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CORE CONCEPT OF

BUSINESS ECONOMICS & ENVIRONMENT

1. What is economics? Briefly explain.
2. Point out the elements of business economics?
3. What do you understand by macro & micro economics? Please explain.
4. Illustrate the wealth definition?
5. Briefly explain the Marshall's definition.
6. Differentiate the wealth & welfare definition.
7. Define business economics & environment and point out its concept. What are the main reasons for the increasing importance of business economics & environment?

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Economics:

Economics is concerned with the application of economic concepts and economic analysis to the problems of formulating rational managerial decisions. This tutorial covers most of the topics of managerial economics including micro, macro, and managerial economic relationship; demand forecasting, production and cost analysis, market structure and pricing theory.

Definition of Economics-

As the science of decision-making, economic philosophy operates in our daily lives whether we realize it or not. When we are evaluating the interest rates on our credit cards or trying to decide whether to buy or lease a new car or go out to dinner or on vacation, these are all decisions we make using economic thinking. We live in a world of limited resources, and economics helps us decide how to use these limited inputs to satisfy our never-ending list of wants and needs. Economics is also a large field with a rich history that's been explored and examined by hundreds of influential people, ranging from philosophers to politicians.

In its most simple and concise definition, **economics** is the study of how society uses its limited resources. Economics is a social science that deals with the production, distribution, and consumption of goods and services. Economics focuses heavily on the **four factors of production**, which are land, labor, capital, and enterprise. These are the four ingredients that make up economic activity in our world today and can each be studied individually.

Economics is split into the following two broad categories of study:

- **Macro economics** - the branch of economics that studies the overall working of a national economy. It is more focused on the big picture and analyzing things such as growth, inflation, interest rates, unemployment, and

taxes. When you hear the Federal Reserve is raising interest rates or that the national unemployment rate is 7.5%, you are hearing about macroeconomic topics.

- **Micro economics** - the branch of economics that studies how households and businesses reach decisions about purchasing, savings, setting prices, competition in business, etc. It focuses at the individual level, while macroeconomics looks at the decisions that affect entire countries and society as a whole.

History, Timeline, & Notable Figures

The history of economics entails numerous figures, courses, and books and can be traced back thousands of years. We'll focus strictly on the last 300 years and what is often considered the beginning of modern day economic thinking. Here are a few of the most notable thinkers and their accomplishments:

1700s- Adam Smith is largely considered the father of modern economics and capitalism. Smith's *Wealth of Nations* has a huge impact on economic thought still today. He reasoned that markets would work best if left alone and promoted that little government intervention in the economy was best.

1800s- Thomas Malthus studied populations, and his main contributions include his work on the relationship between food supply and populations. Karl Marx is most noted for his advocacy of socialism and communism over capitalism, which he strongly denounced. He is arguably one of the most influential economists in history. Marx believed that communism was inevitable in the process of evolution.

Alfred Marshall focused on the study of microeconomics and wrote *Principles of Economics*, which is one of the most influential economic textbooks of all time. Marshall proposed the idea that economics was a scientific discipline that required more mathematics and less philosophy.

1900s- John Maynard Keynes was one of the most revolutionary economists of the 20th century. He argued against free market principles and promoted government involvement as a means of correcting depressions and recessions; the bailouts to large auto companies and banks in response to the recent recession are one such example of government involvement.

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Business Economics:

Business economics is the systemic application of pure economics which assists in decision making and forward planning process of business management. Business economics is that specik branch of general economics which joins the economic theories and business behavior. This is the micro part of economic science which is used in solving the practical problems of business.

Business economics in made up of two words i.e. business and economics. Business is meant to that human activity which is performed with the prime objective to learn optimum money. Hence, business is a practical activity. The second word economics is of theoretical character and studies the optimum uses of resources. The business

economics analyses the various theories of economics and implement them to practical usage so as to smoothen the decision – making and forward planning.

The teaching of economics is, thus, an abstract theorization with little connection to business. But theoretical models of economics are to be applied in business areas. Once theoretical models of economics are applied in business, the gap between economics and business gets minimized. The branch of managerial economics or business economics has established links between business and economics.

Business economics is, thus, an applied economics. Economics is the study of human beings (e.g., consumers, firms) in producing and consuming goods and services in the midst of scarcity of resources. Managerial or business economics is an applied branch of organising and allocating a firm's scarce resources to achieve its desired goals.

