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& Business Strategy

# Chapter 1
# The Fundamentals of Managerial Economics

*McGraw-Hill/Irwin*
*Michael R. Baye, Managerial Economics and Business Strategy*

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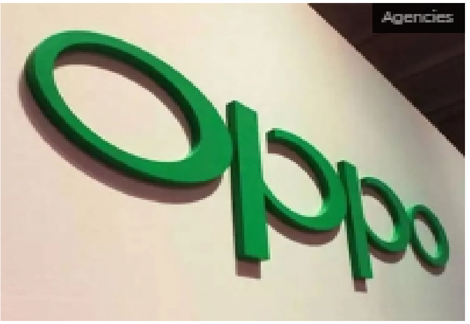
# The “Oppo” story

THE ECONOMIC TIMES | Industry

English Edition | 06 August, 2022, 07:17 PM IST | Today's Paper

## Oppo FY20 net loss widened over 2 times to Rs 2,203 crore, largest since it entered India

**Synopsis**
The China-based brand which holds number 5th rank in India's smartphone market shipped 16.5 million units during calendar year 2020 and captured 11% of the overall market, but on-year growth remained flat, according to research firm IDC India.



The company's revenues increased 78% from Rs 21,724 during FY19 to Rs 38,757 crore in FY20, according to financial data accessed by business intelligence platform Tofler.

Oppo Mobiles' net loss has widened by more than two times to Rs 2,203 crore during FY19-20 which turns out to be the largest loss making year for the smartphone brand since it started operations in 2015.

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| Unit No. | Topics to be Covered | Lecture Hours | Learning Outcome |
|---|---|---|---|
| 1 | Introduction to Economics- Scarcity and allocation of resources, Distinction between Microeconomics and Macroeconomics, Firm- meaning and objectives; Marginal Analysis and Time Value of Money. | 10 | • *Understanding the basic concepts of managerial economics.*<br>• *Understanding the basic concepts of the two main branches of economics—microeconomics and macroeconomics.* |
| 2 | Utility Analysis- consumer's budget constraint, utility maximization; Demand and supply analysis, Government intervention (floor price, ceiling price, tax, etc), Consumer and producer surplus, Price, income and cross elasticity. | 10 | • *Understanding different concepts related to consumer behavior.*<br>• *Understanding the consumer behavior to maximize utility with different constraints.*<br>• *Define the concept and measures of elasticity.* |
| 3 | Production and Cost analysis-Production functions, production and cost in the short run and long run, Economies of scale and scope, Market Analysis-types of market, profit maximization under perfect competition, monopoly, monopolistic competition, and oligopoly | 10 | • *Understanding cost function and the difference between short-run and long-run cost function.*<br>• *Isoquant and Isocost and finding out optimal combinations of inputs.*<br>• *Compare and contrast four basic market types.*<br>• *Meaning and profit maximization conditions under the four market structures.* |
| 4 | Price Discrimination, Pricing Strategies- cost-plus pricing, peak load pricing, product bundling, two-part tariffs, Public Goods and Externalities, Asymmetric Information, Economics of Uncertainty and Risk | 10 | • *Price-output decisions of perfectly competitive, monopoly, monopolistic and oligopoly firms, both in short and long-run.*<br>• *Understanding of different pricing strategies.* |

# References:


1. Managerial Economics and Business Strategy, 8th Edition, Michael R Bay & Jeff Prince, McGraw Hill Education (2017).
2. Intermediate Microeconomics, Hal R. Varian
2. Microeconomics: Theory and Applications with Calculus, 3rd Edition. Jeffrey M. Perloff, Pearson Education (2017).

# Exam structure

| Exam | Marks |
|---|---|
| Mid term | 30 |
| Quiz Assignment | 10 |
| Final | 60 |

# Managerial Economics

- Manager
  - A person who directs resources to achieve a stated goal.
  - Two main characteristics: 1) Decision maker
    2) Takes responsibility
- Economics
  - The science of making decisions in the presence of **scarce resources to achieve certain goals.**
  - Greek word: "Oikonomia" -→ Household management
- Managerial Economics
  - The study of how to direct scarce resources in the way that most efficiently achieves a managerial goal.

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# Examples of Managerial Goals

- Purchase of components from other manufacturers or produce them within your own firm?
- Specialize in making one type of computer or produce several different types?
- How many computers should you produce?
- What should be the price?
- What should be the wage of employees?
- How will the actions of rival computer firms affect your decisions?

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# Economics : the allocation of scarce means that have alternative ends

- *"the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses" (Robbins, 1935, p. 16).*
- *according to Samuelson, "Economics is the study of how people and society choose, with or without the use of money, to employ scarce productive resources which could have alternative uses, to produce various commodities over time and distribute them for consumption now and in the future among various persons and groups of society."*
- *"Economics is the study of scarcity and its implications for the use of resources, production of goods and services, growth of production and welfare over time, and a great variety of other complex issues of vital concern to society."*

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# Two branches of Economics


## Microeconomics

- Economics is Personal
- Implications of individual human action
- Most satisfactory allocation of one's resources
- Daily and life-long decisions

## Macroeconomics

- Economics is Universal
- How the economy behaves as a whole
- Unemployment
- Wealth of nations
- Money circulating in the economy
- A strong impact on leadership skills, decision-making and the ability to plan for a flourishing social future

# Decisions based on:

An effective manager must

(1) identify goals and constraints;

(2) recognize the nature and importance of profits;

(3) understand incentives;

(4) understand markets;

(5) recognize the time value of money;

(6) use marginal analysis

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Identify Goals and Constraints

- Different units within a firm may be given different goals;
- Sales, market share, risk-reduction strategies
- What are the constraints?
- Constraints : available technology and the prices of inputs used in production.

# Importance of profits

- Goal of most firms is to maximize profits or the firm's value

# Opportunity Cost



- Accounting Costs
  - The explicit costs of the resources needed to produce produce goods or services.
  - Reported on the firm’ s income statement.
- Opportunity Cost
  - The cost of the explicit *and* implicit resources that are foregone when a decision is made.
- Economic Profits
  - Total revenue minus total opportunity cost.
- OC > AC
- accounting profits overstate your economic profits, because the costs include only accounting costs
- Think of time invested

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# Economic vs. Accounting Profits

- Accounting Profits
  - Total revenue (sales) minus dollar cost of producing goods or services.
  - Reported on the firm's income statement.
- Economic Profits
  - Total revenue minus total opportunity cost.

# Profits as a Signal

- Profits signal to resource holders where resources are most highly valued by society.
  - Resources will flow into industries that are most highly valued by society.
  - Adam Smith’s classic line from The Wealth of Nations: “It is not out of the benevo□lence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.”
  - You can earn profits, but sustaining profits is another thing
  - Please read mailed notes