UNIT-I

INTRODUCTION TO BUSINESS ECONOMICS

Imagine for a while that you have finished your studies and have joined as an engineer in a manufacturing organization. What do you do there? You plan to produce maximum quantity of goods of a given quality at a reasonable cost. On the other hand, if you are a sale manager, you have to sell a maximum amount of goods with minimum advertisement costs. In other words, you want to minimize your costs and maximize your returns and by doing so, you are practicing the principles of managerial economics.

Managers, in their day-to-day activities, are always confronted with several issues such as how much quantity is to be supplied; at what price; should the product be made internally; or whether it should be bought from outside; how much quantity is to be produced to make a given amount of profit and so on. Business economics provides us a basic insight into seeking solutions for managerial problems.

Managerial economics, as the name itself implies, is an offshoot of two distinct disciplines: Economics and Management. In other words, it is necessary to understand what these disciplines are, at least in brief, to understand the nature and scope of managerial economics.

Introduction to Economics

Economics is a study of human activity both at individual and national level. The economists of early age treated economics merely as the science of wealth. The reason for this is clear. Every one of us in involved in efforts aimed at earning money and spending this money to satisfy our wants such as food, Clothing, shelter, and others. Such activities of earning and spending money are called
"Economic activities". It was only during the eighteenth century that Adam Smith, the Father of Economics, defined economics as the study of nature and uses of national wealth'.

Dr. Alfred Marshall, one of the greatest economists of the nineteenth century, writes "Economics is a study of man's actions in the ordinary business of life: it enquires how he gets his income and how he uses it". Thus, it is one side, a study of wealth; and on the other, and more important side; it is the study of man. As Marshall observed, the chief aim of economics is to promote 'human welfare', but not wealth. The definition given by AC Pigou endorses the opinion of Marshall. Pigou defines Economics as "the study of economic welfare that can be brought directly and indirectly, into relationship with the measuring rod of money".

Prof. Lionel Robbins defined Economics as "the science, which studies human behaviour as a relationship between ends and scarce means which have alternative uses". With this, the focus of economics shifted from 'wealth' to human behaviour'.

Lord Keynes defined economics as 'the study of the administration of scarce means and the determinants of employments and income".

Microeconomics

The study of an individual consumer or a firm is called microeconomics (also called the *Theory of Firm*). Micro means 'one millionth'. Microeconomics deals with behavior and problems of single individual and of micro organization. Managerial economics has its roots in microeconomics and it deals with the micro or individual enterprises. It is concerned with the application of the concepts such as price theory, Law of Demand and theories of market structure and so on.

Macroeconomics

The study of 'aggregate' or total level of economics activity in a country is called *macroeconomics*. It studies the flow of economics resources or factors of production (such as land, labour, capital, organisation and technology) from the resource owner to the business firms and then from the business firms to the households. It deals with total aggregates, for instance, total national income total employment, output and total investment. It studies the interrelations among various aggregates and examines their nature and behaviour, their determination and causes of fluctuations in the. It deals with the price level in general, instead of studying the prices of individual commodities. It is concerned with the level of employment in the economy. It discusses aggregate consumption, aggregate investment, price level, and payment, theories of employment, and so on.

Though macroeconomics provides the necessary framework in term of government policies etc., for the firm to act upon dealing with analysis of business conditions, it has less direct relevance in the study of theory of firm.

Management

Management is the science and art of getting things done through people in formally organized groups. It is necessary that every organisation be well managed to enable it to achieve its desired goals. Management includes a number of functions: *Planning, organizing, staffing, directing, and controlling*. The manager while directing the efforts of his staff *communicates* to them the goals, objectives, policies, and procedures; *coordinates* their efforts; *motivates* them to sustain their enthusiasm; and *leads* them to achieve the corporate goals.

Welfare Economics

Welfare economics is that branch of economics, which primarily deals with taking of poverty, famine and distribution of wealth in an economy. This is also called *Development Economics*. The central focus of welfare economics is to assess how well things are going for the members of the society. If certain things have gone terribly bad in some situation, it is necessary to explain why things have gone wrong. Prof. Amartya Sen was awarded the Nobel Prize in Economics in 1998 in recognition of his contributions to welfare economics. Prof. Sen gained recognition for his studies of the 1974 famine in Bangladesh. His work has challenged the common view that food shortage is the major cause of famine.

