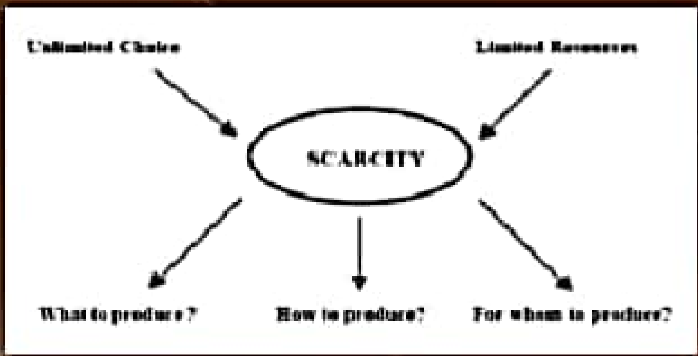
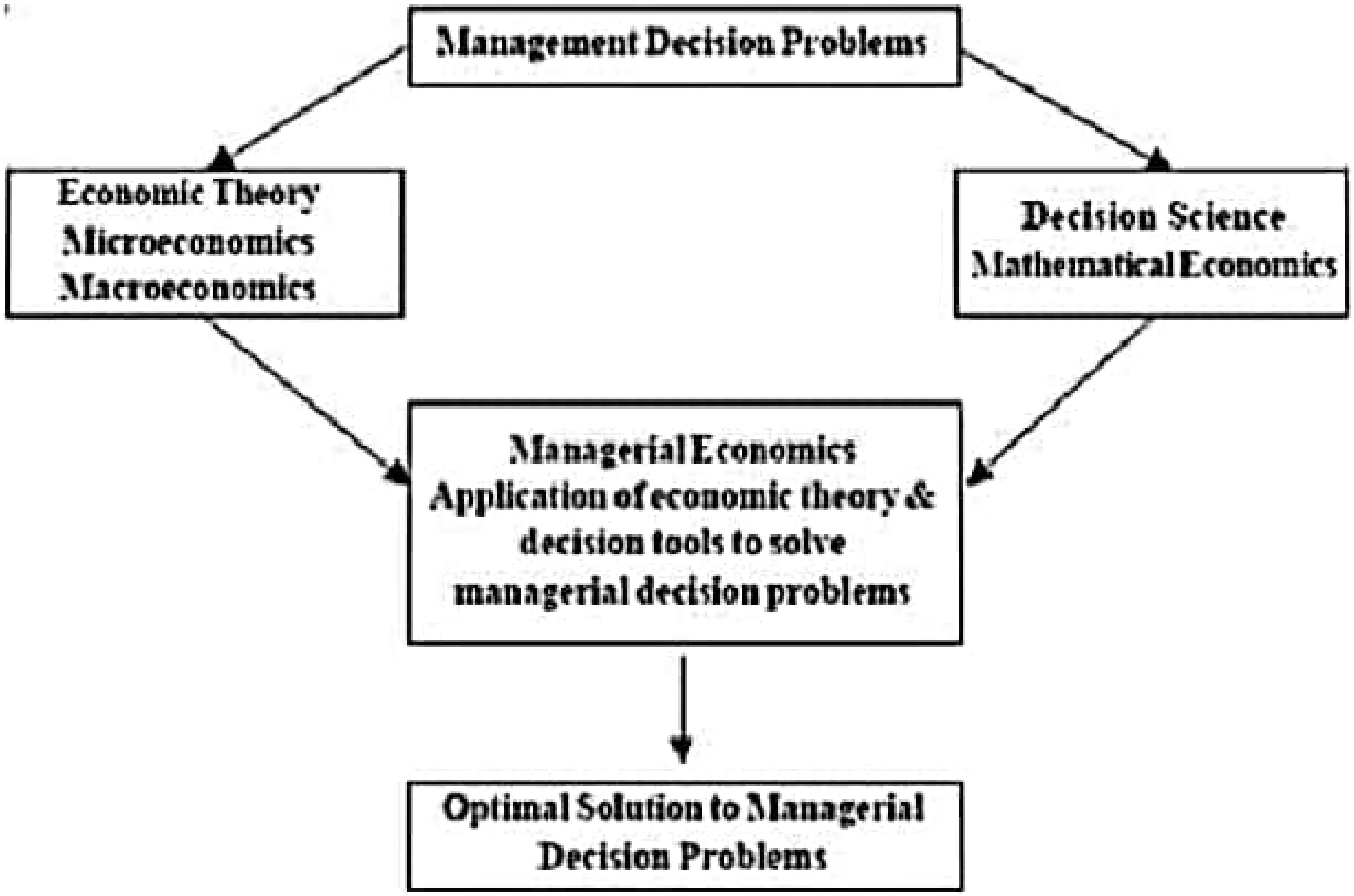
NATURE AND SCOPE OF MANAGERIAL ECONOMICS

