

Managerial Economics- Definition, Scope and its relationship with other subjects

Dr Saroj Lakhawat
Assistant Professor
Department of Economics
Engineering College Ajmer

Managerial Economics Definition

Managerial economics is a stream of management studies that focus on decision making and problem-solving. Both microeconomics and macroeconomics theories are applied. It focuses on the efficient utilization of scarce resources. It is a discipline that brings together the concepts of business and economics. It enables leaders and managers with relevant data—demand projections, capital management, pricing decisions, profit management, cost analysis, and production analysis. Managerial economics analyzes the internal and external factors impacting an organization. It aims to resolve problems using micro and macroeconomic tools.

Thus, it is a practical approach where economic measures are undertaken to solve business problems. In addition to solving problems, this approach extends to the growth and sustainability of a firm.

Scope of Managerial Economics

The concept is implemented in the following ways:

- Microeconomics for Solving Operational Problems

Managers apply microeconomic principles and theories to handle internal issues—production, sales, distribution, capital, pricing, profit, workforce, etc. Given below are the various microeconomic theories:

I Production Theory: In order to ensure high productivity with limited resources, microeconomics studies the impact of production-related decisions: capital requirement, labor requirement, production capacity, process, methods, techniques, cost, and quality,

II Investment Theory: Companies diligently plan their capital investment to ensure resource utilization—generating higher returns.

III Demand Theory: To ensure consumer satisfaction, managers analyze consumer needs and requirements—they understand consumer attitudes and responses toward company products or services.

IV Market Structure Pricing Theory: It involves price determination and management—the business prices its products and services very competitively. To determine the price, the firms consider production cost, market demand, and marketing cost.

V Profit Management: Profit maximization is the ultimate aim—this approach focuses on cost and revenue.

Macroeconomics for Handling External Environment Issues

Businesses operate in external environments—face unforeseen challenges. Macroeconomics deals with external challenges with the help of tools like **PESTEL** analysis. Let us go through the components in detail:

Political (P): The government plays a critical role in a firm's progress. Thus, managerial economics studies how governance style, political unrest, and foreign collaboration affect private sector companies.

Economic (E): Business profitability greatly depends on government policies, tax reforms, GDP, and the nation's economic stability.

Social (S): The social environment molds businesses. This includes factors like societal values, beliefs, attitudes, consumer awareness, employment conditions, literacy rate, and trade unions.

Technological (T): Technology enhances the production and distribution of goods or services.

Environmental (E): When awareness of environmental concerns increases—firms face pressure to adopt sustainable and eco-friendly practices. This includes the curtailing of pollution, waste management, preservation of water, and preservation of natural resources.

Legal (L): Businesses must operate within legal boundaries—national laws pertaining to consumer rights, labor laws, health and safety laws, product labeling regulations, and advertising guidelines.

Nature of Managerial Economics

Managerial economics has often been confused with traditional economics but it has a whole new meaning and purpose. Let us understand the distinction by venturing deeper into its characteristics:

- **Microeconomics:** It solves microeconomic problems faced by a particular firm—does not focus on the entire economy.
- **Pragmatic:** Managerial economics is a practical approach—it applies economic principles in decision-making and problem-solving.
- **Multidisciplinary:** This approach aggregates multiple streams—business, management, accounting, statistics, finance, and mathematics.
- **Application of Macro Economics:** Every firm operates in an external environment—influenced by legal, political, global, social, economic, technological, competitive, and demographic factors. Macroeconomics deals with all these threats.
- **Management Oriented:** It educates leaders and managers on how to make crucial decisions in critical situations.

MANAGERIAL ECONOMICS IN RELATION WITH OTHER DISCIPLINES / BRANCHES OF KNOWLEDGE

Managerial economics has a close linkage with other disciplines and fields of study. The subject has gained by the interaction with Economics, Mathematics and Statistics and has drawn upon Management theory and Accounting concepts.

Managerial eco-nomics integrates concepts and methods from these disciplines and brings them to bear on managerial problems. Managerial Economics & Other Disciplines

Managerial Economics and Economics:

Managerial Economics is economics applied to decision making. It is a special branch of economics, bridging the gap between pure economic theory and manage-rial practice. Economics has two main branches—micro-economics and macro-economics.

Micro-economics:

‘Micro’ means small. It studies the behaviour of the individual units and small groups of units. It is a study of particular firms, particular households, individual prices, wages, incomes, individual industries and particular commodities. Thus micro-economics gives a microscopic view of the economy.

Macro-economics:

‘Macro’ means large. It deals with the behaviour of the large aggregates in the economy. The large aggregates are total saving, total consumption, total income, total employment, general price level, wage level, cost structure, etc. Thus macroeconomics is aggregative economics. It examines the interrelations among the various aggregates, and causes of fluctuations in them. Problems of determination of total income, total employment and general price level are the central problems in macro-economics.

