BUSINESS ECONOMICS AND FINANCIAL ANALYSIS

- **PREPARED BY:**
- **Archana R Kollur ,MBA Dept,NRCM**

UNIT – I

INTRODUCTION TO BUSINESS AND ECONOMICS

Business Economics, also called Managerial **Economics**, is the application of **economic** theory and methodology to **business**. **Business** involves decision-making. Decision making means the process of selecting one out of two or more alternative

Definition of Business

"Business is the exchange of goods, services, or money for mutual benefit or profit." – Skinner and Ivancevich

"Business may be defined as any form of commercial activity to satisfy the economic wants of people at a profit." - Keith Davis

"Business is any enterprise engaged in production and distribution of goods for sale in a market or rendering services for a price."- Professor Owen.

Examples of Business Processes

- ®***Manufacturing and production*:**
  - ➢Assembling product, checking quality, producing bills of materials
- ®***Sales and marketing*:**
  - ➢Identifying customers, creating customer awareness, selling
- ®***Finance and accounting*:**
  - ➢Paying creditors, creating financial statements, managing cash accounts
- ®***Human Resources*:**
  - ➢Hiring employees, evaluating performance, enrolling employees in benefits plans

Theory of a Firm

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

Underlying concepts

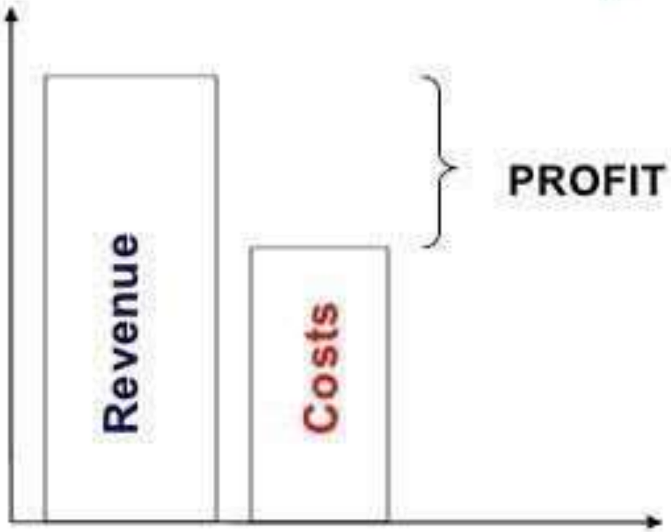
To understand the theory of the firm you must firstly understand some basic concepts underpinning the theory...

1. What is a firm?

A firm is a business enterprise which produces, or trades in, goods and/or services.

A firm can be privately or state owned (i.e. by individuals or government).

Concepts continued...

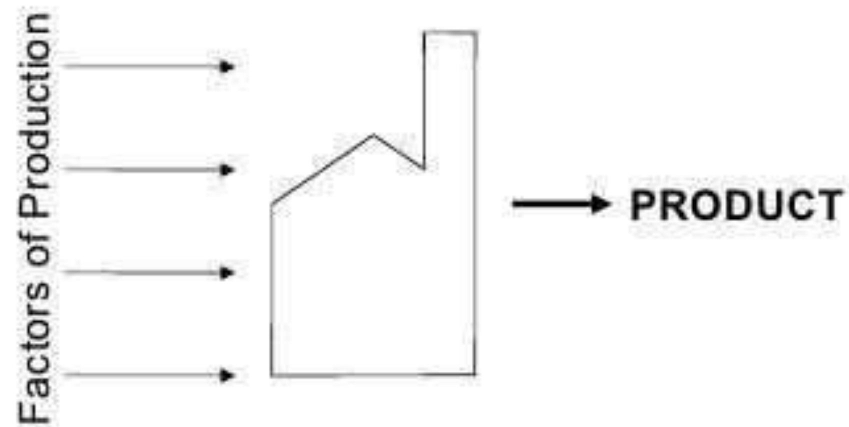


2. Profit Maximisation

Firms aim to make as much profit as possible i.e. produce at the level of output at which the gap between revenue and production costs is greatest.

3. Production

A firm 'adds value' by combining a range of factors of production into a finished product or service. This process is known as production.



