Managerial Economics

Unit 2

MBA/BBA/B.com /B.Tech /UGC Net

By

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Demand and Supply Analysis: Theory of Demand

- Meaning

Types of Demand.

Individual Demand

Market Demand

Joint Demand or Complementary Demand

Composite Demand

Competitive Demand

Indirect/Derived Demand

Direct Demand

Determinants of demand

- Price of product.
- Consumer's Income.
- Price of Related Goods.
- Tastes and Preferences of Consumers.
- Consumer's Expectations.
- Number of Consumers in the Market

Demand Function, Demand Schedule, Demand curve

Demand function shows the functional relationship between Quantity demanded for a commodity and its various.

Formula

$$Q = a - bP$$

Q = linear demand curve

a = factors influencing demand besides price

b = slope

P = price

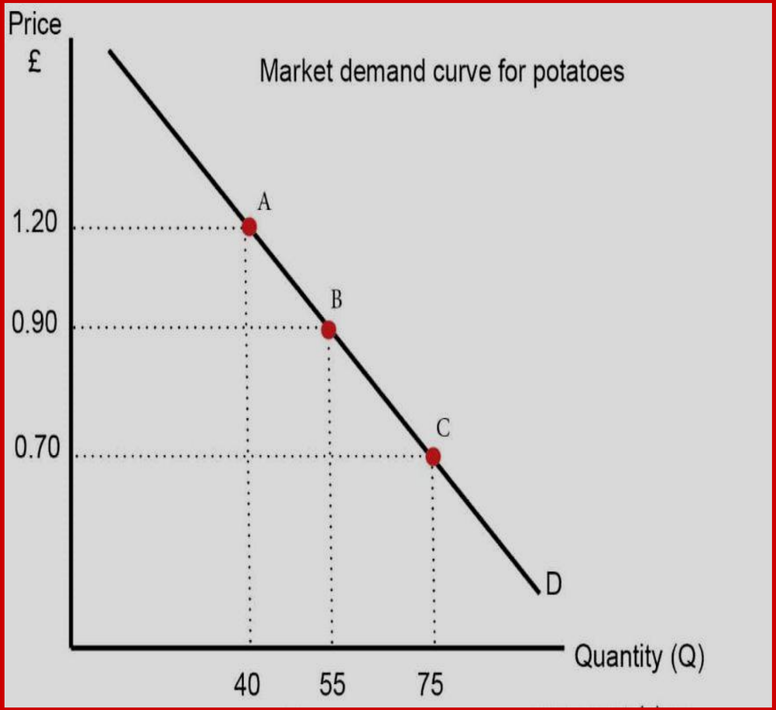
Demand Schedule and Demand curve

A demand schedule is a table that shows the quantity demanded at each price. A demand curve is a graph that shows the quantity demanded at each price.

The demand schedule **shows exactly how many units of a good or service will be purchased at various price points.**

Law of Demand

The law of demand states that **the quantity purchased varies inversely with price**. In other words, the higher the price, the lower the quantity demanded. This occurs because of diminishing marginal utility.

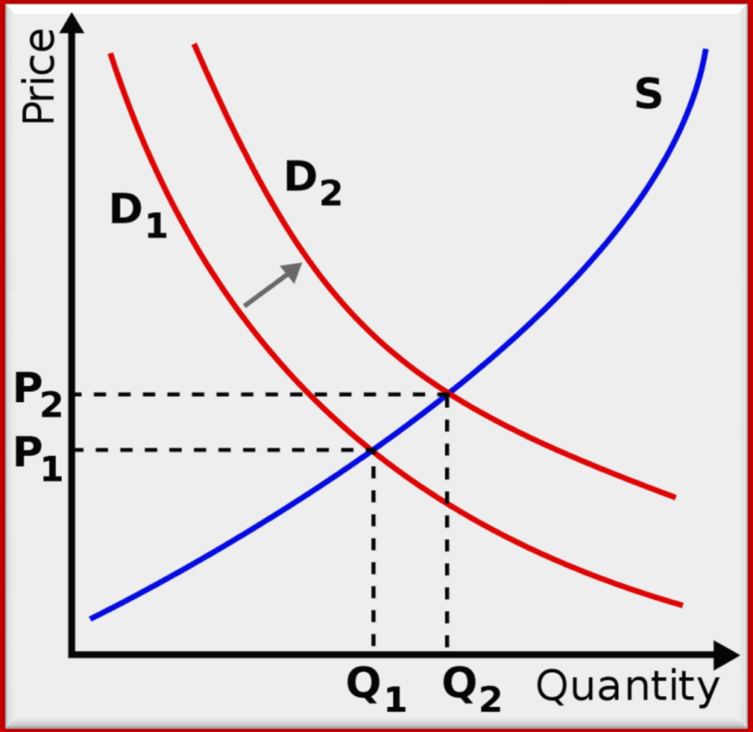


Exceptions to the law of Demand

- The three exceptions to the law of Demand are **Giffen goods, Veblen effect, and income change**.
- A Giffen good is **a low income, non-luxury product for which demand increases as the price increases and vice versa**. (Salt, Bajra)
- Veblen goods are **typically high-quality goods that are made well, are exclusive, and are a status symbol**. (Apple Phone)

Shifts in demand curve,

Demand curve movement refers to changes in price that affect the quantity demanded. A demand curve shift refers to **fundamental changes in the balance of supply and demand that alter the quantity demanded at the same price**



Elasticity of Demand and its measurement.

