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Handout

Ekonomi Manajerial

[EMKU4402]

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Fak. Ekonomi / Manajemen

Chapter 1

Managers, Profits, and Markets

Managerial Economics & Theory

- **Managerial economics applies microeconomic theory to business problems**
 - How to use economic analysis to make decisions to achieve firm's goal of profit maximization
- **Microeconomics**
 - Study of behavior of individual economic agents

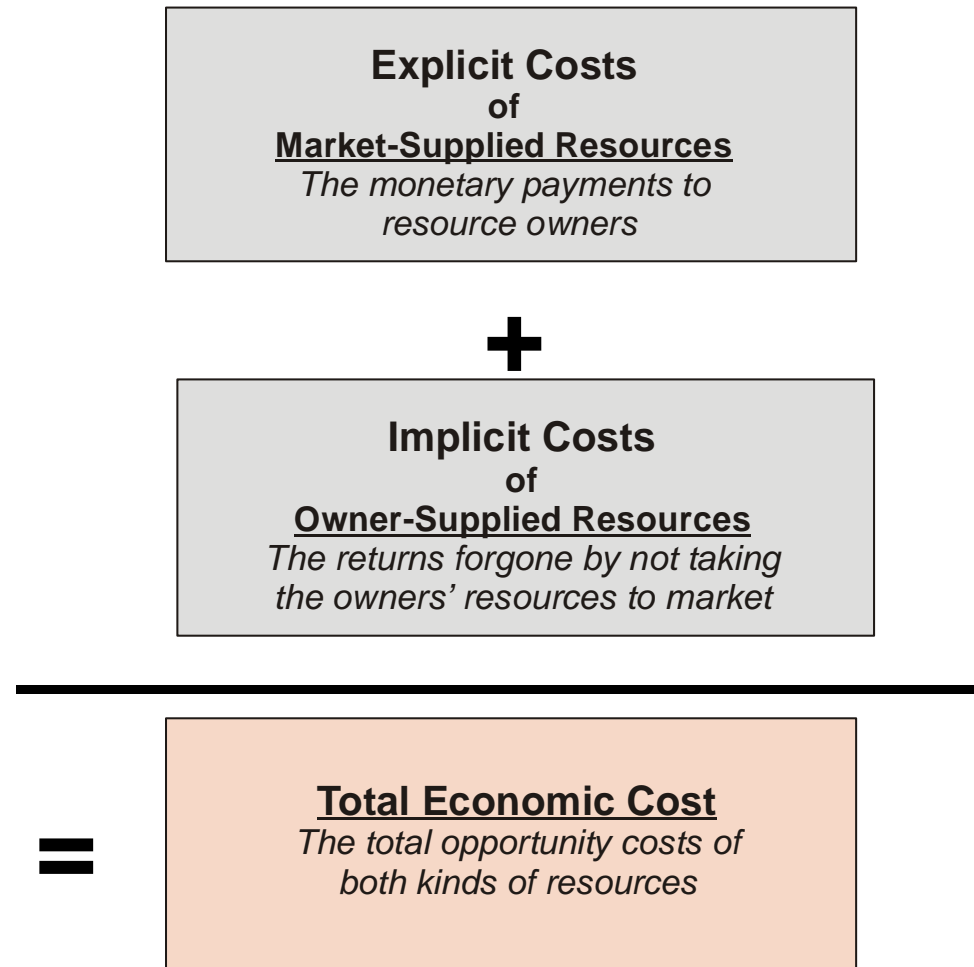
Economic Cost of Resources

- **Opportunity cost of using any resource is:**
 - What firm owners must give up to use the resource
- **Market-supplied resources**
 - Owned by others & hired, rented, or leased
- **Owner-supplied resources**
 - Owned & used by the firm

Total Economic Cost

- **Total Economic Cost**
 - Sum of opportunity costs of both market-supplied resources & owner-supplied resources
- **Explicit Costs**
 - Monetary payments to owners of market-supplied resources
- **Implicit Costs**
 - Nonmonetary opportunity costs of using owner-supplied resources

Economic Cost of Using Resources (Figure 1.1)



Types of Implicit Costs

- **Opportunity cost of cash provided by owners**
 - Equity capital
- **Opportunity cost of using land or capital owned by the firm**
- **Opportunity cost of owner's time spent managing or working for the firm**

Economic Profit versus Accounting Profit

- **Economic profit = Total revenue – Total economic cost**
= Total revenue – Explicit costs – Implicit costs
- **Accounting profit = Total revenue – Explicit costs**
- **Accounting profit does not subtract implicit costs from total revenue**
- **Firm owners must cover all costs of all resources used by the firm**
 - Objective is to maximize economic profit

Maximizing the Value of a Firm

- **Value of a firm**
 - Price for which it can be sold
 - Equal to net present value of expected future profit
- **Risk premium**
 - Accounts for risk of not knowing future profits
 - The larger the risk, the higher the risk premium, & the lower the firm's value

Maximizing the Value of a Firm

- **Maximize firm's value by maximizing profit in each time period**
 - Cost & revenue conditions must be independent across time periods

- **Value of a firm =**

$$\frac{\pi_1}{(1+r)} + \frac{\pi_2}{(1+r)^2} + \dots + \frac{\pi_T}{(1+r)^T} = \sum_{t=1}^T \frac{\pi_t}{(1+r)^t}$$

Separation of Ownership & Control

- **Principal-agent problem**
 - Conflict that arises when goals of management (agent) do not match goals of owner (principal)
- **Moral Hazard**
 - When either party to an agreement has incentive not to abide by all its provisions & one party cannot cost effectively monitor the agreement

Corporate Control Mechanisms

- **Require managers to hold stipulated amount of firm's equity**
- **Increase percentage of outsiders serving on board of directors**
- **Finance corporate investments with debt instead of equity**

Price-Takers vs. Price-Setters

- **Price-taking firm**
 - Cannot set price of its product
 - Price is determined strictly by market forces of demand & supply
- **Price-setting firm**
 - Can set price of its product
 - Has a degree of *market power*, which is ability to raise price without losing all sales

What is a Market?

