Factors leading to a change in demand

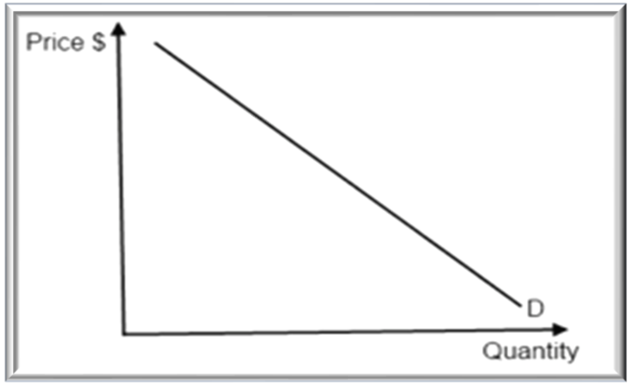
1	**Price of Substitutes**	Many goods sold by a business have substitutes. E.g. Coke and Pepsi. The price of substitute . If the price of a substitute falls the demand will rise. As a result the demand for the product will fall
2	**Price of compliments**	Consumers sometimes purchase certain goods together, this is because the two goods are used together. E.g. Cars and Car Insurances. The price of the complimentary goods effects demand for the original good
3	**Changes in consumer income**	The amount of money that people earn will influence the amount and type of goods they buy.
4	**Fashion and tastes**	Over time as fashion and tastes change products drift in and out of fashion which effects demand
5	**Advertising and branding**	Businesses try to influence demand for their products through advertising. Depending on the costs of the advertising and the success of the campaign this will affect demand for a product or service

External Shocks

1	**Competition**	If a strong new competitor enters the market for the fist time demand is likely to fall for the original firm's product
2	**Government**	Governments can influence demand in a number of ways e.g. Raising taxes or introducing new laws
3	**Economic Climate**	IF the economy is growing demand for goods and service will tend to rise. During a recession demand for non-essential goods is likely to fall.
4	**Social and Environmental factors**	Demand for some goods may be affected by changes in society. Concern has risen in recent times about the damage sustained by the environment by the product of some goods, this has led to a fall in demand

Key Vocabulary

1	**Demand**	The amount of product that consumers are willing and able to purchase at any given price
2	**External Shocks**	Factors beyond the control of the business which can impact demand for goods
3	**Inferior Goods**	Goods for which demand will fall as income rises, or rise as income increases
4	**Normal Goods**	Goods for which demand will fall as income rises, or rise as income increases
5	**Substitute goods**	Goods that can be bought as an alternative to others but perform the same function



Key Tip

When drawing the demand diagram remember the curve runs from top left to bottom right. The price is always on the left on the vertical axis and the quantity on the horizontal axis.

Factors leading to a change in demand

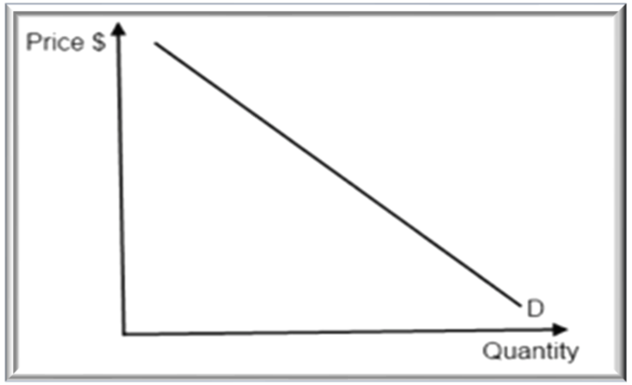
1	**Price of Substitutes**	
2	**Price of compliments**	
3	**Changes in consumer income**	
4	**Fashion and tastes**	
5	**Advertising and branding**	

External Shocks

1	**Competition**	
2	**Government**	
3	**Economic Climate**	
4	**Social and Environmental factors**	

Key Vocabulary

1	**Demand**	
2	**External Shocks**	
3	**Inferior Goods**	
4	**Normal Goods**	
5	**Substitute goods**	



Key Tip

When drawing the demand diagram remember the curve runs from ....
The price is always on the ....axis and the quantity on the .... axis.

