MANAGERIAL ECONOMICS

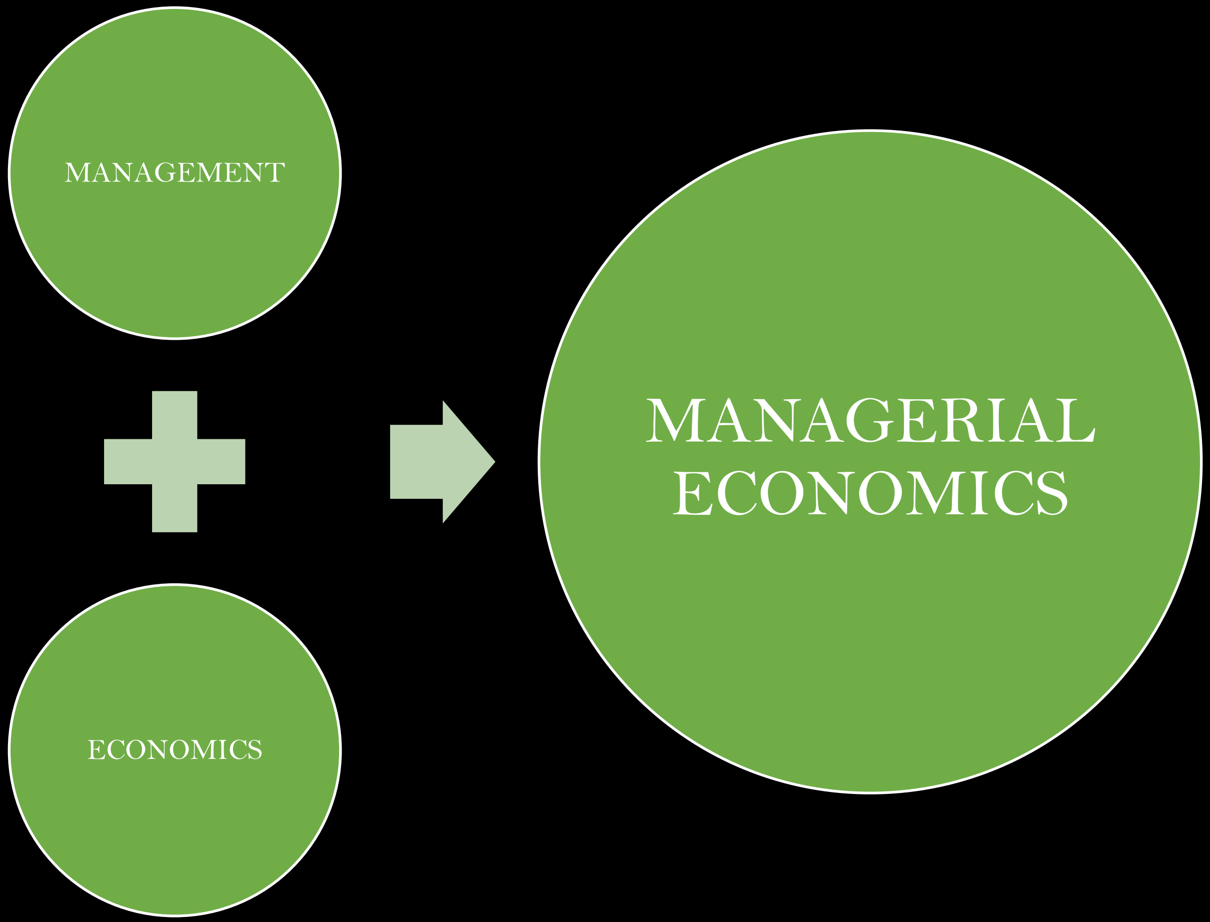
III B.A. ECONOMICS

UNIT I

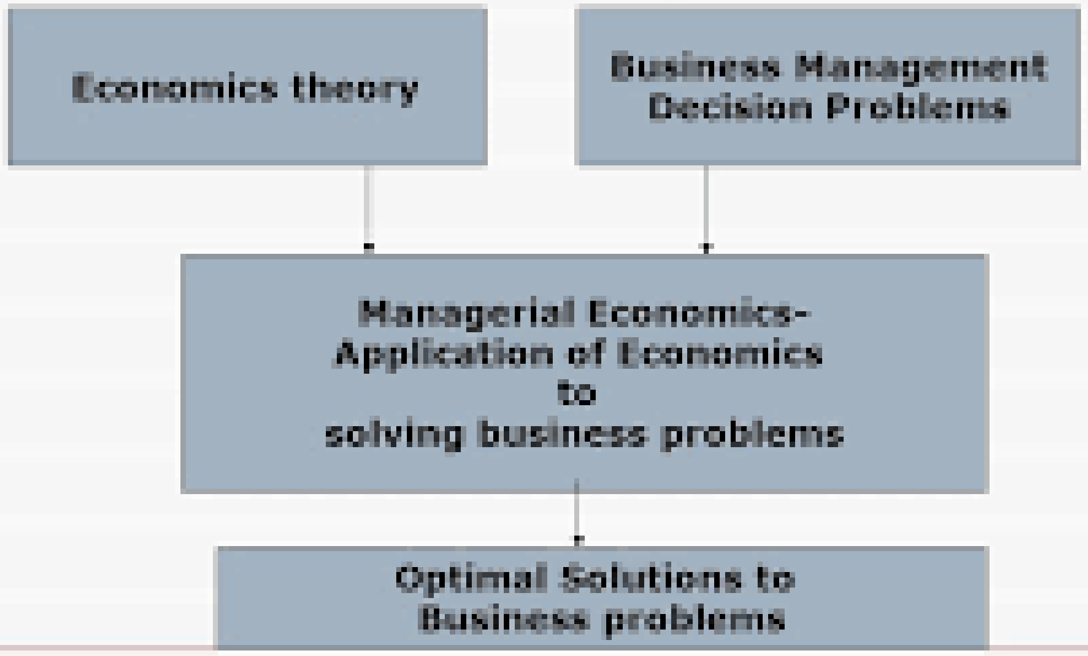
MEANING AND

DR. A. KHAN MOHAMED

MANAGERIAL ECONOMICS



Relationship between Economics & Management



ECONOMICS

Economics is the study of how best people (firms, societies) make their choices to allocate their scarce resources among competing uses of production, distribution, and consumption of goods and services.

Its basic function is to study how people – individual households, firms and nations maximizing their gains from their limited resources and opportunities.

Economics - Study of choice-making behaviour

In economic terminology it is called as "maximizing behaviour" or more approximately "optimizing behaviour".

Optimization means selecting best out of available resources with the objective of maximizing gains from given resources.

Economics is a study of choice-making behaviour of the people.

