**Dr.SNS Rajalakshmi College of Arts & Science (Autonomous)**

**Department of Commerce with Information Technology**

**21UCY302: MANAGERIAL ECONOMICS**

**Unit I: Introduction to managerial economics**

Managerial Economics - meaning, nature and scope - Managerial Economics and business decision making - Role of Managerial Economist - Fundamental concepts of Managerial Economics- Demand Analysis - meaning, determinants and types of demand - Elasticity of demand.

**IntroductiontoEconomics:**

Economics isa study ofhuman activity both atindividual andnational level.Any activityinvolvedineffortsaimedatearningmoneyandspendingthismoneytosatisfyourwantssuchasfood,Clothing, shelter,andothersarecalled“Economic activities”.

It was only during the eighteenth century that Adam Smith, the Father of Economics, definedeconomicsasthe studyofnatureand uses ofnationalwealth’.

**Definition:**

Dr. Alfred Marshall, one of the greatest economists of the nineteenth century, writes “Economicsis a study of man’s actions in the ordinary business of life: it enquires how he gets his incomeandhowhe usesit”.

Prof.LionelRobbinsdefinedEconomicsas“thescience,whichstudieshumanbehaviorasa relationshipbetweenendsandscarcemeanswhichhavealternativeuses”.

**Microeconomics:**

* Thestudyofanindividualconsumer orafirmiscalledmicroeconomics.
* Micromeans‘onemillionth’.
* Microeconomicsdealswithbehaviorandproblemsofsingleindividualandofmicroorganization.
* Itisconcernedwiththeapplicationoftheconceptssuchaspricetheory,LawofDemandandtheories of marketstructure andsoon.

**Macroeconomics:**

* Thestudyof‘aggregate’ortotallevelofeconomicactivityinacountryiscalled Macro Economics.
* It studies the flow of economics resources or factors of production (such as land, labor,capital,organizationandtechnology)fromtheresourceownertothebusinessfirmsandthenfromthe businessfirmstothehouseholds.
* Itis concernedwiththelevelofemploymentintheeconomy.
* Itdiscussesaggregateconsumption,aggregateinvestment,pricelevel,andpayment,theories ofemployment,and soon.

**Nature ofmanagerialEconomics:**

**1. Closetomicro economics:**

Managerialeconomicsisconcernedwithfindingthesolutionsfordifferentmanagerialproblemsofa particularfirm.Thus,itismoreclose tomicroeconomics.

**2. Operatesagainstthebackdrop ofmacro economics:**

The macroeconomics conditions of the economy are also seen as limiting factorsfor thefirmtooperate.Inotherwords,themanagerialeconomisthastobe aware of the limits setbythemacroeconomicsconditionssuchasgovernmentindustrialpolicy,inflationandsoon.

**3. Normativestatements:**

A normative statement usually includes or implies the words ‘ought’ or ‘should’. Theyreflectpeople’smoralattitudesandareexpressionsofwhatateamofpeopleoughttodoSuchstatementarebasedonvaluejudgmentsandexpressviewsof whatis‘good’or‘bad’,‘right’ or‘ wrong’.One problem with normative statements is that they cannot to verify by looking at thefacts, because they mostly deal with the future. Disagreements about such statementsare usuallysettledbyvotingonthem.

**4. Prescriptiveactions:**

Prescriptiveactionisgoaloriented. Given a problem and the objectives of the firm, it suggests the course of action from theavailablealternativesforoptimalsolution.It also explains whether the concept can be applied in a given context on not. Forinstance, the factthat variablecostsare marginal costscan be usedto judge thefeasibilityofan exportorder.

**5. Appliedinnature:**

‘Models’arebuilttoreflectthereallifecomplexbusinesssituationsandthesemodelsare ofimmensehelp tomanagersfor decision-making.Thedifferentareaswheremodelsareextensivelyusedincludeinventorycontrol,optimization, projectmanagementetc.Inmanagerialeconomics,wealsoemploycasestudymethodstoconceptualizetheproblem,identifythatalternative anddetermine thebestcourseofaction.

