**1 (a) Efficiency signifies a level of performance that describes using the least amount of input to achieve the highest amount of output. Efficiency requires reducing the number of unnecessary resources used to produce a given output including personal time and energy.**

**1 (b) Demand in economics means effective demand which can be defined as a desire backed up by willingness and ability to pay for particular period. Therefore the demand constitutes three important things.**

***(1) Effective Desire for a commodity***

 ***(a) Willingness to buy***

 ***(b) Ability to pay***

***(2) A point of time***

***(3) At given price***

**According to *Hansen*, "By demand we mean the quantity of a commodity that will be purchase at a particular price and not merely the desire of a thing."**

**1 (c) Supply is the willingness and ability of producers to create goods and services to take them to market. Supply is positively related to price given that at higher prices there is an incentive to supply more as higher prices may generate increased revenue and profits.**

**1 (d) According to *Ferguson* "The quantity demanded varies inversely with the price"**

 **Assumption of the Law**

* **There should be no change in the income of the consumers.**
* **There should be no change in the tastes and preferences of the consumers, because the law of demand applies only when the tastes and preferences of the consumers remain constant.**
* **There should be no change in the price of the related goods.**
* **There should be no change in the size of the population.**
* **There should be an equal distribution of the wealth.**

**1 (e) Total national income (GDP) divided by total population. It is not the average income (because it includes children and non-working population) but serves as an indicator of a country's living standards.**

# 2 (a) PRICE ELASTICITY OF DEMAND

Price elasticity of demand is defined as the percentage change in quantity demanded of a product due to the percentage change in its price, other things remaining constant. It can also be denoted as:

**ep=** $\frac{Percentage change in quantity demanded }{Percentage change in price}$

**ep=** $^{\frac{Δq}{q}×100}/\_{\frac{Δp}{p}×100}$**=** $\frac{Δqp}{Δpq}$

Assume that the demand for petrol reduces by 2% as a result of an increase in petrol prices by 10%. The price elasticity of demand for petrol is:

 $\frac{-2\%}{10\%}$ = -0.20

**Degrees of Price Elasticity** - Different commodities have different price elasticity’s. Some of the degrees are discussed below.

**1.Perfectly elastic demand**–Perfectly elastic demand is said to happen when a little change in price leads to an infinite change in quantity demanded. A slight fall in price will attract more consumers but the elasticity of demand will remain infinite.

***Perfectly Elastic Demand***

**Quantity Demanded**

**Price**

**D**

**Y**

**X**

**P**

**Q1**

**Q**

**O**

**ep=** ∞

**Q2**

In the adjacent graph quantity and price has been shown on X and Y-axis. The graph shows that at the ruling price OP the demand is infinite. A slight rise in price will contractthe demand to zero. A slight fall in price will attract more consumers but the elasticity of demand will remain infinite.

**2. Perfectly Inelastic Demand** - Under perfectly inelastic demand, irrespective of any rise or fallinprice of a commodity the quantity demandedremains the same. In this case, the elasticity of demand will be equal to zero.However, it is difficult to mark such rare occasion because even the demand for essentials of life does show degree of responsiveness to change in price.

***Perfectly Inelastic Demand***

**Quantity Demanded**

**Price**

**D**

**Y**

**X**

**P**

**P1**

**Q**

**O**

**ep= 0**

**P2**

In the adjacent graph quantity and price has been shown on X and Y axis. DD shows the perfectly inelastic demand. At price OP, the quantity demanded is OQ. When the price falls to OP2 from OP, the demand remains the same. However, it is difficult to mark such rare occasion because even the demand for essentials of life does show degree of responsiveness to change in price.

**3.Unitary Elastic Demand** - The demand is said to be unitary elastic when a given proportionate change in the price level brings about an equal proportionate change in the quantity demanded. The elasticity of demand in this case is exactly one.

***Unitary Elastic Demand***

**Quantity Demanded**

**Price**

**D**

**Y**

**X**

**P**

**Q**

**O**

**ep= 1**

**P1**

**D**

**Q1**

**=450**

In the adjacent graph quantity and price has been shown on X and Y-axis. DD shows the unitary elastic demand. When the price is OP, the quantity demanded is OQ. Now the price falls to OP1, the quantity demanded increases to OQ1. The graph shows that there is a proportionate change in quantity demanded due to proportionate change in the price of the goods.