Concepts continued

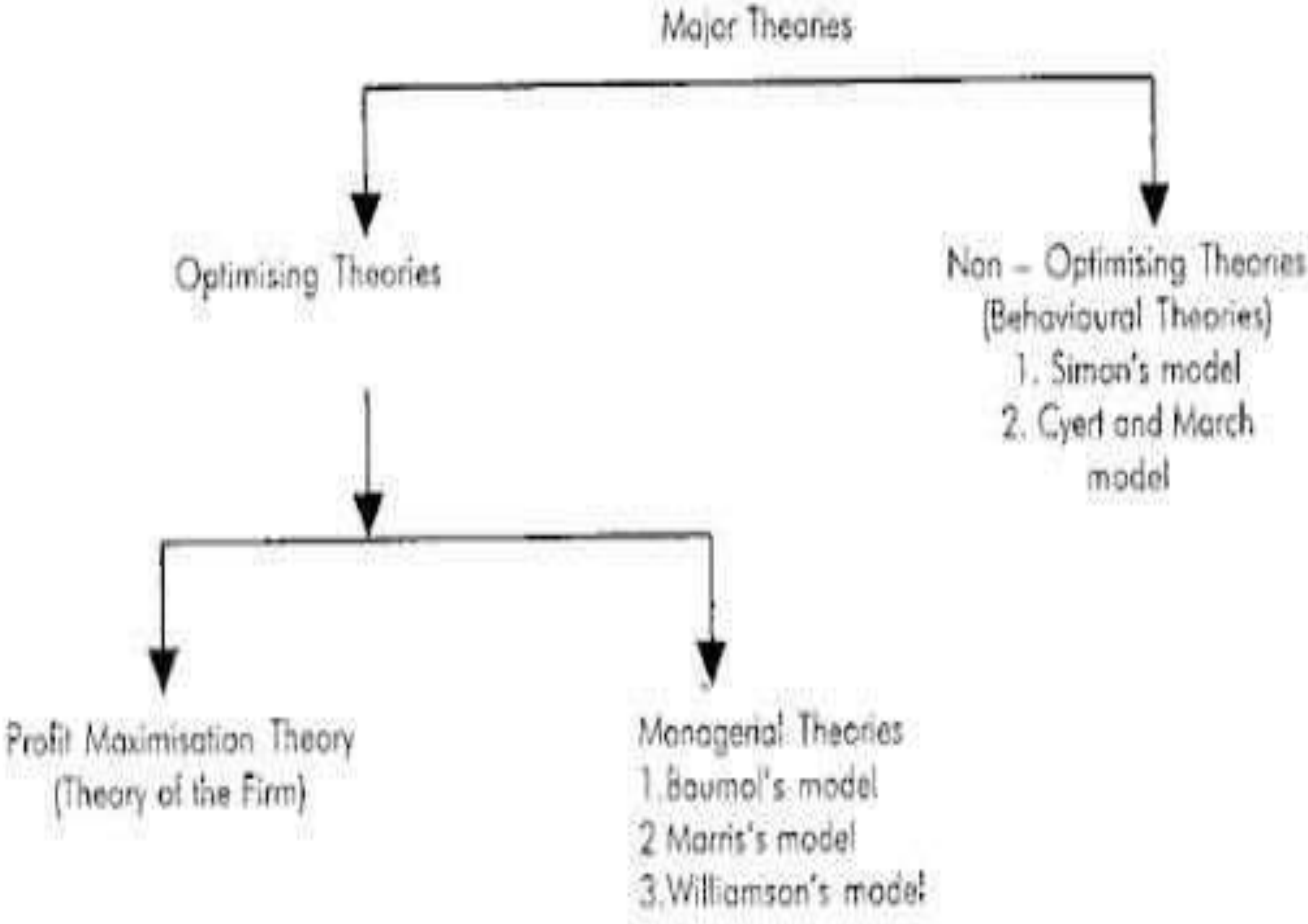
Put these UK markets in order according to the number of firms operating in them.

- Car market
- Hairdressers
- Banks
- Nuclear power plants
- Supermarkets
- Website designers

6. Market structure

The behaviour of a firm will vary according to the nature of the market it is in. An important factor is the number of firms in the market.

