Managerial Economics

As per LU datesheet

B.B.A.LL.B. Sem I · BL-102 · Economics applied to business decisions. Write: definition (Spencer & Siegelman, Joel Dean) → concept → **labelled diagram** → business example (Indian firms) → criticism. Numericals on elasticity, profit and national income are short and scoring.

UNIT I – Introduction

- ★ Nature & scope
- ★ 5 principles
- · Accounting vs economic profit
- ★ Profit max vs sales, growth, satisficing

UNIT II – Demand, Production, Cost

- ★ Law, determinants, exceptions
- ★ Elasticities
- ★ Variable proportions, returns to scale
- ★ Costs, learning curve



UNIT III – Markets

- ★ Perfect competition
- ★ Monopoly, price discrimination
- · Monopolistic comp.
- ★ Oligopoly: kinked, prisoner's dilemma, cartel

UNIT IV – Macro

- ★ GDP, GNP, NNP, NI
- ★ Inflation, deflation
- ★ Monetary & fiscal policy
- · Profit theories

Exam date: As per LU datesheet	**Time:** As per LU datesheet	**Duration:** 3 hours	**Paper:** BL-102

Exam-hall strategy: Read the whole paper first → start with the question you know best → draw neat, labelled diagrams → box every final answer and formula → keep the last 5 minutes for checking.

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Most Important Repeated Questions

From the LUUPDATE B.B.A.LL.B. (Integrated) 5-Year Sem I Important Topics 2026 list — based on the new 2026-27 syllabus (Schedule III) and previous LU papers. ★★★ = must study, ★★ = high chance, ★ = if time permits. ESE: 10 questions, attempt any 5, 15 marks each, MM 75 (+ 25 internal = 100), 3 hours.

#	Tag	Question / Topic	Asked in
1	★★★	Nature and scope of Managerial Economics; its relation with economics and decision-making	Unit I Must study
2	★★★	Opportunity cost, incremental, equi-marginal, time perspective and discounting principles	Unit I Must study
3	★★	Accounting profit vs Economic profit	Unit I High chance
4	★★★	Profit maximisation and alternative objectives (sales, growth, satisficing)	Unit I Must study
5	★★★	Law of demand, determinants of demand and exceptions	Unit II Must study
6	★★★	Price, income and cross elasticity of demand – measurement and importance	Unit II Must study
7	★★★	Production function; law of variable proportions; returns to scale	Unit II Must study
8	★★	Economies and diseconomies of scale	Unit II High chance
9	★★★	Cost concepts; short-run and long-run cost curves; learning curve	Unit II Must study
10	★★★	Price-output determination under perfect competition	Unit III Must study
11	★★★	Monopoly equilibrium and price discrimination	Unit III Must study
12	★★	Monopolistic competition – product differentiation, selling costs	Unit III High chance
13	★★★	Oligopoly, kinked demand curve, prisoner's dilemma, cartels and cartel cheating	Unit III Must study
14	★	Price and non-price competition; market concentration	Unit III If time permits
15	★★★	National income concepts – GDP, GNP, NNP, NI; methods of measurement	Unit IV Must study
16	★★★	Inflation and deflation – types, causes, effects and control	Unit IV Must study
17	★★★	Monetary policy and fiscal policy – instruments and objectives	Unit IV Must study
18	★★	Profit theories – risk, uncertainty, innovation, rent theories	Unit IV High chance

Also revise: Baumol's sales maximisation, Marris growth model, Cobb–Douglas function, isoquant–isocost equilibrium, LAC envelope curve, Herfindahl index, Nash equilibrium, Phillips curve, stagflation, fiscal deficit.

