

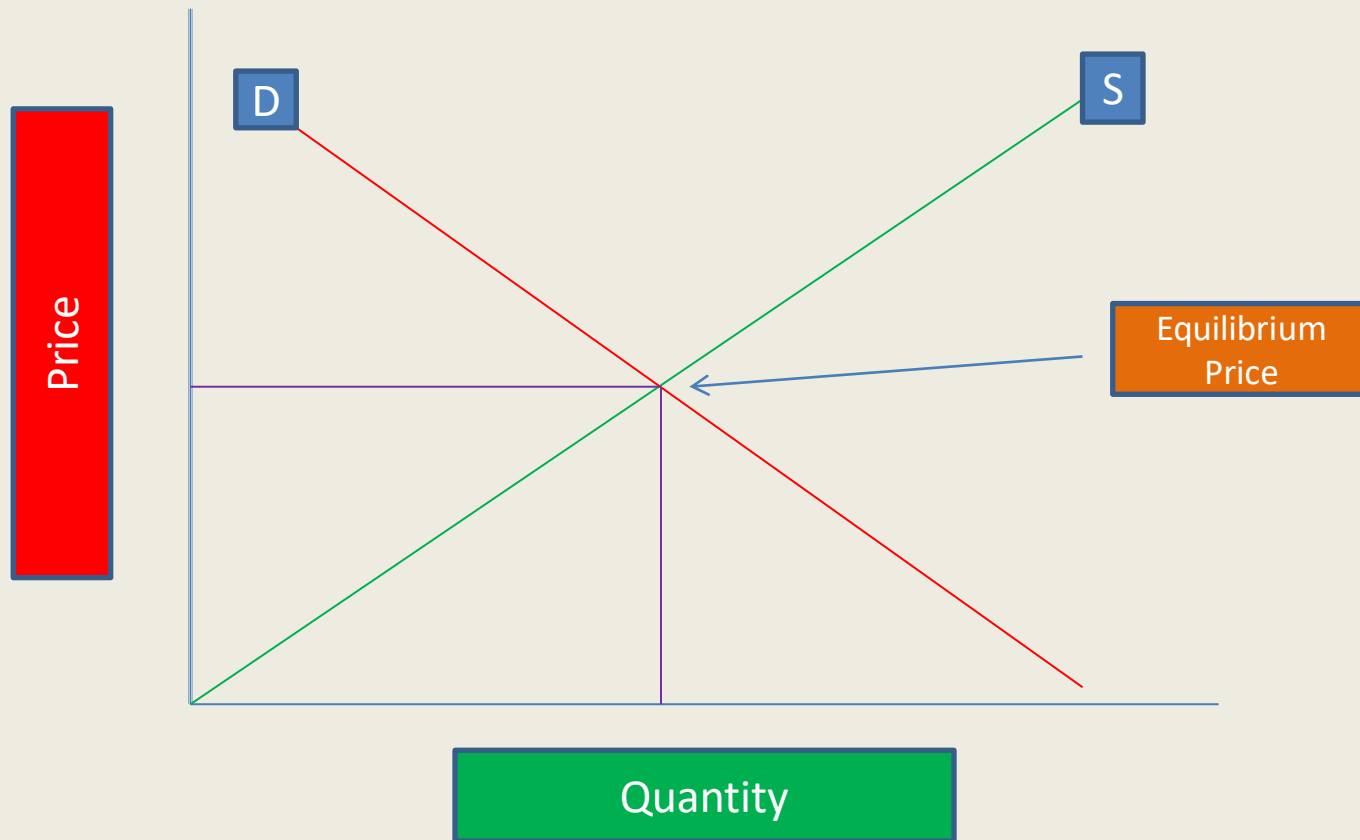
Demand and Elasticity

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Basics of Demand

- Demand – Desire to buy + ability to buy
 - Desire and no ability = Wish
 - Ability and no desire = No Demand
- Law of Demand – Higher the price, lower the demand and vice versa, *ceteris paribus*.
 - Exceptions:
 - Conspicuous consumption or Veblen's goods (products with snob appeal, for e.g., diamonds)
 - Speculative markets (when herd mind-set kicks in)
 - Giffen's goods (allocation for superior goods decreases to fund higher consumption inferior goods, for e.g., Irish meat-potato paradox)

Demand-Supply (Simple Illustration)



Question to Ponder

- Ever wondered why a rickshaw driver is always in a hurry and a carpenter/mason is always slow in his work?
 - What happens when the rickshaw driver is assured of his wishful income by the end of the day?
 - And what happens if time is built into the carpenter's work contract?
- Then why does the average city biker ride fast?
 - When you proceed from certainty towards uncertainty you want to get over with it as quick as possible