Managerial economics or business economics is economics applied in decision-making. Business economics, thus, interweaves economic principles and business. Business managers apply economic laws and principles while presenting business problems and their ways of solutions. Thus, business economics can be defined as the application of economic analysis to business problems faced by an enterprise. It provides a link between economic theory and the decision sciences in the analysis of managerial decision-making. It relies heavily on traditional economics and decision sciences.

Identification of the problems and the solving of the problems are the two crucial elements of decision-making of a business firm. Business economists help business managers in making sound business decisions. Business success, in fact, greatly depends on appropriate business decisions. However, appropriate decision-making is not an easy job in this changing world.

On the basis of past knowledge and experience, business managers take business decisions and make future plans. But decision-makers are constrained by the 'uncertainty' of the real world where changes occur either in a hidden way or in an open way. In this changing but uncertain world, an accurate decision-making is impossible even if talents of top quality business economists are employed.

It is due to this uncertainty, prediction or estimation relating to the volume of sales of a product, cost of production, profit, etc., is more likely to be imperfect. In other words, against the backdrop of uncertainty and a changing world, business managers will have to anticipate changes so that the impact of unfavorable situations becomes insignificant. Thus, business decision-making is an art.

Cultivation of this art is made through economic principles. In this sense, managerial economics is an applied economics. It is concerned with the application of economic concepts and analytical tools to the process of decision-making of a business enterprise.

Thus, managerial economics or business economics is a 'special branch of economics that bridges the gap between abstract economic theory and managerial practice. Through a process of application of the principles,

concepts and tools of economics to solve the managerial problems of a business enterprise, business economists have greatly minimised the problem of uncertainty arising in business.

The application field of economic theory is popularly known as business economics or managerial economics. Can economic theory be applied in business practice efficiently? Fritz Machlup, in answering this question, gave an analogy between the behaviour of a motorist deciding whether or not to overtake on a two-lane highway and the behaviour of a profit- maximising firm. Overtaking decision of the motorist involves construction of a very complex set of equations.

While overtaking, the motorist must have a knowledge about the weight, power, speed of the vehicle being driven, the condition of the road, weather, information about the number of vehicles plying on the highway, and a set of assumptions about the behaviour and objectives of other drivers. Unfortunately, even the most expert and cautious drivers do not have all these information. But the model-builder makes such unrealistic assumptions. Under the circumstance, the decision of overtaking in a two- lane highway seems to be next to impossible. In reality, all the drivers overtake dozens of times every day. Such overtaking decisions are deemed to be 'correct' only if accidents are not met with. If we compare this behavioural overtaking decision of a motorist with that of the behaviour of a profit-maximising firm, we will reach the same conclusion. A profit-maximising firm assumes that it has perfect information about costs and revenue conditions. But that too is an unrealistic assumption.

Still they assume such and are always guided by profit-maximising motive. **"Like the driver taking-the decision to overtake, managers 'behave' as if they had the relevant information, in which case they will behave like the profit- maximising model and that model will be a good predictor of their behaviour. "**

Characteristics of Business Economics:

Business economics is essentially concerned with the various decisions of a business enterprise. The unit of study of business economics is the firm. Thus, managerial economics studies decision-making behaviour of a firm or an industry. Microeconomics takes into account the behaviour of smaller economic agents, such as a firm or a consumer or an input owner.

It deals with the operation of a consumer, a firm involving the determination of price of a commodity, revenue, costs and, hence, profit levels, etc. Managerial economics is, thus, essentially microeconomic in character as it has its origin in theoretical microeconomics. Profs. H. C. Petersen and W. C. Lewis suggest that managerial economics should be thought of as applied microeconomics. It is an application of that part of microeconomics focusing on those

topics which are of great interest and importance to business managers. These topics include theories of demand, production and cost, profit-maximising model of the firm, optimal prices and advertising expenditures, government regulation, etc. Managerial economics is concerned with finding optimal solutions to business decision problems.

Secondly, economic concepts and principles of the 'theory of firm' are employed in business economics. Thus, in business economics, the main emphasis is given upon the firm, the environment in which the firm finds itself, and the business decision which firms have to take. In this sense, managerial economics is narrower in scope than pure economic theory.

Thirdly, broadly there are two main branches of economics—'positive' economics and 'normative' economics. Positive economics deals with 'description' while normative economics deals with 'prescription'. By building up propositions on the basis of a set of assumptions, positive economics tries to explain economic phenomenon.