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Flowcharts & Diagrams — See It at a Glance

→ FLOWCHART: Measuring Elasticity

Percentage method: %ΔQ ÷ %ΔP → Total outlay method (Marshall) →

Point method: lower ÷ upper segment → Arc method: average of two points → Interpret: >1, =1, <1, 0, ∞

→ FLOWCHART: Law of Variable Proportions

Fix one factor, vary another → Stage I: increasing returns (AP rising) →

Stage II: diminishing returns (rational stage) → MP falls, AP falls, TP rises →

Stage III: negative returns (MP < 0) → Firm operates in Stage II

→ FLOWCHART: Cost Concepts

TC = TFC + TVC → AFC = TFC ÷ Q → AVC = TVC ÷ Q → AC = TC ÷ Q = AFC + AVC →

MC = TCn − TCn−1 → MC cuts AC and AVC at their minimum

→ FLOWCHART: Firm's Equilibrium (any market)

Find MR and MC → MR = MC → MC cuts MR from below → Price from AR curve →

Compare AR with AC → profit / loss

→ FLOWCHART: National Income Aggregates

GDP at MP = C + I + G + (X − M) → GNP = GDP + net factor income from abroad →

NNP = GNP − depreciation → NI = NNP at FC = NNP at MP − indirect taxes + subsidies →

PI → DPI (after direct taxes)

→ FLOWCHART: Monetary Policy Transmission

RBI changes repo rate / CRR / OMO → Bank lending rates change → Credit and money supply change →

Spending & investment change → Output and inflation respond

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UNIT I – Nature, Principles & Objectives

Managerial Economics: Nature & Scope ★★★

"The integration of economic theory with business practice for the purpose of facilitating decision-making and forward planning by management" (**Spencer & Siegelman**). Joel Dean — use of economic analysis in formulating business policies.

- **Nature:** micro-economic in character (the firm), uses macro environment, normative and prescriptive, pragmatic, applies theory of the firm, uses tools of statistics, OR and accounting, decision-oriented
- **Scope:** demand analysis and forecasting, production and cost analysis, pricing decisions and market structures, profit management, capital budgeting, risk and uncertainty, business environment (national income, inflation, monetary and fiscal policy)
- **Relation with economics:** economics is theoretical/positive; ME applies it to firm-specific problems; uses micro (firm) and macro (environment). **Decision-making:** define problem → objectives → alternatives → analyse (economic tools) → choose → implement → review

Five Fundamental Principles ★★★

- **Opportunity cost:** cost of a decision = value of next best alternative forgone (using own building = rent forgone)
- **Incremental principle:** a decision is profitable if incremental revenue > incremental cost (accept an extra order if it adds more revenue than cost)
- **Equi-marginal principle:** allocate a resource so that its marginal return (value) is equal in all uses — $MRP_A/P = MRP_B/P$
- **Time perspective:** consider short-run and long-run effects (price cut may raise short-run sales but invite retaliation)
- **Discounting principle:** a rupee tomorrow is worth less than a rupee today — $PV = FV \div (1 + r)^n$

Accounting vs Economic Profit; Profit Maximisation & Alternative Objectives ★★★

- **Accounting profit** = Total revenue − explicit (paid-out) costs. **Economic profit** = Total revenue − (explicit + implicit costs, i.e., opportunity costs of owner's capital, time, land). **Normal profit** — minimum to keep the entrepreneur in business (part of cost); economic (supernormal) profit — above it
- **Profit maximisation** (neo-classical): produce where MR = MC and MC rising. Justification — survival, growth, efficiency measure, rational behaviour. Criticism — firms lack precise MR/MC data, multiple stakeholders, separation of ownership and control, social responsibility, uncertainty
- **Alternative objectives: sales/revenue maximisation** (W. J. Baumol — subject to a minimum profit constraint; managers' prestige linked with sales); **growth maximisation** (Robin Marris — balanced growth of demand and capital); **managerial utility** (O. Williamson — staff, perks, discretionary investment); **satisficing** (Herbert Simon, Cyert & March — "satisfactory" profit, bounded rationality, coalition goals); value/wealth maximisation (shareholders), survival, market share, CSR/ESG

UNIT II – Demand, Production & Cost

Law of Demand ★★

Other things being equal, quantity demanded rises when price falls and falls when price rises (inverse relation).

