BUSINESS ECONOMICS AND FINANCIAL ANALYSIS

Unit-I Introduction to Business and Economics

BUSINESS

A firm is an entity that draws various types of factors of production in different amounts from the economy and converts them into desirable output, through a process with the help of suitable technology.

STRUCTURE OF BUSINESS FIRM

Business structure is a system that consists of explicit and implicit institutional rules and policies designed to outline how various work roles and responsibilities are delegated, controlled, and coordinated. Organizational structure also determines how information flows from level to level within the company. For example, in a centralized structure, decisions flow from the top down, while in a decentralized structure, the decisions are made at various different levels.

At its highest level, an organizational structure is either centralized or decentralized. Traditionally, organizations have been structured with centralized leadership and a defined chain of command. The military, for example, is an organization famous for its highly centralized structure, with a long and specific hierarchy of superiors and subordinates. However, there has been a rise in decentralized organizations, as is the case with many technology startups. This allows the companies to remain fast, agile and adaptable, with almost every employee receiving a high level of personal agency.

The most commonly used business structure is bureaucratic structure and it breaks up a company based on the specialization of its workforce. Most small-to-medium sized businesses implement a functional structure. Dividing the firm into departments consisting of marketing, sales, and operations is the act of using a bureaucratic organizational structure.

THEORY OF FIRM

The theory suggests that firms generate goods to a point where marginal cost equals marginal revenue, and use factors of production such as Land, Labour, Capital, enterprise, and organization to point where their marginal revenue product is equal to the cost incurred in employing the factors.

Behavior of the firm in pursuit of profit maximization, analyzed in terms of what are inputs, what production techniques are employed, what production techniques are employed, what are the quantity produced, and what prices it charges.

Profit-Maximizing Theory:

The traditional objective of the business firm is profit-maximization. The theories based on the objective of profit maximization are derived from the neo-classical marginalist theory of the firm.

Business is for profit, so the golden rule of business is that, one who takes risks will reap profits. This is the most conventional thought, and also the most widely accepted objective of a firm. Traditionally economists assumed that generation of the largest amount of absolute profit over a period of time is the single most important objective of a business organization.

Profit = Total Revenue-Total Cost

The Profit maximization Theory was based on the belief that and individual woulf risk one's risk and time for uncertain returns, only with the exception of generating profits. Nobel Laureate Milton Friedman supported profit maximization theory on the ground that its validity is tested by its ability to predict future business trends and practices.

Baumol's Theory of Sales Revenue Maximisation:

Baumol Raised serious questions on the validity of profit maximization as an objective of the firm. He stressed that in competitive markets, firms would rather aim at maximizing revenue, through maximization of sales. According to him, sales volumes, and not profit volumes, determine market leadership in competition. Sales Maximization theory asserts that managers attempt to maximize the firm's total revenue, instead of profits.

Modern Approach to Theory of Firm

Modern takes on the theory of the firm take such facts as low equity ownership by many decision makers into account; some feel that chief executive officers (CEOs) of publicly held companies are interested in profit maximization as well as in goals based on sales maximization, public relations and market share. Solely focus on Solely focusing on profit maximization comes with a level of risk in regards to public perception and a loss of a sense of goodwill between the business and other individuals or entities.
Further risk exists when a firm focuses on a single strategy within the marketplace. If a business relies on the sale of one particular good for its overall success, and the associated product fails within the marketplace, this can lead to a financial collapse of that particular company or department within a company.
For example, Sega, a gaming console producer, had success with its Sega Genesis console. Sega subsequently released the Dreamcast in Japan in 1998 and in the United States in 1999. First-day U.S. sales reached $100 million. However, the Dreamcast couldn't play DVDs like the rival PlayStation 2, which led to the Dreamcast's eventual failure within the marketplace. Even after a price drop, consumer interest did not rekindle, and Sega's gaming console division ultimately fell.

TYPES OF BUSINESS ENTITIES

A business firm is an organization that uses resources to produce goods and services that are sold to consumers, other firms, or the government. Most businesses exist because a group of people working together can be more effective than a group of people working individually.
The following are the different business structures in India:

1) **Sole Proprietorship:** This is the oldest and most common form of business. It is a one-man organisation where a single individual owns, manages and controls the whole business. The liability of the owner is unlimited. A Sole Proprietorship business is suitable where the market is limited, localized and where customers give importance to personal attention. This form of organisation is suitable where the nature of business is simple and requires quick decisions. This type of organisation is suitable where the capital required is limited and the risk- involvement is not great. It is also considered suitable for the production of goods which involve manual skill e.g. handicrafts, filigree works, jewellery-making, tailoring, haircutting, etc.

   The key features are:

   i) Ownership by a one single individual who has a legal title to the assets and properties of the business.
   ii) The entire profit goes to the sole proprietor. Similarly, he also bears the entire risk or losses of the firm.

iii) The owner of the business is the sole manager of the business.
iv) The entire capital of the business is provided by the owner. He may raise more funds from outside through borrowings.
v) The proprietor and the business enterprise are one and the same in the eyes of the law. • The liability of proprietor is unlimited.
vi) There are less legal formalities.

2) **Partnership Firm:** A partnership is defined as a relation between two or more persons who have agreed to share the profits of a business carried on by them or any of them acting for all. The owners of a partnership business are individually known as partners and collectively as a firm. In a partnership firm, persons from different walks of life, with ability, managerial talent and skill, combine to form a business. This increases the administrative strength of the organisation, the financial resources, the skill and expertise, while reducing risk. Such firms are most suitable for comparatively small businesses such as retail and wholesale trade, professional services, medium-sized mercantile houses and small manufacturing units. Generally, it is seen that many organisations are initially started as partnership firms and, later, when it is economically viable and financially attractive for the investors, it is converted into a company.

