MANAGERIAL ECONOMICS

CONCEPT OF DEMAND

- Demand doesn't only means to have desire or need for the commodity. It means that there is adequate purchasing power or the commodity is actually bought or used.

- Determinants of Demand :-

(I) **Factors influencing individual demand.**

(a) Price – There is inverse relationship between price and demand of the commodity. That means, if price increases, demand decreases and vice versa.
(b) Income- There is a direct relationship between income of a person and demand of a commodity. More income means more of the purchasing power which leads to increase it demand and vice versa.
(c) Relative prices of other goods- Other goods includes Substitute and complimentary goods. Substitute goods are the goods that can be used in place of each other whereas complimentary goods are the goods which can be used alone. They are meant to be consumed together. For e.g. Pen and ink.
There is direct relationship between price of substitute goods and demand for the given commodity. If price of substitute increases then demand for given commodity will increase and vice versa. Whereas,
There is inverse relationship between price of complimentary good and demand of the give commodity i.e. when price of complimentary good increases then demand for the given commodity decreases and vice versa.
(d) Advertisement effect- Better advertisement leads to increase in demand for the product.
(e) Consumer expectations- If consumer expects that the price for the product will decrease in future then he will decrease his consumption in present and will consume after price decrease.

(II) **Factors influencing Market demand**

(a) Price of the product- At low price, market demand will be high and vice versa
(b) Distribution of income – If there would be equal distribution of income among every community then there would be greater demand for the product than in the case of unequal distribution of income.

(c) Common habits and preferences- Demand is greatly affected by the scale of preferences of buyers in general. For example: If there would be more of vegetarian community, then vegetarian food products would be more in demand than non vegetarian.
(d) Sex ratio of population – Age structures and sex ratio determines the market demand for many products in a relative sense.
(e) Level of taxation and Tax structure- High tax would generally mean a low demand for the product and vice versa.
(f) Advertisement – Demand at market level is manipulated through selling efforts and advertisement level for the product.

- Demand Schedule

  A tabular representation which shows an inverse relationship between price and demand for the commodity is called Demand Schedule.
  (I) Individual demand Schedule- Showing the quantities of a commodity that is purchased by an individual at a various prices and during a give period of time.

Price of X in Rs. (per kg)	Quantity demanded of X (in kg)
20	6
15	10
10	16

  (II) Market Demand Schedule – Showing the quantities demanded in aggregate by the all the buyers at various prices and during a given period of time.

Price in Rs. (per unit)	Unit of commodity X demanded per day by individuals			Quantity demanded in the market for X
	A	B	C	
3	2	4	5	11
2	3	5	7	15
1	5	9	10	24

- Demand Curve – It is a graphical representation of a demand schedule. When demand schedule is plotted on graph, a demand curve is drawn.
  The demand curve has a negative slope . It slopes downwards from left to right showing the inverse relationship between price and demand.

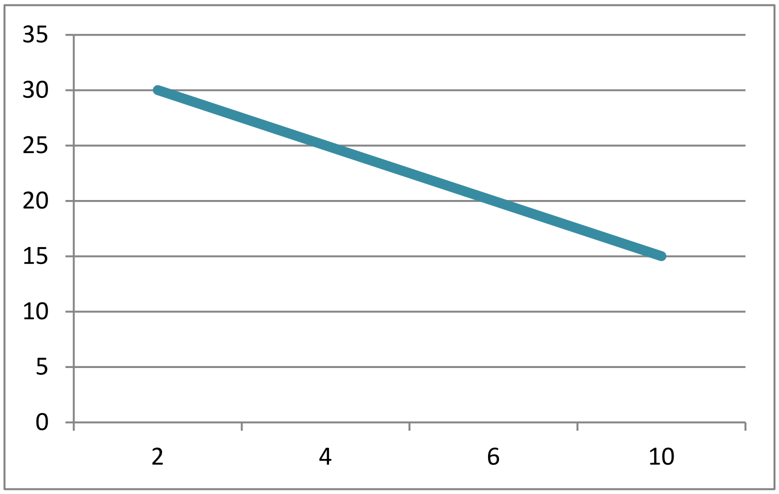
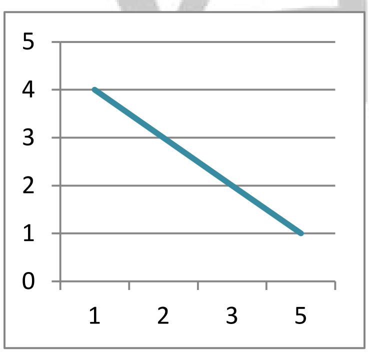
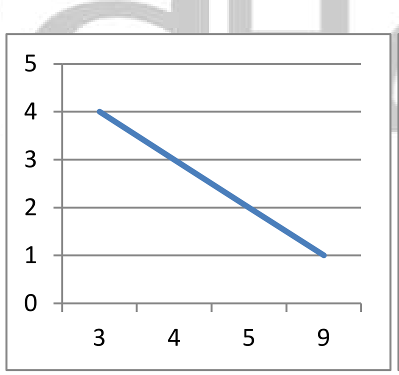


