

The chocolate market industry economics essay



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The chocolate market industry has been around in the UK since the 19th century. Since then, many different firms have developed and established themselves in the market, resulting in a competitive market. Therefore, this project will focus on how the UK chocolate market structure has changed and evolved over the years and the causes of this. Our project will be mainly based on analysing the chocolate company 'Cadbury' and their trend in sales, along with other factors which has caused the takeover of Cadbury by Kraft Foods. From this, we will be able to determine the factors which caused the change of market shares original Cadbury has.

Outline the trend in sales by the major chocolate manufacturers in the UK over the last 10 years, and analyse the structure of the UK chocolate industry.

Western Europe is the largest chocolate market in the world (Haymarket Network Ltd. June 2012) and Britain has the biggest confectionary market among the European Union (Barnett 2006). Moreover the UK has the seventh highest consumption of chocolate in the world. The average Brit consumes 17.49lbs of chocolate per year (The World Atlas of Chocolate 2000).

Since the last ten years the chocolate confectionary sells has grown significantly. During the period of 2000-2005 the compound annual growth rate for chocolate sales in percent was approximately 2.5% Euro. The estimated value of the sales for 2005 was €6,214m (Euromonitor International 2005).

Additionally, according to Mintel - UK market research firm, the chocolate market in the country reached £3,976 billion in 2011, a 21% increase over a

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five-year period and 7.5% growth since 2010. As the people seem to continue purchasing chocolate, even more than before, this is certain premise for involving huge chocolate players in strive for bigger market share in the country.

In the last ten years the chocolate market in United Kingdom was dominated by several companies. Since 2010, when Kraft took over Cadbury, three companies dominated the market with control over 83 percent in 2011 - Nestlé, Mars and Cadbury/Kraft.

Figure 1. Percentage of market share in the UK chocolate industry (Trading Visions 2011)

Other big companies involved in the UK market are - Hershey, Thorntons, Ferrero, Lindt, Divine chocolate and others. The Mintel released table in 2012th explains more detail the changes in the market chocolate share during the last couple of years.

2009

2010

2011 (est)

% change

£m

%

£m

0%

£m

0%

2009-11

Kraft Foods (Cadbury)

1, 187

33

1, 252

33

1, 297

33

9. 3

Mars

953

27

1, 005

27

1, 073

27

12. 6

Nestlé

585

16

606

16

646

16

10. 4

Ferrero

130

4

126

3

129

3

-0.8

Thorntons

68

2

75

2

74

2

8.8

Lindt&Sprüngli

49

1

60

2

63

2

28.6

Total of the above

2, 972

83

3, 124

83

3, 282

83

10. 4

Others

375

10

404

11

423

10

12. 8

Own-label

228

6

244

6

271

7

18.9

Total

3,575

100

3,772

100

3,976

100

11.2

Figure 2. Percentage change in market shares in the UK chocolate market, by value, 2009-11 (Mintel 2012)

The fragmentation between few large companies in the chocolate confectionary industry is a sign for oligopolistic structure of the market. During last 10 years, the situation changed several times. Brand owned by Cadbury, Daily Milk, grew 11, 7% from £374m to £418m in 2010 while Kraft brand's MilkD° sales increased from £8, 7m to £21, 3m according to Miggiano (category vice-president for chocolate in the UK). Normally an oligopoly exists when the top five or less firms in the market account for more than 60% of total market demand/sales (Econ 100 n. d.). Therefore it can be concluded that the situation of the market structure is certainly an oligopoly. A typical characteristic for oligopolistic competition is the big amounts spent for advertising. The leading company Cadbury spends millions for advertising every year, for example for their new chocolate bar "Crispello" they have prepared 7 million£ from their budget (Mail online 2012).

In the UK chocolate industry there are known to be several barriers to entry, contributing to the structure of the market. The huge capital needed for starting business in the market is the main obstacle for new firms.

Advertising and marketing could also be classed as a major barrier to entry, where concerning the oligopolistic confectionary firms. This is because some companies may have the financial power to win over consumer loyalty with their expensive branding. Therefore, the contestability of the market can be questioned as market firms with well-established, branded products make it rather difficult and more expensive for new firms to enter into the market successfully. However there are a lot of chocolate firms in the industry, with small profits and share. An example is the Divine Chocolate company, which is well known for its fair trade policy.

