Unit 1: Managerial Economics

Introduction

The discovery of managerial economics as a separate course in management studies has been attributed to three major factors:

1. The growing complexity of business decision-making processes, because of changing market conditions and the globalization of business transactions.

2. The increasing use of economic logic, concepts, theories, and tools of economic analysis in business decision-making processes.

3. Rapid increase in demand for professionally trained managerial manpower. It should be noted that the recent complexities associated with business decisions has increased the need for application of economic concepts, theories and tools of economic analysis in business decisions. The reason has been that making appropriate business decision requires clear understanding of existing market conditions market fundamentals and the business environment in general. Business decision-making processes therefore, requires intensive and extensive analysis of the market conditions in the product, input and financial markets. Economic theories, logic and tools of analysis have been developed for the analysis and prediction of market behaviors. The application of economic concepts, theories, logic, and analytical tools in the assessment and prediction of market conditions and business environment has proved to be a significant help to business decision makers all over the globe.

Objectives

At the end of this unit, you will be expected to:
1. Have an understanding of the meaning and importance of managerial economics
2. Understand the relevant phases in business decision making processes
3. Be familiar with the scope of Managerial Economics
4. Be able to discuss freely how managerial economics can fill the gap between theory and practice

Definition of Managerial Economics

Managerial economics has been generally defined as the study of economic theories, logic and tools of economic analysis, used in the process of business decision making. It involves the understanding and use of economic theories and techniques of economic analysis in analyzing and solving business problems.

Economic principles contribute significantly towards the performance of managerial duties as well as responsibilities. Managers with some working knowledge of economics can perform their functions more effectively and efficiently than those without such knowledge. Taking appropriate business decisions requires a good understanding of the technical and environmental conditions under which business decisions are taken. Application of economic theories and logic to explain and analyses these technical conditions and business environment can contribute significantly to the rational decision-making process.

Nature of Managerial Economic

- Managerial economics aims at providing help in decision making by firm. It is heavily dependent on microeconomic theory. The various concepts of micro economics used frequently in managerial economics.
  - Elasticity of demand
  - Marginal cost
  - Marginal revenue
  - Market structures and their significance in pricing policies.
- Macro economy is used to identify the level of demand at some future point in time, based on the relationship between the levels of national income only that the level of various products depends.

  In managerial economics macro economics indicates the relationship between (a) the magnitude of investment and the level of national income, (b) the level of national income and the level of employment, (c) the level of consumption and the level of national income.
- In managerial economics emphasis is laid on those prepositions which are likely to be useful to management.

Scope of Managerial Economics

Managerial economics comprises both micro- and macro-economic theories. Generally, the scope of managerial economics extends to those economic concepts, theories, and tools of analysis used in analyzing the business environment, and to find solutions to practical business problems. In broad terms, managerial economics is applied economics. The areas of business issues to which economic theories can be directly applied are divided into two broad categories:
1. Operational or internal issues; and,
2. Environment or external issues.

Operational problems are of internal nature. These problems include all those problems which arise within the business organization and fall within the control of management. Some of the basic internal issues include:
(a) Choice of business and the nature of product (what to produce);
(b) Choice of size of the firm (how much to produce);
(c) Choice of technology (choosing the factor combination);
(d) Choice of price (product pricing);
(e) How to promote sales;
(f) How to face price competition;
(g) How to decide on new investments;
(h) How to manage profit and capital; and,
(i) How to manage inventory.
The microeconomic theories dealing with most of these internal issues include, among others:
4. The ***theory of demand***, which explains the consumer behaviour in terms of decisions on whether or not to buy a commodity and the quantity to be purchased.

5. ***Theory of Production and production decisions***. The theory of production or theory of the firm explains the relationship between inputs and output.

6. ***Analysis of Market structure and Pricing theory***. Price theory explains how prices are determined under different market conditions.

