UNIT – I

INTRODUCTION TO MANAGERIAL ECONOMICS

Introduction to Economics : Economics is the study of the operation of the economy. Economics tells us to satisfy our unlimited wants with the limited means. This is the economic problem – unlimited wants = Very limited means. The fundamental economic problem is that the things are scarce (not enough). This means that our wants almost always exceeds the resources available for their satisfaction individual people never seem to have enough money to buy all the things they would like to have commercial firms never have sufficient financial or other resources to produce all that they would like to supply.

Economics : Economics as the science of wealth

The economics is concerned with the study of economic activities o both individuals and nations. It primarily deals with human wants, all sorts of resources, their employment, the production, exchange and consumption of goods and services. Thus, the subject matter of economics, traditionally, can be divided into four branches viz. production, exchange distribution and consumption. Production deals with the activities that produce goods and services to satisfy human desires or wants. The process of buying and selling of goods and services is known as exchange. It also includes how the prices of these goods or services are determined. Distribution refers to the process of sharing the wealth created by production among the factors of production viz, land, labour, capital and organization. Consumption is the ultimate objective of entire economic activity. It is the process of using the goods and services for getting these desires or wants satisfied. Over the centuries, many economists gave many definition to the subjects of economics, of which the following could be considered and a great importance.

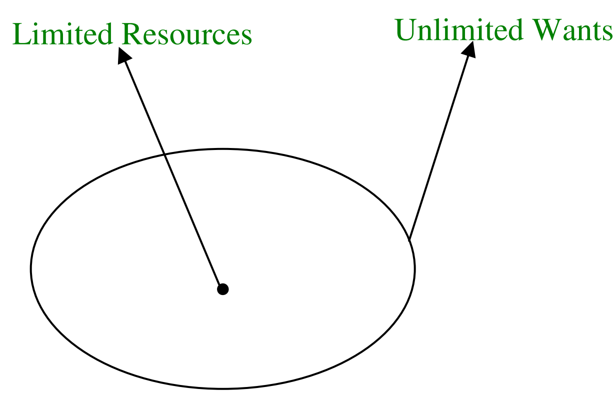
Wealth Definition : According to the classical economists, such a Adam smith defined Economics as the science of wealth. Adam Smith systematized the concepts in the form the book that was entitled as "An enquiry into the nature and cause of the wealth of nations. " These economists stated that Economics is related to and concerned with wealth.

Wealth concept of economics was bitterly criticized, because it assumed wealth as an end of human activities. If it is accepted in life, there will be no place for love, affection, sympathy and patriotism. Absence of thee value will make our real life a hell.

Welfare Concept : Prof. Alfred Marshall strongly condemned the narrow concept of wealth notion and gave anew orientation to the subject. According to him "Economics is a study of mankind in the ordinary business of life. It is on the one side the study of wealth and on the other and more important side, a part of the study of man. He strongly believes that ultimate purpose or objective of economics is to promote the well-being of mankind and thus welfare of society. He however still regarded the economics as the study of wealth but placed more importance on the part of the study of man and his welfare.

The pioneers of 'scarcity concept' also criticized welfare concept. According to these economists, it will be an injustice to the subject, if it is restricted to ordinary business of life, concerned with economic activities and related to human welfare only.

Scarcity Concept : The profounder of this concept was "Lionel Robbins". According to him, "Economics is the science, which studies human behaviors as a relationship between ends and scarce means which have alternative uses".

