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attendance





The Changing Business Environment -BMB4010

Week 2 - Micro and Macro
Economics

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Introduction to Economics

Definition of Economics: The study of how individuals, businesses, and governments make choices on allocating resources to satisfy their needs and wants.

Begg et al (2016) - Economics is the study of how societies make choices under conditions of scarcity.

Why is it important to Business Leaders?

Importance for Business Leaders:

Understanding economic principles helps leaders make informed decisions regarding resource allocation, pricing strategies, and market competition.

It equips them with the knowledge to anticipate market trends and respond to economic shifts effectively.

Examples of how economic principles influence business decisions



Resource Allocation - highlight that all businesses face scarcity there is never unlimited money, time, labour or materials.



Pricing Strategies - helps leaders set prices by explaining how consumers respond to price changes – **Price Elasticity of Demand**



Market Competition - Knowing the type of market a business operates in helps leaders predict competitor behaviour and choose appropriate strategies.

Micro/Macroeconomics



Microeconomics - focuses on the actions of individuals and industries, like the dynamics of supply and demand.



Macroeconomics - considers the economy as a whole, looking at concepts such as inflation, unemployment, and economic growth.



What is Microeconomics?

- Microeconomics examines the behaviour of individuals and firms in making decisions regarding the allocation of scarce resources and the interactions among these individuals and firms.
- It delves into how these behaviours affect the supply and demand for goods and services, which determines prices, and how prices, in turn, determine the supply and demand of goods and services.

Microeconomics in Business

- **Supply** - quantity of a good that sellers wish to sell at each possible price
- **Demand** - quantity that buyers wish to purchase at each conceivable price
- **Marketing Pricing** - the process of setting and managing the price of a product or service in order to create value for customers while achieving the organisation's marketing and financial objectives.



Microeconomics in Business

- **Customer Value** - Prices are set based on how much value customers believe the product or service provides.
- **Business Decisions** - pricing choices and product development decisions.
- **Competition Analysis** - understand their competitive environment, anticipate rivals' behaviour, and design strategies that sustain profitability.



Key Concepts in Microeconomics

Supply and Demand:

The backbone of microeconomic theory, explaining how prices vary because of a balance between product availability and demand.

Market Equilibrium:

Achieved when the quantity of goods supplied equals the quantity demanded, leading to a stable market price.

Supply and Demand

Vertical Axis – Price of goods

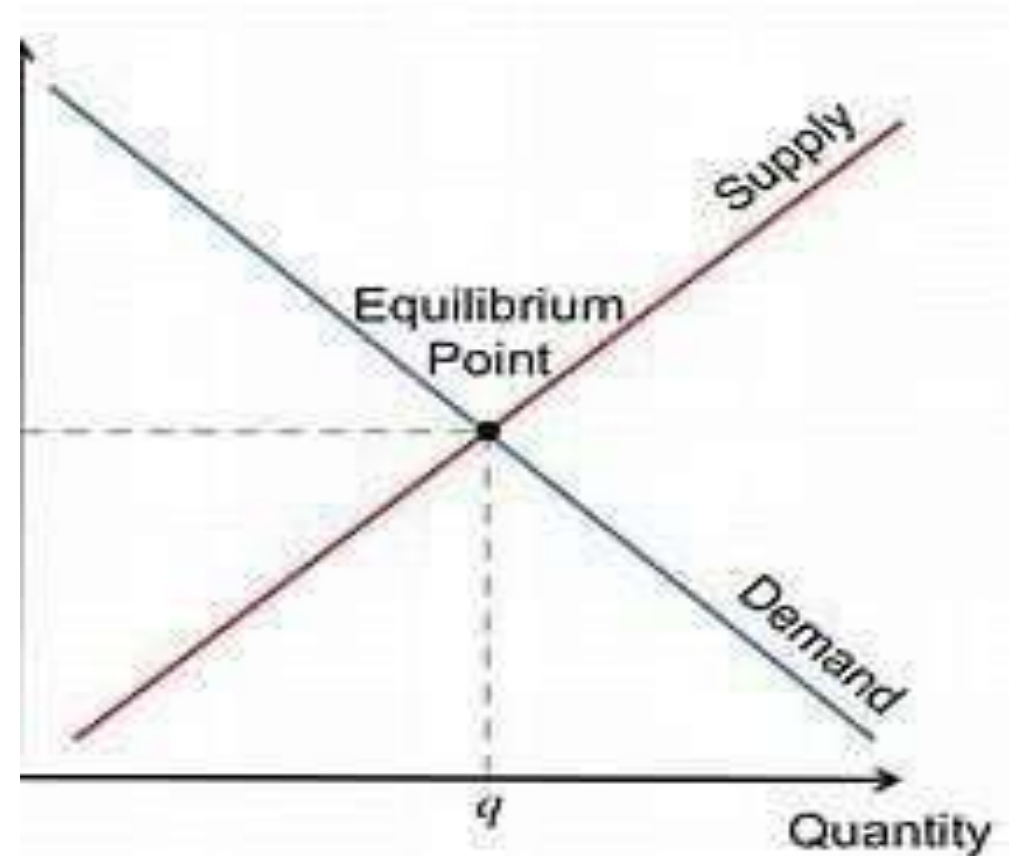
Horizontal Axis – Quantity demanded of that good

