Readings in Managerial Economics

Coyne

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Managerial Economics

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Third Edition

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Preface

An anthology is intended to improve student access to journal articles while allowing authors an outlet for somewhat wider dissemination of their views. Hopefully, this publication does not differ in that respect. This Third Edition retains those articles which reportedly appeal to economics scholars; in addition, it contains research of interest to skills-oriented students who must learn when, how, and why certain tools and techniques of the economist are applicable.

A few articles in the first two versions of this publication were too complicated for some students; a few articles were too easy. An attempt is made here to alter this condition. Professors wanting to maximize application of economic theory may welcome this slight change of emphasis.

The writings of the classical and socialistic economic theorists, which have contributed significantly to the literature, were not found in the first two versions and are *not* found in this third edition. Likewise, the unmistakable brilliance of the many economists who concerned themselves with the study and explanation of how an economy works and whether certain desirable goals such as full employment and price stability could be achieved are unnecessary in this kind of book. For the most part, those writers did not address themselves specifically to the price and output decisions that must be made daily by corporate executives, many of the tools for which *are* explained in this publication.

The purpose of this edition is to demonstrate that economic theory need not be confined to some ivory tower. Its objective is to supplement the reader's understanding of economic theory with enough knowledge of procedural technique(s) so that he or she will become a more effective decision maker, a more useful member of the management team.

Every economy, whether it be capitalistic, socialistic, or communistic, has little choice but to rely upon the subject matter of economics for meaningful decisions. Business executives as well as politicians will continue to lean heavily tomorrow on the "academic scribblers" of yesterday and today. In some small way, this publication should help them make significantly better decisions.

The price and output behavior of a firm operating in a mixed capitalistic system such as we have within the confines of the United States is, *for the most part, the subject matter of this book. It has to do with* economic methodology; demand; costs; production and productivity; pricing; capital budgeting; and economic forecasting. It is an exciting undertaking and one that will prove beneficial to students who pursue it seriously.

The astute student will find that *Readings in Managerial Economics* investigates the place a firm holds within an industry, the contribution it makes to society, and the impact it has upon international affairs.

As a separate subject, *managerial* economics is relatively new, its first serious treatment in textbook format being provided by Joel Dean in 1951. It applies concepts learned in the more traditional courses in microeconomic and/or macroeconomic theory—applies them in a manner useful in the daily operations of the firm. And why not? The last thing most organizations may need is an economist steeped in economic theory but unable to communicate with other executives employed by the firm. This readings book helps to put economic theory and practice in proper perspective.

One hesitates to guess at the number of articles that were reviewed in the selection process for this edition. Suffice it to say that many were called but few were chosen. And the probability is high that some mistakes were made. Naturally, I assume full responsibility for these errors, judgmental or otherwise.

Suggestions received from several colleagues almost caused adoption of a more uniform level of abstraction throughout the volume. The temptation was overcome; consequently, the user has abstract articles that develop important principles mixed with elementary ones that illustrate those principles clearly.

Constraints common to the practice continue with this third edition; namely, space, coverage, and balance. A self-imposed limitation of not reprinting materials from books is retained.

Whenever possible, footnotes are removed and, at times, textual material that does not contribute significantly to the overall aims of the book is omitted. To the greatest possible extent, editorial changes are minimal.

A matrix of cross-references between several leading textbooks and specific articles in this publication is provided for the user. In addition, these chapters are cross-referenced with specific articles in the Table of Contents.

Very sincere thanks is expressed to the authors and publishers who provided permission to reprint these articles.

I have benefited from helpful comments received from a number of students and colleagues. In particular, I would like to acknowledge the help of Ann N. P. Fisher, SUNY College at Fredonia; Oscar Jensen,

University of Connecticut at Storrs; Franklin E. Robeson, College of William and Mary; and Vishal C. Sabherwal, University of San Francisco. My research assistant at the The University of Akron, Glenn D. Weber, made more than his fair share of trips to the library.

I am particularly grateful to the students for feedback and suggestions concerning many of the articles considered but not used. Because of them, this publication should contribute to a better understanding of applied price theory; however, if this Third Edition does not accomplish everything for the student that I hope it will, I can be comforted by the fact that he who achieves everything he sets out to achieve probably doesn't set out to achieve enough in the first place.

