How a manager uses macroeconomics for decision making

Profession, Manager

Importance of Decision Making in Business

Decision making is an important job of corporate managers. They have to take decisions regarding the employment of land, labor, and capital in such a manner that output may be maximized at least possible cost. Hence, they are always in search of optimum combination of resources which would maximize corporate profit.

Appropriate decision making is the strength of business. Success in business depends on proper and correct decision making. Location, scale of operation, quantum of resources to be employed, marketing etc are some of the important problems calling for decisions in business wheremacroeconomicsmay be applied for better results.

Macro Economic Analysis

Macroeconomics is concerned with the study of aggregate economic variables. It is concerned with the whole economy and studies the level and the growth of national income, the levels of employment, the level of private and government spending, the balance of payments, the consumption & the investment, saving functions and oscillations in business cycles. The objective of macroeconomics is to maintain macro equilibrium of the economy. According to Edwin Mansfield, ‘ Macro economics deals with the behavior of aggregates like gross national product and the level of employment. A. koutsoyiannis says, ‘ the aggregate econometric models are relevant for the study and prediction of aggregate magnitudes, such as total output of any economy, total employment, consumption, investment etc.

In all the economies of the world whether free or controlled, business and macroeconomics have become same. In the business decisions, tracking of macroeconomic variables has become an important element. (Macroeconomics, 2002) Managers face difficulty in decision making, understanding of macroeconomics helps CEO's in running the business. Overall economic activity, economic policies (industrial policy, trade policy, monetary policy, fiscal policy), inflation affects the business. Decisions of CEO's or managers are affected by this aggregate which makes up the overall environment of business. Future demand and investment depends upon the growth and the state of the economy.

Role of Macroeconomic Analysis in formulation of Business Policies

Macro economics helps the business in in-depth knowledge of macro economic environment of business relating to industrial policy, licensing policy, economic planning monetary and fiscal framework and overall economic policy. (Mathur, 2002)The role of macro economics in business policy formulation is being discussed in the following points:

1. Macro economic policy

Macro economics helps in formulation of economic policy. The subjects of an economic policy are monetary policy, fiscal policy, incomes policies and policy on balance of payment. Economic policy should be such that it promotes the business environment and provides impetus to business activities. (Mathur, 2002)

2. Economic planning

A serious attempt towards self sustained growth of business is only possible by efficient planning. Planning is now a days synonymous with growth and development. Identification of priority areas, estimation of resources and coordination among various sectors of economy can be done through proper planning. Planning directs the growth in desirable corners.

3. Solving macro paradoxes

Macro economics helps in solving macro paradoxes like paradox of thrift related to savings, paradox of assumption by commercial banks that all depositors would not withdraw their money on any particular day and their right to withdrawal.

4. Tracing effect of government policy on business

Macro economics helps in tracing the implications of government policy changes on existing business activity.

5. Help in solving problem of general unemployment

Effective demand is the focal point of macro economics. Reduction in effective demand brings economic depression and thereby general unemployment. Hence, the level of effective demand should be increased in order to increase the level of employment. (Mathur, 2002)

6. Analysis of trade cycles

Macro economics tries to know about the behavior and occurrence of booms and slumps and their implication on business activity. This analysis is very useful for a free enterprise economy. Business cycles are bound to occur.

Macro economics helps the business in facing booms and slumps so that negative impact is minimized.

7. Macro analysis helps in development of micro analysis

In the deductive method process of logic goes from general to particular. We go on deducting to draw specific conclusions. Many of micro economic conclusions are outcome of macro conclusion. The assumption that consumer is rational has been decided only after knowing about the behavior of a group. A medico is allowed to specialize in some part of human body from surgical view point only when he has understood the anatomy and physiology of human body.

8. Inability of micro economics to study some areas

Micro economics is not able to study monetary problems, fiscal problems, financial sector problems, foreign exchange regulation problems and inflationary and recessionary situations problems. Business needs to be protected from these ticklish problems and therefore, needs the help of macro economics.

9. Macro economic models

Macro economics helps in building or constructing macro economic models. The major objective function of a macro economic model is to maintain the macro equilibrium in the country at the full employment level. The role of government through its monetary and fiscal operations becomes important as independent variables i. e. these policies are used to explain the dependent variable i. e. maintaining macro equilibrium.

Macroeconomic Variables and Business Decisions are highly linked

Business depends on the growth rate, when economic growth slows down; the overall economic environment becomes unfavorable to business. In a period of slow growth, the aggregate demand is very much reduced and the business has no choice but to curtail its operations. (Misra & Puri, 2007) Business depends on the inflation rate. Inflation of a mild sort increase aggregate demand which, in turn, opens up fresh opportunities for business growth. In such an environment, not only the demand for existing goods increases but the business can also introduce new items for which demand may be created through dynamic marketing. Savings and investment in a country determine its business potential. Investment can be undertaken in directly productive activities or in infrastructure.

Excessive current account deficit in a country’s balance of payments is not desirable for business activity. Such a situation leads to a shortage of foreign exchange, which in turn forces restriction on imports. (Misra & Puri, 2007)This may have serious implications for the efficiency in production. In the interest of business the current account position has to be comfortable.

In addition, the net inflows from external assistance and direct foreign investment should be fairly large, but this should not be allowed to result in an overvalued exchange rate.

In case the situation is otherwise, the country’s exports will fall and the business firms will feel seriously constrained account of it.

Phase of economy is highly significant for the business. From the point of view of business, the prosperity phase of business cycle is ideal. In this phase, the economy expands in response to growing aggregate demand and the business firm has many options. There is expectation of rise in prices which induces managers to expand the scope of their activities. A company can introduce new products in this period and markets can be created for these products.

Forces of recession get strengthened during recession. The recession usually gets reflected in the form of stock market crash and some fall in prices. The aggregate demand gradually declines and thus incentive for investment is killed. (Misra & Puri, 2007) At this time managers abandon new projects, resulting in a sharp reduction in demand for capital equipment.

Since, finance is a basic requirement of business, the level of development of the financial system is of crucial importance for business. The basic function of financial markets – both money and capital market is the collection of savings and their transfer to business enterprises for investment purposes and thereby stimulating capital formation which in turn accelerates and process of business growth. The effective channel of domestic savings and obtaining finance from abroad are the important activities in the transfer process. In the transfer process, the principal activity is allocation of funds from the savings surplus to the savings deficit units. Financial markets, if they are well developed, allocate financial resources efficiently among the various business enterprises. (Misra & Puri, 2007)

References

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