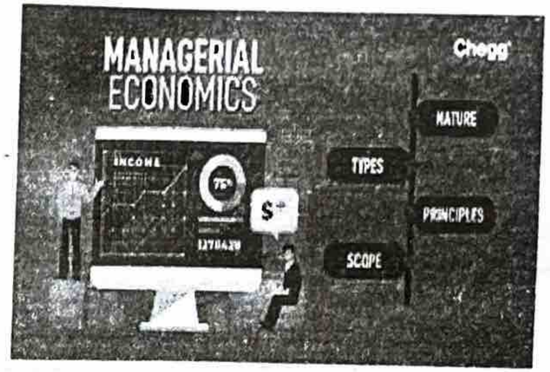
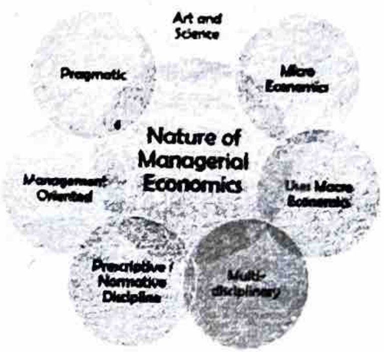
Unit - 1 Nature and Significance of Managerial Economics





Outline of the Unit

1. The Concept of Managerial Economics
2. Nature of Managerial Econimics
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5. Scope of Managerial Economics
6. Role and Responsibilities of Managerial Economist
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➤ Objective Study

➤ Self Study

1. The Concept of Managerial Economics

1. **Introduction** : Managerial Economics is the most important branch of economics in modern times. The development of Managerial Economics started with Joel Dean's book 'Managerial Economics' in 1951. The main function of managerial economics is to co-ordinate abstract principles of economics with managerial decisions. It provides information about how the principles of economics can be useful in taking decisions in management of business and future planning. In managerial economics, data regarding management of a firm are collected, analysed and guidance about appropriate decisions are provided. In managerial economics, such principles and methods are studied that help in solving practical problems of business. How the tools of economics and techniques of economic analysis can help in solving business problems is the essence of discussion in managerial economics.

2. **The Concept of Managerial Economics :** Other terms have also been used for managerial-economics but the most appropriate term is Managerial Economics. Some people have used the words like 'Economics Analysis for Business Decisions' or 'Business Economics'. But there is a vast difference between managerial economics and business economics. In Business Economics, all dynamic aspects of business are studied in which all business activities from production to distribution are included. In Managerial Economics, the management of business activity is studied. From this angle, the concept of managerial economics is wider than business economics. That is the reason why the scope of managerial economics is wider than business economics.

Some people have used the words 'Economics of Enterprise' or 'Economics of the Firm' in place of managerial economics. The use of the terms 'Economics of the Firm' is not appropriate for two reasons : (1) The economics of the firm discusses the principles of the firm while managerial economics discusses how the principles of a firm can be used in solving the business problems. (2) The economics of the firm is based on assumptions and therefore, it is unrealistic in practical world. While in managerial economics, actual business behaviour is studied and therefore, it is more realistic and more prevalent.

In short, managerial economics co-ordinates the economics principles with their implementation. In other words, it can be said, "Managerial Economics is a link between principles of economics and managerial practice."

3. **What is Managerial Economics ? :** To get clear idea of managerial Economics, it is necessary to get the true idea of economics first.

(a) **What is economics ? :** Following are the important definitions of economics.

(1) Economics is such a science which studies activities connected with production and distribution by the people.

(2) It is a science of choice preference. It studies how men choose scarce and limited means of production (land, labor, capital and technical tools) and make production and distribute among people of the society.

(3) Economics analyses the entire activities of economy such as price trends, production and employment. These trends are understood, they became useful to the government in framing economic policies.

(4) According to Robbins, Economics is such a science which studies how means with limited use are distributed to satisfy unlimited needs.

(b) **What is Managerial Economics ? :** To explain the meaning of managerial economics, various economists have given the following definitions.

(1) According to *Spencer and Siegelman* "Managerial Economics, is a science that co-ordinates economist principles with business practice an order to take decisions for management and facilitate future planning".

(2) According to **Joel Dean**, "The objective of managerial is to show how economic principles can be used in framing business policies."

(3) According to **Mac Nair** and **Meriam**, "Managerial Economics is that which uses various economic methods to analyse business situation."

(4) According to **D.C. Hague**, "The science that attempts to understand the problems of decision making regarding business and analyse them is managerial economics."

(5) **Brime** and **Papus** define managerial economics "as a science that uses economic methods and principles in business management."

(6) **Mansfield say that "Managerial Economics is connected with appropriate** managerial decisions, economic concepts and the use of economic analysis."

(7) According to **Haynes, Mote** and **Paul**, "Managerial Economics is such a science which studies how available means can be distributed among various activities of a firm or management."

From the above mentioned definitions, five important points can be deduced as follows :

(1) Managerial Economics studies the management of a firm. (2) A firm has many activities to do. Therefore, many necessities arise. (3) To satisfy these requirements, the firm has limited means. (4) The firm has limited means with alternative uses. Therefore, it has to make distribute these limited means among different requirements. (5) As the firm has to make the choice of the best alternative managerial economics is concerned with the problem of choice.

Various definitions given above have not been successful in explaining the true concept of managerial economics because managerial decision is connected with many aspects. In taking managerial decisions, following factors are used : (1)Economic Principles (2) Economic Analysis (3) Economic Policies (4) Economic Forecasting (5) Human Behaviour and Human Psychology (6) Local and International Political Condition (7) Power of decision making (8) Management abilities (9) Mathematics and Statistics.

