As per New CBCS Syllabus for B.Com, 1st Year, 2nd Semester of All Streams
for Various Universities in Telangana State w.e.f. 2016-17

MANAGERIAL ECONOMICS

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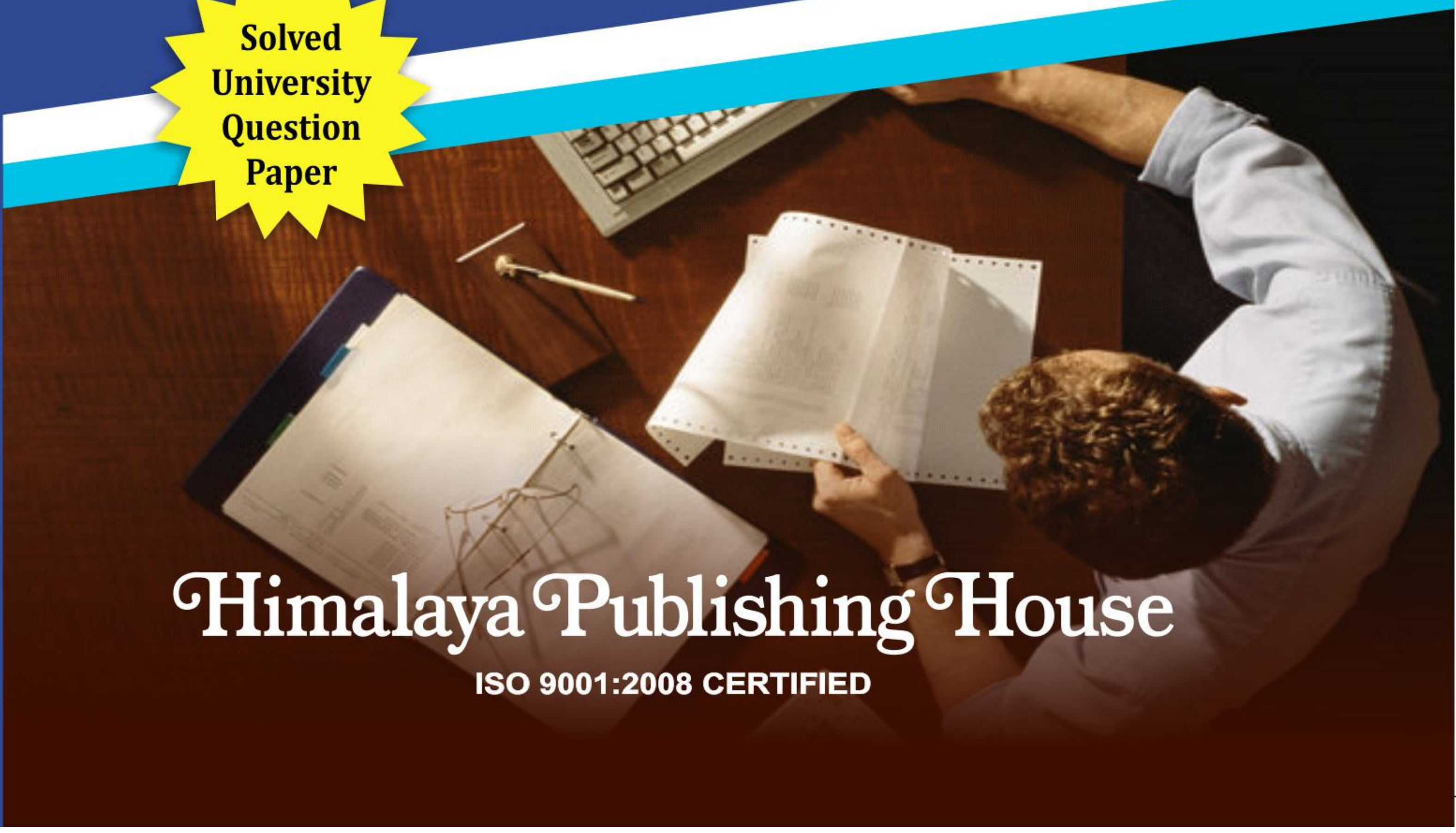
- Kasthuri Srikanth
- K. Samuel Sudhir

Solved University Question Paper



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Himalaya Publishing House
ISO 9001:2008 CERTIFIED

