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F.Y.B.Com – Sem II – Business Economics Paper II – University of Mumbai

First Edition : January 2019

© : Publishers

Published by :

NIRALI PRAKASHAN

Abhyudaya Pragati, 1312 Shivaji Nagar,

Off J.M. Road, Pune – 411005,

Phone : 25512336/37/39 Fax : (020) 25511379

Email : niralipune@pragationline.com

Printed By :

YOGIRAJ PRINTERS AND BINDERS

Works: Sr. No. 10\1, Ghule Industrial Estate,

Nanded Village Road,

TAL-HAVELI, DIT-PUNE 411041.

Mobile – 9850056517, 9404225254

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Syllabus ...

Sr. No.	Modules/Units
1.	Market Structure: Perfect Competition and Monopoly
	Perfect competition and Monopoly models as two extreme cases - profit maximisation and the competitive firm's supply curve - Short run and long run equilibrium of a firm and of industry - monopoly - Sources of monopoly power - short run and long- run equilibrium of a firm under Monopoly
2.	Pricing and Output Decisions under Imperfect Competition
	Monopolistic competition: competitive and monopolistic elements of monopolistic competition - equilibrium of a firm under monopolistic competition, monopolistic competition verses perfect competition - excess capacity and inefficiency - debate over role of advertising (topics to be taught using case studies from real life examples) Oligopolistic markets: Key attributes of oligopoly - Collusive and non collusive oligopoly market - Price rigidity - Cartels and price leadership models (with practical examples)
3.	Pricing Practices
	Cost oriented pricing methods: cost - plus (full cost) pricing, marginal cost pricing, Mark up pricing, discriminating pricing, multiple — product pricing - transfer pricing (case studies on how pricing methods are used in business world)
4.	Evaluating Capital Projects
	Meaning and importance of capital budgeting- steps in capital budgeting - Techniques of Investment appraisal: Payback Period Method, Net Present Value Method, and Internal Rate of Return Method (with numerical examples)

MODULES AT A GLANCE

Sr. No.	Modules	No. of Lectures
1.	Market Structure : Perfect Competition and Monopoly	10
2.	Pricing and Output Decisions under Imperfect Competition	15
3.	Pricing Practices	10
4.	Evaluating Capital Projects	10
	Total	45

QUESTION PAPER PATTERN (Theoretical Course)

Maximum Marks : 100

Duration : 03 Hours

Questions to be set : 06

Question No.	Particular	Marks
Q.1	Objective Questions A. Sub Questions to be asked 12 and to be answered any 10 B. Sub Questions to be asked 12 and to be answered any 10 (*Multiple choice/True or False/Match the columns/Fill in the blanks)	20 Marks
Q.2	Full Length Question OR	15 Marks
Q.2	Full Length Question	15 Marks
Q.3	Full Length Question OR	15 Marks
Q.3	Full Length Question	15 Marks
Q.4	Full Length Question OR	15 Marks
Q.4	Full Length Question	15 Marks
Q.5	Full Length Question OR	15 Marks
Q.5	Full Length Question	15 Marks
Q.6	A. Theory Questions B. Theory Questions OR	10 Marks 10 Marks
Q.6	Short Notes To be asked 06 To be answered 04	20 Marks

Note: Theory questions of 15 marks may be divided into two sub questions of 7/8 and 10/5 Marks.

Chapter 1...

Market Structure : Perfect Competition and Monopoly

SYNOPSIS

- 1.1 Perfect Competition and Monopoly Models as Two Extreme Cases - Profit Maximisation and Competitive Firm's Supply Curve - Short-run and Long-run Equilibrium of a Firm and Industry
- 1.2 Monopoly - Sources of Monopoly Power - Short-run and Long-run Equilibrium of a Firm under Monopoly

1.1 Perfect Competition and Monopoly Models as Two Extreme Cases - Profit Maximisation and Competitive Firm's Supply Curve - Short-run and Long-run Equilibrium of a Firm and Industry

1. Perfect Competition : Meaning & Features.

(April 17, 18; Nov. 17)

(A) Meaning :

- Perfect competition refers to that market structure where competition among the sellers and buyers prevail in its most perfect form.
- A single market price prevails for the commodity, which is determined by the forces of total demand and total supply in the market.
- Under perfect competition, every participant, whether buyer or seller, is a price-taker.
- Everyone in this market structure has to accept the prevailing market price as no single individual is in a position to influence it.
- Perfect competition is a pure theoretical concept.

