

# MANAGERIAL ECONOMICS

## UNIT-1

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### **Introduction**

The subject Managerial Economics is of recent origin. It came into being in the early 1950s. Managerial Economics and Business economics are the two terms, used interchangeably. However, the term Managerial Economics has become more popular and has overcome the term Business Economics. Managerial Economics may be defined as the study of economic theories, logic and methodology which are generally used to provide the solution to the problems faced by the managers in the due course of business. **Managerial Economics is thus regarded as that part of economic knowledge or economic theories which is used as a means to analyse various business problems for sound business decisions.** Managerial Economics serves as a connecting link between traditional economics and the decision-making sciences for decision making in business.

### **Definition of Managerial Economics:**

“Business Economics (Managerial Economics) is the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning by management.” – *Spencer and Seegelman*.

### **Nature of Managerial Economics:**

There are certain chief characteristics of managerial economics, which can help to understand the nature of the subject matter and help in a clear understanding of the following terms:

#### **1. Managerial economics- Positive or Normative:**

**Positive economics is descriptive in nature.** It use to describe economic activities as they are. Prof. Lionel Robbins says that economics is a positive science.

While **normative economics ensures judgments of value**. Managerial economics draws from descriptive economics and tries to pass judgments of value in the context of the firm. **Managerial economics is mainly normative in nature.**

This nature of Managerial Economics can be illustrated with the help of one example. when an investor go to a Financial Analyst he use to tell the fund available, purpose of investment, expected time of return, risk bearing capacity. After listening to the need of the investor using his knowledge, he suggest him the investment avenue in which he can invest in. Same is the case with **Managerial economics it is descriptive as well as prescriptive.**

## **2. Pragmatic and Realistic:**

Managerial economics is pragmatic and realistic in nature. The principles of managerial economics are made use of to find the optimal solution to the problems faced by the manager in due course of business which may be related to the choice and allocation of resources. It attempts to ignore the complexities of the traditional economics. But ensures the consideration of the facts that are important for decision making but ignored by traditional economics. Thus Managerial economics helps to improve the functioning of the organization.

## **3. Goal Oriented :**

Managerial economics is goal oriented, It aims to achieve the objectives to the best possible extent. Right from the very first activity undertaken by the organization it focus on the ultimate goal of the organization, be it the profit maximization, wealth maximization or the sales maximization.

## **4. Applied science:**

Managerial economics attempts to solve the business problem by identifying the cause and effect relationship between the variables. Managerial economics also analyses the effect of change in one variable on the other.

## **5. Related to other Disciplines:**

It makes use of the services of many other related sciences like mathematics, statistics, engineering, accounting, operation research and psychology etc to find solutions to business and management problems. Managerial economics is also found to be in close relation with statistics. In business Managers have to go with the estimates of demand, market trends, probabilities regarding supply. Statistics as an important tool helps to study the various functional relationships and also facilitate forecasting. Operations Research is now largely used in planning and controlling business activities. The various concepts of mathematics that are used by a managerial economist are logarithms and exponential, geometry, algebra and calculus, vectors and determinants, input-out tables.

## **6. Applied Economic Theory:**

Managerial economics is economics which is applied in decision-making process. Managerial economics attempts to link abstract theory with managerial practice. Economics is also concerned with the problem of allocating limited resources among unlimited wants. **It involves the practical application of economic theory and methodology to decision-making problems faced by the various private, public and non-profit making organizations.** It helps in optimal decision making.

## **7. Economics is an art:**

Economics when observed as an art, it is practical. The various branches of economics such as public finance, consumption, production, etc. provide practical and optimal solutions to various economic problems. It helps managers in solving various economic problems which they face in their day-to-day business affairs.

## **SCOPE OF MANAGERIAL ECONOMICS:**

There is no general uniform pattern regarding the scope of managerial economics. However, the following areas encompass scope of managerial economics:

### **1. Demand Analysis and Forecasting**

The very reason for the operation of any business firm is the demand for its product in the market. All significant decisions of the firm depend upon the correct estimation in demand analysis. Managers seek to collect information about the various factors which are going to affect demand for a firm's product, various substitutes available in the market and trends prevailing in the market. All these factors have important bearing on the production schedules. Demand analysis and forecasting is therefore really essential for planning business activities and occupies a relevant place in managerial economics.



## 2. Cost Analysis

Another important area of managerial economics is cost analysis. Whenever managers plan for production, the foremost factors that comes to their mind is the cost of production. Cost analysis facilitates management decisions. The factor that leads to variations in costs is beyond the control of managers and therefore must be recognized. In the absence of cost estimates one may not be able to properly plan its profits & also not able to determine its pricing policies.



### **3. Production Analysis**

Managers while planning for production pays attention to the relation between cost and output, what are the various factors of production which are required to carry on manufacturing, what is the behavior of various cost in relation to the factors, how far we are able to achieve economies of scale. Thus production analysis also another important domain.