First Edition : 2017
Second Revised Edition : 2018

Published by : Mrs. Meena Pandey for **Himalaya Publishing House Pvt. Ltd.,**
"Ramdoot", Dr. Bhalerao Marg, Girgaon, Mumbai - 400 004.
Phone: 022-23860170, 23863863; **Fax:** 022-23877178
E-mail: himpub@vsnl.com; **Website:** www.himpub.com

Branch Offices :

New Delhi : "Pooja Apartments", 4-B, Murari Lal Street, Ansari Road, Darya Ganj, New Delhi - 110 002. Phone: 011-23270392, 23278631; Fax: 011-23256286

Nagpur : Kundanlal Chandak Industrial Estate, Ghat Road, Nagpur - 440 018. Phone: 0712-2738731, 3296733; Telefax: 0712-2721216

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DTP by : **Nilima Jadhav**

Printed at : M/s. Aditya Offset Process (I) Pvt. Ltd., Hyderabad. On behalf of HPH.

PREFACE

We are happy to see that this Revised Edition of this book had come into existence within short span of time. With enormous response from the faculty and students, we had thought to elaborate more information on the subject concern to see that every topic to be up-to-date requirement and reachable to the students concern. By going through the Last Year Final Question Paper 2017, we thought of giving more information as per the need of day-to-day developments in the current trend of Managerial Economics.

We had attempted to provide through understanding of the methods of demand forecasting, statistical and non-statistical techniques, market analysis, monopoly, monopolistic, oligopoly and duopoly, national income, GDP, GVA, business cycles, deflation and stagflation, fiscal policy, deficits, FRBM Act, repo rate, reverse repo rate, CRR, SLR and Finance Commission. These topics had been handled with every care as latest developments as of current market trend.

We are very grateful to our readers and supporters, who had made us to go for 2nd Revised and Enlarged Edition with all the necessary topics for elaborating. We sincerely hope that this book will provide a helping hand to the teaching fraternity in guiding and preparing for upcoming latest trend of present market.

Our wholehearted gratitude to Prof. A. Sudhakar Dean, Professor of Commerce, B.R. Ambedkar Open University, Hyderabad who is our motivator and inspirer; Shri K. Raghuveer, Principal, IIMC, Hyderabad; and Rev. Fr. D. Sunder Reddy, Principal, St. Mary's Centenary Degree College, Secunderabad who had helped us in giving their valuable suggestions and guidance while revising this 2nd Enlarged Edition.

And we would like to thank our Publishers M/s Himalaya Publishing House Pvt. Ltd., Shri Niraj Pandey – Managing Director, Vijay Pandey – Regional Manager, and Shri G. Anil Kumar – Assistant Sales Manager, Hyderabad and his supporting team, for giving us the opportunity of revision of the book.

Though we had taken every little care while revising this book, some mistakes may crept in while preparing. We shall be highly obliged from readers and suggesters, if they provide us their valuable suggestions, comments and criticisms. The same shall be wholeheartedly acceptable and we shall make sure that the same suggestions will be carried out in our coming revised editions.

January 2018 **Authors**

Hyderabad

SYLLABUS

UNIT I : NATURE AND SCOPE OF MANAGERIAL ECONOMICS

Characteristics of Managerial Economics – Nature and Scope of Managerial Economics – Importance of Managerial Economics – Basic Economic Tools in Managerial Economics – Managerial Economist Role and Responsibility.

UNIT II : DEMAND FORECASTING

Demand Estimations for Major Consumer Durables and Non-durable Products – Demand Forecasting Techniques: Statistical and Non-statistical Techniques.

UNIT III : MARKET ANALYSIS

Definition of Market – Market Structure (Perfect Competition, Imperfect Competition) – Price Determination – Firm's Equilibrium in Perfect Competition, Monopoly, Monopolistic, Oligopoly and Duopoly.

UNIT IV : MACROECONOMICS FOR MANAGERS

National Income – Concepts – Methods – Measurement of National Income – GDP and GVA – Business Cycles – Nature – Phases – Causes – Inflation – Causes and Control – Deflation and Stagflation.

UNIT V : FISCAL AND MONETARY POLICY

Fiscal Policy – Deficits – Budgetary Deficit – Primary Deficit – Revenue Deficit – Fiscal Deficit – Objectives of FRBM Act – Monetary Policy – Objectives – Repo Rate – Reverse Repo Rate – CRR – SLR – Finance Commission – Role and Objectives.

