Course: **Business Economics (Micro)**

Field of study: Economics

Form of classes: Regular/Online

Number of hours: 30 h

Number of ECTS credits: 5

Teaching methods: Lectures (including multimodal presentations, individual projects)

Learning outcomes:

Business Economics is a subject involving analytical rigour. And this rigour has become more important in terms of the language of the subject for the students, especially when they come from different academic backgrounds.

The course is designed to give a clear understanding of the present socio-economic environment, understanding of basic economic concepts, legal obligations, and relationship between a producer, consumer and service providers. The course will give a clear understanding of current business economic issues and the solutions of its expansion in a new environment.

Students will be able to understand broad perspective of nature and characteristics of Business Economics such as:

- Fundamentals,
- Economic Rationale of Business Administration,
- Allocation of Resources,
- Microeconomic Nature,
- Theory of the Firm,
- Market Conditions,
- Macro Settings,
- Profit and Pricing,
- Basis of Decision Making,
- Pragmatic Approach and Socio-cultural Aspects,
- Production, pricing and cost analysis.

Methods of verification of learning outcomes (100%):

- Class attendance & active participation (20%),
- Individual/Group presentation (20%),
- Individual project/Group projects (20%),
- Written Examination/Oral examination (40%).

Sources

Basic literature on the subject

Mahajan M., *Business Economics*. Nirali Prakashan, Pune, India, 2016.

Singh S. R., *Micro Economics*. APH Publishing Corporation, New Delhi, India, 2015.

Pratibha B., *Business Economics*. NMIMS Global Access School for Continuing Education, New Delhi, India, 2016.

Paul R., Ferguson Glenys J., Ferguson R., Rothschild R., *Business Economics: The Application of Economic Theory*, Palgrave, London, 1993.

List of websites

https://www.icsi.edu/media/webmodules/BUSINESS%20ECONOMICS.pdf

https://www.dphu.org/uploads/attachements/books/books_3926_0.pdf

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http://www.opentextbooks.org.hk/system/files/export/15/15497/pdf/Principles_of_Managerial_Economics_15497.pdf

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1. Introduction

This course presents a brief introduction of the changing mechanism of a market economy based on allocation of resources and distribution of income. As we are living in a globalised world, it has become an integral part of our lifestyle to know the basic economic concepts and laws, even for day-to-day activities. And this becomes more important for those involved in any business activities. The concept of Business Economy is based on supply and demand methods – supply only increases when demand increases. It simply means that customers or consumers are able to expand more as they are saving more which is enhancing consumers needs and producers or suppliers services in the market.

In such a market scenario when service sectors are growing, all service providers are increasingly trying to get acquainted with basic economic relationships between the consumer, producers and suppliers. This is obvious because they are stakeholders and concerned about economic activities in that particular market. For students (national & international), the fact is that they are the player in such an environment and facing such experiences in the market as a student today, and will be the part of this market either as a producer, consumer or service provider, tomorrow. Hence, it is necessary for them to understand the basic concept of economics, theories with practical experiences with case studies, company goals, cost factors, market conditions, and price factors. This course is designed by covering all such raised issues in the current socio-economic environment and challenges for businesses.

1.1. Meaning, Nature & Scope of Business Economics

The basic meaning of business economics can be understood as a subject providing a full guidance for understanding of market conditions, decision making mechanism and policy formulations. It also presents the actual business situations and practices. The measure of business economics is based on the application of economic concepts. It also concerns predicting economic figures like demand, profits, pricing, etc., which has vital importance for business communities. The nature and characteristics of business economics can be summarised as follows:

1. Business Economics is a fundamental Academic Subject.
2. Business Economics is concerned with administration of a business – Economic Rationale of Business Administration.
3. Microeconomic nature.
4. Allocation of best possible resources.
5. Uses the concepts and principles of the theory of the firm.
6. Market categories and conditions.
7. Profits, pricing and efficiencies for companies.
8. Helps to develop microlevel planning, and decision making mechanism.
9. Business economics is a Normative Science in its nature.
10. Business economics has status of a Natural Science.
11. Business economics is also an Applied Science.

