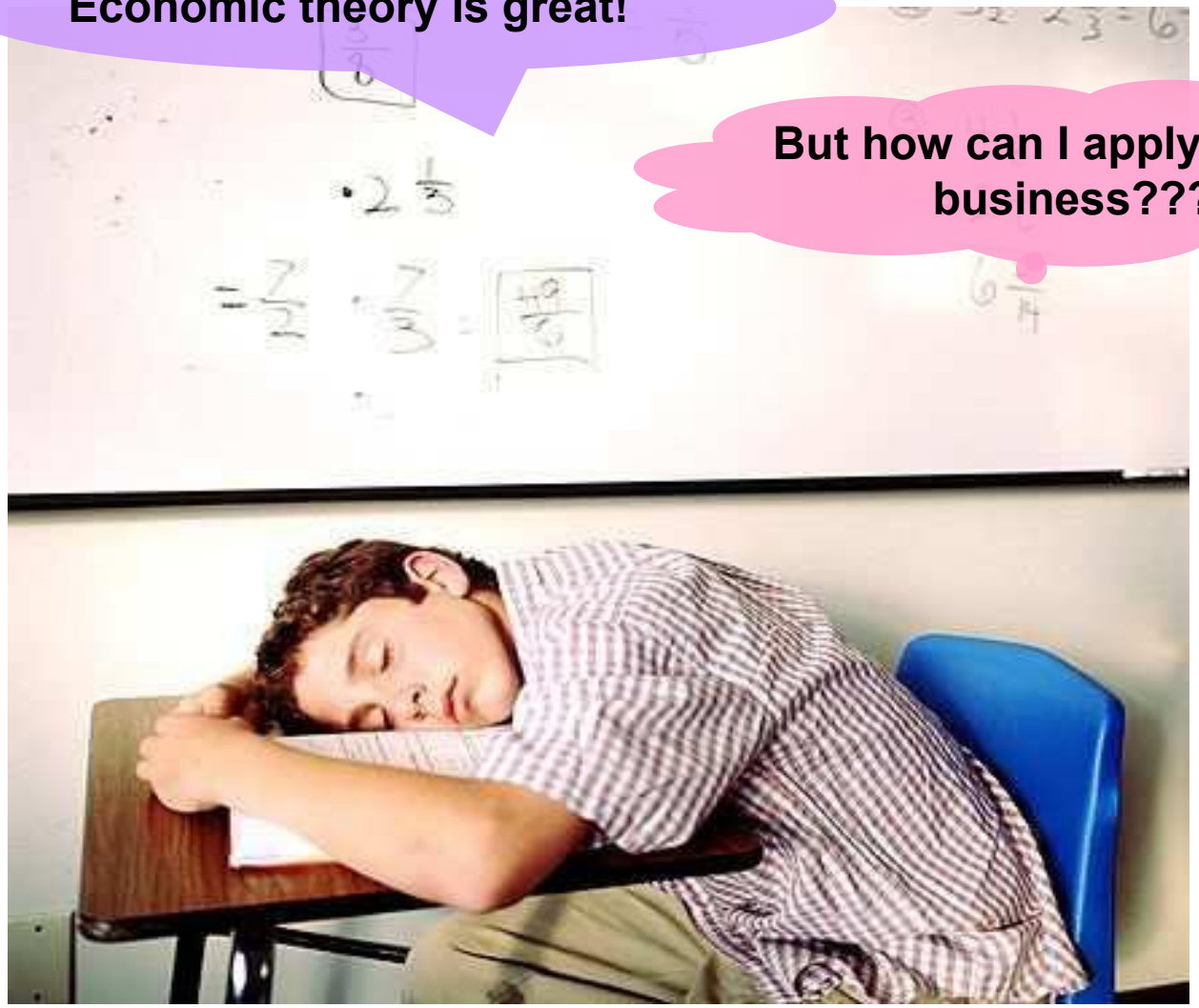
# Managerial economics

Economic theory is great!

But how can I apply it in my business???