Macro-economics is also related to managerial economics. The environment, in which a business operates, fluctuations in national income, changes in fiscal and monetary measures and variations in the level of business activity have relevance to business decisions. The understanding of the overall operation of the economic system is very useful to the managerial economist in the formulation of his policies.

Managerial Economics and Theory of Decision Making:

The theory of decision making is relatively a new subject that has a significance for managerial economics. In the process of management such as planning, organising, leading and controlling, decision making is always essential. Decision making is an integral part of today's business management. A manager faces a number of problems connected with his/her business such as production, inventory, cost, marketing, pricing, investment and personnel.

Economist are interested in the efficient use of scarce resources hence they are naturally interested in business decision problems and they apply economics in management of business problems. Hence managerial economics is economics applied in decision making.

Managerial Economics and Operations Research:

Mathematicians, statisticians, engineers and others join together and developed models and analytical tools which have grown into a specialised subject known as operation research. The basic purpose of the approach is to develop a scientific model of the system which may be utilised for policy making. The development of techniques and concepts such as Linear Programming, Dynamic Programming, Input-output Analysis, Inventory Theory, Information Theory, Probability Theory, Game Theory, Decision Theory and Symbolic Logic.

Managerial Economics and Statistics:

Statistics is important to managerial economics. It provides the basis for the empirical testing of theory. It provides the individual firm with measures of appropriate functional relationship involved in decision making. Statistics is a very useful science for business executives because a business runs on estimates and probabilities. Statistics supplies many tools to managerial economics. Suppose forecasting has to be done. For this purpose, trend projections are used. Similarly, multiple regression technique is used. In managerial economics, measures of central tendency like the mean, median, mode, and measures of dispersion, correlation, regression, least square, estimators are widely used.

Statistical tools are widely used in the solution of managerial problems. For eg. sampling is very useful in data collection. Managerial economics makes use of correlation and multiple regression in business problems involving some kind of cause and effect relationship.

Managerial Economics and Accounting:

Managerial economics is closely related to accounting. It is recording the financial operation of a business firm. A business is started with the main aim of earning profit. Capital is invested / employed for purchasing properties such as building, furniture, etc and for meeting the current expenses of the business.

Goods are bought and sold for cash as well as credit. Cash is paid to credit sellers. It is received from credit buyers. Expenses are met and incomes derived. This goes on the daily routine work of the business. The buying of goods, sale of goods, payment of cash, receipt of cash and similar dealings are called business transactions.

The business transactions are varied and multifarious. This has given rise to the necessity of recording business transaction in books. They are written in a set of books in a systematic manner so as to facilitate proper study of their results.

Management accounting provides the accounting data for taking business decisions. The accounting techniques are very essential for the success of the firm because profit maximization is the major objective of the firm.

Managerial Economics and Mathematics:

Mathematics is another important subject closely related to managerial economics. Mathematics has helped in the development of economic theories and now mathematical economics has become a very important branch of economics. Mathematical approach to economic theories makes them more precise and logical. For the estimation and prediction of economic factors for decision making and forward planning, mathematical method is very helpful. The important branches of mathematics generally used by a managerial economist are geometry, algebra and calculus. Operations research which is closely related to managerial economics is mathematical in character.