Introduction to Managerial Economics

- Economics is a social science, which studies human behaviour in relation to optimizing allocation of available resources to achieve the given ends.
- Brighman and Pappas define managerial economics as," the application of economic theory and methodology to business administration practice".



Managerial Economics



Characteristics of Managerial Economics

- It involves an application of Economic theory – especially, micro economic analysis to practical problem solving in real business life. It is essentially applied micro economics.
- It is a science as well as art facilitating better managerial discipline. It explores and enhances economic mindfulness and awareness of business problems and managerial decisions.
- It is concerned with firm's behaviour in optimum allocation of resources. It provides tools to help in identifying the best course among the alternatives and competing activities in any productive sector whether private or public.

Scope of Managerial Economics

- 1. Demand Analysis and Forecasting
- 2. Cost Analysis
- 3. Production and Supply Analysis
- 4. Pricing Decisions, Policies and Practices
- 5. Profit Management, and
- 6. Capital Management

Demand Analysis & Forecasting

- A business firm is an economic organism which transforms productive resources into goods that are to be sold in a market. A major part of managerial decision-making depends on accurate estimates of demand. Before production schedules can be prepared and resources employed, a forecast of future sales is essential. This forecast can also serve as a guide to management for maintaining or strengthening market position and enlarging profits.

Cost Analysis

- A study of economic costs, combined with the data drawn from the firm's accounting records, can yield significant cost estimates that are useful for management decisions. The factors causing variations in costs must be recognized and allowed for if management is to arrive at cost estimates which are significant for planning purposes. An element of cost uncertainty exists because all the factors determining costs are not always known or controllable.

Production & Supply Analysis

- Production analysis is narrower in scope than cost analysis. Production analysis frequently proceeds in physical terms while cost analysis proceeds in monetary terms. Production analysis mainly deals which different production functions and their managerial uses. Supply analysis deals with various aspects of supply of a commodity. Certain important aspects of supply analysis are: Supply schedule, curves and function, Law of supply and its limitations, Elasticity of supply and Factors influencing supply.