In the words of Prof. Sen, famines can occur even when the food supply is high but people cannot buy the food because they don't have money. There has never been a famine in a democratic country because leaders of those nations are spurred into action by politics and free media. In undemocratic countries, the rulers are unaffected by famine and there is no one to hold them accountable, even when millions die.

Welfare economics takes care of what managerial economics tends to ignore. In other words, the growth for an economic growth with societal upliftment is countered productive. In times of crisis, what comes to the rescue of people is their won literacy, public health facilities, a system of food distribution, stable democracy, social safety, (that is, systems or policies that take care of people when things go wrong for one reason or other).

<u>Business Economics</u>

Introduction

Business Economics as a subject gained popularity in USA after the publication of the book "Managerial Economics" by Joel Dean in 1951.

Business Economics refers to the firm's decision making process. It could be also interpreted as "Economics of Management" or "Economics of Management". BusinessEconomics is also called as "Industrial Economics" or "Business Economics".

As Joel Dean observes managerial economics shows how economic analysis can be used in formulating polices.

***Meaning & Definition**:*

In the words of E. F. Brigham and J. L. Pappas Business l Economics is "the applications of economics theory and methodology to business administration practice".

Busines Economics bridges the gap between traditional economics theory and real business practices in two days. First it provides a number of tools and techniques to enable the manager to become more competent to take decisions in real and practical situations. Secondly it serves as an integrating course to show the interaction between various areas in which the firm operates.

C. I. Savage & T. R. Small therefore believes that Businesseconomics "is concerned with business efficiency".

M. H. Spencer and Louis Siegelman explain the "Managerial Economics is the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning by management".

It is clear, therefore, that managerial economics deals with economic aspects of managerial decisions of with those managerial decisions, which have an economics contest. Managerial economics may therefore, be defined as a body of knowledge, techniques and practices which give substance to those economic concepts which are useful in deciding the business strategy of a unit of management.

Managerial economics is designed to provide a rigorous treatment of those aspects of economic theory and analysis that are most use for managerial decision analysis says J. L. Pappas and E. F. Brigham.

Managerial Economics, therefore, focuses on those tools and techniques, which are useful in decision-making.

Nature of BusinessEconomics

Businesseconomics is, perhaps, the youngest of all the social sciences. Since it originates from Economics, it has the basis features of economics, such as assuming that other things remaining the same (or the Latin equivalent ceteris paribus). This assumption is made to simplify the complexity of the managerial phenomenon under study in a dynamic business environment so many things are changing simultaneously. This set a limitation that we cannot really hold other things remaining the same. In such a case, the observations made out of such a study will have a limited purpose or value. Managerial economics also has inherited this problem from economics.

Further, it is assumed that the firm or the buyer acts in a rational manner (which normally does not happen). The buyer is carried away by the advertisements, brand loyalties, incentives and so on, and, therefore, the innate behaviour of the consumer will be rational is not a realistic assumption. Unfortunately, there are no other alternatives to understand the subject other than by making such assumptions. This is because the behaviour of a firm or a consumer is a complex phenomenon.

The other features of managerial economics are explained as below:

(a) Close to microeconomics: Managerial economics is concerned with finding the solutions for different managerial problems of a particular firm. Thus, it is more close to microeconomics.

(b) Operates against the backdrop of macroeconomics: The macroeconomics conditions of the economy are also seen as limiting factors for the firm to operate. In other words, the managerial economist has to be aware of the limits set by the macroeconomics conditions such as government industrial policy, inflation and so on.

(c) Normative statements: A normative statement usually includes or implies the words 'ought' or 'should'. They reflect people's moral attitudes and are expressions of what a team of people ought to do. For instance, it deals with statements such as 'Government of India should open up the economy. Such statement are based on value judgments and express views of what is 'good' or 'bad', 'right' or ' wrong'. One problem with normative statements is that they cannot to verify by looking at the facts, because they mostly deal with the future. Disagreements about such statements are usually settled by voting on them.

(d) Prescriptive actions: Prescriptive action is goal oriented. Given a problem and the objectives of the firm, it suggests the course of action from the available alternatives for optimal solution. If does not merely mention the concept, it also explains whether the concept can be applied in a given context on not. For instance, the fact that variable costs are marginal costs can be used to judge the feasibility of an export order.

