**Question 11**

**Explain why the price elasticity of demand differs for different products. (12)**

Introduction

The price elasticity of demand (PED) refers to the degree of responsiveness of quantity demanded to a given change in its price. It measures the percentage change in quantity demanded of a good with respect to the percentage change in the price, ceteris paribus. It is calculated as follows: Price elasticity of demand = % change in quantity demanded of good X / % change in price of good X.

Main Body

It is often noted that the coefficient of PED is always often negative showing the inverse relationship between the change in quantity demanded and the change in the price of good. This implies that an increase in price of the good itself will lead to a decrease in the quantity demanded and vice versa. The PED value can differ under different types of goods due to the nature of demand. The value of elasticity of demand can range from zero to infinity. When the value of elasticity is 0, the demand is perfectly inelastic. When it is less than 1, the demand is inelastic. When the value of PED is equal to 1, the demand is unitary, when the value is greater than 1, demand is elastic. When value is at infinity, the demand is perfectly elastic.

To understand why the price elasticity of demand differs for different products, we must examine the determinants of price-elasticity of demand. One such determinant is the degree of necessity of the good to the consumer. If the consumer feels that the demand for the good is necessary, the increase in price will not affect the decrease in the quantity demanded extensively (less than proportionate). This will mean that the demand is price inelastic. Consumers will feel that the good is necessary to them if it is a habitual and staple consumption, just like the consumption of cigarettes which is an undesirable, cultivated consumption behaviour. For goods that consumer does not consume often, the demand is price elastic (change in price will lead to a more than proportionate change in quantity demanded). For goods such as restaurant dining, the consumer does not see it as a definite need, he will be easily switch to other form of consumption and thus consume less of the dining once given a choice.

Another determinant that explains the difference in price elasticity of demand is proportion of income spent on the good. When the proportion of income spent on the good is small, demand will tend to be price inelastic. Consumer will be more price insensitive in this situation. However, with the proportion of income spent on the good is large, demand will tend to be price elastic, which means that consumers are price sensitive. This can be seen on how consumer buys good like sweets in the provision stores which occupies a small percentage of the consumer’s income and a Plasma TV from an electrical store which occupies a large percentage of the consumer income. It is obvious that the consumer will be more price-sensitive when he buys the Plasma TV.

Besides this, the time period for the consideration of purchase will affect the price elasticity of demand. When the time period for consideration of purchase is longer, the consumer behaviour will have more time to find for alternative choices and tend to switch their choice of consumption more often and easily and thus, the PED will most likely be price elastic. For those who begin their search of holiday tours earlier before the tour, the consumer will have more choices than those who sign up for tour very near to tour date. The first group of consumer will decrease their quantity demanded more extensively if there is a small increase in the price level of the tour offered by the tour agency as they have more alternatives and are not decisive over the given choices.

Lastly, the availability of close substitutes affects price elasticity of demand. When more substitutes are available, the consumer will have more choices and hence, they will change their quantity demanded upon a slight change in price, contributing to a price elastic demand. There are availability of substitutes depending on how the relationship of the goods is defined and the degree of market competition which are affected by the relationship of goods and the number of firms in the industry. In an industry such as tour coaches to Malaysia, the broader definition of transport services with the inclusion of air travels and cruises will expand the availability of transport services, making it easier for consumers to switch to other alternatives if the price increases. However, when the market competition is low as the demand is high during the peak season, it will be difficult for the consumer to look for alternative form of traveling, influencing the PED to become inelastic.

Conclusion

In conclusion, the above information will help to explain why there is different value of elasticity of demand for different products. This will be helpful in helping firms to derive price strategies to maximize total revenue.