UNIT-II

LESSON 6 MARKET DEMAND ANALYSIS

STRUCTURE

6.1 INTRODUCTION

Demand for a good is defined as the quantity of the good purchased at a given price at given time.

Thus the definition of demand includes three components

(a) Price of the commodity

(b) Quantity of the commodity bought

(c) Time period.

Note that time period may vary. This can be week, month, year etc.

6.2 OBJECTIVES

The objectives of this lesson are:

- To explain the concept of market demand
- To explain the factors and determinants affecting market demand

6.3 MEANING OF MARKET DEMAND

The aggregate of the demands of all potential customers (market participants) for a specific product over a specific period in a specific market is called as market demand of a particular good.

6.3.1 Definition

The total demand for a product or service in the market as a whole. Market demand is calculated to determine at what level to set production output for a good or service, and to help to determine optimal pricing levels to maximise sales revenues.

6.3.2 Market Demand Curve

A graph that shows the amount of a good or service that consumers purchase on the X axis at a range of pricing levels that are plotted on the Y axis. The market demand curve for a good or service provided by a business can be combined with its market supply curve to determine the product's equilibrium price that is located where the two curves cross.

6.3.3 Difference between Demand and Desire

On many occasions people confuse between desire and demand and use them interchangeably. In fact these are two different terms. Demand is desire backed by ability to purchase. This means that if somebody desires to have a good, he/she can demand it if he/she has the money to purchase it by paying its price. Anyone can desire any good or service. But just by desiring something, one cannot have it without paying the price. Once the price is paid by the person who has desired it, only then it becomes the demand for the good by that person. Take the example given above once again- “Varsha purchased 2 kg of mangoes at Rs. 50 per kg last week.” This is the demand for mangoes by Varsha. Had Varsha desired to have mangoes but could not pay the price to buy, then it would have been said as Varsha’s desire but not demand for mangoes.

6.4 DETERMINANTS OF MARKET DEMAND

Demand schedule and law of demand state the relationship between price and quantity demanded by assuming “other things remaining the same “. When there is a change in these other things, the whole demand sched-ule or demand curve undergoes a change. In other words, these other things determine the position and level of the demand curve. If these other things or the determinants of demand change, the whole demand schedule or the demand curve will change. As a result of the changes in these determinants, a demand curve will shift above or below as the case may be.

The following are the determinants of market demand for goods:

1. Tastes and Preferences of the Consumers:

An important factor which determines demand for a good is the tastes and preferences of the consumers for it. A good for which consumers’ tastes and preferences are greater, its demand would be large and its demand curve will lie at a higher level.

People’s tastes and preferences for various goods often change and as a result there is change in demand for them. The changes in demand for various goods occur due to the changes in fashion and also due to the pressure of advertisements by the manufacturers and sellers of different prod-ucts.

For example, a few years back when Coca Cola plant was established in New Delhi demand for it was very small. But now people’s taste for Coca Cola has undergone a change and become favour-able to it because of large advertisement and publicity done for it. The result of this is that the demand for Coca-Cola has increased very much. In economics we would say that the demand curve For Coca Cola has shifted upward. On the contrary when any good goes out of fashion or people’s tastes and preferences no longer remain favourable to it the demand for it decreases. In economics we say that the demand curve for these goods will shift downward.

2. *Changes in the Prices of the Related Goods:*

The demand for a good is also affected by the prices of other goods, especially those which are related to it as substitutes or complements. When we draw a demand schedule or a demand curve for a good we take the prices of the related goods as remaining constant. Therefore, when the prices of the related goods, substitutes or complements, change the whole demand curve would change its position; it will shift upward or downward as the case may be. When price of a substitute for a good falls, the demand for that good will decline and when the price of the substitute rises, the demand for that good will increase.

For example, when price of the tea as well as the incomes of the people remains the same but price of the coffee falls, the consumers would demand less of tea than before. Tea and coffee are very close substitutes, therefore when coffee becomes cheaper, the consumers substitute coffee for tea and as a result the demand for tea declines. The goods which are complementary with each other, the change in the price of any of them would affect the demand of the other. For instance, if price of the milk falls, the demand for sugar would also be affected. When people would take more milk or would prepare more khoya, burfi, rasgullas with milk; the demand for sugar will also increase. Likewise, when price of cars falls, the demand for them will increase which in turn will increase the demand for petrol Cars and petrol are complementary with each other.

3. *The Number of Consumers in the Market:*

We have already explained that the market demand for a good is obtained by adding up the individual demands of the present as well as pro-spective consumers or buyers of a good at various possible prices. The greater the number of consumers of a good, the greater the market demand for it. Now, the question arises on what factors the number of consumers of a good depends. If the consumers substitute one good for another, then the number of consumers of that good which has been substituted by the other will decline and for the good which has been used in its place, the number of consumers will increase.

Besides, when the seller of a good succeeds in finding out new markets for his good and as a result the market for his good expands the number of consumers of that good will increase. Another Important cause for the increase in the number of consumers is the growth in population. For instance, in India the demand for many essential goods, especially food-grains, has increased because of the increase in the popu-lation of the country and the resultant increase in the number of consumers for them.

