

Economics of business case questions

Chapter 3 Managing demand

P42 Business case questions

This chapter will help you answer the following questions.

1. Which factors do you think influence the demand for electric cars?

Factors may include:

- Income
- Price of alternatives
- Awareness and interest in environmental impact of different energy forms
- Legislation e.g., affecting use of forms of energy
- Availability of charging points
- Quality of the product e.g. battery length

2. Do you think demand for electric cars has been growing or shrinking in recent years?

Why?

- Greater interest in environmental issues
- Greater evidence about damage done by alternatives
- Greater provision of charging points

3. How important do you think the price of an electric car is in terms of influencing the decision to buy an electric car? Why?

Depends on

- price as proportion of income of potential buyers
- strength of desire to be more environmentally friendly

4. Do you think demand for electric cars in general is likely to be more or less sensitive to price than the demand for a particular brand of electric car?

Why?

Less; because you can switch from one brand to another so more price sensitive whereas may be less willing to switch away from electric cars entirely

5. As more producers move into the electric car market, what do you think this will do to demand for Tesla cars? Why?

With more choice this is likely to reduce demand for one brand; however at the same time there may be greater overall demand for electric cars so Tesla may benefit from this

6. The UK government is increasing taxes on diesel cars. What effect will this have on demand for electric cars?

Other factors unchanged this will increase the price and reduce the quantity demanded.

Question

P44 Business insight

Where would you place the following businesses on the strategy clock?

- Poundland probably low price/low benefit
- Gucci probably high price/high perceived benefit
- Travelodge probably low price/low benefit
- Montblanc pens probably high price/high perceived benefit

- IKEA probably low price/relatively high benefit

P45 Business insight

In what ways might Marks & Spencer's analysis affect the decisions it takes?

- Might affect where resources are allocated and future strategy e.g. may determine which countries or products line the company invests in

P47 Business insight

Questions

1. **Which profit do you think Manchester United would tend to use in any press statements?**

Why?

May depend on what the numbers show and the impression the company is trying to create. In general, may quote before tax as tax is out of their control and this is a higher figure than after tax.

2. **Do you think Manchester United should cut employees benefits to boost profits?**

Would need to consider factors such as:

- level of benefits relative to other clubs
- impact on motivation
- impact on employee retention
- perceived fairness
- how it is done

P51 Quick check questions

For each of the following statements, say whether it is true or false.

- a. If demand is price inelastic, the quantity demanded won't change at all when the price changes. FALSE
- b. An increase in price increases revenue if demand is price elastic. FALSE
- c. A heavily branded item is more likely to be price inelastic than price elastic. TRUE

P55 Doing the Business Maths

% change quantity demanded	% change price	price elasticity
-20%	+10%	-2
+50%	-10%	-5
-2.5%	+5%	-0.5
0%	+20%	0

P55 Quick check questions

3.2 Quick check

- a. If price elasticity of demand is negative, the demand curve is downward sloping: true or false? TRUE

- b. Is a price elasticity of demand of -3 more or less elastic than a price elasticity of demand of -0.3 ? Explain. MORE- it has a larger value
- c. If the price is cut and revenue increases, demand is price elastic: true or false?
TRUE
- d. If a price change has no effect on the quantity demanded, demand is perfectly price elastic: true or false? FALSE

P56 Business insight

Question

How could a food and grocery business successfully charge 15 to 20 per cent more than its rivals?

If it provides a significantly different offer e.g. organic food, healthy foods; customers may be prepared to pay more for these additional benefits.

P58 Business insight

Question

1. **Why do people buy flowers, do you think? How might this affect the marketing activities for a business selling flowers?**

Many reasons such as:

- Buy them as gift e.g. thank you, get better soon, celebration
- Buy them to apologise

The motive and occasion may affect all aspects of marketing such as where they should be distributed, how to price them, what types of flowers to stock and what else to sell with them.

2. **Pandora jewellery is often bought as a gift and to mark a special occasion. How might this affect its marketing activities?**

May mean that:

- there is range of price opportunities to reflect how much you want to spend on a gift
- the packaging is important e.g. offer wrapping service so that it looks like a gift
- the products may be linked to key “occasions” in life e.g. anniversaries and birthdays

P65 Doing the Business Maths

% change quantity demanded % change income

+50%	+10%	+5 normal; elastic
-10%	+10%	-1; inferior; unit elastic
-50%	-2%	+25; normal; elastic
-25%	+20%	-1.25 inferior; elastic

P66 Quick check questions

For each of the following statements, say whether it is true or false.

- a. An inferior good has a negative income elasticity of demand. TRUE
- b. An income elasticity of demand of +2 means demand is income elastic. TRUE
- c. An increase of 10% in income leading to an increase in demand of 1% means demand is income inelastic. TRUE
- d. A luxury good will probably have an income elasticity of more than 1. TRUE

P67 Business insight

Question

Can you think of two other products which have a demand that is likely to be closely linked to the age of the population?

- healthcare products
- certain types of holidays e.g. cruises (v activity holidays)
- care homes

P70 Business Insight

Question

By focusing on offering lower prices than the competition what do you think Richer Sounds is assuming about the price elasticity of demand for its products?