MANAGEMENT

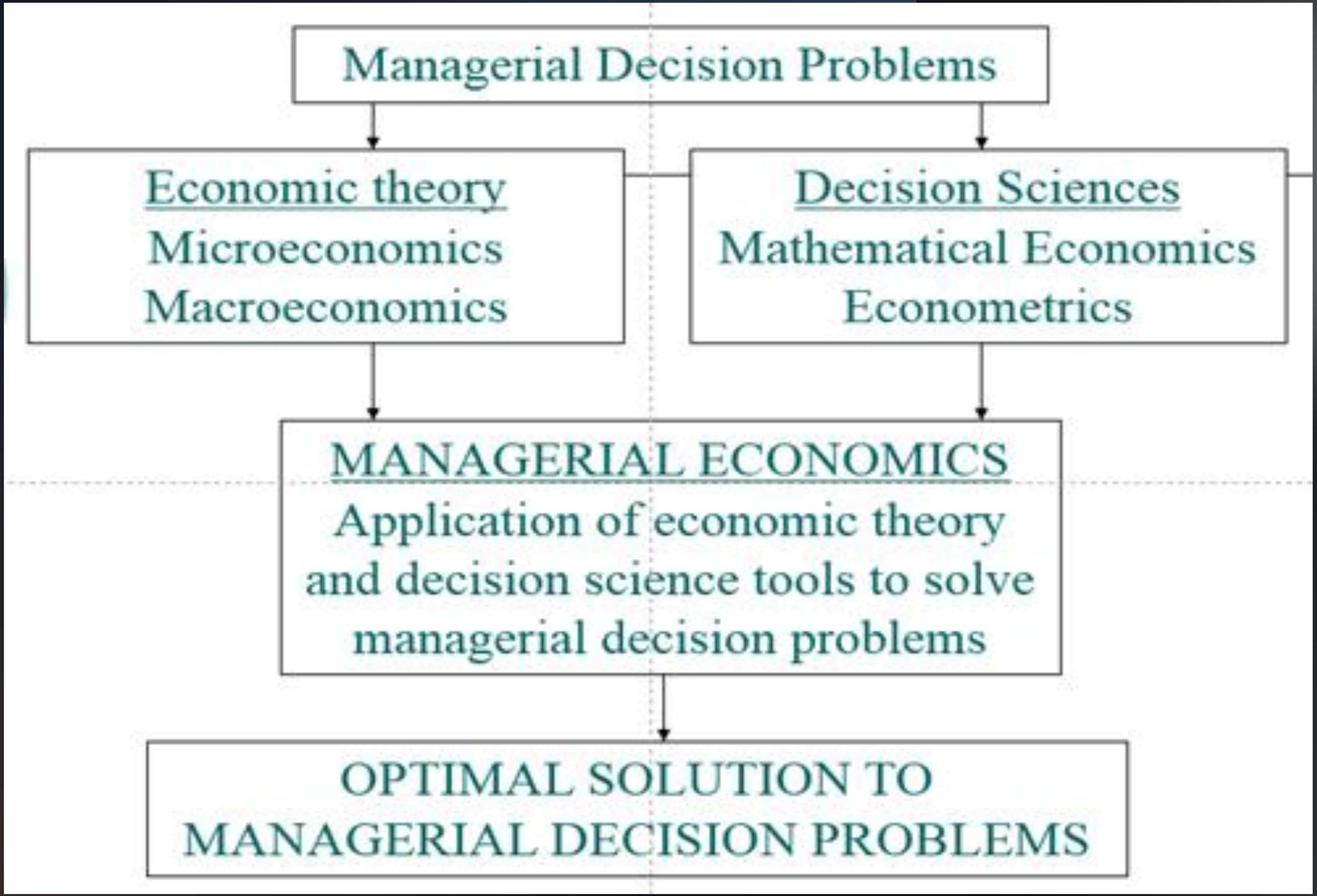
- Management is the discipline of organizing and allocating firm's scarce resources to allocating firm's scarce resources to achieve its desired objectives.
- Management is a process of planning, decision making, organizing, leading, motivation and controlling the human resources, financial, physical, and information resources of an organization to reach its goals efficiently and effectively.

MANAGERIAL ECONOMICS

- A close interrelationship between management and economics had led to the development of managerial economics.
- We can combine these two terms and define managerial economics
- Managerial economics (ME) is the study of how managers can apply economic principles and analyses as well as quantitative tools and methods in making an effective (optimal) business and managerial effective (optimal) business and managerial decisions involving the best use (allocation) of the organizations' scarce resources to achieve their objectives.

MANAGERIAL ECONOMICS……

- Managerial economics is the discipline that deals with the application of economic concepts, theories and methodologies to the practical problems of businesses/firms in order to formulate rational managerial decisions for solving those problems.
- Managerial economics borrows theories from traditional economics i.e. microeconomics
- It borrows tools from decision science i.e. mathematics and statistics
- and it tries to find out optimum solution of business problems.


Managerial Decision Problems
Economic theory
Microeconomics
Macroeconomics
Decision Sciences
Mathematical Economics
Econometrics
MANAGERIAL ECONOMICS
Application of economic theory and decision science tools to solve managerial decision problems
OPTIMAL SOLUTION TO MANAGERIAL DECISION PROBLEMS

Definitions of Managerial Economics

- "The integration of economic theory and business practice for the purpose of facilitating decision-making and forward planning by management." - Spencer and Seligman
- "Managerial economics can be viewed as an application of that part of microeconomics that focuses on such topics as risk, demand, production, cost, pricing, and market structure." - Petersen and Lewis
- "Managerial economics is concerned with the ways in which managers should make decisions in order to maximize the effectiveness or performance of the organizations they manage." - Edwin Mansfield
- "Managerial economics is the study of allocation of resources available to a firm among the activities of that unit." - Hynes

Definitions of Managerial Economics......