THOMAS JOSEPH COYNE

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Recommended for use with:
Douglas—Chapter 2
Henry—Chapter 1
McGuigan and Moyer—Chapter 1
Pappas and Brigham—Chapter 1
Seo and Winger—Chapter 1
Stokes—Chapter 1
Webb—Chapter 1

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* Textbooks referenced include:

Douglas, Evan J. *Managerial Economics*. Englewood Cliffs, N.J.: Prentice-Hall, 1979.

Henry, William R., and Haynes, W. Warren. *Managerial Economics: Analysis and Cases*, 4th ed. Dallas, Texas: Business Publications, 1978.

McGuigan, James R., and Moyer, R. Charles. *Managerial Economics*, 2d ed. St. Paul, Minn.: West Publishing Co., 1979.

Pappas, James L., and Brigham, Eugene F. *Managerial Economics*, 3d ed. Hinsdale, Ill.: The Dryden Press, 1979.

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Stokes, Charles J. *Economics for Managers*. New York: McGraw-Hill, 1979.

Webb, Samuel C. *Managerial Economics*. Boston: Houghton Mifflin, 1976.

Wilson, J. Holton, and Darr, Steven H. *Managerial Economics: Concepts, Applications and Cases*. New York: Harper & Row, 1979.

Zudak, Lawrence S. *Managerial Economics*. New York: Harper & Row, 1980.

PART THREE

Costs, Production, and Productivity

PART SIX

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part ONE

The Scope and Method of Managerial Economics

INTRODUCTION

Managerial economics is economics applied to managerial decision making. It is a branch of economics bringing abstract theory into closer harmony with managerial practice. Its stress is on the use of the tools of economic analysis in clarifying problems, in organizing and evaluating information, and in comparing alternative courses of action. Its methods and point of view are applicable to business institutions, hospitals, government(s), universities, nonprofit foundations, and so forth, which allocate resources.

Economics is defined sometimes as the study of the allocation of scarce resources among unlimited wants. It follows that managerial economics is the study of the allocation of resources available to a firm or other decision-making institution. Thus, like all economics, managerial economics is concerned with choice; but, among the various branches of economics, it is supremely pragmatic. It cuts through many of the refinements of theory. While it seems to avoid some of the most difficult issues of abstract economic theory, it inevitably faces complications that are ignored in pure theory, for it must deal with the total situation in which decisions are made.

Managerial economics is therefore manifestly different from microeconomic theory, but it is somehow related. Just what this relation is has been a lively topic of debate. The extreme positions are, on the one hand, a naïve belief that the most abstract economic theories are applicable to the most complex of managerial problems; on the other, an equally repugnant belief that no part of economic theory is applicable to even the simplest of them. From a large and admirable literature covering the question from one extreme to the other, one article (Baumol's) has been selected to express some of the more tenable views. Another research piece (Simon's) warns the reader against believing economic theories and "laws" can stand alone.

The well-known paper by William Baumol establishes a point of view for managerial economics; namely, that a managerial economist can make significant contributions as a member of the management group simply because he or she is an effective model builder. The economist's analytic tools and techniques help that person deal with problems facing an organization in a very rigorous and revealing manner. Managerial economists tend to probe deeper into complex problems than do persons without such training and these problems, once solved, are often presented in a simplified manner for all to see.

Herbert Simon wants the managerial economist to look beyond the concepts found in economics. He argues for recognition of the numerous instances where applied price theory overlaps the areas of psychology and sociology. He wants one to realize the consumer as well as the entrepreneur is a compassionate person who hopes to gain and maintain a variety of objectives—only one of which might be profit.

How closely one chooses to weave other disciplines into economics depends primarily upon the range of questions being answered and the confidence placed by the economist in assumptions dealing with such things as static equilibrium.

Assumptions made by economists dealing with the behavior of consumers and entrepreneurs leans heavily upon psychology; assumptions concerning their lifestyle, number of persons in the family, education, and ethnic background are rooted in sociology. Surveys of consumer and managerial behavior often rely upon theories of statistical induction, stochastic learning, and concept formation. The manager of scarce and costly resources, namely, the managerial economist, should consider these variables; otherwise, he or she may be overlooking a significant and very helpful managerial tool.