Basic Economics 2 : Industry and Commerce Cheat Sheet

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The Rise and Fall of Businesses

Failure is part of the natural cycle of business. Companies are born, companies die, capitalism moves forward. - Forbes magazine

Social Changes	In the years following the end of WWII, suburbanisation and the American public's rising prosperity gave huge supermarkets in shopping malls with vast parking lots decisive advantages over neighbourhood stores. Automobiles, refrigerators and freezers became far more wide spread, it completely changed the economics of the grocery industry.
Economic changes	Many things that we take for granted today (like credit cards), as features of a modern economy, were resisted when first proposed and and had to fight to establish themselves by the power of the marketplace.
Technological Changes	Changes can leave companies scrambling to convert from old to new technologies, even when they are the ones that came up with the idea (Kodak invented the digital camera). Others can see the potential earlier or develop the technology better.
Business leadership	Business leadership is a factor, not only in the relative success of of various enterprises, but more fundamentally in the advance of the economy as a whole through the spread of the impact of new and better business methods to competing companies and other industries.

The Role of Profits - and Losses

From the standpoint of the economy as a whole, and the well-being of the consuming public, the threat of losses is just as important as the prospect of profits.

Profits as Incentives	The hope for profits and the threat of losses is what forces a business owner to produce at the lowest cost and sell what the customers are more willing to pay. In the absence of these pressures, those who manage enterprises have far less incentive to be as efficient as possible under given conditions, much less to keep up with changing conditions and respond to them quickly in order to survive.
Profit Rates	Rates of profit are nowhere as high as the the average person believes, and there are vas differences between profit on sales and profits on investments.And they can move in opposite directions. Changing rates of profit allocate resources in a market economy - when these are rates of profit on investment. Things might be sold at at prices much higher than the seller paid for them, but if those items sit on a shelf for months, the profit on investment may be less than other items with a smaller markup.

The Role of Profits - and Losses (cont)

Economies of Scale	Large fixed costs are among the reasons for lower costs of production per unit of output as the amount of output increases. Lower costs per unit of output as the number of units increases is what economists call "economies of scale".
Diseconomies of Scale	There comes a point, in every business, beyond which the cost of producing a unit of output no longer declines as the amount of production increases. With increasing size, eventually the diseconomies begin to outweigh the economies, so it does not pay a firm to to expand beyond that point.
Costs and Capacity	In many industries and enterprises, capacity must be built to handle the peak volume - which means that there is excess capacity at other times. The cost of accommodating more users of the product or service during the times when there is excess capacity is much less than the cost of handling those who are served at peak times.
"Passing On" Costs and Savings	The passing on of of either higher costs or savings in costs is not an automatic process and, in both cases, it depends on the kind of competition faced by each business and how many of the competing companies have the same cost increases or decreases.
Middlemen	Despite superficially appealing phrases about "eliminating the middleman", middlemen continue to exist because they can do their phase of the operation more efficiently than others can, since they usually specialise in their phase.
Socialist Economies	Socialist economies not only lack the kinds of incentives which force individual enterprises toward efficiency and innovation, they also lack the kinds of financial incentives that lead each given producer in a capitalist economy to limit its work to those stages of production and distribution at which it has lower costs than alternative enterprises.

The Economics of Big Business

Big business can be big absolutely, even when only selling a modest percentage of the total merchandise in its industry, or they can be big in the sense of making a high percentage of all the sales in its industry. And an absolute monopoly in one industry maybe smaller in size than a much larger company in another industry.

Corporations are different from enterprises owned by individuals, families or partners. A corporation has a separate legal identity, so that the individual owners of the corporation are not personally liable for its financial obligations.

The Economics of Big Business (cont)

Corporate Governance	Like limited liability, the separation of ownership and management is a key characteristic of corporations.Complaints about this separation often overlook the fact that owners of a corporation's stock do not necessarily **want** the time consuming responsibilities that go with control.
Executive Compensation	Some critics have claimed that corporate executives have been overly generously rewarded by boards of of directors, even though they are paid much less than any number of professional athletes and have billions of dollars at stake. And while severance packages can be in the millions, it can still be cheaper than having an underperfo-rming individual at the helm
Non-competitive industries (monopolies and cartels), while not being the same thing, generally have detrimental effects on the economy. Keep in mind that most big businesses are not monopolies, and not all monopolies are big business.	
Monopoly Prices vs. Competitive Prices	Competitive prices allow the consumer to ignore the cost of a product or service, as all the players in an industry will need to make sure their wares are priced at a level that is appealing to consumers. In monopoly prices, the prices remain at levels higher than necessary to compensate for the costs, and also reduces the output for the product, as consumers will not buy as much of it at those higher prices.
Governmental and Market Responses	Laws are not the only to fight monopolies, and have also been used to keep out potential competitors by making it illegal for others to operate in particular industries. Private businesses that are not part of a cartel have incentives to fight them in the marketplace.

Regulation and Anti-Trust Laws

Regulatory Commis-sions	Ideally, a regulatory commission would set prices where they would have been if there were a competitive marketplace. In practice, there is no way to know what those prices would be. And while the original rationale for regulation is to keep prices from rising excessively, the regulatory restrictions most often than not prevent the the prices from **falling** to a level that would threaten the survival of existing firms.

Regulation and Anti-Trust Laws (cont)

Anti-Trust Laws	The basic rationale for anti-trust laws is to prevent monopoly and other non-competitive conditions which allow prices to rise above where they would be in free and competitive marketplace. In practice, most cases have involved some business that charged **lower** prices than its competitors.
Competition vs. Competitors	The most important thing about competition is that it is a **condition** in the marketplace. Throughout the history of anti-trust prosecutions there has been an unresolved confusion between what is detrimental to competition and what is detrimental to competitors, and the question of what is beneficial to the consumer has often been lost sight of.
"Control" of the Market	Even in the rare case where a genuine monopoly exists on its own - that is, has not been created or sustained by government policy - the consequences in practice have tended to be much less dire than in theory. Percentages of the market "controlled" by this or that company ignore the role of substitutes that may be officially classified as products of other industries, but which can nevertheless be used as substitutes by many buyers, if the price of the monopolised product rises significantly.
"Predatory" Pricing	One of the most remarkable things about this theory is that those who advocate it seldom even attempt to provide any concrete examples of when this ever actually happened. Is is also something that make little or no economic sense, the only thing it can be sure of is losing money initially. And it is by no means clear that eliminating all existing competitors will mean eliminating competition.
Benefits and Costs of Anti-Trust Laws	Perhaps the most clearly positive benefit of anti-trust laws has been a blanket prohibition against collusion to fix prices. Whether this outweighs the various negative effects of other anti-trust laws on competition in the market place is another question.

Market and Non-Market Economies

The activities engaged in by profit seeking and non-profit organisations overlap. So do the activities of some governmental agencies, whether local, national and international. Misconceptions of business are almost inevitable in a society where most people have neither studied or run businesses. In a society where most people are employees and consumers, it is easy to think of business as "them" - as impersonal organisations.

Business Versus Non-Market Economies	There have been many theories about the merits and demerits of market versus non-market ways of producing goods and services.But the actual track record of market and non-market producers is the real issue. Monopoly is the enemy of efficiency, whether under capitalism or socialism. The difference between the two systems is that monopoly is the norm under socialism.
Winners and Losers	Whatever the merits and demerits of various political proposals, what must be kept in mind when evaluating them is that the good fortunes and misfortunes of different sectors of the economy may be closely related as cause and effect - and that preventing bad effects can prevent good effects.