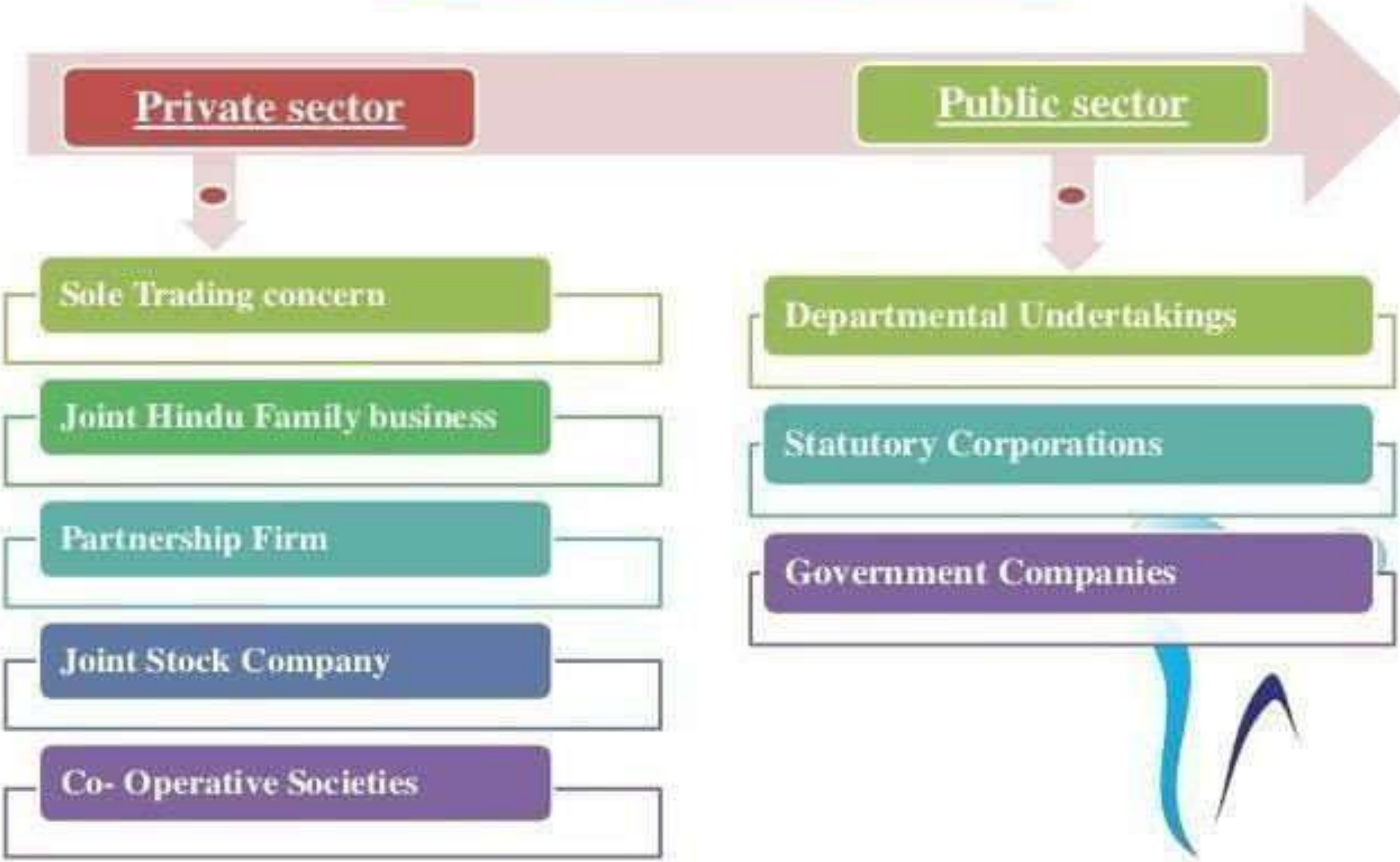
- Monopoly = 1 firm
- Oligopoly = a few firms
- Perfect competition = many firms