**Let’s try to bridge the gap between theory and practice !**

Managerial Economics is the application of economic theory to managerial decision making within various organizational settings such as a firm or a government agency

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Demand analysis and estimation, production and cost analysis, forecasting and decision making under uncertainty

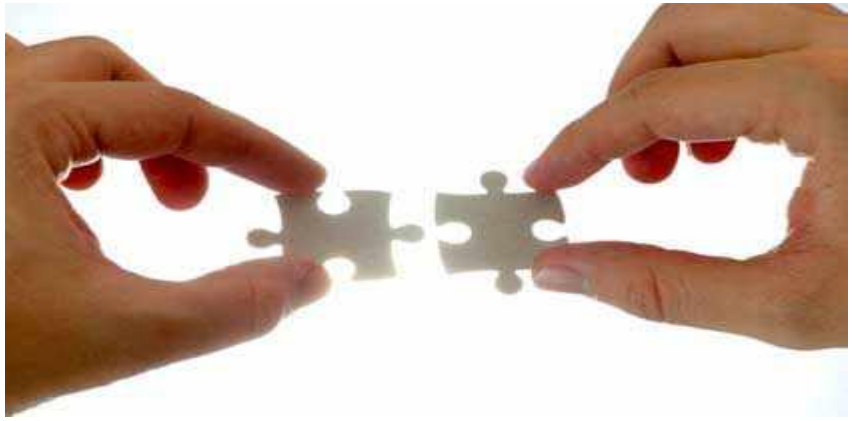

the firm

**The role of firm in society;**

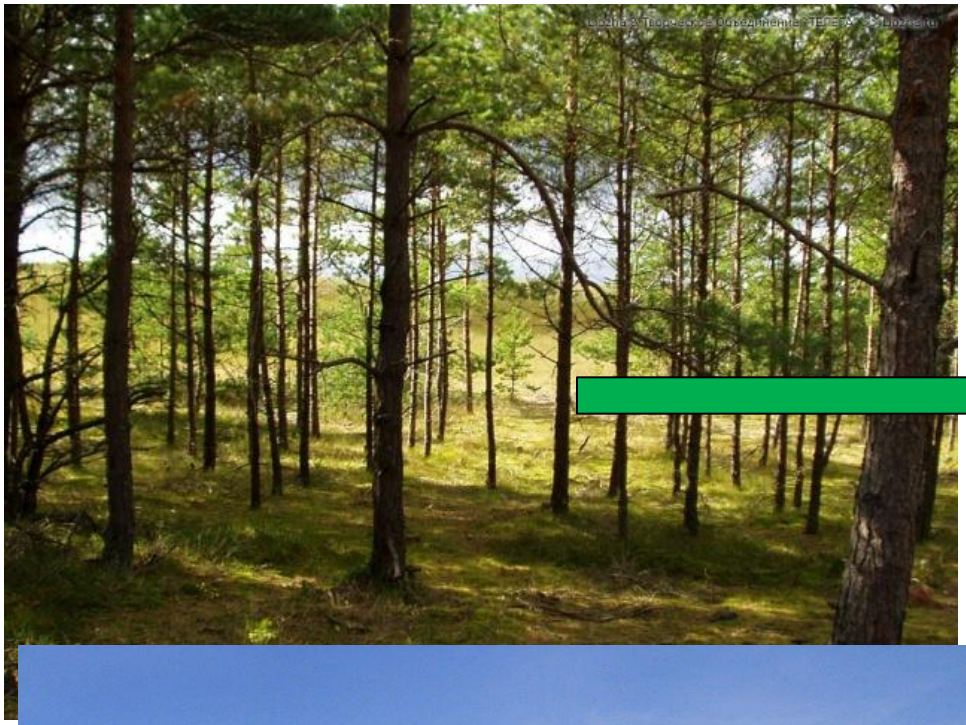
**goals, objectives**

**Explanation of market strategy**

**Comprehension of managerial decisions**



# The role of the firm in society

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Primary resources

The firm

Useful goods or services

Labour

Capital

