NARSIMHA REDDY ENGINEERING COLLEGE
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UGC - Autonomous Institute
Accredited by NBA & NAAC with 'A' Grade
Approved by AICTE
Permanently affiliated to JNTUH

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Subject: BEFA

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Good Morning

UNIT – I

INTRODUCTION TO BUSINESS AND ECONOMICS

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. **Business economic** meets these needs of the **business** firm.

Definition of Business

"Business is the exchange of goods, services, or money for mutual benefit or profit." – Skinner and Ivancevich

"Business may be defined as any form of commercial activity to satisfy the economic wants of people at a profit." - Keith Davis

"Business is any enterprise engaged in production and distribution of goods for sale in a market or rendering services for a price."- Professor Owen.

Examples of Business Processes

- ®***Manufacturing and production*:**
  - ➢Assembling product, checking quality, producing bills of materials
- ®***Sales and marketing*:**
  - ➢Identifying customers, creating customer awareness, selling
- ®***Finance and accounting*:**
  - ➢Paying creditors, creating financial statements, managing cash accounts
- ®***Human Resources*:**
  - ➢Hiring employees, evaluating performance, enrolling employees in benefits plans

Theory of a Firm

- **Definition** : A collection of resources that is transformed into products demanded by consumers.
- The firm buys and coordinates the services of production factors such as land, labour and capital along with its organization for producing a commodity and sells it in the market to the households.
- Firm controlled by entrepreneur who takes major decisions like:
  - What to produce?
  - Where to produce?
  - How and how much to produce?
  - Whom to sell and at what price?

Underlying concepts

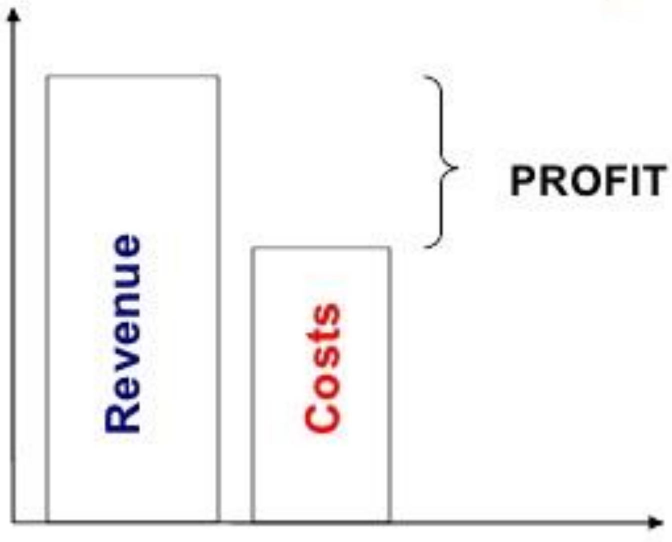
To understand the theory of the firm you must firstly understand some basic concepts underpinning the theory...

1. What is a firm?

A firm is a business enterprise which produces, or trades in, goods and/or services.

A firm can be privately or state owned (i.e. by individuals or government).

Concepts continued...

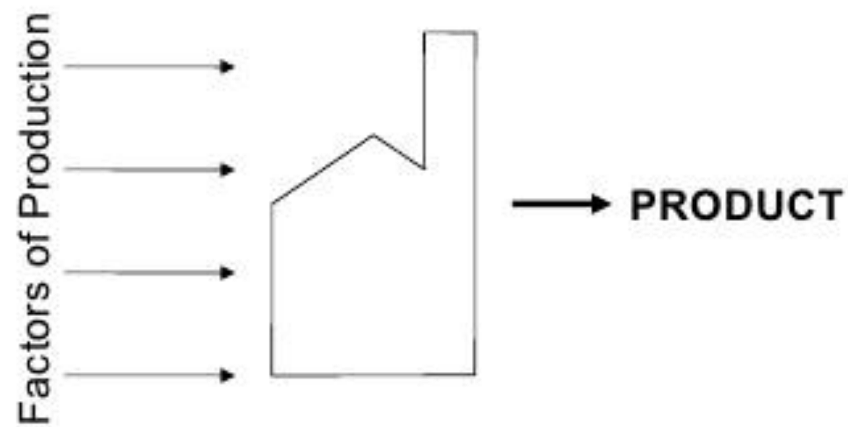


2. Profit Maximisation

Firms aim to make as much profit as possible i.e. produce at the level of output at which the gap between revenue and production costs is greatest.

3. Production

A firm 'adds value' by combining a range of factors of production into a finished product or service. This process is known as production.



Concepts continued

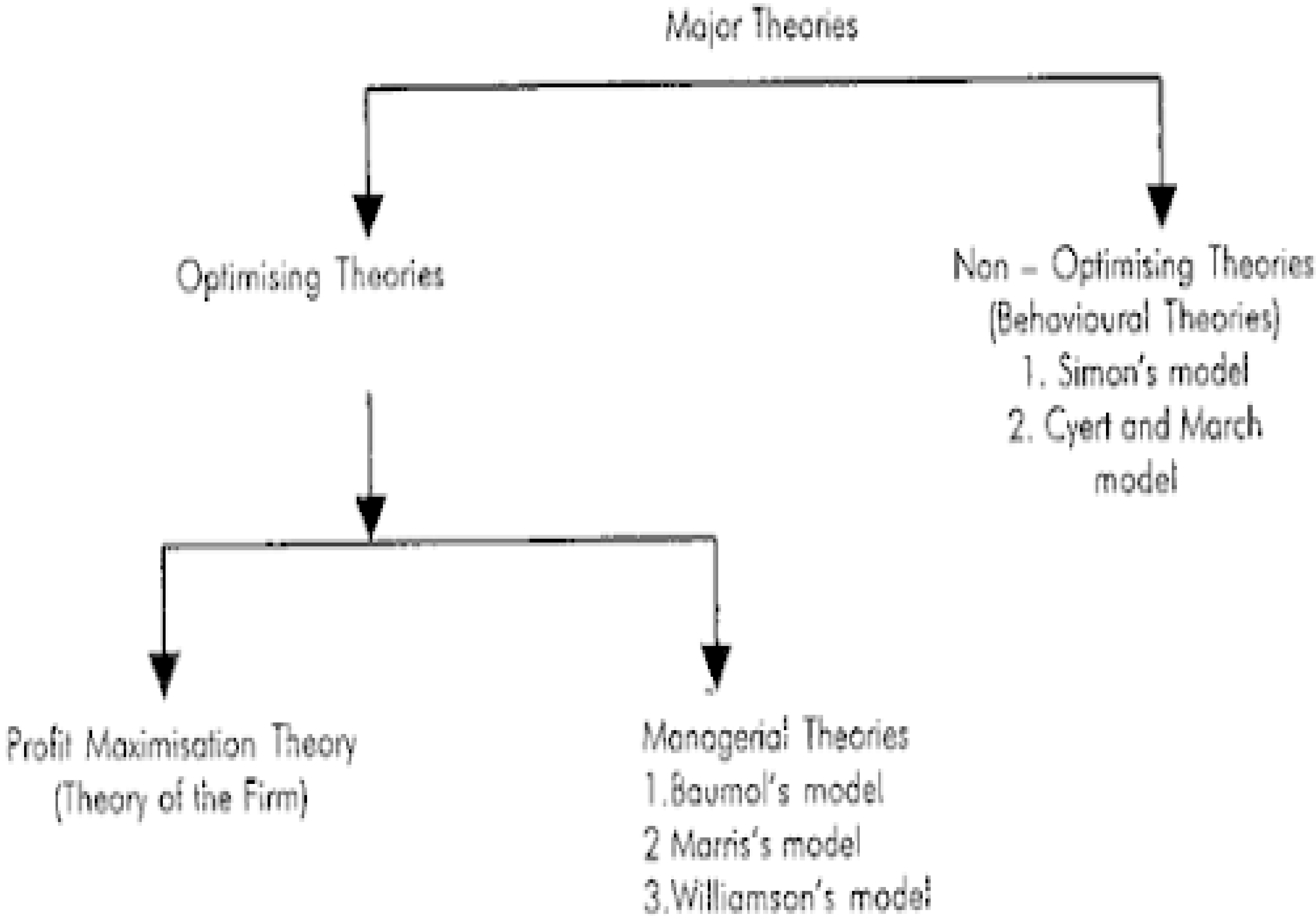
Put these UK markets in order according to the number of firms operating in them.

