

**JOHN SLOMAN • DEAN GARRATT
JON GUEST • ELIZABETH JONES**

ECONOMICS FOR BUSINESS

EIGHTH EDITION

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ECONOMICS FOR BUSINESS



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ECONOMICS FOR BUSINESS

Eighth edition

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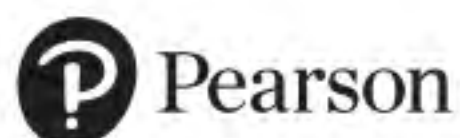
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About the authors



John Sloman was Director of the Economics Network (www.economicsnetwork.ac.uk) from 1999 to 2012. The Economics Network is a UK-wide organisation based at the University of Bristol and provides a range of services designed to promote and share good practice in learning and teaching Economics. John is now a Visiting Fellow at Bristol and a Senior Associate with the Economics Network.

John is also Visiting Professor at the University of the West of England (UWE), Bristol, where, from 1992 to 1999, he was Head of School of Economics. He taught at UWE until 2007. John has taught a range of courses, including economic principles on social science and business studies degrees, development economics, comparative economic systems, intermediate macroeconomics and managerial economics. He has also taught economics on various professional courses.

He is also the co-author with Alison Wride and Dean Garratt of *Economics* (Pearson Education, 10th edition 2018), with Dean Garratt of *Essentials of Economics* (Pearson



Dr Dean Garratt is a Senior Teaching Fellow at Aston Business School. He joined Aston University in September 2018 having previously been a Principal Lecturer at Nottingham Business School. Dean teaches economics at a variety of levels, including modules in macroeconomics and economic principles for business and management students. He is

passionate about encouraging students to communicate economics more intuitively, to deepen their interest in economics and to apply economics to a range of issues.

Earlier in his career Dean worked as an economic assistant at both HM Treasury and at the Council of Mortgage Lenders. While at these institutions he was researching and briefing on a variety of issues relating to the household sector and to the housing and mortgage markets.

Dean is a Senior Fellow of the Higher Education Academy and an Associate of the Economics Network which aims to promote high-quality teaching practice. He has

Education, 8th edition 2019) and with Elizabeth Jones of *Essential Economics for Business* (5th edition 2017). Translations or editions of the various books are available for a number of different countries with the help of co-authors around the world.

John is very interested in promoting new methods of teaching economics, including group exercises, experiments, role playing, computer-aided learning and the use of audience response systems and podcasting in teaching. He has organised and spoken at conferences for both lecturers and students of economics throughout the UK and in many other countries.

As part of his work with the Economics Network he has contributed to its two sites for students and prospective students of economics: *Studying Economics* (www.studyingeconomics.ac.uk) and *Why Study Economics?* (www.whystudyeconomics.ac.uk)

From March to June 1997, John was a visiting lecturer at the University of Western Australia. In July and August 2000, he was again a visiting lecturer at the University of Western Australia and also at Murdoch University in Perth. In 2007, John received a Lifetime Achievement Award as 'outstanding teacher and ambassador of economics' presented jointly by the Higher Education Academy, the Government Economic Service and the Scottish Economic Society.

been involved in several projects promoting a problem-based learning (PBL) approach in the teaching of economics. In 2006, Dean was awarded the Outstanding Teaching Prize by the Economics Network. The award recognises exemplary teaching practice that deepens and inspires interest in economics. In 2013, he won the student-nominated Nottingham Business School teacher of the year award.

Dean is an academic assessor for the Government Economic Service (GES) helping to assess candidates at Economic Assessment Centres (EACs). In this role he assesses candidates looking to join the GES, the UK's largest employer of professional economists.

Dean runs sessions on HM Treasury's Graduate Development Programme (GDP). These sessions cover principles in policy making, applying economics principles and ideas to analyse policy issues and contemporary developments in macroeconomics.

Outside of work, Dean is an avid watcher of many sports. Having been born in Leicester, he is a season ticket holder at both Leicester City Football Club and Leicestershire County Cricket Club.



Jon Guest

Jon is a Senior Teaching Fellow at Aston Business School and a Teaching Associate at Warwick Business School. He joined Aston University in September 2017 having previously been a Senior Lecturer at Nottingham Business School, a Principal Teaching Fellow at Warwick Business School and a Senior Lecturer Coventry University.

Jon has taught on a range of courses including Principles of Microeconomics, Intermediate Microeconomics, Economic Issues and Behavioural Economics. He has also taught economics on various professional courses for the Government Economic Service and HM-Treasury.

Jon has worked on developing teaching methods that promote a more active learning environment in the classroom. In particular, he has published journal articles and carried out a number of funded research projects on the impact of games and experiments on student learning. These include an on-line version of the TV show 'Deal or No Deal' and games that involve students acting as buyers and sellers in the classroom. He has also recently included a series of short videos on economics topics and implemented elements of the flipped classroom into his teaching.



