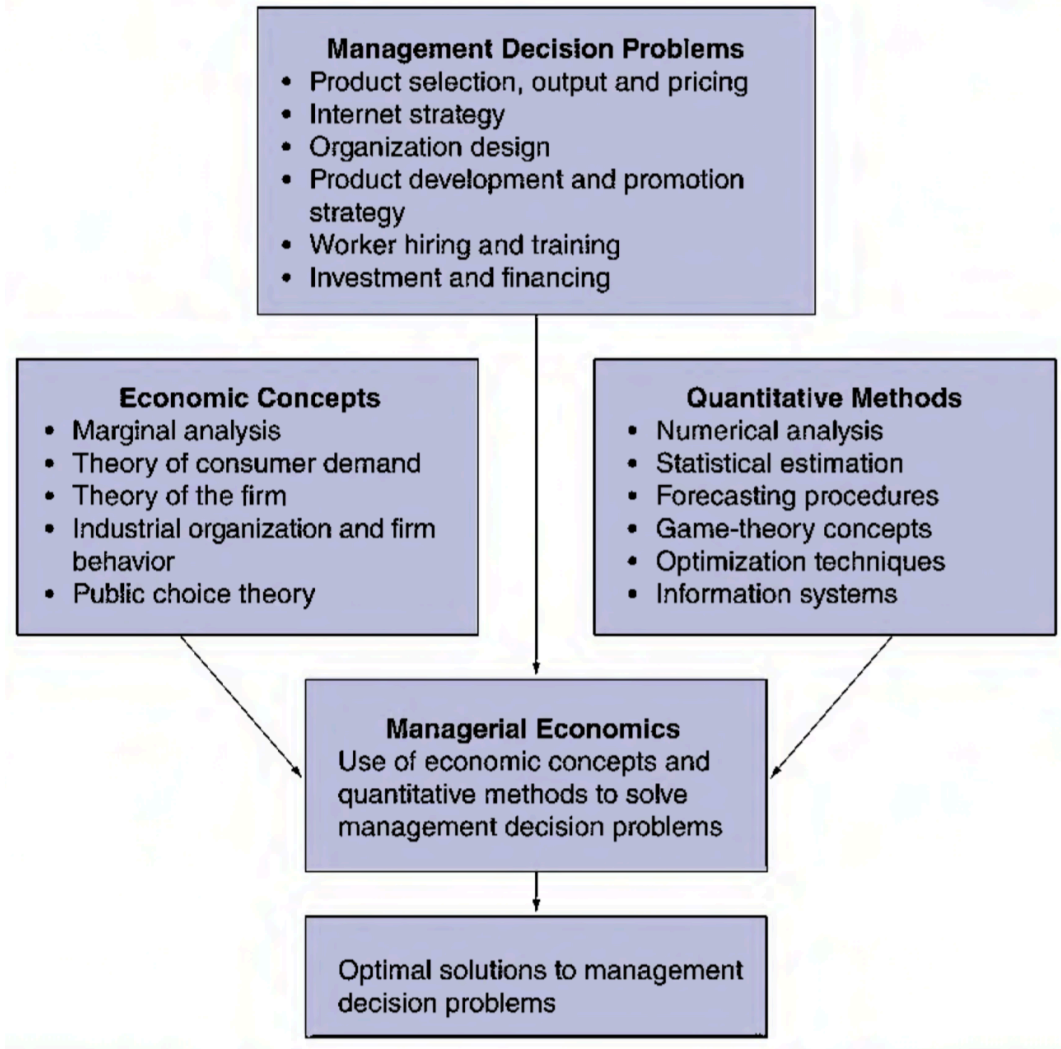
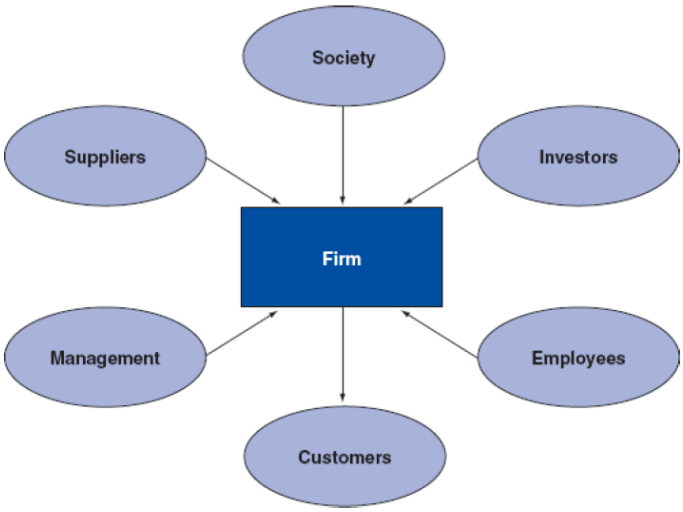
Table of Contents

ECF2731 Final Revision

Week 1 Introduction to Managerial Economic

How is Managerial Economics Useful	
Evaluating Choice Alternatives	Identify ways to efficiently achieve goals Specify pricing & production strategies Spell out production & marketing rules to maximize profits
Making the Best Decisions	Managerial economics helps meet management objectives efficiently Managerial economics shows the logic of consumer, firm, and government decisions
Managerial Economics	Applies (micro)economics principles to key management decisions Micro- provides a set of tools to understand & analyse human behaviour Managerial eco- applies these tools to managerial decision making
Economic Concepts and Methods	
Theory of the Firm – The basic model of business	
Expect Value Maximization	Optimization of profits in light of uncertainty and the time value of money
	Owner managers maximize short-run profits Primary goal is long-term expected value maximization **The value of the firm**: the present value of the firm's expected future net cash flow
Constraints & the Theory of the Firm.	• Resource constraints • Social constraints

