

EDITED BY

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≡ The Oxford Handbook of
**MANAGERIAL
ECONOMICS**

THE OXFORD HANDBOOK OF

MANAGERIAL ECONOMICS

Edited by

CHRISTOPHER R. THOMAS

and

WILLIAM F. SHU



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THE OXFORD HANDBOOK OF
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PART I

NATURE, SCOPE,
AND FUTURE OF
MANAGERIAL
ECONOMICS

CHAPTER 1

MANAGERIAL ECONOMICS: INTRODUCTION AND OVERVIEW

CHRISTOPHER R. THOMAS
AND WILLIAM F. SHUGHART II

1.1 THE CONCEPT OF THIS HANDBOOK

THE *Oxford Handbook of Managerial Economics* assembles a set of timely and authoritative articles designed to inform scholars, MBA faculty, and professional business consultants about new theoretical and empirical developments in applied business decision making and strategy. The research frontier in managerial economics has moved well beyond applying ideas from microeconomics, capital budgeting, and linear programming to the world of business. Modern managerial economics now integrates concepts from the fields of competitive strategy, marketing, organizational economics, corporate control, and financial structure, among others, in order to explain and inform managers, scholars, and consultants on the issues and challenges of making both short-run operational decisions and long-run strategic plans. The timing and nature of the Oxford University Press handbook series could not be more appropriate in light of the current state of the field of managerial economics. The purpose of Oxford's handbook series, being produced under the general editorship of Michael Szenberg and Lall Ramrattan, is to serve as a forum for summarizing and disseminating the latest scholarly developments in various fields of study and to identify new directions for future research. To our knowledge, this will be the first such handbook in the area of managerial economics.

This *Handbook in Managerial Economics* differs substantially from the many college textbooks in managerial economics that are designed for teaching undergraduate and/or MBA courses in business schools. Each chapter is written by one or more academics who have done extensive scholarly research in their specialized areas of expertise.

These chapters are written for academics, Ph.D. graduate students, and business consultants who specialize in economics or other academic areas related to business decision making. Consequently, this *Handbook* is not expected to be useful as a *textbook*. In fact, an entire handbook might be warranted to address the pedagogical questions concerning the teaching of managerial economics. For at least the past decade, faculty and administrators at business schools in the United States have been debating whether business students should be required to take a course in managerial economics, and, if so, exactly which topics should/need to be covered in managerial economics courses for undergraduates and MBA students. As this *Handbook* is intended to advance research in managerial economics and serve as a guide for professional consultants, we will largely avoid pedagogical matters in this volume, although we expect that teachers of managerial economics will find much valuable material for classroom presentation and other types of coursework.

1.2 WHAT IS MANAGERIAL ECONOMICS (Now)?

Economists are far more likely to agree on what managerial economics *was* than on what managerial economics has now become. Ponsard and Tanguy (1999) refer to the 1960s as the “golden years” for managerial economics. During this period, economists applied neoclassical analysis of the firm to a “traditional” set of business decisions involving profit maximization, optimal pricing, production analysis, cost minimization, demand forecasting, and capital budgeting. Every kind of quantitative analysis of business decision making constituted a legitimate topic for managerial economists to study and teach. The tool kit for managerial economics seemed extensive at the time, as it included calculus (unconstrained and constrained optimization methods), decision sciences (operations research methods, including linear and dynamic programming and queuing theory models), and statistics (primarily simple and advanced regression analysis). During this golden age, the firm was treated as a black box that, when properly managed, transformed inputs efficiently into outputs, which were then sold for a profit at the optimally set uniform price. In the early days of managerial economics, there seemed to be little interest or motivation to look inside the neoclassical black box to see what might be going on that could be of any interest to business managers. At best, only production engineers could possibly find the internal workings of the black box worthy of inspection or study.

Beginning in the 1970s and reaching full stride by the early 1980s, economists opened the black box and ushered in the current age of the “new” or “modern” managerial economics. Most economists working in the area of managerial economics are likely to agree with Dnes and Rubin’s description in the next chapter of this *Handbook*, which characterizes the scope of modern managerial economics not so much as a discrete break with the past but rather as an *augmentation* of traditional managerial economics, focusing on areas such as “globalization, the economics of organization, information

economics, strategic behavior, the learning organization, risk management, business ethics, and behavioral economics.” The path of this transformation can be clearly traced by examining the topical coverage in several of the prominent academic journals that focus on economic analysis of business: *Managerial and Decision Economics*, the *Journal of Economic and Management Science*, and *Strategic Management Review*. The dynamic path of managerial economics over the past thirty years has most certainly been shaped by forces of demand and supply: the emerging contemporary issues facing managers during this period created a demand for extending the scope of analysis while the growth of modern industrial organization supplied a rich set of new ideas that promised to advance the economic analysis of business decision making. Modern managerial economics not only developed the new applications but also sped up the delivery of new analytical frameworks to undergraduate business and MBA classrooms. But economists working solely in the field of industrial organization were not the primary suppliers of business applications using game theory, information theory, and advances in organization and behavioral economics.

While a precise definition of (modern) managerial economics is slippery, we think most scholars and professionals whose work involves the application of economics to the formulation and execution of business decisions and strategies will agree that they are employing the tool kit of managerial economics. A look at the table of contents of this *Handbook* also helps define the current scope of managerial economics.¹ We will now describe the architecture of this volume by briefly summarizing the purpose and content of each one of the eight parts of the *Handbook*.

1.3 OVERVIEW OF THIS HANDBOOK

1.3.1 Nature, Scope, and Future of Managerial Economics

This first handbook in managerial economics opens with an essay by the editors of *Managerial and Decision Economics*, a leading scholarly journal in managerial economics. Antony Dnes and Paul H. Rubin offer their perspective on the present scope and future direction of managerial economics, a perspective forged from the vantage point of many years editing *MDE*. Dnes and Rubin see the “new” managerial economics moving away from the traditional focus on demand and revenue optimization techniques to take up problems associated with the development of “modern” industrial organization: asymmetric information, agency problems, organizational matters, and strategic interactions with rivals. Dnes and Rubin discuss the trends they see in managerial and decision economics, including the complexities introduced by incorporating business ethics, globalization, and new insights from behavioral economics. In their conclusion, Dnes and Rubin identify areas they see as most likely to be fruitful directions for research, suggestions which hold great value coming from the editors of *MDE*.