Normative economics comments on the desirability of that phenomenon and suggests policy measures. Value judgments are, thus, pronounced in normative economics. In the words of Profs. Mote, Paul and Gupta: "Managerial economics is a part of normative economics as its focus is more on prescribing choice and action and less on explaining what has happened. Managerial economics draws on positive economics by utilizing the relevant theories as a basis for prescribing choices."

Fourthly, business economics not only seeks to investigate and analyse how and why businesses behave as they do but also the implications of their actions and policies for the industry in which they operate and, finally, for the economy as a whole. In this business environment, both internal and external factors work.

Business economics seeks to analyse various internal and external constraints that businesses experience in their process of growth and survival, draw conclusions as to how and why businesses behave as they do. **"Business economics therefore focuses on the issues relevant to a business and its operations, and to the business environment."** Thus, business economics is considered as applied economics. It casts away abstract economic theories. Managerial economists look at practical applications of theoretical models.

Finally, business economics is essentially microeconomic in character. In other words, macroeconomic theory has less relevance for managerial economics. Truly speaking, business economics should also deal with a wider environment—the macro-economy. Macroeconomics is concerned with the behaviour of the economic system in

totality. It studies the determination of aggregate national income, level of employment, general price level, the international balance of payments, etc.

It is true that aggregating economic trends or external economic factors do not directly affect business decisions of a firm. But what is true is that changing macro-economy not only influences aggregate or national income but also the demand for the product of a business firm. Efficient business managers must have awareness as well as keenness of studying and explaining macro- economic environment. In this sense, business economics cannot be devoid of macroeconomics.

Subject-Matter and Scope of Business Economics:

We know that managerial economics or business economics is applied microeconomics employed for the purpose of facilitating decision-making and forward planning. As far as decision-making and forward planning are concerned, one has to face the following problems:

Problem of resource allocation seems to be a pressing problem for any organisation. Resources are not plentiful. A firm has to organise scarce resources efficiently so that optimal outcomes are obtained. Such resource allocation problem includes production programming, transportation problem, etc. Non-optimal organisation of resources may spell disaster to any organisation.

Inventory and queuing are important problems to any firm. A firm has to hold an optimal level of stocks of raw materials and finished product so that business uncertainties can be minimised. Business managers must decide an optimal level of inventories. Such decisions are taken by firms after considering demand and supply conditions. Since forward planning by management is essential, a firm must make decisions—whether new machines are to be installed or more professionals are to be employed. As most of the decisions cannot be implemented simultaneously, the firm manager must make a trade-off between decisions. Taking a particular decision out of a variety of decisions is known as queuing problem. A manager places or queues alternative decisions and picks up a right one. Price fixation is another interrelated problem connected with decision-making. A firm has to take up a right pricing decision.

Finally, the decision-maker faces investment problems for a variety of reasons. Truly speaking, any forward planning by management involves investment problems which are by nature knotty. Investment problems boil down to the problems of allocating resources over time. A firm has to make decision about the volume of investment. It must decide where to invest, when to invest. It must know the sources of funds, etc.

Anyway, business economics is concerned with decision-making and forward planning.

The scope of business economics (both micro and macro variety) is a wider one since it "uses the logic of Economics, Mathematics and Statistics to provide effective ways of thinking about business decision problems." In view of this saying of Prof. D. C. Hague, we can argue that there are links between managerial economics and management science. In fact, the boundaries between the two subjects are not clear-cut but overlapping.

Managerial economics is largely an applied branch of microeconomics. Its macro economic content is not to be belittled. It uses the methods and techniques of microeconomics mostly in the field of management. As Haynes and William Warren state: "The relation of managerial economics to economic theory (of either the micro or macro variety) is much like that of engineering to physics, or of medicine to biology or bacteriology. It is the relation of an applied field to the more fundamental but more abstract basic discipline from which it borrows concepts and analytical tools."

It is to be pointed out here that measurement without theory may lead to false precision and diagnosis while theory without measurement can hardly be operationally useful. Now we are in a position to explain the scope of business economics. By scope of (business) economics we mean the field of the subject, the boundaries that delimit and delineate the topics to be addressed.

Determination of the scope of the subject includes:

(i) Definition of the subject,

(ii) Subject matter of business economics,

(iii) Is business economics a positive or a normative science?