Society

**Efficiently satisfied needs**

# Profit

=

# Engine for economic system

## Firm's aspiration for profit secure:

**Production of demanded goods and services**

**Employment**

**Tax collection**


**Efficient allocation of scarce resources**

# Paterns of firm's behavior

***? Aims, objectives?***

# Profit maximization model

**The main goal: maximization of benefits in relation to costs**

**Commercial maximization: profit maximization**

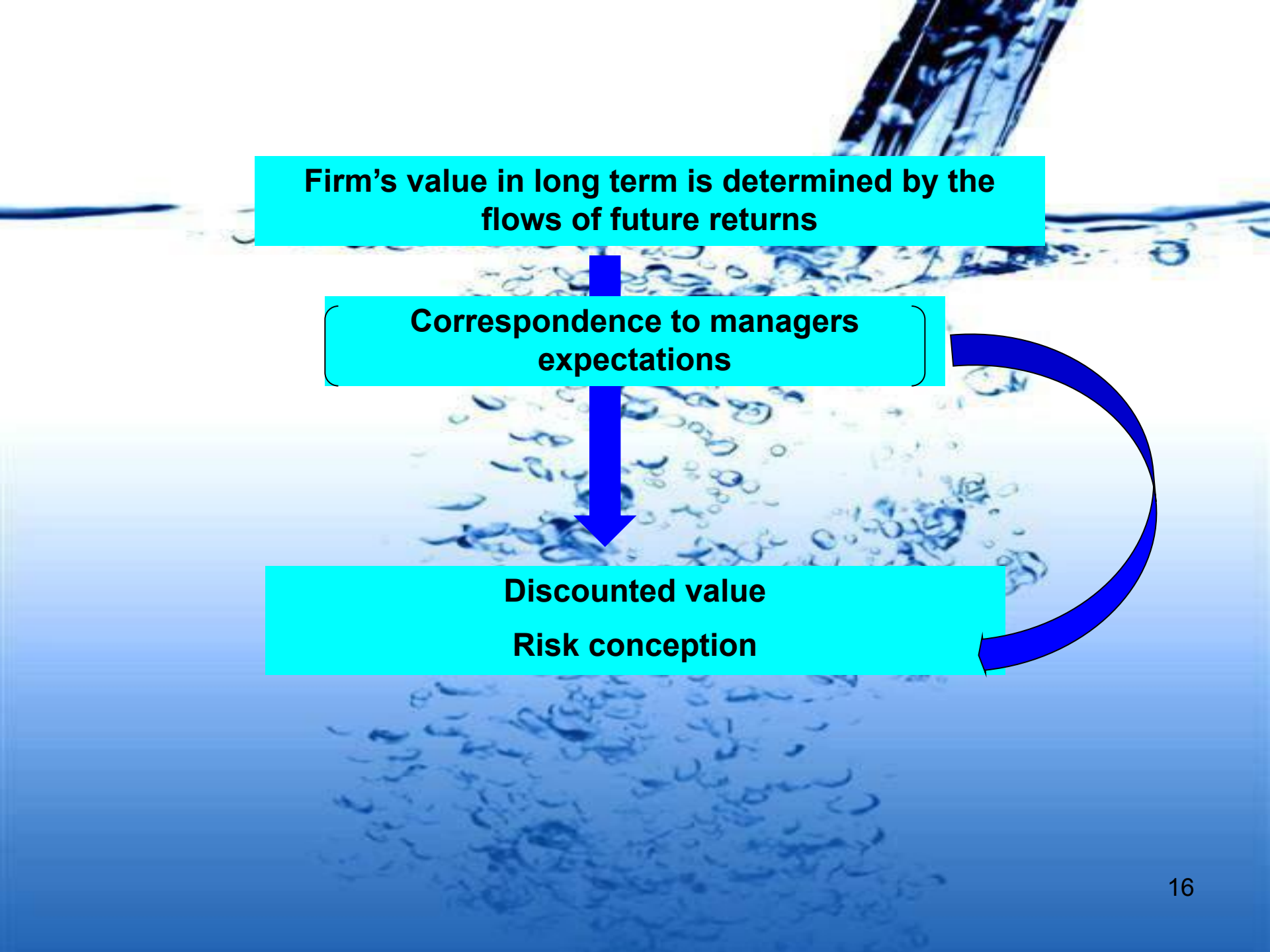
**Profit maximization in short term**

**Firm's value maximization in the long term**

*Cost approach*

*Market approach*

*Income approach*


Firm’s value in long term is determined by the flows of future returns
Correspondence to managers expectations
Discounted value
Risk conception