Major Theories
Optimising Theories
Non – Optimising Theories
(Behavioural Theories)
1. Simon's model
2. Cyert and March model
Profit Maximisation Theory
(Theory of the Firm)
Managerial Theories
1. Baumol's model
2 Marris's model
3. Williamson's model

Structure of Business Firm

Any issue, contact rakesh175@gmail.com or call 8447688161

Types of Business Entities



Sole Proprietorship

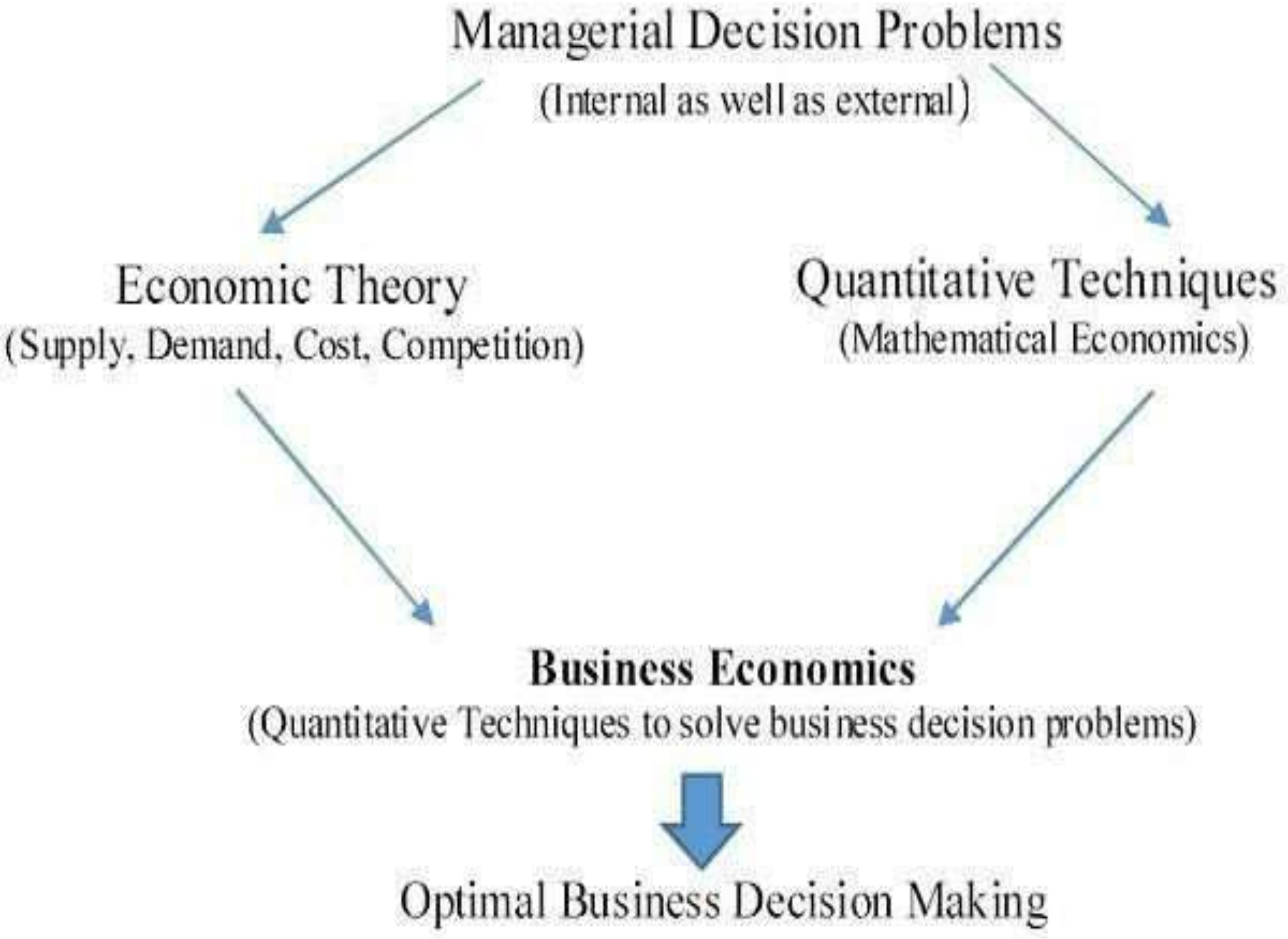
- Owned by Single Person
- Unlimited liability of equity holder
- Limited funds

Partnership

- Owned by Two or more
- Unlimited liability of equity holder
- Limited funds

Limited Liability Company

- Liability is limited to equity owners' commitment to capital
  - Private Limited Company (closely held company)
  - Public Limited Company


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

What is **DEMAND**?

