Module No. 1

Business Economics, also called Managerial Economics, is the application of economic theory and methodology to business. Business involves decision-making. Decision making means the process of selecting one out of two or more alternative courses of action. The question of choice arises because the basic resources such as capital, land, labor and management are limited and can be employed in alternative uses. The decision-making function thus becomes one of making choice and taking decisions that will provide the most efficient means of attaining a desired end, say, profit maximation. Different aspects of business need attention of the chief executive. He may be called upon to choose a single option among the many that may be available to him. It would he in the interest of the business to reach an optimal decision- the one that promotes the goal of the business firm. A scientific formulation of the business problem and finding its optimal solution requires that the business firm is he equipped with a rational methodology and appropriate tools

Scope of Business Economics : As regards the scope of business economics, no uniformity of views exists among various authors. However, the following aspects are 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 various aspects are also considered to be comprising the subject matter of business economic.

1. Demand Analysis and Forecasting : A business firm is an economic organisation which transform productive resources into goods to be sold in the market. A major part of business decision making depends on accurate estimates of demand. A demand forecast can serve as a guide to management for maintaining and strengthening market position and enlarging profits. Demands analysis helps identify the various factors influencing the product demand and thus provides guidelines for manipulating demand. Demand analysis and forecasting provided the essential basis for business planning and occupies a strategic place in managerial economic. The main topics covered are: Demand Determinants, Demand Distinctions and Demand Forecastmg.

2. Cost and Production Analysis : A study of economic costs, combined with the data drawn from the firm's accounting records, can yield significant cost estimates which are useful for management decisions. An element of cost uncertainty exists because all the factors determining costs are not known and controllable. Discovering economic costs and the ability to measure them are the necessary steps for more effective profit planning, cost control and sound pricing practices. Production analysis is narrower, in scope than cost analysis. Production analysis frequently proceeds in physical terms while cost analysis proceeds in monetary terms. The main topics covered under cost and production analysis are: Cost

concepts and classification, Cost-output Relationships, Economics and Diseconomics of scale, Production function and Cost control.

3. Pricing Decisions, Policies and Practices : Pricing is an important area of business economic. In fact, price is the genesis of a firms revenue and as such its success largely depends on how correctly the pricing decisions are taken. The important aspects dealt with under pricing include. Price Determination in Various Market Forms, Pricing Method, Differential Pricing, Product-line Pricing and Price Forecasting.

4. Profit Management : Business firms are generally organised for purpose of making profits and in the long run profits earned are taken as an important measure of the firms success. If knowledge about the future were perfect, profit analysis would have been a very easy task. However, in a world of uncertainty, expectations are not always realised so that profit planning and measurement constitute a difficult area of business economic. The important aspects covered under this area are : Nature and Measurement of profit, Profit policies and Technique of Profit Planning like Break-Even Analysis.

5. Capital Management : Among the various types business problems, the most complex and troublesome for the business manager are those relating to a firm’s capital investments. Relatively large sums are involved and the problems are so complex that their solution requires considerable time and labour. Often the decision involving capital management are taken by the top management. Briefly Capital management implies planning and control of capital expenditure. The main topics dealt with are: Cost of capital Rate of Return and Selection of Projects.

Economics is broadly divided into two different categories namely microeconomics and macroeconomics. Microeconomics is the study of specific segments and markets of an economy. It looks at the issues like consumer behavior, individual labor market, and theory of firms. On the other hand, macroeconomics is the study of the whole economy. It looks at the aggregate variables such as aggregate demand, national output, and inflation.

**Microeconomics**

Microeconomics focuses on the choices made by individual consumers as well as businesses concerning the fluctuating cost of goods and services in an economy. Microeconomics covers several aspects, such as –

- Supply and demand for goods in different marketplaces.
- Consumer behaviour, as an individual or as a group.
- Demand for service and labour, including individual labour markets, demand, and determinants like the wage of an employee.

One of the main features of microeconomics is it focuses on casual situations when a marketplace experiences certain changes in the existing conditions. It takes a bottom-up approach to analyse the economy.