- "Use of economic analysis in formulating policies is known as managerial economics" - Joel Dean
- "Managerial economics is the application of economic theory and the tools of decision science to examine how an organization can achieve its aims or objectives most efficiently." - Dominic Salvatore
- "Managerial economics is the application of economic theory and methodology to business administration practice." - Pappas and Brigham

MANAGERIAL ECONOMICS….

It is combination of economics, statistics and mathematics, problem modeling and business management

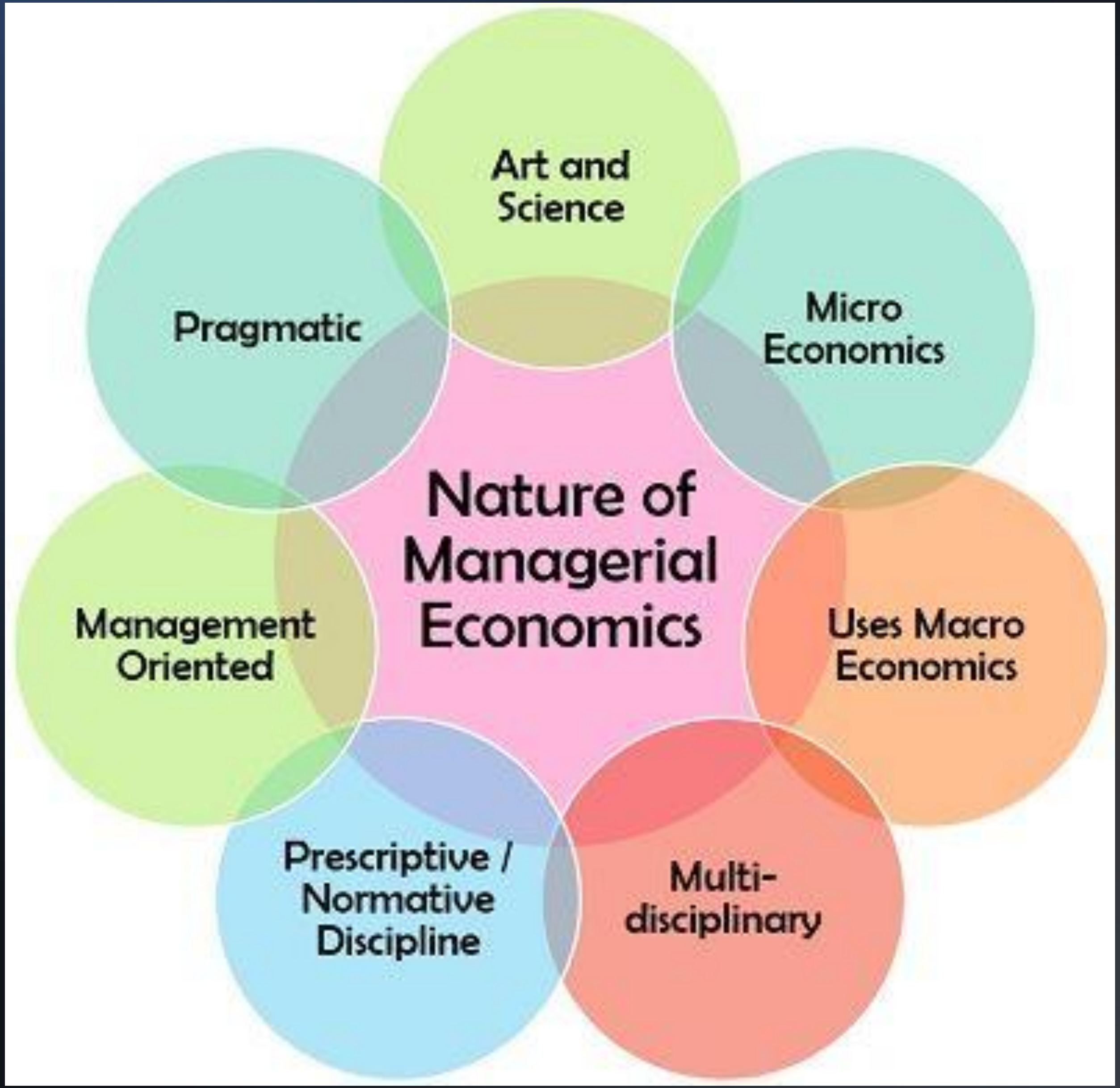
It facilitates management to take business decisions

