**IQRA NATIONAL UNIVERSITY**

**Department of Business Administration**

**Mid Assignment**

**Student Name: Awais Ali** **Roll No. 17021**

**Subject Name: Managerial Economics**

**Question 1: Managerial Economics is a discipline which deals with the application of economic theory to business management. Describe the nature and scope of managerial economics in the context of above mentioned statement?**

**Answer:**

**Definition:**

Managerial economics is a stream of management studies which emphasizes solving business problems and decision-making by applying the theories and principles of microeconomics and macroeconomics. It is a specialized stream dealing with the organization’s internal issues by using various economic theories.

Economics is an inevitable part of any business. All the business assumptions, forecasting and investments are based on this one single concept.

* Nature
* Types
* Scope

**Nature of Managerial Economics**

To know more about managerial economics, we must know about its various characteristics. Let us read about the nature of this concept in the following points:

**Art and Science:**

Managerial economics requires a lot of logical thinking and creative skills for decision making or problem-solving. It is also considered to be a stream of science by some economist claiming that it involves the application of different economic principles, techniques and methods, to solve business problems.

**Micro Economics:**

In managerial economics, managers generally deal with the problems related to a particular organization instead of the whole economy. Therefore it is considered to be a part of microeconomics.

**Uses Macro Economics:**

A business functions in an external environment, i.e. it serves the market, which is a part of the economy as a whole.

Therefore, it is essential for managers to analyze the different factors of macroeconomics such as market conditions, economic reforms, government policies, etc. and their impact on the organization.

**Multi-disciplinary:**

It uses many tools and principles belonging to various disciplines such as accounting, finance, statistics, mathematics, production, operation research, human resource, marketing, etc.

**Prescriptive / Normative Discipline:**

It aims at goal achievement and deals with practical situations or problems by implementing corrective measures.

**Management Oriented:**

It acts as a tool in the hands of managers to deal with business-related problems and uncertainties appropriately. It also provides for goal establishment, policy formulation and effective decision making.

**Pragmatic:**

It is a practical and logical approach towards the day to day business problems.

**Types of Managerial Economics:**

All managers take the concept of managerial economics differently. Some may be more focused on customer’s satisfaction while others may prioritize efficient production.

The various approach to managerial economics can be seen in detail below:

* Liberal Managerialism
* Managerial Economics

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**Liberal Managerialism**

A market is a democratic place where people are liberal to make their choices and decisions. The organization and the managers have to function according to the customer’s demand and market trend; else it may lead to business failures.

**Normative Managerialism**

The normative view of managerial economics states that administrative decisions are based on real-life experiences and practices. They have a practical approach to demand analysis, forecasting, cost management, product design and promotion, recruitment, etc.

**Radical Managerialism**

Managers must have a revolutionary attitude towards business problems, i.e. they must make decisions to change the present situation or condition. They focus more on the customer’s requirement and satisfaction rather than only profit maximization.

**Scope of Managerial Economics**

Managerial economics is widely applied in organizations to deal with different business issues. Both the micro and macroeconomics equally impact the business and its functioning.

**Following points illustrate its scope:**

**Micro-Economics Applied to Operational Issues**

To resolve the organization’s internal issues arising in business operations, the various theories or principles of microeconomics applied are as follows:

* **Theory of Demand**: The demand theory emphasizes on the consumer’s behavior towards a product or service. It takes into consideration the needs, wants, preferences and requirement of the consumers to enhance the production process.
* **Theory of Production and Production Decisions**: This theory is majorly concerned with the volume of production, process, capital and labor required, cost involved, etc. It aims at maximizing the output to meet the customer’s demand.
* **Pricing Theory and Analysis of Market Structure**: It focuses on the price determination of a product keeping in mind the competitors, market conditions, cost of production, maximizing sales volume, etc.
* **Profit Analysis and Management**: The organizations work for a profit. Therefore they always aim at profit maximization. It depends upon the market demand, cost of input, competition level, etc.
* **Theory of Capital and Investment Decisions**: Capital is the most critical factor of business. This theory prevails the proper allocation of the organization’s capital and making investments in profitable projects or venture to improve organizational efficiency.