- **Reasons:** law of diminishing marginal utility, income effect, substitution effect, new buyers, multiple uses
- **Assumptions:** income, tastes, prices of related goods unchanged
- **Exceptions:** Giffen goods (inferior staples), Veblen / prestige goods (diamonds), expectation of further price rise, ignorance (price = quality), necessities, emergencies

Price Elasticity of Demand ★★★

Degree of responsiveness of quantity demanded to a change in price.

Ed = % change in quantity demanded ÷ % change in price

Arc: Ed = [ΔQ ÷ (Q1 + Q2)] ÷ [ΔP ÷ (P1 + P2)]

Point: Ed = Lower segment ÷ Upper segment

- **Types:** perfectly elastic (∞), perfectly inelastic (0), unitary (1), relatively elastic (>1), relatively inelastic (<1)
- **Total outlay method:** price falls and total expenditure rises → Ed > 1; unchanged → Ed = 1; falls → Ed < 1
- **Factors:** nature of good (necessity/luxury), substitutes, share of income, number of uses, time period, habits, postponement possibility
- **Importance:** pricing, taxation, international trade, wage fixation

Income & Cross Elasticity; Supply ★★

- **Income elasticity** = %ΔQ ÷ %ΔY: positive for normal goods (>1 luxuries, <1 necessities), negative for inferior goods
- **Cross elasticity** = %ΔQx ÷ %ΔPy: positive for substitutes (tea–coffee), negative for complements (car–petrol), zero for unrelated
- **Law of supply:** other things equal, quantity supplied rises with price. **Movement** along supply curve (extension/contraction) — due to own price; **shift** (increase/decrease) — due to cost, technology, taxes, subsidies, weather

Law of Variable Proportions ★★★

Short-run law: when more units of a variable factor are applied to fixed factors, TP first increases at an increasing rate, then at a diminishing rate, and finally falls.

Stage	TP	MP	AP
I: Increasing returns	Rises fast	Rises then falls	Rises (to max)
II: Diminishing returns	Rises slowly (to max)	Falls to zero	Falls
III: Negative returns	Falls	Negative	Falls

A rational producer operates in Stage II. Causes: indivisibility of factors, imperfect substitutability, specialisation.

Returns to Scale & Isoquants ★★

Returns to scale (long run; all factors increased in the same proportion): increasing (output rises more than proportionately), constant (same proportion), decreasing (less than proportionately).

Isoquant: combinations of two inputs (L, K) giving the same output. Properties: downward sloping, convex (diminishing MRTS), never intersect, higher = more output.

Producer equilibrium: isoquant tangent to isocost line: **MRTS(L,K) = w/r** (least-cost combination).

Economies & Diseconomies of Scale ★★

- **Internal economies** (within the firm): technical (bigger machines), managerial (specialisation), marketing (bulk buying), financial (cheaper loans), risk-bearing (diversification)
- **External economies** (industry-wide): localisation, infrastructure, ancillary industries, information
- **Diseconomies:** management problems, coordination failure, labour unrest, rising input prices, pollution and congestion
- Explains the U-shape of the long-run average cost curve (envelope curve)

Cost Concepts ★★★

TC = TFC + TVC · AFC = TFC/Q · AVC = TVC/Q

AC = TC/Q = AFC + AVC · MC = TCn − TCn−1

- AFC keeps falling (rectangular hyperbola)
- AVC, AC and MC are U-shaped (law of variable proportions)
- MC cuts AVC and AC at their minimum points
- Long-run AC: envelope curve (economies and diseconomies of scale)
- **Other costs:** opportunity, explicit, implicit, sunk, private & social cost