- ***A market is any arrangement through which buyers & sellers exchange goods & services***
- ***Markets reduce transaction costs***
 - *Costs of making a transaction other than the price of the good or service*

Market Structures

- **Market characteristics that determine the economic environment in which a firm operates**
 - Number & size of firms in market
 - Degree of product differentiation
 - Likelihood of new firms entering market

Perfect Competition

- **Large number of relatively small firms**
- **Undifferentiated product**
- **No barriers to entry**

Monopoly

- **Single firm**
- **Produces product with no close substitutes**
- **Protected by a barrier to entry**

Monopolistic Competition

- **Large number of relatively small firms**
- **Differentiated products**
- **No barriers to entry**

Oligopoly

- **Few firms produce all or most of market output**
- **Profits are interdependent**
 - Actions by any one firm will affect sales & profits of the other firms

Globalization of Markets

- **Economic integration of markets located in nations around the world**
 - Provides opportunity to sell more goods & services to foreign buyers
 - Presents threat of increased competition from foreign producers

Chapter 2

Demand, Supply, and Market Equilibrium

Demand

- **Quantity demanded (Q_d)**
 - Amount of a good or service consumers are willing & able to purchase during a given period of time

General Demand Function

- **Six variables that influence Q_d**
 - Price of good or service (P)
 - Incomes of consumers (M)
 - Prices of related goods & services (P_R)
 - Taste patterns of consumers (\mathfrak{T})
 - Expected future price of product (P_e)
 - Number of consumers in market (N)
- **General demand function**
 - $Q_d = f(P, M, P_R, \mathfrak{T}, P_e, N)$

General Demand Function

$$Q_d = a + bP + cM + dP_R + e\mathfrak{T} + fP_e + gN$$

- ***b, c, d, e, f, & g* are slope parameters**
 - Measure effect on Q_d of changing one of the variables while holding the others constant
- **Sign of parameter shows how variable is related to Q_d**
 - Positive sign indicates direct relationship
 - Negative sign indicates inverse relationship

General Demand Function

Variable	Relation to Q_d	Sign of Slope Parameter
P	Inverse	$b = \Delta Q_d / \Delta P$ is negative
M	Direct for normal goods Inverse for inferior goods	$c = \Delta Q_d / \Delta M$ is positive $c = \Delta Q_d / \Delta M$ is negative
P_R	Direct for substitutes Inverse for complements	$d = \Delta Q_d / \Delta P_R$ is positive $d = \Delta Q_d / \Delta P_R$ is negative
\mathfrak{I}	Direct	$e = \Delta Q_d / \Delta \mathfrak{I}$ is positive
P_e	Direct	$f = \Delta Q_d / \Delta P_e$ is positive
N	Direct	$g = \Delta Q_d / \Delta N$ is positive

Direct Demand Function

- The ***direct demand function***, or simply ***demand***, shows how quantity demanded, Q_d , is related to product price, P , when all other variables are held constant
 - $Q_d = f(P)$
- **Law of Demand**
 - Q_d increases when P falls & Q_d decreases when P rises, all else constant
 - $\Delta Q_d / \Delta P$ must be negative

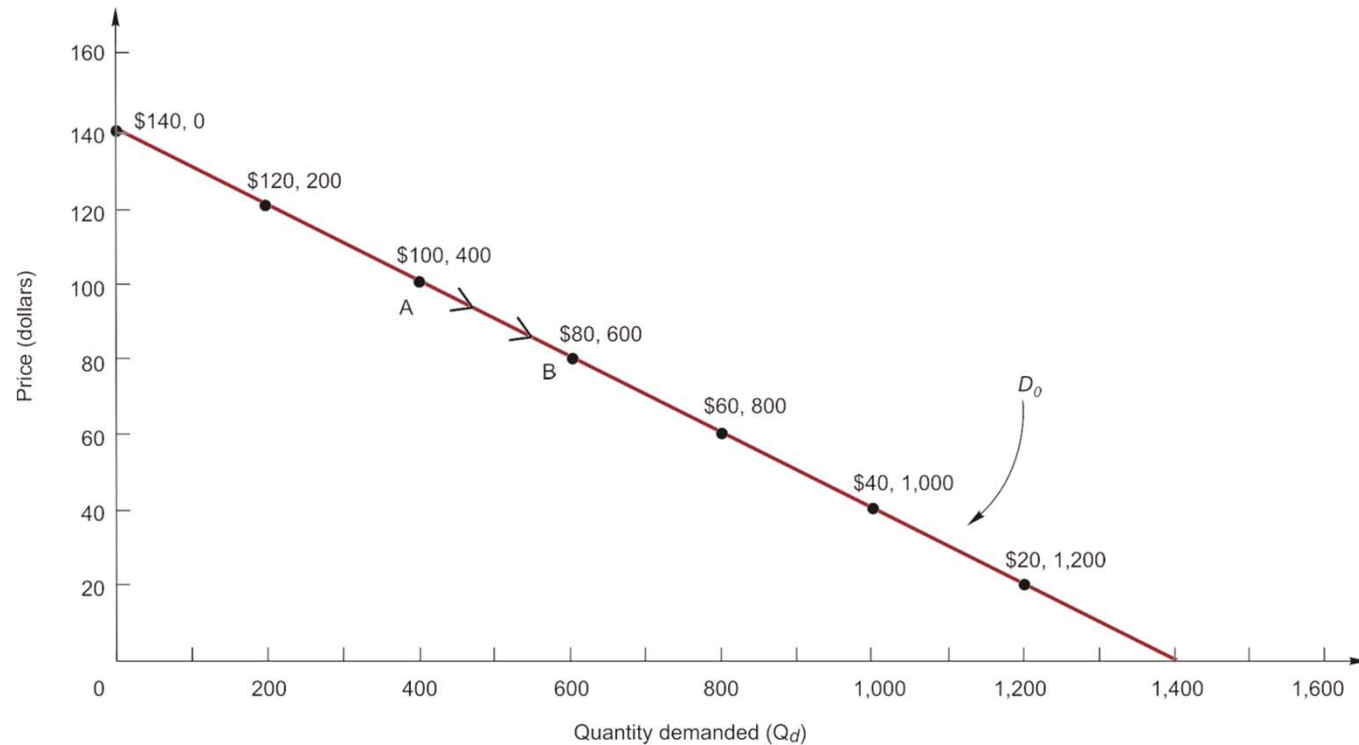
Inverse Demand Function

- **Traditionally, price (P) is plotted on the vertical axis & quantity demanded (Q_d) is plotted on the horizontal axis**
 - The equation plotted is the *inverse demand function*, $P = f(Q_d)$

