EURASIAN EXPERIMENT JOURNAL OF SCIENTIFIC AND APPLIED RESEARCH
(EEJSAR) ISSN: 2992-4146
©EEJSAR Publications Volume 6 Issue 1 2024

The Role of Elasticity in Shaping Business Strategy and Economic Policy

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ABSTRACT

The theory of elasticity is important to economics and businesses because it helps to understand consumption patterns and the effects of actions taken in the economic environment. It is defined by three types: determination of price elasticity of demand (PED), income elasticity of demand (YED), and cross elasticity of demand (XED). Economists like Alfred Marshall and Adam Smith, John Hicks, Roy Allen, and Paul Samuelson contributed to the early development of elasticity theory. Elasticity functions as a tool that businesses apply when coming up with pricing policies, marketing strategies, and product differentiation. It also informs revenue management strategies, product management, consumer choice analysis, supply chain management, and operations management. Other factors, such as market structure, economic conditions, technology, and government policies, affect elasticity when conducting business in different market fields. Real-life examples of elasticity include evaluating price positioning or the demand range. It also influences international trade patterns, such as changes in foreign exchange rates, tariff imposition, and cases of export promotion through subsidies. Innovative approaches to elasticity analysis, including AI, machine learning, and predictive analysis, should have implications for business decision-making and risk management. This review examines the role of elasticity in shaping business strategy and economic policy. We utilised relevant published data (2004–2014) from diverse, reliable databases. Findings suggest the vital role of elasticity in economics and business, emphasising its relevance in shaping strategies, driving innovation, and adapting to dynamic market conditions. Highlight the ongoing evolution of elasticity analysis and its implications for future business practices.

Keywords: Elasticity, Shaping Business Strategy, Economic Policy, Revenue,

INTRODUCTION

Elasticity is an important concept in both economics and business, used to determine the degree of change in one variable when subjected to change in another [1]. It gauges the extent to which a change in one factor, such as the quantity demanded or supplied, influences another factor, like the price, income, or the cost of substitutes. We use it to predict how consumers and organizations will respond to changes in market trends. There are three types of elasticity: These include the price elasticity of demand (PED), the income elasticity of demand (YED), and the cross elasticity of demand (XED). PED assesses the extent to which the quantity demanded of a good change with its price, while YED assesses the extent to which the quantity demanded of a good change with consumers' income. Interpretations are normal goods (YED > 0), inferior goods (YED < 0), luxury goods (high positive YED), necessity goods (low positive YED), and cross elasticity of demand (XED ≈ 0). The elasticity of demand has been defined and explained by several approaches from different economists. British economist Alfred Marshall introduced the earliest known definition of elasticity in his work "Principles of Economics," which is considered a work of reference in microeconomics [2]. Famous British economist Adam Smith first mentioned the topic of elasticity of demand in his work "The Wealth of Nations." In the twentieth century, John Hicks and Roy Allen built on the elasticity concept and incorporated it into consumer theory, enriching their theoretical understanding of the ways in which elasticity functions within different market contexts [3]. Paul Samuelson was a pioneer in including elasticity in his work on consumer theory and general equilibrium analysis, making the

concept easily understandable for students and practitioners of the subject. Through his contributions, he established the place of elasticity in economics and the role it plays in numerous areas of economics. Elasticity theory remains a critical aspect of economics and business that helps to explain consumers' behavior, business strategies, and economic policies [4].

Price Elasticity of Demand in Business Strategy

Business uses the Price Elasticity of Demand (PED), a significant concept that focuses on the degree of change in the quantity demanded over a change in price. It aids organizations in strategic management, including pricing, marketing, and product differentiation [5]. In order to calculate PED, businesses must consider their initial and new price and quantity, and then the percentage change in price, or PED. There are three types of PED: elastic demand or perfectly elastic demand (PED > 1), where demand fluctuates more than the price change; inelastic demand (PED < 1); and unit elastic demand (PED = 1), where demand moves in proportion to the price changes. In the case of high price elasticity, consumers are sensitive; hence, businesses can incorporate this into their operations as a market factor. Some of the strategies are as follows: price competitive strategy, differentiation and value-added strategy, market segmentation and targeting strategy, cost control strategy, and supplier negotiation strategies. Strategies for products with inelastic demand include premium pricing, luxury positioning, value-based pricing, customer perception of price, inertia, price tweaks, cross-selling and up-selling, and achieving a significant market share among the targeted customer groups. Some of the competitive pricing strategies identified in this research include price skimming, promotional pricing and discounting, product differentiation and value addition, product bundling, market targeting and segmentation, loyalty programs, efficiency improvement strategies, and supplier negotiations. For inelastic products, measures include high price skimming, prestige pricing, selective pricing, penetration pricing, frequently involved pricing, right pricing, product bundling and sell-offs, and customer loyalty programmes [6].

