VASIREDDY VENKATADRI INSTITUTE OF TECHNOLOGY

MEFA
(Managerial Economics & Financial Analysis)

Managerial Economics & Financial Analysis

Syllabus

Unit-1: Introduction to managerial economics and Demand analysis

Unit-2: production and Cost analysis

Unit-3: Introduction to markets and Pricing Policies

Unit-4: Types of business organization and business cycles

Unit-5: Introduction to accounting and financial analysis

Unit-6: Capital and Capital Budgeting

Course Objectives

1. To understand the concept and nature of Managerial Economics and its relationship with other disciplines, Concept of Demand and Demand forecasting.
2. To familiarize about the Production function, Input Output relationship, and Concept of Cost-Volume-Profit Analysis.
3. To understand the nature of markets, methods of pricing in the different market structures.
4. To know the different forms of Business organization and the concept of Business Cycles.
5. To learn different Accounting Systems, preparation of Financial Statements and uses of different tools for performance evaluation.
6. To understand the concept of Capital, Capital Budgeting and the techniques used to evaluate Capital Budgeting proposals by using different methods.

Why Engineering graduates study (MEFA)?

- Imagine for a while that you finished your studies and have joined as an engineer in a manufacturing organization.

  What do you do there?

- You plan to produce maximum quantity of goods of a given quality at a reasonable cost.

  If you are a sales manager.

- You have to sell a maximum amount of goods with minimum advertisement costs. In other words, you want to minimize your costs and maximize your returns.
- By doing so, you are practicing the principles of managerial economics.

Why Engineering graduates study (MEFA)?

Managers, in their day-to-day activities, are always confronted with several issues such as;

- how much quantity is to be supplied?
- At what price?
- Should the product be made internally
- Whether it should be bought from outside.
- How much quantity is to be produced to make a given amount of profit and so on.

So managerial economics provides us a basic insight into seeking solutions for managerial problems.

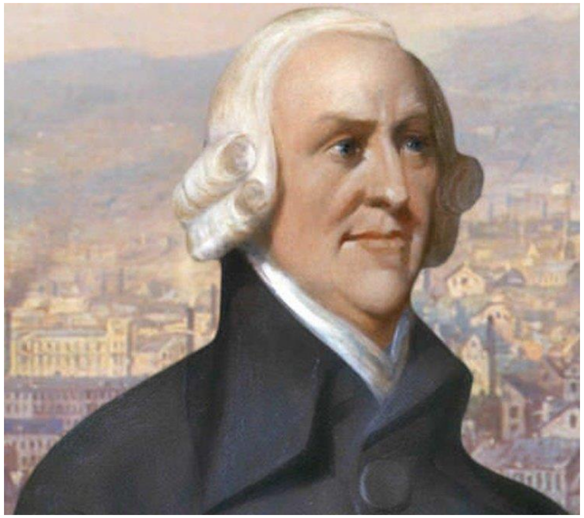
Managerial economics as the name itself two distinct disciplines: Economics and Management.

What is Economics?

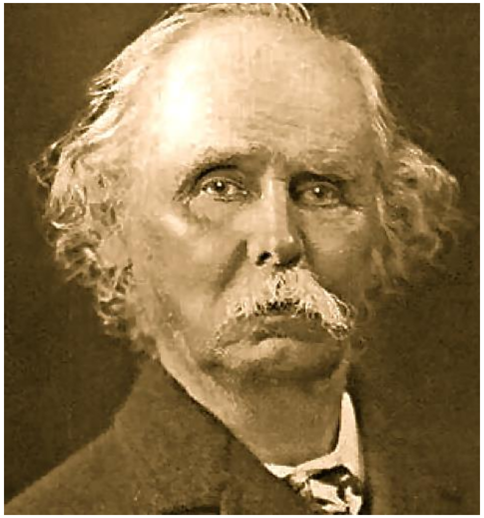
<u>Economics:</u> - it is a study of human activity both at individual and national level. its basic function is to study how people – individuals, households, firms, and nations –maximize their gains from their limited resources and opportunities.