The key features of a Partnership Firm are:

i) A minimum of two persons are required to start a partnership business. The maximum number of partners is 10, in the case of a banking business and 20 in any other case.
ii) The relation between the partners of a partnership firm is created by contract which may be verbal, written, or implied and it is known as the "Partnership Deed".
iii) The partners can share profits in any ratio as agreed.
iv) The partners have unlimited liability.
v) The business in a partnership firm may be carried on by all the partners or any of them acting for all. There is a Principal – Agent relationship between all the partners. There should be mutual trust and faith.
vi) The law does not recognise the firm as a separate entity distinct from the partners.
vii) The registration of a partnership is not compulsory.

3) **Limited Liability Partnership**: The government has passed the LLP Act, 2008 in January, 2009. This Act proposes LLP as a new corporate form of business to provide an alternative to the traditional partnership business, with unlimited personal liability on the one hand, and the statute-based governance structure of the limited liability company, on the other, so that businesses can organize themselves and operate in a flexible, innovative, and efficient manner. LLPs offer clear advantages over Partnership Firms and Companies for small and medium-sized businesses. A registered "Limited Company" in India (private or public) has a lot of complicated formalities, including mandatory director board meetings, auditing etc. The additional overheads in managing a Private Limited Company make LLPs attractive for small firms

It is very easy to form an LLP, as the process is very simple compared to that required by companies and it does not involve much formality

i. Just like a company, an LLP is also a body corporate, which means it has its own existence, compared to a partnership. An LLP and its partners are distinct entities in the eyes of the law. An LLP will be known by its own name and not by the name of its partners

ii. LLPs exist as separate legal entities from the personal life of the partner. Both an LLP and the person who owns it are separate entities and both function separately. Liability for repayment of debts and lawsuits incurred by the LLP lies on it and not the owner. Any business with potential for lawsuits should consider the incorporation an LLP; it will offer an added layer of protection

4) **Private Limited Company:** A private company is a company which has the following ingredients:
   i. The Shareholders' right to transfer shares is restricted.
   ii. The number of shareholders is limited to fifty.
   iii. An invitation to the public to subscribe to any shares or debentures is prohibited. D. Public Limited Company: A Public Limited Company is a company limited by shares in which there is no restriction on the maximum number of shareholders, transfer of shares and acceptance of public deposits. The liability of each shareholder is limited to the extent of the unpaid amount of the face value of the shares and the premium thereon, in respect of the shares held by him. However, the liability of a Director / Manager of such a company can, at times, be unlimited. The minimum number of shareholders is 7.

5) **Co-operative:**
   i. Individuals having a common interest can come together to form a co-operative society
   ii. The minimum membership required to form a co-operative society is 10 and the maximum number is unlimited
   iii. The registration of a society under the Co-operative Societies Act is mandatory. Once it is registered, it becomes a body corporate and enjoys certain privileges just like a joint stock company
   iv. The primary objective of any co-operative organisation is to render services to its members, in particular, and to society in general
   v. Every member has a right to take part in the management of the society. Each member has one vote. Generally the members elect a committee known as the Executive Committee to look after the day to day administration and the said committee is responsible to the general body of members
   vi. A co-operative organisation starts with a fund contributed by its members in the form of units called shares. It can also easily raise loans and secure grants from the government.
   vii. The return on capital subscribed by the members is in the form of a fixed rate of dividend after necessary deductions from the profits.

6) **Corporation:** A corporation is a legal entity whose investors purchase shares of stock as evidence of their ownership in it. A corporation acts as a legal shield for its owners, so that they are generally not liable for the corporation's actions. A corporation pays all types of taxes, including income taxes, payroll taxes, sales and use taxes, and property taxes. The advantages of the corporation are as follows:
   i. The shareholders of a corporation are only liable up to the amount of their investments

ii. A publicly-held corporation in particular can raise substantial amounts by selling shares or issuing bonds
iii. A shareholder can sell shares in a corporation to a third party

The disadvantages of a corporation are as follows:

i. Double taxation
ii. The various types of income and other taxes that must be paid can add up to a substantial amount of paperwork

LIMITED LIABILITY COMPANIES

Like a corporation, a limited liability company or "LLC," is a separate and distinct legal entity. This means that an LLC can get a tax identification number, open a bank account and do business, all under its own name.

One of the primary advantages of an LLC is that its owners, called members, have "limited liability," meaning that, under most circumstances, they are not personally liable for the debts and liabilities of the LLC.

There are mainly two types of companies which are famously known under Limited Liability companies i.e., Private Limited Company and Public Limited Company.

Private Limited Company	Public Limited Company
Minimum-2, Maxmum-50	Minimum-7 and Maximum-No restriction
Certificate of Incorporation is enough	Certificate of Incorporation and Certification of commencement of Business.
Use a suffix 'Private Limited' after its name.	Use a suffix 'Limited' after its name
No restriction on allotment of shares	There are number of legal restriction on allotment of shares
Transferring of shares are restricted by articles.	Freely transferrable
A private company cannot issue a prospectus giving public invitation for purchase of its shares	A public company must issue a prospectus or a statement in lieu of prospectus for inviting public for the purchase of its shares and debentures.
Only 2 members have to sign Memorandum and Articles.	Seven members have to sign
At least 2 Directors	At least three directors
A private company need not send the list of directors, their consent, etc. to the Registrar of Companies.	The list of directors, their consent and a contract with them must be sent to the Registrar of Companies.
Statutory meeting and Report are not required for private companies	Statutory meeting and Report are compulsory for public companies

Regulatory requirements and statutory bodies involved in starting a business

Companies Act 1956 - It is "an act to consolidate and amend the law relating to companies and certain other associations". It regulates the formation, functioning, the winding up of the companies and also the relationship between the company, government, and public.