Elasticity is measured by the ratio of two percentages. For example, consider the price elasticity of demand. The price elasticity of demand is measured by calculating the ratio of the change in the quantity demanded to the change in the price.

Formula

$$e_{(p)} = \frac{dQ/Q}{dP/P}$$

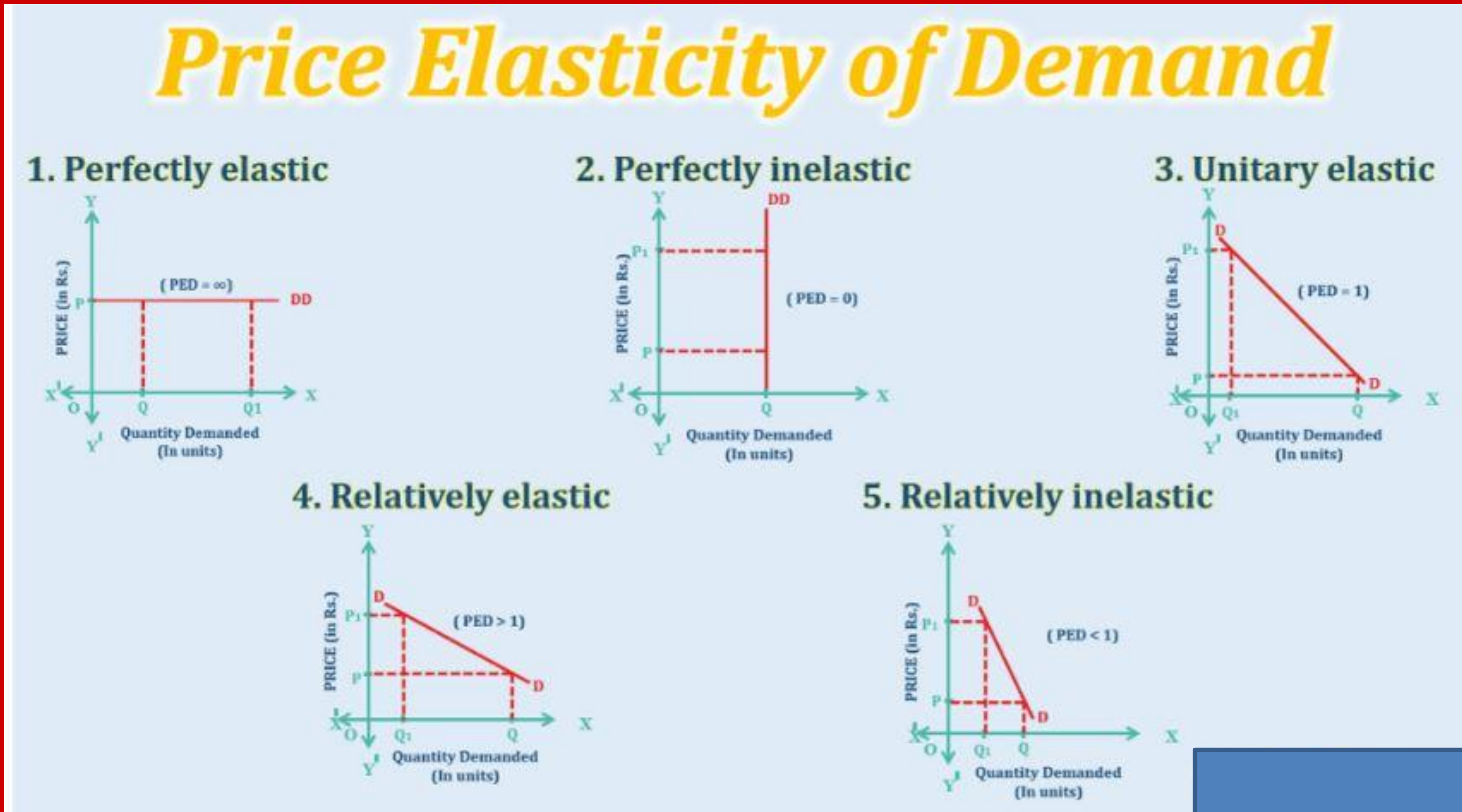
$e_{(p)}$ = price elasticity

Q = quantity of the demanded good

P = price of the demanded good

Price Elasticity,

- **Price elasticity** of demand is a measurement of the change in consumption of a product in relation to a change in its price


