

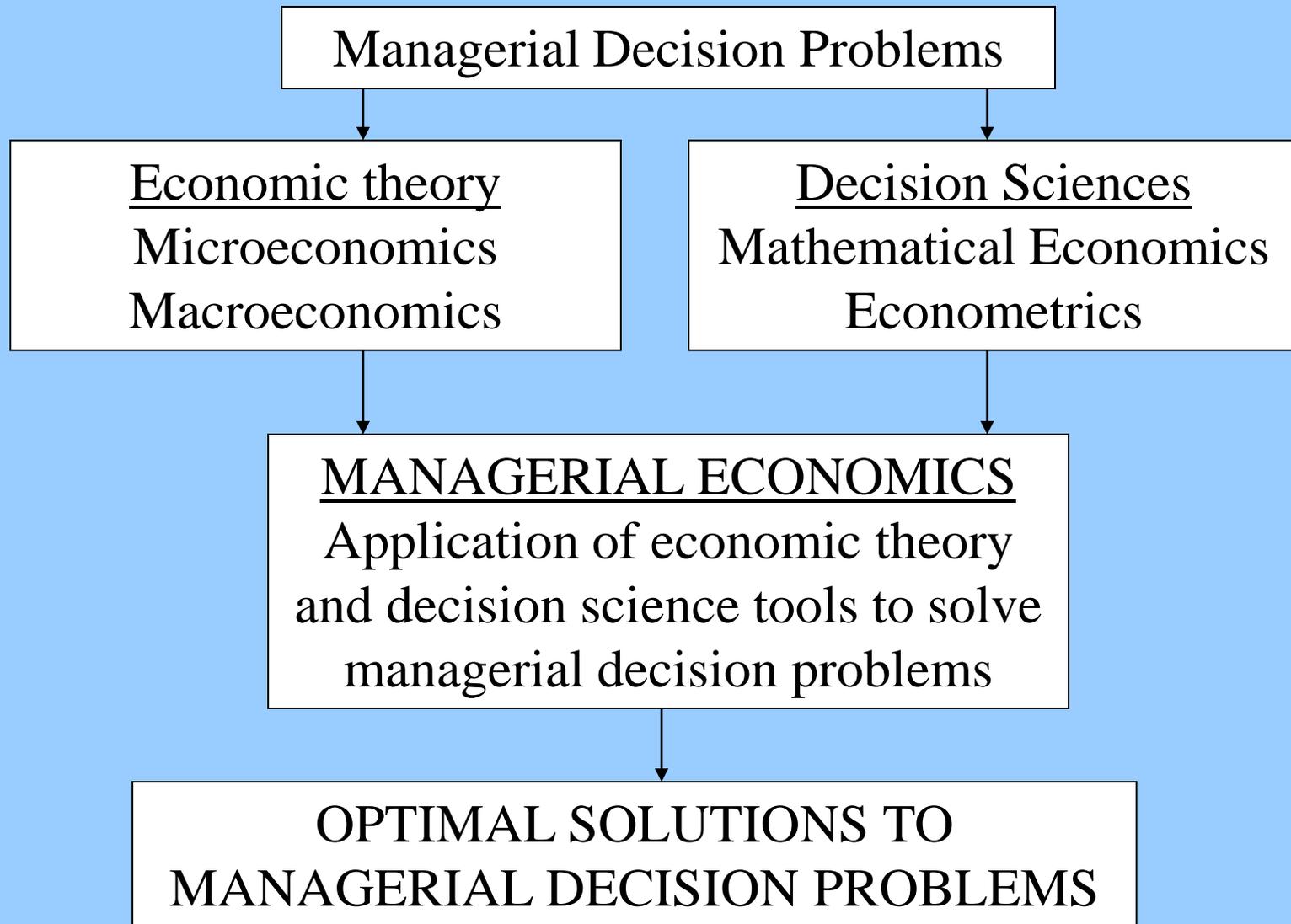
# Managerial Economics in a Global Economy, 5th Edition by Dominick Salvatore

## Chapter 1

### The Nature and Scope of Managerial Economics

# Managerial Economics Defined

- The application of economic theory and the tools of decision science to examine how an organization can achieve its aims or objectives most efficiently.



# Theory of the Firm

- Combines and organizes resources for the purpose of producing goods and/or services for sale.
- Internalizes transactions, reducing transactions costs.
- Primary goal is to maximize the wealth or value of the firm.

# Value of the Firm

The present value of all expected future profits

# Alternative Theories

- Sales maximization
  - Adequate rate of profit
- Management utility maximization
  - Principle-agent problem
- Satisficing behavior

# Definitions of Profit

- Business Profit: Total revenue minus the explicit or accounting costs of production.
- Economic Profit: Total revenue minus the explicit and implicit costs of production.
- Opportunity Cost: Implicit value of a resource in its best alternative use.

# Theories of Profit

- Risk-Bearing Theories of Profit
- Frictional Theory of Profit
- Monopoly Theory of Profit
- Innovation Theory of Profit
- Managerial Efficiency Theory of Profit

# Function of Profit

- Profit is a signal that guides the allocation of society's resources.
- High profits in an industry are a signal that buyers want more of what the industry produces.
- Low (or negative) profits in an industry are a signal that buyers want less of what the industry produces.

# Business Ethics

- Identifies types of behavior that businesses and their employees should not engage in.
- Source of guidance that goes beyond enforceable laws.

# The Changing Environment of Managerial Economics

- Globalization of Economic Activity
  - Goods and Services
  - Capital
  - Technology
  - Skilled Labor
- Technological Change
  - Telecommunications Advances
  - The Internet and the World Wide Web