

# CA Mohnish Vora (MVSIR)

## (CA, CFA L1, BCOM)

- ❑ Faculty for
  - CA Foundation- Business Economics & BCK
  - CA Intermediate- Financial Management & Economics
- ❑ Known for making concepts Chilltu (Easy) and amazing notes
- ❑ Amongst the TOP educators on Unacademy
- ❑ 3+ years of Teaching Experience
- ❑ 10th & 12th Merit Student (CBSE)
- ❑ National Level Roller Hockey Player



CA Foundation - June 2022

# Business Economics

## Chapter 1, 3 & 5

Last Minute Summary (LMS) of Important Points

★  
We will cover Economics Chp 2 & 4 and BCK through MCQs



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**CA Foundation - June 2022**  
**Business Economics & BCK**  
**Pre - Exam Marathon Schedule**  
**by CA Mohnish Vora (MVSIR)**

One link for all lectures

[bit.ly/mvsirunacademy](https://bit.ly/mvsirunacademy)

Date	Time	Platform	Topics
28 June	6.30 to 7.30 PM	Only YouTube "Unacademy CA Foundation"	Economics <u>Chp 1</u>
	10.15 to 12.15 PM	YouTube & Special Class	BCK MCQ Based Marathon (Part 1)
29 June	9.45 to 11.15 AM	YouTube & Special Class	Economics <u>Chp 2</u> (Important MCQs)
	1.15 PM to 3.00 PM	YouTube & Special Class	BCK MCQ Based Marathon (Part 2)
	8.00 to 11.30 PM	YouTube & Special Class	Economics <u>Chp 3 &amp; 4</u> (Important MCQs)
30 June	8.15 AM to 10.15 AM	YouTube & Special Class	Last Minute Questions (LMQs)