Ministry of Corporate Affairs-It regulates the Companies Act 1956 and other allied acts. The ministry governs the following acts:

The Partnership Act 1932

The Chartered Accountants Act 1949

Companies Fund Act 1951
The Companies Act 1956
The Chartered Secretaries Act 1980
The Monopolies and Restrictive Trade Practices Act in 1969
The Companies Amendment Act 2006

Office of Registrar of Companies - The responsibility of the Registrar of Companies is to register the companies for their respective states and Union Territories and ensuring that the companies abide to the legal requirements of the Companies Act.
Company Law Board
The Ministry of Environment and Forest - It is the major administrative entity for:
Governing and ensuring environmental protection
Designing the environmental policy framework in India
Undertaking conservation and survey of flora, fauna, forest and wildlife

The Environment Protection Act- It is an all-inclusive legislation which affirms the Central Government to protect and improve environmental quality control and reduce pollution from all sources. Under the Act, the Central Government shall have the power to take all such actions which it considers necessary or appropriate for the purpose of protecting and improving the quality of environment and for abating environmental pollution.
RBI-It regulates and controls the monetary system of the country.
SEBI-It is a statutory body that controls the Indian capital market.

SOURCES OF CAPITAL FOR A COMPANY

Capital is the wealth which includes land, buildings, equipment, cash, stocks and bonds- all of which have a monetary value. Capital is, in essence the savings of individuals, corporations, governments and many other forms of organizations. It is quite often scare and considered by many as the most valuable of all commodities.
A firm cannot run efficiently if it does not have adequate finance to meet its requirements. Not having enough capital is the cause of many business failures. Adequate capital is needed to start up the business, operate through hard times, and provide a good chance to become a profitable enterprise.
The financial requirements can be categorized into two types

- Long term and
- Short term.

The long term funds are required for financing fixed assets which are for more than one year. These are generally raised through shares, debentures, loans from specialized financial institutions etc.,.
The short term funds are required for meeting the working capital requirements. They are required for a short period of time i.e., less than one year. The reuirements of these funds are usually met by taking short term loans or getting the bill discounted from the commercial banks etc.,.

Long term Sources

1. **Term Loans:** The characteristics of a term loan is very similar to debentures except that it does not include too much cost of issuing because it is given by some bank or financial institutions. The

common public is not involved in it. A rigorous analysis of company's financials and future plans is done by the bank to judge the debt servicing capacity of the company. These loans are also secured by some assets.

2. **Shares**: Equity shares are a common source of finance for big companies. Not all the businesses can use this source as it is governed by a lot of legislations. A key feature of equity share is the 'sharing of ownership rights' and therefore, the current shareholder's rights are diluted to some extent.
3. **The preferred stock** shares characteristics of both common equity stocks and debt. They are called preferred because they have got priority over common equity shares in terms of payment of dividend and the capital also at the time of liquidation.
4. **Debentures:** The Debentures are another common means of finance used by companies who prefer debt over the equity. Debt is considered to be the cheaper mode of finance compared to equity. It does not share control with investors. It is because the interest paid to debenture holders is tax deductible. Rest of process of debentures issue is similar to equity issue. It is offered to the common public and therefore necessary legislations need to be complied with. Debentures also involve some cost of issuing and they are collateralized by some assets of the company.

Short term Sources

1. **Bank overdraft:** Bank overdraft is a simple mode of short-term financing. Businesses need money for their day to day requirement which arises due to a time gap between their collections and payments. To fulfill such requirements, bank overdraft is an ideal short term source of finance.
2. **Trade credit:** Trade credit is nothing but the credit given to a business by their creditors/ suppliers. It allows a business to delay its payments by some period. The period of credit depends on the credit terms between the business and the suppliers.
3. **Factoring of debt:** It is an arrangement whereby the business sells its account receivables/ debtors at a discount. In this arrangement, the buyer, who is known as the factor, collects the money from the debtors on behalf of the business and charges a premium for this service. If the debtor does not pay for any reason, the factor can get back to the business for the payment.

NON CONVENTIONAL SOURCES OF FINANCE

1. **Venture Capital**: This is where you make the big bets. Venture capitals are professionally managed funds who invest in companies that have huge potential. They usually invest in a business against equity and exit when there is an IPO or an acquisition. VCs provide expertise, mentorship and acts as a litmus test of where the organisation is going, evaluating the business from the sustainability and scalability point of view. A venture capital investment may be appropriate for small businesses that are beyond the startup phase and already generating revenues. However, there are a few downsides to Venture Capitalists as a funding option. VCs have a short leash when it comes to company loyalty and often look to recover their investment within a three- to five-year time window.
2. **Angel investors:** Angel investors are individuals with surplus cash and a keen interest to invest in upcoming startups. They also work in groups of networks to collectively screen the proposals before investing. They can also offer mentoring or advice alongside capital. Angel investors have helped to start up many prominent companies, including Google, Yahoo and Alibaba. This alternative form of investing generally occurs in a company's early stages of growth, with investors expecting a upto 30% equity. They prefer to take more risks in investment for higher

returns. Angel Investment as a funding option has its shortcomings too. Angel investors invest lesser amounts than venture capitalists

3. **Crowdfunding:** Crowdfunding is one of the newer ways of funding a startup that has been gaining lot of popularity lately. It's like taking a loan, pre-order, contribution or investments from more than one person at the same time. This is how crowdfunding works – An entrepreneur will put up a detailed description of his business on a crowdfunding platform. He will mention the goals of his business, plans for making a profit, how much funding he needs and for what reasons, etc. and then consumers can read about the business and give money if they like the idea. Those giving money will make online pledges with the promise of pre-buying the product or giving a donation. Anyone can contribute money toward helping a business that they really believe in. Also keep in mind that crowdfunding is a competitive place to earn funding, so unless your business is absolutely rock solid and can gain the attention of the average consumers through just a description and some images online, you may not find crowdfunding to work for you in the end.
4. **Govt Programs That Offer Startup Capital:** The Government of India has launched 10,000 Crore Startup Fund in Union budget 2014-15 to improve startup ecosystem in India. In order to boost innovative product companies, Government has launched 'Bank Of Ideas and Innovations 'program. Government backed 'Pradhan Mantri Micro Units Development and Refinance Agency Limited (MUDRA)' starts with an initial corpus of Rs. 20,000 crore to extend benefits to around 10 lakhs SMEs. You are supposed to submit your business plan and once approved, the loan gets sanctioned. You get a MUDRA Card, which is like a credit card, which you can use to purchase raw materials, other expenses etc. Shishu, Kishor and Tarun are three categories of loans available under the promising scheme.
5. **Micro loans:** Microloan is the extension of very small loans (microloans) to impoverished borrowers who typically lack collateral, steady employment, or a verifiable credit history. It is designed to support entrepreneurship and alleviate poverty. Many recipients are illiterate, and therefore unable to complete paperwork required to get conventional loans.

