BUSINESS ECONOMICS

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UNIT-I

Introduction of economics and Business economics: Meaning, Nature and significance of Economics-Subject matter of Economics-Meaning, Nature and Significance of business economics-Role of business economics in decision making-Role and responsibilities of a business economics.

UNIT-II

Consumption and demand analysis: Business significance of consumption and demand-Demand determinants-Law of demand and demand curves.

INTRODUCTION

The term **Economics** is derived from two Greek words **Oikonomia** which means house hold management. Economics is the study of human behaviour which relates to the production, exchange and use of goods and services. Human wants are the starting point of all economic activities. The French Economist **Bastia t**his summed up the

subject matter of economics in three words" - *"wants, efforts and satisfaction*. This is called the **circle of economics**.

Main Divisions of Economics:

- ✓ **Consumption**
- ✓ **Production**
- ✓ **Exchange**
- ✓ **Distribution**

Definition of Economics:

1. Wealth Definition – Adam Smith
2. Welfare Definition - Alfred Marshall
3. Scarcity Definition - Lionel Robbins

WEALTH DEFINITION

"Economics is a science of wealth"

-Adam Smith

WELFARE DEFINITION

Economics is the study of mankind in the ordinary business of life.

-Alfred Marshall

SCARCITY DIFINITION

"Economics is the science which studies human behaviour as a relationship between unlimited ends and scarce means which have alternative uses "

-**Lionel Robins**

NATURE OF ECONOMICS

There are four factors affecting to nature of economics as per below

- ❖ Economics is a Science.
- ❖ Economics is an Art.
- ❖ Economics is Positive & Normative Science.
- ❖ Economic is Micro and Macro.

SIGNIFICANCE OF ECONOMICS

- Knowledge of what to produce, how to produce and for who to produce is essential for a firm to run its business successfully. Thus, every business involves decision-making.
- The distribution income in a country tells how income is divided between different individuals or groups. If income distribution is left completely to the market forces, inequalities of income and wealth in the society tend to increase.

- Economics discusses the problems in measuring national income, interest rates and their impact on income and employment, balance of trade and balance of payments, exchange rates and also the significance of international trade. These things help to formulate appropriate polices for the development of the economy.

BUSINESS ECONOMICS

- The term business communication is used for all messages that we send and receive for official purposes like running a business, managing an organization and so on.
- Business communication is marked by formality as against personal and social communication like chatting, letters between friends and family, etc.
- It includes both written and oral communication like letters, reports, memos, notices, interviews, meetings, conferences, presentations, group discussions etc.

NATURE OF BUSINESS COMMUNICATION

As the “Queen of all social science”, economics wide applications in almost all branches of social sciences-History, Sociology , ethics, jurisprudences further, economics is a hand- maid of business managerial economics.

- It is a process.
- It is inevitable.

- Meaning based.
- Communication could be intentional and unintentional.
- Communication is systematic.
- A two-way traffic.

BUSINESS ECONOMICS AND ECONOMIC THEORY

Business Economics uses economic theory to solve business decision-making problems. Economics theory has been broadly divided into micro economics and macroeconomics. Micro economics deals with the theory of decision-making by individual consumers and business firms. Macro economics explains how an individual consumer makes purchases to maximize his satisfaction. On the other hand individual business firms decide about the combination of factors to produce its product and to fix price.

Decision sciences provide tools and technique for constructing decision models. They are helpful evaluating the effect and results of alternative course of action. Business economics uses various optimization techniques and statistical tools the decision sciences to estimate the between important variables, which help in decisions sciences are also used in business economics.

BUSINESS ECONOMICS AND DECISIONS SCIENCES

- Business economics is the useful while framing policies related to pricing and business or plant expansion.
- Business economists conduct special studies either on request by the management or sometimes on his own initiative. They collect both primary as well as secondary data related to business activities and give report to the business managers. It helps the business firm while making-decision on different aspects.
- Business economics helps the business managers to frame suitable business policies in harmony with social changes.
- Business economics use different economic concepts to find the firm. It is also useful to measure the plant efficiency at different rates of operations.
- The theory of the firm is useful to produce optimum output to earn maximum profit in the long run.

ROLE OF BUSINESS ECONOMMICS IN DECISIONS-MAKING

- ✓ Demand decision
- ✓ Input-output Decision
- ✓ Price- output decision
- ✓ Investment decision
- ✓ Forward planning
- ✓ Profit related decision

ROLE AND RESPONSIBILITES OF A BUSINESS ECONOMIST

A business economist is the practitioner of the science of managerial economics. The role of business economist becomes increasingly important in view of the different objectives of the firm. He has a significant role to pay in assisting the management of the firm in decision -making and forward planning by using his\her specialized skills and techniques. They cleverly scan the competitiveenvironment in which a firm function and suggest suitable polices for solution of problems.