While taking decision regarding the production of a commodities and the place of productions, it has to consider the preference of consumers, their future expectations, present standards, number of substitutes available, the share of rival producers in the market and local, political, religious and social factors.

In the process of taking managerial decisions following things are included. (1) The process of taking economic decisions. (2) Managerial economics is connected with the decisions taken by the manager for the optimum benefit of the firm. (3) It is a practical science. It is connected with analysis that helps in taking decisions. (4) It uses economic, statistical and mathematical tools. (5) It implements economic and business principles.

In a nut shell, (1) Managerial Economics is a business economics. As it is connected with decisions taken at the level of the firm, it is connected with micro economics. (2) Pure economics explains the economics principles, causes, effects and relationships while managerial economics is result oriented. It is more concerned with solving the causes of losses to firm rather than finding these causes. (3) Micro economics, macro economics and economic analysis are connected with facts. It gives only facts and knowledge about result. It leaves the decisions making to policy framers. (4) Managerial economics is connected with many objects such as business management, financial management, mathematics, statistics, econometrics, psychology, sociology, political science, physiology, medicines marketing etc.

Explaining the nature of managerial economics, **W. F. Samuelson and Stephen G. Mark** have said, "*Managerial Economics is an analysis made through the use of economic tools for majority of managerial decisions. In managerial economics, many economics concepts such as demand and cost, monopoly and competition distribution of means and economic trade etc. are used for decision making.*"

4. How Does Managerial Economics Differ from Economics ? :

(1) Managerial economics involves application of economics principles to the problems of the firm, whereas Economics deals with the body of the principles itself.

(2) Managerial economic is micro-economic in character, whereas Economics is both macro-economic and micro-economic.

(3) Economics theory makes certain assupmtions whereas Managerial economics introduces certain feedbacks such as objectives of the firm, environmental as pects, behavioural constraints, legal constraints etc.

(4) Economic theory hypothesizes economic relationships and builds economic models whereas Managerial economics adopts, modifies and reformulates economic models to suit the specific conditions and serves the specific problem solving process.

(5) Micro-economics as a branch of economics deals with both economics of the firm as well as economics of the individuals where as Managerial economics though micro character, deals only with the firm and has nothing to do with an individual economic problems.

(6) Micro- Economic as a branch of economics is dealt with distribution theories like profit, wages and profit whereas Managerial economics main used only profit, theory, other distribution theories have not much use in managerial economics.

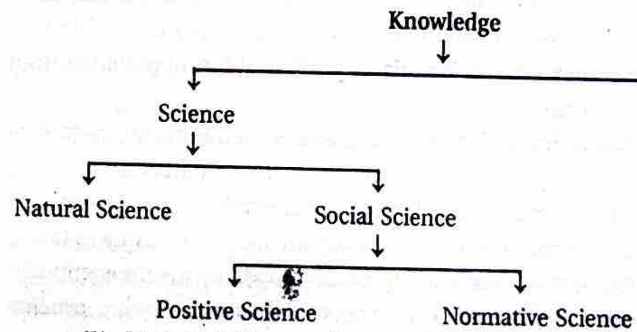
Economics, business management and managerial economics have mainly following differences. In economics, only principles of economics and methods of economics are discussed while in business management, the problems related to decision making are discussed. In managerial economics has business decisions can be solved with the help of economics is discussed. It focuses on how business problems can be solved in the best way possible.

2. Nature (Form) of Managerial Econimics

1. Introduction : The objective of managerial economics is to show how principles of economics and methods of economic analysis can be useful in framing the business policy. Its main function is to co-ordinate the principles of economics with the process of decision making of the firm. Is managerial economics a science or an art ? What is the relationship with micro economics and macro economics ? What is its relationship with other branch ?

All these questions should be discussed and clarified.

2. The following chart will be useful in clarifying the form of Managerial Economics :



(1) Managerial Economics - an Idealistic Science : There are two branches of knowledge : (1) Science and (2) Art.

(a) Natural Science : It includes physics, chemistry, astronomy, etc. Its subject is inanimate things.

(b) Social Science : It includes Economics, Political Science, Sociology, etc. Its subject is living human behaviour. Social Science has two kinds :

(1) Realistic Science : In realistic science, What is discussed ? Its purpose is attaining knowledge. Economics is a realistic science. It studies economic events and deduces rules. It is not concerned with its relevance or appropriateness.

(2) dealistic Science : Managerial economics is an idealistic science. It gives clear cut opinion about what decisions must be taken from the given alternatives for maximum benefit to a firm. Managerial economics is always concerned with attainment of objectives. It is not neutral about objectives. This means that managerial economics is not connected with realistic science. In managerial economics, how principles of econômics and methods of economic analysis can be used in management of a firm is discussed. In reality, managerial economics is idealistic though it is connect with realistic science.

(3) **Managerial economics - an art :** An art is connected with the achievement of same goal. Managerial economics is an art in which best way for the achievement of the goal for the firm is to be presented.

(4) **Managerial Economics and Economics :** Managerial economics is a special branch of economics. Its scope is limited to management of a firm. It shows how the principles of economics can be applied to the management of a firm and how the different methods of analysis can help in management of a firm. It shows the best way to achieve its purpose. Managerial economics is mainly micro economics in its natural.

(5) **Managerial Economics and Micro Economics :** When an economic unit of is studied separately from other units of economics, it is called micro economics. Managerial economics discusses the main problems like demand production, structure of cost, cost determination, maximizing of profit and future planning from the point of view of business firm only.

(6) **Managerial Economics and Macro economics :** Though the nature of managerial economics is basically micro economics, it has an indirect relationship with macro economics also. The knowledge of production, employment, government policies and such other macro economic concepts help the individual firms in taking decisions or future planning of the firms. The forecasting made by macro economics in view of economics events helps individual firms in decision making process regarding production and price etc.

