

# Reading 11

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## *What Causes Change in Consumer Demand?*

In this lesson you will learn about factors that can change the quantity of a product that is demanded at all possible prices. These factors are called determinants of demand. They include change in consumer tastes, change in the price of related products, change in consumer income, and change in the population of potential customers. Entrepreneurs often act to influence determinants of demand.

**I**magine that you own a store that offers women's clothing for sale. You would probably be happy to increase your sales if the sales increase also increased your profits. One way to increase sales would be to lower your prices. However, this action could also lower your profits. It would be better for you if you could increase your sales without having to reduce your prices. There are several factors that could change the quantity of products you are able to sell without lowering your prices. These factors, called **determinants of demand**, include the following: changes in consumer tastes, the price of related products, consumer income, and the population of potential customers. Successful entrepreneurs often try to influence or take advantage of determinants of demand.

Entrepreneurs use advertisements to create positive feelings about their products and to influence **consumer tastes**, or the way consumers view the value of their product. If you advertised your new fall fashions, you would be trying to change customers' tastes. The purpose of your advertisement would be to convince customers to buy more clothing at your store. If you are successful, the quantity of your products demanded will increase without a change in price. As a result, your profits should increase.

Sometimes consumer tastes change for reasons over which entrepreneurs have little or no control. For example, during an unusually cool summer, resort owners are likely to have fewer customers. Such a change is an opportunity for entrepreneurs to be resourceful. They cannot do anything about the weather, but resort owners might offer special meals or advertise discounts on days when the temperature fails to reach 70°F.

There are other determinants of demand over which entrepreneurs have little control, such as the price of substitute goods or services. Products that can be used in place of each other are called **substitute products**. For example, either butter or margarine can be used in most recipes. If the price of butter increased to \$5 a pound, many people would stop buying butter and use



margarine instead. The demand for margarine would increase even though there might be no change in its price. The producers of margarine would benefit from increased sales but not because of anything they had done.

A similar event would take place when one brand of soap is put on sale. People who would have demanded other brands buy the brand on sale instead. Demand for the brands sold at their regular price is less because consumers substitute the brand that is on sale.

Changes in the price of complementary goods can also change demand. **Complementary products** are products that are used together. For example, if you own a car, you need both gasoline and tires. If the price of gasoline increased to \$10 a gallon, many people would drive less. As a result, their demand for tires would decrease. The manufacturers of tires would be hurt by the lower demand.

**Consumer income** is another important determinant of demand. When customers earn more, they are able to buy more products. When people have good jobs and large salaries, they demand more goods and services than when their incomes are low. If workers are unemployed, they reduce their spending. Individual entrepreneurs have little control over consumer income but need to be aware of changes in the average income levels of their customers to avoid offering too many or too few products for sale.

The **consumer population**, or number of potential customers in an area, is also a determinant of demand. Entrepreneurs who do business in a growing community are likely to experience an increase in demand for their products. Entrepreneurs who are in business in an area people are moving out of can expect a decrease in demand for their products. The demand for medical services should increase in areas where retirees are moving in. The demand for school equipment will increase in areas where low-income housing is being built. Even something as simple as a new parking lot can change demand. If customers find it easier to find a parking place, they may be willing to buy more products.

Of the determinants of demand, consumer tastes can perhaps be most easily influenced

by entrepreneurs. This is typically done through advertisements that highlight style or quality. Entrepreneurs must also deal with those determinants of demand they cannot control. Successful entrepreneurs, for example, consider consumer income and the number of potential customers (population) in making decisions about where to locate their business firms, the size of their inventory, the number of people to hire, and so forth. In this way, they are able to take advantage of growing demand or avoid problems that might result from decreasing demand.

Entrepreneurs may use demand schedules to predict the result of a change in demand for their products. In Reading 10 you learned about a coffee-shop owner who sold doughnuts. He had developed the demand schedule in Illustration 10a. (This demand schedule is repeated in the left and center columns of Illustration 11a.) Suppose the coffee-shop owner started to advertise his doughnuts as being "The Freshest Ones in Town" on a local radio station. Also, suppose the advertising resulted in an increase in demand, as indicated in the right-hand column of Illustration 11a. In evaluating his decision, he would need to compare the cost of the advertising with the benefit of increased demand. What other things can you think of that the owner of the coffee shop could do to increase the demand for his doughnuts?