Graphing Demand Curves

- **A point on a direct demand curve shows either:**
 - Maximum amount of a good that will be purchased for a given price
 - Maximum price consumers will pay for a specific amount of the good

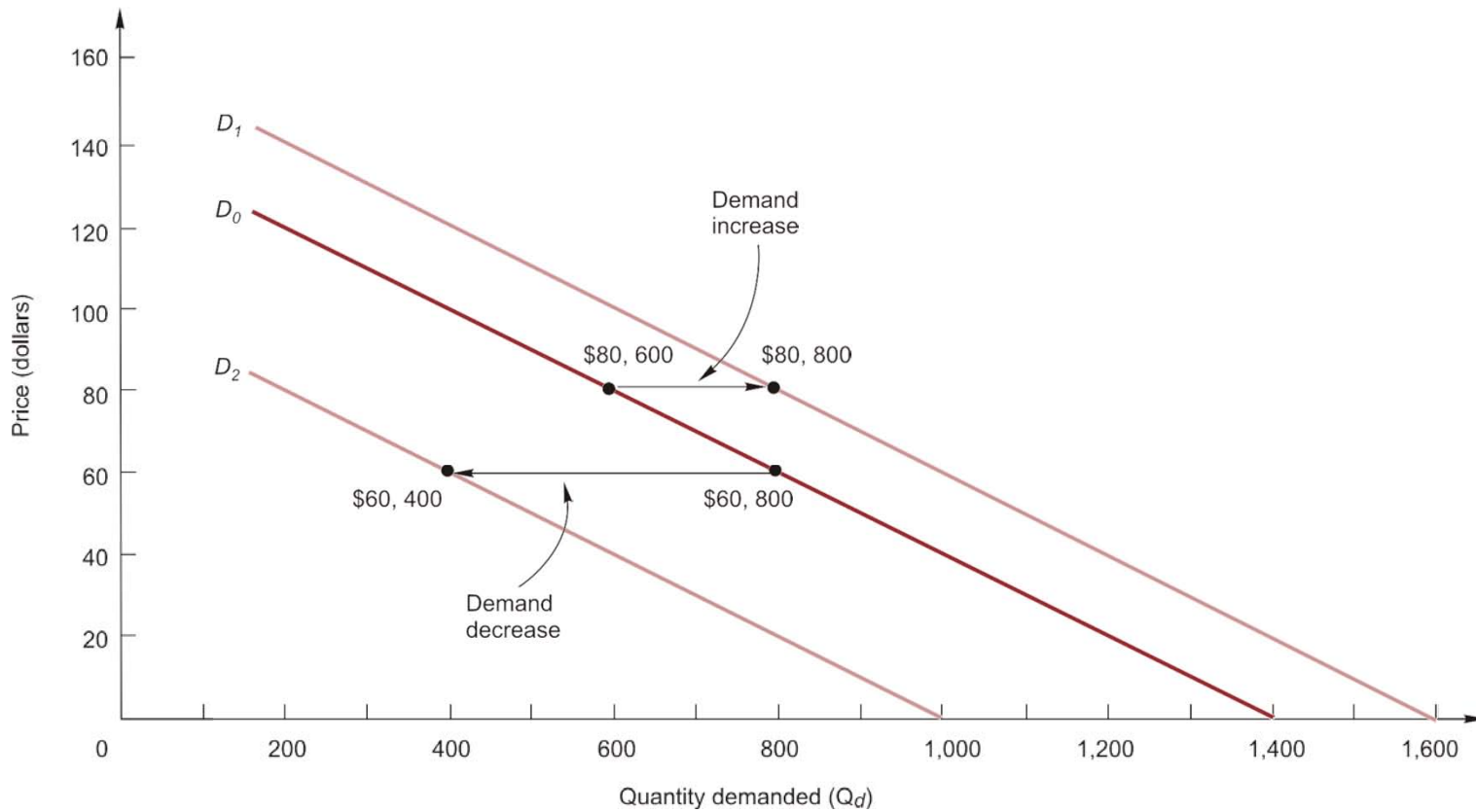
A Demand Curve (Figure 2.1)



Graphing Demand Curves

- **Change in quantity demanded**
 - Occurs when price changes
 - Movement along demand curve
- **Change in demand**
 - Occurs when one of the other variables, or *determinants of demand*, changes
 - Demand curve shifts rightward or leftward

Shifts in Demand (Figure 2.2)



Supply

- **Quantity supplied (Q_s)**
 - Amount of a good or service offered for sale during a given period of time

Supply

- **Six variables that influence Q_s**
 - Price of good or service (P)
 - Input prices (P_I)
 - Prices of goods related in production (P_r)
 - Technological advances (T)
 - Expected future price of product (P_e)
 - Number of firms producing product (F)
- **General supply function**
 - $Q_s = f(P, P_I, P_r, T, P_e, F)$

General Supply Function

$$Q_s = h + kP + lP_I + mP_r + nT + rP_e + sF$$

- **$k, l, m, n, r, \& s$ are slope parameters**
 - Measure effect on Q_s of changing one of the variables while holding the others constant
- **Sign of parameter shows how variable is related to Q_s**
 - Positive sign indicates direct relationship
 - Negative sign indicates inverse relationship

General Supply Function

Variable	Relation to Q_s	Sign of Slope Parameter
P	Direct	$k = \Delta Q_s / \Delta P$ is positive
P_I	Inverse	$l = \Delta Q_s / \Delta P_I$ is negative
P_r	Inverse for substitutes Direct for complements	$m = \Delta Q_s / \Delta P_r$ is negative $m = \Delta Q_s / \Delta P_r$ is positive
T	Direct	$n = \Delta Q_s / \Delta T$ is positive
P_e	Inverse	$r = \Delta Q_s / \Delta P_e$ is negative
F	Direct	$s = \Delta Q_s / \Delta F$ is positive

Direct Supply Function

- **The *direct supply function*, or simply *supply*, shows how quantity supplied, Q_s , is related to product price, P , when all other variables are held constant**
 - $Q_s = f(P)$