Assumes demand is price elastic (priced sensitive) so that the percentage increase in quantity demanded is greater than the percentage fall in price.

P72 Business insight

Question

What do you think are substitutes and complements for a visit to the cinema?

Substitutes may be going out for a meal, going bowling or going to a pub

Complements may include popcorn, soft drinks, sweets bought at the cinema

P72-73 Quick questions

For each of the following statements, say whether it is true or false.

- a. If the cross price elasticity of demand for two products is positive, they are substitutes TRUE
- b. If the cross price elasticity of demand for product A in relation to product B is negative, this means that an increase in the price of B reduces the demand for A. TRUE
- c. If the cross price elasticity of demand is +0.5, a price change of one product has a smaller effect on the quantity demanded of the other product in percentage terms. TRUE

P73 Business insight

Question

- **What do you think are key influences on the demand for:**
 - a. Music festivals?

Influences may include: Price of tickets, timing and location of events, the bands playing, incomes, the weather.

b. Perfume?

Influences may include: Price, brand, smell, incomes, population size, social norms (e.g. are perfumes worn daily? on special occasions?)

c. Energy drinks?

Influences may include: price, brand, marketing activities, perceived health issues, distribution

d. Pubs?

Influences may include: prices, alcohol taxes, price of alcohol in other places, social trends and attitudes to drinking, marketing and what is on offer (e.g. food), incomes, population size

P75 Business case extension questions

- 1. If Tesla has established its brand and a reputation for innovation, how do you think this affects the price elasticity of demand for its products? If, in the future, more competitors start producing electric cars, what effect do you think this has on the price elasticity of demand for Tesla cars? How might this affect its pricing?**

If Tesla is seen as highly innovative this may make demand relatively price inelastic. However, if more competitors start producing cars that could be substitutes this might make demand more price elastic. Tesla might consider lowering prices at this point.

- 2. Do you think electric cars are likely to be a normal or an inferior good? Why?**

Likely to be normal; with more income, demand will increase as people feel they can afford to switch from petrol/diesel cars

- 3. Do you think demand for electric cars is likely to be income elastic or inelastic? Why?**

Likely to be income elastic; probably more of a luxury product

- 4. With increasing concerns about the environmental impact of diesel cars, diesel fuel and cars are likely to be taxed more in the future. Explain the impact of this on demand for electric cars. How would you show this using a demand curve diagram?**

Diesel cars will become more expensive. Customers will switch away towards electric cars. Demand for electric cars will increase. The demand curve for electric cars will shift outwards.

- 5. Do you think electricity and electric cars are substitutes or complements? Why?**

Complements. If the price of electricity increases this is likely to decrease the quantity demanded of electricity and reduce the demand for electric cars.

- 6. If the price of electricity increased, how might this effect demand for electric cars? Can you illustrate this with a demand curve diagram?**

If the price of electricity increases this is likely to decrease the quantity demanded of electricity and reduce the demand for electric cars.

- 7. Look at the data in the table relating to new car sales in the UK. Summarize and explain the key trends in the data.**

8 Look at the data on the evolution of the global electric car stock. Summarize the key elements of the data. Why do you think the levels of sales of electric cars varies between countries?

P77 Quick end of chapter questions

- 1. What is the difference between a change in quantity demanded and a change in demand?**

A change in quantity demanded is due to a change in price; a change in demand is due to a change in other factors - it means at each and every price more or less is demanded.

- 2. If demand is price sensitive, should you increase or decrease price to increase revenue? Why?**

You should decrease price because the increase in the quantity demanded in percentages is greater than the reduction in price and so overall revenue increases

- 3. Explain why an increase in revenue may not increase profits.**

Because the increase in costs to produce the output that is sold may be even greater than the increase in revenue

- 4. Explain the effect on demand of an increase in income if the product is inferior.**

It will reduce demand other things being equal

- 5. Explain the effect on the demand for product A if the cross price elasticity of demand for A in relation to B is positive and the price of B increases. Explain your answer.**

Price of B increases and reduces quantity demanded; if the cross price elasticity of demand is positive demand for the other product will increase; its demand will shift outwards

- 6. If price decreases from £10 to £8, and the quantity demanded increases from 20 units to 30 units, what is the price elasticity of demand?**

- Percentage change in quantity demanded = $(10/20) * 100 = 50\%$
- Percentage change in price = $(-2/10) * 100 = -20\%$
- Price elasticity of demand = $-20/50 = -0.4$

- 7. If income increases from £15,000 a year to £18,000, and the quantity demanded of a product increases from 20,000 units to 22,000 units, what is the income elasticity of demand?**

- Percentage change in quantity demanded = $(+2/20) * 100 = +10\%$
- Percentage change in income = $(+3000/15000) * 100 = +20\%$
- Income elasticity of demand = $+10/+20 = +0.5$

- 8. If price of product B decreases from £10 to £8, and the quantity demanded of A increases from 20 units to 22 units, what is the cross price elasticity of demand?**

- Percentage change in quantity demanded of A = $(+2/20) * 100 = +10\%$
- Percentage change in price = $(-2/10) * 100 = -20\%$
- Income elasticity of demand = $+10/-20 = -0.5$