Price	Estimated quantity demanded before radio advertising	Estimated quantity demanded after radio advertising
70 cents	80 doughnuts	120 doughnuts
60 cents	100 doughnuts	140 doughnuts
50 cents	120 doughnuts	160 doughnuts
40 cents	140 doughnuts	180 doughnuts
30 cents	160 doughnuts	200 doughnuts

**Illustration 11a**

Although entrepreneurs cannot control all the determinants of demand, they need to be aware of them. Knowledge of the determinants of demand will help entrepreneurs make better decisions for their firms.

### **CHECK YOUR UNDERSTANDING**

Consider each of the following questions. If you are not sure of an answer, review the



reading to find the information you need before moving on to the next question.

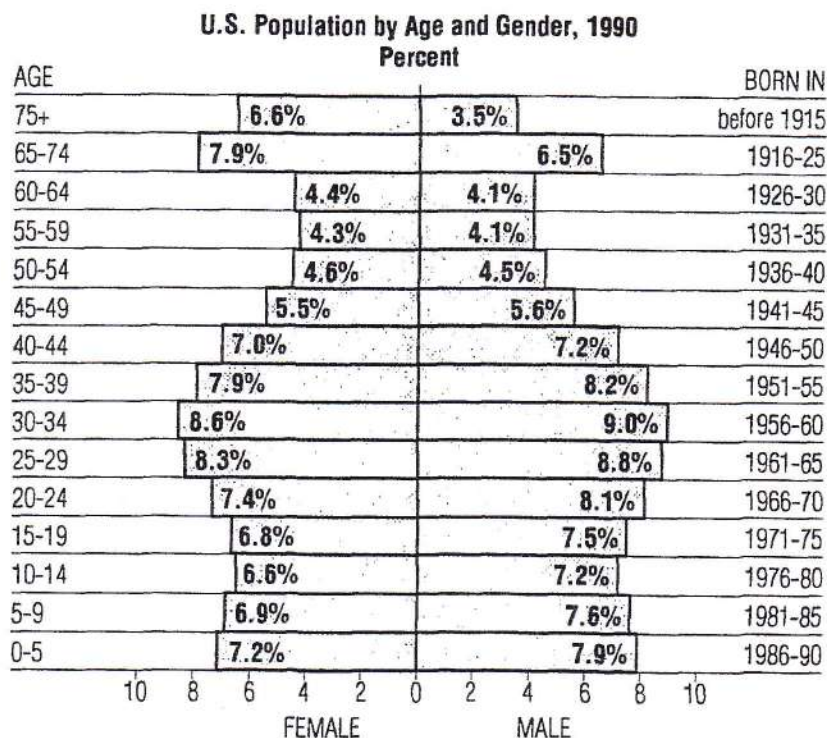
1. Define determinant of demand.
2. Which determinant of demand are many advertisements intended to change?
3. Describe an advertisement you have recently seen and explain how it is trying to change demand.
4. What are substitute products? Give an example.
5. If the price of one substitute product goes up, what will happen to the demand for the other product?
6. What are complementary products? Give an example.
7. If the price of one complementary product increases, what will happen to the demand for the other product?
8. What will happen to the demand for most products when consumer income increases?
9. What will happen to the demand for a

product in an area that has a growing population?

10. Why should entrepreneurs be aware of changes in determinants of demand over which they have no control?

### SOMETHING FOR YOU TO THINK ABOUT

Illustration 11b shows the percentage of the male and female population in the United States that fell into various age groups in 1990. By adding the number of years since 1990 to each group, you may estimate what percentage of the population falls into each age group today. The largest percentage groups in 1990 were those from twenty-five to thirty-four years of age. What age groups are most numerous now? What does this information tell you about the kind of products that are most likely to have experienced an increase in demand? How could this information be useful to an entrepreneur? Would you be more likely to succeed if you started a business that published a magazine featuring articles of interest to older people or one with articles intended to appeal to young people?



Source: U.S. Bureau of the Census.

**Illustration 11b**

## JOSLIN'S DECISION TO ADVERTISE

Joslin was disappointed when her sales fell unexpectedly to only 700 bags a month after she raised her price to \$10. Her first thought was to lower her price to \$9.50 or even to \$9. Still, she knew that other stores charged even more than \$10 and seemed to have many customers. Joslin wondered what she could do to increase the demand for her bags without having to lower her price. Using her entrepreneurial skills, she decided to buy a quarter-page advertisement for \$200 each month in a local shopper's newspaper. This newspaper was delivered to more than 10,000 households in the areas near Joslin's store. In the advertisement Joslin described the quality of her bags and the way they would help the environment. She did not mention price because she was afraid she might be forced to change it in the future.