ECONOMICS

Economics is a social science concerned with the production, distribution, and consumption of goods and services. It studies how individuals, businesses, governments, and nations make choices on allocating resources to satisfy their wants and needs, and tries to determine how these groups should organize and coordinate efforts to achieve maximum output.
Economic analysis often progresses through deductive processes, much like mathematical logic, where the implications of specific human activities are considered in a "means-ends" framework.

Unlimited Wants and Limited Means

One of the earliest recorded economic thinkers was the 8th century Greek farmer/poet Hesiod, who wrote that labor, materials and time needed to be allocated efficiently to overcome scarcity. But the founding of modern western economics occurred much later, generally credited to the publication of Scottish philosopher Adam Smith's 1776 book, "An Inquiry Into the Nature and Causes of the Wealth of Nations."
The principle (and problem) of economics is that human beings occupy a world of unlimited wants and limited means. For this reason, the concepts of efficiency and productivity are held paramount by

economists. Increased productivity and a more efficient use of resources, they argue, could lead to a higher standard of living.

Positive Economics vs. Normative Economics

There are two broad approaches to economic methodology.

- Positive
- Normative economics.

The distinction between positive economics and normative economics may seem simple, but it is not always easy to differentiate between the two. Positive economics is objective and fact based, while normative economics is subjective and value based. For example, the statement, "government should provide basic healthcare to all citizens" is a normative economic statement. There is no way to prove whether government "should" provide healthcare; this statement is based on opinions about the role of government in individuals' lives, the importance of healthcare, and who should pay for it.

The statement, "government-provided healthcare increases public expenditures" is a positive economic statement, as it can be proved or disproved by examining healthcare spending data.

MICRO AND MACRO ECONOMIC CONCEPTS

In the 1930s, Ragnar Frisch classified Economics into two branches, viz., Micro economics and Macroeconomics. An economic system may be looked at as a whole or in terms of its innumerable decision-making units such as consuming units (e.g. individual consumers and households), producing units (e.g. farms, manufacturing and mining concerns), individual factors of production (e.g. laborers, landowners, business owners and entrepreneurs), and individual industries (e.g. cotton textile, iron and steel, toy making). When we analyze the problems of the economy as a whole, we carry out a macroeconomic study. On the other hand, an analysis of the behavior of any particular decision-making unit, such as a firm, an industry, or a consumer, constitutes Micro economics.

Micro Economics: Microeconomics is the branch of economics that concentrates on the behavior 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.

'Opportunity Cost'

Opportunity cost refers to a benefit that a person could have received, but gave up, to take another course of action. Stated differently, an opportunity cost represents an alternative given up when a decision is made. This cost is, therefore, most relevant for two mutually exclusive events. In investing, it is the difference in return between a chosen investment and one that is necessarily passed up.

Opportunity Cost = Return of Most Lucrative Option - Return of Chosen Option

When making big decisions like buying a home or starting a business, you will likely scrupulously research the pros and cons of your financial decision, but most of our day-to-day choices aren't made with a full understanding of the potential opportunity costs. If they're cautious about a purchase, most people just look at their savings account and check their balance before spending money. For the most part, we don't think about the things that we must give up when we make those decisions.

However, that kind of thinking could be dangerous. The problem lies when you never look at what else you could do with your money or buy things blindly without considering the lost opportunities. Buying takeout for lunch occasionally can be a wise decision, especially if it gets you out of the office when your boss is throwing a fit. However, buying one cheeseburger every day for the next 25 years could lead to several missed opportunities.

Macro Economics

Macroeconomics 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.

Examples: Aggregate Demand, National Income, etc.

Macroeconomics encompasses a variety of concepts and variables, but there are three central topics for macroeconomic research. Macroeconomic theories usually relate the phenomena of

1) Output and income,
2) Unemployment, and
3) Inflation.

1) **Output and income:** National output is the total amount of everything a country produces in a given period of time. Everything that is produced and sold generates an equal amount of income. Therefore, output and income are usually considered equivalent and the two terms are often used interchangeably. Output can be measured as total income, or it can be viewed from the production side and measured as the total value of final goods and services or the sum of all value added in the economy.
2) **Unemployment:** The amount of unemployment in an economy is measured by the unemployment rate, i.e. the percentage of workers without jobs in the labor force. The unemployment rate in the labor force only includes workers actively looking for jobs. People who are retired, pursuing education, or discouraged from seeking work by a lack of job prospects are excluded. While some types of unemployment may occur regardless of the condition of the economy, cyclical unemployment occurs when growth stagnates.
3) **Inflation and deflation:** A general price increase across the entire economy is called inflation. When prices decrease, there is deflation. Economists measure these changes in prices with price indexes. Inflation can occur when an economy becomes overheated and grows too quickly. Similarly, a declining economy can lead to deflation.