Business A level | Supply | Year 12 unit 1.2.1

Factors leading to a change in Supply

If the costs of production increase then the amount supplied will decrease as there is less profit to be made

Reasons include:

1	**Raw Materials**	If the wholesale costs of raw materials rises then the unit costs of production rises and sellers are likely to reduce supply
2	**Labour costs**	If wage rates rise for the workforce, or as recently the government increased the minimum wage, costs of production rise and sellers are like to reduce supply.
3	**Overheads**	If the costs of overheads rises, e.g. gas, electricity or rises in business rates or rent and mortgage rates then overall costs of production rises and sellers are may cut supply as the goods they are selling become more expensive.
4	**Exchange Rates**	An exchange rate is the price of one currency expressed in terms of another currency, or against a basket of other currencies. If the pound weak against other currencies then the costs of buying raw materials from overseas rises, therefore production costs rises and the costs of the goods rises and the manufacturer may have to cut supply

External Shocks To Demand

There are some factors beyond the control of the business which can impact on the supply of products. Examples include

1	**World Events**	In recent years the political situation in the Middle East has been volatile. Consequently supplies of oil are threatned price of oil rises. Other examples of world events that effect supply are the Credit Crunch of 2008 and Covid Virus in 2020
2	**Weather**	The supply of agricultural products are particularly affected by the weather. Things like drought and affect crops and cause severe shortage
3	**Government**	Economic policies can impact on supply. EG. The raising of interest rates (in order to meet inflation targets). Legislation can also affect supply. E.g. if the government passes laws to make a particular market more competitive

Key Vocabulary

1	**Supply**	Supply is the quantity of a good or service that a producer is willing and able to supply onto the market at a given price in a given time period.
2	**Automation**	method of operating or controlling processes by automatic means using devices. Reduces need for human interaction.
3	**Indirect Tax**	taxes levied on products or services before they reach the consumer e.g. VAT and excise
4	**Government Subsidy**	a grant or gift of money from the government to encourage supply of certain goods e.g. milk subsidies

Key Tip

When drawing the supply diagram remember the curve runs from bottom left to top right. The price is always on the left on the vertical axis and the quantity on the horizontal axis.

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Business A level	Supply	Year 12 unit 1.2.1

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Factors leading to a change in Supply

1	**Raw Materials**	
2	**Labour costs**	
3	**Overheads**	
4	**Exchange Rates**	

External Shocks To Demand

1	**World Events**	
2	**Weather**	
3	**Government**	

Key Vocabulary

1	**Supply**	
2	**Automation**	
3	**Indirect Tax**	
4	**Government Subsidy**	

Key Tip

When drawing the supply diagram remember the curve runs from ………… to ………….. The price is always on the ………on the ……….axis and the quantity on the …………..axis.

Interaction of Supply & Demand

The price of some goods change slowly over time; others are more volatile. This is caused by changes in supply and demand working or interacting with each other responding to circumstances.

1	**Equilibrium Price**	In any market the price is set where the wishes of the consumers are matched exactly with those of producers. This price, called the equilibrium price, is where supply and demand are equal to each other.
2	**Market Clearing Price**	Another name of the Equilibrium price. This is because the amount supplied in the market completely bough up by the consumers. There are no buyers left without goods and no sellers left with unsold stock.