Red Line - represents the supply curve

Blue Line – Demand curve

Centre Point - The Equilibrium Point

Mankiw (2021) describes demand and supply as the “two forces that make market economies work”.



The Law of Demand

This law states that, all else being equal, as the price of a product decreases, the quantity demanded by consumers increases, and vice versa.

Substitution Effect: When the price of a product increases, consumers switch to cheaper alternatives.

Income Effect: A price increase reduces consumers' purchasing power, meaning they can afford fewer goods overall.

Together, these effects explain why higher prices usually lead to lower demand.



A wooden desk with a calculator, glasses, and a document featuring bar and pie charts.

Why is Law of Demand Important for Business

- Predict how consumers will react to price changes
- Decide whether to increase or reduce prices
- Estimate sales volumes
- Design effective pricing and promotion strategies
- For example - firms may lower prices to increase sales volume or raise prices if demand is relatively inelastic.

The Law of Supply



The law of supply posits that, all else equal, an increase in the price of a good or service will prompt an increase in the quantity supplied, and vice versa.

Profit incentive - When prices rise, firms can cover costs more easily and earn higher profits.

Rising marginal costs - Producing more often becomes more expensive (e.g. overtime pay, machinery wear), so firms require higher prices to justify extra production.

New market entrants - High prices attract new suppliers, increasing total market supply.

Supply Curve: This is depicted as an upward-sloping curve on a graph, demonstrating the direct relationship between price and quantity supplied.



