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# M.S.-9

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# MANAGERIAL ECONOMICS

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## INTRODUCTION OF MANAGERIAL ECONOMICS

# Sample Preview of the Solved Sample Question Papers

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# QUESTION PAPER

**Exam Held in**

**February – 2021**

*( Solved )*

## MANAGERIAL ECONOMICS

**M.S.-9**

*Time: 3 Hours ]* *[ Maximum Marks: 100*

*Note:* (i) *There are* ***two*** *Sections:* ***Section-A*** *and* ***Section-B****.*
(ii) *Attempt any* ***three*** *questions from* ***Section-A****.*
(iii) ***Section-B*** *is compulsory.*

### SECTION-A

**Q. 1. What is the fundamental nature of Managerial Economics? Discuss.**

**Ans. Ref.:** See Chapter-1, Page No.5, Q. No. 1.

**Q. 2. List the basic techniques involved in decision making. Explain any *two* of these techniques.**

**Ans. Ref.:** See Chapter-3, Page No. 22, 'Chapter at a Glance'.

**Q. 3. What do you understand by a demand function? List and explain the impact of any five variables on the demand function.**

**Ans. Ref.:** See Chapter-4, Page No. 34, Q. No. 1.

**Q. 4. Differentiate between Accounting Costs and Economic Costs. Support your answer with suitable examples.**

**Ans. Ref.:** See Chapter-8, Page No. 69, Q. No. 1.

**Q. 5. How is the evaluation of monopoly done? Explain.**

**Ans.** The monopoly power of a firm is inversely related to elasticity of demand for its product. In a pure monopoly price will generally be greater than marginal cost and that the firm is able to generate super normal profits even in the long run. In the market, production processes like food processing, textiles, garments, wood and furniture, it is relatively easy to enter the market as a supplier – for example, capital requirements are low and sunk costs are also low. Many service industries like travel agencies fall into this category. In such industries, competition ensures that prices are set 'right' and moreover the threat of entry ensures that prices never exceed long-run average cost (for example, marginal companies in the industry cannot persistently earn above average profits). Moreover, competition also ensures that price equals long-run marginal cost. Hence, the price of a good accurately reflects the opportunity cost of manufacturing it.

Problems arise when a situation of monopoly occurs. There are economies of scale to be exploited when one company meets market demand. There are several special problems for these industries. First, their size and capital intensity often puts particular strain on private capital markets in satisfying their investment needs. In India, in the 1990s strain was felt instead on the public coffers, and this was a major factor behind the move towards disinvestment and privatisation. Hence, while for example automobile or chemicals manufacture are also characterised by huge scale economies, governments have rarely seen it as their role to regulate companies in these industries. The question for policy makers is what to do about natural monopolies like power and water supply. Left to themselves, they will charge monopoly prices and restrict output. The absence of any competitive threat will also probably leave such organisations wasteful, inefficient and sluggish. Since all costs can be passed on to the consumers, there will be little incentive for managers to keep them under control. In India, privatisation of power and telecommunications has been accompanied by the creation of a regulator, while there is no such institution for cement, automobile or chemical industry. If a monopoly being broken to foster competition, the result will be transfer of income

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from producers to consumers and elimination of deadweight loss. Herein lies the economic basis for regulation of monopoly firms. It is to generate the outcomes of competitive markets and pass these benefits to consumers in the form of lower prices. If competition exists in markets then arguably, that is the best regulation. If it does not, and the industry is envisaged to play a social role, regulation of monopoly becomes an important policy objective.

**SECTION-B**

**Q. 6. Read the following case situation and answer the questions given at the end.**

**Increased Prices for Drinks**

In 2010 the government's main medical adviser drew up plans for a minimum price for alcohol intended to double the cost of some drinks.

Under the proposal no drinks could be sold for less than 50 pence per unit of alcohol they contain. This would mean most bottles of wine could not be sold for under £ 4.50. The proposal is aimed at reducing alcohol abuse. A spokesman for an opposition party said that it was more important to deal with peoples attitudes and not just the price of alcohol. The Portman Group, set up by drinks manufacturers to promote sensible drinking, argues that it would damage the majority of drinkers who behave responsibly in terms of their consumption.

The NHS bill for alcohol abuse is an estimated £ 2.7 bn a year. Recent figures show hospital admissions linked to alcohol use have more than doubled in England since 1995. Alcohol was the main or secondary cause of 207,800 NHS admissions in 2006/07, compared to 93,500 in 1995/96. The number of alcohol related deaths in England has doubled since the early 1990s to nearly 9,000 a year.

**Questions:**

***(a)* What sort of product is alcohol in economic terms if the government wants to restrict consumption of it?**

**Ans.** The most fundamental law of economics links the price of a product to the demand for that product. Accordingly, increases in the monetary price of alcohol (i.e., through tax increases) would be expected to lower alcohol consumption and its adverse consequences.