**6. Offersscopetoevaluate eachalternative:**

Managerial economics provides an opportunity to evaluate each alternative in terms ofits costsandrevenue. The managerial economist can decide which is the better alternative to maximizetheprofitsforthefirm.

**7. Interdisciplinary:**

The contents, tools and techniques of managerial economics are drawn from differentsubjectssuchaseconomics,management,mathematics,statistics,accountancy,psychology,organizational behavior,sociologyand etc.

**Scopeof ManagerialEconomics**:

Thescopeofmanagerialeconomicscoverstwoareasofdecisionmaking

* OperationalorInternalissues
* EnvironmentalorExternalissues

**I. Operational Issues:**

**a. DemandAnalysesandForecasting:**

Demand analysis also highlights for factors, which influence the demand for a product.This helps to manipulate demand. Thus demand analysis studies not only the priceelasticity but also income elasticity, cross elasticity as well as the influence of advertisingexpenditure with the adventofcomputers.

Demandforecastinghasbecomeanincreasinglyimportantfunctionofmanagerialeconomics. A firm can survive only if it is able to the demand for its product at the righttime, within the right quantity. Understanding the basic concepts of demand is essentialfordemandforecasting

**b. Pricingandcompetitivestrategy:**

Pricing decisions have been always within the preview of managerial economics. Pricetheoryhelpstoexplainhowpricesaredeterminedunderdifferenttypesofmarketconditions.

 Competitionsanalysisincludes the anticipation of the response of competitions thefirm’spricing,advertisingandmarketingstrategies.Productlinepricingandpriceforecastingoccupyanimportantplacehere.

**c. Productionandcostanalysis:**

Productionanalysisis inphysicalterms. While the cost analysis is in monetary terms cost concepts and classifications, cost-out-put relationships, economies and diseconomies of scale and production functions aresome ofthepointsconstitutingcostand productionanalysis.

**d. ResourceAllocation:**

Managerial Economics is the traditional economic theory that is concerned with theproblem ofoptimumallocationofscarceresources. Marginal analysis is applied to the problem of determining the level of output, whichmaximizesprofit.

In this respectlinear programming techniques has been used to solve optimizationproblems.Infactlinesprogrammingisoneofthemostpracticalandpowerfulmanagerialdecisionmaking toolscurrentlyavailable.

**e. Profitanalysis:**

Profit making is the major goal of firms. There are several constraints here an account ofcompetitionfromotherproducts,changinginputpricesandchangingbusinessenvironment henceinspiteof carefulplanning,there is alwayscertainrisk involved.

Managerial economics deals with techniques of averting of minimizing risks. Profit theoryguides in the measurement and management of profit, in calculating the pure return oncapital,besidesfutureprofitplanning.

**f. Capitalorinvestmentanalyses:**

Capitalisthefoundationofbusiness.Lackofcapitalmayresultinsmallsizeofoperations. Availability of capital from various sources like equity capital, institutionalfinanceetc.mayhelptoundertakelarge-scale operations. Hence efficient allocation and management of capital is one of the most important tasksofthemanagers.

The major issues related to capital analysis are:

1. Thechoiceofinvestmentproject.

2. Evaluation of the efficiency of capital3.Mostefficientallocationof capital.

Knowledgeofcapitaltheorycanhelpverymuchintakinginvestmentdecisions.Thisinvolves,capitalbudgeting,feasibilitystudies,analysis ofcostofcapitaletc.

**g. Strategicplanning:**

Strategic planning providesa long-term goals and objectives and selects the strategiestoachieve thesame. .Theperspective ofstrategicplanningisglobal. strategicplanninghasgivenrisetobenewareaofstudycalledcorporateeconomics.

