

Reading 11

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.

Imagine 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?

U.S. Population by Age and Gender, 1990

AGE	Percent		BORN IN
75+	6.6%	3.5%	before 1915
65-74	7.9%	6.5%	1916-25
60-64	4.4%	4.1%	1926-30
55-59	4.3%	4.1%	1931-35
50-54	4.6%	4.5%	1936-40
45-49	5.5%	5.6%	1941-45
40-44	7.0%	7.2%	1946-50
35-39	7.9%	8.2%	1951-55
30-34	8.6%	9.0%	1956-60
25-29	8.3%	8.8%	1961-65
20-24	7.4%	8.1%	1966-70
15-19	6.8%	7.5%	1971-75
10-14	6.6%	7.2%	1976-80
5-9	6.9%	7.6%	1981-85
0-5	7.2%	7.9%	1986-90

10 8 6 4 2 0 2 4 6 8 10
FEMALE MALE

Source: U.S. Bureau of the Census.

Illustration 11b

PUTTING IT ALL TOGETHER

How could knowledge of the determinants of demand help you in making decisions and planning for the future of your hypothetical business?

EXTENSION ACTIVITIES

1. Develop a bulletin-board display that depicts recent events that have resulted in an increase or a decrease in demand for various products in your community. For each event depicted, state the relevant determinant of demand.
2. Using resources in the school or public library, locate an old (at least ten years old) advertisement of a product that is still sold today. Write a brief essay comparing the old advertisement with a current advertisement for the same product. Describe how the current advertisement differs from the earlier one and suggest reasons for these differences.