(UNIT- 1)

MANAGERIAL ECONOMICS

AND

FINANCIAL ACCOUNTING

Presented by:

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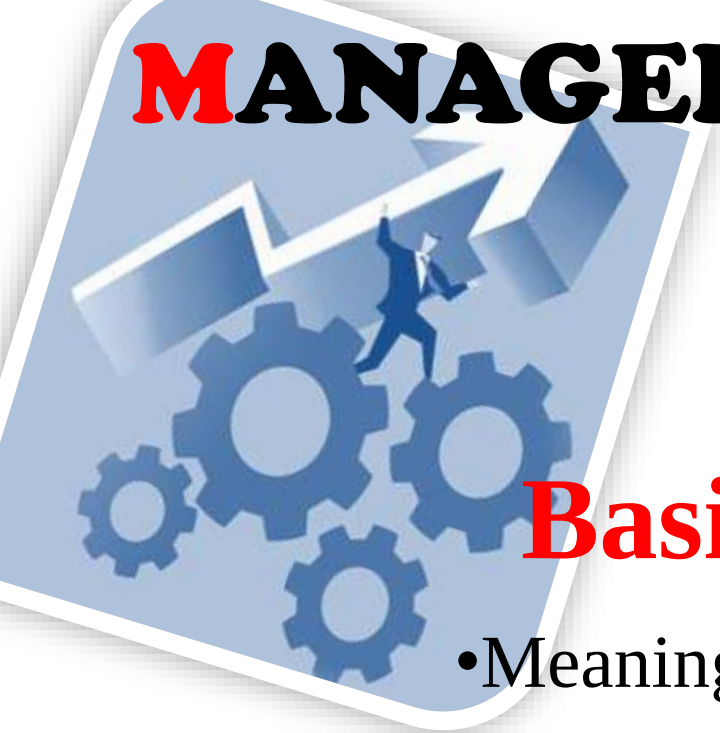


MANAGERIAL ECONOMICS

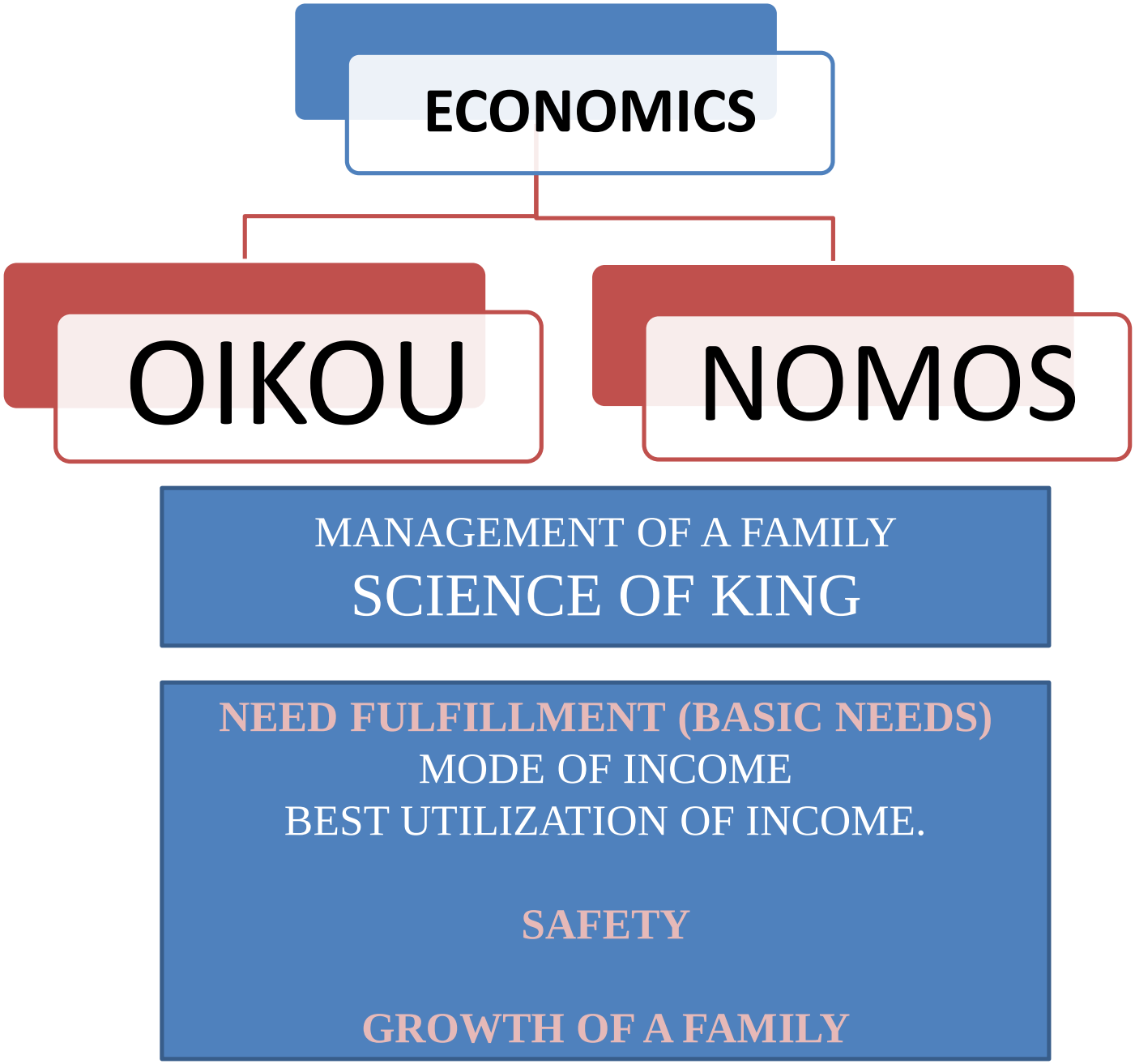
(UNIT-1)

