Beckfoot

Business A level | Price Elasticity of Demand | Year 12 unit 1.2.4

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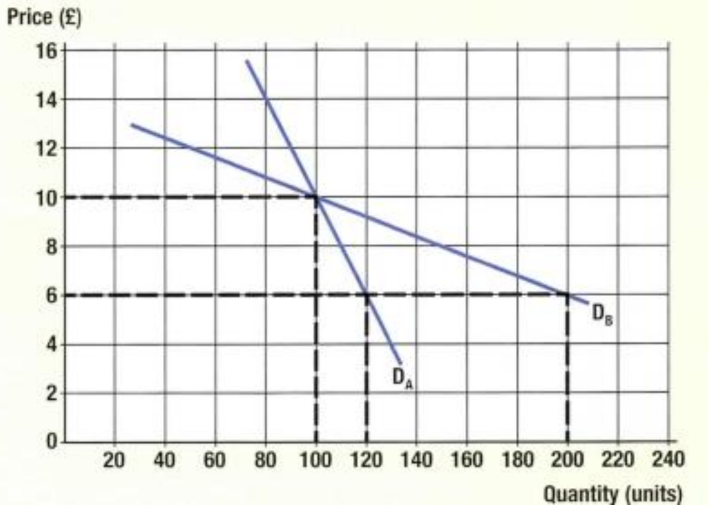
What is Price Elasticity

Price elasticity of demand (PED) measures the responsiveness of quantity demanded for a product to a change in price. It is one of the most important concepts in business, particularly when making decisions about pricing

Figure 1

The effect of a price change on the demand for products A and B



The diagram shows two demand curves D(a) and D(b) representing two different products. At a price of £10 demand of the products is 100. When the price falls to £6 demand increases by differing amounts for each product. Demand for product B is more responsive to price change. This relationship between responsiveness of demand and change in price is called Price Elasticity of Demand

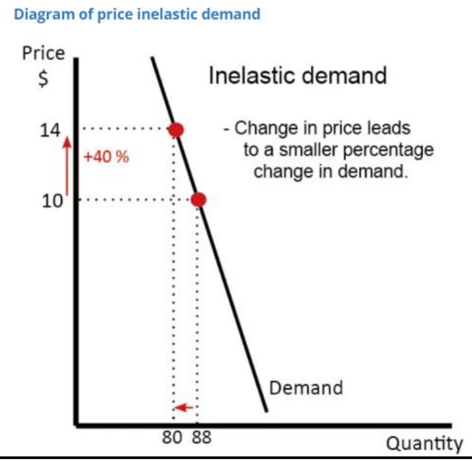
Factors influencing Elasticity of demand

The value of PED is demand for a product is determined by the ease that consumers can switch to a similar substitute product.

1	**Time**	PED tends ot all the longer the time period. This is because consumers are more likely to turn to substitutes in the long term.
2	**Competition**	Some products face great degrees of PED in their market where the product is either identical or little different from those produces by others businesses.3
3	**Branding**	The stronger the branding the less substitutes are acceptable to consumers. Successful branding reduces PED for the product
4	**Income**	For inexpensive products where the proportion of income Spent on the transaction is very small demand is likely to be inelastic. In contrast where the proportion of income is much large the good is likely to be price elastic.
5	**Peak & Off-peak**	Demand is price inelastic at peak times and more elastic at off-peak times – this is particularly the case for transport services.

What is Price Inelasticity

Demand is price inelastic when a change in price causes a smaller percentage change in demand. It occurs where there is a price elasticity of demand (PED) of less than one. Goods which are price inelastic tend to have few substitutes and are considered necessities by users.



In the diagram the price of the product rises by 40% (£4) however the it leads only to a small percentage change in demand because the product is relatively price inelastic.

PED Calculation Formula

$$\frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in price}}$$