Demand's income elasticity and market segmentation

Income elasticity of demand (YED) is a measure that compares the change in quantity demanded of a good due to a change in consumers' income. Products like electronics, fashion apparel, cars, etc., known as luxury products, have very high positive income elasticity, are costly, and are regarded as having better quality or standards [7]. Necessity products, however, are those needed in everyday use and are relatively cheaper and used more frequently. On the other hand, an inferior good's income elasticity coefficient is negative, and such goods are usually cheaper and of lower quality. Income elasticity segmentation is a market segmentation technique that categorises a market based on variations in demand for products that occur with changes in income. Higher income categories include consumers with a lot of disposable income who are interested in expensive products and services, as well as goods and services of superior quality [8]. Consumers with a moderate level of disposable income, known as the middle-income segments, prioritize necessities and inexpensive frills, while the low-income segments prioritize essential products and cheaper grades. Product specialisation targets products at each income level, sets appropriate prices for each income level, and uses language and communication styles that are familiar to the particular income level. Marketing strategies based on income elasticity include premium events, glamorous advertisements, branding personalities, live promotions, broad communications, discounting, informative materials, advocacy, and frugal appeals. Dynamic tactics include changing marketing strategies based on the changing economic climate, analyzing consumer preferences, and modifying products and marketing communications as needed.

Cross-Elasticity of Demand and Competitive Strategy

Cross Elasticity of Demand (XED) is an important factor that helps to define relations between related products and make important decisions about prices, advertisements, and product changes [9]. It demonstrates how the quantity demanded for one good varies with the price of another. We must determine the goods involved in the analysis, including the initial and new prices and quantities of Good B, as well as the initial and new quantities demanded of Good A, to compute XED. For XED > 0, the products are substitutes, while for XED < 0, the products are complements, so pricing should consider the bundle of goods. Thus, zero XED (unrelated) means no relationship in terms of competition or complementarity. Pricing as a competitive response can be achieved through various strategies such as price matching or undercutting, differentiation pricing, adding value services and features, joint promotions, pricing creep, and separating prices for unrelated products [10]. Strategies for substitute products consist of market positioning, innovation, promotions, product bundling, collaborative marketing, supply chain management, and strategic partnering. These strategies include market positioning, innovation, promotional strategies, product bundling, collaborative marketing, supply chain coordination, and strategic alliances on complementary goods. However, for substitute goods, market positioning involves positioning the product in the market by highlighting its unique features, conducting research and development,

analyzing market and customer feedback, and using advertising to highlight the superior features and benefits of the product. In the case of complementary goods, product bundling entails creating packages that can be useful to consumers, in addition to ensuring that the products in the bundle are compatible for functionality. Affiliate marketing refers to teaming up with other companies to produce similar products for joint marketing campaigns, where businesses may share consumer trends and information to make tailored and effective marketing strategies that will benefit both parties [11]. Supply chain integration refers to coordinating with suppliers of related products to improve inventory and price control. We can defend substitute forces by forming alliances or merging with rivals to enhance competition and coordinate on benchmarks, thereby reducing fluctuating market forces. In complement, synergy with producers of other goods helps to build product systems and create consistent solutions for consumers.

Elasticity and revenue optimization

Revenue management is an important component of business processes, as it allows businesses to understand the impact of altering prices, income, and related products [12]. In this process, elasticity of demand is helpful as it provides a clear understanding of pricing and marketing strategies. The types of elasticity of demand include the following: positive YED, or normal goods; high positive YED, or luxury goods; negative YED, or inferior goods; and cross elasticity of demand, or XED. Positive YED (substitutes) suggests that there may be potential for price changes, whereas negative XED (complements) calls for strategic changes.

