BEFA UNIT I

B U S I N E S S

INTRODUCTION

Human beings are continuously engaged in some activity or other in order to satisfy their unlimited wants. Every day we come across the word 'business' or 'businessman' directly or indirectly. Business has become essential part of modern world.

Business is an economic activity, which is related with continuous and regular production and distribution of goods and services for satisfying human wants.

All of us need food, clothing and shelter. We also have many other household requirements to be satisfied in our daily lives. We met these requirements from the shopkeeper. The shopkeeper gets from wholesaler. The wholesaler gets from manufacturers. The shopkeeper, the wholesaler, the manufacturer are doing business and therefore they are called as Businessman.

DEFINITIONS

Stephenson defines business as, "The regular production or purchase and sale of goods undertaken with an objective of earning profit and acquiring wealth through the satisfaction of human wants."

Dicksee defines business as "a form of activity conducted with an objective of earning profits for the benefit of those on whose behalf the activity is conducted."

Lewis Henry defines business as, "Human activity directed towards producing or acquiring wealth through buying and selling of goods."

Thus, the term business means continuous production and distribution of goods and services with the aim of earning profits under uncertain market conditions.

CHARACTERISTICS

1. Exchange of goods and services

All business activities are directly or indirectly concerned with the exchange of goods or services for money or money's worth.

2. Deals in numerous transactions

In business, the exchange of goods and services is a regular feature. A businessman regularly deals in a number of transactions and not just one or two transactions.

3. Profit is the main Objective

The business is carried on with the intention of earning a profit. The profit is a reward for the services of a businessman.

4. Business skills for economic success

Anyone cannot run a business. To be a good businessman, one needs to have good business qualities and skills. A businessman needs experience and skill to run a business.

5. Risks and Uncertainties

Business is subject to risks and uncertainties. Some risks, such as risks of loss due to fire and theft can be insured. There are also uncertainties, such as loss due to change in demand or fall in price cannot be insured and must be borne by the businessman.

6. Buyer and Seller

Every business transaction has minimum two parties that is a buyer and a seller. Business is nothing but a contract or an agreement between buyer and seller.

7. Connected with production

Business activity may be connected with production of goods or services. In this case, it is called as industrial activity. The industry may be primary or secondary.

8. Marketing and Distribution of goods

Business activity may be concerned with marketing or distribution of goods in which case it is called as commercial activity.

9. Deals in goods and services

In business there has to be dealings in goods and service.

Goods may be divided into following two categories :-

1. **Consumer goods** : Goods which are used by final consumer for consumption are called consumer goods e.g. T.V., Soaps, etc.
2. **Producer goods** : Goods used by producer for further production are called producers goods e.g. Machinery, equipments, etc. Services are intangible but can be exchanged for value like providing transport, warehousing and insurance services, etc.

10. To Satisfy human wants

The businessman also desires to satisfy human wants through conduct of business. By producing and supplying various commodities, businessmen try to promote consumer's satisfaction.

11. Social obligations

Modern business is service oriented. Modern businessmen are conscious of their social responsibility. Today's business is service-oriented rather than profit-oriented.

STRUCTURE OF BUSINESS FIRM

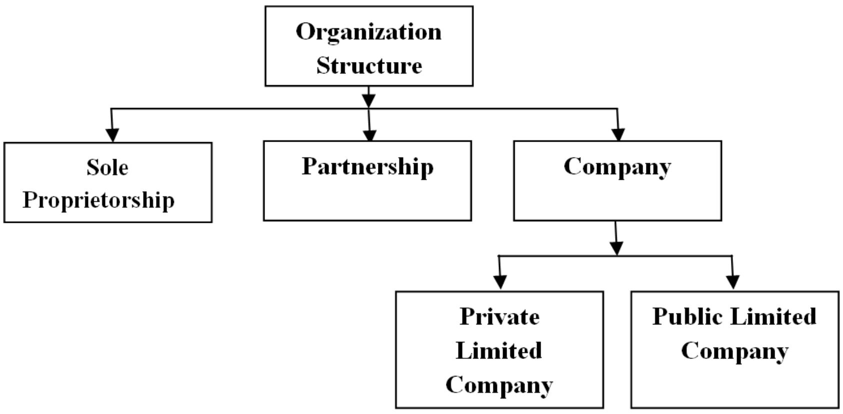
A business firm is an organization that uses resources to produce goods and services that are sold to consumers, other firms, or the government. Most businesses exist because a group of people working together can be more effective than a group of people working individually.

Firms are grouped into three types: sole proprietorships, partnerships, and companies.

A sole proprietorship is a business that is owned by one individual. This owner makes all the business decisions, receives all the profits or losses of the firm, and is legally responsible for the debts of the firm.

A type of business organization in which two or more individuals pool money, skills, and other resources, and share profit and loss in accordance with terms of the partnership agreement. In absence of such agreement, a partnership is assumed to exit where the participants in an enterprise agree to share the associated risks and rewards proportionately.

A company is a legal entity, allowed by legislation, which permits a group of people, as shareholders, to apply to the government for an independent organization to be created, which can then focus on pursuing set objectives, and empowered with legal rights which are usually only reserved for individuals, such as to sue and be sued, own property, hire employees or loan and borrow money.



THEORY OF FIRM

The following are the various theories of the firm.

1. Profit Maximization Theory

Profit maximization is one of the most common and widely accepted objectives of a firm. According to the profit maximization theory, the main aim of the firm is to produce large amount of profits. Profit is considered as the internal source of funds and the market value of the firm also rely mainly on the profits earned by the firm. in order to survive in the market, it is very essential for the firms to earn profits. Profits are obtained by deducting total revenue from the total cost i.e., Profit = Total revenue – total cost

2. Baumol's Theory of Sales Revenue Maximization

According to Baumol, maximization of sales revenue is the main objective of the firms in the competitive markets. It's based on the theory that, once a company has reached an acceptable level of profit for a good or service, the aim should shift away from increasing profit to focus on increasing revenue from sales. According to the theory, companies should do so by producing more, keeping prices low, and investing in advertising to increase product demand. The idea is that applying this sales revenue maximization model will improve the overall reputation of the company and, in turn, lead to higher long-term profits.

He found that sales volumes helps in finding out the market leadership in competition. According to him, in large organization, the salary and other benefits of the managers are connected with the sales volumes instead of profits. Banks give loans to firms with more sales. So, managers try to maximize the total revenue of the firms. The volume of sales represents the position of the firm in the market. The managers' performance is measured on the basis of the attainment of sales and maintain minimum profit. Thus, the main aim of the firm is to maximize sales revenue and maintain minimum profits for satisfying shareholders.

3. Marris theory of Growth Maximization

According to Marris, owners/shareholders strive for attaining profits and market share and mangers strive for better salary, job security and growth. These two objectives can be attained by maximizing the balanced growth of the firm. The balanced growth of the firm relies mainly on the growth rate of demand for the firm's products and growth rate of capital supplied to the firm. if the demand for the firm's product and the capital supplied to the firm grows at the same rate then the growth rate of the firm will be considered as balanced.

Marris found that the firms faces two difficulties while attaining the objectives of maximization of balanced growth which are managerial difficulties and financial difficulties. For maximizing the growth of the firm the managers should have skills, expertise, efficiency and sincerity in them. The prudent financial policy of the firm depends on at least three financial ratios which restricts the growth of the firm. 1. Debt-Equity Ratio 2. Liquidity Ratio, 3. Retention Ratio.

4. Williamson's Model of Managerial Utility Functions

Williamson's model combined profits maximization and growth maximization objectives. According to the model of managerial utility functions, managers makes use of their discretionary powers for maximizing their own utility function and maintains minimum profits for satisfying shareholders.

- Minimum profits for minimum investment and growth of the firm.
- Managers want to maximize their own utility (satisfaction).
- Satisfaction or utility of managers depends on three variables.
  1. Staff salaries, S: Includes management salaries, administration expenses, selling expenditure. More the staff exp. more sales. Power and prestige of managers increases with S.
  2. Management emoluments, M: i.e., luxury offices, fancy cars. Perks.
  3. Discretionary investments, D: Amount spent at his own discretion, e.g. on latest equipment, furniture, decoration material etc. to satisfy ego and give them a sense of pride. These give a boost to the manager's esteem and status in the organization.
- Managers use that combination of above variables that maximizes their own satisfaction.

The Williamson's model is written as,

UM = f(S,M,D)

Where, UM = Utility of Manager, S = Salaries, M = Managerial emoluments, D = Discretionary power for investments.

The utility function of the managers rely on salary of the mangers, job security, power, status, professional satisfaction and power to affect the objectives of the firm.

5. Behavioral Theories

According to the behavioral theories, the firm tries to attain a satisfactory behaviour instead of maximization. There are two important behavioral models, 1. Simon's satisfying model and 2. model developed by Cyest and March.

The Simon's satisfying model states that firms carry out their operations under 'bounded rationality' and can only attain a satisfactory level of profit, sales and growth. Simon carried out a research and found that modern business does not have adequate information and is uncertain about future due to which it is very difficult to attain profit, sales and growth objectives.

