L. S. RAHEJA COLLEGE OF ARTS AND COMMERCE, DEPARTMENT OF ECONOMICS

BUSINESS ECONOMICS II GLOSSARY

FYBCOM SEMESTER II

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MODULE 1

1) Perfect competition

The Perfect Competition is a market structure where a large number of buyers and sellers are present, and all are engaged in the buying and selling of the homogeneous products at a single price prevailing in the market.

2) Monopoly

Monopoly is a market structure in which there is only one seller.

3) Normal profit

Normal Profit exists when total revenue, TR, equals total cost, TC. Normal profit is defined as the minimum reward that is just sufficient to keep the entrepreneur supplying their enterprise. In other words, the reward is just covering opportunity cost - that is, just better than the next best alternative.

4) Supernormal profit

If a firm makes more than normal profit it is called super-normal profit. Supernormal profit is also called economic profit, and abnormal profit, and is earned when total revenue is greater than the total costs.

5) Sub-normal profit

If a firm makes less than normal profit it is called sub-normal profit. Sub-normal profit is also called as loss, and is incurred when total revenue is less than the total costs.

6) Shut down point

A shutdown point is a level of operations at which a company experiences no benefit for continuing operations, and therefore decides to shut down temporarily (or in some cases permanently). It results from the combination of output and price where the company earns just enough revenue to cover its total variable costs. The shutdown point denotes the exact moment when a company’s (marginal) revenue is equal to its variable (marginal) costs - in other words, it occurs when the marginal profit becomes negative.

7) Firm

Firm is a unit of production that employs factors of production (or inputs) to produce goods & services under given state of technology. It is an independently administered business unit

8) Industry

Industry is a group of related firms. The relationship between the firms may be either based upon product or process criterion, e.g. dairy industry or food processing industry etc. The concept of industry is helpful to government and businessmen to formulate their policies.

MODULE 2

1) Monopolistic Competition

Monopolistically competitive market is the market which has some characteristics of perfect competition and some of monopoly. Even though there are many sellers under monopolistic competition, each seller has its monopoly but still there is a competition due to product differentiation.

2) Product differentiation

Product differentiation is one of the characteristics of monopolistic competition. Products are close substitutes of each other due to small differences in them. In case of products like soaps, garments, tooth paste etc. variety of products are available but each product is different from another due to various factors.

3) Production cost

It refers to the total expenses incurred to produce goods and services. They are in the form of rent wages interest and profit. It also includes depreciation and payment for their inputs which are not normally included in the above mentioned payments. Thus expenditure incurred to produce and reach commodity to the retail shop is called production cost.

4) Selling cost

Close substitute products are available in monopolistic competition, firms have to spend money for increasing sale of their product in the market. This cost is called as selling cost. It includes all expenditures of the firm which can increase their sale. It is in the form of newspaper advertisement, hoardings, exhibitions, distribution of free samples, discounts offered on products etc.

5) Excess capacity

Excess capacity is created under monopolistic competition the equilibrium of a firm under monopolistic competition is attained at a less than optimum level of output. This means that the resources are not fully utilised and therefore this underutilisation of existing capacity leads to excess capacity.

6) Oligopoly

Oligopoly is a market structure with a small number of firms, none of which can keep the others from having significant influence. The concentration ratio measures the market share of the largest firms. A monopoly is one firm, duopoly is two firms and oligopoly is two or more firms. There is no precise upper limit to the number of firms in an oligopoly, but the number must be low enough that the actions of one firm significantly influence the others.

7) Collusive oligopoly

Collusive oligopoly is a form of market in which few firms form a mutual agreement to avoid competition. They form a cartel and fix the output quotas and the market price. Leading firm in the market is accepted by the cartel as a price leader. All the firms in the cartel accept the price as fixed by the price leader.

8) Non-collusive oligopoly

Non-collusive oligopoly is a form of market in which few firms. Each firm has its price and output policy is independent of the rival firms in the market. The entire firms enable to increase its market share through competition in the market.

9) Price rigidity

Price stickiness or sticky prices or price rigidity refers to a situation where the price of a good does not change immediately or readily to the new market-clearing price when there are shifts in the demand and supply curve.

10) Cartels

A cartel is an organization created from a formal agreement between a group of producers of a good or service to regulate supply in an effort to regulate or manipulate prices. In other words, a cartel is a collection of otherwise independent businesses or countries that act together as if they were a single producer and thus are able to fix prices for the goods they produce and the services they render without competition.

11) Dominant firm leadership

This refers to a type of leadership in which only one organization dominates the entire industry. Under dominant price leadership, other organizations in the industry cannot influence prices. The dominant organization uses its power of monopoly to maximize its profits and other organizations have to adjust their output with the set price.The interests of other organizations are ignored by the dominant organization. Therefore, dominant price leadership is sometimes termed-as partial monopoly. Price leadership by the leading organization is most commonly seen in the industry.

12) Low cost firm leadership

In the low-cost price leadership model, an oligopolistic firm having lower costs than the other firms sets a lower price which the other firms have to follow. Thus the low-cost firm becomes the price leader.

13) Barometric price leadership

Refers to a leadership in which one organization declares the change in prices at first and assumes that other organizations would accept it. The organization does not dominate others and need not to be the leader in the industry. Such type of organization is known as barometer. This barometric organization only initiates a reaction to changing market situation, which other organizations may follow it if they find the decision in their interest. On the contrary, the leading organization has to be accurate while forecasting demand and cost conditions, so that the suggested price is accepted by other organizations.

14) Aggressive price leadership

Implies a leadership in which one organization establishes its supremacy by threatening the organizations to follow its leadership. In other words, a dominant organization establishes leadership by following aggressive price policies and forces other/organizations to follow the prices set by it.