Elasticity variance pricing models enable companies to change prices frequently depending on factors like demand, market environment, and competitors' activities [13]. Companies employ these models to maximise revenues by accurately estimating prices based on the current market conditions. Some of the popular strategies include time pricing, demand pricing, customer-specific pricing, competitor-based pricing, and point pricing [14]. In the service industries, revenue management is a system of monitoring product pricing and availability to increase revenue with the help of big data and knowledge of price sensitivity. Yield management is the practice that allows airlines to set charges according to the requirements of demand and the availability of seats in the airplane. Accommodation makes rate adjustments based on supply and demand, time, and competitor rates; elasticity of demand assists in setting optimum rates for room occupancy and revenue. Companies in the rental industry, including car rental services and accommodation rental services, rely on fleet management to set prices for services based on demand, fleet availability, and competitive market prices. An organisation pursuing the highest possible revenues uses seasonal pricing to control both demand and supply [15]. Ride-sharing services use elasticity to adjust pricing in response to demand, increasing prices during periods of high demand to increase supply and generate more revenue. During periods of low demand, ride-sharing services use temporary price reductions, popularly known as dynamic discounts, to increase demand and fill the available fleet.

Elasticity in Product Lifecycle Management

Product lifecycle management (PLM) involves overseeing a product from its inception through design, manufacture, service, and disposal [16]. Understanding elasticity is crucial in PLM as it informs pricing, marketing, and product development strategies at different stages of a product's life. In the introduction stage, demand is less elastic due to low awareness and early adopters. Concentrate on creating awareness and instructing prospective clients, keeping their price sensitivity in check. Price reductions and promotional efforts can boost sales volume, while product improvements and differentiation become important as competition increases. In the growth stage, demand becomes more elastic as more competitors enter the market and consumers become more price-sensitive. Competitive pricing is crucial to maintaining market share, with a focus on differentiation and customer loyalty programs [14]. In the decline stage, demand becomes highly elastic due to the availability of newer alternatives and decreased interest in the product. Adjusting the marketing mix based on the lifecycle stage is essential for product development. Focus on quality and unique features, limited versions, and high investment in awareness campaigns, product trials, and influencer endorsements. Expand the product line with additional features and variants, competitive pricing, and broader distribution channels. Emphasize brand differentiation and product benefits; increase advertising and promotional offers. Elasticity insights drive innovation and product development by identifying opportunities, improving products, customizing and differentiating them, managing dynamic product portfolios, forecasting and planning, and devising competitive strategies [17]. By understanding elasticity, companies can make informed decisions about investing in new products, adjusting prices, and introducing new features to stay competitive.

Elasticity and Consumer Behaviour Analysis

An important concept in the study of consumer behaviour is the coefficient of elasticity, which enables organisations to predict how shifts in price, income, and other variables will affect the consumption level. Behavioural economics, a discipline that explores how psychological, behavioural, emotional, cultural, and social

factors impact economic choices and their implications on prices, profits, and resource allocation, shows that consumers are not always rational [18]. The major concepts of behavioural economics influencing elasticity include anchoring, loss aversion, mental accounting, fairness, psychological pricing, and perceived value. Pricing uses this psychological theory because consumers make decisions based on the first piece of information and a high initial price, which makes subsequent price drops more appealing. Loss aversion, in particular, is more reactive to changes on the higher end, whereas mental accounting influences the consumer's response to price changes [19]. Consumer perceptions of price fairness can affect demand since customers tend to decrease their demand when they think that a price is unfair.

Psychological pricing and perceived value are strategies that take into account the psychological aspects of prices, in addition to the economic or rational perspective. They include charm pricing, prestige pricing, bundling, and reference pricing. Perceived value is the value that a consumer assigns to a product when comparing its benefits to its cost. Quality perception, brand loyalty, utility, and necessity are some of the influencing factors. The analysis of the consumer response to the changes in prices indicates that various Apple iPhone prices are less sensitive to the price changes when compared to the Netflix subscription price, where the elasticity was moderate due to the difference in the content offered as well as the habits of users [20]. The decrease in prices at Starbucks reveals that the price elasticity of demand is rather inelastic for core consumers, whereas a surge pricing system at Uber leads to a sharp increase in the cost of rides. Elasticity Insight is highly elastic under normal conditions but is relatively inelastic during high demand, which can be beneficial for Uber. Finally, the Coca-Cola price cut demonstrates the extent of the soft drinks industry's competitiveness: the price reduction results in increased consumer demand, proving the concept of price elasticity.