(e) Applied in nature: 'Models' are built to reflect the real life complex business situations and these models are of immense help to managers for decision-making. The different areas where models are extensively used include inventory control, optimization, project management etc. In managerial economics, we also employ case study methods to conceptualize the problem, identify that alternative and determine the best course of action.

(f) Offers scope to evaluate each alternative: Managerial economics provides an opportunity to evaluate each alternative in terms of its costs and revenue. The managerial economist can decide which is the better alternative to maximize the profits for the firm.

(g) ***Interdisciplinary***: The contents, tools and techniques of managerial economics are drawn from different subjects such as economics, management, mathematics, statistics, accountancy, psychology, organizational behavior, sociology and etc.

(h) ***Assumptions and limitations***: Every concept and theory of managerial economics is based on certain assumption and as such their validity is not universal. Where there is change in assumptions, the theory may not hold good at all.

Scope of BusinessEconomics:

The scope of Businesseconomics refers to its area of study. Managerial economics refers to its area of study. Managerial economics, Provides management with a strategic planning tool that can be used to get a clear perspective of the way the business world works and what can be done to maintain profitability in an ever-changing environment. Managerial economics is primarily concerned with the application of economic principles and theories to five types of resource decisions made by all types of business organizations.

a. The selection of product or service to be produced.
b. The choice of production methods and resource combinations.
c. The determination of the best price and quantity combination
d. Promotional strategy and activities.
e. The selection of the location from which to produce and sell goods or service to consumer.

The production department, marketing and sales department and the finance department usually handle these five types of decisions.
The scope of managerial economics covers two areas of decision making

a. Operational or Internal issues
b. Environmental or External issues

a. Operational issues:
Operational issues refer to those, which wise within the business organization and they are under the control of the management. Those are:

1. Theory of demand and Demand Forecasting
2. Pricing and Competitive strategy
3. Production cost analysis
4. Resource allocation
5. Profit analysis
6. Capital or Investment analysis
7. Strategic planning

1. Demand Analyses and Forecasting:

A firm can survive only if it is able to the demand for its product at the right time, within the right quantity. Understanding the basic concepts of demand is essential for demand forecasting. Demand analysis should be a basic activity of the firm because many of the other activities of the firms depend upon the outcome of the demand fore cost. Demand analysis provides:

1. The basis for analyzing market influences on the firms; products and thus helps in the adaptation to those influences.
2. Demand analysis also highlights for factors, which influence the demand for a product. This helps to manipulate demand. Thus demand analysis studies not only the price elasticity but also income elasticity, cross elasticity as well as the influence of advertising expenditure with the advent of computers, demand forecasting has become an increasingly important function of managerial economics.

2. Pricing and competitive strategy:

Pricing decisions have been always within the preview of managerial economics. Pricing policies are merely a subset of broader class of managerial economic problems. Price theory helps to explain how prices are determined under different types of market conditions. Competitions analysis includes the anticipation of the response of competitions the firm's pricing, advertising and marketing strategies. Product line pricing and price forecasting occupy an important place here.

3. Production and cost analysis:

Production analysis is in physical terms. While the cost analysis is in monetary terms cost concepts and classifications, cost-out-put relationships, economies and diseconomies of scale and production functions are some of the points constituting cost and production analysis.

4. Resource Allocation:

Managerial Economics is the traditional economic theory that is concerned with the problem of optimum allocation of scarce resources. Marginal analysis is applied to the problem of determining the level of output, which maximizes profit. In this respect linear programming techniques has been used to solve optimization problems. In fact lines programming is one of the most practical and powerful managerial decision making tools currently available.

5. Profit analysis:

Profit making is the major goal of firms. There are several constraints here an account of competition from other products, changing input prices and changing business environment hence in spite of careful planning, there is always certain risk involved. Managerial economics deals with techniques of averting of minimizing risks. Profit theory guides in the measurement and management of profit, in calculating the pure return on capital, besides future profit planning.

6. Capital or investment analyses:

Capital is the foundation of business. Lack of capital may result in small size of operations. Availability of capital from various sources like equity capital, institutional finance etc. may help to undertake large-scale operations. Hence efficient allocation and management of capital is one of the most important tasks of the managers. The major issues related to capital analysis are:

1. The choice of investment project
2. Evaluation of the efficiency of capital
3. Most efficient allocation of capital

Knowledge of capital theory can help very much in taking investment decisions. This involves, capital budgeting, feasibility studies, analysis of cost of capital etc.