7. ***Profit analysis and profit management***. Profit making is the most common business objective. However, making a satisfactory profit is not always guaranteed due to business uncertainties. Profit theory guides firms in the measurement and management of profits, in making allowances for the risk premium, in calculating the pure return on capital and pure profit, and for future profit planning.

8. ***Theory of capital and investment decisions***. Capital is the foundation of any business. It efficient allocation and management is one of the most important tasks of the managers, as well as the determinant of the firm's success level. Some of the important issues related to capital include: choice of investment project; assessing the efficiency of capital; and, the most efficient allocation of capital.

Environmental issues are issues related to the general business environment. These are issues related to the overall economic, social, and political atmosphere of the country in which the business is situated. The factors constituting ***economic environment*** of a country include:

1. The existing economic system
2. General trends in production, income, employment, prices, savings and investment, and so on.
3. Structure of the financial institutions.
4. Magnitude of and trends in foreign trade.
5. Trends in labour and capital markets.
6. Government's economic policies.
7. Social organizations, such as trade unions, consumers' cooperatives, and producer unions.
8. The political environment.
9. The degree of openness of the economy.

Managerial economics is particularly concerned with those economic factors that form the business climate. In macroeconomic terms, managerial economics focus on business cycles, economic growth, and content and logic of some relevant government activities and policies which form the business environment.

Process of Management

Process management is the ensemble of activities of planning and monitoring the performance of a process. The term usually refers to the management of business processes and manufacturing processes. Business process management (BPM) and business process reengineering are interrelated, but not identical.

Process management is the application of knowledge, skills, tools, techniques and systems to define, visualize, measure, control, report and improve processes with the goal to meet customer requirements profitably. It can be differentiated from program management in that program management is concerned with managing a group of inter-dependent projects. But from another viewpoint, process management includes program management. In project management, process management is the use of a repeatable process to improve the outcome of the project.

ISO 9001 promotes the process approach to managing an organization.

Importance of Managerial Economics

In a nutshell, three major contributions of economic theory to business economics have been enumerated:

1. ***Building of analytical models*** that help to recognize the structure of managerial problems, eliminate the minor details that can obstruct decision making, and help to concentrate on the main problem area.
2. ***making available a set of analytical methods*** for business analyses thereby, enhancing the analytical capabilities of the business analyst.
3. ***Clarification of the various concepts used in business analysis***, enabling the managers avoid conceptual pitfalls.

Various management activity or roles

Management bear the responsibility for ensuring that the organization operates to meet its objectives, taking into account the various participants, regulatory authorities and laws. Management activities include setting objectives, controlling work, reviewing results, applying corrective action and providing an environment that stimulates and motivates.

Are the right things being done? Often, the time consumed by management activities is in inverse proportion to the importance of them, for example, when an inordinate amount of time is spent approving trifling expenses as compared to the time given to defining where the organization sees itself in ten years time. Managers often do the easy things to appear busy, rather than contemplate difficult issues. Management should evaluate its activities to see which are really required. The question should be asked: 'Is the time and effort we spend on a particular issue worth more than the results obtained?' If not - why do it? For example, if people were allowed to spend money on expenses without prior authorization and only spot checks were made, how much money would the organization actually lose compared with the saving in management time?

Sundry activities: Management activities are not the same as the activities of a manager. The latter may include many other activities as well as managing work and people; indeed some 'managers' may not do any actual managing at all! These other activities could involve professional work, being a media spokesman or sitting on various external committees. They really come under the category of support or incidental activities.

Problems with appraising: An important management activity is appraisal and benchmarking, that is, comparing various aspects of the organization with internally imposed objectives, other similar organizations or government imposed standards. However, monitoring and appraisal can be overdone - continually asking someone how well they are coping, producing financial accounts more than necessary or continually assessing students, may make the manager look busy but is actually obstructive and counterproductive.

Functional areas of Management

Small business has its own distinguishing features. The entrepreneur himself often acts as the manager and looks after more than one function. Therefore, managerial practices used successfully in big firms cannot be blindly used in small-scale units. Basic managerial functions