

UNIT- II

LESSON 5

DEMAND ANALYSIS

STRUCTURE

- 5.1 INTRODUCTION
- 5.2 OBJECTIVES
- 5.3 MEANING OF DEMAND
 - 5.3.1 Types of Demand
- 5.4 FEATURES OF A DEMAND
- 5.5 DETERMINANTS OF DEMAND
- 5.6 EXCEPTIONS TO THE LAW OF DEMAND
- 5.7 ELASTICITY OF DEMAND
- 5.8 SUMMARY
- 5.9 SELF ASSESSMENT QUESTIONS
- 5.10 SUGGESTED READINGS

5.1 INTRODUCTION

The concepts of demand and supply are useful for explaining what is happening in the market place. Every market transaction involves an exchange and many exchanges are undertaken in a single day. A market is a place where we buy and sell goods and services. A buyer demands goods and services from the market and the sellers supply the goods in the market. This chapter describes demand which is the driving force behind a market economy. In Economics, use of the word 'demand' is made to show the relationship between the prices of a commodity and the amounts of the commodity which consumers want to purchase at those prices. Demand is one of the forces determining price. The theory of demand is related to the economic activities of a consumer, called consumption.

The process through which a consumer obtains the goods and services he wants to consume is known as demand. Demand is one of the most important managerial factors because it assists the managers in predicting changes in production and input prices. The manager can take better decisions regarding the kind of product to be produced, the quantity, the cost of the product and its selling price. Let us understand the concept of demand and its importance in decision making.

5.2 OBJECTIVES

The objectives of this chapter is:

- To understand the general theory of demand.
- To know about the various types of demand.
- To know about the factors affecting demand of a product.

5.3 DEFINITION OF DEMAND

An economic principle that describes a consumer's desire and willingness to pay a price for a specific good or service. Holding all other factors constant, the price of a good or service increases as its demand increases and vice versa. Demand means the ability and willingness to buy a specific quantity of a commodity at the prevailing price in a given period of time. Therefore, demand for a commodity implies the desire to acquire it, willingness and the ability to pay for it.

According to Prof. Hibdon, "Demand means the various quantities of goods that would be purchased per time period at different prices in a given market." Thus, three things are necessary for demand to exist; (1) the price of a commodity (2) the amount of the commodity the consumer or consumers are prepared to buy per unit of time; (3) a given time. Similarly, Benham wrote down, "The demand for anything at a given price is the amount of it which will be bought per unit of time at that price."

5.3.1 Types of Demand

There are eight demand states and their details given below:

1. **Negative Demand:** Product is disliked in general. The product might be beneficial but the customer does not want it.

For example: for dental care, and others have a negative demand for air travel.

2. **No demand:** Target consumers may be unaware and uninterested about the product. For examples: Farmers may be not interested in new farming method. College students may not be interested in foreign language course.
3. **Latent demand:** Consumers may share a strong need that cannot be satisfied by any existing product. For examples: Harmless cigarette, safer neighborhood, more fuel efficient car.
4. **Declining demand:** When the demand of the product or service becomes lower. For examples private colleges have seen application falls.
5. **Irregular demand:** Demand varies on a seasonal, daily and hourly basis. For examples: Museums are under visited in week days and overcrowded on week days.
6. **Full demand:** When the organisation is pleased with their volume of business. For example, Ideal Situation where supply is equal to demand.
7. **Overfull demand:** Demand level is higher that the organisation can and want to handle. For example, national park is terribly overcrowded in the summer.
8. **Unwholesome demand:** Those kinds of demands, not acceptable by the society. For example Cigarettes, hard drinks, alcohol.

5.4 FEATURES OF DEMAND

- a) **Difference between desire and demand.** Demand is the amount of a commodity for which a consumer has the willingness and the ability to buy. There is difference between need and demand. Demand is not only the need, it also implies that the consumer has the money to purchase it.
- b) **Relationship between demand and price.** Demand is always at a price. Unless price is stated, the amount demanded has no meaning. The consumer must know both the price and the commodity and he will tell his amount demanded.
- c) **Demand at a point of time.** The amount demanded must refer to some period of time such as 10 quintals of wheat per year or six shirts per year or five kilos of

sugar per month. Not only this, the amount demanded and the price must refer to a particular date.

5.5 DETERMINANTS OF DEMAND

The demand for a product is determined by a large number of factors. It would be impossible to include all possible determinants of demand in any study. Therefore, a few factors which underlie the demand for most of the products can be easily spotted. These factors are price of the commodity, incomes of the buyers' of the commodity, prices of related goods, advertising and sales promotion. These factors are found to have a substantial influence on the sales of a commodity. These are expressed and measured in various ways. In demand studies, these constitute the controlling variables. The importance of each determinant varies from product to product. As such the demand for a particular product has to be analysed only after the importance of each determinant is specified. Some of these factors are within a firm's control, others may not be so. For example, a firm can change the price of the commodity, its promotional expenditure, quality of the product and sales conditions. Let us discuss all these determinants in brief:

- i. **Price of the Commodity-** The most important factor affecting amount demanded is the price of the commodity. The amount of a commodity demanded at a particular price is more properly called price demand. The relation between price and demand is called the Law of Demand. It is not only the existing price but also the expected changes in price which affect demand.
- ii. **Income of the Consumer-** The second most important factor influencing demand is consumer income. In fact, we can establish a relation between the consumer income and the demand at different levels of income, price and other things remaining the same. The demand for a normal commodity goes up when income rises and falls down when income falls. But in case of Giffen goods the relationship is the opposite.
- iii. **Prices of related goods.** The demand for a commodity is also affected by the changes in prices of the related goods also. Related goods can be of two types: (1) Substitutes which can replace each other in use; for example, tea and coffee are substitutes. The change in price of a substitute has effect on a commodity's demand in the same direction in which price changes. The rise in price of coffee

shall raise the demand for tea; (2) Complementary goods are those which are jointly demanded, such as pen and ink. In such cases complementary goods have opposite relationship between price of one commodity and the amount demanded for the other. If the price of pens goes up, their demand is less as a result of which the demand for ink is also less. The price and the demand go in opposite direction. The effect of changes in price of a commodity on amounts demanded of related commodities is called Cross Demand.