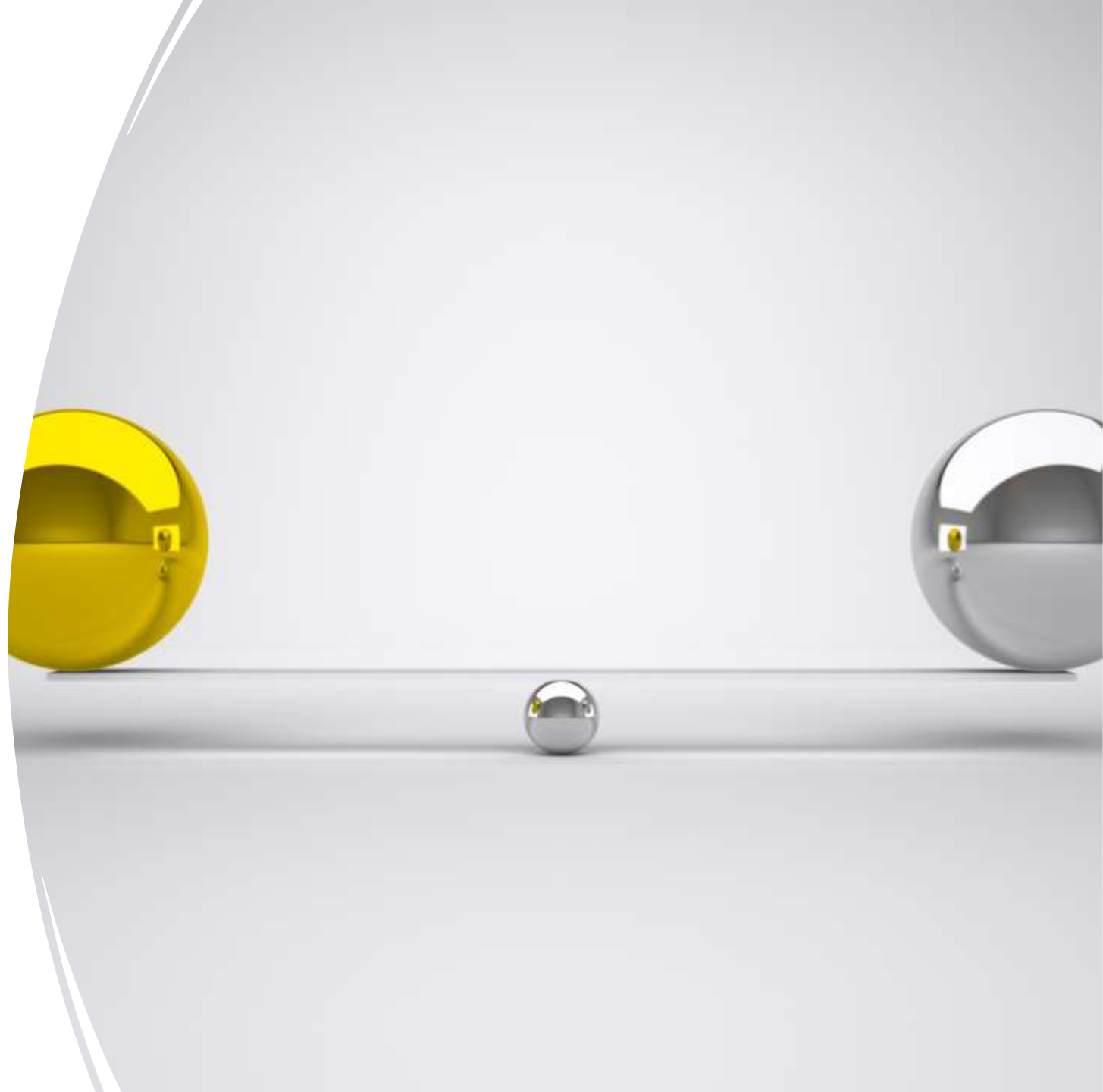
Why is Law of Supply Important for Business

How price changes affect their willingness and ability to produce goods and services.

- Guides production and output decisions.
- Supports pricing and cost control.
- Influences investment and expansion.
- Helps manage risk in changing market conditions.
- Explains market entry and exit behaviour.
- Allows responses to external changes.

Market Equilibrium

The point where the quantity demanded by consumers equals the quantity supplied by producers. It represents a state of balance in the market with no tendency for change.



Implications of Market Equilibrium on Business

- **Pricing decisions** – set prices close to equilibrium price.
- **Production levels** - how much to produce
- **Stock Management** - how much to stock
- **Market changes** - when to respond
- **Example** - At £2.50 per coffee: Customers buy 100 coffees a day - The shop is happy to sell 100 coffees - This is market equilibrium
- If price rises to £3.50: Fewer customers buy coffee, some coffee goes unsold → surplus



**Adjustment to
Equilibrium:**



Prices adjust in
response to
surpluses and
shortages.



Surplus: Price
tends to fall until
equilibrium is
restored.



Shortage: Price
tends to rise until
equilibrium is
restored.

Price Elasticity

Definition - A measure of the responsiveness of quantity demanded to a change in price.