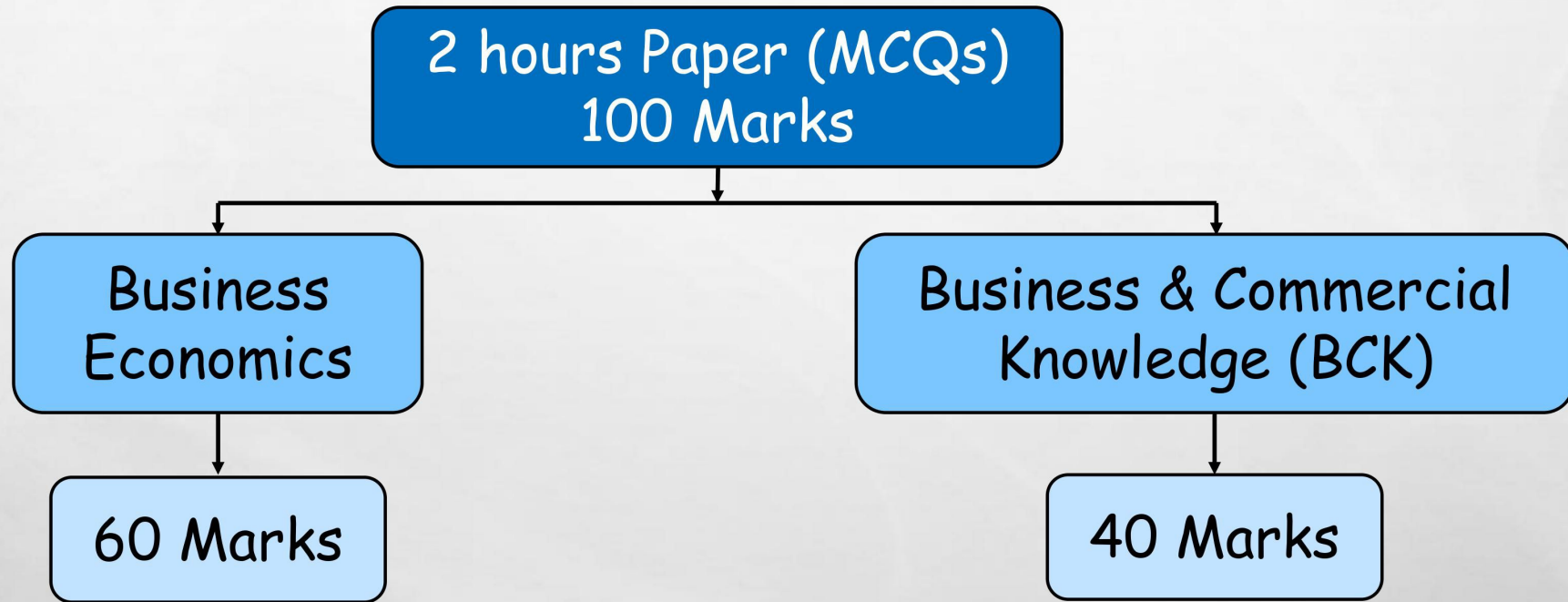


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# CA Foundation - Paper 4

## Marks Weightage

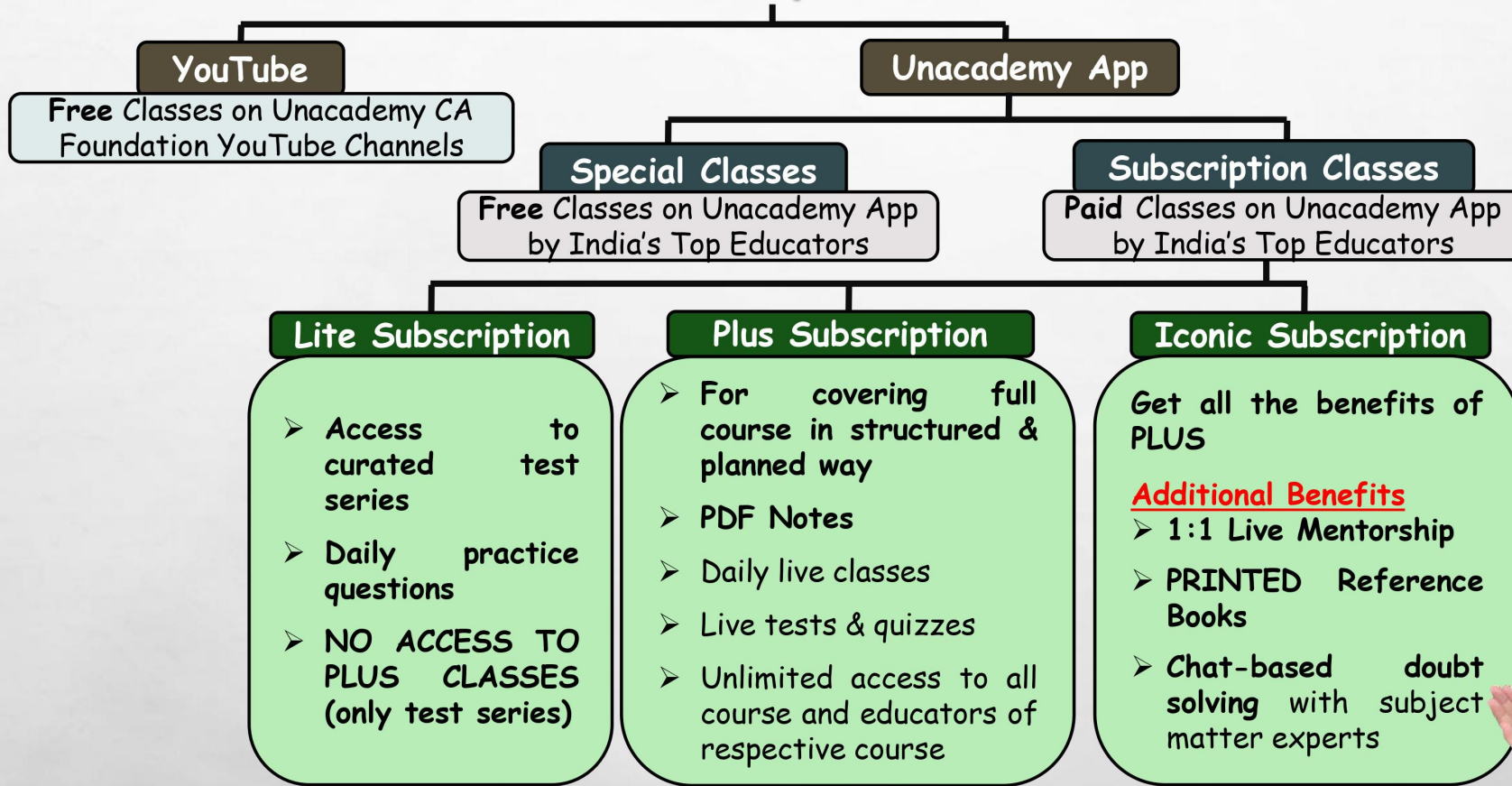


The above weightage is given as per ICAI. In exams MCQs in exams will be JUMBLED  
(It is not necessary that first 60 MCQs will be of Eco & next 40 of BCK )





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CA Foundation - June 2022

# Business Economics Chapter 1

Last Minute Summary (LMS) of Important Points



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# Economics Chapter 1 - Unit 1

Two fundamental facts of Economics

- Unlimited Wants
- Resources are relatively scarce resources (Problem of Scarcity) and have alternative uses

We cannot have everything we want with resources we have, we are **forever forced to make choices**.

Therefore, we **choose to satisfy only some of our wants** leaving many other wants unsatisfied.

Problem of scarcity is faced by EVERYONE in this world

Thus Economics is "कहानी घर घर की"

'Economics' is derived from **Greek** word '**Oikonomia**'. Its meaning is '**household management**'.

Economics is the study of the processes by which **relatively scarce resources** are **allocated to satisfy competing unlimited wants** of human beings in a society.

Till 19th century, Economics was known as '**Political Economy**'

**Father of Economics - Adam Smith**. He wrote a book 'An Inquiry into the Nature and Causes of the **Wealth of Nations**' (1776)

Economists	Various Definitions of Economics
Adam Smith	<b>Wealth</b> Definition
J B Say	Economics is a " <b>Science which deals with wealth</b> "
Alfred Marshall	<b>Welfare</b> Definition Limitation : neglect of immaterial services
Lionel Robbins or Robinson	<b>Scarcity</b> Definition Economics is <b>neutral between ends</b> .
Paul A. Samuelson	<b>Growth</b> Definition

Decision making refers to process of

- selecting an appropriate alternative that will provide the
- most efficient means of attaining a desired end,
- from two or more alternative courses of action.

Business Economics may be defined as the **use of economic analysis to make business decisions** involving the **best use of an organization's scarce resources**.

**Joel Dean** defined "Business Economics" as use of economic analysis in formulation of business policies.

Business Economics is aka. **Applied Economics** or **Managerial Economics**

Micro Economics	Macro Economics
Study of behaviour of <b>individuals</b> or <b>group of units</b> rather than all the units combined	Study of <b>economy as a whole</b> . It analyzes the <b>overall economic environment</b> .
It examines how individual units make decisions as to how to <b>efficiently allocate their scarce resources</b>	Aka - <b>Aggregate Economics</b>
Few areas under Micro- Economics are: (i) Product pricing; (ii) Consumer behaviour; (iii) <b>Factor pricing</b> ; (iv) The economic <b>conditions of a section of people</b> ; (v) Behaviour of firms; and (vi) Location of industry.	Few areas under Macro- Economics are: (i) National Income and National Output; (ii) <b>General price level</b> and interest rates; (iii) Balance of trade and balance of payments; (iv) External value of currency; (v) The overall level of <b>savings and investment</b> ; and (vi) The level of employment and rate of economic growth.

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## Nature of Business Economics

- 1) Business Economics is a Science
- 2) Based on Micro Economics
- 3) Incorporates elements of Macro Analysis
- 4) Business Economics is an art
- 5) Use of Theory of Markets and Private Enterprises
- 6) **Pragmatic** in Approach
- 7) **Interdisciplinary** in nature
- 8) **Normative** in Nature
  - Positive Economics - **Descriptive**, "What is" current situation
  - Normative Economics - **Prescriptive**, "What should be" done for **welfare**, involves value judgements

## Scope of Business Economics

- Operational / Internal issues - Those issues that **arise within organisation** and are **within control of management**. In business economics we **apply microeconomic theory** to these issues
- Environmental / External Factors are not within the control of management. In business economics we **apply macroeconomic theory** to these issues

## Economics Chapter 1 - Unit 2

**Every economic system** has to deal with **central problem of scarcity of resources** relative to the wants for them. This is generally called 'the central economic problem'.

- 1) What to produce?
- 2) How to produce?
- 3) For whom to produce?
- 4) What provisions are to be made for economic growth?

### 3 Types of Economies-

- 1) Capitalist - All resources are owned and controlled by **private individuals for profit**
- 2) Socialist - Material resources are owned by **State** (aka Govt. or Central Planning Authority)
- 3) Mixed - It depends on **both markets and governments** for allocation of resources

### Capitalism

Aka **free market economy** or **laissez-faire economy**

#### Characteristics

- **Profit motive** is driving force.
- Right to private property
- Freedom of enterprise & economic choice (consumer sovereignty)
- Absence of Government Interference
- Competition (Efficiency increases, optimum allocation, cost minimized; but wastage of resources due to advertisement)

#### Merits

- Consumers are benefitted - many good quality goods at low prices
- Self-regulating and resources allocated automatically by **price mechanism**
- Functions in a democratic framework
- Encourages enterprise and risk taking

#### Demerits

- Vast economic inequality and social injustice, splits society into 'haves' and 'have-nots'
- Exploitation of labour & consumers
- Resource misallocation - production of more luxury goods
- Conspicuous & unethical consumption - environmental degradation.

How do capitalist economies solve central problems?