- Car market
- Hairdressers
- Banks
- Nuclear power plants
- Supermarkets
- Website designers

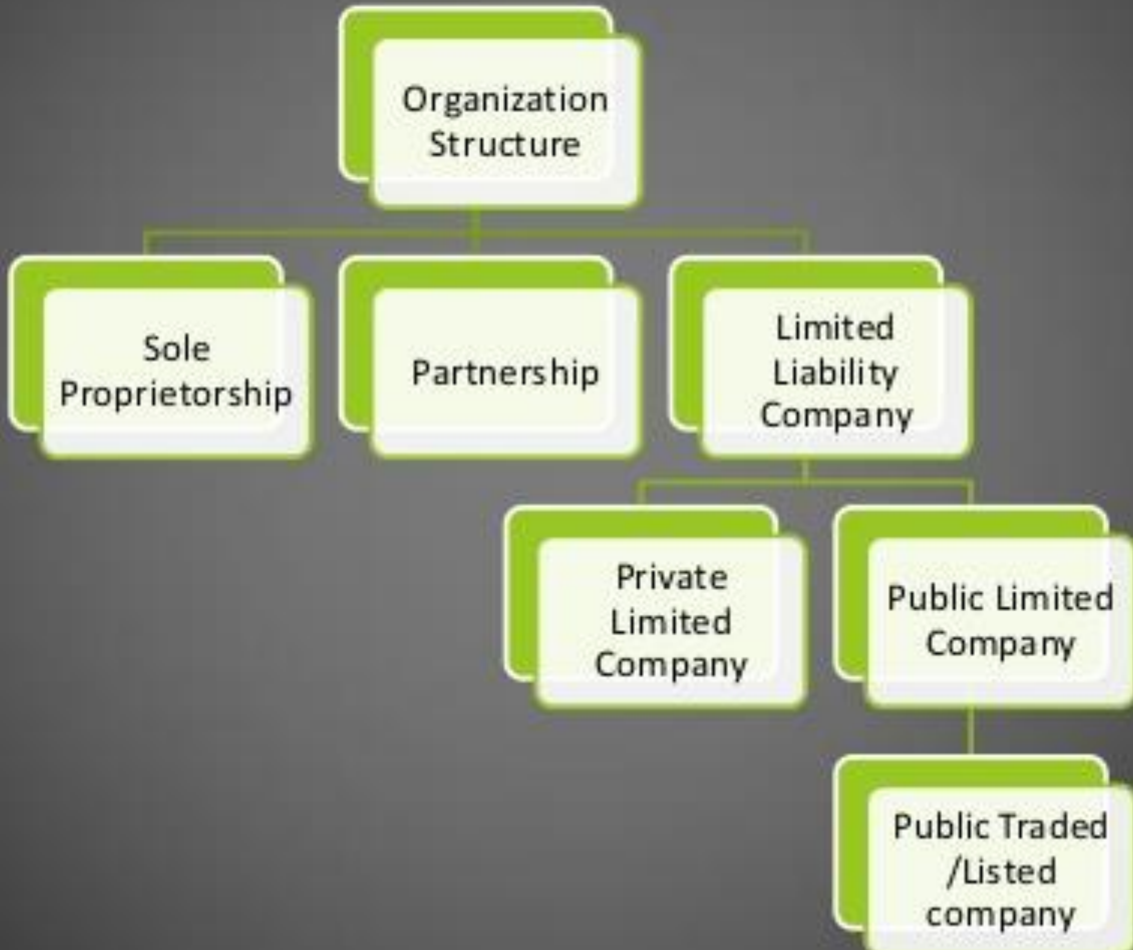
6. Market structure

The behaviour of a firm will vary according to the nature of the market it is in. An important factor is the number of firms in the market.

- Monopoly = 1 firm
- Oligopoly = a few firms
- Perfect competition = many firms


Major Theories
Optimising Theories
Non – Optimising Theories
(Behavioural Theories)
1. Simon's model
2. Cyert and March model
Profit Maximisation Theory
(Theory of the Firm)
Managerial Theories
1.Baumol's model
2 Marris's model
3.Williamson's model

Structure of Business Firm



Types of Business Entities

Sole Proprietorship

- Owned by Single Person
- Unlimited liability of equity holder
- Limited funds

Partnership

- Owned by Two or more
- Unlimited liability of equity holder
- Limited funds

Limited Liability Company

- Liability is limited to equity owners' commitment to capital
  - Private Limited Company (closely held company)
  - Public Limited Company

Private Limited Company

- Not allowed to invite public to provide share capital
- Minimum number of shareholder – 2
- Maximum – 50

Public Limited Company

- Share capital is contributed by large number of individuals
- Minimum number of shareholder – 7
- Maximum – no limit

Along with an individual, A body corporate, a partnership firm, a joint family or any other entity can contribute risk capital to limited liability company

Sole Proprietorship

- Run by a single individual who bears the sole responsibility of the whole business;
- Business and owner is one entity, so much so that the personal property of the Proprietor may be attached to fulfill business liability;
- Profits earned in the business are added to the business owners income which are later subject to taxation. Same for losses
- Personal Property of the Proprietor may be attached to fulfill business liability;
- Ownership not transferable though assets can be transferred;
- Can trade in his own name or name of the business. E.g. Mr. A trading as X business;
- Some of the world's biggest companies started off as Sole Proprietorships, E.g. Mc. Donalds,

SELVAM & SELVAM

Partnership Firm

- Run by a minimum of 2 and a maximum 20 members;
- Responsibilities and liabilities are shared equally among partners; as stated in the partnership deed;
- The business maybe carried on by all or by one for all;
- Sleeping partner is one who simply provides the capital, but does not take part in the management;
- Loses incurred by one partner renders all the partners liable ;
- May or may not be registered with the Registrar of Firms;
- Name must not contain words like 'Crown', 'Emperor' or any such words implying patronage by the government. Unless the State Government by consent in writing allows the firm to do so.

SELVAM & SELVAM

Limited Liability Partnership

- Is a mix of both partnership and an company;
- The LLP and the partners are separate legal entity;
- No maximum number of partners ;
- Can be formed for any business, not restricted to any particular form of business;
- Private or Public Limited Company or a Partnership can be converted to an LLP;
- Only difference from a company is that it cannot come out with its IPO and sell its shares to the general public;