**4.Relatively Elastic Demand –**Relatively elastic demand refers to situation in which a small change in price leads to a big change in quantity demanded. In such a case the elasticity of demand is said to be more than one.

 **ep**>**1**

**5.Relatively Inelastic Demand** - Under the relatively inelastic demand a given percentage change in price produces a relatively less percentage change in quantity demanded, in such a case elasticity of demand is said to be less than one. But this change is relatively less.

***Relatively Inelastic Demand***

**<450**

**Quantity Demanded**

**Price**

**D**

**Y**

**X**

**P**

**Q**

**O**

**ep**< **1**

**P1**

**D**

**Q1**

In the adjacent graph quantity and price has been shown on X and Y axis. DD is the demand curve which shows relatively inelastic demand. When the price falls from OP to OP1 quantity demanded also increases from OQ to OQ1. But this change is relatively less.

**2 (b) Change in Demand Due to Change in Price** - In this case there will be extension and contraction of demand, which are as follows.

**1. Extension of Demand** - Extension of demand refers to a situation in which there is an extension of demand due to reduction in the prices of the goods.

**Y**

**X**

**D**

**D**

**O**

**P=5**

**P1=1**

**Q=10**

**Q1=50**

**Extension in Demand**

**Price**

**Quantity Demanded**

|  |  |
| --- | --- |
| Price**P** | QuantityDemanded (**Qd)** |
| 5 | 10 |
| 1 | 50 |

The above chart depicts that when the price of the commodity falls to Rs. 1 the quantity demanded increase to 50 units. In the graph draw above DD is the demand curve. When the price is Rs. 5, quantity demanded is 10kg and the consumer at Point A. When the price falls to Rs.1,demands extends to 50 kg and the consumer move to point B. Movement along the demand curve from A to B is the extension of demand.

**2.Contraction of Demand** - Contraction of demand refers to a fall in demand due to rise in prices.

**Y**

**X**

**D**

**D**

**O**

**P1=5**

**P=1**

**Q1=10**

**Q=50**

**Contraction in Demand**

**Price**

**Quantity Demanded**

|  |  |
| --- | --- |
| Price**P** | Quantity Demanded (**Qd)** |
| 1 | 50 |
| 5 | 10 |

It is clear from the above given table and the graph that when the price of the commodity is increased there is decrease in the quantity demand of that commodity, as it is apparent that when price was Rs.1 the demand was 5 units and as soon the price increases to Rs.5 the quantity demanded diminishes to 1 units. In the graph DD is the demand curve, where in the demand has been shown on X axis and Price on the Y axis. Due to the change in the price of the commodity the consumers moves to a point movement along the demand curve from the lower point i.e. from B to a higher point i.e. A, which is called contraction in demand.

**2 (c)**

 Inflation is a sustained increase in the general price level of goods and services in an economy over a period of time.

##  Types of Inflation

### Demand Pull Inflation

This is when the aggregate demand in an [economy](https://www.toppr.com/guides/economics/indian-economy-1950-1990/types-of-economies/) exceeds the aggregate supply. This increase in the aggregate demand might occur due to an increase in the money supply or income or the level of public expenditure.

This concept is associated with full employment when altering the supply is not possible. 

In the graph above, SS is the aggregate supply curve and DD is the aggregate demand curve. Further,

* Op is the equilibrium price
* Oq is the equilibrium output

Exogenous causes shift the demand curve to the right to D1D1.  Therefore, at the current price (Op), the demand increases by qq2. However, the supply is Oq.

Hence, the excess demand for qq2 puts pressure on the price, increasing it to Op1. Therefore, there is a new equilibrium at this price, where demand equals supply. As you can see, the excess demand is eliminated as follows:

### Cost-Push Inflation

Supply can also cause inflationary pressure. If the aggregate demand remains unchanged but the aggregate supply falls due to exogenous causes, then the price level increases. Take a look at the graph below:

 

In the graph above, the equilibrium price is Op and the equilibrium output is Oq. If the aggregate supply falls, then the supply curve SS shifts left to reach S1S1.

