UNIT-1

(Nature and Scope of Managerial Economics)

Module-3

CONTENTS

3.0 : OBJECTIVES: The basic objective of this module is to introduce you to the definitions and scope of managerial economics. After reading this module you will be in a position to understand:

- Definitions of managerial economics
- Basic characteristics of managerial economics
- Scope of managerial economics

3.01 : DEFINITIONS OF MANAGERIAL ECONOMICS:

Economists have defined managerial economics in a different manner. But the substance of their definitions converge on a single line. The following are some of the definitions of managerial economics:

1. McNair and Meriam defined managerial economics as “the application of economic modes of thought to analyse business situations”.

2. Spencer and Seigelman defined managerial economics as “the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning by the management”.

3. According to Watson, managerial economics is “the price theory in the service of business executive”.

4. Hague defined managerial economics as “a fundamental academic subject which seeks to understand and to analyse the problems of business decision making”

5. Brigham and Pappas stated that managerial economics is “the application of economic theory and methodology to business administration practice”.

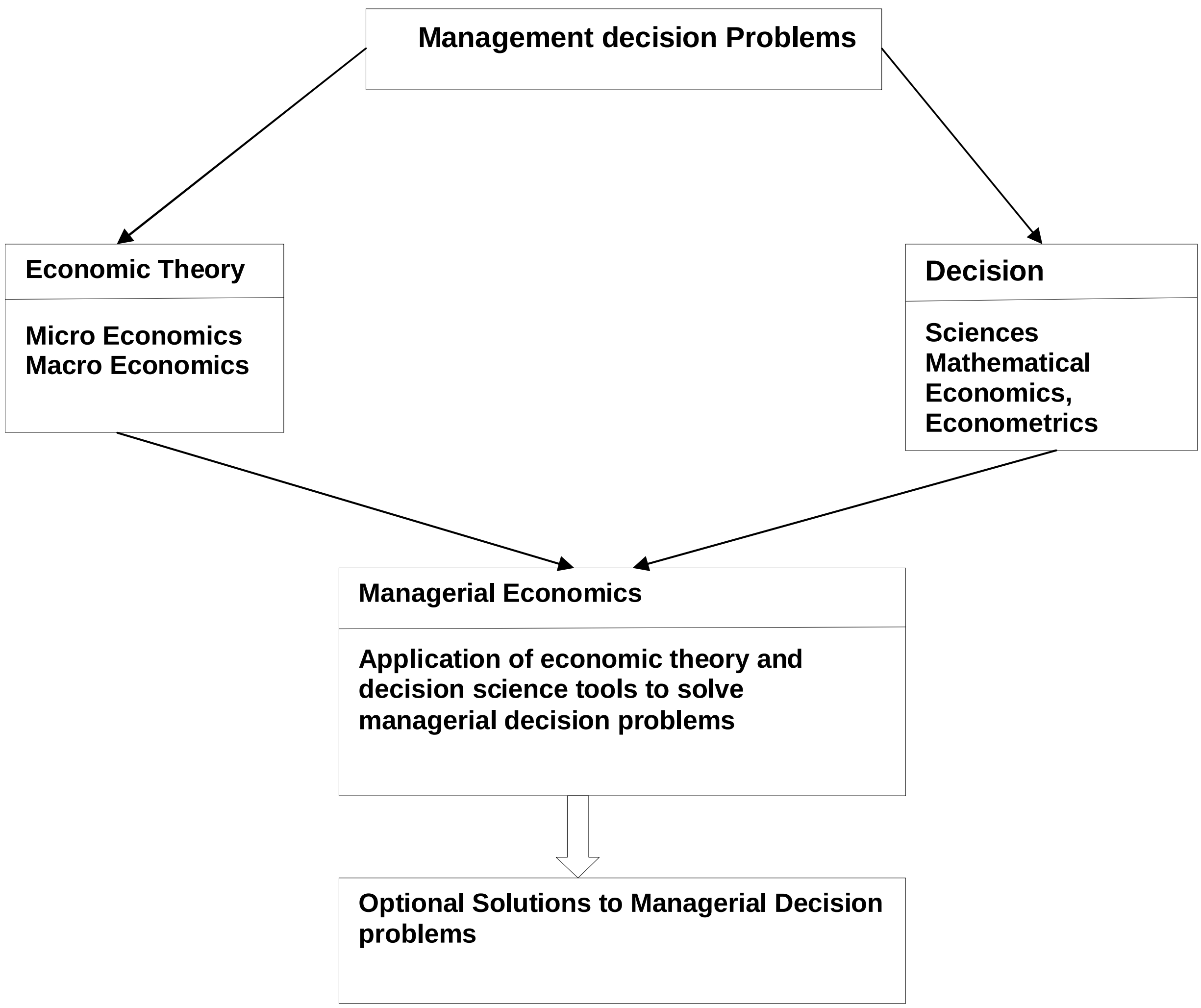
We can summarise the substance of these definitions as :

1. Managerial economics is concerned with decision making problems which are economic in nature. This implies that managerial economics deals with identification of economic choices and allocation of scarce resources.
2. Managerial economics is objective oriented and has a perspective. It deals with how decisions should be taken by the management to achieve organizational goals.
3. Managerial economics is pragmatic. It is concerned with those analytical tools which are useful in arriving at optimal decisions.