Definitions:-[wealth, welfare, scarcity]

- **Adam Smith** The father of economics, defined economics as "the study of nature and uses of national wealth".



- **Dr. Alfred Marshall**, one of the greatest economists of the 19th century, writes "Economics is a study of man's actions in the ordinary business of life; it enquires how a man gets his income and how he uses it". Thus, it is one side, a study of wealth; and on the other hand, it is the study of man. As Marshall observed, the chief aim of economics is to promote 'human welfare' but not wealth.



- **Prof. Lionel Robbins** defined economics as "the study of human behaviour as a relationship between endless wants and scarce means which have alternative uses". With this the focus of economics shifted from 'wealth' to 'human behaviour'.

What is Economics

- **Pigou** defines economics as "the study of economic welfare".

Economics consists of two branches:

- 1. Micro Economics
- 2. Macro economics
- Professor Ragnar Frisch of Oslo University (Norway) was the first person to these two concepts in the year 1933.

Micro Economics:

The term 'micro economics' is derived from the Greek word 'micros' means small.

Micro Economics deals with the analysis of a particular economic unit and considers in detail the behaviour of that particular unit.

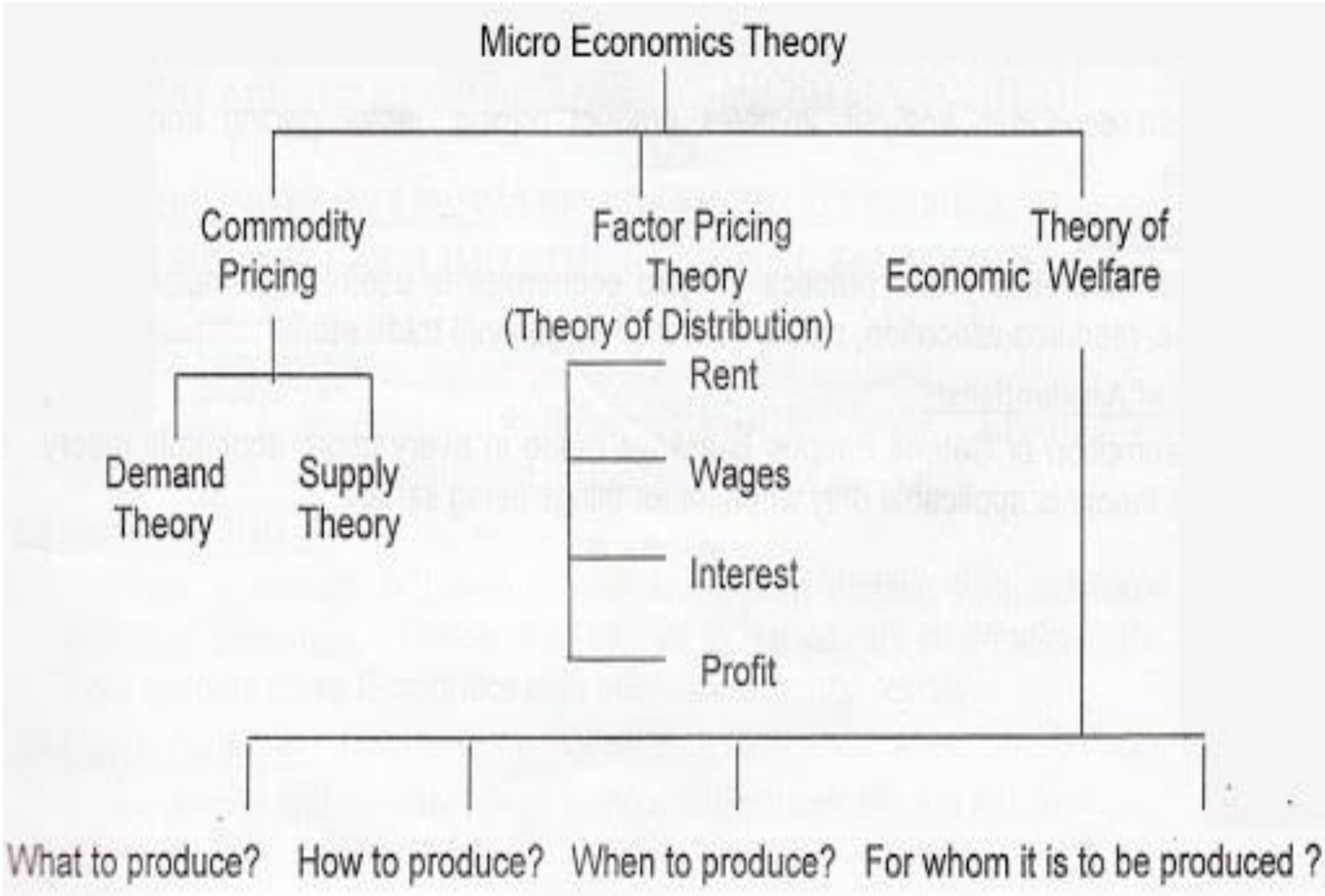
In other words micro economics is the microscopic study of the economy. Here we study the behaviour of individual units such as households, firms and industries.