Explain why Kraft Foods wanted to take over Cadbury. To what extent do you think the arguments against this takeover were valid?

Cadbury is known to be one of the largest confectionary companies in the world. The British owned company was founded in 1824 and has been in existence since. However, in February 2010, Kraft Foods Group a reputable company within their own rights took over the multi-billion pound business, which caused significant outrage. The unprecedented event meant that Cadbury did not expect other firms to bid for the company, especially when it was not for sale. However, Kraft Foods had other intentions stating that ' The British confectioner offers Kraft greater access to sharp growth in emerging markets as well as some of the world's leading chocolate' (Ruddick 2010). It is therefore, evident that Kraft wanted to takeover Cadbury purely for economic gain, and to raise the company's profile and reputation amongst other respectable markets. Kraft Foods felt this was the perfect opportunity to do so and as a result, forcefully imposed a deal on Cadbury which they felt was sufficient enough for Cadbury to transfer/ give up their assets (company). This is also evident in this statement which mentions that ' Not only was Cadbury not for sale, but it actively resisted the Kraft takeover' (Moeller 2012).

Additionally, recent information suggests it is also debatable whether arguments in opposition of the takeover were valid, particularly due to Cadbury's profits increasing in recent years. Telegraph staff and agencies (The Telegraph 2012) indicates that the purchase of Cadbury by Kraft allowed for Cadbury to be reinstated into the global market where consumerism remains at large. ' Kraft has reported strong sales and profit increases in the

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first full quarter since it took over Cadbury. Sales rose 25% to \$12.3bn (£7.75bn) in the three months to 30 June, and Cadbury accounted for 90% of the gains. Net profits were up 13.3% to \$937m (£590.1m), compared with \$827m (£521m) in 2009 (Barker 2010). Thus, allowing for Cadbury to expand and increase its profitability. It can therefore be said, that although some felt apprehensive towards the move of Cadburys ownership, it seems to have been for the better. With MP Steve McCabe even stating "I think the investment is what's crucial to the long term future," and pointed out that Kraft had also expanded the research and development section'. On the other hand, 'Now, nearly two years on since the hostile takeover in February 2010, the firm has announced a further 200 job cuts, the company has given no specific assurances over the future of 4,500 UK jobs' (BBC 2011). Therefore, suggesting that those against the transfer of the company did undoubtedly have reasons to be concerned. An additional article even goes further to suggest 'Kraft already has a track record of cutting production and moving production abroad. There's no guarantee that they'll keep production in the UK in the long run' (BBC 2010). This indicates that there were implications of giving permission to Kraft to handle the company. Yet, this risk was still taken instilling fear in workers who were already apprehensive of this transition. This suggests arguments against the takeover were indeed valid.

Overall, it can be argued in this section that although Kraft, being a well-established company with a strong portfolio to build upon, it caused much controversy in its takeover of Cadbury. The addition of Cadbury to the firm means that Kraft is able to emerge in markets successfully that they were

restricted from before. Many argued that the takeover allowed for Cadbury to develop further into global markets rather than remaining in the UK. The company became increasingly profitable and as a result, a popular one in which many are interested in investing. However, with the good comes the bad and in a situation as such, it meant that the UK staff of Cadbury were at risk of losing their jobs. This would occur if Kraft moved the Cadbury business abroad, which has partially occurred since. Kraft has produced good results for Cadbury but not without causing implications in the UK (where Cadbury originates from). It can be stated from the research evidence that the intentions behind Kraft's takeover of Cadbury are quite clear and the opposition arguments of the UK Cadbury staff and the UK government are most certainly valid as displayed throughout this section.

On a chart show what has happened to the UK pound (sterling) against the dollar between December 2007 and September 2012

Source: Bank of England

Using a supply and demand diagram, explain this change in the sterling exchange rate against the US dollar.