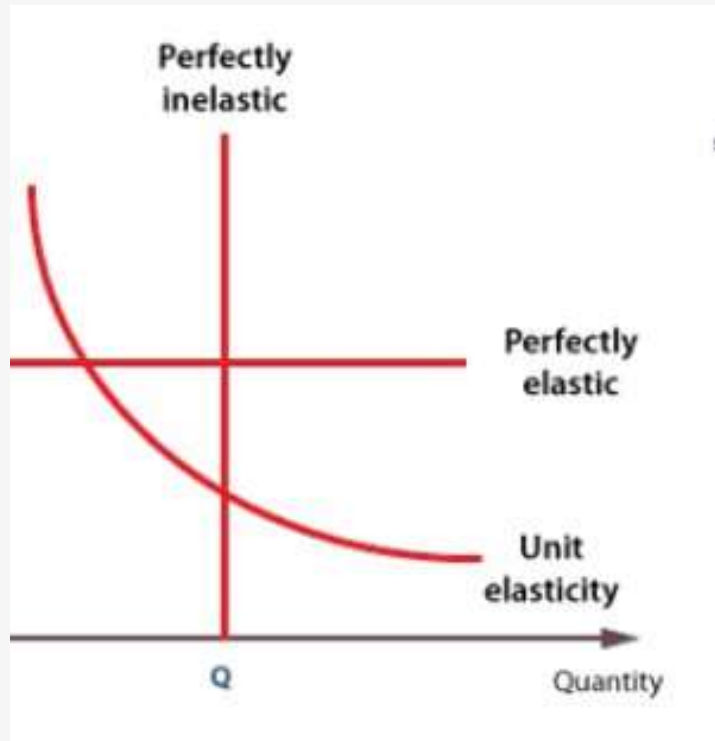
High elasticity indicates demand is **sensitive** to price changes.

Low elasticity indicates demand is **insensitive** to price changes.

PED Formula:

$$\text{PED} = \frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}}$$

The answer is usually negative because price and demand move in opposite directions



Price Elasticity

Price Elastic Demand ($E_d > 1$): Consumers are highly responsive to price changes. Why?:

- Many Substitutes
- Not Essential
- Takes a large share of income

Example – Holiday prices

Price Inelastic Demand ($E_d < 1$): Consumers are less responsive to price changes.why?:

- Essential Goods
- Few Substitutes
- Habit-forming
- Examples – Oil

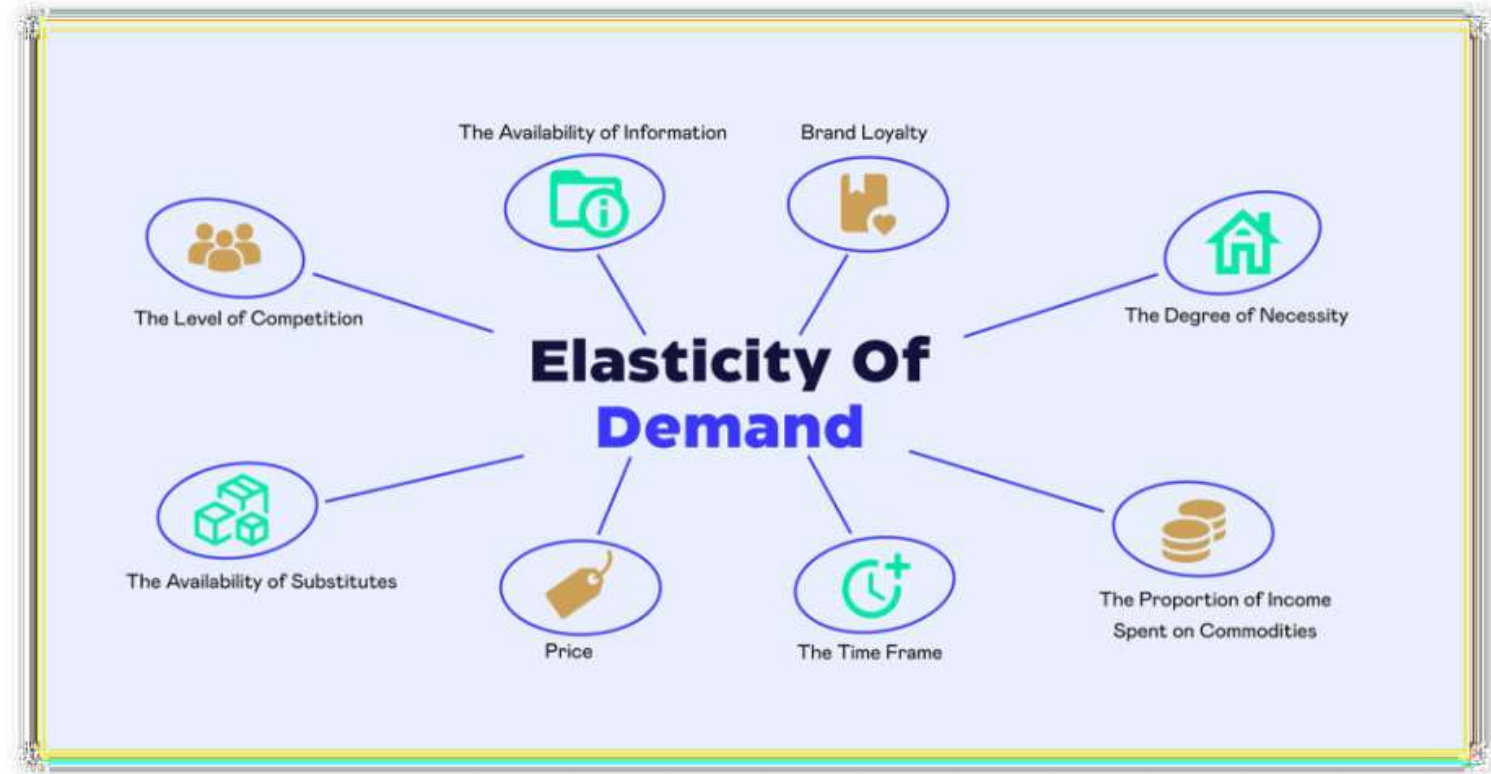
Perfectly Inelastic Demand $E_d = 0$: Quantity demanded does not change at all whatever the price e.g. life saving medicines or Water companies

Perfectly Elastic Demand $E_d = \infty$: Consumers will only buy at one price i.e. milk at fixed wholesale price

Price Unitary Elastic ($E_d = 1$): Proportional response of quantity demanded to price change i.e. a change in price has no effect on total revenue e.g.

- Increase broadband price – some customers leave but others stay

Determinants of Price Elasticity



Macroeconomics and Business Strategy

Overview: National economic trends and their broader impact.

Economic Health Indicators:
Understanding GDP, unemployment rates.

Policy Influence: Fiscal and monetary policies shaping business environments.

Strategic Implications: Aligning business strategies with macroeconomic conditions.



Circular Flows of Income in the Economy



Shows interaction between the main groups – business and consumers



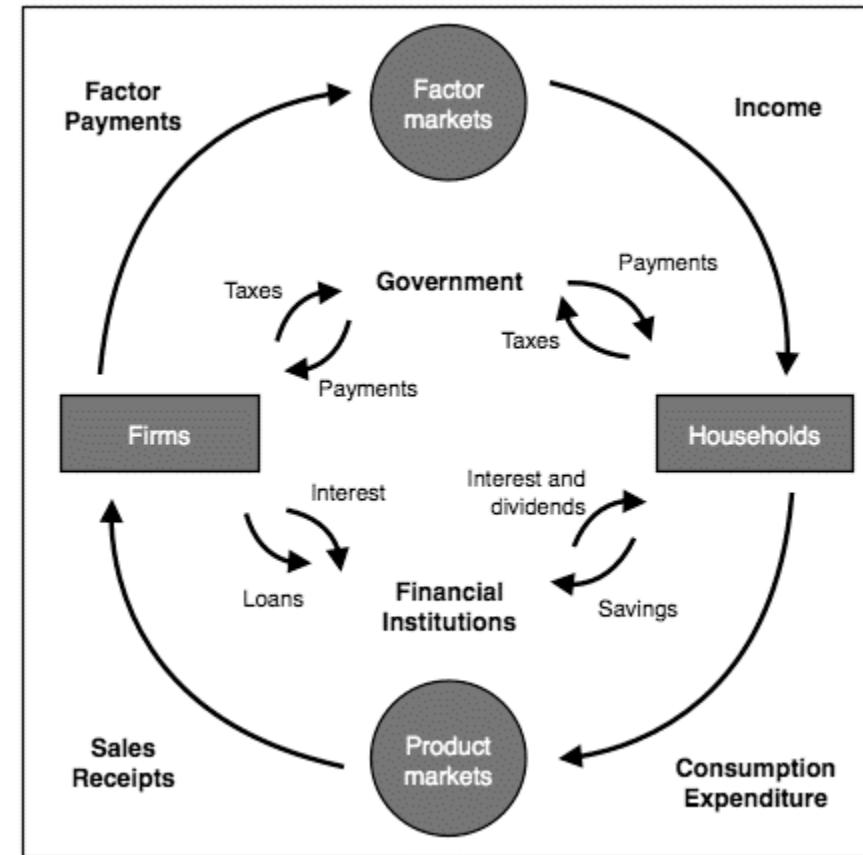
Businesses provide employment and wages to consumers