Elizabeth Jones is a Professor in the Department of Economics at the University of Warwick. She joined the University of Warwick in 2012 and was the Deputy Director of Undergraduate Studies for 2 years. Since 2014, she has been the Director of Undergraduate Studies, with overall responsibility for all Undergraduate Degree programmes within the Economics

Department. She is a Founding and now Alumni Fellow of the Warwick International Higher Education Academy and through this, she has been involved in developing and sharing best practice in teaching and learning within Higher Education. She was the external panellist for the curriculum review at the London School of Economics, advising on content, delivery and assessment.

She has previously co-ordinated and taught at the Warwick Economics Summer School and has also been involved in delivering the Warwick Economics Summer School in New Delhi, India. Within this, Elizabeth was delivering introductory courses in Economics to 16-18 year olds and has also delivered taster events to schools in Asia about studying Economics at University.

Prior to being at Warwick, Elizabeth was a Lecturer at the University of Exeter within the Business School and was in this position for 5 years, following the completion of her MSc in Economics. She also taught A level Economics and Business

Jon is also interested in innovative ways of providing students with feedback on their work.

Through his work as an Associate of the Economics Network, Jon has run sessions on innovative pedagogic practices at a number of universities and major national events. He is also an academic assessor for the Economics Assessment Centres run by the Government Economic Service. This involves interviewing candidates and evaluating their ability to apply economic reasoning to a range of policy issues. He has also acted as an External Examiner for a number of UK universities.

The quality of his teaching was formally recognised when he became the first Government Economic Service Approved Tutor in 2005 and won the student nominated award from the Economics Network in the same year. Jon was awarded the prestigious National Teaching Fellowship by the Higher Education Academy in 2011.

Jon is a regular contributor and editor of the Economic Review and is a co-author of the 10th edition of the textbook, Economics. He has published chapters in books on the Economics of Sport and regularly writes cases for the 'Slooman in the News' website. He has also published research on the self-evaluation skills of undergraduate students.

Outside of work Jon is a keen runner and has completed the London Marathon. However, he now has to accept that he is slower than both of his teenage sons – Dan and Tom. He is also a long suffering supporter of Portsmouth Football Club.

Studies at Exeter Tutorial College and continues to work as an Examiner in Economics for AQA. She is also a member of the OCR Consultative Forum and has previously been involved in reviewing A level syllabi for the main Examining bodies.

Elizabeth has taught a range of courses including Principles of Economics; Economics for Business; Intermediate Microeconomics; Economics of Social Policy; Economics of Education and Applied Economics. She has won multiple student-nominated awards for teaching at Warwick and Exeter University, winning the Best Lecturer prize at the 2017 Warwick Awards for Teaching Excellence, where she used her prize money to invest in her development as a teacher at a conference in Boston. She has a passion for teaching Economics and particularly enjoys teaching Economics to non-economists and loves interacting with students both inside and outside of the classroom.

Elizabeth has taught on a number of professional courses, with EML Learning Ltd, where she teaches Economics for Non-economists and Intermediate Microeconomics to the public sector. She has delivered courses across all government Departments, including BIS, Department for Transport, HM-Treasury and the Department for Health. She is involved in teaching on the Graduate Development Programme for the new intake of HM Treasury employees twice each year, where she delivers sessions on economics, the role of policy and its implementation.

Outside of work, Elizabeth loves any and all sports. She is an avid fan of Formula 1 and tennis and provides ongoing support to her father's beloved Kilmarnock FC.

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Preface

TO THE STUDENT

If you are studying economics on a business degree or diploma, then this book is written for you. Although we cover all the major principles of economics, the focus throughout is on the world of business. For this reason, we also cover several topics that do not appear in traditional economics textbooks.

As well as making considerable use of business examples throughout the text, we have included many case studies (in boxes). These illustrate how economics can be used to understand particular business problems or aspects of the business environment. Many of these case studies cover issues that you are likely to read about in the newspapers. Some cover general business issues; others look at specific companies. Nearly all of them cover topical issues, including the rise of online business, the video gaming market, entrepreneurship, the social responsibility of business, the effects of business activity on the environment, competition and growth strategy, mergers and takeovers, executive pay, the banking crisis of the late 2000s, the sluggish recovery from recession, quantitative easing, the role of global trade, increased competition from newly industrialised countries and the effects of Brexit.

The style of writing is direct and straightforward, with short paragraphs to aid rapid comprehension. There are also questions interspersed throughout the text in 'Pause for thought' panels. These encourage you to reflect on what you are learning and to see how the various ideas and theories relate to different issues. Definitions of all key terms are given in definition boxes, with defined terms appearing in bold. Also, we have highlighted 44 'Key ideas', which are fundamental to 'thinking like an economist'. We refer back to these every time they recur in the book. This helps you to see how the subject ties together, and also helps you to

develop a toolkit of concepts that can be used in a host of different contexts.

Summaries are given at the end of each chapter, with points numbered according to the section in which they appear. These summaries should help you in reviewing the material you have covered and in revising for exams. Each chapter finishes with a series of questions. These can be used to check your understanding of the chapter and help you to see how its material can be applied to various business problems. References to various useful websites are listed at the end of each Part of the book.

