mood-book

Introduction to Business

Business

A **business** (also known as an **enterprise**, a **company**, or a **firm**) is an organizational entity and legal entity made up of an association of people, be they natural, legal, or a mixture of both who share a common purpose and unite in order to focus their various talents and organize their collectively available skills or resources to achieve specific declared goals and are involved in the provision of goods and services to consumers.[1][2]A business can also be described as an organisation that provides goods and services for human needs.

Businesses serve as conductors of economic activity, and are prevalent in capitalist economies, where most of them are privately owned and provide goods and services allocated through a market to consumers and customers in exchange for other goods, services, money, or other forms of exchange that hold intrinsic economic value. Typically private-sector businesses aim to maximize their profit, although in some contexts they may aim to maximize their sales revenue or their market share.

Businesses may also be social nonprofit enterprises or state-owned public enterprises operated by governments with specific social and economic objectives. Government-run businesses may aim to maximize some measure of social welfare.

A business owned by multiple private individuals may form as an incorporated company or jointly organized as a partnership. Countries have different laws that may ascribe different rights to the various business entities.

The word "business" can refer to a particular organization or to an entire market sector (for example, "the finance business" is "the financial sector") or to all economic sectors collectively ("the business sector"). Compound forms such as "agribusiness" represent subsets of the concept's broader meaning, which encompasses all activity by suppliers of goods and services.

Structure of a Business Firm

When beginning a business, you must decide what form of business entity to establish. Your form of business determines which income tax return form you have to file. The most common forms of business are the sole proprietorship, partnership, corporation, and S corporation. A Limited Liability Company (LLC) is a business structure allowed by state statute. Legal and tax considerations enter into selecting a business structure.

Types of Business Structures

Sole Proprietorship

A Sole Proprietorship is one individual or married couple in business alone. Sole proprietorships are the most common form of business structure. This type of business is simple to form and operate, and may enjoy greater flexibility of management, fewer legal controls, and fewer taxes. However, the business owner is personally liable for all debts incurred by the business.

General Partnership

A General Partnership is composed of 2 or more persons (usually not a married couple) who agree to contribute money, labor, or skill to a business. Each partner shares the profits, losses, and management of the business and each partner is personally and equally liable for debts of the partnership. Formal terms of the partnership are usually contained in a written partnership agreement.

Limited Partnership

A Limited Partnership is composed of one or more general partners and one or more limited partners. The general partners manage the business and share fully in its profits and losses. Limited partners share in the profits of the business, but their losses are limited to the extent of their investment. Limited partners are usually not involved in the day-to-day operations of the business. Filing with the Washington Secretary of State is required.

Limited Liability Partnership (LLP)

A Limited Liability Partnership (LLP) is similar to a General Partnership except that normally a partner doesn't have personal liability for the negligence of another partner. This business structure is used most by professionals, such as accountants and lawyers. Filing with the Washington Secretary of States is required.

Corporation

A Corporation is a more complex business structure. A corporation has certain rights, privileges, and liabilities beyond those of an individual. Doing business as a corporation may yield tax or financial benefits, but these can be offset by other considerations, such as increased licensing fees or decreased personal control. Corporations may be formed for profit or nonprofit purposes. Filing with the Washington Secretary of State is required.

Nonprofit Corporation

A Nonprofit Corporation is a legal entity and is typically run to further an ideal or goal rather than in the interests of profit. Many nonprofits serve the public interest, but some engage in private sector activities. If your nonprofit organization is, or plans to, raise funds from the public, it may also be required to register with the Charities Program of the Washington Secretary of State. Charitable activities may require additional registration. Contact the Office of the Secretary of State for more information.

Limited Liability Company (LLC)

A Limited Liability Company (LLC) is formed by 1 or more individuals or entities through a special written agreement. The agreement details the organization of the LLC, including provisions for management, assign ability of interests, and distribution of profits and losses. LLCs are permitted to engage in any lawful, for-profit business or activity other than banking or insurance. Filing with the Washington Secretary of State is required.

Trust

A Trust is a legal relationship in which one person, called the trustee, holds property for the benefit of another person, called the beneficiary.

Joint Venture

A Joint Venture is formed for a limited length of time to carry out a business transaction or operation.

Tenants in Common

A Tenants in Common allows 2 or more people to occupy the same business while retaining separate identities in regard to assets or liabilities resulting from business activities.

Municipality

A Municipality is a public corporation established as a subdivision of a state for local governmental purposes.

Association

An Association is an organized group of people who share in a common interest, activity, or purpose.

Theory of Firm

What is a Firm?

We can define a firm (company, enterprise) as "**an organization that employs productive resources to obtain products and/or services which are offered in the market with the aim of making a profit.**"

First, firms are organizations, but not all organizations are firms.

“An organization is a complex social system created by people to cooperate in the achievement of some goal”[1]. For instance, a political party is an organization, but its goal is to contribute to positively transform society by means of collectively exerting political power. What distinguishes firms from other organizations is the aim of obtaining a profit through selling products and services in the market.

