneurship

Overview

This section deals with finance and promotion of Entrepreneurship. It discusses the financial requirements of businesses. It also discusses sources of financing.

Learning Outcomes

At the end of this section, you will be able to:

- Identify the financial requirements for Entrepreneurial ventures.
- Explain the various sources of finance.

Dear distance learner, from your previous study and experience, what do you understand about the sources of finance for entrepreneurial development? Did you think about it? Good.

Finding the sources of finance may be important for a variety of reasons. The development of new products can be costly but capital may be required. Such developments are financed internally, whereas capital to purchase machinery may come from external sources. In this case, many organisations have to look for short term capital in the form of loans, working capital etc., in order to provide finance.

(A) Financial Requirements

All businesses need money to finance different activities. Considering the types and adequacy of funds available, it is important to use funds with appropriate funding methods.

1) **Permanent Capital**: The permanent capital base for a small firm usually comes from investment in a share company or personal loans to form partnerships or to invest in sole proprietorship. It is used to finance the start-up costs of an enterprise, or major developments and expansions in its life-cycle. It may be required for a significant innovation, such as a new product development. Ideally, permanent capital is only required when the firm can afford it; investment in equity is rewarded by dividends from profits, or a capital gain when shares are sold.

2) **Working Capital**: It is short-term finance. Most small firms need working capital to pay for raw materials and cover other costs. Requirements for this kind of short-term financing will vary considerably by business type. In some cases, this will be sufficient to finance the start-up of a small business, so that suppliers are effectively financing the business. Although short-term finance is normally used to fund the trading of a business, it is also sometimes needed to purchase assets that are short-lived such as company vehicles, which may be changed every 4 or 5 years.

3) **Asset Finance**: This is medium- to long-term financing. The purchase of physical assets is usually financed on a longer-term basis, from 3 to 10 years or more, depending on the useful life of the asset. Plants, machinery, equipment, company vehicles, and buildings may all be financed by medium- or long-term loans from a variety of sources.

(B) Sources of Financing

Financial resources are essential for business, but particular requirements change as an enterprise grows. Obtaining those resources in the amount needed and at the right time can be difficult for entrepreneurial projects because they are generally considered more risky than established enterprises. Financing means more than obtaining money; it is very much a process of managing assets wisely to use capital efficiently.

The critical issue in financing is guaranteeing sufficient cash flow for operations as well as to planning financing that matches with changes in the enterprise. Businesses obtain cash from different sources.

1) **Personal saving**: In the first place, entrepreneurs should take start-up money from their own pockets. As a general rule, entrepreneurs should provide at least half of the start-up funds in the form of personal savings.

2. Friends and relatives: After finishing their own saving, entrepreneurs should turn to friends and relatives who might be willing to invest in the business. The entrepreneur is expected to describe the opportunities and risks of the business.

3. Partners: An entrepreneur can choose to take on partners to expand the capital formation of the proposed business.

4. Angels: These are private investors who are wealthy individuals, often entrepreneurs, who invest in start-up businesses in exchange for taking risks in these businesses.

5. Venture capital companies: These are private organisations that purchase shares in new business expecting high return and high growth potential. They provide start-up capital, development funds, or expansion funds.

Activity 8.6

1. Explain the financial requirements for entrepreneurship.
2. Describe the various sources of finance.

Self-check

Dear distance learner, we hope you enjoyed working on this section. Now it is time to check your understanding of finance and promotion of entrepreneurship. Read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide on your level of understanding of the points presented so far.

Question	Yes	No
Can you explain the financial requirements for entrepreneurship?		
Can you give examples of financial sources in your area?		

Dear distance learner, did you mark any boxes under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it.

Self-test exercise 8.6

Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. Entrepreneurs should borrow start-up money from friends and relatives.
2. Working capital is short-term finance.
3. Venture capital companies are private organisations that purchase shares in existing business expecting high return and high growth potential.

Unit summary

An entrepreneur is an individual who creates a new business, bearing most of the risks and enjoying most of the rewards. The process of setting up a business is known as entrepreneurship. The entrepreneur is commonly seen as an innovator, a source of new ideas, services, and business, or procedures. Entrepreneurship is the process, and the entrepreneur is the person undertaking entrepreneurial activity, such as starting their own business.

Social entrepreneurship hints at the imperative to drive social change, and it has that potential payoff, with its lasting and transformational benefit to society. Social entrepreneurship is the process by which individuals, start-ups, and entrepreneurs develop and fund solutions that directly address social issues. A social entrepreneur, therefore, is a person who explores business opportunities that have a positive impact on their community, society, or the world.

Entrepreneurs are business people who can detect and sense the availability of business opportunities in any given scenario. They will then utilise these opportunities to create new products by employing new production methods in different markets.

