What is managerial economics

Economics

Managerial economics (also called business economics), is a branch of economics that applies microeconomic analysis to specific business decisions. As such, it bridges economic theory and economics in practice. It draws heavily from quantitative techniques such as regression and correlation, Lagrangian calculus, [linear If there is a unifying theme that runs through most of managerial economics it is the attempt to optimize business decisions given the firm’s objectives and given constraints imposed by scarcity.

Almost any business decision can be analyzed with managerial economics techniques, but it is most commonly applied to ; * Risk analysis – various uncertainty models, decision rules, and risk quantification techniques are used to assess the riskiness of a decision. * Production analysis- microeconomic techniques are used to analyze production efficiency, optimum factor allocation, costs, economies of scale and to estimate the firm’s cost function. * Pricing analysis – microeconomic techniques are used to analyze various pricing decisions including transfer pricing, joint product pricing, pricediscrimination, price elasticity estimations, and choosing the optimum pricing method. * Capital budgeting- Investment theory is used to examine a firm’s capital purchasing decisions. Definitions

Managerial economics is most easily understood as the applications of economic analysis to business problems. This comes in a wide variety of subject matter and a number of very different approaches to the subject.

Managerial economics and microeconomics are closely associated as most of the economics analysis found in books has its origin in theoretical microeconomics. Topics like the theory of demand the profit- making, optional prices and advertising expenditures and the impact of market structure on the firm’s behavior are all approached using the economist’s standard intellectual ‘ tool kit’ which consists of trading and testing models.

‘ Managerial economics is concerned with the application of economics concepts and economics to the problems of formulating rational decision making’. * Mansfield “ Managerial economics is the integratin of economics theory with business practices for the purpose of facilitating decision making and forward planning by management”. * Spencer ‘ Managerial economics is concerned with the application of economics principles and methodologies to the decision- making process within the firm or organization. It seeks to establish rules and principles to facilitate the attainment of the desired economicsgoalsof management” * Douglas

“ Managerial economics applies the principles and methods of economics to analyze problems faced by management of a business, or other types of organizations and to help find solutions that advance the best interests of such organizations ”.- Davis and Chang These definitions of managerial economics together reveal the nature of managerial economics. Three major factors have contributed to the emergence of managerial economics as a separate course of managerial studies they are (a) changing market condition (b) the increment of the use of economics logic concepts theories and tools of economics analysis in the process of business decision making. (c) Rapid increase in demand for professionally trained managerial power. what is managerial economics

Economics theories and analytical tools that are widely applied to business decision – making constitute managerial economics. First of all let us understand what is economics. Economics is a socialsciencewhere the basic function is to study how people, individuals households, firms and nations maximize their gains from their limited resources and opportunities. It is in economics terminology is called maximizing behavior or more appropriately optimizing behavior. Optimizing behavior is selecting the best out of available options with the objective of maximizing gains from the given resources. Economics is thus a social science which studies human behavior in relation to optimizing allocation of available resource to achieve the given ends. The analytical tools and techniques, economic laws and theories developed by economists constitute the body of economics. Business decision making with present scenario makes use of economic laws and tools of economic analysis resulting in the emergence of a separate branch of study called ‘ Managerial Economics’.

Working knowledge of economics is essential for managers, as they have to take a number of decisions in conformity with the goals of the firm under the condition of uncertainty and risk. The process of decision- making comprises of four main stages.

1. Determining and defining the objective to be achieved 2. Collection and analyzing of information regarding economics, social, political and technologicalenvironmentand seeing the necessity and occasion for decision. 3. Inventing, developing and analysis of possible course of action. 4. Selecting a particular course of action from available alternation. Scope of Managerial Economics

Microeconomics and Macro economics are the two main branches of economics. Both the branches are applied to business analysis and decision-making, directly or indirectly. The purpose of analysis will choose between micro and macroeconomics. In other words managerial economics is broadly applied economics.

Economic theories, which can be directly be applied to areas of business, may be divided into two main categories. 1. Operational or internal issues 2. Environmental or external issues Operational problems include all those problems which emerge with in the business organization and fall within the purview and control of the management. Theory of demand: consumer’s behavior is explained by the Demand theory. It answers the questions of which product to buy, the quantity to buy, where to stop consuming a commodity, how does the price influence the choice, how does the fashion faster the change etc. The knowledge of demand theory will be helpful in the choice of commodities for production. Theory of Production and Production decision

This is also called the theory of the firm, which explains the relationships between inputs and outputs. It explains the conditions where the cost increases or decreases ; how total output increases when units of one factor (input) are increased keeping other factors constant or when all the factors are simultaneously increased, the system by which output is maximized from a given quantity of resources, how can optimum size of output be determined etc. This help in determining the size of the total output and the account of capital of labour to be employed.