ROLE OF BUSINESS ECONOMICS

- Business economic advisers
- Full time professional managers
- Academic economists
- Team leader
- Business environment analyst

RESPONSIBILITES OF A BUSINESS ECONOMIST

- Product planning
- Investment analysis
- Sales forecasting
- Marketing research
- Analysing competing firms
- Profit making

❖ Analysis problems

❖ Informing to the management

BASIC ECONOMIC TOOLS IN BUSINESS ECONOMMICS

- **Functions**

Functions indicate the relationship between two or more variables. For example, if is possible to calculate variable Y for a given variable X, we say that Y is a function of a function of X. Symbolically,

$$Y= f (x)$$

Name of the function	**functions**
Consumption function	C = f (Y)
Demand function	D = f (P)
Cost function	C = f (Q)
Revenue function	R = f (P, Q)
Investment function	I = f (MEC, r)
Profit function	

- **Incremental principles**

The incremental principle is widely used in economics. (E. g) marginal utility (MU), marginal cost (MC), marginal revenue (MR), marginal productivity (MP), marginal rate of substation (MRS) and marginal efficiency of capital (MEC). All these concepts refers to *increment* or ‘change’ independent variable.

a. Incremental cost.

b. Incremental revenue.

- **Discounting principles**

A firm has to operate under uncertain business conditions. A firm invests during the current period. Whereas it gets return in future. It cannot take investment decision on the assumption that the expected return is more than the invested amount. An investment decision is beneficial only when the value if the future yield is more the supply price if an asset.

- **Time perspective**

Time factor plays an important role in business decision – making. It was Alfred Marshall, who introduced the concept of time element in the determination of value of a commodity. But, the time factor is considered important not only in exchange of goods but also in the production process.

- **Opportunity cost**

Opportunity cost is concerned with the cost of foregone opportunity. It involves a comparison betweenthe policy that was rejected. This concept can be made clear with the following examples,

a. The opportunity cost of time spent by a student in studies is the wage that he may get in some other jobs.

b. The opportunity cost of lending or using capital is the interest that it can earn in the next best use.

- **Equal marginal principle**

The law of Equi-Marginal utility explains how s consumer attains maximum satisfaction with a given income. The very same principle can be used in production or business also. The budget constrains compel the businessmen to behave rationally to achieve their goal. He has to allocate his limited resources in such a way to get equal marginal product from the factors employed.

- **Costs**

By cost, we generally mean money cost. Cost of product expressed in terms of money is called *money cost.* It can be expressed in terms of gods and services. It is called as *real cost.*

- **Price**

*Price*is defined as the exchange value of a commodity in terms of money. When values is expressed in terms of money it is called 'price'. For example, a student purchases 10 notebooks for Rs.100. if one pen can be exchanged for 3 notebooks, the exchange value of one is 3notebooks.

- **Competition**

Competition is a factor, which influence business decision-making. Competition can be;

a) Perfect competition

Competition is perfect when the demand for the product is perfectly elastic.

b) Imperfect competition

Imperfect competition has both the features of perfect competition and monopoly. If there are few sellers it called as 'oligopoly'. On the other hand, if there are only two sellers, it is *duopoly*.

- **Profit**

Profit is the reward for organisation. Profit is the inducing factor in any type of business undertaking. In economics,profit is the difference between total revenue (TC or R) and total cost (TC or C). symbolically,

$$\mathbf{P = TR - TC \text{ or } R - C}$$

- **Goods**

Anything which can satisfy human is called goods. Pen, ball, water, fruits etc., satisfy our wants and hence they are goods.

Kinds of Goods;

Goods can be broadly divided into:

1. **Free goods**

   Free goods are gifts of nature. They found in plenty. They cannot be produced by man. There3 is no cost of production free goods.they has any value in the market. But they human wants. (E.g.) air, water, sunshine, sand on the sea-shore, etc.

2. **Economic goods;**

   Economic goods are not free gifts of nature. Their supply is limited compared to their demand. They are produced by man. Cost is incurred for their production. They have to be paid for. They have value in the market. They also become economic goods when their supply becomes limited. (E.g.) water.

   - Consumer goods.
   - Producer's goods.
   - Material goods.
   - Durable goods.
   - Perishable goods.
   - Transferable goods.
   - Non-transferable goods.

