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BLOCK - I

BASICS OF MANAGERIAL DEVELOPMENT

UNIT 1 BASICS OF MANAGERIAL ECONOMICS

Structure

1.0 INTRODUCTION

Managerial Economics has emerged as a separate branch of economics. The emergence of managerial economics can be attributed to at least three factors: (i) growing complexity of the business environment and decision-making process; (ii) increasing application of economic logic, concepts, theories and tools of economic analysis in the process of business decision-making; and (iii) rapid increase in demand for professionally trained managerial manpower with good knowledge of economics. The growing complexity of the business world can be attributed to rapid growth of large scale industries, increasing number of business firms, quick innovation and introduction of new products, globalization and growth of multinational corporations, merger and acquisition of business firms, and large-scale diversification of business activities. These factors have contributed a great deal to the inter-firm, inter-industry and inter-country business rivalry and competition, enhancing uncertainty and risk in the business world.

Business decision-making in this kind of complex business environment has become a very complex affair. There was a time when family training, personal experience and business acumen were sufficient to make good business decisions

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and run an organization successfully. In today's business world, however, personal experience, knowledge and family training are no longer sufficient to meet the managerial challenges of the modern business world, though one can find a number of reputed businessmen with no management training.

Before we proceed to discuss the nature and scope of managerial economics, let us first know "what economics is about".

1.1 OBJECTIVES

After going through this unit, you will be able to:

- Prepare an introduction to economics
- Discuss the meaning, nature and scope of economics
- Explain the general foundations of managerial economics
- Analyse the relationship between economics and business decisions

1.2 ECONOMICS: INTRODUCTION

Economists of different generations have defined economics in different ways according to their perception and subject matter of economics. For example, according to Adam Smith (1976), the "father of economics", economics is "an inquiry into the nature and causes of the wealth of nations". According to Alfred Marshall, (1922), an eminent economist of the neo-classical era, "Economics is the study of mankind in the ordinary business of life; it examines that part of individual and social actions which is most closely connected with the attainment and with the use of the material requisites of well-being."

Economics can, thus be defined as a social science that studies economic behaviour of the people, the individuals, households, firms, and the government. *Economic behaviour* is essentially *economizing behaviour*. Economizing behaviour is the effort of the people to derive maximum gain from the use of their limited resources—land, labour, capital, time and knowledge, etc., which have alternative uses. Technically, the term 'economizing' means deriving maximum gains from a given cost and alternatively minimizing cost for a given gain. This is economizing behaviour—a natural behaviour.

Why do People Economize? People tend to adopt economizing behaviour because of the following facts of economic life of human beings.

1. ***Human wants, desires and aspirations are endless.*** Human wants are endless is the sense that they go on increasing with the availability of new kinds of goods and services and increase in ability to pay.
2. ***Resources available to the people are scarce.*** Resources (labour, land, capital, time and knowledge, etc.) available to the people at any point on time are scarce and limited; though they have alternative uses.

3. ***People are by nature economizers.*** Attempt to economize is a natural behaviour of the people. For example, if metro service is easily available, one would not like to hire a taxi, and if a pizza is available at ₹50 in college canteen and for ₹100 in a nearby restaurant, students would prefer to eat pizza in the canteen. This is economizing behaviour.

In order to maximize their gains, people allocate their resources between their competing wants in such a way that their total gain is maximized. Thus, *economics as a social science studies how people allocate their limited resources to their alternative uses with the objective of deriving maximum possible gains from the use of their resources.* For analysing economic behaviour of the people, economists use certain specific concepts, logic, tools of analysis and maximization techniques. The ultimate result of this kind of analysis is the formulation of economic theories.

Microeconomics and Macroeconomics

Economics as a social science has two major branches—*microeconomics* and *macroeconomics. Microeconomics* is the study of the economizing behaviour of the individual economic entities—individuals, households, firms, industries and factory owners. For example, *microeconomics* studies how *individuals* and *households* with limited income decide 'what to consume' and 'how much to consume' so that their total utility is maximized. In other words, microeconomics studies how individual consumers make choice of goods and services they want to consume and how they allocate their limited income between the goods and services of their choice to maximize their total economic welfare.

