BUSINESS-ECONOMICS
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DEMAND : Meaning and definition of demand, Factors of demand, Determinants of demand, Law of demand , Assumptions of law of demand , Exceptions of law of demand

Definition of Demand

Demand is an economic term that refers to the amount of products or services that consumers wish to purchase at any given price level. The mere desire of a consumer for a product is not demand. Demand includes the purchasing power of the consumer to acquire a given product at a given period. In other words, it's the amount of products or services that consumers are willing and able to purchase.

The factors of demand for given products or services is related to:

1. The price of the good or service
2. The income level
3. The prices of complementary products
4. The prices of substitute products
5. Consumer preferences
6. Consumption patterns

Determinants of Demand

Some of the important determinants of demand are as follows,

1] Price of the Product

People use price as a parameter to make decisions if all other factors remain constant or equal. According to the law of demand, this implies an increase in demand follows a reduction in price and a decrease in demand follows an increase in the price of similar goods.

The demand curve and the demand schedule help determine the demand quantity at a price level. An elastic demand implies a robust change quantity accompanied

by a change in price. Similarly, an inelastic demand implies that volume does not change much even when there is a change in price.

2) Income of the Consumers

Rising incomes lead to a rise in the number of goods demanded by consumers. Similarly, a drop in income is accompanied by reduced consumption levels. This relationship between income and demand is not linear in nature. Marginal utility determines the proportion of change in the demand levels.

3] Prices of related goods or services

7. Complementary products – An increase in the price of one product will cause a decrease in the quantity demanded of a complementary product. Example: Rise in the price of bread will reduce the demand for butter. This arises because the products are complementary in nature.

1. Substitute Product – An increase in the price of one product will cause an increase in the demand for a substitute product. Example: Rise in price of tea will increase the demand for coffee and decrease the demand for tea.

4] Consumer Expectations

Expectations of a higher income or expecting an increase in prices of goods will lead to an increase the quantity demanded. Similarly, expectations of a reduced income or a lowering in prices of goods will decrease the quantity demanded.

5] Number of Buyers in the Market

The number of buyers has a major effect on the total or net demand. As the number increases, the demand rises. Furthermore, this is true irrespective of changes in the price of commodities.

<u>Individual's demand schedule and curve:</u>

An individual consumer's demand refers to the quantities of a commodity demanded b y him at various prices. A demand schedule is a list of prices and quantities and its graphic representation is a demand curve.

Individual's demand schedule & curve
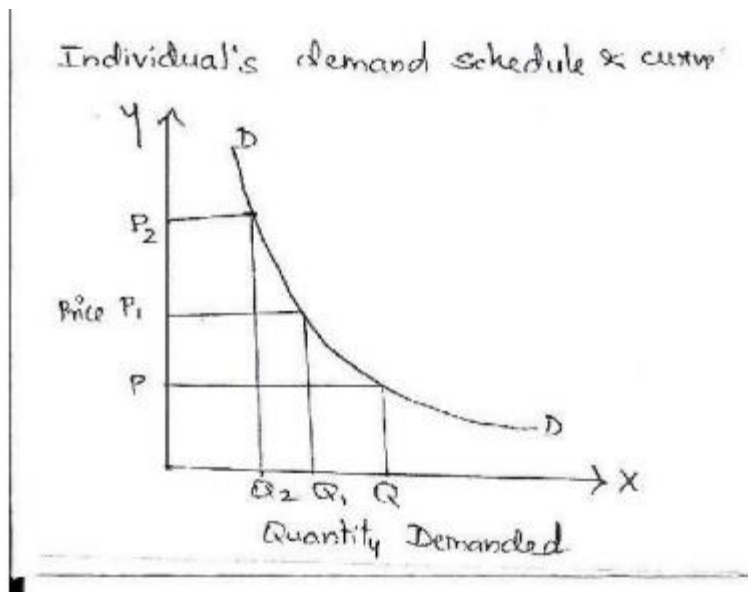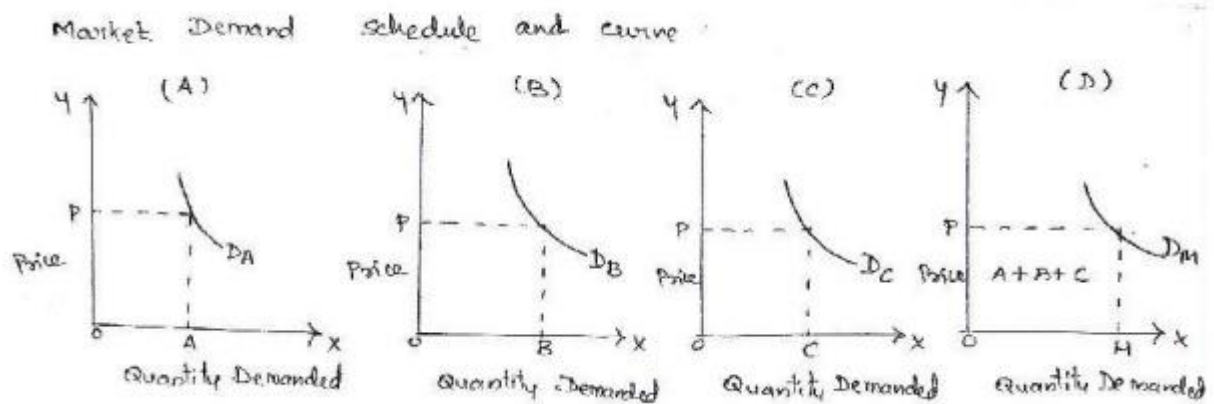
X axis-quantity demanded

