

# MANAGERIAL ECONOMICS AND FINANCIAL ANALYSIS

## Online Lecture Series

Topic: Law of Demand

Lecture-o6



**Dr. P.TIRUMALA**

**M.COM., M.B.A., B.L., M.HRM, Ph.D**

ASSOCIATE PROFESSOR  
MANAGEMENT STUDIES

DEPARTMENT OF SCIENCE AND HUMANITIES

LENDI INSTITUTE OF ENGINEERING & TECHNOLOGY



# LAW OF DEMAND

Statement of Law : “ Other things being equal, the higher the price of a commodity, the smaller is the quantity demanded and lower the price, larger the quantity demanded”.

→ **Factors behind Law of demand**

- Substitution effect
- Income effect
- Utility Maximising behaviour

→ **Exceptions to Law of demand**

- ❑ Expectation regarding future prices
- ❑ Giffen goods
- ❑ Articles of snob appeal / Veblen effect
- ❑ Consumer's psychological bias ( about quality and price relationship)

# Description of Law of Demand

## Law of Demand

- States that a quantity of a good demanded during a given period relates **inversely** to its price, other things constant.
- Price increases → Quantity Demanded decreases
- Price decreases → Quantity demanded increases
- Creates a downward sloping demand curve



# Demand Analysis

## *Law of Demand*

When the  
price goes  
up...

...the  
quantity  
demanded  
goes down.

**NOTE:** *The  
relationship  
between  
price and  
quantity is  
inverse.*

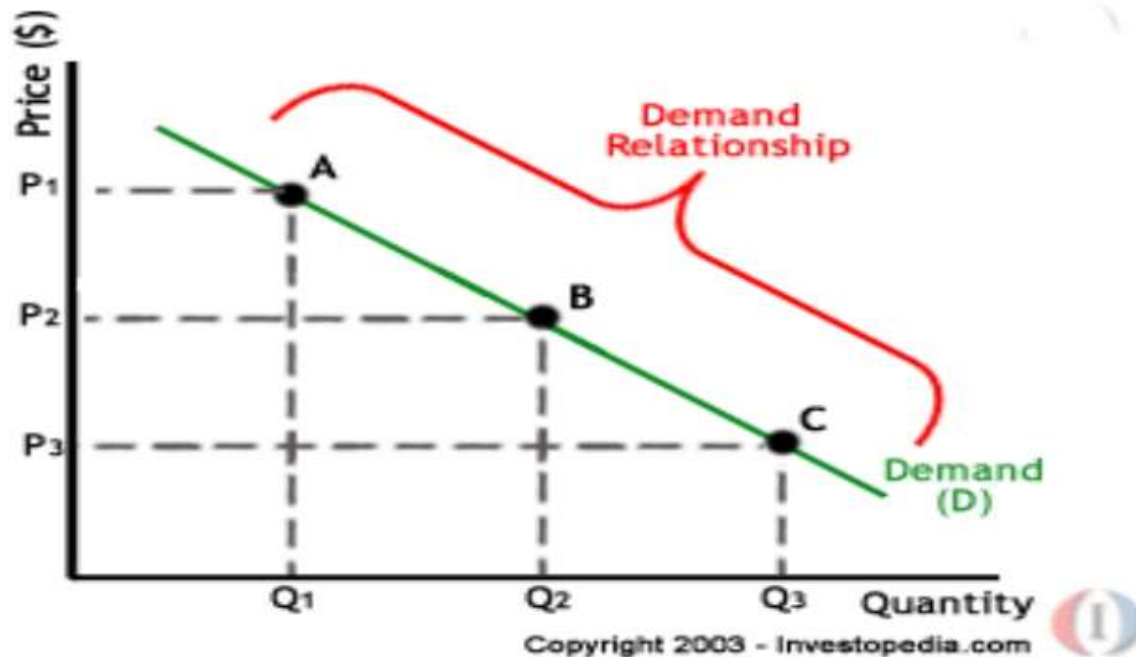
When the  
price goes  
down...