Scope of Business Economics includes varieties of topics, and can be presented as follows:

- Scarcity of resources.
- Clear understanding of a company *vis-a-vis* the industry.
- Organisation of business.
- Supply and demand analysis.
- Cost behaviour and understanding of production.

- Pricing and distribution.
- Government policies and support.
- Macroeconomic environment of business consideration.
- Management and Capital circulation.
- Profit analysis.

1.2. Microeconomics

Microeconomics is a branch of economics that studies the behaviour of individual households and companies in making decisions on the allocation of limited resources. Generally, it is applied where goods and services are bought and sold. For example, an individual consumer faces a problem of distributing his income on various commodities which he can buy within the limited range of his income. He wants to do this with a view to maximising his personal satisfaction. This is a micro level problem and equilibrium of an individual consumer forms a part of microeconomics.

In other words, it analyses the market behaviour of individual consumers and companies in an attempt to understand the decision-making process of companies and households.

1.3. Micro foundations

The term micro foundation refers to the microeconomic analysis of the behaviour of individual households or companies, or any other agents involved in the exchange of a commodity (buying or selling something) that underpins the macroeconomic theory. The early theory presented by the Kenesian model is based on hypotheses about relationships between aggregate quantities, such as aggregate output, employment, consumption, and investment. It was criticised by many scholars as to whether these aggregate relationships were consistent with the principles of microeconomics. Therefore in current decades macroeconomists have attempted to combine microeconomic models of household and company behaviour to derive relationships between macroeconomic variables. We are going to discuss different economic models and understand different theoretical points of view.

1.4. Economic History

Economic history is the study of economies or economic phenomena in the past. Analysis in economic history is undertaken using a combination of historical methods, statistical methods, and by applying economic theory to historical situations and institutions. The topic includes business history, financial history and overlaps with areas of social history such as demographic and labour history.

1.5. Market Failure

Market failure is a concept within economic theory describing when the allocation of goods and services by a free market is not efficient. That is, there is another conceivable outcome where a market participant may be made better-off without making someone else worse-off. Market failure can be viewed as a scenario where individuals' pursuit of pure self-interest leads to results that are not efficient – that can be improved upon from the special point of view. Market failures are often associated with information asymmetries, non-competitive markets, principal agent problems, externalities, or public goods. The existence of a market failure is often used as a justification for government intervention in a particular market. Market failure can occur for three main reasons:

- If the market is “monopolised” or a small group of businesses hold significant market power,
- If production of the goods or services results in an externality, or
- If the goods or services are a “public good”

1.6. Market structure

Market structure is the number of companies manufacturing identical products which are homogeneous. The types of market structures include the following:

- Monopolistic competition, also called competitive market, where there is a large number of companies, each having a small proportion of the market share and slightly differentiated products.
- Oligopoly, in which a market is dominated by a small number of companies that together control the majority of the market share.
- Duopoly, a special case of an oligopoly with two companies.
- Monopsony, when there is only one buyer in a market.
- Oligopsony, a market where many sellers can be present but meet only a few buyers.
- Monopoly, where there is only one provider of a product or services.
- Natural monopoly, a monopoly in which economies of scale cause efficiency to increase continuously with the size of the company. A company is a natural monopoly if it is able to serve the entire market demand at a lower cost than any combination of two or more smaller, more specialised companies.
- Perfect competition, a theoretical market structure that features no barriers to entry, an unlimited number of manufacturers and consumers, and perfectly elastic demand curve.

1.7. Trade

Trade is the transfer of ownership of goods and services from one person or entity to another by getting something in exchange from the buyer. Trade is sometimes loosely called commerce of financial transaction or barter. A network that allows trade is called a market. The original form of trade was barter, the direct exchange of goods and services. Later one side of the barter started using metals, precious metals (poles, coins), bills, paper money. Modern traders generally negotiate through a medium of exchange instead, such as money. As a result, buying can be separated from selling, or earning. The invention of money greatly simplified and promoted trade. Trade between two traders is called bilateral trade, while trade between more than two traders is called multilateral trade.