#### 1) What to produce?

decided by consumers who show preferences by spending on goods which they want

#### 2) How to produce?

If labour is relatively cheap than capital, then use labour-intensive method & vice versa

#### 3) For whom to produce?

Higher the income, higher buying capacity and higher demand for goods. Goods produced for people having buying capacity

#### 4) Provision (Saving & Invnt)

Interest Rate on saving high- more saving  
More profit expectation- more investment

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## Socialism

Aka **Command Economy** or **Controlled Economy** or **Centrally Planned Economy**

Concept given by **Karl Marx** and **Frederic Engels** in 'The Communist Manifesto' (1848)

Production by Govt. is aimed at **maximizing welfare** of public

### Characteristics

- Collective Ownership
- Economic planning
- Absence of Consumer Choice
- Relatively Equal Income Distribution
- Minimum role of Price Mechanism or Market forces - Prices prevailing here are '**administered prices**' which are set by Govt.
- Absence of Competition

### Merits

- Central planning of resources- Rapid development, better utilization, waste is avoided
- Unemployment is minimised,
- Business fluctuations are eliminated
- Right to work and minimum standard of living
- **Labourers and consumers are protected from exploitation**
- Comprehensive social security

### Demerits

- Bureaucracy & red tapism, inefficiency and delays, corruption, favouritism
- **Takes away the basic right- right to property**
- Does not provide necessary incentives to hard work
- Consumers have **no freedom of choice**
- **Extreme form of socialism** is not at all practicable (Socialist economy is a **myth**)

How do socialist economies solve central problems? - **Central Planning Authority**

## Mixed Economy

It **includes the best features of both capitalism & socialism**

Private enterprise is allowed to do any type of economic activity. However, the Govt. imposes measures to control and regulate private sector

The Government itself runs important and selected industries and eliminate the free play of profit motive and self-interest.

In a mixed economy, there are three sectors of industries:

- 1) Private sector
- 2) Public sector
- 3) Combined sector

### Demerits

- **Excessive controls by the state** resulting in reduced incentives and constrained growth of the private sector.
- Poor implementation of planning
- Higher rates of **taxation**
- Undue delays, Lack of efficiency, Corruption, Wastage of resources
- **Poor performance** of the public sector

How do mixed economies solve central problems?

It uses a **mix of both price mechanism and central planning**

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# Business Economics Chapter 3

Last Minute Summary (LMS) of Important Points



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# Economics Chapter 3 - Unit 1 - Theory of Production

## Basics

As per Economics, **production** denotes **process** by which **man utilises resources** to **transform** them into **goods and services** to make them **satisfy human wants**. (similar definition given by James Bates and J.R. Parkinson)

The performance of an economy is judged by level of its production.

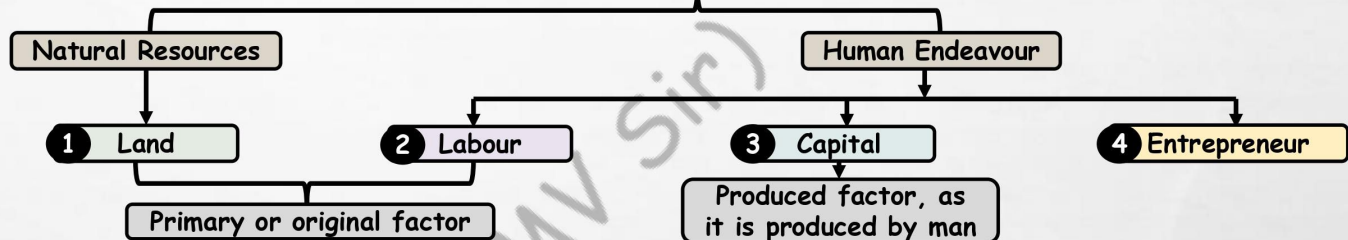
**Production** can also be defined as **creation or addition of utility**. During production we can confer 4 types of utility-

- 1) **Form Utility**- **Changing form** of things to add utility to it. Eg- Wood to chair.
- 2) **Place Utility**- **Changing place** of resources **from a place** where they are of **little or no use** to **another place where they are of greater use**. Eg- extraction of minerals from earth, apple from Kashmir to Mumbai etc.
- 3) **Time Utility**- **Making available** materials **at times** when they are **not normally available**. Eg- Canning of seasonal fruits
- 4) **Personal Utility**- Making use of personal skills in the form of **services**, e.g., those of organisers, merchants, transport workers etc

Production **does not include** **work done within a household** by anyone out of **love and affection**, **voluntary services** and goods produced for **self consumption**. Eg- Food made by mother in home is NOT production

## Factors of Production (Inputs)

An input is a good or service which a **firm buys** for use in its production process.



### Land

It refers to soil or earth's surface and also to **all free gifts of nature** which would include all **natural resources**, **soil**, **water**, **air**, **light**, etc.

#### Characteristics

- 1) Land is a **free gift of nature**
- 2) **Supply** of land is **fixed**  
**Supply** of land is **perfectly inelastic** from view of **economy** And **relatively elastic** from the point of view of a **firm**
- 3) Land is **permanent** and has **indestructible** powers
- 4) Land is a **passive factor**
- 5) Land is **immobile**
- 6) Land has **multiple uses**
- 7) Land is **heterogeneous**

### Labour

It refers to various types of human efforts which require use of **physical exertion**, **skill** and **intellect**.

Labour must be done with **motive** of **economic reward**. Anything done out of **love and affection** or for sake of **pleasure or love**, is **not labour**

#### Characteristics

- Labour is **perishable**, requires **human effort**, **active factor**, **inseparable from labourer**, **mobile**.
- **Labour power differs** from labourer to labourer
- Labour has **poor bargaining power**
- **Supply** of labour **cannot be increased** or **decreased instantly**
- **Supply curve** of labour has **backward bending shape**

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# Economics Chapter 3 - Unit 1 - Theory of Production

## Capital

**Capital** is 'produced means of production' or 'man-made instruments of production'. It refers to all man made goods (assets) that are a **part of wealth** (total assets) and are **used for further production** of wealth.

**Produced factor**, as it is **produced by man** by working with nature.

Eg- Machine tools and instruments, factories, etc.

**Capital** is a **stock concept** which yields a periodical income which is a flow concept

## Types of Capital

- 1) **Fixed capital** - **Durable nature** & renders services over a period of time
- 2) **Circulating capital** - For **single use** and is **not available for further use**. Eg, seeds, fuel, raw materials etc
- 3) **Real (Tangible) capital** - **Physical goods** (can be **perceived by senses**)
- 4) **Intangible Capital** - rights & benefits which **cannot be perceived** by senses. Eg- patents, goodwill etc.
- 5) **Human capital** - **Human skill and ability**
- 6) **Individual capital** - **Personal property**
- 7) **Social capital** - **Belongs to society** as a whole in form of roads, bridges, etc.

## Capital Formation (aka Investment)

Capital formation means a **sustained increase in the stock of real capital** in a country.

It involves **production of more capital goods** like, machines, factories, etc. which are **used for further production** of other goods.

