Assignment

Managerial Economics

Program

MBA (Non Business)

Submitted to

Sir Dr Muhammad jalaludin

Submitted by

Farhad Alam

ID: 16476

Department of

Management Science

Q1: 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?

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:Scope of Managerial Economics

Micro-Economics Applied to Operational Issues

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

Theory of Demand: The demand theory emphasises on the consumer’s behaviour 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 labour required, cost involved, etc. It aims at maximising 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, maximising sales volume, etc.

Profit Analysis and Management: The organisations work for a profit. Therefore they always aim at profit maximisation. 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 organisation’s capital and making investments in profitable projects or venture to improve organisational efficiency.

Macro-Economics Applied to Business Environment

Any organisation 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 organisation 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.

Managerial economics provides an essential tool for determining the business goals and targets, the actual position of the organization, and what the management should do fill the gap between the two.

The application of economics to business management or the integration of economic

Therefore, managerial economics integrates economic theory with business practice for facilitating decision-making and forward planning by management.

Managerial economics lies on the borderlines between economics and business management and bridges the gap between the two.

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:Nature of Managerial Economics

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 organisation 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 analyse the different factors of macroeconomics such as market conditions, economic reforms, government policies, etc. and their impact on the organisation.

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.

The application of economics to business management or the integration of economic theory with business practice as Spencer and Segelman have put it has the following aspects:

Applications

1. Reconciling theoretical concepts of economics in relation to the actual business behaviour and conditions:

Analytical techniques of economic theory builds models by which we arrive at certain assumptions and conclusions arc reached thereon in relation to certain firms.

There is need to reconcile the theoretical principles based on simplified assumptions with actual business practice and develop or reformulate the economic theory, if necessary.

For example, it is assumed in economic theory that a firm always acts to maximize profits and on that basis the theory suggests how much the firm will produce and at what price it would sell.

But in actual practice firms do not always aim at maximizing profits and theory of firm fails to explain this behaviour of the firms.

Moreover certain terms such as profits and costs are not used in business at they are used in economics.

In managerial economics an attempt is made to reconcile the accounting concepts with the economic concepts so that financial data may be used more effectively.

2. Estimating economic relationship:

Measurement of various types of elasticities of demand like price elasticity, income elasticity, cross elasticity, substitution elasticity, etc., arc provided by economics. The estimates of these economic relationships can be used for purpose of business forecasts.

3. Predicting economic quantities:

Most of the business decisions arc taken in an environment of uncertainty. Economic analysis makes possible the forecasting of economic quantities like profit, demand, production costs, price, capital and other relevant quantities.

The task of taking business decisions and formulating forward plans becomes simpler and less risk)' due to prediction of economic quantities.

4. Basis of business policies:

Business policies and plans for the future can be formulated on the basis of economic quantities.

5. Helpful in understanding the external forces constituting the environment:

The business management has to sec the relevance and affects of external forces such as business cycle, trends in national income and expenditure, government policies relating to taxation, licensing and price control etc., and adjust his business policies the bearing in mind the full impact of these external forces. Economic theories are applied to know the impact of these external forces on business.

It is amply clear from the above discussion that economic analysis and economic theories are widely used in business management.

Managerial economics analyze the practical application of economic logic and principles Managerial Economics elaborates how economic concepts, principles and economic logic can be applied in taking business decisions and formulating future plans.

Therefore, managerial economics integrates economic theory with business practice for facilitating decision-making and forward planning by management.

Managerial economics lies on the borderlines between economics and business management and bridges the gap between the two.

In the words of Hague, "Managerial economics is concerned with using logic of economics, mathematics and statistic? to provide effective ways of thinking about business decision problems."

Q2: Discuss demand analysis and forecasting under the umbrella of Business Management?

Q2: 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.

Forecasting:

It is a decision-making tool used by many businesses to help in budgeting, planning, and estimating future growth. In the simplest terms, forecasting is the attempt to predict future outcomes based on past events and management insight.

There are two forecast types: judgment-based (e.g. "gut feel") and quantitative (e.g. statistics). The most trustworthy forecasts combine both methods to support their strengths and mitigate their weaknesses.

Judgement Forecasting

Judgement forecasting uses only our intuition and experience. Our minds are able to make connections and understand the context in a way that no computer can. However, we're also prone to certain biases that make analyzing large amounts of data difficult. Judgment forecasting is best where there is little to no historical data- such as new product launches, competitor actions, or new growth plans.