- "Every want supported by the willingness and ability to buy" – constitutes demand for a particular product or services.....
- In other words, if a person wants a CAR and cannot pay for it. There is no demand for the CAR from his or her side............

- A product or service is said to have demand when **three conditions** are met:
- 1.Desire on the part of the buyer to buy.
- 2.Willing to pay for it
- 3,Ability to pay the specified price for it.
- Unless all these conditions are fulfilled, the product is not said to have any demand.

Nature of **DEMAND**

- The nature of demand is better understood when we see these variations as follows:
- **Consumer goods vs producer goods**
- **Autonomous demand vs derived demand**
- **Durable vs perishable goods**
- **Firm demand vs industry demand**
- **Short-run demand vs long-run demand**
- **New demand vs replacement demand**

Consumer goods vs producer goods

- The goods can be grouped under consumer goods and producer goods.
- Cg refers to such product and services, which are capable to satisfying human needs.
- Cg are those which are available for ultimate consumption.(give direct and immediate satisfaction)
- Example: bread, apple, rice, etc

- Pg are those which are used for further processing or production of goods/service to earn to INCOME.
- This goods yield indirect satisfactionand are used to produce cg
- Example: machinery , tractor etc.,
- The product may be both pg & cg
- **The farmer having 10 bags of paddy, 5 bags personel use, next 5 bags as SEEDS for the next crop.**
- **PADDY is both pg & cg**

Autonomous demand vs derived demand

- Ad refers to direct demand for product and services.
- Example: the demand for the service of a super-specialty hospital can be consider ad
- Dd the demand for the product arises out of the purchase of a parent product.
- Example: the demand for hotel around that hospital is called dd.
- A demand for houses is autonomous whereas a demand for these input is derived.

Short-run demand vs long-run demand

- The demand for a particular product or service in a given REGION for a particular DAY can be viewed as a shor-run demand.
- Example: available taste and technology
- The demand for a longer period for the same region can be viewed as a long-run demand.
- Example: changes in design and technology

New demand vs replacement demand

- The demand for a new product and it is in addition to the existing stock.
- Example: new model car
- The item of purchase to maintain the asset in good condition
- Example: replacement of car spare parts

Total markets vs Segment market

- **The total demand for a product in the region is the total market demand.**
- Example; sugar, rice
- The demand for the sugar from the sweet industry from the region is the segment (specific criteria)market demand.
- Example: age, gender, income,

Factors determining **DEMAND**

- The following factor determine the demand for a given product:
- 1.Price of the product **(P)**
- 2.Income level of the consumer **(I)**
- 3.Tastes and preferences of the consumer **(T)**
- 4.Prices of related goods which may be substitutes/complementary **(P_R)**
- 5.Expectation about the prices in future **(E_P)**

UNIT-3

MARKET STRUCTURES AND PRICING

Models of Competition

How businesses compete and what impact it has on me.

What are Models of Competition?

- *Def. a description of the type of market that a particular business or industry operates in.*
- *Also known as Market Structure.*

4 Types of Models of Competition

1. *Perfect Competition*
2. *Monopoly*
3. *Monopolistic Competition*
4. *Oligopoly*

Perfect Competition

- *Def. a market structure in which a large number of firms (businesses) produce the same product.*
  - *Only reason to choose one firm over another is the PRICE*

Four Conditions for Perfect Competition

1. *Many buyers and sellers*

   People have lots of options to choose whom they buy from.

2. *Identical Products*

   There are no differences between what is sold by different suppliers. They are exactly the same!

Four Conditions for Perfect Competition (cont.)

