

## 12.26: Price Elasticity

### Learning Objectives

- Define price elasticity

Elasticity is a classic economic principle that helps us understand how much a change in price will affect market behaviors. If we make a change in price, how will that impact the demand for the product? Price elasticity is the measure of the market's response to price changes.

Elasticity is important to pricing decisions because it helps us understand whether raising prices or lowering prices will enable us to achieve our business objectives. How much will a lower price increase sales? Will a price increase cause us to lose many customers or just a few? Price elasticity is another factor to consider in order to select the most effective pricing strategy.

Elasticity in price denotes a large impact on demand due to changes in price. Raising the price causes decreased demand, while lowering the price stimulates increased demand. Inelasticity refers to the situation where there is insensitivity to price—demand will not increase or decrease despite changes in price.

### Case study from a mass-merchant retailer illustrating price elasticity

In the 1980's there was a certain men's denim jean manufacturer who had the dominant brand in the market. Their brand was so popular that they could not physically produce enough product to satisfy all of their retail customers. In order to be fair to all of their customers, the company devised an "allocation" system that gave all retailers the same percentage of their desired orders. For example, if a retailer wanted to buy 100,000 pairs of denim jeans for the season, and the allocation was 80%, the retail customer could expect to receive 80,000 pairs.

On the retail side, an annual event called "Back to School" was the most popular time to sell denim jeans. All of the major retailers targeted the middle of August to advertise their big sale of the popular jean brand. These were days well before "big data" analytics, but the mass merchant in question had been running this promotion at the same time for many years and so knew exactly how many pairs of the denim jean product it would sell by month, week and day given the price.

The retailer in this case study knew that it would sell 50,000 pairs a week at a sale price of \$24.99, 75,000 pairs at \$22.99, and 120,000 pairs at \$19.99 sale prices. So it became a matter of the supply (how much did the retailer have in stock) versus the projected sales at the various sale price options. If the mass-merchant could procure 85,000 units of the denim jean product, then they had to set their big sale price no lower than \$22.99 or risk selling out.

This is a classic example of price elasticity. You have the situation of limited supply and highly sensitive market reaction to the price of the goods in question.

### Practice Questions

<https://assessments.lumenlearning.co...sessments/9274>

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