- iv. **Tastes of the Consumers-** The amount demanded also depends on consumer's taste. Tastes include fashion, habit, customs, etc. A consumer's taste is also affected by advertisement. If the taste for a commodity goes up its amount demanded is more even at the same price. This is called increase in demand. The opposite is called decrease in demand.
- v. **Wealth-** The amount demanded of a commodity is also affected by the amount of wealth as well as its distribution. The wealthier are the people higher is the demand for normal commodities. If wealth is more equally distributed, the demand for necessities and comforts is more. On the other hand, if some people are rich, while the majorities are poor, the demand for luxuries is generally higher.
- vi. **Population-** Increase in population increases demand for necessities of life. The composition of population also affects demand. Composition of population means the proportion of young and old and children as well as the ratio of men to women. A change in composition of population has an effect on the nature of demand for different commodities.
- vii. **Government Policy-** Government policy affects the demands for commodities through taxation. Taxing a commodity increases its price and the demand goes down. Similarly, financial help from the government increases the demand for a commodity while lowering its price.

5.6 EXCEPTIONAL DEMAND CURVE

The demand curve slopes from left to right upward if despite the increase in price of the commodity, people tend to buy more due to reasons like fear of shortages or it may be an absolutely essential good. The law of demand does not apply in every case and

situation. The circumstances when the law of demand becomes ineffective are known as exceptions of the law. Some of these important exceptions are as under.

1. Giffen Goods:

Some special varieties of inferior goods are termed as Giffen goods. Cheaper varieties millets like bajra, cheaper vegetables like potato etc come under this category. Sir Robert Giffen of Ireland first observed that people used to spend more of their income on inferior goods like potato and less of their income on meat. After purchasing potato the staple food, they did not have staple food potato surplus to buy meat. So the rise in price of potato compelled people to buy more potato and thus raised the demand for potato. This is against the law of demand. This is also known as Giffen paradox.

2. Conspicuous Consumption / Veblen Effect:

This exception to the law of demand is associated with the doctrine propounded by Thorsten Veblen. A few goods like diamonds etc are purchased by the rich and wealthy sections of society. The prices of these goods are so high that they are beyond the reach of the common man. The higher the price of the diamond, the higher its prestige value. So when price of these goods falls, the consumers think that the prestige value of these goods comes down. So quantity demanded of these goods falls with fall in their price. So the law of demand does not hold good here.

3. Conspicuous Necessities:

Certain things become the necessities of modern life. So we have to purchase them despite their high price. The demand for T.V. sets, automobiles and refrigerators etc. has not gone down in spite of the increase in their price. These things have become the symbol of status. So they are purchased despite their rising price.

4. Ignorance:

A consumer's ignorance is another factor that at times induces him to purchase more of the commodity at a higher price. This is especially true, when the consumer believes that a high-priced and branded commodity is better in quality than a low-priced one.

5. Emergencies:

During emergencies like war, famine etc, households behave in an abnormal way.

Households accentuate scarcities and induce further price rise by making increased purchases even at higher prices because of the apprehension that they may not be available. . On the other hand during depression, , fall in prices is not a sufficient condition for consumers to demand more if they are needed.

6. Future Changes in Prices:

Households also act as speculators. When the prices are rising households tend to purchase large quantities of the commodity out of the apprehension that prices may still go up. When prices are expected to fall further, they wait to buy goods in future at still lower prices. So quantity demanded falls when prices are falling.

7. Change In Fashion:

A change in fashion and tastes affects the market for a commodity. When a digital camera replaces a normal manual camera, no amount of reduction in the price of the latter is sufficient to clear the stocks. Digital cameras on the other hand, will have more customers even though its price may be going up. The law of demand becomes ineffective.

8. Demonstration Effect:

It refers to a tendency of low income groups to imitate the consumption pattern of high income groups. They will buy a commodity to imitate the consumption of their neighbours even if they do not have the purchasing power.

9. Snob Effect:

Some buyers have a desire to own unusual or unique products to show that they are different from others. In this situation even when the price rises the demand for the commodity will be more.

10. Speculative Goods/ Outdated Goods/ Seasonal Goods:

Speculative goods such as shares do not follow the law of demand. Whenever the prices rise, the traders expect the prices to rise further so they buy more. Goods that go out of use due to advancement in the underlying technology are called outdated goods. The demand for such goods does not rise even with fall in prices

Seasonal Goods:

Goods which are not used during the off-season (seasonal goods) will also be subject to similar demand behaviour.

Goods in Short Supply:

Goods that are available in limited quantity or whose future availability is uncertain also violate the law of demand.

ELASTICITY OF DEMAND

In economics, the term elasticity means a proportionate (percentage) change in one variable relative to a proportionate (percentage) change in another variable. The quantity demanded of a good is affected by changes in the price of the good, changes in price of other goods, changes in income and changes in other factors. Elasticity is a measure of just how much of the quantity demanded will be affected due to a change in price or income. Elasticity of Demand is a technical term used by economists to describe the degree of responsiveness of the demand for a commodity due to a fall in its price. A fall in price leads to an increase in quantity demanded and vice versa.