Microeconomics and Company Growth

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ABSTRACT

Microeconomics is as important to our economy as air is to living. The way we make buying decisions, how much we spend and even down to the factors that influence our buying decisions are all factors which are very important to modern companies. This paper sets out to explain some key functions of how businesses grow using microeconomics.

The way in which a company grows and develops will be a result of different influences. These are commonly known as micro and macro factors. Macro factors are those over which the company can have little, if any direct influence. These are major issues such as the economy as a whole, the political situation and technological breakthroughs. When we consider the micro factors, these are more influenced by the business consumers, and by how we respond to these factors will decide what the affect on the businesses will be. Microeconomics is very inter-relational.

Companies that wish to grow and maximize its profits, must determine how to grow. What's the plan? Is this an overall market size in profit or actual physical size? If we are looking at growing the market share then we need to consider the resources that the company has and how they may be used and managed. Company resources range from tangible resources, such as stock and physical premises, to the less tangible assets such as terms of the employees and the intellectual capital that a company has access to. In addition to this, there is also the aspect of capital that exists or can be accessed. These microeconomics factors are all manageable, and may be controlled.

Let us consider each in turn. The most obvious is that of capital. There are many ways that capital will be used. However, where growth is required, either organically, or through acquisition, there is a need to ensure that the capital that is available is being maximized in the potential return.

The first stage may be to consider the different growth projects that are available. Some may appear more attractive than others, but they need to be compared for their long term returns and growth. Tools such as discounting and net present value may aid with these different decisions, and as such ensure that growth is maximized and opportunity costs are minimized.

There is also the aspect of considering the cost and source of the capital that is used. For example, interest rates that are higher than necessary may be constraining. There may be options such as a rights issue or binds that will raise finance without adversely affecting the credit available through the traditional routes. This may also be used to fund growth and this may also be a more cost effective or more flexible manner of raising capital.

Ironically, the use of raising capital in terms of a share issue may be used to reduce debt, so that growth with other commitments may take place. Where funds are taken up by interest payments, there is an opportunity cost, meaning that the payments cannot be used more productively.

For growth to take place there also needs to be a market place that is influenced by the company. This may mean that there is an increase in marketing that is backed up by an increase in production. This may reduce the profits in the short term, and a reduced price may also increase sales, even if this is temporary in order to capture more of the market. In order to consider the role of price in considering the growth of a company we need to look at the type of product and its elasticity. This will tell us the amount the sales may be impacted by an increase or a decrease in price, and thus help us to understand the effect of price changes on the way the market may be grown.

A product that is seen as an essential may continue to sell even when the price is forced up. A product which is seen as a luxury may behave differently, when the price goes up, there also may be a greater effect on the numbers sold. A producer or supplier should understand the way in which a market will react to price changes or availability and the overall effect on the income, and therefore profit received by the supplier.

This enables the decision to be made as to the extent of the price change and the impact on required production (Hodrick, 1993). To ascertain this effect there is an economic formula that will calculate the 'elasticity' of a product. This gives the supplier a strong indication of the effect a price change may have.

In calculating the impact on the demand the calculation is the percentage change in the quantity demanded divided by the percentage change in price. The standard result of this calculation will be a negative one when there is an increase in price. A higher price increase will decrease the demand, as seen in supply and demand curves. If it does not, the item will be known as a Giffen good, such as some designer labels for which demand does not decrease when prices go up.

This calculation will give an indication of the results a price change will have on total revenue rather than number of sales. If the result is more than 1, then the price is elastic. This means that the increase in price will result in a decrease in demand, but it will also result in a decrease in total revenue.

If the result of the calculation is less than 1, then the result is different. The demand may still fall due to the increase, but the overall total revenue will increase.

The best way of demonstrating this is to give a simplified example. A supermarket sells many different types of foods and drinks. Bottles of champagne are sold at 100 a week and a price of $10 with a total revenue of 100 x $10 = $1,000.00. The supermarket's have decided to put the price up by 20% to $12 a bottle, and as a result the demand has reduced to 50 a week. The total revenue here is reduced to 50 x $12 = $620.00. This is an elastic product. Therefore, if the price is already at $12 a bottle, but then is reduced there is the knowledge that the market will be grown as a result of the terms of sales and revenues.

This gives the firm the information it needs in order to attempt to influence the sales. However, there are more factors than a single factor, such as the influence of substitutes, complimentary products and also the role of advising. Moreover, a comprehensive understanding of this can be used to determine how much should be spent on advertising and how much needs to be cut in terms of costs to reduce the price to the required level.

In turn this may mean reducing base level costs, such as redundancies, or it may mean increasing costs to meet the additional demand so that the optimum point may be reached. This may also influence the choice of suppliers.

We may also consider the micro factors and the less tangible aspects such as intellectual capital and management. Where there is a requirement for growth employees may be a valuable asset. They may be able to top increase productivity, as well as spawn ideas that can grow the company. This may mean the adoption of better motivational techniques, different pay systems and different social structures or cultures so that there is a maximization of this resource. In many ways this may take the lowest capital investment, but the highest level of personal investment.

There are many different factors, and there are just as many different ways each may be used to impact the growth of the company, and each will have very different reasons and results. The results that are required may need a combination of measures, or a single measure may have the desired effect.

Problems may also arise, and these can be due to interaction as well as the unexpected. Information is never perfect, inaccurate assumptions may be made, the macro environment may change, and some aspects are less reliable than others. For example, key employees may decide to leave. There is also the aspect of competition, where there are changes here, these cannot be foreseen, although game theory does try and account for this. Any environment is dynamic and changing, therefore there is a need to re-evaluate and reconsider regularly, and using a flexible approach that will take into consideration any needs to change. This is also a requirement for any successful company.

References

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