The model developed by Cyest and March states that firms should be oriented towards multi-goal and multi-decisions making. Instead of dealing with uncertainty and inadequate information, the firms should fulfil the conflicting goals of various stakeholders (such as shareholders, employees, customers, financiers, government and other social interest groups).

BEFA UNIT I

TYPES OF BUSINESS ENTITIES

I. Sole Proprietorship

The sole trader is the simplest, oldest and natural form of business organization. It is also called sole proprietorship. 'Sole' means one. 'Sole trader' implies that there is only one trader who is the owner of the business.

It is a one-man form of organization wherein the trader assumes all the risk of ownership carrying out the business with his own capital, skill and intelligence. He is the boss for himself. He has total operational freedom. He is the owner, Manager and controller. He has total freedom and flexibility. Full control lies with him. He can take his own decisions. He can choose or drop a particular product or business based on its merits. He need not discuss this with anybody. He is responsible for himself. This form of organization is popular all over the world. Ex: Restaurants, Supermarkets, pan shops, medical shops, hosiery shops etc.

Features

- It is easy to start a business under this form and also easy to close.
- He introduces his own capital. Sometimes, he may borrow, if necessary
- He enjoys all the profits and in case of loss, he lone suffers.
- He has unlimited liability which implies that his liability extends to his personal properties in case of loss.
- He has a high degree of flexibility to shift from one business to the other.
- Business secretes can be guarded well
- There is no continuity. The business comes to a close with the death, illness or insanity of the sole trader. Unless, the legal heirs show interest to continue the business, the business cannot be restored.
- He has total operational freedom. He is the owner, manager and controller.
- He can be directly in touch with the customers.

- He can take decisions very fast and implement them promptly.
- Rates of tax, for example, income tax and so on are comparatively very low.

Advantages

1. **Easy to start and easy to close**: Formation of a sole trader form of organization is relatively easy even closing the business is easy.
2. **Personal contact with customers directly:** Based on the tastes and preferences of the customers the stocks can be maintained.
3. **Prompt decision-making:** To improve the quality of services to the customers, he can take any decision and implement the same promptly. He is the boss and he is responsible for his business Decisions relating to growth or expansion can be made promptly.
4. **High degree of flexibility:** Based on the profitability, the trader can decide to continue or change the business, if need be.
5. **Secrecy:** Business secrets can well be maintained because there is only one trader.
6. **Low rate of taxation:** The rate of income tax for sole traders is relatively very low.
7. **Direct motivation:** If there are profits, all the profits belong to the trader himself. In other words. If he works more hard, he will get more profits. This is the direct motivating factor. At the same time, if he does not take active interest, he may stand to lose badly also.
8. **Total Control:** The ownership, management and control are in the hands of the sole trader and hence it is easy to maintain the hold on business.
9. **Minimum interference from government:** Except in matters relating to public interest, government does not interfere in the business matters of the sole trader. The sole trader is free to fix price for his products/services if he enjoys monopoly market.

10. **Transferability:** The legal heirs of the sole trader may take the possession of the business.

Disadvantages

1. **Unlimited liability:** The liability of the sole trader is unlimited. It means that the sole trader has to bring his personal property to clear off the loans of his business. From the legal point of view, he is not different from his business.

2. **Limited amounts of capital:** The resources a sole trader can mobilize cannot be very large and hence this naturally sets a limit for the scale of operations.

3. **No division of labour:** All the work related to different functions such as marketing, production, finance, labour and so on has to be taken care of by the sole trader himself. There is nobody else to take his burden. Family members and relatives cannot show as much interest as the trader takes.

4. **Uncertainty:** There is no continuity in the duration of the business. On the death, insanity of insolvency the business may be come to an end.

5. **Inadequate for growth and expansion:** This from is suitable for only small size, one-man-show type of organizations. This may not really work out for growing and expanding organizations.

6. **Lack of specialization:** The services of specialists such as accountants, market researchers, consultants and so on, are not within the reach of most of the sole traders.

7. **More competition:** Because it is easy to set up a small business, there is a high degree of competition among the small businessmen and a few who are good in taking care of customer requirements along can service.

8. **Low bargaining power:** The sole trader is the in the receiving end in terms of loans or supply of raw materials. He may have to compromise many times regarding the terms and conditions of purchase of materials or borrowing loans from the finance houses or banks.

II. Partnership

Partnership is an improved from of sole trader in certain respects. Where there are like-minded persons with resources, they can come together to do the business and share the profits/losses of the business in an agreed ratio. Persons who have entered into such an agreement are individually called 'partners' and collectively called 'firm'. The relationship among partners is called a partnership.

Indian Partnership Act, 1932 defines partnership as the relationship between two or more persons who agree to share the profits of the business carried on by all or any one of them acting for all.

Features

1. **Relationship:** Partnership is a relationship among persons. It is relationship resulting out of an agreement.
2. **Two or more persons:** There should be two or more number of persons.
3. **There should be a business**: Business should be conducted.
4. **Agreement:** Persons should agree to share the profits/losses of the business
5. **Carried on by all or any one of them acting for all:** The business can be carried on by all or any one of the persons acting for all. This means that the business can be carried on by one person who is the agent for all other persons. Every partner is both an agent and a principal.
6. **Unlimited liability:** The liability of the partners is unlimited. The partnership and partners, in the eye of law, and not different but one and the same. Hence, the partners have to bring their personal assets to clear the losses of the firm, if any.
7. **Number of partners:** According to the Indian Partnership Act, the minimum number of partners should be two and the maximum number if restricted, as given below:
    - 10 partners is case of banking business

- 20 in case of non-banking business

8. **Division of labour:** Because there are more than two persons, the work can be divided among the partners based on their aptitude.
9. **Personal contact with customers:** The partners can continuously be in touch with the customers to monitor their requirements.
10. **Flexibility:** All the partners are likeminded persons and hence they can take any decision relating to business.

Partnership Deed

The written agreement among the partners is called 'the partnership deed'. It contains the terms and conditions governing the working of partnership. The following are contents of the partnership deed.

1. Names and addresses of the firm and partners
2. Nature of the business proposed
3. Duration
4. Amount of capital of the partnership and the ratio for contribution by each of the partners.
5. Their profit sharing ration (this is used for sharing losses also)
6. Rate of interest charged on capital contributed, loans taken from the partnership and the amounts drawn, if any, by the partners from their respective capital balances.
7. The amount of salary or commission payable to any partner
8. Procedure to value good will of the firm at the time of admission of a new partner, retirement of death of a partner
9. Allocation of responsibilities of the partners in the firm
10. Procedure for dissolution of the firm

11. Name of the arbitrator to whom the disputes, if any, can be referred to for settlement.

12. Special rights, obligations and liabilities of partners(s), if any.

Kind Of Partners:

1. **Active Partner:** Active partner takes active part in the affairs of the partnership. He is also called working partner.

2. **Sleeping Partner:** Sleeping partner contributes to capital but does not take part in the affairs of the partnership.

3. **Nominal Partner:** Nominal partner is partner just for namesake. He neither contributes to capital nor takes part in the affairs of business. Normally, the nominal partners are those who have good business connections, and are well places in the society.

4. **Partner by Estoppels:** Estoppels means behavior or conduct. Partner by estoppels gives an impression to outsiders that he is the partner in the firm. In fact be neither contributes to capital, nor takes any role in the affairs of the partnership.

5. **Partner by holding out:** If partners declare a particular person (having social status) as partner and this person does not contradict even after he comes to know such declaration, he is called a partner by holding out and he is liable for the claims of third parties. However, the third parties should prove they entered into contract with the firm in the belief that he is the partner of the firm. Such a person is called partner by holding out.

6. **Minor Partner:** Minor has a special status in the partnership. A minor can be admitted for the benefits of the firm. A minor is entitled to his share of profits of the firm. The liability of a minor partner is limited to the extent of his contribution of the capital of the firm.

Advantages

1. **Easy to form:** Once there is a group of like-minded persons and good business proposal, it is easy to start and register a partnership.

2. **Availability of larger amount of capital:** More amount of capital can be raised from more number of partners.

3. **Division of labour:** The different partners come with varied backgrounds and skills. This facilities division of labour.

4. **Flexibility:** The partners are free to change their decisions, add or drop a particular product or start a new business or close the present one and so on.

5. **Personal contact with customers**: There is scope to keep close monitoring with customers requirements by keeping one of the partners in charge of sales and marketing. Necessary changes can be initiated based on the merits of the proposals from the customers.

6. **Quick decisions and prompt action:** If there is consensus among partners, it is enough to implement any decision and initiate prompt action. Sometimes, it may more time for the partners on strategic issues to reach consensus.

7. **The positive impact of unlimited liability:** Every partner is always alert about his impending danger of unlimited liability. Hence he tries to do his best to bring profits for the partnership firm by making good use of all his contacts.

Disadvantages:

1. **Formation of partnership is difficult:** Only like-minded persons can start a partnership. It is sarcastically said,' it is easy to find a life partner, but not a business partner'.