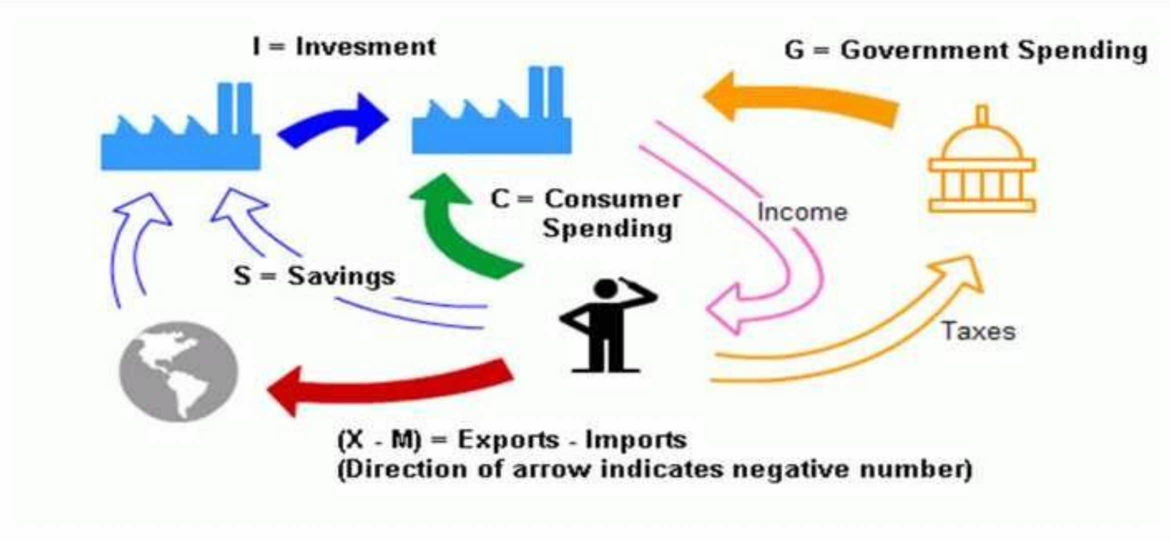
Comparison Chart

BASIS FOR COMPARISON	MICROECONOMICS	MACROECONOMICS
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
Business Application	Applied to operational or	Environment and external issues

	internal 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.

CONCEPTS AND IMPORTANCE OF NATIONAL INCOME

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 annually in a country. In other words, the total amount of income accruing to a country from economic activities in a year's time is known as national income.



- National Income = C + I + G + (X − M)
  Where, C = Total consumption expenditure
  I = Total investment expenditure
  G = Total government expenditure ; X − M = Export − Import

It includes payments made to all resources in the form of wages, interest, rent, and profits.

The important concepts of national income are:

1) Gross Domestic Product (GDP)
2) Gross National Product (GNP)
3) Net National Product (NNP) at Market Prices
4) Net National Product (NNP) at Factor Cost or National Income
5) Personal Income
6) Disposable Income

1) **GDP (GROSS DOMESTIC PRODUCT)**:
   - Here the catch word is 'Domestic' which refers to 'Geographical Area'
   - The total value of all final goods and services produced within the boundary of the country during a given period of time (generally one year) is called as GDP.
   - In this case, the final produce of resident citizens as well as foreign nationals who reside within that geographical boundary is considered.

   Types of GDP: Real GDP and Nominal GDP

   1. **Real GDP:** Refers to the current year production of goods and services valued at base year prices. Such base year prices are Constant Prices.

   2. **Nominal GDP:** Refers to current year production of final goods and services valued at current year prices.

   Concept of base year: It is the year used as the beginning or the reference year for constructing an index, and which is usually assigned an arbitrary value of 100.The base year is also known as Rebasing as by every 10 years there is a change which will be minimum 4% rise in price of items which require changing the base year.

2) **Gross National Product (GNP):** Gross National Product is the total market value of all final goods and services produced in a year. GNP includes net factor income from abroad whereas GDP does not. Therefore,

   GNP = GDP + Net factor income from abroad.

   Net factor income from abroad = factor income received by Indian nationals from abroad -factor income paid to foreign nationals working in India.

3) **Net National Product (NNP) at Market Price:** NNP is the market value of all final goods and services after providing for depreciation. That is, when charges for depreciation are deducted from the GNP we get NNP at market price. Therefore'

   NNP = GNP – Depreciation

   Depreciation is the consumption of fixed capital or fall in the value of fixed capital due to wear and tear.

4) **Net National Product (NNP) at Factor Cost (National Income):** NNP at factor cost or National Income is the sum of wages, rent, interest and profits paid to factors for their contribution to the production of goods and services in a year. It may be noted that:

   NNP at Factor Cost = NNP at Market Price – Indirect Taxes + Subsidies.

5) **Personal Income:** Personal income is the sum of all incomes actually received by all individuals or households during a given year. In National Income there are some income, which is earned but not actually received by households such as Social Security contributions, corporate income taxes and

undistributed profits. On the other hand there are income (transfer payment), which is received but not currently earned such as old age pensions, unemployment doles, relief payments, etc. Thus, in moving from national income to personal income we must subtract the incomes earned but not received and add incomes received but not currently earned. Therefore,

Personal Income = National Income – Social Security contributions – corporate income taxes – undistributed corporate profits + transfer payments.

6) Disposable Income: From personal income if we deduct personal taxes like income taxes, personal property taxes etc. what remains is called disposable income. Thus,

Disposable Income = Personal income – personal taxes.

Disposable Income can either be consumed or saved. Therefore, Disposable Income = consumption + saving.

IMPORTANCE OF NATIONAL INCOME

Measuring national income is crucial for various purposes:

- The measurement of the size of the economy and level of country's economic performance;
- To trace the trend or the speed of the economic growth in relation to previous year(s) also in other countries;
- To know the composition and structure of the national income in terms of various sectors and the periodical variations in them.
- To make projections about the future development trend of the economy.
- To help government formulate suitable development plans and policies to increase growth rates.
- To fix various development targets for different sectors of the economy on the basis of the earlier performance.
- To help businesses to forecast future demand for their products.
- To make international comparison of people's living standards.

INFLATION

Inflation is the rate at which the general level of prices for goods and services is rising and, consequently, the purchasing power of currency is falling. Central banks attempt to limit inflation, and avoid deflation, in order to keep the economy running smoothly.

