UNIT – I

INTRODUCTION TO MANAGERIAL ECONOMICS

1) Define Managerial Economics. Explain its nature andscope.

Meaning &Definition:

Managerial Economics refers to the firm's decision-making process. It could be also interpreted as "Economics of Management". Managerial Economics is also called as "Industrial Economics" or "Business Economics".

In the words of E.F.Brigham and J.L. Pappas Managerial Economics is "the applications of economics theory and methodology to business administration practice".

C.I. Savage&T.R.Small therefore believes that managerial economics "is concerned with businessefficiency"

Nature of Managerial Economics:

a) Close tomicroeconomics
b) Operates against the back drop ofmacroeconomics
c) Normative statements
d) Prescriptive actions
e) Applied innature
f) Offers scope to evaluate eachalternative
g) Interdisciplinary
h) Assumptions andlimitations

Scope of Managerial Economics:

The scope of managerial economics covers two areas of decision making

a) Operational or Internalissues

b) **Environmental or Externalissues**

A. Operationalissues:

Operational issues refer to those, which wise within the business organization and they are under the control of the management. Thoseare:

1. Theory of demand and DemandForecasting
2. Pricing and Competitivestrategy
3. Production costanalysis
4. Resourceallocation
5. Profitanalysis
6. Capital or Investmentanalysis
7. Strategic planning

B. Environmental or External Issues:

An environmental issue in managerial economics refers to the general business environment in which the firm operates. They refer to general economic, social and political atmosphere with in which the firm operates. A study of economic environment should include:

- The type of economic system in thecountry.
- The general trends in production, employment, income, prices, saving andinvestment.
- Trends in the working of financial institutions like banks, financial corporations, insurance companies
- Magnitude and trends in foreigntrade;
- Trends In Labour and capitalmarkets;
- Government's economic policies viz. industrial policy monetary policy, fiscal policy, price policyetc.

2) Enumerate the relationship of financial accounting and management with Managerial Economics?

Managerial Economics refers to the firm's decision-makingprocess. It could be also interpreted as "Economics of Management". The economic analysis also a part of human analysis or mind analysis, so it does totally inter related each other. The major objective of the managerial economics is profitmaximization.

Relation with Financial Accounting:

a) CapitalBudgeting
b) Budgetarycontrol
c) Cost andrevenue
d) Financial analysis andinformation
e) Generation and interpretation of accountingdata

Relationship with Management:

a) Assumptions
b) Decisionmaking
c) Allocation ofresources
d) Planning andcontrolling
e) Organizing anddirecting

DEMAND ANALYSIS AND LAW OF DEMAND

3) Define demand function and explain the determinants ofdemand.

There are factors on which the demand for a commodity depends. These factors are economic, social as well as political factors. The effect of all the factors on the amount demanded for the commodity is called Demand Function.

Mathematically the demand function for a product can be expressed –

$$\boxed{Qd=f(P,I,T,P_{R}, E_{P}, E_{I},S_{P},D_{C},A,O)}$$

Determinants of demand:

a) Price of the product(P)
b) Income level of the consumer(I)
c) Tastes and preferences of the consumer(T)

d) Prices of related goods which may be substitute(P_R)

e) Expectations about the prices in future(E_P)

f) Expectations about the incomes in future(E_I)

g) Size of the population(S_P)

h) Distribution of the consumers over different regions(D_C)

i) Advertising efforts(A)

j) Any other factor capable of effecting the demand(O)

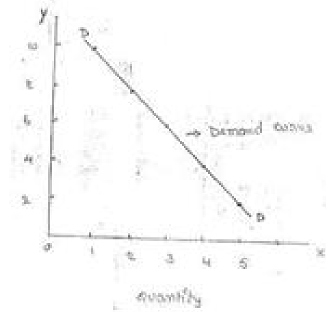
4) Define law of demand with itsexceptions?

Law of demand shows the relation between price and quantity demanded of a commodity in the market. In the words of Marshall, "the amount demand increases with a fall in price and diminishes with a rise in price".

Assumptions:

Law of demand is based on certain assumptions:

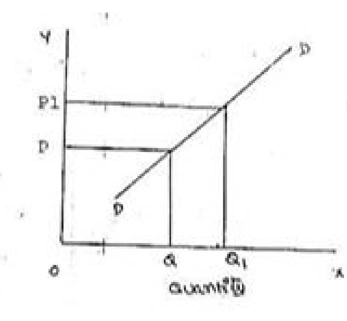
1. This is no change in consumers taste andpreferences.
2. Income should remainconstant price
3. Prices of other goods should notchange.
4. There should be no substitute for thecommodity
5. The commodity should not confer at anydistinction
6. The demand for the commodity should becontinuous
7. People should not expect any change in the price of thecommodity



Law of demand slopes downwards when the demand curve inverse relation between price and quantity demand.

The reasons for exceptional demand curve slope every time upward areas follows.

1. Giffenparadox
2. Veblen or Demonstrationeffect
3. Ignorance
4. Speculative effectprice
5. Fear ofshortage
6. Necessaries



5) What is meant by elasticity of demand and types of elasticity ofdemand?

Elasticity of demand explains the relationship between a change in price and consequent change in Amount demanded. "Marshall" introduced the concept of elasticity of demand. Elasticity of demand shows the extent of change in quantity demanded to a change in price.

In the words of "Marshall", "The elasticity of demand in a market is great or small according as the Amount demanded increases much or little for a given fall in the price and diminishes much or little for a given rise in Price"

Elastic demand: A small change in price may lead to a great change in quantity

demanded. In this case, demand is elastic.
In-elastic demand: If a big change in price is followed by a small change in demanded then the demand in “inelastic”.