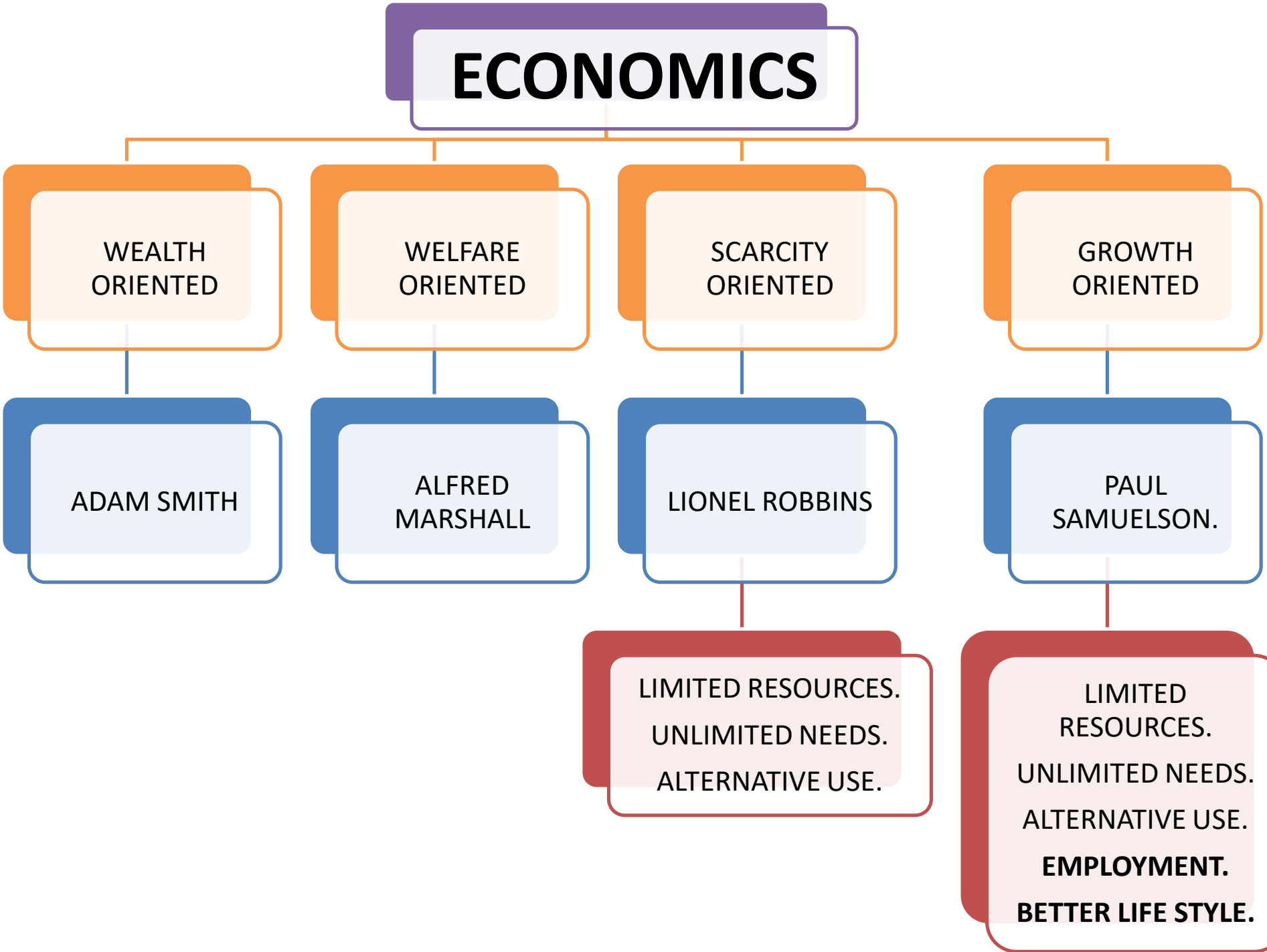
Basic Economic Concepts

- Meaning, Nature and Scope of Economics.
- Deductive v/s Inductive methods.
- Static and Dynamic Economics.
- Economic problems: scarcity and choice.
- Circular flow of economic activity.
- National Income-concepts and measurement.

CONCEPT OF ECONOMICS

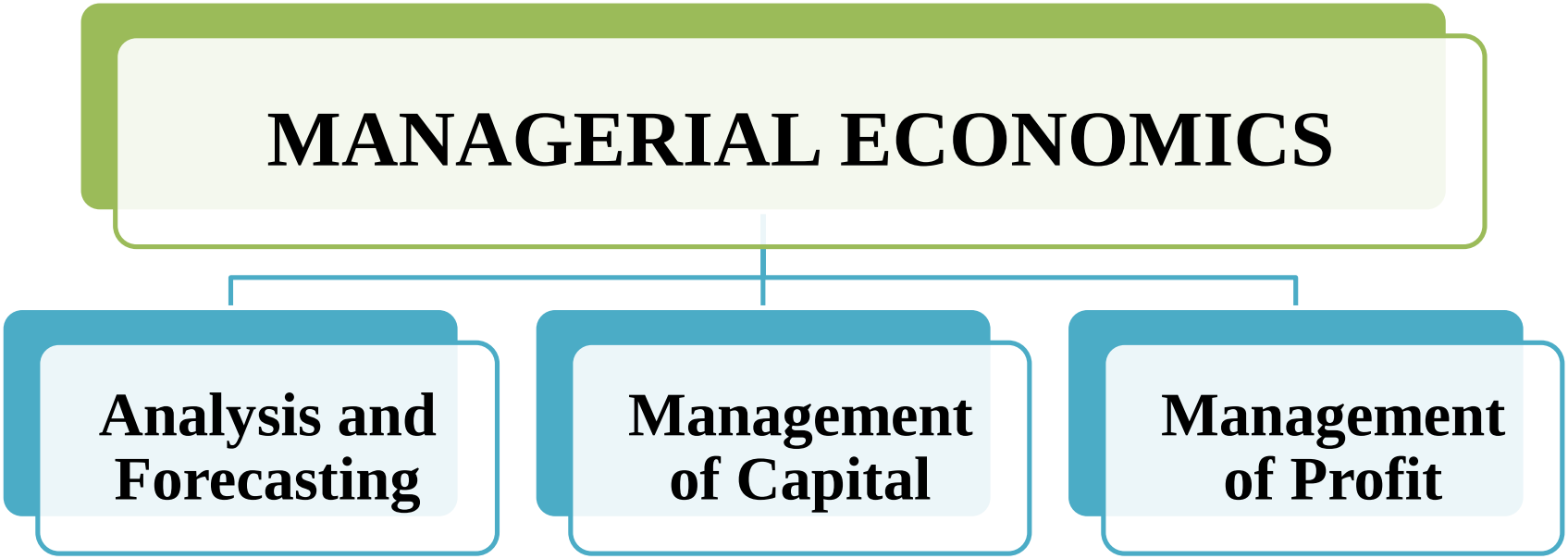
- ECONOMIC IS AN ART
- NEED FULFILLMENT OF THE CONSUMERS.
- **OPTIMUM UTILIZATION OF AVALILABLE RESOURSES.**
- CONTRIBUTION TOWARDS THE ECONOMIC GROWTH OF THE COUNTRY.


ECONOMICS
OIKOU
NOMOS
MANAGEMENT OF A FAMILY
SCIENCE OF KING
NEED FULFILLMENT (BASIC NEEDS)
MODE OF INCOME
BEST UTILIZATION OF INCOME.
SAFETY
GROWTH OF A FAMILY

