



CHAPTER – 1

Nature & Scope of Business Economics

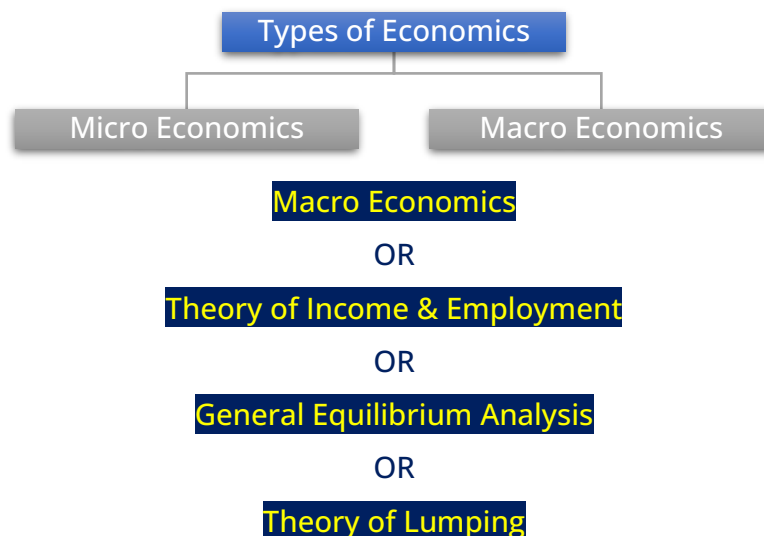
Unit – 1 (Introduction)

- (1) Economics owes its origin to the greek word “Oikonomia” which means management of household.
- (2) There are 2 Fundamental fact of Economy?
 - (i) Human wants are unlimited
 - (ii) Means to satisfy these unlimited wants are relatively scarce
- (3) **Business Economics** : It is application of economic analysis to make decisions in business operations. This concept was given by Joel dean in 1951.

In Simple words :

Business Economics means decision making.

- (i) Business economics means use the economic analysis to make decisions involving the best use of an organisation’s scarce resources.
- (ii) Business economics are also known as Managerial economics.
- (iii) Business economics integrates economy theory with business practice.
- (iv) Economics theory just provide the tools which explain the concept of demand, supply, cost, production, price, marketing, competition etc.
- (v) Business economics apply these tools in the process of decision making of business.
- (vi) Business economics fill the gap between economic theory and business practice.
- (vii) Business economics is also useful for **NGO and Non-profit organisation as well.**





Macro Economics

1. Study of Economy at its whole level
2. Aggregate study
3. We study mainly the following factors
 - (a) Overall level of output
 - (b) National Income
 - (c) General price level
 - (d) Interest rate
 - (e) Balance of trade
 - (f) Balance of payments
 - (g) External value of currency
 - (h) Overall level of savings
 - (i) Overall level of investment
 - (j) Level of employment
 - (k) Rate of economic growth
 - (l) Export, Import and foreign investment

Micro Economics/Price theory/slicing theory

1. Study at individual level
2. We focus on small number of groups
3. We mainly study the following factors
 - (a) Product pricing
 - (b) Consumer behaviour
 - (c) Factor pricing
 - (d) Economic condition of a section of people
 - (e) Behaviour of Firm
 - (f) Location of Industry.

Macro Economics Vs Micro Economics

Micro Economics	Macro Economics
(1) It is study of individual economic unit of an economy	It is the study of economy as a whole and its aggregates
(2) It deals with individual income, individual prices and individual output etc.	It deals with national income, general price level and national output etc.
(3) Its central problem is price determination and allocation of resources	Its central problem is determination of national income
(4) Its main roots are demand and supply of particular commodity / factor	Its main roots are aggregate demand & aggregate supply of economy as a whole.
(5) It discusses how equilibrium of a consumer, a producer or an industry is attained.	It is concerned with determination of equilibrium level of income and employment.



Nature of Business Economics

(SPAM-MINT)- Love sir's way of learning

■ Business Economics is a Science

1. Science means Systemized body of knowledge which establishes cause and effect relationship.
2. Economics provides tools like statistics, econometrics, mathematics etc.
3. Business economics integrates the tools in to decision making

■ Business economics is an art

It involves practical application of rules and principles.