## Discounted value conception

**Basis: compound interest**

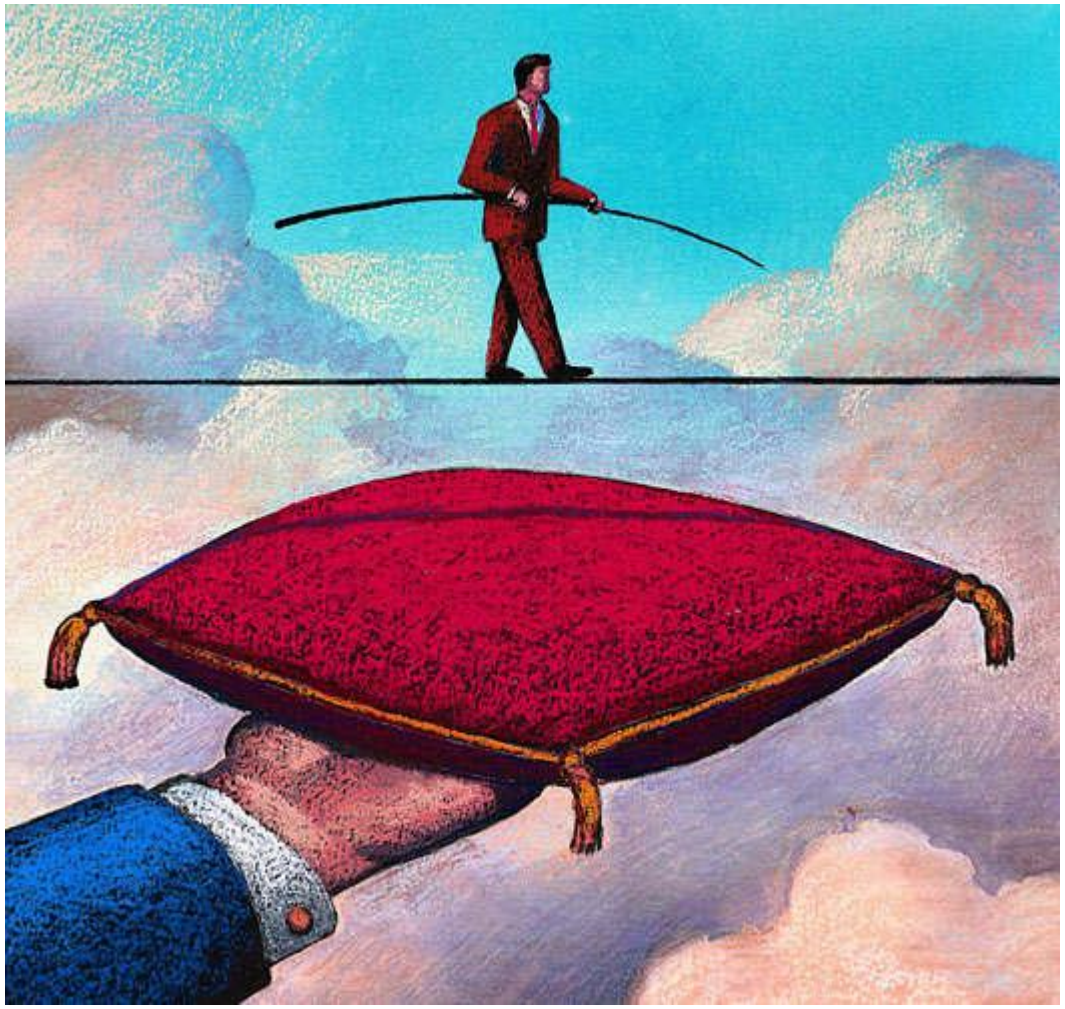
**Discounting – the reversal of compounding interest.**