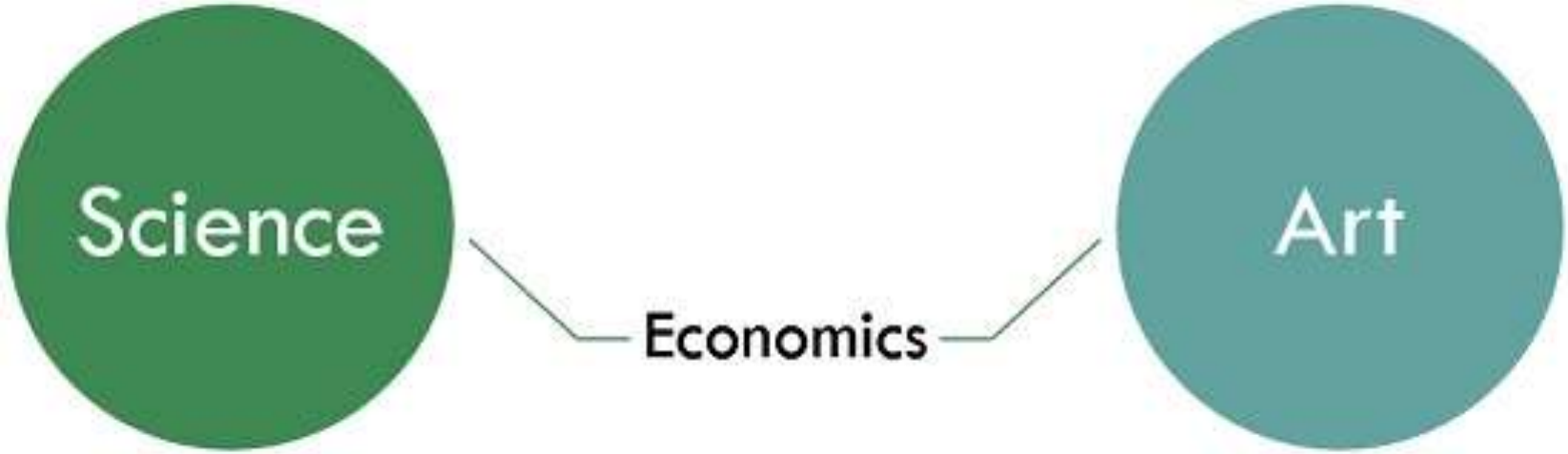

ECONOMICS
WEALTH ORIENTED
WELFARE ORIENTED
SCARCITY ORIENTED
GROWTH ORIENTED
ADAM SMITH
ALFRED MARSHALL
LIONEL ROBBINS
PAUL SAMUELSON.
LIMITED RESOURCES.
UNLIMITED NEEDS.
ALTERNATIVE USE.
LIMITED RESOURCES.
UNLIMITED NEEDS.
ALTERNATIVE USE.
EMPLOYMENT.
BETTER LIFE STYLE.

Managerial economics is a branch of economics involving the application of economic methods in the managerial decision-making process. Managerial economics aims to provide a frame work for decision making which are directed to maximize the profits and outcomes of a company. Managerial economics focuses on increasing the efficiency of organizations by employing all possible business resources to increase output while decreasing unproductive activities. The two main purposes of managerial economics are:

- To optimize decision making when faced the firm is faced with problems or obstacles, with the consideration of macro and microeconomic theories and principles.
- To analyze the possible effects and implications of both short and long-term planning decisions on the revenue and profitability of the Business.



