CHAPTER III

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. Its stress is on the use of the tools of economic analysis in clarifying problems, in organizing -- and evaluating information, and in comparing alternative courses of action. While managerial economics is sometimes known as business economics, it encompasses methods and a point of view applicable both in business -- and in other institutions faced with optimization in decision making. Economics is sometimes defined as the study of the allocation of scarce social resources among unlimited ends. It follows that managerial economics is the study of the allocation of the resources available to a firm or other unit of management among the activities of that unit. Such a definition implies that managerial economics is concerned with choice-with the selection among alternatives.

Managerial economics is pragmatic: It is concerned with analytical tools that are useful, that have proven themselves in practice, or that promise to improve decision making in the future. In the attempt to be -

practical it cuts through many of the refinements of theory. While it avoids some of -- the most difficult abstract issues of economic theory, it inevitably involves complications that are ignored in theory, for it -- must face up to the total situation in which decisions are made.

One way to clarify the scope of a field of study is to discuss its relation to other subjects. Managerial economics has a close connection with microeconomic theory, macroeconomic theory, the theory of decision making, operations research, and statistics. The fully trained managerial economist integrates concepts and methods from all of these disciplines, bringing them to bear on managerial problems.

Microeconomic theory:
The main source of concepts and analytical tools for managerial economics is microeconomic theory, also known as price theory or -- Marshallian economics.

Macroeconomic theory:
The chief debt of managerial economics to macroeconomic theory is in the area of forecasting. Post-Keynesian aggregative theory -- (the theory of income and employment) has -- direct implications for forecasting general business conditions.

Since the prospects of an individual firm -- often depend greatly on business in general, individual firm forecasts depend on general business forecasts, which make use of models derived from theory.

The theory of Decision Making

The theory of decision making (closely related to and hardly separable from organization theory) is a relatively new subject that has a significance for managerial economics. Much of economic theory is based on the assumption of a single goal-maximization of utility for the individual or maximization of profit for the firm. It also usually rests on the assumption of certainty of perfect knowledge. The theory of decision making, in -- contrast, recognizes the multiplicity of -- goals and the pervasiveness of uncertainty - in the real world of management. The theory of decision making often replaces the notion of a single optimum solution with the view - that the objective is to find solutions that "satisfice" rather than maximize. It proves into an analysis of motivation, of the relation of rewards and aspiration levels, of -- patterns of influence and authority.

The theory of decision making is concerned with the processes by which expectations under conditions of uncertainty are formed.- It recognizes the costs of collecting and -- processing information, the problem of - -

communication, and the need to reconcile the diverse objectives of individuals and inte-- rests in the organization. It requires the consideration of the psychological and sociological influences on human behavior.

Operations Research

Operations research is concerned with "model building" --with the construction of theoretical models that aid in decision making. Operations research is frequently concerned with optimization; economics has long dealt with the consequences of the maximization of profits or minimization of costs. The best - way to describe operations research is to -- identify its recurrent techniques and models.

Statistics

Statistics provides the basis for the empirical testing of theory. Statistics is important because it provides the individual firm with measures of the appropriate functional relationships involved in decision making. It is not enough to state that the firm - - should base its pricing decisions on considerations of demand and cost. To take such - action, the firm could use statistical measurements of the shape and position of the demand and cost functions.