The book also has a blog, *The Sloman Economics News Site*, with frequent postings by the authors. The blog discusses topical issues, links to relevant articles, videos and data and asks questions for you to think about.

There is also an open-access student website. This companion website contains 154 additional case studies, answers to 'Pause for thought' questions, animations of key models in the book with audio explanations suitable for playing on a smart phone, tablet or computer, a set of videoed interviews with business people about decision making and the relevance of economics to their businesses, hotlinks to 285 websites, plus other materials to improve your understanding of concepts and techniques used in economics.

We hope that, in using this book, you will share some of our fascination for economics. It is a subject that is highly relevant to the world in which we live. And it is a world where many of our needs are served by business – whether as employers or as producers of the goods and services we buy. After graduating, you will probably take up employment in business. A thorough grounding in economic principles should prove invaluable in the business decisions you may well have to make.

TO LECTURERS AND TUTORS

The aim of this book is to provide a course in economic principles as they apply to the business environment. It is designed to be used by first-year undergraduates on business studies degrees and diplomas where economics is taught from the business perspective. It is also suitable for students studying economics on postgraduate courses in management, including the MBA, and various professional courses.

Being essentially a book on economics, we cover all the major topics found in standard economics texts – indeed, some of the material in the principle sections is drawn directly from *Economics* (10th edition). But, in addition, there are several specialist business chapters and sections to build upon and enliven the subject for business studies students. These have been fully updated and revised for this new edition. The following are some examples of these additional topics:

- The business environment
- Business organisations
- Characteristics theory
- Consumer behaviour and behavioural economics
- Advertising and marketing of products
- Business strategy
- Alternative aims of firms
- Behavioural analysis of firms
- Growth strategy
- Strategic alliances and various other forms of co-operation between firms
- The small-firm sector
- Pricing in practice, including topics such as mark-up pricing, an extended analysis of first-, second- and third-degree price discrimination in various contexts, multiple product pricing, transfer pricing and pricing over the product life cycle
- Government and the firm, including policies towards research and development (R&D) and policies towards training
- Government and the market, including environmental policy and transport policy
- Financial markets and the funding of business investment
- The financial well-being of firms, households and governments and its impact on the business environment
- The multinational corporation
- Globalisation and business
- Trading blocs and their development
- Monetary union, the future of the Eurozone and implications for business
- The impact of Brexit on business

The text is split into 32 chapters. Each chapter is kept relatively short to enable the material to be covered in a

single lecture or class. Each chapter finishes with a summary and review questions, which can be used for seminars or discussion sessions.

The chapters are grouped into 11 Parts:

- Part A Business and economics (Chapters 1–3) establishes the place of business within the economy and the relevance of economics to business decision making.
- Part B Business and markets (Chapters 4 and 5) looks at the operation of markets. It covers supply and demand analysis and examines the importance of the concept of elasticity for business decisions.
- Part C Background to demand (Chapters 6–8) considers the consumer – how consumer behaviour can be predicted and how, via advertising and marketing, consumer demand can be influenced.
- Part D Background to supply (Chapters 9 and 10) focuses on the relationship between the quantity that businesses produce and their costs, revenue and profits.
- Part E Supply: short-run decision making by firms (Chapters 11–13) presents the traditional analysis of market structures and the implications that such structures have for business conduct and performance. Part E finishes (Chapter 13) by considering various alternative theories of the firm to that of short-run profit maximisation.
- Part F Supply: alternative strategies (Chapters 14–17) starts by looking at business strategy. It also examines how businesses attempt to grow and how size can influence business actions. It finishes by considering why pricing strategies differ from one firm to another and how these strategies are influenced by the market conditions in which firms operate.
- Part G The firm in the factor market (Chapters 18 and 19) focuses on the market for labour and the market for capital. It examines what determines the factor proportions that firms use and how factor prices are determined.
- Part H The relationship between government and business (Chapters 20–22) establishes the theoretical rationale behind government intervention in the economy, and then assesses the relationship between the government and the individual firm and the government and the market.
- Part I Business in the international environment (Chapters 23–25) starts by examining the process of globalisation and the growth of the multinational business. It then turns to international trade and the benefits that accrue from it. It also examines the issue of protection and international moves to advance free trade. Finally, it examines the expansion of regional trading agreements.
- Part J The macroeconomic environment (Chapters 26–29) considers the macroeconomic framework in which

firms operate. We focus on the principal macroeconomic variables, investigate the role of money in the economy, and briefly outline the theoretical models underpinning the relationships between these variables.

- Part K Macroeconomic policy (Chapters 30–32) examines the mechanics of government intervention at a macro level as well as its impact on business and its potential benefits and drawbacks. Demand-side and supply-side policy and economic policy co-ordination between countries are all considered.