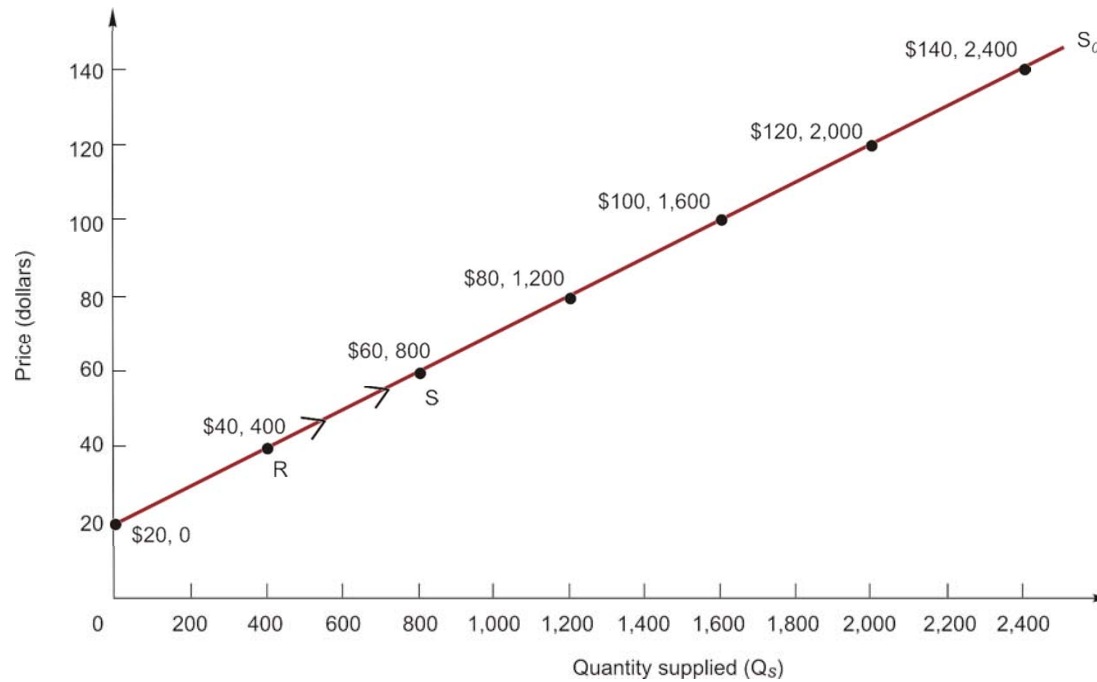
Inverse Supply Function

- **Traditionally, price (P) is plotted on the vertical axis & quantity supplied (Q_s) is plotted on the horizontal axis**
 - The equation plotted is the *inverse supply function*, $P = f(Q_s)$

Graphing Supply Curves

- **A point on a direct supply curve shows either:**
 - Maximum amount of a good that will be offered for sale at a given price
 - Minimum price necessary to induce producers to voluntarily offer a particular quantity for sale

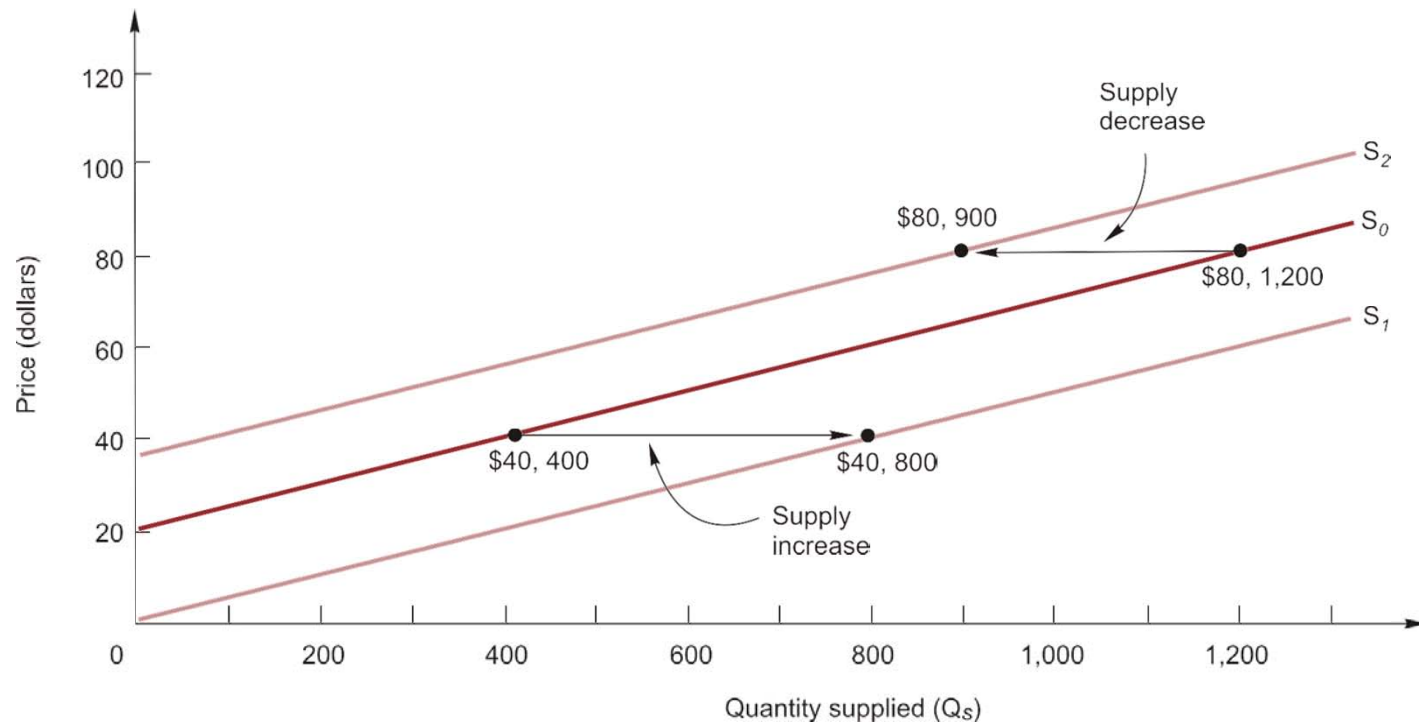
A Supply Curve (Figure 2.3)



Graphing Supply Curves

- **Change in quantity supplied**
 - Occurs when price changes
 - Movement along supply curve
- **Change in supply**
 - Occurs when one of the other variables, or *determinants of supply*, changes
 - Supply curve shifts rightward or leftward