## Stages of Capital Formation

- 1) **Savings**
- 2) **Mobilisation of savings**
- 3) **Investment**

## Entrepreneur

Entrepreneur is a factor which

- **mobilises other factors** of production,
- **combines them** in right proportion,
- **initiates process of production** and **bears risks** involved in it.

## Functions of Entrepreneur

- 1) **Initiating business enterprise** and resource co-ordination
- 2) **Risk bearing** or uncertainty bearing  
**Financial risks & Technological risks**, **Profit** is **reward**, risk bearing cannot be delegated
- 3) **Innovations** - **Most Important Function**

## Enterprise's Objectives

- 1) **Organic objectives**
- 2) **Economic objectives**
- 3) **Social objectives**  
To provide **fair deal to employees etc.**
- 5) **National objectives**

## Enterprise's Problems

- 1) **Objectives**
- 2) **Location and size of the plant**
- 3) **Selecting & organising physical facilities**
- 4) **Finance**
- 5) **Organisation structure**
- 6) **Marketing**
- 7) **Legal formalities**
- 8) **Industrial Relations**

## Production Function

**Production function** is a mathematical statement of **relationship** between **dependent** variable (**output**) and **independent** variable (**inputs**). [ similar definition given by Samuelson]

$$Q = f(\text{Labour}, \text{Capital}) = f(L, K)$$

## Assumptions of Production Function

- 1) Relationship between inputs and outputs exists for a **specific period of time**
- 2) Production **technology** remains **constant**
- 3) **Output** resulting from use of inputs is **at the maximum level** (no wastage)

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# Economics Chapter 3 - Unit 1 - Theory of Production

## Short Run Production Function

Short-run production function shows **maximum amount** of a good or service that can be produced by set of inputs, **assuming** that amount of **at least one of inputs** used remains **unchanged**.

In short run, **Capital is fixed** and **Labour is variable**.

It is the subject matter of the **law of variable proportion**

## Long Run Production Function

A long run production function shows **maximum quantity** of a good or service that can be produced by set of inputs, **assuming** that **all inputs are variable**

It is the subject matter of the **law of returns to scale**.

## Law of Variable Proportions

Aka. Law of returns to a variable input OR Law of diminishing returns

Law states that as we **increase quantity of one input (Labour)** which is combined with other fixed inputs, **marginal product (MP)** of the **variable input** must eventually **decline**.

### Assumptions of Law of Variable Proportions

- 1) Production **technology** remains **constant**
- 2) Must be **some inputs** which are **fixed (Short Run)**
- 3) Law **does not apply** where **factors must be used in fixed proportions** to yield output
- 4) Consider **only physical inputs and outputs (unit terms)** and not in monetary terms

### TP vs AP vs MP

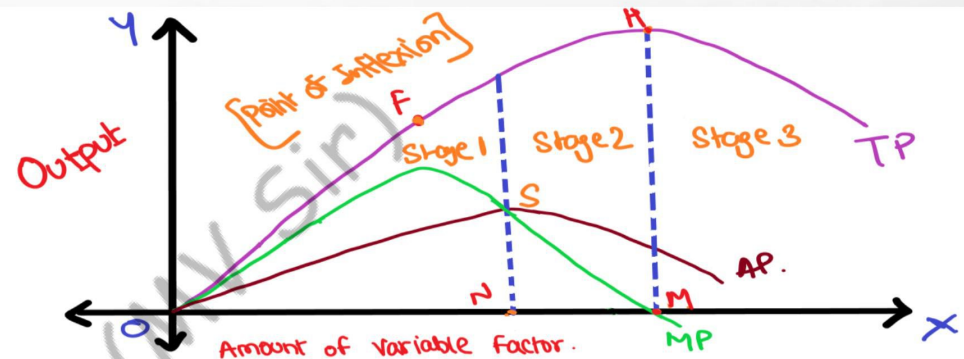
**Total Product (TP)** : **Total output** resulting from **efforts of all factors of production combined** together at any time

**Average Product (AP)** : **Total product per unit of the variable factor**.

$$AP = TP / \text{No. of Units of Variable Factor}$$

**Marginal Product (MP)** : **Change in TP per unit change in quantity of variable factor**.

$$MP = \Delta TP / \Delta Q$$



Stages		TP	MP	AP
1	Increasing Returns	TP increases at increasing rate till POI After POI, TP increases with decreasing rate.	MP rises & is maximum corresponding to POI, and then falls. MP > AP, throughout.	AP is rising. Stage ends= AP is max & AP = MP
2	Diminishing Returns	TP increases with decreasing rate Stage ends= TP is max.	MP is decreasing but positive. Stage ends= MP is 0 MP < AP, throughout.	AP is decreasing but positive.
3	Negative Returns	TP is decreasing	MP is decreasing & negative.	AP is decreasing but positive.

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# Economics Chapter 3 - Unit 1 - Theory of Production

## Law of Variable Proportions

### Relationship between AP & MP

- When AP rises  $\rightarrow MP > AP$
- When AP is maximum  $\rightarrow MP = AP$
- When AP falls  $\rightarrow MP < AP$

### Stage of Operation

- Stage 1 & 3 are  $\rightarrow$  'economic absurdity' or 'economic non-sense'
- Rational producer will **always produce in stage 2**

## Cobb-Douglas Production Function

This function **applies not to an individual firm** but to **whole of manufacturing industry**.

**Labour contributed about 3/4th and capital about 1/4th of increase in production**

$$Q = K \cdot L^a \cdot C^b$$

Where 'Q' is output, 'L' the quantity of labour and 'C' the quantity of capital, 'K' and 'a' and 'b' are positive constants.

- $a + b > 1$ , **Increasing returns** to scale
- $a + b = 1$ , **Constant returns** to scale
- $a + b < 1$ , **decreasing returns** to scale

## Returns to Scale

Occurs in **LONG RUN**

A **change in scale** means that **all factors of production** are **increased** or **decreased** in **same proportion**.

The study of **changes in output** as a consequence of **changes in scale** forms subject matter of **returns to scale**.

Eg- When ALL inputs are increased by 40%

### ➤ Constant Returns to Scale (CRS)

% Increase in Output = % Increase in Input

Eg: If output increases by 40%, then it is CRS

CRS is also referred to as "**Linear Homogeneous Production Function**"

### ➤ Increasing Returns to Scale (IRS)

% Increase in Output  $>$  % Increase in Input

Eg: If output increases by 70%, then it is IRS

### ➤ Decreasing Returns to Scale (DRS)

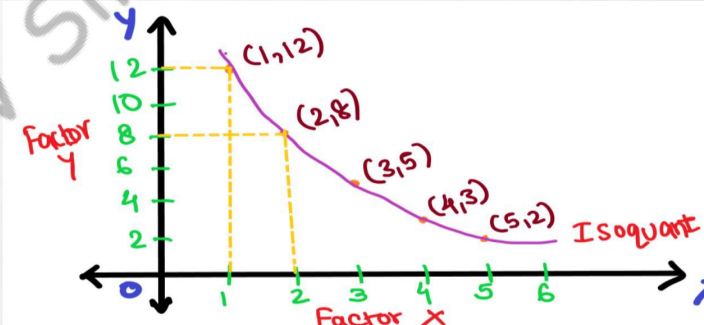
% Increase in Output  $<$  % Increase in Input

Eg: If output increases by 35%, then it is DRS

## Isoquants

An isoquant represents **all those combinations of inputs** which are capable of **producing the same level of output**.