Pricing Decisions, Policies and Practices

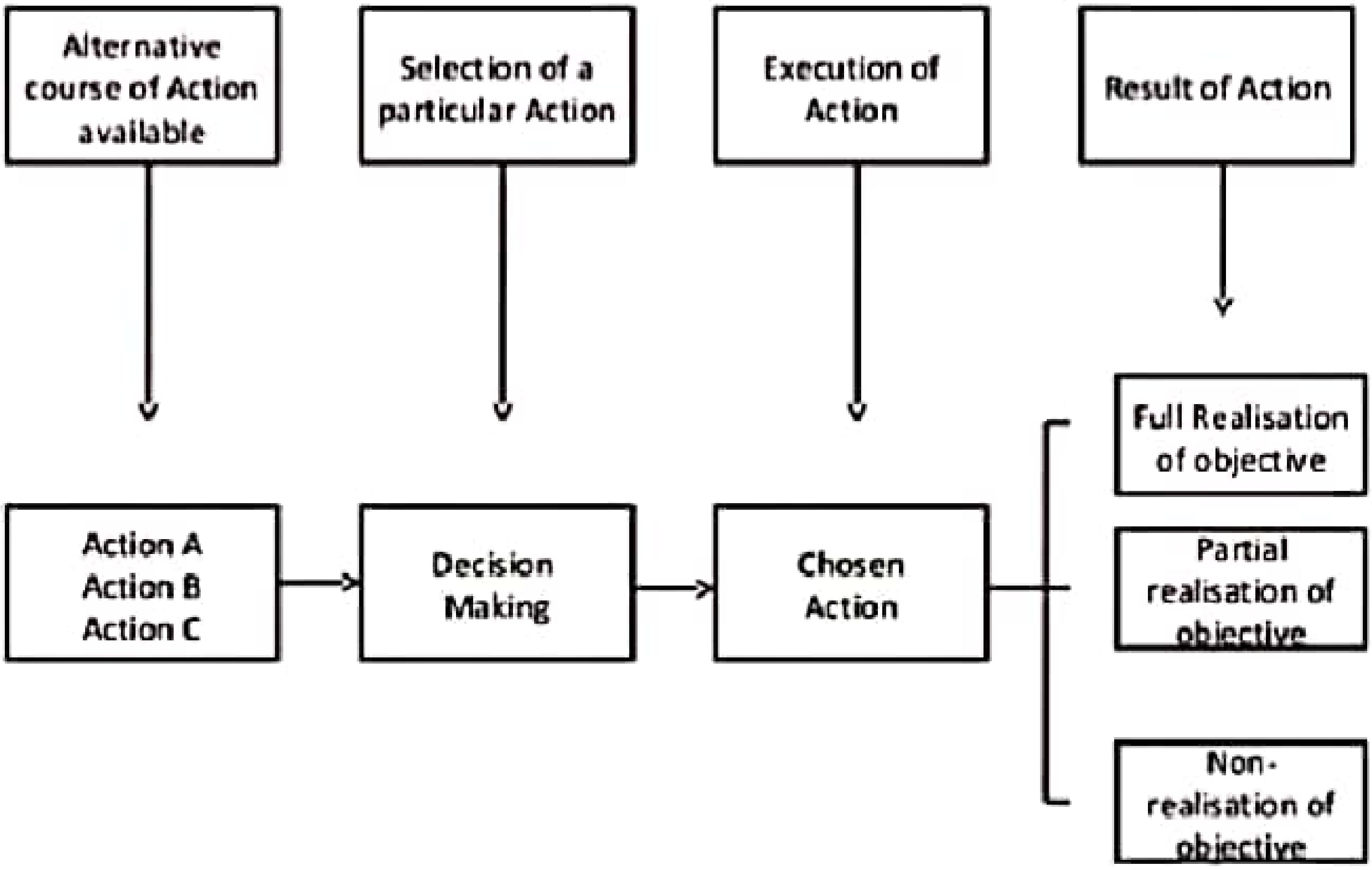
- Pricing is a very important area of Managerial Economics. In fact, price is the genesis of the revenue of a firm and as such the success of a business firm largely depends on the correctness of the price decisions taken by it. The important aspects dealt with under this area are: Price Determination in various Market Forms, Pricing Methods, Differential Pricing, Product-line Pricing and Price Forecasting.

Profit Management

- Business firms are generally organised for the purpose of 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. If knowledge about the future were perfect, profit analysis would have been a very easy task.

Capital Management

- Of the various types and classes of business problems, the most complex and troublesome for the business manager are likely to be those relating to the firm's capital investments. Relatively large sums are involved, and the problems are so complex that their disposal not only requires considerable time and labour but is a matter for top-level decision. Briefly, capital management implies planning and control of capital expenditure.