Now, at the price Op, the demand is Oq but the supply is Oq2 which is lesser than Oq. Therefore, the prices are pushed high till a new equilibrium is reached at Op1.

At this point, there is no excess demand. Hence, you can see that inflation is a self-limiting phenomenon.

### Open Inflation

This is the simplest form of inflation where the price level rises continuously and is visible to people. You can see the annual rate of increase in the price level.

### Repressed Inflation

Let’s say that there is excess [demand](https://www.toppr.com/guides/business-economics/theory-of-demand/meaning-and-determinants-of-demand/) in an economy. Typically, this leads to an increase in price.

However, the Government can take some repressive measures like price [control](https://www.toppr.com/guides/business-studies/controlling/meaning-of-controlling/), [rationing](https://www.toppr.com/guides/accountancy/accounting-ratios/types-of-ratios/), etc. to prevent the excess demand from increasing the [prices](https://www.toppr.com/guides/business-studies/marketing/pricing/).

### Hyper-Inflation

In hyperinflation, the price level increases at a rapid rate. In fact, you can expect prices to increase every hour. Usually, this leads to the demonetization of an economy.

### Creeping and Moderate Inflation

* **Creeping**– In this case, the price level increases very slowly over an extended period of time.
* **Moderate** – In this case, the rise in the price level is neither too fast nor too slow – it is moderate.

### True Inflation

This takes place after the full employment of all the factor inputs of an economy. When there is full employment, the national output becomes perfectly inelastic. Therefore, more [money](https://www.toppr.com/guides/fundamentals-of-economics-and-management/money/quantity-theory-of-money/) simply implies higher prices and not more output.

### Semi-Inflation

Even before full [employment](https://www.toppr.com/guides/economics/employment/workers-and-employment/), an economy might face inflationary [pressure](https://www.toppr.com/guides/physics/force-and-pressure/introduction-to-pressure) due to bottlenecks from certain sectors of the economy

**2 (d)**

## SECTORS OF INDIAN ECONOMY

#### Three Sectors of Indian Economy: Primary, Secondary & Tertiary

On the basis of nature of activity Indian economy can be classified into primary, secondary and tertiary sectors.



#### Primary Sector of Indian Economy

» Primary Sector is directly dependent on the environment for manufacture and production.

» A primary sector is a sector whereby the raw materials are extracted from the earth.

» Primary Sector includes those activities which lead to the production of goods by exploitation of natural resources.

» Examples of primary sector activities are agriculture, fishing, mining, animal husbandry etc.

» In India, agriculture is the biggest example of the primary sector.

» However, forestry and fishing can also be cited as other examples of this particular sector.

» Primary sector is also known as agriculture and related sector.

|  |
| --- |
| » It produces natural products like cotton, milk, fruits, wheat, fish, rubber etc.  |

#### The Secondary Sector

» A secondary sector is a sector whereby the raw material that is extracted from earth is converted to semi- finished goods or finished goods.

» Secondary sector activities of the secondary sector follow the primary activities, in which the natural products are changed to manufacture different commodities.

» When the main activity involves manufacturing then it is the secondary sector.

» All industrial production where physical goods are produced come under the secondary sector thus, the secondary sector is also called the industrial sector.

» An agricultural product like cotton is woven into cotton fabric or sugar cane is processed to produce sugar.

» Secondary Sector covers activities in which natural products are changed into other forms through ways of manufacturing that we associate with industrial activity.

» Product is not produced by nature but has to be made and therefore some process of manufacturing is essential.

» It includes those activities which result in the transformation of natural products into other forms by manufacturing.

» It produces manufactured goods like cloth, sugar, bricks etc.

» It is also called the industrial sector as this sector has come to be associated with different kinds of industries.

» In the secondary sector of the national economy, natural ingredients are used to create products and services that are consequently used for consumption.

» Examples of secondary sector activities are manufacturing and construction.

#### Tertiary Sector

» Tertiary Sector activities help in the development of the primary and secondary sectors.

» These activities, by themselves, do not produce a good but they are an aid or a support for the production process.