**II. EnvironmentalorExternalIssues:**

 Theyrefer to generaleconomic, socialandpoliticalatmospherewithinwhichthefirmoperates.Astudyofeconomicenvironmentshouldinclude:

* Thetypeofeconomicsysteminthecountry.
* Thegeneraltrendsinproduction, employment,income,prices,savingandinvestment.
* Trends in the working of financial institutions like banks, financial corporations, insurancecompanies
* Magnitudeandtrendsinforeigntrade;
* Trendsinlabour andcapitalmarkets;
* Government’seconomicpoliciesviz.industrialpolicymonetarypolicy,fiscalpolicy,pricepolicyetc.
* Thesocialenvironmentreferstosocialstructure.
* ThePoliticalenvironmentreferstothenatureofstateactivity,chieflystates’attitude towardsprivatebusiness,politicalstabilityetc.
* Theenvironmentalissueshighlightthesocialobjectiveofafirmi.e.;thefirmowesaresponsibilityto thesociety.Privategainsofthefirmalonecannotbethegoal.

**Role of Managerial Economist:**

**1. Useful Advice in Economic Matters:**By providing financial advice, provides assistance to managers in planning and decision-making. [Managerial Economics](https://www.googlesir.com/managerial-economics-definition-nature-scope-notes/) presents various types of advice and different types of data to assist managers in planning and decision making in order to take the right decision in the right direction.

**2. Reduction in Risks of Uncertainties:**The managerial economist reduces the risk of the future by removing uncertainties. It helps managers make decisions using [successful pre-estimates in the business.](https://www.googlesir.com/identification-of-business-opportunities/) The economist advances in future prospects and reduces future risk.

### 3. Trustworthy Forecasting:Managerial economists make useful information on future planning to managers by guessing the firm’s value, sales, [capital,](https://www.googlesir.com/nature-and-scope-of-venture-capital/) goods tables. Market research can be made to improve the firm’s products.

###  4. Economic Operation: The managerial economist can promote financial flexibility in different areas of the firm and encourage frugalness in each sector so that the firm’s friendly operation is possible.

### 5. Reduction in Production and Distribution Costs:By analyzing the internal and external conditions of the firm, the managerial economist reduces the [production and distribution](https://www.googlesir.com/nature-and-scope-of-venture-capital/) of appropriate adjustments. [Management Accounting -Techniques and Tools](https://www.googlesir.com/management-accounting-techniques/)

**6. Increase in Competition Power of the Firm:**Reliable forecasts of the firm are enhanced by the lack of friendly operation and cost, the [firm’s reputation](https://www.scribd.com/doc/19470190/Unit-III-Utility-Analysis-Economics) is increased in self-power.

 **7. Increase in Profit Earning Capacity:**Managerial economists can increase the state of [profit](https://www.soas.ac.uk/courseunits/151030009.html) by giving useful advice to managers.

### 8. Implementation of Government policies:Due to increasing political intervention in business and industry, [managerial economists](https://london.ac.uk/courses/managerial-economics-mn3028) can help the firm to protect the government from harming the government’s related economic policies.

### 9. Coordination with External Situations:It helps in keeping pace with the conditions and is useful in adjusting monetary policy, [fiscal policy](https://www.googlesir.com/objectives-of-fiscal-policy/), price policy in the firm’s own policies.

**Fundamental concepts in Managerial Economics**:

Managerial Economics is both conceptual and metrical. Before the substantive decision problems which fall within the purview of managerial economics are discussed, it is useful to identify and under­stand some of the basic concepts underlying the subject.

### 1. The Incremental Concept:

The incremental concept is probably the most important concept in economics and is certainly the most frequently used in Managerial Economics. Incremental concept is closely related to the mar­ginal cost and marginal revenues of economic theory. The two major concepts in this analysis are incremental cost and incremental revenue. Incremental cost denotes change in total cost, whereas incremental revenue means change in total revenue resulting from a decision of the firm.

### 2. Concept of Time Perspective:

The time perspective concept states that the decision maker must give due consideration both to the short run and long run effects of his decisions. He must give due emphasis to the various time periods. It was Marshall who introduced time element in economic theory.