3. *Informed Buyers and Sellers*

Buyers know the prices and quality of product sold by all venders to make the best decision

4. *Free Market Entry and Exit*

Businesses can enter the market when they can make money and exit when they can't.

What types of businesses are Perfectly Competitive?

- *Farm Markets (ex. Public Market)*
  - *Many farmers selling their vegetables (Many buyers and sellers)*
  - *A carrot from farmer Brown is equal to a carrot from farmer Jones (Identical Products)*
  - *Buyers can compare prices and quality by walking the market (Informed Buyers/Sellers)*
  - *Farmers choose to bring produce or not. Inexpensive to rent a space in the market (Free Market Entry/Exit)*

Are there many perfectly competitive businesses?

- *NO! All 4 of the conditions must be met for perfect competition. This is very difficult in most industries.*
  - *Often people can only buy from one supplier*
  - *Products are rarely identical*
  - *Buyers often do not know if a product is cheaper/better at a different supplier*
  - *Barriers to entry prevent free market entry*

Barriers to Entry

Def. Factors that make it difficult for new firms to enter a market.

- *Start-up Costs*

The expenses that a new business must pay before the first product reaches the customer.

Ex. Rent, machines, product, labor, etc.

- *Technology*

Some markets require a high degree of technological know-how. As a result, new entrepreneurs cannot easily enter these markets.

Ex. Software and Pharmaceutical companies

UNIT-4
Financial Accounting

- *Accounting is---*
  - *A system by which assumed responsibility is validated*
- *Accounting may validate—*
  - *Internal responsibility to one's own self*
  - *External responsibility to people other than one's own self*
- *Financial Accounting –*
  - *Primarily validates responsibility externally*

Financial Statements
The Means of External Reporting

- *Balance Sheet--*
  - *Investing and Financing Activities are the first order of business*
  - *Defined by the basic accounting equation*
  - *That is, Assets = Liabilities + Owners' Equity*
  - *Increases and (or) decreases on each side of the*

= sign must balance

- *Algebraic Equation: A = L + OE; can be rearranged to A – L = OE or Net Assets; also known as net worth or equity*

Income Statement

- *Also called the Statement of Operations—*
  - *Operating activities (day-to-day) operations by which the business attempts to make a profit*
- *Revenues and gains represent inflows of resources (assets)*
- *Expenses and losses represent outflows of assets or increases in liabilities*
- *The net difference is either Net Income or Net Loss for a specific period of time*
- *Net Income increases owners' equity and net losses decrease owners' equity*

Cash Flow Statement

- *Identifies cash flows during the period—*
  - *Operating Activity Inflows (Outflows)*
  - *Investing Activity Inflows (Outflows)*
  - *Financing Activity Inflows (Outflows)*
  - *Sum of above three is net increase (decrease) in cash for the period*
  - *Net increase (decrease) for period is then added (subtracted) to the beginning balance to give the ending balance*

Owners' Equity Statement

- *Must be either a separate financial statement or disclosed in the Notes to the Financial Statements*
- *Depends on type of entity—*
  - *Sole proprietorship or partnership*
    - *Capital account for each owner*
  - *Corporation—(Illustrated in this chapter)*
    - *Contributed Capital (capital from sources other than profit seeking activities)*
    - *Retained Earnings—Represents all profits current and past that have not been returned to owners in the form of dividends*

Owners' Equity Statement, Cont'd

- *If no activity during the period in contributed capital accounts—*
  - *Just the Retained Earnings Statement*
    - *Beginning Balance plus (+) Net Income for the period, or minus (–) Net Loss; Minus (–) Dividends Declared during the period (example on p. 17 in your text)*
    - *Note: Dividends are not expenses so they do not go on the income statement*
- *If activity in Contributed Capital Accounts, then a complete Owners' Equity Statement must be prepared, similar to p 766*

UNIT-5
Financial Analysis Through Ratios

Financial Analysis

- Assessment of the firm’s past, present and future financial conditions
- Done to find firm’s financial strengths and weaknesses
- Primary Tools:
  - Financial Statements
  - Comparison of financial ratios to past, industry, sector and all firms