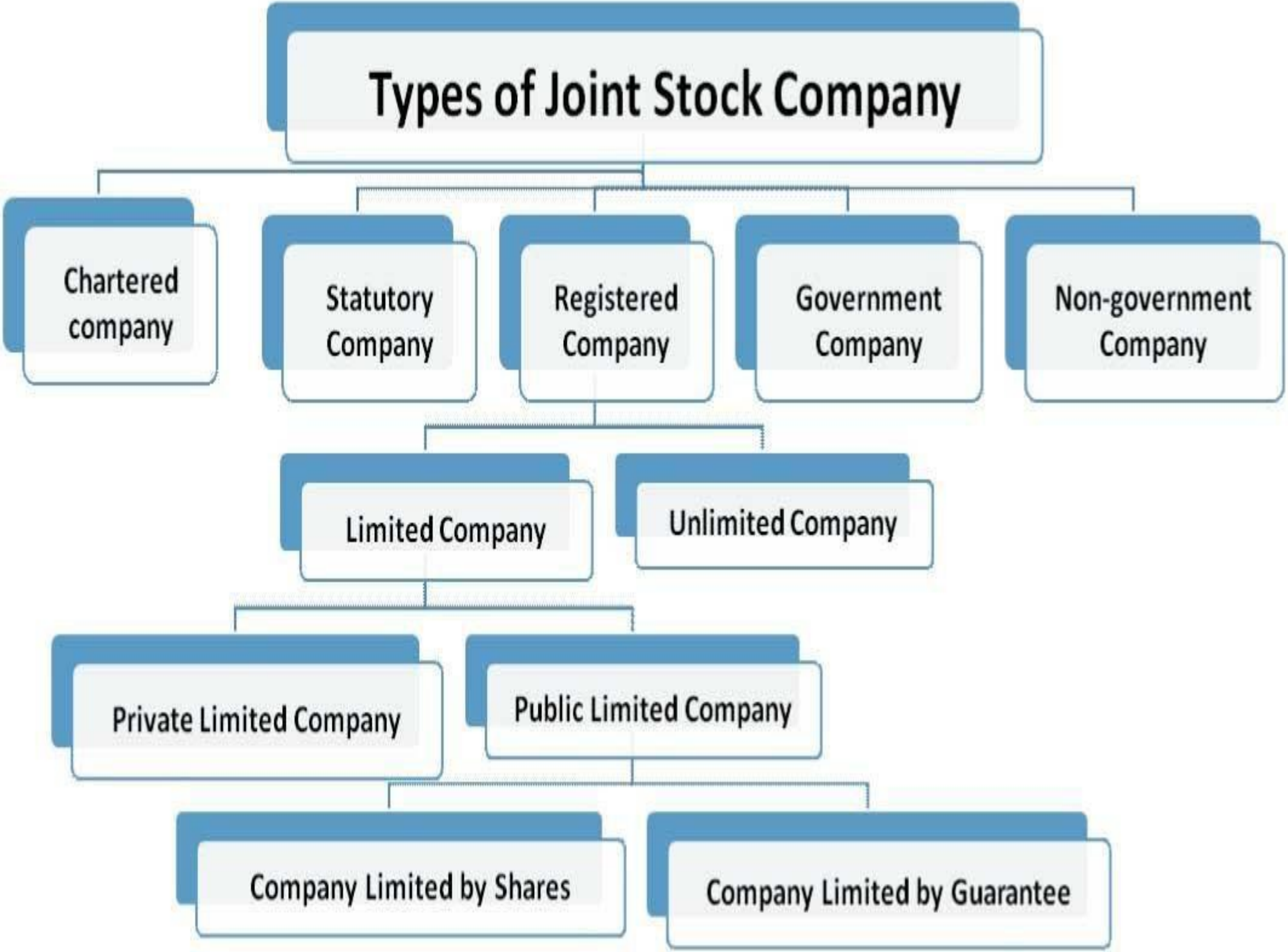
Private Limited Company

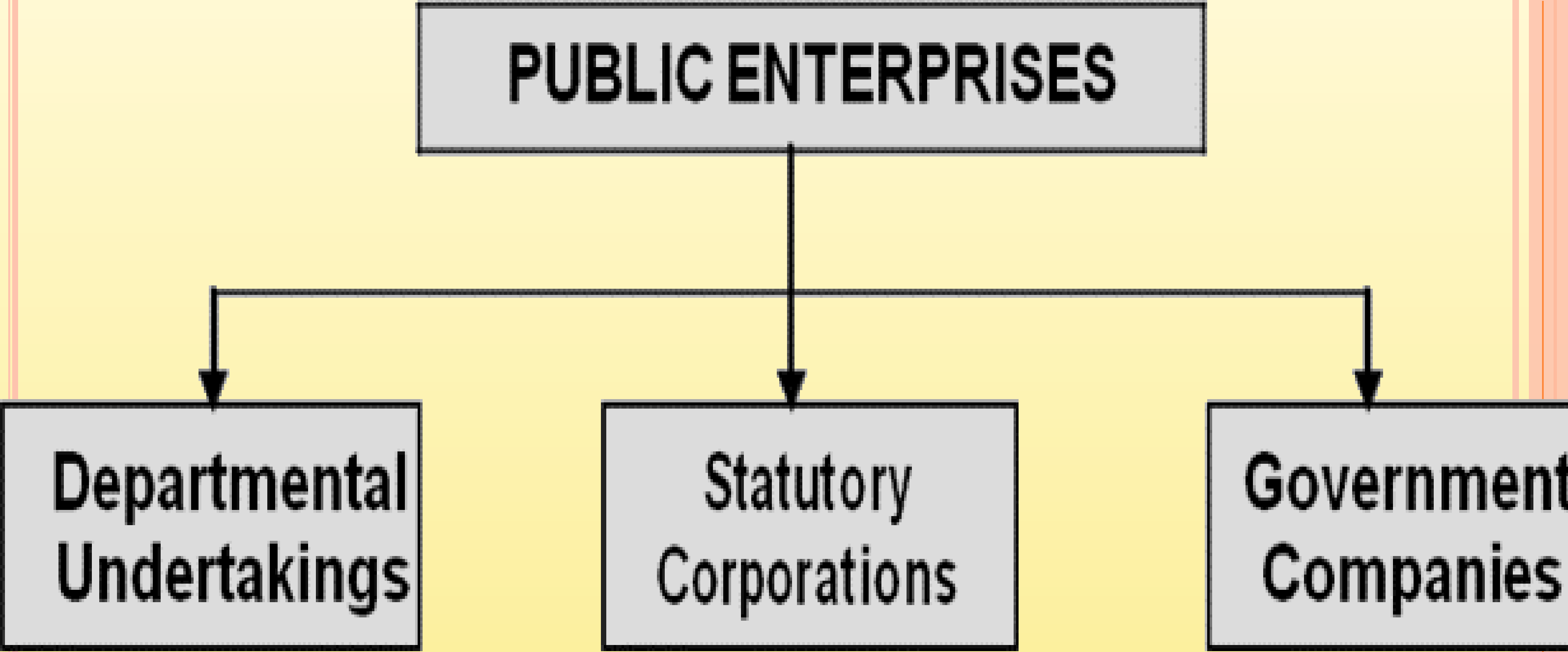
- Is formed by registering the company name with the Appropriate Registrar of Companies;
- Allows people to own and subscribe to shares and become shareholders of the company;
- Can have 2 – 50 shareholders and a minimum share capital of Rs.1 lakh;
- Liability of shareholder limited to invested share capital;
- More liability than an LLP, Board to meet quarterly and have at least one annual general meeting;
- Change in shareholders do not affect the legal status of the company;

Public Limited Company

- Most difficult to establish;
- Minimum number of shareholders to be 7, no maximum limit;
- Allows shareholders to trade freely with the shares at the stock market;
- Is under strict scrutiny by the government as well as SEBI(Securities and Exchange Board of India);
- Like a private limited company, the change in shareholders do not affect the legal status of the company;

SELVAM & SELVAM


Types of Joint Stock Company
Chartered company
Statutory Company
Registered Company
Government Company
Non-government Company
Limited Company
Unlimited Company
Private Limited Company
Public Limited Company
Company Limited by Shares
Company Limited by Guarantee



Example

1. Posts & Telegraph
2. Railways
3. All India Radio (AIR)
4. DoorDarshan (TV)
5. Ordnance Factories

Example

1. Food Corporation of India
2. Industrial Finance Corporation of India
3. Life Insurance Corporation of India
4. Unit Trust of India
5. State Trading Corporation

Example

1. Hindustan Machine Tools Limited
2. Steel Authority of India Limited
3. Hindustan Shipyard Limited

Forms of Public Enterprises: Features at a Glance

Features	***Departmental Undertaking***	***Public Corporation***	***Government Company***
1. Formation	*Executive Order of Govt*	*Statute of Parliament or State Legislature*	*Registered under Companies Act, 1956*
2. Legal Position	*An extension to a govt department*	*Separate legal entity*	*Separate legal entity*
3. Finances	*Budget of the concerned ministry*	*Government Provides the initial capital*	*Govt provides a minimum of 51% of capital and the balance is raised from public*
4. Degree of Autonomy	*Nil*	*Fairly Good*	*High*
5. Power to recruit staff	*Manned by govt employees and civil servants*	*It can recruit its own staff*	*It can recruit its own staff*

Limited Liability Partnership

A LLP is a form of business organization that is mid-way between a Private Limited company and a partnership firm. It embraces the ease and low-compliance of a partnership firm and the limited liability concept of a Private Limited company.

All tax, business & statutory registrations are to be done in the name of the LLP.

Income tax returns for the business and the partners of the company are to be filed separately.

