Managerial Economics

UNIT II

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Market Demand and Supply:

- **Demand** refers to the quantity of a good or service that consumers are willing and able to purchase at various prices. It typically decreases as price increases, showing a negative relationship.
- **Supply** represents the quantity of a good or service that producers are willing and able to sell at different prices. It generally increases with price, showing a positive relationship.
- **Market Equilibrium** occurs when the quantity demanded equals the quantity supplied at a given price, known as the equilibrium price.

Determinants of Demand and Supply

- **Demand Determinants**: Price of the good, consumer income, tastes and preferences, prices of related goods (substitutes and complements), and consumer expectations.
- **Supply Determinants**: Price of the good, production costs, technology, number of producers, and expectations of future prices.

Forecasting

- **Forecasting**:
- Forecasting is predicting future demand, supply, or market conditions based on historical data and trends. It helps businesses anticipate changes in the market to make informed decisions about production, pricing, and inventory.

Elasticity of Demand and Supply

- **Price Elasticity of Demand (PED)**: Measures how sensitive the quantity demanded is to a change in price. If demand changes significantly with price changes, it’s considered elastic; if not, it’s inelastic.
- **Price Elasticity of Supply (PES)**: Measures how responsive the quantity supplied is to a change in price. If supply can be easily increased, it’s elastic; if not, it’s inelastic.

Production Analysis

- **Production Function**: Describes the relationship between inputs (like labor and capital) and the resulting output. In the short run, at least one input is fixed, while in the long run, all inputs can be varied.
- **Short-Run Analysis**: Focuses on the law of variable proportions, where adding more of one input (e.g., labor) to a fixed amount of another input (e.g., capital) will initially increase output but eventually lead to diminishing returns.
- **Long-Run Analysis**: Involves adjusting all inputs to find the optimal combination for producing goods or services efficiently.

Law of Variable Proportion

- In the short run, when one factor of production is varied while others are fixed, there will be phases of increasing returns, followed by diminishing returns. As more units of a variable input are added, the additional output produced by each new unit of input decreases after a certain point.

Returns to Scale

- **Increasing Returns to Scale**: Output increases by a greater proportion than the increase in inputs. This happens when larger-scale production leads to more efficient use of resources.
- **Constant Returns to Scale**: Output increases in direct proportion to the increase in inputs.
- **Decreasing Returns to Scale**: Output increases by a lesser proportion than the increase in inputs, often due to inefficiencies at large scales.

Economies of Scale

- **Economies of Scale** refer to the cost advantages that businesses experience when increasing the scale of production. As production expands, per unit cost generally decreases due to factors like mass production, specialization, and better use of resources.

Market Equilibrium

- **Equilibrium Price and Quantity**: In a free market, the **equilibrium price** is where the supply and demand curves intersect, indicating the price at which the quantity demanded equals the quantity supplied. The **equilibrium quantity** is the amount of goods or services exchanged at this price.
- **Shifts in Equilibrium**: If there is a shift in either the demand or supply curve (due to factors like changes in consumer preferences, income levels, or production costs), the market equilibrium price and quantity will adjust according

Elasticity and Its Types

- **Price Elasticity of Demand (PED)**: A higher absolute value of PED indicates greater sensitivity to price changes. It can be:
  - **Elastic (>1)**: A small change in price leads to a large change in quantity demanded.
  - **Inelastic (<1)**: A price change leads to a small change in quantity demanded.
  - **Unitary (1)**: A price change results in a proportional change in quantity demanded.

- **Income Elasticity of Demand**: Measures the responsiveness of demand to changes in consumer income. For normal goods, demand increases as income rises, while for inferior goods, demand decreases as income rises.**Cross Elasticity of Demand**: Measures the responsiveness of the demand for one good to a change in the price of another good. Positive cross elasticity indicates substitute goods, while negative cross elasticity indicates complementary goods.