Managerial Economics (BACC-535)

**To increase a company’s performance, a manager suggests that the company needs to increase the value of its product to customers. Describe three ways in which this advice might be incorrect (Hint: Think about what else might or might not change that affects profit.)**

To succeed in a competitive market companies are required to find an advantage over other companies and then try to protect that advantage. The main strategy for companies is try slowing down the margin erosion. Firms have competitive advantage when companies can deliver the same product or service at lower cost or deliver superior product or service at a similar cost. This can be achieved by either reducing cost or raising product cost.

In this case when manager is suggesting increasing product value for the customer they should keep in mind every time increasing value is not the right solution. The three main issues with this solution are listed below:

**Value increases but price does not**; consumer surplus increases but not profit. In this case when you increase the value of the product but couldn’t take a price increase for the product maybe because of competition this increases the customer surplus as value is increased without any real increase in the price.

**Value increases, price increases and cost increases** all by the same amount; no change in profit. In this case when you try to increase the value of product it leads to an increase in the cost and price of the products. All these can be increased by same amount leading to a scenario where there is no change in the profit, but the value of the product is increased.

**Value increases, price increases but cost increase is greater than price increase**; profit is reduced. In this case your profit will eventually decrease as increasing the value of product will also lead to the increase in price, but the cost increase can be higher than the price increase this will decrease the overall profit.

In conclusion, when manager is deciding to increase the value of the product should keep in mind that it should lead to the increase in profit and should not ignore these three scenarios. Value increases but price does not; consumer surplus increases but not profit. Value increases, price increases and cost increases all by the same amount; no change in profit. Value increases, price increases but cost increase is greater than price increase; profit is reduced.