Since business economics is thought of as applied microeconomics, the scope of business economics includes:

i. Analysis, estimation and forecasting of consumer demand for a product;

ii. Analysis of cost and output;

iii. Determination of price of a commodity, work policy and business strategies of a business enterprise;

iv. Long-run planning decisions of a firm that studies capital budgeting and capital management.

Managerial economics now includes 'operations research'—a mathematical technique to solve business problems.

Finally, we must say that there is a great deal of linkages between managerial economics and other disciplines and fields of study. It uses the logic of economics, mathematics and statistics. Managerial economics is related to management science or the decision sciences. Management science is concerned with techniques for improvement of decision-making.

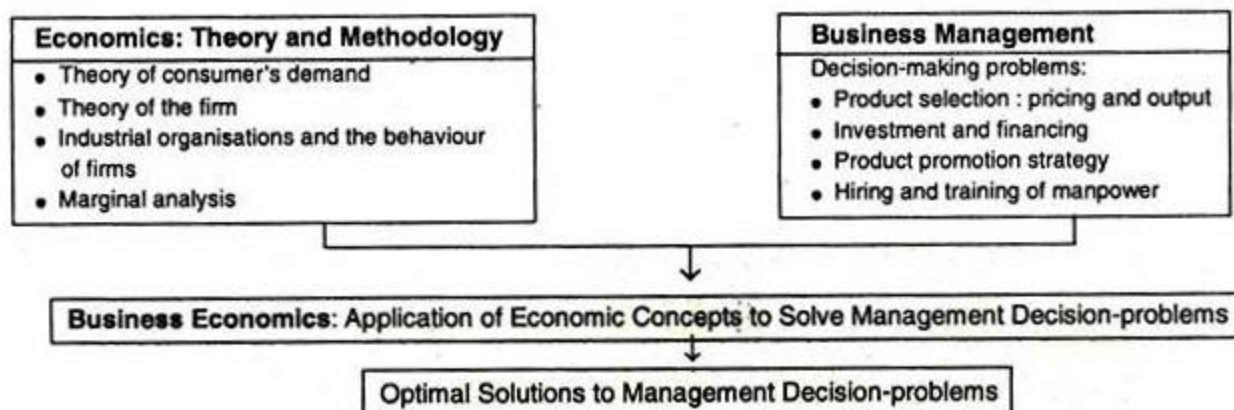
Business economics is related to accounting. Accounting is essentially concerned with recording and analysing the financial activities of a business firm. To quote Prof. D. C. Hague: "The main task of management accounting is now seen as being to provide the sort of data which managers need if they are to apply the idea of managerial economics to solve business problems correctly; accounting data are also to be provided in a form so as to fit easily into the concepts and analysis of managerial economics."

In view of the relationship between managerial economics and other disciplines, it may be called an art, and not a science. Though an art, decision-making in this uncertain world has become more perfect. Better choices, better prediction, etc., are likely to emerge because of the interaction among basic disciplines.

Thus, it is clear from the above discussion that managerial or business economics helps managers of firms, administrators of non-profit and profit-making hospitals, schools, colleges and universities to recognise how economic forces affect organisations. It applies economic theory and methods to business and administrative decision-making in both profit and non-profit sector.

Business economics links economic concepts with quantitative methods to develop tools for managerial decision-making. Business economics, thus, intends to bridge the gap that exists between economics and business management theory. This process is illustrated in Fig. 1.1.

Fig. 1.1 Economics, Business Management and Business Economics



Thus, business economics is closely linked with many disciplines (such as marketing, finance, management accounting, management science etc. in a business curriculum).

Adam Smith's Wealth Definition:

The formal definition of economics can be traced back to the days of Adam Smith (1723-90) — the great Scottish economist. Following the mercantilist tradition, Adam Smith and his followers regarded economics as a science of wealth which studies the process of production, consumption and accumulation of wealth. His emphasis on wealth as a subject-matter of economics is implicit in his great book— 'An Inquiry into the Nature and Causes of the Wealth of Nations or, more popularly known as 'Wealth of Nations'—published in 1776.

According to Smith: "The great object of the Political Economy of every country is to increase the riches and power of that country." Like the mercantilists, he did not believe that the wealth of a nation lies in the accumulation of precious metals like gold and silver.