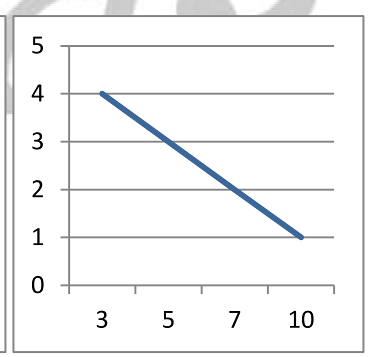
Figure 1- Individual demand curve

The quantity demanded is measured on horizontal axis (X axis) and Price on vertical axis (Y axis)

- <u>Derivation Of Market Demand Curve</u> – Horizontal summation of individual demand curves forms market demand curve and graphically depicts the nature of price and quantity demanded of a market as a whole.







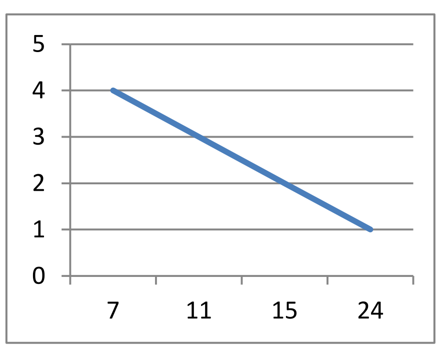


Figure 2- Market demand curve

- <u>Law Of Demand</u> – Law of demand states that other things being equal, there is an inverse relationship between the price and the quantity demanded of a commodity.

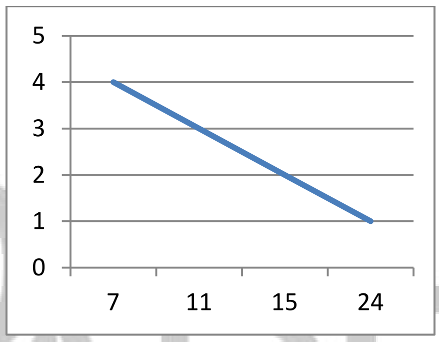
  D=f (P)

  Where, D = Demand

  P= Price and,

  f= functional relationship between the two.

  The law of demand usually referred to the market demand and can be understood with the demand schedule which shows that as the price of a commodity decreases, the corresponding quantity demanded increases and vice- versa.



where , x axis- Quantity demanded

Y axis- Price

and Demand curve is shown through

- <u>Assumptions to the Law of demand</u>

  It is always stated in the definition of Law of demand that 'Other things being equal' which means that there is no change in factors that affects demand other than the price. Assumptions are as below :-

  (a) No change in consumer's income.

  (b) No changes in prices of related goods.

  (c) No change in government policy.

  (d) No change in tastes and preferences.

  (e) No change in age composition sex ratio.

  Law of demand basically works on an assumption that demand is getting affected only by price and all other factors are constant.

- <u>Exceptions to the Law of Demand</u>

It has been observed that in many situations, there could be a direct relationship between price and demand of the commodity and it is regarded as exception to the law of demand . In this case, Demand curve slopes upwards from left to right expressing the direct relationship between price and demand.