(B) Features/Characteristics of Perfect Competition :

(i) Large Number of Buyers and Sellers :

- This is the first and the most important feature of perfect competition.
- When the number of buyers and sellers are large, no single seller or buyer can influence market conditions and price of a commodity in the market.

(ii) Homogeneity of Product :

- Under perfect competition, it is assumed that all the firms are producing a product which is homogeneous.
- This means no product available in the market can be distinguished from another both qualitatively or quantitatively.

- All the units supplied by the sellers would be of the same weight, same size, same colour, same taste and so on.
- (iii) Free Entry and Free Exit :**
- In perfect competition, there should be free entry and free exit both for buyers and the sellers.
 - Because of this freedom, there will always be a large number of buyers and sellers in this market.
- (iv) Perfect Knowledge of the Market :**
- All the sellers and buyers should possess perfect knowledge about the market.
 - Buyers should know the availability of products with the sellers and their prices.
 - Similarly, sellers should also have knowledge about the total number of buyers, their demand pattern and the prices they are willing to pay.
- (v) Perfect Mobility of Factors of Production :**
- All the factors of production have freedom of movement i.e. there should be no obstacle in their mobility.
 - This is essential for keeping elasticity of supply in the market and mutual competition among the sellers.
 - A labourer must be free to move from one occupation to another. This is called the occupational mobility of the labour.
- (vi) Absence of Transport Costs :**
- From the geographical point of view, it is assumed that all the producers are close to the market.
 - If the producers are away, there would be expenditure on transport cost which would influence the price of the product.
- (vii) Government Non-intervention :**
- Perfect competition also implies that there is no government intervention in the working of market economy.
 - That is to say, there are no tariffs, subsidies, rationing of goods and control on supply of raw materials, licensing policy or other government interference.
 - Government non-intervention is essential to permit free entry of firms and for automatic adjustment of the forces of demand and supply through the market mechanism.

2. Monopoly : Meaning, Types and Features.**(April 17, 18; Nov. 18)****(A) Meaning :**

- The word 'monopoly' is made up of two words 'mono' and 'poly'. 'Mono' means 'single' while 'poly' means 'selling'. Thus, monopoly implies single seller of a product in the market.
- Monopoly is understood as a market situation in which there is only one seller (or producer). He controls the entire supply of a single commodity.
- In this way, the literal meaning of 'monopoly' is a single seller of a product in the market.

(B) Features of Monopoly :**(i) Single Seller and Many Buyers :**

- There is only one producer or seller in the market or a single firm for any product but there are many buyers.
- The mono manufacturer may be an individual, a group of partners or a joint stock company or state, being the only source of supply for the goods or services with no close substitute.

(ii) Firm and Industry Coincides :

- There is a single firm in the entire industry for any product.

(iii) Restricted Entry :

- There are restrictions to new entrants into the market so there is no competition.
- Few of the primary barriers, constricting the entry of new sellers are :
 - (a) Government license or franchise.
 - (b) Resource Ownership.
 - (c) Patents and Copyrights.
 - (d) High start-up cost.
 - (e) Decreasing average total cost.

(iv) Price Maker :

- The absence of competition spares the monopolizing company from price pressure and grants him the opportunity to charge the product as per his advantage, targeting profit maximizing via predetermined quantity choice.
- Thus, a monopolist is a 'price maker' and not a 'price taker', wherein he decides the price and the buyers have to accept it.

(v) No Close Substitutes :

- A monopoly firm manufactures a commodity that has no close substitute and is a homogeneous product.
- With the absence of availability of a substitute, the buyer is bound to purchase what is available at the tagged price.

(vi) No Competition :

- There is lack of competition in the monopoly market.

(vii) Fixes the Price and Quantity :

- A monopolist fixes the price in relation to demand position as well as the quantity.

(viii) Increased Scope for Mergers :

- Scope for vertical and/or horizontal mergers increase in lieu of control exhibited by a single entity under a monopoly.
- The mergers efficiently absorb competition and maintain the supply chain management.

