

Price Elasticity of Demand

- ▶ Elasticity measures the change in demand in response to a change in a variable (price, advertising, income etc.)
- ▶ If the change in demand is **proportionately significant** the product is 'elastic'. If not, the product is 'inelastic.'
- ▶ A change in a variable generally always results in a change in demand – the question is whether this change is **significant** or not
- ▶ If not, the firm can do whatever it wants without significant consequences. If it is significant, the firm should tread carefully.
- ▶ An elasticity of 1+ is said to be 'elastic'. -1 is said to be 'inelastic'
- ▶ A product is not 'elastic' or 'inelastic' – it is PRICE (in)elastic, or INCOME (in)elastic, or ADVERTISING (in)elastic.



The formula

$$\frac{\% \text{ change in demand}}{\% \text{ change in variable}} = \frac{20\%}{33.6\%}$$

$$\frac{P}{\frac{1.49 - 0.99}{1.49}} = \frac{D}{\frac{300,000 - 250,000}{250,000}}$$

$$\% \text{ change} = \frac{\text{difference}}{\text{original}} \times 100\%$$

e.g. Price of a McD's Egg McMuffin goes from £1.49 to £0.99. Demand increases from 250,000 to 300,000.

0.59 (inelastic). McD's should choose a price carefully...why?



Other Elasticities - Income

The responsiveness of demand to a change in peoples' incomes.

If incomes rise, demand for 'inferior' goods (those that have 'superior' branded alternatives to compete with such as?) falls and vice versa.

More expensive, 'superior' goods are classed as 'normal' because we would expect that demand falls as incomes fall and vice versa.

Necessities (income inelastic) (such as?) are not significantly affected by income levels.

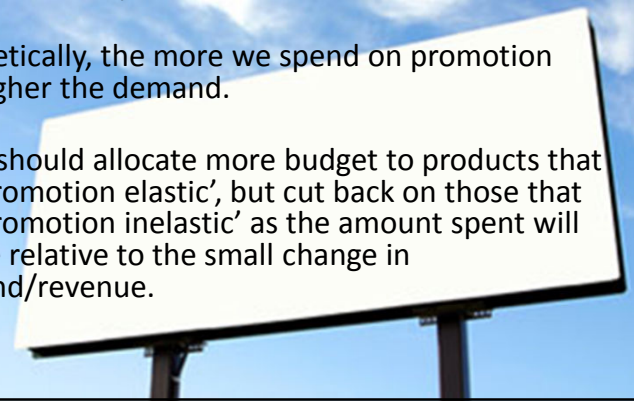


Other Elasticities - Promotional

The responsiveness of demand to a change in promotional expenditure.

Theoretically, the more we spend on promotion the higher the demand.

Firms should allocate more budget to products that are 'promotion elastic', but cut back on those that are 'promotion inelastic' as the amount spent will not be relative to the small change in demand/revenue.



Other elasticities - cross

The responsiveness in demand for a product following a change in price of another product.



If cinema prices increase, demand for Netflix will increase. Netflix is a 'substitute' for cinema.



Other elasticities - cross

The responsiveness in demand for a product following a change in price of another product.



If iPad sales increase, demand for iPad covers will increase. The two products are 'complements' to each other.



Other elasticities - cross

CED = $\frac{\% \text{ change in demand for good A}}{\% \text{ change in price for good B}}$

If the result is positive, the goods are substitutes for each other and competing for customer demand.



If negative, the goods are complements for each other, one usually being bought with or because of the other.



Evaluating Elasticity

- ▶ Useful to help businesses think about the consequences of their marketing decisions
- ▶ Cannot use the data in isolation – other factors (e.g. PEST) may have been significant
- ▶ Best to take elasticities over a longer period to build a trend – increases reliability
- ▶ Need to also consider SWOT, PEST, competitors etc.