Micro economics is the study of economics action of individuals or groups of individuals.

"Micro economics is the study of economic actions of a particular firms, particular households, particular commodities, individual prices, individual wages, individual incomes and individual industries.

-------K.E Boulding.

SCOPE OF MICRO ECONOMICS

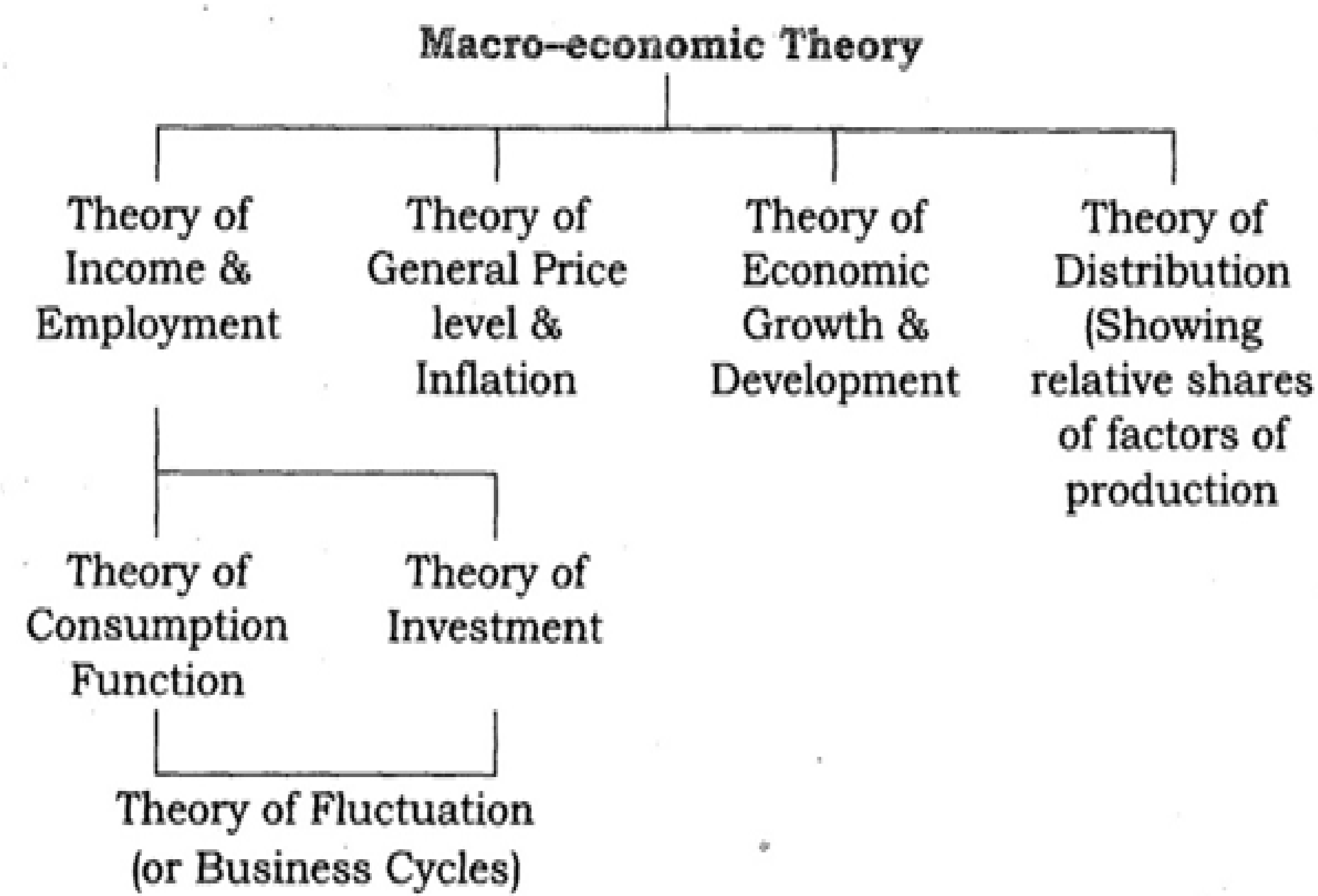


Macro economics:

- Macro economics is derived from the Greek word 'macros' which means large.
- Macro economics is the study of economic systems as a whole.
- It is not concerned with the individual units but all such units combined together. thus macro economics is a study of aggregates like national income, total employment, total savings, total consumptions, total investment.
- most of the modern economics is macro economics.
- "Macro economics studies national income, not individual income, general price level instead of individual prices and national output instead of individual output."

