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Paper Managerial Economics

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Class MBA (Finance)

"Q No 1"

Definition of Managerial Economics :-

Managerial economics refers to the application of economics theory and the tools of analysis of decision Science to examine how an organization Can achieve its aims or objectives most efficiently the meaning of this definition Can best be examined with the aid of.

Management decisions need to be made in any organization be it a firm a not for Profit organization (Such as a hospital or a university). or government angency when it seeks to achieve Some goal or objective Subject to Some Constraints for example a firm may seek to maximize Profits Subject to limitations on the availability of essential inputs and in the face of Legal Constraints A hospital may seek to treat as many patients as possible at an "adequate" medical standard with its limited physical resources (Physicians, technicians, nurses, equipment

beds) and budget. The goal of a State university may be to Provide an adequate education to as many Students as Possible, Subject to the Physical and Financial Constraints it Faces. Similarly a government agency may Seek to provide a particular service (Which Cannot be provided as efficiently by business firms) to as many Peple as Possible at the Lowerst Possible Cost. In all these Cases, the organization faces management decision Problem as it Seeks to achieve its goal or Objective Subject to the Constraints it faces. The goals and Constraints may differ from to Case. but the basic decision making Process is the Same.

Economic theories :-

Statistical and analytical tools to assess economic theories in Solving practical business Problems. Study of managerial economics helps in enhancement of analytical Skills, assists in rational Configuration as well as Solution of Problems While microeconomics is the Study

of decisions made regarding the allocation of resources and prices of goods and services macroeconomics is the field of economics that studies the behavior of the economy as a whole (i.e entire industries and economies). Managerial economics applies micro economics tools make business decisions. it deals with a firm.

Managerial economics uses both economic theory as well as econometrics for rational managerial decision making. Econometrics is defined as use of statistical tools for assessing economic theories by empirically measuring relationship between economic variables. It uses factual data for solution of economic problems managerial economics is associated with the economic theory ~~wh~~ which constitutes "Theory of firm". Theory of firm states that the primary aim of the firm is to maximize wealth. Decision making in managerial economics generally involves establishment of firm's objectives, identification of problems in achievement of those objectives development of various alternative

Solutions. Selection of best alternative and finally implementation of the decision.

As such, it bridges economic theory and economics in practice. it draws heavily from quantitiative techniques such as regression analysis correlation and calculus. If there is a unifying theme that runs through most of managerial economics. it is the attempt to optimize bussiness decision given the firm's objective and given constraints imposed by scarcity. For example through the use of operations research mathematical programming game theory for strategic decisions.

Nature of Managerial Economics.

To Know more about managerial economics. we must know about its various Characteristic 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 Skill 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 principle, techniques and methods to Solve business problems

Scope of Managerial economics:

Managerial economics is widely applied in organization to deal with different business issues. Both the micro and macroeconomics equally impact the business and its Functioning To resolve the organisation's internal issues arising business operations.

"Q No 2"

Demands :-

Demand is an economic Principle referring to Consumer's Desire to purchase goods and Services and willingness to pay a price for a Specific goods or Service Holding all other Factors Constant an increase in the Price of a goods or Service will decrease the quantity demanded and vice versa. Market demanded is the total quantity demanded across all Consumers in a market for a given goods Aggregate demand is the total demand for all goods and Services in an economy. Multiple stocking Strategies are often required to handle demand.

* Demand refers to Consumer's desire to purchase goods and Services at given prices.
* Demand Can mean either market demand for a Specific good or aggregate demand for the total of all goods in economy.

Forecasting:

It is a technique for estimation of Probable demand for a product or Services in the future. it is based on the analysis of past demand for that product or Service in the present market Condition. Demand forecasting should be done on a Scientific basis and facts and events related to forecasting should be Considered.

Therefore, in Simple words, we Can Say that after gathering information about various aspect of the market and demand based on the past, and attempt may be made to estimate future demand. This Concept is Called Forecasting.

Demand forecasting reduces risk related to business activities and helps it to take efficient decisions. For firms having production at the mass level, the importance of forecasting had increased more. A good forecasting helps a firm in better planning related to business goals.

