

THE OPEN UNIVERSITY OF TANZANIA
FACULTY OF BUSINESS MANAGEMENT
MASTERS IN BUSINESS ADMINISTRATION (MBA)
OBS 602: MANAGERIAL ECONOMICS
COURSE OUTLINE

1.0. INTRODUCTION

There is always a wide gap between economic theory and the application of economic analysis, particularly at the microeconomic level. The theory of the firm is considered to be one thing; while the application of economic analysis to the problems of the firm is another. Due this gap, business economists found that most of the research analyses, publications, and discussions of traditional economics provide little help in solving the day – to- day economic problems of the firm. Basing on this problem the body of knowledge known managerial economics or business economics was developed to bridge the gap between economic theory and the application of economic analysis. This provides powerful tools and approaches for managerial policy and decision making in business management.

1.1. COURSE OBJECTIVE:

The objective of this course is to provide students with basic methods and principles of economic analysis, relevant to solving business problems in organizations where managers' face in day- to- day decision making.

1.2. COURSE DESCRIPTION

It has been given that, this course is aimed at providing students with basic methods and principles of economic analysis relevant to managerial policy and decision making with emphasis on a firm's specific problems. To achieve this, the course covers the following topics:

Introduction to managerial economics; optimization techniques and new management tools; demand theory; demand estimation; business and economic forecasting; production theory; cost theory; linear programming; market structure; pricing policy and pricing methods; risk analysis and Long - run investment decisions.

1.2.1. COURSE CONTENT:

TOPIC 1: INTRODUCTION TO MANAGERIAL ECONOMICS

This topic is aimed to present the nature of managerial economics, which are outlined in the objectives and the subsequent subtopics.

Objectives

After learning this topic students should be able to:-

Define managerial economics, its nature and objectives.

Explain the relationships of:-

(a) Managerial economics to economic theory.

(b) Managerial economics to other disciplines of business administration studies.

(c) Discuss the theory of the firm.

1.3. Subtopics

1.3.1 The nature of managerial economics

This section will try to focus on the definition of managerial economics and examine its relationship to economic theory, management decision sciences and functional areas of business administration studies.

1.3.2. Definition of managerial economics

This section devotes to provide the meaning of the function of managerial economics.

1.3.3. Relationship of managerial economic to economic theory

Managerial economics applies methods and principles of economic theory to solve managerial decision problems. Therefore this section will present to you the relationship of managerial economics to economic theory.

1.3.4 Relation of managerial economics to other disciplines

Having defined the subject matter of managerial economics and understanding the relationship of this course to economic theory, this

section will discuss the relationships of managerial economics to other disciplines as given below -:

(a) **Relationship to the functional areas of Business Administration**
(Finance, Accounting, Marketing, Human Resource Management, Production etc.)

(b) **Relationship to the decision science**

- **Decision sciences** refer to mathematical economics and econometrics.
- **Managerial economics** use the tools of mathematical economics and econometrics to construct and estimate decision models aimed at determining the optimal behaviour of the firm.

1.3.5 The Theory of the Firm

Although managerial economics is not concerned solely with the management of business firm, this is its principal field of application. To apply managerial economics to business management, we need a theory of the firm, a theory indicating how firms behave and what their goals are.

To understand this theory, we examine the following in this section.

- Reasons for the existence of firms and their function.
- The objective and value of the firm.
- Constraints on the operation of the firm.
- Limitation of the theory of the firm.

TOPIC 2: OPTIMIZATION TECHNIQUES AND NEW MANAGEMENT TOOLS

2.1 Introduction

In the previous topic we learned that managerial economics is concerned with the ways in which managers should make decisions in order to maximize the effectiveness or performance of the organizations they manage (refer to the definition of managerial economics and the theory of the firm). To understand how this can be done, you must learn the basic

optimization techniques, which includes expression of economic relationship forms and techniques used to solve optimization problems.

2.2 Objectives

After learning this topic students should be able to: -

1. Express the economic relationship in different forms i.e. equation, tabular or graphical and be able to give out which form is more useful.
2. Show the relationship between total, average and marginal concepts of revenue, product, cost and profit.
3. Discuss the methods or techniques used to solve optimization problems.

2.3 Subtopics

2.3.1 Methods of expressing economic relationships

Economic relationship can be expressed in the form of equations, tables or graphs (curves) depending on the number of economic variables given.

2.3.2 Relationship between total, marginal and average values

The relationship between total, average and marginal concepts and measures is crucial in optimization analysis. The relationship is basically the same whether we deal with revenue, product, cost or profit.

Therefore, this section we shall learn:-

- The relationship between total profit, average profit, and marginal profit.
- The relationship between total revenue, average revenue and marginal revenue.
- The relationship between total, average and marginal cost.
- The relationship between total product, average product and marginal product.

2.3.3 Optimization techniques

There are many methods used in determining the optimal decision making. However, in this section we will learn the following techniques:-

- Marginal analysis technique.
- Derivative technique – this involves the use of calculus in solving maximization and minimization problems.

