Managerial economics essay sample

Profession, Manager

Price Elasticity:

Price Elasticity is used to explain the degree of responsiveness of the demand for a product to a change in its price. Ep= Percentage change in quality demanded/Percentage change in price (Ep= Price Elasticity)

Practical applications of Price Elasticity:

1)Helps in fixing the prices of different goods: It helps a producer to fix the price of his product. A higher price is charged if the demand for the product is inelastic and a lower price is charged if the demand for the product is elastic. Thus, the price-increase policy is to be followed if the demand is inelastic in the market and the price-decrease policy is to be followed if the demand is elastic. 2) Poverty in the midst of plenty: Inelastic demand for agricultural products helps to explain why bumper crops or rice or wheat depress the prices and total revenues for farmers.

3)Helps in fixing the rate of taxes: Governments look at elasticity of demand when levying excise taxes. Excise taxes on products with inelastic demand will raise the most revenue and have the least impact on quantity demanded for those products.

4)Demand for cocaine is highly inelastic and presents problems for law enforcement. Stricter enforcement reduces supply, raises prices and revenues for sellers, and provides more incentives for sellers to remain in business. Crime may also increase as buyers have to find more money to buy their drugs.

5)The concept of elasticity of demand is made practical use of by the Finance Minister and the monopolist. When the Government imposes a tax on a commodity, its price will tend to rise. But if the demand is very elastic, it will considerably fall when the price has risen. The result will be that Government will not get larger revenue from this tax because the people will have considerably curtailed their demand for it. If the Finance Minister, therefore, wants to be certain of the revenue from a particular tax he must levy it on such commodities for which the demand is less elastic. Income Elasticity:

Income elasticity of demand refers to the percentage change in quantity demanded that results from some percentage change in consumer incomes Ei = Percentage change in quantity demanded/Percentage change in income (Ei= Income Elasticity)

Practical applications of Income Elasticity:

1) Helps in determining the rate of growth of the firm. If the growth rate of the economy and income growth of the people is reasonable forecasted, in that case it is possible predict expected increase in the sales of a firm and vice versa.

2) Helps in the demand forecasting of a firm. It can be in estimating future demand provided the rate of increase in income and Ei for the products are known. Thus, it helps in demand forecasting activities of a firm.

3) Helps in production planning and marketing.

The knowledge of Ei is essential for production planning, formulating marketing strategy, deciding advertising expenditures and nature of distribution channel etc in the long run.

4) Helps in ensuring stability in production.

Proper estimation of different degrees of income elasticity of demand for different types of product helps in avoiding over-production or under-production of a firm. One should know whether rise or fall in income is permanent or temporary.

5) Helps in estimating construction of houses.

The rate of growth in incomes of people also helps in housing programs in a country. Thus it helps a lot in managerial decisions of a firm.