4. Changes in Propensity to Consume:

People's propensity to consume also affects the de-mand for them. The income of the people remaining constant, if their propensity to consume rises, then out of the given income they would spend a greater part of it with the result that the demand for goods will increase.

On the other hand, if propensity to save of the people increases, that is, if propensity to consume declines, then the consumers would spend a smaller part of their income on goods with the result that the demand for goods will decrease. It is thus clear that with income remaining constant, change in propensity to consume of the people will bring about a change in the demand for goods. Similarly, when the consumers hope that in the future they will have good income, then in the present they will spend greater part of their incomes with the result that their present demand for goods will increase.

5. Income Distribution:

Distribution of income in a society also affects the demand for goods. If distribution of income is more equal, then the propensity to consume of the society as a whole will be relatively high which means greater demand for goods. On the other hand, if distribution of income is more unequal, then propensity to consume of the society will be relatively less, for the propensity to consume of the rich people is less than that of the poor people.

Consequently with more unequal distribution of income, the demand for consumer goods will be comparatively less. This is the effect of the income distribution on the propensity to consume and demand for goods. But the change in the distribution of income in the society would affect the demand for various goods differently. If progressive taxes are levied on the rich people and the money so collected is spent on providing employment to the poor people, the distribution of income would become more equal and with this there would be a transfer of purchasing power from the rich to the poor.

As a result of this, the demand for those goods will increase which are generally purchased by the poor because the purchasing power of the poor people has increased and, on the other hand, the demand for those goods will decline which are usually consumed by the rich on whom progressive taxes have been levied.

6. *Advertisement Expenditure:*

Advertisement expenditure made by a firm to promote the sales of its product is an important factor determining demand for a product, especially of the product of the firm which gives advertisements. The purpose of advertisement is to influence the consumers in favour of a product. Advertisements are given in various media such as newspapers, radio, and television. Advertisements for goods are repeated several times so that consumers are convinced about their superior quality. When advertisements prove successful they cause an increase in the demand for the product.

6.5 FACTORS AFFECTING MARKET DEMAND

When examining demand factors, especially for businesses, it is important to realize that there is a relationship between Individual and Market Demand. These two, though slightly different, share the same causes and are impacted by macro and micro economic variables in the same way, but not the same magnitude.

The demand changes as a result of changes in price, other factors determining it being held constant. These other factors determine the position or level of demand curve of a commodity. It may be noted that when there is a change in these non-price factors, the whole curve shifts rightward or leftward as the case maybe. The following factors determine market demand for a commodity.

6.5.1 PRICE OF GOOD

Individual and market demand are affected by the price of the good or service being offered. The law of demand shows that there is an inverse relationship between price and demand. An increase in one will cause a decrease in the other. This holds true at both the individual and market level.

6.5.2 PRICE OF COMPLIMENTARY GOODS

A complimentary good is one that is used with another good. For example, when you buy a cooker, you have to buy cooking gas or electricity. Another example would be a car and gas. By buying one good, you have to buy the other in order to use it. When the price a complimentary good increases all other factors remaining constant and the demand for the others good decreases with it. With an increase in the price of cars, less people will buy gas.

6.5.3 PRICE OF SUBSTITUTE GOODS

Substitute goods are goods that compete for consumption. When you take one, you substitute it for the other. You consume either one or the other. This is as long as the substitute is seen as matching or being better in terms of quality. For both individual and market demand, when the price of substitute goods change, there is an effect on the demand.

6.5.4 INCOME

Income is a major factor influencing individual and market demand. When there is an increase in income, demand for goods increase. This is because there is more money to be spent on the good. A good or service that experiences this is called a "normal" good. However, some goods experience a decrease in demand with an increase in income. These are classified as "inferior goods". People purchase these goods because they are cheap and that is what they can afford. However, as their income increase, they go for better quality goods and services. For example, some people view public transport as an inferior good.

6.5.5 FUTURE EXPECTATIONS

People aim to place themselves at an advantage when theyhave information about the future. If they expect, for example, to have a shortage of a vital good, they will increase their demand drastically today to beat the shortage. Every year you know winter is coming, so you buy winter clothing before it happens.

6.5.6 TASTES AND PREFERENCE

Beyond the rational reasons, people purchase simply because they like it. Sometimes they are influenced by fashion trends. Other times it is because a celebrity endorsed a product, or they simply have a taste for it. Out of all the factors influencing individual and market demand, this is probably the hardest to predict. This is because it is influenced by psychological factors, which are difficult to categorise and tabulate.

6.6 DIFFERENCE BETWEEN INDIVIDUAL DEMAND AND MARKET DEMAND

The quantity of a commodity an individual is willing and able to purchase at a particular price, during a specific time period, given his/her money income, his/her taste, and prices of other commodities, such as substitutes and complements, is referred to as the individual demand for the commodity whereas,

The total quantity which all the consumers of the commodity are willing and able to purchase at a given price per time unit, given their money incomes, their tastes, and prices of other commodities, is referred to as the market demand for the commodity.
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