Isoquants are aka : **equal-product curves**, **production indifference curves** or **iso-product curves**.



Properties of Isoquants-

- **Negatively sloped**, (Slope of Isoquant = MRTS)
- **Convex to the origin** due to diminishing MRTS
- **Curve on right represents a higher level of output**,
- **non intersecting**.

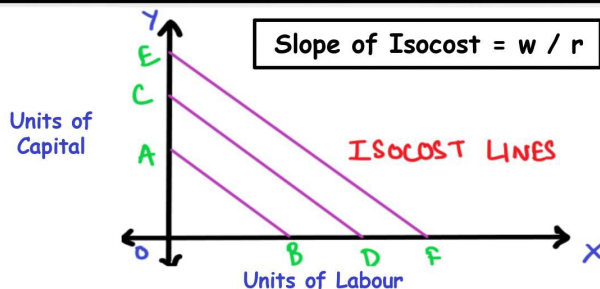
However, one **important difference** between isoquant & indifference curve is that in an isoquant **level of production** is **easily quantified** whereas in an indifference curve it is **not possible to quantify the level of satisfaction** acquired by the consumer.

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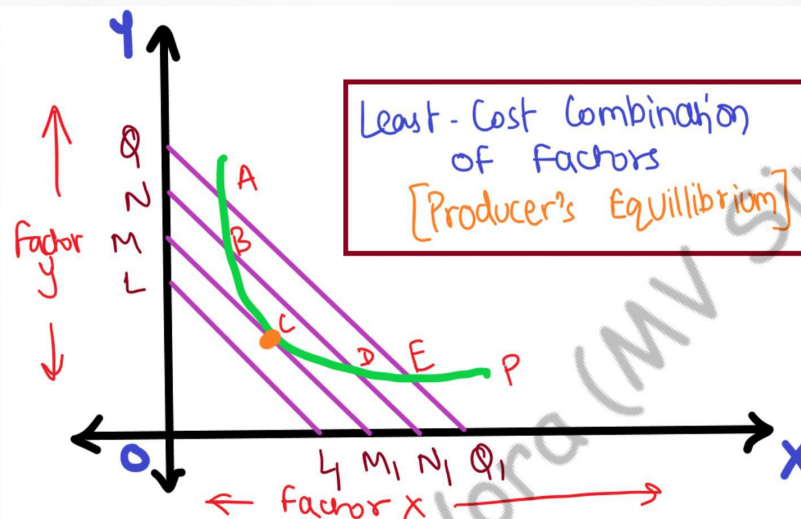


## Isocost

- Isocost line, aka. Equal-Cost Line or budget line or budget constraint line,
- It shows various alternative combinations of two factors which the firm can buy with given outlay.
- Whatever be the combination of factors the firm chooses on isocost line, the total cost to firm remains the same.



## Producer Equilibrium



A producer can produce the desired output at least possible cost at equilibrium.

Producer equilibrium will be achieved where iscost line is **TANGENT** to isoquant (at point C)

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# Economics Chapter 3 - Unit 2 - Theory of Cost

## Cost Analysis

Cost analysis is concerned with the **financial aspects of production relations** as against physical aspects which were considered in production analysis.

## Cost Concepts

### 1) Accounting Costs & Economic Costs

Accounting (Explicit or Outlay) costs are expenses which will **have to be incurred** by firm and are **recorded in financial statements**.

**Economic Cost = Explicit + Implicit Cost**

Implicit Cost is **cost of using self owned factors**. Eg- normal return on capital invested by owner himself in his business; salary not paid to entrepreneur which could have been earned elsewhere

### 2) Outlay costs & Opportunity costs

Outlay costs involve **actual expenditure**

Opportunity cost is the **cost of next best alternative opportunity which was foregone** to pursue certain action. It is **cost of the missed opportunity**

## Cost Concepts

### 3) Traceable (Direct) costs & Non-Traceable (Indirect) costs

Direct costs are costs that are **readily identified** and are **traceable** to a **particular product, operation or plant**

Indirect costs are those which are **not easily and definitely identifiable** in relation to a plant, product, process or department. Eg- Electricity exp, common or general exp etc.

### 4) Incremental costs & Sunk costs

Incremental cost refers to the **additional cost** incurred by a firm **as result of a business decision**

Sunk Costs are costs which are **already incurred once and for all** and **cannot be recovered**. They are based on past commitments and **cannot be revised or reversed** if the firm wishes to do so.

### 5) Historical costs & Replacement costs

Historical cost refers to the **cost incurred in the past** on the **acquisition of a productive asset** such as machinery etc

Replacement cost is the money expenditure that has to **be incurred for replacing an old asset**

### 6) Private costs & Social costs

Private costs are **costs actually incurred** or provided for **by firms** and are either explicit or implicit

Social cost refers to the total **cost borne by the society on account of a business activity** and includes private cost and external cost

### 7) Fixed Costs & Variable costs

➤ Fixed or constant costs are costs which **do not vary with output upto a certain level of activity**.

❑ These require **fixed expenditure of funds** irrespective of level of output, e.g., rent, property taxes, interest on loans etc

❑ Fixed cost is a function of **capacity**

❑ If the **firm closes down for some time** in the short run but remains in business, fixed cost **CANNOT be avoided (inescapable)**

❑ Shut down costs **are costs** which will **continue even after operations are suspended**. Eg- for **storing of old machines** which cannot be sold in market.

➤ Variable Costs (VC) are costs which **vary with the level of output (function of output)**

❑ If a **firm shuts down** for a short period, then VC can be avoided

❑ Eg- **wages of labour, prices of raw material, fuel, transportation cost etc**

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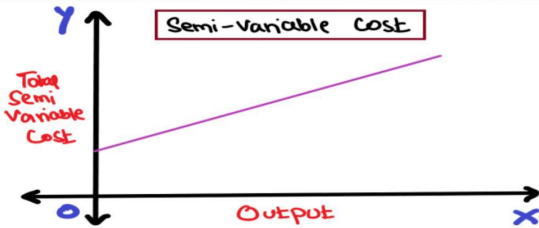
# Economics Chapter 3 - Unit 2 - Theory of Cost

## Cost Concepts

### 8) Semi-Variable Cost

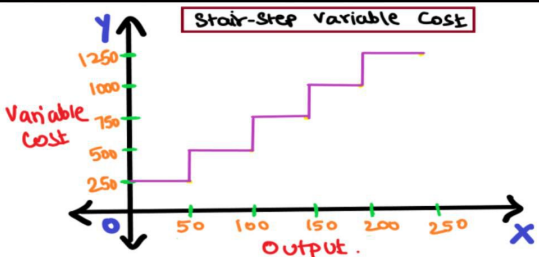
Some costs which are **neither perfectly variable, nor absolutely fixed** in relation to the changes in the size of output.