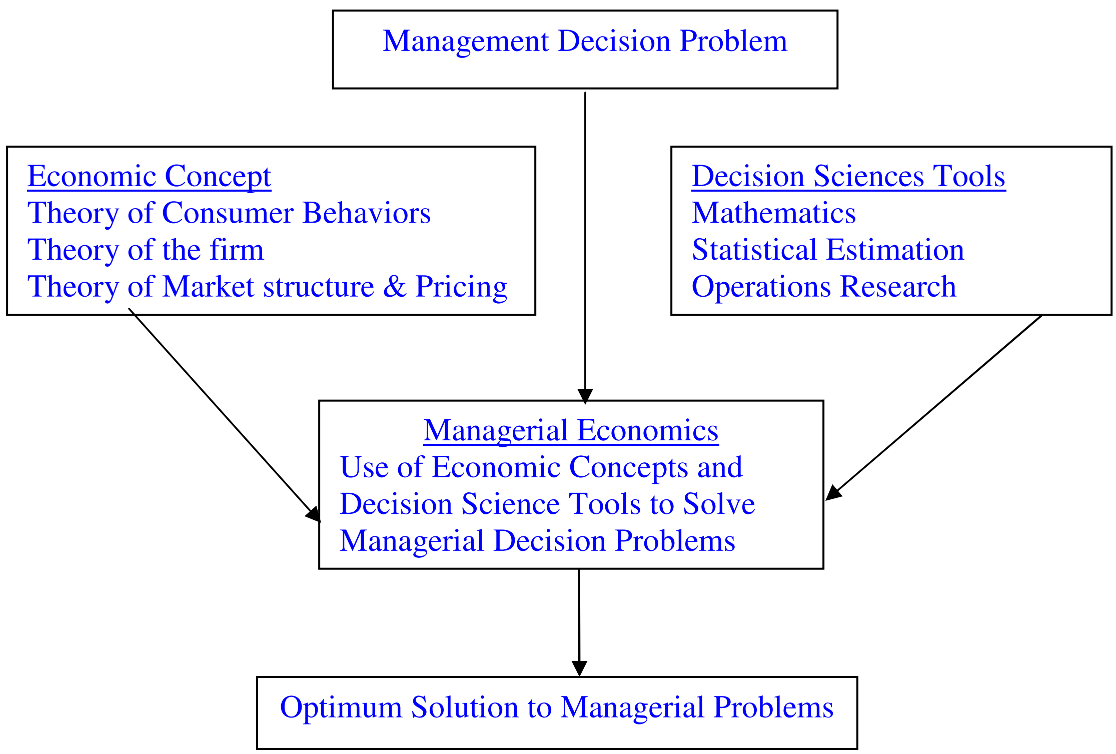


According to this approach certain universal truth are regarded as the basis of economic problems. Every individual and economy has unlimited wants and scarce means to satisfy these wants. Inability to satisfy unlimited wants with limited resources creates the problems of choice making i.e., fixing priority of wants to be satisfied.

Managerial Economics : "Managerial Economics is the integration of economic theory with Business practice for the purpose of facilitating decision making and forward planning By management." ___Spence and Siegel

"Managerial economics refers to the application of economic theory and tools of analysis of decision science to examine how an organization can achieve its aims and objectives more efficiently." ____Salvatore

"Managerial economics is the application of economic theory and methodology to business administration practice." _____Brigham and Pappas.



Nature of Managerial Economics:

Important features of managerial economics are as under:

Similar to Micro Economics: Managerial economics studies about the firm and scarce resources for maximizing output, finding solutions to the problem of the firm for maximizing profit.

Operates against the backdrop of Macroeconomics: The Limiting conditions of macroeconomics are same for managerial economics. So managerial economist can decide the strategy to work considering these conditions such as inflation, government etc.

Normative Statement : The statements are usually based on moral attitude and value judgements

Perspective actions : Managerial economics is goal oriented. The course of action is chosen from available alternatives.

Applied in nature : The model relects the real business situations hence are more useful for decision making in diverse fields. Case study methods are also used to identify and understand the problem

Interdisciplinary : Managerial Economics uses tools and techniques which are derived from management economics, statistics, accountancy, sociology and psychology.

Scope of Managerial Economics: Managerial economics has close connection with economic theory (micro-economics as well as macro-economics), operations research, statistics, mathematics and the theory of decision-making. Managerial economics also draw together and relates ideas from various functions areas of management like production, marketing, finance and accounting, project management etc.

Demand analysis and forecasting: A business firm is an economic organism, which transforms productive resources into goods that are to be sold in a market.

Cost analysis: The factors causing variations in cost must be recognized and allowed for, if management is to arrive at cost estimates, which are significant for planning purposes.