Changes

The market does not stay in an equilibrium and from time to time changes occur:

1	**Demand**	If demand increases prices will rise. This is because producers react to rising customer demand by putting up their prices. They can do this because consumers are wanting the product in higher numbers. If demand was to fall then the opposite would happen because consumers would lower their prices , otherwise they would be left with too much stock.
2	**Supply**	A change in supply will effect the equilibrium price. If the a supplies of the good increases then prices will fall. If supply was to fall then the opposite would happen

The Diagrams

1	**Equilibrium**	Diagram 1 shows the that supply and demand are in balance with each other. Therefore the market is in equilibrium The equilibrium point is shown on the diagramed where the supply and demand curves interest each other.
2	**Contraction of supply**	Diagram 2 shows that a decrease in supply has caused an inward movement of the supply curve from S1 to S2 . Demand for the product has increased and demand curve has moved from D1 to D2. Accordingly the price has risen to reflect the new equilibrium point from P1 to P2
3	**Contraction of Demand**	Diagram shows an inward movement of the demand curve due to a contract of demand. A demand drops a new equilibrium point is found where S2 and D2 intersect each other. Accordingly the price has dropped from P1 to P2.

Diagram 1

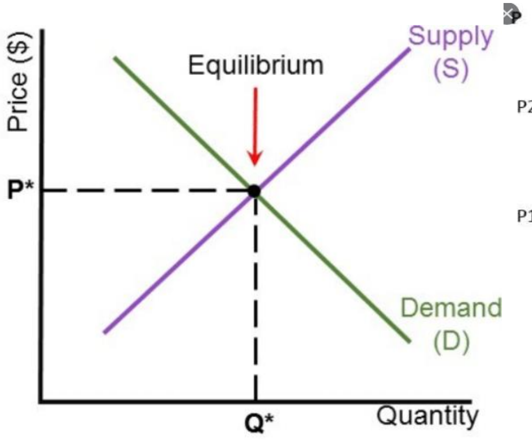


Diagram 2

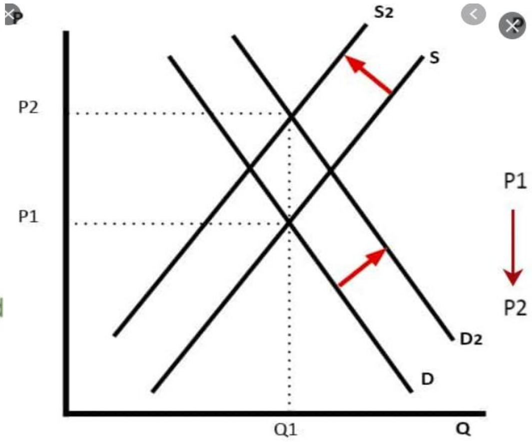
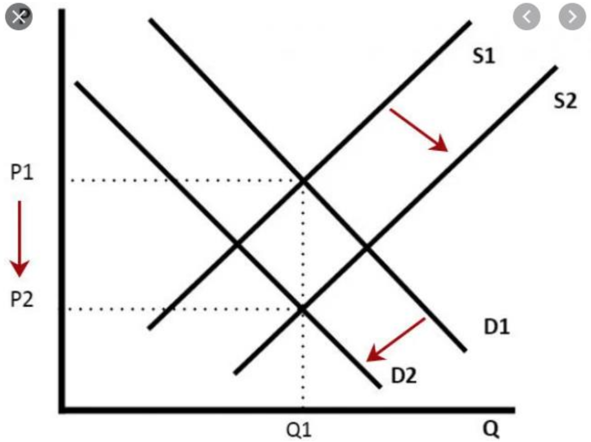


Diagram 3



When drawing supply and demand diagrams always remember to annotate the diagram correctly

Interaction of Supply & Demand

1	**Equilibrium Price**	
2	**Market Clearing Price**	.

