Chapter - 1

Managerial Economics

Concept

(Managerial Economics is a special branch of economics which provides the link betn traditional economics & decision Science, in managerial decision making.) After the publication of Joel Dean's 'Managerial Economics' in 1951, it developed as a popular subject in business management. It is said to be applied micro economics & it is part of traditional economics. It applies micro economics theory & methodology to business & administrative decision making. It uses tools & techiniques of economics analysis to solve the managerial problems. It covers the study of demand analysis, business & economic forecasting, production, pricing, profit, investment etc theories relating to them are applied in managerial decision. It bridges economic theory & economics in practice.

Dominik Salvatore

"Managerial economic refers to the application of economic theory & tools of decision science to examine how an organization can achieve its aims or objectives most efficiently."

microeconomics → the part of economics concerned with single factors & effected by individual decision.

macroeconomics → the part of economics concerned with large scale or general economic factors such as interest rate & national productivity

Business Administrative / Management Decision

Traditional Economics Theory & Methodology

Decision Scien
Tools & techiniques
analysis

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Business / Managerial Economics
Application of economic theory & methodology for solving specific problems of the business organization.

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Optimal solution to business problems.

Characteristics or features of managerial business economics.

1) Based on micro economics

It is mainly related to micro economics analysis, i studies business units, not the economy as a whole. It is concerned with the analysis of problems & their Solution rel ting to individual form, individual industry & their manag ment. It covers the study of theories relating to dema analysis, business & economic forecasting, output, pricing, profit, investment in the business, it assists helps the manage in analyzing & forecasting the trends of market.

2) Use of macro economic parameter

Macro economic parameter variables & policies relating to them affect business decision it is necessary to understand the economic environment in which an individual firm or an industries has to adjust while making successful business management. Business man have to consider the importance of National Income (NI), general price level, taxation & industrial policies, government budget etc. Economic fluctuation (trade cycle) has to be dealed while solving the business problem.

3) Application (use) of the theory of firm

Economics theories such as theory of a firm & profit are used in analyzing & solving the problems relating to price determination, market structure, output, cost condition & employment of the firm & industry.

4) Pragmatic (Practical)

Managerial economics is an applied micro economics, it uses only those parts of micro economics which are significant to the managers in solving problems relating to demand, supply, output, pricing, cost analysis etc that appear in their day to day functions.

Watson & Getz

"The price theory in business executive is known as business economics"

5) Normative (prescriptive) in character

It uses the normative micro economics of the firm. It makes the value judgement concerning better business decision. It prescribes what ought to do for solving certain specific business problems. Though, it is normative micro economics of the firm, it has its descriptive role too. It explains, how various economic forces affect in firms & predicts the consequences of its decision. This is its descriptive role in business decision making. Besides this, the firm in order to achieve the desire goal efficiently it makes planning, policies, optimal allocation of resources, marketing etc.

6) Link betn traditional economics & business decision

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Differences betn Traditional Economics & Business Economics.

Traditional Economics	Business Economics
1) It deals with the study of concepts, principles & theoretical aspects of economic analysis.	1) It deals with the application of economic principles to the problems of an individual firm.
2) It include both the microeconomics & macroeconomics.	2) It include microeconomics only.
3) Scope of traditional economics is very wide.	3) Scope of business economics is narrow because it is only a branch of traditional economics
4) It studies human behaviour on the basis of certain assumptions.	4) It is concerned with practical problems.
5) It is both positive & normative science.	5) It is only normative science.
6) It is affected by the economic factors.	6) It is affected by both economic & non-economic factors.

Traditional Economics	Business Economics
7) It studies the rent, wages, interest, & profit theories.	7) It studies the theory of profit management only
8) It Studies the economic activities of producer, consomer, NI & business firms.	8) It studies the economic activities of business firm only.

Microeconomics

Ragner Frich, first use terms microeconomics & macro economics in 1933, the word micro has been derived from the Greek word 'micro' means small, most of the traditionals divisions of subject matter of economics is covered by microeconomics. (Micro economics is the study of economic actions of individual units & small group of individual units (industry & market). It studies the behaviour of producers (firms) & industry, consumers & market & allocation of scarces resources. It includes, the study of product & factor pricing) (rent, wage, interest & profit). It explains, how price of a product is determined by an interaction of demand & supply & how rent, wage, interest & profit are determined.

According to K.E Boulding, "Microeconomics is the study of particular firms, particular households, individual prices, wages, income, individual industries, particular commodities."

Given, the assumptions of full employment of resources in the economics , we study here how the consumer & producer attain equilibrium ~~&~~ & how limited resources are allocated.