(ix) Perfect Knowledge :

- A monopolist is assumed to be having perfect knowledge about the market conditions.

(C) Types of Monopoly :**(i) Legal Monopoly :**

- When the law of the country gives monopoly power with respect to purchase or sale of product or services to a particular individual or organisation, it is called 'Legal monopoly'. Legal protection can be acquired in the form of patent, copyrights, trademarks, license etc.

(ii) Absolute Monopoly/Pure Monopoly :

- When the seller has complete control over the supply of a commodity and its market, it is said to possess 'Absolute monopoly'. There is no substitute at all.

(iii) Relative Monopoly :

- When there are no close substitutes but have some remote substitutes for a given product in the market, the monopolist possesses only a relative degree of monopoly power which is called 'Relative monopoly'.

(iv) Public Monopoly :

- When the government nationalises an industry and acquires a complete control over its market, that monopoly is called 'Public monopoly'.

(v) Natural Monopoly :

- When the seller finds lack of competition due to natural resources or possesses some unique management talent in his favour, he acquires monopoly called 'Natural monopoly'.

(vi) Joint Monopoly/Cartel Formation :

- This type of monopoly is acquired jointly by some firms through mutual agreements and business combinations like trusts, cartels, syndicates etc.
- For example, Organisation of Petroleum Exporting Countries (OPEC).

(vii) Private Monopoly :

- It is owned and operated by the private individuals or organisations. The ultimate aim is to maximise their profit.

(viii) Discriminating Monopoly :

- When the firm charges different prices for the same product to different consumers in different regions, different markets, on the basis of socio-economic conditions, it is called 'discriminating monopoly'.

3. Difference between : Perfect Competition and Monopoly :**(April 17)**

Perfect Competition	Monopoly
	(i) Meaning :
Under perfect competition, there are large number of buyers and sellers in the market.	Under monopoly, there is a single seller who controls the supply of the commodity and there are a large number of buyers.

(ii) Nature :	
Under perfect competition, there is free entry and exit i.e. new sellers can enter the market or leave the market freely.	Under monopoly, there are barriers which prevent the entry of the rivals. Thus, under monopoly, there is no competition.
(iii) Profits :	
In perfect competition, in the long run, the firm can get only normal profits.	Under monopoly, the monopolist can get abnormal profits in the short-run and in the long-run.
(iv) Price :	
Normally, under perfect competition, the price of a given commodity is lower.	Normally, under monopoly, the price of a given commodity is higher than that under perfect competition.
(v) Price Determination :	
The firm in a perfect competition is a price-taker.	The firm in a monopoly is a price-maker.
(vi) Demand :	
Demand is perfectly inelastic. Demand curve is a horizontal straight line.	Demand is inelastic. Demand curve slopes downward.
(vii) Output :	
Output is large, fixed by $MR=MC$.	Output is small, fixed by the sole seller.

4. 'Perfect competition and monopoly models are two extreme cases'. (Nov. 18)

- Monopoly and perfect competition represent two extremes along a continuum of market structures.
- At the one extreme is perfect competition, representing the ultimate of efficiency achieved by an industry that has extensive competition and no market control.
- Monopoly, at the other extreme, represents the ultimate of inefficiency brought about by the total lack of competition and extensive market control.

(Give differences between the two models : Refer 3. (Section 1.1) on Page 1.4.)

Consequences of these differences :

- (i) The demand curve for a perfectly competitive firm is perfectly elastic and the demand curve for a monopoly firm is the market demand, which is negatively-sloped according to the law of demand. A perfectly competitive firm is thus a price taker and a monopoly is a price maker.
- (ii) The monopoly firm charges a higher price and produces less output than would be achieved with a perfectly competitive market. In particular, the monopoly price is not equal to marginal cost, which means a monopoly does not efficiently allocate resources.

- (iii) While an economic profit is not guaranteed for any firm, a monopoly is more likely to receive economic profit than a perfectly competitive firm. In fact, a perfectly competitive firm is guaranteed to earn nothing but a normal profit in the long run. The same cannot be said for monopoly.
- (iv) The positively-sloped marginal cost curve for each perfectly competitive firm is its supply curve. This ensures that the supply curve for a perfectly competitive market is also positively sloped. The marginal cost curve for a monopoly is not the firm's supply curve. There is no positively-sloped supply curve for a market controlled by a monopoly. A monopoly might produce a larger quantity if the price is higher, in accordance with the law of supply, or it might not.