Eg: **Electricity** charges, **Postpaid Telephone Bill** etc



### 9) Stair-Step Variable Cost

Some costs which may **increase in a stair-step fashion**, i.e., they remain fixed over certain range of output; but **suddenly jump** to new higher level when output goes beyond a given limit.



## Short Run Total Costs

$$TC = TFC + TVC$$

### Total Fixed Cost curve (TFC)

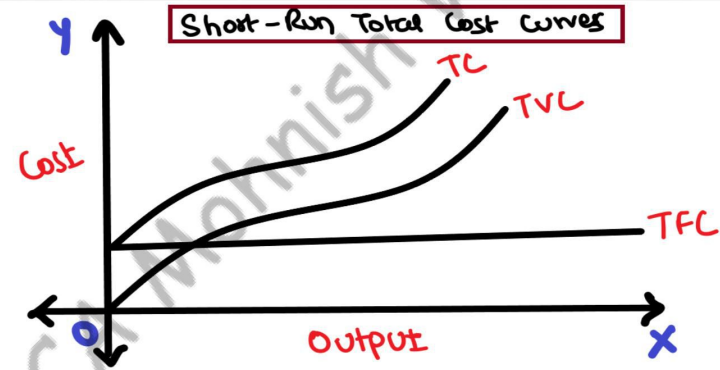
- horizontal straight line parallel to X-axis
- Starts from a point on the Y-axis

### Total Variable Cost (TVC)

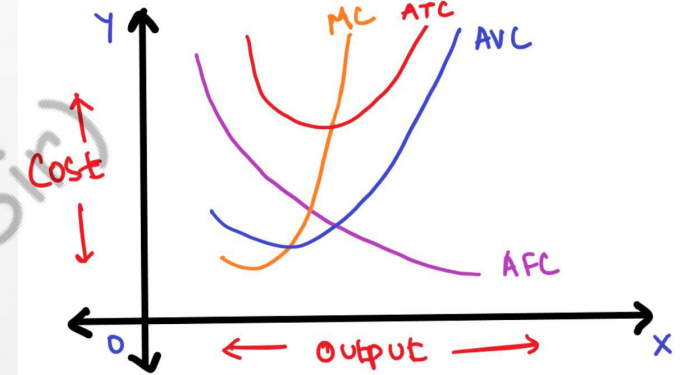
- Initially increases at a decreasing rate and then at an increasing rate. (Inverted-S shaped)

### Total Cost Curve (TC)

- Obtained by adding vertically the TFC curve and the TVC curve.
- Slopes of TC & TVC are same (Inverted-S shaped)
- At each point the TC & TVC curves have vertical distance equal to total fixed cost.



## Short Run Average Costs



### Average Fixed Cost curve (AFC)

- $AFC = TFC / Q$
- AFC is **fixed cost per unit of output**.
- AFC **falls** as output increases.
- AFC curve will **slope downwards** throughout its length but will **not touch the X-axis** as AFC **cannot be zero**. (shape- rectangular hyperbola)

### Average Variable Cost (AVC)

- $AVC = TVC / Q$
- AVC curve will **first fall**, then reach a **minimum** and then **rise** (U-shaped)

### Average Total Cost (ATC or AC)

- $ATC = TC / Q$  or  $ATC = AFC + AVC$
- ATC curve will **first fall**, then reach a **minimum** and then **rise** (U-shaped)

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## Marginal Cost Curve (MC)

Marginal cost is **addition made to total cost** by **production of an additional unit** of output.

$$MC = \Delta \text{ in TC} / \Delta \text{ in Output}$$

Or

$$MC = \Delta \text{ in TVC} / \Delta \text{ in Output}$$

MC is **independent of fixed cost**.

The value of MC comes **due to the changes in variable costs**.

MC curve becomes **minimum corresponding** to the **point of inflection** on the total cost curve

MC curve **declines first**, reaches its **minimum** and **then rises** ("U" shaped)

MC Curve **intersects AC** curve and **AVC** curve at their respective **minimum points**.

### MC & AC

AC falls  $\rightarrow MC < AC$

AC rises  $\rightarrow MC > AC$

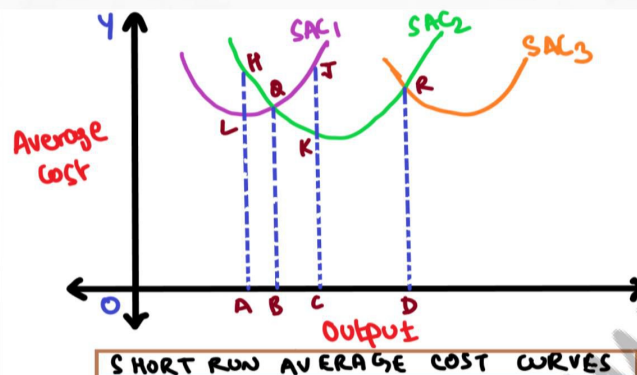
AC min.  $\rightarrow MC = AC$

### MC & AVC

AVC falls  $\rightarrow MC < AVC$

AVC rises  $\rightarrow MC > AVC$

AVC min.  $\rightarrow MC = AVC$



How to select a Short Run Average Cost Curve (SAC Curve) in the long run ?

SAC Curve is aka. **PLANT Curves**

As per above figure,

- For making output upto OB - use SAC 1
- For output more than OB, but less than OD - use SAC 2
- For output more than OD - use SAC 3

## Long Run Average Cost Curve

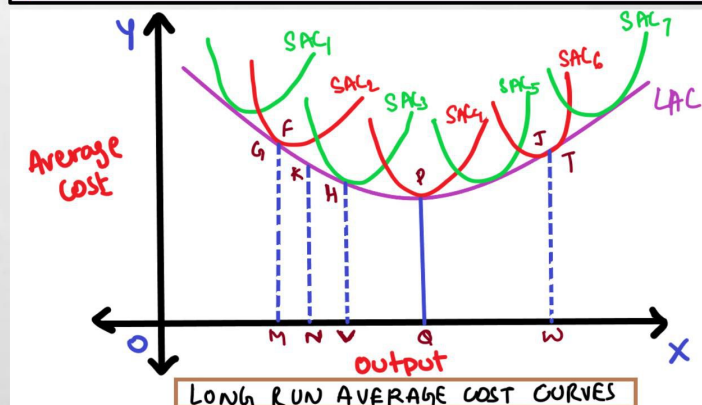
Long run is a period during which firm can **vary** all its inputs (Labour & Capital both)

In the long run the firm can **build any size or scale of plant** and therefore, can move from one plant to another. Long run is **planning horizon**.