The exchange rate is the rate at which one currency trades for another on the foreign exchange market. On the open market prices of goods, commodities and value of nation's currency (under a floating exchange rate) are subordinated to the control of two forces- supply and demand (Sloman: 360). Generally, the exchange rate is determined by the fundamental law of the market forming an equilibrium rate (price) by equating demand and supply of the currency. One of the primary laws of supply and demand

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indicates that high supply causes low prices and high demand results in high prices. This fact implies that when there is a rich supply of a particular good then the price should fall and vice versa. The price increases when there is a scarcity of the product. Consequently, an increase in the demand of a commodity would cause it to appreciate in value, whereas an increase in supply would cause it to depreciate (Capital Market Services 2012). The change in the exchange rate of UK pound sterling to US dollar can be explained using a basic supply and demand diagram. 1. jpg

Figure 1

Figure 1 shows a normal downward sloping demand curve. A decrease in the price of the pound in relation to dollars from \$2 to \$1 will cause British exports in the USA to become much cheaper than the domestic product. The demand for British export will rise in the USA, and in a result, the demand for British currency to buy these goods will increase, as the Americans will have to exchange their money for British pounds. Thus, at lower prices (lower exchange rate) more pounds will be demanded, and vice versa. Movements up the vertical axis represent an increase in price of the pound, which is equivalent to a fall in the price of the dollar. Similarly, movements down the vertical axis represent a decrease in the price of the pound (Capital Market Services 2012).

2. jpg

Figure 2

Figure 2 describes the supply side of the determination of the exchange rate. When UK importers wish to buy goods from USA, they will supply pounds on <https://assignbuster.com/the-chocolate-market-industry-economics-essay/>

the foreign exchange market in order to obtain dollars. The higher the exchange rate, the more dollars they will get for their pounds (Sloman 2009: 360). If the price of pound in relation to dollar rises from \$1.50 to \$2, price of imports from the USA will fall. Assuming the price elasticity of demand for the American imports is greater than one, the amount of pounds that UK consumers will need to supply in order to obtain the dollars to buy the goods- will rise. The supply curve slopes up because British firms and consumers are willing to buy a greater quantity of American goods as the dollar becomes cheaper (i. e. they receive more dollars per pound). Thus, the higher the exchange rate, the more pounds will be supplied (Sloman 2009: 360).

3. jpg

Figure 3 Based on Sloman 2008: 162

Suppliers and consumers meet at a particular quantity and price at which they are both satisfied, known as the equilibrium price pictured by Figure 3. At any higher price there would be an excess supply of British pounds that would drive price down. A lower price would cause a shortage of pounds driving the price up. In practice, the process of reaching equilibrium is instantaneous. The foreign exchange dealers working for the banks are incessantly adjusting the rate as new customers make new demands for currencies (Sloman 2009: 361).

4. jpg

Figure 4 Based on Sloman 2008: 161

A change in the exchange rate is caused by any shift in the supply and demand curves. When the demand and supply curves shift from D1 and S1 to D2 and S2 respectively the exchange rate will fall from \$1.60 to \$1.40. A decrease in the free-market exchange rate is called depreciation, an increase is an appreciation.

Explain the impact of this change in the value of sterling against the US dollar on a UK chocolate manufacturer who buys cocoa beans which are priced in dollars

Appreciation of pound against dollar is most beneficial for importers, like given UK chocolate manufacturer who buys cocoa beans priced in dollars. They are advantages as they need to find fewer pounds to buy their imported goods. Depreciation of home currency makes foreign buyers disadvantages as they need to find more money to pay for their imports (tutor2u). Therefore, in this example the best time for foreign investments was between December 2007 and June 2008 when the pound exchange rate was the highest.

Outline the causes of the current recession in the UK. Using relevant economic theory show how recession affected the UK economy.

Economist and experts still disagree on the definition of recession. However, technically speaking, the economy of a country would slide into recession when it experiences two continual quarters of negative economic growth. This happens when the GDP would have to contract on a quarter by quarter basis for a total period of six months. GDP (gross domestic product) is the

total amount of goods and services produced by a country in a given period of time.