7. Strategic planning:

Strategic planning provides management with a framework on which long-term decisions can be made which has an impact on the behavior of the firm. The firm sets certain long-term goals and objectives and selects the strategies to achieve the same. Strategic planning is now a new addition to the scope of managerial economics with the emergence of multinational corporations. The perspective of strategic planning is global.

It is in contrast to project planning which focuses on a specific project or activity. In fact the integration of managerial economics and strategic planning has given rise to be new area of study called corporate economics.

B. Environmental or External Issues:

An environmental issue in managerial economics refers to the general business environment in which the firm operates. They refer to general economic, social and political atmosphere within which the firm operates. A study of economic environment should include:

a. The type of economic system in the country.
b. The general trends in production, employment, income, prices, saving and investment.
c. Trends in the working of financial institutions like banks, financial corporations, insurance companies
d. Magnitude and trends in foreign trade;
e. Trends in labour and capital markets;
f. Government's economic policies viz. industrial policy monetary policy, fiscal policy, price policy etc.

The social environment refers to social structure as well as social organization like trade unions, consumer's co-operative etc. The Political environment refers to the nature of state activity, chiefly states' attitude towards private business, political stability etc.

The environmental issues highlight the social objective of a firm i.e.; the firm owes a responsibility to the society. Private gains of the firm alone cannot be the goal.

The environmental or external issues relate managerial economics to macro economic theory while operational issues relate the scope to micro economic theory. The scope of managerial economics is ever widening with the dynamic role of big firms in a society.

Business **economics relationship with other disciplines:**

Many new subjects have evolved in recent years due to the interaction among basic disciplines. While there are many such new subjects in natural and social sciences, managerial economics can be taken as the best example of such a phenomenon among social sciences. Hence it is necessary to trace its roots and relation ship with other disciplines.

1. Relationship with economics:

The relationship between managerial economics and economics theory may be viewed form the point of view of the two approaches to the subject Viz. Micro Economics and Marco Economics. Microeconomics is the study of the economic behavior of individuals, firms and other such micro organizations. Managerial economics is rooted in Micro Economic theory. Managerial Economics makes use to several Micro Economic concepts such as marginal cost, marginal revenue, elasticity of demand as well as price theory and theories of market structure to name only a few. Macro theory on the other hand is the study of the economy as a whole. It deals with the analysis of national income, the level of employment, general price level, consumption and investment in the economy and even matters related to international trade, Money, public finance, etc.

The relationship between managerial economics and economics theory is like that of engineering science to physics or of medicine to biology. Managerial economics has an applied bias and its wider scope lies in applying economic theory to solve real life problems of enterprises. Both managerial economics and economics deal with problems of scarcity and resource allocation.

2. Management theory and accounting:

Managerial economics has been influenced by the developments in management theory and accounting techniques. Accounting refers to the recording of pecuniary transactions of the firm in certain books. A proper knowledge of accounting techniques is very essential for the success of the firm because profit maximization is the major objective of the firm.

Managerial Economics requires a proper knowledge of cost and revenue information and their classification. A student of managerial economics should be familiar with the generation, interpretation and use of accounting data. The focus of accounting within the firm is fast changing from the concepts of store keeping to that if managerial decision making, this has resulted in a new specialized area of study called "Managerial Accounting".

3.Busines ***Economics and mathematics:***

The use of mathematics is significant for managerial economics in view of its profit maximization goal long with optional use of resources. The major problem of the firm is how to minimize cost, hoe to maximize profit or how to optimize sales. Mathematical concepts and techniques are widely used in economic logic to solve these problems. Also mathematical methods help to estimate and predict the economic factors for decision making and forward planning.

Mathematical symbols are more convenient to handle and understand various concepts like incremental cost, elasticity of demand etc., Geometry, Algebra and calculus are the major branches of mathematics which are of use in managerial economics. The main concepts of mathematics like logarithms, and exponentials, vectors and determinants, input-output models etc., are widely used. Besides these usual tools, more advanced techniques designed in the recent years viz. linear programming, inventory models and game theory fine wide application in managerial economics.