Macroeconomics, on the other hand, studies the economic phenomena at the national aggregate level. Specifically, macroeconomics is the study of working and performance of the economy as a whole. It studies what factors and forces determine the level of national output or national income, rate of economic growth, employment, price level, and economic welfare. Besides, macroeconomics studies how government of a country formulates its macroeconomic policies—taxation and public expenditure policies (the fiscal policy), monetary policy, price policy, employment policy, foreign trade policy, etc., to resolve the problems of the country.

1.3 MEANING AND NATURE OF MANAGERIAL ECONOMICS

Managerial economics can be defined as *the study of economic theories, logic, concepts and tools of economic analysis applied in the process of business decision-making.* In general practice, economic theories and techniques of economic analysis are applied to diagnose the business problems and to evaluate alternative options and opportunities open to the firm for finding an optimum solution to the problems.

Managerial economics is an integration of economic science with decision making process of business management. The integration of economic science with management has become inevitable because application of economic theories and analytical tools make significant contribution to managerial decision-making.

As we know, the basic managerial functions are planning, organizing, staffing, leading and controlling business related factors. The ultimate objective of these managerial functions is to ensure maximum return from the utilization of firm's resources. To this end, managers have to take decisions at each stage their functions in view of business issues and implement decisions effectively to achieve the goals of the organization. As we will see later, almost all managerial decision issues involve economic analysis and analytical techniques. Therefore, economic theories and analytical tools are applied as a means to find solution to the business issue. This is how economics gets integrated to managerial functions and gives emergence of managerial economics. The integration of economic theories and concepts with quantitative methods creates *managerial economics.*

Some other definitions of managerial economics are given below:

According to **Spencer and Siegelman:**

"The integration of economic theory with business practice for the purpose of facilitating decision-making and forward planning by management".

According to **McGutgan and Moyer:**

"Managerial economics is the application of economic theory and methodology to decision-making problems faced by both public and private institutions".

In the words of **TJ. Webster**, "Managerial economics is the synthesis of microeconomic theory and quantitative methods to find optimal solutions to managerial decision-making problems."

In the words of **Hirschey and Pappas**, "Managerial economics applies economic theory and methods to business and administrative decision making"

According to **Mansfield**, "Managerial economics provides a link between economic theory and decision sciences in the analysis of managerial decision making."

Brigham and Poppas believe that managerial economics is "the application of economic theory and methodology to business administration practice."

Hague on the other hand, considers managerial economics as "a fundamental academic subject which seeks to understand and to analyse the problems of business decision-making."

It may be added at the end that economic science has a very wide perspective. All economic theories are neither applicable nor are applied to business decision-making. Most business management issues are of internal nature and a significant part of microeconomics deals with internal decision-making issues of the business firms—what to produce, how to produce, how much to produce, and what price to charge, etc. That is why most microeconomic theories and analytical tools are generally applied to managerial decision-making. Therefore, *managerial economics is* treated as *applied microeconomics.* Macroeconomics *deals with environmental issues*—how is the economic condition of the country; what is the likely trend; what are government's economic policies; how government policies might affect business environment of the country; what kind of business policy will be required, and so on.

1.3.1 Scope of Managerial Economics

The scope of managerial economics is comprised of economic concepts, theories and tools of analysis that can be applied in the process of business decision making to analyse business problems, to evaluate business options, to assess the business prospects, with the purpose of finding appropriate solution to business problems and formulating business policies for future. As noted above, *economic science* has two major branches, viz., *microeconomics* and *macroeconomics.* Both Microeconomics and Macroeconomics are applied to business analysis and business decision making depending on the nature of the issue to be examined. Managerial decision issues can be divided broadly under two broad categories: (*a*) *Internal managerial issues* and (*b*) *External environmental issues.*

Microeconomic Theories Applied to Internal Issues

Internal managerial issues refer to decision-making issues arising in the management of the firm. Internal managerial issues include problems that arise in operating the business organization. All such managerial issues fall within the purview and the control of the managers. Some of the basic internal management issues can be listed as follows.