» For example, goods that are produced in the primary or secondary sector would need to be transported by trucks or trains and then sold in wholesale and retail shops also called the service sector.

» A tertiary sector is a sector that transports and distributes goods to retailers or wholesalers.

» Like the secondary sector, it also provides value addition to a product.

» This sector is also known as the service sector.

» Tertiary Sector includes those activities that in the development of the primary & secondary sectors by supporting the production process.

» Tertiary Sector does not produce goods but generates services like transportation, communication, basting etc.

» Examples of tertiary sector activities are banking, insurance, finance etc.

» Tertiary sector also includes certain new services based on information technology like cyber cafes, ATM booths, call centers, software companies.

3 (a)

The upward and downward fluctuations in the cumulative economic magnitudes of a country show variations in different economic activities in terms of production, investment, employment, credits, prices, and wages. Such changes represent different phases of business cycles.

**The different phases of business cycles are :**

****

****

**1. Expansion:**

In expansion phase, due to increase in investment opportunities, idle funds of organizations or individuals are utilized for various investment purposes. Therefore, in such a case, the cash inflow and outflow of businesses are equal. This expansion continues till the economic conditions are favorable.

**2. Peak:**

The growth in the expansion phase eventually slows down and reaches to its peak. This phase is known as peak phase. In other words, peak phase refers to the phase in which the increase in growth rate of business cycle achieves its maximum limit. In peak phase, the economic factors, such as production, profit, sales, and employment, are higher, but do not increase further. In peak phase, there is a gradual decrease in the demand of various products due to increase in the prices of input.

The increase in the prices of input leads to an increase in the prices of final products, while the income of individuals remains constant. This also leads consumers to restructure their monthly budget. As a result, the demand for products, such as jewellery, homes, automobiles, refrigerators and other durables, starts falling.

**3. Recession:**

As discussed earlier, in peak phase, there is a gradual decrease in the demand of various products due to increase in the prices of input. When the decline in the demand of products becomes rapid and steady, the recession phase takes place.

In recession phase, all the economic factors, such as production, prices, saving and investment, starts decreasing. Generally, producers are unaware of decrease in the demand of products and they continue to produce goods and services. In such a case, the supply of products exceeds the demand.

**4. Trough:**

During the trough phase, the economic activities of a country decline below the normal level. In this phase, the growth rate of an economy becomes negative. In addition, in trough phase, there is a rapid decline in national income and expenditure.

In this phase, it becomes difficult for debtors to pay off their debts. As a result, the rate of interest decreases; therefore, banks do not prefer to lend money. Consequently, banks face the situation of increase in their cash balances.

Apart from this, the level of economic output of a country becomes low and unemployment becomes high. In addition, in trough phase, investors do not invest in stock markets. In trough phase, many weak organizations leave industries or rather dissolve. At this point, an economy reaches to the lowest level of shrinking.

**5. Recovery:**

As discussed above, in trough phase, an economy reaches to the lowest level of shrinking. This lowest level is the limit to which an economy shrinks. Once the economy touches the lowest level, it happens to be the end of negativism and beginning of positivism.

This leads to reversal of the process of business cycle. As a result, individuals and organizations start developing a positive attitude toward the various economic factors, such as investment, employment, and production. This process of reversal starts from the labor market.

Therefore producers are always able to earn a certain amount of profit, which increases at trough stage. The increase in profit also continues in the recovery phase. Apart from this, in recovery phase, some of the depreciated capital goods are replaced by producers and some are maintained by them. As a result, investment and employment by organizations increases. As this process gains momentum an economy again enters into the phase of expansion. Thus, a business cycle gets completed.

## 3 (b)

##  ****Liberalization****

The basic aim of [liberalization](https://www.toppr.com/guides/economics/liberalization-privatisation-and-globalisation/liberalization/) was to put an end to those restrictions which became hindrances in the development and growth of the nation. The loosening of government control in a country and when [private sector companies](https://www.toppr.com/guides/business-studies/private-public-and-global-enterprises/types-of-companies-and-forms-of-organising-public-sector/)’ start working without or with fewer restrictions and government allow private players to expand for the growth of the country depicts liberalization in a country.