- **Market**

  Generally, by market, we mean a place where goods are bought andsold. But in economics, it implies the presence of

competition in buying in and selling *Benham* defines market as 'any area over which buyers and sellers are in such close touch with one another, either directly or through dealers, that the prices obtainable in one part of the market affect the prices in other parts. Market may be classified into;

- ❖ Local
- ❖ National
- ❖ International.

- **Value**

Value is an important concept in economics value always means value in exchange. It means the rate at which one commodity is exchanged for others. To possess value. Goods should have utility, scarcity and transferability. Economic goods etc., may have high use value, but have no exchange value.

- **Price**

Price is defined as the exchange value of a commodity expressed in terms of money. When value is expressed in

- **Utility**

Utility is the capacity of a commodity to satisfy human wants. It is the want satisfying power of goods. it refers the satisfaction obtained from goods and services by an individual at a given time. Utility does not always meansusefulness. A thing may

satisfy a want, but may not be useful. It may be injurious to health. (E.g) Cigarettes and liquors.

UTILITY

Utility cannot be measured directly. According to **Marshall,** utility can be measured in terms of money. According to **Hicks**, utility cannot be measured but can be compared.

TYPES OF UTILITY

There are two types of utilities.

They are;

- Form utility
- Place utility
- Time utility

Form utility:

Utility created by changing the shape, colour or smell of a commodity is called 'form utility'. For example, utility of clay increases when a potter converts it in to pots.

Place utility:

Utility created by changing the place of availability of a particular commodity is called 'place utility'. For example, when a log of wood is transported from a thick forest to a town its utility increases.

Time utility:

Utility created by changing the time of availability of a particular commodity is called 'time utility'. It is being done by storing a commodity for a time it is wanted. For example, paddy merchants store too much of paddy till the non-harvest season comes.

TOTAL UTULITY AND MARGINAL UTILTY

Total utility:

Total utility (TU) is the sum of the utilities obtained from consuming different units of a particular commodity at a given time. It can be obtained by adding the utilities derived from succeeding units.

Marginal utility:

Marginal utility (MU) is the utility obtained from the last unit consumed. It is the addition made to total utility by consuming one more unit of a particular commodity. Economics is

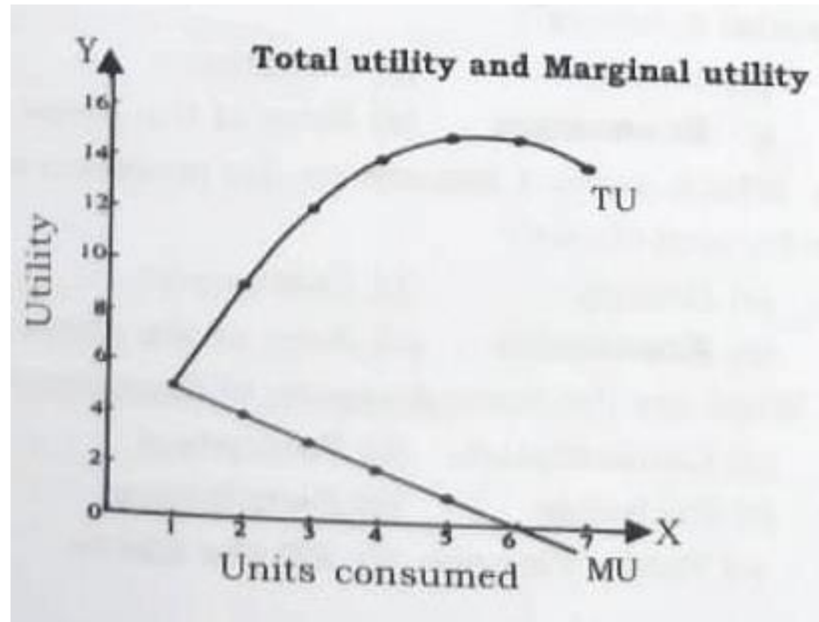
more concerned with marginal utility than total utility. They can be explained with the following table and diagram.

Marginal and total utility

Units consumed	Marginal utility	Total utility
1	10	10
2	8	18
3	6	24
4	4	28
5	2	30
6	0	30
7	-2	28

The above table indicates that marginal utility (MU) is diminishing continuously. Total utility (TU) is increasing at a diminishing rate. The relationship between MU is explained with the help of the figure.

Total utility and managerial utility



In the figure, TU is total utility curve and MU marginal utility curve. the total utility increases at diminishing rate and the marginal utility declined continuously. When the total utility reaches the maximum, marginal utility becomes zero. When the declines, MU becomes negative.