It deals all about firm level decisions like pricing, production, demand, market structure, cost, output maximization and inputs minimization, efficient and effectiveness of business functions

It directs the utilization of scarce in a goal -oriented manner

Its ultimate goal is optimal utilization of firm's resource and optimal solution for business problems

Nature of Managerial Economics



Nature of Managerial Economics

- **Art and Science:** Management theory requires a lot of critical and logical thinking and analytical skills to make decisions or solve problems. Many economists also find it a source of research, saying it includes applying different economic concepts, techniques, and methods to solve business problems.
- **Microeconomics:** Managers typically deal with the problems relevant to a single entity rather than the economy as a whole. It is therefore considered an integral part of microeconomics.
- **Uses of Macro Economics:** A corporation works in an external world, i.e., it serves the consumer, which is an important part of the economy. For this purpose, managers must evaluate the various macroeconomic factors such as market dynamics, economic changes, government policies, etc., and their effect on the company.

Nature of Managerial Economics

Multidisciplinary: Managerial economics uses many tools and principles that belong to different disciplines, such as accounting, finance, statistics, mathematics, production, operational research, human resources, marketing, etc.

Prescriptive or Normative Discipline: By introducing corrective steps managerial economics aims at achieving the objective and solves specific issues or problems.

Nature of Managerial Economics

Management Oriented: This serves as an instrument in managers' hands to deal effectively with business-related problems and uncertainties. This also allows for setting priorities, formulating policies, and making successful decisions.

Pragmatic: The solution to day-to-day business challenges is realistic and rational. Different individuals take different views of the principles of managerial economics. Others may concentrate more on customer service, while others may prioritize efficient production.