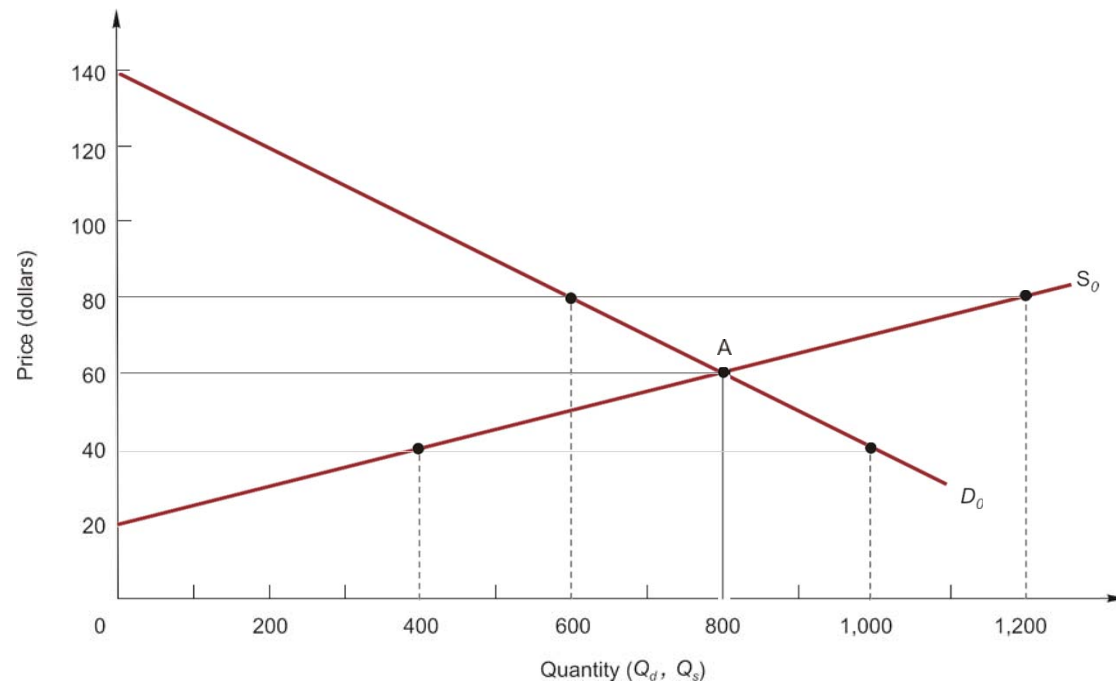
Shifts in Supply (Figure 2.4)



Market Equilibrium

- **Equilibrium price & quantity are determined by the intersection of demand & supply curves**
 - At the point of intersection, $Q_d = Q_s$
 - Consumers can purchase all they want & producers can sell all they want at the "market-clearing" or price

Market Equilibrium (Figure 2.5)



Market Equilibrium

- **Excess demand (shortage)**
 - Exists when quantity demanded exceeds quantity supplied
- **Excess supply (surplus)**
 - Exists when quantity supplied exceeds quantity demanded

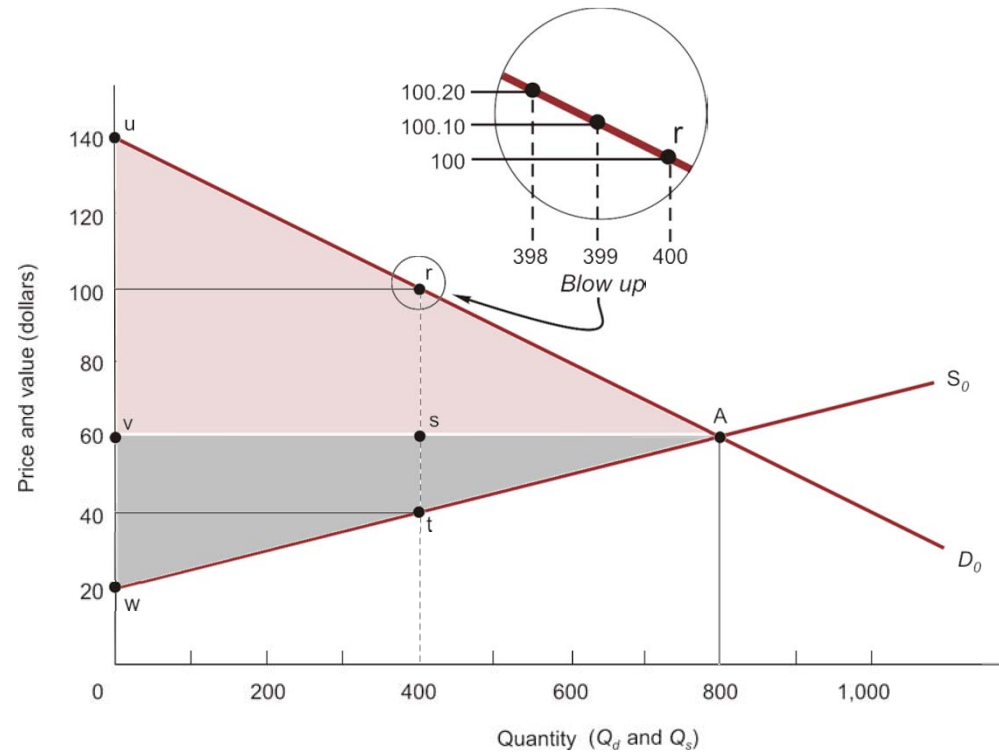
Value of Market Exchange

- **Typically, consumers value the goods they purchase by an amount that exceeds the purchase price of the goods**
- **Economic value**
 - Maximum amount any buyer in the market is willing to pay for the unit, which is measured by the demand price for the unit of the good

Measuring the Value of Market Exchange

- **Consumer surplus**
 - Difference between the economic value of a good (its demand price) & the market price the consumer must pay
- **Producer surplus**
 - For each unit supplied, difference between market price & the minimum price producers would accept to supply the unit (its supply price)
- **Social surplus**
 - Sum of consumer & producer surplus
 - Area below demand & above supply over the relevant range of output

