

Answer on Question #69331 - Economics -Microeconomics

Question: What are the uses of elasticity's to the private sector

Answer: There are specific economic forms of elasticity, what are used in business:

Cross elasticity of demand

Companies utilize cross elasticity of demand to establish prices to sell their goods. Products with no substitutes have the ability to be sold at higher prices, because there is no cross elasticity of demand to consider. However, incremental price changes to goods with substitutes are analyzed to determine the appropriate level of demand desired and the associated price of the good. Additionally, complimentary goods are strategically priced based on cross elasticity of demand. For example, printers may be sold at a loss with the understanding that the demand for future complementary goods, such as printer ink, should increase.

Income elasticity of demand

Income elasticity of demand can be used as an indicator of industry health, future consumption patterns and as a guide to firms investment decisions.

Price elasticity of demand

It may be assumed that a business firm pursues the goal of maximizing profit. Its profit is the excess of its revenue receipts over its total cost. The former, in turn, is determined by the product of the unit price of the good (P_x) and the quantity of its demand (D_x).

Price elasticity of supply

It is important for a firm to be highly responsive to changes in price and other market conditions. This is because a high price elasticity of supply makes the firm more competitive than its rivals and it allows the firm to generate more revenue and profits.

Consequently, the use of elasticity allows entrepreneurs to make the right decisions about pricing, to predict possible revenues from the sale of their own goods and services. Understanding whether or not a business's product or service is elastic is integral to the success of the company. Beyond prices, the elasticity of a good or service directly affects the customer retention rates of a company. Businesses often strive to sell goods or services that have inelastic demand; doing so means that customers will remain loyal and continue to purchase the good or service even in the face of a price increase.

Sources:

Bordley; McDonald. "Estimating Income Elasticities from the Average Income of a Product's Buyers and the Population Income Distribution". Journal of Business and Economic Statistics

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