Extensive revision

As with previous editions, the eighth edition of *Economics for Business* contains a great deal of applied material. Consequently, there have been considerable revisions from the previous editions to reflect contemporary issues, debates and policy interventions. Specifically, you will find that:

- many of the boxes are new or extensively revised;
- there are many new examples given in the text;
- all tables and charts have been updated, as have factual references in the text;
- economic analysis and debate has been strengthened and revised at various points in the book in the light of economic events and developments in economic thinking;
- building on the revisions in previous editions, we have enhanced further our discussion around behavioural economics. In particular, we have expanded our treatment of consumer demand in a new chapter (Chapter 7). This has allowed us to explore in more detail the traditional economics treatment of the ‘rational consumer’ alongside insights from behavioural economics;
- we have extended the analysis throughout the book on the issues of globalisation and financialisation;
- the text provides extensive coverage of the recent developments in money and banking and their impact on the economy;
- all policy sections have been thoroughly revised to reflect the changes that have taken place since the last edition. This includes an analysis of the implications of the Brexit vote and also of the Trump administration’s policies in several parts of the book;
- most importantly, every part of the book has been carefully considered and, if necessary, redrafted, to ensure both maximum clarity and contemporary relevance.

SPECIAL FEATURES

The book contains the following special features:

- A direct and straightforward written style, with short paragraphs to aid rapid comprehension. The constant aim is to provide maximum clarity.
- Attractive full-colour design. The careful and consistent use of colour and shading makes the text more attractive to students and easier to use by giving clear signals as to the book’s structure.
- Double-page opening spreads for each of the 11 Parts of the book. These contain an introduction to the material covered and an article from the *Financial Times* on one of the topics.
- Key ideas highlighted and explained where they first appear. There are 44 of these ideas, which are fundamental to the study of economics. Students can see them recurring throughout the book, and an icon appears in the margin to refer back to the page where the idea first appears. Showing how ideas can be used in a variety of contexts helps students to ‘think like an economist’ and to relate the different parts of the subject. All 44 Key ideas are defined in a special section at the end of the book.
- ‘Pause for thought’ questions integrated throughout the text. These encourage students to reflect on what they have just read and make the learning process a more active one. Answers to these questions appear on the student website.
- Highlighted technical terms, all of which are clearly defined in definition panels on the page on which they appear. This feature has proved very popular in previous editions and is especially useful for students when revising.
- A comprehensive glossary of all technical terms.
- Additional applied material can be found in the boxes within each chapter. The extensive use of applied material makes learning much more interesting for students and helps to bring the subject alive. This is particularly important for business students who need to relate economic theory to their other subjects and to the world of business generally. The boxes are current and include discussion of a range of companies and business topics. They are ideal for use as case studies in class. Answers to the questions in boxes can be found on the lecturer website, which lecturers can make available to students, if they choose.
- Boxes containing questions allowing students to assess their own understanding. New to this edition, each box contains an activity designed to develop important skills around research, data analysis and the communication of economic ideas and principles. These skills are not

only of use to students while at university but also in the world of work. They are frequently identified by employers as being especially valuable. Hence, undertaking the activities in the boxes helps students to increase their employability.

- Additional case studies with questions appearing on the student website are referred to at the end of each Part. Again, they can be used for class, with answers available on the lecturer website, which can be distributed to students, if lecturers choose to do so.
- Detailed summaries appear at the end of each chapter with the points numbered by the chapter section in which they are made. These allow students not only to check their comprehension of the chapter's contents, but also to get a clear overview of the material they have been studying.
- A series of review questions concluding each chapter to test students' understanding of the chapter's salient points. These questions can be used for seminars or as set work to be completed in the students' own time. Again, answers are available on the lecturer website.
- References at the end of each Part to a list of relevant websites, details of which can be found in the Web appendix at the end of the book. You can access any of these sites easily from the book's own website (at www.pearsonblog.campaignserver.co.uk/). When you enter the site, click on 'Hotlinks'. You will find all the sites from the Web appendix listed. Click on the one you want and the 'hotlink' will take you straight to it.
- A comprehensive index, including reference to all defined terms. This enables students to look up a definition as required and to see it used in context.

SUPPLEMENTS

Blog

Visit the book's blog, *The Sloman Economics News Site*, at www.pearsonblog.campaignserver.co.uk/. This refers to topical issues in economics and relates them to particular chapters in the book. There are frequent postings by the authors, with each one providing an introduction to the topic, and then links to relevant articles, videos, podcasts, data and official documents, and then questions which students and lecturers will find relevant for homework or class discussion.

Student website

There is an open-access companion website for students with a large range of other resources, including:

- animations of key models with audio explanations. These 'audio animations' can be watched online or downloaded to a computer, MP4 player, smart phone, etc;
- links to the *Sloman Economics News Site* blog, chapter by chapter, with news items added several times each month, with introductions, links to newspaper and other articles and to relevant data, questions for use in class or for private study, and references to chapters in the book. You can search the extensive archive by chapter or keyword;
- 154 case studies with questions for self-study, ordered Part-by-Part and referred to in the text;
- updated list of 285 hotlinks to sites of use for economics;
- answers to all in-chapter (Pause for thought) questions;
- videoed interviews with a number of business people, where they discuss business decision making and the relevance of economic concepts to them.