Creativity is the ability to come up with new ideas and to identify new and different ways of looking at problems and opportunities. Essentially, creative entrepreneurs are investors in talent, whether their own or others. The most renowned creative entrepreneurs have combined creative flair with entrepreneurial ability to build multimillion-dollar business empires.

Innovation lies at the heart of the entrepreneurial process and is a means to the exploitation of opportunity. An innovation is a process by which a domain, a product, or a service can be renewed and brought up to date by applying new processes, new techniques, or establishing successful ideas to create new value.

Unit Review Exercises

Part I: Write 'True' if the statement is correct, or 'False' if it is not correct for each of the following statements.

1. An entrepreneur is a person who creates the job, not a job-seeker.
2. All business people are entrepreneurs.
3. Interest in social entrepreneurship transcends the phenomenon of popularity and fascination with people.
4. Tests of creativity measure only the number of alternatives that people can generate.
5. Cooperation among teammates is one of the key elements of success.
6. Finding the sources of finance may be important for the development of new products.
7. The process of setting up a business is known as "entrepreneurship".
8. Social entrepreneurship is the process by which individuals explore business for personal interest.
9. Innovation is a means to the exploitation of opportunity.
10. Extension is described as the creation of a new product, service or process.

Part II: Choose the correct answer among the alternatives for the following questions.

1. _____ is a term used to describe a sort of innovation that is defined as the development of a new good, service, or method.

   A . Invention C . Duplication
   B . Extension D . Synthesis

2. Which of these factors is critical to business success?

   A . Cooperation C . Team working
   B . Work independently D . Both A and C

3. The first place, entrepreneurs should look: for start-up money is

   A . Friends and relatives C . Partners
   B . Personal saving D . Angels

4. What is an ability to use spoken and written language to express ideas and inform others?

   A . Motivation Skills C . Communication Skills
   B . Delegation Skills D . Delegation Skills

5. The term ___ refers to the impetus for social progress as well as a prospective reward from the benefits society may experience.

   A . Social entrepreneurship C . Trader
   B . Entrepreneur D . All of the above

6. __________ has been recognized as important contributors to a nation's economic growth.

   A . Creativity C . Entrepreneurship
   B . Innovation D . All of the above

7. The idea that business owners should be enthusiastic about their concepts, goals, and companies is denoted by the word_______.

A . Bravery
C . Passion
B . Flexibility
D . Integrity

8. Which of the following is the most important general management skill?

A . Planning Skills
C . Strategy Skills
B . Financial Skills
D . All of the above

9. _____ the ability to allocate tasks to different people.

A . Delegation Skills
C . Negotiation Skills
B . Motivation Skills
D . Communication Skills

10. _____refers to what entrepreneurs must demonstrate to others as a show of their trustworthiness and honesty.

A . Integrity
C . Strong Work Ethics
B . Flexibility
D . Passion

III. Answer the following questions briefly and to the point.

1. Give at least two definitions for entrepreneurship and two meanings of entrepreneur.
2. Who could be good candidates for entrepreneurship?
3. Identify any five qualities of a successful entrepreneur
4. What are the main phases of the creativity process?
5. Describe the four distinct types of innovation.

Answer Key

✓ **Suggested Answers for Activities**

Activity 8.1

1. – Entrepreneurship is the process of identifying opportunities in the market, arranging the resources required to pursue those opportunities, and investing resources in order to exploit the opportunities for long-term gains.

   – An enterprise is defined as a legal entity possessing the right to conduct business on its own in order to enter into contracts, own property, incur liabilities, and establish bank accounts.

   – An entrepreneur is any person who creates and develops a business idea and takes the risk of setting up an enterprise to produce a product or service which satisfies customer needs.

2. Social entrepreneurship is attracting growing amounts of talent, money, and attention, but along with its increasing popularity has come less certain about what exactly a social entrepreneur is and does.

Activity 8.2

1. Creativity leads to generation of novel and innovative ways of doing business. Exploring new niches and generating new ideas lead to efficiency and eventually give an entrepreneur the required edge over the competition. In this way, we move from creativity and innovation towards entrepreneurship.

2. Creativity is the ability to come up with new idea and to identify new and different ways of looking at a problem and opportunities. Innovation is a process of intentional change made to rate value by meeting opportunity and seeking advantage. Entrepreneurship is the combination of both creativity and innovation.

Activity 8.3

1. Every entrepreneur must have the following key attitudes: Passion, Bravery, Flexibility, Strong Work Ethics, and Integrity.

2. To be more innovative, an entrepreneur must have General Management Skills and People Management Skills.

Activity 8.4

1. Possible entrepreneurial opportunities in your surroundings include:
   - Develop a new market for an existing product.
   - Find a new supply of resources that would enable the entrepreneur to produce the product for less money.
   - Use existing technology to produce an old product in a new way.
   - Use an existing technology to produce a new product.
   - Finally, use new technology to produce a new product.

