BUSINESS ECONOMICS

UNIT-I

Business Economics : Definition, Nature and Scope

Business economics is a discipline which deals with the application of economic theory to business management. It deals with the use of economic concepts and principles of business decision making. Formerly it was known as “Business Economics” but the term has now been discarded in favour of Business Economics.

Business Economics may be defined as the study of economic theories, logic and methodology which are generally applied to seek solution to the practical problems of business. Business Economics is thus constituted of that part of economic knowledge or economic theories which is used as a tool of analysing business problems for rational business decisions. Business Economics is often called as Business Economics or Economic for Firms.

Definition of Business Economics:

“Business Economics is economics applied in decision making. It is a special branch of economics bridging the gap between abstract theory and Business practice.” – *Haynes, Mote* and *Paul*.

“Business Economics consists of the use of economic modes of thought to analyse business situations.” - *McNair* and *Meriam*

“Business Economics (Business Economics) is the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning by management.” - *Spencer*and *Seegelman.*

“Business economics is concerned with application of economic concepts and economic analysis to the problems of formulating rational Business decision.” – *Mansfield*

Nature of Business Economics:

- The primary function of management executive in a business organisation is decision making and forward planning.
- Decision making and forward planning go hand in hand with each other. Decision making means the process of selecting one action from two or more alternative courses of action. Forward planning means establishing plans for the future to carry out the decision so taken.
- The problem of choice arises because resources at the disposal of a business unit (land, labour, capital, and Business capacity) are limited and the firm has to make the most profitable use of these resources.
- The decision making function is that of the business executive, he takes the decision which will ensure the most efficient means of attaining a desired objective, say profit maximisation. After taking the decision about the particular output, pricing, capital, raw-materials and power etc., are prepared. Forward planning and decision-making thus go on at the same time.

- A business manager's task is made difficult by the uncertainty which surrounds business decision-making. Nobody can predict the future course of business conditions. He prepares the best possible plans for the future depending on past experience and future outlook and yet he has to go on revising his plans in the light of new experience to minimise the failure. Managers are thus engaged in a continuous process of decision-making through an uncertain future and the overall problem confronting them is one of adjusting to uncertainty.
- In fulfilling the function of decision-making in an uncertainty framework, economic theory can be, pressed into service with considerable advantage as it deals with a number of concepts and principles which can be used to solve or at least throw some light upon the problems of business management. E.g are profit, demand, cost, pricing, production, competition, business cycles, national income etc. The way economic analysis can be used towards solving business problems, constitutes the subject-matter of Business Economics.
- Thus in brief we can say that Business Economics is both a science and an art.

Scope of Business Economics:

The scope of Business economics is not yet clearly laid out because it is a developing science. Even then the following fields may be said to generally fall under Business Economics:

1. Demand Analysis and Forecasting
2. Cost and Production Analysis
3. Pricing Decisions, Policies and Practices
4. Profit Management
5. Capital Management

These divisions of business economics constitute its subject matter.

Recently, Business economists have started making increased use of Operation Research methods like Linear programming, inventory models, Games theory, queuing up theory etc., have also come to be regarded as part of Business Economics.

1.Demand Analysis and Forecasting: A business firm is an economic organisation which is engaged in transforming productive resources into goods that are to be sold in the market. A major part of Business decision making depends on accurate estimates of demand. A forecast of future sales serves as a guide to management for preparing production schedules and employing resources. It will help management to maintain or strengthen its market position and profit base. Demand analysis also identifies a number of other factors influencing the demand for a product. Demand analysis and forecasting occupies a strategic place in Business Economics.

2.Cost and production analysis: A firm's profitability depends much on its cost of production. A wise manager would prepare cost estimates of a range of output, identify the factors causing are cause variations in cost estimates and choose the cost-minimising output level, taking also into consideration the degree of uncertainty in production and cost calculations. Production processes are under the charge of engineers but the business manager is supposed to carry out the production function analysis in order to avoid wastages of materials and time. Sound pricing practices depend much on cost control. The main topics discussed under cost and production analysis are: Cost concepts, cost-output relationships, Economics and Diseconomies of scale and cost control.

3. **Pricing decisions, policies and practices**: Pricing is a very important area of Business Economics. In fact, price is the genesis of the revenue of a firm ad as such the success of a business firm largely depends on the correctness of the price decisions taken by it. The important aspects dealt with this area are: Price determination in various market forms, pricing methods, differential pricing, product-line pricing and price forecasting.
4. **Profit management:** Business firms are generally organized for earning profit and in the long period, it is profit which provides the chief measure of success of a firm. Economics tells us that profits are the reward for uncertainty bearing and risk taking. A successful business manager is one who can form more or less correct estimates of costs and revenues likely to accrue to the firm at different levels of output. The more successful a manager is in reducing uncertainty, the higher are the profits earned by him. In fact, profit-planning and profit measurement constitute the most challenging area of Business Economics.
5. **Capital management:** The problems relating to firm's capital investments are perhaps the most complex and troublesome. Capital management implies planning and control of capital expenditure because it involves a large sum and moreover the problems in disposing the capital assets off are so complex that they require considerable time and labour. The main topics dealt with under capital management are cost of capital, rate of return and selection of projects.

