Introduction of Managerial Economics

☆ Introduction :

Managerial Economics is economics applied in decision making. It is the application of economics theory and decision sciences to the managerial decision making process. It deals with how decisions should be taken by the managers to achieve the organisational goals.

☆ Meaning :

Managerial Economics refers to that branch of Economics which is related with the application of various laws, theories and methods of Economics to the business decision - making by the business mangers.

Its study helps the business mangers to solve the various problems related to his business and there by it helps the business manger in achieving various goals of his business.

" Managerial Economics is the application of economic theory and methodology to business administrative practice"

☆ Nature :

1. **Micro Economics** : In managerial economics, managers typically deal with the problems

relevant to a single entity rather than the economy as a whole. It is therefore considered as intergral part of microeconomics.

2. Uses of Macro Economics : A corporation work is an external world, i.e. it serves the consumer, which is an important part of the economy.
For this purpose, it is important that managers evaluate the various macroeconomics factors such as market dynamics, economics changes, government policies, etc., and their effect on the company.

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

4. Normative Science :
A branch of study may either be positive or normative. Managerial Economics is normative in nature. It deals with "What Ought To Be?" and it is not neutral about ends or objectives.
It suggests how the business manager should achieve the specific goals of his

business by making appropriate business decisions.

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

6. Pragmatic: The solution to day-to-day business challenges is realistic and rational.

7. 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.

★ Scope and Relationship with other disciplines:

The scope of Managerial Economics includes various concepts, laws, theories and methods of analysis ~~with~~ which help a business manager during the process of business decision-making.

Therefore, the scope of Managerial

Economics is very wide. Important elements of the scope of Managerial Economics have been explained below:

1. **Theory of Demand:**

Theory of Demand helps to analyse the behaviour of a consumer. It deals with the questions like:

- Why do consumers buy a particular product?
- Which factors influence the demand or decision of consumers?
- If circumstances changes, how will consumer demand's change?, etc.

The knowledge about all this can be had from the theory of demand and it is highly essential for any business manager to have the knowledge of theory of demand. So, theory of demand is included in the scope of Managerial Economics.

2. **Theory of Production:**

Theory of production, also known as Production function, explain the physical relationship between factor input and output. It explain the behaviour of total output when unit of one input are increased while keeping the unit of other input as constant or when

unit of all the factor input are increased in a fixed proportions.

It also deal with how can the maximum output be produced with given quantity of resources. That is why, theory of production is also included in the scope of Managerial Economics.

3. Theory of Exchange or Price Theory:

Under different types of market, price determination is explained by the price theory. The success of any business firm mainly depends upon the appropriate price decisions amidst the prevalent market structure.

Therefore, a business manager must have the knowledge about market structure and price theory and that is why these are included in the scope.

4. Theory of Profit:

The most important objective of any business is to earn maximum profit. Profit mainly depends on production cost and sales revenue. However, there is an element of risk and uncertainty related to profit even through the most important techniques are used to predict future and estimate profit.

In this regard, a business manager

takes the help of theory of profit and take business decisions accordingly.

5. Theory of capital and Investment :

Theory of capital deals with various issues concerning the optimum allocation and productive utilization of capital input. It is also known as Capital Management or Capital Budgeting.

A business manager must have the knowledge of theory of capital because Capital is the most important input of any business in modern times.

This knowledge plays an important role in investment decision making by helping the business manager in the choice of projects, cost-benefit analysis, planning of capital expenditure, etc.

As the result, theory of capital is also included in the scope of Managerial Economics.

6. Environmental Issues :

Certain issues of macro-economics also form a part managerial economics. These relate to social and political environment in which a business and industrial firm has to operate.

The scope of Managerial Economics also includes various macro ecocomic issues because general business environment in the country has great influence on any business.

☆ Opportunity Cost Principle:

Opportunity cost of any commodity is the amount of other commodity which has been given up in order to produce that commodity.

It refers to the expected returns from the next best alternative use of resources that are foregone due to the scarcity of resources.

Opportunity cost is also called transfer cost, additional cost, substitute cost, optional cost or economic cost.

Opportunity cost ~~which are recognized~~ includes both the explicit and implicit costs:

1. **Explicit cost:**
   The cost which are recognized in the accounts, e.g. the payment of labour, raw material, etc.

2. **Implicit cost:**
   The cost which are sacrifies that are not recored in accounting, e.g. cost of capital supplies by the owner of the business.

☆ Production Possibility Curve:

Production Possibility Curve showing different possible combination of two goods which can be produced within the available resources.

In other words, a production possibility graph is a model that shows alternative ways that an economy can use its scare resources.