Activity 8.5

1. Teamwork has the following benefits for making business successful.
   i. Teamwork fosters cooperation
   ii. Teamwork broadens horizons
   iii. Teamwork increases productivity
   iv. Teamwork provides learning opportunities
   v. Teamwork frames the company culture

Activity 8.6

1. Financial requirements for entrepreneurship include:
   i. **Permanent Capital**: This capital's base to a small firm usually comes from investment in a share company or personal loans to form partnerships or to invest in sole proprietorship. It is used to finance the start-up costs of an enterprise, or major developments and expansions in its life-cycle.
   ii. **Working Capital**: It is short-term finance. Most small firms need working capital to pay for raw materials and cover other costs. Requirements for this kind of short-term financing will vary considerably by business type.
   iii. **Asset Finance**: This is medium-to long-term financing. The purchase of physical assets is usually financed on a longer-term basis, from 3 to 10 years or more, depending on the useful life of the asset.
2. The various sources of finance are: Personal saving, Friends and relatives, Partners, Angels and Venture capital companies.

✓ Suggested Answers for Self-test Exercises

Self-test Exercise 8.1

1. True 2. False 3. False

Self-test Exercise 8.2

1. True 2. False 3. True

Self-test Exercise 8.3

1. True 2. False 3. True

Self-test Exercise 8.4

1. True 2. False 3. True

Self-test Exercise 8.5

1. True 2. False 3. True

Self-test Exercise 8.6

1. False 2. True 3. False

✓ Suggested Answers for Unit Review Exercises

Part I

1. True	2. False	3. True	4. False	5. True
6. False	7. True	8. False	9. True	10. False

Part II

1. A 2. D 3. B 4. C 5. A 6. D 7. C 8. D 9. C 10. A

Part III

1. Entrepreneurship is the process of identifying opportunities in the marketplace, arranging the resources required to pursue these opportunities, and investing the resources to exploit them for long term gains. It involves creating incremental wealth by bringing together resources in new ways to start and operate an enterprise.

Entrepreneurship is the process through which individuals become aware of business ownership, then develop ideas for, and initiate a business.

An entrepreneur is any person who creates and develops a business idea and takes the risk of setting up an enterprise to produce a product or service that satisfies customer needs.

An entrepreneur can also be defined as a professional who discovers a business opportunity to produce improved or new goods and services and identifies a way in which the resources required can be mobilized.

2. An entrepreneur is an individual who has the ability to identify and pursue a business opportunity, raises the capital to finance it; gathers the necessary physical, financial, and human resources needed to operate the business venture; sets goals for him/herself and others; initiates appropriate action to ensure success; and assumes all or a major portion of the risk.

3. Passion, Bravery, Flexibility, Strong Work Ethic, Integrity.

4. Steps in the creativity process:

Step 1: Opportunity or problem Recognition: A person discovers that a new opportunity exists or that a problem needs resolution.

Step 2: Immersion: the individual concentrates on the problem and becomes immersed in it. He or she will recall and collect information that seems relevant, dreaming up alternatives without refining or evaluating them.

Step 3: Incubation: The person keeps the assembled information in mind for a while. He or she does not appear to be working on the problem actively; however, the subconscious mind is still engaged. While the information is simmering it is being arranged into meaningful new patterns.

Step 4: Insight: The problem-conquering solution flashes into the person's mind at an unexpected time, such as on the verge of sleep, during a shower, or while running.

Step 5: Verification and Application: The individual sets out to prove that the creative solution has merit. Verification procedures include gathering supporting evidence, using logical persuasion, and experimenting with new ideas.

5. Types of innovations:

- An invention is described as the creation of a new product, service or process
- Extension is the expansion of a product, service or process
- Duplication is defined as replication of an already existing product, service, or process
- Synthesis is the combination of existing concepts and factors into a new formulation.

Glossary

Attitude: refers to the way in which a person views and evaluates something or someone, a predisposition or a tendency to respond positively or negatively toward a certain idea, object, person, or situation.

Barter: the direct exchange of goods or services—without an intervening medium of exchange or money—either according to established rates of exchange or by bargaining. It is considered the oldest form of commerce.

Behaviour: is "any observable overt movement of the organism generally taken to include verbal behaviour as well as physical movements". Behaviour is anything that an organism does involving action and response to stimulation. It is the response of an individual, group, or species to its environment.

Cost: refers to *the total expenditure a firm incurs when utilising economic resources to produce goods and* services. In a basic economic sense, cost is the measure of the alternative opportunities foregone in the choice of one good or activity over others. This fundamental cost is usually referred to as opportunity cost.

