

# When prices change, so do customer habits!

It's a fact. Consumers are looking to get the most out of every dollar they spend. It's no surprise then that they usually make their choices based on price.

Businesses have long understood that price plays a decisive role in consumer behaviour. This is why they use sales and promotions to sell their inventory.

## HOW THE LAW OF SUPPLY AND DEMAND WORKS

When the relative prices of goods and services change, people must redirect their consumer choices if they want to preserve their financial well-being. The recent increase in gas prices is a good example of the universal applicability of the law of supply and demand. This law stipulates that, given a constant supply, if the price of a product goes up, the demand for it goes down. Price, which is determined by the equilibrium of supply and demand, is the mechanism whereby optimal resource allocation is achieved in a capitalist system.

However, there are some nuances to the law. In reality, price variations have a greater effect on the demand for some goods and services than for others. Gas is another story, since it is not very sensitive to price variations in the short-term, but becomes more sensitive as time goes on. In order to reduce gas consumption, consumers would have to drive less or buy fewer energy-consuming goods, or both.

Of course, if the price of gas goes up, consumers may well decide not to change their driving habits, but they will have to reduce their spending on other goods or make sacrifices elsewhere. But sacrifice means less enjoyment. And consumers are intelligent: they will try to reduce their gas consumption habits while limiting the amount of inconvenience this will entail.

## SETTING USER FEES TO PREVENT WASTE

The impact of price on resource allocation and on our individual decision-making process is so clear that even the Québec government is seriously studying this issue. It created a Task Force on Fees for Public Services, chaired by economist Claude Montmarquette, which recently published a report entitled *The Right Fees to Live Better Together*. The report covers electricity and water rates, university tuition fees and road tolls. The ultimate goal is still the same: manage our resources better while sending the right message to users. →



“Free water [...] leads to people watering their driveways with the lawn sprinkler [...].”

It stands to reason that when the price or rate of a product or service is too high or too low, this will create distortions in its consumption. Free water, for example, leads to people watering their driveways with the lawn sprinkler or filling their swimming pools without having to pay for the cost of treating the water. Charging user fees for water would certainly change this type of behaviour and help save this precious natural resource.

Ontario is a good example of the effective management of limited electrical resources. Starting December 31, 2010, Ontario Hydro plans

to install smart meters in all their customers' homes. This will allow the utility to bill consumers for electricity based on time of use. The goal is to reduce peak demand periods with, for example, higher rates between 5 p.m. and 10 p.m. and much lower rates after 10 p.m. This new price structure will most certainly create changes in the way Ontario residents use electricity. Hydro-Québec is currently conducting a similar pilot project, which is expected to end in 2010.

#### OUR CHANGING BEHAVIOUR

To a large extent, the government sets rates for public utilities, and there is strong public sentiment against any change. Until now, economic conditions have not necessarily been conducive to manipulating these rates in an attempt to redirect consumer behaviour. However, current gas price hikes might help wake people up to the fact that our resources are finite and that we have to consume them responsibly.

While persuasion takes a long time to produce results, price variations trigger immediate reactions. With the growing focus on environmental issues and the substantial impact of price on consumer behaviour, public utility rates could become the ultimate weapon for influencing consumer choices. In ten years' time, our consumer habits will have changed completely! **D**



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