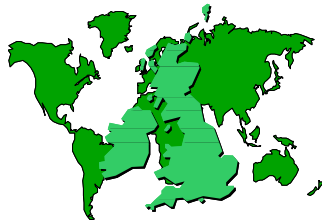


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Lecture 5 - Economic Environment 2 -
Macroeconomics

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Yesterday, we looked briefly at...



- **Macroeconomics** deals with the way the economy works at international or national level
- **Microeconomics** deals with **individual organisations** and their **customers** and **suppliers**



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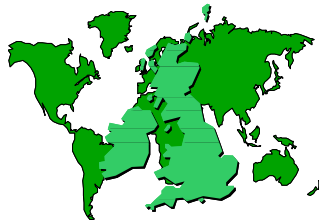
Agenda

- ▶ Macroeconomic environment
 - The structure of the economy
 - Measures
 - Circular flow of income
 - Multiplier effect
 - Accelerator effect
 - Inflation
 - Business cycle
 - Measuring and tracking economic activity

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Today, we'll find out how Macroeconomics is affecting us...



- **Macroeconomics** deals with the way the economy works at international or national level
- **Microeconomics** deals with individual organisations and their customers and suppliers



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Macroeconomics - definition

- “the branch of economics that studies economic aggregates (grand totals) e.g. the level of prices, output and employment in the economy” [10]
- Macroeconomics is concerned with the **whole economy**. It is therefore concerned with: [9]
 - **Aggregate demand** – “the total level of spending in the economy”
 - **Aggregate supply** – “the total amount of output in the economy”

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Macroeconomics - National

- The focus in this lecture is on the macroeconomic environment at the **national** level
- The **international economy** will be covered in the ‘Globalisation and international business’ lecture

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Key aspects of national macroeconomics

- The structure of the economy
 - Measures
- Circular flow of income
 - Multiplier effect
 - Accelerator effect
 - Inflation
- Business cycle
 - Measuring and tracking economic activity

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The structure of the national economy

- The national economy can be divided into three sections:
- **Primary** –the production and extraction of natural resources e.g. mining and from agriculture
- **Secondary** – output of the manufacturing and construction sectors (e.g. phone makers)
- **Tertiary** (Services) – production of services; includes finance, leisure, retail, communications and transport



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Measures of economic structure

Measuring the relative importance of each of the three sectors is recorded in three different ways:

- The share of **Gross Domestic Product** (GDP) that each sector accounts for
- The proportion of **labour** employed in each sector
- The contribution of the sector to the nation's **balance of payments**

Balance of payments – “a record of all transactions between domestic consumers and firms and those based overseas”

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The reasons for change

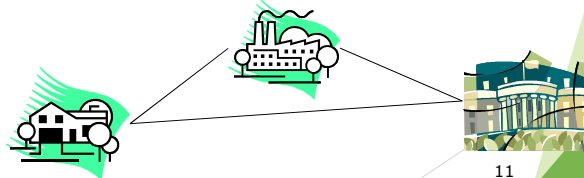


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Circular flow of income

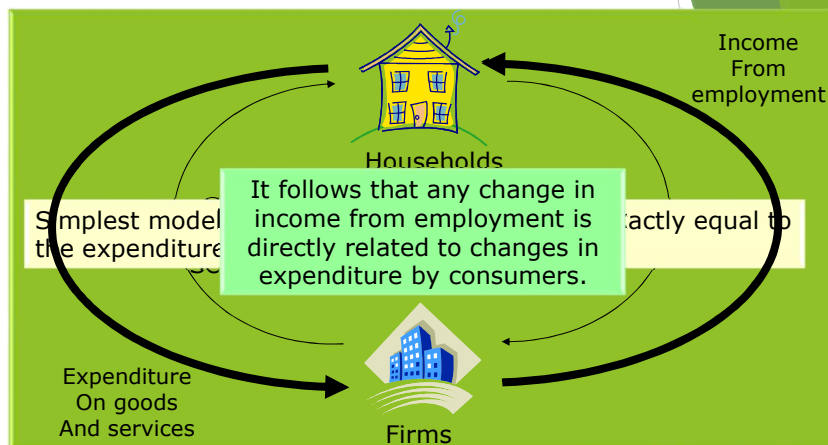
- Definition
 - “the means by which money circulates in an economy between households and firms”
Palmer
- The **level of wealth** within an economy is influenced by the **interactions** between households, firms and government