Relationship between total utility and marginal utilization

- ✓ When total utility increases marginal utility decreases continuously.
- ✓ When total utility is maximum marginal utility is zero.
- ✓ When total utility decreases marginal utility iscomes negative.

UNIT- 2

CONSUMPTION AND DEMAND ANALYSIS

CONSUMPTION

Consumption means the satisfaction of human wants by using the available goods and services. According to Ely, "Consumption means the use of economic goods and personal services in the satisfaction of human wants".

Business significance of Consumption and Demand

The concepts, consumption and demand play a vital role in business decision-making. Consumption is significant for business in the following ways:

- Consumption is the starting point of all economic activities.
- To solve the central problem of economics- what, where, and how to produce.
- Law of Equi-marginal utility.
- Law of diminishing marginal utility.
- To transform productive resources into goods that is to be sold in market.
- Demand analysis and forecasting is essential for business planning.

DEMAND ANALYSIS

DEFINITION:

"Demand is the quantitative expression of preferences".

-CHAPMAN

KINDS OF DEMAND:

- ✓ Price demand
- ✓ Income demand
- ✓ Cross demand
- ✓ Direct demand
- ✓ Indirect demand
- ✓ Joint demand
- ✓ Composite demand
- ✓ Alternate demand

THE LAW OF DEMAND

Demand reacts to price. Such a relationship between price and demand is called the law of demand which is based on the law of diminishing marginal utility.

Statement:

According to the law, "Other things being constant, quantity demanded of a commodity is inversely related to the price of the commodity".

Explanation:

In simple terms, the law of demand states that, other things being equal, more will be demanded at lower prices than higher prices.

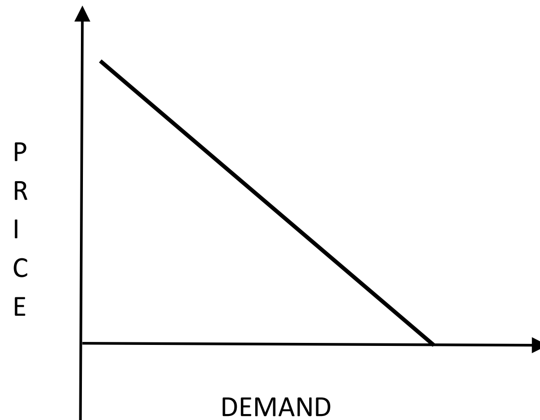
Individual Demand schedule

price	demand
Rs. 20	2 units
Rs. 15	4 units
Rs. 10	6 units
Rs. 5	8 units

Demand Curve:

The diagrammatic presentation of a demand schedule is called a demand curve. Thus, there exists inverse relationship between price and quantity demanded.

DEMAND CURVE



MARKET DEMAND SCHEDULE

When we add up the various quantities demanded by the number of consumers in the market, we can obtain the market demand schedule.

Price	Individual A	Demand B	C	Market Demand
1	7	10	15	32
2	6	9	14	29
3	5	8	13	26
4	4	7	12	23
5	3	6	11	20
6	2	5	10	17

MARKET DEMAND CURVE:

It is the graphical presentation of market demand schedule that gives the market demand curve. In other words, this curve is the lateral summation of individual demand curves. The slope of all the demand curves indicates inverse relationship between price and demand.

ASSUMPTIONS:

- ✓ There should be no change in the taste and preference of the consumers.
- ✓ Consumer's income should not change.
- ✓ Prices of other goods should remain constant.
- ✓ There should be no substitute for the commodity.

Why does the demand curve slope downwards?

Generally, the demand curve slopes downward from left to right. It is because of the following reasons:

- ❖ Law of Diminishing Marginal Utility
- ❖ Price effect
- ❖ Income effect
- ❖ Substitution effect
- ❖ Psychological effect

- Different uses
- Equalization of marginal utility

EXCEPTIONAL DEMAND CURVE:

Generally, a demand curve slopes downwards from left to right. But, an exceptional demand curve goes upward from left to right. It shows the direct relationship between price and quantity demanded. This shows the positive relationship between prices and demand.

REASONS:

- People more of a commodity at high price because of ignorance.
- Giffen paradox implies that at higher price the demand for stable food increases.
- People may buy more at higher price because of acute shortage.
- Rich people purchase more to show their higher status.
- Demand may expand when the price goes up if the commodity is in fashion.
- Speculators buy more at higher price expecting further rise in price.