Managing Financial Resources

Business economics

Basics (1)

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Basics of business economics

Nellis & Parker (2006) & Study guide chapter 1

Basic concepts 1

Economic environment

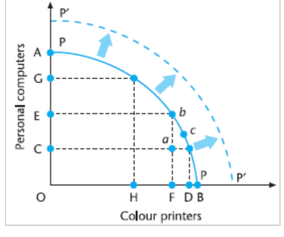
- microeconomics
  - immediate firm environment (price, revenue, costs etc.)
- macroeconomics
  - general economic environment (politics, law etc.)

1 Resource allocation

- what goods? How (combine resources, inputs) ? For whom ?
  - allocative, productive, distributive choices
  - **Price and command** is central to what, how and for whom
  - vertical integration (make or buy)
    - Transaction costs = Costs incurred for buy-in at market or inhousing

2 Opportunity costs

- "Is the loss of the opportunity to pursue the most attractive alternative given the same time and resource"
- **Production possibilty curve** (frontier)
  - increase in production of one good over another happens at a declining rate after some point --> diminishing marginal returns
- depends on factors of production



3 Marginal analysis (Grenzkosten analyse)

- Marginal utility (Grenznutzen)
  - amount by which the total utility changes when the consumption of a good or service changes by 1 unit (if 0 then no further utility)
- Marginal product
  - amount by which total product changes due to 1 unit change in input
- Marginal revenue
  - change in total revenue when 1 more unit is sold
- Marginal cost
  - change in total cost when production is increased by 1 unit

4 Business objectives

- profit maximisation
  - sometimes just "satisfactory level of performance" --> satisficing

5 Time dimension

- short run
- long run
  - scale of production can be changed

6 Economic efficiency and equity

- productivity
  - firm's efficiency to use resources to produce output
  - labour productivity (pro Kopf Produktivität)
  - total factor productivity (Produktivität)
- equity
  - to pay fair wages etc ...trade-off to productivity

Basic concepts 2

8 Externalities

- social costs & benefits

7 Risk and uncertainty

- Risk
  - element of chance of injury or loss, possible to insure
- Uncertainty
  - not possible to insure, difficult to estimate

9 Discounting

- "Time Preference"
  - "costs and benefits in future are less worth than costs and benefits today"
- NET PRESENT VALUE (NPV)

$$NPV = \sum \frac{S_t}{(1+r)^t}$$

- Property rights
  - tangible
  - intangible
  - must be protected by law

Competitive environment

- **Perfectly competitive market**
  - complete freedom of entry or exit of markets, homogeneous products
  - Price taker rather than Price maker
  - e.g. Commodity (wheat, sugar etc.)
- **Monopolistically competitive market**
  - many sellers, some degree of differentiation
  - "imperfectly competitive markets"
  - e.g. car repairs, grocery sales
- **Oligopolistic competition**
  - small number of relatively large firms wary of each others actions regarding price and non price action
  - e.g. Banking, brewing, motor oil etc.
- **Monopoly**
  - 1 supplier, monopolist
  - price maker, "producing a product where there is no close substitute for it"
  - regulated by "anti-trust" law (25-40% market share = monopoly)