CONTENTS

Chapter 1

CHARACTERISTICS OF MANAGERIAL ECONOMICS

INTRODUCTION

Every individual endeavors to employ his capital so that its produce may be of greatest value. He generally neither intends to promote the public interest, nor knows how much he is promoting it. He intends only his own security, only his own gain. And he is in this led by an invisible hand to promote an end which was no part of his intention. By pursuing his own interest, he frequently promotes that of society more effectually than when he really intends to promote it.

Adam Smith, The Wealth of Nations (1776)

What is Economics?

Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people. Behind this definition are two key ideas in economics: that goods are scarce and that society must use its resources efficiently. Indeed, economics is an important subject because of the fact of society and the desire for efficiency.

- Consider a world without scarcity. If infinite quantities of every good could be produced or if human desires were fully satisfied, what would be the consequences?
- People would not worry about stretching out their limited incomes because they could have everything they wanted;
- Businesses would not need to fret over the cost of labour or healthcare;
- Governments would not need to fight back over taxes, spending, or pollution because nobody would care.
- Moreover, all of us have as much as we gratify, no one would be concerned about the distribution of incomes among different people or classes.

- In such privileged circumstances, all goods would be free, like sand in the desert or seawater at the beach. All prices would be zero, and markets would be unnecessary. Indeed, economics would no longer be a useful subject. However, no society has reached a *utopia* (discussed in detail in evolution of economics) of limitless possibilities.

MANAGERIAL ECONOMICS

Definition and Meaning of Managerial Economics

Managerial economics is used synonymously with business economics. It is a branch of economics that deals with the application of microeconomic analysis to decision-making techniques of businesses and management units. It acts as the via media between economic theory and pragmatic economics. Managerial economics bridges the gap between "theory and practice". Managerial economics can be defined as:

According to **Spencer and Siegelman:**

"The integration of economic theory with business practice for the purpose of facilitating decision-making and forward planning by management".

According to **McGutgan and Moyer:**

"Managerial economics is the application of economic theory and methodology to decision-making problems faced by both public and private institutions".

Managerial economics studies the application of the principles, techniques and concepts of economics to managerial problems of business and industrial enterprises. The term is used interchangeably with microeconomics, macroeconomics and monetary economics.

Characteristics of Managerial Economics

1. It studies the problems and principles of an individual business firm or an individual industry. It aids the management in forecasting and evaluating the trends of the market.
2. It is concerned with varied corrective measures that a management undertakes under various circumstances. It deals with goal determination, goal development and achievement of these goals. Future planning, policy making, decision-making and optimal utilization of available resources come under the banner of managerial economics.
3. Managerial economics is pragmatic. In pure microeconomic theory, analysis is performed, based on certain exceptions, which are far from reality. However, in managerial economics, managerial issues are resolved daily and difficult issues of economic theory are kept at bay.
4. Managerial economics employs economic concepts and principles, which are known as the 'Theory of Firm' or 'Economics of the Firm'. Thus, its scope is narrower than that of pure economic theory.
5. Managerial economics incorporates certain aspects of macroeconomic theory. These are essential to comprehending the circumstances and environments that envelop the working

conditions of an individual firm or an industry. Knowledge of macroeconomic issues such as business cycles, taxation policies, industrial policy of the government, price and distribution policies, wage policies and anti-monopoly policies and so on, is integral to the successful functioning of a business enterprise.

6. Managerial economics aims at supporting the management in taking corrective decisions and charting plans and policies for future.

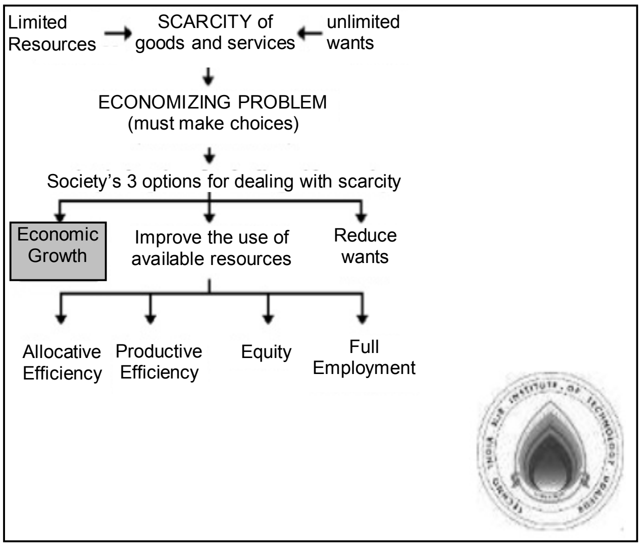
7. Science is a system of rules and principles engendered for attaining given ends. Scientific methods have been credited as the optimal path to achieving one's goals. Managerial economics has been is also called a scientific art because it helps the management in the best and efficient utilization of scarce economic resources. It considers production costs, demand, price, profit, risk, etc. It assists the management in singling out the most feasible alternative. Managerial economics facilitates good and result oriented decisions under conditions of uncertainty.

