

# Ch1 Nature And Scope Of Business Economics

## 1. INTRODUCTION

General definition of the study of Economics is individual and social choice in the face of scarcity. The law of scarcity implies that consumer's wants will never be completely satisfied. Economic problems arise due to two reasons:

- a) Unlimited wants
- b) Scarce resources

The term 'Economics' owes its origin to the Greek word 'Oikonomia' meaning 'household' Management.

- Economics is a science that studies those activities, which are, concerned with the efficient consumption, production, exchange and distribution of scarce means which have alternative uses.
- The purpose of economics is to achieve maximum satisfaction of wants and increasing of welfare as well as economic growth.

## 2. Meaning of Business Economics

➤ Business Economics is also referred to as Managerial Economics. It is application of economic theory and methodology.

➤ Every business involves decision-making as survival and success depends on sound decisions.



▷ Decision making means the process of:-

1. evaluating various course of action
2. making rational judgment on the basis of available information, and
3. selecting i.e making choice of a suitable alternative by decision maker.

• Decision making is not simple and straight forward. It has become very complex due to ever changing business environment, growth competition, large scale production, big size of business houses, complex laws, cost awareness, etc. in other words the economic environment in which the firm operates in very complex and dynamic.

• Business Economics provides a scientific base to the professional management of a business activity. It provides tools like budgeting, market analysis, cost-benefit analysis, etc. which can be scientifically applied to take sound business decision. Thus, Business Economics is a sub-branch of Economic which aims at the scientific application of economic knowledge, logic, theories and tools to take rational business decision. Thus it is an APPLIED ECONOMICS.

• Business Economics is closely connected with both viz, Micro Economic Theory as well as Macro Economic Theory. It is also useful to the manager of 'not-for-profit' organizations.



### 3. Definitions of Business Economics

• "Business Economics in terms of the use of economic analysis in the formulation of business policies. Business Economics is an essentially component of Applied Economics as it includes application of selected quantitative techniques such as linear programming regression analysis, capital budgeting, break-even analysis and cost analysis."

(Joel Dean)

• "Business Economics is concerned with the application of economic laws, principles of methodologies to the managerial decision making process within a business firm under the condition of risk and uncertainties." (Evan Douglas)

### 4. Types of Economics

1. **Microeconomics** :- Microeconomics is the study of particular firm, particular household. Individual price, wages, income, industry and particular commodity. Thus, it is a study of a particular unit rather than all the units combined. Microeconomics theory deals with the problem of allocation of resources. Under microeconomics, we study:
- a) Theory of product pricing / price theory
  - b) Theory of consumer behaviour
  - c) Theory of factor pricing
  - d) study of a firm.



2. **Macroeconomics**:- Macro economics theory is that part of economics which studies the overall average and aggregates of the system, such as total production, total consumption, total saving and total investment. Thus, macroeconomics is the study of overall phenomena as a whole rather than its individual parts. Macroeconomics deals with growth and development of resources. Under macroeconomics, we study:

- a) Theory of national income, employment and money
- b) Theory of general price level
- c) Theory of economic growth and development
- d) Theory of international trade



## 5. Difference Between Microeconomics and Macroeconomics

Basis	Microeconomics	Macroeconomics
Study of	It is study of individual economics units.	It is study of the <del>eg</del> economics as a whole and its aggregates.
Deal with	It deals with individual income, individual prices and individual output, etc.	It deals with national income, price level, national output, etc.
Tools	Its main tools are demand & supply of a particular commodity.	Its main tools are aggregate demand and aggregate supply of the economy as a whole.
Central Problem	Its central is price determination of commodities of factor of production.	Its central problem is determination of level of income and employment.
Prices	Price determined under this are called 'relative prices'.	Price determined under this are called 'absolute price'.
Type of analysis	It is a partial equilibrium analysis.	It is a general equilibrium analysis.
Scope	Its scope is limited.	It is wider in scope.
Example	(a) Lock out in TELCO. (b) Finding the causes of failure of X and Co.	(a) Per capita income (b) Corporate income tax (c) Economy growth



## 6. Nature of Business Economics

1. **Business Economics is a Science** :- Science is a systematized body of knowledge which trace the cause and effect relationships. Business Economics uses the tools of Mathematics, Statistics and Econometrics with economic theory to take decision and frame strategies. Thus, it make use of scientific methods.