2. **Liability:** The partners have joint and several liabilities beside unlimited liability. Joint and several liability puts additional burden on the partners, which means that even the personal properties of the partner or partners can be attached. Even when all but one partner become insolvent, the solvent partner has to bear the entire burden of business loss.

3. **Lack of harmony or cohesiveness:** It is likely that partners may not, most often work as a group with cohesiveness. This result in mutual

conflicts. Lack of harmony results in delay in decisions and paralyses the entire operations.

4. **Limited growth:** The resources when compared to sole trader, a partnership may raise little more. But when compare to the other forms such as a company, resources raised in this form of organization are limited. Added to this, there is a restriction on the maximum number of partners.

5. **Instability:** The partnership form is known for its instability. The firm may be dissolved on death, insolvency or insanity of any of the partners.

6. **Lack of Public confidence:** Public and even the financial institutions look at the unregistered firm with a suspicious eye. Though registration of the firm under the Indian Partnership Act is a solution of such problem, this cannot revive public confidence into this form of organization overnight. The partnership can create confidence in other only with their performance.

III. Joint Stock Company

The joint stock company emerges from the limitations of partnership such as joint and several liability, unlimited liability, limited resources and uncertain duration and so on. Normally, to take part in a business, it may need large money and we cannot foretell the fate of business. It is not literally possible to get into business with little money. Against this background, it is interesting to study the functioning of a joint stock company. The main principle of the joint stock company from is to provide opportunity to take part in business with a low investment as possible say Rs.1000. Joint Stock Company has been a boon for investors with moderate funds to invest.

Company Defined

Lord justice Lindley explained the concept of the joint stock company from of organization as **'an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose'.**

Features

1. **Artificial person:** The Company has no form or shape. It is an artificial person created by law. It is intangible, invisible and existing only, in the eyes of law.

2. **Separate legal existence**: it has an independence existence, it separate from its members. It can acquire the assets. It can borrow for the company. It can sue other if they are in default in payment of dues, breach of contract with it, if any. Similarly, outsiders for any claim can sue it.

3. **Voluntary association of persons**: The Company is an association of voluntary association of persons who want to carry on business for profit. To carry on business, they need capital. So they invest in the share capital of the company.

4. **Limited Liability**: The shareholders have limited liability i.e., liability limited to the face value of the shares held by him.

5. **Capital is divided into shares**: The total capital is divided into a certain number of units. Each unit is called a share.

6. **Transferability of shares**: In the company form of organization, the shares can be transferred from one person to the other. A shareholder of a public company can sell his holding of shares at his will. However, the shares of a private company cannot be transferred.

7. **Common Seal**: As the company is an artificial person created by law has no physical form, it cannot sign its name on a paper; so, it has a common seal on which its name is engraved. The common seal should affix every document or contract.

8. **Perpetual succession**: 'Members may comes and members may go, but the company continues for ever.

9. **Ownership and Management separated**: The shareholders are spread over the length and breadth of the country, and sometimes, they are from different parts of the world. To facilitate administration, the shareholders

elect some among themselves directors to a Board, which looks after the management of the business. The Board recruits the managers and employees at different levels in the management. Thus the management is separated from the owners.

10. **Winding up**: Winding up refers to the putting an end to the company. Because law creates it, only law can put an end to it. The company is not affected by the death or insolvency of any of its members.

11. **The name of the company ends with 'limited'**: it is necessary that the name of the company ends with limited (Ltd.) to give an indication to the outsiders that they are dealing with the company with limited liability and they should be careful about the liability aspect of their transactions with the company.

Advantages

1. **Mobilization of larger resources:** A joint stock company provides opportunity for the investors to invest, even small sums, in the capital of large companies. The facilities rising of larger resources.

2. **Separate legal entity:** The Company has separate legal entity. It is registered under Indian Companies Act, 1956.

3. **Limited liability:** The shareholder has limited liability in respect of the shares held by him. In no case, does his liability exceed more than the face value of the shares allotted to him.

4. **Transferability of shares:** The shares can be transferred to others. However, the private company shares cannot be transferred.

5. **Liquidity of investments**: By providing the transferability of shares, shares can be converted into cash.

6. **Inculcates the habit of savings and investments**: Because the share face value is very low, this promotes the habit of saving among the common man and mobilizes the same towards investments in the company.

7. **Democracy in management**: the shareholders elect the directors in a democratic way in the general body meetings.

8. **Continued existence**: The Company has perpetual succession. It has no natural end. It continues forever and ever unless law put an end to it.

9. **Growth and Expansion**: With large resources and professional management, the company can earn good returns on its operations, build good amount of reserves and further consider the proposals for growth and expansion.

Disadvantages

1. **Formation of company is a long drawn procedure**: Promoting a joint stock company involves a long drawn procedure. It is expensive and involves large number of legal formalities.

2. **High degree of government interference**: The government brings out a number of rules and regulations governing the internal conduct of the operations of a company such as meetings, voting, audit and so on, and any violation of these rules results into statutory lapses, punishable under the companies act.

3. **Inordinate delays in decision-making**: As the size of the organization grows, the number of levels in organization also increases in the name of specialization. The more the number of levels, the more is the delay in decision-making.

4. **Lack or initiative**: In most of the cases, the employees of the company at different levels show slack in their personal initiative with the result, the opportunities once missed do not recur and the company loses the revenue.

5. **Lack of responsibility and commitment**: In some cases, the managers at different levels are afraid to take risk and more worried about their jobs rather than the huge funds invested in the capital of the company lose the revenue.

IV. Limited Liability Company (LLC)

Limited Liability Company is another category of company registered under the Indian New Companies Act, 2013. There are number of companies available in India including private limited and public limited ones but Limited Liability Company is a brand new one in the line. It's often called as a Limited Liability Corporation and its nature of business is quite similar with partnership firm and sole trade business. Company is an association of persons or an artificial person formed under the Indian Companies act in order to carry out a certain business. Under the Limited Liability Company Act, liability is limited among members or partners.

New Companies Act, 2013 has defined all rules and regulations regarding incorporating and registering all limited liability companies. One should apply to the Registrar of Companies (ROC) by giving all the details regarding company including name of the company, name and address of board of directors, location of the company as per the company registration services.

A private company whose owners are legally responsible for its debts only to the extent of the amount of capital they invested. A Limited Liability Company, also known as an LLC, is a type of business structure that combines traits of both a sole-proprietorship and a company. An LLC is eligible for the pass-through taxation feature of a partnership or sole proprietorship, while at the same time limiting the liability of the owners, similar to a company. As the LLC is not considered a separate entity, the company does not pay taxes or take on losses. Instead, this is done by the owners as they have to report the business profits, or losses, on their personal income tax returns. However, just like company, members of an LLC are protected from personal liabilities, thus the name Limited Liability.

A limited liability company is an U.S. form of privately owned company that combines the limited liability of a company with the simplified taxation of a sole proprietorship or partnership. Owners of a limited liability company, referred to as an "LLC," report the company's profits and losses on their personal income tax returns, rather than preparing separate corporate tax returns. This is known as "pass-through taxation." LLC owners are referred to as "members," and the company may be owned by a single individual, two or more individuals, or by a company or another LLC.

Features

1. **Limited liability:** As the name implies, members' liabilities for the debts and obligations of the LLC are limited to their own investment.

2. **Pass-through taxation:** For taxation purposes, income from your business can be treated as your own personal income, and is therefore not subject to certain corporate taxes for which companies are liable.

3. **Separate Legal Entity:** A LLP is a legal entity and a juristic person established under the Act. Therefore, a LLP has wide legal capacity and can own property and also incur debts. However, the Partners of a LLP have no liability to the creditors of a LLP for the debts of the LLP.

4. **Uninterrupted Existence:** A LLP has 'perpetual succession', that is continued or uninterrupted existence until it is legally dissolved. A LLP being a separate legal person, is unaffected by the death or other departure of any Partner. Hence, a LLP continues to be in existence irrespective of the changes in ownership.

5. **Audit not Required:** A LLP does not require audit if it has less than Rs. 40 lakhs of turnover and less than Rs.25 lakhs of capital contribution. Therefore, LLPs are ideal for startups and small businesses that are just starting their operations and want to have minimal regulatory compliance related formalities.

6. **Easy Transferability:** The ownership of a LLP can be easily transferred to another person by inducting them as a Partner of the LLP. LLP is a separate legal entity separate from its Partners, so by changing the Partners, the ownership of the LLP can be changed.

7. **Owning Property:** A LLP being an artificial judicial person, can acquire, own, enjoy and sell, property in its name. No Partner can make any claim upon the property of the LLP - so long as the LLP is a going concern.

Advantages

1. **Limited liability:** As the name implies, members' liabilities for the debts and obligations of the LLC are limited to their own investment.

2. **Pass-through taxation:** For taxation purposes, income from your business can be treated as your own personal income, and is therefore not subject to certain corporate taxes for which companies are liable.