Second, firms fulfill the social role of production, transforming resources into finished goods and services. Typically, firms use four different basic types of resources in productive activities:

Natural resources: taken directly from nature without previous transformation (land, air, water, wood, etc.).

- Capital: funds needed to invest in tools, machinery, equipment, technology.
- Human resources: physical and intellectual capabilities of the workers.
- Entrepreneurship: the innovative ideas that shape the business model.

Third, resources are combined and transformed into final products or services which are, in turn, commercialized in markets to customers who are willing to pay for them. If the firm produces something that customers like, it will certainly be able to set prices that can cover production costs and more. If not, covering costs will be difficult and firm survival will be threatened.
A few keywords in this definition deserve further attention.

The major factors affecting how a business is organized are usually:

- **The size and scope of the business firm** and its structure, management, and ownership, broadly analyzed in the theory of the firm. Generally, a smaller business is more flexible, while larger businesses, or those with wider ownership or more formal structures, will usually tend to be organized as corporations or (less often) partnerships. In addition, a business that wishes to raise money on a stock market or to be owned by a wide range of people will often be required to adopt a specific legal form to do so.
- **The sector and country.** Private profit-making businesses are different from government-owned bodies. In some countries, certain businesses are legally obliged to be organized in certain ways.
- **Tax advantages.** Different structures are treated differently in tax law and may have advantages for this reason.
- **Disclosure and compliance requirements**. Different business structures may be required to make less or more information public (or report it to relevant authorities) and may be bound to comply with different rules and regulations.

A few relevant factors to consider in deciding how to operate a business include:

1. General partners in a partnership (other than a limited liability partnership), plus anyone who personally owns and operates a business without creating a separate legal entity, are personally liable for the debts and obligations of the business.
2. Generally, corporations are required to pay tax just like "real" people. In some tax systems, this can give rise to so-called double taxation, because first the corporation pays tax on the profit, and then when the corporation distributes its profits to its owners, individuals have to include dividends in their income when they complete their personal tax returns, at which point a second layer of income tax is imposed.
3. In most countries, there are laws which treat small corporations differently from large ones. They may be exempt from certain legal filing requirements or labor laws, have simplified procedures in specialized areas, and have simplified, advantageous, or slightly different tax treatment.
4. "Going public" through a process known as an initial public offering (IPO) means that part of the business will be owned by members of the public. This requires the organization as a distinct entity, to disclose information to the public, and adhering to a tighter set of laws and procedures. Most public entities are corporations that have sold shares, but increasingly there are also public LLC's that sell units (sometimes also called shares), and other more exotic entities as well, such as, for example, real estate investment trusts in the USA, and unit trusts in the UK. A general partnership cannot "go public".

Business Entity

A **business entity** is an entity that is formed and administered as per corporate law in order to engage in business activities, charitable work, or other activities allowable. Most often, business entities are formed to sell a product or a service. There are many types of business entities defined in the legal systems of various countries. These include corporations, cooperatives, partnerships, sole traders, limited liability company and

other specifically permitted and labeled types of entities. The specific rules vary by country and by state or province. Some of these types are listed below, by country. For guidance, approximate equivalents in the company law of English-speaking countries are given in most cases,

≈ public limited company (UK, Ireland and the Commonwealth)
≈ Ltd. (UK, Ireland and the Commonwealth)
≈ limited partnership
= unlimited partnership
= chartered company
= statutory company
= holding company
= subsidiary company
= one man company (sole proprietor)
= NGOs

However, the regulations governing particular types of entity, even those described as roughly equivalent, differ from jurisdiction to jurisdiction.

When creating or restructuring a business, the legal responsibilities will depend on the type of business entity chosen.

TYPES OF BUSINESS ENTITY

Business entity is an organization that carries out some economic activity for profit-making purpose. Economic activity is the one that is money centred—done with money and done for money to earn money. Different business activities are trading, manufacturing and services (such as banking, insurance and transportation).

We shall discuss about three types of business entity as in the following:

- Sole enterprise
- Partnership
- Limited liability company, i.e., joint stock company

Sole Enterprise

It is a business enterprise that is managed by a single owner. It is the single owner who bears the risk of running the business and reaps out the profit. Practically, the owner always has the residual claim on the profits and the assets of the business organization. A sole entrepreneur has **unlimited liability**. If business property is not sufficient to repay the external liabilities of business, the personal property, including house, personal belongings, bank deposits, etc., of the owner can be utilized to pay off the business liabilities. This fact makes it more risky as compared to a limited liability company.

A sole enterprise is a business entity that is owned by one person who contributes towards the required capital as owner's equity.

