SNS COLLEGE OF TECHNOLOGY

An Autonomous Institution
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ed to Anna University, Chennai

Department of Automobile Engineering

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19MEE301 / Engineering Economics and cost Analysis

UNIT-2

Factors Affecting Price Elasticity of Demand

Elasticity of demand for any commodity is determined or influenced by a number of factors which are discussed as under:

Nature of the Commodity:

The elasticity of demand for any commodity depends upon the category to which it belongs, i.e., whether it is a necessity, comfort or luxury. The demand for necessaries of life or conventional necessaries is generally less elastic. For example, the demand for necessaries like food, salt, matches, etc. does not change much with rise or fall in their prices. Similar is the case with commodities which are required at the time of marriage, death ceremonies, etc.

The demand for necessaries of efficiency and for comforts is moderately elastic because with the rise or fall in their prices the demand for them decreases or increases moderately. On the other hand the demand for luxuries is more elastic because with a small change in their prices there is a large change in their demand. But the demand for prestige goods, like jewels, rare coins, rare stamps, paintings by Tagore or Picasso, etc. is inelastic because they possess unique utility for the buyers who are prepared to buy them at all costs.

Substitutes:

Commodities having substitutes have more elastic demand because with the change in the price of one commodity the demand for its substitute is immediately affected. For example if the price of coffee rises the demand for coffee will decrease and that for tea will increase and vice versa. But the demand for commodities having no good substitutes is inelastic.

Variety of Uses:

The demand for a commodity having composite demand or variety of uses is more elastic. Such commodities are coal, milk, steel, electricity, etc. For example coal is used for cooking and heating, for power generation in factories, in locomotives, etc. If there is a slight fall in the price of coal its demand will increase from all quarters.

On the other hand a rise in its price will bring a considerable decrease in demand in less important uses and in more important uses efforts will also be made to economise its use as in railways and factories. Thus the overall effect will be a reduction in demand. A commodity which cannot be put to more than one use has less elastic demand.

Joint Demand:

There are certain commodities which are jointly demanded such as car and petrol, pen and ink, bread and jam, etc. The elasticity of demand of the second commodity depends upon the elasticity of demand of the major commodity. If the demand for cars is less elastic, the demand for petrol will also be less elastic. On the other hand if the demand for say bread is elastic the demand for jam will also be elastic.

Deferred Consumption:

Commodities whose consumption can be deferred have an elastic demand. This is the case with durable consumer goods like cloth, bicycle, fan, etc. If the price of any of these articles rises people will postpone their consumption. As a result their demand will decrease and vice versa.

Habits:

People who are habituated to the consumption of a particular commodity, like coffee, tea or cigarette of a particular brand the demand for it will be inelastic. We find that the prices of coffee, tea and cigarettes increase almost every year but there has been little effect on their demand because people are in the habit of consuming them.

Income Groups:

The elasticity of demand also depends on the income group to which a person belongs. Persons who belong to the higher income group their demand for commodities is less elastic. It is immaterial to a rich man whether the price of a commodity has fallen or risen and hence his demand for the commodity will be unaffected.

On the other hand the demand of persons in lower income groups is generally elastic. A rise or fall in the prices of commodities will reduce or increase the demand on their part. But this does not apply in the case of necessities the demand for which on the part of the poor is less elastic.

Proportion of Income Spent:

If the consumer spends a small proportion of his income on a commodity at a time the demand for that commodity is less elastic because he does not bother much about small expenditure. Such commodities are shoe polish, pen, pencil, thread, needle, etc. But commodities which entail a large proportion of the income of the consumer, the demand of them is elastic, such as bicycle, watch, etc.

Level of Prices:

The level of prices also influences the elasticity of demand for commodities when the price level is high, the demand for commodities is elastic and when the price level is low and the demand is less elastic.

Time Factor:

Time factor plays an important role in influencing the elasticity of demand for commodities. The shorter the time in which the consumer buys a commodity, the lesser will be the elasticity of demand tor that product. On the other hand the longer the time which the consumer takes in buying a commodity the higher will be the elasticity of demand for that product.

Prof. Stigler mentions three possible reasons for the long-period elasticity being higher than the short-period elasticity. In the long run the consumer has a better knowledge of the price changes takes time to readjust his budget and might change his consumption pattern due to possible technological changes.

Brand:

The price of demand for a given brand of product may be elastic. If its price increases people turn towards the other brands easily. This is substitution effect for example if the price of the Hero bicycle increases the consumer will buy the Atlas bicycle.

Recurring Demand:

Goods which have recurring demand their prices are more elastic than the goods which are not demanded time and again.

Distribution of Income:

If a country has equal distribution of income and wealth the demand for majority of goods is elastic because there are more middle class people whose purchasing power is almost equal.