TYPE OF ELASTISITY OF DEMAND

1. **Price elasticity of demand**

$$\text{Price elasticity} = \frac{\text{Proportionate change in the quantity demand of commodityX}}{\text{Proportionate change in the price of commodityX}}$$

a) Elastic price demand-E>1
b) Inelastic price Demand-E<1
c) Unit price elasticity -E=1

2. Income elasticity ofdemand

$$\text{Income Elasticity} = \frac{\text{Proportionate change in the quantity demand of commodity X}}{\text{Proportionate change in the income of people}}$$

a) Zero income elasticity -Ey=0
b) Negative Income elasticity -Ey<0
c) Unit income elasticity -Ey=1
d) Income elasticity greater than unity -Ey>1
e) Income elasticity less than unity –Ey<1

3. Cross elasticity of demand

$$\text{Cross elasticity} = \frac{\text{Proportionate change in the quantity demand of commodity “X”}}{\text{Proportionate change in the price of commodity “Y”}}$$

a) In case of substitutes, cross elasticity of demand ispositive
b) In case of compliments, cross elasticity isnegative
c) In case of unrelated commodities, cross elasticity of demanded iszero

4. Advertising elasticity of demand – is alwaysPOSITIVE

$$\text{Advertising elasticity} = \frac{\text{Proportionate change in the quantity demand of commodity X}}{\text{Proportionate change in the advertisement cost}}$$

6) **Explain how do you measure elasticity of demand? Explain different types of price elasticity of demand?**

Measure of elasticity of demand:

a) Perfectly elastic demand-E=∞
b) Perfectly Inelastic Demand-E=0
c) Relatively elastic demand-E>1
d) Relatively in- elastic demand -E<1
e) Unit elasticity of demand-E=1

Types of Price elasticity of demand

a) Elastic price demand-E>1
b) Inelastic price Demand-E<1
c) Unit price elasticity -E=1

7) Explain the significance of elasticity and the factors influencingelasticity Significance of Elasticity ofdemand:

1. Pricefixation
2. Production
3. Distribution
4. InternationalTrade
5. Public Finance
6. Nationalization

Factors influencing the elasticity of demand:

Elasticity of demand depends on many factors.

1. Nature ofcommodity
2. Availability ofsubstitutes
3. Variety ofuses
4. Postponement of demand
5. Amount of moneyspent
6. Time
7. Range ofPrices

8) What is the contemporary importance of managerialeconomics?

Managerial economics decides the business is going towards profit or loss. That's why it has its own priority on optimization of resources. Means to decrease the cost and increase the profit.

a) Useful in business organization andpolicies
b) Profit Planning andcontrolling
c) Creates demand forcasting

d) Price determination
e) Demandforecasting
f) Solutions fortaxation
g) Understanding the mechanism of economicsystem
h) Analysis of effects of governmentpolicies
i) Supporting themanufacture
j) Gives in right directions (decisionmaking)
k) Maintaining and distribution ofprofit
l) Measurement of the efficiency of thefirm

9) What are the needs for demand forecasting? Explain the factors governing of demand forecasting?

Need for demand forecasting

a) Estimate & Assessment of futuredemand
b) Businessdecision-making
c) Productionplanning
d) Estimating of revenue andexpenditures
e) Distinguish between forecast of demand andsales
f) Time and reliability offorecast

'actors governing Demand Forecasting

a) Functional nature ofdemand
b) Forecastinglevels
c) Types offorecasting
d) Degree oforientation
e) Established or newproducts
f) Nature ofgoods
g) Degree ofcompetition
h) Marketdemand
i) Functional nature of marketdemand

10)What do you understand by demand forecasting? Explain different methods of demand forecasting?

The information about the future is essential for both new firms and those planning to expand the scale of their production. Demand forecasting refers to an estimate of future demand for the product.

Based on the time span and planning requirements of business firms, demand forecasting can be classified into 1. Short-term demand forecasting and 2. Long–term demand forecasting.

a) Estimate & Assessment of futuredemand
b) Businessdecision-making
c) Productionplanning

d) Estimating of revenue andexpenditures

e) Distinguish between forecast of demand andsales

f) Time and reliability offorecast

Methods of forecasting:

Several methods are employed for forecasting demand. All these methods can be grouped under Survey method and statistical method. Survey methods and statistical methods are further subdivided into different categories.

1. SurveyMethod:

a) **Opinion survey method-** This method is also known as sales- force composite method (or) collective opinion method. The salesmen are more knowledge. They can be important source of information. They arecooperative.

b) **Expert opinion method-** Firms in advanced countries make use of outside experts for estimating futuredemand.

c) **Delphi Method-** A variant of the survey method is Delphimethod.

d) This method has been used in the area of technologicalforecasting.

e) **Consumer's interview method-** contacted personally to know about their plans and preference regarding the consumption of the product. This method seems to be the most ideal method for forecastingdemand

2. StatisticalMethods:

a) **Time series analysis or trend projection methods-** presented either in a tabular form or a graph.

1. Trend line by observation 2. Least square method 3. Moving averages methods4. Exponential smoothing

b) **Barometric Technique-** (1) Construction Contracts awarded for building Materials (2) Personalincome(3)AgriculturalIncome (4)Employment(5)Grossnationalincome(6) Industrial Production (7) Bank Deposits

c) **Regression and correlation method-** provides the values of the independent variables from within the modelitself