A firm **plans for the long run** and **operates in short run**.

Long run cost of production is the **least possible cost** of producing any given level of output **when all individual factors are variable**.

A long run cost curve depicts the functional relationship between **output** and the **long run cost of production**.



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# Economics Chapter 3 - Unit 2 - Theory of Cost

## Long Run Average Cost Curve

LAC Curve is aka. **Planning Curve** or **Envelope Curve** or **Boat Curve**

LAC Curve is drawn so as to be **tangent to each** of the **SAC curves**

However, LAC curve is **NOT** tangent to minimum points of SAC curves

- When **LAC curve is declining**, it is **tangent to falling portions of SAC curves** and
- When **LAC curve is rising**, it is **tangent to rising portions of SAC curves**

"OQ" is the optimum output. This is because "OQ" is being produced at **minimum point of LAC and corresponding SAC 4 (as per graph)**. Production of OQ is done at **FULL CAPACITY**.

For producing output less than "OQ", firm will construct relevant plant and operate it at **less than its full capacity**,

Whereas for outputs larger than OQ the firm will construct a plant and **operate it beyond its optimum capacity**.

The falling portion (negatively sloped) region of LAC curve is due to **Increasing Returns to Scale** and **Economies of Scale**

The rising portion (positively sloped) region of LAC curve is due to **Decreasing Returns to Scale** and **Diseconomies of Scale**

## SCALE OF PRODUCTION

**Economies of scale** are **cost advantages** that enterprises obtain **due to their scale of operation**, with **cost per unit** of output **decreasing** which causes scale increasing.

### Internal Economies

Internal economies accrue to firm when it **expands its output**, so that **cost of production** would **come down**.

Internal economies arise purely due to **endogenous (internal) factors**

### External Economies

External economies are **benefits** accruing to **each member firm** of the industry as a result of **expansion** of the **industry**.

They are **not dependent on the output level** of **individual firms**.

### Internal Economies and Diseconomies

- 1) Technical
- 2) Managerial
- 3) Commercial
- 4) Financial
- 5) Risk bearing

### External Economies and Diseconomies

- 1) Cheaper raw materials and capital equipment
- 2) Technological external economies
- 3) Development of skilled labour
- 4) Growth of ancillary industries
- 5) Better transportation and marketing facilities
- 6) Economies of Information

### External diseconomies

External diseconomies are **disadvantages** that **originate outside firm**, especially in input markets.

Eg- **rise in factor prices** etc.

The government may also, through its **location policy**, **prohibit or restrict** the **expansion** of an industry at a **particular place**.

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# Business Economics Chapter 5

Last Minute Summary (LMS) of Important Points



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# Economics Chapter 5 - Business Cycles

## Business Cycles- Introduction

- The **rhythmic fluctuations** in **aggregate economic activity** that an economy experiences **over a period of time** are called **business cycles** or **trade cycles**.
- A trade cycle is composed of-
  - Periods of **Good trade** characterised by **rising prices** and **low unemployment** percentage, (Expansion)
  - Periods of **bad trade** characterised by **falling prices** and **high unemployment** percentages. (Contraction)
- Business cycles is that they **occur again & again** but **not always at regular intervals**, nor are they of **same length**.

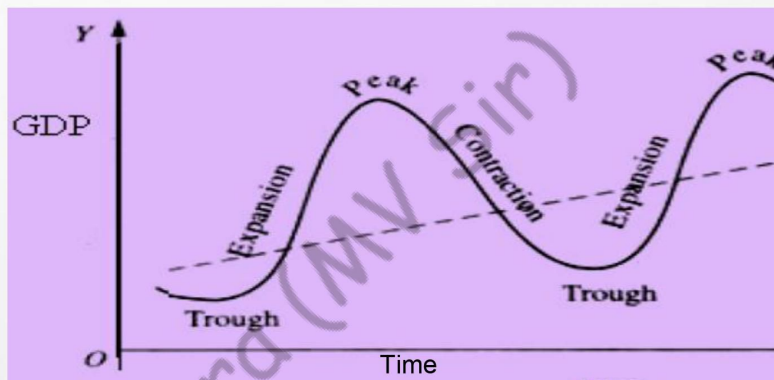
Phases of  
Business  
Cycles

Expansion  
(aka Boom or  
Upswing)

Peak  
(aka  
Prosperity)

Contraction  
(aka Downswing  
or Recession)

Trough  
(aka  
Depression)



Peak & Trough are collectively called "turning points" of business cycle.

## Expansion (aka Boom or Upswing)

Increase in national output  
(production of G/S)

Increase in employment;  
Involuntary unemployment is  
almost zero

Increase in income

Increase in agg. Demand  
(demand for all types of  
goods and services rises)

Increase in sales,  
profits, rising stock  
prices and bank  
credit

Increase in capital &  
consumer  
expenditure

Expansion  
stage  
continues till  
there is full  
employment  
of resources  
& production  
is maximum  
possible

## Peak (aka Prosperity)

Growth rate in expansion stage **eventually slows down** and reaches its **peak**.

Peak = **top** or **highest point** of business cycle.

In later stages of expansion, **inputs are difficult to find** as they are **short of their demand** and therefore **input prices increase**.

**Output prices also rise** rapidly leading to **increased cost of living** and **greater strain on fixed income earners**. Consumers begin to **review their consumption expenditure** on housing, durable goods etc. Actual **demand stagnates**.

**It is end of expansion** and it occurs when **economic growth** has reached point where it will **stabilize** and then **move in reverse direction**, starting **contraction stage**

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## Contraction (aka Downturn or Recession)

Producers do not instantaneously recognize pulse of economy (that contraction is coming) & keep anticipating high level of demand (because earlier expansion was going on), and maintain their investments.

Consequence is mismatch between demand & supply. Supply far exceeds demand. Gradually it spreads to all sectors.

Producers, now being aware of above, respond by

- holding back future investment plans,
- cancellation of orders for equipments and all inputs incl. labour.

This in turn generates a chain of reactions in input markets and producers of capital goods and raw materials in turn respond by cancelling and curtailing their orders. This is beginning of recession.

Decline of aggregate economic activity over a period of time is **RECESSION** (when contraction stage lasts for 2 or more quarters continuously, then it is called recession)

Decrease in input demand  
pulls input prices down

Decrease in employment;  
Leads to decrease in income

Producers lower their prices  
to dispose off inventories

Consumers, expect further  
decreases in prices and  
postpone their purchases

Investor confidence is at its lowest  
& stock prices fall

Bank credit decreases

Business firms become pessimistic  
about future and Investments, prodn  
and emp. further decline

Aggregate demand further falls, &  
gap between demand & supply gets  
further widened and recession  
becomes severe

## Trough (aka Depression)

➤ Severe contraction in economic activities pushes economy into phase of depression.

➤ Growth rate becomes negative and national income and expenditure declines rapidly.

➤ Agg. demand decreases, prices are lowest - forcing some firms to shutdown. It leads to mounting unemployment which leaves consumers with very little income.