(7) **Deductive theory of logic for study :** In deductive method, the process of reasoning is to general deduce from the particular e.g. for the maximum marginal cost of a firm the principle of marginal cost = marginal income has been deduced on this deductive method. Accepting this rule the individual firm acts or behaves. In the same way, the concept of linear planning is also deduced on deductive method.

(8) **Economic analysis and mistaken benefit :** In managerial economics, decisions are taken on the basis of economic analysis to deduce the conclusion and on the basis of this conclusion, decisions are taken is managerial economics. Such deductions may be faulty also. e.g. sample survey on smaller base and larger base might result in different results. In the same way, all entrepreneurs do not get equal success inspite of the similar circumstances.

(9) **Managerial economics and other science :** In managerial economics, in the process of decision making, mathematics, statistics, economics, accounting, operating researches etc. become quite useful. To establish the relationship between, interrelated economic factors for the process of decision making of a firm, statistics is used.

The economic equations, models etc. presented in reference to economic trends in economics principles are useful in framing the economic policy. Its examination is the function of an operational researcher.

In modern time, economics, statistics and mathematics - three are used by econometrics. Thus, econometric helps very much in taking decisions in managerial economics. In the same way, the accounting provides the information to the management regarding profit and loss in business.

3. Characteristics of Managerial Economics

(1) **Micro Economics :** Economics have two forms - micro economics and macro economics. Managerial Economics is micro economics as the unit of its study is a firm. Here, everything like demand, production, cost-structure, profit margin based on price, investment etc. are considered firm the angle of a firm. Major concepts of managerial economics and tools of analysis are taken from economics e.g. Elasticity of demand, marginal income, marginal cost, market structure, models of price determination etc. are used in the process of decision making in managerial economics.

(2) **A Branch of Economics :** Economics has many branches. Managerial economics is a special branch of economics. In managerial economics, how the principles of economics and economic methods can be used is discussed. Economics that studies, the different economic aspect of agriculture is called, 'Agriculture Economics'. In the same way, economics that studies different economic aspects of industries can be called 'Industrial Economics'. Economics that studies the economic aspects of management of a firm is called managerial economics.

(3) **Applied Economics :** Managerial Economics is an applied economics. Here, how the principles of econômics and economic analysis can be used in decision making and future planning of a firm is discussed.

(4) **Idealistic Science :** Economics is a realistic science. It is concerned with what is. Its purpose is merely the attainment of knowledge. While managerial economics is an idealistic science. It aims at maximum advantage for the firm. It does not merely give the idea of alternatives for solution of any economic problem but shows which alternative is the best. In managerial economics, the objective of the firm is determined and then, it suggests the best option that can provide the maximum

advantage. Managerial economics is connected with attainment of objectives. It is not neutral about the objective. It has to give clear cut opinion about the decisions regarding the management of a firm and about beneficial or non-beneficial decisions. It cannot remain indifferent or aloof. It has to give opinion and guide about to best alternative for the process of management in decision making and future planning. In other words, managerial economics does not aim at knowledge but advantage or benefit for the firm. It is connected with attainment of an objective. D. C. Hague has mightily said, "Managerial Economics is a micro-economics of a firm which is identified in nature ."

(5) Its relationship with macro economics : Though the nature of managerial economics is micro economics, it is connected with macro economics also. In macro-economics, entire economy is considered and not a unit. In macro economics, trade cycle, national income, unemployment, economic policies of the state etc. are studied. No individual firm can remain aloof from such changes. It is necessary to know the trends of income, employment, trade cycle etc. while framing the policy for future planning or decision making.

(C) Limited scope of managerial economics : Managerial Economics is a branch of economics. It is concerned with the problems of management of a firm. While economics is connected with every economic aspect individually as well as collectively. e.g. In economics, profit, rent, wages, interest are included in distribution while in managerial economics, the principle of profit has been included in distribution. Thus, the scope of managerial economics is more limited than economics.

(7) Managerial Economics is an art too : Realistic science is connected with reality while idealistic science is connected with ideals. Art is concerned with certain objectives. Managerial Economics is an art because it is concerned with attainment of certain objectives e.g. managerial economics guides how maximum profit can be obtained by choosing the most appropriate alternative for profit making.

(8) Use of deductive method : There are two methods of studying any science : (1) Deductive and (2) Inductive. In deductive method, particular is deduced from the general. In managerial economics, decisions are taken by using statistics, mathematics, etc. e.g. it is a general rule of a firm that the aim of a firm is to make maximum profit. When marginal income and marginal cost equal in production, maximum profit can be achieved. This fact is used in managerial economics to investigate practical conduct of a firm.

(9) More useful : The study of managerial economics is more useful in real life than economics. In economics, only principles of economics and methods of economic analysis are given. Managerial economics uses these economics principles and methods of economic analysis to make maximum profit for the firm. Thus, it helps in taking logical decisions for the managers.

4. Significance (Importance) of Managerial Economics

1. **Introduction :** In modern time, in the field of industries task of management is getting more and more difficult. Economics presents the principles of economics and methods of analysis. Business economics discusses the problems arising in business while in managerial economics how business problems can be solved with the help of obstruct principles of economics and its analytical methods. Thus, it focuses on solutions of such problem along with its possible options. In managerial economics, guidance is provided regarding the problems of a firm related to internal workings as well as external problems. Managerial economics is a connecting link between principles of economics and managerial dealings or tasks. That is the reason why in modern time, the role of managerial economics has become quite important. The importance of managerial economics can be explained in the following manner.