4. Busines ***Economics and Statistics:***

BusinessEconomics needs the tools of statistics in more than one way. A successful businessman must correctly estimate the demand for his product. He should be able to analyses the impact of variations in tastes. Fashion and changes in income on demand only then he can adjust his output. Statistical methods provide and sure base for decision-making. Thus statistical tools are used in collecting data and analyzing them to help in the decision making process.

Statistical tools like the theory of probability and forecasting techniques help the firm to predict the future course of events. Managerial Economics also make use of correlation and multiple regressions in related variables like price and demand to estimate the extent of dependence of one variable on the other. The theory of probability is very useful in problems involving uncertainty.

5. Business***Economics and Operations Research:***

Taking effectives decisions is the major concern of both managerial economics and operations research. The development of techniques and concepts such as linear programming, inventory models and game theory is due to the development of this new subject of operations research in the postwar years. Operations research is concerned with the complex problems arising out of the management of men, machines, materials and money.

Operation research provides a scientific model of the system and it helps managerial economists in the field of product development, material management, and inventory control, quality control, marketing and demand analysis. The varied tools of operations Research are helpful to managerial economists in decision-making.

6. Business ***Economics and the theory of Decision- making:***

The Theory of decision-making is a new field of knowledge grown in the second half of this century. Most of the economic theories explain a single goal for the consumer i.e., Profit maximization for the firm. But the theory of decision-making is developed to explain multiplicity of goals and lot of uncertainty.

As such this new branch of knowledge is useful to business firms, which have to take quick decision in the case of multiple goals. Viewed this way the theory of decision making is more practical and application oriented than the economic theories.

7. Business ***Economics and Computer Science:***

Computers have changes the way of the world functions and economic or business activity is no exception. Computers are used in data and accounts maintenance, inventory and stock controls and supply and demand predictions. What used to take days and months is done in a few minutes or hours by the computers. In fact computerization of business activities on a large scale has reduced the workload of managerial personnel. In most countries a basic knowledge of computer science, is a compulsory programme for managerial trainees.

To conclude, managerial economics, which is an offshoot traditional economics, has gained strength to be a separate branch of knowledge. It strength lies in its ability to integrate ideas from various specialized subjects to gain a proper perspective for decision-making.

A successful managerial economist must be a mathematician, a statistician and an economist. He must be also able to combine philosophic methods with historical methods to get the right perspective only then; he will be good at predictions. In short managerial practices with the help of other allied sciences.

THE ROLE OF BusinessECONOMIST

Making decisions and processing information are the two primary tasks of the managers. Managerial economists have gained importance in recent years with the emergence of an organizational culture in production and sales activities.

A management economist with sound knowledge of theory and analytical tools for information system occupies a prestigious place among the personnel. A managerial economist is nearer to the policy-making. Equipped with specialized skills and modern techniques he analyses the internal and external operations of the firm. He evaluates and helps in decision making regarding sales, Pricing financial issues, labour relations and profitability. He helps in decision-making keeping in view the different goals of the firm.

His role in decision-making applies to routine affairs such as price fixation, improvement in quality, Location of plant, expansion or contraction of output etc. The role of managerial economist in internal management covers wide areas of production, sales and inventory schedules of the firm.

The most important role of the managerial economist relates to demand forecasting because an analysis of general business conditions is most vital for the success of the firm. He prepares a short-term forecast of general business activity and relates general economic forecasts to specific market trends. Most firms require two forecasts one covering the short term (for nest three months to one year) and the other covering the long term, which represents any period exceeding one-year. He has to be ever alert to gauge the changes in tastes and preferences of the consumers. He should evaluate the market potential. The need to know forecasting techniques on the part of the managerial economics means, he should be adept at market research. The purpose of market research is to provide a firm with information about current market position as well as present and possible future trends in the industry. A managerial economist who is well equipped with this knowledge can help the firm to plan product improvement, new product policy, pricing, and sales promotion strategy.

The fourth function of the managerial economist is to undertake an economic analysis of the industry. This is concerned with project evaluation and feasibility study at the firm level i.e., he should be able to judge on the basis of cost benefit analysis, whether it is advisable and profitable to go ahead with the project. The managerial economist should be adept at investment appraisal methods. At the external level, economic analysis involves the knowledge of competition involved, possibility of internal and foreign sales, the general business climate etc.