TOPIC 3: DEMAND THEORY

3.1 Introduction

Managers spend much of their time, energy and money analyzing the demand for their products, and this is not an easy task. In order to make sound managerial economic decisions about prices and sales, one needs a thorough understanding and analysis of the theory and application of demand. Therefore this topic will focus on the theory of demand and we shall mainly focus on the demand function, price elasticity of demand, cross elasticities and other elasticities and the importance of elasticities in decision making.

3.2 Objectives

After learning this topic, students should be able to: -

1. Explain demand function and demand curve.
2. Discuss price elasticity of demand.
3. Describe income elasticity of demand.
4. Explain cross elasticities and other elasticity.
5. Account for the importance of elasticity in decision making.

3.3 An overview of demand and supply concepts

This section introduces students to an overview of the basic principles of demand and supply which are very basic in learning other subtopics in this topic. Thus, this section will cover: -

- The meaning or definition of the term market.
- Definitions of demand and supply.
- The market demand curve.
- The market supply curve

- Market equilibrium price

3.4 The market demand curve

The market demand curve for a commodity shows the various quantities of the commodity demanded in the market per time period at various alternative prices of the commodity, while holding everything else, constant

- Students should know how to use demand schedule to plot the market demand curve.

3.5 Industry and firm demand functions

- Market demand function.

The market demand function for a product is the relationship between the quantity demanded of the product and the price of the product demanded and the various factors that influence this quantity:

3.6 Price elasticity of demand

Market demand curves vary with regard to the sensitivity of quantity demanded to price. To show how sensitive quantity demanded is to change in price, economists use a measure called the price elasticity of demand.

This section will present this concept by focusing on the following: -

- Point and Arc elasticities
- Price elasticity, total revenue and marginal revenue
- Factors affecting the price elasticity of demand
 - Determinants of the price elasticity of demand
- Income elasticity of demand
- Cross-price elasticities and other elasticities
- The importance of elasticities in managerial decision making.

TOPIC 4 : DEMAND ESTIMATION

4.1 Introduction

In topic 3 we learned about the theory of demand; now in this section we will focus on how to estimate a product's demand function.

In order to achieve this we begin by examining some difficulties encountered in deriving the demand curve for a product from market data, the process which is referred to as identification problem. Then we shall discuss some marketing research approaches to demand estimation. Finally we will focus on regression analysis as the most useful and common method of demand estimation.

4.2 Objectives

At the end of this topic students should be able to:

1. Identify problem encountered in deriving the demand curve.
2. Discuss various marketing research approaches to demand estimation.
3. Use regression analysis to estimate demand of a product.

4.3 Subtopics:

4.3.1 The identification problem

Demand curve and supply curve are not always stable. Over time or across different individuals or markets, the demand for the commodity shift or differ because of changes in tastes, incomes price of related goods, and so on.

This also occurs to supply curve as a result the equilibrium price also changes. In order to generate the demand curve, we need to identify problem that make demand curve to change so as to determine the new or future demand. In this section we shall discuss **factors that affect demand and supply curves.**

4.3.2 Methods of estimating demand

There are many methods used in estimating demand. However, in this section we shall learn the following methods.

- Consumer surveys and observational research
- Consumer clinics
- Market experiments
- Regression analysis.

TOPIC 5: PRODUCTION THEORY

5.1 Introduction

In this topic we examine production theory and measurement or how firms combine inputs to produce goods and services. Within the topic we shall learn the production function, the optimal combination of inputs, returns to scale.

5.2 Objectives

After learning this topic students should be able to:

1. Define production function.
2. Explain the production function with one variable.
3. Discuss the production function with two variables.
4. Determine the optimal combinations of inputs (for production function with two variables).
5. Explain the concepts of returns to scale.

5.3 Subtopics

5.3.1 The production function

This section provides to you the following:-

- Definition or meaning of the production function.
- Mathematical expression of the production function.

5.3.2 The production function with one variable input

In this section, we present the theory of production when only one input is variable. This situation we refer as the short run. Within this section we examine the following: -

- Total, the average and the marginal product of the variable input.
- The law of diminishing returns.
- The stages of production – their meaning and importance.

5.3.3 The optimal level of utilization of an input

This provides the level of variable input needed in order to maximize profits.

5.3.4 The production function with two variables

Having examined the production function with one variable input in section 5.3.2, we will now examine the production function with two variable inputs. This is the long run situation in which all inputs are variable.

In this section we shall learn:

- The production isoquants.
- The marginal rate of technical substitution.

5.3.5 Determination of optimal combinations of inputs

- Isoquants and isocosts – used to determine the optimal input combination for the firm to maximize profits.

5.3.6 Returns to scale concept

Returns to scale refers to the degree by which output changes as a result of a given change in the quantity of all inputs used in production.