Sources of Capital for a Company

Definition of capital

- "Capital is a necessary factor of production and, like any other factor, it has a cost,"

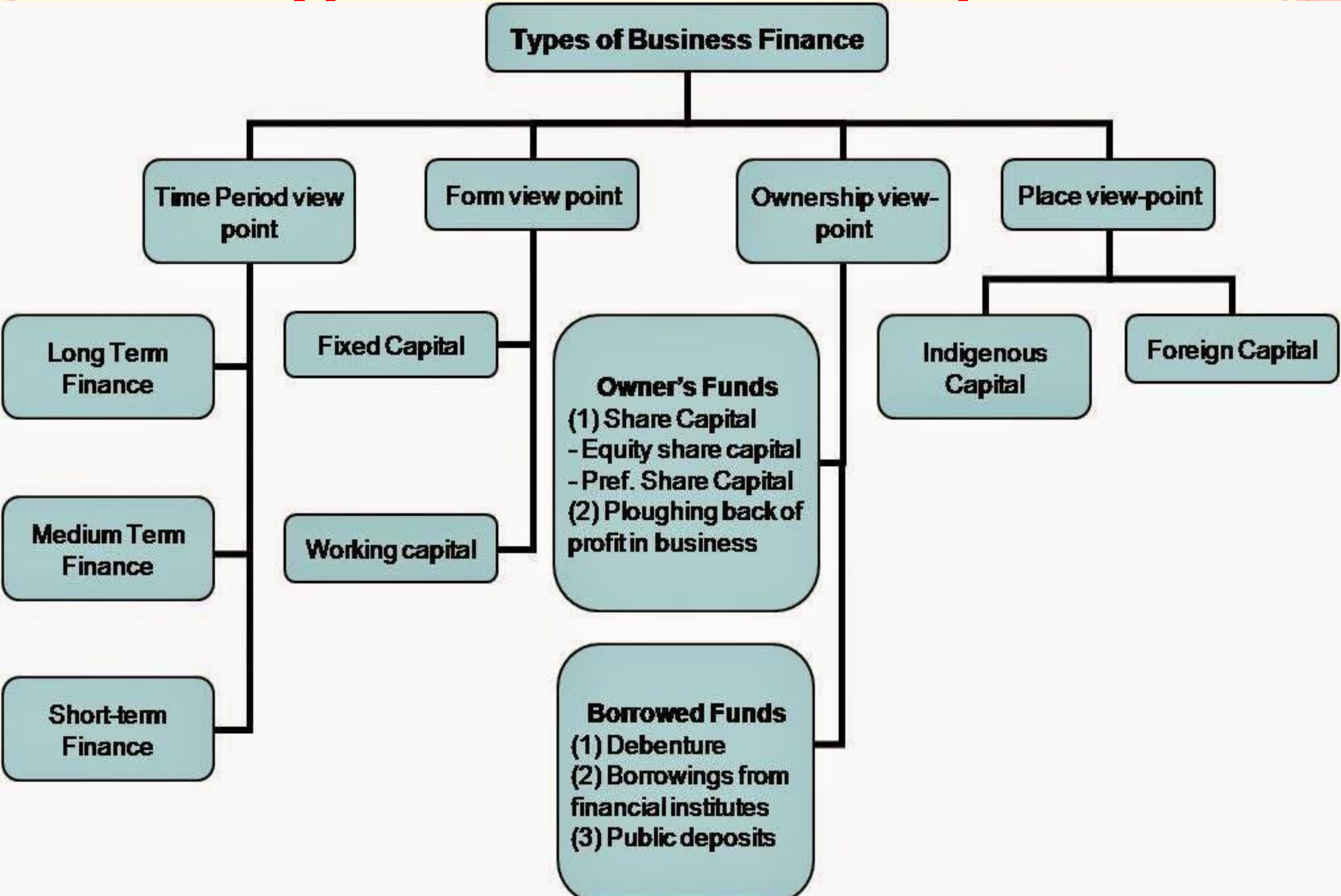
  \- Eugene F. Brigham

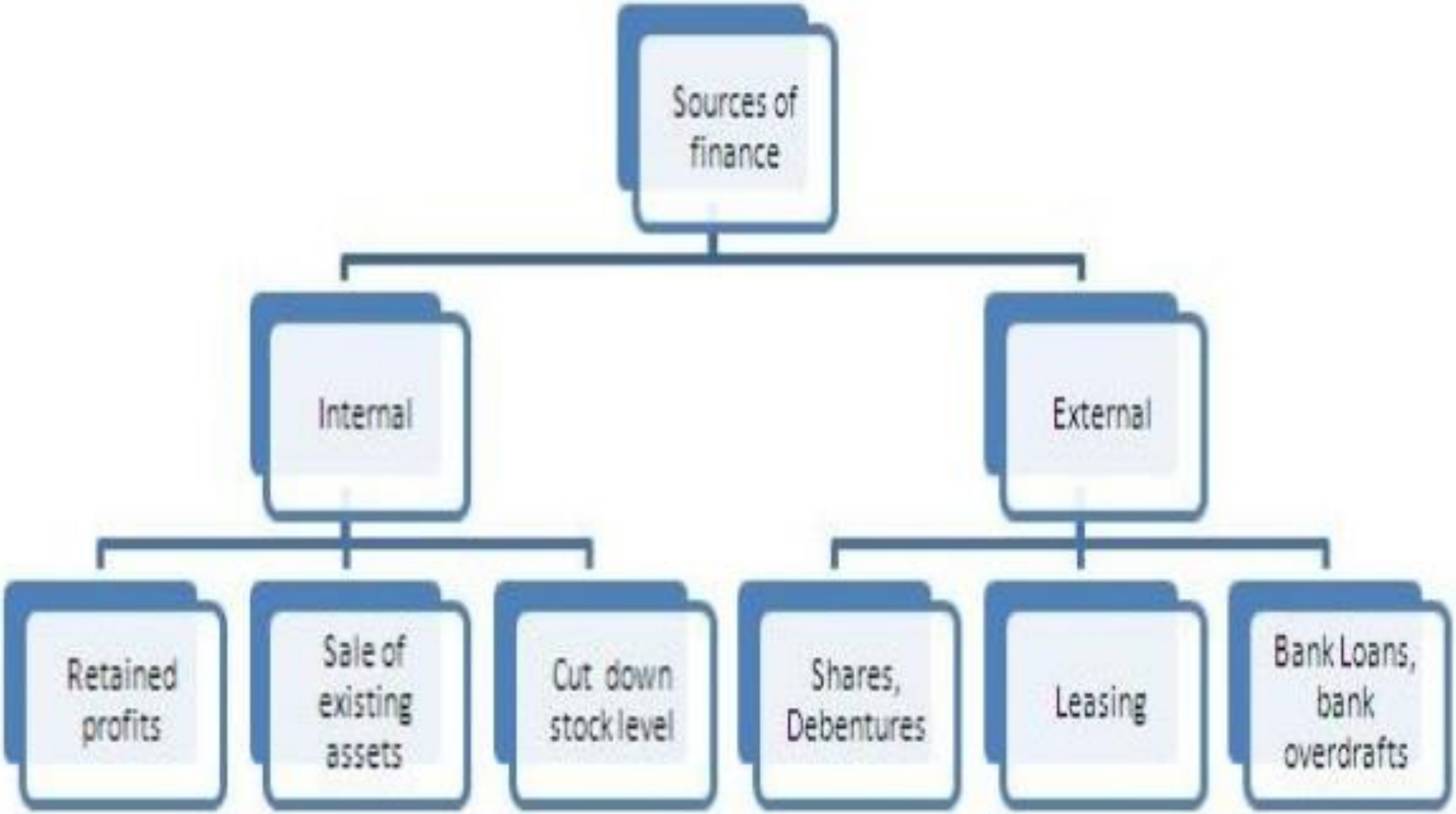
- "Firms with the most profitable investment opportunities are willing and able to pay the most for capital, so they tend to attract it away from inefficient firms or from those whose products are not in demand,"

  \- Brigham

- Capital is the money or wealth needed to produce goods and services. In the most basic terms, it is money. All businesses must have capital in order to purchase assets and maintain their operations.

Types and Sources Of Capital





Sources of finance
Internal
External
Retained profits
Sale of existing assets
Cut down stock level
Shares, Debentures
Leasing
Bank Loans, bank overdrafts

Non-Conventional Sources of Finance

DEFINITION

✓'Non conventional' refers to the financial mechanisms employed, and not necessarily to the financial institutions who employ them.

✓Use of modified loan terms or eligibility requirements that allow lending to borrowers with limited financial resources.

✓Some of the more common nontraditional **financing sources** include selling assets, borrowing against the cash value of a life insurance policy, and taking out a second mortgage on a home or other property.

Introduction

Finance is the lifeblood of business.

No business can be carried out without Finance.

There are several sources of Finance which can be categorized as Internal or External, Long Term or Short Term and Fixed and Working Capital Finance

Sources for Finance . . .

- Conventional : Bank / State Financial Corporation
- Non-conventional : Venture / Angel funds
- Country specific Govt. Schemes
- Industry / Technology specific schemes

Modern sources of Finance

Modern days the ways have changed as to how Startups and established business are sourcing funds for business. Below are the unconventional sources of Finance:

- Angel Investment
- Venture Capital (VC)
- Private Equity (PE)

Angel Investment

An angel investor is an experienced industry person who provides needed funds for small startups or entrepreneurs. Apart from funds, Angels invest their time, experience, network and energy in business they invest in.

Sanjay Mehta, an Angel Investor has invested in several startups viz., OYO Rooms, FabAlley, OrangeScape etc.