Price Elasticity of Demand
1. Perfectly elastic
(PED = ∞)
DD
PRICE (in Rs.)
Quantity Demanded
(In units)
2. Perfectly inelastic
DD
(PED = 0)
PRICE (in Rs.)
Quantity Demanded
(In units)
3. Unitary elastic
(PED = 1)
PRICE (in Rs.)
Quantity Demanded
(In units)
4. Relatively elastic
(PED > 1)
PRICE (in Rs.)
Quantity Demanded
(In units)
5. Relatively inelastic
(PED < 1)
PRICE (in Rs.)
Quantity Demanded
(In units)

Income Elasticity,

Income Elasticity of Demand

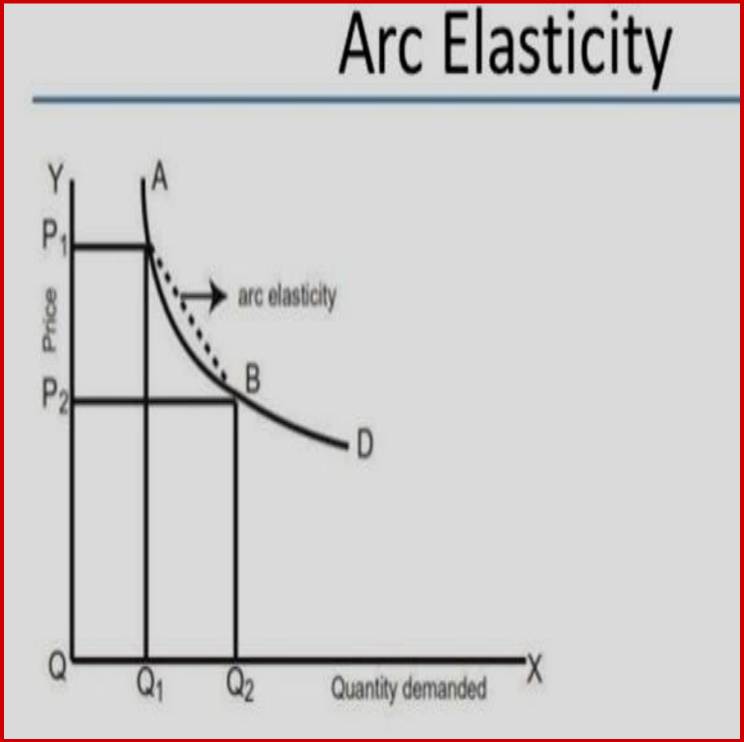
A measure of how demand for a product changes when people's incomes change

Income Elasticity of Demand – 3 Types

Negative	Positive	Zero
Associated with inferior goods.	Associated with luxury goods.	These are sticky goods.
For example, cheap cars. When my income rises, I stop buying cheap cars.	For example, when my income rises I buy more vacations abroad.	For example, electricity, butane gas, water, salt, cooking oil, and kerosene.

Arc Elasticity

- Arc elasticity is **the elasticity of one variable with respect to another between two given points**. It is used when there is no general function to define the relationship between the two variables. Arc elasticity is also defined as the elasticity between two points on a curve.



Cross Elasticity

Uses of Elasticity of Demand for managerial decision making

- Elasticity is an economic concept used **to measure the change in the aggregate quantity demanded of a good or service in relation to price movements of that good or service**. A product is considered to be elastic if the quantity demand of the product changes more than proportionally when its price increases or decreases.

Demand forecasting meaning

- Demand forecasting is **the process of using predictive analysis of historical data to estimate and predict customers' future demand for a product or service**. Demand forecasting helps the business make better-informed supply decisions that estimate the total sales and revenue for a future period of time

Demand forecasting significance

- Demand forecasting **reduces risk related to business activities and helps it to take efficient decisions**. For firms having production at the mass level, the importance of forecasting had increased more. A good forecasting helps a firm in better planning related to business goals

Supply Analysis

- Supply Analysis is **a research and analysis done to understand the supply trends and responses to changing market and production variables**. Supply Analysis takes into account the production costs, raw material costs, technology, labour wages etc

Law of Supply

- The law of supply is a fundamental principle of economic theory which states that, keeping other factors constant, an increase in price results in an increase in quantity supplied. In other words, there is a direct relationship between price and quantity: quantities respond in the same direction as price changes.

Price of a Product under demand and supply forces

- **Equilibrium price**. When a product exchange occurs, the agreed upon price is called an equilibrium price, or a market clearing price.