2. Company Goals

What is the motivation of a company? What does a company try to achieve through various activities?

2.1. Economic Goals

- *Profit maximisation:* businesses are regarded as an economic entities with a basic objective of maximising profits. There are following objects of profit maximisation goals:
  - Driving Force of the modern capitalist society,
  - Determinate solution,
  - Proprietorships,
  - Assumption of competition,
  - Simplified model,
  - Rationality assumption.
- *Shareholder's Wealth Maximisation:* with growing uncertainties due to several reasons including a fierce competition among large-sized companies, innovative changes, technological advances and changes in the strategies of attracting the customers, it has become necessary for a company to attract stock-holders to the company's stock and maintain their interest in retaining the stocks. There are many strategies followed by companies for Shareholder's wealth maximisation:

- Branding of products,
- Strengthening core business,
- Cost-reduction measures,
- Value-Creating partnership,
- Sustaining growth.

- *Management Reward Maximisation:* the reward which managers seek to maximise in a form of several quantifiable variables. They include the salaries, rate of annual increment, compensation in terms of dearness allowance for offsetting real income loss due to inflation and city compensatory allowance, etc.
- *Growth of companies:* growth of companies is also referred to as size maximisation. By growth, the advocates of this goal focus on an increase in sales, assets and the number of employees.
- *Sales maximisation:* maximisation of sales rather than of profits is the ultimate objective of a company and that sales maximisation is the most valid assumption about the behaviour of the company.
- *Long-Run Survival:* the primary motive of a company is its long-run survival.

2.2. Non-Economic Goals

- Political Power, Prestige.
- Social Responsibility and Welfare.
- Goodwill of Employees.

3. Demand Analysis

In the market economy, market mechanisms perform several important functions. The most important functions performed by market mechanisms are, perhaps, the allocation of resources and distribution of income. The operation of the market mechanism is based on the working of the two forces of demand and supply.

- *Concept and definition of Demand:* according to prof. Hobdon, "Demand means the various quantities of a good that would be purchased per time period at different prices in a given market". Demand, from an economic point of view required following three things:
  - The price of a commodity,
  - The quantity of the commodity that a consumer or, consumers are willing to buy during a period of time, and
  - A given period of time.

- *Characteristics of Demand*
  - Desire of demand,
  - Price and demand,
  - Reference to a period of time.

- *Factors Determining Demand*
  - Price of the product,
  - Income and income distribution,
  - Number and prices of substitutes,
  - Consumers preferences, Tastes and Needs,
  - Number of consumers,
  - Consumer expectations,
  - Advertisement,
  - Other facilities.

3.1. Supply and Demand:

Supply and demand is an economic model of price determination in a market. It states that in a competitive market, the unit price for a particular good will vary until it settles at a point where the quantity demanded by consumers (at current price) meets the quantity supplied, resulting in an economic equilibrium of price and quantity. Therefore basic laws of supply and demand are as follows:

I. If demand increases and supply remains unchanged, then it leads to higher equilibrium price and higher quantity.
II. If demand decreases and supply remains unchanged, then it leads to lower equilibrium price and lower quantity.
III. If demand remains unchanged and supply increases, then it leads to lower equilibrium price and higher quantity.
IV. If demand remains unchanged and supply decreases, then it leads to higher equilibrium price and lower quantity.

Determinants of supply flow:

- Production costs, how much it costs to manufacture a good,
- The technology used in production, and technology advances,
- A good's own price,
- Companies' expectations about future prices,
- Number of suppliers

Determinants of demand flow:

- Income
- Taste and preferences
- Price of related goods and services
- Consumers' expectations about future prices and income that can be checked
- Number of potential consumers

4. Production and Cost Analysis

The relationship between the physical inputs and the physical outputs of a company is referred to as the production function. Mathematically, this relationship can be expressed as:
$p = f(a, b, c \dots n)$, where p, a dependent variable, stands for the rate of output and a, b, c ….. n are independent variables representing factors of production of inputs employed by the company, per unit of time.