8. Managerial economics is a normative and applied discipline. It suggests the application of economic principles with regard to policy formulation, decision-making and future planning. It not only describes the goals of an organization but also prescribes the means of achieving these goals.

What Does Scarcity Actually Mean?

Scarcity is non-linear process. As something becomes scarcer or less scarce, the desire for it does not change in a proportionate way.

If everything is scarce, then scarcity itself lacks its value and people become too used to it. Studies of retail sales have shown that if more than about 30 per cent of goods have 'sale' sticker on them, the effectiveness of this method decreases."



Scarcity and Choice

Scarcity actually means Fear Of Missing Out (FOMO). For example, we are rarely finding white elephants and dinosaurs because we already missed those flora and fauna. In other words, Scarcity means proper utilization of available resources to meet individual's needs and desires with alternatives.

Example of Scarcity for Different Stakeholders in Economics

Scarcity	Alternative solutions
The gasoline shortage in the 1970s.	Alternative usage of solar power and wind power should be developed.
Over-fishing can result in a scarcity of a type of fish.	Need to develop aqua culture, need to introduce vocational courses at plus two levels to have the full knowledge about it.
Fewer farmers raising cattle can result in a scarcity of milk and cheese.	Need to encourage the farmers who are dealing with cattle.
A prohibition on imports from a country can result in a scarcity of the resources that country exports.	Need to encourage exports with import substitution.
Due to politics, Kaveri water issue is creating a problem between Karnataka and Chennai, with this water may be scarce in Karnataka state.	Transitional solution must be identified with the interest of the states and general public.
Coal is used to create energy; the limited amount of this resource that can be mined is an example of scarcity.	Hydel power and wind power projects should be developed for scientific (systematic) mining of coal, which reduces wastage in mining.
People who are without access to clean water are experiencing a scarcity of water.	Need to develop usage of water purifiers or traditional ways to solve the problem.
In 2012, avian flu wiped out millions of chickens in Mexico creating a scarcity of eggs, a stable of the Mexican diet.	For the moment, customers may shift to some other vegetarian or staple food.
Enlightening that a population of cattle in a country has Mad Cow disease, resulting in a need to kill the animals, could result in a scarcity of beef in the country.	Non-vegetarian consumers may shift to other sources for their consumption of food.
Over-hunting of an animal population could make it scarce.	Strict policies should be implemented.
Refusal of pharmaceutical companies to create drugs that do not make large profits can cause medication of certain types to be scarce.	Government should take policy decision in the interest of the general public and in the interest of the nation.
Flooding in Nigeria washed farmlands away and has the potential to create a scarcity of food for the residents of the nation.	Have to depend on importing of food from the neighbor countries. Here, comparative cost advantages should be adopted.
Getting of skilled labourers in a country with illiterate population and clientele.	National Skill Development Corporation programs should be increased.
Those who live in harsh climates in which it can be hard for transportation to reach them can experience food shortages if weather prevents delivery.	Production process should be taken as per geographical or climatic conditions; changing mode of transportation for the smooth running of supply chain and logistics.
The depletion of forests in India and other countries has led to a scarcity of wood forcing folks to take wood from demolished buildings in order to build new ones.	Strengthen and to adopt stringent policy measures – not to cut trees and allied activities related to cutting down of forests.

Waste of water through long showers or allowing water to run while brushing one's teeth can contribute to a scarcity of water.	Censored water tap system must be used for the reduction of wastage of water to reduce the scarcity.

Modern Definition

Paul Samuelson defined economics on the basis of the modern concept of growth criteria. In his view, "economics is a study of how men and society 'choose' with or without the use of money, to employ scarce productive uses resource which could have alternative uses, to produce various commodities over time and distribute them for consumption, now and in the future among the various people and groups of society".

Though Samuelson's definition takes into account, men, money, scarce resources and production aspect, but economics is not only the concern of material welfare, it has to take into account certain other socio-economic, politico-economic environment, which may give the human being maximum welfare. In modern-day economics, Physical Quality of Living Index (PQLI) and Human Development Index (HDI) has been taken as the criteria of judging economic development of an economy. Hence, economics is a broader concept.

