SNS COLLEGE OF TECHNOLOGY

An Autonomous Institution

Coimbatore-35

Accredited by NBA – AICTE and Accredited by NAAC – UGC with 'A+' Grade
Approved by AICTE, New Delhi & Affiliated to Anna University, Chennai

Department of Automobile Engineering

III YEAR/ VI SEMESTER

19MEE301 / Engineering Economics and cost Analysis

UNIT-1

Nature and scope of managerial economics

Definition of Managerial Economics:

Managerial Economics is economics applied in decision making. It is a special branch of economics bridging the gap between abstract theory and managerial practice. – Haynes, Mote and Paul.

Business Economics consists of the use of economic modes of thought to analyse business situations." - McNair and Meriam

"Business Economics (Managerial Economics) is the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning by management." - Spencer and Seegelman.

Managerial economics is concerned with application of economic concepts and economic analysis to the problems of formulating rational managerial decision. – Mansfield.

Nature of Managerial Economics:

The primary function of management executive in a business organisation is decision making and forward planning.

Decision making and forward planning go hand in hand with each other. Decision making means the process of selecting one action from two or more alternative courses of action. Forward planning means establishing plans for the future to carry out the decision so taken.

The problem of choice arises because resources at the disposal of a business unit (land, labour, capital and managerial capacity) are limited and the firm has to make the most profitable use of these resources.

The decision making function is that of the business executive, He takes the decision which will ensure the most efficient means of attaining a desired objective say profit maximisation. After taking the decision about the particular output pricing, capital, raw-materials and power etc. are prepared. Forward planning and decision-making thus go on at the same time.

A business manager's task is made difficult by the uncertainty which surrounds business decision- making. Nobody can predict the future course of business conditions. He prepares the best possible plans for the future depending on past experience and future outlook and yet he has to go on revising his plans in the light of new experience to minimise the failure. Managers are thus engaged in a continuous process of decision-making through an uncertain future and the overall problem confronting them is one of adjusting to uncertainty.

In fulfilling the function of decision-making in an uncertainty framework economic theory can be pressed into service with considerable advantage as it deals with a number of concepts and principles which can be used to solve or at least throw some light upon the problems of business management. E.g profit, demand, cost, pricing, production, competition, business cycles, national income etc. The way economic analysis can be used towards solving business problems constitutes the subject-matter of Managerial Economics.

Thus in brief we can say that Managerial Economics is both a science and an art.

Scope of Managerial Economics:

The scope of managerial economics is not yet clearly laid out because it is a developing science. Even then the following fields may be said to generally fall under Managerial Economics:

Demand Analysis and Forecasting.

1. **Cost and Production Analysis.**

Pricing Decisions, Policies and Practices.

2. **Profit Management.**

Capital Management.

These divisions of business economics constitute its subject matter. Recently managerial economists have started making increased use of Operation Research methods like Linear programming, inventory models, Games theory, queuing up theory etc., have also come to be regarded as part of Managerial Economics.

1. **Demand Analysis and Forecasting:** A business firm is an economic organisation which is engaged in transforming productive resources into goods that are to be sold in the market. A major part of managerial decision making

depends on accurate estimates of demand. A forecast of future sales serves as a guide to management for preparing production schedules and employing resources. It will help management to maintain or strengthen its market position and profit base. Demand analysis also identifies a number of other factors influencing the demand for a product. Demand analysis and forecasting occupies a strategic place in Managerial Economics.

2. **Cost and production analysis:** A firm's profitability depends much on its cost of production. A wise manager would prepare cost estimates of a range of output identify the factors causing are cause variations in cost estimates and choose the cost-minimising output level taking also into consideration the degree of uncertainty in production and cost calculations. Production processes are under the charge of engineers but the business manager is supposed to carry out the production function analysis in order to avoid wastages of materials and time. Sound pricing practices depend much on cost control. The main topics discussed under cost and production analysis are: Cost concepts, cost-output relationships, Economics and Diseconomies of scale and cost control.

3. **Pricing decisions, policies and practices:** Pricing is a very important area of Managerial Economics. In fact price is the genesis of the revenue of a firm and as such the success of a business firm largely depends on the correctness of the price decisions taken by it. The important aspects dealt with this area are: Price determination in various market forms, pricing methods, differential pricing, product-line pricing and price forecasting.

4. **Profit management**: Business firms are generally organized for earning profit and in the long period it is profit which provides the chief measure of success of a firm. Economics tells us that profits are the reward for uncertainty bearing and risk taking. A successful business manager is one who can form more or less correct estimates of costs and revenues likely to accrue to the firm at different levels of output. The more successful a manager is in reducing uncertainty, the higher are the profits earned by him. In fact profit-planning and profit measurement constitute the most challenging area of Managerial Economics.

5. **Capital management:** The problems relating to firm's capital investments are perhaps the most complex and troublesome. Capital management implies planning and control of capital expenditure because it involves a large sum and moreover the problems in disposing the capital assets off are so complex that they require considerable time and labour. The main topics dealt with under capital management are cost of capital, rate of return and selection of projects.