Elasticity in Supply Chain and Operations Management

Various elasticity concepts are vital in operations management, especially in supply chain management [21]. By mastering the concepts of elasticity, one is able to improve decision-making when it comes to inventory control, supply chain responsiveness, and cost, volume, and profit analysis. It also assists in determining the effect of price changes on the quantity demanded, highlighting the importance of demand forecasting. When dealing with elastic products, it's crucial to properly manage your inventory levels to avoid excess stock when demand decreases due to high prices [22]. These strategies involve utilizing historical consumption figures and elasticity estimates to predict future consumption quantities at varying prices, and implementing dynamic stock management systems that continuously adjust stock quantities to align with the anticipated demand elasticity. Another aspect of elasticity is stock levels, which should be low to minimise holding costs, especially for products that experience high price elasticity. Stable demand may necessitate higher inventories of inelastic products. It is essential that JIT inventory systems adapt quickly to changes in demand, and elasticity provides insight on when to ramp up or decrease production and order frequency. Responsive supply chains are most suitable for elastic products; such products need a supply chain that responds swiftly to fluctuations in demand or other factors [23]. Some of them are forming long-term partnerships with suppliers, utilizing advanced technologies for real-time monitoring and predictive analytics of production lines, and establishing adaptable production units for the production of diverse goods. Inventory buffering is also important for elastic products in order to avoid deviations from the expected demand rate. Other aspects of these concepts include cost-volume-profit analysis and elasticity. This is because changes in price affect the volume of sales and, consequently, the probable profit figures. Flexible products require break-even analysis because the volume needed to break even is dependent on the price [24]. For products with high price elasticity, the margin of safety is even more important, as it includes fluctuations in sales. By applying elasticity to profit formulation, one can ascertain the optimal price for a product that will generate the highest profit before any impact on demand. These include using elasticity estimates to increase price sensitivity and altering the cost structure to account for anticipated changes in demand elasticity.

Impact of External Factors on Elasticity

Changes in price, income, or any other relevant factor can impact the quantity demanded or supplied of a given good, a phenomenon known as elasticity. External forces such as the market structure of the goods, the availability of close substitutes, the necessity or luxury status of the good, and the time period can influence elasticity [25]. In competitive markets, demand is typically higher because consumers are able to switch to other products in the event of price changes. In monopolistic and oligopolistic competition, the demand function is usually inelastic. Economic factors such as inflation, recession, or even economic growth can affect elasticity. Unlike recessions that increase the price elasticity of demand for many products, inflation induces changes in the elasticity of both necessary and luxury goods. Economic growth can also cause a decrease in the price elasticity of many commodities, especially those regarded as luxuries.

The technological factor affects the price of the product by increasing the supply elasticity, thus making the product substationary, while on the same note, it also affects the demand elasticity by improving market access. Government policies and taxes can influence both demand and supply elasticity. Taxes, on the other hand, may have an impact on the price elasticity of demand, while subsidies may reduce production costs or prices, thus influencing elasticity. Supply restrictions, including quotas or licenses, can make supply less elastic, as producers cannot increase or decrease production in response to price variations. Trade policies can also influence the availability of these goods and their close substitutes, which has a bearing on elasticity. Pricing domestic products high because of high tariffs on imported goods can make demand for them inelastic since consumers have limited choices [26].

Elasticity in Business: Practical Applications

Elasticity is an important factor in business because it assists in the determination of the right prices to charge, direction in the marketing and promotion of goods or services, and inventory management. You can apply it for various purposes such as pricing strategy analysis, product development management, and demand forecasting. Examples of successful businesses that have implemented elasticity include the following: For instance, airlines apply the concept of price elasticity of demand to flexibly set ticket prices depending on the time of the flight, competitors, and season, while technology companies such as Netflix set subscription prices following the demand elasticity of different markets. Retailers commonly use an elasticity analysis to determine the appropriate price to offer consumers during special occasions like Black Friday [27]. However, they may also arise in situations where businesses neglect the concept of demand elasticity in the process of introducing new products or adopting new prices. For instance, increasing the prices of goods that have an elastic demand without factoring in the likelihood of losing sales quantities will prove counterproductive. Furthermore, promotion planning that fails to consider elasticity may lead to the promotion of products with inelastic demand, which is not profitable because it does not make businesses sell more of the product. To effectively apply elasticity theory in a business setting, businesses need to gather data to estimate the demand elasticity for various products and markets. This is because elasticity is dynamic, meaning that it constantly changes depending on market conditions and consumer behaviour patterns. The definition of segments based on price sensitivity helps business entities develop suitable pricing policies in relation to the various segments in the market. Experimentation and A/B testing can also determine pricing and promotional decisions that are likely to prove more effective, thereby reducing risks. Last but not least, another long-term success factor involves the ability to adapt to changes in elasticity and market conditions.