**Absences:** There is ample evidence that people with alcohol dependence and drinking problems are on sick leave more frequently than other employees, with a significant cost to employees, employers, and social security systems.

**Work accidents:** In Great Britain, up to 25% of workplace accidents and around60% of fatal accidents at work may be linked to alcohol. In India about 40% of work accidents have been attributed to alcohol use.

**Productivity:** Heavy drinking at work may reduce productivity. In Latvia, 10% of productivity losses are attributed to alcohol. Performance at work may be affected both by the volume and pattern of drinking. Co-workers perceive that heavy drinkers have lower performance, problems in personal relationships and lack of self-direction, though drinkers themselves do not necessarily perceive effects on their work performance.

**Unemployment:** Heavy drinking or alcohol abuse may lead to unemployment and unemployment may lead to increased drinking.

***(b)* Analyze the social costs of alcohol consumption.**

**Ans.** Anti-social behaviour associated with binge drinking impacts not just those who over-consume but impose external costs on the health service and uses up the scarce resources of the police and criminal justice system. Alcohol abuse can also lead to increased absenteeism from work and lower labour productivity in the long run. Thus, we can say that excessive drinking leads to negative externalities from consumption which is a major cause of market failure and leads to significant social costs.

***(c)* Analyze the factors that would determine the impact of a price increase on the consumption of alcohol.**

**Ans.** Although in theory higher prices will limit demand and consumption, in practice consumers will always find ways around a regulation. One effect might be an increase in home-brewing of beer, gin and wine which might then lead to a rise in alcoholic poisoning and additional external costs. Youngers drinkers in particular might look to get around the legal minimum price by finding illicit alcohol in shadow markets. They are at great risk of suffering the effects of information failure which is another cause of market failure. This is also a policy that could be quite expensive to enforce.

***(d)* Is introducing a minimum price a better way of reducing consumption than trying to change peoples' attitudes?**

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# Sample Preview
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# The Chapter

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# MANAGERIAL ECONOMICS

*INTRODUCTION OF MANAGERIAL ECONOMICS*

## Scope of Managerial Economics

1

### INTRODUCTION

Since economics has two primary classifications namely macroeconomics and microeconomics. The basic difference between the both is that macroeconomics is considered as the study of the whole economy, which caters to areas like Gross National Product, Inflation, Unemployment, Exports, Imports, Tax Policies, etc. On the other hand, microeconomics deals with the individual factors in the economy that is firms and individuals.

It is vital to understand that macroeconomics also provides answers to questions pertaining to any changes in investments, employment, prices, exchange rate of the rupee, etc, as these affect the economy at large. Microeconomic data on the other hand forms a part of the data for macroeconomic study of variables. Since only aggregate data of the above mentioned variables is considered, however, the aggregate also includes the data for changes in output of a number of individual firms, plus the consumer's consumption levels and their choice based on any change in the prices of the particular goods and services.

It is on the basis of the importance that the macroeconomics and microeconomics issues command that one gets the attention in media and newspapers while the latter is taken care of in the day-to-day handlings of the manager.

It is said that in order to take appropriate managerial decisions it is important to have an analytical perspective blended with rational decision making skills. These can be enhanced with the understanding of the applications of Managerial Economics.

Managerial Economics falls under the microeconomics section, which caters to a wide variety of topics that may range from risk, demand, supply to the understanding of the cost and market structure. Thus, in layman's language it can be said that market is a place where individuals and various products come in contact with each other and the prices of the products are determined. Therefore it is important to keep the profit maximization quotient for the firm producing the products in mind. The entity, which makes available the factors of production in the form of produced goods and services, is termed as a firm.

The main aim of economics is to have the appropriate allocation of resources, so that they can be utilized to their maximum capacity. It is with the help of economics that managers are able to take the optimizing decisions keeping in mind the alternatives available vis-à-vis the best option for the resources.

The firms operate in the market whereby the forces of demand and supply, inflation, government policies affect it. Thus, it is with the help of managerial economics that the firm is able to react to such changes in the economic environment and predict and devise the best possible alternative, so that their objectives are also met.

### CHAPTER AT A GLANCE

As mentioned in the introduction, Managerial Economics is a part of microeconomics. Thus, it deals with the micro aspects of the economy. The main aim

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of Managerial Economics through microeconomics usage is to focus on the interaction of firms and individuals in the market. It can also be said that managerial Economics has emerged due to a close interrelationship between management and economics.