2. **Importance of Managerial Economics :**

(1) In the process of decision making : Managerial economics helps and guides in decision making process. It provides alternative solutions to the managers on taking decisions with the help of principles of economics and methods of analysis by practical research. The manager can take proper business decisions and make planning of the business for future. In short, managerial economics provides suitable sources of guidance for decision making from traditional economics.

(2) The process of future planning : The purpose of a firm is not merely to set up a business unit but to achieve remarkable development in future. Managerial economics becomes very useful in making future planning. By studying the interrelationship among various factors related to business, estimate of future demand can be made. e.g. various determinants of demand, elasticity of demand etc. can be studied in order to make demand forecasting. It provides guidance regarding which solution can be adopted viz. price, selling cost etc. for the development of business.

(3) In managing business : In gigantic industrial units in modern time, many departments in different areas are functioning. In big companies, there are various departments such as - finance, marketing, personnel, production etc. To supervise each division, a manager is appointed. Decisions of all these departments often affect one another. Thus, managerial economics plays a role of co-ordination agent of all these departments.

(4) To solve business problems : The firm faces two types of problems : (A) Internal or functional problems. (B) External environmental / circumstantial problems. Managerial economics provides guidance how business problem can be solved with the help of the principles of economics and methods of analysis in economics.

(A) **Internal or Functional problem of a firm :** The firm faces the following internal problems regarding production, pricing, marketing, capital distribution etc. These problems are as follows :

(1) What commodities and what services to produce ? (2) What inputs and what method of production to be adopted ? (3) How much to produce and at what price it is to be sold ?(4) What is the ideal size of a new unit and at which location, it is to be established ? (5) When to change tools and equipments ? (6) How to distribute the available capital ? (7) How to face the competitors in the markets ? (8) How to manage profit and capital ? etc.

Managerial economics provides guidance regarding all these internal problems with the help of principles of economics and methods of analysis through practical functional management techniques.

(B) **External or Environmental problems of the firm :** Internal problems are often under the control of the firm but the external problems are beyond the control of the firm. External problems of a country are related with economics, social and political circumstances of a country. Such problems are called environmental or circumstantial problems. If the firm takes decisions without taking them into consideration, they can be quite harmful.

Such factors are of three types : (i) Economic activities taking place in the entire country. If the economic growth rate of a country is high, there is a possibility of increase in demand in the entire market. In that context, the individual firm can take decision regarding its production. (ii) Trade relations with other countries, international demand, changes in prices, exchange rate changes etc. affect the process of decision making of the firm. (iii) Government policies always affect economics action of the country. They naturally affect the process of decision making in the firm. The firm must always consider the present financial, industrial and trade policy of the present government of the country.

(5) **For forecasting :** For successful management of the firm, successful forecasting in very important. In managerial economics, the forecasting regarding the income of the firm, cost, selling, profit, price etc. can be in the basis of knowledge of business factors and their analysis. For this, the principles of economics and their analytical methods can be used and practical, functional management can be useful in it. The firm can make planning in advance on the basis of such forecasting.

(6) **Others :** Managerial economics performs the important function of co-ordinating the firm and the society. Optimum social and economic welfare is possible in this way. The firm has to consider social interest along with the interests of the shareholders also. Therefore, business decisions are taken in view of social welfare as well as the optimum interest of the shareholders. Thus, managerial economics helps in guiding in this respect also. In short, economic decisions of the firm can never be taken neglecting the social decisions.

In managerial economics, to obtain useful ideas for the process of decision making, the subjects take psychology, sociology etc. are consulted. For solving business problems managerial economics provides group of alternative method of solution to the managers.

5. Scope of Managerial Economics

1. **Introduction :** Managerial economics is a developing science. In the beginning, its emphasis was mainly on financial matters but now the importance of econometry and operational research has increased to examine business conditions and in the process of decision making. Thus, its scope has widened. The main objective of managerial economics is to take decisions regarding management and to use economic principles and economic analysis for future planning. All matters included in this process are included in the scope of managerial economics.

2. **The Scope of Managerial Economics :** We know that the main scope of managerial economics is to take decisions and plan for future. This is mainly connected with following four things.

(1) **Allocation of Resources :** Limited resources are allocated to attain certain fixed goals for the optimum result. These resources have alternative uses.

(2) **Inventory control :** The decision has to be made regarding the stock of raw material and prepared goods according to demand and supply factors.

(3) **Pricing problem :** The firm has to take decision regarding the price of goods. Prices are decided on the basis of demand or cost or both. For price determination marginal pricing method or mark up method has to be adopted.

(4) **Investment problem :** For future planning the problem of investment is also connected. How limited resources must be allocated, to decide the volume of investment and its nature, to decide the sources of availability of finances, to decide the programme of expansions, to continue the existing structure of production or arrange a new structure of new production etc. have to be decided by the manager.

In managerial economics, following main things are also included : (1) Demand analysis (2) Elasticity of demand (3) Estimates of demand (4) Demand forecasting (5) Determination of production and profit in the market (6) Price analysis (7) Capital budgeting (8) Cost analysis (9) Marginal analysis (10) Business Environment (11) Business finance (12) Measurement and analysis of national income (13) Domestic and foreign trade (14) Study of labour cost (15) Public finance.

3. **Scope of managerial economics in the context of decision making :** The scope of managerial economics can be divided into two parts in the context of decision making process. (a) operational issue (b) environmental issues.

A **Operational Issues :** The issues under the control of the management are operational issues.

(1) **Factor distribution :** Like economics proper, managerial economics is also concerned with the optimum use of scarce means with alternative uses . To determine the production giving maximum profit, linear planning method is used.