THE ECONOMIC PROBLEM: SCARCITY AND CHOICE

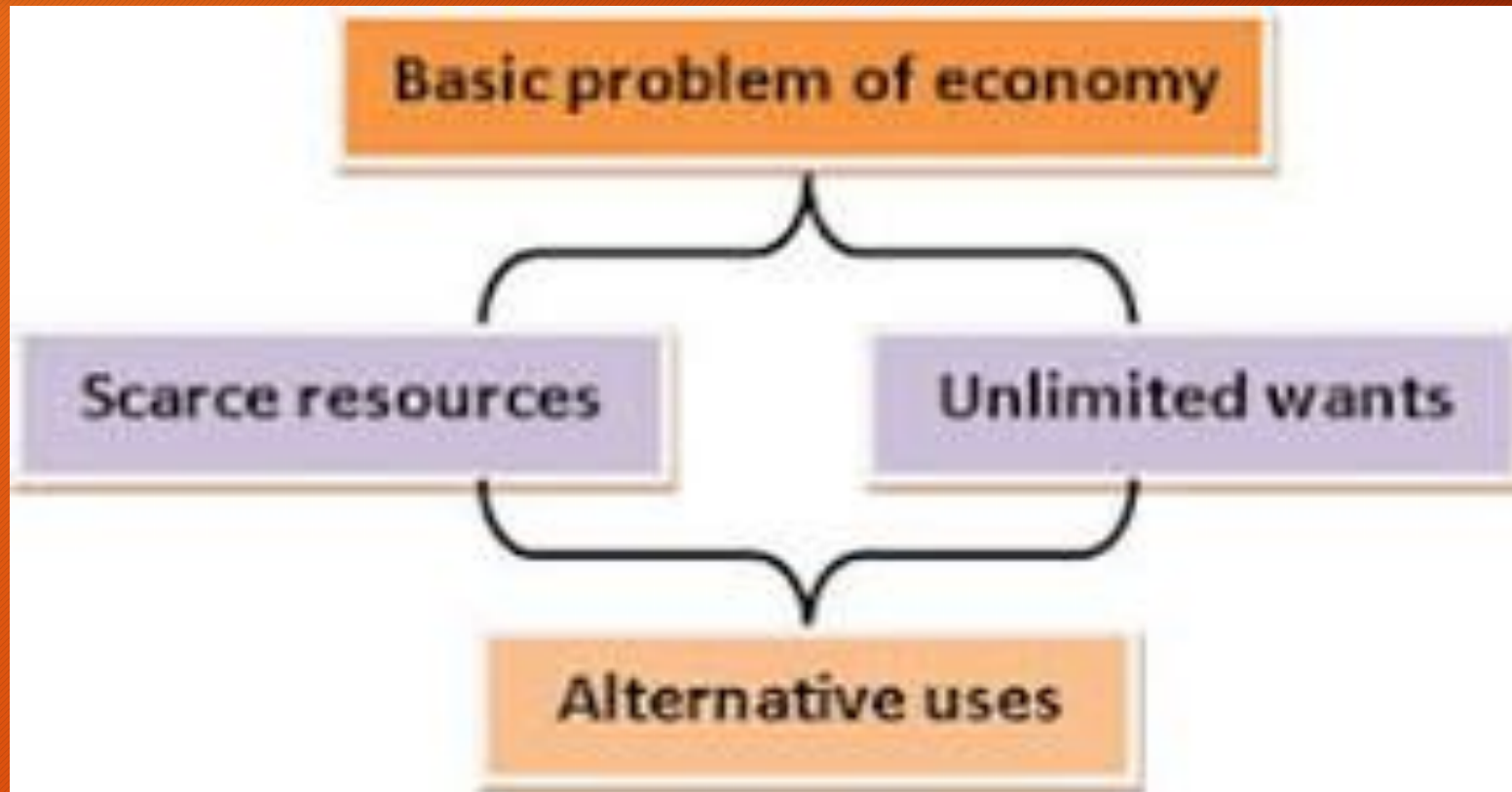
Dr. Saroj Lakhawat
Assistant Professor-Economics
Engineering College Ajmer

THE ECONOMIC PROBLEM: SCARCITY AND CHOICE

The basic problem of an economy deals with the needs and wants of a man being unlimited and the resources are scarce. The resources include the factors of production that are land, labour, capital and entrepreneurship.