2. **Based on Micro-Economics** :- As Business Economics is concerned more with the decision making problem of a particular business establishment. Micro level approach suits is more. Thus, Business Economics largely depends on the techniques of Micro-Economics.

3. **Incorporates elements of Macro Analysis** :- A business unit is affected by external environment of the economy in which it operates. A business is affected by general price level, level of employment, govt. policies related to taxes, interest rates, industries, exchange rates, etc. A business manager should consider such macro-economic variable which may affect present or future business environment.

4. **Business Economics is an Art** :- It is related with practical application of laws and principles to achieve the objectives.

5. **Use of Theory of Market & Private Enterprise** :- It uses the theory of market and resource allocation in a capitalist economy.



6. **Pragmatic approach**:- Micro-Economics is purely theoretical while, Business Economics is practical in its approach.
7. **Inter-disciplinary in nature**:- It incorporates tools from other disciplines like Mathematics, Statistic, Econometrics, Management Theory, Accounting, etc.
8. **Normative in Nature**:- Economic theory has been developed along two lines - POSITIVE and NORMATIVE

Positive science	Normative science
1. Robbins	Alfred Marshall
2. What it is	What should be or ought to be
3. Based on analysis, facts, realistic	Based on ethics
4. Will not pass value Judgement (not give solution)	Will pass value Judgement (gives solution)
5. E.g. India is an over populated country.	Family planning should be started to control population.

A positive science or pure science deal with the things as they are & their **CAUSE** and **EFFECTS** only. It states 'what is'? It is **DESCRIPTIVE** in nature. It does not pass any moral or value judgements.

A normative science deals with 'what ought to be' or 'what should be'. It passes value judgments and states what is right & what is wrong / it is **PRESCRIPTIVE** in nature as it offers suggestions to solve problems. Normative science is more practical, realistic and useful science.



## 9. Scope of Business Economics

The scope of Business Economics is wide. Economics theories can be directly applied to two types of business issues namely -

➤ Micro-economics is applied to operational or internal issues of a firm.

➤ Macro-economics is applied to environment or external issues on which the firm has no control.

1. Micro-economics applied to operational or internal; issues.

Issues like choice of business size of business, plant layout, technology, product decision, pricing, sales promotion, etc. are dealt by Micro-economic theories. It covers -

- Demand analysis and forecasting
- Product and cost analysis
- Inventory Management
- Market structure and Pricing Analysis
- Resource Allocation
- Theory of Capital and Investment Decisions
- Profitability Analysis
- Risk and Uncertainty Analysis.



2. Macro-economics applied to environment or external issues.

The major economic factors relate to---

- The type of economic system
- The stage of business cycles
- The general trends in national income, employment, price, saving and investment.
- Government's economic policies
- Working of financial sector and capital market
- Socio-economic organizations
- Social and political environment.

These external issues has to be considered by a firm in business decision and frame its policies accordingly to minimize their adverse effects.

10. Central Economic Problem (scarcity)

1. What to produce (capital goods, consumer goods)
2. How to produce (capital use capital, labour use labourer)
3. From whom to produce (poor or rich, in india it gives to poor for upliftment)
4. What provision should be made for economic growth.

When are goods produced

&

How much to produce

} not an economic problem.