(2) **Demand analysis and demand forecasting :** To take decisions regarding what to produce and how much to produce, the demand analysis and demand forecasting become very useful. Producer can get the information regarding the proportion of demand at different prices by studying demand elasticity. Demand analysis, demand determiners, differences between different kinds of demand, elasticities, demand estimates and demand forecasting are studied in managerial economics. The decision of total production depends upon all these things. Demand forecasting guides the management to sustain market or to expand it.

(3) **Cost and production :** In taking business decisions, price determination and proper distribution of factors, the analysis of cost is useful to the producers. The firm wants to achieve maximum production at minimum cost and profit therefore, in managerial economics, cost analysis, cost production ratio, cost control etc. are studied.

Every firm tries to make maximum production with minimum cost on the basis of forecasting of demand. Therefore, to decide the size of the plot of land, laws of production, production function analysis, cost-benefit analysis etc. are studied.

(4) **Cost determination and pricing policies :** In managerial economics, pricing policies and decisions regarding prices are very important. The success of failure of a firm depends mainly on the decisions regarding price. Therefore, price determination in different markets, pricing policies, pricing methods, price differences, relationship of prices among commodities of the same group, price forecasting etc. are included in the scope of managerial economics.

(5) **Planning of profit and measurement :** The purpose of a firm is to make maximum profit, profit is a measurement of efficiency. Risk and uncertainties are connected with profit. So, the management must be aware of competition in commodities, changes in prices of inputs, changes in technology, changes in government policies etc. management should take decisions in which the element of uncertainties are minimum. For this, the law of probability becomes the guiding principle. In managerial economics, the principles of profit, nature and measurement of profit, the methods of planning of profit such as break even analysis cost etc. are studied.

(6) **Capital budget and decisions regarding investment :** In managerial economics, the decisions regarding investment are very important. Capital budget

becomes very useful in it. The estimates of capital for project, marginal productivity of capital costs, the availability of capital for certain field of business or project, profitability of capital choice of a project, capital distribution among projects, etc. are necessary to know for investment by the management.

(7) **Strategic planning :** For framing the future planning of a firm, the principles of managerial economics and economic analysis methods are employed. For such operational planing, within certain period, for the implementation of a certain strategy, necessary things are studied, Portfolio model and corporate simulation model are useful in this direction.

(8) **Project evaluation :** It is necessary for the manager to know the achievements and limitations of different project which the firm has implemented for future planning decision. For this operational research, input-output analysis, linear planning rules of the games etc. need to be studied in managerial economics.

B **Environment Issues :** There are certain issues regarding environment that affects the process of decision making of a firm and future planning. Therefore, they have to be studied in managerial economics. Such factors are as follows :

(1) **Trends regarding income, production, employment, investment etc. :** At macro level, the factors like income, production, employment or investment of the country have to be studied as they affect the decisions of the firms. Therefore, they have to be studied in managerial economics.

(2) **Trends in foreign trade :** The changes in the nature, direction and proportion of foreign trade affect the firm indirectly. The firm has to take decisions to make changes in the form or production of goods suited to these changes. The manager has to take managerial decisions keeping in touch with exchange rate, proportion of import-exports, government policies regarding defence etc. These aspects have to be studied in managerial economics.

(3) **Government policies :** The Government policies pertaining to financial, fiscal, industrial and pricing matters affect the process of decision making and future planning of the firm. They have to be studied in managerial economics.

(4) **Business decisions :** Short-term as well as long term business decisions of the firm depend mainly on macro level decisions. The subsidy or tax relief provided by the government affect the demand of goods. The manager has to consider how far these changes will affect the demand of goods.

(5) **Strategy of sales :** The strategy of sales adopted by as a whole by others at macro level affect individual strategies of sales also. The demand by the customers depends on preference or choice of customers, priority, availability of goods prices of substitute commodities, quality etc.

(6) **Social factors :** The choice of consumers regarding commodity is affected by social values, property rights, customs, habits etc. In a country, existing labour unions, consumer co-operative unions, the manufacturing unions and their policies affect the decision making of the firm. The changes in social structures also affect the changes in nature of demand for commodities. The study of social factors are therefore, necessary in managerial economics.

(7) **Economic policies :** The economic policy of the government affects the decisions of individual firms. e.g. Due to changes in policies of privatisation, liberalization and globalisation, there have major changes in demand of goods in the country. The banks, insurance companies, financial corporations, and other policies affect the decisions of individual firm. The policies of the government regarding agriculture, industries, trade affect the demand of goods and production cost of goods. Therefore, all these things are included in managerial economics. The changing political scenario of the country also influence the decisions of the firm. When political circumstances change in a country, the import-export transfer of capital etc. are affected. On the whole, the scope of managerial economics is wider than other sciences.

6. Role and Responsibilities of Managerial Economist

1. **Introduction :** The main function of managerial economist is to show how the principles of economics and economic analysis can be used in the process of decision making and future planning. The main question in front of a firm is to receive the maximum profit and to distribute the factors having alternative uses optimally. To solve this problem, the role of managerial economist is very crucial. For example, if there is a decrease in demand of product of a firm, then managerial economist tries to find out the factors responsible for it with the help of analytical method. He tries to know whether people need multi-use product or due to high price, the demand has reduced. On the basis of this information, he shows the way to tackle this problem by changing the nature of the product or by reducing the cost of production. A managerial economist guides the entrepreneur to take the decision and to plan for future to solve the difficult problem.

2. **Role of Managerial Economist :** The role or working of managerial economist is as follows : (A) Specific Decisions, and (B) General Decisions.

The working (functions) of a managerial economist : The managerial economists like Alexandar and Kemp showed the specific functions from the study of British Industries.

