Industrial Economics

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An Applied Approach

W. Stewart Howe

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for Kerrie

‘Political Economy . . . is an abstract science which labours under a special hardship. Those who are conversant with its abstractions are usually without a true contact with its facts; those who are in contact with its facts have usually little sympathy with and little cognisance of its abstractions . . . And so the “theory of business” leads a life of obstruction, because theorists do not see the business, and the men of business will not reason out the theories. Far from wondering that such a science is not completely perfect, we should rather wonder that it exists at all.’

Walter Bagehot, *Economic Studies*

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Introduction

The purpose of this text is to offer a survey of the world of industrial economics. Briefly, this is the world of the business firm — large or small: the enterprise as it is referred to in economic statistics. Industrial economics cannot exist within the broad discipline of economic analysis as a separate watertight compartment. But as a separate perspective within the area of microeconomics it exists apart from, but alongside, business finance and managerial economics. Chapter I is devoted to a more detailed enquiry into the scope, perspective and methodology of industrial economics.

Broadly, the course adopted in this text is to show the student the environment in which the modern business corporation operates, and to consider in more detail some of the most significant aspects of this world. Thus, Chapter I is followed by an analysis of the theory of the firm. This is an area of economics which has changed fairly rapidly over the past decade or so; and Chapter II deals in particular with the more recent developments in the theory of the firm along managerial and behavioural lines. In Chapters III and IV a more detailed treatment is given of the market structure, conduct and performance model which is the basis of an increasing number of industrial economics studies. Included in this treatment is some reference to the growing volume of statistical work in this area which is helping economists to develop some of the earlier purely *a priori* analysis.

The first three chapters deal with the environment of industrial economics at the more general level. As a contrast they are followed by four somewhat more specialist chapters on economic phenomena which are crucial to an understanding of the modern business firm. These are the tendency, on the one hand, for businesses to bring within one organisation a number of successive stages in the production of any commodity, and on the other hand the increasing desire for businesses to make more than one product —

indeed in some cases a range of quite diverse products. Chapter VII looks in some detail at why and how firms set about acquiring other businesses as a means of expanding output; while in Chapter VIII an analysis is offered of the relevant economic aspects of the pricing decision in business.

Finally an examination is made of the influence of the State in industrial economics. In other contexts — such as the provision of goods and services, or the location of industry — the U.K. economy is characterised by considerable government intervention. Likewise in the area of industrial economics few firms are free of some form of State control. Decisions on pricing methods, mergers, market dominance, or even entry into particular markets are all areas within which government policies impinge upon the private decision-taking of business.

Two points need to be made about the content of this text. First, some topics have had to be omitted: partly because of the space constraint, but more importantly because they have been dealt with satisfactorily in separate texts. These include the retail trade, and the role of the small firm in the economy. Second, some topics are dealt with here in a wider context and may thus appear either to have been omitted altogether or to have been given insufficient emphasis. These include cost conditions (including the extent of economies of scale), the role of research and development, and the quite new concept of X-efficiency. These have been dealt with in the context of market structure and (in the case of X-efficiency) the theory of the firm. Wherever possible U.K. data have been used throughout the text, and U.S. figures are only used where no U.K. data are available and there is reason to assume a close correspondence between the situation concerning a phenomenon on both sides of the Atlantic.

Finally, two points may be made. First, only a limited knowledge of formal economic analysis or of mathematics is required to understand the text. (This latter aspect will no doubt come as a relief to many readers; and indeed to the author also!) With regard to the former, students are assumed only to have a knowledge of basic supply and demand curves

(including elasticities) and also to have a basic understanding of cost conditions.

Second, there may appear to some to be an excessive number of footnotes or references for a text of this level (first or second year undergraduate). The explanation for this is not academic pendency, but a desire to allow the reader to follow up the references to the management and economics literature, i.e. to show that industrial economics is a living discipline; and also the need to emphasise the controversial nature of much of industrial economics, i.e. to remind the student that on a number of issues in this field there is no unique answer. In an obituary notice to him the story is told of the reaction of the late Professor P. W. S. Andrews to the news that the son of a friend of his was going up to a prestigious university to study economics. Andrews is said to have remarked rather sadly that the young man would not now be likely to be encouraged to read the really great books in economics. But without having read such texts — including Andrews' own *Manufacturing Business*, published in 1949 — no one can be said to be really educated in industrial economics. The reader is encouraged to use the references in this text to turn from the brief treatment of a number of issues to read some of the original books, and to discover for himself the painful origins from which some of the now fully accepted ideas in industrial economics sprang. This experience will undoubtedly lead to a greater understanding of the current conflicts in the field.