Conclusion: The various aspects outlined above represent the major uncertainties which a business firm has to reckon with, viz., demand uncertainty, cost uncertainty, price uncertainty, profit uncertainty, and capital uncertainty. We can, therefore, conclude that the subject-matter of Business Economics consists of applying economic principles and concepts towards adjusting with various uncertainties faced by a business firm.

Chapter-II

Role of a Business Economist

A Business economist plays a vital role in the decision-making process of an organization. He/she is responsible for assisting the top management of an organization to make efficient business decisions. A Business economist is also called business economist or economic advisor. He/she makes use of a number of complicated and specialized techniques required in the process of business decision making.

Apart from this, he/she is also accountable for analyzing the internal and external factors that affect the business environment of an organization. The internal factors are those factors that are under the control of an organization. These factors include formulation of price policy, expansion or contraction of business, level of efficiency, and determination of wage policy.

On the other hand, external factors include economic policies of the government, fluctuations in economic conditions, and labor laws. All these internal and external factors directly or indirectly influence the performance of an organization. Therefore, a Business economist needs to carefully study and analyze these factors.

Besides this, a Business economist has various functions in an organization, which are as follows:

a. Forecasting sales of an organization

b. Performing individual market research

c. Performing economic analysis of rival organizations

d. Analyzing the pricing policy of the industry; thereby formulating the pricing policy of the organization

e. Performing investment analysis

f. Assisting the top management in making decisions related to trade and public relations and foreign exchange

g. Performing capital budgeting and production planning

h. Measuring the earning capacity of an organization

i. Keeping the top management informed regarding any changes in the business environment.

Thus, a Business economist guides the management of an organization regarding the environment of the economy and its impact on the activities of an organization. In India, the importance of a Business economist is growing rapidly. Nowadays, all large organizations and industrial houses are hiring Business economists so that they can take efficient business decisions.

Responsibilities of Business Economist

The following points highlight the top five responsibilities of Business economist.

Responsibility # 1. To make a reasonable profit on capital employed:

He must have a strong conviction that profits are essential and his main obligation is to assist the management in earning reasonable profits on capital employed in the firm.

Responsibility # 2. He must make successful forecasts by making in depth study of the internal and external factors:

This will have influence over the profitability or the working of the firm. He must aim at lessening if not fully eliminating the risks involved in uncertainties. He has a major responsibility to alert management at the earliest possible time in case he discovers any error in his forecast, so that the management can make necessary changes and adjustments in the policies and programmes of the firm.

Responsibility # 3. He must inform the management of all the economic trends:

A Business economist should keep himself in touch with the latest developments of national economy and business environment so that he can keep the management informed with these developments and expected trends of the economy.

Responsibility # 4. He must establish and maintain contacts with individuals and data sources:

(i) To establish and maintain contacts:

A Business economist should establish and maintain contacts with individuals and data sources in order to collect relevant and valuable information in the field.

(ii) To develop personal relations:

To collect information he should develop personal relations with those having specialised knowledge of the field.

(iii) To join professional associations and should take active part in their activities:

The success of this lies in how quickly he gathers additional information in the best interest of the firm.

Responsibility # 5. He must earn full status in the business and only then he can be helpful to the management in good and successful decision-making:

(i) He must receive continuous support for himself and his professional ideas by performing his function effectively.

(ii) He should express his ideas in simple and understandable language with the minimum use of technical words, while communicating with his management executives.

CHAPTER-III

OBJECTIVES OF FIRMS

The main objectives of firms are:

1. Profit maximisation
2. Sales maximisation
3. Increased market share/market dominance
4. Social/environmental concerns
5. Profit satisficing
6. Co-operatives

Sometimes there is an overlap of objectives. For example, seeking to increase market share, may lead to lower profits in the short-term, but enable profit maximisation in the long run.

Profit maximisation

Usually, in economics, we assume firms are concerned with maximising profit. Higher profit means:

- Higher dividends for shareholders.
- More profit can be used to finance research and development.
- Higher profit makes the firm less vulnerable to takeover.
- Higher profit enables higher salaries for workers

2. Sales maximisation

Firms often seek to increase their market share – even if it means less profit. This could occur for various reasons:

- Increased market share increases monopoly power and may enable the firm to put up prices and make more profit in the long run.
- Managers prefer to work for bigger companies as it leads to greater prestige and higher salaries.
- Increasing market share may force rivals out of business. E.g. the growth of supermarkets have lead to the demise of many local shops. Some firms may actually engage in predatory pricing which involves making a loss to force a rival out of business.

3. Growth maximisation

This is similar to sales maximisation and may involve mergers and takeovers. With this objective, the firm may be willing to make lower levels of profit in order to increase in size and gain more market share. More market share increases its monopoly power and ability to be a price setter.

4. Long run profit maximisation

In some cases, firms may sacrifice profits in the short term to increase profits in the long run. For example, by investing heavily in new capacity, firms may make a loss in the short run but enable higher profits in the future.

5. Social/environmental concerns

A firm may incur extra expense to choose products which don't harm the environment or products not tested on animals. Alternatively, firms may be concerned about local community / charitable concerns.

- Some firms may adopt social/environmental concerns as part of their branding. This can ultimately help profitability as the brand becomes more attractive to consumers.
- Some firms may adopt social/environmental concerns on principal alone – even if it does little to improve sales/brand image.