WILLIAMSON'S THEORY OF MANAGERIAL DISCRETION

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Williamson is of the opinion that the managers of a modern business firm organised as a corporate unit do not maximise the profits which result in the maximisation of the utility of the owners. Onstead they maximise their own utility using their discretion. However, for their job security, managers attempt to ensure a certain minimum of profit to shareholders in the form of dividends. Thus profit is a constraint to the manager's discretion.

WILLIAMSON'S THEORY OF MANAGERIAL DISCRETION

- Managers' utility depends on such variables as salary, job security, power, prestige, status, job satisfaction and professional excellence. Of these variables only salary can be quantified. Therefore, Williamson uses measurable variables like staff empenditures, managerial emoluments and discretionary investment in the utility function of managers on the assumption that these are the source of the job security and reflect power, prestige, status and professional achievements of managers.

WILLIAMSON'S THEORY OF MANAGERIAL DISCRETIONП

Basic Concepts:

The demand for the firm. The firm's demand curve is assumed to be downward sloping and is defined by the function

$$X = f_1 (P, S, e)$$

$$P = f_2 (X, S, e)$$

Where X = output, P = price, S = staff expenditure

e = a demand shift parameter reflecting autonomous changes in demand.

The demand is negatively related to price and is assumed to be positively related to staff expenditure and to the shift factor.

Basic concepts:

Various concepts of Profit:

The actual profit: Sales Revenue minus production costs and less staff expenditure.

$$\Pi = R - C - S$$

The reported Profit : Π is the profit that the firm reports to the tax authorities. It is the actual profit less tax deductible managerial emoluments.(M)

$$\Pi = \Pi - M = R - C - S - M$$

Various concepts of profit:

Minimum Profit: is required to satisfy the shareholders. If this profit is not earned, the shareholders will either sell their shares or change the top management, adversely affecting the job security of managers.

The Discretionary Profit: is the amount of profit left after subtracting the minimum profit and the tax from the actual profit.

Discretionary Investment: I_D - Discretionary investment is the amount that is left from the reported profit after subtracting the minimum profit and the tax from the reported profit.