## 11. Economic System

Capitalist  
economy

Socialist  
economy

Mixed  
economy

### 1. Capitalist Economy

#### FEATURES

1. Means of production are privately owned
2. Freedom of enterprise & freedom of price choice
3. Allocation of resources is as per consumer preference
4. Entrepreneurs are guided by profit motive.
5. Competition exist among producers
6. Capitalist economy use price mechanism as a principle motive

#### MERITS

1. Greater efficiency & incentive to work hard
2. Faster economic growth possible
3. Consumer are benefitted because of good quality product
4. Higher standard of living
5. Innovation & technological progress

#### DEMERITS

1. Uneven distribution of Income & wealth
2. Income inequality & social injustice
3. Exploitation of consumer and labourer
4. Economic instability which may lead to depression
5. Creation of monopoly power

#### Others name for capitalist economy

1. Market economy
2. Market system
3. Free markets
4. Market mechanism
5. Price mechanism



## 2. Socialist Economy

### FEATURES

1. It is known as command economy, controlled economy, centrally planned economy
2. Collective ownership of means of production
3. Promote welfare of people
4. Lack of competition

### MERITS

1. Balance economic development
2. No class conflict
3. Economic Fluctuation & unemployment are minimized
4. Right to minimum work
5. No exploitation of consumer & worker

### DEMERITS

1. Corruption, Red tapism, results into inefficiency
2. No freedom of choice
3. Price are administered by state

## 3. Mixed Economy

### FEATURES

1. Combination of both capitalism & socialism
2. Freedom to join any occupation trade or business
3. People are free to consume goods of their choice

### MERITS

1. Freedom of occupation
2. Encourages enterprise & Risk taking
3. Development of technology through R&D vaccine & UPI
4. Economic & social equality possible