(1) Production planning (2) Demand forecasting (3) Research in market (4) Economic analysis of a firm (5) Decision for price (6) Valuation of investment (7) Advice on trade (8) Advice on management of foreign exchange (9) Environment means forecasting for external factors (10) Advice on capital project (11) Economic analysis of under developed countries (12) Managerial analysis of security.

A managerial economist gives proper guidance to the entrepreneur after studying all this points and after analysing which helps an entrepreneur to take decision and to plan for future.

The most important task of a managerial economist is to forecast on sales and market research. A managerial economist checks the trends of market demand, and how much part of market is available to the firm in increased demand. He tries to provide the information. An entrepreneur gets the guidance of it on the basis of decision making and future planning.

3. **General Tasks (functions) of Managerial Economist :** The general tasks of a managerial economist can be studied on the basis of below factors :

(A) External Factors (B) Internal Factors.

(A) External Factors (Business Environment) : The factors like sales, income or profit which affect the business but remain outside the control of the firm are known as external factors or also known as business environment. From this information, the firm makes the process of decision making and future planning. These are important factors which help the firm for taking decision. The following factors are included in it.

(1) **Economic policy of government :** The economic policy of government affects the business noteworthy. For example, leaving socialistic policy accepting capitalistic economy, reducing restrictions (controls) on trade or production, accepting liberalisation and globalisation policy, then the firm can get the global market. For example, the companies like Reliance, Tata. etc. prepare the future planning policy in India presently not an the basis of Indian market but on the basis of world (global) market. How is the global market in this situation ? What kind of changes can be possible in global market ? This information can be provided by the managerial economist to an entrepreneur.

(2) **Changes in level of competition :** A managerial economist should provide the information about the possible changes in forms of situation of country and international situation for competition at national and international level. For example, if the government puts the liberal trade policy in place of protectionist trade policy, sometimes due to increase in imports, the competition also increases.

(3) **Regarding present and future market demand :** A managerial economist provides the information regarding the choice and invention so that what is the probability of present and future market demand change can be known to a firm. A firm can prepare profit policy on decision making and future planning based on it. For

example, there is revolution in mobile market in India, so the mobile producing company prepares the policy regarding future demand.

(4) **Regarding the overall picture of an economy :** A managerial economist should provide the information regarding national income and production in an economy in terms of monetary and fiscal policy of the government so that the overall picture of a country can be seen. An entrepreneur prepares the policy of production and price on the basis of it.

(5) **Monetary and Fiscal policy :** A managerial economist should provide the information regarding the effects of monetary and fiscal policy of government on the market and production cost of a firm. For example, in present India the cheap money policy is implemented and what will be the reduction of production cost due to providing loan at low rate of interest. If the firm gets credit at cheaper rate of interest then, it is profitable for the firm to use the capital intensive methods.

(6) **Others :** A managerial economist should get the information from the market about the present & future the price of raw material and finished goods. In addition to it, in future what is the probability of getting raw material, this information should be provided to an entrepreneur.

(B) Internal Factors (Business Operations) : Internal factors are also called business operations. The factors which are directly under control of management of firm are called internal factors. In this the main factors like profit, price, capital investment, expansion-contraction of a firm etc. are included. A managerial economist studies the below internal factors and guides the entrepreneur.

(1) **Regarding the objective of a firm :** Generally, the objective of a firm is to earn maximum profit. A managerial economist helps the firm to take the decision for achieving the other objectives of a firm like sustaining goodwill of a consumer, disappointing the probable opponent, getting the leadership in industry or avoiding the interference of government in addition to achieving maximum profit.

(2) **Using the basic economic concepts in process of decision making :** A managerial economist should provide information to an entrepreneur regarding the decision making and future planning and methods of economic analysis. For example incremental principle, discounting principle, opportunity cost or equi-marginal principle, etc. can be used in the process of decision making.

(3) **Management of demand and sales :** A managerial economist informs an entrepreneur about the changes in demand with the help of methods of economic analysis after studying the factors affecting demand. For this, he have to find out the price elasticity of demand, income elasticity of demand, cross elasticity of demand elasticity of demand etc. and from this he finds out the effect of changes in demand due to price changes. An entrepreneur can give guidance for preparing budget for sales.

(4) **For production sector :** A managerial economist should provide the guidance regarding the optimum level of production in short run after studying the production function and law of variable proportion.

(5) **Regarding Expenditure :** The object of a firm is to produce at least cost. A managerial economist should show the way how to produce the goods at least cost after analysing the cost function, short and long run expenditure production relationship.

(6) **Regarding price determination :** A managerial economist should perform the task of giving guidance for price determination in different condition. Out of different pricing methods, he has to choose which price method is profitable or which price strategy is profitable.

(7) **Other factors :** A managerial economist makes the decision making easier by providing guidance as follows : (a) Budget of sales and profit for next year (b) Storage policy of goods and schedule for the next six months regarding production. (c) Choice regarding the highest profitable goods of a firm (d) Changes in the policy of present wages and price if needs. (e) How is the structure of cash and its investment in next month ? (f) Forecasting regarding the general business activity (g) Product design, production planning, etc.

So, a managerial economist plays a very crucial and important role in production structure of present corporate structure and plays a very important role in the process of management. He does not give advice in internal factors but also study the external factors and after analysing he makes an entrepreneur aware regarding the business effects.

4. **Responsibilities of a Managerial Economist :** A managerial economist guides an entrepreneur in the process of decision making and in preparing future planning. This function should be performed seriously and with responsibility so that the success can be achieved. In this situation, the managerial economist should be aware with the below responsibilities and duties.

