

CHP-1. NATURE & SCOPE OF BUSINESS ECONOMICS

SDS

Page No.

ECONOMICS

UNIT-1: INTRODUCTION

⇒ Meaning of Economics.

In words of Paul A. Samuelson, "Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people."

These two fundamental facts that :-

- (i) Human beings have unlimited wants and
- (ii) The means to satisfy these unlimited wants are relatively scarce form the subject matter of Economics.
- (iii) We need to satisfy our maximum wants with limited resources which provides maximum satisfaction.

⇒ Meaning of Business Economics/Definition of BE.

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 in terms of the use of economic analysis in the formulation of business ^{policy} ~~politics~~ ~~police~~. Business Economics is essentially a 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.

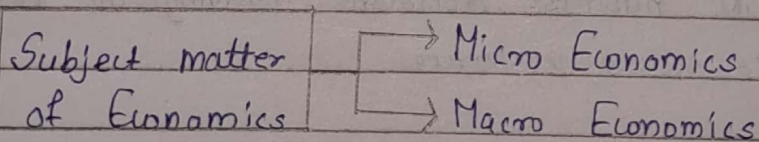
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→ Important note on Business Economics

1. Business Economics are also known as 'Managerial Economics'.
2. Business Economics integrates economy theory with business practice.
3. Economics theories just provide the tools which explains the concept of demand, supply, cost, production, price, marketing, competition, etc.
4. Business Economics applies these tools in the process of business decision making.
5. Business Economics fill the gap between Economic Theory and business practice.
6. Business Economics is also useful for NCR and Non-Profit Organisation as well.

→ Nature of Business Economics

Economics has been broadly divided into two major parts ;



① Micro Economics

→ Micro Economics is basically the study of the behaviour of ~~diff~~ different individuals and organizations ~~at~~ within an economic system.

→ We mainly study the following in Micro-Economics:

- (i) Product Pricing;
- (ii) Consumer Behaviour;
- (iii) Factor Pricing;
- (iv) The Economic Conditions of a Section of People;
- (v) Behaviours of Firms; and
- (vi) Location of Industry.

② Macro Economics

→ Macro Economics is the study of the overall economic phenomena or the economy as a whole, rather than its individual parts.

→ A few areas that come under Macro Economics are:

- (i) National Income and National Output;
- (ii) The General Price Level and Interest Rates;
- (iii) Balance of Trade and Balance of Payments;
- (iv) External Value of Currency;
- (v) The Overall Level of Savings and Investments; and
- (vi) The Level of Employment and Rate of Economic Growth;
- (vii) Import, Export and Foreign Investment.
- (viii) Knowledge regarding condition of Inflation and Interest Rates.

→ Important Points

1. The term 'Economics' owes its origin to the Greek word 'Oikonomia' which means 'household'.
2. Till 19th century, Economics was known as 'Political Economy'.
3. The book named 'An Inquiry into the Nature and Causes of the Wealth of Nations' [1776] usually abbreviated as 'The Wealth of Nations', by Adam Smith is considered as the first modern work of Economics.
4. Scarcity definition of Economics is given by Lionel Robbins [Robinson].

Unit-2

⇒ Nature of Business Economics

1. Business Economics is a Science.

→ Science means systematized body of knowledge which establishes cause and effect relationship.

→ Economics provides tools like statistics, economics, mathematics, etc.

→ Business Economics integrates the tools into decision making.

2. Business Economics is Art.

→ It involves practical application of rules & principle.

3. Business Economics is based on Micro Economics.

4. Business Economics is based on Macro Economics.

5. Business Economics use the theory of Markets and Private Enterprise.

6. Business Economics is interdisciplinary in approach.

→ It uses multiple tools/ subjects such as:-

- (i) Mathematics
- (ii) Operational Research
- (iii) Management Theory
- (iv) Accounting, Marketing, Finance
- (v) Statistics and Econometrics.

7. Business Economics is pragmatic in approach.

→ As it tackles practical problems which the firm face in the real world.