### Objectives of Liberalization Policy

* To increase competition amongst domestic industries.
* To encourage foreign trade with other countries with regulated[imports and exports](https://www.toppr.com/guides/business-studies/international-business/importing-and-exporting/).
* Enhancement of foreign capital and technology.
* To expand global market frontiers of the country.
* To diminish the debt burden of the country.

## ****Privatization****

This is the second of the three policies of LPG. It is the increment of the dominating role of private sector companies and the reduced role of public sector companies. In other words, it is the reduction of [ownership](https://www.toppr.com/guides/legal-aptitude/jurisprudence/kinds-of-ownership/) of the management of a government-owned enterprise. Government companies can be converted into private companies in two ways:

* By disinvestment
* By withdrawal of governmental ownership and management of public sector companies.

### ****Forms of Privatization****

* ***Denationalization or Strategic Sale***: When 100% government ownership of productive assets is transferred to the private sector players, the act is called denationalization.
* ***Partial Privatization or Partial Sale***: When private sector owns more than 50% but less than 100% ownership in a previously construed public sector company by transfer of shares, it is called partial privatization. Here the private sector owns the majority of shares. Consequently, the private sector possesses substantial control in the functioning and autonomy of the company.
* ***Deficit Privatization or Token Privatization:*** When the government disinvests its share capital to an extent of 5-10% to meet the deficit in the budget is termed as deficit privatization.

### ****Objectives of Privatization****

* Improve the financial situation of the government.
* Reduce the workload of [public sector companies](https://www.toppr.com/guides/business-studies/private-public-and-global-enterprises/types-of-companies-and-forms-of-organising-public-sector/).
* Raise funds from disinvestment.
* Increase the efficiency of government organizations.
* Provide better and improved goods and services to the consumer.
* Create healthy competition in the society.
* Encouraging foreign direct investments (FDI) in India.

## ****Globalization****

It means to integrate the economy of one country with the global economy. During Globalization the main focus is on foreign trade & private and institutional foreign investment. It is the last policy of LPG to be implemented.

Globalization as a term has a very complex phenomenon. The main aim is to transform the world towards independence and integration of the world as a whole by setting various strategic policies. Globalization is attempting to create a borderless world, wherein the need of one country can be driven from across the globe and turning into one large economy.

### ****Outsourcing as an Outcome of Globalization****

The most important outcome of the globalization process is Outsourcing. During the outsourcing model, a company of a country hires a professional from some other country to get their work done, which was earlier conducted by their internal resource of their own country. Various Business Process Outsourcing companies or call centers, which have their model of a voice-based business process have developed in India. Activities like accounting and book-keeping services, clinical advice, banking services or even education are been outsourced from developed countries to India. The most important advantage of outsourcing is that big [multi-national corporate](https://www.toppr.com/guides/business-environment/scales-of-business/multinational-corporations-mnc/) or even small enterprises can avail good services at a cheaper rate as compared to their country’s standards. The skill set in India is considered most dynamic and effective across the world. Indian professionals are best at their work. The low wage rate and specialized personnel with high skills have made India the most favourable destination for global outsourcing in the later stage of reformation.

**4 (a)** National income is an uncertain term which is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways. In common parlance, national income means the total value of goods and services produced.

**Methods to measure the National income:**

#### 1) Product Method:

According to this method, the total value of final goods and services produced in a country during a year is calculated at market prices. To find out the GNP, the data of all productive activities, such as agricultural products, wood received from forests, minerals received from mines, commodities produced by industries, the contributions to production made by transport, communications, insurance companies, lawyers, doctors, teachers, etc. are collected and assessed at market prices. Only the final goods and services are included and the intermediary goods and services are left out.

#### (2) Income Method:

According to this method, the net income payments received by all citizens of a country in a particular year are added up, i.e., net incomes that accrue to all factors of production by way of net rents, net wages, net interest and net profits are all added together but incomes received in the form of transfer payments are not included in it. The data pertaining to income are obtained from different sources, for instance, from income tax department in respect of high income groups and in case of workers from their wage bills.