5. Profit Maximization by the Perfectly Competitive Firm :

- The main objective of a business firm is profit maximisation.
- The firm maximises its profits when it satisfies the two rules : (a) $MC = MR$ and (b) the MC curve cuts the MR curve from below
- Maximum profits refer to pure profits which are a surplus above the average cost of production.
- It is the amount left with the entrepreneur after he has made payments to all factors of production, including his wages of management. It is the residual income over and above his normal profits.
- Under perfect competition, the firm is one among a large number of producers. It cannot influence the market price of the product. It is the price-taker and quantity-adjuster. It can only decide about the output to be sold at the market price.
- Therefore, under conditions of perfect competition, the MR curve of a firm coincides with its AR curve. The MR curve is horizontal to the X-axis because the price is set by the market and the firm sells its output at that price.
- The firm is, thus, in equilibrium when $MC = MR = AR$ (Price).
- The equilibrium of the profit maximisation firm under perfect competition is shown in Figure 1.1.

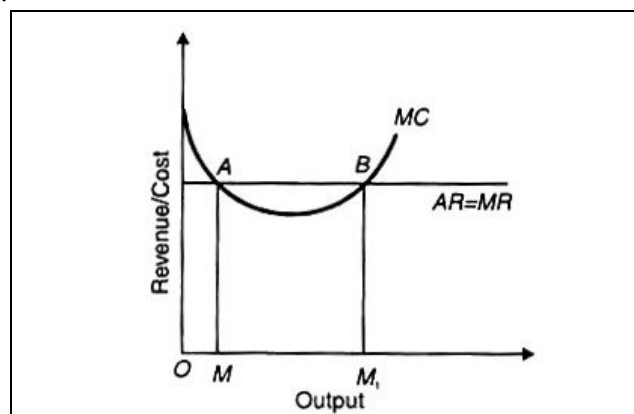


Fig. 1.1 : Equilibrium of the Profit Maximizing Firm.

- The MC curve cuts the MR curve first at point A. It satisfies the condition of $MC = MR$, but it is not a point of maximum profits because after point A, the MC curve is below the MR curve.
- It does not pay the firm to produce the minimum output when it can earn larger profits by producing beyond OM.
- The firm will stop further production when it reaches the OM_1 level of output where the firm satisfies both conditions of equilibrium.
- If it has any plans to produce more than OM_1 it will be incurring losses, for the marginal cost exceeds the marginal revenue after the equilibrium point B.
- Thus the firm maximises its profits at M_1B price and at the output level OM_1

6. Competitive Firm's Short-run Supply Curve.

- Under the short-run equilibrium of a perfectly competitive firm, a firm under perfect competition keeps operating in the short run, so long as it is able to cover at least its variable costs.
- Thus, a firm which is not in a position to cover its short run variable costs will choose to shut down its business. By doing so, the competitive firm minimizes its losses in the short run.

