Business Economics and Financial Analysis

UNIT I :

INTRODUCTION TO BUSINESS AND ECONOMICS

Definitions of Business

- Business as a system is a combination of business commerce, occupations, and organizations that produces and distributes the goods and services that create value for people in a society.

Structure of business firm

- Sole proprietorship
- Partnership
- Limited Liability Company (2 types)
- i) Private Limited Company
- ii) Public Limited Company
-     a) Public Traded Listed Comapny

Theory of a Firm

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

Types of Business Entities

Under Business Registration Act 1956 (Amendment 1978) & Procedures Of Business Registration 1957:

- Sole Proprietorship
- Partnership

Under Company Act 1965

- Limited Company by Guarantee
- Limited Company by Share
  - Private Limited Company (Sendirian Berhad)
  - Public Limited Company
  - Foreign Owned Company
- Unlimited Company

LIMITED LIABILITY COMPANIES

- A Limited Liability Company is the U.S. Specific form of a Private Limited Company. It is a business structure that can combine pass through taxation of a partnership or sole proprietorship with the limited liablity of a corporation.

Advantages

- Choice of tax regime
- The owners of the LLC Called members, are protected from some or all liability for acts and debts of the LLC, depending on state shield laws.
- Much less administrative paperwork and record keeping than a corporation.
- LLCs in some states can be set up with just one natural person involved.

Disadvantages

- The Principals of LLC use may different titles – e.g. member, manager, managing member, managing director, chief executive director.
- It may be more difficult to raise financial capital.

Sources of capital for a company

- Commercial Banks
- Commercial Finance Companies
- Leasing companies.
- State and Local Government Lending Programs.
- Trade credit and Peer to Peer Lending
- Private Investors.
- Institutional Venture capital Firms.
- Strategic Investors and Corporate Venture Capitalists.

Sources for Finance . . .

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

Non Conventional Sources of Finance

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

ECONOMICS

Economics is a logic of choice. It teaches the art of rational decision making in economizing behavior to deal with the problem of scarcity.

what is economics?

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

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

An economic problem arises on account of the following reasons

1.Unlimited wants

2.Limited resources

3.Alternative use of resources

4.Problem of choices

Definitions

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

Difference between Micro and Macro economics

Micro economics	Macro economics
1. It studies the small part of the economy	1. It studies the large part of the economy
2. It is a study of individual units of the economy	2. It study the whole economy
3. Partial picture of the economy	3. It gives total picture of the economy
4. It covers limited area of study	4. It covers a wider scope
5. It gives worms eye view of the economy	5. It gives us birds eye view of the economy

Difference between economics and business economics

Economics

1. It is more comprehensive and wider in scope
2. It is concerned with body of principles
3. It includes both micro and macro economics
4. It is based on no of assumption
5. It is both positive and normative science
6. It discusses general economic problems
7. Model building is the main function of the economist

Business Economics

1. It is too narrow and has limited scope
2. It deals with the application of economic principles to the problems faced
3. It is micro in nature
4. The scope of assumptions are limited as it is concerned with application of theories
5. It is mainly a normative science
6. It deals with the problems of a firm only
7. Decision making and forward planning is the main function of the business economist

Significance of Micro economics

- It explains price determination and allocation of resources
- It has relevance in business decision making
- It serves as a guide for business planning
- It serves as a basis for prediction
- It teaches the area of economising
- It is useful in determination of economic policies of the government
- It serves as the basis for welfare economics
- It explains the phenomena of International trade

Limitation of Micro Economics

- Theories are abstract
- Theories are static based on ceteris paribus that is assuming other things being equal
- It assumes laissez faire policy
- It cannot explain the functioning of the economy at large
- Unrealistically assumes full employment

Importance of Macro Economics to managers

- It explains the working of the economic system as a whole.
- It examines the aggregate behavior of the macro economic entities like firms households and the government.
- Its knowledge is indispensable for policy makers for formulating macro economic policies such as monetary policy ,fiscal policy etc.
- Useful in preparing economic plans
- Its study facilitate overall purpose of control and prediction.

Limitation

- It ignores individual behaviors
- Tendency of excessive generalization.
- Not easy to get correct and complete measures of economic aggregates.
- It is based on rough indicators, therefore predictions are not fully reliable.
- Macro level policies may not produce the same results at micro levels.

Important Concepts of National Income

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

Meaning of National Income

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

Importance :

- When the National Income is divided by the population of the country we get the average per capita income which is an indicator of the standard of living of people.
- Based on International comparison of per capita incomes, countries can be classified as developed and underdeveloped.
- The problems of less developed countries are clearly analysed by making use of national income estimates.