Determinants of Demand & Exceptions; Learning Curve ★★★

- **Determinants:** own price, income, prices of related goods (substitutes, complements), tastes and preferences, expectations, population and its composition, advertisement, credit availability, government policy (taxes, subsidies), season/weather. $D_x = f(P_x, Y, P_r, T, E, N...)$
- **Exceptions to law of demand:** Giffen goods (inferior staple), Veblen/prestige goods, expectation of further price rise (speculation), ignorance (price–quality illusion), necessities, emergencies, change in fashion
- **Learning (experience) curve:** average labour time/cost per unit falls as cumulative output doubles because workers and managers learn (Wright, 1936 — aircraft). An 80% curve: each doubling of cumulative output cuts unit time to 80%. Uses — pricing, bidding, cost estimation, capacity planning (aircraft, semiconductors, solar panels)
- **Short-run vs long-run costs:** SR — some factors fixed (TFC, TVC, AFC, AVC, SMC; U-shaped ATC due to diminishing returns). LR — all variable; **LAC is an envelope** of SACs, flatter U due to economies/diseconomies of scale; LMC cuts LAC at its minimum (optimum plant)

UNIT III – Market Structures

Perfect Competition vs Monopoly ★★★

Basis	Perfect competition	Monopoly
Sellers	Very large number	Single seller
Product	Homogeneous	No close substitute
Entry	Free	Barriers
Price	Price-taker; P = AR = MR	Price-maker; AR > MR
Demand curve	Perfectly elastic	Downward sloping
Equilibrium	MR = MC = P	MR = MC, P > MC
Long-run profit	Normal profit only	Super-normal possible

Price Discrimination ★★★

Charging different prices for the same product to different buyers.

- **Degrees (Pigou):** first (each buyer charged maximum willingness), second (by quantity blocks), third (by markets/groups: students, senior citizens)
- **Conditions:** monopoly power, separate markets, no resale, different elasticities
- **Equilibrium:** MR in each market = combined MC; higher price where demand is less elastic
- **Examples:** railway fares, electricity tariffs, doctor's fees

Monopolistic Competition ★★

Chamberlin (1933): many firms selling **differentiated** products.

- **Features:** many sellers, product differentiation (brands), free entry & exit, selling costs (advertising), downward-sloping, relatively elastic demand
- **Short run:** super-normal profit possible; **long run:** normal profit (AR tangent to AC), excess capacity
- **Examples:** toothpaste, soaps, restaurants, garments

Oligopoly – Kinked Demand, Prisoner's Dilemma, Cartels ★★★

Oligopoly: few large sellers, interdependence, barriers to entry, homogeneous (steel, cement) or differentiated (cars, telecom — Jio, Airtel, Vi) products, advertising, price rigidity.

- **Kinked demand curve** (Paul Sweezy, 1939): rivals follow a price cut but not a price rise → demand elastic above the current price, inelastic below → kink at prevailing price → MR curve has a **discontinuous gap**; MC can shift within the gap without changing price → explains **price rigidity**. Criticism — does not explain how the initial price is set
- **Prisoner's dilemma** (game theory): two firms each choose high or low price; each has a dominant strategy to cut price, so both end up at the low-profit Nash equilibrium though both would gain by cooperating — explains price wars and advertising wars
- **Cartel:** formal collusion to fix price/output and share markets (OPEC) — acts like a joint monopoly. **Cartel cheating:** each member has an incentive to secretly produce more or under-cut price (prisoner's dilemma) → instability; also entry, differing costs, detection difficulty. Illegal in India — Competition Act 2002 Sec 3(3) (cement, tyre, beer cartel cases)
- **Other models:** Cournot (quantity), Bertrand (price), price leadership (dominant/barometric), collusive vs non-collusive

Price & Non-price Competition; Market Concentration ★

- **Price competition:** discounts, price cuts, penetration pricing — risk of price wars
- **Non-price competition:** product differentiation, quality, branding, advertising, after-sales service, loyalty programmes, packaging, distribution — preferred in oligopoly
- **Market concentration: concentration ratio** (CR_4 = market share of top 4 firms);

  Herfindahl–Hirschman Index (HHI = sum of squared market shares; > 2,500 highly concentrated); used by CCI in merger review

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UNIT IV – Macroeconomics & Profit

