SRINIVASAN ENGINEERING COLLEGE, PERAMBALUR

DEPARTMENT OF MANAGEMENT STUDIES

BA9202-ECONOMIC ANALYSIS FOR BUSINESS

I MBA I SEMESTER

2 MARKS

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1. Define consumer behavior

Consumer behavior is the study of when, why, how, and where people do or do not buy a product. It blends elements from psychology, sociology, social anthropology and economics. It attempts to understand the buyer decision making process, both individually and in groups. It studies characteristics of individual consumers such as demographics and behavioral variables in an attempt to understand people's wants. It also tries to assess influences on the consumer from groups such as family, friends, reference groups, and society in general.

2. What is consumer equilibrium?

When consumers make choices about the quantity of goods and services to consume, it is presumed that their objective is to maximize total utility. In maximizing total utility, the consumer faces a number of constraints, the most important of which are the consumer's income and the prices of the goods and services that the consumer wishes to consume. The consumer's effort to maximize total utility, subject to these constraints, is referred to as the consumer's problem. The solution to the consumer's problem, which entails decisions about how much the consumer will consume of a number of goods and services, is referred to as consumer equilibrium.

3. Define microeconomics

Branch of economics concerned with the behavior of individual entities such as markets, firms, and households.

4. Define macroeconomics

The branch of economics concerned with the overall performance of the economy.

5. What is market mechanism?

The market mechanism allows an economy to simultaneously solve the three economic problems of *what*, *how*, and f*or whom*. Consumers indicate their preferences over *what* is produced through their willingness to pay for a good or service. Firms respond to this by considering the mix of final products that will maximize their own profits, that is, the difference between their revenues from sales and their production costs.

6. Define demand schedule

When economists refer to the *law of downward-sloping demand*, they are speaking of a particular kind of behavior among buyers that is observed with so few exceptions that it can be designated as a “law” of behavior.

7. Define supply schedule

The supply schedule (and supply curve) for a commodity shows the relationship between its market price and the amount of that commodity that producers are willing to produce and sell, other things being held equal.

8. What is equilibrium of supply and demand?

The division between buyers and sellers is nearly absolute. In all but a very few exceptional cases, economic forces directly influence either the demand side of a market or the supply side of a market, but not both.

9. Define utility and marginal utility

Utility measures the want-satisfying power of a good or service. Marginal utility is the rate at which utility changes as each additional unit of a particular good is consumed. As with other marginal concepts, marginal utility measures the change in a total value when an additional unit of something else is used.

10. What is law of diminishing utility?

The law of diminishing marginal utility holds that as the amount of good consumed increases, the marginal utility of that good tends to diminish. That is, the more you have of any one thing, the less an additional unit of it is worth to you. These ties nicely into the paradox of value discussed later in the chapter. People are not willing to pay much for an additional gallon of water because they have so much of it that an additional gallon has a low marginal utility.

11. What is paradox of value?

The paradox of value addresses the somewhat counterintuitive observation that water costs less than diamonds in spite of the fact that water sustains life and diamonds are often simply decorative. This can be explained by the fact that water is relatively abundant, and hence in great supply, but diamonds are relatively scarce. Note that the total utility from water is greater than the total utility from diamonds.

12. Define consumer surplus

Consumer surplus represents the difference between what people would have been willing to pay for a given quantity of some good, one unit at a time, and how much they actually had to pay in a market quoting one price for all units.

13. Define production function

A production function describes a relationship between total product or output of a firm and the employment of inputs.

14. Define perfectly competitive industry

A perfectly competitive industry is characterized by many small firms, each so small that no single firm can affect market price. Firms produce a homogeneous product so that consumers view all firms' outputs as perfect substitutes. Together, these two characteristics lead individual firms to perceive demand as perfectly elastic. Finally, competitors can easily enter or exit the industry.

15. What is allocative efficiency?

Allocative efficiency occurs when no possible reorganization of production can make anyone better off without making someone else worse off. This means that there can be no reallocation of resources without lowering the utility of at least one person in the economy.

