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**Master of Business Administration**

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***MANAGERIAL ECONOMICS- WEEK 2 NOTES***

**CERTIFICATE OF AUTHORSHIP:**

I certify that I am the author of this paper and that any assistance I receive in its preparation is fully acknowledged and disclosed in this paper. I have also cited any sources from which I used data, ideas, or works, either quoted directly or paraphrased. I also certify that this paper was prepared by me specifically for this course/program.

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Professor Comments:

# Managerial Economics

## Week II Chapters 6 & 7

$$\text{Profit} = (P - AC) \times Q$$

Marginal Value:

Total Value:

**First Law of demand:** When the consumer purchases more as price falls

**Consumer Surplus** = total value - amount paid

**Aggregate demand curve:** The relationship between the price and the number of purchases made by this group of consumers

Marginal Profits:

Average Revenue:

Marginal Revenue:

**Marginal analysis** tells you where to price or, equivalently, how many units to sell.

If  $MR > MC$ , reduce price

If  $MR < MC$ , increase price

$e = (\% \text{ Quantity demanded}) / (\% \text{ Price})$

If  $e > 1$ , demand is **elastic**

If  $e < 1$ , demand is **inelastic**

When it is inelastic, when price increases, the quantity demanded might not decrease that much, but in the long run, it might move.

$$e = [(Q_1 - Q_2) / (Q_1 + Q_2)] / [(P_1 - P_2) / (P_1 + P_2)]$$

For an **elastic demand**, a **decrease in price** leads to an increase in revenue

$$(\% \text{ Revenue}) = \% \text{Quantity} + \% \text{Price}$$

**For elastic demand:**

Price increase ——— Revenue decrease

Price decrease ——— Revenue increase

**For inelastic demand:**

Price increase——Revenue increase

Price decrease——Revenue decrease

The **more elastic** is a demand, the **lower is the profit-maximizing price**

Products with **close substitutes** have **more elastic demand**

$\%Q = e(\%P)$

Factor elasticity of demand =  $(\%Q / \%P)$

Income elasticity of demand measures the change in demand arising from changes in income.

**Cross price elasticity** of demand measures the change in quantity demanded for A caused by a change in the price of B.

**Stay-even analysis** tells whether a given price increase will be profitable

$1) \%Q = \%P / (\%P + \text{margin})$

Margin =  $(P - MC) / P$

1. Predict how much quantity will go down if price is raised by the given amount

If the predicted quantity is less than the stay even quantity, then the price increase will likely to be profitable, and vice versa

See page 79

## Chapter 7

**The law of diminishing marginal returns:** As you try to expand output, your marginal productivity (the extra output associated with extra inputs) eventually declines.

**Diminishing marginal productivity** implies increasing marginal cost.

**Increasing marginal costs** eventually lead to increasing average costs.

**Economics of Scope:** The cost of producing two products jointly is less than the cost of producing those two products separately.

**Economics of Scale:** As you produce more, the price goes down per unit. Quantity goes up, average cost goes down.

Constant returns to scale: When in long-run average costs are constant with respect to output

**Decreasing returns to scale or diseconomies of scale:** When in the long-run average costs rise with output

**Increasing returns to scale or economies of scale:** When in the long-run average costs fall with output

**Average fixed Cost:** It's your fixed cost divided by your quantity.

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- **In class Notes:**

**Explicit**= everything that comes out of your pocket

**Implicit cost**= opportunity cost

**Economic Profit:** accounting cost-your opportunity costs

**Accounting profit:** Looks at your revenue -your explicit cost

$$TC=FC+VC \cdot Q$$

**Marginal Cost:** The cost for adding one more unit

**PV(present value)**=  $FV (Future Value) \div (1+r)^{\text{exponent } y}$

$$Q_{be}=FC/(P-MC)$$

**Sunk cost:** Money that has already been spent and cannot be removed

**Fixed Cost:** A fixed cost is a repeated cost.

Price causes demand to change.

**Demand curve:** The higher the price, the more you are willing to pay for it.

**Quiz:**

You want to sell quantity goes low to high. Be careful not to put it in the chart from high to low.