8. Business Economics are Positive and Normative in approach.

| Positive Approach | Normative Approach |
|-------------------------|---|
| → Pure Science | → Rule Based |
| → No value judgement | → Value Judgement |
| → Descriptive in nature | → Prescriptive in nature ^{nature} |
| → "What is" | → "What should be" |

⇒ Scope of Business Economics.

The scope of Business Economics is quite wide. It covers most of the practical problems a manager or a firm faces. There are two categories of business issues to which economic theories can be directly applied, namely;

1. Internal Issues / Operational Issues.

→ Issues arise within the organisation.

→ Within the control of management.

→ Internal in nature.

→ Ex, Choice of business, Size of business, ~~prod~~ Product of decisions,

→ Technology, Pricing, Sales Promotion, Financial Management of Investment, Management of Inventory, etc.

⇒ How to resolve Internal Issues?

→ Micro Economic applied to resolve internal issues.

→ Following Micro Economics theories deal the internal issues:-

- (i) Demand Analysis and Forecasting.
- (ii) Production and Cost Analysis.
- (iii) Inventory Management.
- (iv) Market Structure and Pricing Policies.
- (v) Resources Allocation.
- (vi) Theory of Capital & Investment decisions.
- (vii) Profit Analysis.
- (viii) Risk and uncertainty analysis.

2. External Issues / Environmental Issues

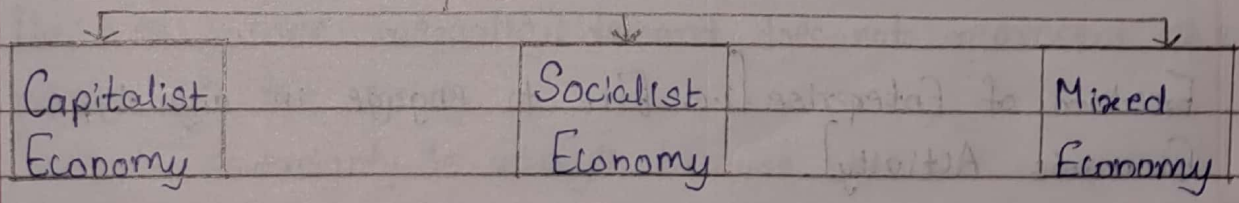
- Environmental factors affect the Performance of Business.
- Macro Economics applied to resolve these issue.
- Macro theories deal with external issues.

⇒ How to resolve External Issues?

- Macro Economics applied to resolve external issues.
- Following Macro Economics theories deal the external issues :-

- (i) Type of Economic system.
- (ii) Stages of Business Cycle.
- (iii) Government Policies and Regulations.
- (iv) Banking Policies and Regulations.
- (v) Social and Political Environment.
- (vi) Trend in National Income/Employment, Prices/Savings, etc.
- (vii) Foreign Trade Policies, Fiscal Policies.
- (viii) Globalisation Policies.

⇒ Types of Economy System



1. Capitalist Economy

→ Other Name

- (i) Free Market Economy
- (ii) Not Centrally Planned
- (iii) Laissez Faire Economy
- (iv) Private Economy

→ Meaning

- (i) Resources owned and controlled by private individuals.
- (ii) Profit motive is driving force.
- (iii) The Government has a very limited role in management of Economic affairs.
- (iv) At present no Economy is pure Capitalist.
- (v) Ex, US, UK, Hongkong, etc.

→ Characteristics

- (i) Right to private property [i.e. all factor of production under private ownership].
- (ii) Freedom of Enterprise [i.e. Free to engage in any type of Economic Activity].
- (iii) Freedom of Economic choice [i.e. What you want regarding consumption, work, production, etc].
- (iv) Profit making motive.
- (v) Consumer Sovereignty [i.e. Consumer is King].

(vi) Competition exist.

(vii) Absence of Government Interference.

→ Merits

- (i) Self Regulating.
- (ii) Works automatically through price mechanism.
- (iii) Incentive to work, labour, technology.
- (iv) Greater efficiency and Operate efficiency.
- (v) Economic growth is faster.
- (vi) Cost of production is minimized.
- (vii) Consumer benefitted / satisfaction.
- (viii) Functions in a democratic manners.
- (ix) Encourage ~~at~~ enterprise for risk taking.