------- K.E. Boulding

Scope of Macro Economics



Difference between micro economics and macro economics

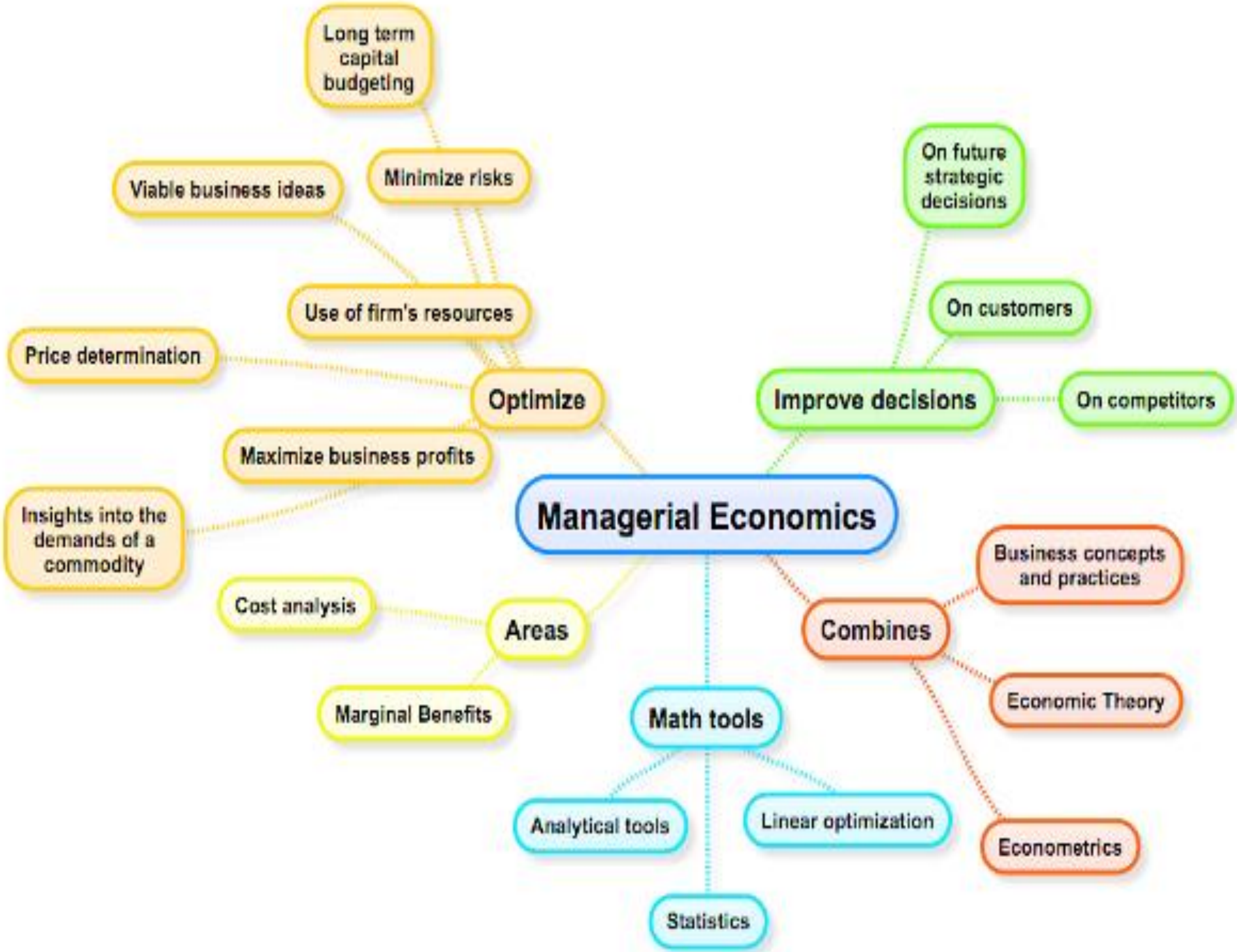
Micro economics	Macro Economics
1.Micro economics is the study of Individual units of the economy i.e., individualistic	1. Macro economics is the study of economy as a whole i.e., aggregative
2. **It is called as 'price theory'** as it explains the allocation of resources on the basis of relative prices of various goods and services.	2. **It is called as income and employment theory** as it explains the changing levels of national income during any particular time period.
3. Micro economics explains price determination in both commodity and factor markets.	3. Macro Economics deals with national income, total investment, total employment, total consumption, aggregate savings, general price level and economic growth.
4. The basic of micro economics is price mechanism which depends on demand and supply.	4. The basis for macro economics is aggregate demand and aggregate supply.

What is Management?

1. Management is the art and science of getting things done through people informally organized groups.
2. It is necessary that every organization be well managed to enable it to achieve desired goals.
3. Management includes number of functions: planning, organizing, staffing, directing, and controlling.
4. The manager while directing the efforts of his staff communicated to them the goals, objectives, policies, and procedures; coordinates their efforts; motivates them to sustain their enthusiasm; and leads them to achieve the corporate goals.

Managerial Economics

- Managerial economics as a subject gained popularity in USA after the publication of the book "Managerial Economics" by Joel Dean in 1951.
- Managerial economics is the "application of the economic concepts and economic analysis to the problems of formulating rational managerial decisions".
- It assists the managers to make rational decisions of a firm.
- Managerial economics generally refers to the integration of economic theory with business practice.


Managerial Economics
Optimize
Long term capital budgeting
Minimize risks
Viable business ideas
Use of firm's resources
Price determination
Maximize business profits
Insights into the demands of a commodity
Improve decisions
On future strategic decisions
On customers
On competitors
Areas
Cost analysis
Marginal Benefits
Math tools
Analytical tools
Linear optimization
Statistics
Combines
Business concepts and practices
Economic Theory
Econometrics