### **4. Pricing Policies**

Pricing is a very important area of managerial economics. Managers have to spent a lot of time on forecasting & determining the price of products in the various market structures as price acts as a major source of revenue .There are various methods to determine the prices but the choice of right method is the greatest challenge. Wrong pricing decision will turn the firm out of the market. An accurate pricing decision contributes a lot to the success of a business firm.

### **5. Profit Management**

The ultimate objective of any economic organization is to earn handsome profits& is considered as the barometer of success. But we also know that the future is` always uncertain. There is uncertainty on account of various factors such as social , political ,economic factors ,which acts as a obstacle in our way of objective. Thus profit planning and management is regarded as the important area of managerial economics.

### **6. Capital Management**

Capital is regarded as the most important resource and also require greater attention of the managers. capital expenditure not only have the binding on the present but also on the future profits & once such decisions are taken these are irreversible. Therefore manager do keep focus on this aspect.

### **7. Advertising**

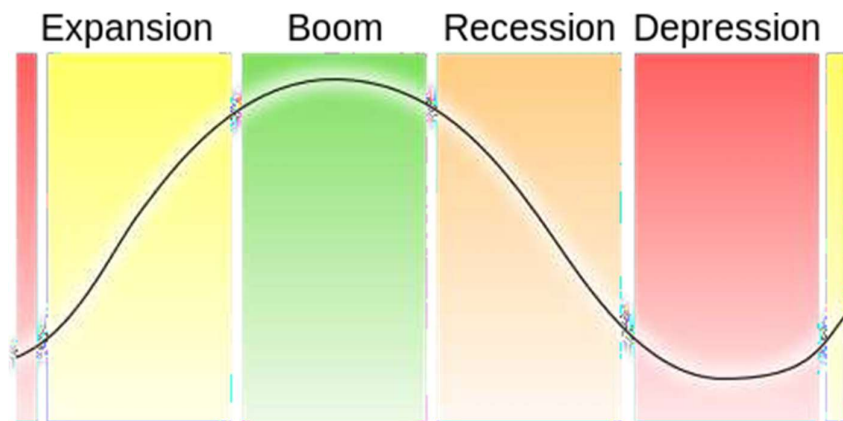
Since decision making and forward planning are the important areas of managerial economics, therefore the managers have to plan many things about the product they are going to launch in the market. The various activities in this regard are its design, shape, quantity, deciding about the marketing of good etc. In this context advertising is important area of managerial Economics.

## 8. Environmental issues

There are many areas of macroeconomics which also becomes part of managerial economics, since the business organization can't work in isolation. These areas are related to general business, social, political and demographic environment in which a business enterprise works. All these issues have great bearing on Business activities.

## 9. Business cycles

Business cycles also seem to affect business decisions. Business cycles are regular fluctuations in economic activities in the country. The various phases that constitute business cycle are depression, recovery, boom and recession. Therefore managers have to modify their plans according to the phase through which the business is passing out.



## ROLE AND RESPONSIBILITY OF A MANAGERIAL ECONOMIST:

A managerial economist realistic attitude can lead the firm to the path of success. He uses his analytical skills in solving complex aspects of successful decision-making and future planning. Since the ultimate goal of any economic organization is to make profits ,therefore managerial economist also woks and serves the firm by working for the same In advanced countries, big firms employ managerial economists to assist the management. The various roles played by him are highlighted as follows:

### **1. Acquiring knowledge about Environment**

A firm cannot work in isolation. The internal & external environment surrounds the firm. It is a matter of importance that internal environment is controllable but external environment is beyond the control & has important bearing on business. Right information about the environment helps manager a lot to wisely define the extent and trend of their own business plans. The managerial economist has to study the economic trends and use the same information for the best functioning of his firm.

### **2. Participating in Public Debates**

The role of managerial economists is not confined to the four walls of their business firm rather they actively participate in public debates. They are regularly being the source of advice and views are being sought by the government in the formulation of the various national policies as having their hands on experience of the firm and industry.

### **3. Efficient Functioning of the Organization**

A managerial economist is the one who keep constant eye on the various factors and operations going in the organization. He ensures the efficient functioning of the organization by helping in formulation of decisions relating to the various areas like price, rate of operations, investment, expansion or contraction, cash availability, wage and price policies , purchase of raw material and production schedules.

### **4 . Varied Functions**

In the due course of business managerial economists has to perform the various functions such as planning about finance, production, purchase, marketing, sales, making various kinds of forecast, market analysis, determining pricing policies and Practices, acting as an analyst, acting as an adviser and also projecting various technological changes in the market.

### **5. Economic Intellect**

Managerial economist use to provide general intelligence service by providing relevant information in regard to prices fixed by competitors, products offered by them, tax and, tariff rates, trends prevailing in the market ,competitive moves, things

going on in the international market ,new developments taking place in the market, political issues having effect on the business practices.etc.

## 6. Cost Benefit Analysis

Managerial Economist is constantly involved in the process of cost benefit analysis.while taking the various decisions manager gives due consideration to the cost invoved in the particular venture and the benefit expected from the same.