INFLATION:

Inflation: a key **concept** in Economics. Percentage increase in price level. When most prices grow, there is **inflation**, provided the other prices don't drop too heavily. If **inflation** is not compensated by nominal increases of income, people become poorer.

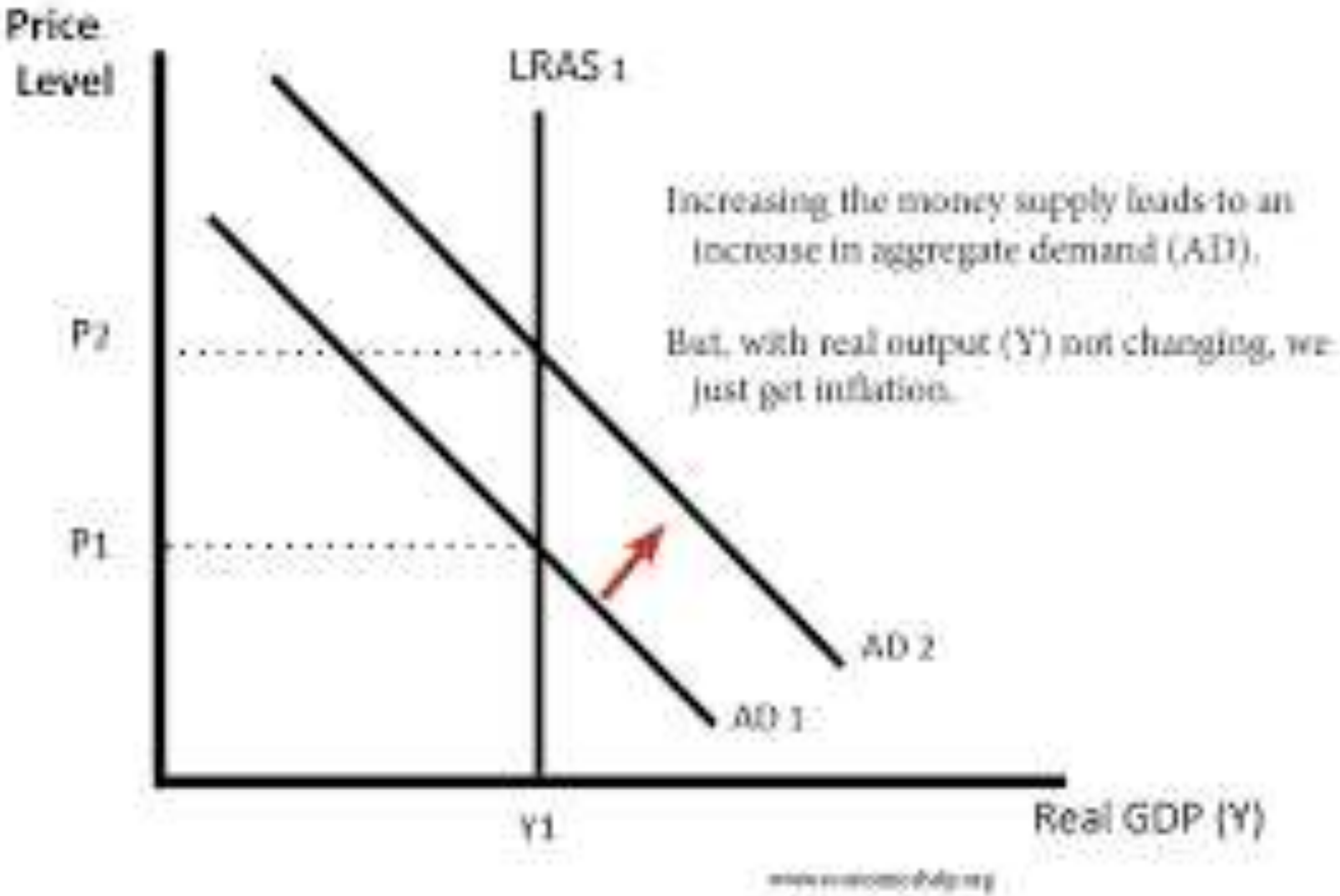
Meaning of Inflation

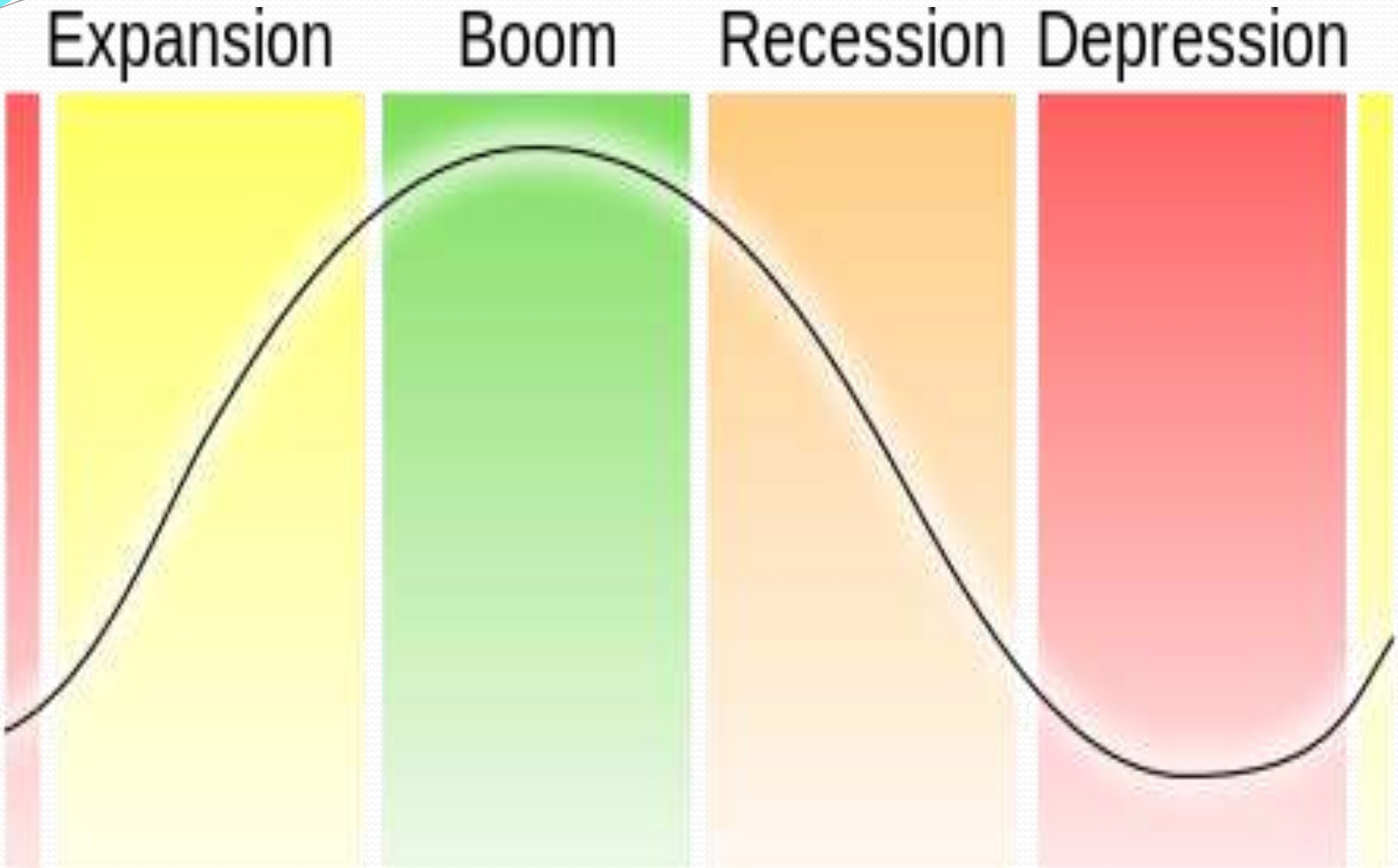
Persistent Upward Movement in General Price Level

Decline of Purchasing Power

<u>MONEY SUPPLY IN INFLATION:</u>

The increase in demand for goods and services may cause a rise in imports. Although this leakage from the domestic economy reduces the **money supply**, it also increases the **supply** of **money** on the foreign exchange market thus applying downward pressure on the exchange rate. This may cause imported **inflation**.


Price Level
LRAS 1
Increasing the money supply leads to an increase in aggregate demand (AD).
But, with real output (Y) not changing, we just get inflation.
P2
P1
AD 2
AD 1
Y1
Real GDP (Y)


Expansion
Boom
Recession
Depression

Business Cycles

- The business cycle is the periodic but irregular up-and down movement in economic activity, measured by fluctuations in real gross domestic product (GDP) and other macro economic variables.
- How do we measure “ Up –and-down movement in business activity” - Percentage change in Real GDP.