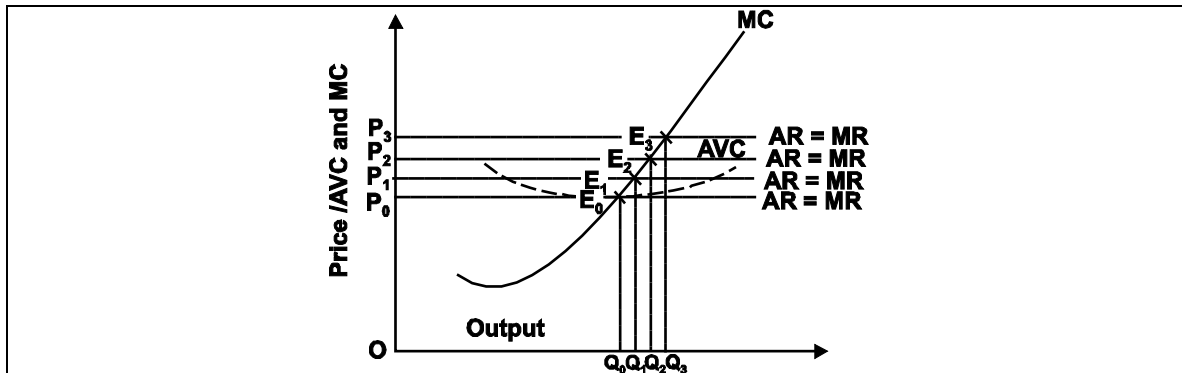


Fig. 1.2 : Short-run Supply Curve of a Competitive Firm

- The point at which the firm just covers its variable costs of production is called *shut-down point* or *closing down point*. With U-shaped cost curves, it is at the minimum point of the average variable cost.
- The concept of shut-down point can be used to derive the supply curve of a competitive firm in the short run. This is illustrated in Fig. 1.2.
- In the Fig. 1.2, it can be seen that, if the market price is OP_0 , the firm will supply an output of OQ_0 and operate at equilibrium point E_0 , where MC is equal to MR . Similarly when the price rises to OP_1 , the firm will supply an equilibrium output of OQ_1 . Further, when the price rises to OP_2 , the firm raises the supply to OQ_2 . Likewise, the firm supplies OQ_3 output at OP_3 price.

- OP_0 is the minimum acceptable price in this short run for the firm under consideration, below which the firm stops production. At this price, only variable costs are covered.
- The corresponding equilibrium point E_0 is the shut-down point of the firm, where price (P) = minimum of AVC and $TR = TVC$.
- As the market price increases gradually, the firm confronts new demand curves at higher and higher levels.
- With positive slope of the MC curve, each higher demand curve ($AR = MR$) cuts the given MC curve at a point, which lies to the right of the previous intersection.
- This means that the quantity supplied by the firm along its MC curve increases as price rises in the short run.
- The horizontal co-ordinate of a point on the rising MC curve measures the quantity of product that the firm will supply at that price.
- Thus, the MC curve of the firm indicates the quantities of output which the firm will supply at various prices.
- It is important to note that the competitive firm's short run supply curve is identical with only that portion of the short-run MC curve, which lies above the AVC curve. It is derived by joining the points of intersection of the MC curve with the successive individual demand curves, as the market price of the product keeps rising above the AVC.
- The quantity supplied by the firm is equal to zero at all prices less than those corresponding to the shut-down point. The firm's supply curve is shown by the dark segment in Fig. 1.2 (from point E_0 upwards).

7. Competitive Firm's Long-run Supply Curve :

- The derivation of long run supply curve of a competitive firm is similar to the derivation of its short-run supply curve. This is shown in Fig. 1.3.

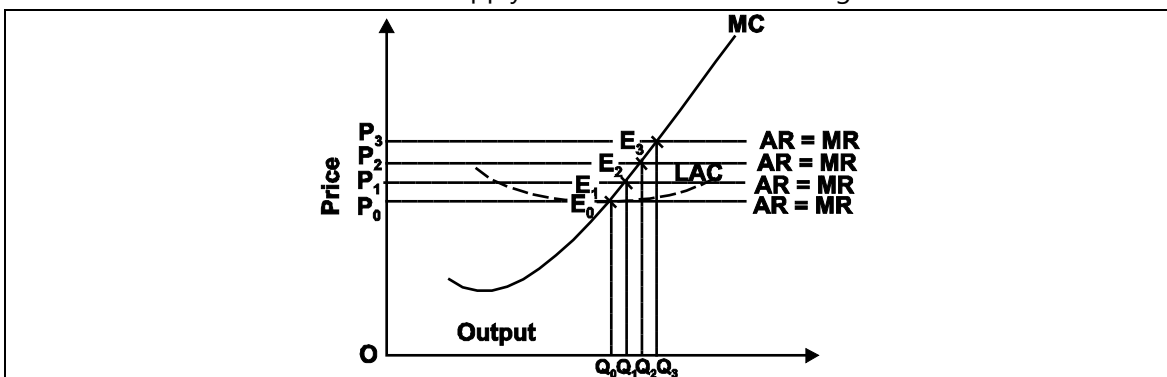


Fig. 1.3 : Long-run Supply Curve of a Competitive Firm

- The firm's long-run optimal output corresponding to different price levels is determined by the equality of price ($AR = MR$) and the long run marginal cost (LMC).

