Income elasticity of demand: analysis of nestle

ASSIGN BUSTER

Economics is the study of making choices, It examines how people choose the product in satisfying their unlimited wants by considering many factors.

Economics is “ The study of how society decides what, how and for whom to produce”.

(Begg, 2003)

COMPANY PROFILE

Nestlé was founded in 1867 on the shores of Lake Geneva in Vevey, Switzerland and its first product was “ Farine Lactée Nestlé”, an infant cereal specially formulated by Henri Nestlé to provide and improve infant nutrition. From its first historic merger with the Anglo-Swiss Condensed Milk Company in 1905, Nestlé has grown to become the world's largest and most diversified food Company, and is about twice the size of its nearest competitor in the food and beverages sector. In 2004, Nestlé had around 247, 000 employees worldwide, operated 500 factories in approx. 100 countries and offered over 8, 000 products to millions of consumers universally.

In India Nestle has its headquarters in Gurgaon, Haryana. One of the main brand is Chocolates and Confectionery which is been studied here.

DEMAND

Demand is the quantity buyers wish to purchase at each conceivable. The demand of the product can vary from consumers to consumers and product to product. Demand is not a particular quantity but it is the price at which

the consumers will purchase the product. In case of chocolates the demand can vary if the price increases.

The supply of the product is also very much essesntial, The product is to be reached to the consumers in right quantity at the right time with the right price.

The demand of goods can be classified into three types:

- The Price of related goods : This relates to the price and demand for the substitute product , If the Nestle Chocolates are not available in the market the people will start buying the substitute goods such as ice cream, cakes etc. But there is a major role for competitors, if the nestle chocolates are not available consumers can go for Cadbury chocolates also. The price increase in the complementary products such as milk, sugar, choco powder will effect the price of the product . So the price of related good playes a important role in fixing the price of the product.
- Consumer Income : The income of a person plays a major role in the market, if the person income goes high the demand of the product goes high as the people start buying more chocolates. The person consuming low priced chocolates will buy good quality chocolates this is the situation where the inferior goods demand gets lower. When the income increases the per capita income of the person increases which rather increases the purchasing power of the consumer.
- Taste : This is one of the major factor which controls the demand of a product, when the income of the consumers are high the people will

think of buying good quality chocolates, when there are competitors for nestle like Cadbury, amul etc the consumers depends on taste, the taste and preferences of a product plays a major role in setting the demand of a product.

ELASTICITY

Elasticity is the sensitivity of change in percentage of one variable with respect to the proportional percentage change in other variable. The Elasticity can be classified in to three :

- Price Elasticity of Demand - This is explained as the difference between the percentage change in demand by the percentage change in price.

Ed = % change in Quantity Demanded

% change in Price

From the above figure if the price of chocolate is been reduced by 20 pounds from 30 pounds the degree of change in demand increases from 30 kg to 50 kg , the change in price can give a very good result on the products sale , where as when the price is been increased by 50 pounds the demand falls to 20 kg there is a great loss and the sales and demand of the product has fell down.

20%/10 %= 2 , hence it is a highly elastic .

- Income Elasticity of Demand

Income elasticity of demand measures the responsiveness of the quantity demanded of a good to the change in the income of the people demanding

the product . It is calculated as the ratio of the percent change in quantity demanded to the percent change in income. For example, if, in response to a 10% increase in income, the quantity of chocolate demanded increased by 20%, the income elasticity of demand would be 20%/10% = 2.

A negative income elasticity of demand is associated with inferior goods an increase in income will lead to a fall in the quantity demanded and may lead to changes to more luxurious substitutes. A positive income elasticity of demand is associated with normal goods; an increase in income will lead to a rise in the quantity demanded. If income elasticity of demand of a commodity is less than 1, It is necessity good. If the elastisity of demand is greater that 1, It is a luxuary good. A zero income elasticity or inelastic demand occurs when an increase in income is not associated with a change in the quantity deanded of a good.

