When looking at the determinants that affect price elasticity of demand

The price is the cost of the product or service to the consumer and the demand is how many consumer wish to have that product or service. Elasticity is the effect that occurs to one variable, in this case it is the demand, after there is a change to another variable, this being the price. How we calculate the PED is by dividing the percentage of change in quantity demanded by the percentage of change in price. From this equation there can be three outcomes; the result is less than one, equal to one or greater than one. Each of these outcomes means three different things; if it is less than one the good is elastic, if it is equal to one the good has unit elasticity and if the result is greater then one the good is inelastic.

When a product is elastic it means that a change in price causes a larger change in demand e. g. if the price increases the demand will drop considerably, where as if the good is inelastic, a change in price has a little effect on the demand for the product e. g. you increase the price by 10% the demand only drops by 5%. If a product has a unit elasticity it means that the change in demand is equal to that of the change in price, for every 10% increase in price there is a 10% decrease in demand.

The information from this can help a company who provides a product or service to determine the affects on total revenue if there is an increase/decrease in price, so if the PED is inelastic, an increase in price will increase the total revenue, where as if the PED is elastic an increase in price will cause the total revenue to decrease.

So the price elasticity of demand measures the responsiveness of a good's demand to a change in price and there are many factors that determine if a good is elastic or inelastic. These factors include substituted goods, degree of necessity, income (consumers), time and brand loyalty.

When a good is in a large market with lots of alternative or substitute goods it is most likely to have PED that is more elastic, due to the fact that when the price increases on one product the consumer can probably find another of the same standard or round about the same for less. This can be seen in house hold products like detergents, toilet paper and other toiletry products.

In the market place there are certain products that are necessary to have for everyday life these products have a PED that is more inelastic. We can see this with oligopolies in such industries as electricity, gas and water; with these industries, any change in price will not affect that demand for that product to a great degree due to their necessity and lack of alternative companies supplying that service.

Where as if a product is a luxury, demand can fall when the price is increased as the consumer may feel that the price is too high to justify buying the product, being not a necessity, giving it an elastic PED. One product that could contradict this is soap, as this to most people is necessity, it could be inelastic, but there are a large number of soap brands ranging from luxury products to very cheap alternatives. So the consumer has wide choice giving the market for soap an elastic PED.

Another determinant of PED is income of the average consumer, this covers the disposable income and not the money spent on necessities. A large proportion of consumer's disposable income is spent on goods and services that tend to be elastic. This is due to the fact that most people notice and increase in price on expensive good compared to the minimal change in price on less expensive products. This can be seen by looking at some food product, even through this may be a necessity people do have a choice of brands and quality. If you look at meat, you can see that people have options of different meat to buy, some people may buy expensive steak as they can afford to, but if the price should increase they can then opted for a cheaper meat.

Time is also a key factor in determining the PED, as time passes peoples trends and tastes may change, also the longer consumer has to react to the price the more quantity demanded will be responsive to price. This is because the more time a person has to find a close substitute, meaning the longer a company waits to see if demand has change once they have given their product a new price, the more chance that the outcome could be different. The elasticity of their product may change due to time e. g. if a company raises the price of a good and the demand drops a lot straight away, they would say that PED is elastic, but if they look at the demand over a longer time the demand may rise, giving a inelastic PED. This may be due to the consumer deciding that the product they changed to was to inferior to the original good.

The final determinant of PED is brand loyalty, this the consumers right to stay with one particular brand than to change to another, even when the price of their favourite brand has increased. If a product has a large group of loyal customers its PED is likely to be inelastic, as any change to the price of the product will not change the demand from their loyal customers.

The price elasticity of demand of any product or service can be affected by any or all of the determinants that I've discussed. So without taking into account the affects of the above, a company wishing to use PED to estimate their total revenue will not get a true reading.