PAPER C04
Fundamentals of Business Economics

Acorn chapters

Syllabus overview

This paper primarily deals with the economic context of business and how competition, the behaviour of ýnancial markets, and government economic policy can inþuence an organisation. It also provides the key microeconomic techniques underlying price determination and proýt maximisation decisions.

The focus of this syllabus is on providing candidates with an understanding of the areas of economic activity relevant to an organisationǿs decisions

The syllabus comprises:

A	**The macroeconomic context of organisations**	**25%**
B	**The goals and decisions of organisations**	**25%**
C	**The market system and the competitive process**	**25%**
D	**The financial system**	**25%**

Assessment strategy

There will be a two hour computer based assessment, comprising 75 compulsory questions, each with one or more parts. A variety of objective test question styles and types will be used within the assessment.

A: The macroeconomic context of organisations (25%)

On completion of their studies students should be able to:

(i) explain the determination of macroeconomic phenomena, including equilibrium in national income, growth in national income, price inflation, unemployment, and trade deficits and surpluses
(ii) explain the stages of the trade cycle, its causes, and its consequences for the policy choices of government
(iii) explain the consequences of the trade cycle for organisations
(iv) explain the main principles of public finance (i.e. deficit financing and forms of taxation) and macroeconomic policy
(v) describe the impacts on organisations of potential policy responses of government, to each stage of the trade cycle
(vi) explain the concept of the balance of payments and its implications for government policy
(vii) identify the main elements of national policy with respect to trade
(viii) explain the impacts of exchange rate policies on business
(ix) explain the concept of globalisation and the consequences for businesses and national economies
(x) explain the role of major institutions promoting global trade and development.

Indicative syllabus content:

- changes to the equilibrium level of national income using an aggregate demand and supply analysis
- types and consequences of unemployment, inflation and balance of payments deficits
- the circular flow of income, the main injections and withdrawals and their determinants
- the trade cycle and the implications for unemployment, inflation and trade balance of each stage (recession, depression, recovery and boom)
- government macroeconomic policy goals: low unemployment, inflation, external equilibrium and growth
- government policy for each stage of the trade cycle
- impacts of recession and boom on forecast sales of capital and consumption goods, industry profitability and employment levels in the firm
- the main principles of public finance: the central government budget and forms of direct and indirect taxation, incidence of taxation (progressive and regressive) and potential impact of high taxation on incentives and avoidance
- the main principles of public finance: fiscal, monetary and supply side policies, including relative merits of each
- the effects on organisations of changes to interest rates, government expenditure and taxation
- the effects on organisations of direct government macroeconomic policies, including prices and income policies, labour market regulation, regulation on trade, and policies to encourage investment
- the main flows measured in the balance of payments accounts and the causes and effects of fundamental imbalances in the balance of payments

- arguments for and against free trade and policies to encourage free trade (e.g. bilateral trade agreements, multilateral agreements, free trade areas, economic communities and economic unions) and protectionist instruments (tariffs, quotas, administrative controls and. embargoes)
- the effect of changing exchange rates on the profits of firms and the international competitiveness of national industries
- the nature of globalisation and factors driving it (improved communications, political realignments, growth of global industries and institutions, and cost differentials)
- the main trade agreements and trading blocks
- the social and political impacts of globalisation (e.g. widening economic divisions between countries) and its influence on business (e.g. offshoring, industrial relocation, emergence of growth markets, enhanced competition, and cross national business alliances and mergers)
- the impacts of modern information and communication technologies on international trade and patterns of development
- the principal institutions encouraging international trade (e.g. WTO/GATT, EU and G8).

B: The goals and decisions of organisation (25%)

On completion of their studies students should be able to:
(i) distinguish between the goals of profit seeking organisations, not for profit organisations (NPOs) and governmental organisations
(ii) explain shareholder wealth, the variables affecting shareholder wealth and its application in management decision making
(iii) identify stakeholders and their likely impact on the goals of organisations and the decisions of management
(iv) distinguish between the potential objectives of management and those of shareholders, and the effects of this principal-agent problem on decisions concerning price, output and growth of the firm
(v) distinguish between the likely behaviour of a firmôs unit costs in the short run and long run
(vi) illustrate the potential effects of long run cost behaviour on prices, the size of the organisation and the number of competitors in the industry
(vii) illustrate the potential impact on prices and competition of ebusiness and globalisation
(viii) demonstrate the point of profit maximisation graphically using total cost and total revenue curves
(ix) calculate the point of profit maximisation for a single product firm in the short run using data.

Indicative syllabus content:

- the forms of public, private and mutual ownership of organisations and their goals
- concept of returns to shareholder investment in the short run (ROCE and EPS) and long run (NPV of free cash flows) and the need for firms to provide rates of return to shareholders which are at least equal to the firmôs cost of capital
- impact on share price of changes to a companyôs forecast cash flows or its required rate using perpetual annuity valuations with constant annual free cash flows, or NPV calculations with variable cash flows over three years
- role of stakeholders in setting goals and influencing decisions in organisations
- types of not for profit organisations
- the status of economic considerations as constraints rather than primary objectives of not for profit organisations
- the potential difference in objectives between management and shareholders
- the principal-agent problem, its likely effect on decision making in profit seeking organisations
- changing efficiency in the short run (eventually diminishing marginal returns) and the long run (increasing and diminishing returns to scale)
- graphical treatment of short run cost and revenue behaviour as output increases using curvilinear and total cost curves
- long run cost behaviour and the long run average cost curve
- increased competition and lower prices, from the impact of ebusiness on costs of information searches and the enabling of low or zero variable cost
- impact on competition of the ability of business to source products and services from low cost emerging economies
- short run profit maximisation using graphical techniques

- profit maximising output using data on price, quantity and unit costs.