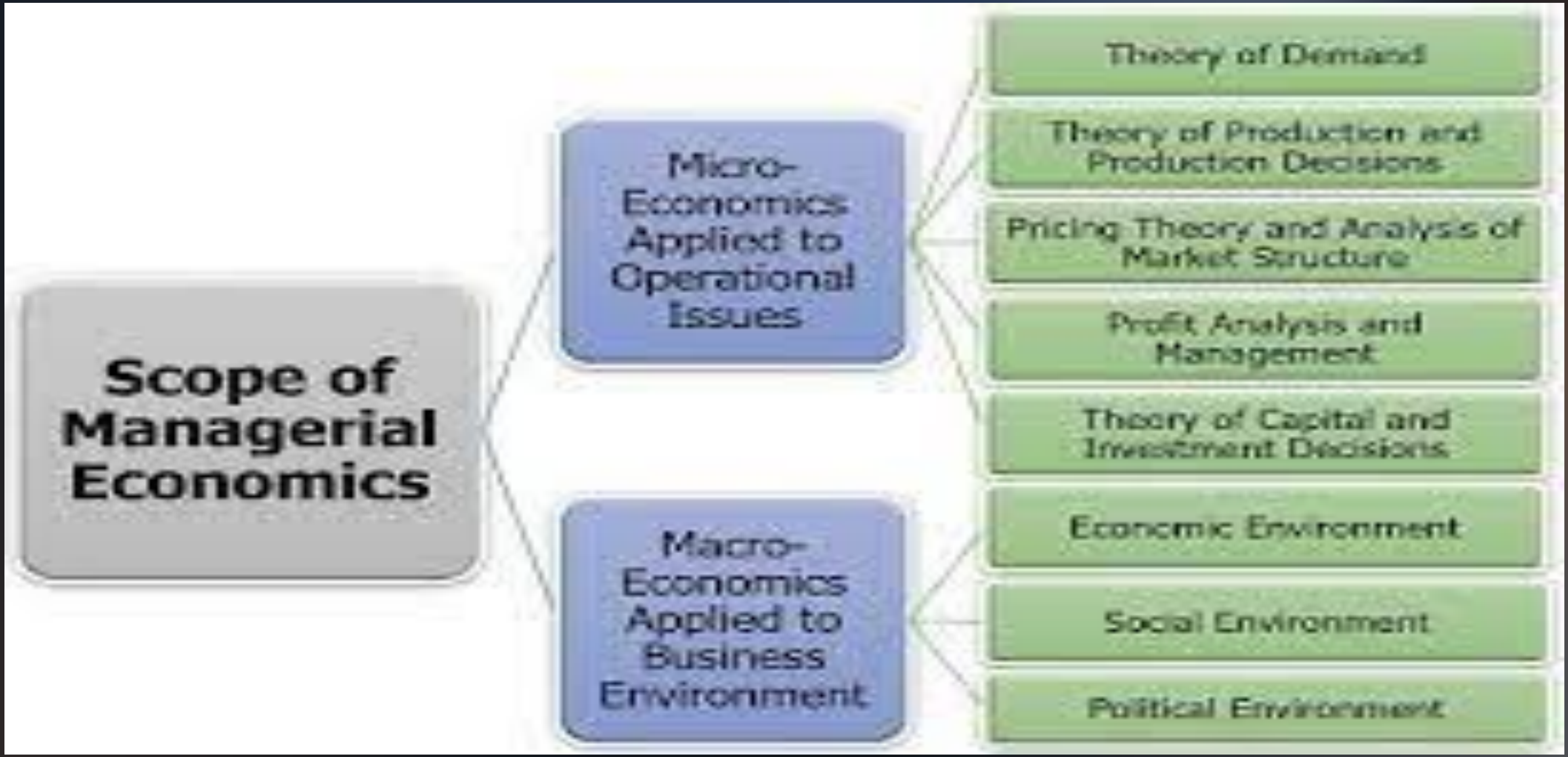
Scope of Managerial Economics

The definition of managerial economics is commonly used to deal with various business problems within organizations. Both microeconomics and macroeconomics have an equal effect on the organization and its work.

Micro-economics applied to Operational Matters

Macro-Economics applied to Business Environment

Scope of Managerial Economics



Micro-economics applied to Operational Matters

- The various theories or principles of microeconomics used to solve the internal problems of the organization arising in the course of business operations are as follows:
- **Demand Theory:** Demand Theory emphasizes the consumer's behavior toward a product or service. This considers the customers' desires, expectations, preferences, and conditions to enhance the manufacturing process.
- **Decisions on Production and Production Theory:** This theory is primarily concerned with the volume of production, process, capital and labour, costs involved, etc. It aims to optimize the production analysis to meet customer demand.