**Present value of the future profits:**

$$PV = \pi/(1+i)^n$$

***Discount rate - i – free of risk***

**Reliable future profits => discount rate without risk**



**Future profit is not reliable**


**Risk discount rate**

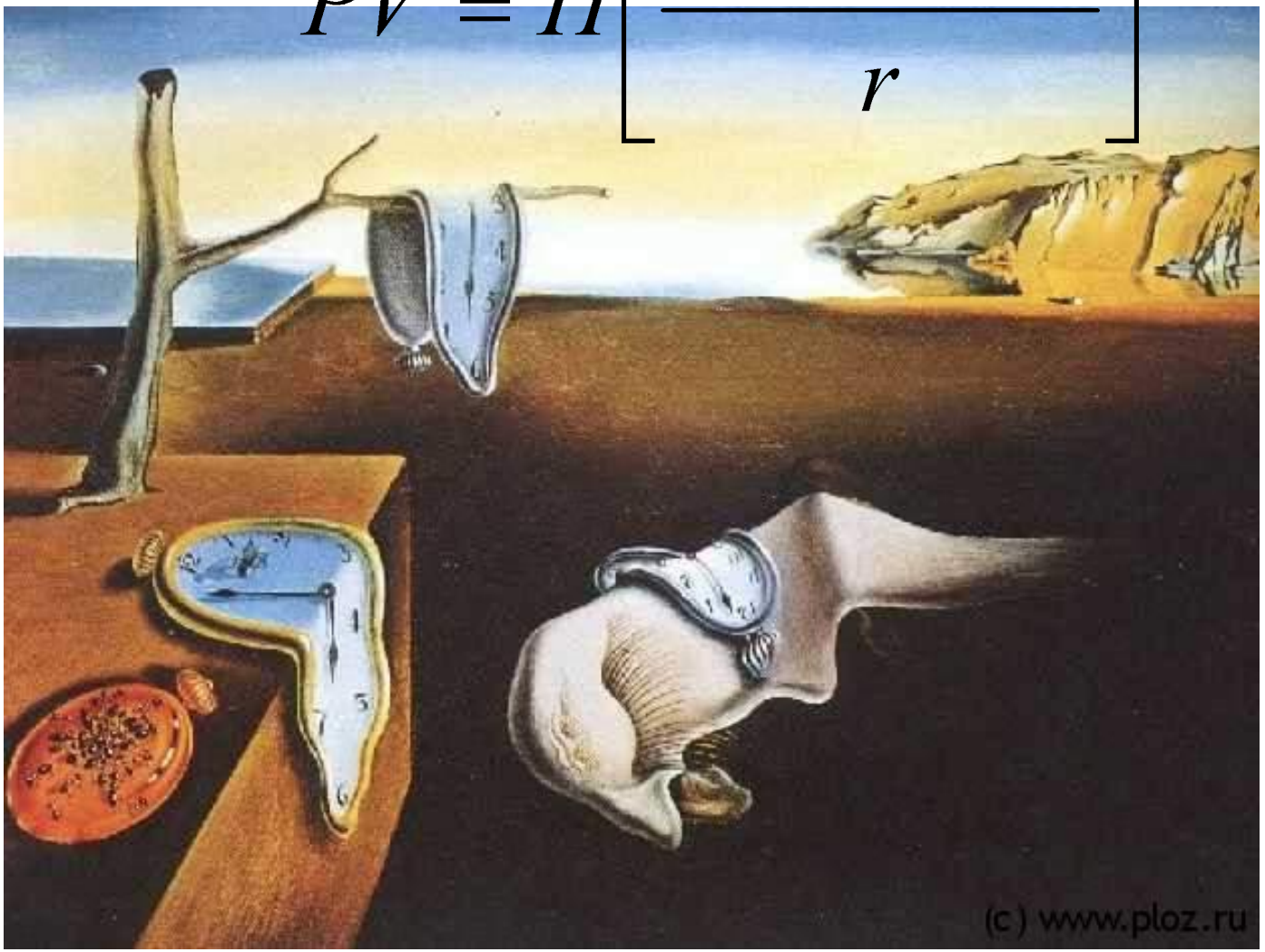