NATURE OF ECONOMICS

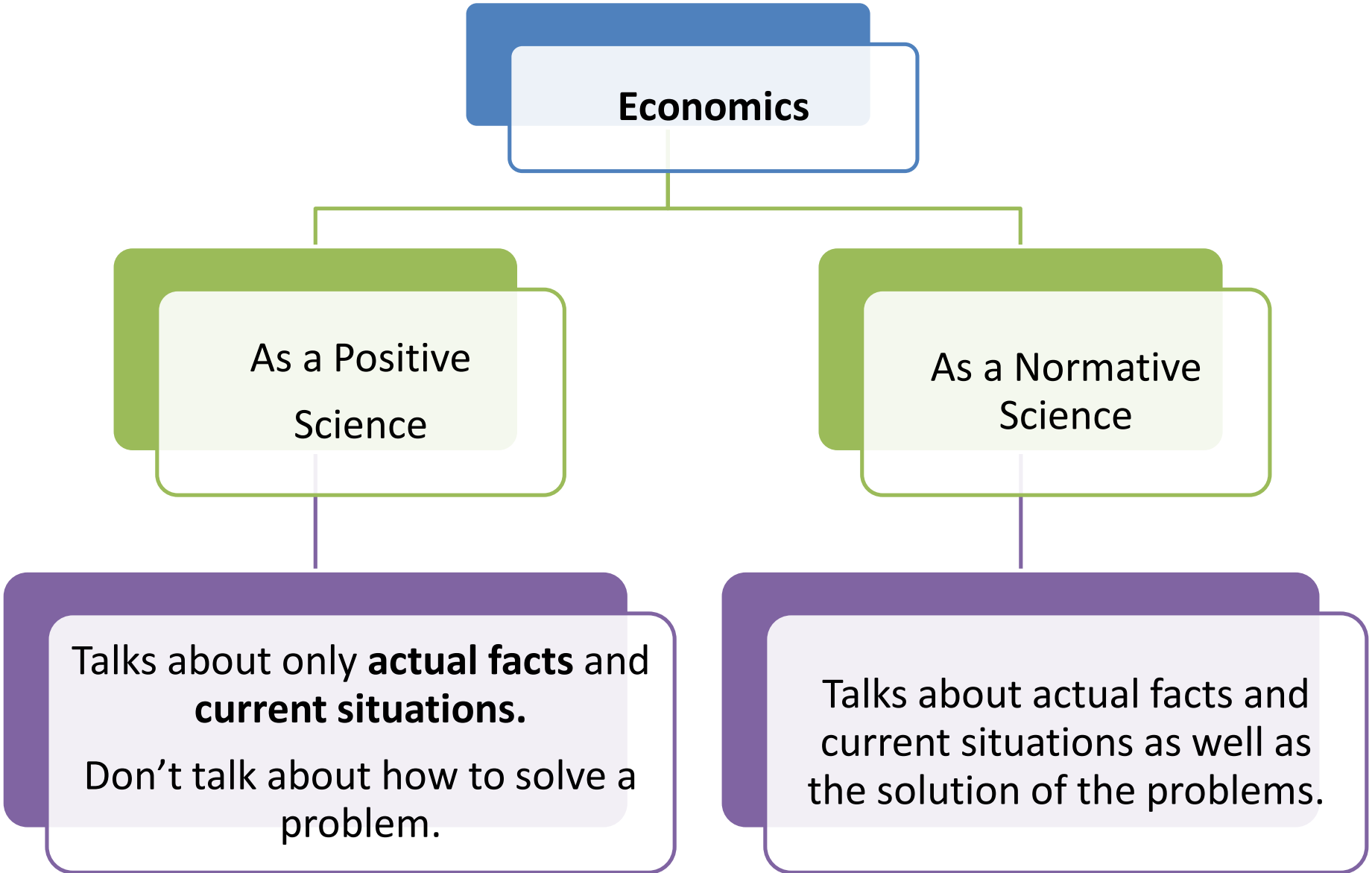


COLLECTION AND ANALYZING DATA

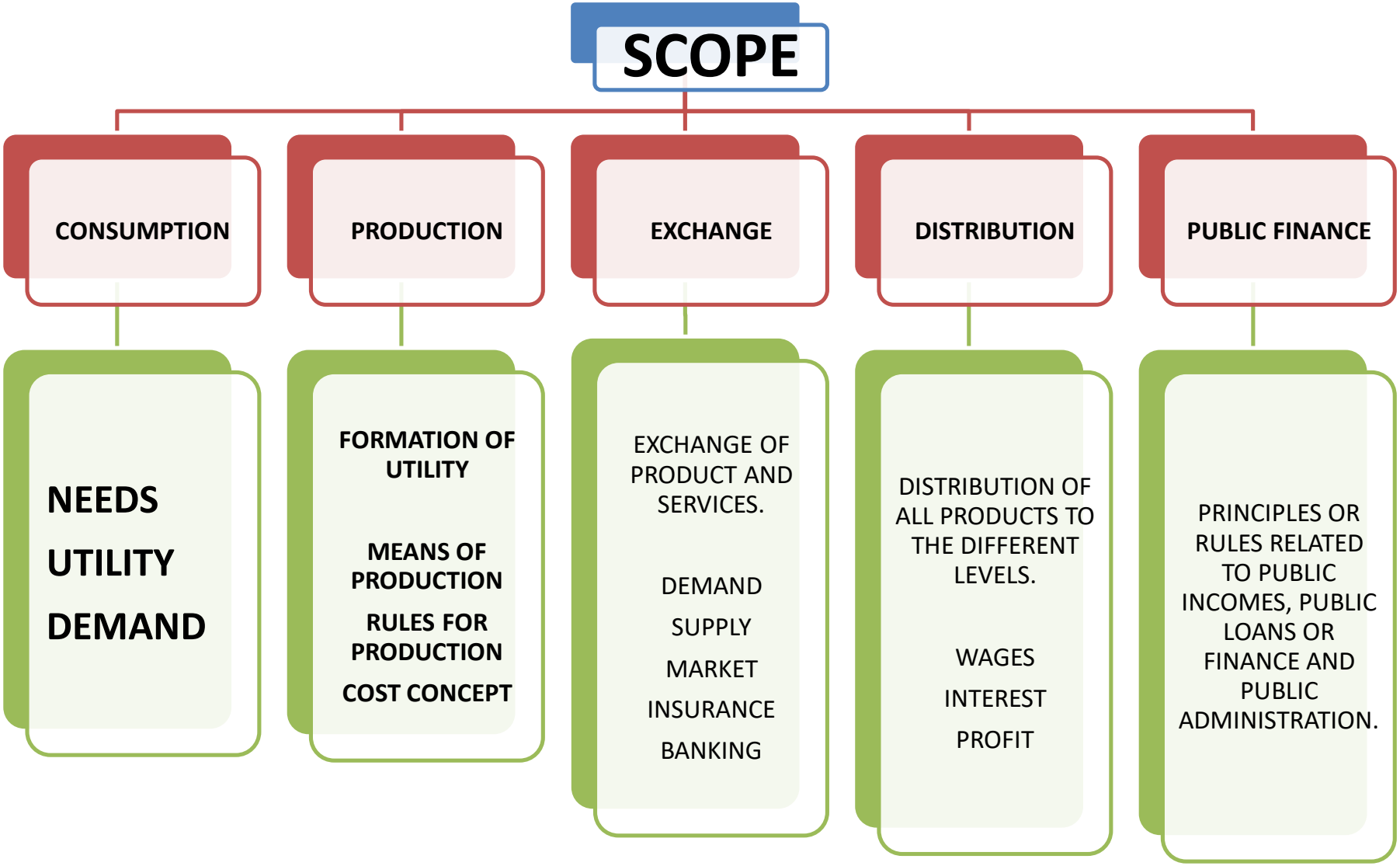
MAKING RELATED LAWS AND THEORIES.

THE BEST WAY TO DO SOMETHING.

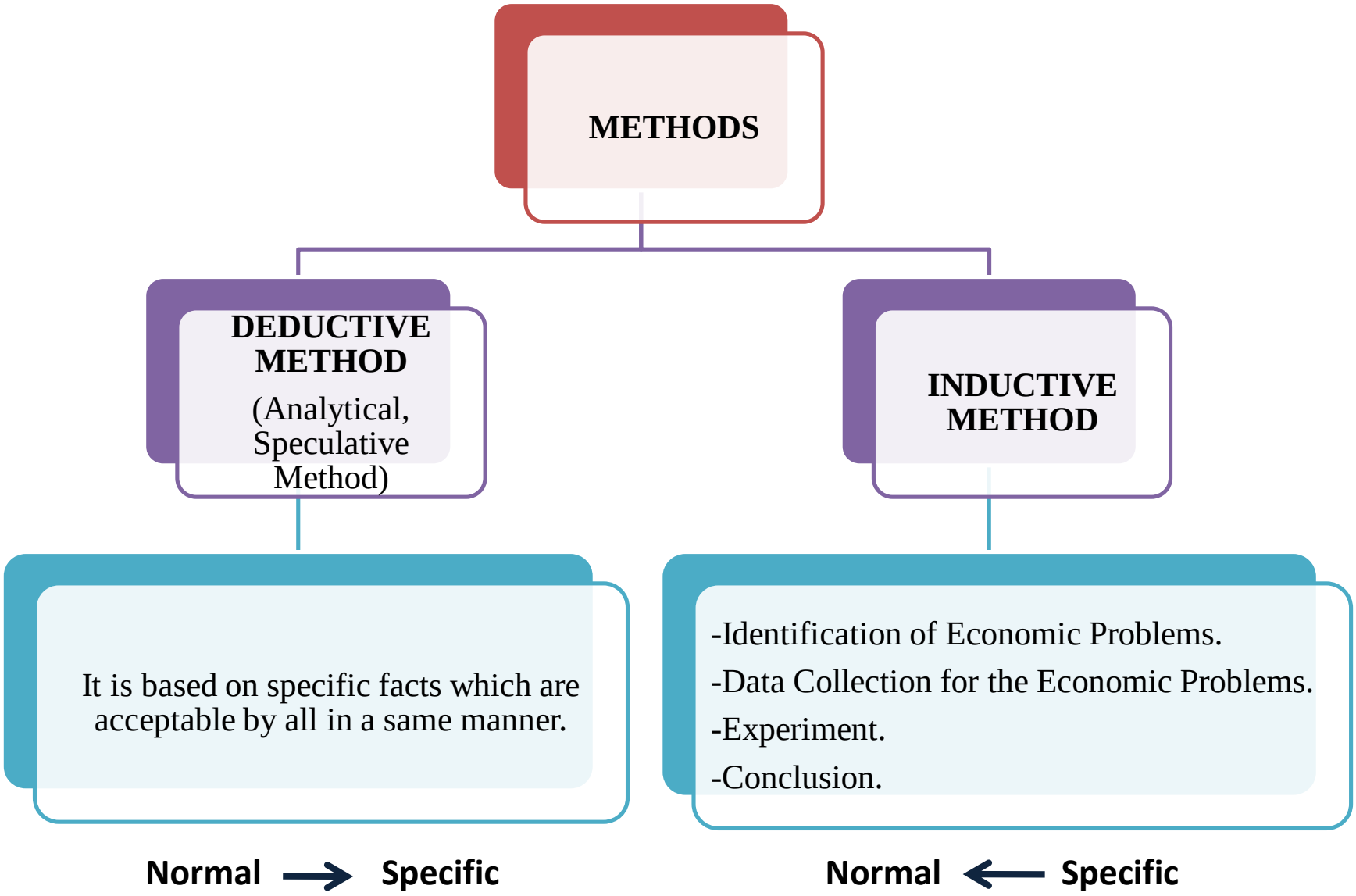
ECONOMICS: As a Positive and Normative Science