Micro-economics applied to Operational Matters.....

- **Market Structure Pricing Theory and Analysis:** It focuses on assessing a product's price considering the competition, market dynamics, production costs, optimizing sales volume, etc.
- **Exam and management of profit:** the companies are operating for assets; hence, they aim to maximize profit. It also depends on demand from the market, input costs, level of competition, etc.
- **Decisions on capital and investment theory:** Capital is the most important business element. This philosophy takes priority over the proper distribution of the resources of the company and investments in productive programs or initiatives to boost operational performance.

Macro-Economics applied to Business Environment

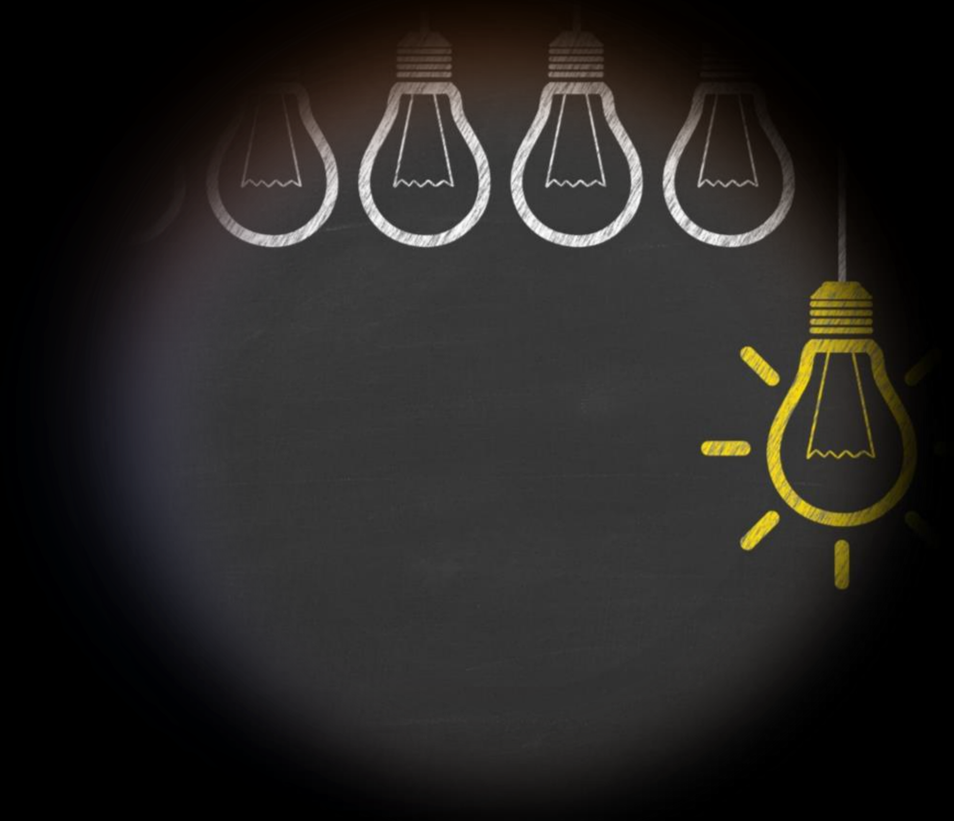
Any organization is greatly affected by the environment in which it operates. The business climate can be defined as:

Economic environment: A country's economic conditions, GDP, government policies, etc., have an indirect effect on the company and its operations.

Social environment: The society in which the organization works, like employment conditions, trade unions, consumer cooperatives, etc also affect it.

Political environment: A country's political system, whether authoritarian or democratic, political stability, and attitude towards the private sector, impact the growth and development of the organization.

Characteristics of Managerial Economics



- More Sophisticated and New Topic

Managerial Economics is a more sophisticated and a new topic. So Managerial economics is a very refined topic compared to general economics. It is sophisticated for these reasons that now currently its use in mathematical concepts and scientific instruments. Including computer etc.

- Practical utility

Managerial economics demonstrates, the method of economic theory and analysis used in economic decision making and policy determiners. Therefore, it is a tool of practical utility, not a principle

Characteristics of Managerial Economics……

- Normative Economics

Managerial economics belongs to normative economics. It is concerned with what management should do under particular circumstances. It determines the goals of the enterprise and then develops the ways to achieve these goals. It deals with the future planning, policy-making, decision- making and making full utilization of the available resources of the enterprises.

- Micro- Economics

Managerial economics is micro- economics in character as it is concerned with smaller units of the economy. It studies the problems and principles of an individual business firm or and individual industry.. It assist the management in forecasting and evaluating the trends in the market.

- Uses Theory of firm

Managerial economics uses economic concepts and principles which are known as the theory of firm or economics of the firm. Thus, its scope is narrower than that of Pure Economic Theory.

Characteristics of Managerial Economics……

- Takes help of Macro Economics

Managerial economics takes help of macro - economics also because it needs an understanding of the circumstances and environment the individual firm or industry has to work. Issues of macro - economics whose knowledge is necessary for the successful management of a firm, or an industry are Business Cycles, Taxation Policies, Industrial Policy, Price and Distribution Policies, Wage Policies and Anti-Monopoly Policies etc.

- Aims at helping the Management

Managerial economics aims at helping the management in taking correct decisions and preparing plans and policies in the future.

Characteristics of Managerial Economics……

Analysis: Managerial economics analyses the business and provides the right direction to determine business policies.

The Vital Part of the Firm: Managerial economics is very useful for every firm, so it is an integral part of a firm.

Significance of Managerial Economics

MANAGERIAL ECONOMICS HOLDS GREAT SIGNIFICANCE IN VARIOUS MANAGEMENT PROCESSES. THE MAIN IMPORTANCE OF MANAGERIAL ECONOMICS IN AN ORGANIZATION ARE DEMAND ANALYSIS & FORECASTING, PROFIT MANAGEMENT, AND CAPITAL MANAGEMENT. IT ASSISTS AN ORGANIZATION IN ITS DECISION-MAKING PROCESS BY INTEGRATING THE TOOLS AND TECHNIQUES OF ECONOMIC THEORIES WITH MULTIPLE BUSINESS ACTIVITIES.

