The Meaning, Scope And Methods Of Managerial Economics

1.1 MANAGERIAL ECONOMICS – ITS MEANING
Managerial Economics is the application of Economic Theory to managerial practice. It relates to the use of tools and techniques of economic analysis to solve managerial problems. According to **Milton Spencer & Louis Siegelman "Managerial Economics is the integration of economic theory with business practice to facilitate decision making and forward-planning."** According to **Eugene Brigham and James Pappas "Managerial Economics is the application of economic theory and methodology to business administration practice."** It deals with economic aspects of managerial decisions and with those of management decisions that have an economic content. Thus from the broad and wide canvas of the subject of Economics, that body of knowledge, which emerges to facilitate the process of managerial decision-making in shaping efficiently the destiny of the firm constitutes the subject matter of Managerial Economics.

1.2 FEATURES OF MANAGERIAL ECONOMICS
1) **Micro Economics oriented**: There are two approaches to the study of Economics, the Micro

Economic Approach and the Macro Economic Approach. Micro Economic Approach deals with the study of individual economic behaviour i.e. the behaviour of individual producer, individual consumer etc; whereas the Macro Economic Approach deals with the behaviour of the economy as a whole such as National Income, Trade Cycle etc. In Managerial Economics we are more concerned with the analysis of the decision taking aspects of the unit of management at the firm level and therefore Managerial Economics is micro-oriented.

2) **Normative Approach**: As such there are two approaches to the study of science; namely the Positive approach and the Normative approach. In positive approach we are concerned with the situation ‘as it is’, whereas in case of normative approach we are concerned with the situation ‘as it ought to be’. Robbins has made economics a pure and positive science. Its purpose is only to describe and not to prescribe. It is only a light-bearing science and not a fruit bearing one; whereas Managerial Economics adopts a normative approach. Its purpose is not only to describe but more so to prescribe. It is the fruit-bearing science.

3) **Only a part of the Science of Economics**: Of the whole set of Economic Science which deals with many aspects and issues related to human behaviour in allocating scarce resources **Managerial Economics is only a part of the Science of Economics**. The study of Economics, covers issues like welfare economics, agricultural economics, international trade, public finance, money, banking, foreign exchange, development, underdevelopment, poverty, inflation, inequalities, utility analysis, consumer behavior etc, whereas Managerial Economics is just a subset of the set of Economics. It mainly deals with decision-taking of managerial cadre at the level of the firm i.e. the production unit or a business unit and thus it becomes only a part of the subject of Economics.

4) **Knowledge of Macro Economics is essential:** Although Managerial Economics is micro economic oriented yet knowledge of macro economics is essential i.e. no single firm works in isolation. It has got to consider so many other aspects while taking decisions for itself. It has to consider the reactions of rival firms, the possibility of Government interference through taxation, tariffs, export and import policies, the cyclical changes in the levels of business activities, the policy of disinvestment, liberalization, globalization, risks and uncertainties etc. Many of these are exogenous factors i.e. external to the theory of the firm and yet the Managerial Economist

cannot afford to overlook them. Neglect of these may lead to wrong decisions.

1.3 SCOPE AND SUBJECT MATTER OF MANAGERIAL ECONOMICS

The scope of Managerial Economics envisages the inclusion of the study of specific problems of a business enterprise whose main objective is to organize resources in such a way so as to achieve the best or at least satisfactory results out of the activities undertaken. **The subject matter of Managerial Economics revolves round the Theory of the firm**. The Firm is a business unit or a production unit.

There are two dimensions to the theory of the firm: i) The Financial aspect and ii) The Physical aspect.

The **Financial aspect** itself comprises of : a) the cost side and b) the revenue side. Between the revenue and the cost, the firm aspires to gain profits and just not profits but maximum possible profit. This implies that the managerial economist after working out the cost will have to fix the **price** of the product which in turn will also depend on the demand for the product. It is not only the current demand that will have to be considered but the firm will also have to predict or **forecast demand** for its product in the near and distant future. The product will have to be sold in the market and hence the firm will have to consider the **market morphology**. It has to find out the number of competitors producing either identical products or close substitutes. It will have to work out the **price output relations** and the **condition for profit maximization**. Although the aim of the firm is to maximize profits it may also encounter losses. As it incurs a loss the very objective of the firm will change. It would like to **minimize its losses**. The firm need not therefore close down as soon as it incurs a loss but should adopt methods **to promote sales** to minimize the loss. As long as the revenue can cover the variable cost, the firm will continue to remain in production but if the returns can't cover even the variable cost then the firm should decide to take an honorable exit. This would be regarded as **the shutdown decision** in Managerial Economics.

Besides the financial aspects the analysis of the firm also has certain **Technical aspects or Physical aspects** i.e. the **input-output relationship**. In fact, technologically, production is a process of transforming inputs into output. Inputs refer to the various factors of production such as land, labour, capital and organization. The aim of the managerial economist with reference to input-output relation is

optimization i.e. **to make the best possible use of the available resources in order to produce the maximum possible desirable output**.