Additional resources for lecturers and tutors

There are many additional resources for lecturers and tutors that can be downloaded from the Lecturer Resources section of the book's website at www.pearsoned.co.uk/sloman. These have been thoroughly revised for the eighth edition. These include:

- PowerPoint® slide shows in full colour for use with a data projector in lectures and classes. These can also be made available to students by loading them on to a local network. There are several types of slideshows:
 - *All figures from the book and most of the tables.* Each figure is built up in a logical sequence, thereby allowing lecturers to show them in lectures in an animated form. There is also a non-animated version suitable for printing or for display on an OHP or visualiser.
 - *Customisable lecture slideshows.* There is one for each chapter of the book. Each one can be easily edited, with points added, deleted or moved, so as to suit particular lectures. A consistent use of colour is made to show how the points tie together. It is not intended that all the material is covered in a single lecture; you can break at any point. It is just convenient to organise them by chapter. They come in various versions:
 - Lecture slideshows with integrated diagrams. These include animated diagrams, charts and tables at the appropriate points.
 - Lecture slideshows with integrated diagrams and questions. These are like the above but also include multiple-choice questions, allowing lectures to become more interactive. They can be used with or without an audience response system (ARS).

A special ARS version is available for TurningPoint® and is ready to use with appropriate ‘clickers’ or with smartphones, tablets or laptops.

- Lecture plans without the diagrams. These allow you to construct your own diagrams on the blackboard, whiteboard or visualiser or to use pre-prepared ones on a visualiser or OHP.
- Case studies. These, also available on the student companion website, can be reproduced and used for classroom exercises or for student assignments. Answers are also provided (not available on the student site).
- Workshops. There are 24 of these, each one covering one or more chapters. They are in Word® and can be reproduced for use with large groups (up to 200 students) in a

lecture theatre or large classroom. Suggestions for use are given in an accompanying file. Answers to all workshops are given in separate Word® files.

- Teaching/learning case studies. There are 20 of these. They examine various approaches to teaching introductory economics and ways to improve student learning of introductory economics.
- Answers to all end-of-chapter questions, Pause for thought questions, questions in boxes, questions in the case studies on the student website and to the 24 workshops. They have been completely revised with new hyperlinks where appropriate.

The following two pages show in diagrammatic form all the student and lecturer resources.

ACKNOWLEDGEMENTS

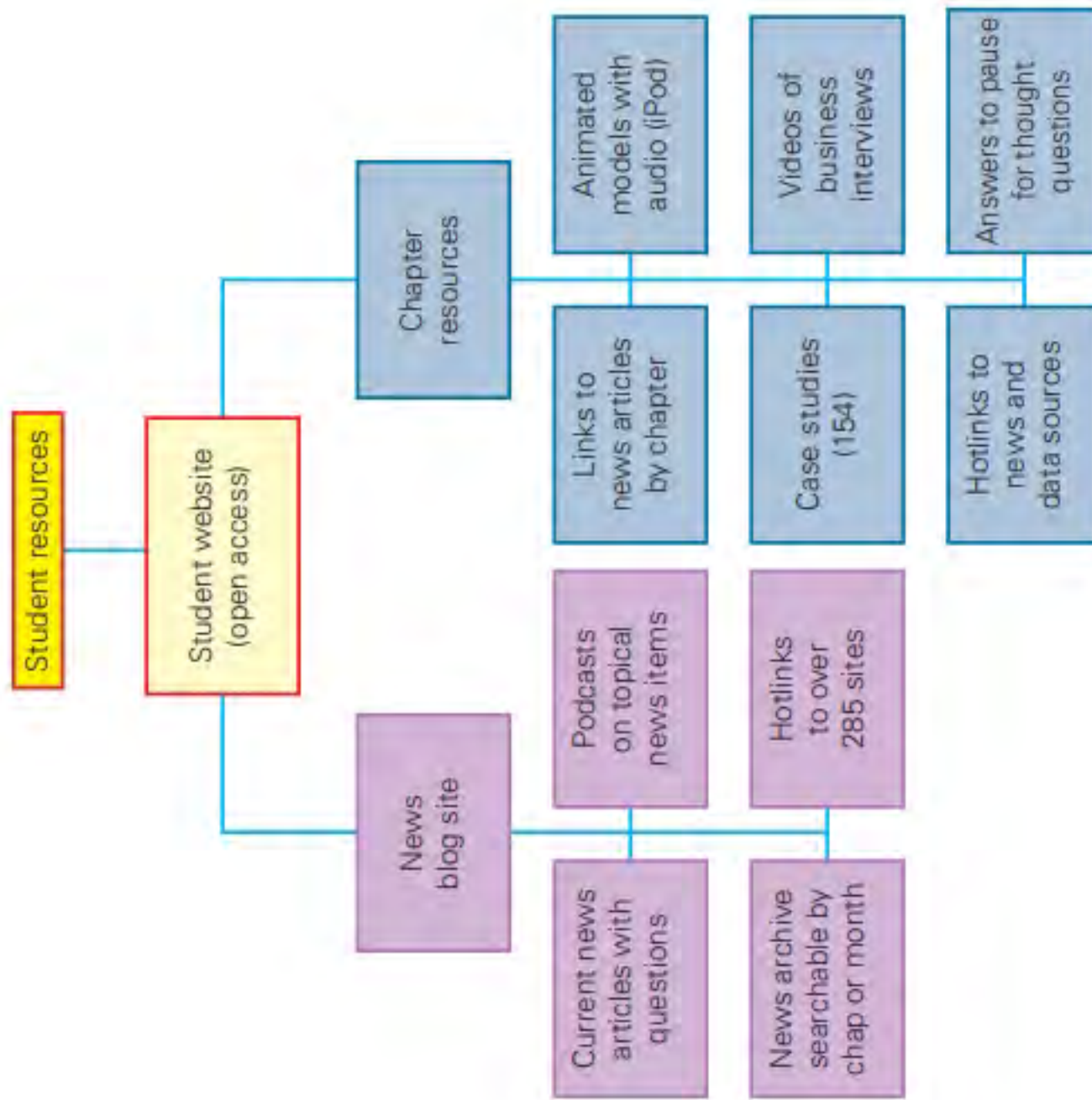
As with previous editions, we’ve had great support from the team at Pearson, including Catherine Yates, Carole Drummond and Natalia Jaszczuk. We’d like to thank all of them for their hard work and encouragement. Thanks, too, to the many users of the book who have given us feedback. We always value their comments. Please continue to send us your views.