■ Business Economics largely/heavily Based on Micro Economies

■ Business Economics incorporates tools of Macro economics (doesn't operate in vacuum)

■ Business Economics use the theory of markets and private enterprise

■ Business Economics is inter-disciplinary in approach

It uses multiple tools such as :

- (a) Mathematics
- (b) Operational Research
- (c) Management theory
- (d) Accounting, marketing, finance
- (e) Statistics and econometrics

■ Business Economics is Pragmatic in approach as it tackles practical problems which the firm faces in the real world.

■ Business Economics is Normative in Nature

Positive Economics	Normative Economics
1. It refers to the economics studies "What is"	It refers to the economics studies "What should be" or "What ought to be"
2. Its statements can empirically verified	Its statements may or may not be verified
3. It depends upon scientific logics or facts	It depends on ethical logic or values.
4. It studies the cause & effect relationship.	It depends on ethical logic or values
5. It is objective and descriptive in nature.	It is subjective and prescriptive.
6. Example (i) India is over populated (ii) Demand falls when price rises	Example (i) Rich people should be more taxed (ii) Govt. should increase expenditure on health care.



Scope of Business Economics

- (i) Internal Issues (Operational Issues)
- (ii) External Issues (Environmental Issues)

■ Internal Issues

1. Also known as operational issues
2. Issues arise within the organisation
3. Within the control of management
4. Internal in Nature
5. Issues :
 - (a) Choice of Business
 - (b) Size of business
 - (c) Productive decision
 - (d) Technology
 - (e) Pricing
 - (f) Sales promotion
 - (g) Financial management of investment
 - (h) Management of inventory etc.

■ Micro economics applied to Resolve internal issues:

- (a) Demand analysis and forecasting
- (b) Production and cost analysis
- (c) Inventory management
- (d) Market structure and pricing policies
- (e) Resources allocation
- (f) Theory of capital and investment decisions
- (g) Profit analysis
- (h) Risk and uncertainty analysis

■ External Issues

1. Also known as Environmental issues
2. Environmental factors affect the performance of business
3. Micro Economics applied to Resolve these issues
4. Following macro theories deal with external issues.



Macro-economic theory is applied to solve external issues.



2. Stages of Business cycle
3. Government policies and Regulations
4. Banking policies and Regulations
5. Social and political environment
6. Trend in national income / employment / prices / savings etc.
7. Foreign Trade policies, fiscal policies

■ **Recap lelo thoda sa jaldi – jaldi**

- An economic environment exists because of two facts i.e., human wants are unlimited and Resources are limited.
- Economics is the study of process by which the scarce resources are allocated to satisfy the maximum wants, gives maximum satisfaction.
 - (i) Macro economics
 - (ii) Micro economics
- Microeconomics examines how the individual firm make decision as to how to efficiently allocate their scarce Resources.
- Macroeconomics study the behaviour of the large economic aggregate such as level of output, investment, growth rate etc.
- Business economics integrates economic theory with business practice.
- Business economics concern with micro and macro also play important Role. Macro economics analyses the environment in which business has to function.
- Business issues has two category
 - (i) Internal
 - (ii) External



Unit – 2 : Basic Problems of An Economy

■ Central Economic Problems

What to produce?	Resources being limited, societies have to decide which goods & services to produce & it's quantity.
How to produce?	It refers to the problem of choice related to production technology. There are two types of production technology :- (1) Labour intensive technology (2) Capital intensive technology
Whom to produce ?	A society cannot satisfy each and every want of all the people. It has to decide the share of different people in the national cake of goods and services.
What Provisions are to be made for economic growth?	The society instead of using all the scarce resources for current consumption, makes provision for saving and investing the resources for future economic growth.

■ Types of Economies

- (1) Capitalist Economy
- (2) Socialist Economy
- (3) Mixed Economy

■ Capitalist Economy

- An economy where all means of production are privately owned and run for individual profits.
- Government's role in the management of the economic affairs is limited.
- Other names- Free market economy, Laissez-Faire
- Eg- USA, Japan, Hong Kong, South Korea etc.

■ Features - Capitalist Economy

1. **Right to private property** – All the productive factors (land, machines etc) can be privately owned, and used as the owner desires.
2. **Freedom of enterprise** – Individuals (producers, consumers or resource owners) can engage in any business/economic activity.