All these aspects require proper **project planning** as well as **capital budgeting**. The firm will have to work out certain strategies to undertake production and sales to meet its objectives. Thus, cost analysis, demand and supply analysis, pricing strategies, business forecasting, market morphology and the theories of profit will be covered in the scope and subject matter of Managerial Economics. In fact, 'Management without Economics has no roots and Economics without Management bears no fruits'.

Mathematical tools and techniques are also incorporated in the study of Managerial Economics. **Simple diagrams** are drawn to make the subject interesting and easily understandable. The diagrams provide a visual impact and help the viewer in capturing the detailed explanation in the shortest and simplest manner. We also make use of **derivatives, correlation and**

regression, linear-programming, probability theory, econometric models, the game theory and the input-output analysis to provide a scientific base to the subject matter of managerial economics.

As an Economic Man, i.e. an individual who behaves in an economically rational manner, the aim of the producer is to maximize profit but **profit maximization need not necessarily be the only objective of the firm**. There can be several other alternative objectives such as sales maximization, safety margins of profits, long run survival, quite-life, maintaining the goodwill of the firm, satisfying the consumers through quality of the product, etc. and therefore **judicious decisions** will have to be taken to achieve a combination of these objectives.

1.4 METHODS OF MANAGERIAL ECONOMICS

Having discussed the meaning and scope of Managerial Economics, we now turn to highlight the methods of Managerial Economics. The term 'method' symbolizes a procedure which applies some rational and systematic pattern to diverse objects, not only to make observations more accurate but also to avoid the common errors and illusions which hamper human knowledge. It is often argued that in the study of Managerial Economics, we utilize any one or more of the following methods; namely;

1) The Scientific Method or Experimental Method,
2) The Statistical Method,

3) The Method of Intellectual Experiment,

4) The Method of Simulation and

5) The Descriptive Method.

The Experimental method is of limited use to Managerial Economics, because it is difficult to carry out experiments to test the validity of managerial behavior as it deals with human aspects and human behavior is inherently complex; it is ever changing. We can think in terms of adopting the blend of Deductive and Inductive methods in analyzing the behavior of Managerial Economist. Sometimes deduction precedes induction whereas at other times induction precedes deduction. To make it a little more clear, in deductive method, we go from the general rule to the particulars, whereas in inductive method we examine behavior of individual Managerial Economists and then eventually generalize E.g. the aim of one producer is to maximize profit, the aim of the other producer is also to maximize profit. Similarly, the aim of still other producers is also to maximize profit thus we come to the generalization that the primary aim of the producer is to maximize profits and then work out the method to derive the condition for profit maximization.

Statistical Method is a device by which the quantitative data are collected and scientifically analyzed in order to give us a more clear picture of happenings. The collected data are classified, tabulated, compared, correlated and finally interpreted. The statistical methods are generally used by Managerial Economist in demand forecasting and sales promotion. **Model Building** is yet another method used in Managerial Economics. It helps us to understand the actual socio-economic relationship existing in a firm. It can guide the Managerial Economist in taking more appropriate decisions. **The Method of Simulation** has acquired prominence with the oncoming of electronic computers. With the help of this method we can program a complex system of relationships. **The Descriptive Method** is often used by Managerial Economist to analyze the impact of original structure on the working of business enterprises. However, in the study of, Managerial Economics we do not employ any specific approach but utilize any one or more of the above mentioned methods.

If by ‘methods’ we mean the procedural routes to accomplish predetermined results then the methods outlined below are used in Managerial Economics to solve the problems faced by managers in their day-to-day business.
Reference to facts and figures of the firm provides complete information about the working of the firm. Systematically an approach can be set up to compile the data from the various departments of the firm. The management then is able to **co-ordinate and compile the data** so as to derive a complete picture of the overall performance of the firm which could help him to take decisions for any further future action. Thus the knowledge derived from the compilation of firm’s internal data could be considered as one of the methods of Managerial Economics. Similarly the businessmen or manufacturers involved in similar process of production **may form voluntary associations** and compile the data about different business activities. Yet another method of Managerial Economics could be to obtain and **act upon the information compiled from published works or through surveys conducted by way of field investigation.**

Case Studies undertaken would provide **an invigorating method** in the learning process in the science of Managerial Economics. Case Studies bring out the complexity of the environment in which the managers have to take economic decisions and therefore case study should be regarded as an important method used for taking decision in Managerial Economics.

Undoubtedly the success of Managerial Economics lies in accepting and adopting the necessary tool-kit from economic theory and also incorporating relevant ideas from other related disciplines.

The Managerial Economist should also be conversant with important lessons from other related subjects such as Philosophy, Sociology, Psychology, Politics, Human Resource Development, Operation Research, Finance, Mathematics, Statistics, Computers, IT etc which should help him in drawing more accurate decisions.