Y axis- price

DD- demand curve

Explanation:

i. The demand schedule reveals that when the price is Rs.P2, quantity demanded is Q2 units. As the price decreases to P, the quantity demanded increases t o Q.

ii. The individual demand curve focuses on the effects of a fall or rise in the price of one commodity on theconsumer'sbehavior.Theyarethesubstation and income effects.

Market demand schedule and curve:

In a market, there is not one consumer but many consumers of a commodity. The market demand of a commodity is depicted on a demand schedule and demand curve. The y show the sum total of various quantities demanded by all

the individuals at various prices. S uppose there are three individuals A, B and C in a market who purchase the commodity. The demand schedule for the commodity is depicted in table below.

Market Demand Schedule and curve

(A)   (B)   (C)   (D)

Xaxis-quantity demanded

Yaxis- price

DD- demand curve

Explanation:

i. Suppose there are three individuals A,B and C in a market who buy OA,OB and OC quantities of the commodity at the price OP, as shown in panels (A),(B) and (C) respectively.

ii. In the market OQ quantity will be bought which is made up by adding together the quantities OA,OB and OC.

iii. The market demand curve D_M is obtained by the lateral summation of the individual demand curves D_A, D_B and D_c

Introduction to the Law of Demand:

The law of demand expresses a relationship between the quantity demanded and its price. It may be defined in Marshall's words as **"the amount demanded increases with a fall in price, and diminishes with a rise in price".** Thus it expresses an inverse relation between price and demand. The law refers to the direction in which quantity demanded changes with a change in price.

On the figure, it is represented by the slope of the demand curve which is normally negative throughout its length. The inverse price- demand relationship is based on other things remaining equal. This phrase points towards certain important assumptions on which this law is based.

Assumptions of the Law of Demand:

These assumptions are:

(i) There is no change in the tastes and preferences of the consumer;

(ii) The income of the consumer remains constant;

(iii) There is no change in customs

(iv) The commodity to be used should not confer distinction on the consumer;

(v) There should not be any substitutes of the commodity;

(vi) There should not be any change in the prices of other products;

(vii) There should not be any possibility of change in the price of the product being used;

(viii) There should not be any change in the quality of the product; and

(ix) The habits of the consumers should remain unchanged. Given these conditions, the law of demand operates. If there is change even in one of these conditions, it will stop operating.

Given these assumptions, the law of demand is explained in terms of Table 3 and Figure 7.

Table 3.
Demand Schedule

Price (Rs)	Quantity Demanded
5	100 Units
4	200 Units
3	300 Units
2	400 Units
1	600 Units
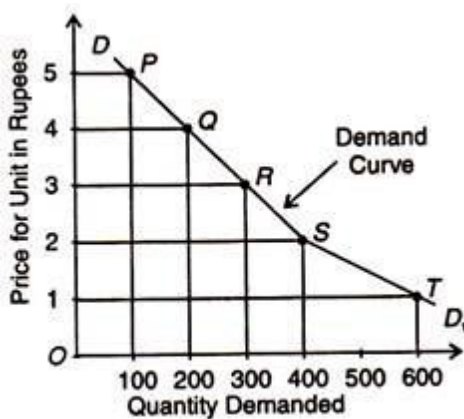
Fig. 7

The above table shows that when the price of say, orange, is Rs. 5 per unit, 100 units are demanded. If the price falls to Rs.4, the demand increases to 200 units. Similarly, when the price declines to Re.1, the demand increases to 600 units. On the contrary, as the price increases from Re. 1, the demand continues to decline from 600 units.