Production and Supply analysis: Production analysis deals with different production functions and other managerial uses. Supply analysis deals with various aspects of supply of a commodity. Certain important aspects of supply analysis are supply schedule, and functions, law of supply and its limitation, elasticity of supply of factors influencing supply.

Pricing decisions, policies and practices: The important aspects dealt with under this are price determination in various market forms, pricing methods, differential pricing, product line pricing and price forecasting.

Profit Management: Business firms are generally organized for making profits and in the long run, profits provide the chief measure of success. In this connection, an important point worth considering is the element of uncertainty existing about profits because of variations in costs and revenues, which in turn are caused by factors both internal and external to the firm.

Characteristics of Managerial Economics:

1. Managerial economics is micro-economics in character. Because, the unit of study is a firm. Managerial economics does not deal with the entire economy as unit of study.
2. Managerial economics largely uses that body of economic concepts and principle which is known as 'Theory of the firm' or economics of the firm. In addition, it also seeks to apply profit theory, which forms part of distribution theories in economics.
3. Managerial economics considers the particular environment of decision-making
4. Managerial economics belongs to normative economics rather than positive economics.
5. It is prescriptive rather than descriptive.

Relationship of Managerial Economics with other branches of learning's

Micro Economics: Managerial economics is concerned with optimization of certain objective functions of a firm within given constraints. Obviously, the goals of business have to be determined, resources assessed and their use pattern decided upon, to accomplish the goal of business in the best possible manner.

Macro Economics: Macroeconomics deals with the concepts of business cycle, national income, employment, investment etc. The macro economic concepts are used in managerial economic for forcecasting the general business activities.

Accounting: Managerial economics draws heavily on him accounting records, which provide an authentic source of information, as far as the statistics of production, marketing, finance, etc. are, concerned accounting records provide a fund of information over a period of time that has to be analyzed and sometimes classified according to the need of decision-making.

Mathematics: Estimation and modeling are the integral part of managerial economics for decision-making and forward planning mathematics provides a set of tools, which includes algebra, calculus, exponentials and vectors. These tools are used for managerial economic analysis.

Statistics and Managerial Economics: Statistics are techniques used for analyzing cause and effect relationship. Managerial economics aims at quantifying the past economic activity to predict its future. Average, correlation, regression, time-series interpolation are popularly used statistical techniques.

Operations Research and Managerial Economics: Both operations research and managerial economics are focused for problem solving and decision-making. In addition, they are used for building economic models.

Public Economics: The role of government interference by means of tax policy, fiscal policy, monetary policy, trade policy, industrial policy etc., greatly affects the business activities of every firm. Therefore public economics is also has vital association with the subject matter of managerial economics.

Decision Making: The success of every management depends upon its correct decision-making. The theory of decision-making has significance in managerial economics. The theory of decision-making is concerned with the processes by which expectations under conditions of uncertainty is formed.

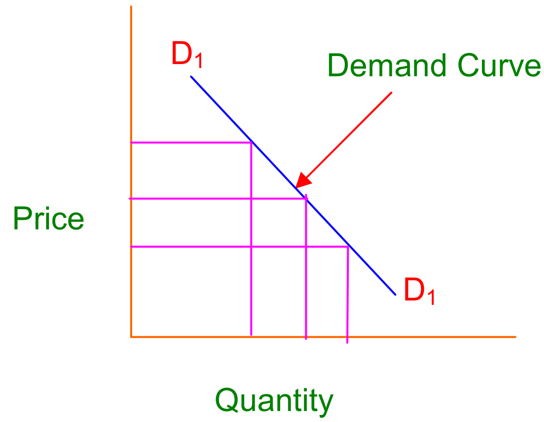
Meaning of Demand: Demand in economics is the desire for something plus willingness and ability to pay a certain price in order to possess it. It means being both willing and able to buy something just wanting something is not enough. Needing it desperately is also not acceptable unless you have the money to pay. Thus, demand is a want for something supported by the money to but it.

Demand Analysis : Demand analysis seeks to identify, analyze and measure the forces and factors that determine sales.