16. Define imperfect competition

Competition exists in a market when firms have been able to gain some control over the price of output. Recall that, in a perfectly competitive industry, firms produce a standardized product. This, combined with the fact that they are all very small, means that firms are price-takers. Imperfect competition describes any market setting in which firms have a degree of price-setting ability. This means that instead of the perfectly elastic demand curve, imperfect competitors face a downward-sloping demand curve for their products, which have been differentiated in some way.

17. Define monopoly

A monopoly is a single seller of a unique product.

18. Define oligopoly

An oligopoly includes a relatively small number of sellers of a similar product; because there are just a few competitors in the industry, mutual interdependence is a critically important factor in describing the behavior of competitors.

19. Define monopolistically competitive industry

A monopolistically competitive industry has many sellers of close substitutes. Firms take their market power from downward-sloping demand curves which allow them to choose both a profit-maximizing price and quantity of output to produce.

20. Define marginal revenue

Marginal revenue is defined as the addition to total revenue that comes when a firm sells an additional unit of output. Because the demand curve slopes downward for the monopolist, the market price at which all units are traded must fall in order for the firm to sell additional units of output. This means that the sale of a marginal unit increases revenues by the amount of the sale; this increase is offset to some extent because prices on all previous units must also fall.

21. What is game theory?

Game theory has been applied by economists to provide the structure for systematic analysis of these sorts of situations. The basic structure involves (a) identifying the players, (b) specifying the various actions or strategies available to each player, and (c) completing a payoff table which records the outcomes of each combination of players' strategies.

22. Define theory of income of the distribution of income

The theory of the distribution of income is concerned with (1) the determination of income, and (2) the allocation of total product among factors of production. Both these questions are important; we need to understand how income is generated in an economy, and then how these wages, rent, interest, and profits are distributed across the owners of labor, land, capital, and entrepreneurial ability.

23. Define marginal revenue product

Marginal revenue product measures the addition to total revenue that occurs when a firm hires an additional unit of an input. MRP translates marginal product, which is measured in output units, to a meaningful dollar figure. To calculate MRP, multiply the marginal product of the input by the marginal revenue.

24. Define least-cost rule

The least-cost rule states that a firm will hire its optimal combination of inputs when each input's marginal revenue product is equal to its price. This means that the last dollar spent on each input will yield the same marginal productivity.

25. Define renewable resources

Renewable resources are those whose services can be replenished regularly. Notice that people may choose not to replenish those resources. For example, for years timber companies cut acres and acres of timber without replanting. The trees would eventually replenish themselves, but not for hundreds of years.

26. Define non renewable resources

A nonrenewable resource is one whose services are essentially fixed in supply and not regenerated quickly enough to be economically relevant. Oil is essentially nonrenewable. The earth produces more of it but it takes thousands of years.

27. Define economic rent

Economic rent is the return paid to a specialized factor available in fixed supply. In this chapter, land is the specialized factor of interest. The market equilibrium price of land is determined mainly by the demand for it, relative to the fixed supply available. We call the price of using a piece of land for a period of time rent.

28. What is physical capital?

Physical capital consists of structures, equipment, and inventories of inputs and outputs that are in turn used as productive inputs for further production. Payments for the temporary use of capital goods are called rentals.

29. What is rate of return to capital?

The rate of return to capital is a percentage computed from the ratio of net annual receipts and the dollar value of capital.

30. What is present value?

Present value is the value today of a stream of future returns.

31. Differentiate accounting profit and economic profit

Accounting profits are the residual income that accountants measure in financial statements. Economic profits are the income after all costs – both money and implicit or opportunity costs – are subtracted.

32. Define income

Income is measured as the flow of money to an individual during a specified period of time; major sources include labor earnings, rental payments, dividends, interest payments, and transfer payments.

33. Define wealth

Wealth is a measure of the net dollar value at a given point in time of tangible and intangible assets, including homes, rental properties, other real estate, and motor vehicles, on the one hand, and cash holdings, bank accounts, business equity, and stocks and bonds, on the other.

34. Define poverty

Poverty is a condition in which people have inadequate incomes. In order to define poverty numerically, government determines a “poverty line,” which is a minimum level of income that families need to maintain a subsistence level of consumption.