SCOPE OF ECONOMICS



METHODS OF STUDY OF ECONOMICS



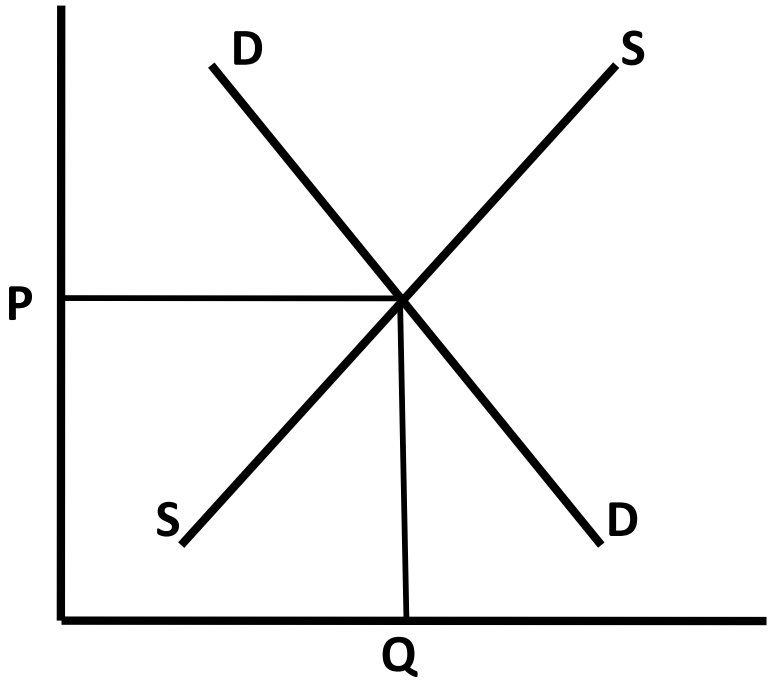
STATIC AND DYNAMIC ECONOMICS

STATIC ECONOMICS

the word *'static'* implies causing to stand or unchanged. Static position is a position of rest or unchanged position. However, economic statics does not imply absence of movement, rather it denotes a state in which there is a continuous, regular, certain and constant movement without change. In economics, the concept of static refers to a situation where there is a movement but this movement is continuous, certain, regular and constant. Static economics does not deal with the unexpected changes. It studies only the expected economic activities.

STATIC ECONOMICS (Explanation)

The meaning of static economic analysis can be explained with the help of following figure:



Economic Statics Equilibrium of a competitive market at a point of time is static economics.

Features of Static Economics

According to **Clark**, static state is the absence of five kinds of change:

- The size of population and its composition.
- The supply and quantity of capital,
- The methods and techniques of production,
- The forms of business organization and
- The habits, tastes and fashions of the people

i.e. the wants of people remain the same.

STATIC AND DYNAMIC ECONOMICS

DYNAMIC ECONOMICS

The word *'dynamics'* means causing to move. In economics, the term *'dynamics'* refers to the study of economic change. It aims to trace and study the behaviour of variables through time, and determine whether these variables tend to move towards equilibrium.

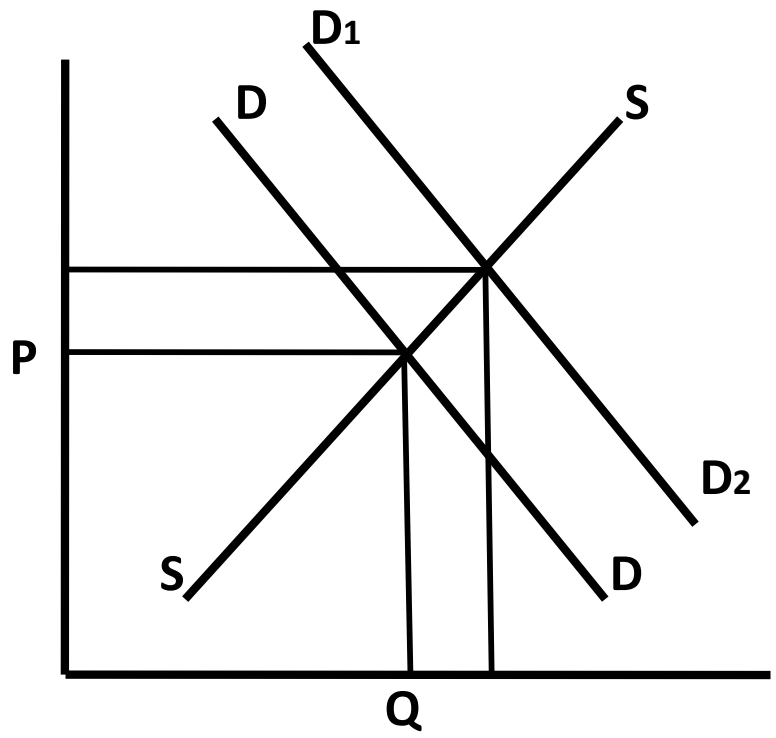
We have know than there is movement in statics also but this movement is certain, regular and expected. While dynamics refers to that movement which is uncertain, unexpected and irregular.

DYNAMIC ECONOMICS (Example)

In dynamic we focus on the change of time and how the equilibrium change with time. It is the same as watching the movie you can see how the image animate and move. Dynamic analysis allows us to see the path of variable how the variable change with time it help us to see whether the equilibrium will reach or not.

DYNAMIC ECONOMICS (Explanation)

In dynamic economics we also study the path of change or the movement towards equilibrium. This path can be explained with the help of the diagram given below which relates to price determination in a market.



FEATURES OF DYNAMIC ECONOMICS

Recently the concept of dynamics has been applied to the economy as a whole, Prof. Clark has pointed out the following features of a dynamic economy:

- In a dynamic economy, population grows;
- Quantity of capital grows;
- Modes of production improve;
- Industrial institutions undergo changes. Inefficient organizations are replaced by efficient organizations.
- Habits of the people, fashions and customs change, as wants of the people increase.

DIFFERENCE

Difference # 1. Time Element:

In static economic analysis time element has nothing to do. In static economics, all economic variables refer to the same point of time. Static economy is also called a timeless economy. Static economy, according to Hicks, is one where we do not trouble about dating.

Difference # 2. Process of Change:

Another difference between static economics and dynamic economics is that static analysis does not show the path of change. It only tells about the conditions of equilibrium. On the contrary, dynamic economic analysis also shows the path of change. Static economics is called a ‘still picture’ whereas the dynamic economics is called a ‘movie’ of the market.

DIFFERENCE

Difference # 3. Equilibrium:

Static economics studies only a particular point of equilibrium. But dynamic economics also studies the process by which equilibrium is achieved. As a result, there may be equilibrium or may be disequilibrium. Therefore, static analysis is a study of equilibrium only whereas dynamic analysis studies both equilibrium and disequilibrium.