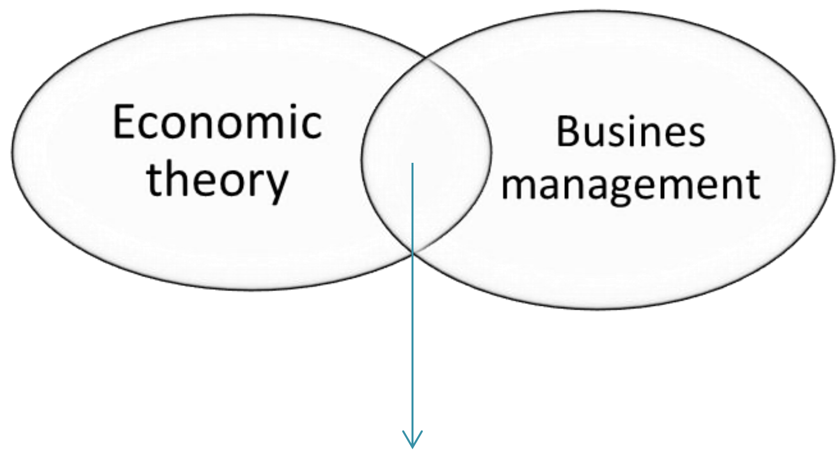
Managerial Economics

- Economics provides tools; Managerial economics applies these tools to the management of business.
- In simple words, Managerial economics means the application of economic theory to the problem of management.
- Managerial economics may be viewed as economics applied to problem solving as the level of the firm.
- According to M.H. Spencer and Louis Siegelman: ”Managerial economics is the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning by management.”

Managerial Economics

- According to M. C. Nair and Meriam: ”managerial economics is the use of economic modes of thought to analyse business situations”.
- According to Joel Dean: ”The purpose of managerial economics is to how economic analysis can be used in formulating policies”.
- According to Mansfield: ”Managerial economics is concerned with application of economic concepts and economic analysis to the problems of formulating rational managerial decisions”.
- Managerial economics is often called as business economics or economics for firms.
- Thus managerial economics is an attempt to use economics and economic logic in formulating business policies.
- It is that body economic knowledge, which is used in analysing business problems for taking appropriate business decisions, and formulating forward plans.

Managerial Economics



Managerial economics

Managerial Economics

Finally we can observe that Managerial economics

- Refers to application of principles of economics to solve the managerial problems such as minimising costs or maximising productions and productivity.
- Directs the utilisation of scarce resources in a goal-oriented manner.
- Seeks to understand and to analyse the problems of business decision-makings.
- Examine how an organisation can achieve its aims and objectives mast efficiently.

NATURE OF MANAGERIAL ECONOMICS OR CHARACTERISTICS

a) Close to micro economics: Managerial economics is concerned with finding the solutions for different managerial problems of a particular firm. Thus it is more close to micro economics.

b) Realistic: Managerial economics is realistic subject. It avoids difficult abstract issues of economic theories; it takes in to consideration the important elements which are useful in decision making.

c) It is normative in nature rather than positive: Positive economics describes what is i.e., observed economic phenomenon. Normative economics prescribes what ought to be i.e., It distinguishes the ideal from the actual. Managerial economics is prescriptive, rather than descriptive.

d) Conceptual in nature: Managerial economics is based on a sound frame work of economic concepts. Its subject –manner is not an arbitrary collection of prescriptions. Its aims to analyse business problems on the basis of established concepts.

NATURE OF MANAGERIAL ECONOMICS OR CHARACTERISTICS

e) Problem solving nature: Besides analysing the managerial problems of business units managerial economics aims at finding out optimal solutions to the business problems of firms.

f) Inter disciplinary: the contents, tools and techniques of managerial economics are drawn from different subjects such as economics, management, mathematics, statistics, accountancy, psychology, organisational behaviour, sociology etc...

g) Assumptions and limitations: Every concept and theory of managerial economics is based on certain assumptions and as such their validity is not universal. Where there is change in assumptions the theory may not hold good at all.

NATURE OF MANAGERIAL ECONOMICS OR CHARACTERISTICS

h) It deals with the application of economics: It deals with economic theory and its application to business management. Manager needs to understand pertinent aspects of economic theory like demand, supply, production, pricing, markets etc... Some of the important aspects of economic theory which can be applied to business management are as follows.