Another function is security management analysis. This is very important in the case of defense-oriented industries, power projects, and nuclear plants where security is very essential. Security management means, also that the production and trade secrets concerning technology, quality and other such related facts should not be leaked out to others. This security is more necessary in strategic and defense-oriented projects of national importance; a managerial economist should be able to manage these issues of security management analysis.

The sixth function is an advisory function. Here his advice is required on all matters of production and trade. In the hierarchy of management, a managerial economist ranks next to the top executives or the policy maker who may be doyens of several projects. It is the managerial economist of each firm who has to advise them on all matters of trade since they are in the know of actual functioning of the unit in all aspects, both technical and financial.

Another function of importance for the managerial economist is a concerned with pricing and related problems. The success of the firm depends upon a proper pricing strategy. The pricing decision is one of the most difficult decisions to be made in business because the information required is never fully available. Pricing of established products is different from new products. He may have to operate in an atmosphere constrained by government regulation. He may have to anticipate the reactions of competitors in pricing. The managerial economist has to be very alert and dynamic to take correct pricing decision in changing environment.

Finally the specific function of a managerial economist includes an analysis of environment issues. Modern theory of managerial economics recognizes the social responsibility of the firm. It refers to the impact of a firm on environmental factors. It should not have adverse impact on pollution and if possible try to contribute to environmental preservation and protection in a positive way.

The role of management economist lies not in taking decision but in analyzing, concluding and recommending to the policy maker. He should have the freedom to operate and analyze and must possess full knowledge of facts. He has to collect and provide the quantitative data from within the firm. He has to get information on external business environment such as general market conditions, trade cycles, and behavior pattern of the consumers. The managerial economist helps to co-ordinate policies relating to production, investment, inventories and price.

He should have equanimity to meet crisis. He should act only after analysis and discussion with relevant departments. He should have diplomacy to act in advisory capacity to the top executive as well as getting co-operation from different departments for his economic analysis. He should do well to have intuitive ability to know what is good or bad for the firm.

He should have sound theoretical knowledge to take up the challenges he has to face in actual day to day affairs. "BANMOL" referring to the role of managerial economist points out. "A managerial economist can become a for more helpful member of a management group by virtue of studies of economic analysis, primarily because there he learns to become an effective model builder and because there he acquires a very rich body of tools and techniques which can help to deal with the problems of the firm in a far more rigorous, a far more probing and a far deeper manner".

THEORY OF FIRM

What Is the Theory of the Firm?

In neoclassical economics—an approach to economics focusing on the determination of goods, outputs, and income distributions in markets through supply and demand—the theory of the firm is a microeconomic concept that states that a firm exists and make decisions to maximize profits.

A firm maximizes profits by creating a gap between revenue and costs.

The theory of the firm consists of a number of economic theories that explain and predict the nature of the firm, company, or corporation, including its existence, behaviour, structure, and relationship to the market.

The theory of the firm aims to answer these questions:

2 1. Existence. Why do firms emerge? Why are not all transactions in the economy mediated over the market?

2. Boundaries. Why is the boundary between firms and the market located exactly there with relation to size and output variety? Which transactions are performed internally and which are negotiated on the market?

3. Organization. Why are firms structured in such a specific way, for example as to hierarchy or decentralization? What is the interplay of formal and informal relationships?

4. Heterogeneity of firm actions/performances. What drives different actions and performances of firms?

Types of theories:

- Transaction Cost Theory
- Managerial Theories
- Behavioural Theories

Micro and Macro Economics:

Micro-economics – The term 'micro' means small. Therefore, micro-economics deals with the economic actions of individuals and groups of individuals and firms. This can be stated in another way that microeconomics presents the economic microscopic view of the company.

Macro-economics– The term 'macro' means large. Macro-economics is concerned with the economic behaviour of the whole nation (or economy) in terms of allocation of productive resources, consumption pattern, distribution of income etc.

National Income: National income of a country means the sum total of incomes earned by the citizens of that country during a given period, say a year .It should be noted that national income is not the sum of all incomes earned by all citizens, but only those incomes which accrue due to participation in the production process.

Importance of National Income:

- Economic Policy
- Economic Planning
- Inflationary and Deflationary Gaps
- Budgetary Policies
- National Expenditure
- Standard of Living Comparision
- Defence and Development

• Public Sector

Inflation

: Inflation refers to General rise in Prices Measured against a Standard Level of Purchasing Power.