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Features of sole enterprises:
• Single owner • Single owner contributes the capital • Single owner bears the risk
• Unlimited liability of owner • No need for any specific documentation

Partnership

A partnership is the result of an agreement of doing business between partners. Under partnership, the business organization is called the **firm**, that is managed by all the partners as per the provisions of Partnership Deed (agreement). The partners share the profit/loss as per the agreement executed by them. There is an agency relationship between/among the partners. The partnership firm does not enjoy the benefit of a separate legal entity. As a result, the partners, i.e., the owners of the partnership firm, own **unlimited liability**.

A partnership is the outcome of an agreement between two or more people for doing some business activity.

USEFUL INFO

Features of partnership:
• Two or more owners • Maximum 10/20 partners • Agency relationship
• Unlimited liability • Capital contribution is not the pre-condition to become a partner
• Governed by agreement between partners • Registration not obligatory but optional

Limited Partnerships

- Limited Partnerships are actually more costly and complicated to set up than LLCs and are not often used by small business owners. Surprisingly, because of their limitations on the decision-making power of the limited partners, they are often used in estate planning (so the kids can receive benefit from, but not manage, the assets of the Limited Partnership).

Think of Limited Partnerships as a hybrid between the General Partnership and the Limited Liability Company. The Limited Partnership provides liability protection to the silent partners in the business (called "limited partners") but not the operating partners in the business (called "general partners"). The limited partners receive profit distributions, but do not take an active role in the day-to-day operations of the business. Because of this liability protection, all that

the limited partners have to lose is the total amount that they have invested in the company. However, the general partners in the business, who manage the day-to-day operations, still are completely at risk.

Limited Liability Company

A limited liability company is a business enterprise that is an association of a large number of contributors who contribute towards the capital for business purpose. The capital contribution by the contributors is in the form of shares; therefore, they are called **shareholders**.

Types of Limited Liability Companies

A limited liability company can be established in two basic forms—public limited company and private limited company. The difference is how they register themselves and accordingly, they are governed by legal provision.

Public Limited Company

A public limited company is the one that is promoted by seven promoters and does not impose certain restrictions as applicable on a private limited company. This company can raise the capital by issuing securities—shares and debentures through a public issue. **Public issue** means inviting general public through mass media to subscribe towards the capital of the company. Public issue may be an **IPO or FPO.** A public limited company can commence the business only after obtaining a letter of commencement of business from the ROC.

A public limited company is the one that is started by seven promoters and can arrange the capital by issuing the shares through a public issue—**initial public offer (IPO); further public offer or follow-on public offer (FPO).**

IPO vs FPO

Launching of a maiden public issue by a company is called **IPO.** In IPO, the general public is invited through mass media to contribute towards the capital of the company, i.e., by issuing the shares of the company to public.

Launching of a public issue any time after the first public issue of the company is called **FPO.** In FPO, general public is invited through mass media to contribute towards the capital of the company, i.e., by issuing the shares of the company to public.

Shares issued through IPO or FPO must be listed on a recognized stock exchange.

Private Limited Company

A private limited company is the one that is promoted by two promoters and follows certain restrictions on its working. The most practical limitation on a private limited company is not to issue shares/debentures through public issue—IPO or FPO. It can raise the capital by issuing the shares/debentures through private placement or rights issue only. There are certain legal restrictions on a private limited company as in the following:

- It cannot come out with a public issue.
- It cannot have more than 50 Shareholders.
- Its shares are not transferable freely as that of a public limited company.

A private limited company is the one that can be promoted by two promoters and cannot arrange the capital by issuing shares through public issue—IPO or FPO.

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Types of limited liability companies:
- Public Limited Company
- Private Limited Company
- Government Company
- Holding vs Subsidiary Company
- Chartered Company

The companies can further be classified on the basis of control through shareholding pattern. A company in which government holds at least 51% shareholding having voting rights or it is controlled by the government is called **government company**. Such company may either be a public limited or a private limited company. A public limited or private limited company can be a holding company or a subsidiary company. A **holding company** is the one that holds at least 51% shares having voting rights or exercises control on the other company. The company being controlled by the holding company is called **subsidiary company.** All these companies are governed by the legislation of Companies Act. Other forms of companies, such as **chartered company**, are established as a result of promulgation of the order by a king/queen or Parliament. Such companies are governed by the provisions of the charter passed by the promulgating authority.

Corporations

The next step up from an LLC is a Corporation. Corporations are different in the sense that they are a completely unique entity upon themselves. Meaning, they are separate from you in every way. Creating a Corporation is almost like creating another person.

Because Corporations are legally separate entities and they also have a much different tax structure. They pay their own separate taxes at a corporate tax rate instead of a personal tax

rate. This tax is assessed on the profits (the money that is left over at the end of the year) as opposed to the business's gross income.

Another benefit that Corporations offer is that they've been around for hundreds of years. In other words, this isn't their first time around the block. With so many centuries of developed case law, you don't have to worry about any legal gray areas that are left up to the whim of a glorified traffic judge while your livelihood hangs in the balance.

