UNIT-I

(Nature and Scope of Managerial Economics)

MODULE-2: NATURE OF MANAGERIAL ECONOMICS

CONTENTS

2.0: OBJECTIVES: The basic objective of this lesson is to introduce to you the nature of managerial economics. After reading this lesson you will be able to understand the:

Meaning and nature of managerial economics

Relationship between economics and managerial economics

Meaning of economic theory

2.01: INTRODUCTION: In module-1, you have been exposed to economics in terms of definitions, micro and macro economics. The part of micro economics applied to study the behavior of business firm is called as managerial economics. It is the branch of economics which serves as a link between abstract theory and managerial practice. Managerial economics is based on identifying problems, organizing information and evaluating alternatives. Traditionally, the problem of optimal decision by firms and individuals has been studied in micro economic theory. Managerial economics as a separate branch owes its origin to the growing dissatisfaction with the economic theory in providing solutions to the problems faced by business firms.

2.02: MEANING AND NATURE OF MANAGERIAL ECONOMICS:

Managerial economics is basically related to the decision making by a business firm. For example the decisions pertaining to:

1. What to produce?
2. How to produce?
3. How much to produce?
4. What is the break-even level of output?
5. Where to locate the firm?
6. Where to get rawmaterial?
7. Where to procure finances?
8. How many skilled and semi skilled personnel to be employed?
9. What should be the volume of promotional expenditures?
10. What is the kind of marketing strategy to be adopted?
11. What is the price at which commodity is to be placed in the market?
12. How to place the commodity in the market?
13. Is there any need for product differentiation?
14. Whether to expand the firm or not?
15. How to face competition in domestic and world markets?
16. Whether to merge the firm or take over other firms to reap economies of scale?.

This is not the end of the list. The decision problems of potential entrant differs from established firms. For example: the decision problem of a new entrant is how to survive in the market?. Where as the decision problem of an established firm is, how to acquire dominant position in the market?.

2.03: ECONOMICS vs MANAGERIAL ECONOMICS

The decisions of business firms are some way or other related to economics. The concern of economics is with economic problem and its identification, description, explanation and finally finding out a solution, if possible. An economic problem is a problem of choice. The problem of choice arises because of limited resources, which have alternative uses. In the sense that, at the same time these resources are to be used to satisfy unlimited wants. Had the resources such as labour, capital, money, rawmaterials and other inputs not been in short supply i.e. scarce, there would have been no problem of choice. Scarcity is the birth place of all economic problems. Since the resources at the disposal of a business firm are scarce, the available resources must be allocated efficiently so as to derive maximum by using minimum. Whatever the decisions that the management arrives at, these decisions must help the firm to attain its goal of either profit maximization, revenue maximization, output maximization or cost minimization.

The study of managerial economics helps the management executives to arrive at optimal or efficient decisions, when confronted with the allocation of limited resources among unlimited alternative uses. But the fact is that, managerial economics does not provide ready made solutions to day-to-day problems of business firms. It helps the management, like a tool-kit in the hands of a technician. After knowing the problem, the technician will take out a specific tool to rectify the defect. In the same way a management executive can use the knowledge of managerial economics to solve decision problems.

Business firms conduct their production operations under conditions of uncertainty. This makes the decision making and forward planning very complicated and rudderless. If the knowledge of future were perfect, plans could be formulated without error and no need for revision. But practically speaking, the management executive rarely has perfect information related to future demand, cost, profit etc. As the decisions are implemented in the long-run, more facts become known. So that in the light of these facts decisions have to be revised and different course of action has to be adopted.

A manager at any level always exercises choice in the name of decision making. A finance manager selects the sources and uses of funds. A production manager chooses the optimum product mix, aiming at minimizing cost or maximising output. Marketing manager strives to maximize sales revenue through proper market segmentation. A personnel manager chooses the right staffing pattern. Brach manager always aims at maximizing profit. A purchase manager chooses the quality of rawmaterial given the cost. This implies that all managers select one thing or the other from among a set of alternatives. A manager’s choice is dictated by objectives of firm and the internal and external constraints. The optimal decision making is an act of optimal economic choice, keeping in view the objectives and constraints. Thus there is rationality on the part of economics to evaluate managerial decisions through its concepts, principles and other tools of analysis.

2.04: MEANING OF ECONOMIC THEORY:

In fulfilling the function of decision making in an uncertain environment, economic theory can be pressed into service with great degree of advantage. Economic theory deals with a number of concepts and principles like demand, supply, cost, production, profit, competition, trade cycles etc. Economics with the help of allied subjects namely statistics, mathematics, econometrics, operations research can solve or at least throw some light upon the problems of business management. The way economic analysis used to solve business problems constitutes the subject matter of managerial economics.

Optimisation principles of managerial economics also are important in the not-for-profit sectors of the economy. For example universities strive to maximize the value of teaching and research output subject to an annual budget constraint. Decisions about the number of hours of teaching, the right mix of faculty in terms of regular and visiting, from reputed institutes across the country & rest of the world, exposure of students to outside environment, the balance between classrooms and laboratories, the extent of use of modern technology, the adoption of innovative and interactive methods of teaching, Maintaining peaceful internal environment will help the CEO of universities to achieve an indelible ink mark in the international arena.

ACTIVITY-I

1. List out the decision making problems of CEO of your university.

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2. Identify the decision problems of hostel management of your university.

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3. Have you ever faced any decision problems while fulfilling your ends? If answer is ‘yes’ write down the nature of decision problems you have faced.

4. Is there any difference between the decision problems of a firm and an individual?. Substantiate your answer with suitable examples.

5. Observe the business environment and identify decision problems.

6. Observe the business environment and list out decision problems of new entrant and an established business firm in the field of education, health, communication services.

7. Spell out the meaning of economic theory.

2.05: SUMMARY:

Managerial economics is a branch of micro economics applied to study the behavior of business firms operating under uncertain environment. Managerial economics refers to application of economic theory and the tools of analysis of decision to examine, how an organization can achieve its objectives most efficiently. Managerial economics is based on identifying problems, organizing information and evaluating alternatives. These decisions of business firms are some way or other related to economics. The concern of economics is with economic problem and its identification, description, explanation and finally finding out a solution, if possible. An economic problem is a problem of choice. The problem of choice arises because of limited resources, which have alternative uses. Since the resources at the disposal of a business firm are scarce, the available resources must be allocated efficiently so as to derive maximum by using minimum. The study of managerial economics helps the management executives to arrive at optimal or efficient decisions, when confronted with the allocation of limited resources among unlimited alternative uses

2.06: ADDITIONAL REFERENCES:

1.Dominick Salvatore: *Managerial Economics in a Global Economy*, McGRAW-HILL international edition.

2. H.Craig Petersen and W.Lewis: *Managerial Economics*, Prentice –Hall of India.

3.William F.Samuleson and Stephen G.Marks :*Managerial Economics*, Wiley Student Edition

4.Brigham, E.F & Pappas: *Managerial Economics*, the Dryden Press, Illinois,USA.

2.07: SELF ASSESSMENT TEST:

1. Discuss, how managerial economics helps the management executives to arrive at optimal decisions?.
2. Discuss the decision making problems of a 'not-for –profit' business firms such as hospitals, educational institutions, research labs.
3. 'Choice' is a universal economic problem. Discuss.