Types of inflation

1. **Deflation:** Deflation is a general decline in prices, often caused by a reduction in the supply of money or credit. Deflation can also be caused by a decrease in government, personal or investment spending. The opposite of inflation, deflation has the side effect of increased unemployment since there is a lower level of demand in the economy, which can lead to an economic depression.
2. **Stagflation:** this is a condition of slow economic growth and relatively high unemployment - a time of stagnation - accompanied by a rise in prices, or inflation. Stagflation occurs when the economy isn't growing but prices are, which is not a good situation for a country to be in.
3. **Hyperinflation** is extremely rapid or out of control inflation. There is no precise numerical indication of hyperinflation. Hyperinflation is a situation where the price increases are so out of control that the concept of inflation is meaningless. Although hyperinflation is considered a rare

event, it occurred as many as 55 times in the 20th century in countries such as China, Germany, Russia, Hungary and Argentina.

CAUSES OF INFLATION

1. **Demand-pull inflation:** Demand-pull inflation results from strong consumer demand. Many individuals purchasing the same good will cause the price to increase, and when such an event happens to a whole economy for all types of goods, it is called demand-pull inflation. There are five causes for demand-pull inflation: an increase in spending and investing of consumers padded on confident firms who then hire more people to meet demands; a sudden rise in exports which then translates to an undervaluation of the involved currencies; a rise in government spending; and forecasts and expectations of inflation, where companies increase their prices to go with the flow of the expected rise. Lastly, demand-pull inflation is produced by an excess in monetary growth. Too much money in an economic system with too few goods makes prices increase.
2. **Cost-push inflation:** Cost-push inflation is a phenomenon in which the general price levels rise (inflation) due to increases in the cost of wages and raw materials. The most common cause of cost-push inflation starts with an increase in the cost of production, which may be unexpected. This can be related to an increase in the cost of raw materials, unexpected damage or shutdown to a production facility (such as one caused by a fire of natural disaster), or mandatory wage increases for production employees, including instances where a rise in minimum wage automatically increases the compensation of employees who were being paid below the new standard. As a result of inflation, the purchasing power of a unit of currency falls. For example, if the inflation rate is 2%, then a candy that costs Re.1 in a given year will cost Rs.1.02 the next year. As goods and services require more money to purchase, the implicit value of that money falls.

MEASUREMENT OF INFLATION

In India, inflation is measured on two price indices, viz, wholesale price index (WPI) and consumer price index (CPI). WPI measures price rise or inflation at the level of seller or retailer who buy commodities in bulk or 'whole sale'. CPI is also called retail inflation since it measures inflation at the retail or consumer level. In India, WPI is the basis for determining the inflation of the economy.

1) **Wholesale Price Index (WPI):** The Wholesale Price Index (WPI) is the **price** of a representative basket of wholesale goods. The wholesale price index (WPI) is based on the wholesale price of a few relevant commodities of over 240 commodities available. The commodities chosen for the calculation are based on their importance in the region and the point of time the WPI is employed. The base year of WPI is revised periodically. Till date, 5 revisions have take place. The current WPI base year is 2004-05 based on prices of 670 commodities.
2) **Consumer Price Index (CPI):** Unlike WPI, there is not a single measure of CPI. In India, four CPI indices are used to determine inflation at the consumer level. These are: CPI-IW (Industrial Worker), CPI-UNME (Urban Non-Manual Employees), CPI-AL (Agricultural Labourers), and CPI-RL (Rural Labourers). The price data are collected for a sample of goods and services from a sample of sales outlets in a sample of locations for a sample of times. The weighting data are estimates of the shares of the different types of expenditure in the total expenditure covered by the index.

MONEY SUPPLY IN INFLATION

In the economy, inflation and the money supply correlate with each other. The money supply can be defined as notes and coins circulating outside the central bank. Inflation is a sustained rise in prices, as money supply circulating around the economy increases inflation and balance of payments in turn also increases; however, this has very little effect on employment. The increase in money supply can be defined as the direct monetary transmission mechanism, which means that an increase in money supply leads to people spending the excess of their money supply over money demand. When people have more disposable income to spend on luxury goods aggregate demand also increases. Therefore businesses must increase the aggregate supply to give consumers what they want.

Increasing the money supply faster than the growth in real output will cause inflation. The reason is that there is more money chasing the same number of goods. Therefore, the increase in monetary demand causes firms to put up prices.

Examples of increased money supply causing inflation:

The link between the money supply and inflation can be seen in many historical cases.

- US Confederacy 1962-65: During the Civil war, the Confederacy of southern states found itself short of finance (it could only raise 46% of the cost of war from taxes and bonds) so it increased the printing of money to pay for materials and soldiers. However, with economic output falling, this caused inflation of 700% in the first two years of war and reaching a peak of over 5000% by the end.
- German Hyperinflation 1923:In the aftermath of the First World War, Germany faced high reparation payments. To meet these demands, the government started printing more money – so that firms could continue to pay workers. This led to an explosion in the inflation rate. By the end of 1923, printing money had got out of hand, and the economy experienced hyperinflation.
- Zimbabwe 2008: Zimbabwe found itself in a similar situation. High government debt, falling output and a need to print money to stave off a short-term crisis. This printing of money led to hyperinflation of an estimated 79,600,000,000% in Nov 2008. A daily inflation rate of 98%

The Quantitative Easing by the central banks with the effect of an increased money supply in an economy often helps to increase or moderate inflationary targets. There is a puzzle formation between low-rate of inflation and a high growth of money supply. When the current rate of inflation is low, a high worth of money supply warrants the tightening of liquidity and an increased interest rate for a moderate aggregate demand and the avoidance of any potential problems. Further, in case of a low output a tightened monetary policy would affect the production in a much more severe manner. The supply shocks have known to play a dominant role in the regard of monetary policy.

Therefore in conclusion, in using the monetary policy a government should have a clear idea of what the aims of the policy are. What monetary variable it is going to attempt to control and by what means. Whether to take out a long term policy or a short term perspective, and how well the policy fits in with other policies. By assessing these reasons then the government would be able to reach a stable economy which is best achieved by ensuring a steady and low rate of growth in the money supply. So by using the monetary and the fiscal policy correlating with each other then the government would have a much better chance of controlling the economy. This would also be beneficial for consumers and businesses.