The economic concepts of the long run and the short run have become part of everyday language. Managerial economists are also concerned with the short run and long run effects of decisions on revenues as well as costs. The main problem in decision making is to establish the right balance between long run and short run.

### 3. The Opportunity Cost Concept:

Both micro and macro economics make abundant use of the fundamental concept of opportunity cost. In everyday life, we apply the notion of opportunity cost even if we are unable to articulate its significance. In Managerial Economics, the opportunity cost concept is useful in decision involving a choice between different alternative courses of action. Resources are scarce, we cannot produce all the commodities. For the production of one com­modity, we have to forego the production of another commodity. Opportunity cost of a decision is the sacrifice of alternatives required by that decision. Sacrifice of alternatives is involved when carrying out a decision requires using a resource that is limited in supply with the firm.

### 4. Equi-Marginal Concept:

One of the widest known principles of economics is the equi-marginal principle. The principle states that an input should be allocated so that value added by the last unit is the same in all cases. This generalization is popularly called the equi-marginal. An optimum allocation cannot be achieved if the value of the marginal product is greater in one activity than in another. It would be, therefore, profitable to shift labour from low marginal value activity to high marginal value activity, thus increasing the total value of all products taken together.

### 5. Discounting Concept:

This concept is an extension of the concept of time perspective. Since future is unknown and incalculable, there is lot of risk and uncertainty in future. This judgment is made not on account of the uncertainty surround­ing the future or the risk of inflation. It is simply that in the intervening period a sum of money can earn a return which is ruled out if the same sum is available only at the end of the period.

### 6. Risk and Uncertainty:

Managerial decisions are actions of today which bear fruits in future which is unforeseen. Future is uncertain and involves risk. The uncertainty is due to unpredictable changes in the business cycle, structure of the economy and government policies. This means that the management must assume the risk of making decisions for their institution in uncertain and unknown economic conditions in the future. Economic theory generally assumes that the firm has perfect knowledge of its costs and demand relationships and of its environment.

**DEMAND ANALYSIS**

**INTRODUCTION:**

Demand in common parlance means the desire for an object This means that the demand becomes effective only it if is backed by the purchasing power in addition to this there must be willingness to buy a commodity. Thus demand has three essentials – price, quantity demanded and time.

**DEMAND DEFINITION:**

“Demand means the various quantities of goods that would be purchased at a particular price and not merely the desire of a thing.”

**LAW OF DEMAND:**

Law of demand shows the relation between price and quantity demanded of a commodity in the market. In the words of Marshall, “the amount demand increases with a fall in price and diminishes with a rise in price”.

**Demand Schedule.**

|  |  |
| --- | --- |
| **Price of Apple (in Rs)** | **Quantity Demanded** |
| 10 | 1 |
| 8 | 2 |
| 6 | 3 |
| 4 | 4 |
| 2 | 5 |

When the price falls from Rs. 10 to 8 quantity demand increases from 1 to 2. In the same way as price falls, quantity demand increases on the basis of the demand schedule we can draw the demand curve.



The demand curve DD shows the inverse relation between price and quantity demand of apple. It is downward sloping.

**Assumptions:**

Law is demand is based on certain assumptions

**1.** This is no change in consumers taste and preferences.

**2.** Income should remain constant.

**3.** There should be no substitute for the commodity

**4.** The commodity should not confer at any distinction

**5.** The demand for the commodity should be continuous

**6.** People should not expect any change in the price of the commodity

**EXCEPTIONS TO THE LAW OF DEMAND:**

**1. Giffen paradox:**

The Giffen good or inferior good is an exception to the law of demand. When the price of an inferiorgood falls, the poor will buy less and vice versa. For example, when the price of maize falls, the poor arewilling to spend more on superior goods than on maize if the price of maize increases, he has to increase the quantity of money spent on it.