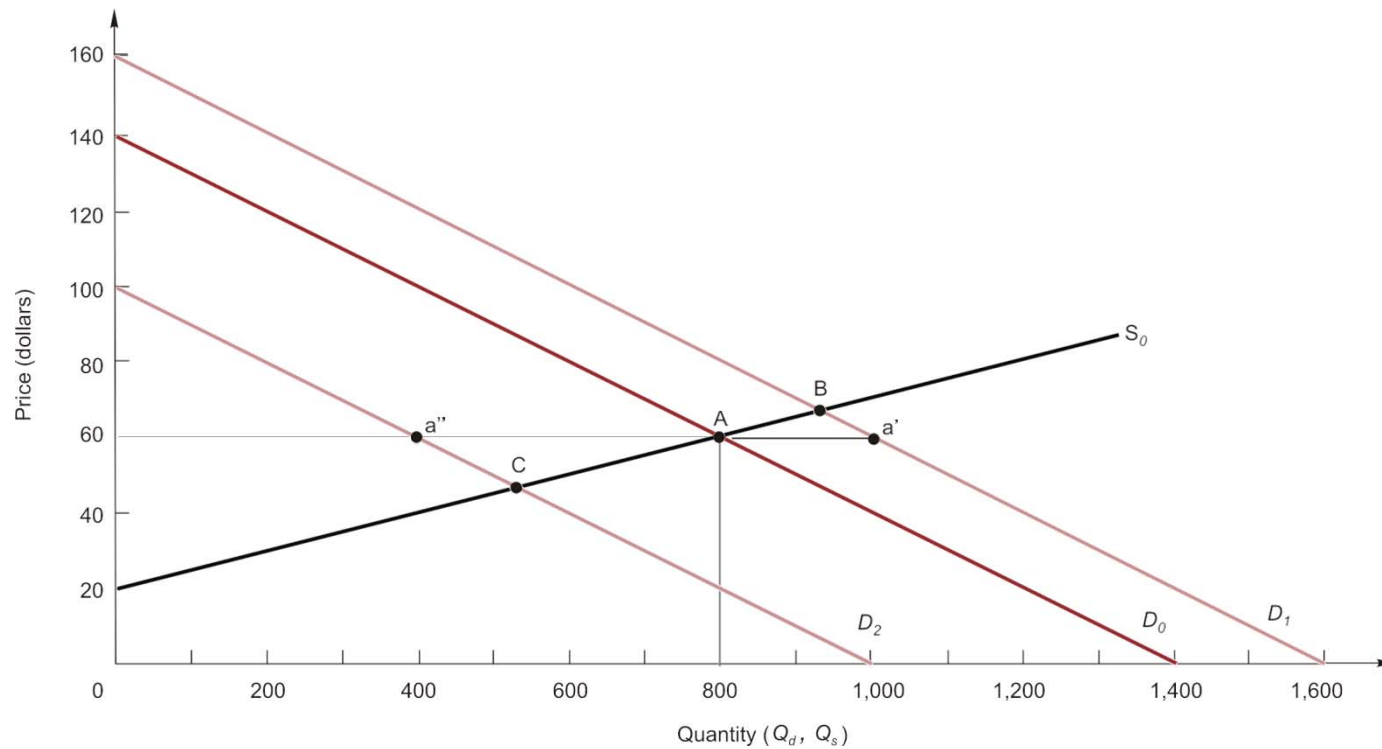
Measuring the Value of Market Exchange (Figure 2.6)



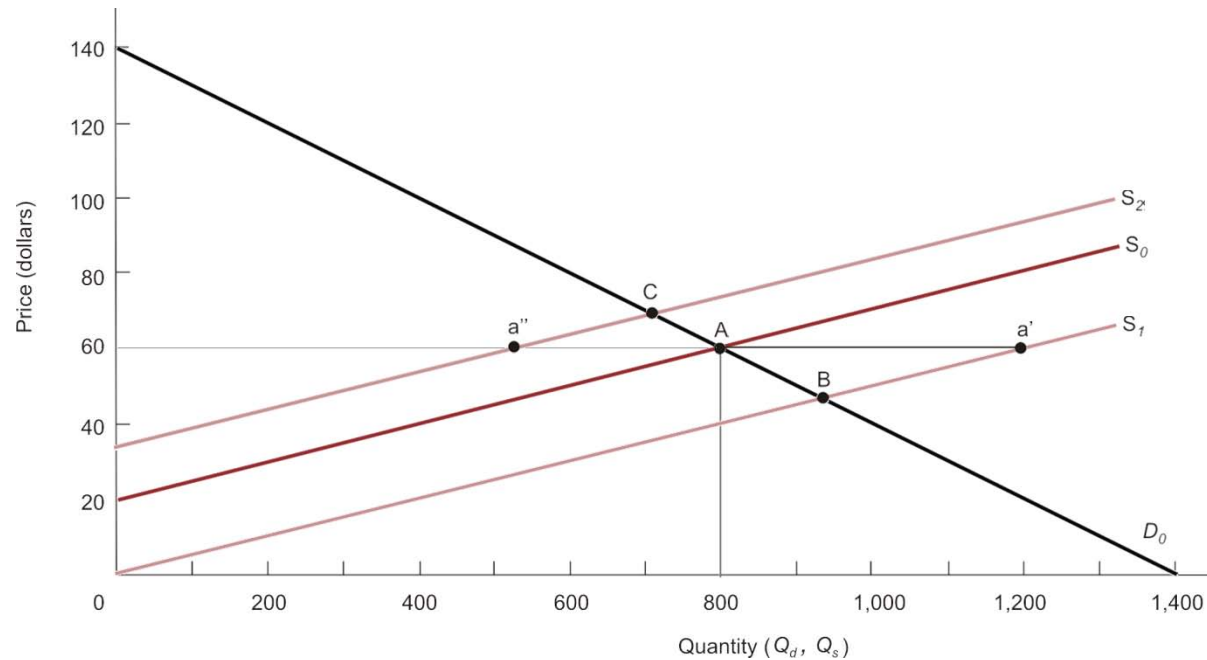
Changes in Market Equilibrium

- **Qualitative forecast**
 - Predicts only the direction in which an economic variable will move
- **Quantitative forecast**
 - Predicts both the direction and the magnitude of the change in an economic variable