In addition to the separate tax structure, Corporations have an unlimited life, free transferability of ownership (unlike LLCs, where it's harder to transfer your membership shares) and tax benefits that allow for many more deductions. A corporation also has complete flexibility in ownership and management structures. These benefits make corporations an ideal choice for businesses intent on going public but, with all of the recordkeeping requirements, can also create paperwork havoc for small businesses.

S-Corporations

An S-Corporation is subject to the same filing requirements (e.g. "paperwork havoc") as a regular Corporation (also sometimes called a "C-Corporation), however has a pass-through tax status that is similar to a partnership, though filed on a different addendum to your personal return. This makes life a little bit easier by avoiding the need to calculate corporate taxes and file a corporate tax return. It is also great if you have a lot of business losses that you wish to deduct from some of your personal income.

Designating a corporation as an S-Corporation is easy. It is just a matter of filing a Small Business S-Election (form 2253) within three months of formation.

A word of caution -- S-Corporations have severe ownership limitations. Non-U.S. citizens and other entities cannot own shares in an S-Corporation and the number of shareholders is limited to 100. Also, all shares are equal, meaning that the officers of the company cannot place limitations on any set of shares, like they can in an LLC.

SOURCES OF CAPITAL FOR A COMPANY

A company arranges the capital by issuing different types of securities (shares/debentures) in the primary market. The isssue of the securities in the primary market is completely regulated by the provisions of Securities and Exchange Board of India (SEBI). Sources of capital as used by a limited liability company are broadly classified as long-term sources and short-term sources.

USEFUL INFO

Long-term sources of capital:

- Owner's Capital
  - Equity shares
  - Preference shares
- Debt Capital
  - Debentures
  - Long-term loan

Short-term sources of capital:

- Commercial Papers
- Bills of Exchange

Long-Term Sources of Capital

Long-term sources of capital are the one for which repayment by the company is to be made after a long-time period. Generally, this period is beyond five to ten years and in certain cases, these offer life-long source of capital, such as equity shares. Equity shares, preference shares, debentures, long-term loan, mortgage loan are the examples of long-term sources of capital for the company (Table 1.2). Long-term sources of capital are broadly classified as owner's capital and debt capital/borrowed capital.

TABLE 1.2 Comparative View of Sources of Capital

Point of Difference	Equity Shares	Preference Shares	Debentures/Loan
Voting Right	Yes	No	No
Preference	Last preference in income distribution and at the time of winding up of the company	Preference over equity shareholders in income distribution and at the time of winding up of the company	Preference over preference shareholders and equity shareholders in income distribution and at the time of winding up of the company
Residual Claim	Yes	No	No
Maturity	Perpetual	Yes, redeemed/converted into equity shares at the end of maturity period	Yes, redeemed/converted into equity shares at the end of maturity period
Conversion	Not applicable	Yes, convertibles are converted into equity shares	Yes, convertibles are converted into equity shares
Bonus and Rights	Yes	No	No
Fixed Dividend/Interest	No, payment of dividend changes from year to year	Fixed percentage of dividend	Fixed percentage of interest
Incidence of Dividend/ Interest Payment	If profits then subject to the approval in AGM	Conditional, subject to the availability of sufficient profits	Payment of interest is a legal and contractual obligation of company
Market Value	Changes very frequently	Does not change frequently	Does not change frequently

Owner's Capital

The amount of capital belonging to owners, i.e., shareholders of the company is called **owner's capital.** Owner's capital comprises paid-up share capital and net amount of reserves and surplus.

Capital structure is the composition of long-term sources of capital used by a company.

Equity Shares The capital of a company is represented by shares; a **share** is the unit to represent the capital of the company. **Equity share** represents real ownership of the company. The holders of the equity shares have voting rights. They have the power to cast their votes in the meeting of shareholders in proportion to their holding. Equity shares are also called **common stock** or **ordinary shares.** These are also called the **shares with residual claim.** These shares do not have any maturity period. At the same time, the company does not promise any fixed dividend. The dividend on these shares is paid after considering the level of profits and the factors, such as liquidity, market trends, investment opportunities for the company, etc.

Preference Shares Preference shares are accorded preference over equity shares; such preference is given at the time of dividend distribution and also at the time of liquidation of the company. A company promises a fixed percentage of dividend on these shares, the payment of which depends upon the availability of sufficient divisible profits. These shares either have a fixed maturity period or get converted into the equity shares/debentures of the issuing company. All the terms and conditions regarding redemption/conversion are specified by the company at the time of issue of preference shares.

Capital structure comprising borrowed capital along with owner's capital is called **leveraged capital** structure.

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Types of Preference shares:
- Redeemable vs Non-redeemable
- Convertible vs Non-convertible
- Participating Preference Shares

Because of a fixed dividend and no privilege for rights and bonus shares, these shares do not command high market value, such as equity shares.