The credit crunch that began in August 2007 brought recession in Britain and other countries across the world. Soon everything worsened dramatically and turned into global financial crisis in the autumn of 2008. The recession started in America where mortgage companies got into massive debt by giving out many subprime mortgages. They then bundled this debt on to other countries such as the UK by borrowing from abroad to finance this risky lending. The central problem of UK was Britain's banks, which had invested their reserves in those bundle's or effects that turned out to be unsafe, illiquid or even worthless. As UK banks began to struggle, the government allowed them to lend to each other to promote liquidity. They did not know that this would result in even more debt and tension between the banks. Consumer confidence dropped dramatically down. Along with the overvalued housing market finally failing, consumption began to fall. The British economy was officially declared to be in a recession in January 2009, when the Office for National Statistics (ONS) announced that the estimate of gross domestic product (GDP) showed a fall of 1.5 per cent in the last three months of 2008 after a 0.6 per cent drop in the previous quarter. This was the biggest quarter-on-quarter decline since 1980 and the first time the economy had been in recession since 1991. ONS figures show that GDP fell by 2.4 per cent in the first quarter of 2009 compared with the last quarter of 2008. GDP fell by a further 0.7 per cent in the second quarter of 2009, leaving the level of GDP 5.5 per cent lower than in the second quarter of 2008, the largest annual fall on record (ONS 2009).

It was the deepest recession since the war. The Manufacturing output was down 7% by end 2008. It has affected many sectors including banks and investment firms. Many well-known and established businesses went bankrupt. Britain has struggled to come out of the latest recession, with much speculation of a 'double dip' recession during the 2010s. Output fell by 0.5% in the 4th quarter of 2010. The unemployment rate rose to 8.1% (2.57m people) in August 2011, the highest level since 1994. As of January 2012[update], after 15 quarters, GDP is still 4% down from peak at start of recession. And now end of 2012 there are also speculation of a 'triple dip' recession.

Explain the statement about cocoa, referring to the relevant types of elasticity.

Supply conditions play a big role in determining the price of chocolates. Since Cocoa is a farm product it is subject to fast-developing changes in growing conditions. Ivory Coast is the biggest and Ghana the second biggest producer of cacao therefore if any viruses, like the stunted shoot disease, or any bad weather conditions affect their harvest will have consequences on the chocolate prices. On the other side good weather conditions will boost supply and drop the prices. Unpredictability of prices is increased by the fact that chocolate demand is very inelastic. In the US, short-term elasticity of demand has been estimated at about -0.2, and is even lower in some big European consumer countries (Henri Jason 1994). When demand is inelastic, even a small shift in the supply curve can produce a big change in the market price.

$IEoD = (\% \text{ Change in Quantity Demanded}) / (\% \text{ Change in Income})$

Another factor that determines the prices of chocolate is the strong income elasticity of demand. For example in the United States, a 10% increase in income has been estimated to increase per capita chocolate consumption by 9.2% (Henri Jason 1994). Income elasticity is not lot different in other countries. The recession makes people believe they should spend less and most of the cases people do earn less money or they have recently lost their job because of the financial crisis. Therefore they have less to spend. This will affect their choice between normal goods and luxury goods. If chocolate becomes too expensive they might become luxury good for some people, at the moment it is a normal good for most people.

undefined

Source: tutor2u

As a part of your conclusion, assess the future of the major chocolate companies in the UK. Do you foresee future growth, stagnation or decline?

Overall, it is evident that many factors influence the chocolate market in today's world. In recent years the best market decision by various chocolate companies was offering a variety of products to the consumer market. This strategy led to big profits for the biggest players in the industry, as they could afford the expensive advertising for their products. However, the trend for chocolate purchases has not slowed down regardless of the economic situation. In fact opposite to logic, people seem to have taken advantage from chocolate products in the recession, as they have spent more time staying home during the hard times of the British economic stagnation. On <https://assignbuster.com/the-chocolate-market-industry-economics-essay/>

holidays such as Easter and Christmas, purchases for some specific products has doubled, tripled or even more compared to the rest of the year.

According to professional investigators of the chocolate trends, like Mintel, the future of the chocolate market in UK will face a growth in the next several years. However, as a group we believe based on the evidence from this project, that the UK chocolate industry could potentially be dominated by foreign companies, resulting in stagnation for British chocolate companies.