To him, wealth may be defined as those goods and services which command value-in- exchange. Economics is concerned with the generation of the wealth of nations. Economics is not to be concerned only with the production of wealth but also the distribution of wealth. The manner in which production and distribution of wealth will take place in a market economy is the Smithian 'invisible hand' mechanism or the 'price system'. Anyway, economics is regarded by Smith as the 'science of wealth.'

Other contemporary writers also define economics as that part of knowledge which relates to wealth. John Stuart Mill (1806-73) argued that economics is a science of production and distribution of wealth. Another classical economist Nassau William Senior (1790-1864) argued "The subject-matter of the Political Economics is not Happiness but Wealth." Thus, economics is the science of wealth. However, the last decade of the nineteenth century

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saw a scathing attack on the Smithian definition and in its place another school of thought emerged under the leadership of an English economist, Alfred Marshall (1842-1924).

Criticisms:

Following are the main criticisms of the classical definition:

i. This definition is too narrow as it does not consider the major problems faced by a society or an individual. Smith's definition is based primarily on the assumption of an 'economic man' who is concerned with wealth-hunting. That is why critics condemned economics as 'the bread-and-butter science'.

ii. Literary figures and social reformers branded economics as a 'dismal science', 'the Gospel of Mammon' since Smithian definition led us to emphasise on the material aspect of human life, i.e., generation of wealth. On the other hand, it ignored the non-material aspect of human life. Above all, as a science of wealth, it taught selfishness and love for money. John Ruskin (1819-1900) called economics a 'bastard science.' Smithian definition is bereft of changing reality.

iii. The central focus of economics should be on scarcity and choice. Since scarcity is the fundamental economic problem of any society, choice is unavoidable. Adam Smith ignored this simple but essential aspect of any economic system.

Marshall's Welfare Definition:

Alfred Marshall in his book 'Principles of Economics published in 1890 placed emphasis on human activities or human welfare rather than on wealth. Marshall defines economics as "a study of men as they live and move and think in the ordinary business of life." He argued that economics, on one side, is a study of wealth and, on the other, is a study of man.

Emphasis on human welfare is evident in Marshall's own words: "Political Economy or Economics is a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being."

Thus, "Economics is on the one side a study of wealth; and on the other and more important side, a part of the study of man." According to Marshall, wealth is not an end in itself as was thought by classical authors; it is a means to an end—the end of human welfare.

This Marshallian definition has the following important features:

i. Economics is a social science since it studies the actions of human beings.

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ii. Economics studies the 'ordinary business of life' since it takes into account the money-earning and money-spending activities of man.

iii. Economics studies only the 'material' part of human welfare which is measurable in terms of the measuring rod of money. It neglects other activities of human welfare not quantifiable in terms of money. In this connection A. C. Pigou's (1877- 1959)—another great neo-classical economist—definition is worth remembering. Economics is "that part of social welfare that can be brought directly or indirectly into relation with the measuring rod of money." iv. Economics is not concerned with "the nature and causes of the Wealth of Nations." Welfare of mankind, rather than the acquisition of wealth, is the object of primary importance.

Criticisms: Though Marshall's definition of economics was hailed as a revolutionary one, it was criticised on several grounds.

They are:

i. Marshall's notion of 'material welfare' came in for sharp criticism at the hands of Lionel Robbins (later Lord) (1898- 1984) in 1932. Robbins argued that economics should encompass 'non- material welfare' also. In Teal life, it is difficult to segregate material welfare from non-material welfare. If only the 'materialist' definition is accepted, the scope and subject-matter of economics would be narrower, or a great part of economic life of man would remain outside the domain of economics.

ii. Robbins argued that Marshall could not establish a link between economic activities of human beings and human welfare. There are various economic activities that are detrimental to human welfare. The production of war materials, wine, etc., are economic activities but do not promote welfare of any society. These economic activities are included in the subject-matter of economics.

iii. Marshall's definition aimed at measuring human welfare in terms of money. But 'welfare' is not amenable to measurement, since 'welfare' is an abstract, subjective concept. Truly speaking, money can never be a measure of welfare.

iv. Marshall's 'welfare definition' gives economics a normative character. A normative science must pass on value judgments. It must pronounce whether a particular economic activity is good or bad. But economics, according to Robbins, must be free from making value judgment. Ethics should make value judgments. Economics is a positive science and not a normative science.

v. Finally, Marshall's definition ignores the fundamental problem of scarcity of any economy. It was Robbins who gave a scarcity definition of economics. Robbins defined economics in terms of allocation of scarce resources to satisfy unlimited human wants.

