Factors Affecting Demand

Even though the focus in economics is on the relationship between the price of a product and how much consumers are willing and able to buy, it is important to examine all of the factors that affect the demand for a good or service.

These factors include:

Price of the Product

There is an inverse (negative) relationship between the price of a product and the amount of that product consumers are willing and able to buy. Consumers want to buy more of a product at a low price and less of a product at a high price. This inverse relationship between price and the amount consumers are willing and able to buy is often referred to as **The Law of Demand**.

The Consumer's Income

The effect that income has on the amount of a product that consumers are willing and able to buy depends on the type of good we're talking about. For most goods, there is a positive (direct) relationship between a consumer's income and the amount of the good that one is willing and able to buy. In other words, for these goods when income rises the demand for the product will increase; when income falls, the demand for the product will decrease. We call these types of goods **normal goods**.

However, for some goods the effect of a change in income is the reverse. For example, think about a low-quality (high fat-content) ground beef. You might buy this while you are a student, because it is inexpensive relative to other types of meat. But if your income increases enough, you might decide to stop buying this type of meat and instead buy leaner cuts of ground beef, or even give up ground beef entirely in favor of beef tenderloin. If this were the case (that as your income went up, you were willing to buy less high-fat ground beef), there would be an inverse relationship between your income and your demand for this type of meat. We call this type of good an **inferior good**. There are two important things to keep in mind about inferior goods. They are not necessarily low-quality goods. The term inferior (as we use it in economics) just means that there is an inverse relationship between one's income and the demand for that good. Also, whether a good is normal or inferior may be different from person to person. A product may be a normal good for you, but an inferior good for another person.

The Price of Related Goods

As with income, the effect that this has on the amount that one is willing and able to buy depends on the type of good we're talking about. Think about two goods that are typically consumed together. For example, bagels and cream cheese. We call these types of goods **compliments**. If the price of a bagel goes up, the Law of Demand tells us that we will be willing/able to buy fewer bagels. But if we want fewer bagels, we will also want to use less cream cheese (since we typically use them together). Therefore, an increase in the price of bagels means we want to purchase less cream cheese. We can summarize this by saying that when two goods are complements, there is an inverse relationship between the price of one good and the demand for the other good.

On the other hand, some goods are considered to be substitutes for one another: you don't consume both of them together, but instead choose to consume one or the other. For example, for some people Coke and Pepsi are substitutes (as with inferior goods, what is a substitute good for one person may not be a substitute for another person). If the price of Coke increases, this may make Pepsi relatively more attractive. The Law of Demand tells us that fewer people will buy Coke; some of these people may decide to switch to Pepsi instead, therefore increasing the amount of Pepsi that people are willing and able to buy. We summarize this by saying that when two goods are substitutes, there is a positive relationship between the price of one good and the demand for the other good.

The Tastes and Preferences of Consumers

This is a less tangible item that still can have a big impact on demand. There are all kinds of things that can change one's tastes or preferences that cause people to want to buy more or less of a product. For example, if a celebrity endorses a new product, this may increase the demand for a product. On the other hand, if a new health study comes out saying something is bad for your health, this may decrease the demand for the product. Another example is that a person may have a higher demand for an umbrella on a rainy day than on a sunny day.

The Consumer's Expectations

It doesn't just matter what is currently going on - one's expectations for the future can also affect how much of a product one is willing and able to buy. For example, if you hear that Apple will soon introduce a new iPod that has more memory and longer battery life, you (and other consumers) may decide to wait to buy an iPod until the new product comes out. When people decide to wait, they are decreasing the current demand for iPods because of what they expect to happen in the future. Similarly, if you expect the price of gasoline to go up tomorrow, you may fill up your car with gas now. So your demand for gas today increased because of what you expect to happen tomorrow. This is similar to what happened after Huricane Katrina hit in the fall of 2005. Rumors started that gas stations would run out of gas. As a result, many consumers decided to fill up their cars (and gas cans), leading to long lines and a big increase in the demand for gas. This was all based on the expectation of what would happen.

The Number of Consumers in the Market

As more or fewer consumers enter the market this has a direct effect on the amount of a product that consumers (in general) are willing and able to buy. For example, a pizza shop located near a University will have more demand and thus higher sales during the fall and spring semesters. In the summers, when less students are taking classes, the demand for their product will decrease because the number of consumers in the area has significantly decreased.

Factors Affecting Supply

The Price of Inputs

In addition to the price of the product being the main factor as stated in the Law of Supply, the price of production inputs also plays a part. The lowest price at which a firm can sell a good without losing money is the amount of money that it costs to produce it. Producing a good or service involves taking inputs and applying a process to them to produce an output. The output is the finished good or service, and inputs are raw materials, labor, utilities, liscensing fees, or even other goods. These inputs are also known as factors of production. If the price of inputs goes up, the cost of producing the good increases. And therefore at each price producers need to sell their good for more money. So an increase in the price of inputs leads to a decrease in supply. Simarly, a decrease in the price of inputs leads to an increase in supply.

The Current State of Production Technology

Production of a good involves taking inputs, applying a process to them, and producing an output. Well, production technology is involved in the process part. Increases in the level of production technology can make that process more efficient. For example, imagine that you run a basic T-Shirt screen printing business out of your home. Now lets say you decide to invest in a workshop installed with the latest production technology. With this use of technology, the operation becomes more efficient and you are able increase the supply of T-shirts. If you decide to expand even further, some added technological improvements might be warranted. This further increases your ability to supply t-shirts since it reduces your labor costs. By automating the process, reliance upon labor is lessened and those resources are released for utilization elsewhere.

The Producer's Expectations

It doesn't just matter what is currently going on - one's expectations can also affect how much of a product one is willing and able to sell. For example, if your firm produces mp3 players and you hear that Apple will soon introduce a new iPod that has more memory and longer battery life, you (and other producers) may decide to hurry up and sell your players to stores before the new iPod comes out. When people decide to increase production/sales today, they are increasing the current supply for mp3 players because of what they EXPECT to happen in the future.

The Number of Producers in the Market

As more or fewer producers enter the market this has a direct effect on the amount of a product that producers (in general) are willing and able to sell. More competition usually means a reduction in supply, while less competition gives the producer a opportunity to have a bigger market share with a larger supply.