#### (3) Expenditure Method:

According to this method, the total expenditure incurred by the society in a particular year is added together and includes personal consumption expenditure, net domestic investment, government expenditure on goods and services, and net foreign investment. This concept is based on the assumption that national income equals national expenditure.

#### (4) Value Added Method:

Another method of measuring national income is the value added by industries. The difference between the value of material outputs and inputs at each stage of production is the value added. If all such differences are added up for all industries in the economy, we arrive at the gross domestic product.

4 (b)

# DETERMINANTS OF DEMAND OR FACTORS AFFECTING DEMAND:

1. Price of Commodity

2. Price of Related Goods: These goods are two types, viz substitute goods and complementary goods. Substitute goods are those which can replace each other in use like tea and coffee while the complementary goods are those which are jointly demanded as petrol and car.

3. Income of the Consumers - The demand for the normal goods rises, with an increase in income and falls with a fall in income. In case of inferior goods the demand falls with an increase in income and arises with decreases in income.

4. Distribution of Wealth - If there is an equal distribution of wealth in the society; the demand will be higher and in case of inequality demand will be less.

5. Tastes and Preferences - Tastes and preferences of the consumers also influences the demand to a greater extent they include fashions, habits, customs and advertisements, climate etc.

6. Government Policies -The government imposes taxes on various commodities which lead to an increase in the prices of the commodities.

7. State of Business - If the country is passing through the period of boom, there will be an increase in the market demand. During the period of depression, the market demand will be on the lower side.

**8. Population Growth -**Increase in population leads to an increase in demand for types of goods whereas decrease in population means less demand for such commodities.

**5 (a) Change in Demand Due to Change in Other Factor**-There are various factors other than price, which affect the demand in the market like fashion, customs, habits etc. and the effect of change in those factors results in:

**1.Increase in Demand -** Increase in demand refers to a situation when there is more demand at the same price or the same demand at higher prices. In such a case, there will be a shift in demand curve in the upward direction.

***I: When P constant & Q increases;* *II: When P increases & Q constant***

**Y**

**D**

**D**

**D1**

**D1**

**P=10**

**X**

**O**

**Q=20**

**Q1=30**

**Y**

**D**

**D**

**D1**

**D1**

**P=10**

**X**

**O**

**Q=20**

**P1=20**

|  |  |
| --- | --- |
| P | Q |
| 10 | 20 |
|  10 | 30 |

|  |  |
| --- | --- |
| P | Q |
| 10 | 20 |
| 20 | 20 |

It is clear that in the first case there is same price i.e. Rs.10 but initially the demand is 20, which increases to 30. In the second case, we see that when price changes i.e. increases from Rs.10 to Rs.20, demand remains the same. Thus same price more demand and more price but the same demand. In both the cases we call it increase in demand; in the graph given DD is the original demand curve. When the price of a commodity is OP1 the consumer is at point OQ1. Now due to change in any factor other than price, the demand curve shifts to D1D1. New demand curve indicates that the price being same the demand for commodity increases from OQ to OQ1. In the same way, the demand curve signifies that as the price increases i.e. from OP to OP1 the demand remains the same.

**2. Decrease in Demand** - Decrease in demand means that either less quantity is demanded at the same price or same quantity at a lower price. In such case the demand curve shifts downward.

***I: When P constant & Q decreases;* *II: When P decreases & Q constant***

**Y**

**D**

**D**

**D1**

**D1**

**P=10**

**X**

**O**

**Q1=10**

**Q=20**

**Y**

**D**

**D**

**D1**

**D1**

**P1=05**

**X**

**O**

**Q=20**

**P=10**

|  |  |  |
| --- | --- | --- |
| **Case** | **P** | **Qd** |
| ***I*** | *10* | *20* |
| *10* | *10* |

|  |  |  |
| --- | --- | --- |
| ***Case*** | ***P*** | ***Qd*** |
| ***II*** | *10* | *20* |
| *05* | *20* |

*The table shows that in first case when there is same price, demand for a commodity shifts downward from 20 to 10. This is called decrease in demand. On the other hand in the second case, we see that as price decreases from Rs.10 to Rs.5, demand for a commodity remains constant. This is also the same type of situation of decrease in demand. The graph shows DD which is the original demand curve. The demand curve signifies the fact that at the same price demand decreases OQ to OQ1 at the same price of OP.When the price of a commodity is OP, the demand for a commodity is OQ. Now suppose due to change in factors, the demand curve shifts to D1D1 which indicates the situation of decrease in demand.*

**5 (b)**

**According to *Spencer and Seigalman*:** “Managerial economics is the integration of economic theory with business practice for the purpose of facilitating decision-making and forward planning by management”.