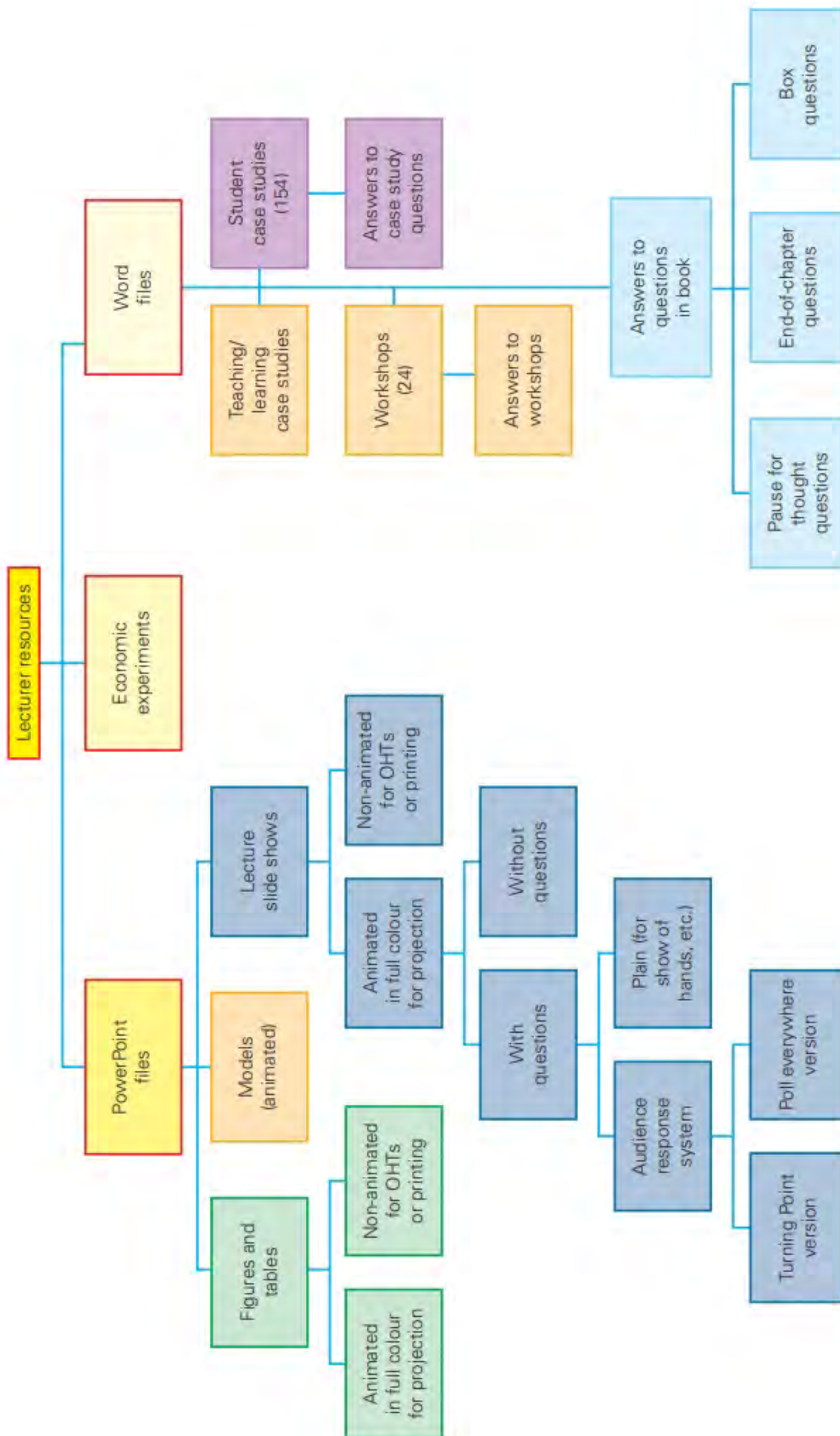
Kevin Hinde and Mark Sutcliffe, co-authors with John on previous editions, have moved on to new ventures. However, many of their wise words and ideas are still

embedded in this eighth edition and, for that, we once more offer a huge thank you.