Venture Capital (VC)

Venture capital (VC) is money provided to seed early-stage, emerging growth companies. Venture capital funds invest in companies in exchange for equity in the companies they invest in, which usually have a novel technology or business model in high technology industries, such as biotechnology and IT.

Foodpanda is funded by a Venture Capital Firm, Rocket Internet.

Private Equity (PE)

Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies

Justdial, the local search engine was funded by Private Equity Investors like Sequoia Capital and SAP Ventures.

Introduction

- The word Economics is derived from the Greek words "OKIOS NEMEIN" meaning household management .
- Man is bundle of desires. Goods and services satisfy these wants. But almost all the goods are scarce. To produce goods land, labour, capital and organization are needed. Economic problem arises because of scarcity.
- Economics is a study of economic problems. Wants are motive force for economic activity. Wants leads to efforts. Efforts secures satisfaction.

ECONOMICS

What Is Economics?

Economics is a social science concerned with the production, distribution, and consumption of goods and services. It studies how individuals, businesses, governments, and nations make choices on allocating resources to satisfy their wants and needs, trying to determine how these groups should organize and coordinate efforts to achieve maximum output.

Economics can generally be broken down into ***macroeconomics***, which concentrates on the behavior of the aggregate economy, and ***microeconomics***, which focuses on individual consumers and businesses.

what is economics?

Economics as a subject deals with how people earn and spend their income to maximize their economic gains. It is concerned with the study of economic activities of various individuals and the society.

Economics deals with economic problems of the individuals business units, society and that of the globe.

An economic problem arises on account of the following reasons

1. Unlimited wants
2. Limited resources
3. Alternative use of resources
4. Problem of choices

Economic Activities

1. Consumption: Extracting utility from goods and services.
2. Production: Production of goods and services which posses utility.
3. Exchange: means buying and selling of goods and services. It is link between consumer and producer.
4. Distribution: Sharing of income by the four factors of production.

Economics Definitions

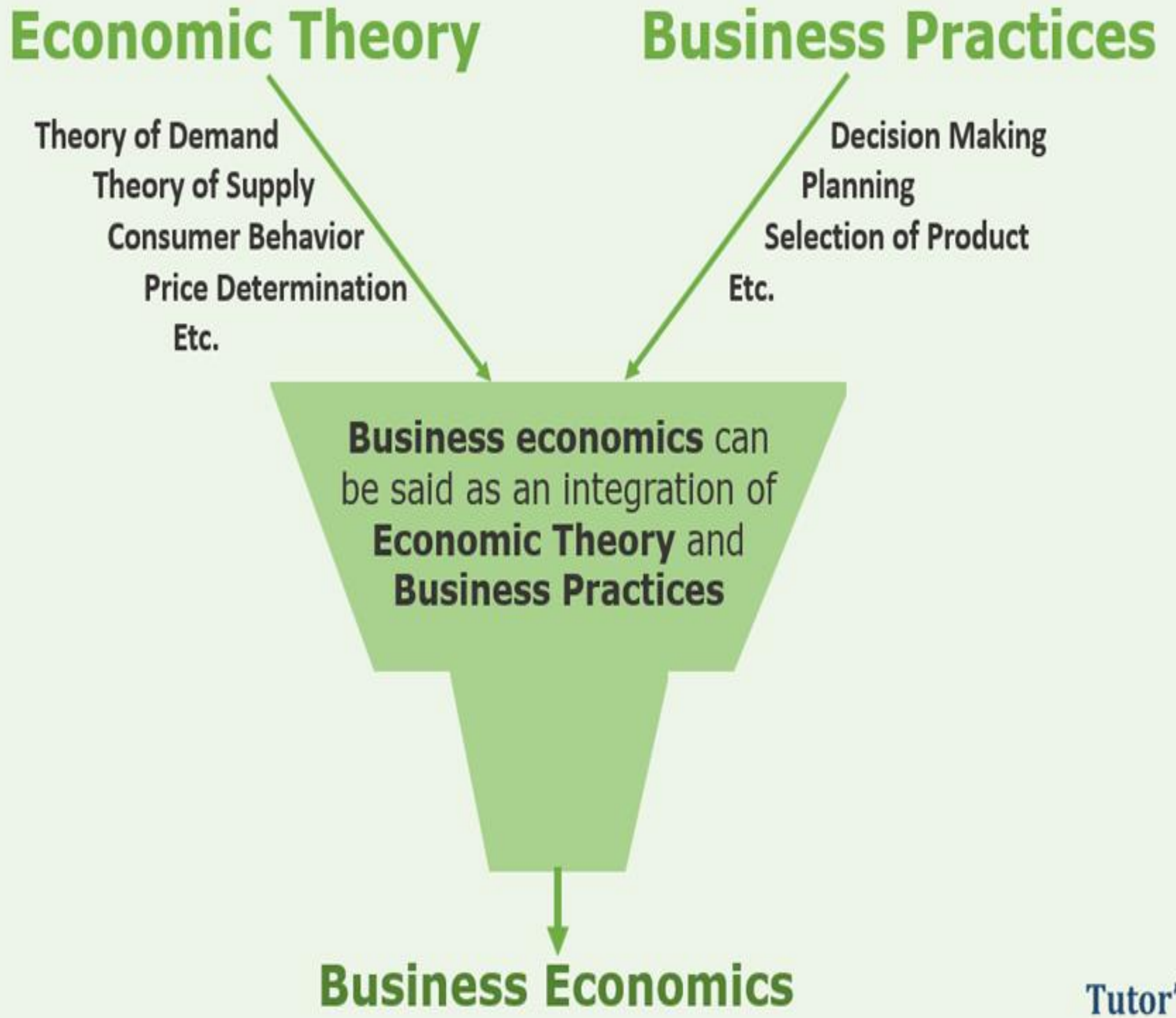
1. Wealth Definition. Adam Smith
2. Welfare Definition. Alfred Marshall
3. Scarcity Definition. Lionel Robbins
4. Growth Definition. Paul Samuelson

Definitions of Economics

Acc to Prof. Spencer and Seigelman "Managerial economics is the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning".

1. In the words of **TJ. Webster,** "Managerial economics is the synthesis of microeconomic theory and quantitative methods to find optimal solutions to managerial decision-making problems?
2. In the words of **Hirschey and Pappas**, "Managerial economics applies economic theory and methods to business and administrative decision making".
3. **Brigham and Poppas** believe that managerial economics is "the application of economic theory and methodology to business administration practice."
4. According to **McNair and Meriam,** "Managerial economics is the use of economic modes of thought to analyse business situations."