Borrowed Capital or Debt Capital

Debt capital is the amount of capital that is borrowed from an external agency, such as bank, financial institution or from public issuing debentures. On the debt capital, the company has the legal obligation to make the **payment of interest** and repayment of the principal amount to the loan provider or debenture holders. **Interest** is the cost of using debt capital for the company and it is a reward for the loan provider and debenture holders. **Borrowed capital** is also called **debt capital** or **loan capital**. It comprises the following:

USEFUL INFO

Types of Debentures
- Redeemable vs Non-redeemable
- Convertible vs Non-convertible
- Debentures with warrants
- Debentures with option
- Deep discount debentures/Zero coupon bonds
- Floating rate debentures
- Index linked debentures

Debentures It is like an acknowledgement evidencing debt of the company. It is a kind of loan taken by the company from general public; these carry a coupon rate called **rate of interest**. Interest on these is generally paid six monthly and the payment of it is a legal obligation on the part of the issuing company. The company is liable to pay the interest whether it earns the profit or not.

Long-term Loan Long-term loan is the money borrowed from a bank or financial institution the repayment of which is to be made over the long term, i.e., five to ten years or even beyond it. Usually, it is granted by the lending agency—bank or financial institution against the security of the asset. The asset offered as security for the loan is called **collateral security (asset)** and value of such asset is called **collateral value**. When a loan carries the security of an asset, it is also called **secured loan**. A secured loan is issued against the security of the asset through the process of mortgage; therefore, it is also called **mortgage loan**. The secured loan implies that in the event of default, the money lender can recover the loan amount along with the due interest by selling the collateral asset.

Short-Term Sources of Capital

Short-term sources of capital are the one for which repayment is to be made during the short-time duration that is usually between three to five years. It is generally in the form of a loan or an instrument representing features of loan. On this, a payment of interest and repayment of the principal amount is the legal liability of company, i.e., the borrower. A company can arrange a short-term capital by using any of the following instruments:

- Commercial Papers
- Bills of Exchange

Commercial papers (CPs)

It is a promissory note issued as an unsecured debt obligation of the issuing company to raise short-term capital. As these are issued at a discount to face value and redeemed at par on maturity, these do not carry any coupon rate. The difference between the issue price and the maturity value is like a compensation for interest for the holding period. These are issued in negotiable form that brings in the concept of liquidity in these papers.

It is a money market instrument and issued by a large number of companies and commercial banks to raise funds for short term. As per Reserve Bank of India (RBI) rules, only the corporates, who obtain an investment grade rating, can issue CPs. In India, these have a minimum maturity period of 15 days with a maximum of one year.

Bills of exchange

With the help of bills of exchange, sundry debtors get converted into a negotiable instrument. A **bills of exchange** is an unconditional order by the seller to his/her credit customer to make the payment on the specified due date for the value received by him/her. The seller of the goods who writes the bill is called **drawer/holder** of the bill and the buyer of the goods on whom such bill is written is called **drawee/acceptor** of the bill. Once the drawer receives the accepted bill, it becomes bills receivable for him/her and for the acceptor, it becomes bills payable. Bills receivable is a current asset, such as sundry debtors and bills payable is a current liability, such as sundry creditors.

The drawer, also called **holder of the bill**, has three ways to dispose off the bill: (i) hold the bill till maturity (ii) endorse it in favour of another party and (iii) get it discounted with the bank.

NON-CONVENTIONAL SOURCES OF FINANCE

Non-conventional sources are the one that are different from the traditional sources, such as owner's capital and borrowed capital. Usually, companies use following non-conventional sources of finance:

- Lease Financing
- Hire Purchase
- Factoring Services

Lease Financing

With the help of lease financing, the owner of the asset passes the right to use the asset in favour of the user. It is the result of an agreement between the owner of the asset and user of the asset. The user can use the

assets as per the terms and conditions specified in the agreement for which he/she is bound to make periodic payment to the owner. The owner of the asset is called **lessor** and the user is called **lesse**.

Finance companies also provide lease finance. The mechanism is such that the lessee identifies the asset as per his/her requirement that is purchased by the finance company and given to lessee on lease. By this mechanism, the lessee can use the asset without making the full payment. In certain cases, a nominal downpayment is to be paid that is adjustable against the lease rental. At the end of the lease term, the lessee has the obligation to return (revert) the asset to the lessor, which implies that the lessee does not become the owner of the asset. All the benefits related to ownership of the asset are vested with the lessor.

Lease financing can be used to fulfill long-term as well as short-term finance needs.

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Types of leases:
- Finance lease
- Operating lease
- Sale and lease back
- Cross-border lease
- Dry vs wet lease
- Big ticket lease
- Leveraged lease

Hire Purchase

Hire purchase system of buying the asset is a system in which the buyer does not make the complete payment for the asset at the time of taking the possession of the asset; instead he/she has the obligation to make the payment for the asset in several installments to be paid for a definite time period at a regular interval. The purchaser is called **hire purchaser** and seller is called **hire vendor**. The title to asset transfers in the favour of hire purchaser only when he/she makes the payment of the last installment. In case the hire purchaser defaults in making the payment of instalments, then the hire vendor has the right to repossess the asset and recover the due instalments. The ownership-related benefits are vested with the hire purchaser.

