# MANAGERIAL ECONOMICS

## UNIT 1 NATURE AND SCOPE OF MANAGERIAL ECONOMICS

Definitions: Brighman and Pappas define managerial economics as," the application of economic theory and methodology to business administration practice.

Economics is a social science, which studies human behaviour in relation to optimizing allocation of available resources to achieve the given ends.

It is concerned with firm's behaviour in optimum allocation of resources. It provides tools to help in identifying the best course among the alternatives and competing activities in any productive sector whether private or public

It is a science as well as art facilitating better managerial discipline. It explores and enhances economic mindfulness and awareness of business problems and managerial decisions.

SCOPE: Scope--------→ coverage

Capital Management, Profit Management, Pricing Decision, Policies and Practices, Production and Supply Analysis, Cost Analysis, Demand Analysis and Forecasting.

Role of Managerial Economist

Problems are complex in nature depends on the the scope and complexity responsibilities lies.

a. cost-benefit analysis

b. managerial economist has to analyze changes in macro- economic indicators such as national income, population, business cycles

c. The most significant function of a managerial economist is to conduct a detailed research on industrial market

d. At times, a managerial economist has to prepare speeches for top management. He must be vigilant and must have ability to cope up with the pressures. In order to perform all these roles, a managerial economist has to conduct an elaborate statistical analysis.

**Demand Forecasting** is a systematic and scientific estimation of future demand for a product. Simply, estimating the sales proceeds or demand for a product in the future is called as demand forecasting.

There are several methods of demand forecasting applied in terms of; the purpose of forecasting, data required, data availability and the time frame within which the demand is to be forecasted. Each method varies from one another and hence the forecaster must select that method which best suits the requirement

**Methods: Survey & Statistical**

1. **Survey Methods:** Under the survey method, the consumers are contacted directly and are asked about their intentions for a product and their future purchase plans. This method is often used when the forecasting of a demand is to be done for a short period of time.

The survey method includes:

(i) Consumer Survey Method

(ii) Opinion Poll Methods

2. **Statistical Methods:** The statistical methods are often used when the forecasting of demand is to be done for a longer period. The statistical methods utilize the time-series (historical) and cross-sectional data to estimate the long-term demand for a product. The statistical methods are used more often and are considered superior than the other techniques of demand forecasting due to the following reasons:

- There is a minimum element of subjectivity in the statistical methods.
- The estimation method is scientific and depends on the relationship between the dependent and independent variables.
- The estimates are more reliable
- Also, the cost involved in the estimation of demand is the minimum.

The statistical methods include:

(i) Trend Projection Methods (Using Regression equations)

(ii) Barometer Methods

These are the different kinds of methods available for demand forecasting. A forecaster must select the method which best satisfies the purpose of demand forecasting..

## UNIT 4 PROFIT CONCEPT AND THEORIES

Profit is the earning of entrepreneur. To the economist, the most significant point about profit is that it is a residual income. However, the term profit has different connotations.

Features: (i) It is not a predetermined contractual payment. (ii) It is not a fixed remuneration. (iii) It is a residual surplus. (iv) It is uncertain. (v) It may even be negative. Other factor rewards are always positive.

Gross Profit = Net profit + implicit rent + implicit wages + implicit interest + normal profit + depreciation and maintenance charges + non-entrepreneurial profit.

Net Profit = Gross profit – (implicit rent + implicit wages + implicit interest + normal profit + depreciation and maintenance charges + non-entrepreneurial profit)

***Accounting Profit and Economic Profit:***

The accountant does not take care of implicit or opportunity cost. Accounting profit is also called residual profit.

The economist points out that in addition to the deduction of explicit cost, imputed cost, i.e., the cost that would have been incurred in the absence of the employment of self owned factors, should also be deducted.

**Profit Policies:**

Industry Leadership

**Restricting the Entry**

**THEORIES OF PROFIT**

Innovation theory of profits – Joseph Schumpeter

Uncertainty bearing theory of Profit ----: Economist Prof Knight

Dynamic theory of profits ------- J.B Clark

Marginal Productivity Theory ------Classical

**UNIT 5 CAPITAL BUDGETING & PROJECT EVALUATION**

Meaning: Capital budgeting refers to the process of allocating cash expenditures to investment which have a life longer than the operating period — normally a year. In other words, capital budgeting, or capital expenditure planning is allocation of capital among alternative investment opportunities.

Steps: (i) Deciding on the amount of capital expenditure needed. (ii) Ascertaining the availability of capital and (iii) Deciding on how to allocate the available capital among alternative investment proposals.

The problem of deciding on the required amount of capital is referred to as the problem of demand for capital. Since the capital expenditures are undertaken with a view to netting in additional profits, this step involves a survey of investment opportunities and a process of screening them from the point of view of prospective profitability. --------------- *Demand for Capital*

The second step referred to above is essentially the process of determining the supply of capital. This involves ascertaining how much capital can be raised by the firm internally and from external sources. --------------- *Supply of Capital*

The third step is the crucial one of determining which proposed projects among the competing ones are to be undertaken. Our main task will be to elaborate on each of these three steps in the capital budgeting process. ------------ *Capital Rationing*

Project Evaluation

Various methods are used by a modern business firm to allocate its limited resources to the most profitable investments. These are actually methods for measuring project profitability.

***i. Payback Criterion:***

The payback criterion is perhaps the most widely used method of capital budgeting. By using this method capital funds are allocated by estimating the length of time required for the cash earnings on a given investment to return the original cost to the owner. This measure goes by the -name of payout, pay-off or payback period (or the period of recovery).

P = I/E or, cash outlay/net annual cash inflow = x years

***ii. The Return on Investment Criterion:***

Many companies make use of the return on investment (KOI) criterion in making investment decisions. This measures the performance of operating units by accounting return (unadjusted) and is expressed as

ROI = income/investment

***iii. The Discounted Cash Flow (DCF) Method:***

Both the above methods ignore what is broadly called the time value of money. But in reality rupees at different times are not directly comparable unless they are expressed in terms of a common denominator. The common denominator that is used for this purpose is the market rate of interest which acts as the discount factor.

IV. Net Present Value Method:

NPV is the net present value of an investment and is used in the capital budgeting process. According to the NPV method any investment whose NPV (i.e., the present value of net cash flows) is positive is acceptable. The firm can rank various investment projects in order of their NPVs. Therefore, projects with the largest NPVs are ranked highest in priority, although any investment with a positive NPV will add to the value (profitability) of the firm.

***v. Capital Rationing Problems:***

We have noted that two discounted cash-flow methods — NPV and IRR — will always give the same accept/reject decision. It is because investment projects with an IRR in excess of the company’s cost of capital will also have a positive NPV at a rate of discount equal to the cost of capital.