Lesson - 1

Business Economics- Meaning, Nature, Scope and significance

Introduction and meaning :

Business Economics, also called Managerial Economics, is the application of economic theory and methodology to business. Business involves decision-making. Decision making means the process of selecting one out of two or more alternative courses of action. The question of choice arises because the basic resources such as capital, land, labour and management are limited and can be employed in alternative uses. The decision-making function thus becomes one of making choice and taking decisions that will provide the most efficient means of attaining a desired end, say, profit maximation.

Different aspects of business need attention of the chief executive. He may be called upon to choose a single option among the many that may be available to him. It would he in the interest of the business to reach an optimal decision- the one that promotes the goal of the business firm. A scientific formulation of the business problem and finding its optimals solution requires that the business firm is he equipped with a rational methodology and appropriate tools.

Business economic meets these needs of the business firm. This is illustrated in the following presentation.

Economic Theory and Methodology	Decision problems in Business

Business Economic
Application of Economic
Theory and Methodology to
solving Business problems

Optimal Solution
to Business
Problems

it may be that business economics serves as a bridge between economic theory and decision-making in the context of business.

According to Mc Nair and Meriam, "Business economic consists of the use of economic modes of thought to analyse business situations."

Siegel man has defined managerial economic (or business economic) as "the integration of economic theory with business practice for the purpose of facilitating decision-making and forward planning by management."

We may, therefore, define business economic as that discipline which deals with the application of economic theory to business management. Business economic thus lies on the borderline between economic and business management and serves as a bridge between the two disciplines.

Nature of Business Economics :

Traditional economic theory has developed along two lines; viz., normative and positive. Normative focuses on prescriptive statements, and help establish rules aimed at attaining the specified goals of business. Positive, on the other hand, focuses on description it aims at describing the manner in which the economic system operates without staffing how they should operate.

The emphasis in business economics is on normative theory. Business economic seeks to establish rules which help business firms attain their goals, which indeed is also the essence of the word normative. However, if the firms are to establish valid decision rules, they must thoroughly understand their environment. This requires the study of positive or descriptive theory. Thus, Business economics combines the essentials of the normative and positive economic theory, the emphasis being more on the former than the latter.

Scope of Business Economics :

As regards the scope of business economics, no uniformity of views exists among various authors. However, the following aspects are said to generally fall under business economics.

1. Demand Analysis and Forecasting
2. Cost and production Analysis.
3. Pricing Decisions, policies and practices.
4. Profit Management.
5. Capital Management.

These various aspects are also considered to be comprising the subject matter of business economic.

1. Demand Analysis and Forecasting :

A business firm is an economic organisation which transform productive resources into goods to be sold in the market. A major part of business decision making depends on accurate estimates of demand. A demand forecast can serve as a guide to management for maintaining and strengthening market position and enlarging profits. Demands analysis helps identify the various factors influencing the product demand and thus provides guidelines for manipulating demand.

Demand analysis and forecasting provided the essential basis for business planning and occupies a strategic place in managerial economic. The main topics covered are: Demand Determinants, Demand Distinctions and Demand Forecastmg.

2. Cost and Production Analysis :

A study of economic costs, combined with the data drawn from the firm’s accounting records, can yield significant cost estimates which are useful for management decisions. An element of cost uncertainty exists because all the factors determining costs are not known and controllable. Discovering economic costs and the ability to measure them are the necessary steps for more effective profit planning, cost control and sound pricing practices.

Production analysis is narrower, in scope than cost analysis. Production analysis frequently proceeds in physical terms while cost analysis proceeds in monetary terms. The main topics covered under cost and production analysis are: Cost concepts and classification, Cost-output Relationships, Economics and Diseconomics of scale, Production function and Cost control.

3. Pricing Decisions, Policies and Practices :

Pricing is an important area of business economic. In fact, price is the genesis of a firms revenue and as such its success largely depends on how correctly the pricing decisions are taken. The important aspects dealt with under pricing include. Price Determination in Various Market Forms, Pricing Method, Differential Pricing, Product-line Pricing and Price Forecasting.

4. Profit Management :

Business firms are generally organised for purpose of making profits and in the long run profits earned are taken as an important measure of the firms success. If knowledge about the future were perfect, profit analysis would have been a very easy task. However, in a world of uncertainty, expectations are not always realised so that profit planning and measurement constitute a difficult area of business economic. The important aspects covered under this area are : Nature and Measurement of profit, Profit policies and Technique of Profit Planning like Break-Even Analysis.

5. Capital Management :

Among the various types business problems, the most complex and troublesome for the business manager are those relating to a firm’s capital investments. Relatively large sums are involved and the problems are so complex that their solution requires considerable time and labour. Often the decision involving capital management are taken by the top management. Briefly Capital management implies planning and control of capital expenditure. The main topics dealt with are: Cost of capital Rate of Return and Selection of Projects.

Conclusion :

The various aspects outlined above represent major uncertainties which a business firm has to reckon with viz., demand uncertainty, cost uncertainty, price uncertainty, profit uncertainty and capital uncertainty. We can therefore, conclude that the subject matter of business economic consists of applying economic principles and concepts to dea1 with various uncertainties faced by a business firm.

Significance of Business Economics :

The significance of business economics can be discussed as under :

1. Business economic is concerned with those aspects of traditional economics which are relevant for business decision making in real life. These are adapted or modified with a view to enable the manager take better decisions. Thus, business economic accomplishes the objective of building a suitable tool kit from traditional economics.

2. It also incorporates useful ideas from other disciplines such as psychology, sociology, etc. If they are found relevant to decision making. In fact, business economics takes the help of other disciplines having a bearing on the business decisions in relation various explicit and implicit constraints subject to which resource allocation is to be optimized.

3. Business economics helps in reaching a variety of business decisions in a complicated environment. Certain examples are :

   (i) What products and services should be produced?

   (ii) What input and production technique should be used?

   (iii) How much output should be produced and at what prices it should be sold?

(iv) What are the best sizes and locations of new plants?

(v) When should equipment be replaced?

(vi) How should the available capital be allocated?

4. Business economics makes a manager a more competent model builder. It helps him appreciate the essential relationship Characterising a given situation.

5. At the level of the firm. Where its operations are conducted though known focus functional areas, such as finance, marketing, personnel and production, business economics serves as an integrating agent by coordinating the activities in these different areas.

6. Business economics takes cognizance of the interaction between the firm and society, and accomplishes the key role of an agent in achieving the its social and economic welfare goals. It has come to be realised that a business, apart from its obligations to shareholders, has certain social obligations. Business economics focuses attention on these social obligations as constraints subject to which business decisions are taken. It serves as an instrument in furthering the economic welfare of the society through socially oriented business decisions.

Conclusion :

The usefulness of business economics lies in borrowing and adopting the toolkit from economic theory, incorporating relevant ideas from other disciplines to take better business decisions, serving as a catalytic agent in the process of decision making by different functional departments at the firm's level, and finally accomplishing a social purpose by orienting business decisions towards social obligations.