Difference # 4. Study of Reality:

Static analysis is far from reality while dynamic analysis is nearer to reality. Static analysis is based on the unrealistic assumptions of perfect competition, perfect knowledge, etc. Here all the important economic variables like fashions, population, models of production, etc. are assumed to be constant. On the contrary, dynamic analysis takes these economic variables as changeable

ECONOMIC PROBLEM

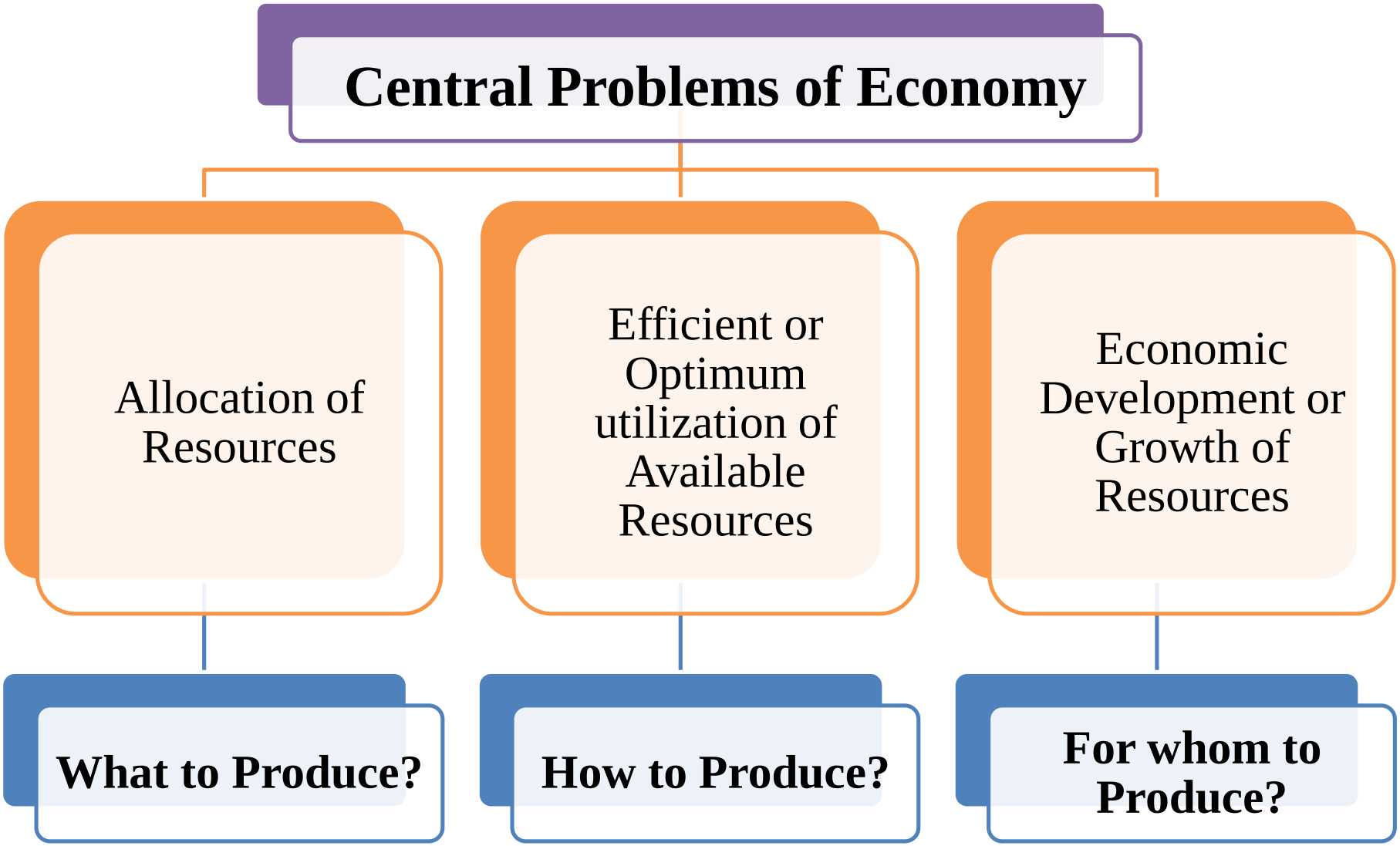
Economic problems are the science that **studies human behavior in relationship with ends and scarce means that have alternative uses**. In other words, it deals with the problem of choice.

Problem of allocation of resources in capital and consumer goods.
The problem of allocation of resources arises due to the **scarcity of resources**, and refers to the question of which wants should be satisfied and which should be left unsatisfied. In other words, what to produce and how much to produce.

The problem of full employment of resources.
A community should achieve maximum satisfaction by using the scarce resources in the best possible manner—not wasting resources or using them inefficiently.

The problem of economic growth:
If productive capacity grows, an economy can produce progressively more goods, which raises the standard of living and employment.

ECONOMIC PROBLEM



ECONOMIC PROBLEM

1. **What to produce?**

   It is related to the type of goods and services that need to be produced and the quantity to be produced. Since resources are in limited quantities, producing more of one good will result in less production of the other.

ECONOMIC PROBLEM

2. How to produce?

This aspect deals with the process or technique by which the goods and services can be produced. Generally, there are two techniques that can be used for producing, which are:

- Labour Intensive Techniques
- Capital Intensive Techniques

The choice of technique for production depends on the availability of the resource in that nation, and hence resource allocation becomes a challenge.