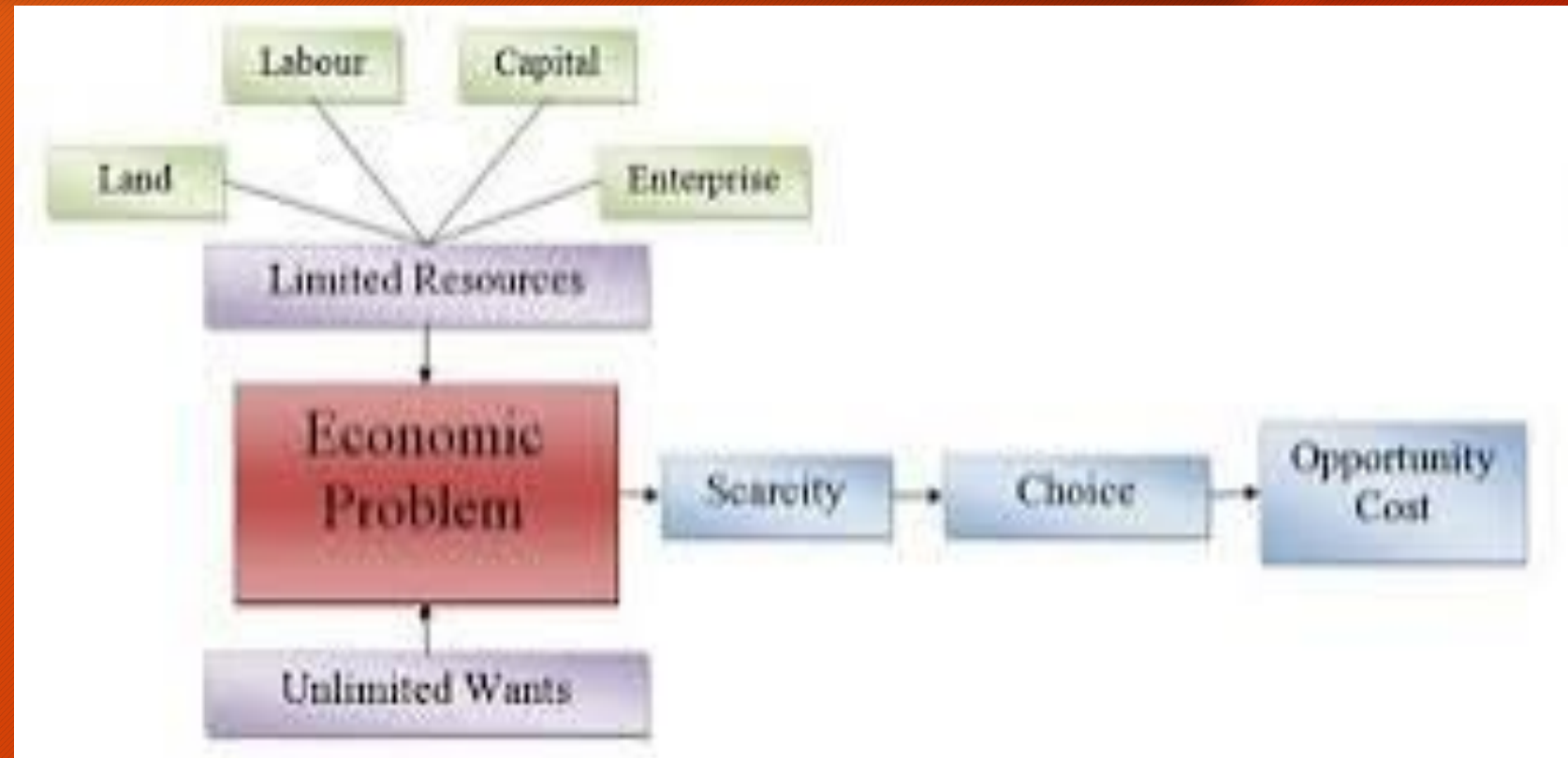
Scarcity refers to the finite nature and availability of resources while choice refers to people's decisions about sharing and using those resources. The problem of scarcity and choice lies at the very heart of economics, which is the study of how individuals and society choose to allocate scarce resources.

THE ECONOMIC PROBLEM: SCARCITY AND CHOICE



THE ECONOMIC PROBLEM: SCARCITY AND CHOICE

Economics is the social science that studies how people use their scarce resources to satisfy unlimited needs and wants. From a teenager to a homemaker and then to a businessman all face the same issue of how to spend their income to attain maximum satisfaction.