Skill India

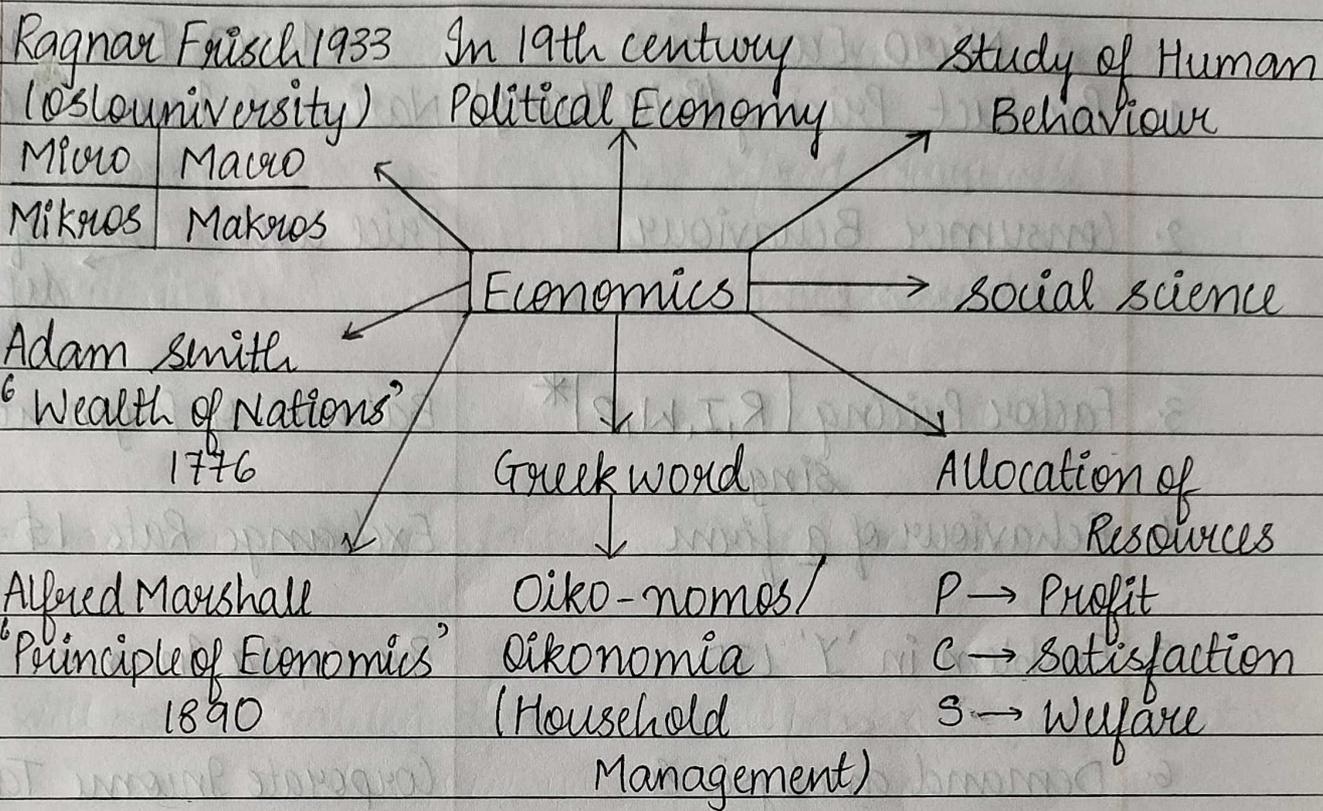
Mudra loan  
upto 10 lac

Innovation in India



### DEMERITS

1. Poor implementation of plans
2. High level of taxes <sup>Petroleum</sup> ₹106 - ₹72 tax
3. Good level of corruption
4. Wastage of Resources



- \* The word Economics is associated with scarcity.
- \* Unlimited wants and limited resources is the subject matter of economics (Resources have alternative uses)
- \* Wants are also called as ends & Resources are also called as means
- \* As per economics wealth is stock and income is flow.
- \* According to Samuelson Economics is a Queen of Social Science.
- \* Allocation of resources is a micro concept.
- \* Country without scarcity is not found in real world.
- \* Value of next best alternative is called as Opportunity cost.
- \* Alfred Marshall is an architect of Micro economics.



## \* Rent, Interest, Wages, Profit

	Micro Economics	Macro Economics
1.	Product Pricing (Price Theory)	National Income / Output
2.	Consumer Behaviour	Price level $\begin{cases} \rightarrow \text{inflation} \\ \rightarrow \text{deflation} \end{cases}$
3.	Factor Pricing [R, I, W, P]* single	Balance of Payment
4.	Behaviour of a firm	Exchange Rate 1\$ = 81
5.	Problem in 'Y' LTD	Per Capita Income
6.	Demand analysis & Forecasting	Corporate Income Tax
7.	Market structure	savings rate savings / and investment
8.	Location of industry (Industry ka location)	Social and Political environment
9.	Income from Railways	Interest rates
10.	Allocation of Resources	Capital Formation
11.	Particular industry eg: steel industry	



Positive Science	Normative Science
1. Robbins	Alfred Marshall
2. What it is	What should be or ought to be
3. Based on <u>analysis</u> , facts, realistic	Based on Ethics
4. Will not Pass value judgement	Will pass value judgement
5. Supports Neutrality	Does not support Neutrality
6. Descriptive in Nature	Prescriptive in Nature

Central economic Problem → Scarcity

1. What to Produce
2. How to Produce
3. For whom to Produce (Distribution of national income)
4. An what Provisions should made for economic growth.

\* When are goods Produced } Not a central  
    & } Problem  
    How much to Produce }

Deductive Method  
General to  
Particular

Inductive Method  
Particular to  
General

## Definition of Economics

Economics is the study of Processes by which relatively scarce resources are allotted to satisfy unlimited wants of human beings in a society.



## Points to Remember

1. Business Economics involves practical application of economic theory and has a multi disciplinary approach.
2. Macro economics is also called as aggregate economics.
3. Capital budgeting, risk analysis, business cycle are within the scope of business economics.  
(accounting standards is not a part of it) (can be asked for odd man out)
4. Larger production of capital goods would lead to higher production in future.
5. Social securities benefits, sickness benefits are found under both socialism and mixed economy.
6. Science of wealth → Adam Smith
7. Science which deals with wealth of nation → Adam Smith
8. Science which deals with wealth → J.B. Say (classical economics) ↑
9. Growth and development definition → Paul Samuelson
10. Welfare oriented definition → Alfred Marshall, Pigeu
11. Study of mankind → Alfred Marshall (-) (+)
12. Scarcity oriented definition → Robins / Robinson