4.1. Production function – Meaning

A company's primary concern is its production. It states the relationship between the output of the company's product and the combination of inputs or factors of production. Production means creation of utilities. Utility can be created in the following ways:

- Form utility: a wide range of productive activity creates form utility. Transforming a log of wood into a piece of furniture, a lump of gold into a necklace and fertility of soil interacting with seed into an ear of corn are all cases of creation of form utility.
- Place utility: utility can be created by changing the place of an object. Water from a river or reservoir is brought to the city; sand can be brought to a construction site; and timber is brought to a workshop. All these are productive activities.
- Time utility: preservation or storage creates this type of utility. A raincoat has utility in the rainy season and aged, preserved, rice or canned food get added value because they represent time-utility.

- Possession utility: utility can be created by changing possession. Grocery items or books change possession from their sellers to their users and they attain utility this way.
- Service utility: service, not embodied in a material or tangible object, also has utility. The services of doctors, lawyers, teachers, priests, singers, dancers, and snake charmers provide service utility to consumers.
- Knowledge utility: information can create knowledge utility. Medicinal properties of herbs and plants, when spread through passing information, can be harnessed to cure disorder.

4.2. Law of Variable Proportion – The Three stages

Production, in short run, is subject to the Law of Variable Proportions. This is because in the short-run, some factors are fixed and production levels can be changed only by changing factors which are variable. When one factor is changed and others are kept constant, the proportion in which these factors were originally combined also changed. This changed proportion has an impact upon the output. The Law of Variable Proportions seeks to study this impact on output.

A. *The Law of Diminishing Return.*
B. *Modern View.*
C. *Average-Marginal Relations.*
D. *Three Phases or Stages of the Law of Variable Proportion.*
E. *An Explanation of the three phases.*
F. *Assumptions of the Law of Variable Proportion.*

4.3. Law of Return to Scale – The Three Stages

Returns to scale are likely to be confused with what are known as laws of returns. It is therefore necessary to know the meaning of law of returns:

A. *Laws of returns and returns to scale:* according to Marshall, the part played by nature corresponded to diminishing returns and the part played by man to increasing returns. In agriculture, due to the constraints of nature, we experience diminishing returns; while in manufacturing industries we experience increasing returns because man can affect all sorts of economies.
B. *Illustrating Returns to Scale.*
C. *Explanation of Returns to Scale.*

4.4. Cost Analysis, Types of Cost

Clarity of cost concept is important in theory as well as in practice of a company. For one thing, whatever is the objective of a company, it is necessary to ascertain that it is not incurring losses. Besides, the firm is required to take decisions like expansion, adding new products, marketing of old products, etc. It is, therefore, necessary to have a clear idea of different cost concepts. The cost analysis is needed for:

I. Clearing the fallacies in the traditional outlook.
II. Providing a proper perspective to costs.
III. Analysis of accounting costs.
IV. Forecasting and policy making.

- *Types of Cost*
  A. *Total Cost,*
  B. *AverageCost,*
  C. *Marginal Cost,*
  D. *Opportunity Cost and Actual or Outlay Costs.*

5. Factor Pricing

In any type of production concerns every manufacturer has to utilise various factors of production. This makes it necessary for the manufacturer to determine the proportion of combining the factors of production. While doing this, it becomes necessary for him to take into account the type of market, the type of competition prevailing in the market, availability and productivity of different factors of production, etc. This is so because every manufacturer has to make his production profitable and because profit maximisation is and should be, the goal of the manufacturer. In order to achieve this, it is necessary to take into account prices of various factors of production. So, we have to consider how the prices of these factors of production are determined.

- *Concept of Marginal Productivity:* the productivity of every factor of production is of great importance; the case of a labourer, however, is an exception as his productivity cannot be operated from his person. So the productivities of labour and the labourer are regarded as one and the same and will be used synonymously in further discussion. The wages obtained by the labourer are always related to productivity. So, for our convenience, we will assume the following conditions:
  - There is a large number of buyers and sellers.
  - Perfect competition is present in the product market.
  - All factors of production are substitutable and are perfectly homogeneous or completely identical in all respects.
  - The number of hours of labourers for daily work is also fixed.
  - The type and prevailing conditions or the work environment are one and the same.
  - All labourers have a similar social status.
  - Labour is the one variable factor of production and all remaining factors of production are constant.