Factoring Services

Factoring is a financial service as well as a means to provide working capital finance for the companies.

Under factoring, the seller of the goods assigns his/her accounts receivables to an agency called **factor**. The factor provides the service of making follow-up with the receivables assigned, makes the collection, maintains the related books of accounts and, in certain cases, provides advance against the receivables factored.

For providing the service, the factor charges his/her commission and interest on the advance provided against the receivables factored. The factoring service can be provided by an agency that is established for this purpose and registered as factor.

With the help of factoring, an organization simply outsources its activities of collection of book debts and maintenance of the related books of accounts; when an advance is provided by the factor, this service also becomes a source of working capital finance. Generally, following types of factoring arrangements can be made:

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Types of factoring arrangements:
- Recourse factoring vs non-recourse factoring
- Advance factoring vs maturity factoring
- Full factoring
- Bank-participating factoring
- Cross-border factoring

Introduction - Economics

Economics is a field of study that has become increasingly relevant in our globalized, financialised society. The economy is part of our collective conscious and a buzzword that links personal finances to big business and international trade deals. Economics deals with individual choice, but also with money and borrowing, production and consumption, trade and markets, employment and occupations, asset pricing, taxes and much more. What then is the definition of economics? One way to think of it is the study of what constitutes rational human behavior in the endeavor to fulfill needs and wants given a world with scarce resources. In other words, economics tries to explain how and why we get the stuff we want or need to live. How much of it do we get? Who gets to have more? Who makes all this stuff? How is it made? These are the questions and decisions that economics concerns it with.

Significance of Economics

Significance of Economics

- First and foremost, the most important advantage of economics is helping the society decide and formulate the ways for the optimal allocation of its limited and scarce resources.
- Economics provides us the mechanism and analytical techniques to optimise the utilisation of the available resources and reduce wastages.
- Optimum utilisation of the 'Opportunity cost' is another principle in which the scarce resources are utilised efficiently after calculating and checking the opportunity cost. Minimising the opportunity cost gives maximum profits. The use of this principle by governments in budget allocations results in better growth rates for a nation.
- The stability of an economy is a must for any country or society to survive in the long run. The adoption of sound economic practices in a society can only ensure that the economy is stable and growing at the same time.
- Economics is equally important for the economical growth of individuals. A person may not need the knowledge and understanding of the theoretical side of economics, but he definitely needs to understand the basic economic practices that he must follow to save himself from going broke or bankrupt and to enjoy a healthy and wealthy life. Also, understanding of at least the basic economics helps maximising the profit.
- Economists can advise governments on how to manage the economy and avoid inflation and unemployment through well devised economic policies.
- Economists can also be of great help to the society by suggesting certain policies to the governments to overcome the market failures caused due to various factors such as under or over-production.

Macro and Micro Economics

Macro Economics may be defined as that branch of economic analysis which studies the behaviour of not one particular unit, but of all the units combined together. Macroeconomics is a study of aggregates. It is the study of the economic system as a whole ï¿½ total production, total consumption, total savings and total investment. The following are the fields covered by macroeconomics:

- Theory of Income, Output and Employment with its two constituents, namely, the theory of consumption function, the theory of investment function and the theory of business cycles or economic fluctuations.
- Theory of Prices with its constituents of the theories of inflation, deflation and reflation.
- Theory of Economic Growth dealing with the long-run growth of income, output and employment.
- Macro Theory of Distribution dealing with the relative shares of wages and profits in the total national income.

The study of macroeconomics is indispensable as it is the main agent for formulation and successful execution of government economic policies. It is also indispensable for the formulation of microeconomic models.

Microeconomics may be defined as that branch of economic analysis, which studies the economic behavior of the individual unit, maybe a person, a particular household, or a particular firm. It is a study of one particular unit rather than all the units combined together. In microeconomics, we study the various units of the economy, how they function and how they reach their equilibrium. An important tool used in that of microeconomics is that of Marginal Analysis. In fact, it is an indispensable tool used in microeconomics. Some of the important laws and principles of microeconomics have been derived directly from marginal analysis. The following are the fields covered by microeconomics:

- Theory of Product pricing with its two constituents, namely, the theory of consumer behavior and the theory of production and costs.
- Theory of Factor pricing.
- Theory of Economic Welfare.

Concepts and Importance of National Income

The main **concepts** of NI are: GDP, GNP, NNP, NI, PI, DI, and PCI.

The most **important concept** of **national income** is Gross Domestic Product. Gross domestic product is the money value of all final goods and services produced within the domestic territory of a country during a year.

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 various sectors of the economy.

Gross Domestic Product (GDP)

The most important concept of national income is Gross Domestic Product. Gross domestic product is the money value of all final goods and services produced within the domestic territory of a country during a year.