1. *Demand analysis:* law of demand, elasticity of demand, factors affecting demand.
2. *Production analysis:* Law of variable proportions, law of returns to scale, economic and diseconomies of scales.
3. *Market analysis:* Nature of product market like perfect competitions, monopoly, oligopoly, monopolistic competitions. Product pricing and output decisions in different forms of market.

NATURE OF MANAGERIAL ECONOMICS OR CHARACTERISTICS

I) It is the study of allocation of resources: the theory of economics also deals with The problems of resources allocation like what to produce, how to produce and for whom to produce.

i) theory of economics being an essential part of managerial economics makes it clear that the allocations of resources is important to the application of the principles of managerial economics.

ii) Allocation of resources is a wide concept which includes

1. *Input allocations:* raw materials, labours hours, machines hours etc.
2. *Output allocations:* It includes meeting customers demand in different segments of market t different locations.
3. *Allocation of funds:* it includes efficiency of use of cash and other resources.

Scope of Managerial Economics (Area of study)

- The main focus in managerial economics is to find an optimal solution to a given managerial problem.
- The problem may relate to production, reduction, or control of costs, determination of price of a given product or services make or buy decisions, inventory decisions, capital management or profit planning and management, Investment decisions or human resources management.
- While all these are the problems ,the managerial economists makes use of the concepts ,tools and techniques of economics and other related disciplines to find an optimal solution to a given managerial problem.

Scope of Managerial Economics

Concepts and techniques of managerial economics

Applied to →

Managerial decision area:

--Production

--reduction or control of costs

--Determination of price of a given product / services

--Make or buy decisions

--Inventory decisions

--capital management

--profit planning and management

--investment decisions

For →

Optimum solutions

Linkage with other Disciplines:

1. Managerial economics and statistics:

- Statistical tools are a great aid in business decision making.
- The techniques are used in collecting, processing and analysing data, testing the validity of the laws with the real economic phenomenon before they are applied to business analysis.
- Statistical tools examples: Theory probability and forecasting techniques, averages, measures of dispersion, correlation, regression, time series analysis.

2. Mathematics:

- The major problem of a business man is how to minimize cost or how to maximize profits or how to optimize sales.
- Mathematical concepts and techniques are widely used in economics logic with a view finding out answers to these questions.
- Mathematical techniques are: Knowledge of geometry, Trigonometry, Algebra, Logarithms and exponentials, vectors, matrix, calculus, differential, as well as integral are required for managerial economics.

Linkage with other disciplines:

3. Accounting:

- The accountant provides accounting information relating costs, revenues, receivables, payables, profit/losses etc. and this forms the basis for the managerial economist acts upon.
- The main objective of accounting function is record, classify and interpret the given accounting data so the managerial economist depends upon accounting data for decision making and forward planning.

4. Operations research:

- Decisions making is the main focus in operations research and managerial economics.
- so managerial economics has generalized and developed the models and tools of operation research for the purpose of business decision making.
- Example: Linear programming model, Inventory model, game theory, etc. are few tools in operations research.
- Operation research provides a scientific model of the system and it helps managerial economics in the field of product development, material management, and inventory control, quality control, marketing and demand analysis.
- The various tools of operations research are helpful to managerial economists in decision making.

Linkage with other disciplines:

5. Economics:

- managerial economics has been described as economics applied to decisions making .
- It may be studied as a special branch of economics, bridging the gap between pure economic theory and managerial practice.
- Economics two main branches:
- ------Micro economics
- ------Macro economics

6. Psychology:

- Consumer psychology is the basis on which managerial economists' acts upon.
- How the customer reacts to a given change in price or supply and its consequential effect on demand/profits is the main focus of study in managerial economics.
- so psychology contributes towards understanding the behaviour implications, attitudes and motivations of each of the micro economic variables such as consumer, supplier/seller, investor, workers or an employee.


Question?


THANK
YOU