- Zero output is produced at prices less than the long-run average cost (LAC). In Fig. 1.3, OP_0 is the minimum acceptable price in the long run.
- At this price, the competitive firm attains equilibrium at point E_0 and supplies OQ_0 output. In the long run, firms earn only normal profit i.e. $AC = AR$.
- At price OP_1 , equilibrium is attained at point E_1 with OQ_1 as the output produced.
- Further, at OP_2 price, the output supplied is OQ_2 , while the output supplied is OQ_3 at OP_3 price and so on.
- All equilibrium points, such as E_0 , E_1 , E_2 and E_3 lie on the firm's LMC curve. These points also show the supply curve of the competitive firm in the long-run at various prices.
- Therefore, the portion of LMC curve of the competitive firm above its LAC curve is its long-run supply curve.
- Long-run supply curve of a perfectly competitive firm, is thus, derived by joining together the points of intersection of the LMC curve with the successive demand curves of the firm, as the market price of the product under consideration keeps rising above its average cost.

8. Equilibrium of the Firm in the Short-run under Perfect Competition :**(April 17, 18; Nov. 17)**

- Short-run is characterised by the market condition in which new firms cannot be established, existing firms cannot expand their output and new techniques of production cannot be introduced.
- During the short-run, a firm has to confront with the two types of costs, (i) Fixed costs and (ii) Variable costs.
- In the short-run, a competitive firm may get abnormal profit, suffer loss and in certain cases get only normal profit i.e. no profit, no loss.

(A) Identical Cost Conditions:

- Identical cost conditions imply that all firms are facing same cost conditions, i.e., their average and marginal cost curves are of the same level and shapes.
- In fig. 1. , the average and marginal cost curves of the firm are shown together with its demand curve.
- In order to decide the equilibrium output, the firm compares its marginal cost with marginal revenue.
- Refer **5. Profit Maximization of Perfectly Competitive Firm (point no. 5 to 13)** on Page 1.6
- But this does not ensure that the profits will be earned by the firm.

- Whether the firm makes excess profits or losses depends on the level of ATC or AC at the short run equilibrium as shown below :

(a) Short Run Equilibrium with Abnormal Profits :

- At the equilibrium level of output, a firm may get abnormal profit if its average total cost of production (AC) is below the price or marginal revenue or average revenue.

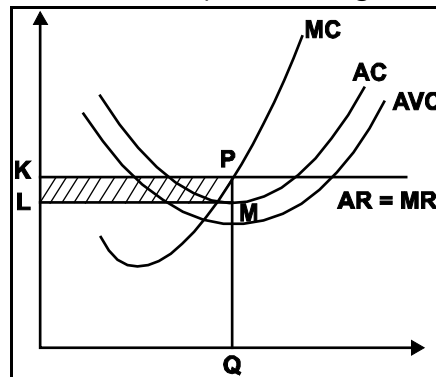


Fig. 1.4 : AR > AC Abnormal Profit

- In Fig. 1.4, firm's equilibrium is attained at point P, where the MC curve intersects the MR curve.
- At OK price, firm produces OQ output. At OQ output, firm's average revenue (AR) is PQ, while its average cost (AC) is MQ.
- Since AR is more than AC, the firm gets abnormal profit, PM per unit of output.
- Total profit being KLMP i.e. per unit profit multiplied by the total output.

(b) Losses :

- At equilibrium output, a firm may suffer loss.
- It is because of the fact that a part of the fixed cost may not be recovered in the short-run.
- In spite of these losses the firm would decide to produce, so long as it is able to recover the average variable cost.

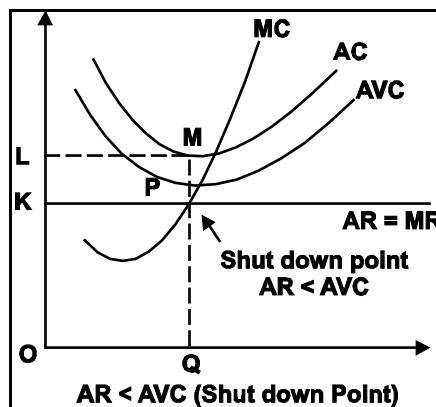


Fig. 1.5 : AR < AVC (Losses)

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Publisher : Nirali Prakashan

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