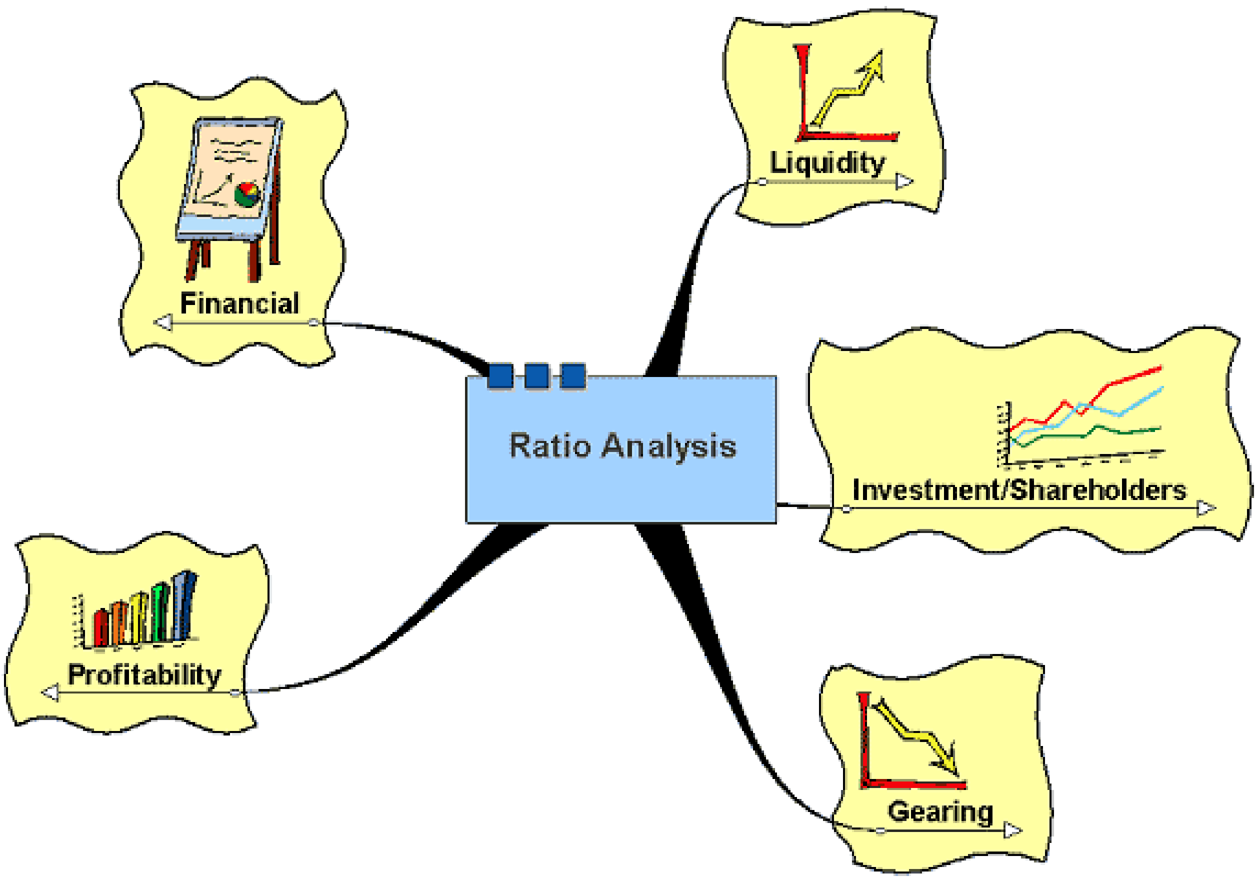
Financial Statements

- Balance Sheet
- Income Statement
- Cashflow Statement
- Statement of Retained Earnings

Objectives of Ratio Analysis

- Standardize financial information for comparisons
- Evaluate current operations
- Compare performance with past performance
- Compare performance against other firms or industry standards
- Study the efficiency of operations
- Study the risk of operations