National Income Concepts & Measurement ★★★

- **GDP** — market value of all final goods and services produced within the domestic territory in a year; **GNP** = GDP + net factor income from abroad (NFIA); **NNP** = GNP − depreciation; **NI** (NNP at factor cost) = NNP at market price − indirect taxes + subsidies; personal income; disposable income; per capita income; nominal vs real GDP (base-year prices, GDP deflator)
- **Methods:** (1) **product/value-added** — sum of value added by all sectors; (2) **income** — rent + wages + interest + profit + mixed income; (3) **expenditure** — C + I + G + (X − M). In India — NSO (MoSPI) estimates
- **Difficulties:** double counting, non-monetised and informal sector, black money, depreciation estimates, transfer payments, self-consumption

Inflation & Deflation ★★★

Inflation — sustained rise in the general price level (measured by CPI, WPI, GDP deflator). **Deflation** — sustained fall in prices.

- **Types:** by speed — creeping, walking, running, hyperinflation; by cause — **demand-pull** (excess demand, money supply), **cost-push** (wages, oil, raw materials, taxes), structural; stagflation (inflation + stagnation)
- **Effects:** hurts fixed-income earners and lenders, helps debtors and producers in the short run, reduces purchasing power and savings, distorts investment, worsens balance of payments
- **Control:** monetary (raise repo rate, CRR, OMO sales), fiscal (cut spending, raise taxes, reduce deficit), supply-side (raise output, imports, buffer stocks, price controls). India — RBI's flexible inflation targeting: CPI 4% ± 2% (RBI Act Sec 45ZA)
- **Deflation effects:** falling profits, unemployment, debt burden rises; cure — expansionary policies

Monetary & Fiscal Policy; Profit Theories ★★★

- **Monetary policy** (RBI, Monetary Policy Committee of 6 members): objectives — price stability with growth, financial stability, credit flow. **Quantitative instruments:** repo and reverse repo rate, standing deposit facility, marginal standing facility, bank rate, CRR, SLR, open market operations; **qualitative:** margin requirements, credit rationing, moral suasion, selective credit control
- **Fiscal policy** (Government — Union Budget): objectives — growth, employment, price stability, equitable distribution, BoP. **Instruments:** taxation (direct, GST), public expenditure, public borrowing/debt, deficit financing; FRBM Act 2003 for fiscal discipline. Expansionary vs contractionary; in recession fiscal policy more effective (Keynes), in inflation monetary policy
- **Profit theories: risk** (F. B. Hawley — reward for risk-bearing), **uncertainty** (F. H. Knight — reward for non-insurable uncertainty), **innovation** (J. A. Schumpeter — reward for introducing new products, processes, markets; temporary until imitated), **rent theory** (F. A. Walker — profit is rent of superior entrepreneurial ability), dynamic theory (J. B. Clark — profit due to dynamic changes). **Profit management:** profit planning, break-even analysis, profit policy and measurement

Solved Numericals & Diagrams

Example 1 — Percentage Method

Price falls from ₹10 to ₹8; quantity demanded rises from 100 to 130 units.

- % change in Q = 30/100 × 100 = 30%
- % change in P = 2/10 × 100 = 20%
- Ed = 30/20 = **1.5** → relatively elastic

Arc method: [30/(100+130)] ÷ [2/(10+8)] = 0.1304 ÷ 0.1111 = **1.17**

Example 2 — Total Outlay Method

Price	Quantity	Total outlay	Elasticity
10	100	1,000	
8	150	1,200	> 1 (outlay rises)
6	200	1,200	= 1 (outlay same)
4	250	1,000	< 1 (outlay falls)

Example 3 — Accounting vs Economic Profit

Revenue ₹20 lakh; explicit costs ₹14 lakh; owner's forgone salary ₹3 lakh; own capital ₹10 lakh (could earn 8%).

Accounting profit = 20 − 14	₹6.0 lakh
Implicit costs = 3 + 0.8	₹3.8 lakh
Economic profit = 6.0 − 3.8	**₹2.2 lakh**

Example 4 — National Income

C 60, I 20, G 15, X 10, M 8, NFIA −2, depreciation 7, indirect taxes 10, subsidies 3 (₹ '000 crore).