3. **Limitless ownership:** Some legal structures limit the number of people allowed to file as owners. With an LLC, there is no limit to the number of owners. An LLC can have one member or hundreds of members.

4. **Allocation flexibility:** In an LLC, the amount of money that owners invest into the business doesn't need to equal their percentage of ownership. When an LLC is formed, members create an operating agreement, in which different percentages of company profits and losses can be assigned to owners regardless of the amounts of their initial investments.

5. **Freedom in management:** Unlike standard companies, LLCs are not required to have a board of directors, annual meetings, or strict book requirements. This can free up a lot of time and stress to let you run your business on your own terms. As you can imagine, this can be an important advantage of a limited liability company as well.

Disadvantages

1. **Building capital:** Unlike companies, which can issue stock in order to increase funds for their companies, LLCs have to work a little harder to find investors and sources of capital due to the greater legal obligations to add a new member to an LLC. If you have a fast growth internet company that needs venture capital to scale, this limitation is one of the major disadvantages of a limited liability company.

2. **Higher fees:** LLCs must typically pay more fees to file as LLCs compared to some other business entities or sole proprietorships.

3. **Government regulation:** Because of the protections afforded to LLCs, some types of businesses are ineligible to file as LLCs. Banks, insurance

companies, and medical service companies are examples of businesses that may be barred from filing.

4. **Lack of case law:** The LLC business form is a relatively new concept. As a result, not a lot of cases have been decided surrounding LLCs. Case law is important because of predictability. If you know a court has ruled a certain way, you can act accordingly to protect yourself.

5. **Confusion About Roles:** Whereas corporations have specific roles (like directors, managers, and employees), LLCs generally do not. This can make it difficult for the company and especially investors to know who's in charge, who can sign certain contracts, etc. Some of this confusion can be avoided by creating an LLC Operating Agreement.

6. **Limited Life:** In many jurisdictions, if a member departs the LLC, the LLC ceases to exist. This is unlike a corporation whose identity is unaffected by the comings and goings of shareholders. Members of LLCs can combat this weakness in the Operating Agreement.

SOURCES OF RAISING CAPITAL

Sources of raising long-term capital:

1) **Issue of Shares**: The amount of capital decided to be raised from members of the public is divided into units of equal value. These units are known as share and the aggregate values of shares are known as share capital of the company. Those who subscribe to the share capital become members of the company and are called shareholders. They are the owners of the company.

   a) **Issue of Preference Shares**: Preference share have three distinct characteristics. Preference shareholders have the right to claim dividend at a fixed rate, which is decided according to the terms of issue of shares. Moreover, the preference dividend is to be paid first out of the net profit. The balance, it any, can be distributed among other shareholders that is, equity shareholders. However, payment of dividend is not legally compulsory. Only when dividend is declared, preference shareholders have a prior claim over equity shareholders.

Preference shareholders also have the preferential right of claiming repayment of capital in the event of winding up of the company. Preference capital has to be repaid out of assets after meeting the loan obligations and claims of creditors but before any amount is repaid to equity shareholders.

b) **Issue of Equity Shares**: The most important source of raising long-term capital for a company is the issue of equity shares. In the case of equity shares there is no promise to shareholders a fixed dividend. But if the company is successful and the level profits are high, equity shareholders enjoy very high returns on their investment. This feature is very attractive to many investors even though they run the risk of having no return if the profits are inadequate or there is loss. They have the right of control over the management of the company and their liability is limited to the value of shares held by them.

2) Issue of Debentures: When a company decides to raise loans from the public, the amount of loan is divided into units of equal. These units are known as debentures. A debenture is the instrument or certificate issued by a company to acknowledge its debt. Those who invest money in debentures are known as 'debenture holders'. They are creditors of the company. Debentures carry a fixed rate of interest, and generally are repayable after a certain period.

3) Loans from financial Institutions: Government with the main object of promoting industrial development has set up a number of financial institutions. These institutions play an important role as sources of company finance. These institutions provide medium and long-term finance to industrial enterprises at a reason able rate of interest. Thus companies may obtain direct loan from the financial institutions for expansion or modernization of existing manufacturing units or for starting a new unit.

4) Retained Profits: Successful companies do not distribute the whole of their profits as dividend to shareholders but reinvest a part of the profits. The amount of profit reinvested in the business of a company is known as retained profit.

5) **Public Deposits:** An important source of medium – term finance which companies make use of is public deposits. This requires advertisement to be issued inviting the general public of deposits. Against the deposit, the company mentioning the amount, rate of interest, time of repayment and such other information issues a receipt.

Sources of raising short-term capital:

1) **Trade credit**: Trade credit is a common source of short-term finance available to all companies. It refers to the amount payable to the suppliers of raw materials, goods etc. after an agreed period, which is generally less than a year. It is customary for all business firms to allow credit facility to their customers in trade business. Thus, it is an automatic source of finance.

2) **Bank loans and advances**: Money advanced or granted as loan by commercial banks is known as bank credit. Companies generally secure bank credit to meet their current operating expenses. The most common forms are cash credit and overdraft facilities. Under the cash credit arrangement, the maximum limit of credit is fixed in advance on the security of goods and materials in stock.

3) **Overdraft**: In the case of overdraft, the company is allowed to overdraw its current account up to the sanctioned limit. This facility is also allowed either against personal security or the security of assets. Interest is charged on the amount actually overdrawn, not on the sanctioned limit.

4) **Discounting of Bills**: Commercial banks also advance money by discounting bills of exchange. A company having sold goods on credit may draw bills of exchange on the customers for their acceptance. A bill is an order in writing requiring the customer to pay the specified amount after a certain period (say 60 days or 90 days). After acceptance of the bill, the company can drawn the amount as an advance from many commercial banks on payment of a discount. The amount of discount, which is equal to the interest for the period of the bill, and the balance, is available to the company. Bill discounting is thus another source of short-term finance available from the commercial banks.

5) **Short term loans from finance companies**: Short-term funds may be available from finance companies on the security of assets. Some finance companies also provide funds according to the value of bills receivable or

amount due from the customers of the borrowing company, which they take over.

NON-CONVENTIONAL SOURCES OF FINANCE

1. Venture capital

Venture capital is financing that investors provide to start-up companies and small businesses that are believed to have long-term growth potential. Venture capital generally comes from venture capital firms, which comprise of professionally well-off investors, investment banks and any other financial institutions. However, it does not always take just a monetary form; it can be provided in the form of technical or managerial expertise.

Though it can be risky for the investors who put up the funds, the potential for above-average returns is an attractive payoff. For new companies or ventures that have a limited operating history (under two years), venture capital funding is increasingly becoming a popular – even essential – source for raising capital, especially if they lack access to capital markets, bank loans or other debt instruments. The main downside is that the investors usually get equity in the company, and thus a say in company decisions.

In a venture capital deal, large ownership chunks of a company are created and sold to a few investors through independent limited partnerships that are established by venture capital firms. Sometimes these partnerships consist of a pool of several similar enterprises. One important difference between venture capital and other private equity deals, however, is that venture capital tends to focus on emerging companies seeking substantial funds for the first time , while private equity tends to fund larger, more established companies that are seeking an equity infusion or a chance for company founders to transfer some of their ownership stake.

2. Angel Investors

An **angel investor** is a person who invests in a business venture, providing capital for start-up or expansion. Angel investors are typically individuals who have spare cash available and are looking for a higher rate of return than would be given by more traditional investments. An angel investment is a form of equity financing - the investor supplies funding in exchange for taking an equity position in the company.

3. Private Equity

Private equity is capital that is not noted on a public exchange. Private equity is composed of funds and investors that directly invest in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity. Institutional and retail investors provide the capital for private equity, and the capital can be utilized to fund new technology, make acquisitions, expand working capital, and to bolster and solidify a balance sheet.

Private equity comes primarily from institutional investors and accredited investors, who can dedicate substantial sums of money for extended time periods. In most cases, considerably long holding periods are often required for private equity investments, in order to ensure a turnaround for distressed companies or to enable liquidity events such as an initial public offering (IPO) or a sale to a public company.

4. IPO

An initial public offering, or IPO, is the very first sale of stock issued by a company to the public. Prior to an IPO the company is considered private, with a relatively small number of shareholders made up primarily of early investors (such as the founders, their families and friends) and professional investors (such as venture capitalists or angel investors). The public, on the other hand, consists of everybody else – any individual or institutional investor who wasn’t involved in the early days of the company and who is interested in buying shares of the company. Until a company’s stock is offered for sale to the public, the public is unable to invest in it. You can potentially approach the owners of a private company about investing, but they're not obligated to sell you anything. Public companies, on the other hand, have sold at least a portion of their shares to the public to be traded on a stock exchange. This is why an IPO is also referred to as "going public."