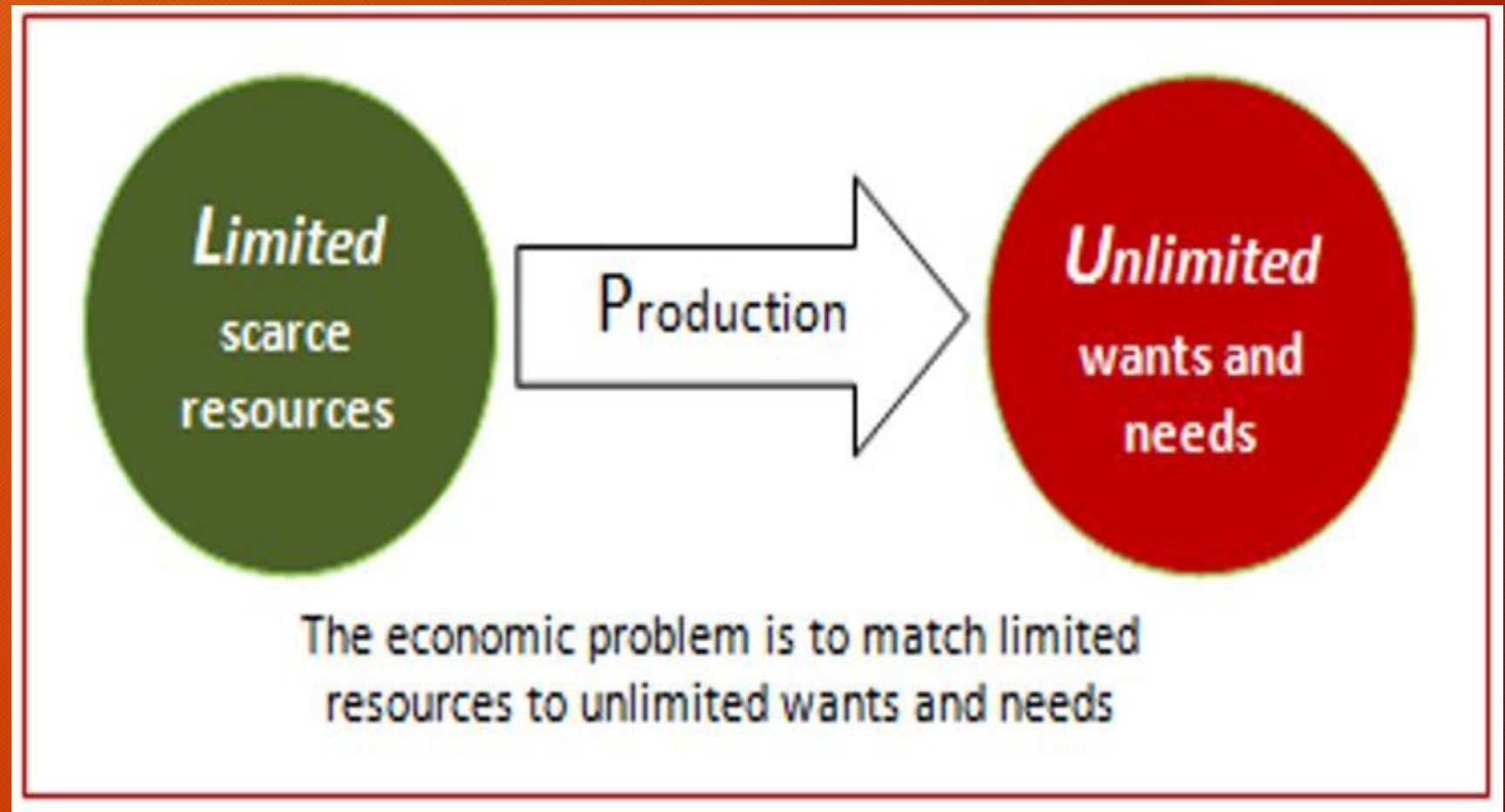


SCARCITY

Scarcity

The purpose of production is to satisfy one's want but as the resources are limited, not enough output is available to fulfil every man's want. This explains that human wants are unlimited which are not fulfilled by the limited resources as stated by the Law of scarcity.

Dr Saroj Lakhawat



SCARCITY AND CHOICE

The demand is high as compared to the supply, and due to insufficient resources satisfaction is not achieved. To overcome this, the choice is made available to man to allocate their resources in such a way that maximum satisfaction can be achieved.