- Cross Elasticity of Demand :

Measures the responsiveness of the quantity demand of a good to a change in the price of another good. For example, if, in response to a 10% increase in the price of Sugar, the quantity of Chocolates demanded decreased by 20%, the cross elasticity of demand would be -20%/10% = -2.

It can be calculated using the following formula

= % Change in Quantity deamand of product A

% Change in Price of Product B

Where the two goods are substitutes the cross elasticity of demand will be positive, so that as the price of one goes up the quantity demanded of the

other will increase. For example in response to an increase in the price of cadbury chocolate, the demand for Nestle chocolate will rise. In case of perfecr sustitutes, the cross elastisity of demand is equal to infinity.

Where the two goods are complements the cross elasticity of demand will be negative, so that as the price of one goes up the quantity demanded of the other will decrease. For example, in response to an increase in the price of sugar, the demand Chocolates will decrease

Where the two goods are independent, the cross elasticity demand will be zero , as the price of one good changes, there will be no change in quantity demanded of the other good

(B. Johns, S, Atkinson,. 2001)

ECONOMICS OF SCALE :

Individual fixed Cost - It is the fixed cost incurred by the company for a long term period, it can be the the machinery cost or the materials required for the production of chocolates such as milk, sugar etc , the price of these will be fixed for certain period . The labour cost also will be also fixed .

Specialisation - The company will be specialised in some fields or the other . Nestle chocolates can be experts in making bar chocolate while they wont be specialed in making toffees .

Purchasing - It is like purchasing the product in huge quantities . If the company gives the suppliers with good price and of good quality, The supplier will buy the product from the the manufacturer, they accept lower

prices to secure steady demand. The customers exploit the market power. When the purchase is been made by the suppliers in large qualtity the production will be high and it can help to increase the profit.

Research and Development - The Company will have to concentrate on the R and D in order to get new technologies there by they can increase their production and they can research for new kind of chocolates where they can attract more customers. The company will have to invest n R & D and they have to achieve a right solution.

The Minimum Efficient Scale= Size of Market /No of Producers

= 63ooo/7= 9000

MES= 9000/63000= 14. 28%.

http://www. nestle. com/Resource. axd? Id= 24E5A5E2-93F8-43A3-956E-0F259448CB90

TECHNOLOGY

Technological progress can improve the company's production, its products its labour etc. By introducing new technology machine where by new designs of chocolates can be produced and new mixture of flavours can be added together so that the customers can be attracted. The new technology machines can even cut down the cost of production there by the price of the product can be reduced there by the supply can go high.

Economies of scope

1) Common Facilities:

In this the company makes different products with the same employed workers, this can help the company to reduce the cost there by increase the company's profit. For example the people who make nestle chocolates can even try for making nestle biscuits there by the product can be successful and don't want to incur much expenses.

2) Transferable Experience

It is the experience been transferred from one place to another, the experience gained from one organisation is been applied and their strategies are been blended together so that the company can earn more profit and the production can be increased.

3) Influences on Demand Demand for the product can increase if the product has a good brand image. If the Nestle chocolates are having demand in the market and the consumers purchase nestle chocolates by seeing the brand name and good will , the product next launched my Nestle will be more easy to be sold as the first product benefits the sale of the second.

CONCLUSION

The company need to keep a track on the markets demand and supply of the product there by the company can gain more profit by providing with the right product at the right time, The company should try to sell the chocolates to its suppliers within the equilibrium price so that they benefit in selling and they favour in selling our companies chocolates as they give them more profit. When the demand gets high, ample amount of products should be

available in the market there by increasing the production and this can increase the company's goodwill. The company should follow the consumer's tastes and preferences and should also consider the income of persons and price of related good. When taking in to consideration all the factors like technological, elasticity, economic scope, economies of scale the company can gain the goodwill of the market and people.

References:

Begg. D (2003) Foundations of Economics , Second edition, McGraw Hill Education, Berkshire.

http://www. nestle. com/

Atkinson, B. Johns, S.(2001)Studying Economics: Palgrave.

http://www. nestle. com/Resource. axd? Id= 24E5A5E2-93F8-43A3-956E-0F259448CB90