**2. Veblen or Demonstration effect:**

‘Veblan’ has explained the exceptional demand curve through his doctrine of conspicuous consumption.Rich people buy certain good because it gives social distinction or prestige for example diamonds arebought by the richer class for the prestige

**3. Ignorance:**

Sometimes, the quality of the commodity is Judge by its price. Consumers think that the product issuperior if the price is high. As such they buy more at a higher price.

**4. Speculative effect:**

If the price of the commodity is increasing the consumers will buy more of it because of the fear that itincrease still further, Thus, an increase in price may not be accomplished by a decrease in demand.

**5. Fear of shortage:**

During the times of emergency of war People may expect shortage of a commodity. At that time, theymay buy more at a higher price to keep stocks for the future.

**6. Necessaries:**

In the case of necessaries like rice, vegetables etc. people buy more even at a higher price.

**FACTORS AFFECTING THE DEMAND:**

▪ **Price of the Commodity:**

The relation between price and demand is called the Law of Demand. It is not only the existing price but also the expected changes in price, which affect demand.

▪ **Income of the Consumer:**

The second most important factor influencing demand is consumer income. IThe demand for a normalcommodity goes up when income rises and falls down when income falls. But in case of Giffen goods therelationship is the opposite.

▪ **Prices of related goods**:

The demand for a commodity is also affected by the changes in prices of the related goods also. Related goods can be of two types:

(i). Substitutes which can replace each other in use; for example, tea and coffee are substitutes. The change in price of a substitute has effect on a commodity’s demand in the same direction in which price changes. The rise in price of coffee shall raise the demand for tea;

(ii).Complementary foods are those which are jointly demanded, such as pen and ink. If the price of pens goes up, their demand is less as a result of which the demand for ink is also less. The price and demand go in opposite direction. The effect of changes in price of a commodity on amounts demanded of related commodities is called Cross Demand.

▪ **Tastes of the Consumers:**

The amount demanded also depends on consumer’s taste. Tastes include fashion, habit, customs, etc.A consumer’s taste is also affected by advertisement. If the taste for a commodity goes up, its amount demanded is more even at the same price. This is called increase in demand. The opposite is called decrease in demand.

▪ **Population:**

Increase in population increases demand for necessaries of life. A change in composition of population

has an effect on the nature of demand for different commodities.

▪ **Government Policy:**

Government policy affects the demands for commodities through taxation. Taxing a commodity increases its price and the demand goes down. Similarly, financial help from the government increases the demand for a commodity while lowering its price.

▪ **Expectations Price in the future:**

If consumers expect changes in price of commodity in future, they will change the demand at present even when the present price remains the same. Similarly, if consumers expect their incomes to rise in the near future they may increase the demand for a commodity just now.

▪ **Climate and weather:**

The climate of an area and the weather prevailing there has a decisive effect on consumer’s demand. Incold areas woolen cloth is demanded. During hot summer days, ice is very much in demand. On a rainyday, ice cream is not so much demanded.

**ELASTICITY OF DEMAND**

Elasticity of demand explains the relationship between a change in price and consequent change inamount demanded.

**Elastic demand:** A small change in price may lead to a great change in quantity demanded. In this case, demand is elastic.

**In-elastic demand:** If a big change in price is followed by a small change in the quantity demanded, then the demand in “inelastic”.

**Types of Elasticity of Demand:**

**1. Price elasticity of demand:**

Marshall was the first economist to define price elasticity of demand. Price elasticity of demand measures changes in quantity demand to a change in Price. It is the ratio of percentage change in quantity demanded to a percentage change in price.