BUSINESS CYCLE

Business cycles are characterized by boom in one period and collapse in the subsequent period in the economic activities of a country. These fluctuations in the economic activities are termed as phases of business cycles. The fluctuations are compared with ebb and flow. 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 business cycle is the fluctuation in economic activity that an economy experiences over a period of time. A business cycle is basically defined in terms of periods of expansion or recession. During expansions, the economy is growing in real terms (i.e. excluding inflation), as evidenced by increases in indicators like employment, industrial production, sales and personal incomes. During recessions, the economy is contracting, as measured by decreases in the above indicators. Expansion is measured from the trough (or bottom) of the previous business cycle to the peak of the current cycle, while recession is measured from the peak to the trough.

FEATURES AND PHASES OF BUSINESS CYCLE

The phases of business cycle are

1. Expansion,
2. Peak,
3. Recession,
4. Trough and
5. Recovery

1. **Expansion:**
   - The line of cycle that moves above the steady growth line represents the expansion phase of a business cycle. In the expansion phase, there is an increase in various economic factors, such as production, employment, output, wages, profits, demand and supply of products, and sales.
   - In this phase, debtors are generally in good financial condition to repay their debts; therefore, creditors lend money at higher interest rates. This leads to an increase in the flow of money.
   - 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. This situation is firstly considered as a small fluctuation in the market, but as the problem exists for a longer duration, producers start noticing it.
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. 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.
   - Consequently, organizations discontinue laying off individuals and start hiring but in limited number. At this stage, wages provided by organizations to individuals is less as compared to their skills and abilities. This marks the beginning of the recovery phase.

NATURE AND SCOPE OF BUSINESS ECONOMICS

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, labor 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 maximization.

NATURE OF BUSINESS ECONOMICS:

Managers study managerial economics because it gives them insight to reign the functioning of the organization. If manager uses the principles applicable to economic behaviour in a reasonably, then it will result in smooth functioning of the organisation.

1. **Business Economics is a Science:** Managerial Economics is an essential scholastic field. It can be compared to science in a sense that it fulfills the criteria of being a science in following sense: Science is a Systematic body of Knowledge. It is based on the methodical observation. Managerial economics is also a science of making decisions with regard to scarce resources with alternative applications. It is a body of knowledge that determines or observes the internal and external environment for decision making.
2. **Business Economics requires Art:** Managerial economist is required to have an art of utilizing his capability, knowledge and understanding to achieve the organizational objective. Managerial economist should have an art to put in practice his theoretical knowledge regarding elements of economic environment.
3. **Business Economics for administration of organization:** Managerial economics helps the management in decision making. These decisions are based on the economic rationale and are valid in the existing economic environment.
4. **Business economics is helpful in optimum resource allocation:** The resources are scarce with alternative uses. Managers need to use these limited resources optimally. Each resource has several uses. It is manager who decides with his knowledge of economics that which one is the preeminent use of the resource.
5. **Business Economics has components of micro economics**: Managers study and manage the internal environment of the organization and work for the profitable and long-term functioning of the organization. This aspect refers to the micro economics study. The managerial economics deals with the problems faced by the individual organization such as main objective of the organization, demand for its product, price and output determination of the organization, available substitute and complimentary goods, supply of inputs and raw material, target or prospective consumers of its products etc.
6. **Business Economics has components of macro economics:** None of the organization works in isolation. They are affected by the external environment of the economy in which it operates such as government policies, general price level, income and employment levels in the economy, stage of business cycle in which economy is operating, exchange rate, balance of payment, general expenditure, saving and investment patterns of the consumers, market conditions etc. These aspects are related to macro economics.
7. **Business Economics is dynamic in nature:** Managerial Economics deals with human-beings (i.e. human resource, consumers, producers etc.). The nature and attitude differs from person to person. Thus to cope up with dynamism and vitality managerial economics also changes itself over a period of time.

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.
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 transforms 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 Forecast.

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 Diseconomies 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 firm's 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 organized for purpose of making profits and in the long run profits earned are taken as an important measure of the firm's 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 realized 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 labor.
   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.

ROLE OF BUSINESS ECONOMIST

Business economics is a division of microeconomics that focuses on applying economic theory directly to businesses. The application of economic theory through statistical methods helps businesses make decisions and determine strategy on pricing, operations, risk, investments and production. The overall role of business economics is to increase the efficiency of decision making in businesses to increase profit.
Some of the important duties performed by business economist are as follows:

- **Study of the Business Environment:**
  Every firm has to take into consideration such external factors as the growth of national income, volume of trade and the general price trends, for its policy decision.
  A firm works within a business environment. The basic elements of business environment for a firm are the trend of growth of national economy and world economy and phase of the business cycle in which the economy is moving.
- **Business Plan and Forecasting:**
  The business economists can help the management in the formulation of their business plan by forecasting and economic environment. The management can easily decide the timing and locating of their specific action. The managerial economist has to interpret the national economic trends and industrial outlook for their relevance to the firm in which he is working.
- **Study of Business Operations:**
  The business economist can also help the management in decision making relating to the internal operations of a firm, i.e., in deciding about price, rate of operations, investment, and growth of the firm for offering this advice: the economist has specific analytical and forecasting techniques which yield meaningful conclusions.
  What will be the reasonable sales and profit budget for the next year? What are the suitable production schedules and inventory policies? What changes in wage and price policies are imperative now? What would be the sources of finance? Thus, he is trained to answer such questions posed by the top management.
- **Economic Intelligence:**
  The business economist also provides general intelligence services by supplying the management with economic information of general interest so that they can talk intelligently in conferences and seminars. They have also supplied the facts and figures for preparing the annual reports of the firm. Those facts and figures are collected by the business economist as he understands the literature available on business activities.
- **Specific Functions:**
  Business economists are now performing specific functions as consultants also. Their specific functions are demand forecasting, industrial market research, pricing problems of industry, production programmers, investment analysis and forecasts. They also offer advice on trade and public relations, primary commodities and capital projects in agriculture, industry, transport, and tourism and also of the export environment.
- **Participation in Public Debates:**
  The business economists participate in public debates organized by different agencies. Both governments and society seek their advice. Their practical experience in business and industry gives

value to their observation. In nutshell a business economist can play a multi-faceted role. He is not only an analyst of current trends and policies for his employers but also a bridge between the businessmen in the specific industry and the government. He acts as a spokesman of his firm and interpreter of the Government.