Consumers spend income on goods and services



Government collect taxes from businesses and consumers – funds public spending & social security



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Gross Domestic Product (GDP)

Definition - GDP represents the value of the total economic activity produced within a country in a single year, including domestic and foreign producers.

Effects of GDP on Business Strategies:

1. Demand Forecasting and sales strategies:

Impact -

1. Rising GDP – higher household incomes & spending
2. Falling GDP – reduced consumer confidence & demand

Strategic response:

1. Growth: expand output, widen product range, invest in marketing
2. Recession: focus on essentials, value pricing & promotions

2. Investment & Expansion Decisions

Impact:

- Strong GDP growth - optimism and confidence
- Weak GDP growth - uncertainty and risk

Strategic response

- Growth: invest in new technology, premises, and staff
- Slowdown: delay or cancel major investments

3. Employment & Workforce Planning

Impact of GDP

- Growth - job creation
- Recession - rising unemployment

Strategic response

- Growth: recruit, increase training, raise wages
- Recession: hiring freezes, redundancies, flexible contracts

4. Pricing Strategy:

Impact of GDP

- Growth - consumers more willing to accept higher prices
- Low or negative growth - higher price sensitivity

Strategic response

- Growth: premium pricing and differentiation
- Slowdown: competitive pricing and discounts

5. Risk Management and Financial Strategy

Impact of GDP

- GDP growth reduces business risk
- GDP decline increases financial pressure

Strategic response

- Growth: higher risk tolerance
- Recession: build cash reserves, reduce debt

Gross Domestic Product

Types of GDP: Nominal and Real

Nominal GDP: Measures the value of all finished goods and services within a country using current prices.

Real GDP: Adjusts nominal GDP for inflation to reflect the true value of goods and services.

Importance:

- Indicates economic health and growth rates.
- Guides business decisions – forecast demand, plan investment, expand or cut costs
- Guides policymakers in making economic decisions.
- Financial markets & confidence – investor confidence, exchange rates, business/consumer confidence



Unemployment

- **Types of Unemployment:**
 - **Cyclical Unemployment:** Linked to the natural ups and downs of the economy.
 - **Frictional Unemployment:** Occurs when workers are between jobs or are entering the workforce for the first time.
 - **Structural Unemployment:** Results from industrial reorganisation, typically due to technological change and mismatches between the skills of the workforce and the demands of the job market.
 - **Seasonal Unemployment:** Occurs when demand for labour varies during the year.
 - **Real Wage (Classical) Unemployment:** Occurs when wages are set above the market equilibrium, often due to minimum wages or strong trade unions.



Discussion

In groups discuss the two statements below:

“high unemployment can lead to slowing of economic growth.”

“extremely low levels of unemployment can have a negative economic impact”

In your groups present your thoughts to the rest of the class.

National Income

Definition – total value of all final goods and services produced within a country over a specified period.