Elasticity in International Business and Trade

Governments and policymakers need to assess the degree of price sensitivity, buyers' income, and cross-elasticity in international business and trade. An understanding of these factors allows exporters and importers to forecast changes in demand levels in relation to the growth or decline of certain economies. Global markets sometimes have distinct market characteristics, and cultural and regulatory differences can impact the degree of market price elasticity concerning particular products [28]. This is a fact because exchange rate influences can greatly alter the relative price of goods making up international trade, possibly changing the demand for exports as well as imports. Understanding exchange rate pass-through is crucial for determining the price competitiveness of exports and imports, as well as for firms' sales strategies in the global market. Businesses must strategically incorporate the exchange rate pass-through elasticity of demand into their strategies. Tariffs and quota mechanisms: These policies, such as tariffs and quotas, have the potential to modify the demand elasticity of imported products by driving up prices, thereby reducing the elasticity of demand. Subsidies on exports in government policy could boost the comparative advantage of local products in the global market, and the elasticity of demand for exports defines the increase in volume and revenue of the export industry based on government subsidies. We can determine the likely effects of liberalising trade agreements on industries and consumers by analyzing the nature of specific demands.

Future Trends in Elasticity and Business

Another area where the application of predictive analytics is beneficial is its ability to predict the elasticity of demand for various businesses, using data retrieved from historical analysis. Additionally, enhanced computing capacity, data analysis, and computing abilities enable faster business decisions related to pricing strategies, changing marketing strategies, and managing product inventory. This improves decision-making and risk evaluation in areas with numerous risks and ambiguities within the market. Employing AI and machine learning approaches to elasticity analysis, the researcher can identify nonlinear patterns and interdependencies, which contributes to precise estimation [29]. These techniques can help in the discovery of relationships and trends in data that would not be observable when using the standard econometric models. AI has the capability to understand prior customer behaviour and their needs for particular products or services, as well as their sensitivity

towards price changes, and can make the necessary adjustments within the blink of an eye. AI-based models of demand forecasting can incorporate several factors such as macroeconomic factors, consumer psychology, and competitors' behaviour, all of which can produce accurate demand forecasts [30]. This makes it easier for the business to be ready in advance for any change that might affect production, stock, or marketing. The issues with emerging market elasticity include cultural aspects, socioeconomic factors, infrastructure and distribution challenges, and regulatory and political risks. These factors are relevant and crucial to understand for businesses that are willing to venture into these markets. Therefore, it is crucial to mitigate these challenges and guarantee the timely delivery of goods and services.

CONCLUSION

This article's analysis of elasticity highlights the profound influence this feature has on economics and business in general. Specifically, the current research concentrates on three key aspects of economics: Price Elasticity of Demand (PED), Income Elasticity of Demand (YED), and Cross Elasticity of Demand (XED) are collectively known as elasticity, as this provides a fundamental foundation for measuring and thereby analysing consumer behaviour and ultimately business and economic policy formulation. However, elasticity theory had started developing from the works of Alfred Marshall and Adam Smith in the early twentieth century and was directly codified by John Hicks, Roy Allen, and Paul Samuelson later on in the mid-twentieth century to become a comprehensive concept applied in numerous economic investigations. The concept applies in various fields, including strategic pricing and revenue management, procurement and supply chain management, international trade, and more. When it comes to business strategy, Price Elasticity of Demand helps organisations pursue the best pricing strategies, advertising and promotional campaigns, and commercial offerings. Cross-elasticity of demand helps you see how related and replacement products are related so you can come up with strategies to beat your competitors. Income elasticity segmentation helps you focus your advertising on specific groups. Furthermore, organizations today require elasticity awareness in almost all functional areas to effectively influence and manage overall revenues, product life cycles, consumption behaviours, and supply chains. Interestingly, we can use elasticity concepts as powerful tools to make informed decisions about prices, positioning, inventory, and demand levels. We expect future trends in elasticity analysis to expand these areas of effectiveness, leveraging analytics, artificial intelligence, and machine learning to enhance demand forecasting accuracy and develop sophisticated decision-making strategies. However, cultural differences, rules and regulations, and the lack of infrastructure should also be considered, as they may prevent easy market entry for organisations willing to engage in emerging markets. In other words, regardless of the differing perspectives and analyses it can assume, elasticity is an indispensable component of economic theory as well as business practice, allowing companies to operate in uncertain markets, predict emerging trends, and achieve lasting success. Elasticity is crucial and fundamental here because it keeps open the possibility of coping and transforming in the face of the constant changes in the contemporary business environment.

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CITE AS: Echegu Darlington Arinze, and Aleke Jude Uchechukwu. (2024). The Role of Elasticity in Shaping Business Strategy and Economic Policy. EURASIAN EXPERIMENT JOURNAL OF SCIENTIFIC AND APPLIED RESEARCH, 6(1):17-24