

# PREFACE

## MANAGERIAL ECONOMICS

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This book is the result of my teaching experience in the subject Managerial Economics to Sikkim Manipal University, Udupi students for about 8 years. It is designed to meet the requirements of students at Bachelor's, Masters and Ph D levels in Engineering and Management (M E, MCA MBA and Ph D in Project Management, Engg, Computer Applications and Business Administration).

The main highlight of the book is the theoretical and graphical problem approach framed by the author with many theoretical concepts. This book has a large number of Economics concepts applied to Management and Business with explanations.

This book can be best suitable for Bachelors, Masters & Ph D students during their RESEARCH WORK in the three fields mentioned below:

ENGINEERING-ALL FIELDS. (BACHELOR LEVEL, MASTERS LEVEL AND DOCTORS LEVEL)

COMPUTER APPLICATIONS. (BACHELOR LEVEL, MASTERS LEVEL AND DOCTORS LEVEL)

BUSINESS ADMINISTRATION. (BACHELOR LEVEL, MASTERS LEVEL AND DOCTORS LEVEL)

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## **ABOUT THE BOOK**

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This book is on **MANAGERIAL ECONOMICS**

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which is a compulsory subject for Commerce students .Even the higher level students and bachelor level students can also read it as it contains a lot of numerical problems framed by me.

### **CHAPTER – I**

General Foundations of Managerial Economics - Economic Approach

- Circular Flow of Activity - Nature of the Firm - Objectives of Firms - Demand Analysis and Estimation - Individual, Market and Firm demand
- Determinants of demand - Elasticity measures and Business Decision Making

- Demand Forecasting.

### **CHAPTER - II**

Law of Variable Proportions - Theory of the Firm - Production Functions in the Short and Long Run - Cost Functions – Determinants of Costs – Cost Forecasting - Short Run and Long Run Costs –Type of Costs - Analysis of Risk and Uncertainty.

### **CHAPTER - III**

Product Markets -Determination Under Different Markets - Market Structure – Perfect Competition – Monopoly – Monopolistic Competition – Duopoly - Oligopoly - Pricing and Employment of Inputs Under Different Market Structures – Price Discrimination - Degrees of Price Discrimination.

### **CHAPTER - IV**

Introduction to National Income – National Income Concepts - Models of National Income Determination - Economic Indicators - Technology and Employment - Issues and Challenges – Business Cycles – Phases – Management of Cyclical Fluctuations - Fiscal and Monetary Policies.

## CHAPTER – V

Macro Economic Environment - Economic Transition in India - A quick Review - Liberalization, Privatization and Globalization - Business and Government - Public-Private Participation (PPP) - Industrial Finance - Foreign Direct Investment(FDIs).

are the 5 chapters with various sub-topics covered in this book. All theories are given and explained and all formulae and methods are also covered in this book related to Business Economics or Managerial Economics subject.

I feel that this is a unique book as there are theory, formulae & numerical problems solved with all possible steps.

HAPPY READING.

THANKS

REGARDS

AUTHOR

(SRINIVAS R RAO)





## ABOUT THE AUTHOR

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Author's name is Srinivas R Rao, born and done his school level education in Mangalore, Karnataka in a reputed private school Canara High School and PUC(+2) from Canara PUC in Science stream with PCMB as main subjects.

Later, pursuing LL.B(5 Years) course passed the degree in 1999 and done Diploma in Export Management ,Diploma in Customs and Central Excise , Diploma in Business Administration and some important IT subjects like MS-Office,Internet/Email,Visual Basic 6.0,C,C++,Java,Advanced Java,Oracle with D2K,HTML with Javascript,VBscript and Active Server Pages.

Joined as a FACULTY for students in a small computer Institute in 2002 July and later after 4 months worked in a company by name CRP Technologies(I) .P.Ltd as Branch Manager(Risk Manager) for Mangalore,Udupi and Kasargod areas from January 26 2003 to June 11 2007.In the year 2005 pursued MBA distance education course. Currently working as a FACULTY in Sikkim Manipal University , Udupi centre for BBA & MBA students and teaching numerical subjects like Statistics/Operations Research(Mgt Science/Quant. Techniques for Mgt)/Accounting and several numerical and difficult oriented subjects for distance education students in their weekend contact classes from July 2010 till present day.