3. **Freedom of economic choices** – Individuals are free to make economic choices about consumption, work, production etc.
4. **Profit Motive** – It's a driving force and directs all economic activities.
5. **Consumer sovereignty** – Consumer is uncrowned King i.e. they decide what to produce and in what quantities through their freedom to make purchase.
6. **Competition** – It brings out better and innovative products and helps in efficient use of resource.
7. **Absence of Government Interference** – In the absence of government, the economic activities are regulated by self-interest and price mechanism.

■ Capitalist Economies - Solving Central Problems

Deciding what to produce?	Producers produce for profit, thus they decide what to produce depending on consumer's preference, which is shown through their purchases.
Deciding how to produce?	Producers choose techniques with minimum cost of production thus, Relative prices of factors of production being a major determinant.
Deciding whom to produce for?	Goods are produced for those who have the buying capacity which depends on their income+ price of factors they owned+ property.
Deciding provisions for economic growth?	Consumers consume and save which depends on their income and interest rate whereas the entrepreneurs invest and it depends on the rate of return on the capital.

MERITS	DEMIRITS
Self-regulating Price mechanism	Economic inequalities Two Classes of Society (i) Haves & (ii) Have-Nots
Greater efficiency & incentive to work	Less Merit Goods like Education, health etc
Lower cost of production	Demand Pattern Does not represent real needs of society
Maximum consumer satisfaction	Consumer sovereignty is a myth
Encourages Innovation (Rewards men of initiative and punishes inefficient)	Property rights > human rights
Democratic framework	Formation of monopolies & No Security of Employment



■ Socialist Economy

- The concept of socialist economy was propounded by Karl Marx and Frederic Engels in their work 'The Communist Manifesto' published in 1848.
- The erstwhile U.S.S.R. was an example of socialist economy from 1917 to 1990. In today's world there is no country which is purely socialist. Other examples include Vietnam, China and Cuba. North Korea, the world's most totalitarian state, is another example of a socialist economy.
- All members get benefit from the production on the basis of equal rights.
- Other names - Command economy, Centrally planned economy, controlled economy.

■ Socialist Economy - Features

- **Collective ownership** – All means of production are collectively owned (except small farms, trading firms etc.)
- **Economic planning** – A centrally planning authority exists to set objectives and to take major economic decisions (what to produce etc.)
- **Absence of consumer choices** – Consumers are free from hunger but not free to make choices
- **Relatively equal income distribution** – The income is distributed relatively equally
- **Minimum role of price mechanism** – Price mechanism only has a secondary role (in disposal of accumulated stock) because of predetermined distribution of productive resources and the prices are administered (set by the govt.).
- **Absence of competition** – State being the sole entrepreneur, there is no competition.

MERITS	DEMIRITS
Equal distribution of wealth	State monopolies
No wastage of resources on advertisement	Inefficiency, Corruption, Red tapism etc.
Unemployment is reduced	less freedom of choice
labors are protected against exploitation	inefficient price administration i.e. Administered Prices
Absence of profit motive	not practicable
Comprehensive social security	No incentive for hard work in form of profit
balanced economic growth	Denies basic right of private ownership
Minimum standard of living	Absence of competition restricts innovation



■ Mixed Economy

- It is a system that depends on Government & markets for allocation of resources as it includes the best features and excludes the demerits of both controlled and market economies.
- The presence of profit motive doesn't promote the interest of a community, as a whole, Thus the government runs the important industries itself to eliminate the free play of profit motives.

■ Mixed Economy - Coexistence of Sectors

Private Sector	Production & distribution is managed by private individuals or groups to promote personal profit but the government may regulate them directly or indirectly.
Public Sector	Industries set up by state for the welfare of the community and not for profit
Combined Sector	Government and private enterprise come together to produce goods and services.

MERITS	DEMIRITS
Economic freedom & efficient decision making because of competition	excessive state control reduces efficiency
consumers' sovereignty & freedom of choice	
Appropriate Incentives for innovation & technological progress.	Difficult to maintain a proper balance between public sector & pvt. Sector
Absence of strong govt. initiative, pvt. Sector grows disproportionately	Absence of strong govt. initiative, pvt. Sector grows disproportionately