Money Supply and Inflation:

The money supply measures the total amount of money in the economy at a particular time.

It includes actual notes and coins and also any deposits which can be quickly converted into cash.

Monetarists believe there is a strong link between the money supply and inflation.

If the money supply increases faster than real output, then prices will increase causing inflation. This is known as the quantity theory of money (MV=PT)

However, other economists believe this link between the money supply and inflation is more complicated.

Business Cycles:

The alternating periods of expansion and contraction in economic activity has been called business cycles. They are also known as trade cycles.

J.M. Keynes writes, “A trade cycle is composed of periods of good trade characterized by rising prices and low unemployment percentages with periods of bad trade characterized by falling prices and high unemployment percentages.”

Features of Business Cycles:

• Business cycles occur periodically

• Business cycles are synchronic

• Thirdly, it has been observed that fluctuations occur not only in level of production but also simultaneously in other variables such as employment, investment, consumption, rate of interest and price level.

• Another important feature of business cycles is that investment and consumption of durable consumer goods such as cars, houses, refrigerators are affected most by the cyclical fluctuations.

• Another important feature of business cycles is that profits fluctuate more than any other type of income.

Phases of Business Cycles

: • Expansion (Boom, Upswing or Prosperity)

• Peak (upper turning point)

• Contraction (Downswing, Recession or Depression)

• Trough (lower turning point)

Types of Business Entities:

• Sole Proprietorship: Sole Proprietorship from of business organisation refers to a business enterprise exclusively owned, managed and controlled by a single person with all authority, responsibility and risk.

• Partnership Firm: Partnership is an association of two or more persons who pool their financial and managerial resources and agree to carry on a business, and share its profit. The persons who form a partnership are individually known as partners and collectively a firm or partnership firm.

• Joint Hindu Family Business: The Joint Hindu Family (JHF) business is a form of business organisation run by Hindu Undivided Family (HUF), where the family members of three successive generations own the business jointly. The head of the family known as Karta manages the business. The other members are called coparceners and all of them have equal ownership right over the properties of the business.

• Cooperative Society: The Section 4 of the Indian Cooperative Societies Act 1912 defines Cooperative Society as “a society, which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles.”

Sources of Finance

. Long term finance: Long term finance available for a long period say five years and above. The long term methods outlined below are used to purchase fixed assets such as land and buildings, plant and so on.

a) Own capital : Money invested by the owners, partners or promoters is permanent and will stay with the business throughout the life of business.

b) Share capital : Normally in the case of a company, the capital is raised by issue of shares. The capital so raised is called share capital. The share capital can be of two types, preference share capital and equity share capital.

c) Debentures: Debentures are the loans taken by the company. It is a certificate or letter by the company under its common seal acknowledging the receipt of loan. A 3 debenture holder is the creditor of the company. A debenture holder is entitled to a fixed rate of interest on the debenture amount

. d) Government grants and loans: Government may provide long term finance directly to the business houses or by indirectly subscribing to the shares of the companies.

Medium term finance

a. Bank loans: Bank loans are extended at a fixed rate of interest. Repayment of the loan and interest are scheduled at the beginning and are usually directly debited to the current account of the borrower. These are secured loans
b. . . Hire purchase: It is a facility to buy a fixed asset while paying the price over a long period of time. In other words , the possession of the asset can be taken by making a down payment of a part of the price and the balance will be repaid with a fixed rate of interest in agreed number of instalments.
c. . Leasing or renting: where there is a need for fixed assets, the asset need not be purchased. It can be taken on lease or rent for specified number of years.
d. Venture capital: this form of finance is available only for limited companies. Venture capital is normally provided in such projects where there is relatively a higher degree of risk.

Short Term Finance

a. Commercial paper: It is new money market instrument introduced in India in recent times. Cps are issued in large denominations by the leading, nationally reputed, highly rated and credit worthy, large manufacturing and finance companies in the public and private sector.

b. Bank overdraft: This is special arrangement with the banker where the customer can draw more than what he has in his saving/ current account subject to a maximum limit. interest is charged on a day to day basis on the actual amount overdrawn .

c. Trade credit: This is short term credit facility extended by the creditors to the debtors, normally, it is common for the traders to buy the materials and other supplies on credit basis.