The **Physical Quality of Life Index (PQLI)** is an attempt to measure the **quality of life** or well-being of a country. The value is the average of three statistics: basic literacy rate, infant mortality, and life expectancy at age one, all equally weighted on a 0 to 100 scale.

It was developed for the Overseas Development Council in the mid-1970s by Morris David Morris, as one of a number of measures created due to dissatisfaction with the use of GNP as an indicator of development.

Physical Quality of Life Index (PQLI)

Rank	Country	Quality of Life Index	Purchasing Power Index	Safety Index	Health Care Index	Cost of Living Index	Property Price to Income Ratio	Traffic Commute Time Index	Pollution Index	Climate Index
47	India	106.28	83.16	55.19	68.42	24.02	10.75	45.07	76.65	14.49

Source: www.numbeo.com

This index has been employed to measure the difference in living. In such index of suffering, 10 following indicators have been included:

1. income,
2. inflation,
3. chances of new jobs,
4. pressure of population in urban areas,
5. the infant mortality rates,
6. nutritional level,
7. clean water,

8. use of energy,
9. adult education,
10. personal freedom.

The **Human Development Index (HDI)** is a composite statistic of life expectancy, education, and per capita income indicators, which are used to rank countries into four tiers of **human development.**

HDI:India's Rank

		HDI Value	Life Expectancy at Birth	Expected Years of Schooling	Mean Years of Schooling	GNI Per Capita	GNI Per Capita Rank Minus HDI Rank
130	India	0.609	68.0	11.7	5.4e	5,497	-4

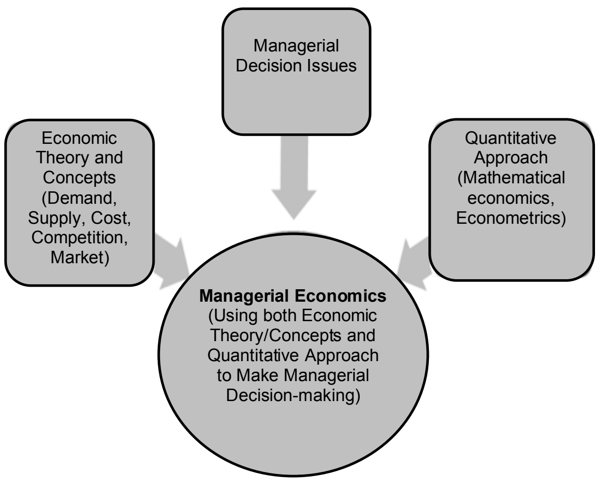
http://hdr.undp.org/en/composite/HDI

HDI Rank	1980	1985	1990	1995	2000	2005	2010	2011	2012	2013	2014
130	0.362	0.397	0.428	0.462	0.496	0.539	0.586	0.597	0.600	0.604	0.609

Source: hdr.undp.org

In contemporary society, the service sector is dominating more. Hence, it is not only a definition of 'scarce resources and ends' but here the resources must include the service sector also. It should not be only production of goods but also the services available to the individual. Economic problem is generally takes into account the macroeconomic problem of scarce resources, alternative uses, problem of distribution, etc.

Characteristics of Managerial Economics



Managerial economics has some special characteristics, and these characteristics indicate the nature of managerial economics. The main feature or characteristic of managerial economics is dealing with the managerial decision issues such as **economic theory and concepts** applying to demand analysis, elasticity of demand, demand forecasting, supply, elasticity of supply, cost concepts, nature of cost curves and estimation of cost analysis, perfect and imperfect market structures.

Quantitative approach deals with Econometrics and mathematical economics in making explicit links between statistical techniques and formulation of economic problems and it gives structure to complex economic problems by using mathematical models.

QUESTIONS

I. Long Answer Questions

1. Define managerial economics. Discuss the origin of economics, which is explained by Plato.
2. Discuss the "convergent economics regime supreme" in detail.
3. "Scarcity and efficiency go hand in to hand in a society." Discuss the statement in the light of the themes of economics.
4. What are the characteristics of managerial economics? Discuss.
5. What is econometrics? What are the different methods of econometrics?

II. Short Answer Questions

1. What is economics?
2. What are different economic concepts?
3. What is HDI?
4. What is PQLI?
5. What is scarcity?
6. Give a few examples of scarcity.
7. What are the characteristics of managerial economics?
8. What is econometrics?
9. What are the different methods of econometrics?

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