Our families have also been remarkably tolerant and supportive throughout the writing of this new edition. Thanks especially to Alison, Pat, Helen, Elizabeth, Douglas and Harriet, who all seem to have perfected a subtle blend of encouragement, humour, patience and tolerance.

John, Dean, Elizabeth and Jon





Publisher's acknowledgements

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Business and economics

The FT Reports . . .

Financial Times, 30 April 2018.

Deliveroo's speedy expansion belies tricky time for sector

By Chloe Cornish

Had its driver assessment system been operational when Deliveroo's co-founder and chief executive delivered its first ever order, he would not have scored highly.

William Shu, a former banker, motor-scooted a calzone from an Italian restaurant through London streets to a friend, only to eat the folded pizza himself – as he was hungry.

Deliveroo, which he says he started simply “to solve a personal problem”, has topped this year's FT 1000 list of Europe's fastest growing companies. Between 2013, when Mr Shu and co-founder Greg Orlowski started the enterprise, and 2016, its revenues grew by a staggering compound annual growth rate of 924 per cent.

Deliveroo's platform provides 10 000 UK restaurants with delivery drivers on a combination of bicycles, scooters and cars.

“I kind of knew it would work in central London,” says Mr Shu. But it was demand outside the capital that encouraged the company's breakneck growth: “That makes you more ambitious and want to go to more places.” Since launch, Deliveroo has raised \$957m in venture capital, according to company figures.

As Deliveroo has expanded into other UK cities, Europe and Asia, critics have questioned the profitability of its business model.

This is against the backdrop of a proliferation of competing app-based services, such as UberEats, part of the US ride-hailing company, and Just Eat, another FT 1000 business.

In 2016 . . . Deliveroo made losses of £129.1m on revenues of £128.6m. Mr Shu argues that this did not reflect performance in the cities Deliveroo has been operating in longest. “That year we expanded into 11 new countries, so there's an upfront investment required to do that,” he says.

“I can assure you that the mature markets are much more profitable than newer markets,” he adds, citing greater efficiencies and lower marketing costs.

Labour groups and Deliveroo riders have attacked the company over the flexible working arrangements it has with drivers. Mr Shu says this flexibility is the reason 92 per cent of Deliveroo's casual workforce choose to work for it. The company has 1000 people applying to do so each week in the UK, he says.

It now operates so-called “dark kitchens”, which restaurants can use to produce food off-site. It offers restaurants help with branding and is even extending its consulting services to advise them on adding more marketable dishes to their menus.

It is all a matter of riders, restaurants and customers, he says. Without any one of these “the whole triangle breaks down”.

I dread admitting I am an economist. The cab driver quizzes you on what is going to happen to the economy, the dinner companion turns to talk to the person on the other side and the immigration officer says, with heavy sarcasm, that his country needs people like you.

John Kay, 'Everyday economics makes for good fun at parties',
Financial Times, 2 May 2006



Businesses play a key role in all our lives. Whatever their size, and whatever the goods or services they provide, they depend on us as consumers to buy their products.

But just as businesses rely on us for their income, many of us also rely on them for our income. The wages we earn depend on our employer's success, and that success in turn depends on us as suppliers of labour.

And it is not just as customers and workers that we are affected by business. The success of business in general affects the health of the whole economy and thus the lives of us all.

The extract from the *Financial Times* takes the case of Deliveroo. To be successful, firms must be capable of responding to changes in the market environment in which they operate. This requires a thorough understanding of economics. Developing a business strategy that simultaneously responds to technological changes, changes in consumer tastes and the activities of rival companies is not an easy task. Fortunately, economics provides frameworks for thinking about these issues, and many more.

In Part A of this text, we consider the relationship between business and economics.

In Chapter 1 we look at the structure of industry and its importance in determining firms' behaviour. We also look at a range of other factors that may affect business decisions and how we can analyse the environment in which a firm operates in order to help it devise an appropriate business strategy.

Then, in Chapter 2 we ask what it is that economists do and, in particular, how economists set about analysing the world of business and the things businesses do. In particular, we focus on rational decision making – how to get the best outcome from limited resources.

Finally, in Chapter 3 we look at the different ways in which firms are organised: at their legal structure, at their internal organisation and at their goals.