- What to produce—choice of the business
- How much to produce—determining the size of the firm
- How to produce choice of efficient and affordable technology
- How to price the product—determining the price of the product
- How to promote sale of the product
- How to face price competition from the competing firms
- How to enlarge the scale of production—planning new investment
- How to manage profit and capital.

The microeconomic theories and tools of analysis that provide a logical basis and ways and means to find a reasonable solution to business problems constitute the microeconomic scope of managerial economics. The main microeconomic theories that fall within the scope of managerial economics are following: Theory of Consumer Demand, Theory of Production, Theory of Cost, Theory of Price Determination and Theory of Capital and Investment Decisions.

Macroeconomics Applied to Business Decision

Macroeconomics is the study of economic conditions of the economy as a whole whereas a firm is a small unit of the economy. As such, macroeconomic theories are not directly applicable to managerial decisions. However, business managers, while making business decisions, cannot assume the economic conditions of the country to remain the same for ever. As a matter of fact, economic conditions of the country keep changing. Changing economic conditions change the economic environment of the country, and thereby business environment and business prospect. And, as management experts Weihrich and Koontz point out, "... managers cannot perform their task well unless they have an understanding of, and are responsive to the many elements of the external environment—economic, technological, social, political, and ethical factors that affect their areas of operations." Therefore, while making business decisions, managers have to take into account the economic environment of the country. The factors which, in general, determine the economic environment of a country are (*i*) the general trend in national income (GDP), saving and investment, prices, employment, etc., (*ii*) the structure and role of the financial institutions, (*iii*) the level and trend in foreign trade, (*iv*) economic policies of the government, (*v*) socio-economic organizations like trade unions, consumer associations, and (*vi*) political environment.

It is far beyond the powers of a single firm, howsoever large it may be, to determine the course of economic, political and social conditions of the country. But the *environmental factors* have a far reaching bearing on the functioning and performance of the business firms. Therefore, it is essential for business decision-makers to take in view the present and future economic environment of the country. It is essential because business decisions taken ignoring the environmental factors may not only fail to produce the result but may also cause heavy losses.

Macroeconomic Factors

The major macroeconomic environmental factors that figure in business decisions, especially those related to forward planning and formulation of strategy, may be described under the following three categories: Trend in the Economy, International Economic Conditions and Government Policies.

1.4 GENERAL FOUNDATIONS OF MANAGERIAL ECONOMICS

Managerial economics is defined as science which deals with the application theory of economics in managerial practice. It is the study of allocation of resources available to an enterprise. In simple words, Managerial economics is economics applied in decision-making.

1.4.1 Economic Approach

What is a Positive and a Normative Science? A *positive science* studies the phenomena as they actually are or as they actually happen. It does not involve any *value judgement* on whether what happens is good or bad, desirable or undesirable. A *normative science,* on the other hand, involves *value judgement* on whether what happens is socially desirable or undesirable, and if undesirable, how it can be made desirable. As J.N. Keynes puts it, "…a *positive science* is a body of systematized knowledge concerning *what is* [and] a *normative* or regulatory *science* is a body of systematized knowledge relating to criteria of *what ought* to be and is concerned therefore with ideal as distinguished from actual." Friedman has defined 'positive science' more elaborately and clearly. In his own words, "The ultimate goal of a positive science is the development of a 'theory' or 'hypothesis' that yields valid and meaningful (i.e., not truistic) predictions about phenomena not yet observed." Judged against these definitions of positive and normative science, *economics* as a social science deals with both *positive* and *normative* economic questions: 'what is' and 'what ought to be'. Thus, **economics is both a positive and a normative science**. Let us look at positive and normative character of economic science in some detail.