**Business Management**- Decision Problems like assessment of investible funds; Selecting Business area; Determining optimum output, Price of the product, Input combination and technology, Sales promotion, Choice of product etc.

**Economics: Theory &Methodology** :Mathematical Tools

:Statistical Tools

:Econometrics

:Opportunity,

:Discounting etc.

**Managerial Economics = Management + Economics**

Managerial Economics- Application of Economic Concepts, Theories and Analytical Tools to solving problems

Optimum Solution to Business Problems

# SCOPE OF BUSINESS ECONOMICS

The scope of business economics comprehends all those economic concepts, theories and tools of analysis which can be used to analyze the business situation and to find solution to practical business problems. The areas of business issues to which economic theories can be directly applied may be broadly divided into two categories.

**A. Microeconomic Issues/Operational Issues/Internal Issues**.

They include all those problems which arise within the business organization and fall within the purview and control of the management. Some of the internal issues are

* Choice of business and the nature of product
* Choice of size of the firm
* Choice of technology
* Choice of price
* How to promote sales
* How to manage profit and capital
* How to manage inventory

Given below are some of the scopes of business economics covered under internal issues of a business enterprises:

**1. Demand Analysis and Forecasting** - A firm must decide its total output before preparing its production schedule and deciding on the resources to be employed*.* Demand forecast can also serve as a guide to the management for maintaining its market share in competition with its rivals, thereby securing profits. Demand analysis also facilitates the identification of the various factors affecting the demand for its output.

**2. Cost and Production Analysis** - Firms profitability depends upon its costs of production. A wise manager would prepare cost estimates of a range of output, identify the factors causing variations in costs and choose the cost minimizing output level, taking also into consideration the degree of uncertainty in production and cost calculation. In this whole process the various tools and logics of business economics is usually applied by him.

**3. Pricing Decision, Policies and Practices** - Business Economics scope ranges to the pricing policies of the firm. A business manager makes uses of various market analysis tools to determine the price of the product as well as find out the breakeven point of the firm.

**4. Profit Management** - Economics tells us that profit is the reward for uncertainty bearing and risk taking. A successful manager is one who can form more or less correct estimates of cost and revenue likely to accrue to the firm at different levels of output. In fact profit planning and profit measurement constitutes the most of the challenging of Business Economics.

**5. Capital Management** - Business Economics finds its application in the sphere of capital management too. Capital Investment is a long term investment in plant and machinery, lands or any other fixed assets, therefore before coming to any conclusion regarding capital investment, business managers usually analyze the whole business situation and plan and control capital investment and capital expenditure.

**B. Macroeconomic issues/External issues/Environmental issues**

**1. General Trend in Economic Activities** - By general trend in the economic activities of the country we mean investment climate, price trends and trends in output and employment. These factors not only determine the prospects of private business, but also greatly influence the functioning of individual firms. Therefore while planning about the size of the firm, business managers finds the answers to the question like, what is the consumption level of the economy, what are the trends in the economic system of the country?

**2. Issues related to Foreign Trade** - Due to the infusion of globalization, business units get affected by each and every small movement in the business world operating globally. An economy gets affected by the trade relations with other countries. Fluctuations in the international market exchange rate and inflows and outflows of capital in an open economy have a serious bearing on its economic environment and thereby on the functioning of its business undertakings. The managers of a firm would, therefore be interested in knowing the trends in international trade, prices*,* exchange rates and prospectus in the international market

**3. Government Policies** - The government policies and its various regulatory measures are designed by and large to minimize the conflicts in between the firm and society. The managers should therefore be fully aware of aspiration of the people and give such factors due consideration in their decisions. The economic concepts and tools of analysis help in determining such costs, and benefits.