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Micro Vs Macro Economics-

The **micro economics** is the study of an economic behavior of a particular individual, firm, or household, i.e. it studies a particular unit. On the other hand, **macro economics** is the study of the economy as a whole i.e., not a single unit but the combination of all, firms, households, nation, etc. 'Economics' is defined as the study of how the humans work together to convert limited resources into goods and services to satisfy their wants (unlimited) and how they distribute the same among themselves. Economics has been divided into two broad parts i.e. Micro Economics and Macro Economics. Here, in the given article we've broken down the concept and all the important differences between micro economics and macro economics, in tabular form, have a look.

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Contents: Micro Economics Vs Macro Economics

1. Comparison Chart
2. Definition
3. Pros and Cons
4. Similarities
5. Conclusion

1. Comparison Chart

Basis for Comparison	Micro Economics	Macro Economics
Meaning	The branch of economics that studies the behavior of an individual consumer, firm, family is known as Microeconomics.	The branch of economics that studies the behavior of the whole economy, (both national and international) is known as Macroeconomics.
Deals with	Individual economic variables	Aggregate economic variables

Basis for Comparison	Micro Economics	Macro Economics
Business Application	Applied to operational or internal issues	Environment and external issues
Scope	Covers various issues like demand, supply, product pricing, factor pricing, production, consumption, economic welfare, etc.	Covers various issues like, national income, general price level, distribution, employment, money etc.
Importance	Helpful in determining the prices of a product along with the prices of factors of production (land, labor, capital, entrepreneur etc.) within the economy.	Maintains stability in the general price level and resolves the major problems of the economy like inflation, deflation, reflation, unemployment and poverty as a whole.
Limitations	It is based on unrealistic assumptions, i.e. In microeconomics it is assumed that there is a full employment in the society which is not at all possible.	It has been analyzed that 'Fallacy of Composition' involves, which sometimes doesn't proves true because it is possible that what is true for aggregate may not be true for individuals too.

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2. Definition

Micro Economics: Micro economics is the branch of economics that concentrates on the behaviour and performance of the individual units, i.e. consumers, family, industry, firms. Here, the demand plays a key role in determining the quantity and the price of a product along with the price and quantity of related goods (complementary goods) and substitute products, so as to make a judicious decision regarding the allocation of scarce resources, concerning their alternative uses. **Examples**: Individual Demand, Price of a product, etc.

Macro Economics: Macro economics is the branch of economics that concentrates on the behaviour and performance of aggregate variables and those issues which affect the whole economy. It includes regional, national and international economies and covers the major areas of the economy like unemployment, poverty, general price level, GDP (Gross Domestic Product), imports and exports, economic growth, globalisation, monetary/ fiscal policy, etc. It helps in resolving the various problems of the economy, thereby enabling it to function efficiently. E**xamples**: Aggregate Demand, National Income, etc.

3. On the Basis of Pros and Cons

Micro Economics:

Pros:

- It helps in the determination of prices of a particular product and also the prices of various factors of production, i.e. land, labour, capital, organisation and entrepreneur.
- It is based on a free enterprise economy, which means the enterprise is independent to take decisions.

Cons:

- The assumption of full employment is completely unrealistic.
- It only analyses a small part of an economy while a bigger part is left untouched.

Macro Economics

Pros:

- It is helpful in determining the balance of payments along with the causes of deficit and surplus of it.
- It makes the decision regarding economic and fiscal policies and solves the issues of public finance.

Cons:

- Its analysis says that the aggregates are homogeneous, but it is not so because sometimes they are heterogeneous.
- It covers only the aggregate variables which avoid the welfare of the individual.

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4. Similarities

As microeconomics focuses on the allocation of limited resources among the individuals, the macro economics examines that how the distribution of limited resources is to be done among many people, so that it will make the best possible use of the scarce resources. As micro economics studies about the individual units, at the same time, macro economics studies about the aggregate variables. In this way, we can say that they are interdependent.

5. Conclusion

Micro and Macro Economics are not contradictory in nature, in fact, they are complementary. As every coin has two aspects- micro and macroeconomics are also the two aspects of the same coin, where one's demerit is others merit and in this way they cover the whole economy. The only important thing which makes them different is the **area of application.**

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