**Macro-Economics Applied to Business Environment**

Any organization is much affected by the environment it operates in. The business environment can be classified as follows:

* **Economic Environment**: The economic conditions of a country, GDP, economic policies, etc. indirectly impacts the business and its operations.
* **Social Environment**: The society in which the organization functions also affects it like employment conditions, trade unions, consumer cooperatives, etc.
* **Political Environment**: The political structure of a country, whether authoritarian or democratic; political stability; and attitude towards the private sector, influence organizational growth and development.

**Question 2: Discuss demand analysis and forecasting under the umbrella of Business Management?**

**Answer:**

**Demand Analysis**

**Definition:**

The Demand Analysis is a process whereby the management makes decisions with respect to the production, cost allocation, advertising, inventory holding, pricing, etc. Although, how much a firm produces depends on its production capacity but how much it must endeavor to produce depends on the potential demand for its product.

Thus, the marketer is required to analyze properly the demand for its product in the market and must hold inventory accordingly. Such as if there is a potential demand in the future, then the firm should hold more inventories and in case there is no demand, then the production remains unwarranted, and hence, lesser inventories are held.

There is a possibility that production might exceed the demand, then the marketer must use alternative ways such as better advertisements to create a new demand.

The demand shows the relationship between two economic variables, the price of the product and the quantity of product that a consumer is willing to buy for a given period of time, other things being equal.

**Features/Characteristics of Demand**

The following are the main features or characteristics of demand that the marketer must keep in mind while analyzing the demand for its product:

* The demand is the specific quantity that a consumer is willing to purchase. Thus, it is expressed in numbers.
* The demand must mean the demand per unit of time, per month, per week, per day.
* The demand is always at a price, e. any change in the price of a commodity will bring about a certain change in its quantity demanded.
* The demand is always in a market, a place where a set of buyers and sellers meet. The market needs not to be a geographical area.

Thus, demand plays a crucial role in the success of any business enterprise. And it must be remembered that demand is always at a price and a particular time period in which it is created. Such as demand for woolen clothes will be more in winters than in any other season. Hence, demand analysis is always done in terms of the price and the relevant time period.

**Demand Forecasting**

Demand forecasting is a combination of two words; the first one is Demand and another forecasting. Demand means outside requirements of a product or service. In general, forecasting means making an estimation in the present for a future occurring event.

Demand is the most important aspect for business for achieving its objectives. Many decisions of business depend on demand like production, sales, staff requirement, etc. Forecasting is the necessity of business at an international level as well as domestic level.

Following is the significance of Demand Forecasting:

* Fulfilling objectives of the business
* Preparing the budget
* Taking management decision
* Evaluating performance etc.

Moreover, forecasting is not completely full of proof and correct. It thus helps in evaluating various factors which affect demand and enables management staff to know about various forces relevant to the study of demand behavior.

**The Scope of Demand Forecasting**

The scope of demand forecasting depends upon the operated area of the firm, present as well as what is proposed in the future. Forecasting can be at an international level if the area of operation is international. If the firm supplies its products and services in the local market then forecasting will be at local level.

The scope should be decided considering the time and cost involved in relation to the benefit of the information acquired through the study of demand. Cost of forecasting and benefit flows from such forecasting should be in a balanced manner.

**Types of Forecasting:**

There are two types of forecasting:

* Based on Economy
* Based on the time period

**1. Based on Economy**

There are three types of forecasting based on the economy:

* Macro-level forecasting: It deals with the general economic environment relating to the economy as measured by the Index of Industrial Production(IIP), national income and general level of employment, etc.
* Industry level forecasting: Industry level forecasting deals with the demand for the industry’s products as a whole. For example demand for cement in India, demand for clothes in India, etc.
* Firm-level forecasting: It means forecasting the demand for a particular firm’s product. For example, demand for Birla cement, demand for Raymond clothes, etc.

**2. Based on the Time Period**

Forecasting based on time may be short-term forecasting and long-term forecasting

* Short-term forecasting: It covers a short period of time, depending upon the nature of the industry. It is done generally for six months or less than one year. Short-term forecasting is generally useful in tactical decisions.
* Long-term forecasting casting: Long-term forecasts are for a longer period of time say, two to five years or more. It gives information for major strategic decisions of the firm. For example, expansion of plant capacity, opening a new unit of business, etc.