The topics which are related to industry and a market or a firm & industry include in the study of the scope of micro economics.

i) Allocation of resources

Micro economics is the study of allocation of given resources in the production of particular goods in a free market economy. Allocation of resources is determined by price/market mechanism which is the guide line to the producer for what to produce? in what quantity, how to produce & for whom to produce?

2) Theory of product pricing

The price of a product is determined by the forces of demand & Supply. Demand is influenced by consumer's behaviour, taste & preferences & income, price of the commodity & price of substitute.

Supply is influenced by the cost of production & the behaviour of the producer.

3) Theory of factor pricing / Distribution

In this section, how the price is paid for the services of the factors are determined.

with the help of theory of distribution rent, wage, inter & profit are determined for land, labour, capital & orga nization respectively.

4) Theory of economic welfare

Welfare economics is a special branch of micro economics it is concerned with the problem & improveme in the economic efficiency.

a. Efficiency in production

The given resources should be utilized in such way that the production & profit become maximum as far a possible.

b. Efficiency in consumption / distribution

It deals with optimum pattern of distributi The produced goods should be distributed in such a way tha consumers gain maximum satisfaction in limited consumptio

c. Overall efficiency / Efficiency indirection to production

In this section, we study either the resources have bee allocated in the production of desire goods or not. In this way overall or total production can be maximized.

Limitations of micro-economics.

1. Not true incase of aggregates

What is true for an individual may not be true for aggregates. For eg: saving is good for an individuals but if all the individual of an economy starts to save, the whole economy will collapse. It will reduce aggregate demand, investment, employment & income. Eg: if a firm cuts the wage it increases employment in it but if general wage cutting in the whole economy takes place it causes reduction in aggregate demand, profit, investment, employment & income.

2. Assumption of full-employment

Micro-economics analysis is based on the assumption of full-employment, which is a rare phenomenon in the capitalist economy. Hence, the assumptions of micro-economics are unrealistic.

3. Deals with individuals

Micro-economics doesn't explain the function of the whole economy. It just explains, how a consumer gets maximum satisfaction with his limited income Or how a producer allocates his resources in the production of goods for getting maximum profit even if firm is developing the economy may be in the worst condition. Thus, micro-economics doesn't give the picture of collective functioning of the whole economy.

4. Unrealistic assumption of 'Other thing remaining constant'.

Most of the theories in microeconomics are based on certain unrealistic assumptions of other things remaining constant It can be true in economy which is static in natu[re] but its not true in real dynamic economy.

Importance/uses of Microeconomics.

1. Free market economy

Microeconomics explains the functioning of a free market economy. In a free market economy, there is no central authority to guide producers what to produce, how to produce & for whom to produce. Price or mark[et] mechanism guides the producers to solve these problem. Thus, allocation of resources is directed by the price or market mechanism which refers an interaction of demand & supply.

2. In the determination of relative prices of products & factors

The knowledge of microeconomics helps ~~u~~ us to understand the determination of the price of the factors. The price of the product is determined by market mecha[-] nism. Microeconomics helps us in analyzing the determinants of demand & supply. Similarly, microeconomics provides us with different theories relating to the prices of factor rent, wage, interest & profit.

3. Efficient allocation of resources

Microeconomics gives us the idea of how the consu[-] mer & producer efficiently allocate the scarce resources to get the maximum satisfaction & maximum production & profit respectively.

4 Basis of managerial economics

Microeconomics used in the Service of business man is known as managerial economics. Business man has to make cost & profit calculation & price determination. These are the topic of microeconomics theory. Hence, microeconomics is very helpful to the business man.

5 Basis of welfare economics

Microeconomics is concerned with the maximization of social welfare. It study how given resources are utilized for the maximum benifit possible. Analysis of production efficieny, consumption efficiency & overall economic efficiency are conducted on the basis of microeconomics.

6. Formulation of public economic policies

Microeconomic tools are used for introducing different policies relating to tax, tariff (custom duty), debt, subsidy etc. They can change the allocation of resources & they have direct & indirect effects on the production & price.

Public enterprise

Microeconomic also helps the government in formulating correct price policies of the goods & services produced & distributed by public enterprises.

7. Helpful in international trade

Microeconomics is used to explain:

a) The gain from international trade depends on the elasticity of demand of each others product.

b) The rate of exchange between currency is determined by the demand for & supply of foreign exchange.

c) The disequilibrium in the balance of payment (BOP) is cause by the inequality betn demand for & supply of foreign exchange.

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