(1) **Regarding maximum return :** The aim of a firm is to get maximum return on investment and maximum profit. To achieve this aim a managerial economist should use all his abilities and knowledge. He should guide the firm in such a way so that the firm receives maximum profit by putting a side his own feelings or principles.

(2) **Regarding doing perfect forecasting :** A managerial economist has to do perfect forecasting. The factors like available data and information, external economic environment, government policy etc. are considered. So, a managerial economic tries to do perfect forecasting so that the uncertainties can be avoided.

(3) **Regarding quick collection of information :** The importance of managerial economist is based on how quickly information he collects. For this, he has to keep in

touch with business people or with experts of that sector or become a member of business union / organisation, participating in seminars.

(4) **Regarding guidance and discussion with entrepreneurs :** A managerial economist performs his duties very well only when he gets the position which looks good in process of management. He must get an idea of day to day transactions, taking the independent decision. He has to study the projects and with the use of his ability and skill he has to study, analyse and compare after discussion.

(5) **Regarding winning the trust of entrepreneurs :** A managerial economist should win the trust of entrepreneurs. He should perform his task very well so that he should have training experience and must have excellent personality and able to make entrepreneurs understand is based on his skills.

(6) **Regarding effective implementation of decision :** A managerial economist implement his decision very effectively so that the decision will be fully effective. For this, he has to put the real facts, giving importance to the aim, giving proper suggestions and trying to make his success more probable.

(7) **Regarding standing against the economic challenges :** A managerial economist should have the ability to fight with the challenges against the firm. He should inform the entrepreneurs about the effects of production process on production of goods and on customers health, so that on entrepreneur takes a long term decision.

7. Limitations of Managerial Economics

1. **Introduction :** The limitations of a science depend more on the user of that science than the science itself. e.g. atomic energy can be used for the welfare of mankind but it can destroy mankind if used as a means of distraction. In the same way managerial economics can be used profitably and in the context of its user.

2. **Limitations of Managerial Economics :** Following limitations are found in Managerial Economics:

(1) **It is not absolutely true science :** Economics and managerial economics are social science. They depend on continuity of certain behaviour. Particularly, it is so in the context of demand and supply. Project is determined on the basis of these assumptions. But it is not possible that all such assumptions, then into reality in real world. Therefore, it is not necessary that all assumptions of managerial economics come true.

(2) **It is not welfare science :** The objective of any firm in managerial competition structure in modern time is to make maximum profit. In this context, the method implemented is not always welfare oriented because maximum profit is the primary objective while social welfare is a secondary objective. Very often, high prices

are charged on certain goods due to the limitation of demand and supply even more than the production cost. The prices charged at higher rates reduce the social welfare. Sometimes, luxury goods are produced for the purpose of profit only. Sometimes even harmful goods are produced for the purpose of profit only. They reduce the quality and quantity of social good.

(3) **Decision according to time and place :** In managerial economics, decisions are taken in the context of time and place according demand and supply. Such decisions are not always true for all the time. e.g. If a firm takes certain decision regarding time production of X does not hold true for all the time in future. If future changes, the decision has to be changed. In the same way, the place factor also affects the demand and supply and in the final analysis the decision.

(4) **The effect of policies of macro economics :** In macro economic level, decisions regarding agriculture, industries, foreign trade and monetary and fiscal policies take longer period of time. Such a delay makes the decision irrelevant as the demand and supply factors also change. Identification of policy and its possible impact at micro-economic level may take and that adversely affect the unit at the micro level.

Objective Study

➤ **Choose the correct option from the given options :**

(1) Who is considered to have started the development of Managerial Economics with a book published in 1951 ?
(A) John Maynard Keynes (B) Joel Dean
(C) Adam Smith (D) Milton Friedman

(2) Which of the following best describes the main function of managerial economics ?
(A) To coordinate abstract principles of economics with managerial decisions
(B) To study the history of economic thought
(C) To analyze macroeconomic trends
(D) To develop new economic theories

(3) what is a major difference between Managerial Economics and Business Economics ?
(A) Managerial Economics is narrower in scope than Business Economics.
(B) Managerial Economics focuses on management of business activity, while Business Economics includes all business activities from production to distribution.
(C) Business Economics is a subfield of Managerial Economics.
(D) There is no difference; the terms are interchangeable.

(4) Why is the term "Economics of the Firm" considered inappropriate for Managerial Economics ?
(A) It does not discuss principles of the firm.
(B) It is based on assumptions and thus unrealistic in practical scenarios.
(C) It is too broad and includes macroeconomic aspects.
(D) It focuses exclusively on individual economic problems.

(5) Which definition of economics emphasizes the science of choice preference, studying how men choose scarce means for production ?
(A) Joel Dean's definition (B) Robbins' definition
(C) Spencer and Siegelman's definition (D) Mac Nair and Meriem's definition

(6) Which of the following factors is not typically used in managerial decision-making ?
(A) Economic Principles
(B) Human Psychology
(C) Local and International Political Conditions
(D) Astrology

(7) Which aspect is not a key feature of Managerial Economics ?
(A) Process of taking economic decisions
(B) Exclusive focus on government policy making
(C) Use of economic, statistical, and mathematical tools
(D) Implementation of economic and business principles

(8) How does Managerial Economics primarily differ from Economics ?
(A) Managerial Economics involves macroeconomic principles.
(B) Managerial Economics applies economic principles to firm-level problems.
(C) General Economics is practical and result-oriented.
(D) Managerial Economics does not use economic models.

(9) Which of the following best describes the nature of Managerial Economics according to W.F. Samuelson and Stephen G. Mark ?
(A) It is purely theoretical with no practical application.
(B) It involves the use of economic tools for most managerial decisions.
(C) It excludes competition analysis.
(D) It is concerned only with macroeconomic issues.