**Question 3: Business firms are generally organized for earning profits. Explain Profit Management as a challenging issue in the managerial economics?**

**Answer:**

**THE THEORY OF THE FIRM:**

The behavior of firms is usually analyzed in the context of an economic model, an idealized version of a real-world firm. The basic economic model of a business enterprise is called the theory of the firm.

**PROFIT MAXIMIZATION AND THE FIRM.**

Under the simplest version of the theory of the firm it is assumed that profit maximization is its primary goal. In this version of the theory, the firm's owner is the manager of the firm, and thus, the firm's owner-manager is assumed to maximize the firm's short-term profits (current profits and profits in the near future). Today, even when the profit maximizing assumption is maintained, the notion of profits has been broadened to take into account uncertainty faced by the firm (in realizing profits) and the time value of money (where the value of a dollar further and further in the future is increasingly smaller than a dollar today). In this more complete model, the goal of maximizing short-term profits is replaced by goal of maximizing long-term profits, the present value of expected profits, of the business firm.

Defining present value of expected profits is based on first defining "value" and then defining "present value." Many concepts of value, such as book value, market value, going-concern value, break-up value, and liquidating value, are encountered in business and economics. The value of the firm is defined as the present value of expected future profits (net cash flows) of the firm. Thus, to obtain an estimate of the present value of expected profits, one must identify the stream of net cash flow in future years.

**THE CONSTRAINED PROFIT MAXIMIZATION.**

Profit maximization is subject to various constraints faced by the firm. These constraints relate to resource scarcity, technology, contractual obligations, and laws and government regulations. In their attempt to maximize the present value of profits, business managers must consider not only the short-term and long-term implications of decisions made within the firm, but also various external constraints that may limit the firm's ability to achieve its organizational goals.

The first external constraint of resource scarcity refers to the limited availability of essential inputs (including skilled labor), key raw materials, energy, specialized machinery and equipment, warehouse space, and other resources. Moreover, managers often face constraints on plant capacity that are exacerbated by limited investment funds available for expansion or modernization. Contractual obligations also constrain managerial decisions. Labor contracts, for example, may constrain managers' flexibility in worker scheduling and work assignment. Labor contracts may also determine the number of workers employed at any time, thereby establishing a floor for minimum labor costs. Finally, laws and regulations have to be observed. The legal restrictions can constrain decisions regarding both production and marketing activities. Examples of laws and regulations that limit managerial flexibility are: the minimum wage, health and safety standards, fuel efficiency requirements, antipollution regulations, and fair pricing and marketing practices.

**PROFIT MAXIMIZATION VERSUS OTHER MOTIVATIONS BEHIND MANAGERIAL DECISIONS.**

The present value maximization criterion as a basis for the study of the firm's behavior has come under severe criticism from some economists. The critics argue that business managers are interested, at least partly, in factors other than the firm's profits. In particular, they may be interested in power, prestige, leisure, employee welfare, community well-being, and the welfare of the larger society. The act of maximization itself has been criticized; there is a feeling that managers often aim merely to "satisfice" (seek solutions that are considered satisfactory), rather than really try to optimize or maximize (seek to find the best possible solution, given the constraints).

**BUSINESS VERSUS ECONOMIC PROFITS.**

An economist also defines profit as the difference between sales revenue and costs of doing business, but includes more items in figuring costs, rather than considering only explicit accounting costs. For example, inputs supplied by owners (including labor, capital, and space) are accounted for in determining costs in the definition used by an economist. These costs are sometimes referred to as implicit costs—their value is imputed based on a notion of opportunity costs widely used by economists. In other words, costs of inputs supplied by an owner are based on the values these inputs would have received in the next best alternative activity. For illustration, assume that the owner of the firm works for ten hours a day at his business. If the owner does not receive any salary, an accountant would not consider the owner's effort as a cost item. An economist would, however, value the owner's service to his firm at what his labor would have earned had he worked elsewhere. Thus, to compute the true profit, an economist will subtract the implicit costs from business profit; the resulting profit is often referred to as economic profit. It is this concept of profit that is used by economists to explain the behavior of a firm. The concept of economic profit essentially recognizes that owner-supplied inputs must also be paid for. Thus, the owner of a firm will not be in business in the long run until he recovers the implicit costs (also known as normal profit), in addition to recovering the explicit costs, of doing business.