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ECONOMICS, MANAGERIAL ECONOMICS AND DEMAND

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Introduction

To make an informed decision an organization should be able to understand various things like which industry do you operate in, the main competitors, the dynamics of forces like demand and supply, what expansion path and strategy you should follow. The economic principles help an organization to understand above factors and help make business decisions.

What is Economics

Economics is the study of how scare resources are allocated to competing needs (Samuelson & Temin 1976). Most resources like Capital, Human resources, material etc. are limited in availability, application of Economics helps use these limited resources to maximize the value. Managerial economics refers to the use of economic principles to make business decisions and enable business to efficiently and effectively achieve its objectives. For example, Managerial economics can be used to assess the new production system and how it will impact the cost of the product and how the market will respond to the new product.

Fundamental Assumptions of Economics

1) Scarcity: A business manager must have to give up one opportunity to pursue another one as there exists only a finite amount of human and nonhuman resources to use.
2) Rationality: Individuals and firms usually act rationally by consistently making decisions that maximize their benefit that means essentially acting in a logical and self-interested manner when making economic decisions.
3) Individuals and firms pursue their self -interest: It is necessary for any economic activity to take place It is the main driving force of any economic activity to happen.

The Demand Curve

Demand in simple terms means how much a consumer desires a product and willing to pay for it in return. Demand also describes the relation between the price of the product and consumers' willingness and ability to purchase at that price.

The demand curve is a graphical representation that shows the relationship between the price of a good and the quantity demanded. The graph represents changes in quantities when price of the product change, keeping all the other variables constant. "The demand curve is used when economists want to analyze how consumers respond to a change in price or other factors (Baumol and Blinder, 2012)."

A simple version of demand curve is shown in the below figure. Price is indicated on the y-axis and quantity demanded is indicated on the x-axis. The demand curve shows the demand in relationship to price and proves that demand is inversely related to the price of the product. That means, as the price goes up the demand goes down and vice versa.

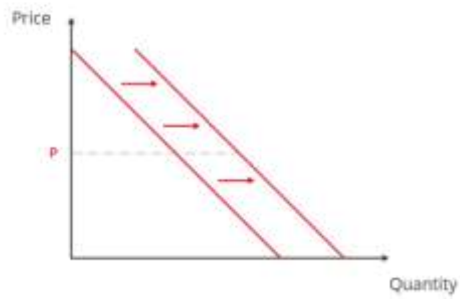
Standard Demand Curve

However, it's the willingness to pay by a consumer which determines the demand but keep in mind willingness to pay differs from one Individual to another, it depends on the ability to pay (income), It can be driven by time and change overtime and depends on the competitors of the product.

Sometimes there is no driving factors or logical explanation to consumers' willingness to pay. It depends on one's personal likes, dislikes, taste, circumstances and choices.

Shifts in the Demand Curve

As a demand curve is specific to a particular place and time, it is affected by the various factor other than the price and causing the curve to shift to right or left entirely. A right shift indicates the increase in the demand and the left means a decrease in demand.



Demand Shift

Following factors cause the demand curve to shift:

- Change in the characteristic or feature of the product. For example, an I-phone may have an added feature making it faster than previous one.
- Change in prices and feature of the other competing goods.
- Change in consumers circumstances leading to change in income.
- Change in the conditions driven by natural, political and economic circumstances. One big example of this was during covid times, the demand for goods and services fell.
- Changes driven by business due to change in their strategy and plan.

Price elasticity of Demand

Price elasticity of demand is a measurement of how quantity demanded is affected by changes in price, i.e. it shows how demand for a product increase or decrease as its price increase or decrease. PED refers to the percentage change in quantity demanded when the price of the product changes by 1%. An inelastic demand means that a small change in price will not drive a major change on the quantity demanded. Consumer will continue to purchase the product irrespective of the increase in price. However, if the product has elastic demand that means a small change in the price will drive significant change in the quantities demanded.

PED= % Change in quantity demanded I % Change in price

Table comparing and summarizing price elasticity of demand.

Elasticity value	Demand	Description	Shape of demand curve
ED < -1	Elastic	Quantity demanded changes by more than 1% for every 1% change in price.	Slopes downward gradually; leans towards being horizontal
ED = -1	Unit elastic	Quantity demanded changes proportionally with a change in price.	Standard downward-sloping demand curve
ED > -1	Inelastic	Quantity demanded changes by less than 1% for every 1% change in price.	Slopes downward sharply; leans towards being vertical
ED = 0	Perfectly inelastic	Quantity demanded does not change with a change in price.	Perfectly vertical
ED = ∞	Perfectly elastic	Quantity demanded is infinite at a particular price. Any change in price results in no demand for the product.	Perfectly horizontal

The Elasticity of demand can vary across the demand curve. The shape of firms demand curve is driven by its products price elasticity. The managers can forecast the demand curve by doing market research, studying the past data and analyzing the past trends.

Conclusion

Business manager should apply economic principles to make crucial pricing decision on their product. While pricing the products they should consider the price elasticity of their product and consumers willingness to pay. This is crucial for the business's objective of growth, maximum profit margins and maintain higher demand.

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