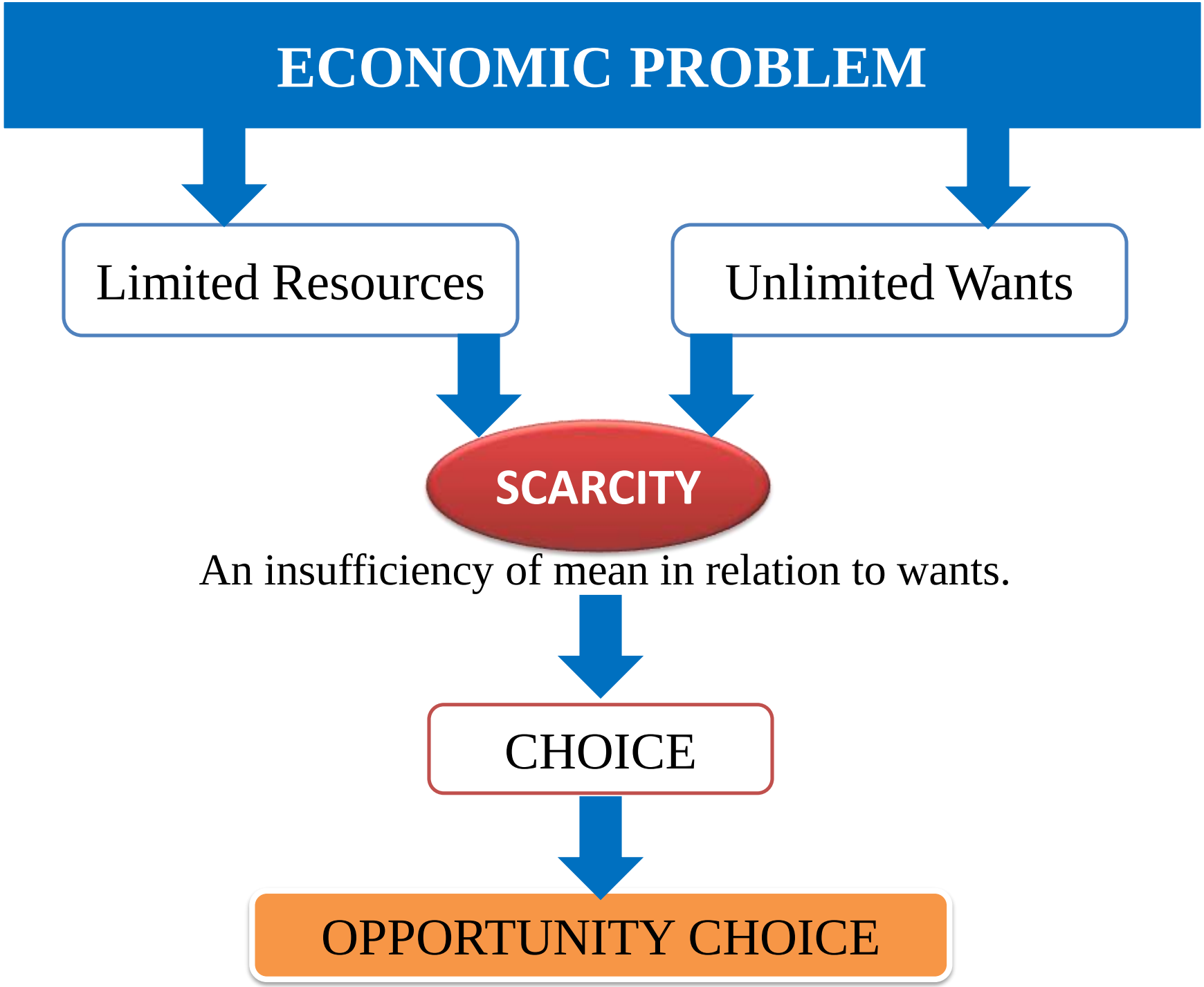
ECONOMIC PROBLEM

3. For whom to produce?

This problem deals with determining the people who will be the final consumers of the goods produced. As the resources are scarce in an economy, it becomes difficult to cater to all sections of society.

It leads to the creation of a problem of choice in an economy as a good that may be in demand among a section, may not be in demand for another section of the society.

Such a situation arises due to the difference in income distribution among the population, which causes a change in buying behaviour.


ECONOMIC PROBLEM
Limited Resources
Unlimited Wants
SCARCITY
An insufficiency of mean in relation to wants.
CHOICE
OPPORTUNITY CHOICE

CIRCULAR FLOW OF ECONOMY

The circular flow model demonstrates how money moves through society. Money flows from producers to workers as wages and flows back to producers as payment for products. In short, an economy is an endless circular flow of money.

To start off, consider 2 groups of people

Households – people like yourself

Firms – companies like BMW, Vodafone e.t.c.

Householders (people like you or me) could get a job in a factory making cars. This leads to an **output** of goods.

In return, workers get **income** (wages) from the firm.

With this income, we can buy the goods firms are producing. This is **Expenditure.** Thus in a closed economy with no saving, tax or imports. Total Output should be the same as Total Income and Total Expenditure.

CIRCULAR FLOW OF ECONOMY

Note: Factor markets are markets like labour markets.
Product markets are the production of goods like cars.
Therefore, this is the very basic circular flow of income.

Government tax and spending

To this circular flow, you could add a government which **collects taxes from firms and households**. The government then **spends this money in the form of benefits and subsidies.**

Foreign trade

Also, you could add a foreign dimension.
Goods and services could be **exported** – Money comes into economy
Goods and services could be **imported** – Money leaves the economy
Also, we don't spend all the money we receive, but will save some in banks. Firms could borrow from banks to invest.

CIRCULAR FLOW OF ECONOMY

Output (product) markets

TVs, Cars, Food, Services etc.

PAYMENT

SUPPLY

Firms sell goods and service

PAYMENT

DEMAND

Supply in Output markets Demand in input markets

FIRMS

HOUSEHOLDS

Demand in Output markets Supply in input markets

Firms buy the Households productive resources.

Households sell their productive resources.

DEMAND

PAYMENT

SUPPLY

PAYMENT

Input (factor) markets

Labor, Entrepreneurship, Capital, Land

EXPORT

IMPORT

ABROAD

Spend

TAx

GOVERNMENT

Understanding the Circular Flow Model

Sectors: Households Sector (engages in consumption spending) **C**
Business Sector (Invest and produces the goods) **I**
Government Sector (injects money into the circle) **G**
Foreign trade Sector (Import and Export) **M,X**

Outflows of Cash

Just as money is injected into the economy, money is withdrawn or leaked through various means**.**

Taxes (T) : imposed by the government reduce the flow of income.

imports (M): Money paid to foreign companies and also constitutes a leakage.

Savings (S) : by businesses that otherwise would have been put to use area decrease in the circular flow of an economy's income.

Understanding the Circular Flow Model

GDP is calculated as:

Consumer spending	**(C)**	(+plus)
Government spending	**(G)**	(+plus)
Business investment	**(I)**	(+plus)
The sum of exports	**(X)**	(-minus)
Imports	**(M)**	

Calculating GDP

GDP is calculated as C + G + I + (X – M).

If businesses decided to produce less, it would lead to a reduction in household spending and cause a decrease in GDP. Or,

If households decided to spend less, it would lead to a reduction in business production, also causing a decrease in GDP.

GDP is calculated as consumer spending plus government spending plus business investment plus the sum of exports minus imports.

Understanding the Circular Flow Model

A government calculates its gross national income by tracking all of these injections into the circular flow of income and the withdrawals from it.

Adding Up the Factors:

The circular flow of income for a nation is said to be balanced when withdrawal equals injections. That is:

The level of injections is the sum of government spending (G), exports (X) and investments (I).

The level of leakage or withdrawals is the sum of taxation (T), imports (M) and savings (S).

When G + X + I is greater than T + M + S, the level of national income (GDP) will increase.

G + X + I > T + M+ S = GDP will Increase.

When the total leakage is greater than the total injected into the circular flow, national income will decrease.

G + X + I < T + M+ S = GDP will Decrease.

NATIONAL INCOME - Concepts and Measurement

NATIONAL INCOME - Concepts

National income is the **money value of all the final goods and services produced by a country during a period of one year**. National income consists of a collection of different types of goods and services of different types.

Why is national income important?

Measuring the level and rate of growth of national income is important to economists when they are considering:

- Economic growth and where a country is in the business cycle
- Changes to average living standards of the population
- Looking at the distribution of national income (i.e. measuring income and wealth inequalities)

NATIONAL INCOME – Basic Concepts

- Gross Domestic Product (GDP)
- Gross National Product (GNP)
- Net National Product (NNP)
- National Income at Factor Cost (NI)
- Personal Income (PI)
- Disposable Income (DI)
- Per Captica Income

GROSS DOMESTIC PRODUCT (GDP)

• Gross domestic product is the money value of all final goods and services produced within the domestic territory of a country during a year.

GDP=(P*Q)

where

P = price of goods and services

Q = quantity of goods and services

• Includes:-

Goods & services + government exp.+ private domestic investment in capital goods+ exports & imports

GDP – By Sum of Spending, Factor Incomes or Output

GDP (Expenditure)

- Consumption
- Government spending
- Investment spending
- Change in value of stocks
- Exports
- **- Imports**
- = GDP (known as aggregate demand)

GDP (Factor Incomes)

- Income from people in jobs and in self-employment (e.g. wages and salaries)
- Profits of private sector businesses
- Rent income from the ownership of land

GDP (Value of Output)

- Value added from each of the main economic sectors
- These sectors are
  - Primary
  - Secondary
  - Manufacturing
  - Quarternary

GROSS NATIONAL PRODUCT(GNP)

- Total market value of all final goods and services produced annually in a country plus net factor income from aboard.

- GNP=GDP+NFIA (net factor income from aboard)

- Includes: Goods & services government exp.+ private domestic investment in capital goods+ exports & imports+ net factor income from aboard.