This chapter provides for a basic introduction to Managerial Economics, also mentioning its importance in the current economic phase. Since economics being a vast subject it provides a platform to various parts of it to be dealt as specific subjects, these may include industry, public finance, international trade, etc. Managerial Economics is one such part of economics. Thereby, it provides for place where, the various desires of individuals co-ordinate with each other for them to be fulfilled. This can further be studied in the form of allocation of scarce resources in order to satisfy the wants and desires of individuals.

It is in the market that the firms make available the various products that can fulfill the desire of the individuals. It is not necessary for the market to be a physical one; it refers to any place where exchange is involved. It is in the market that the firms operate and they tend to improve on their profitability with the help of Managerial Economics principles. Since there is no restriction on the number of firms that may enter the market, thus the mere individual is flooded with choice in order to fulfill their desire.

Since the main of the individual is the fulfilment of his wants and desires, on the hand the firm's aim is to provide goods and services for the fulfilment. It is a known fact that human wants are unlimited and insatiable while at the other end; the economic resources available to satisfy the same are limited. This gives rise to the fundamental issue of scarcity of resources.

Thus, it is important for the firm to have a clear idea about what it wants to produce, the manner of production, i.e. how to produce and the third vital point the category for which such production has to be undertaken. It is on the basis of answers to the above questions of "what, how and whom" that an effective strategy can be developed so that resources can be utilized to their maximum capacity.

In order to answer the above questions, the firms are faced with three options namely, using the market mechanism; secondly, entirely by the government; the third option is the one most commonly used by the firm, i.e. using the combination of the above. Therefore it needs to be kept in mind that the resources need to be allocated effectively. Efficiency is maintained by making anybody better off without making somebody else worse-off.

It is important to understand the scope and importance that Managerial Economics carries to the firms. It helps them in solving the choice and allocation of scarce resources issues. It helps the firm to identify the activities to which the scarce resources need to be allocated for its proper functioning. The scope of Managerial Economics is not limited to just allocation of resources, it also provides a platform for rational decision-making and forward planning concepts in the managerial decisions. The managers are responsible for appropriate resource allocation, inventory, price and investment issues, which can be taken care of with the help of Managerial Economics concepts.

The aim of the economic activity is to strike a balance between ends and means due to the scarcity of resources. It can be said that the center of economic activity is decision making by management, as it involves making a choice among the various alternative courses of action. Thus, the best economic choices, keeping in mind the objectives and obstacles are the outcome of best decision-making skills. The various tools that come handy to the management for taking rational decisions may include micro-macro, partial-general equilibrium, and positive-normative analysis. Therefore, it can be said that Managerial Economics acts as a link between traditional economics and the decision-making sciences for the business firms.

As it is with the help of Managerial Economics tools that firms tend to improve their profitability. In other words, it is the application of economic theory blended with the analysis of decisions that the firms can know the path for achieving their objectives in an effective manner.

Managerial Economics also have a bearing on other fields of study as well. Since it is considered a microeconomics thus its direct relation is created with Microeconomic Theory. As mentioned in the introduction that microeconomics forms a part of macroeconomics thus, it can be linked with Macroeconomic Theory as well. Likewise, its association can be found with operations research, theory of decision-making, statistics, accounting as well.

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Therefore, it can be said that Managerial decisions are evaluated through various concepts, tools and techniques of economic analysis.

## CHECK YOUR PROGRESS

**Q. 1. Development of Managerial Economics is the result of close interrelationship between management and economics. Discuss.**

**Ans.** As according to McNair and Meriam, "Managerial Economics is the use of economic modes of thought to analyze business situations." Based on this definition of Managerial Economics, the relationship between economics and management may be justified. The management provides the guidance, leadership as well as the way to appropriately channelize the efforts of a group of individuals towards the attainment of some common objective. While economics, provides for analyzing and providing solution to the big question of scarcity of resources.

According to Koontz and O'Donell, "Management is the creation and maintenance of an internal environment in an enterprise where individuals, working together in groups, can perform efficiently and effectively towards the attainment of group goals." Therefore, management is co-ordination, an ongoing activity, a purposive process and the manner of getting work done through others.

While economics provides for answers to the basic questions such as what should the firm produce, the production process, i.e. how to produce and the third, for whom to produce. It is in these answers that relationship between management and economics lies. As the firm wants to produce so that it delivers goods and services to the individuals and thereby attain objective and also derive some profits as well. For which certain factors of production in the form of material, machine, labour etc, need to be deployed. And it is also a known fact that such resources are scarce in nature, as compared to the unlimited and insatiable human wants. Thus here economics comes as a savior as provides for the concepts and tools to determine the best possible alternative for the factors of production.