Thanks

Regards

Author

(SRINIVAS R RAO)

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**Managerial Economics**

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## CHAPTER – I

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### **Lesson I The Fundamentals Of Managerial Economics**

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Why study Economics?

Managerial Economics

Nature of Managerial Economics

Circular flow of economic activity

Objectives of the firm

Review questions



## Introduction

People have limited number of **needs** which must be satisfied if they are to survive as human beings. Some are material needs, some are psychological needs and some others are emotional needs. People's needs are limited; however, no one would choose to live at the level of basic human needs if they want to enjoy a better standard of living. This is because human **wants** (desire for the consumption of goods and services) are unlimited. It doesn't matter whether a person belongs to the middle class in India or is the richest individual in the World, he or she wants always something more. For example bigger a house, more friends, more salary etc., Therefore the basic economic problem is that the resources are limited but wants are unlimited which forces us to make choices.

Economics is the study of this allocation of resources, the choices that are made by economic agents. An **economy** is a system which attempts to solve this basic economic problem. There are different types of economies; household economy, local economy, national economy and international economy but all economies face the same problem. The major economic problems are (i) what to produce? (ii) How to produce? (iii) When to produce and (iv) For whom to produce?

Economics is the study of how individuals and societies choose to use the scarce resources that nature and the previous generation have provided. The world's resources are limited and scarce. The resources which are not scarce are called free goods. Resources which are scarce are called economic goods.

## Why Study Economics?

A good grasp of economics is vital for managerial decision making, for designing and understanding public policy, and to appreciate how an economy functions. The students need to know how economics can help us to understand what goes on in the world and how it can be used as a practical tool for decision making. Managers and CEO's of large corporate bodies, managers of small companies, nonprofit organizations, service centers etc., cannot succeed in business without a clear understanding of how market forces create both opportunities and constraints for business enterprises.

## Reasons For Studying Economics:

- It is a study of **society** and as such is extremely important.
- It trains the mind and enables one to **think systematically** about the problems of business and wealth.
- From a study of the subject it is possible to **predict** economic **trends** with some precision.
- It helps one to **choose** from various economic **alternatives**.

**Economics** is the science of making decisions in the presence of scarce resources. Resources are simply anything used to produce a good or service to achieve a goal. Economic decisions involve the allocation of scarce resources so as to best meet the managerial goal. The nature of managerial decision varies depending on the goals of the manager.

A **Manager** is a person who directs resources to achieve a stated goal and he/she has the responsibility for his/her own actions as well as for the actions of individuals, machines and other inputs under the manager's control.

**Managerial economics** is the study of how scarce resources are directed most efficiently to achieve managerial goals. It is a valuable tool for analyzing business situations to take better decisions.

Prof. Evan J Douglas defines Managerial Economics as “Managerial Economics is concerned with the application of economic principles and methodologies to the decision making process within the firm or organization under the conditions of uncertainty”

According to Milton H Spencer and Louis Siegelman “Managerial Economics is the integration of economic theory with business practices for the purpose of facilitating decision making and forward planning by management”

According to Mc Nair and Miriam, ‘Managerial Economics consists of the use of economic modes of thoughts to analyze business situations.’

Economics can be divided into two broad categories: micro economics and macro economics. **Macro economics** is the study of the

economic system as a whole. It is related to issues such as determination of national income, savings, investment, employment at aggregate levels, tax collection, government expenditure, foreign trade, money supply etc., **Micro economics** focuses on the behavior of the individuals, firms and their interaction in markets. Managerial economics is an application of the principles of micro and macro economics in managerial decision making.

The economic way of thinking about business decision making provides all managers with a powerful set of tools and insights for furthering the goals of their organization. Successful managers take good decisions, and one of their most useful tools is the methodology of managerial economics.

