MANAGERIAL ECONOMIC'S

Master of Commerce (M-Com)

Semester – I
Unit-I
Lecture-1

Topic – Concept of Managerial Economic's

Synopsis:-
(1)Introduction
(2)Meaning
(3)Definition
(4) Application
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MEANING, NATURE & DEFINITION OF MANAGERIAL ECONOMICS

The application of economics science in business decision-making is all pervasive. More specifically, economic laws and tools of economic analyses are now applied a great deal in the process of business decision making. This has led, as mentioned earlier to the emergence of a separate branch of study called Managerial Economics. The application of economic concepts and theory in combination with quantitative methods is illustrated in figure given below-

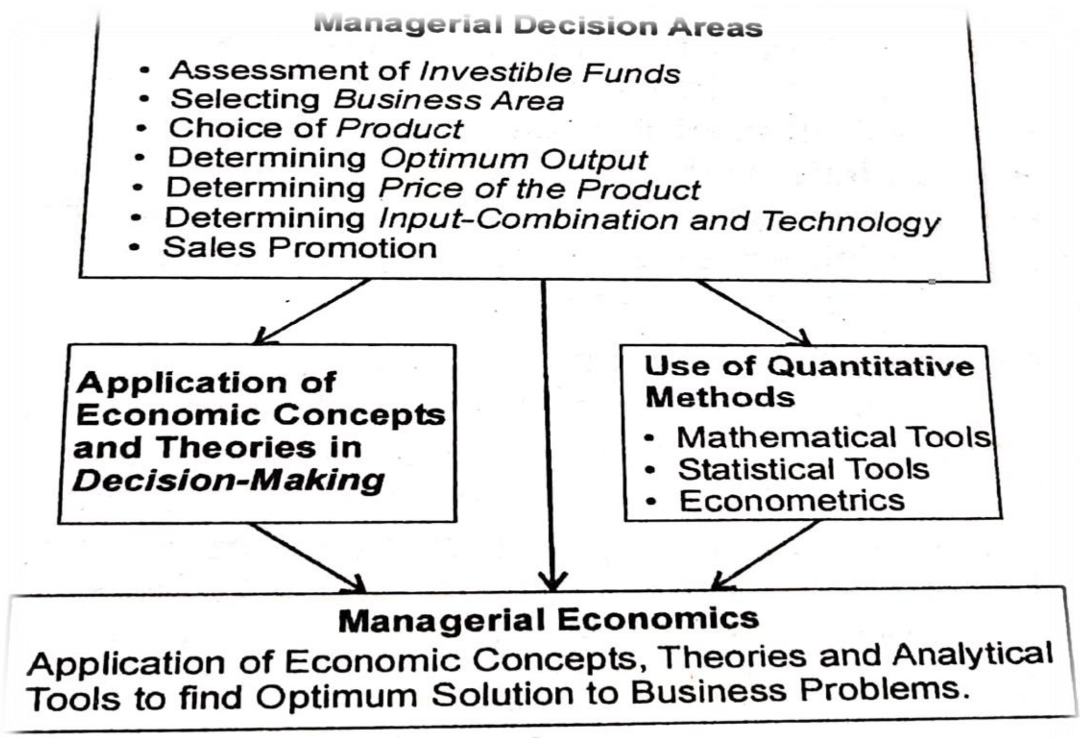

Fig. 1.1 *Application of Economics to Managerial Decision-Making*

Managerial Economics can be broadly defined as the study of economic theory, logic and tools of economic analysis that are used in the process of business decision-making. Economic theories and techniques of economic analysis are applied to analyze business problems, evaluate business options and opportunities with a view to arrive at an appropriate business decision. Managerial Economics is thus constituted of that part of economic knowledge, logic, theories and analytical tools that are used for rational business decision making.

Let us look at some definitions of Managerial Economics offered by a few eminent economists

'Managerial economics is concerned with the application of economic concepts and economics to the problems of formulating decision making'- E. Mansfield

'Managerial economics is the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning by management'- M.H Spencer & Sigelman

'Managerial Economics applies the principles and methods of economics to analyze problems faced by management of a business, or other type of organizations and to help find solutions that advance the best interest of such organizations' – Davis Ronnie & Semoon Chang

These definitions of Managerial Economics together reveal the nature of the discipline even though they do not provide its perfect definition

THE SCOPE OF MANAGERIAL ECONOMICS

Economics has 2 major branches-

1. Microeconomics
2. Macroecomics

Both micro and macro economics are applied to business analysis and decision making- directly or indirectly. Managerial Economics comprises, therefore, both micro and macro economic theories. The part of micro economics and macro economics that constitute managerial economics depend on the purpose of analysis.

In general, the scope of managerial economics comprises all those economics concepts, theories and tools of analysis which can be used to analyze issues related to demand prospects, production and costs, market structure, level of competition and general business environment and to find solutions to practical business problems. In other words, managerial economics is economics applied to the analysis of the business problems and decision making. Broadly speaking, it is applied economics.