C: The market system and the competitive process (25%)

On completion of their studies students should be able to:

(i) identify the equilibrium price in a product or factor markets likely to result from specified changes in conditions of demand or supply
(ii) calculate the price elasticity of demand and the price elasticity of supply
(iii) explain the determinants of the price elasticities of demand and supply
(iv) identify the effects of price elasticity of demand on a firmȏs revenues following a change in prices
(v) identify causes of instability of prices in markets for primary goods
(vi) explain the impact of instability of prices on incomes of producers and the stability of the industry
(vii) explain the effects on prices, producer revenues and market equilibrium, of government policies to influence prices in markets
(viii) illustrate the impacts of price regulation in goods and factor markets
(ix) explain market concentration and the factors giving rise to differing levels of concentration between markets, including acquisitions and combinations
(x) identify the impacts of the different forms of competition on prices, output and profitability
(xi) explain the main policies to prevent abuses of monopoly power by firms
(xii) explain market failures and their effects on prices, efficiency of market operation and economic welfare
(xiii) explain the likely responses of government to market failures.

Indicative syllabus content

- the price mechanism, determinants of supply and demand and their interaction to form and change equilibrium price
- the price elasticity of demand and supply (NB: calculate using arc and point methods)
- influences on the price elasticities of demand and supply
- consequences of different price elasticities of demand for total revenue, following price changes
- impact of periodic variations in output, short run inelasticity of supply, inelastic demand and the cobweb (or hog cycle) on price stability in primary markets
- implications of price fluctuations for producer incomes, industry stability and supply
- government price stabilisation policies, deficiency payments, set aside and subsidies
- impact of employment costs
- impact of minimum price (minimum wage) and maximum price policies in goods and factor markets
- measures of market concentration and the impacts of market concentration on efficiency, innovation and competitive behaviour
- business integration, including mergers, vertical integration and conglomerates
- effect of monopolies and collusive practices on prices and output, and profitability
- competition policy and fair trading regulations
- positive and negative externalities in goods markets, merit goods and demerit goods

- government response to market failure: indirect taxes, subsidies, polluter pays policies and regulation
- government response to market failure: public assurance of access to public goods, healthcare, education and housing
- government response to market failure: public versus private provision of services (nationalisation, privatisation, contracting out and public private partnerships).

D: The financial system (25%)

On completion of their studies students should be able to:

(i) identify the factors leading to liquidity surpluses and deficits in the short, medium and long run in households, firms and governments
(ii) explain the role of various financial assets, markets and institutions in assisting organisations to manage their liquidity position and to provide an economic return to holders of liquidity
(iii) explain the financial and economic functions of financial intermediaries
(iv) explain the role of commercial banks in the process of credit creation and in determining the structure of interest rates
(v) explain the role of the ócentral bankô in ensuring liquidity and in prudential regulation
(vi) explain the origins of the 2008 banking crisis and credit crunch
(vii) explain the role of the foreign exchange market in setting exchange rates, and the factors influencing it
(viii) explain the role of national and international governmental organisations in regulating and influencing the financial system
(ix) explain the role of supranational financial institutions in stabilising economies and encouraging growth.

Indicative syllabus content:

- finance for households: month to month cash flow management, short term saving and borrowing, home buying and pension provision
- finance for firms: cash flow management, finance of working capital and short term assets, and long term permanent capital
- finance for government: cash flow management, finance of public projects, and long term management of the national debt
- role of financial assets, markets and institutions: credit agreements, mortgages, bills of exchange, bonds, certificates of deposit, and equities
- role and functions of financial intermediaries: maturity transformation, risk management, aggregation, matching borrowers and lenders
- role and influence of commercial banks on the supply of liquidity to the financial system through their activities in credit creation
- yield on financial instruments (i.e. bill rate, running yield on bonds and net dividend yield on equity), relation between rates, role of risk, and the yield curve
- role and common functions of central banks: banker to government, banker to banks, lender of last resort, and prudential regulation

- influence of central banks on yield rates through market activity and as providers of liquidity to the financial system as lenders of last resort, including by quantitative easing
- the 2008 banking crisis and credit crunch: exposure to subprime debt, poor regulation and excessive lending
- role of foreign exchange markets in facilitating international trade and in determining the exchange rate
- influences on exchange rates: interest rates, inflation rates, trade balance and currency speculation
- governmental and international policies on exchange rates (exchange rate management, fixed and floating rate systems, and single currency zones)
- role of major institutions (e.g. World Bank Group, International Monetary Fund and European Central Bank) in fostering international development and economic stabilisation.