5.1. Marginal Productivity theory of Distribution:

The demand for a factor of production – let's say for labour – is the derived demand which comes from manufacturers in order to manufacture goods directly demanded by consumers. A manufacturer employs a factor of production because of its productivity or contribution which it makes to the production. The price he will be prepared to pay for that factor will therefore, depend upon its productivity. The greater the productivity of a factor, the higher will be its remuneration. The theory states that:

A. The remuneration of a factor will depend upon the productivity or contribution that it makes to the production;
B. The remuneration of a factor unit will be determined by and will be equal to the marginal productivity of that factor unit; and
C. Under certain conditions, the remuneration of a factor unit will be equal to both the average and marginal productivities of that factor.

- *The assumption of the marginal productivity theory*
  - Perfect competition in product market and market for factors of production,
  - Homogeneous units of factors of production,
  - Maximum profits,
  - Full employment,
  - Increase or decrease in production with small change in the quantity of a factor,
  - Perfect mobility of a unit of a factor of production,
  - Long period.

5.2. Rent

Many times, the terms which are ordinarily used to mean one thing in practice are used in a broader sense in economics. For example, rent is a term used in ordinary sense to define the payment made by a tenant to the owner of land to allow him to cultivate the land. But, in Economics, rent is a term used to define a differential surplus, accruing to any factor of production. Similarly, in Economics, the term land is also used to define all the free gifts of nature which can be used for production.

- How rent arises,
- Site rent,
- Scarcity rent,
- Rent and price,
- Quasi rent,
- Rent and Quasi rent.

5.3. Wages

One of the important factors of production is labour. The returns obtained by labour for contributing to the production are called wages.

- Real and money wages;
- Factors influencing real wages:
  - Purchasing power of money,
  - Perquisites,
  - Other benefits,
  - Periods and cost of training,
  - Trade expenses,
  - Working hours,
  - Working conditions,
  - Regularity of employment,
  - Family concessions,
  - Opportunities for extra earnings,
  - Prospects of promotion,
- Methods of wage determination.

5.4. Interest

Interest, in the area of economics, has its place of great importance. Level of investment in the country generally depends upon the rate of interest. How much investment will be made, whether it is worthwhile to invest, etc., are questions, the answers to which depend on the rate of interest. The central bank of a country controls the credit creation in a country by controlling the bank rate, which indicates the importance of the rate of interest in the economy.

- Gross and Net Interest:
  - Insurance Against Risk,
  - Reward for management,
  - Net Interest.
- The concept of Capital, Saving and Investment;
- Nominal and Real rate of interest;
- Theories of interest.

5.5. Profit

Maximisation of profit is the main object of modern production. That is why every manufacturer is very eager to find out whether the production will be profitable or not. He also tries to foresee the probable rate of profit because the future of the manufacturer and production entirely depends on

the profitability of the production. Profits are the returns to the factors of production known as investment.

- Concept of Profit as a residual income;
- Theories of Profits:
  - Dynamic Theory of Profit,
  - Innovation Theory of Profit,
  - Risk and Uncertainty Theory of Profit.

6. Course Revision

7. Question samples

- What is Business Economics? State its Nature.
- Explain the characteristics of Business Economics.
- Explain the Scope of Business Economics.
- Describe the various Economic Company Goals.
- Explain the concept of Demand.
- What is Price Elasticity of Demand? State its types.
- Describe the modern theory of Rent.
- Explain various types of costs.
- Explain the Law of Returns to Scale.

Short Notes:

- Social Responsibility and Welfare.
- Sales Maximisation.
- Marginal Productivity.
- Cost Analysis.
- Marginal Cost.
- Consumer’s Demand.
- Marginal Utility Approach.
- Scarcity Rent.
- Collective Bargaining.
- Gross Interest and Net Interest.
- Profit as Residual Income.

8. Examination

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