Indicators – Wages, rent, interest, profits & taxes

Provides - measure of economic activity of a country and serves as a key indicator of its economic health and development.

Impact:

- Crucial for evaluating the economic performance of a country.
- Assess the health of an economy
- Guiding policymakers in decision-making processes related to fiscal policy, monetary policy, and other economic strategies
- Higher national income levels are often associated with higher standards of living

National Income

How affects Business decisions:

- Adjust product ranges and marketing strategies
- Pricing – low = more competitive pricing & discounts
- Investment & expansion – low = cautious investment, no expansion
- Employment & wages – low = hiring freezes or layoffs
- Risk & financial planning – reduce debt or build cash reserves

3 ways of calculating:

- **Income Approach:** Adds up all incomes received by the factors of production within a country, including wages, rents, interest, and profits
- **Output Approach:** Measures the total value of goods and services produced by an economy, adjusting for any goods used up in the production process (intermediate goods).
- **Expenditure Approach:** Calculates the total spending on the nation's final goods and services, including consumer spending, investment, government purchases, and net exports (exports minus imports)

Inflation and Deflation

Inflation: A general increase in prices and fall in the purchasing value of money.

Causes - demand-pull inflation, cost-push inflation, and built-in inflation.

Deflation: A general decrease in prices, often associated with a reduction in the supply of money or credit.

Causes - by a decrease in demand or an increase in supply.



Impact on business decisions

Pricing:

- Inflation – rise prices to cover rising costs – may risk losing customers if demand is elastic
- Deflation – lower prices to stimulate demand, profit margins shrink

Cost:

- Inflation - higher input, wage & energy costs. Greater focus on efficiency & productivity
- Deflation – Investments are delayed, focus on survival rather than growth

Employment:

- Inflation – pressure to raise wages to retain staff
- Deflation – Hiring freezes or redundancies

Fiscal and Monetary Policies

Fiscal Policy: Government spending and taxation policies aimed at influencing economic conditions, including levels of employment, inflation, and economic growth. Controlled by Government & Treasury

Types:

- **Expansionary** – used during recessions to boost demand – higher government spending, lower taxes
- **Contractionary** – used to control inflation – lower government spending & higher taxes

Monetary Policy: Central bank actions, such as setting interest rates and controlling the money supply, aimed at controlling inflation and stabilising the currency. Controlled by Bank of England

Types:

- **Expansionary** – encourages borrowing and spending – lower interest rates & increased money supply
- **Contractionary** – reduces inflation and spending – higher interest rates & reduced money supply



Impact on Business Decisions

Fiscal:

- Taxation – higher corporation tax = lower profits = reduced investment
- Government spending – increase creates opportunities in – Construction, Defence, Healthcare & Education
- Regulation & Incentives – Grants, subsidies & tax relief influence location decisions, green investment & innovation

Monetary:

- Interest rates – high = borrowing more expensive & investment delayed. Low = encourages expansion & supports start-ups
- Exchange rates – affects export & import strategies
- Cash flow & finance – loan availabilities, debt management & financial planning

Why does this matter to business:

- Forecast demand
- Manage costs
- Plan investment
- Reduce risk

4 Economic Cycles

Expansion: Characterized by rising economic activity, employment, and output – Recovery/growth

Peak: The highest point of economic activity before a downturn. Economy is at maximum output

Contraction: A period of declining economic activity, leading to increased unemployment and lower production.

Trough: The lowest point of economic activity, setting the stage for recovery and the next phase of expansion.



Impact on Business Decisions

Expansion -

- Expand production
- Employ more staff
- Invest in new technology or projects

Peak -

- Focus on efficiency to manage costs
- Consider rising prices
- Caution with borrowing as interest rates may rise

Contraction -

- Cut costs
- Reduce workforce if necessary
- Delay investments & expansion
- Focus on essential budget products

Trough -

- Prepare for future recovery
- Focus on efficiency
- Seek opportunities to gain market share



**Any
questions?**

**Next lecture –
Monday
9th February – 9.00
am**