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Simplified Circular Flow of Income

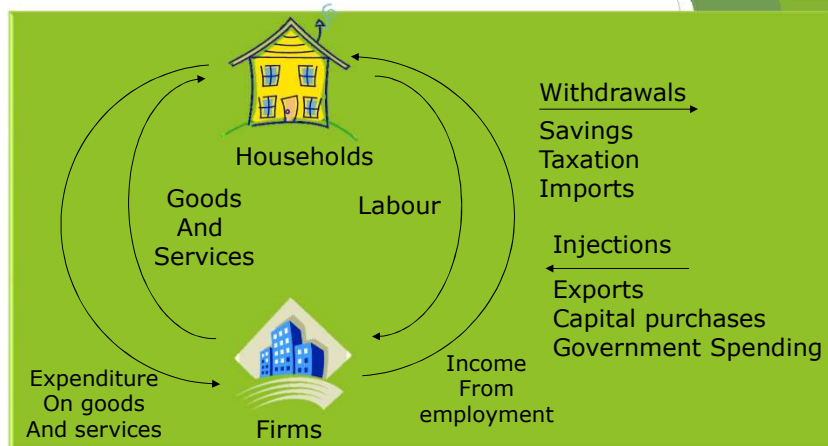


[12]

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Modified Circular Flow of Income

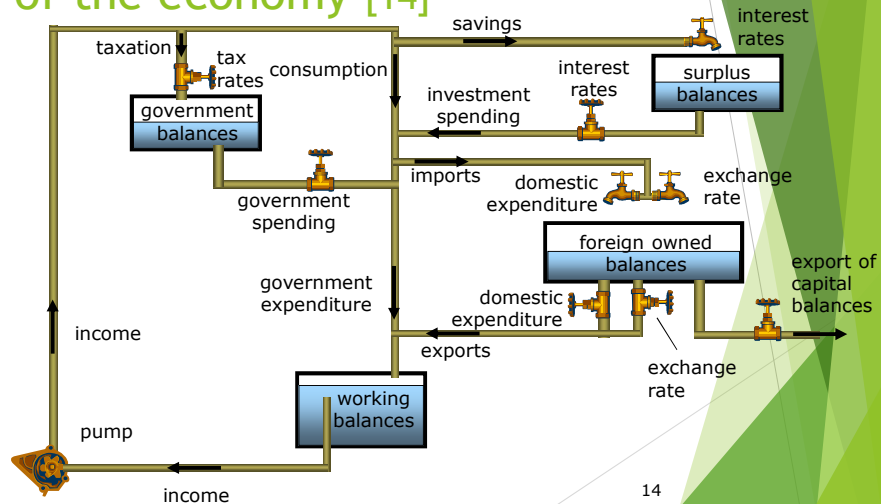


[13]

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The Phillips machine model of the economy [14]



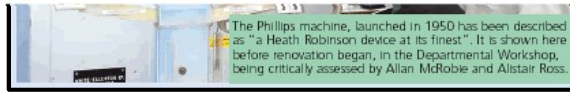
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The Phillips machine model of the economy



The Phillips Machine is actually a physical hydraulic computer that can predict the running of the national economy to within 4% accuracy. Only fourteen Phillips Machines were ever made and the Cambridge University machine is believed to be the only one still in a potentially-working condition.