There is a huge role of forecasting in functional areas of accounting. Good forecast helps in appropriate Production planning, process selection, Capacity planning, facility layout Planning, and inventory management, etc.

Demand forcasting provides reasonable data for organization's Capital investment and expension decision. it also provides a way for the formulation of suitable Pricing and advertisement strategies.

Demand plays a vital role in the decision making of a business. In Competitive market Conditions, there is a need to take correct decision and make planning for future events related to business like a sale, production, etc.

The effectiveness of a decision taken by business managers depends upon the accuracy of the decision taken by them.

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, 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 forecasting should be in a balanced mannar.

Types of forecasting :-

There are two types of forecasting:

(1) Based on Economy.
2 Based on the time period.

⇒ Based on Economy :-

There are three types of forecasting based on the economy.

(1) **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.

(ii) **Industry level forecasting:-** Industry level for the industry's products as a whole. For example demand for cement in India, demand for clothes in India etc.

(iii) **Firm-Level Forecasting:-** It means forecasting the demand for example demand for Birla Cement demand for Raymond clothes etc.

2 Based on the time Period:-

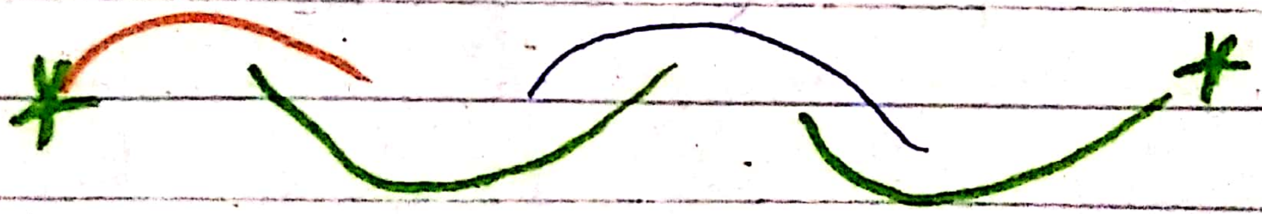
Forecasting based on time may be Short-term forecasting and long-term forecasting.

(i) **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 then one year. Short-term forecasting is generally ~~usef~~ ~~useful~~ useful in tactical decisions.

(ii) **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.



"Q No 8"

Earning Profits:-

The free enterprise system would fall without profit and the profit motive. Even in planned economics, 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 manager and employees have led to higher product quality and cost efficiency thus profit and the profit motive play a growing role in the efficient allocating 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 resources

used by the firm. This definition of profit is accounting profit or business profit.
The economist also defines profit as the excess of ~~effort~~ revenue 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 puls an opportunity cost for the effort of the owner-entrepreneur as cost 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) cost 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 profit in a free enterprise economy. A normal 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 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 ownermanger and for other resources that owners bring to the firm. These opportunity costs for owner provided inputs offer a primary explanation for the existance of business profit, especially among small businesses.

Variability of Business Profit :-

In practice reported profits fluctuate widely.

table Shows business profits for a well know 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 economists Concept of a normal rate of profit is typically assessed in terms of the realized rate of return on Stockholders' equity (ROE) Return on Stockholder's equity is define 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 anverage annual ROE of roughly 10 percent Can be regarded as a typical or normal rate of return in the United States and Canda, This Standard is routinely exceeded by Companies Such as Coca-Cola Which has Consistently paper a Company that has suffered massive losses in an attempt

to Cut Costs and increase product quality in the Face of tough enviromental 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. In the pharmaceuticals industry, for overstate the relative profilability of the drug industry; it could be Cut by one-half with proper risk adjusment Similarly reported profit rates Can overstate difference in economic profit if accounting error or bias Cases investment with long-term benefits to be omitted from the balance sheet. For example, Current accounting practice often fails to Consider long-term benefits. Because advertising and research and development expendenditures are immediately expensend rather than Capitalized and written off over useful lives, intangible assets Can be grossly understand for Certain Companies.