𝑷𝒓𝒊𝒄𝒆𝒆𝒍𝒂𝒕𝒊𝒄𝒊𝒕𝒚 = P𝒓𝒐𝒑𝒐𝒓𝒕𝒊𝒐𝒏𝒂𝒕𝒆𝒄𝒉𝒂𝒏𝒈𝒆𝒊𝒏𝒕𝒉𝒆𝒒𝒖𝒂𝒏𝒕𝒊𝒕𝒚𝒅𝒆𝒎𝒂𝒏𝒅𝒐𝒇𝒄𝒐𝒎𝒎𝒐𝒅𝒊𝒕𝒚

 P𝒓𝒐𝒑𝒐𝒓𝒕𝒊𝒐𝒏𝒂𝒕𝒆𝒄𝒉𝒂𝒏𝒈𝒆𝒊𝒏𝒕𝒉𝒆𝒑𝒓𝒊𝒄𝒆𝒐𝒇𝒄𝒐𝒎𝒎𝒐𝒅𝒊𝒕𝒚

There are five cases of price elasticity of demand

▪ Perfectly elastic demand

▪ Perfectly inelastic

▪ Relatively elastic demand

▪ Relatively inelastic demand

▪ Unitary demand

**2. Income elasticity of demand:**

Income elasticity of demand shows the change in quantity demanded as a result of a change in income.

Income elasticity of demand may be slated in the form of a formula.

I𝑛𝑐𝑜𝑚𝑒𝑒𝑙𝑎𝑠𝑡𝑖𝑐𝑖𝑡𝑦 =P𝑟𝑜𝑝𝑜𝑟𝑡𝑖𝑜𝑛𝑎𝑡𝑒𝑐h𝑎𝑛𝑔𝑒𝑖𝑛𝑡h𝑒𝑞𝑢𝑎𝑛𝑡𝑖𝑡𝑦𝑑𝑒𝑚𝑎𝑛𝑑𝑜𝑓commodity

P𝑟𝑜𝑝𝑜𝑟𝑡𝑖𝑜𝑛𝑎𝑡𝑒𝑐h𝑎𝑛𝑔𝑒𝑖𝑛𝑡h𝑒𝑖𝑛𝑐𝑜𝑚𝑒

**3. Cross elasticity of Demand:**

A change in the price of one commodity leads to a change in the quantity demanded of another commodity. This is called a cross elasticity of demand. The formula for cross elasticity of demand is:

I𝑛𝑐𝑜𝑚𝑒𝑒𝑙𝑎𝑠𝑡𝑖𝑐𝑖𝑡𝑦 = P𝑟𝑜𝑝𝑜𝑟𝑡𝑖𝑜𝑛𝑎𝑡𝑒𝑐h𝑎𝑛𝑔𝑒𝑖𝑛𝑡h𝑒𝑞𝑢𝑎𝑛𝑡𝑖𝑡𝑦𝑑𝑒𝑚𝑎𝑛𝑑𝑜𝑓𝑐𝑜𝑚𝑚𝑜𝑑𝑖𝑡𝑦𝑥

P𝑟𝑜𝑝𝑜𝑟𝑡𝑖𝑜𝑛𝑎𝑡𝑒𝑐h𝑎𝑛𝑔𝑒𝑖𝑛𝑡h𝑒 price of commodity y

**a. In case of substitutes**, cross elasticity of demand is positive. Eg: Coffee and Tea. When the price of coffee increases, Quantity demanded of tea increases. Both are substitutes.



**b. Incase of compliments**, cross elasticity is negative. If increase in the price of one commodity leads to a decrease in the quantity demanded of another and vice versa. When price of car goes up from OP to OP!, the quantity demanded of petrol decreases from OQ to OQ!.



The cross-demanded curve has negative slope.

**4. Advertisement elasticity of Demand:**

A change in the advertisement cost for a commodity leads to the change in the quantity demanded for a

commodity.