Demand Shifts (Supply Constant) *(Figure 2.7)*



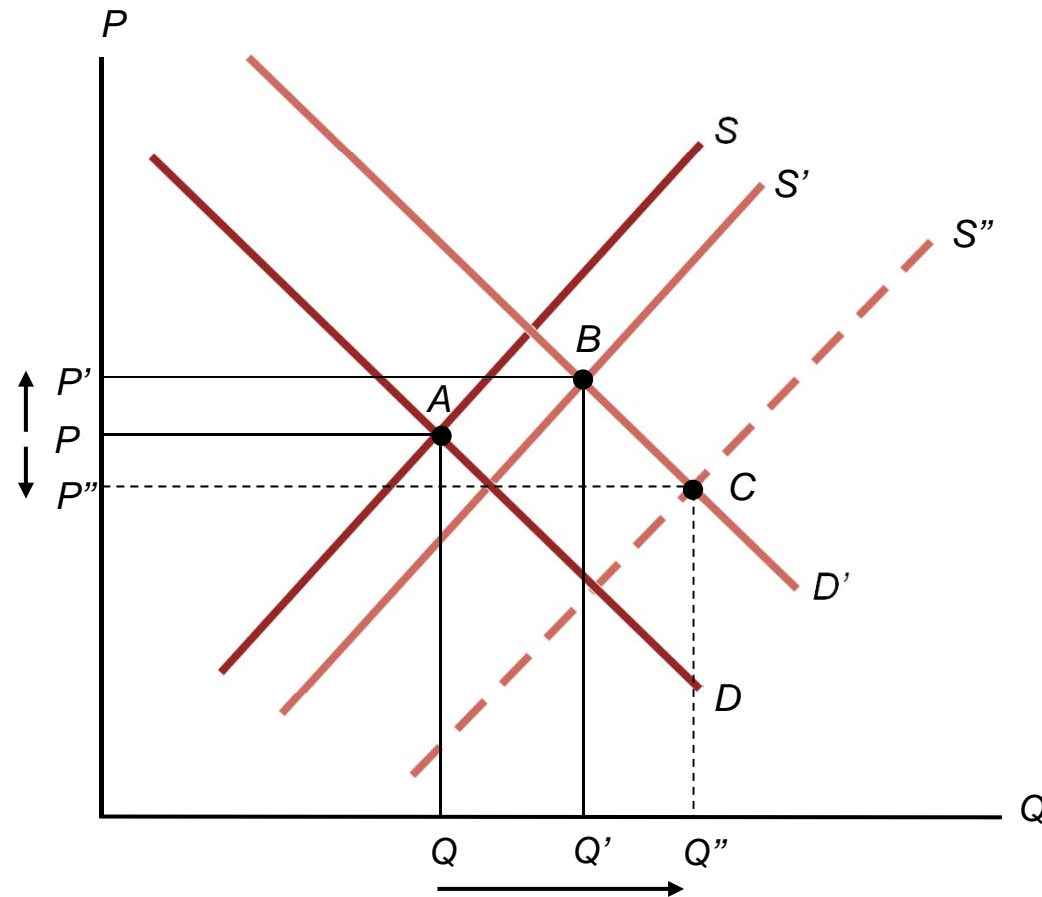
Supply Shifts (Demand Constant) (Figure 2.8)



Simultaneous Shifts

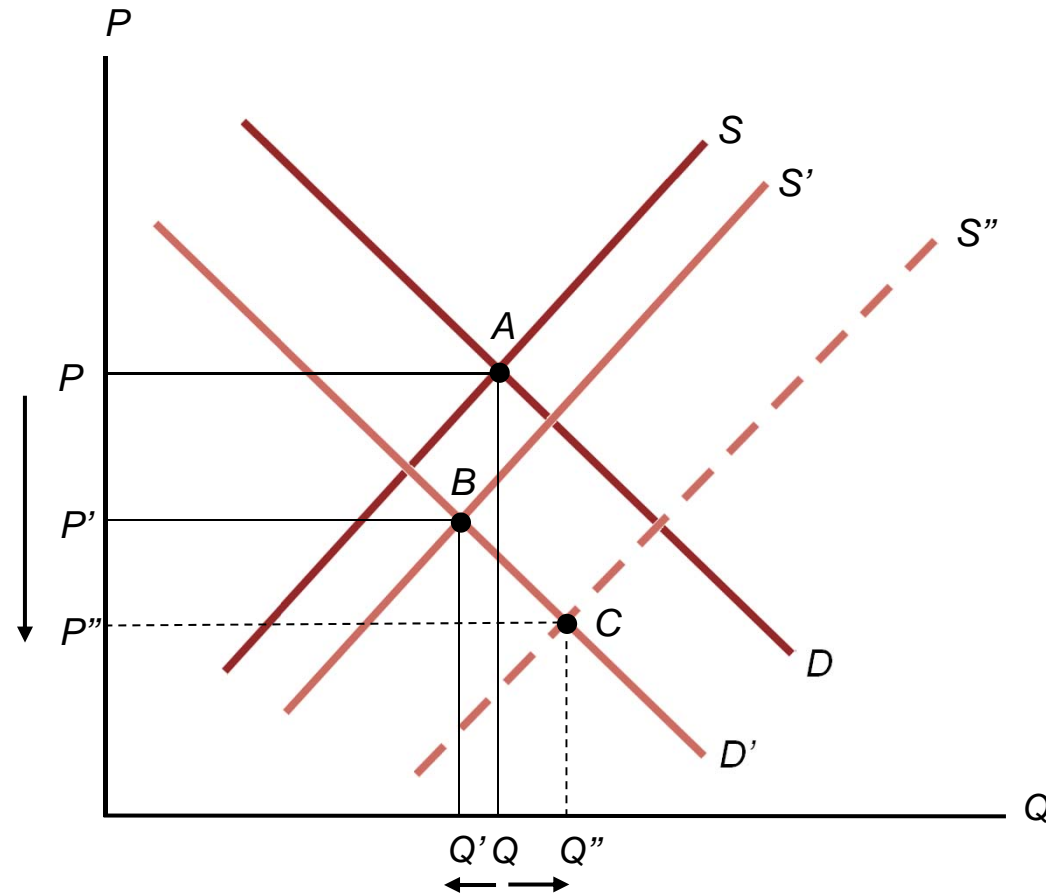
- **When demand & supply shift simultaneously**
 - Can predict either the direction in which price changes or the direction in which quantity changes, but not both
 - The change in equilibrium price or quantity is said to be *indeterminate* when the direction of change depends on the relative magnitudes by which demand & supply shift

Simultaneous Shifts: ($\uparrow D$, $\uparrow S$)