In the figure, point P of the demand curve DD_1 shows demand for 100 units at the Rs. 5. As the price falls to Rs. 4, Rs. 3, Rs. 2 and Re. 1, the demand rises to 200, 300, 400 and 600 units respectively. This is clear from points Q, R, S, and T. Thus, the demand curve DD_1 shows increase in demand of orange when its price falls. This indicates the inverse relation between price and demand.

Exceptions to the Law of Demand:

In certain cases, the demand curve slopes up from left to right, i.e., it has a positive slope. Under certain circumstances, consumers buy more when the price of a commodity rises, and less when price falls, as shown by the D curve in Figure 8. Many causes are attributed to an upward sloping demand curve.
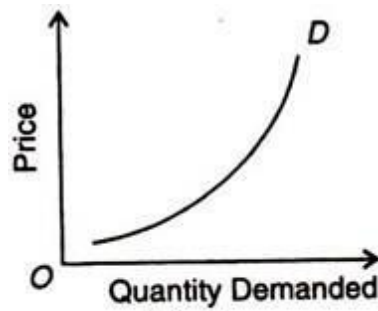
Fig. 8

(1) **War:** If shortage is feared in anticipation of war, people may start buying for building stocks or for hoarding even when the price rises.

(ii) Depression:

During a depression, the prices of commodities are very low and the demand for them is also less. This is because of the lack of purchasing power with consumers.

(iii) Giffen Paradox:

If a commodity happens to be a necessity of life like wheat and its price goes up, consumers are forced to curtail the consumption of more expensive foods like meat and fish, and wheat being still the cheapest food they will consume more of it. The Marshallian example is applicable to developed economies.

In the case of an underdeveloped economy, with the fall in the price of an inferior commodity like maize, consumers will start consuming more of the superior commodity like wheat. As a result, the demand for maize will fall. This is what Marshall called the Giffen Paradox which makes the demand curve to have a positive slope.

(iv) Demonstration Effect:

If consumers are affected by the principle of conspicuous consumption or demonstration effect, they will like to buy more of those commodities which confer distinction on the possessor, when their prices rise. On the other hand, with the fall in the prices of such articles, their demand falls, as is the case with diamonds.

(v) Ignorance Effect: Consumers buy more at a higher price under the influence of the "ignorance effect", where a commodity may be mistaken for some other commodity, due to deceptive packing, label, etc.

(vi) Speculation Marshall mentions speculation as one of the important exceptions to the downward sloping demand curve. According to him, the law of demand does not apply to the demand in a campaign between groups of speculators. When a group unloads a great quantity of a thing on to the market, the price falls and the other group begins buying it. When it has raised the price of the thing, it arranges to sell a great deal quietly. Thus when price rises, demand also increases.

(vii) Necessities of Life:

Normally, the law of demand does not apply on necessities of life such as food, cloth etc. Even the price of these goods increases, the consumer does not reduce their demand. Rather, he purchases them even the prices of these goods increase often by reducing the demand for comfortable goods. This is also a reason that the demand curve slopes upwards to the right.

Why does Demand Curve Slopes Downward?

When price fall the quantity demanded of a commodity rises and vice versa, other things remaining the same. It is due to this law of demand that demand curve slopes downward to the right.
Now, the important question is why the demand curve slopes downward, or in other words why the law of demand describing inverse price-demand relationship is valid. We can explain this with marginal utility analysis and also with the indifference curve analysis.
When the price of a commodity falls, the consumer can buy more quantity of the commodity with his given income. Or, if he chooses to buy the same amount of quantity as before, some money will be left with him because he has to spend less on the commodity due to its lower price.

In other words, as a result of the fall in the price of the commodity, consumer's real income or purchasing power increases. This increase in real income induces the consumer to buy more of that commodity. This is called income effect of the change

in price of the commodity. This is one reason why a consumer buys more of a commodity whose price falls.

The other important reason why the quantity demanded of a commodity rises as its price falls, is the substitution effect. When the price of a commodity falls, it becomes relatively cheaper than other commodities. This induces the consumer to the commodity whose price has fallen for other commodities which have now become relatively dearer. As a result of this substitution effect, the quantity demanded of the commodity, whose price has fallen, rises.

This substitution effect is more important than the income effect. Marshall explained the downward-sloping demand curve with the aid of this substitution effect alone, since he ignored the income effect of the price change. But in some cases even the income effect of the price change is very significant and cannot be ignored.