➤ A typical feature of depression is the fall in the interest rate. With low interest, people's demand for holding liquid money (i.e. in cash) increases.

➤ Despite lower interest rates, demand for credit declines because investors' confidence has fallen. It may lead to possible banking or financial crisis.

➤ Industries, especially capital and consumer durable goods industry, suffer from excess capacity. Large number of bankruptcies and liquidation.

## RECOVERY

The economy cannot continue to contract endlessly. Trough lasts for some time & marks end of pessimism and beginning of optimism. This reverses process.

Process of reversal is initially felt in labour market. Pervasive unemployment forces workers to accept lower wages.

The producers anticipate lower costs and better business environment. Slowly business confidence takes off, & firms start to invest again and to build stocks

Technological advancements require fresh investments; thus bank credit increases. employment incr, agg. demand picks up and prices gradually rise.

Price mechanism acts as a self-correcting process in free market economy.

Spurring of investment causes recovery of economy. This acts as a turning point from depression to expansion.

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## Economics Chapter 5 – Business Cycles

### Indicators

It is very **difficult to predict** the **turning points** of business cycles. Economists use **changes in a variety of activities** to **measure** the business cycle and to **predict** where the economy is headed towards. These are called indicators

#### Leading Indicators

Indicator that **changes before (prior to)** **economy starts to follow a particular pattern**.

Eg- **value of new orders** for consumer goods, **new orders for plant and equipment**, **building permits for private houses**, delayed deliveries

#### Lagging Indicators

Lagging indicators **reflect economy's historical performance** and changes in these indicators are observable only **after** an economic **trend** has already occurred.

If **leading indicators** signal the **onset** of business cycles, **lagging indicators confirm** these trends.

Eg- **unemployment**, **corporate profits**, **labour cost per unit of output**, interest rates, the **consumer price index** and commercial lending activity

#### Coincidental / Concurrent Indicators

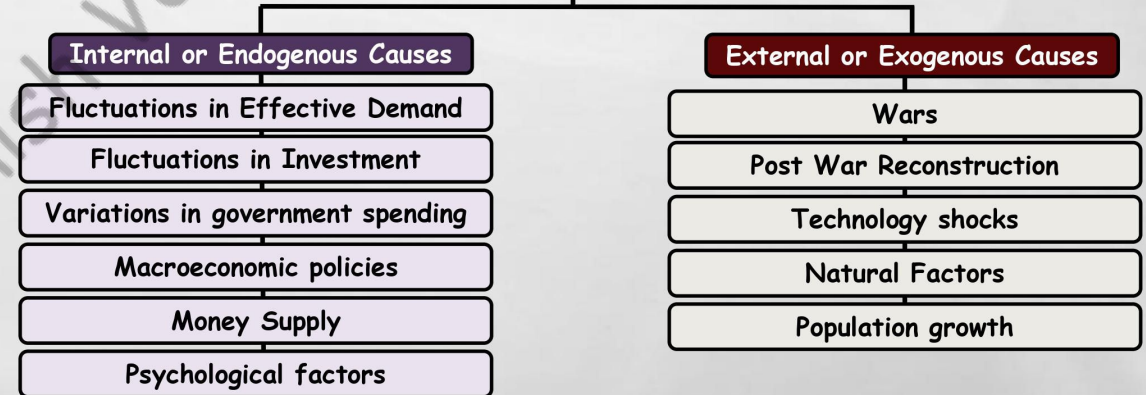
They **coincide or occur simultaneously** with business-cycle movements. They **describe current state** of **business cycle**.

Eg- **GDP**, **industrial production**, **inflation**, personal income, retail **sales** and financial market trends such as **stock market prices**

### Features Of Business Cycles

- Business cycles occur periodically, but **do not exhibit the same regularity**. The **duration & intensity** of fluctuations **varies**.
- The phases seldom (only sometimes) display smoothness and regularity.
- Generally originate in free market economies. Get transmitted to all sectors.
- Capital goods & durable consumer goods industries are disproportionately (more) affected. Industrial sector is more prone as compared to agricultural sector
- Complex phenomena; they do not have uniform characteristics and causes.
- Repercussions of get simultaneously felt on nearly all economic variables
- Contagious and are international in character.
- Have serious consequences on well-being of society.

### Causes Of Business Cycles



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## Economics Chapter 5 - Business Cycles

### Causes Of Business Cycles

**Macroeconomic policies** (**monetary & fiscal policies**) also cause business cycle

- ❑ **Expansionary policies** - Policies resulting in **increasing agg. demand** (Results in booms)
  - Fiscal Policy- **Increase government spending** and **tax cuts**,
  - Monetary Policy- **Softening (decr) interest rates**.
- ❑ **Anti-inflationary measures** - Policies resulting in **decreasing agg. demand** (Controlling inflation)
  - Fiscal Policy- **Decrease government spending** and **increasing tax**,
  - Monetary Policy- **Increasing interest rates**.

Keynes	Business Cycles are caused due to fluctuations in <b>aggregate effective demand</b>
Pigou	Business Cycles are caused due to <b>anticipations</b> of business firms & are affected by waves of <b>optimism or pessimism</b>
Schumpeter	Business Cycles are caused due to <b>innovation</b> theory.
Nicholas Kaldor	Business Cycles are caused due to <b>cobweb theory</b> - <b>present prices</b> substantially <b>influence production at some future date</b> .
Hawtrey	Business cycle is purely <b>monetary</b> phenomenon. Unplanned changes in <b>supply of money</b> may cause business fluctuation.

### Important Points

Businesses whose **fortunes** are closely **linked to the rate of economic growth** are referred to as "**cyclical**" businesses.

These include **fashion retailers, electrical goods, house-builders, restaurants, advertising, overseas tour operators, construction and other infrastructure firms**.

During a **boom**, such businesses see a **strong demand** for their products but during a **slump**, they usually **suffer a sharp drop in demand**.

### Demand-Pull Inflation

If **demand** for goods and services is **more than** their **supply**, the resultant inflation is Demand-Pull Inflation

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**CA Foundation - June 2022**  
**Business Economics & BCK**  
**Pre - Exam Marathon Schedule**  
**by CA Mohnish Vora (MVSIR)**

One link for all lectures

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Date	Time	Platform	Topics
28 June	6.30 to 7.30 PM	Only YouTube "Unacademy CA Foundation"	Economics <u>Chp 1</u>
	10.15 to 12.15 PM	YouTube & Special Class	BCK MCQ Based Marathon (Part 1)
29 June	9.45 to 11.15 AM	YouTube & Special Class	Economics <u>Chp 2</u> (Important MCQs)
	1.15 PM to 3.00 PM	YouTube & Special Class	BCK MCQ Based Marathon (Part 2)
	8.00 to 11.30 PM	YouTube & Special Class	Economics <u>Chp 3 &amp; 4</u> (Important MCQs)
30 June	8.15 AM to 10.15 AM	YouTube & Special Class	Last Minute Questions (LMQs)



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