You sell 8 at 1 dollar

7 at 2 dollars

See Board picture

There is a difference between demand and quantity demanded. Look it up

**Elasticity:** How much you are willing to stretch

Products that are inelastic: Starbucks

Price elasticity is always negative.

$E = Q/P$

Quizz

If you are asked a question about price elasticity, remember that the number is always negative.

When

$MR = P(1 - |e|)$  (valeur absolue de e).

$MR > MC$

$(P - MC)/P > 1/|e|$

Profit margin-Marginal Cost

Besides price, what could affect the quantity demanded?

Competition/Substitutes

**Cross Price elasticity:** How much one product is affected by the other? Ex. Peanut butter and jelly. They go in opposite directions.

Cross Price Elasticity could be either be positive or negative

If it is a substitute product, cross price elasticity is always going to be positive.

If two products are complements, their cross price elasticity has to be negative.

When talking about cross elasticity, if it is positive, they are substitutes, if elasticity is negative, they are complements.

**Income elasticity:** income goes up, demand for hamburger goes down.- demand for filet mignon goes up

income goes down, demand for hamburgers goes up.

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## Week II- Part II

Law of diminishing return is focused on capacity limitation. It will cause your capacity to go up, which will cost you more in return.

Deficiencies of scale:  
Deficiencies of scope;

Learning Curve: Per ex. IKEA

Inelastic: 0 to -1

Normal good:  
Inferior good:

## Week II Part II

### **Supply curve:**

DO NOT USE DEMAND & SUPPLY ANALYSIS TO DESCRIBE CHANGES FACING AN INDIVIDUAL FIRM. EX. iPhones

Changes in **price** lead to changes in quantity demanded

**Controllable Factor:** Something that affects demand that a company can control.

**Uncontrollable factors:** weather,

**Shift of demand curve:** Third variable that impacts quantity demanded

**Supply curves:** describe the behavior of a group of sellers and tell you how much will be sold at a given price.

The higher the price, the higher the quantity.

**Market equilibrium;** Price at which quantity supplied equals quantity demanded. **Where supply equals demand.**

In market equilibrium, there are no unconsummated wealth-creating transactions.

When the quantity of supply is greater than the quantity demanded, there is surplus or excess supply.

Consumers	Quantity	Suppliers	Q
\$10	1	6	1
\$9	2	7	2
\$8	3	8	3
\$7	4	8	4
\$6	5	10	5

Equilibrium in this chart is where price = demand  
 On the quiz, when it asks about equilibrium, figure out the quantity.

Price moves along the curve  
 If supply goes up and demand goes down,

## Chapter 9

### **Competitive industries**

Long-run equilibrium: When capital stops flowing into the industry. The length of the short run depends on how quickly assets move into or out of the industry.

In the long run, no competitive industry earns more than an average rate of return. Also, in the long-run equilibrium, economic profit is zero (including the opportunity cost of capital).

A competitive firm can earn positive or negative economic profit in the short run but only until entry or exit occurs. In the long run, competitive firms earn only an average rate of return.

**Indifference principle;** If an asset is mobile, then in long-run equilibrium, the asset will be indifferent about where it is used; that is, it will make the same profit no matter where it goes.

In equilibrium, differences in the rate of return reflect differences in the riskiness of an investment.

### **9.3 Monopoly**

Monopolies have attributes that protect them from the forces of competition:

- Produce a product or service with no close substitutes
- Have no rivals
- Barriers to entry prevent other firms from entering the industry

10.

To increase performance, figure out a way to increase P (price) or reduce C (cost)

The five Forces model is a framework for analyzing the attractiveness of an industry.

**Attractive industries:**

Low supplier power

Low buyer power

Low threat of entry

Low threat of substitutes

Low rivalry

**Strategy:** art of matching the resources and capabilities of a firm to the opportunities and risks in its external environment for the purpose of developing a sustainable competitive advantage

**Class note**

One thing impacts quantity quantity demanded: Price