(10) How does Managerial Economics relate to Macroeconomics ?
(A) It solely focuses on microeconomic aspects and ignores macroeconomic factors.
(B) It studies trade cycles and national income in detail.
(C) It considers macroeconomic trends while making firm-level decisions.
(D) It is unrelated to Macroeconomics.

(11) The scope of Managerial Economics is _______.
(A) Broader than general Economics
(B) Limited to the management of a firm
(C) More comprehensive than Industrial Economics
(D) Focused on public policy analysis

(12) Managerial Economics is an art because _______.
(A) It involves scientific theories.
(B) It aims at the attainment of certain objectives like maximizing profit.
(C) It does not involve practical application.
(D) It is purely theoretical.

(13) Which method is commonly used in Managerial Economics for decision-making ?
(A) Inductive Method (B) Deductive Method
(C) Experimental Method (D) Comparative Method

(14) The primary objective of managerial economics is to _______.
(A) Understand consumer behaviour
(B) Apply economic principles to business policy and decision making
(C) Study the production of goods and services
(D) Analyze government policies

(15) Managerial economics is considered an idealistic science because _______.
(A) It focuses solely on economic events without concern for objectives
(B) It gives clear-cut opinions on decisions for maximum benefit
(C) It studies human behavior in a realistic context
(D) It deals with inanimate things

(16) Which sciences are particularly useful in the decision-making process in managerial economics ?
(A) Physics and Chemistry (B) Biology and Medicine
(C) Mathematics, Statistics, and Accounting
(D) History and Geography

(17) The term "positive science" in the context of managerial economics refers to_______.
(A) Making value-based judgments about economic policies
(B) Analyzing what is, without prescribing what should be
(C) Creating normative statements about economic decisions
(D) Focusing on future economic trends

(18) Which of the following statements best describes econometrics in managerial economics ?
(A) It ignores mathematical methods
(B) It combines economics, statistics, and mathematics for decision making
(C) It is unrelated to managerial decision processes
(D, It solely focuses on qualitative analysis

(19) Which of the following is not included in the scope of managerial economics ?
(A) Demand analysis (B) Inventory control
(C) Personal management (D) Cost analysis

(20) Managerial economics primarily assists in decision-making related to
(A) Natural resource conservation
(B) Future planning and management decisions
(C) Historical economic analysis
(D) Personal finance management

(21) Which method is adopted for price determination in managerial economics ?
(A) Marginal pricing method (B) Random pricing method
(C) Arbitrary pricing method (D) None of the above

(22) What is the main goal of managerial economics concerning resource allocation ?
(A) To increase employee wages
(B) To achieve optimum results with limited resources
(C) To reduce resource availability
(D) To eliminate the need for future planning

(23) Which of the following areas is considered under operational issues in managerial economics ?
(A) Government policies (B) Social factors
(C) Demand analysis and forecasting (D) Trends in foreign trade

(24) Which factor does not fall under environmental issues in managerial economics ?
(A) Income trends (B) Business decisions
(C) Cost and production analysis (D) Government policies

(25) Which of the following is not an internal problem that managerial economics helps to solve ?
(A) What commodities to produce
(B) Trade relations with other countries
(C) How to manage profit and capital
(D) What inputs and methods of production to adopt

(26) What role does managerial economics play in managing different departments within a large industrial unit ?
(A) It acts as a coordinating agent among different departments
(B) It only focuses on financial management
(C) It provides solutions only for the production department
(D) It ignores the marketing department's needs

(27) Which disciplines, aside from economics, are consulted in managerial economics to solve business problems ?
(A) History and geography (B) Psychology and sociology
(C) Literature and arts (D) Sports and entertainment

(28) What is the relationship between managerial economics and traditional economics ?
(A) Managerial economics is entirely separate from traditional economics
(B) Managerial economics ignores the principles of traditional economics

(C) Managerial economics applies the principles and methods of traditional economics to business decision-making
(D) Managerial economics opposes the methods of traditional economics

(29) What is the primary function of a managerial economist in a firm ?
(A) Maximizing sales revenue (B) Minimizing production costs
(C) Maximizing profit through economic analysis
(D) Maximizing market share

(30) Which of the following is not a specific function of a managerial economist ?
(A) Production planning (B) Demand forecasting
(C) Employee training (D) Economic analysis of a firm

(31) A managerial economist assists in decision-making related to ________.
(A) Government policy analysis (B) Marketing strategies
(C) Stock market predictions (D) All of the above

(32) Responsibilities of a managerial economist include ________.
(A) Maximizing company expenses
(B) Making independent decisions without analysis
(C) Forecasting economic conditions
(D) Ignoring external economic factors

(33) What is one of the roles of a managerial economist in relation to pricing decisions ?
(A) Increasing prices to maximize revenue
(B) Following competitors' pricing strategies
(C) Advising on profitable pricing methods
(D) Lowering prices to increase market share

Answers

(1) B	(2) A	(3) B	(4) B	(5) B	(6) D	(7) B	(8) B	(9) B
(10) C	(11) B	(12) B	(13) B	(14) B	(15) B	(16) C	(17) B	(18) B
(19) C	(20) B	(21) A	(22) B	(23) C	(24) C	(25) B	(26) A	(27) B
(28) C	(29) C	(30) C	(31) D	(32) C	(33) C			

Self Study

1. Define Managerial Economics. Discuss its relation with economic theory.
2. Define Managerial Economics and discuss its scope.
3. "Managerial Economics is the study of allocation of resources available to a firm or other unit of management among activity of that unit." Examine and evaluate this statement.
4. Explain clearly the nature of Managerial Economics.
5. Explain the importance of Managerial Economics.