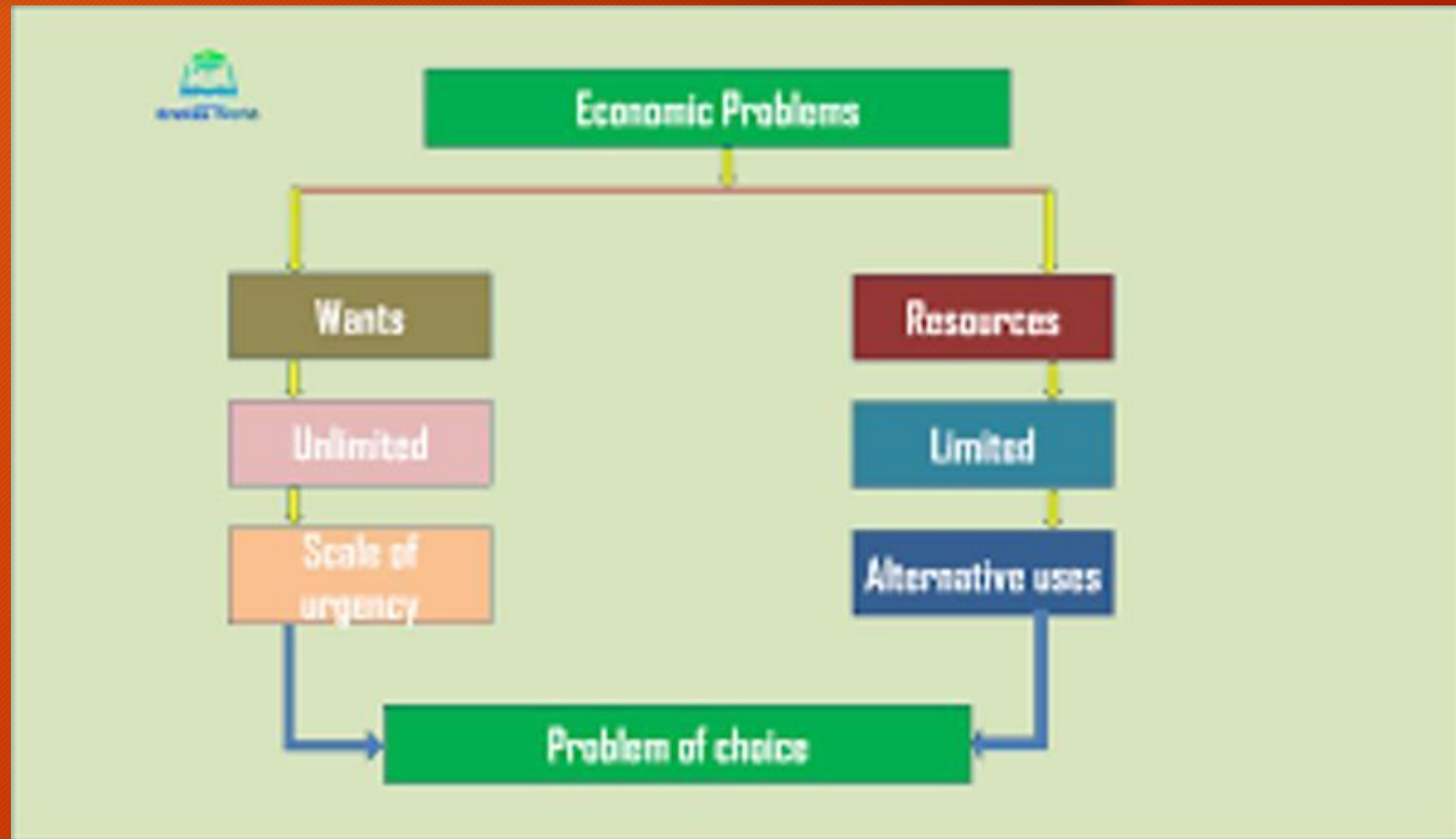
For instance, a man walks into a grocery store with ₹500, he would buy products in a way that when he walks out the products with him would be equal to the value of ₹500. He might want food grains, toiletries, milk, cooking essentials, etc but he would allocate the money available to him in such a way that he attains maximum satisfaction from his purchase.

CHOICES

Choices

Scarcity gives rise to the economic problem of choice. As there are limited resources, the choice is given to decide what one wishes to get by sacrificing one of its demand. When the choice is made there is sacrifice involved in it. The decision to consume a product also means a decision to not consume another. One product can only be consumed by giving up something in exchange. Opportunity Cost refers to the cost of sacrifice that is done to choose the next best alternative.

Dr Saroj Lakhawat



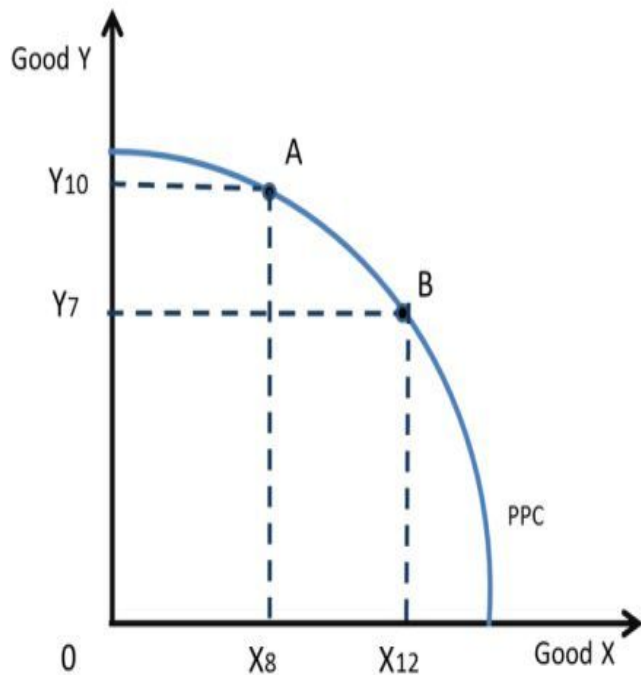
CHOICES AND OPPORTUNITY COST

To Exemplify, a farmer has 10 acres of land he has a choice to either grow wheat or cotton on it. The limited land is a scarcity of the resource. The alternative crops wheat and cotton show how we have choices. To grow one of the two crops the other crop's production has to be sacrificed, this is the opportunity cost involved.

Production Possibility Curve (PPC) gives a graphical representation of how two alternatives can be used in combination to achieve maximum satisfaction.

CHOICES

Choice



With the given possibilities of production outcomes, countries need to decide which combination of goods to produce.

For example, a country must make a choice between a combination A, which implies more of Y and less of X, or combination B, which implies more of X and less of Y.