Economics as a Positive Science

Economics as a positive science seeks to analyze systematically and explain economic phenomena as they actually happen; find common characteristics of economic events; brings out the 'cause and effect' relationship between the economic variables, if any; and generalizes this relationship in the form of a theoretical proposition. One of the main purposes of economic studies is 'to provide a system of generalization' in the form of economic theories that can be used to make predictions about the future course of related events. It means that economics has a positive character. Economics explains the economic behaviour of individual decision-makers under given conditions; their response to change in economic conditions; and it brings out the relationship between the change in economic conditions and economic decision of the people.

Economics as a Normative Science

Economics as a normative science is concerned with ideal economic situation, not with what actually happens. Its objective is to examine 'what actually happens' from moral and ethical points of view and to judge whether 'what happens' is socially desirable. It examines also whether economic phenomena like production, consumption, distribution, prices, etc. are socially desirable or undesirable. Desirability and undesirability of economic happenings are determined on the basis of socially determined *values.* Thus, *normative economics involves value judgement* and values are drawn from the moral and ethical values and political aspirations of the society. In simple words, normative side of economics deals with such normative questions as 'what ought to be?' and whether 'what happens' is good or bad from society's point of view? It not, then how to correct it.

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1.4.2 Working of Economic System and Circular Flow of Activities

If you look around, you find people busy in some kind of economic activity. Farmers, firms and factories are busy in producing goods and services; buyers and sellers in the shops are busy in buying goods; some persons are busy in ferrying the people from one place to another; some persons are busy in offices in finalizing their deals and recording the transactions; and so on. All these people are performing some kind of economic activity. Any activity that produces goods and services is productive activity and any activity that creates goods and services of value is called *economic activity.* The basic objective behind all economic activities is to make income, the source of livelihood.

An *important feature* of economic activities is that they are *interrelated* and *interdependent* in the sense that producers produce what consumers want to consume and consumers can consume only what producers produce and they produce only as much as consumers are willing to consume. Similarly, sellers can sell only what buyers are willing to buy and buyers can buy only what is offered for sale; and so on. This interrelatedness and interdependence of economic activities are carried out in a self-operated system. Given this brief description of people's interrelated and interdependent, we may now attempt to define *economy.*

An economy is a social organism in which people act, interact, cooperate and compete in the process of production and consumption to make their living. An economy is constituted of interrelated and interdependent economic activities of the *economic players.* Economic players include individuals, households, firms, farms, factories, financial institutions and government. These economic players participate in economic organism in different ways. Individuals and households use their resources (land, labour, capital and skill) either themselves to produce goods and services, or sell services of their resources to other producers (firms, farms, factories and the government) to make their living. Producers hire the resources to produce goods and services which they sell in market at a profit. Financial institutions, e.g., banks, financial corporations, mutual funds, insurance companies, collect savings from the households and make it available to the producers on interest. Obviously, people of a society are constantly busy in some kind of these economic activities—production of commodities, buying and selling, transporting men and materials, saving and investing, borrowing and lending, and so on.

Government is an important institution in the modern economy. The government performs both non-economic (administrative) and economic functions. It taxes people's income and hires factors of production and produces certain goods and services for the people. In addition, it intervenes with the economic activities of the people, as it controls, regulates and guides their economic activities with the purpose of achieving certain social and economic goals. The level of intervention and participation of the government in overall economic activities of the people determines the nature of economic system, i.e., whether an economy is a *capitalist* or *free enterprise economy, a socialist* or *command economy* or *a mixed economy.* The basic features of these kinds of economic systems are discussed below.