GDP_{MP} = 60 + 20 + 15 + 10 − 8	97
GNP_{MP} = 97 − 2	95
NNP_{MP} = 95 − 7	88
NI = 88 − 10 + 3	**81**

Example 5 — 80% Learning Curve

First unit takes 100 hours. Cumulative output 1 → 2 → 4 → 8 units: unit time 100 → **80** → **64** → **51.2** hours.

Prisoner's Dilemma — Pricing Game (profit ₹ crore)

	B: High price	B: Low price
A: High price	A 10, B 10	A 2, B 14
A: Low price	A 14, B 2	**A 5, B 5** (Nash)

Each firm's dominant strategy is a low price → both earn 5, though cooperation would give 10 each → cartel incentive and cheating.

Diagrams to Practise

- Demand curve and its exceptions (Giffen)
- Five types of elasticity
- Point elasticity on a straight-line demand curve
- Indifference map + budget line + equilibrium
- TP, AP, MP curves with three stages
- AFC, AVC, AC, MC curves
- Perfect competition: industry and firm
- Monopoly equilibrium; price discrimination
- Ricardian rent on grades of land
- Liquidity preference curve

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Practice Set with Answers

Cover the answer column, try each question yourself, then check.

#	Question	Answer
1	Definition of ME?	Spencer & Siegelman — economic theory + business practice.
2	Accept order if?	Incremental revenue > incremental cost.
3	Equi-marginal principle?	Equal marginal returns in all uses.
4	Discounting formula?	$PV = FV \div (1 + r)^n$.
5	Sales maximisation model?	Baumol.
6	Satisficing?	Herbert Simon.
7	Giffen good?	Inferior good — exception to law of demand.
8	Negative cross elasticity?	Complements.
9	LAC curve is called?	Envelope curve.
10	Kinked demand curve?	Paul Sweezy (1939).
11	Explains cartel cheating?	Prisoner's dilemma.
12	Concentration index?	HHI / CR4.
13	GNP − depreciation?	NNP.
14	Inflation target in India?	CPI 4% ± 2%.
15	Who sets repo rate?	RBI's Monetary Policy Committee.
16	Innovation theory of profit?	Schumpeter.

Common Mistakes to Avoid

- No diagrams for elasticity, costs, markets
- Confusing accounting and economic profit
- Mixing returns to factor and returns to scale
- Kinked demand without the MR gap
- National income steps in wrong order
- Monetary and fiscal instruments mixed up

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Answer Plans — What to Write for Each Question

Q. Nature & scope
Definitions → nature → scope list → relation with economics & decisions.

Q. Principles
Five principles each with example.

Q. Objectives of firm
Profit max (MR = MC) → criticism → Baumol, Marris, Williamson, Simon.

Q. Demand & elasticity
Law → determinants → exceptions → elasticity types → measurement → importance.

Q. Production & cost
Variable proportions (3 stages) → returns to scale → economies → SR/LR costs → learning curve.

Q. Markets
Perfect competition → monopoly & discrimination → monopolistic → oligopoly models.

Q. National income / inflation
Concepts → methods → difficulties; inflation types → effects → control.

Q. Policies & profit
Monetary vs fiscal instruments → objectives → profit theories.

Last-Minute Formula Sheet

Principles	Opportunity cost · incremental · equi-marginal · time perspective · discounting $PV = FV/(1+r)^n$
Demand	$Ep = \%\Delta Q/\%\Delta P$ · EY · Exy (+ substitutes, − complements) · Giffen, Veblen exceptions
Cost	$TC = TFC + TVC$ · MC cuts AVC, AC at minimum · LAC envelope · 80% learning curve
Markets	MR = MC · PC: P = MR · monopoly P > MC · Sweezy kink · Nash · HHI
Macro	GDP = C + I + G + (X − M) · NNP = GNP − dep · NI = NNP − IT + S · CPI 4% ± 2% · FRBM 2003

Before you enter the exam hall: revise the mind map, the flowcharts and the formula sheet once more. Read the paper fully, draw labelled diagrams, box your answers, and keep 5 minutes for checking. **You have prepared well. All the best!** Team LUUPDATE

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