Analysis of Market Structure and Pricing Theory This explains how prices are determined under different market conditions when price discrimination is desirable, feasible and profitable, to what extent advertising can be helpful in expanding sales in competitive market etc. Price and production theories get the help in determining the optimum size of the firm. Profit Analysis and Profit Management

For most of the business undertaking there is not guarantee that a business venture will make reasonable profit. There is always an element of risk but the firm will have to safeguard against this. Project Theory guides the firms in the measurement and management of profit, in making allowances for the risk premium, in calculating the pure return on capital and pure profit and also for future profit placing. Theory of capital & investment decisions

All inputs especially capital is a scarce and expensive factor. It is the foundation of business and its efficient allocation and management is one of the most important tasks of the managers and a yardstick of the success level of the firm. Choice of investment project, assessing the efficiency capital and most judicious allocation of capital are the major wares related to capital. Macroeconomics applied to business environment

Environmental issues pertain to the general business environment in which a business operates. They are related to the overall economic, social and political atmosphere of the country. The factors which constitute economic environment of a country include the following factors:

(i) The type of economic system of the country (ii) General trends in production, employment, income prices, saving and investment etc. (iii) Structure of and trends in the working of financial institutions, e. g., banks, financial corporations, insurance companies etc. (iv) Magnitude of and trends in foreign trade (v) Trends in labour and capital markets. (vi) Government's economics policies, e. g., industrial policy, monetary policy, fiscal policy, price policy, etc., (vii) Social factors like the value system of the society, property rights, customs and habits. (viii) Social organizations like trade unions, consumers' cooperatives and producers' unions (ix) Political environment is constituted of such factors as political systems, democratic, authoritarian, socialist, or otherwise, state's attitude towards private business, size and working of the public sector and political stability, and (x) The degree of openness of the economy and the influence of MNCs on the domestic markets. Macroeconomics issues

1. Issues Related to macro Variables There are issues that are related to the trends in macro variables, e. g., the general trend in the economics activities of the country, investment climate, trends in output and employment, and price trends. These factors not only determine the prospects of private business, but also greatly influence the functioning of individual firms. 2. Issues Related to foreign trade

An economy is also affected by its trade relations with other countries. The sectors and firms dealing in exports and imports are affected directly and more than the rest of the economy. Fluctuations in the international market, exchange rate and inflows and outflows of capital in an open economy have a serious bearing on its economic environment and, thereby, on the functioning of its business undertakings. 3. Issues Related to Government policies

Government policies designed to control and regulate economic activities of the private business firms affect the functioning of the private business undertakings. some other topics in managerial economics

Mathematical tools Businessman deal firstly with concepts that are essentially quantitative in nature, e. g., demand, price, cost, product, capital, wages, inventories etc. these variables assume different meanings in different contexts. What is needed is to have clarity of these concepts in order to have, as far as possible, accurate estimates of these economic variables. The use of mathematical logic in the analysis of economic variables provides not only clarity of concepts, but also a logical and systematic framework within which quantitative relationship may be explored. Mathematical tools are widely used in ‘ model’ building for exploring the relationship between related economic variables. Mathematical logic is, therefore, a great aid to economic analysis. Statistics

Similarly, statistical tools are a great aid in business decision- making. Statistical techniques are used in collecting, processing and analyzing business data, testing the validity of economic laws with the real economic phenomenon before they are applied to business analysis. Good deals of business decisions are based on probable economic events. The statistical tools e. g., theory of probability, forecasting techniques and regression analysis help the decision- makers in predicting the future course of economic event and probable outcome of their business decisions. Operations Research (OR)

OR is an inter- disciplinary solution finding techniques. It combines economics, mathematicsand statistics to build models for solving specific business problems and to find a quantitative solution thereto. Linear programming and goal programming are two widely used OR in business decision- making. Management theory and accounting

Management theories bring out the behavior of the firm in their efforts to achieve certain predetermined objectives. Accounting is the main sources of data regarding the functioning and performance of the firm. Besides, certain concepts used in business accounting are different from those used in pure economic logic.