MULTIDISCIPLINARY NATURE OF BUSINESS ECONOMICS

An important feature of Managerial Economics is its relationship with other disciplines. Although essentially a branch of Economics, the subject draws upon a number of other disciplines for propounding its theories and concepts for managerial decision making.

Business Economics and Economics: Business economics is defined as a subdivision of economics that deals with decision-making. It may be viewed as a special branch of economics bridging the gulf between pure economic theory and Business practice. A survey in the U.K. has shown that business economists have found the following economic concepts quite useful and of frequent application:

- Price elasticity of demand
- Income elasticity of demand
- Opportunity cost
- Multiplier
- Propensity to consume
- Marginal revenue product
- Speculative motive
- Production function
- Liquidity preference

Business economists have also found the following main areas of economics as useful in their work. Demand theory, Theory of firms – price, output and investment decisions, Business financing, Public finance and fiscal policy, Money and banking, National income and social accounting, Theory of international trade, Economies of developing countries. Thus, it is obvious that Business Economics is very closely related to Economics.

1. **Business Economics and Statistics**:
   Statistics is important to Business economics in several ways. Business economics calls for the organizing quantitative data and deriving a useful measure of appropriate functional relationships involved in decision-making. For instance, in order to base its pricing decisions on demand and cost considerations, a firm should have statistically derived or calculated demand and cost functions. Business economics also employs statistical methods for experimental testing of economic generalizations.
2. **Business Economics and Mathematics:**
   Mathematics is yet another important subject closely related to Business economics. This is because Business economics is mathematical in character, as it involves estimating various economic relationships, predicting relevant economic quantities and using them in decision-making and forward planning. Knowledge of geometry, trigonometry ad algebra is not only essential but also certain mathematical tools and concepts such as logarithms and exponential, vectors, determinants, matrix, algebra, calculus, differential as well as integral, are the most commonly used devices. Further, operations research, which is closely related to Business economics, is

mathematical in character. It provides and analyses data ad develops models, benefiting from the experiences of experts drawn from different disciplines, viz., psychology, sociology, statistics, and engineering.

3. **Business economics and accounting**:

   Business economics is also closely related to accounting, which is concerned with recording the financial operations of a business firm. In fact, a Business economist depends chiefly on the accounting information as an important source of data required for his decision-making purpose. for instance, the profit and loss statement of a firm shows how well the firm has done and whether the information it contains can be used by Business economist to throw significant light on the future course of action that is whether the firm should improve its productivity or close down. Therefore, accounting data require careful interpretation, reconstruction, and adjustments before they can be used safely and effectively.

   It is in this context that the link between management accounting and Business economics deserves special mention. The main task of management accounting is to provide the sort of data, which managers need if they are to apply the ideas of Business economics to solve business problems correctly.

4. **Business Economics and Operations Research:**

   Operations research is a subject field that emerged during the Second World War and the years thereafter. A good deal of interdisciplinary research was done in the USA. as well as other western countries to solve the complex operational problems of planning and resource allocation in defense and basic industries.

   Several experts like mathematicians, statisticians, engineers and others teamed up together and developed models and analytical tools leading to the emergence of this specialized subject. Much of the development of techniques and concepts, such as linear programming, inventory models, game theory, etc., emerged from the working of the operation researchers.

   Several problems of Business economics are solved by the operation research techniques. These highlight the significant relationship between Business economics and operations research.

5. **Business Economics and Econometrics:**

   Econometrics is derived from Greek and literally means “measurement in economics”. More particularly, Econometrics is concerned with the application of statistical and mathematical techniques for the analysis of economic data. The chief role of Econometrics is the specification, estimation and testing of economic models, and so it is used for the analysis and verification of economic models or theories. Therefore, it becomes evident that Econometrics plays a crucial role in Business Economics as regards, for example, the forecasting of sales, cost, or any other function we are interested in.

   Clearly, for Business Economist interested in the values of the estimates parameters of functional relationships used in decision-making, such as elasticities, rates of change, multipliers, and their economic interpretation, a basic understanding of econometric methods, their assumptions and limitations is very useful if not possible.

6. **Business Economics and relationship with Decision-making and forward planning:**

   Decision-making refers to the process of selecting one action from two or more alternative courses of action. Forward planning on the other hand is arranging plans for the future. In the functioning of a firm the question of choice arises because the available resources such as capital, land, labor and management, are limited and can be employed in alternative uses.

The decision-making function thus involves making choices or decisions that will provide the most efficient means of attaining an organizational objectives, for example profit maximization. Once a decision is made about the particular goal to be achieved, plans for the future regarding production, pricing, capital, raw materials and labor are prepared. Forward planning thus goes hand in hand with decision-making. The conditions in which firms work and take decisions, is characterized with uncertainty. And this uncertainty not only makes the function of decision-making and forward planning complicated but also adds a different dimension to it. If the knowledge of the future were perfect, plans could be formulated without error and hence without any need for subsequent revision.

In the real world, however, the business manager rarely has complete information about the future sales, costs, profits, and capital conditions. Etc. Hence, decisions are made and plans are formulated on the basis of past data, current information and the estimates about future that are predicted as accurately as possible. While the plans are implemented over time, more facts come into the knowledge of the businessman. In accordance with these facts the plans may have to be revised, and a different course of action needs to be adopted. Managers are thus engaged n a continuous process of decision- making through an uncertain future and the overall problem that they deal with is adjusting to uncertainty