ECF2731 Final Revision

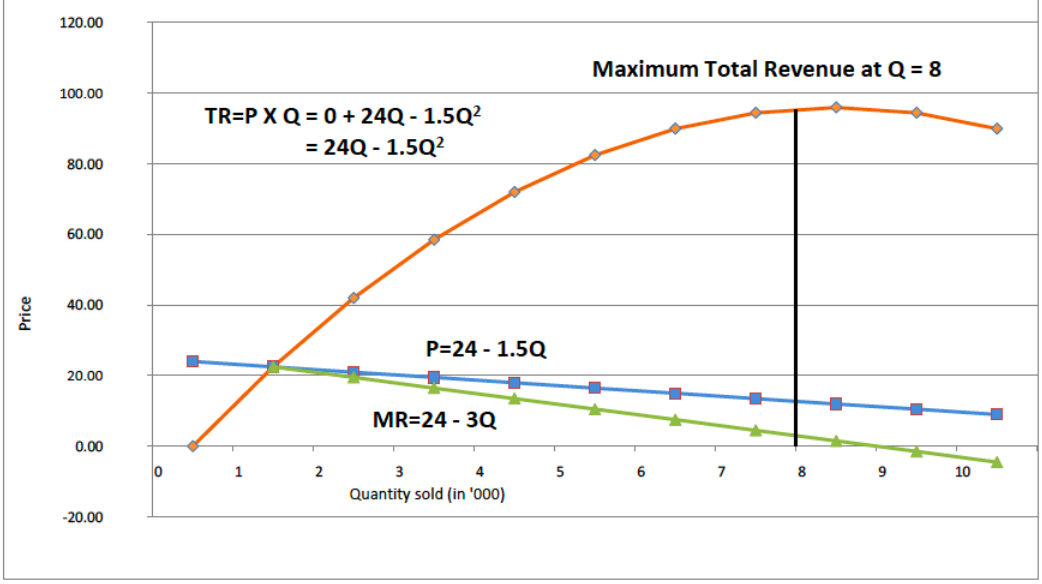
Limitations of the Theory of the Firm	• Alternative theory adds perspective • Competition forces efficiency • Hostile takeovers threaten inefficient managers
The firm can be views as a series of contractual relationship	
Profit Measurement	
Business vs. Economic Profit	**Business (accounting) profit**: residual of sales revenue – explicit accounting costs of doing business • Reflects explicit costs & revenue
	Economic profit: business profit – the implicit costs of capital & any other owner provided inputs • Profit above a risk-adjusting normal return • Considers cash & noncash items
Variability of Business Profits	• Business profits vary widely • **Profit margin**: accounting net income dived by sales • **Retune on Stockholder's Equity (ROE):** accounting net income divided by the book value of total assets – total liabilities
Profits vary among firms – many firms experience significant economic profits/losses	
Disequilibrium profit theories	• Unexpected revenue growth/cost savings
	Possible explanations of economic profits/losses: • **Fictional Profit Theory**: abnormal profits observed following unanticipated changes in demand or cost conditions • **Monopoly Profit Theory**: above-normal profits caused by barriers to entry that limits competition
Compensatory Profit Theories	• Profits accrue to firms that are better/faster/cheaper than the competition • **Innovation-Profit Theory**: describes above-normal profits that follow successful invention or modernization • **Compensatory Profit Theory**: above-normal rates of return that reward efficiency
Role of Profits in the Economy	• Economic profits play an important role in any market-based economy • Above-normal profit → may signal that the firm/industry should increase output
Role of Business in Society	
Why Firms Exit?	• Businesses help satisfy consumer wants • Businesses contributes to social welfare
Social Responsibility of Business	• Serve customers • Provide employment opportunity • Obey laws & regulations

ECF2731 Final Revision

Week 2 Economic Optimization / Demand & Supply

Economic Optimization Process	**Optimal decisions**: best decision produces the result most consistent with managerial objectives
	Maximizing the value of the firm • Produce what customers want • Meet customer needs efficiently
	• Simplest version of a firm's goal: profit maximization • Value of the firm is the present value of future profits • Profits = Total Revenue – Total Costs
Revenue Relations	
Total Revenue (TR)	• The amount of combination by quantity and prices • TR is a function of price and quantity $TR = f(P, Q)$ → $TR = P \times Q$ • Assume that the demand is downward-sloping → must ↓ P to ↑ Q sold
Demand (D)	• Relationship between quantity demanded and price.
Marginal Revenue (MR)	• The change in TR associated with a 1-unit change in quantity sold (Q). • $MR = \frac{Change\ in\ TR}{Change\ in\ Q} = \frac{\delta TR}{\delta Q}$
Revenue Maximization	• Activity level that generates the highest revenue. • TR is maximized when marginal value shifts from positive to negative → MR = 0

Figure 3. Relationship between Price, Output,Total Revenue and Marginal Revenue



Cost Relations	
Total Cost (TC)	$TC = FC + VC$ • **Fixed Cost (FC)**: do not vary with output • **Variable Cost (VC)**: vary with output
Average Cost (AC)	Total cost divided by the number of units produced. $AC = \frac{TC}{Q}$
Marginal Cost (MC).	Change in TC associated with a change in quantity. • Always positive because almost all goods & services entail at least some labour/material… • $MC = \frac{\delta TC}{\delta Q}$