Algebraic expression under product method is,

GDP=(P*Q)

where,
GDP=Gross Domestic Product
P=Price of goods and service
Q=Quantity of goods and service
denotes the summation of all values.

According to expenditure approach, GDP is the sum of consumption, investment, government expenditure, net foreign exports of a country during a year.

Algebraic expression under expenditure approach is,

GDP=C+I+G+(X-M)

Where,
C=Consumption
I=Investment
G=Government expenditure
(X-M)=Export minus import

GDP includes the following types of final goods and services. They are:

1. Consumer goods and services.
2. Gross private domestic investment in capital goods.
3. Government expenditure.
4. Exports and imports.

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)
or, GNP=C+I+G+(X-M)+NFIA

Hence, GNP includes the following:

Consumer goods and services.

1. Gross private domestic investment in capital goods.
2. Government expenditure.
3. Net exports (exports-imports).
4. Net factor income from abroad.

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
or, NNP=C+I+G+(X-M)+NFIA-Depreciation

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-Interest Taxes
or,GNP-Depreciation+Subsidies-Indirect Taxes
or,NI=C+G+I+(X-M)+NFIA-Depreciation-Indirect Taxes+Subsidies

Personal Income (PI)

Personal Income i s 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

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

From consumption approach,

DI=Consumption Expenditure+Savings

Per Capita Income (PCI)

Per Capita 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

'INFLATION'

Inflation is the rate at which the general level of prices for goods and services is rising and, consequently, the purchasing power of currency is falling.

The first definition of inflation given by the American College Dictionary is any increase in the currency not redeemable in specie. Other definitions consider inflation to be a general rise in the price of goods, which may or may not be directly related to the money supply.

Central banks attempt to limit inflation, and avoid deflation, in order to keep the economy running smoothly.

As a result of inflation, the purchasing power of a unit of currency falls. For example, if the inflation rate is 2%, then a pack of gum that costs $1 in a given year will cost $1.02 the next year. As goods and services require more money to purchase, the implicit value of that money falls.

The Federal Reserve uses core inflation data, which excludes volatile industries such as food and energy prices. External factors can influence prices on these types of goods, which does not necessarily reflect the overall rate of inflation. Removing these industries from inflation data paints a much more accurate picture of the state of inflation.

Money Supply in Inflation

Quantity Theory

The theory most discussed for the relationship between prices and the money supply is called the quantity theory of money. The quantity theory proposes that the exchange value of money is determined like any other good, with supply and demand. The basic equation for the quantity theory, developed by American economist Irving Fisher, is expressed as: (total money supply) x (velocity of money) = (average price level) x (volume of economic transactions)

Some variants of the quantity theory propose that inflation and deflation occur proportionately to increases or decreases in the supply of money. Empirical evidence has not demonstrated this, and most economists do not hold this view.

A more nuanced version of the quantity theory adds two caveats. New money has to actually circulate in the economy to cause inflation, and inflation is relative, never absolute. In other words, prices tend to be higher than they otherwise would have been if more dollar bills are involved in economic transactions.

Challenges to Quantity Theory

Keynesian and other no monetarist economists reject orthodox interpretations of the quantity theory. Their definitions of inflation focus more on actual price increases, with or without money supply considerations.

According to Keynesian economists, inflation comes in two varieties: demand-pull and cost-push. Demand-pull inflation occurs when consumers demand goods, possibly because of a larger money supply, at a rate faster than production. Cost-push inflation occurs when the input prices for goods tend to rise, possibly because of a larger money supply, at a rate faster than consumer preferences change.

The Business Cycle

The business cycle refers to the fluctuations in economic activity that an economy experiences over a period of time. It consists of expansions - or periods of economic growth - and contractions, or periods of economic decline.

Features of Business Cycle

1. The economy spends most of its time in recessions, recoveries or expansions rather than in the steady state condition of “full-employment equilibrium” favored by economic theorists.
2. Cycles are recurrent but not periodic – makes decisions risky and creates an exposure to unemployment and bankruptcy.
3. Occur at about the same time in many economic activities.

Expansions

i. During **expansions,** the economy is growing in real terms (i.e. excluding inflation), as evidenced by increases in indicators like employment, industrial production, sales and personal incomes.
ii. Expansion is measured from the trough (or bottom) of the previous business cycle to the peak of the current cycle

Contractions

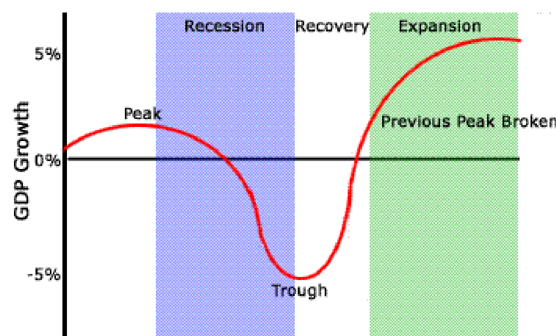
i. During **contractions** - also called recessions - unemployment rises, production slows, sales decrease and incomes stagnate or decline.
ii. Recession is measured from the peak to the trough.