...the  
quantity  
demanded  
goes up.



# Geographical Representation

The geometrical representation of demand schedule is called the demand curve.



# Example of Law of Demand

## Demand Schedule and Curve

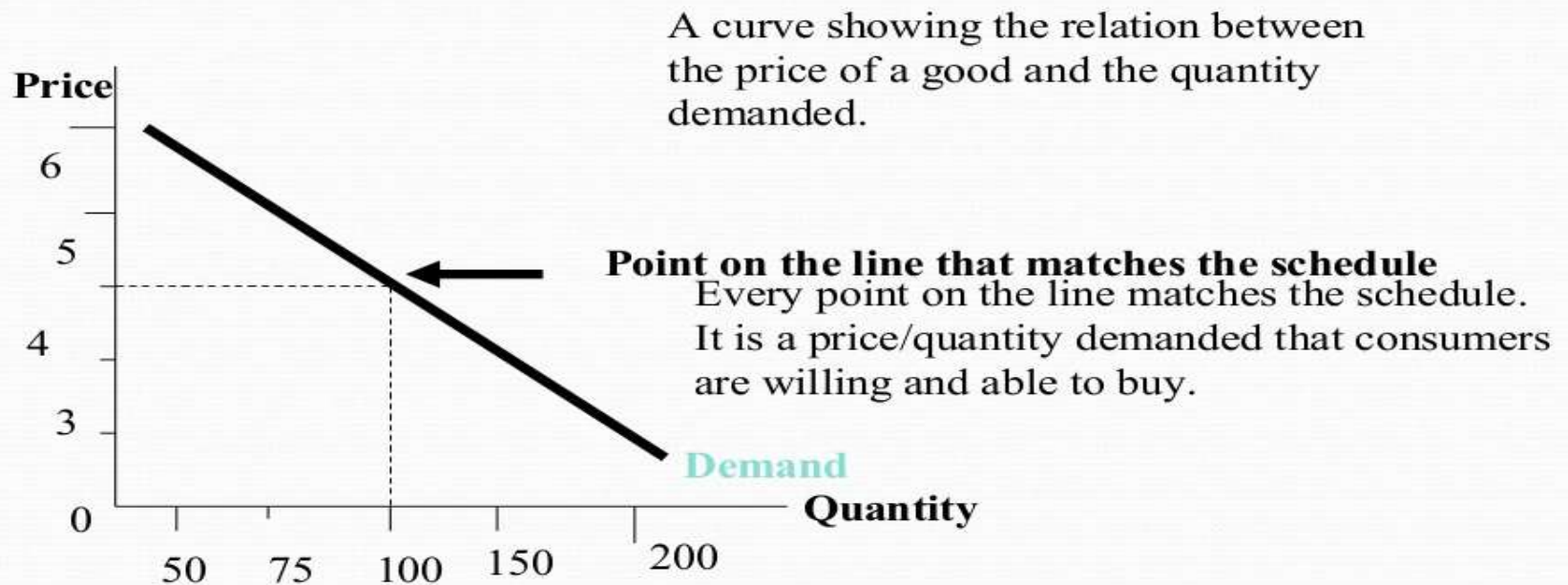
- Demand curve:
  - a curve showing the relation between the price of a good and quantity demanded during a given period, other things constant.
  - Suppose we are making pizza.

Price of Good	Quantity Demanded
3	200
4	150
5	100
6	75
7	50



# Graphical Representation

## Demand Curve



# Reletivity between Price and Demand

## Movement Along the Demand Curve

- Caused by a change in price
  - **Only a change in price**
- Move from one point to another on the same graph
- Called a
  - Change in quantity demanded.