Business Economics | Meaning | Definition



Business Economics

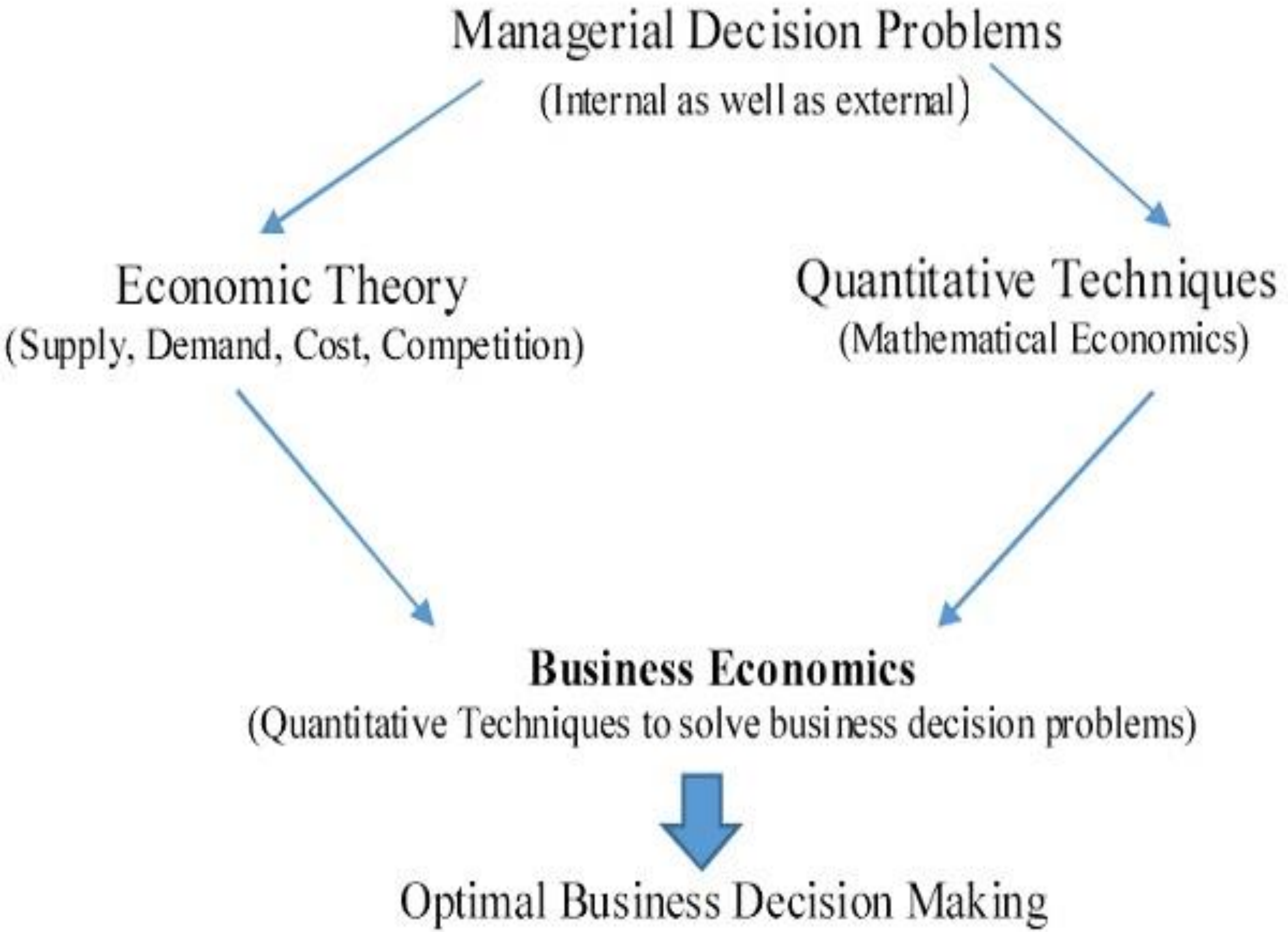
- Business Economics, also called Managerial Economics, is the application of economic theory and methodology to business.
- Business involves decision-making. Decision making means the process of selecting one out of two or more alternative courses of action.
- The question of choice arises because the basic resources such as capital, land, labour 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 maximisation.

Significance of Managerial Economics

- Business Planning
- Cost Control
- Price Determination
- Business Prediction
- Profit Planning and Control
- Inventory Management
- Manages Capital

Micro and Macro Economic Concepts

MICROECONOMICS	MACROECONOMICS
Studies individual income	Studies national income
Analyzes demand and supply of labor	Analyzes total employment in the economy
Deals with households and firms decisions	Deals with aggregate decisions
Studies individual prices	Studies overall price level
Analyzes demand and supply of goods	Analyzes aggregate demand and aggregate supply


Managerial Decision Problems
(Internal as well as external)
Economic Theory
(Supply, Demand, Cost, Competition)
Quantitative Techniques
(Mathematical Economics)
Business Economics
(Quantitative Techniques to solve business decision problems)
Optimal Business Decision Making

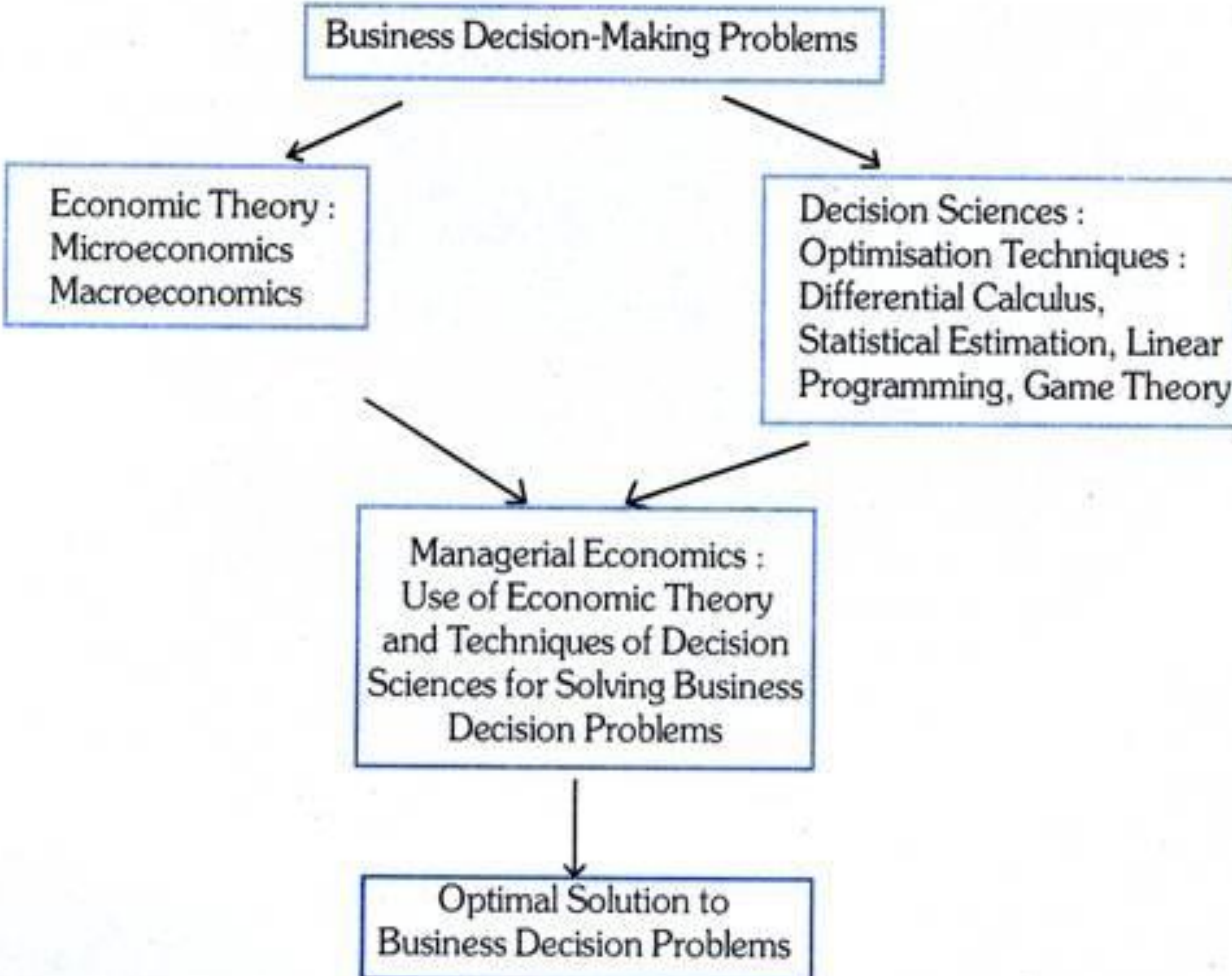


Fig. 1.1. *The Nature of Managerial Economics*

Meaning of National Income

- National income is the money value of all the final goods and services produced by a country during a period of one year. National income consists of a collection of different types of goods and services.

Concepts of National Income

Important Concepts of National Income

- Gross Domestic Product
- Gross National Product
- Net Domestic Product
- Net National Product
- Personal Income
- Disposable Income

1. GDP at market price: Is money value of all goods and services produced within the domestic domain with the available resources during a year.

$$GDP = (P*Q)$$

Where,

GDP = Gross Domestic Product

P = Price of goods and services

Q= Quantity of goods and services

GDP is made up of 4 Components

consumption

investment

government expenditure

net foreign exports of a country

$$GDP = C+I+G+(X-M)$$

Where,

C=Consumption

I=Investment

G=Government expenditure

(X-M) =Export minus import

2. Gross National Product (GNP): Is market value of final goods and services produced in a year by the residents of the country within the domestic territory as well as abroad. GNP is the value of goods and services that the country's citizens produce regardless of their location.

GNP=GDP+NFIA or,

GNP=C+I+G+(X-M) +NFIA

Where,

C=Consumption

I=Investment

G=Government expenditure

(X-M) =Export minus import

NFIA= Net factor income from abroad.

Net Domestic Product

- It represents the net book value of all goods and services produced within a nation's geographic borders over a specified period of time.

- **NDP = Gross domestic product (GDP) - Depreciation**

4. Net National Product (NNP): Is market value of net output of final goods and services produced by an economy during a year and net factor income from abroad.

NNP = GNP - Depreciation

or, NNP=C+I+G+(X-M) +NFIA- IT-Depreciation

Where,

C=Consumption

I=Investment

G=Government expenditure

(X-M) =Export minus import

NFIA= Net factor income from abroad.

