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Topic: Price Elasticity of Demand

Price Elasticity of Demand

Price elasticity of demand is a measurement of the change in the demand for a product in relation to a change in its price. Elastic demand is when the change in demand is large when there is a change in price. Inelastic demand is when the change in demand is small when there is a change in price.

Economists have found that the prices of some goods are very inelastic. That is, a reduction in price does not increase demand much, and an increase in price does not hurt demand, either. For example, gasoline has little price elasticity of demand. Drivers will continue to buy as much as they have to, as will airlines, the trucking industry, and nearly every other buyer.

Other goods are much more elastic, so price changes for these goods cause substantial changes in their demand or their supply.

Not surprisingly, this concept is of great interest to marketing professionals. It could even be said that their purpose is to create inelastic demand for the products that they market. They achieve that by identifying a meaningful difference in their products from any others that are available.

If the quantity demanded of a product changes greatly in response to changes in its price, it is elastic. That is, the demand point for the product is stretched far from its prior point. If the quantity purchased shows a small change after a change in its price, it is inelastic. The quantity didn’t stretch much from its prior point.

Price elasticity of demand expressed mathematically is as follows:

Price Elasticity of Demand = Percentage Change in Quantity Demanded ÷ Percentage Change in Price

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Factors that affect Price Elasticity of Demand

Availability of Substitutes

The more easily a shopper can substitute one product for another, the more the price will fall. For example, in a world in which people like coffee and tea equally, if the price of coffee goes up, people will have no problem switching to tea, and the demand for coffee will fall. This is because coffee and tea are considered good substitutes for each other.

Urgency

The more discretionary a purchase is, the more its quantity of demand will fall in response to price increases. That is, the product demand has greater elasticity.

Say you are considering buying a new washing machine, but the current one still works; it's just old and outdated. If the price of a new washing machine goes up, you're likely to forgo that immediate purchase and wait until prices go down or the current machine breaks down.

The less discretionary a product is, the less its quantity demanded will fall. Inelastic examples include luxury items that people buy for their brand names. Addictive products are quite inelastic, as are required add-on products, such as inkjet printer cartridges.

One thing all these products have in common is that they lack good substitutes. If you really want an Apple iPad, then a Kindle Fire won't do. Addicts are not dissuaded by higher prices, and only HP ink will work in HP printers (unless you disable HP cartridge protection).

Duration of Price Change

The length of time that the price change lasts also matters. Demand response to price fluctuations is different for a one-day sale than for a price change that lasts for a season or a year.

Clarity of time sensitivity is vital to understanding the price elasticity of demand and for comparing it with different products. Consumers may accept a seasonal price fluctuation rather than change their habits.

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