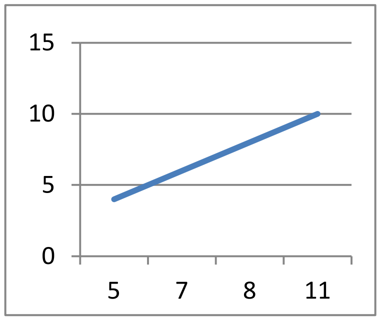


Figure 3- Exceptional Demand Curve

The situations where it could be possible are:-
(I) Giffen goods- These are the inferior quality goods that may be purchased at low income but with increase in income, consumer switches to good quality good which are of higher price.
(II) Snob Appeal- These are the articles that are preferred as status symbol i.e. more expensive product leads to more better status symbol.
(III) Consumer's Psychological bias- Some customers don't want to compromise with the quality of the product and because of this, they would like to pay good prices for more better quality.

- Difference between Changes in Quantity Demanded and Changes in demand

Change in Quantity Demanded	Change in Demand
The term change in quantity demanded means when demand for the commodity changes because of price factor only, remaining all other factors constant.	The term Change in demand means when demand changes due to change in determinants of demand other than price i.e. price remains constant.
In context to quantity demanded, the variation referred as expansion and contraction in demand.	In context to demand, the variation referred to as increase and decrease in demand.

- <u>Expansion and Contraction of Demand (Changes in Qty. demanded)-</u> Demand expands when the price falls and it contracts when the price rises. Further, expansion and contraction implies a movement on the same demand curve which means demand schedule remains the same.

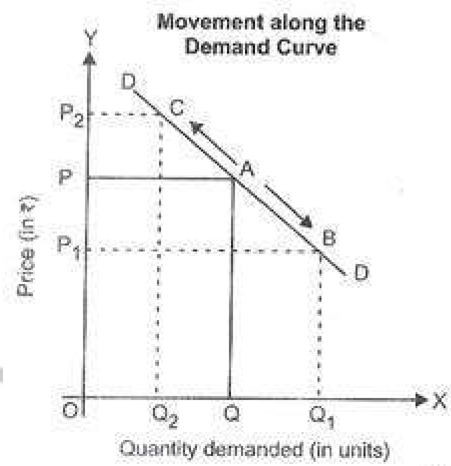


Fig. 3.4

- <u>Increase and Decrease in demand</u>

  It is the result of change in conditions and factors determining other than the price. When more of a commodity is bought than before at any given price, there is increase in demand. Similarly, when at a constant price, less of a commodity is bought then there is decrease in demand.

  However, increase and decrease in demand is shown by a shift in demand curve.

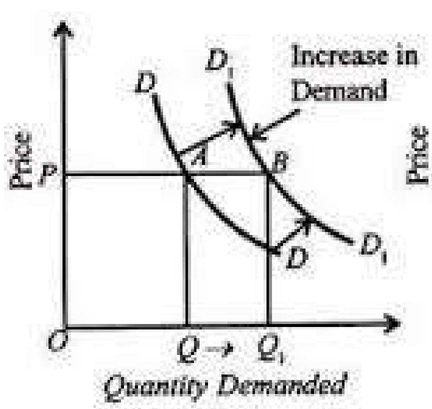


Fig. 4

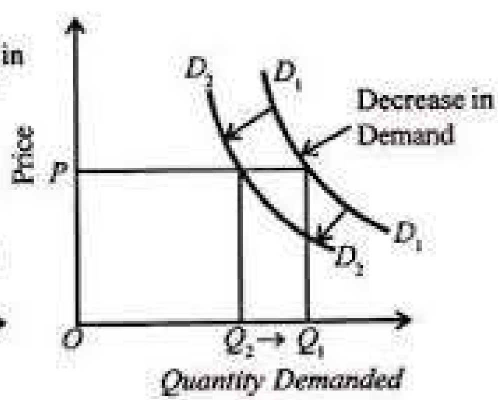


Fig. 5