- 4 Key Assumption:

1. Only two goods can be produced
2. Full employment of resources
3. Fixed Resources
4. Fixed Technology

- Table:

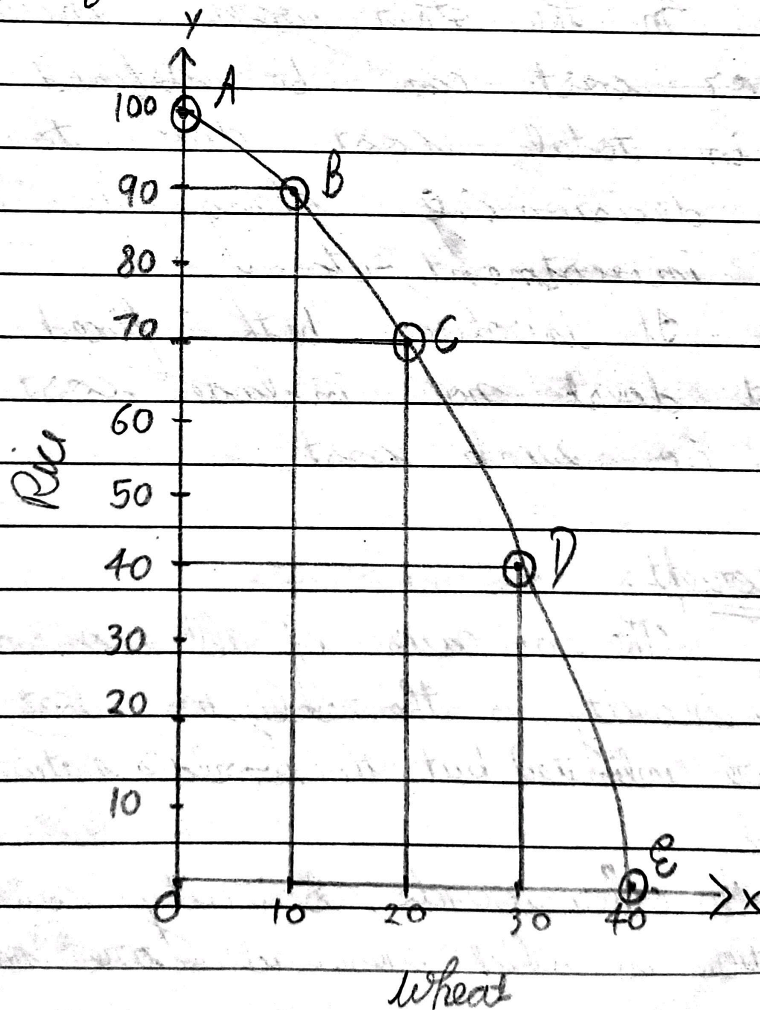
Production Possibility	~~Butter~~ Wheat	~~Jam~~ Rice
A	0	100
B	10	90
C	20	70
D	30	40
E	40	0

- **Explaination of Table :**

1) We are producing ~~Butter and Jam~~ ~~on a s~~ wheat and Rice on a same land. Firstly we grow 100 ~~takk~~ ~~tones~~ unit of rice on land and 0 wheat.

2) If we want to grow rice with wheat then we have to reduce the growth of rice. In rice there are fine combination which are showing us both growth of wheat and rice.

3) Quantity of wheat is shown on 'x' axis and quantity of rice is shown on 'Y' axis.



4) Points A, B, C, D and E show different possibilities of production with the given resources and techonology.

- Why PPC slopes downward?

When a curve is concave to origin, it means that it has an leasing slope. As we move along this went from left to right.

★ Incremental Concept:

Incremental concept applied to business decision's which involves a large change in total cost or total revenue.

In the other words, incremental concept or cost can be defined as a change in total cost due to a particular business decision e.g. change in level of output, investment, etc.

It involves both fixed & variable cost but doest not include cost already incurred i.e. sunk cost.

★ Scarcity concept:

The root cause of all economic problems is 'Scarcity'. Scarcity is the realization that our wants & desires are unlimited but the world's natural resources are limited.

In other words, Scarcity can be defined as a condition in which resources are not available to

satisfy all the needs and wants of a specified group of people.

Basic Problem of economy

Scare resources — Unlimited wants

Alternative uses

☆ Role of Managerial Economics in Decision Making :

1. **Production Decisions :** Supply of goods and services for the sale in a market to satisfy consumer wants is done through the production which is an economic activity and this is made possible to get maximum profit. It is necessary that the business executive has to make the rational allocation of avaliable resources.

2. **Inventory Decisions :** The amt. of goods, raw-material or other resources that are idle at any given point of time which is held by any firm is referred to as inventory. The decision about how much inventory is required for meeting the demand is very important. In certain situation, production planning is affected by the level of inventories and hence it is a strategic management variable.

3. **Cost Disions :** The ability of any firm to produce goods at the lowest cost is influenced by the competitive ability of the firm. In business decisions cost structures, reduction of cost and cost control plays an important role. If cost control is not used, then profits would come down because of increasing cost. For business decision making, it is necessary to know the cost information about resources.

4. Marketing Decisions: For marketing planning, a marketing executive must take decisions about the target market, market positioning, product development, pricing channels of distribution, physical distribution, communication and promotion. In marketing, a businessman has to take mainly two different but interrelated decisions namely sales decision and purchase decision.

5. Investment Decisions: For any investment decision, the problems of risks and wrong estimation are very common. In real business situation, there is seldom an investment, the source of financing this investment, allocation of this investment among different projects over time. These decisions are of immense significance for ensuring the growth of an enterprise on sound lines. Hence, decisions on investment are to be taken with utmost caution & care by the executive.

6. Personnel Decisions: The services of a large number of personnel are required in an organization. These personnel are appoined at various posts. For achieving organisational objectives, every position of the organisation should have specific duties. Manpower planning, recruitment, selection, training and development, performance appraisal, promotion, transfer, etc. are covered by the personnel decisions.