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Multiplier effect

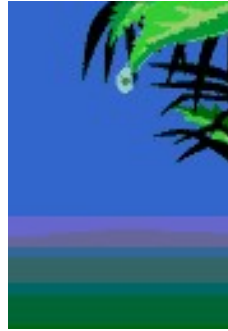
- Definition:
 - “the **addition** to total income and expenditure within an economy resulting from an **initial injection** of expenditure” *Palmer*
- The impact of injecting money into the circular flow of income will
 - have an **initial impact** on households and businesses that are **directly** affected,
 - but will also **indirectly impact** those in the remainder of the economy

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Multiplier effect

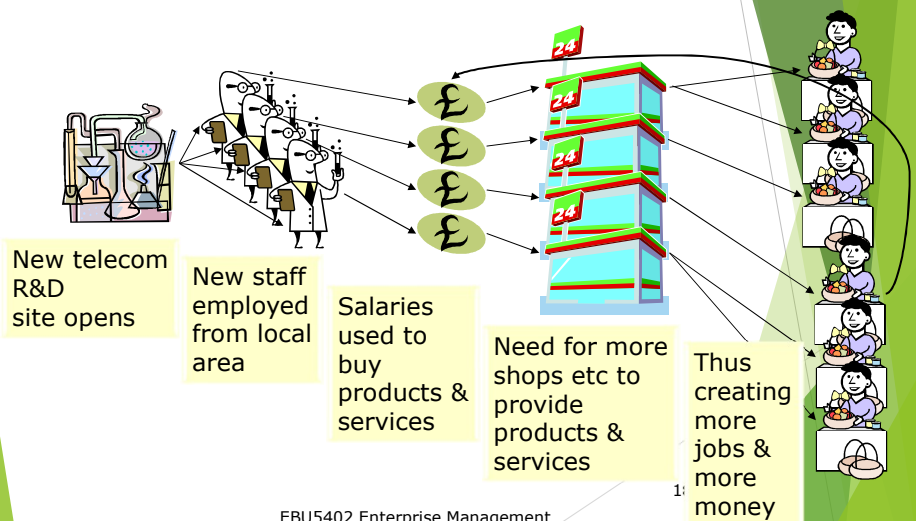
The multiplier effect is like the effects of a drop of water falling on a pond and causing ripples to spread out across the pond



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Multiplier effect - example



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Accelerator effect

- Definition:
 - “When a small change in demand has a much larger effect on investment or supply”
- The level of investment depends on the **rate of change** of national income or of demand
- Because it depends on rate of change, there can be large fluctuations

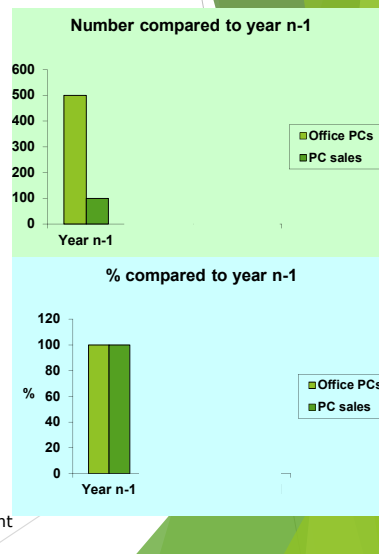
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Accelerator effect - example

- An office
 - normally **replaces 100 PCs** each year (i.e. scraps 100 and buys 100 new ones)
 - It has a total of 500 PCs in use
- It decides to **reduce** its total number of PCs to 450
- Thus, in the next year, it scraps 100 PCs and only **buys 50** new PCs
- The **office** has reduced its PC numbers by **10%** but the **manufacturer** has lost **50%** of its sales for that year
- In later years, the office needs 45 PCs a year