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How an Economy Works

Working of a modern economy is extremely complex. Millions of persons participate and contribute to its working in different ways and different capacities—as producers, traders, workers, financiers, and consumers. Thousands of goods and services are produced and consumed and millions of persons are engaged in production and distributions of a single commodity. All those who are involved in economic activities act and interact with different interests and motivations. The various forms and nature of cross-section interdependence and interrelatedness of their economic activities add to the complexity of the economic system. To present a complete picture of economic system showing the role of each individual participation in respect of each commodity is an extremely difficult task, rather impossible. However, we present below working of an economy in a simplified model.

A Simple Model of an Economy

A simple model of the economy consists of two sectors: (i) households, and (ii) business firms. The households and business firms are, in fact, the two main decision makers in an economy. The *functions* and the roles of these economic units in the model economy are described below.

The *households* play two major roles in the economic system: (i) households supply all the factors of production, viz., land, labour and capital, to the firms which constitute the production sector, and (ii) they consume all the goods and services produced by the business firms.

Business firms include all firms, farms, factories and shops engaged in production and distribution of goods and services. *Business firms* perform two functions: (i) they hire factors of production from the households and transform them into final goods and services, and (ii) they supply all the goods and services to the households, the consumers.

Interaction between the Households and Firms

The *functions* and the mode of *interaction* between the two kinds of economic entities and working of the economic system are exhibited in Fig. 1.1. Households and firms interact in two ways: (i) as sellers and buyers of inputs, and (ii) as buyers and sellers of output. The sale and purchase of inputs creates *factor market* where factor prices are determined, and sale and purchase of final goods and services creates *product market* where product prices are determined.

As Fig. 1.1 shows, factors of production (land, labour, capital, etc.) flow from the households to the *factor market.* The interaction between households (the input suppliers) and business firms (the input demanders) determines the factor prices. Once factor prices are determined, inputs move to business firms. In return, factor payments (wages, rent and interest, etc.) flow to the households.

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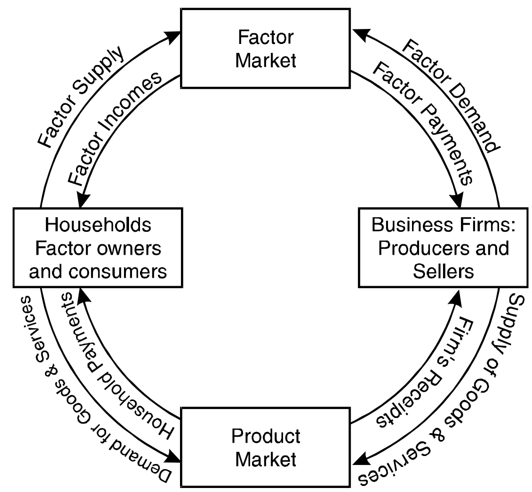

Fig 1.1 *Working of a Simple Economy and Circular Flows*

The business firms transform the factor inputs into finished products. Finished products flow to the *product market.* The interaction between the business firms, the suppliers, and the households, the buyers, determine the product prices. Once product prices are determined, products flow to the households. In return, the payments made by the households for their purchases flows to the firms. They use their receipts to hire inputs again and the process continues. In this process, two circular flows are generated: (i) *real flows,* i.e., flows of inputs and final products as shown by the outer circle, and (ii) *money flows,* show by the inner circle.

1.5 ECONOMICS AND BUSINESS DECISIONS

The primary function of managers is to take appropriate decisions and implement them effectively to achieve the objective of the organization to maximum possible extent, given the resources. Application of economics contributes a great deal to managerial decision-making as it provides guidance in finding an appropriate solution to the business problem. Just as biology contributes to medical profession and physics to engineering, economics contributes to managerial functions. As such, a working knowledge of economics is essential for managers. Managers are, in fact, practicing economists.

Let us now see how economics contributes to managerial decisions. All the areas of managerial decisions, as noted in Figure 1.1, have economic perspective. Therefore, economic theories, concepts and tools of analysis are applied as roadmap to find solution to business problems. It has been found empirically that application of economic theories and tools of analysis makes significant contribution to the process of business decision making in many ways.