## 7. Assists in Decision-making

He helps the decision maker in formulating the decisions relating to internal functioning of a firm like changes in price, plans of investment , type of goods and services to be manufactured, factor inputs to be employed, production techniques to be used, expansion or contraction plans of firm, allocation of funds, location of various plants, quantity of output to be manufactured, replacement of plant equipment, sales forecasting, inventory forecasting, etc.

## 8. Maintaining Relationships

The managerial economists have to undertake forecasting and also have to analyse various situations. For the same he must establish contacts with the sources of data. He maintains contacts with experts in the different fields and must also join trade and professional associations, subscribe to the journals providing him the updates of the market.

## **Economic Theory**

Economic Theory provides an outlet for research in all areas of economics based on rigorous theoretical reasoning and on topics in mathematics that are supported by the analysis of economic problems. Published articles contribute to the understanding and solution of substantive economic problems.

Among the topics addressed in the journal are classical and modern equilibrium theory, cooperative and non-cooperative game theory, macroeconomics, social choice and welfare, uncertainty and information, intertemporal economics (including dynamical systems), public economics, international and developmental economics, financial economics, money and banking, and industrial organization.

In addition to original research articles, Economic Theory publishes surveys for particular areas of research that clearly set forth the basic underlying concepts and ideas, the essential technical apparatuses, and the central open questions.

## **Managerial Economics**

Managerial economics is a stream of management studies, which emphasises solving business problems and decision-making by applying the theories and principles of microeconomics and macroeconomics. It is a specialised stream dealing with the organisation's internal issues by using various economic theories. Economics is an inevitable part of any business. All the business assumptions, forecasting and investments are based on this one single concept.

## **IMPORTANCE OF MANAGERIAL ECONOMICS:**

Managerial Economics has become a highly useful and practical discipline now days as it helps to analyze and offers best solutions to various kinds of problems faced in routine affairs of the organisation in a systematic and realistic manner. The following points highlights significance of the managerial economics:

### **1. Better allocation of resources:**

Managerial economics not only offers the better allocation of scarce resources among competing ends but also ensure the proper utilization of resources.

### **2. Right decision at the right time:**

It helps the executives working in the firm to understand the various details of business and problems encountered and to take right decision at the right time by the identification of key variables in decision-making process. Thus managerial economics attempt to avoid the complexities of wrong decisions. Every manager has to take various relevant decisions about the utilization of limited resources like land, capital, labour, funds etc. to get the maximum returns, therefore, managerial economics, concentrates on practical aspects which facilitates decision-making.

### **3. Identification of Problems:**

In todays scenario economy is becoming highly competitive and dynamic, it helps in identifying various business and managerial problems, their causes and consequence, and suggests various policies and programs to overcome them.

### **4. Offers tools and techniques:**

Managerial economics ensures availability of the various conceptual and technical skills, tools of analysis and techniques of judgment and other modern tools and instruments like elasticity of demand and supply, cost and revenue, income and expenditure, profit and volume of production etc to solve various dynamic problems of business.

### **5. Attainment of business objectives:**

Managerial economics helps the business executives to become more responsive, realistic and competent to overcome upcoming challenges in the dynamic business scenario. This in turn facilitates achievement of various objectives like profit and wealth maximization, society welfare, Customer satisfaction, attaining industry leadership, market share expansion and social responsibilities etc.

## **6. Facilitates decision making and forward planning:**

Managerial Economics enables decision making and forward planning by the evaluation of alternatives available to the managers.

## **7. Understanding the various external factors:**

It also helps in understanding and analyzing the various external factors which affect the decision-making of an organisation and ultimately affecting the functioning and the success of the firm.

### **Limitations of Managerial Economics**

Every coin has two sides, positive and negative. No doubt managerial economics provides sophisticated tools of analysis and facilitates the decision making initiated by the managers but on the other side it suffers from certain limitations. The various limitations are as follows:

1. Managerial economics has led to the emergence of monopolies for the production of some important product and services. For example: electricity companies, Railways, Telephone companies. These companies exploit the consumers by charging high prices just to earn handsome profits.
2. Small scale companies have to face high degree of competition due to the emergence of Multinational companies in or country, posing threat to the existence of the small firms. Small firms find it difficult to survive in the market.
3. There seems to be great exploitation of worker, due to weak bargaining power of the workers. It is felt that women and child labour are offered very low wages for the work being taken from them.
4. Another limitation of Managerial Economics seems from the emergence of Oligopoly in the market, where firms and producers formally collude with each other or enters into cartel agreement and charge higher price and restricts output.

### **Summary**

Managerial Economics has helped a lot to the business community to arrive at the best decision in regard to the various functional areas like demand forecasting ,production scheduling, resource mobilisation, planning different activities, control of costs, minimisation of uncertainties, maximisation of profits and wealth etc. leading to the success of the firm and simultaneously achieving the goal of social Responsibility.