MODULE 3

1) Price discrimination

Price discrimination refers to the act of selling the same article, produced under single control at different prices to different buyers. Price discrimination generally takes place in case of monopoly. Following are the types of price discrimination.

Personal price discrimination- In this type different prices are charged to different buyers for the same product or service. Example: Doctors, Lawyers, Tuition Teachers etc. Charges high fees for rich and low fees for poor. It is similar to first degree price discrimination.

Group Price Discrimination – Here entire population or area is divided into different groups and different prices are charged for different groups of people.

Example: Railways charges lower ticket to children and senior citizens and more for others. Industrial areas are charged more electricity charges as compared to residential areas. This is same as second degree price discrimination.

Market Price Discrimination – This means charging different prices for the same product in different markets.

2) Dumping

Dumping is a term used in the context of international trade. It's when a country or company exports a product at a price that is lower in the foreign importing market than the price in the exporter's domestic market. Because dumping typically involves substantial export volumes of

a product, it often endangers the financial viability of the product's manufacturers or producers in the importing nation.

3) Marginal cost pricing

According to marginal cost pricing method price is determined on the basis of the marginal cost of production. Marginal cost is the cost of producing on additional unit of output. Here the price is charged on the basis of cost of additional unit of output which the firm produces. The price is determined in such a way that it must cover the marginal cost.

4) Cost plus pricing

Cost-plus pricing is also called as full cost pricing or mark-up pricing. Two famous economist of Oxford University Hall and Hitch developed this concept of pricing. This is the most commonly adopted method of pricing. It is used by a company or firm to determine the selling price of their product. Cost-plus pricing is a very simple method for setting the prices of goods and services. According to this method Price of a commodity is determined by taking into consideration Average Fixed Cost (AFC), Average Variable Cost (AVC) and Normal Profit Margin (NPM) or mark-up percentage. This mark-up percentage is nothing but profit. In other words Price is determined by adding a fixed mark-up to the cost of producing the product. This method is generally used by manufacturing firms. It is often by Government. Thus, it is imperative to have an accurate information of average costs.

$P = AFC + AVC + NPM$

5) Multiple product pricing

Most of the companies today produce more than one product and sell them in more than one markets. They produce variety of products instead of specializing in one product. They do this in order to make optimum utilization of their production capacities. The goods sold by them may be substitutes or complementary goods. An automobile firm like Maruti Suzuki produces wide range of cars. So each product will have an independent demand cure and hence a separate price. Pricing of variety of goods produced by a single firm is called multiple product pricing. It is also known as multi-product pricing or product line. In this type of pricing firms needs to be very vigilant about the repercussions of prices of one product on another.

6) Transfer pricing

Transfer prices are internal prices at which intermediate goods from upstream divisions are sold to downstream divisions. Upstream divisions are those which are producing intermediate product & downstream divisions are those that are producing finished product.

MODULE 4

1) Capital Budgeting

Capital budgeting or investment appraisal is an official procedure used by firm for assessing and evaluating possible expenses or investments. It is a process of planning of expenditure which involves current expenditure on fixed/durable assets in return for estimated flow of benefits in the long run. Capital budgeting is the process of planning used to determine whether firms long term investments such as heavy machinery, new plant, research and development projects are worth the funding or not.

Charles T. Horngreen defines Capital budgeting as a long term planning for making and financing proposed capital outlays.

Peterson defines capital budgeting as the process of planning capital projects, raising funds and efficiently allocating resources to capital projects.

2) Payback Period Method

It is one of the simplest method of investment appraisal. It helps to calculate period within which initial investment or entire cost of project would be completely recovered. It is also known as pay-off or pay out method. It gives total number of years in which the total investment in particular capital project pays back itself. As per this method there will be no profit till the payback period is over.

Selection criteria: According to payback period criteria, project with lowest payback period should be selected.

Following methods are used to calculate Payback period.

$$\text{Payback Period} = \frac{Initial\ Investment}{Net\ annual\ Cash\ inflows}$$

3) Net Present Value (NPV) Method:

Investment in project generates series of income (cash inflows) over a number of years. It is also known as discounted cash flow technique. NPV method considers the time value of money. To find out whether investment is worthwhile or not, the present value of this series of income (cash inflows) is calculated at a given rate of discount. This gives us Gross Present Value (GPV). If we deduct initial cost (investment) of project from GPV we get Net Present

Value i.e. NPV. Investment should be made if present value of the expected future cash inflows from project is larger than the cost of the investment. In simple terms if NPV > 0 then accept the project and if NPV < 0, then reject the project. In case of more than one project, project with higher NPV should be preferred by the firm.

NPV = GPV – Initial Cost.

If R_1 , R_2 , R_3 , ……. R_n are yields of assets after first, second, third, ………n^{th} year and r is the rate of discount then,

$$NPV = \frac{R1}{(1+r)} + \frac{R2}{(1+r)^2} + \frac{R3}{(1+r)^3} + \ldots\ldots + \frac{Rn}{(1+r)^n} - Initial\ Cost$$

4) Internal rate of return method

Internal rate of return method like NPV also considers time value of money by discounting annual cash inflows. This method is also known as time adjusted rate of return method. In this method we find out that rate of return which will equate the present value of future cash inflows to the present cost of the project. It is generally the rate of return that project earns. It is the discount rate (r) which equates aggregate present value of the net cash inflows with aggregate present value of cash outflows of a project. In simple terms it is the rate which makes NPV of a project equals to zero. In case of multiple projects, project with higher IRR should be selected. Following formula is used for calculating IRR.

$$I = \frac{R}{1+r}$$

Where,

I = Initial Investment

R = Cash flows

r = Rate of return

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For LSRC Students only.