IT= Indirect Taxes

Personal Income

Personal Income is the total income received by the individuals of country from all sources before direct taxes. Personal income is not the same as National Income, because it includes **'Transfer payments'**

Personal income also includes:

1. Wages
2. Salaries
3. Interest and rent received by the individuals.

Personal Income = Private Income - Saving of Private enterprise – Corporate tax

Disposable Income

- All personal income is not at the disposal to be spent on consumption. Individuals have to pay personal direct taxes to the government. They are free to spend only after the payment of taxes.

- DPI = Personal income – Personal Direct taxes.

6. Disposable Income (DI) **:** It is the income left with the individuals after the payment of direct taxes from personal income. It is the actual income left for disposal or that can be spent for consumption by individuals.

Thus, it can be expressed as:

DI=PI-Direct Taxes

7. Per Capita Income (PCI): The average income of the people of a country in a particular year is called Per Capita Income for that year. I**s** **c**alculated by dividing the national income of the country by the total population of a country.

Thus,

PCI=Total National Income/Total National Population

Inflation

INFLATION

- Inflation is defined as a sustained increase in the price level or a fall in the value of money.
- Inflation is a rise in general level of prices of goods and services in the country over a period of time.

Definition of Inflation according to few Economists.

MEYER:

" An increase in the prices that occurs after full employment has been attained."

CROWTHER:

" In the state of inflation, the prices are rising , i.e., the value of money is falling."

Coulburn:

" In inflation , too much money chases too few goods."

Types Of Inflation

1. Demand Pull Inflation
2. Cost Push Inflation

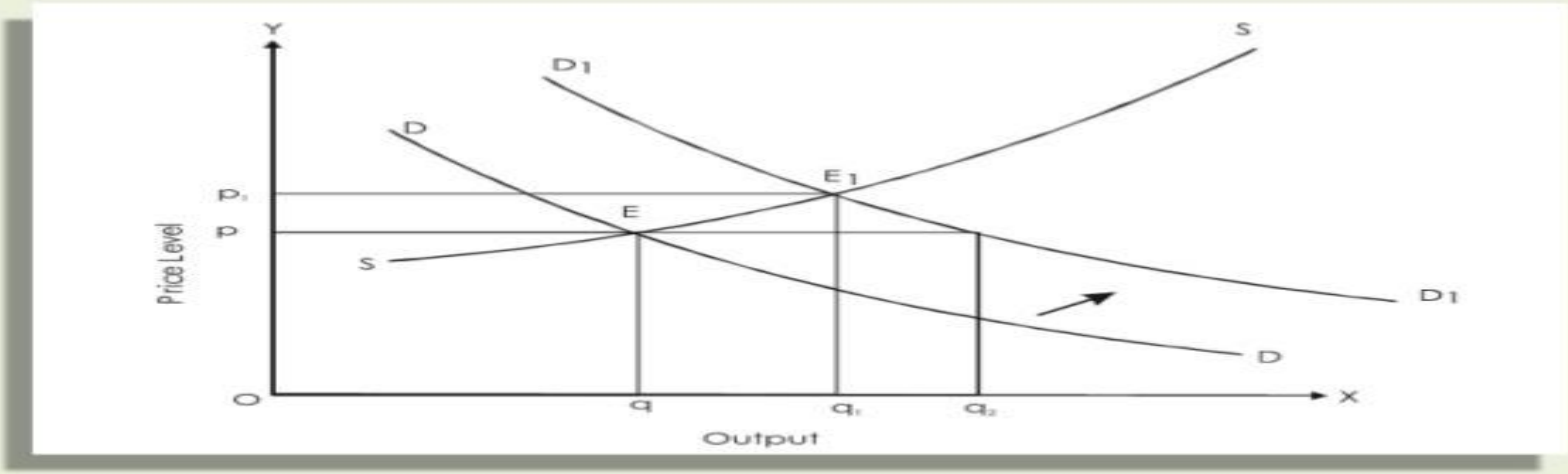
Demand Pull Inflation

- The demand for goods and services increases and production remains same or does not increase as fast.
- The excess demand results in prices being pulled up.

Demand Pull Inflation

- The demand pull inflation occurs when total demand for goods and services exceeds the total supply.
- This type of inflation happens when there is an inflationary gap.

Demand Pull Inflation



Demand Pull Inflation

- In this graph SS and DD are aggregate supply and demand curves.
- Op and Oq are equilibrium price and equilibrium output.
- Due to exogenous causes demand curves shifts right-wards to D
- At the current price Op, demand increase by qq
- But supply is Oq.
- Excess demand qq
- Put pressure on price, which gradually rises from Op to Op
- At this price a new equilibrium is achieved where Demand=Supply.
- The excess demand is eliminated by fall in demand and rise in supply arising out of rise in price

Cost Push Inflation

- The cost push inflation is caused by an increase in the cost of production.
- Increased costs push up the price level.

Causes of Inflation:

- Population explosion.
- Political Instability.
- Imported goods.
- Increase in wages and salaries.
- Climatic factors.

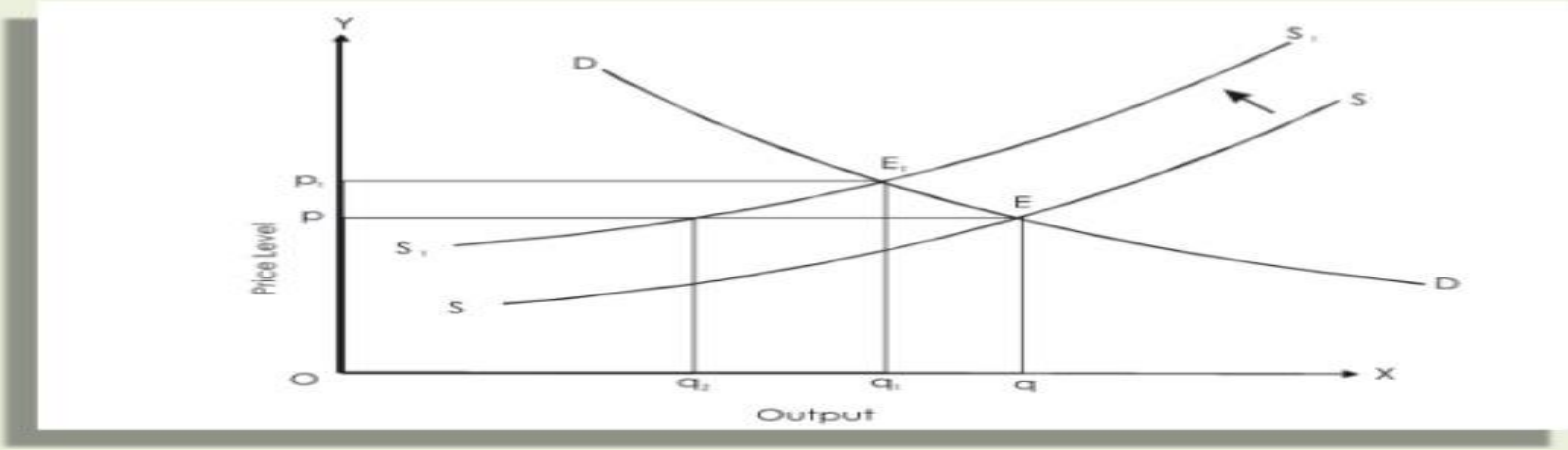
Causes of Inflation:

- Oil prices.
- Corruption.
- Slow agricultural development
- Slow Industrial growth.

Effects Of Inflation:

- Un employment
- Decreasing the purchasing power
- Decrease in stock.
- Exports decline.
- Breakdown of monetary system.
- Investment fall.

Cost Push Inflation



Cost Push Inflation

- In this graph, the starting point is the equilibrium price(Op)and output (Oq).
- If aggregate supply has fallen, the SS curve shifts leftward to S
- At price Op now supply will be Oq
- But demand Oq.
- This will push prices high till a new equilibrium is reached at Op
- At the new price there will be no excess demand.
- Inflation is thus a self limiting phenomenon.

Money Supply in Inflation

Money

- Money does not have any inherent value
- It is valuable because it is:
- ***Medium of Exchange***:
  - the most convenient medium of exchange.
  - all the things which have utility are available in exchange for money.
  - Under barter system where goods (or services) are exchanged for goods (or services) *dual coincidence of wants* is the basis for exchange.
- ***Measure of Value:***
  - Provides a common denominator to all types of goods and services.
- ***Store of Value:***
  - Can be saved for future with convenience, whereas other goods can be saved for a limited time period only.