Debt: can be simply understood as the amount owed by the borrower to the lender. A debt is the sum of money that is borrowed for a certain period of time and is to be return along with the interest.

Deflation: is when the prices of goods and services decrease across the entire economy, increasing the purchasing power of consumers. It is the opposite of inflation and can be considered bad for a nation as it can signal a downturn in an economy, leading to a recession or depression.

Diversity: is the range of human differences, including but not limited to race, ethnicity, gender, gender identity, sexual orientation, age, social class, physical ability or attributes, religious or ethical values system, national origin, and political beliefs.

Durability: refers to the ability of an object or a system to endure physical damage from normal use. It is the ability of the object or system to last over time, resisting wear, breakage, deterioration, etc.

Employment: is a paid mutual work arrangement between an employer and an employee. This term applies to an individual who is hired for a salary or compensation to initiate work or tasks for an organisation.

Enterprise: is an organisational unit producing goods or services which has a certain degree of autonomy in decision-making. An enterprise can carry out more than one economic activity and it can be situated at more than one location.

Entrepreneur: is someone who has an idea and who works to create a product or service that people will buy, as well as an organisation to support that effort. An entrepreneur takes on most of the risk and initiative for her or his new business and is often seen as a visionary or innovator.

Entrepreneurship: refers to the process of creating a new enterprise and bearing any of its risks, with the view of making the profit. The person who creates a new enterprise and embraces every challenge for its development and operation is known as an entrepreneur.

Full employment: is an economic situation in which all available labour resources are being used in the most efficient way possible. Full employment embodies the highest amount of skilled and unskilled labour that can be employed within an economy at any given time.

Gross Domestic Product (GDP): the final value of the goods and services produced within the geographic boundaries of a country during a specified period, normally a year. GDP growth rate is an important indicator of the economic performance of a country.

Gross National Product (GNP): is Gross Domestic Product (GDP) plus net factor income from abroad. GNP measures the monetary value of all the finished goods and services produced by the country's factors of production irrespective of their location.

Inflation: is a continuous increase in the general price of the goods and services that households buy. Inflation is typically a broad measure, such as the overall increase in prices or the increase in the cost of living in a country. It is measured as the rate of change of those prices.

Input: refers to the elements of production that go into the process of creating a certain good or service. All these elements, especially manufacturing, are using inputs for their processes, also known as factors of production.

Long-run: refers to a period of time where all factors of production and costs are variable. Over the long run, a firm will search for the production technology that allows it to produce the desired level of output at the lowest cost.

Mindset: a person's way of thinking and her or his opinions to have a different or the same mindset. It is extraordinary how hard it is to change the mindset of the public and the press.

National Income: refers to the total monetary value of all goods and services that are produced by a nation during a period of time. In other words, it is the sum of all the factor income that is generated during a production year. National income serves as an indicator of the nation's economic activity.

Output: is the finished product or service that is the result of all the production elements combined. Output in economics is the "quantity (or quality) of goods or services produced in a given time period, by a firm, industry, or country", whether consumed or used for further production.

Per capita income: is a measure of the amount of money earned per person in a nation or geographic region. Per capita income is used to determine the average per-person income for an area and to evaluate the standard of living and quality of life of the population.

Precautionary motive: unexpected expenses, such as medical or car repair bills, often require immediate payment. The need to have money available in such situations is referred to as the precautionary motive for demanding money.

Precious metals: are rare, naturally occurring metallic chemical elements of high economic value. Precious metals provide a means for investors to store wealth and seek growth in value. The most common types of precious metals that people invest in are gold, silver, and platinum.

Production function: refers to an equation that expresses the relationship between the quantities of productive factors (such as labour and capital) used and the amount of a product obtained.

Short-run: refers to a production planning period where at least one input remains fixed while the rest are subject to change. It works when a business wants to achieve the target within a short duration due to the sudden or seasonal demand for a specific product.

Speculative motive: is a strategy employed by investors and traders to keep cash on hand in order to take advantage of future investment opportunities. It works with the idea that the future is uncertain. It justifies the need for a certain amount of liquidity in a portfolio.

Stock: is a security that represents the ownership of a fraction of the issuing corporation. Units of stock are called "shares" which entitles owners to a proportion of the corporation's assets and profits equal to how much stock they own.

Teamwork: is when a group of people works together toward a common goal or purpose. If each person willingly and intentionally makes the team's interests and objectives their first priority, work reaches heightened levels of success. The results can make a big impact.

Total product: refers to the total amount of goods and services produced with the given input in a specific period of time.

Transaction: is a completed agreement between a buyer and a seller to exchange goods, services, or financial assets in return for money. The term is also commonly used in corporate accounting.

Unemployment: is the condition of one who is capable of working, actively seeking work, but unable to find any work. *Unemployment* is a key indicator of the health of an economy.

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