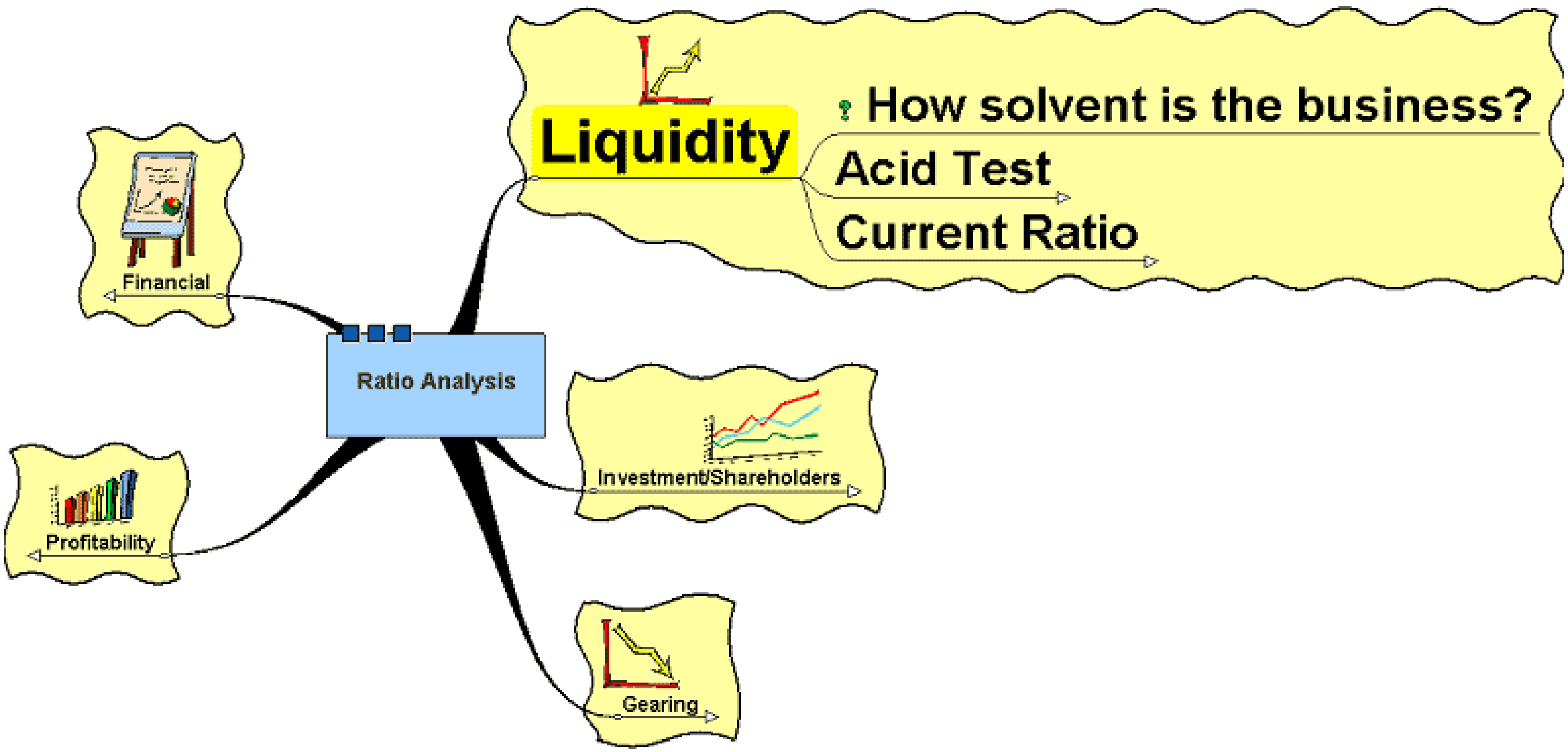
Ratio Analysis



Ratio Analysis

1. **Liquidity** – the ability of the firm to pay its way
2. **Investment/shareholders** – information to enable decisions to be made on the extent of the risk and the earning potential of a business investment
3. **Gearing** – information on the relationship between the exposure of the business to loans as opposed to share capital
4. **Profitability** – how effective the firm is at generating profits given sales and or its capital assets
5. **Financial** – the rate at which the company sells its stock and the efficiency with which it uses its assets

Liquidity


Liquidity
How solvent is the business?
Acid Test
Current Ratio
Financial
Ratio Analysis
Investment/Shareholders
Profitability
Gearing