BEFA UNIT I

E C O N O M I C S

INTRODUCTION

The English word economics is derived from the ancient Greek word oikonomikos—meaning the management of a family or a household. Economics is the study of how individuals and societies make decisions about way to use scarce resources to fulfil wants and needs. Economics deals with individual choice, money and borrowing, production and consumption, trade and markets, employment and occupations, asset pricing, taxes and much more.
As an individual, for example, you constantly face the problem of having limited resources with which to fulfil your wants and needs. As a result, you must make certain choices with your money – what to spend it on, what not to spend it on, and how much to save for the future. You'll probably spend part of your money on relative necessities such as rent, electricity, clothing and food. Then you might use the rest to go to the movies, dine out or buy a smart phone. Economists are interested in the choices you make, and investigate why, for instance, you might choose to spend your money on a new mobile phone instead of replacing your old pair of shoes. The underlying essence of economics is trying to understand how individuals, companies, and nations as a whole behave in response to certain material constraints.

DEFINITIONS

1. **Adam Smith's Definition:-** Adam Smith, considered to be the founding father of modern Economics, defines Economics as **"the study of the nature and causes of nations' wealth or simply as the study of wealth".** The central point in Smith's definition is wealth creation. He assumed that, the wealthier a nation becomes the happier are its citizens. Thus, it is important to find out, how a nation can be wealthy. Economics is the subject that tells us how to make a nation wealthy. Adam Smith's definition is a wealth-centred definition of Economics.

2. **Alfred Marshall's Definition:-** Alfred Marshall also stressed the importance of wealth. But he also emphasised the role of the individual in the creation and the use of wealth. He defines: **"Economics is a study of man in the ordinary business of life. It enquires how he gets his income and how**

he uses it. Thus, it is on the one side, the study of wealth and on the other and more important side, a part of the study of man".

3. **Lionel Robbins' Definition:-** In his book **'Essays on the Nature and Significance of the Economic Science', published in 1932,** Robbins gave a definition which has become one of the most popular definitions of Economics. According to Robbins, **"Economics is a science which studies human behaviour as a relationship between ends and scarce means which have alternative uses".**

SIGNIFICANCE OF ECONOMICS

1. Allows to know the basics of human needs, production, distribution, reuse and better use of resources.
2. It provides the basis for exchange of goods and services between individuals, organizations and even countries.
3. Generates systems, techniques and public policies to improve social welfare.
4. Help to set target prices of goods and services.
5. Adjust political, financial and even social imbalances.
6. Provides knowledge and techniques that prevent crises and help them out.
7. It uses econometric techniques to predict future economic conditions that could harm or benefit certain situations in ascertain place, and how to maximize the benefits and problems mystify.
8. As you can see, economics is a science that encompasses us completely.
9. To be an expert in this field you can study a university degree in economics, in this course the student will learn how the economy moves and how to generate the best social conditions.

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MICRO AND MACRO ECONOMICS

The whole economic theory is broadly divided into two parts –

Micro economics and Macro economics.

These two terms were at first used by Ragner Frisch in 1933. But these two words became popular worldwide and most of the economist using nowadays. The term 'micro' and 'macro' were derived from Greek words 'Mikros' and 'Makros' meaning 'small' and 'large' respectively. So micro economics deals with the analysis of an individual unit and macro economics with economy as a whole. For example, in micro economics we study how price of goods or factors of production are determined. In macro economics we study what are the causes of high or low level of employment.

So, according to Edwin Mansfield – "Micro economics deals with the economic behaviour of individual units such as consumers, firms, and resource owners; while macro economics deals with behaviour of economic aggregates such as gross national product and the level of employment.

Meaning of Micro – economics

The term micro was originated from Greek word 'Mikros' which means small. Hence, microeconomics is concerned on small economic units like as individual consumer, households, firms, industry etc.

Microeconomics may be defined as the branch of economic analysis which studies about the economic behaviour of individual economic unit may be a person, a particular households, a particular firm and an industry. The main objective of micro – economics is to explain the principles, problems and policies related to the optimum allocation of resources. According to K. E. Boulding, "Microeconomics is the study of particular firm, particular households, individual price, wage, income of the industry and particular commodity".

It is the study of individual tree not a whole forest. Hence, microeconomics tries to explain how an individual allocates his money income among various needs as well as how an individual maximize satisfaction level from the consumption of available limited resources. Microeconomics also explains about the process of determination of individual price with interaction of demand and supply. It helps to determine the price of the product and factor inputs. Therefore, it is also called as price theory or demand and supply theory. Simply microeconomics is microscopic study of the economy.

Meaning of Macro - economics

The term macro- economics is derived from Greek word " Makros", which means " big". Hence, macro- economics studies not individual units but all the units combined together or the economy as a whole. Since it studies the economy in aggregate. It studies national income, national output, general price level, total employment, total savings, total investment and so on. It is also called "aggregate economics" or the "income theory".

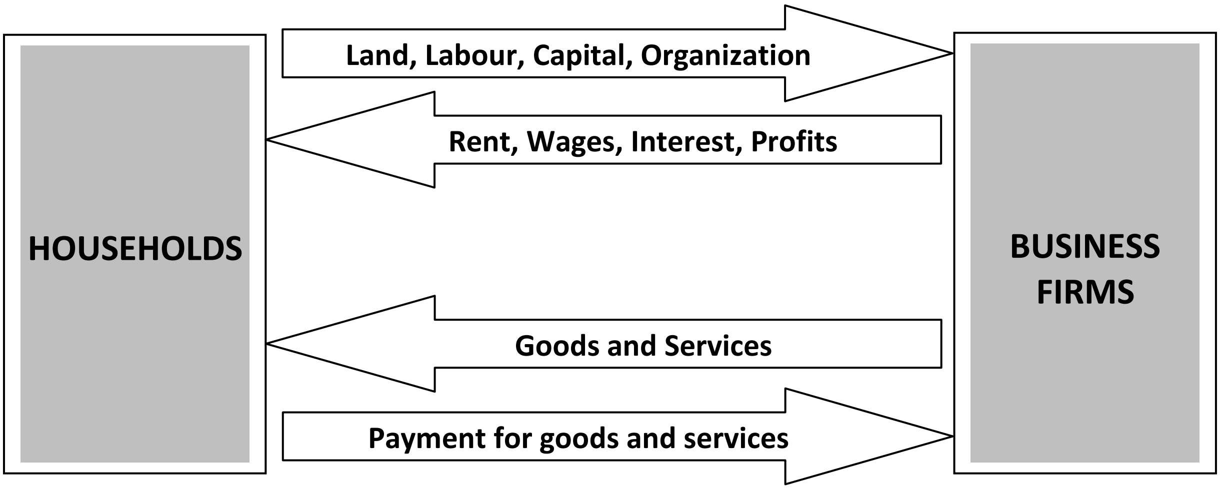
According to K.E. Boulding –" Macro- economics deals not with individual quantities but with aggregate of these quantities, not with individual incomes, but with national income, not with individual prices but with price level, not with individual output but with national output."

J.M. Keynes made and outstanding contribution in the development of macro-economics. It is also known as Keynesian Phenomenon.

NATIONAL INCOME

In every country goods and services are produced in agriculture sector, industrial sector and service sector. The total value of final goods and services produced in a country in a year is called national income. National income was first calculated in India by Dadabai Noaroji in 1876. In our country national income is calculated every year by Central Statistical Organization (CSO).It includes payments made to all resources in the form of wages, interest, rent and profits.

According to Marshall: "The labour and capital of a country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial including services of all kinds. This is the true net annual income or revenue of the country or national dividend." In this definition, the word 'net' refers to deductions from the gross national income in respect of depreciation and wearing out of machines. And to this, must be added income from abroad.



Circular Flow of National Income :-

National income is a flow of money payments resulting from the productive resources of a country during a year. It has the concept of circular flow in this sense that the economic transactions which are made in a country during a particular year appears in different ways. The expenditure of one person is the income of another person, and his expenditure is also equal to value of goods and services. To explain this idea we assume that there is economy where are only two sectors in the economy.

1. Firms.

2. Households.

Firms are required to produce goods. Households own the various factors of production. Firms require the services of households to produce goods. The firms hire the services of households to produce goods. These goods are again supplied to the households. When households sector purchases the goods it makes the payments. Similarly firms make the payment in the shape of rent, wages, and interest to the households against their services.

In this way the sum of prices of the goods and services must be equal to the sum of the reward for the services of factors of production.

So income flows from firms to households in exchange for these services and again the expenditure flows from households to firms. The goods which are produced by the firms these are purchased by the household. The flow of income flows from firms to household and flow of expenditure from household to firms will be equal. This is called circular flow of national income.

National income can be calculated on the basis of:

1. Flow of goods and services
2. Flow of income
3. Flow of expenditure on goods and services

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CONCEPTS OF NATIONAL INCOME

There are various concepts of National Income. The main concepts of NI are: GDP, GNP, NNP, NI, PI, DI, and PCI. These different concepts explain about the phenomenon of economic activities of the various sectors of the economy.

1. **Gross Domestic Product (GDP)**

Gross domestic product- the market value of all final goods and services produced in a country during a specific period of time which is usually one year.

GDP is measured using market values, and not quantities. Production is measured in quantities, but then those quantities have to be changed to account for their value. In economics we use prices to place values on the final goods, so total production times price will give us the total value.