### **Nature Of Managerial Economics:**

1. Managerial economics is concerned with the analysis of finding optimal solutions to decision making problems of businesses/ firms (micro economic in nature).
2. Managerial economics is a practical subject therefore it is pragmatic.
3. Managerial economics describes, what is the observed economic phenomenon (positive economics) and prescribes what ought to be (normative economics)
4. Managerial economics is based on strong economic concepts. (conceptual in nature)
5. Managerial economics analyses the problems of the firms in the perspective of the economy as a whole ( macro in nature)
6. It helps to find optimal solution to the business problems (problem solving)

### **Managerial Economics And Other Disciplines**

Managerial economics has its relationship with other disciplines for propounding its theories and concepts for managerial decision making. Essentially it is a branch of economics. Managerial economics is closely related to certain subjects like statistics, mathematics, accounting and operations research.

Managerial economics helps in estimating the product demand, planning of production schedule, deciding the input combinations, estimation of cost of production, achieving economies of scale and increasing the returns to scale. It also includes determining price of the product, analyzing market structure to determine the price of the product for profit maximization, which helps them to control and plan capital in an effective manner.

Successful managers make good decisions, and one of their most useful tools is the methodology of managerial economics. Warren E Buffett, the renowned chairman and CEO of Berkshire Hathaway Inc., invested \$100 and went on to accumulate a personal net worth of \$30 billion. Buffett credits his success to a basic understanding of managerial economics. Buffett's success is a powerful testimony to the practical usefulness of managerial economics.

Managerial economics has a very important role to play by helping managements in successful decision making and forward planning. To discharge his role successfully, a manager must recognize his responsibilities and obligations. There is a growing realization that the managers contribute significantly to the profitable growth of the firms.

We can conclude that managerial economics consists of applying economic principles and concepts towards adjusting with various uncertainties faced by a business firm.

### **Circular Flow Of Economic Activity**

The individuals own or control resources which are necessary inputs for the firms in the production process. These resources (factors of production) are classified into four types.

**Land:** It includes all natural resources on the earth and below the earth. Non renewable resources such as oil, coal etc once used will never be replaced. It will not be available for our children. Renewable resources can be used and replaced and is not depleted with use.

**Labour:** is the work force of an economy. The value of the worker is called as human capital.

**Capital:** It is classified as working capital and fixed capital (not transformed into final products)

**Entrepreneurship:** It refers to the individuals who organize production and take risks.

All these resources are allocated in an effective manner to achieve the objectives of consumers (to maximize satisfaction), workers (to maximize wages), firms (to maximize the output and profit) and government (to maximize the welfare of the society).

The fundamental economic activities between households and firms are shown in the diagram. The circular flows of economic activities are explained in a clockwise and counterclockwise flow of goods and services. The four sectors namely households, business, government and the rest of the world can also be considered to see the flow of economic activities. The circular flow of activity is a chain in which production creates income, income generates spending and spending in turn induces production.

The major four sectors of the economy are engaged in three economic activities of production, consumption and exchange of goods and services. These sectors are as follows:

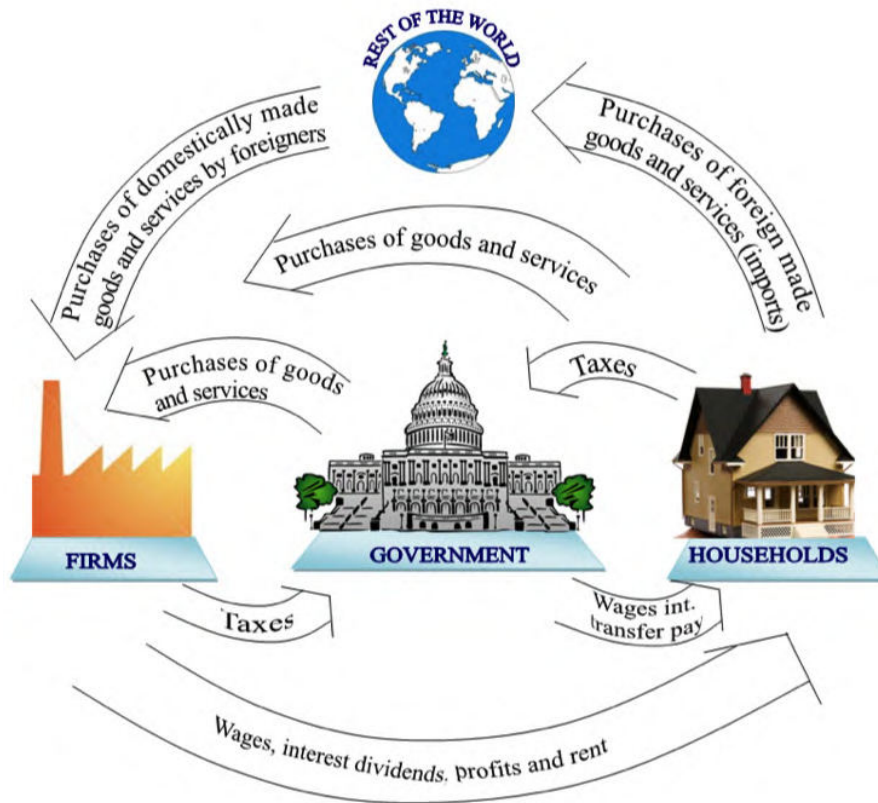
**Households:** Households fulfill their needs and wants through purchase of goods and services from the firms. They are owners and suppliers of factors of production and in turn they receive income in the form of rent, wages and interest.

**Firms:** Firms employ the input factors to produce various goods and services and make payments to the households.

**Government:** The government purchases goods and services from firms and also factors of production from households by making payments.

**Foreign sector:** Households, firms and government of India purchase goods and services (import) from abroad and make payments. On the other hand all these sectors sell goods and services to various countries (export) and in turn receive payments from abroad

**Chart - 1**  
**Circular Flow Of Economic Activity**



The above said four agents take economic decisions to produce goods and services and to exchange them and to consume them for satisfying the wants of the economy as a whole. Understanding the opportunities and constraints in the exchange is essential to take better decision in business. This is discussed in the forthcoming chapters in detail.

The economy comprises of the interaction of households, firms, government and other nations. Households own resources and supply factor services like land, raw material, labour and capital to the firms which helps them to produce goods and services. In turn, firms pay rent for land, wages for their labour and interest against the capital invested by the households. The earnings of the household are used to purchase goods and services from the firms to fulfill their needs and wants, the remaining is saved and it goes to the capital market and is converted as investments in various businesses. The household and business firms have to pay taxes to the government for enjoying the services provided. On the other hand firms and households purchase goods and services (import) from various countries of the world. Firms tend to sell their products to

the foreign customers (export) who earn income for the firm and foreign exchange for the country. Therefore, it is clear that households supply input factors, which flow to firms. Goods and services produced by firms flow to households. Payment flows in the opposite direction (refer chart 1)

## **Nature Of The Firm**

A **firm** is an association of individuals who have organized themselves for the purpose of turning inputs into output. The firm organizes the factors of production to produce goods and services to fulfill the needs of the households. Each firm lays down its own objectives which is fundamental to the existence of a firm.

The major **objectives** of the firm are:

- To achieve the Organizational Goal
- To maximize the Output
- To maximize the Sales
- To maximize the Profit of the Organization
- To maximize the Customer and Stakeholders Satisfaction
- To maximize Shareholder's Return on Investment
- To maximize the Growth of the Organization

Firms are established to earn profit, to keep the shareholders happy. To increase their market share, they try to maximize their sales. In the present business world firms try to produce goods and services without harming the environment. Firms are not always able to operate at a profit. They may be facing the operating loss also. Economists believe that firms maximize their long run rather than their short run profit. So managers have to make enough profit to satisfy the demands of their shareholders and to maximize their wealth through the company.

## **Review Questions**

1. Distinguish between micro economics, macro economics and managerial economics.
2. What is managerial economics? Why does study managerial economics?
3. Describe the circular flow of economic activity of India.
4. Discuss the nature of the firm.
5. List out the major objectives of the firm.
6. How does managerial economics relate with other disciplines for propounding its theories?
7. Identify the areas of decision making where managerial economics prescribes specific solutions to business problems.
8. Discuss the role and responsibilities of a managerial economist.

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