Quantitative Forecasting

Quantitative forecasting uses analytics to analyze large amounts of historical data in order to discern trends and patterns. Quantitative forecasting is excellent at churning through large amounts of data and is less prone to bias. However, it is weakest when there is little to no historical data that can be analyzed. Quantitative forecasting relies, more or less, on identifying repeated patterns in your data so it may take a while to see the same pattern repeat more than once. Combining judgment and quantitative forecasting gets the best results.

Q3: Business firms are generally organized for earning profits. Explain Profit Management as a challenging issue in the managerial economics?

The free enterprise system would fail without profits and the profit motive. Even in planned economies, where state ownership rather than private enterprise is typical, the profit motive is increasingly used to spur efficient resource use. In the former Eastern Bloc countries, the former Soviet Union, China, and other nations, new profit incentives for managers and employees have led to higher product quality and cost efficiency. Thus, profits and the profit motive play a growing role in the efficient allocation of economic resources worldwide.

Business Versus Economic Profit

The general public and the business community typically define profit as the residual of sales revenue minus the explicit costs of doing business. It is the amount available to fund equity capital after payment for all other resources used by the firm. This definition of profit is accounting profit, or **business profit**.

The economist also defines profit as the excess of revenues over costs. However, inputs provided by owners, including entrepreneurial effort and capital, are resources that must be compensated. The economist includes a normal rate of return on equity capital plus an opportunity cost for the effort of the owner-entrepreneur as costs of doing business, just as the interest paid on debt and the wages are costs in calculating business profit. The risk-adjusted **normal rate of return** on capital is the minimum return necessary to attract and retain investment. Similarly, the opportunity cost of owner effort is determined by the value that could be received in alternative employment. In economic terms, profit is business profit minus the implicit (noncash) costs of capital and other owner-provided inputs used by the firm. This profit concept is frequently referred to as **economic profit**.

Measurement of Profit and Profit Policy

The concepts of business profit and economic profit can be used to explain the role of profits in a free enterprise economy. Anormal rate of return, or profit, is necessary to induce individuals to invest funds rather than spend them for current consumption. Normal profit is simply a cost for capital; it is no different from the cost of other resources, such as labor, materials, and energy. A similar price exists for the entrepreneurial effort of a firm’s ownermanager and for other resources that owners bring to the firm. These opportunity costs for owner-provided inputs offer a primary explanation for the existence of business profits, especially among small businesses.

Variability of Business Profits

In practice, reported profits fluctuate widely. Table shows business profits for a well-known sample of 30 industrial giants: those companies that comprise the Dow Jones Industrial Average. Business profit is often measured in dollar terms or as a percentage of sales revenue, called **profit margin**, as in Table The economist's concept of a normal rate of profit is typically assessed in terms of the realized rate of **return on stockholders' equity** (ROE). Return on stockholders' equity is defined as accounting net income divided by the book value of the firm.The average ROE for industrial giants found in the Dow Jones Industrial Average falls in a broad range of around 15 percent to 25 percent per year. Although an average annual ROE of roughly 10 percent can be regarded as a typical or normal rate of return in the United States and Canada, this standard is routinely exceeded by companies such as Coca-Cola, which has consistently earned a ROE in excess of 35 percent per year. It is a standard seldom met by International Paper, a company that has suffered massive losses in an attempt to cut costs and increase product quality in the face of tough environmental regulations and foreign competition.

Some of the variation in ROE depicted in Table represents the influence of differential risk premiums. In the pharmaceuticals industry, for example, hoped-for discoveries of effective therapies for important diseases are often a long shot at best. Thus, profit rates reported by Merck and other leading pharmaceutical companies overstate the relative profitability of the drug industry; it could be cut by one-half with proper risk adjustment. Similarly, reported profit rates can overstate differences in economic profits if accounting error or bias causes investments with long-term benefits to be omitted from the balance sheet. For example, current accounting practice often fails to consider advertising or research and development expenditures as intangible investments with long-term benefits. Because advertising and research and development expenditures are immediately expensed rather than capitalized and written off over their useful lives, intangible assets can be grossly understated for certain companies. The balance sheet

of Coca-Cola does not reflect the hundreds of millions of dollars spent to establish and maintain the brand-name recognition of *Coca-Cola*, just as Merck's balance sheet fails to reflect research dollars spent to develop important product names like *Vasotec* (for the treatment of high blood pressure), *Zocor* (an antiarthritic drug),
and *Singulair* (asthma medication).