According to Baumol, a Nobel laureate in economics, economic theory contributes to business decision making in *three important ways.*

First, 'one of the most important things which the economic theory can contribute to management science' is providing framework for building analytical models which can help recognize the structure of managerial problem, determine the important factors to be managed, and eliminate the minor factors that might obstruct decision making.

Secondly, economics provides 'a set of analytical methods' which may not be directly applicable to analyse specific business problems but they do widen the scope of business analysis and enhance the analytical capability of the business analyst in understanding the nature of the business problems.

Thirdly, various economic terms are used in common parlance, which are not applicable to business analysis and decision making. Economic theory offers clarity to various economic concepts used in business analysis, which enables the managers to avoid conceptual pitfalls. For example, in general sense, 'demand' means quantity demanded at a point of time. But, in economic sense, 'demand' means the quantity people are willing to buy at a given price and they have ability and willingness to pay.

Apart from providing analytical models and methods and conceptual clarity, economics contributes to business decision in many other ways also. Most business conditions are taken under the condition of *risk* and *uncertainty.* Risk and uncertainty arise in business because of continuous change in business conditions and environment, and unpredictable market behaviour. Economics provides models, tools and technique to predict the future course of market conditions, ways and means to assess the risk and, thereby, helps in business decision making.

It is because of these important contributions of economics to business decision making that economics has been integrated with managerial decisions. Managerial decision making without applying economic logic, theory and analytical tools may not offer a reasonable solution.

1.5.1 Relationship between Economic Theory and Managerial Economics

We have noted above that application of theories to the process of business decision-making contributes a great deal in arriving at appropriate business decisions. In this section, we highlight the gap between the theoretical world and the real world and see how managerial economics bridges this gap.

Theory *vs.* Practice

It is widely known that there exists a gap between theory and practice in all walks of life, more so in the world of economic theory and behaviour. A theory which

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appears logically sound may not be directly applicable in practice. For example, if there is a constant relationship between inputs and outputs, it may be theoretically concluded that if inputs are doubled, output will be doubled and if inputs are trebled, output will be trebled. This theoretical conclusion may not hold in practice. This gap between theory and practice has been very well illustrated in the form of a story by a classical economist, J.M. Clark. He writes:

'There is a story of a man who thought of getting the economy of large scale production in plowing, and built a plow three times as long, three times as wide, and three times as deep as an ordinary plow and harnessed six horses [three times the usual number] to pull it, instead of two. To his surprise, the plow refused to budge, and to his greater surprise it finally took fifty horses to move the refractory machine… [and] the fifty could not pull together as well as two'.

The gist of the story is that managers—assuming they have abundant resources—may increase the size of their capital and labour, but may not obtain the expected results. Most probably the man in Clark's story did not get the expected result because he was either not aware of or he ignored or could not measure the resistance of the soil to a huge plow. This incident clearly shows the gap between theory and practice.

Economic theories are, no doubt, *hypothetical in nature but not away from reality*. Economic theories are, in fact, a caricature of reality under certain specified conditions. In their abstract form, however, they do look divorced from reality. Besides, abstract economic theories cannot be straightaway applied to real life problems. This should, however, not mean that economic models and theories do not serve any useful purpose. 'Microeconomic theory facilitates the understanding of what would be a hopelessly complicated confusion of billions of facts by constructing simplified models of behaviour, which are sufficiently similar to the actual phenomenon and thereby help in understanding them'. Nevertheless, it cannot be denied that there is apparently *a gap between economic theory and practice*. This gap arises mainly due to the inevitable gap between the abstract world of economic models and the real world.