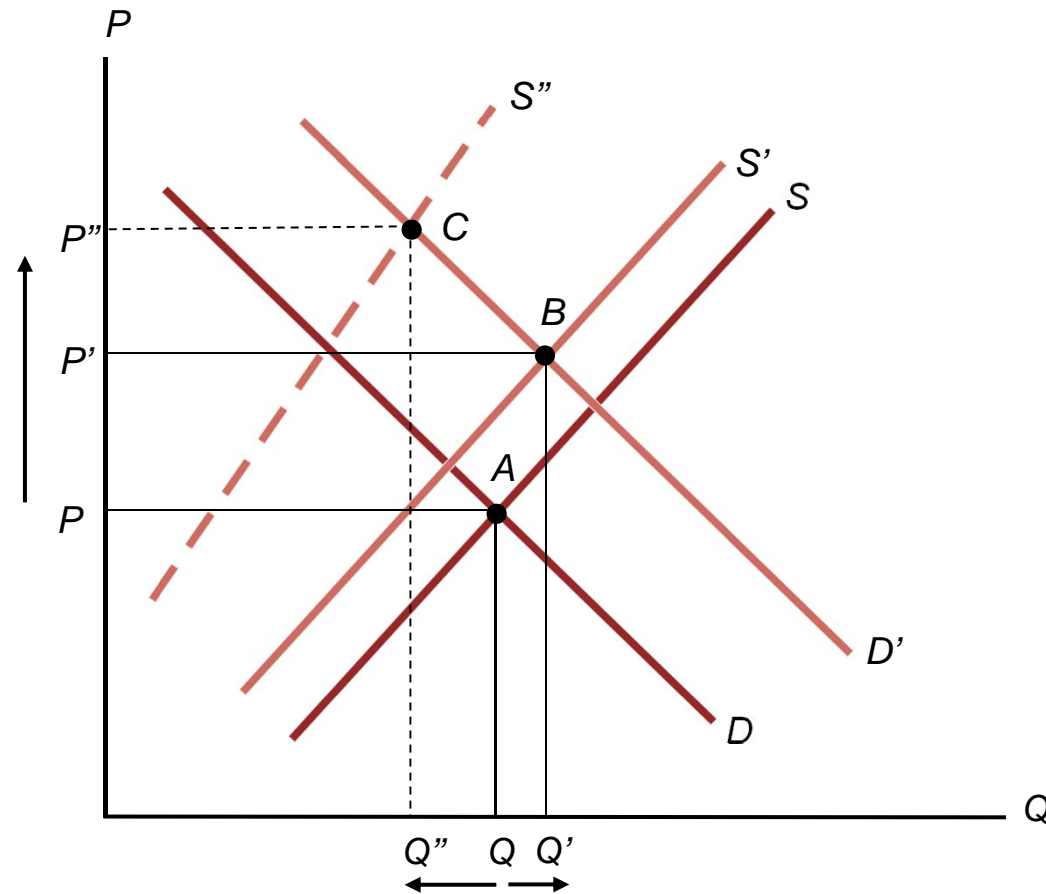
Price may rise or fall; Quantity rises

Simultaneous Shifts: ($\downarrow D$, $\uparrow S$)



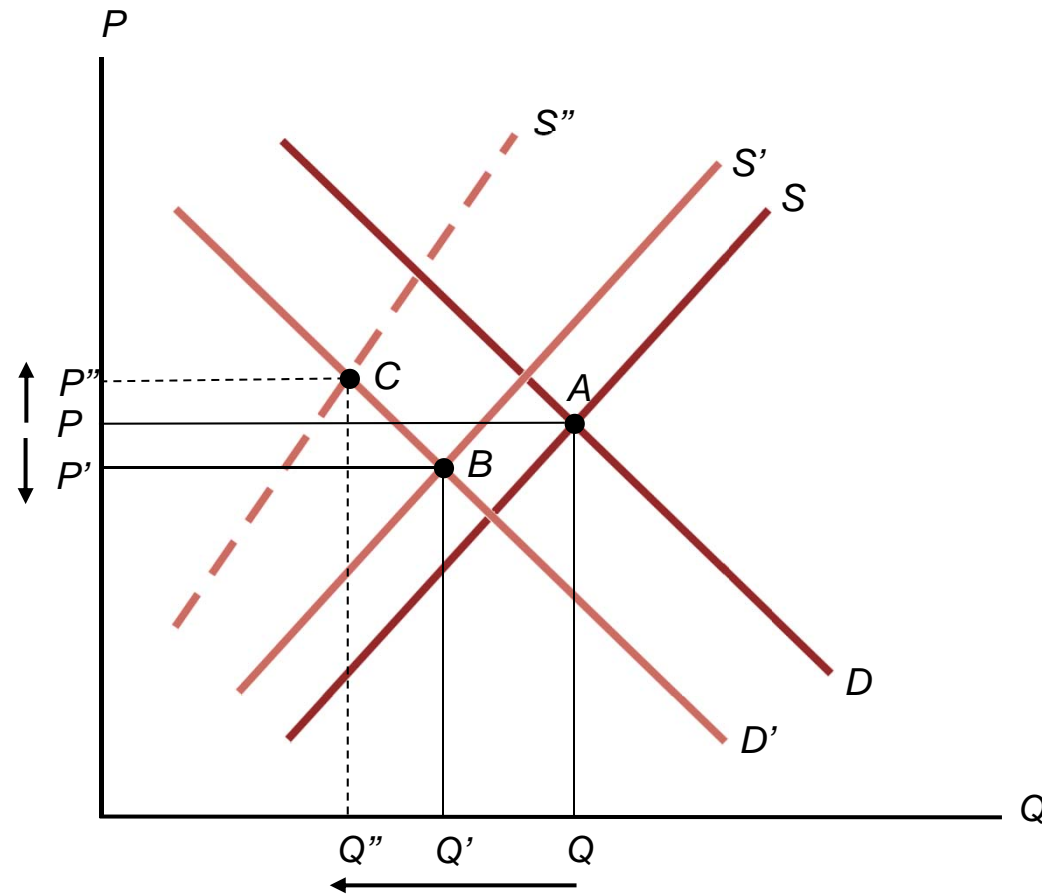
Price falls; Quantity may rise or fall

Simultaneous Shifts: ($\uparrow D$, $\downarrow S$)



Price rises; Quantity may rise or fall

Simultaneous Shifts: ($\downarrow D$, $\downarrow S$)



Price may rise or fall; Quantity falls