The PPC curve shows different possible points of attaining satisfaction. Points A and B give two different combinations. At point A, X8 and Y10 goods are produced and at point B X12 and Y7 goods are produced. To produce more of product X, Product Y is to be produced less this is seen at point B, X12 goods are produced only when good Y is decreased to Y7. This shows that more and more of good X is to be produced only when good Y is sacrificed at its place. A choice needs to be made as to what amount of a particular good can be produced to get the maximum satisfaction from the available resources.



THANK YOU

INFLATION

Dr. Saroj Lakhawat
Assistant Professor-Economics
Engineering College Ajmer

INFLATION

Inflation is the rate at which the general price level for goods and/ or services rises, and subsequently, the purchasing power of the currency declines.

Inflation indicates the decrease in the purchasing power of a unit of the currency in the country. It is measured in percentages.

It is categorized into three types, that is, Demand-pull, Cost-pull, and Built-in.

The most commonly used inflation indexes are the Consumer Price Index (CPI) and Wholesale Price Index (WPI)

Inflation measures the average change in price in a basket of commodities and services over a period of time. The opposite and rare fall in the price index of this basket of items is termed as “Deflation”

WHAT IS INFLATION?

It is nothing but an increase in the general level of price of the goods and/ or services in an economy over a certain period of time. As per the law of Economics, when the general level of prices increase, each unit of currency buys a decreased number of goods and services. Hence, inflation also reflects a decrease in the purchasing power of money.

In the world of Economics, the word ‘inflation’ literally means a general price rise against a standard level of the purchasing power. As per Crowther’s findings, “Inflation is a state in which the value of money is falling and the prices are rising”.

ADVANTAGES

It means the price levels increase, but for an economy to run healthily, wages should also be rising. Inflation is a sign that an economy is flourishing. The Reserve Bank of India (RBI) considers the range of 4-5% as an ideal situation for inflation in India.

Following are some of its advantages:

- 1 Slow inflation aids economic growth
- 2 Better than deflation as it does not lead to recession
- 3 Allows adjustment of prices
- 4 Helps in adjustment of real wages

DISADVANTAGES

On the other hand, now let's take a quick look at the disadvantages of Inflation:

- 1 May lead to uncertainty and lower investments
- 2 Higher rate of inflation can lead to lower growth and instability
- 3 Reduces international competitiveness
- 4 Distorts the planning process
- 5 May also give rise to speculative investment
- 6 May result in a decline in the value of savings
- 7 May lead to inequality in the income distribution

TYPES OF INFLATION

one may observe different types of inflation in the contemporary society:

A. On the Basis of Causes:

Currency inflation:

This type of inflation is caused by the printing of currency notes.

Credit inflation:

Being profit-making institutions, commercial banks sanction more loans and advances to the public than what the economy needs. Such credit expansion leads to a rise in price level.

Deficit-induced inflation:

The budget of the government reflects a deficit when expenditure exceeds revenue. To meet this gap, the government may ask the central bank to print additional money. Since pumping of additional money is required to meet the budget deficit, any price rise may be called the deficit-induced inflation.

TYPES OF INFLATION

The three types are demand-pull, cost-pull, and hyperinflation.

Demand-pull

- Takes place when the total demand is growing at an unsustainable rate leading to an increased pressure on the scarce resources and a positive output gap.
- When there is excess, producers utilize the situation, resulting in increased prices to derive greater profits.
- The situation is also known as “too much purchasing power chasing too few goods”.

Causes

- Declined exchange rate of the country's currency: It results in increased prices of imports and reduces the foreign prices of a country's exports.
- Higher government spending: It will ultimately increase the money supply in the economy and create extra demand in the circular flow of income.
- Lower tax rate: If the direct taxes are reduced, consumers will be left with more disposable income causing an increased demand.
- Loose monetary policy: A decline in interest rates because of loose monetary policy by the central bank may stimulate too much demand causing inflation.
- Increase in standard of living: It will ultimately lead to an increased demand for various goods associated with a decent standard of living.

TYPES OF INFLATION

Cost-push

It takes place when firms respond to the rising costs of materials used in the manufacturing of goods by increasing prices to protect their profits.

The cost of production may rise due to a rise in the cost of factors such as wages, imports, taxes, etc.

Causes

Decline in the exchange rate of the country's currency: It may lead to an increase in the prices of imported products such as raw materials, components, and finished goods, resulting in an increased price of goods.

Higher tax rate: If the rate of direct taxes increases, it will ultimately result in an increase in the prices of the final goods as a certain rate of tax is charged on every product.

Increase in the labour cost: It may rise when the rate of unemployment is low because skilled workers become very scarce. Such a scenario can stimulate their pay levels to increase.