4. Managerial economics is a discipline which deals with the application of economic theory to business management. Thus it lies on the border line between economics and business management and thereby serves as a bridge between these two disciplines.

The link between economics and business management on the one hand and managerial economics on the other can be understood with the help of following chart.

-CHART-1



ACTIVITY-I

1. Write the summary of definitions of managerial economics.
2. In what way does managerial economics act as a link between economics and business management?
3. What do you understand by 'optimal decision'?.

3.02: CHARACTERISTICS OF MANAGERIAL ECONOMICS:

1 Managerial economics is basically micro in character. It examines the decision problems of business firms. It never examines the aggregate economic problems.

2. To provide solutions to business problems it uses concepts and principles of micro economics.

3. Managerial economics is pragmatic in its approach and optimistic in arriving at optimal decisions under uncertain conditions.

4. Managerial economics is normative in character and not positive. It belongs to normative economics. It is concerned with ethical/value judgments of decisions. It is also concerned with the discussion of what should be or what ought to be the optimal decision keeping in mind the resource constraint and objectives of the business firm. In fact, it is prescriptive in character.

5. Managerial economics, though basically micro in character, also examines concepts of macro economics for example: national income, trade cycles, industrial policies, tax policies, foreign trade, etc.

3.03: SCOPE OF MANAGERIAL ECONOMICS:

The scope of any subject indicates the areas of coverage or boundaries of that subject. Managerial economics basically covers the following areas of economics:

1. Demand analysis

2. Demand forecasting
3. Cost analysis
4. Production analysis
5. Pricing decisions and policies
6. Profit management
7. Capital budgeting

All these areas together are called scope or subject matter of managerial economics. We shall try to understand these areas in brief.

1. Demand : Under this we discuss the meaning of demand, types of demand, demand function, demand schedule, statistical demand function, estimation of demand, meaning of elasticity of demand, types of elasticity of demand, applications of elasticity concept.

2. Demand forecasting: This implies estimation of future or potential demand for the product produced by a firm. Forecasting implies decisions related to future movement of economic variables for example: sales, profits. Demand estimation is the first step in attempting to forecast the future demand. In demand forecasting analysis we discuss various methods for example: survey and statistical methods adopted to forecast demand.

3. Cost analysis: Value of inputs used in production process to produce a given level of output is called is known as cost. Given other things, the cost of production determines the future growth of business firm. In modern days, since there is severe competition in the market with respect to the production of any commodities or services, business firms are attempting to adopt cost minimization strategies.

Under cost analysis we discuss relationship between cost and output, estimation of cost functions.

4. Production analysis: Production analysis always takes into account physical quantities. It deals with input- output relationship in physical terms. Since the resources at the disposable of business firms are in general limited, with the help of production function the business firm attempts to maximize production by employing minimum quantity of resources. The main topics covered under production analysis are: concept of production function, short-run and long-production function, estimation of production function.

5. Pricing decisions and policies: It is a fact that, given other things, the price of a product determines the future growth of business firms. The primary decision problem of any management is to fix rational or just price which ultimately takes care of the business in the future. The important topics dealt with under this area are: price determination in various market forms, pricing strategies, product line pricing.

6. Profit management: According to traditional theory of firm, the basic objective of business firm is profit maximization. In general the volume of profit is used as an indicator to judge the success or failure of business. The important topics covered under profit management are: nature and measurement of profit, break-even analysis.

7. Capital management: Of all the decisions, this is the most difficult decision that always bothers the management. The top level management generally takes decisions pertaining to capital investments. Capital management implies planning and control of capital expenditure. The important topics under capital management are: Cost of capital, rate of return and selection of projects.

ACTIVITY-2

1. What is the meaning of 'the scope of a subject'?.
2. Spell out the areas of coverage of demand and demand forecasting.
3. What do you understand by cost and production analysis?
4. "Profit is used as an indicator to judge the success or failure of business"-Discuss.

3.04: SUMMARY:

In this module we discussed in detail the definitions, main characteristics and scope of managerial economics. Managerial economics is an applied branch of micro economics at the level of a business firm. The understanding of managerial economics helps management executives to arrive at optimal solutions decision problems. Managerial economics is basically a normative science which deals with what ought to be the optimal or best decision under given conditions. Managerial economics seeks to study demand and demand forecasting, cost and production analysis, pricing decisions, profit and capital management.

3.05: SELF ASSESSMENT TEST

1. Summarise the definitions of managerial economics.
2. Discuss the scope of managerial economics.
3. Describe the characters of managerial economics.