In the United States, the National Bureau of Economic Research (NBER) determines the official dates for business cycles.

The entire financial industry rests on the fundamental concept of the market economy, which means you should be armed with some basic economic theory when you walk into the testing room.

Phases of the Business Cycle

The first concept you need to know is the business cycle, the series of fluctuations in the level of economic activity. The timing and degree of these fluctuations are notoriously unpredictable; however, there is a pattern that seems to recur with these gyrations. A hypothetical business cycle is comprised of the following phases:



- **Peak**: Economic activity is growing rapidly and production facilities are operating at full capacity.

- **Contraction (Recession, Depression)**: Economic growth slows or the economy actually shrinks; sales decline and unemployment rises. This phase follows the peak. There are also different classifications of contractions:
  - A recession is a contraction in which gross domestic production (explained below) declines for two consecutive quarters.
  - A depression is a prolonged, severe recession.

- **Trough**: Economic activity is at its lowest point in the cycle.

- **Recovery**: Sales, employment levels and other measures of economic activity rebound and eventually reach a new peak. This phase follows the trough.

Nature and Scope of Business Economics

Nature of Business Economics : Traditional economic theory has developed along two lines; viz., normative and positive. Normative focuses on prescriptive statements, and help establish rules aimed at attaining the specified goals of business. Positive, on the other hand, focuses on description it aims at describing the manner in which the economic system operates without staffing how they should operate. The emphasis in business economics is on normative theory. Business economic seeks to establish rules which help business firms attain their goals, which indeed is also the essence of the word normative. However, if the firms are to establish valid decision rules, they must thoroughly understand their environment. This requires the study of positive or descriptive theory. Thus, Business economics combines the essentials of the normative and positive economic theory, the emphasis being more on the former than the latter.

Scope of Business Economics : As regards the scope of business economics, no uniformity of views exists among various authors. However, the following aspects are said to generally fall under business economics. 1. Demand Analysis and Forecasting 2. Cost and production Analysis. 3. Pricing Decisions, policies and practices. 4. Profit Management. 5. Capital Management.

Significance of Business Economics : The significance of business economics can be discussed as under : 1. Business economics is concerned with those aspects of traditional economics which are relevant for business decision making in real life. These are adapted or modified with a view to enable the manager

take better decisions. Thus, business economic accomplishes the objective of building a suitable tool kit from traditional economics. 2. It also incorporates useful ideas from other disciplines such as psychology, sociology, etc. If they are found relevant to decision making. In fact, business economics takes the help of other disciplines having a bearing on the business decisions in relation various explicit and implicit constraints subject to which resource allocation is to be optimized. 3. Business economics helps in reaching a variety of business decisions in a complicated environment.

Role of Business Economist

The role of Business Economist becomes increasingly important in view of the different objectives of the firm.

i. He has a significant role to play in **assisting the management of the firm in decision-making** and **forward planning** by using specialized skills and techniques. In advanced countries, large companies employ Business Economist or Managerial Economist to assist the management.

ii. **Business Economists should study the Environment**

It is the primary duty of Business Economists to make **extensive study of the business environment** and the external factors affecting the firm's interest, viz., general prices, national income and output, volume of trade, etc. These factors have to be thoroughly analyzed.

iii. **Business Economists should make decisions regarding Business Operations**
The Business Economist can **help the management in making decisions** regarding the internal business operations by studying and analyzing.

iv. **Business Economist** to **provide the necessary economic intelligence**, besides statistical information to the Management for effecting planning. The Business Economist has to keep in mind the main objectives of the firm and take decisions on the basis of these objectives.

Besides making the above studies, the Business Economist should have to perform specific functions like

1. Sales forecasting,
2. Market research,
3. Analysis of competing firms,
4. Pricing problems,
5. Production programmers',
6. Investment analysis and environmental forecasting, etc.

Multidisciplinary nature of Business Economics.

With the continuous expansion of business world, the scope of managerial economics has also increased to a great extent. It has become a multi-disciplinary subject, and draws not only on economics but also on other subjects such as psychology, sociology, mathematics, statistics, accounting theory, etc. Business firms use various techniques to forecast the demand pattern, estimate the economic viability of a project, etc. Thus, analysis of the present business environment, and forward planning require not only the knowledge of economic theory but also other related subjects like mathematics and statistics. Hence, managerial economics takes into consideration all these aspects of analytical framework. Though the scope and subject-matter of managerial economics have been increasing day by day, we can mention some of the important fields of study which fall under the purview of managerial economics. These are stated below:

1. Demand analysis,
2. Production and cost analysis,
3. Objectives of business firms,
4. Pricing policies,
5. Capital budgeting, etc.