How Managerial Economics Fills the Gap

There is undeniably a gap between economic theory and the real economic world. Therefore, economic theories do not offer a custom-made or readymade solution to business problems. However, economic theories do provide a framework for logical economic model-building and systematic analysis of economic issues. The need for such a framework arises because the real economic world is too complex to permit considering every bit of relevant facts that influence economic decisions. In the words of Keynes, 'The objective of [economic] analysis is not to provide a machine, or method of blind manipulation, which will furnish an infallible answer, but to provide ourselves with an organized and orderly method of thinking out particular problem…'. In the opinion of Boulding, the objective of economic analysis is to present the 'map' of reality rather than a perfect picture of it. In fact, economic analysis equips us with a road map; it guides us to the destination, but does not carry us there. This is how managerial economics bridges the gap between economics and business decision-making. As an example, **managerial economics** can also be compared with medical science. Just as the knowledge of medical science helps in diagnosing the disease and prescribing an appropriate medicine, managerial economics helps in analyzing the business problems and in arriving at an appropriate decision.

Let us now see how managerial economics bridges this gap. On one side, there is the complex business world and, on the other, are abstract economic theories. 'The big gap between the problems of logic that intrigue economic theorists and the problems of policy that plague practical management needs to be bridged in order to give executive access to the practical contributions that economic thinking can make to top management policies'. Managerial decision-makers deal with the complex, rather chaotic, business conditions of the real world and have to find the way to their destination, i.e., achieving the goal that they set for themselves. Managerial economics applies economic logic and analytical tools to sift wheat from the chaff. Economic logic and tools of analysis guide business managers in the following ways.

(*i*) Identifying their problems in achieving their goal,

(*ii*) Collecting the relevant data and related facts,

(*iii*) Processing and analyzing the facts,

(*iv*) Drawing relevant conclusions,

(*v*) Determining and evaluating the alternative means to achieve the goal, and

(*vi*) Taking a decision.

Without application of economic logic and tools of analysis, business decisions are most likely to be irrational and arbitrary, which may often prove counter-productive.

Check Your Progress

1. Name the two branches of economics.
2. What is the ultimate objective of the managerial functions?
3. State the main sectors comprising a simple model of an economy.

1.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The two branches of economics are microeconomics and macroeconomics.
2. The ultimate objective of the managerial functions is to ensure maximum return from the utilization of firm's resources.

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3. A simple model of the economy consists of two main sectors: (i) households and (ii) business firms.

1.7 SUMMARY

- The emergence of managerial economics can be attributed to at least three factors: (i) growing complexity of the business environment and decision-making process; (ii) increasing application of economic logic, concepts, theories and tools of economic analysis in the process of business decision-making; and (iii) rapid increase in demand for professionally trained managerial manpower with good knowledge of economics.
- Economists of different generations have defined economics in different ways according to their perception and subject matter of economics.
- Economics can, thus be defined as a social science that studies economic behaviour of the people, the individuals, households, firms, and the government.
- *Internal managerial issues* refer to decision-making issues arising in the management of the firm. Internal managerial issues include problems that arise in operating the business organization.
- Economics has two major branches—microeconomics and macroeconomics. The main economic theories and tools of analysis of both microeconomics and macroeconomics constitute the subject matter of managerial economics.
- Working of a modern economy is extremely complex. Millions of persons participate and contribute to its working in different ways and different capacities—as producers, traders, workers, financiers, and consumers.
- The primary function of managers is to take appropriate decisions and implement them effectively to achieve the objective of the organization to maximum possible extent, given the resources.
- It is because of these important contributions of economics to business decision making that economics has been integrated with managerial decisions. Managerial decision making without applying economic logic, theory and analytical tools may not offer a reasonable solution.

1.8 KEY WORDS

- **Microeconomics:** It is the study of the economizing behavior of the individual economic entities—individuals, households, firms, industries and factory owners.

- **Managerial economics:** It can be defined as the study of economic theories, logic, concepts and tools of economic analysis applied in the process of business decision-making.

1.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Prepare an introduction to economics.
2. What is the subject matter of microeconomics and macroeconomics?
3. Write a short note on the scope of managerial economics.

Long Answer Questions

1. Discuss the general foundations of managerial economics.
2. Explain the working of a simple economy.
3. Analyse the relationship between economics and business decisions.

1.10 FURTHER READINGS

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