Key terms

The business environment
PEST and STEEPLE analysis
Production
Firms
Industries
Industrial sectors
Standard Industrial Classification (SIC)
Industrial concentration
Structure-conduct-performance
Scarcity
Factors of production
Macroeconomics
Microeconomics
Opportunity cost
Marginal costs
Marginal benefits
Rational choices
Circular flow of income
Transaction costs
Principal and agent
Business organisation
Price taker
Perfectly competitive market
Price mechanism
Demand
Supply

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Chapter

The business environment and business economics

Business issues covered in this chapter

- What do business economists do?
- What is meant by the 'business environment'?
- How are businesses influenced by their national and global market environment?
- How are different types of industry classified in the official statistics?
- What things influence a firm's behaviour and performance?

What is business economics?

What is the role of *business economics*? What will you study in this text?

The world economy has experienced many changes in recent decades, including the 2008/09 financial crisis and subsequent recession, the political changes in the USA, the vote to leave the EU in Britain, ongoing terrorist attacks, a growing environmental agenda, political tensions with Russia and changes in key emerging economies, such as China and India, to name a few. All of these events have had profound effects on businesses across the world and many have created an uncertain business environment, making it increasingly challenging for firms to operate.

Business economists examine *firms*: the changing environment in which they operate, the decisions they make, and the effects of these decisions – on themselves, on their customers, on their employees, on their business rivals, on the public at large and on the domestic and international economy.

All firms are different but, in one way or another, they are all involved in the production of goods and services. They use inputs, which cost money, to make output that earns money. The difference between the revenue earned and the costs incurred constitutes the firm's profit. Although firms may pursue a range of objectives, we assume that firms normally will want to make as much profit as possible or, at the very least, avoid a decline in profits.

In order to meet these and other objectives, managers will need to make effective choices: what to produce, how much to produce and at what price; what techniques of production to use, how many workers to employ and of what type, what suppliers to use for raw materials, equipment, etc. Business economists study these choices. They study economic decision making by firms.

The study of decision making can be broken down into three stages:

The external influences on the firm (the 'business environment'). Here we are referring to the various factors that affect the firm that are largely outside its direct control. Examples are the competition it faces, the prices its

suppliers charge, the state of the economy (e.g. whether growing or in recession) and the level of interest rates. Businesses need a clear understanding of their environment before they can set about making the right decisions.

Internal decisions of the firm. Given a firm's knowledge of these external factors, how will it then decide on prices, output, inputs, marketing, investment, etc.? Here the business economist can play a major role in helping firms achieve their business objectives.

The external effects of business decision making. When the firm has made its decisions and acted on them, how do the results affect the firm's rivals, its customers and the wider public? In other words, what is the impact of a firm's decision making on people outside the firm? Are firms' actions in the public interest or is there a case for government intervention?

What do business economists do?

Our study of business will involve three types of activity:

- *Description.* We will describe the objectives of businesses (e.g. making profit or increasing market share), the types of market in which firms operate (e.g. competitive or non-competitive) and the constraints on decision making (e.g. the costs of production, the level of consumer demand and the state of the economy).
- *Analysis.* We will analyse how a firm's costs might vary with the amount of output it produces and how its revenues will be affected by a change in consumer demand or a change in the price charged by rivals. We will also analyse the upswings and downswings in the economy: something that will have a crucial bearing on the profitability of many companies.
- *Recommendations.* Given the objectives of a firm, the business economist can help to show how those objectives can best be met. For example, if a firm wants to maximise its profits, the business economist can advise on what prices to charge, how much to invest, how much to advertise, etc. Of course, any such recommendations will only be as good as the data on which they are based. In an uncertain environment, recommendations will necessarily be more tentative.

In this chapter, as an introduction to the subject of business economics, we shall consider the place of the firm within its business environment, and assess how these external influences are likely to shape and determine its actions. In order to discuss the relationship between a business's actions and its environment, first we need to define what the business environment is.

1.1 THE BUSINESS ENVIRONMENT

Traditionally, we identify four dimensions to the business environment: political, economic, social/cultural and technological.

Political factors. Firms are directly affected by the actions of government and other political events. These might be major events affecting the whole of the business community, such as the problems in Syria and Iraq, the tensions between Russia and the USA, Britain leaving the EU or a change of government. Alternatively, they may be actions affecting just one part of the economy. For example, the charge on plastic carrier bags affects the retail sector and the ban on smoking in public places affects the tobacco industry.

Economic factors. Businesses are affected by a range of economic factors, including the changing costs of raw materials, the entry of a new rival into the market, the current availability of investment funds, the economic performance of the

domestic and world economy, and changes in domestic and foreign economic policy.

It is normal to divide the economic environment in which the firm operates into two levels:

- *The microeconomic environment.* This includes all the economic factors that are *specific* to a particular firm operating in its own particular market. Thus one firm may be operating in a highly competitive market, whereas another may not; one firm may be faced with rapidly changing consumer tastes (e.g. a designer clothing manufacturer), while another may be faced with a virtually constant consumer demand (e.g. a potato merchant); one firm may face rapidly rising costs, whereas another may find that costs are constant or falling.
- *The macroeconomic environment.* This is the *national* and *international* economic situation in which business as a whole operates. Business in general will fare much better when the economy is growing, as opposed to when