Law of Demand : The relation of price to sales is known in economics as the law of demand. The law of demand states that higher the price, lower the demand, and vice-versa other things, remains the same.

Example:

Price	Quantity
Rs.5	80 Units
Rs.4	100 Units
Rs.3	150 Units
Rs.2	200 Units

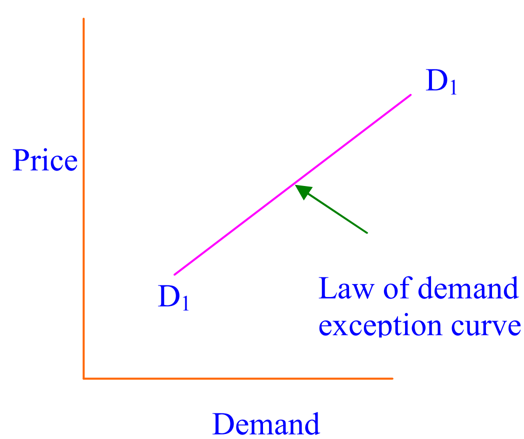


Exceptions to the Law of Demand :

Veblen or Demonstration Effect: These are some goods, which are purchased mainly for their 'snob appeal'. They are cases of what veblen, and American economist, called "Conspicuous consumption", He thought that some purchases were made not for the direct satisfaction, which they yield, but for the impression, which they made on other people. EX : Diamonds

Speculative Effect: In the speculative market, a rise in prices is frequently followed by larger purchases and a fall in prices by small purchases. When share prices rise, people expect further rise and rush to buy when prices fall, they wait for further fall and stop buying. EX : TCS share value in stock market

Giffen Goods: The Giffen goods/Inferior goods are exception to the law of demand. When the price of an inferior good falls, the poor will buy less and vise versa. Sir Robert Giffen has made a study on expenditure pattern of workers in Ireland in the 19th century. He found that when there was an increase in the price of potatoes; there was more demand for it. This exceptional behavior was found because of the following reason. Normally, the



working class in Ireland used to have potatoes and meat as daily consumption, potato being the main food. When there was an increase in the price of potatoes, the same quantity was consumed, as it was an essential item. To buy the same quantity of potato, more money had to be spent. As a result, less money was available for buying meat. Due to that, the consumption of meat became less. This led to less satisfaction and less calorie content in the food. People wanted to compensate this and have purchased more of potatoes. Thus Giffen has indicated this position as a paradox which is against the normal operation of law of demand.

Ignorance: Sometimes, the quality of the commodity is judged by its price. Consumers think that the product is superior if the price is high as such they buy more at a higher price.

Fear of Shortage: During the times of emergency or war, people may expect shortage of a commodity. At that time, they may buy more at a higher price to keep stocks for the future.

Necessaries: In the case of necessaries like rice, vegetables, etc., people buy more even at a higher price.

Factor Influencing the Demand/Determinants of Demand :

Price of the commodity : The price of a given commodity is an important factor in influencing its demand. If the price is very high, only a few persons can afford to buy it. Hence, the quantity of the commodity bought at this high price will be low i.e. the commodity will have a lower demand and vice versa.

Income of the consumer : Besides the price level, income of the consumer greatly determines the demand for a commodity. If there is a change in the income of the consumer, then it will reflect on the demand of the commodity he purchases. A rise in his income will lead to purchase more units of the commodity and vice versa.

Size and composition of the population : If there is a change in the population of a given market, there will be a change in demand. Rise in the population will result in increase in demand and fall will lead to decrease.

Price of substitutes : In case of substitutes of a product, the change in the price of substitute will effect the demand for the other product.

Price of complementary : The changes in the price of a complementary goods will affect the demand for primary good.

Tastes and fashions : Changes in tastes and fashions of the society will effect the demand for a product.

Advertisement and sales promotion : In today's world, advertisement has a major role in demand creation for a product. Advertisement creates the awareness about product, so the consumer will be influenced and the demand for the product goes up.

Quality of product : Any product with proven high quality will have a greater demand.

Season and weather condition : Certain goods are seasonal in nature. They will be demand only in a particular season. Weather condition also creates demand for some products.