Some market related exceptions to Law of Demand

- Repetitive purchase behaviour (so demand optimization does not happen in every transaction)
 - Reflect on your vegetable purchase behaviour – price comparison is against a time reference
 - Reflect on your toiletries purchase behaviour – what do you compare prices against?
- Knock off price – lesser perceived value – lost sales
 - Try your local biryani joint
- Confidence in quality-price matrix
 - EAMCET college vs. MEC

Some market related exceptions to Law of Demand


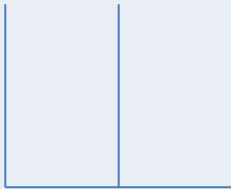
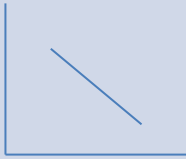
- Experience as an exception
 - Inexperienced buyer cannot judge quality or impute value to his purchase so pays more
 - Check into Reliance Digital or a car showroom
- Brand perception
 - Arrow vs. GAP vs. Cherokee vs. Geoffrey Beene vs. Nautica vs. Flying Machine vs. Radheyshyam vs. FBB ----which would you choose?
 - Hanes vs. Amul Macho?
- Increased Income
 - Discretionary spends increase
 - Does increase in fuel deter us from our weekend trips?
 - Flight vs. train/bus

Price Elasticity

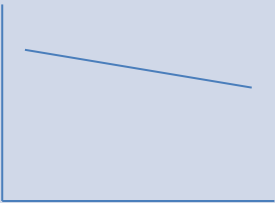
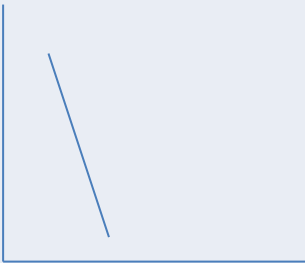
- Law of Demand tells us only the direction of change not the rate at which the change takes place.
- Elasticity of Demand tells us the rate of change in quantity demanded due to a change in price
 - At Rs.100 per kg, an average customer buys 2 kgs of mangoes.
 - Assume that the price of mango has gone up and is Rs.200 per kg today.
 - Will the customer buy only 1 kg or will he buy more/less?
- Price elasticity = Proportionate change in quantity demanded/Proportionate change in price
 - For e.g., If $Q_1 = 2000$ when $P_1 = 100$; and $Q_2 = 2500$ when $P_2 = 90$, then
 - $PE = \frac{(Q_2 - Q_1)/Q_1}{(P_2 - P_1)/P_1} = \frac{(2500 - 2000)/2000}{(90 - 100)/100} = -2.5$ 

Why is this value negative?

Types of Elasticity

Type of Elasticity	Curve (X: Quantity Demanded; Y: Price)	Description	Example
Perfectly Elastic Demand		<p>Price need not be reduced to increase demand;</p> <p>At prevailing rate, there is demand.</p> <p>If price is increased, zero demand.</p>	Ice cream candy
Perfectly Inelastic Demand		<p>Change in price (howsoever large) does not impact quantity demanded</p> <p>Reason: Non-availability of substitutes</p>	Stents, Transport
Unit Elasticity		<p>Unit change in price brings in unit change in quantity demanded</p> <p>Revenue remains unchanged</p>	Fuel

Types of Elasticity

Type of Elasticity	Curve (X: Quantity Demanded; Y: Price)	Description	Example
Relatively Elastic		Small drop in price leads to disproportionate increase in demand	Luxury Items for e.g., appliances
Relatively Inelastic		Significant drop in price leads to relatively less increase in demand	Food products (cooking oil) Fuel Essential Commodities

Income Elasticity

Income Elasticity =

$$\frac{\text{Proportionate change in quantities demanded}}{\text{Proportionate change in incomes}}$$

- Your dad increases your pocket allowance by 10%. Will it increase your consumption by 10%?
- Will an increase in your household income proportionately increase the demand for salt? (**Zero income elasticity**)
- If increase in income does not lead to proportionate increase in demand then **negative income elasticity**
- Increase in income increases demand proportionately then **positive income elasticity**

Cross Elasticity

Cross Elasticity =

$$\frac{\text{Proportionate change in quantity purchased of X}}{\text{Proportionate change in price charged for Z}}$$

Ebooks vs. Hard copies – which would you buy?

Cartridge prices have gone down. Will printers be in demand? Why?

Tea prices have gone down. Will coffee be in demand? Why?

If CE is +ve then goods are **substitutes**

If CE is –ve then good are **complementary**