Demand for Money

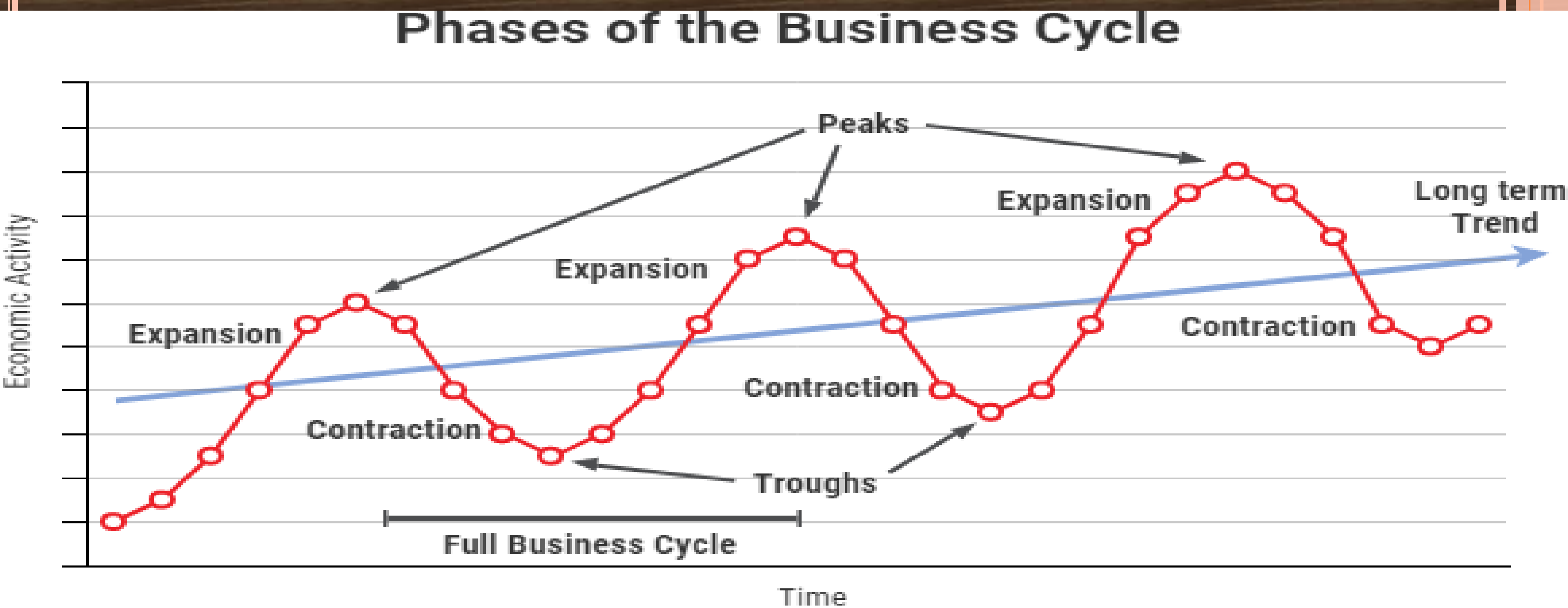
- *Keynes has identified three motives to hold money*
  - ***Transaction Motive*:**
    - Consumers need money to meet their day to day needs,
    - producers need money to make investments.
  - ***Precautionary Motive*:**
    - To cover for unforeseen events such as sickness, accidents and losses, money is kept as precaution for contingency.
  - ***Speculative Motive*:**
    - For making gains from speculation on future value of bonds and securities.
- Money may be demanded as a *flow* (transaction motive) as well as a *stock* (precautionary motive).
- Money as a flow is that which is in circulation.
- Total money supply at any point of time consists of money in circulation as well as in stock (in various forms of savings and deposits).

Supply of Money

- Earlier money was in the form of coins, composed of gold, silver and copper ,etc. Value of the coins was based on the value of the metals they contained.
- The gold standard broke down in 1930 in UK, in USA it lasted till 1971
- A currency issued by the government is called a *fiduciary issue* (based on trust and confidence).
- Modern form of money is simply pieces of paper or numbers in a ledger.
- System of paper money was introduced based on the *gold standard* or *silver standard* or some combination of the two, to ensure people's faith in the system.

Business Cycle

The **business cycle**, also known as the economic **cycle** or trade **cycle**, is the downward and upward movement of gross domestic product (GDP) around its long-term growth trend. The length of a **business cycle** is the period of time containing a single boom and contraction in sequence.



GROWTH TREND

Features and Phases of Business Cycles

Variable	Expansion	Peak	Recession	Trough
Industrial Production	Increase	Rapid Increase	Decline	Lowest
Demand	Increase	Highest	Decline	Lowest
Prices	Increase	Rapid Increase	Decline	Rapid decline
cost	Increase	Rapid Decrease	Gradual Decline	Rapid decline
Investment	Increase	High	Falls slowly	Falls rapidly
Employment	Gradual Increase	Rapid Increase	Falls	Rapid falls
Bank Credit	Liberal	Very liberal	Falls	Rapid falls

Nature and Scope of Business Economics

Nature of Managerial Economics

1. **Close to Micro-Economics** – finding solutions for different managerial problems of a particular firm (production schedules)
2. **Operates against the backdrop of Macro-Economics** – macroeconomic conditions of the economy are also seen as limiting factors for a firm to operate. (industrial policy and Inflation)
3. **Normative Statements** – one problem with normative statements is that they cannot be verified by looking at the facts, because they mostly deals with the future. (agreement or disagreement – L.P.G.)
4. **Prescriptive Action** – suggest the course of action from the available alternatives for optimal solution. (mention concept to given context)
5. **Applied in Nature –** case study method to conceptualize problem
6. **Offers scope to evaluate each alternative** - cost and revenue
7. **Interdisciplinary** – drawn from different subjects (as mentioned)
8. **Assumptions and Limitations** – validity is not universal (changes)

Scope of Managerial Economics

Operational issues of firms are of internal nature. Internal issues include all those problems which arise within the business organization and fall within the control of the management. Some of the basic internal issues are:

- ✓ *Choice of business and the nature of products, that is, what to produce,*
- ✓ *Choice of size of the firm, that is, how much to produce,*
- ✓ *Choice of technology, that is, choosing the factor-combination*
- ✓ *Choice of price, that is, how to price the commodity,*
- ✓ *How to promote sales,*
- ✓ *How to face competition,*
- ✓ *How to decide on new investments,*
- ✓ *How to manage profit and capital,*
- ✓ *How to manage an inventory, that is, stock of both finished goods and raw materials.*

Scope of Managerial Economics (Cont..)

Concepts and Techniques of Managerial Economics

→

MANAGERIAL DEDISION AREAS:

- Production Analysis
- Cost Control
- Price Determination
- Make or Buy Decisions
- Inventory Decisions
- Capital Management
- Profit Management
- Investment Decisions

→

Optimal Solution

Fig : Scope and Decision Areas of Managerial Economics

Scope of Managerial Economics (Cont..)

1. **Demand Decisions** – Forecasting demand, Demand response with the changes of price and supply, impact of income and alternatives on demand , profit and demand relation etc..
2. **Input-Out put Decisions** – Input relation with Output to maximize profit, production function, factors of production, cost and production relationship, analyze cost – out put relation in the short run and long run etc..
3. **Price -Output Decisions** – production to determine price, understand price at different market structures, pricing policies, methods and strategies etc…
4. **Profit related Decisions** – BEP Analysis, Cost reduction and control, Ration Analysis, production needed to gain profit, reduce wastage etc…

Scope of Managerial Economics (Cont..)

5. **Investment Decisions** – Capital Budgeting decision, allocation and utilization of Investment, cost of capital, capital structure, to maximize return on capital etc…..

6. **Economic Forecasting and Forward Planning** – understanding major external factors like, government policy, competition, employment, labour, price and income levels and so on. Internal factors like finance, people, market and products. It is necessary to forecast the trends in the economy to plan for the future in terms of investments, profits, products and markets.

Role of Business Economist

1. Demand estimation and forecasting

2.Preparaton of business /sales forecast

3.Analysis of the market survey

4. Analysing the issues and problems of the concernedindustry

5.Assisting he business planning process of the firm

6.Advising on pricing, investment and capital budgeting.

7. Building micro and macro models.

8. Directing economic research activity.

9. Briefing the management on current domestic & global economic issues and emerging challenges.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