**Chapter 1**

**Introduction**

**Chapter Outline**

1.1 Managerial Decision Making

Profit

Trade-Offs

Other Decision Makers

Strategy

1.2 Economic Models

Mini Case: Using an Income Threshold Model in China

Simplifying Assumptions

Testing Theories

Positive and Normative Statements

**Learning Objectives**

**1. Managerial Decision Making:** Economic analysis helps managers develop strategies to achieve a firm’s objective—such as maximizing profit—in the presence of scarcity.

**2. Economic Models:** Managers use models based on economic theories to help make predictions about consumer and firm behavior, and as an aid to managerial decision making.

**Overview**

This chapter, as is befitting its title, lays out the scope and nature of the course.

***Managerial Decision Making:*** It is a good idea to start any discussion of managerial decision making with a step back to think about decision making more generally. Most students will be aware that economics is the science of making decisions in the face of scarcity, but a brief reminder that this involves personal and private decisions, along with the more obvious decisions that take place in the context of a firm or government agency is worthwhile.

With that reminder out of the way, the focus can shift to what makes managerial decisions worthy of the focused study that will take place in this course. There are a number of dimensions to highlight including the complexity of the modern firm, the role of government regulation in the marketplace, the difficulty inherent in managing a large group of diverse constituents, etc.

It is also a good idea to discuss how managerial decisions are, or should be, made. Good decision making involves first identifying the goals and constraints of the firm. In most cases the goal is profit maximization and the constraints include things such as regulatory environment and market structure. A second step is to acknowledge and understand the role of prices, costs, and profits as signals to the firm about the returns associated with various options. In addition to the obvious, direct effects of any decision, a third step involves identifying any unintended consequences or collateral effects of the decision. Finally, implementation typically takes place through the judicious application of marginal analysis.

This summary of managerial decision making provides many opportunities to highlight the contributions of most of the chapters in the rest of the text and serves as a summary of what’s to come.

***Economic Models:*** A discussion of what a model is and how it is developed is important at this stage, particularly for students who are new to the economic way of thinking. It should be emphasized early on that the models that will be used throughout the text and course are developed with particular goals in mind, and those goals often do not include exactly mimicking reality. For some students this comes as a shock, but a reminder that there is often tradeoff between reality and simplicity versus ease of use is usually well received.

A discussion of the role of theories, models, hypotheses, and perhaps even a quick review of the scientific method would be time well spent at this stage as well. This naturally will include a discussion of positive versus normative statements and analysis.

**Teaching Tips**

***Examples of Economic Decisions*** – On the opening day in my class, I always ask students to take out a sheet of scratch paper and write down three examples of economic decisions that they themselves made in the past week. These examples almost uniformly involve money (e.g. I had to decide whether to go out on Friday night or save my money so I could pay my share of the electric bill). With a little prodding, I can usually get students to at least start to think in broader terms by noting that the decision to come to class on the first day is an economic one with costs and, one hopes, benefits. We then move on to work on examples of firm or managerial decisions. Having primed them with the idea that there may be dimensions other than money, they quickly identify a wide variety of decisions in a wide variety of contexts.

***Maps as Models*** – Another of my favorite exercises on day one is to bring a few maps along to class. I usually grab whatever is convenient, but try to bring at least one world map, one state-level road map, and one local topographical map showing hiking trails, etc. We talk about the purpose of each map, scale, level of detail, what’s intentionally left out, etc. This is a natural jumping off point for discussing economic models and gives me something to refer back to throughout the course when the ‘I don’t see how this is very relevant, most firms do…’ kind of comments arise. I can point out that the models that we derive and use are intended for a specific purpose and cannot possibly answer all related questions.