**Q. 2. Which statement is true of the basic economic problem?**

***(a)*** **The problem will exist as long as resources are limited and desires are unlimited.**

***(b)*** **The problem exists only in less developed countries.**

***(c)*** **The problem will disappear as production expands.**

***(d)*** **The advancement of technology will cause the problem to disappear.**

**Ans.** *(a)* The problem will exist as long as resources are limited and desires are unlimited.

As the 3 choice problems faced by an economy are:

*(a)* What to produce?

*(b)* How to produce?

*(c)* For whom to produce?

These problems arise due to the scarcity of resources. Managerial economics caters to the fundamental question of scarcity of resources by providing the organization with appropriate analysis of the various activities undertaken by the organization vis-à-vis the best possible alternative for the effective utilization of the factors of production.

As the scarcity of resources results from the following issues, namely:

*(a)* Human wants being unlimited and insatiable.

*(b)* Limited economic resources available to satisfy the wants and desires.

The effective and efficient use of the available resources is thus very important, that is the resources need to be utilized to their maximum capacity so that the profits are enhanced and maximum returns are available to the organization as a whole. The purpose of this ongoing process is to maximize the returns and thereby the profits.

**Q. 3. Why is decision making by any management truly economic in nature?**

**Ans.** Mostly managerial decisions are economic in nature as the firms' management is faced with the "problems of choice" in simple words various alternatives. And it is the management's responsibility to see that the resources are allocated appropriately as they are scarce in nature. As the firms operate in the market and are responsible for providing goods and services to the individuals, they are also affected by the economic environment they function in. Therefore, managerial economic provides for the study of allocation of resources available with firm vis-à-vis its activities, keeping in mind the best possible alternative available to the firm.

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The management is therefore responsible for taking rational decisions and future planning with regards to the economic concepts and problem analysis. As it needs to ensure that scarce resources are utilized to the utmost efficiency and that best results are achieved. The resource allocation decision may include taking decisions pertaining to production and transportation process.

The mangers are also faced with inventory issues, which involve taking decisions pertaining to holding the appropriate levels of stock of raw materials and finished goods for a period of time. For which it is important to understand the demand and supply conditions in the market.

The decision-making process also involves an important decision relating to fixing the prices of the products. For which various methods may be adopted keeping in mind that the price is neither too high nor too low. As, if the price is high, it will be out of reach for various individuals and if the price is too low then people may tend to have second thoughts about its quality. As the firms operate for profits thus accurate price decisions play a vital role in the growth of the organization as a whole.

The managers are also faced with taking decisions regarding future planning. It relates to taking various investment decisions.

Therefore, any management decision has a bearing either direct or indirect on the economic standing of the organization and vice-versa, any change in the economic environment, like changes in the government policies etc. have a bearing on the organizations business as well.

**Q. 4. Enlist the major groups of problems in decision-making.**

**Ans.** The major groups of problems faced in the decision-making process may be listed as follows:

*(a)* Resource Allocation

*(b)* Inventory and queuing problem

*(c)* Pricing problem

*(d)* Investment problem

**Resource Allocation:** Since the resources are scarce in nature as compared to the unlimited wants and desires of individuals, which makes it important for the resources to be properly allocated so that the best results are achieved from the same. This problem also caters to the questions pertaining to planning the production process and the problem of transporting the necessary factors of production to the particular activity. Therefore it is the manager's responsibility to decide the appropriate areas for resource allocation keeping in mind the achievement of the organizational objectives.

**Inventory and Queuing Problem:** The mangers are also faced with inventory issues, which involve taking decisions pertaining to holding the appropriate levels of stock of raw materials and finished goods for a period of time. For which it is important to understand the demand and supply conditions in the market. Queuing problems relate to the decisions regarding the installation of additional machines or hiring extra labour.

**Pricing problem:** The decision making process also involves an important decision relating to fixing the prices of the products. For which various methods may be adopted keeping in mind that the price is neither too high nor too low for example, demand elasticity study. As, if the price is high, it will be out of reach for various individuals and if the price is too low then people may tend to have second thoughts about its quality. As the firms operate for profits thus accurate price decisions play a vital role in the growth of the organization as a whole.

**Investment problem:** The managers are also faced with taking decisions regarding future planning. It relates to taking various investment decisions. For example, investing in new plants, how much to invest, sources of funds, etc.

**Q. 5. Mention the 3 choice problems of an economy. And also explain why these problems arise.**

**Ans.** The 3 choice problems of an economy are:

*(a)* What to produce?

*(b)* How to produce?

*(c)* For whom to produce?

The problems arise due to the scarcity of resources.

In order to solve the above questions the firms are provided with three choices, with the first being depending on the market mechanism, the second one is being totally dependent on the government. However, the third option is the most commonly used option in today's world where firms make their decisions based on the combination of both the market mechanism and the prevailing government policies. For example, more institutes will start providing for MBA courses and more students with opt for the same

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