𝐴𝑑𝑣𝑒𝑟𝑡𝑖𝑠𝑒𝑚𝑒𝑛𝑡𝑒𝑎𝑠𝑡𝑖𝑐𝑖𝑡𝑦 = P𝑟𝑜𝑝𝑜𝑟𝑡𝑖𝑜𝑛𝑎𝑡𝑒𝑐h𝑎𝑛𝑔𝑒𝑖𝑛𝑡h𝑒 quantity demanded 𝑜𝑓𝑐𝑜𝑚𝑚𝑜𝑑𝑖𝑡𝑦

 p𝑟𝑜𝑝𝑜𝑟𝑡𝑖𝑜𝑛𝑎𝑡𝑒𝑐h𝑎𝑛𝑔𝑒𝑖𝑛𝑡h𝑒 advertisement of commodity

**Measures of elasticity of demand:**

**A. Perfectly elastic demand:**

When small change in price leads to an infinitely large change is quantity demand, it is called perfectlyelastic demand**. In this case (E=∞).** The demand curve DD1 is horizontal straight line. Itshows the at “OP” price any amount is demand and ifprice increases, the consumer will not purchase thecommodity.

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**B. Perfectly Inelastic Demand**

In this case, even a large change in price fails to bring about a little or no change in quantity demanded.When price increases from ‘OP’ to ‘OP’, the quantity demanded remains the same. In other words the response of demand to a change in Price is nil. In this **case (‘E’=0)**



**C. Relatively elastic demand:**

Demand changes more than proportionately to a change in price. i.e. a small change in price loads to a very big change in the quantity demanded. In this case (E > 1). This demand curve will be flatter. When price falls from ‘OP’ to ‘OP1’, amount demanded increase from “OQ’ to “OQ1’ which is larger than the change in price



**D. Relatively in-elastic demand.**

Quantity demanded changes less than proportional to a change in price. A large change in price leads to small change in amount demanded. Here( E < 1) Demanded carve will be steeper. When price falls from “OP’ to ‘OP1 amount demanded increases from OQ to OQ1, which is smaller than the change in price.



**E. Unit elasticity of demand:**

The change in demand is exactly equal to the change in price. When both are equal E=1 and elasticity if said to be unitary. When price falls from ‘OP’ to ‘OP1’ quantity demanded increases from ‘OP’ to ‘OP1’, quantity demanded increases from ‘OQ’ to ‘OQ1’. Thus a change in price has resulted in an equal change in quantity demanded so price elasticity of demand is equal to unity.



**SIGNIFICANCE OF ELASTICITY OF DEMAND**

The concept of elasticity is very useful to the producers and the policy makers. It is very valuable tool decide the extent of increase or decrease in price for a desired change in the quantity demanded for theproducts and services in the firm or the economy.

**1. Prices of factors of production:**

The factors o f production is land, labour,capital and organization and technology. We need to payrent,wages,interest, profits and price for the factors of production.

2. .**Price fixation:**

The manufacturer can decide the amount of prices that can be fixed for his product based on the conceptof elasticity , if the manufacturer is monopoly, the manufacturer is free to fix as long as it doesnot attractthe attention of the government .If the demand for the product is inelastic, he can fix a higher price.

**3. Government policies**

I. **Tax policies:** Government extensively depends on this concept to finalize its policies relating to thetaxes and revenue, where the product is such that the people cannot postpone its consumption,the government tends to increase the prices.**Eg:** Petrol prices.

II. **Raising bank deposits:** If the government wants to mobilize larger deposits from the customers , itproposes to raise the rates of fixed deposits marginally and vice versa.

III. **Public Utilities**: Government uses the concept of elasticity in fixing charges for the public utilities suchas electricitytariff, water charges.

IV. **Revaluation or devaluation of currency**: The govt has to study the impact of revaluation and

devaluation on the interests of th e exporter and importer.

4. **Forecasting Demand**:

The trade can estimate the quantity of goods to be sold at different income levels to raise the targeted revenue. The impact of changing income levels on the demand of the product can be assessed with the help of income elasticity.

**5. Planning the level of output and price:**

It helps the producer to evaluate whether a change in price will bring in adequate revenue or not in general for items whose demand is elastic, it would benefit him to charge relatively low prices. If the demand for the product is inelastic, a little higher price may be helpful to him to get huge profitswithout losing sales