Final goods and services vs intermediate goods or services. A product is a final good or service when it is purchased by the final user. Intermediate products are used as an input to produce another good or service such as sugar being purchased to make soda. Sugar is an intermediate good, while soda is a final good.

GDP only includes the value of final goods, intermediate goods are not included. GDP only includes current production, and ignores the sale of used goods. If you purchase a bike in 2011, then that purchase is included in 2011 GDP measure, not 2010 or 2012. Also, if you sell that bike at any time in the future, the sale of that bike is not included in GDP.

An equation for GDP and some actual values:

$$GDP = C + I + G + NX$$

The GDP equation shows us that GDP is equal to consumption expenditure (C) plus investment expenditure (I) plus government expenditure (G) plus net exports (NX = Exports - Imports).

2. **Gross National Product (GNP)**

Gross National Product is the total market value of all final goods and services produced annually in a country plus net factor income from abroad. Thus, GNP is the total measure of the flow of goods and services at market value resulting from current production during a year in a country including net factor income from abroad. The GNP can be expressed as the following equation:

GNP=GDP+NFIA (Net Factor Income from Abroad)

NFIA = Income earned by Indians in abroad through jobs or businesses – Income earned by foreigners in India by jobs or businesses.

3. **Net National Product (NNP)**

Net National Product is the market value of all final goods and services after allowing for depreciation. It is also called National Income at market price. When charges for depreciation are deducted from the gross national product, we get it. Thus,

NNP=GNP-Depreciation

4. **National Income (NI)**

National Income is also known as National Income at factor cost. National income at factor cost means the sum of all incomes earned by resources suppliers for their contribution of land, labor, capital and organizational ability which go into the years net production. Hence, the sum of the income received by factors of production in the form of rent, wages, interest and profit is called National Income. Symbolically,

NI=NNP + Subsidies given by Govt. - Indirect Taxes

5. **Personal Income (PI)**

Personal Income is the total money income received by individuals and households of a country from all possible sources before direct taxes. Therefore, personal income can be expressed as follows:

PI=NI-Corporate Income Taxes-Undistributed Corporate Profits-Social Security Contribution + Transfer Payments

6. Disposable Income (DI)

The income left after the payment of direct taxes from personal income is called Disposable Income. Disposable income means actual income which can be spent on consumption by individuals and families. Thus, it can be expressed as:

DI=PI-Direct Taxes

7. Per Capita Income (PCI)

Per Capita Income (average income) of a country is derived by dividing the national income of the country by the total population of a country. Thus,

PCI=Total National Income/Total National Population

IMPORTANCE OF NATIONAL INCOME

The following points highlight the top eleven reasons for growing importance of national income studies in recent years.

1. Economic Policy:

Economic policy refers to the actions which Govt. Takes in the economic feild such as Tax policy, Money supply policy, Interest rate policy etc. National income figures are an important tool of macroeconomic analysis and policy.

National income estimates are the most comprehensive measures of aggregate economic activity in an economy. It is through such estimates that we know the aggregate yield of the economy and can lay down future economic policy for development.

2. Economic Planning:

National income statistics are the most important tools for long-term and short-term economic planning. A country cannot possibly frame a plan without having a prior knowledge of the trends in national income. The Planning Commission in India also kept in view the national income estimates before formulating the five-year plans.

3. Economy's Structure:

National income statistics enable us to have clear idea about the structure of the economy. It enables us to know the relative importance of the various sectors of the economy and their contribution towards national income. From these studies we learn how income is produced, how it is distributed, how much is spent, saved or taxed.

4. Inflationary and Deflationary Gaps:

Inflationary gap means the amount by which the total demand is higher than the total supply. Deflationary gap means the amount by which the total demand is less than the total supply. National income and national product figures enable us to have an idea of the inflationary and deflationary gaps. For accurate and timely anti- inflationary and deflationary policies, we need regular estimates of national income.

5. Budgetary Policies:

Modern governments try to prepare their budgets within the framework of national income data and try to formulate anti-cyclical policies according to the facts revealed by the national income estimates. Even the taxation and borrowing policies are so framed as to avoid fluctuations in national income.

6. National Expenditure:

National income studies show how national expenditure is divided between consumption expenditure and investment expenditure. It enables us to provide for reasonable depreciation to maintain the capital stock of a community. Too liberal allowance of depreciation may prove harmful as it may unnecessarily lead to a reduction in consumption.

7. Distribution of Grants-in-aid:

National income estimates help a fair distribution of grants-in-aid by the federal governments to the state governments and other constituent units.

8. Standard of Living Comparison:

National income studies help us to compare the standards of living of people in different countries and of people living in the same country at different times.

9. International Sphere:

National income studies are important even in the international sphere as these estimates not only help us to fix the burden of international payments equitably amongst different nations but also enable us to determine the subscriptions and quotas of different countries to international organisations like the UNO, IMF, IBRD. etc.

10. Defense and Development:

National income estimates help us to divide the national product between defence and development purposes. From such figures we can easily know how much can be spared for war by the civilian population.

11. Public Sector:

National income figures enable us to know the relative roles of public and private sectors in the economy. If most of the activities are performed by the state, we can easily conclude that public sector is playing a dominant role.

INFLATION

Inflation is defined as a sustained increase in the general level of prices for goods and services in a county, and is measured as an annual percentage change. Under conditions of inflation, the prices of things rise over time. Put differently, as inflation rises, every rupee you own buys a smaller percentage of a good or service. When prices rise, and alternatively when the value of money falls you have inflation.

The value of a rupee (or any unit of money) is expressed in terms of its purchasing power, which is the amount of real, tangible goods or actual services that money can buy at a moment in time. When inflation goes up, there is a decline in the purchasing power of money. For example, if the inflation rate is 2% annually, then theoretically a Rs.1 chocolate will cost Rs.1.02 in a year. After inflation, your rupee does not go as far as it did in the past.

FEATURES OF INFLATION

Following are the main features of inflation:

1. Inflation is always accompanied by a rise in the price level. It is a process of uninterrupted increase in prices.
2. Inflation is a monetary phenomenon and it is generally caused by excessive money supply.

3. Inflation is essentially an economic phenomenon as it originates in the economic system and is the result of action and interaction of economic forces.

4. Inflation is a dynamic process as observed over the long period.

5. A cyclical movement of prices is not inflation.

6. Pure inflation starts after full employment.

7. Inflation may be demand-pull or cost-push.

TYPES OF INFLATION

1. **Creeping Inflation:** This is also known as mild inflation or moderate inflation. This type of inflation occurs when the price level persistently rises over a period of time at a mild rate. When the rate of inflation is less than 10 per cent annually, or it is a single digit inflation rate, it is considered to be a moderate inflation.

2. **Galloping Inflation:** If mild inflation is not checked and if it is uncontrollable, it may assume the character of galloping inflation. Inflation in the double or triple digit range of 20, 100 or 200 percent a year is called galloping inflation . Many Latin American countries such as Argentina, Brazil had inflation rates of 50 to 700 percent per year in the 1970s and 1980s.

3. **Hyperinflation:** It is a stage of very high rate of inflation. While economies seem to survive under galloping inflation, a third and deadly strain takes hold when the cancer of hyperinflation strikes. Nothing good can be said about a market economy in which prices are rising a million or even a trillion percent per year . Hyperinflation occurs when the prices go out of control and the monetary authorities are unable to impose any check on it. Germany had witnessed hyperinflation in 1920's.

4. **Stagflation:** It is an economic situation in which unemployment increases along with rising inflation causing demand to remain stagnant in a given period. In fact, it is an indication of an inefficient market, as traditionally, there is an inverse relationship between unemployment rates and inflationary

pressures. Stagflation was witnessed by developed countries in 1970s, when world oil prices rose dramatically.

5. **Deflation:** Deflation is the reverse of inflation. It refers to a sustained decline in the price level of goods and services. It occurs when the annual inflation rate falls below zero percent (a negative inflation rate), resulting in an increase in the real value of money. Japan suffered from deflation for almost a decade in 1990s.

MONEY SUPPLY AND INFLATION

Inflation refers to a sustained rise in the prices of goods and services. When inflation occurs, the buying value of a currency unit erodes, meaning that a person needs more money to buy the same product. Most economists suggest there is a direct relationship between the amount of money in an economy, known as the money supply, and inflation levels. Understanding the relationship between money supply and inflation is far from easy or predictable, since inflation can easily be influenced by other factors as well.

The relationship between money supply and inflation is explained differently depending on the type of economic theory used. In the quantity of money theory, also called monetarism, the relationship is expressed as MV=PT, or Money Supply (the amount of money in circulation) x Velocity of circulation (the speed with which money flows round the economy)=Price Level x Transactions or output. The Velocity and Transactions are considered to be constants, so according to this explanation, supply and prices have a direct relationship. MV represents supply of money and PT represents demand for money. Assuming V and T are constant, price level varies in direct proportion to the quantity of money. If supply of money increases, there is inflation or rise in prices. In Keynesian theory, while there is still a relationship between money supply and inflation, it is not the only large factor that can affect inflation and prices. Generally, the Keynesian theory stresses the relationship between total or aggregate demand and inflationary changes.