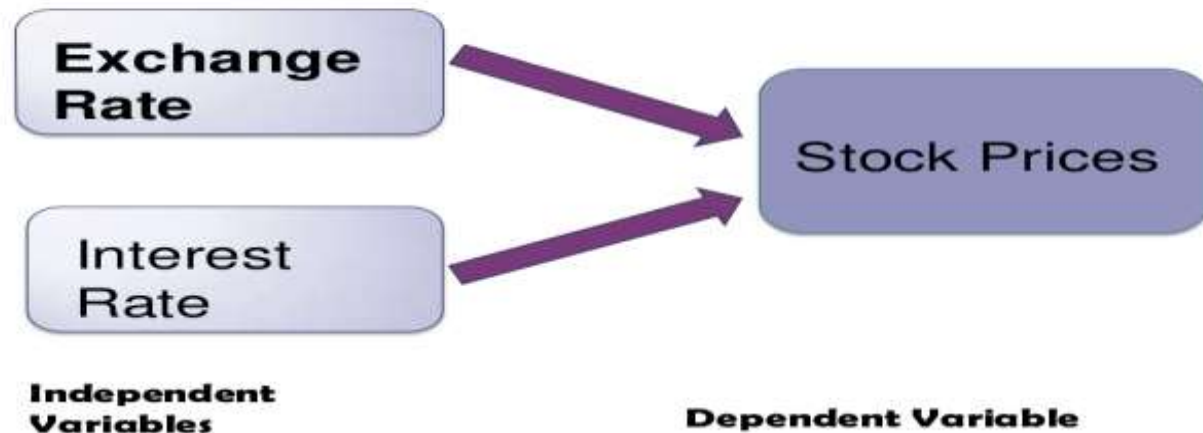
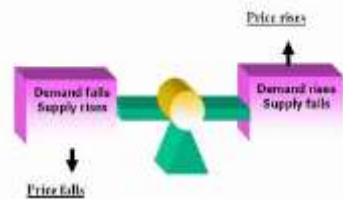




# FEATURES OF LAW OF DEMAND

- There are four important features of law of demand. They are:
  - Inverse relation between price and demand
  - Price is always independent
  - Demand is dependent on price
  - Other determinants of demand are constant

## Theoretical Framework



# EXCEPTIONS OF LAW OF DEMAND

- In some cases the demand don't increases with decrease in price or not the vice versa.
- There are some reasons which will not obey law of demand. They are:
  - Giffens paradox rule
  - Ignorance of prices
  - Speculative effect
  - Fear of shortage
  - Necessaries

# *GIFFEN'S PARADOX RULE*

- The Giffen good or inferior good is an exception to the law of demand. When the price of an inferior good falls, the poor will buy less and vice versa.
- “Giffen” first explained this and therefore it is called as Giffen’s paradox.



# Normal Good Vs Inferior Good

## Normal Good

- |                            |                     |
|----------------------------|---------------------|
| ↑ An increase in income... | ↑ increases demand. |
| ↓ A decrease in income...  | ↓ decreases demand. |

## Inferior Good

- |                            |                     |
|----------------------------|---------------------|
| ↑ An increase in income... | ↓ decreases demand. |
| ↓ A decrease in income...  | ↑ increases demand. |

## Inferior Goods



Vs.



Vs.



Vs.



What is an inferior good?



# *IGNORANCE OF PRICE*

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

# FEAR OF SHORTAGE

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

# PRICE OF RELATED GOODS

- 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 ranges. The rise in price of coffee shall raise the demand for tea;
- Complementary goods are those which are jointly demanded, such as pen and ink. In such cases complementary goods have opposite relationship between price of one commodity and the amount demanded for the other. If the price of pens goes up, their demand is less as a result of which the demand for ink is also less.

# ***FEAR OF INCREASE IN PRICE***

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



# FACTORS INFLUENCING LAW OF DEMAND

- Price of the product
- Income of consumer
- Price of related goods
- Taste of consumers
- Wealth
- Population
- Government policy
- Expectations about price in future
- State of business

***THANK YOU***