Changes

1	**Demand**	
2	**Supply**	

The Diagrams

1	**Equilibrium**	
2	**Contraction of supply**	
3	**Contraction of Demand**	

Diagram 1

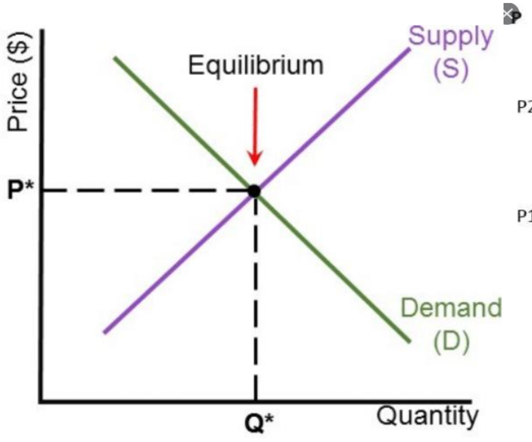


Diagram 2

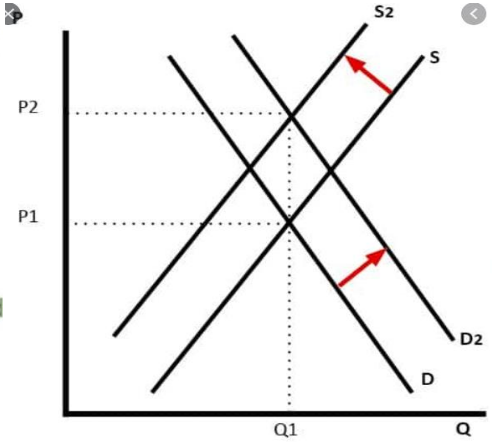
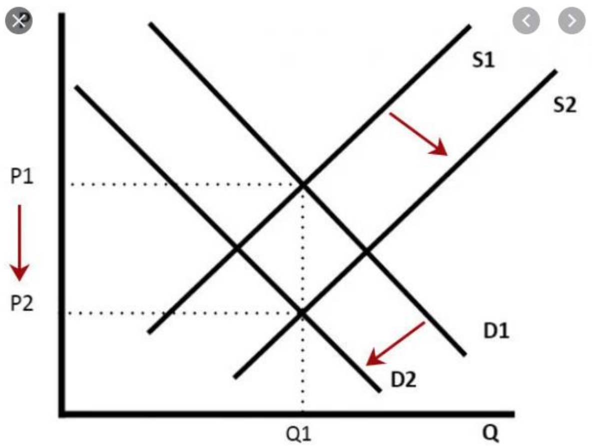


Diagram 3



When drawing supply and demand diagrams always remember to annotate the diagram correctly

Income Elasticity of Demand (YED)

1	Definition	A measurement of the responsiveness of demand to a change in people's incomes.
2	Formula	$\frac{\textbf{\% Change in Quantity Demanded}}{\textbf{\% Change in Income}}$
3	Interpretation: Greater than 1	Demand is income elastic. This means that the change in demand is proportionally greater than the change in income.
4	Interpretation: Less than 1	Demand is income inelastic. This means that the change in demand is proportionally less than the change in income.
5	Interpretation: Negative Figure (-)	Demand is decreasing, showing the good is an inferior good.
6	Interpretation: Positive Figure (+)	Demand is increasing, showing the good is a normal good.

The significance of income elasticity of demand to businesses

1	Businesses selling goods with high income elasticity	Demand for highly elastic goods is likely to be cyclical, i.e. demand will be high when the economy is growing, but low when the economy falls into recession. This means that businesses may need to cut costs by making staff redundant or postponing expansion during tough economic times. Because demand can fluctuate is can be difficult for these businesses to predict/forecast future sales.
2	Businesses selling goods with low income elasticity	Demand for goods is likely to be more stable during different phases of the business cycle. This makes production planning and investment decisions easier.
3	Production Planning	If businesses know the YED for their products, they can then respond to predicted changes in incomes. E.g. if a business is highly income elastic, they can plan to increase capacity, e.g. expand factory sizes, or conversely halt production depending on what is happening in the economy. Producers of inferior goods may want to increase capacity should a recession be forecast, as demand for their goods will increase.
4	Product Switching	If manufacturers are flexible, they can produce a range of goods, some of which may be more income elastic than others. This allows them to upscale production of the income elastic goods when the economy is doing well to maximise profits, whilst having the income inelastic goods bringing in a steady income constantly.

Income Elasticity of Demand (YED)

1	Definition	
2	Formula	
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The significance of income elasticity of demand to businesses

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3	Production Planning	
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