For example, assume a very small economy that has a money supply of Rs.50 and only two people i.e., Farmer and Mechanic. Farmer goes to Mechanic for getting his tractor repaired and paid Rs. 50. In turn, Mechanic purchases rise worth of Rs. 40 from Farmer. After few months, again Mechanic purchases maize worth of Rs. 10. These are the transactions taken place in our imaginary economy in a year.

$$MV = PT$$

M = Money supplied, V = Velocity (The rate at which money is exchanged from one transaction to another), P = Average general price, T = No. of transactions.

MV = Total money supply; PT = Value of all the transactions (Value of goods and services produced, i.e., GDP)

$M = 50$ $V = ?$ $P = (50+40+10)/3$ transactions $= 33.33$ $T = 3$

$$V = PT/M$$

$$50 \times V = 33.33 \times 3$$

$$V = 100/50 = 2$$

If money supplied is increased by 100%, then price level also increases by 100% when V and T are constant.

$$MV = PT$$

$$100 \times 2 = P \times 3$$

$$P = 200/3 = 66.67$$

Changes in money supply are often used to try and control inflationary conditions. Central bank will generally lower lending rates and increase interest. When inflation drops below a target level, these standards are generally relaxed in an attempt to stimulate the economy.

BUSINESS CYCLE

Business cycles, also called trade cycles or economic cycles, refer to perpetual features of the economic environment of a country. In simple words, business cycles can be defined as fluctuations in the economic activities of a country. The economic activities of a country include total output, income level, prices of products and services, employment, and rate of consumption. All these activities are interrelated; if one activity changes, rest of them would also show changes.

These changes in the economic activities together produce a bigger change in the overall economy of a nation. This overall change in an economy is termed as a business cycle. Business cycles are generally regular and periodical in nature.

Definition: Lord Keynes defines business cycle as " a business cycle is composed of periods of good trade characterized by rising prices and low unemployment percentage, altering with periods of bad trade characterized by falling prices and high unemployment percentage".

CHARACTERISTICS OF A BUSINESS CYCLE

1. **Cyclical movements**: When excess movement in one direction, say depression tends to bring into operations not only in its remedy but also a stimulus to an excess movement in the other direction, say boom, the movement is said to be cyclical. It is like the movement of a pendulum. The movement in one direction tends to automatically generate a movement in the opposite direction of prosperity in the economy sow the seeds of depression also.
2. **International in nature:** it is very likely that boom in the economy of one country boom in another country. Different countries are linked with one another through international trade and foreign exchange. This implies that prosperity in one country contributes to prosperity in other countries also.
3. **Varying degree of impact:** Since periods of business cycles are more likely to be different, they tend to vary in the degree of their impact on an economy. Business cycles may affect different industries in an economy in varying degrees.
4. **Irregular patterns:** No two business cycles are similar in rhythm. There is no fixed pattern governing each business cycle.
5. **Wave like movement:** Business cycles reflect a wavelike movement that implies a composite photograph of all the recorded cycles. One complete round from boom to depression and depression to boom is called business cycle.
6. **Fluctuation in productive capacities:** Production capacities undergo wild fluctuations are measured in terms of unemployment.
7. **Fluctuations in price levels:** The upward phase of cycle is identified with expansion of production capacities, diminishing unemployment and rise in prices. On the other hand, the downward phase of cycle is identified with contraction of production capacities, increasing unemployment and fall in prices.
8. Every cycle has four distinct phases: (a) depression, (b) revival, (c) prosperity or boom, and (d) recession.

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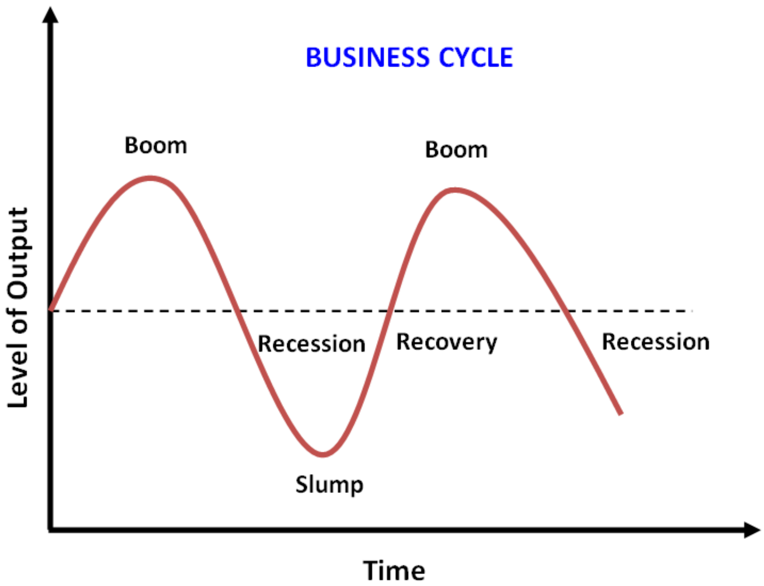
PHASES OF A BUSINESS CYCLE

(a) Prosperity/Expansion/Boom : In this stage increase production, high capital investment in basic industries, expansion of the bank credit, high prices, high profit, full employment.

(b) Recession : This stage is characterized by liquidation in the stock market, strain in the banking system and some liquidation of bank loan, small fall in price, sharp reduction in demand for capital equipment and abandoning of relatively new projects. Unemployment leads to full income expenditure, price & profits. It is cumulative effect once a recession starts it goes on gathering momentum and finally assumes the shape of depression.

(c) Depression/Slump : It is a protective period in which Business activities in the country is far below the normal. It is characterized by a sharp deduction of production, mass unemployment, low employment, falling prices, falling profits, low wages, and contraction of credit, high rate of business failures and an atmosphere of all round pessimism and despair all construction activities come to a more or less complete stand still during depression. The consumer goods industries and however, not much affected.

(d) Recovery : It implies increase in business activity after the lowest point of depression has been reached. The entrepreneur began to feel that the economic situation was after all not so bad. This leads to new innovation in business activities. The industrial production picks up slowly and gradually. The volume of employment also straightly increases. There is a slow rise in prices accompanied by a small rise in profit. Wages also raise new investment takes place in capital goods industries. The bank also expands credit. Pessimism is gradually replaced by an atmosphere of all round cautious hope.



BUSINESS ECONOMICS

INTRODUCTION

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

Economic theory underscores the fact that each firm in the industry operates under competitive conditions and hence tries to operate more efficiently to withstand the competition. The indicator of efficiency is profits. The assumption here is that each firm has one man as the owner and entrepreneur, and that his sole aim is to maximize profits. As time passed, one man firms were replaced by partnerships and giant companies and the structure of the firm changed to include the owner/entrepreneur/shareholders on the one hand and that managers on the other. The responsibility of the owners/entrepreneur/shareholders got bifurcated. The day to day affairs of the firm were looked after by the managers and owners/entrepreneur/shareholders took organizational decisions aimed at maximizing profits. The goals of the owners/entrepreneurs/shareholders are called organizational goals while the goals of the managers are referred to as Business goals also known as operational goals.

DEFINITIONS

According to **E. F. Brigham** and **J. L. Pappas**, *"Managerial Economics is the application of Economic theory and methodology to business administration practise."*

According to **McNair** and **Meriam**, *"Managerial Economics consists of the use of Economic modes of thought to analyse business situations."*

According to **M. H. Spencer** and **L. Siegelman**, *"Managerial Economics is the integration of economic theory with business practise for the purpose of facilitating decision making and forward planning."*

According to **Hauge**, *"Managerial Economics is concerned with using logic of economics, mathematics & statistics to provide effective ways of thinking about business decision problems."*

According to **Joel Dean**, *"The purpose of Managerial Economics is to show how economic analysis can be used in formulating business policies."*

NATURE OF BUSINESS ECONOMICS

Business economics is, perhaps, the youngest of all the social sciences. Since it originates from Economics, it has the basis features of economics, such as assuming that other things remaining the same. This assumption is made to simplify the complexity of the Business phenomenon under study in a dynamic business environment so many things are changing simultaneously. This set a limitation that we cannot really hold other things remaining the same. In such a case, the observations made out of such a study will have a limited purpose or value. Managerial economics also has inherited this problem from economics.

The other features of managerial economics are explained as below:

(a)Microeconomics in nature: Business economics is concerned with finding the solutions for different managerial problems of a particular firm. Thus, it is more close to microeconomics.

(b)Operates against the backdrop of macroeconomics: The macroeconomics conditions of the economy are also seen as limiting factors for the firm to operate. In other words, the managerial economist has to be aware of the limits set by the macroeconomics conditions such as government industrial policy, inflation and so on.