Alternative course of Action available
Selection of a particular Action
Execution of Action
Result of Action
Action A
Action B
Action C
Decision Making
Chosen Action
Full Realisation of objective
Partial realisation of objective
Non-realisation of objective

Basic tools in Managerial Economics

- Incremental Principle
- Equi-marginal Principle
- Opportunity Cost Principle
- Time Perspective Principle
- Discounting Principle

Incremental Principle

- This principle states that a decision is said to be rational and sound if given the firm's objective of profit maximization, it leads to increase in profit, which is in either of two scenarios-
- If total revenue increases more than total cost
- If total revenue declines less than total cost

Equi-marginal Principle

- The laws of equi-marginal utility states that a consumer will reach the stage of equilibrium when the marginal utilities of various commodities he consumes are equal.
- The law of Equi-marginal utility
- According to the modern economists, this law has been formulated in form of law of proportional marginal utility. It states that the consumer will spend his money-income on different goods in such a way that the marginal utility of each good is proportional to its price

Opportunity Cost Principle

- Opportunity cost is one of the most important and fundamental concepts in the whole of economics. Given that we have said that economics could be described as a science of choice, we have to look at what sacrifices we make when we have to make a choice. That is what opportunity cost is all about.
- Sacrifice of Alternatives
- Opportunity cost is the minimum price that would be necessary to retain a factor-service in it's given use. It is also defined as the cost of sacrificed alternatives
- By opportunity cost of a decision is meant the sacrifice of alternatives required by that decision

Time Perspective Principle

- According to this principle, a manger should give due emphasis, both to short-term and long-term impact of his decisions, giving apt significance to the different time periods before reaching any decision
- Time periods
- Short-run refers to a time period in which some factors are fixed while others are variable. The production can be increased by increasing the quantity of variable factors
- long-run is a time period in which all factors of production can become variable. Entry and exit of seller firms can take place easily

Discounting Principle

- According to this principle, if a decision affects costs and revenues in long-run, all those costs and revenues must be discounted to present values before valid comparison of alternatives is possible
- Discounting
- Discounting can be defined as a process used to transform future rupees into an equivalent number of present rupees.
- This is essential because a rupee worth of money at a future date is not worth a rupee today. Money actually has time value. For instance, Rs.100 invested today at 10% interest is equivalent to Rs.110 next year.

Roles and Responsibilities of Managerial Economist

- He studies the economic patterns at macro-level and analysis it's significance to the specific firm he is working in.
- He has to consistently examine the probabilities of transforming an ever-changing economic environment into profitable business avenues.
- He assists the business planning process of a firm.
- He also carries cost-benefit analysis.

Roles and Responsibilities of Managerial Economist

- He assists the management in the decisions pertaining to internal functioning of a firm such as changes in price, investment plans, type of goods /services to be produced, inputs to be used, techniques of production to be employed, expansion/ contraction of firm, allocation of capital, location of new plants, quantity of output to be produced, replacement of plant equipment, sales forecasting, inventory forecasting, etc.
- In addition, a managerial economist has to analyze changes in macro- economic indicators such as national income, population, business cycles, and their possible effect on the firm's functioning.

Roles and Responsibilities of Managerial Economist

- He is also involved in advicing the management on public relations, foreign exchange, and trade. He guides the firm on the likely impact of changes in monetary and fiscal policy on the firm's functioning.
- He also makes an economic analysis of the firms in competition. He has to collect economic data and examine all crucial information about the environment in which the firm operates.
- The most significant function of a managerial economist is to conduct a detailed research on industrial market.

Roles and Responsibilities of Managerial Economist

- In order to perform all these roles, a managerial economist has to conduct an elaborate statistical analysis.
- He must be vigilant and must have ability to cope up with the pressures.
- He also provides management with economic information such as tax rates, competitor's price and product, etc. They give their valuable advice to government authorities as well.
- At times, a managerial economist has to prepare speeches for top management.