5.14: Introduction to Price Elasticity and Total Revenue

What you'll learn to do: explain the relationship between a firm's price elasticity of demand and total revenue

Price elasticity of demand describes how changes in the price for goods and the demand for those same goods relate. As those two variables interact, they can have an impact on a firm's total revenue. Revenue is the amount of money a firm brings in from sales—i.e., the total number of units sold multiplied by the price per unit. Therefore, as the price or the quantity sold changes, those changes have a direct impact on revenue.

Businesses seek to maximize their profits, and price is one tool they have at their disposal to influence demand (and therefore sales). Picking the right price is tricky, though. What happens with a price increase? Will customers buy only a little less, such that the price increase raises revenues, or will they buy a lot less, such that the price increase lowers revenues? Might the company earn more if it lowers prices, or will that just lead to lower revenue per unit without stimulating new demand? These are critical questions for every business.

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