The areas of business issues to which economic theories can be directly applied maybe broadly divided into 2 categories

a- Micro economics applied to operational and internal issues
b- Macro-economic applied to environmental and external issues

A-Micro economics applied to operational and internal issues:

Operational issues are of internal nature. Internal issues include that entire problem which arise within the business organization and fall within the purview and control of the management. Some of the basic internal issues are-

1- Choice of business and the nature of product i.e., what you produce
2- Choice of size of the firm i.e., how much to produce
3- Choice of technology i.e., choosing the factor combination
4- Choice of price i.e., how to price the commodity
5- How to promote sales
6- How to face price competition
7- How to decide on new investments
8- How to manage profit and capital
9- How to manage an inventory i.e., stock of both finished goods and raw material

These problems may also figure in forward planning. Macroeconomics deals with such questions confronted by managers of business enterprises. The following microeconomic theories deal with most of these questions

THEORY OF DEMAND:

Demand theory deals with consumers behavior. It answers such questions as how do the consumers decide whether or not to buy a commodity? How do they decide on the quantity of a commodity to be purchased? When do they stop consuming a commodity? How do the consumers behave when price of the commodity, their income and tastes and fashions etc, change? At what level of demand, does changing price become inconsequential in terms of total revenue? The knowledge of demand theory can, therefore, be helping in making the choice of commodity, finding the optimum level of production and determining the price of the product.

THEORY OF PRODUCTIONS & PRODUCTION DECISIONS:

Production Theory explains the relationship between input and output. It also explains under what conditions, costs increase or decrease, how total output behaves when units of one factor(input) are increased keeping other factors constant, or where all factors are simultaneously increased, how can output be maximized from a given quantity of resources, and how can the optimum size of output could be determined. Production Theory, thus helps in determining the size of the firm, size of the total output and the amount of capital and labor to be employed, given the objective of the firm.

ANALYSIS OF MARKET- STRUCTURE & PRICING THEORY:

Price Theory explains how price is determined under different kinds of market conditions, when price discrimination is desirable, feasible and profitable, and to what extent advertising can be helpful in expanding sales in a competitive market. Thus, price theory can be helpful in determining the price policy of a firm. Price and Production theories together, in fact, help in determining the optimum size of the firm.

PROFIT ANALYSIS & PROFIT MANAGEMENT:

Profit Management is the most common objectives of all business undertakings. But, making a satisfactory profit is not always guaranteed because a firm has to carry out its activities under conditions of uncertainty with regard to-

1- Demand for the product
2- Input prices in the factor market
3- Nature and degree of competition in the product market
4- Price behavior under changing conditions in the product market etc.

Therefore, an element of risk is always there even if the most efficient techniques are used for predicting the future and if business activities are meticulously planned. The firms are, therefore supposed to safeguard their interests and avert or minimize the possibilities of risk. Profit Theory guides firms in the measurement and management of profit, in making allowances for the risk premium, in calculating the pure return on capital and pure profit and also for future profit planning

1- Theory of Capital & Investment decisions: Capital like all other inputs, is a scarce and expensive factor. Capital is the foundation of business. Its efficient allocation is one of the most important task of the managers and determinant of the success of the firms. The major issues related to capital are-

a- Choice of Investment project
b- Assessing the efficiency of capital
c- Most efficient allocation of capital

Knowledge of Capital Theory can contribute a great deal in investment decision-making, choice of projects, capital budgeting etc.

B- Macro-economic applied to business environment:

Environmental issues pertain to the general business environment in which a business operates. They are related to the overall economic social political atmosphere of the country. The factors which constitute the economic environment of the country include the following-

a- The types of economic systems in the country.
b- General trends in national income, employment, prices, savings and investments etc.
c- Structure of and trends in the working of financial institutions i.e., banks, financial corporations, insurance companies etc.
d- Magnitude of and trends in foreign trade.
e- Trend in labor supply and strength of the capital market

f- Government's economic policies i.e., industrial policy, monetary, fiscal, price and foreign trade
g- Social factors like value system of the society, property rights, customs and habits.
h- Socio-economic organizations like trade-unions, consumer's associations, consumer's co-operatives and producer's unions.
i- Political environment which is constituted of such factors as political systems- democratic, authoritarian, socialists or otherwise. State's attitude towards private business, size and working of the public sector and political stability
j- The degree of globalization of the economy and the influence of **MNC'S** on the domestic market.

CONCLUSION:

Briefly speaking, macro-economic theories including those of demand, production, price determination, profit and capital busting. Macro-economics theories including of national income, those economic growth and fluctuations, international trade and monetary mechanisms, and the study of state policies and their repercussions on the private business activity by and large, constitute the scope of managerial economics. This should, however, not mean that only these economic theories from the subject matter of managerial economics matter. Nor does the knowledge of these theories fulfill wholly the requirement of economic logic in decision making. An overall study of economics and a wider understanding of economic behavior of the society, individuals, firms and state would always be desirable and more helpful