**r = i + risk premium**

**r - capitalization rate**

**Future profit flow is changing by years:**

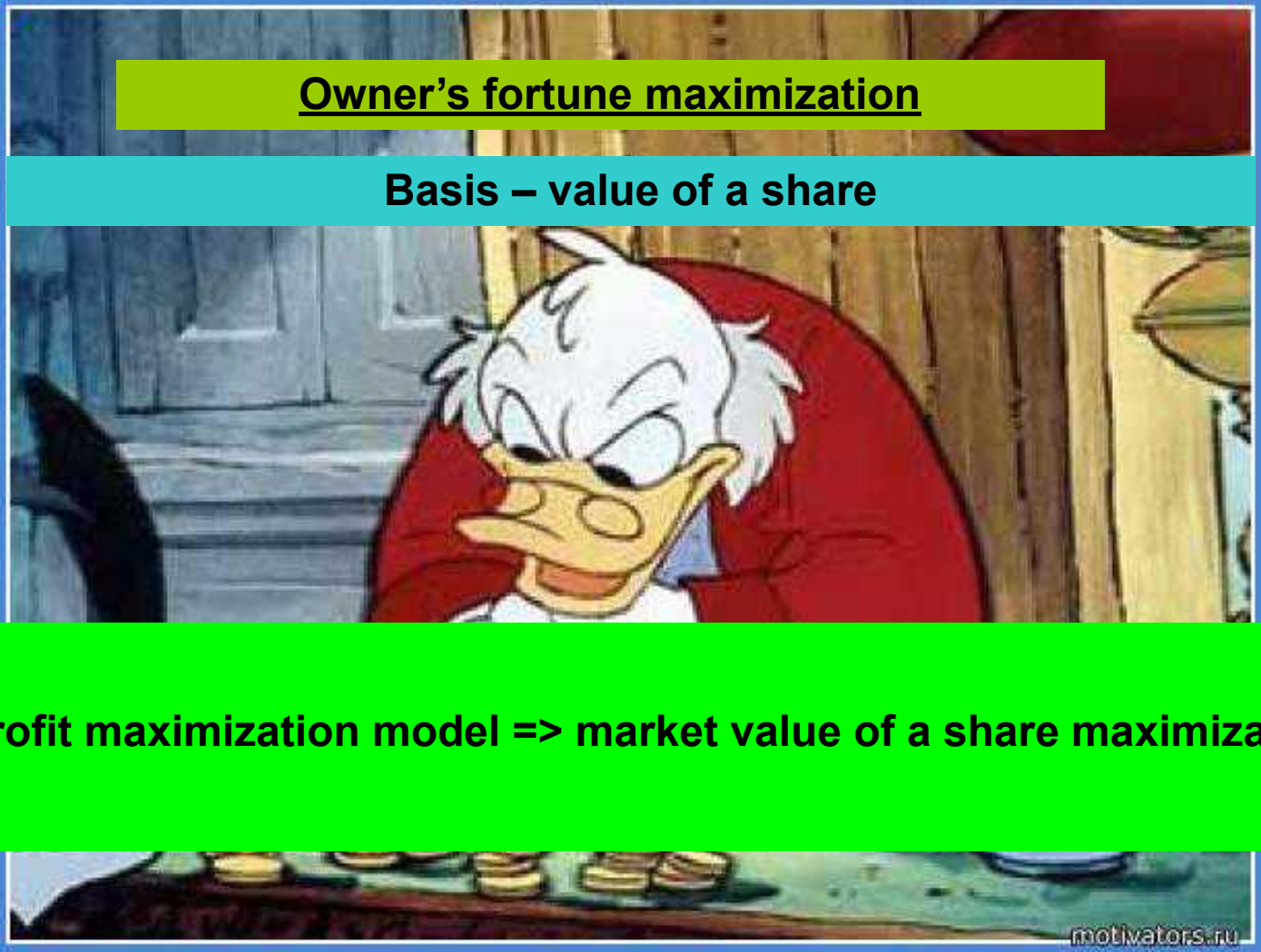
$$PV = \frac{\Pi_1}{(1+r)} + \frac{\Pi_2}{(1+r)^2} + \frac{\Pi_3}{(1+r)^3} + .... + \frac{\Pi_n}{(1+r)^n}$$