(c)Normative economics: Economics can be classified into two broad categories normally. Positive Economics and Normative Economics. Positive economics describes " what is" i.e., observed economic phenomenon. The statement " Poverty in India is very high" is an example of positive economics. Normative economics describes "what ought to be" i.e., it differentiates the ideals form the actual. Ex: People who earn high incomes ought to pay more income tax than those who earn low incomes. A normative statement usually includes or implies the words 'ought' or 'should'. They reflect people's moral attitudes and are expressions of what a team of people ought to do.

(d)Prescriptive actions: Prescriptive action is goal oriented. Given a problem and the objectives of the firm, it suggests the course of action from the available alternatives for optimal solution. It does not merely mention the concept, it also explains whether the concept can be applied in a given context on not. For instance, the fact that variable costs as marginal costs can be used to judge the feasibility of an export order.

(e)Applied in nature: 'Models' are built to reflect the real life complex business situations and these models are of immense help to managers for decision-making. The different areas where models are extensively used include inventory control, optimization, project management etc. In Business economics, we also employ case study methods to conceptualize the problem, identify that alternative and determine the best course of action.

(f)Offers scope to evaluate each alternative: Business economics provides an opportunity to evaluate each alternative in terms of its costs and revenue. The Business economist can decide which is the better alternative to maximize the profits for the firm.

(g)Interdisciplinary: The contents, tools and techniques of Business economics are drawn from different subjects such as economics, management, mathematics, statistics, accountancy, psychology, organizational behavior, sociology and etc.

(h)Assumptions and limitations: Every concept and theory of Business economics is based on certain assumption and as such their validity is not universal. Where there is change in assumptions, the theory may not hold good at all.

BEFA UNIT I

SCOPE OF BUSINESS ECONOMICS

The main focus of Business economics is to find the solution to Business problems for which the Business economist makes use of the concepts, tools and techniques of economics and other related disciplines.

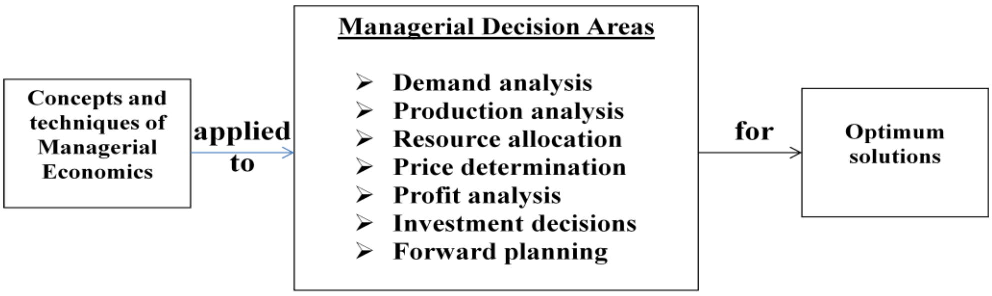


Fig: Scope of Managerial Economics

1. Demand Analyses and Forecasting:

A firm can survive only if it is able to the demand for its product at the right time, within the right quantity. Understanding the basic concepts of demand is essential for demand forecasting. Demand analysis should be a basic activity of the firm because many of the other activities of the firms depend upon the outcome of the demand forecast. Demand analysis provides:

a) The basis for analyzing market influences on the firms; products and thus helps in the adaptation to those influences.

b) Demand analysis also highlights for factors, which influence the demand for a product. This helps to manipulate demand. Thus demand analysis studies not only the price elasticity but also income elasticity, cross elasticity as well as the influence of advertising expenditure. With the advent of computers, demand forecasting has become an increasingly important function of Business economics.

2. Price determination:

Pricing decisions have been always within the preview of Business economics. Pricing policies are merely a subset of broader class of Business economic problems. Price theory helps to explain how prices are determined under different types of market conditions. Competition analysis includes the anticipation of the response of competing firms' pricing, advertising and marketing strategies. Product line pricing and price forecasting occupy an important place here.

3. Production and cost analysis:

Production analysis is in physical terms. While the cost analysis is in monetary terms. Cost concepts and classifications, cost-out-put relationships, economies and diseconomies of scale and production functions are some of the points constituting cost and production analysis.

4. Resource Allocation:

Business Economics is the traditional economic theory that is concerned with the problem of optimum allocation of scarce resources. Marginal analysis is applied to the problem of determining the level of output, which maximizes profit. In this respect, linear programming techniques are used to solve optimization problems. In fact, linear programming is one of the most practical and powerful managerial decision making tools currently available.

5. Profit analysis:

Profit making is the major goal of firms. There are several constraints here on account of competition from other products, changing input prices and changing business environment hence in spite of careful planning, there is always certain risk involved. Business economics deals with techniques of averting of minimizing risks. Profit theory guides in the measurement and management of profit, in calculating the pure return on capital, besides future profit planning.

6. Investment decisions:

Capital is the foundation of business. Lack of capital may result in small size of operations. Availability of capital from various sources like equity capital, institutional finance etc. may help to undertake large-scale operations. Hence efficient allocation and management of capital is one of the most important tasks of the managers. The major issues related to capital analysis are:

1. The choice of investment project
2. Evaluation of the efficiency of capital

3. Most efficient allocation of capital

Knowledge of capital theory can help very much in taking investment decisions. This involves, capital budgeting, feasibility studies, analysis of cost of capital etc.

7. Forward planning:

Strategic planning provides management with a framework on which long-term decisions can be made which has an impact on the behavior of the firm. The firm sets certain long-term goals and objectives and selects the strategies to achieve the same. Strategic planning is now a new addition to the scope of Business economics with the emergence of multinational corporations. The perspective of strategic planning is global.

THE ROLE OF BUSINESS ECONOMIST

The **role of business economist** can be summarized as follows:

1. He studies the economic patterns at macro-level and analysis it's significance to the specific firm he is working in.
2. He has to consistently examine the probabilities of transforming an ever-changing economic environment into profitable business avenues.
3. He assists the business planning process of a firm.
4. He also carries cost-benefit analysis.
5. He assists the management in the decisions pertaining to internal functioning of a firm.
6. In addition, a business economist has to analyze changes in macro-economic indicators such as national income, population, business cycles, and their possible effect on the firm's functioning.
7. He is also involved in advising the management on public relations, foreign exchange, and trade.
8. He guides the firm on the likely impact of changes in monetary and fiscal policy on the firm's functioning.

9. The most significant function of a business economist is to conduct a detailed research on industrial market.

10. He must be vigilant and must have ability to cope up with the pressures.

11. He also provides management with economic information such as tax rates, competitor's price and product, etc.

MULTI-DISCIPLINARY NATURE OF BUSINESS ECONOMICS

Many new subjects have evolved in recent years due to the interaction among basic disciplines. While there are many such new subjects in natural and social sciences, Business economics can be taken as the best example of such a phenomenon among social sciences. Hence it is necessary to trace its roots and relationship with other disciplines.

1. Relationship with economics:

The relationship between Business economics and economics theory may be viewed from the point of view of the two approaches to the subject Viz. Micro Economics and Marco Economics. Microeconomics is the study of the economic behavior of individuals, firms and other such micro organizations. Business economics is rooted in Micro Economic theory. Business Economics makes use to several Micro Economic concepts such as marginal cost, marginal revenue, elasticity of demand as well as price theory and theories of market structure to name only a few. Macro theory on the other hand is the study of the economy as a whole. It deals with the analysis of national income, the level of employment, general price level, consumption and investment in the economy and even matters related to international trade, Money, public finance, etc.

2. Relationship with accounting:

Business economics has been influenced by the developments in management theory and accounting techniques. A proper knowledge of accounting techniques is very essential for the success of the firm because profit maximization is the major objective of the firm. Business Economist requires a proper knowledge of cost and revenue information and their classification.

3. Relationship with mathematics:

The use of mathematics is significant for Business economics in view of its profit maximization goal long with optional use of resources. The major problem of the firm is how to minimize cost, how to maximize profit or how to optimize sales. Mathematical concepts and techniques are widely used in economic logic to solve these problems. Geometry, Algebra and calculus are the major branches of mathematics which are of use in Business economics.

4. Relationship with Statistics:

A successful businessman must correctly estimate the demand for his product. Statistical methods provide and sure base for decision-making. Thus statistical tools are used in collecting data and analyzing them to help in the decision making process. Statistical tools like the theory of probability and forecasting techniques help the firm to predict the future course of events. Business Economics also make use of correlation and multiple regressions in related variables like price and demand to estimate the extent of dependence of one variable on the other.

5. Relationship with Operations Research:

The development of techniques and concepts such as linear programming, inventory models and game theory is due to the development of this new subject of operations research in the post-war years. Operations research is concerned with the complex problems arising out of the management of men, machines, materials and money.

Operation research provides a scientific model of the system and it helps Business economists in the field of product development, material management, and inventory control, quality control, marketing and demand analysis.

7. Relationship with Computer Science:

Computers are used in data and accounts maintenance, inventory and stock controls and supply and demand predictions. What used to take days and months is done in a few minutes or hours by the computers. In fact computerization of business activities on a large scale has reduced the workload of Business personnel.