MANAGERIAL ECONOMICS DEALS WITH THE OPTIMUM UTILIZATION OF SCARCE RESOURCES. IT ENSURES THE PROPER FUNCTIONING OF THE FIRM BY USING THE RESOURCES EFFECTIVELY. IT GUIDES THE MANAGEMENT IN RATIONAL DECISION-MAKING, IMPLEMENTING BOTH ECONOMIC THEORIES AND ECONOMETRICS. WITH THE HELP OF FACTUAL DATA SOLUTIONS, SEVERAL ECONOMIC PROBLEMS ARE CURATED.

Managerial Economist

- Managerial economist is a person who manages business efficiently using various economic theories and methodologies. He supports the management team in better decision making through his analytical skills and specialized techniques.
- A Managerial Economist is also termed as an economic advisor or business economist. He is responsible for analyzing various internal and external environmental forces that influence the functioning of business organizations. Managerial economist makes several successful business forecasts and updates the management team regarding the economic trends from time to time.
- Managerial Economist always remains in touch with all the latest economic developments and environmental changes for informing the management. He has an efficient role in earning reasonable profits on invested capital as it supplies all relevant information which helps in making proper plans and strategies.

Role of Managerial Economist

The **role of managerial economist** can be summarized as follows:

He studies the economic patterns at macro-level and analysis it's significance to the specific firm he is working in.

He has to consistently examine the probabilities of transforming an ever-changing economic environment into profitable business avenues.

He assists the business planning process of a firm.

He also carries cost-benefit analysis.

Role of Managerial Economist..

He assists the management in the decisions pertaining to internal functioning of a firm such as changes in price, investment plans, type of goods /services to be produced, inputs to be used, techniques of production to be employed, expansion/ contraction of firm, allocation of capital, location of new plants, quantity of output to be produced, replacement of plant equipment, sales forecasting, inventory forecasting, etc.

In addition, a managerial economist has to analyze changes in macro- economic indicators such as national income, population, business cycles, and their possible effect on the firm's functioning.

Role of Managerial Economist..

He is also involved in advising the management on public relations, foreign exchange, and trade. He guides the firm on the likely impact of changes in monetary and fiscal policy on the firm's functioning.

He also makes an economic analysis of the firms in competition. He has to collect economic data and examine all crucial information about the environment in which the firm operates.

The most significant function of a managerial economist is to conduct a detailed research on industrial market.

Role of Managerial Economist..

In order to perform all these roles, a managerial economist has to conduct an elaborate statistical analysis.

He must be vigilant and must have ability to cope up with the pressures.

He also provides management with economic information such as tax rates, competitor's price and product, etc. They give their valuable advice to government authorities as well.

Responsibilities of Managerial Economist

- **To make a reasonable profit on capital employed:** He must have a strong conviction that profits are essential, and his main obligation is to assist the management in earning reasonable profits on capital employed in the firm.
- **He must make successful forecasts by making in depth study of the internal and external factors:** This will have influence over the profitability or the working of the firm. He must aim at lessening if not fully eliminating the risks involved in uncertainties. He has a major responsibility to alert management at the earliest possible time in case he discovers any error in his forecast, so that the management can make necessary changes and adjustments in the policies and programmes of the firm.

Responsibilities of Managerial Economist....

- **He must inform the management of all the economic trends:** A managerial economist should keep himself in touch with the latest developments of national economy and business environment so that he can keep the management informed with these developments and expected trends of the economy.
- **He must earn full status in the business and only then he can be helpful to the management in good and successful decision-making, For this:**

I. He must receive continuous support for himself and his professional ideas by performing his function effectively.

II. He should express his ideas in simple and understandable language with the minimum use of technical words, while communicating with his management executives.

Responsibilities of Managerial Economist....

- **He must establish and maintain contacts with individuals and data sources:**

(i) To establish and maintain contacts: A managerial economist should establish and maintain contacts with individuals and data sources in order to collect relevant and valuable information in the field.

(ii) To develop personal relations: To collect information he should develop personal relations with those having specialised knowledge of the field.

(iii) To join professional associations and should take active part in their activities: The success of this lies in how quickly he gathers additional information in the best interest of the firm.

Concept of Risk and Uncertainty

- **Managerial decisions are made under conditions of risk or uncertainty.**
- **Risk refers to decision-making situations under which all potential outcomes and their likelihood of occurrences are known to the decision-maker(All decision makers are equally likely to profit as well as to lose), and uncertainty refers to situations under which either the outcomes and/or their probabilities of occurrences are unknown to the decision-maker.**