Features and Phases of Business Cycles

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

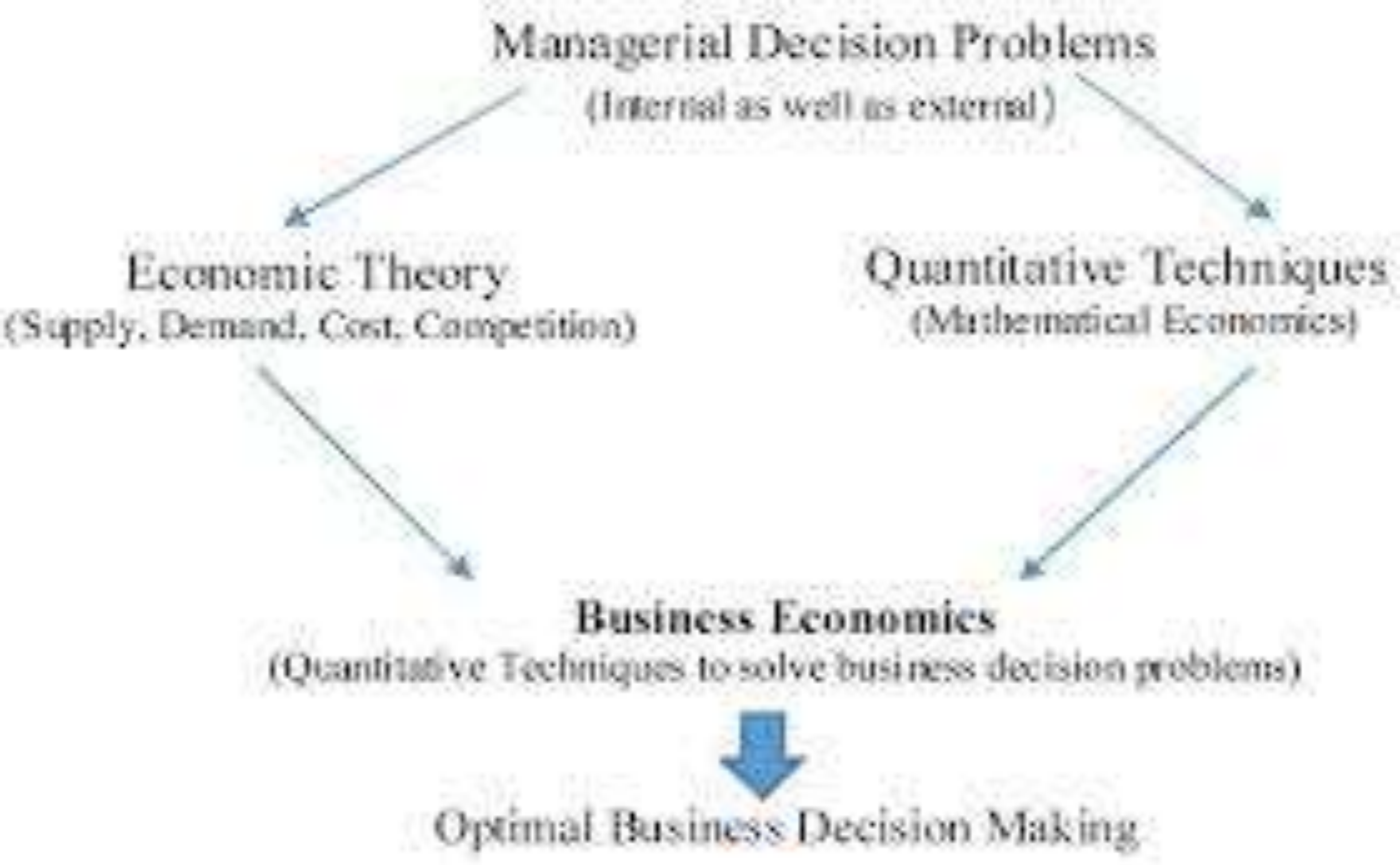
WHO IS BUSINESS ECONOMIST ?

Business Economist is the practitioner of the science of managerial economics.

- Companies employ business economists to guide them in making appropriate economic decisions – present and future (forecasting – short & long run)

- They astutely scan the competitive environment in which a firm functions and suggest suitable policies for solution of problems.


BUSINESS
ECONOMIST


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

RESPONSIBILITIES OF BUSINESS ECONOMISTS

- To bring reasonable profit to the company.
- To study external and internal factors influencing the business
- To make accurate forecast.
- To establish and maintain contact with individual and data sources.
- To keep the management informed of all the possible economic trends.
- To participate in public debates
- To earn full status in the business team.

Assisting the management towards facilitating effective decision making and forward planning.

Nature/Characteristics of Business Economics

- **Micro in nature** - concerned with business at firm level
- **Normative science** -Concerned with goals and their achievement
- **Pragmatic**-Applies economic theory in practical
- **Prescriptive** -Prescribes solutions
- **Decision Making** -Helps management takes correct decision and prepare/plan for future
- **Multidisciplinary** -Makes use of mathematics, statistic, operations research
- **Art and science-** It is both an art and science

Nature of Business Economics

- The emphasis in business economics is on normative theory. Business economic seeks to establish rules which help business firms attain their goals
- 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.