Component costs: An increase in the prices of raw materials and other components can lead to cost-pull inflation. It may be because of a rise in the commodity prices such as oil, agricultural products, minerals, etc. used in manufacturing goods.

Tight monetary policy: It will ultimately lead to an increased rate at which the investors buy money from the bank. Eventually, it will result in the increasing cost for the firm thus causing cost inflation.

TYPES OF INFLATION

B. On the Basis of Speed or Intensity:

(i) Creeping or Mild Inflation:

If the speed of upward thrust in prices is slow but small then we have creeping inflation. What speed of annual price rise is a creeping one has not been stated by the economists. To some, a creeping or mild inflation is one when annual price rise varies between 2 p.c. and 3 p.c. If a rate of price rise is kept at this level, it is considered to be helpful for economic development. Others argue that if annual price rise goes slightly beyond 3 p.c. mark, still then it is considered to be of no danger.

(ii) Walking Inflation:

If the rate of annual price increase lies between 3 p.c. and 4 p.c., then we have a situation of walking inflation. When mild inflation is allowed to fan out, walking inflation appears. These two types of inflation may be described as 'moderate inflation'.

Often, one-digit inflation rate is called 'moderate inflation' which is not only predictable, but also keep people's faith on the monetary system of the country. Peoples' confidence get lost once moderately maintained rate of inflation goes out of control and the economy is then caught with the galloping inflation.

TYPES OF INFLATION

(iii) Galloping and Hyperinflation:

Walking inflation may be converted into running inflation. Running inflation is dangerous. If it is not controlled, it may ultimately be converted to galloping or hyperinflation. It is an extreme form of inflation when an economy gets shattered.”Inflation in the double or triple digit range of 20, 100 or 200 p.c. a year is labelled “galloping inflation”.

HOW IS INFLATION MEASURED?

It can be measured through the following indexes: Consumer Price Index (CPI) & Wholesale Price Index (WPI)

| CPI | Points of Difference | WPI |
|---|----------------------|---|
| It is the average change in prices of the goods and/or services over time that the consumer pays for a basket of goods and/ or services | Meaning | It measures the changes in the prices of goods sold and traded in bulk by the wholesale businesses to other businesses. |
| The RBI and other statistical agencies study the CPI in order to understand the price change of various commodities and keep inflation under control. | Uses | It is used to measure inflation. The rate of inflation is the difference between the WPI calculated at the start and end of a year. |
| Ministry of Statistics and Program Implementation | Computed by | Ministry of Commerce & Industry |
| $\text{CPI} = (\text{Cost of basket divided by Cost of basket in the base year}) \text{ multiplied by } 100$ | Formula | $(\text{WPI of end of year} - \text{WPI of beginning of year}) / \text{WPI of beginning of year} \times 100$ |

HOW TO CONTROL INFLATION?

Some of the methods with which inflation can be controlled are:

Monetary Policy

The Central Bank can increase the interest rates, making borrowing more expensive and savings more attractive. This would lead to a lower growth of consumer spending and an increase in investment.

Controlling money supply

As part of the monetary policy, many countries have set up an inflation target. The reason for this is if people believe the inflation target is credible, then it will also help to decrease inflation expectations. It will result in a controlled inflation.

Fiscal policy

The government can increase the rate of taxes and may also cut its spending. This will not only improve the government's budget situation but also help reduce demand in the economy. Both these policies will help in reducing inflation by reducing the growth of total demand.

HOW TO CONTROL INFLATION?

Wage control

If inflation is caused due to wages, then limiting the growth of wages can also help to control inflation. Lower wage growth will help in reducing cost-push inflation along with moderating the demand-pull inflation.

Supply-side policies

Inflation is many times caused by lack of competitiveness and rising costs of raw materials. Supply-side policies may enable the economy to become more competitive and it will also help in controlling inflationary pressures.

EFFECTS OF INFLATION

| | |
|--|--|
| Creditors & Debtors | Creditors lose and debtors gain during inflation because debts are fixed in rupee terms. When debts are repaid by debtors, their real value declines due to the price level increase and hence creditors lose in monetary terms. |
| Bond & Debenture holders | Bondholders earn fixed interest income thus such individuals suffer a reduction in real income when price rises. |
| Investors | Individuals who invest money in shares during inflation are expected to gain since the possibility of earning business profit increases. |
| Salaried individuals & wage-earners | Individuals earning a fixed income are negatively affected due to inflation, resulting in a reduction in the real purchasing power of the fixed-income earners. |
| Profit-earners, speculators, black marketers | Profits tend to rise during inflation as businessmen raise the prices of their products which ultimately results in greater profits. |



THANK YOU