Following are its three main components:

(i) Net compensation of employees.

(ii) Net income from property and entrepreneurship (rent, interest, profit).

(iii) Net retained earnings of resident companies in abroad.

NET NATIONAL PRODUCT(NNP)

- Derived by subtracting depreciation allowance from GNP.

NNP = GNP - Depreciation

NATIONAL INCOME – Basic Concepts

NATIONAL INCOME AT FACTOR COST (NI)

• Sum of all incomes earned by resources suppliers for their contribution of Land, Labour, Capital and Organization.

NI = NNP + Subsidies - Interest

NATIONAL INCOME – OTHER TERMS

- **Personal Income (PI)**

Personal Income is the total money income received by individuals and households of a country from all possible sources before direct taxes.

PI = NI - Corporate Income Taxes - Undistributed Corporate Profits - Social Security Contribution + Transfer Payments

NATIONAL INCOME – OTHER TERMS

Disposable Income (DI)

The income left after the payment of direct taxes from personal income is called Disposable Income. Disposable income means actual income which can be spent on consumption by individuals and families.

DI = PI - Direct Taxes

NATIONAL INCOME – OTHER TERMS

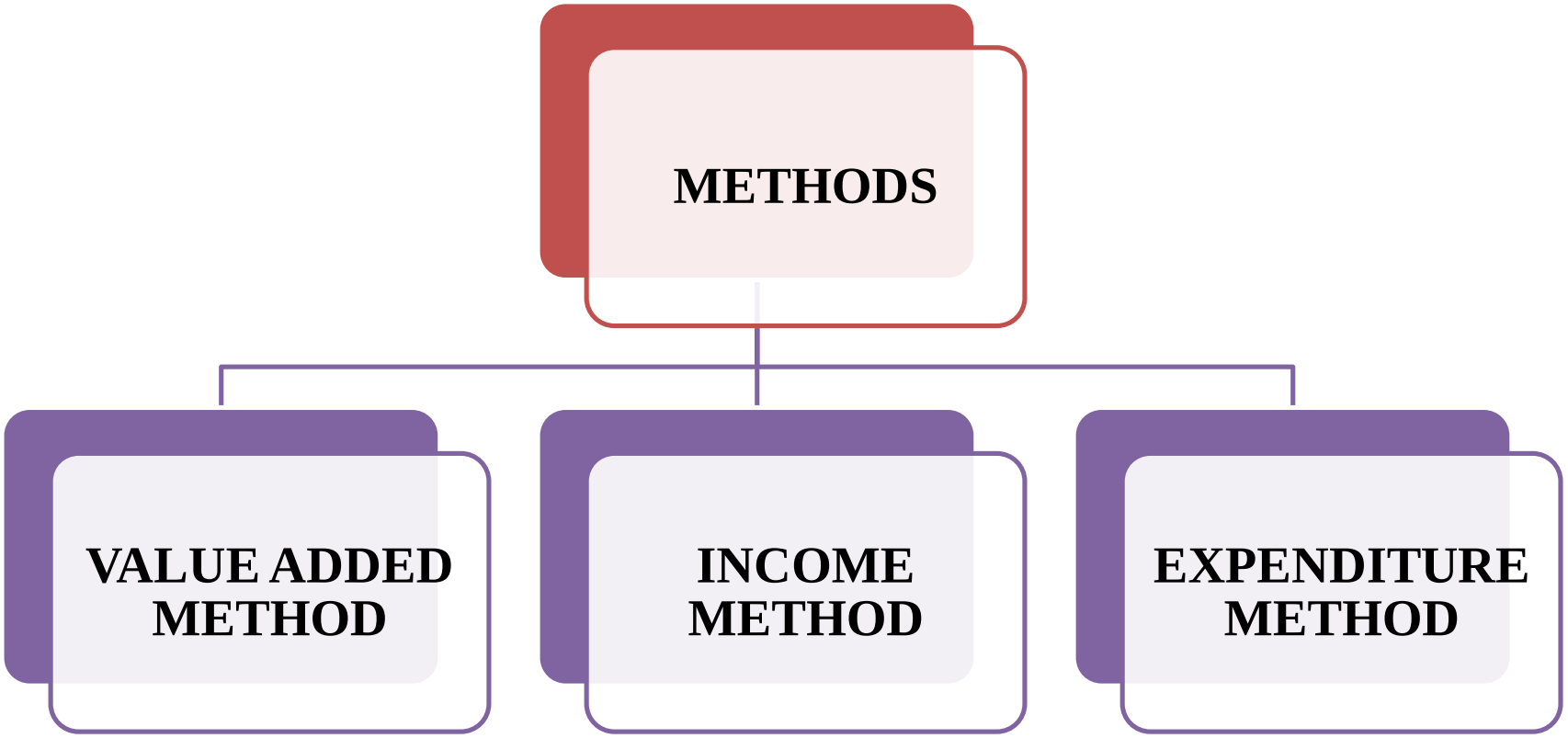
Per Capita Income (PCI)

Per Capita Income of a country is derived by dividing the national income of the country by the total population of a country. Thus,

PCI= Total National Income / Total National Population

NATIONAL INCOME – Methods

- Three methods of measuring national income:-



NATIONAL INCOME – **Value added method**

The value-added method is also known as Product Method; Inventory Method; Net Output Method; or Industrial Origin Method. This method is used to measure national income in different phases of production in the circular flow. It shows the contribution (value added) of each producing unit in the production process.

i. Every individual enterprise adds certain value to the products, which it purchases from some other firm as intermediate goods.
ii. When value added by each and every individual firm is summed up, we get the value of national income.

Value Added = Value of Output – Intermediate Consumption

As this method focuses on **net value addition** by each of the components in production, therefore the following elements should be **excluded or subtracted from the output** of the enterprise.

- Raw materials consumption
- Capital consumption
- Net Indirect Taxes

NATIONAL INCOME – **INCOME METHOD**

It is the sum of all income derived from providing the factors of production. It includes wages and salaries, rent, interest and profits within a country in a given year.

The income method measures national income from the side of payments made to the primary factors of production in the form of rent, wages ,interest and profit for their productive services in an accounting year.

Land	: rent
Labor	:wages
Capital	: interest
Entrepreneur	: profit

TOTAL INCOME = NATIONAL INCOME

NATIONAL INCOME – EXPENDITURE METHOD

Expenditure method measures national income as aggregate of all the final expenditure on gross domestic product in an economy during a year.

This is the sum of expenditure made for final consumer goods and investment demand, and for net export.

Therefore, the sum of total income (Y) equals to the sum of final expenditure incurred on consumption goods (C) and the sum of investment goods (I). Symbolically, Y = C + I.

• Total amount spent on goods and services produced in a nation by households, firms, government and foreigners .

I. HOUSEHOLD : CONSUMPTION
II. FIRMS : INVESTMENT
III. GOVERNMENT :GOV'S SPENDING
IV. FOREIGNERS : EXPROT-IMPORT

C + I + G + (X - M) = TOTAL EXPENDITURE

FACTORS EFFECTING NATIONAL INCOME

- Factors of production
- Technology
- Government
- Political stability
- Corruption

APPLICATIONS OF NATIONAL INCOME

- Living Standard
- Policy formation
- International comparison
- Business decision
- Growth of economy
- Helpful in removing inequalities in income distribution