In this section we shall examine: -

- Constant returns to scale.
- Increasing returns to scale.
- Decreasing returns to scale.

TOPIC 6: COST THEORY

6.1 Introduction

In the previous topic we learnt about production theory. However, in order to be able to make a wise decisions concerning how much to produce and what prices to charge, it needs understanding of the relationship between the firms output rate and its costs. In this topic we learn the concept of opportunity costs, short run cost functions, and long run cost functions, economics of scale and diseconomies of scale and break-even analysis.

6.2 Objectives

After learning this topic, students should be able to:-

1. Explain the concepts of opportunity costs.
2. Understand the concepts of fixed costs, Variable costs, and Total Cost.
3. Distinguish between the short run and long run cost functions.
4. Describe economies and diseconomies of scale
5. Discuss break even analysis.

6.3 Subtopics

6.3.1 Costs

This section devoted to explain the basic concepts of production costs and will cover the following: -

- The meaning of opportunity costs.
- Explicit costs Vs implied costs.
- Accounting costs Vs economic cost.

6.3.2 Short-run cost function

In this section we will distinguish between fixed and variable costs and derive the firms' total, marginal, and average cost.

6.3.3 Long run cost functions

In this section we will derive the firm's long run total, average and marginal cost curves. We then show the relationship between the firm's long run average cost curve and the firm's short run average cost curves.

6.3.4 Plant size and economies of scale

This section discussed the concepts of: -

- Economies of scale
- Diseconomies of scale.

6.3.5 Break even analysis

Break even analysis sometimes is referred to as cost-volume-profit analysis. It is a technique, which is frequently used in managerial decision. This section devotes to discuss the use of the following tools of break even analysis: -

- Break even chart.
- Mathematical breaks even analysis.

TOPIC 7: MARKET STRUCTURE

7.1 . Introduction

A market consists of a group of firms and individuals who interact with one another in order to buy or sell goods or service. Therefore, in this topic we will discuss four types of markets, namely perfect competition, monopoly, monopolistic competition and oligopoly

7.2 Objectives

At the end of the topic students should be able to: -

1. Discuss the four types of market structure.
2. Explain market price under the four market structures.
3. Describe the output decision of the four markets.

7.3 Subtopic

7.3.1 Perfect competition market

In this section we deal with:-

- Meaning of perfect competitive market
- Characteristics of competitive market
- Market price under perfect competition.
- The output decision of a perfectly competitive firm.
- Long run equilibrium of the firm.

7.3.2 Monopoly market

- What is monopoly
- Features of monopoly market
- Market price under monopoly market
- The output decision under monopoly.

7.3.3 Monopolistic competition

- Meaning and sources of monopolistic market
- Price and output decisions under monopolistic competition.

7.3.4 Oligopoly and strategic behaviour market

- Meaning and sources of oligopolies market.
- Oligopoly models.

TOPIC 8: PRICING TECHNIQUES

8.1 Introduction

In this section we examine some of the actual pricing practices followed by firms in the real world. The methods that will be discussed in this topic are given in section 10.3.2.

8.2 Objectives

At the end of the topic students should be able to:-

- 1 1. Explain the pricing goal.
- 2 2. Discuss various methods of pricing.

8.3 Subtopic

8.3.1 Pricing Goal

Individual firms have different pricing objectives. The pricing goal is determined by:-

- Objective of the firm or target
- Pricing policy of the firm

8.3.2 Methods used in Pricing.

There many methods used in pricing, however in this topic we shall discuss the following methods:-

Cost - plus pricing; Marketing pricing; Marginal cost pricing; Customary pricing; Incremental pricing; Price discrimination; transfer pricing; Incremental pricing; Prestige pricing; Public utility pricing.

9. Course assessment

This course will be assessed as follows: -

1	Two assignments	20%
2	Two Timed test	30%
3	Final examination	50%
		100%

A LIST OF RECOMMENDED READINGS

1. Bradley R. Schiller (1997). The Economy Today, Irwin McGraw- Hill, 7th edition, Chapt. 22, pp. 502- 551.
2. Robert Frank & Ben Bernanke (2001). Principles of Economics, McGraw Hill Irwin, International edition, Chapt. 9, pp.222- 243.
3. Stephen L. Slavia (1998). Economics, Irwin McGraw, 4th editions, Chapt. 23-27, pp. 515- 617.
4. Henderson M.H., and R.E. Quandt (1980 or more recent edition). Microeconomic Theory. A Mathematical Approach. 3rd edition. McGraw- hill. New York.

Mansfield Edwin, (1996) Managerial Economics: Theory, Applications and cases. W.W. Norton and company New York. 3rd edition,

5. Salvatore, D (1989). Managerial economics, McGraw Hill, 3rd edition.
6. Mulligan G. James, (1989) Managerial Economics. Allyn and bacon publishers. Massachusetts.
8. Any other textbook titled Managerial Economics or Business Economics may be useful.