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Inflation

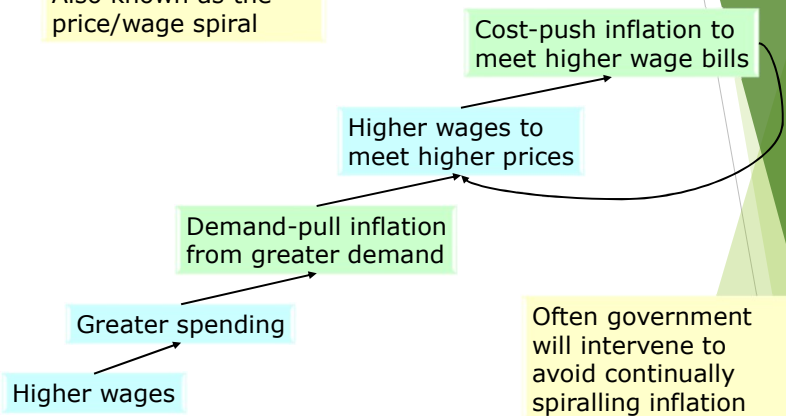
- Definition:
 - “a rise in the general level of prices of services and goods” *Palmer*
- As a result of inflation, a particular amount of money is able to buy less
- When **more money** enters the market through the multiplier effect, there is **more demand** for the limited amount of products, this leads to **demand-pull** inflation
- Where increases in **product costs** push up the **price** at which companies will supply their goods, this leads to **cost-push** inflation

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Inflationary spiral

Also known as the
price/wage spiral



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Business cycle

- National economies are **seldom stable**
- An increase in **withdrawals** will result in a **decrease** in economic activity
- An excess of **injections** will result in an **increase** in economic activity
- A business cycle describes the **fluctuations** of activity in an economy
 - Recession ↔ prosperity
 - Expansion ↔ contraction
 - Boom ↔ bust

Withdrawals

Savings
Taxation
Imports

Injections

Exports
Capital purchases
Government Spending

[13]

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Other indicators

- GDP is not the only major way of monitoring the economic environment

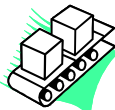
Others include [17]:

- **Unemployment rates**

- unemployment rates have both financial and social implications on a nation

- **Output levels –**

- output of firms is an important indicator of business cycles
- it is watched closely because of its effects on employment and
- the multiplier effects of firms producing less and therefore spending less with their suppliers



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Other indicators



○ Average earnings

- *under*-employment can affect the national economy just as importantly as *un*employment as workers are put on short-time working or lose opportunities for overtime work



○ Disposable income

- average disposable income refers to the income that individuals have available to spend after taxation



○ Consumer spending

- trends in consumer spending may not be the same as trends in income because of changes in consumers' desire to borrow or save

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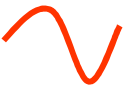
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Other indicators



○ Inflation rate

- a commonly used general indicator of inflation in European countries is the consumer prices index



○ Interest rates

- interest rates tend to follow a cyclical pattern, which is partly a reflection of the level of activity in the economy



Overseas trade figures

- indicate the difference between a country's imports and exports



○ Exchange rates

- falling rates of exchange against other currencies may be interpreted as overseas investors losing their confidence in an economy or its government

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Mini Case Study

- ▶ In groups, list the key macroeconomic variables that are affecting Apple in it's global operations (as of autumn 2018), do you think Apple will continue its success in the next 18 months?
- ▶ 3 randomly selected groups will present in front of the class.

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Coursework - Part A (25%)

1. Consider the external factors, both macro and micro, that your organisation faces and how these will influence any decision to diversify into a new area of products or services.
2. For each of the factors given to you in the lecture notes and in the core text, provide an evaluation of how these factors have influenced your organisation **over the last 18 months** and how they will affect your desire and ability to move into a new product/service area. You should ensure that you include both a theoretical analysis and specific examples for your organisation.
3. Based on this analysis, **choose a new area** of products or services for your organisation to move into (in addition to its current activities).

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Coursework - First Submission

- Part A (25%) – by **Friday 2nd of November, 2018**
 - Electronic submission via QM+
 - Only, 1 submission per cw group
 - Late submission will not be marked

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References

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5. Sloman Pg. 212
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11. Sloman Pg. 10
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