35. Define unemployment rate

The unemployment rate measures the percent of the labor force that is seeking work. Individuals who are neither working nor seeking work are not in the labor force. These individuals include young children, full-time students, retirees, and full-time household caregivers. These individuals are not counted by economists as being unemployed, because they are not seeking employment. Individuals who would like to work full-time but are currently stuck in part-time jobs are counted as employed.

36. How to determine consumption and saving

Consumption (C) is determined primarily by disposable income (DI); a consumption function therefore relates consumption to disposable income. Saving (S) is the amount of disposable income not devoted to consumption. The savings function is the mirror image of the consumption function because saving plus consumption always exhausts disposable income.

37. Define marginal propensity to consume

The marginal propensity to consume (MPC) is the ratio of a change in consumption to the underlying change in disposable income. The marginal propensity to save (MPS) is the corresponding ratio of a change in saving with respect to a change in disposable income. MPC + MPS = 1 because C + S = DI.

38. What are business cycles?

Business cycles are all different—and all the same. Each one has its own cause, its own length of time, its own degree of severity, and its own trajectory. Despite all these differences, though, they all seem to follow the same general pattern: decline into recession (contraction); bottom out (trough); climb into recovery and continue into boom (expansion); reach an apex (peak); and start all over. The differences are confounding, but the similarities suggest the possibility that some general pattern of policy might reduce the severity of the cycle.

39. What is aggregate demand?

Aggregate demand (AD) includes all the desired spending by the different sectors in the economy: consumption (C), private domestic investment (I), government purchases of goods and services (G), and net exports (X).

40. What is exogenous variable?

Exogenous variables are variables determined outside the framework of the model, or beyond the control of policymakers. Examples of exogenous variables include changes in foreign countries (oil-production decisions, growth rates abroad), advances in technology, and movements in the stock market.

41. Define monetary transfer mechanism

The monetary transmission mechanism describes the ‘mechanisms’ by which monetary policy affects economic conditions, such as interest rates, output, employment, and inflation

42. Define neutrality of money

It is possible that in the long run changes in the money supply lead to proportionate changes in all nominal values but no changes in the real variables of output and employment. This is the so-called neutrality of money.

43. What are the components of balance of payments?

a. the current account (for goods and services)

b. the financial account (for capital goods and services)

c official settlements

d. statistical discrepancy (a catchall category)

44. Define Okun's law

Okun's Law is one of the miracles of statistics—a simple rule that fits reality. It tells us that every 2 percent reduction in actual GDP relative to potential GDP causes unemployment to increase by 1 percentage point. If real GDP simply grows at the same rate as potential GDP (which does tend to increase marginally every year), the unemployment rate would remain unchanged.

45. Define frictional unemployment

Frictional unemployment, caused by the usual turnover of some workers, reentry of others, and migration by still others, is the first major category. It is generally viewed as a lubricant for the overall labor market because it improves that market's economic efficiency. It can, however, be taken to an extreme. Teenagers typically change jobs frequently, and their unemployment rate is among the highest in the country.

46. Define structural unemployment

Structural unemployment, meanwhile, arises from the contraction of some industries whose time has come and is now going. Even in a growing economy, some industries contract as the demand for their products contracts, and they must therefore lay workers off.

47. Define cyclical unemployment

cyclical unemployment is the natural manifestation of the business cycle in the labor market; an overall contraction in business activity means that fewer people are required to produce the desired level of output, and employment must therefore fall.

48. Define demand pull inflation

Demand-pull inflation is the result of excessive aggregate demand and can be associated with higher levels of real as well as nominal GDP.

49. Define cost plus inflation

Cost-push inflation is caused by increased costs which push aggregate supply up; it is therefore associated with lower levels of real GDP, so nominal GDP can be higher or lower.

50. What is real business cycle

The real business cycle (RBC) theory explains business cycles purely as shifts in aggregate supply. Shifts in the long run (vertical) aggregate supply curve are independent of aggregate demand and cause changes in real output. Proponents of the RBC theory argue that these shifts in AS may give the appearance of a short-run Phillips curve.