The demand schedule below shows the quantity of bags demanded at several possible prices before Joslin started to advertise. (You worked with these prices in Activity 39.) Then Joslin surveyed customers to estimate her sales at the same prices after she had placed her first advertisement.

**Joslin's Demand Schedule**

Price	Bags Sold per Month before Advertisement	Bags Sold per Month after Advertisement
\$10.00	700	1,000
\$9.50	900	1,200
\$9.00	1,100	1,400

- How did Joslin try to change consumer tastes, a determinant of demand?  
\_\_\_\_\_
- How much money would Joslin take in at each price after she advertised?  
 $\$10.00 \times 1,000 = \$$  \_\_\_\_\_  
 $\$9.50 \times 1,200 = \$$  \_\_\_\_\_  
 $\$9.00 \times 1,400 = \$$  \_\_\_\_\_
- What other things should Joslin think about before she decides what price to charge?  
\_\_\_\_\_
- Describe something else that would change the demand for Joslin's bags and an entrepreneurial step she might take as a result.  
\_\_\_\_\_  
\_\_\_\_\_



## LET THEM EAT MORE CAKE

Kerry was laid off from her regular job a few months ago. She decided to turn her fancy cake business into a full-time job. To do this, she needed to sell many more cakes. She spent \$500 to place advertisements in local publications. She also sent letters to people who had wedding announcements in the newspaper. These mailings cost \$400. In her advertisements and letters, Kerry emphasized the quality of her cakes and how much they would mean to the people who received them. She did not mention price until someone actually called her.

Kerry estimated the number of cakes she would be able to sell if she charged different prices. She made a new demand schedule, which appears below, along with her old demand schedule. Study them and answer the questions that follow.

Price	Estimated Old Demand per Week	Estimated New Demand per Week
\$15.00	1	10
\$14.00	3	20
\$13.00	6	30
\$12.00	10	50

- How did Kerry try to change the demand for her cakes?  
\_\_\_\_\_
- Which determinant of demand did she want to influence?  
\_\_\_\_\_
- If there are many more young people graduating from school in her community, what is likely to happen to demand for cakes in the next few years? Can Kerry be sure this will help her business?  
\_\_\_\_\_  
\_\_\_\_\_
- If the biggest employer in town closes down and many people are unemployed, what is likely to happen to the demand for cakes? Explain your answer.  
\_\_\_\_\_  
\_\_\_\_\_
- What other information does Kerry need to think about before she decides which price to charge?  
\_\_\_\_\_  
\_\_\_\_\_

## LESSON 11

# COMPREHENSION QUIZ

Part I: Write the letter of the determinant of demand that is demonstrated before each statement that follows.

- A. a change in consumer tastes
- B. a change in the price of a substitute product
- C. a change in the price of a complementary product
- D. a change in consumer income
- E. a change in the number of consumers

- \_\_\_\_\_ 1. When the price of hot dogs went up, the demand for hamburgers increased.
- \_\_\_\_\_ 2. When the new low-income housing project was finished, more bus tickets in that part of the city were purchased.
- \_\_\_\_\_ 3. When the local automobile plant closed, restaurants in the area had fewer customers.
- \_\_\_\_\_ 4. When a big snowstorm was predicted, the sales of boots increased 50%.
- \_\_\_\_\_ 5. When the price of computers went down, the demand for computer disks increased.

Part II: Explain how each of the following events will probably affect the demand for small automobiles if there is no change in automobile prices.

- 6. There is a 20 percent increase in the price of gasoline.  
This should cause the demand for small cars to \_\_\_\_\_  
because \_\_\_\_\_.
- 7. A report states that small cars are dangerous to drive.  
This should cause the demand for small cars to \_\_\_\_\_  
because \_\_\_\_\_.
- 8. The price of motorcycles increases 50 percent.  
This should cause the demand for small cars to \_\_\_\_\_  
because \_\_\_\_\_.
- 9. Many workers receive lower wages.  
This should cause the demand for small cars to \_\_\_\_\_  
because \_\_\_\_\_.
- 10. There are many more people who are just graduating from school.  
This should cause the demand for small cars to \_\_\_\_\_  
because \_\_\_\_\_.