$$PV = \Pi\left[\frac{1-(1+r)^{-n}}{r}\right]$$



## Owner's fortune maximization

**Basis – value of a share**

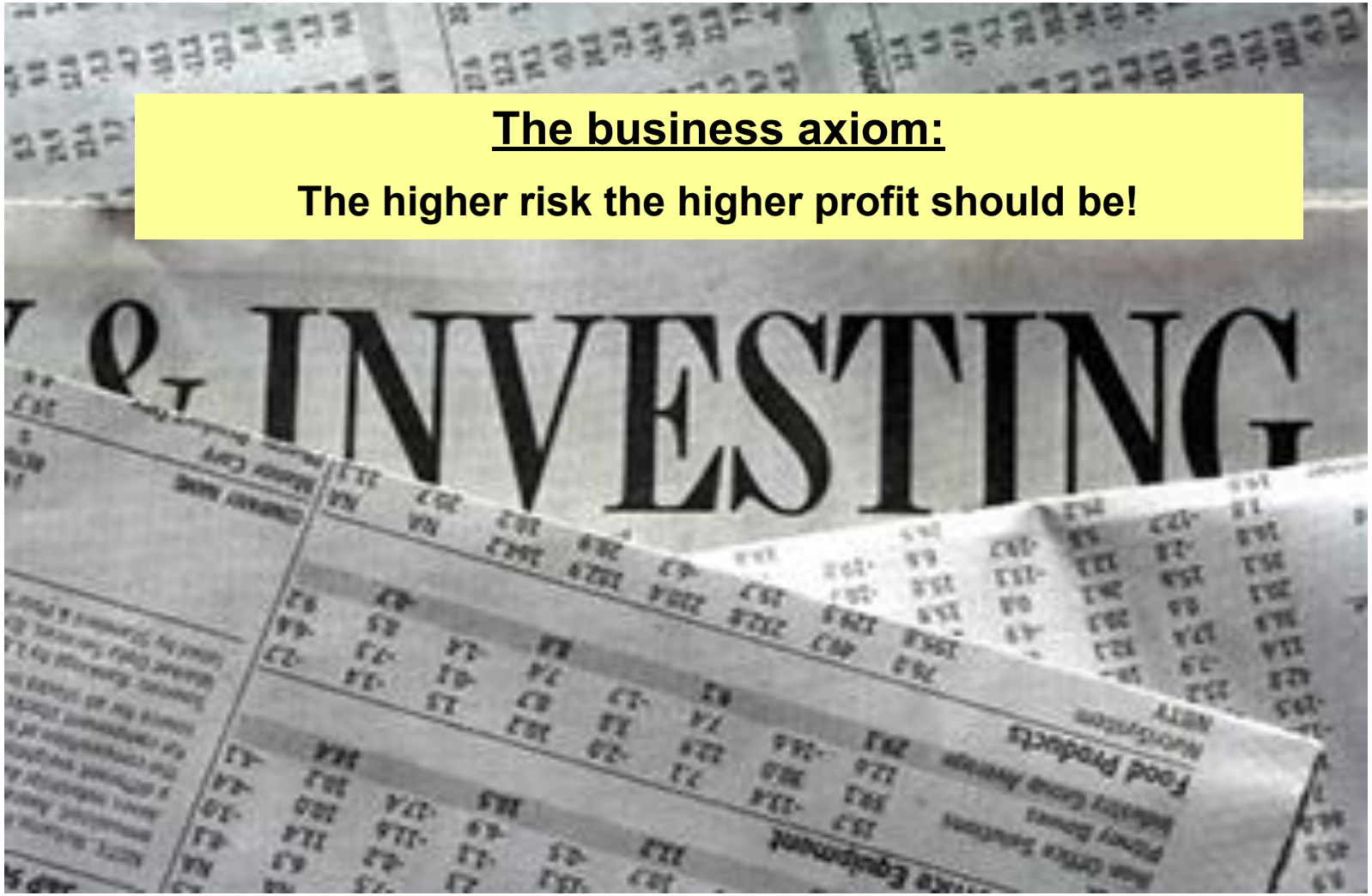



**The profit maximization model => market value of a share maximization**

**Fundamental approach to market value of a share evaluation:**

$$V = \frac{E}{r}$$

**Capitalized value of a firm per share**


The business axiom:
The higher risk the higher profit should be!
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## Disadvantages of the profit maximization model

**How can we forecast the amount and time distribution of future returns ?**

**Difficult tusk!**