→ Demerits

- (i) Economy inequality, split the society into two classes - namely "haves" and "have-not's".
- (ii) Precedence of property rights over human rights.
- (iii) Ignores human welfare.
- (iv) Due to income inequality, demand does not represent the real needs of the society.
- (v) Consumer sovereignty is a myth because excessive competition and profit-motiv work.
- (vi) Against consumer welfare.
- (vii) Misallocation of Resources.
- (viii) Less of merit goods, more of harmful good.
- (ix) Economic instability [depression, unemployment].
- (x) Wasting of Resources in Advertisement.
- (xi) Formation of Monopoly / Monopolies.
- (xii) Environment Degradation.

2. Socialist Economy

→ Other Name

- (i) Centrally Planned Economy.
- (ii) Command Economy.
- (iii) Controlled Economy.

→ Propounded

Karl Marx and Frederic Engels

→ Meaning

- (i) Resources owned by State / Authority [Government].
- (ii) Resources allocated on the basis of decision taken by CPA.
- (iii) Aim maximizing the welfare of the community as a whole.

→ Characteristics

- (i) Collective ownership of state except small firms, workshops.
- (ii) Economic planning done by CPA.
- (iii) Absence of consumer choice, but freedom from hunger guaranteed.
- (iv) Relatively equal income distribution.
- (v) Minimum role of price mechanism or market force.
- (vi) Price mechanism exist with secondary role.
- (vii) In the absence of profit motive price mechanism loses its importance.
- (viii) Prevailing prices are known as administered prices.

→ Merits

- (i) Equitable distribution of income wealth and opportunity.
- (ii) Rapid and balanced economic development.
- (iii) Resources allocated efficiently.
- (iv) Better utilization of resources.
- (v) Maximum production.
- (vi) Waste avoided through strict planning.
- (vii) No wastage of resources on advertisement.
- (viii) Unemployment minimised.
- (ix) Economic Stability.
- (x) Absence of profit making, welfare of the society.
- (xi) Removal of monopolies and exploitation of labour, security of citizen.

→ Demerits

- (i) Involves corruption, favouritism, etc.
- (ii) Restricts the freedom of individuals.
- (iii) No ^{incentives} ~~incentives~~ to hard work.
- (iv) Price is not based on any calculation like market negotiations.
- (v) Creation of State Monopolies.

In real world: no pure economy is a social economy

3. Mixed Economy

→ Meaning

- (i) Private + Government [Controlled + Market]
- (ii) Best features of both.
- (iii) Excluding the demerits of both.
- (iv) Advantage of both.
- (v) Co-existence of private and public sector.

→ Three sectors of Industry

- (i) Private sector → Profit making.
- (ii) Public sector → ^{Welfare} Welfare of society.
- (iii) Combine sector → both

→ Advantage

- (i) Freedom of choice / Consumer sovereignty.
- (ii) Existence of Private Property.
- (iii) Incentive to labour, technology, etc.
- (iv) Price mechanism exist.
- (v) Better allocation of resources.
- (vi) Encourage enterprise and Risk taking.
- (vii) Economic growth Rapidly.
- (viii) Social Equality.
- (ix) Removal of cut-throat competition.

→ Disadvantage.

- (i) Excessive Control.
- (ii) Reduce the incentives, controlled growth.
- (iii) Delay in decisions, poor performance of public sectors. Some timely absence of government ~~gives~~ gives benefit to Pvt. sector.

⇒ Basic problem of an economy

1. Resources are limited.
2. Resources have alternative uses.

This is generally called "The Central Economic Problem."

The Central Economic Problem is divided into Four Parts

Problem 1: What to produce?

Solution: Consumer Demand & Profit making.

Problem 2: How to produce?

Solution: Best technology & Minimum cost of production.

Problem 3: For whom to produce?

Solution: Products/Goods with having higher buying capacity.

Problem 4: What provisions should be made for economic growth?

Solution: Provision for future use i.e. Consumption/Saving/Investment.

{All types of economy faces these problems.}