**Components of Microeconomics**

The different components of microeconomics include:

- Market demand and supply (For example Textile)
- Consumer Behavior ( for example Consumer Choice Theory)
- Producers are driven by individual preferences.
- Market-specific labor markets ( For example demand labor wage determination in specific markets).

**Macroeconomics**

Macroeconomics studies the economic progress and steps taken by a nation. It also includes the study of policies and other influencing factors that affect the economy as a whole. Macroeconomics follows a top-down approach, and involves strategies like –

- The overall economic growth of a country.
- Reasons that are likely to influence unemployment and inflation.
- Fiscal policies are likely to influence factors like interest rates.
- Effect of globalization and international trade.
- Reasons that affect varying economic growths among countries.

**Components of Macroeconomics**

The different components of macroeconomics include:

- National Output
- Unemployment
- Inflation

**Difference between Micro & Macro Economics**

| S.No | Microeconomics | Macroeconomics |
|---|---|---|
| 1. | Microeconomics studies individual economic units | Macroeconomics studies a nation's economy, as well as its various aggregates. |
| 2. | Microeconomics primarily deals with individual income, output, price of goods, etc. | Macroeconomics is the study of aggregates such as national output, income, as well as general price levels. |
| 3. | Microeconomics focuses on overcoming issues concerning the allocation of resources and price discrimination. | Macroeconomics focuses on upholding issues like employment and national household income. |
| 4. | Microeconomics accounts for factors like the demand and supply of a particular commodity. | Macroeconomics account for the aggregate demand and supply of a nation's economy. |
| 5. | Microeconomics offers a picture of the goods and services that are required for an efficient economy. It also shows the goods and services that might grow in demand in the future. | Macroeconomics helps ensure optimum utilization of the resources available to a country. |
| 6. | Microeconomics helps to point out how equilibrium can be achieved at a small scale. | Macroeconomics help determine the equilibrium levels of employment and income of the nation. |
| 7. | Microeconomics also focuses on issues arising due to price variation and income levels. | The primary component of macroeconomic problems is income. |

Fundamental Concepts that aid Decision Making.

1. Incremental Principle: -

The incremental concept is probably the most important concept in economics and is certainly the most frequently used in Managerial Economics. Incremental concept is closely related to the marginal cost andmarginal revenues of economic theory.

The two major concepts in this analysis are incremental cost and incremental revenue. Incremental cost denotes change in total cost, whereas incremental revenue means change in total revenue resulting froma decision of the firm.

The incremental principle may be stated as follows:

A decision is clearly a profitable one if

(i) It increases revenue more than costs.
(ii) It decreases some cost to a greater extent than it increases others.
(iii) It increases some revenues more than it decreases others.

(iv) It reduces costs more than revenues.

Concept of Inflation; -

Inflation is the decline of purchasing power of a given currency over time. A quantitative estimate of the rate at which the decline in purchasing power occurs can be reflected in the increase of an average price level of a basket of selected goods and services in an economy over some period of time.

1) Types of inflation; -
   Inflation is sometimes classified into three types: Demand-Pull inflation, Cost-Push inflation, and Built-In inflation.

   Most commonly used inflation indexes are the Consumer Price Index (CPI) and the Wholesale Price Index (WPI).

2) Impact of Inflation: -
   Rising prices, known as inflation, impact the cost of living, the cost of doing business, borrowing money, mortgages, corporate, and government bond yields, and every other facet of the

   economy. Inflation can be both beneficial to economic recovery and, in some cases, negative.

6. The Equi-marginal Concept: -

State that consumer chooses combination of various goods in order to achieve to maximum total utility. The principle states that an input should beallocated so that value added by the last unit is the same in all cases. This generalization is popularly called the Equi-marginal. In other word consumer will allocate spending their income across goods of services so that the marginal utility per rupee of expenditure on each good. Purchase will be equal to all other goods purchased.

It explains the way in which each consumer will spend portion of their income across a variety of different goods in such a way to maximize theiroverall satisfaction.

for example, if the value of the marginal product of labor in activity A is Rs.50 while that in activity B is Rs. 70 then it is possible and profitable to shift labor from activity A to activity B. The optimum is reached when the valuesof the marginal product is equal to all activities.