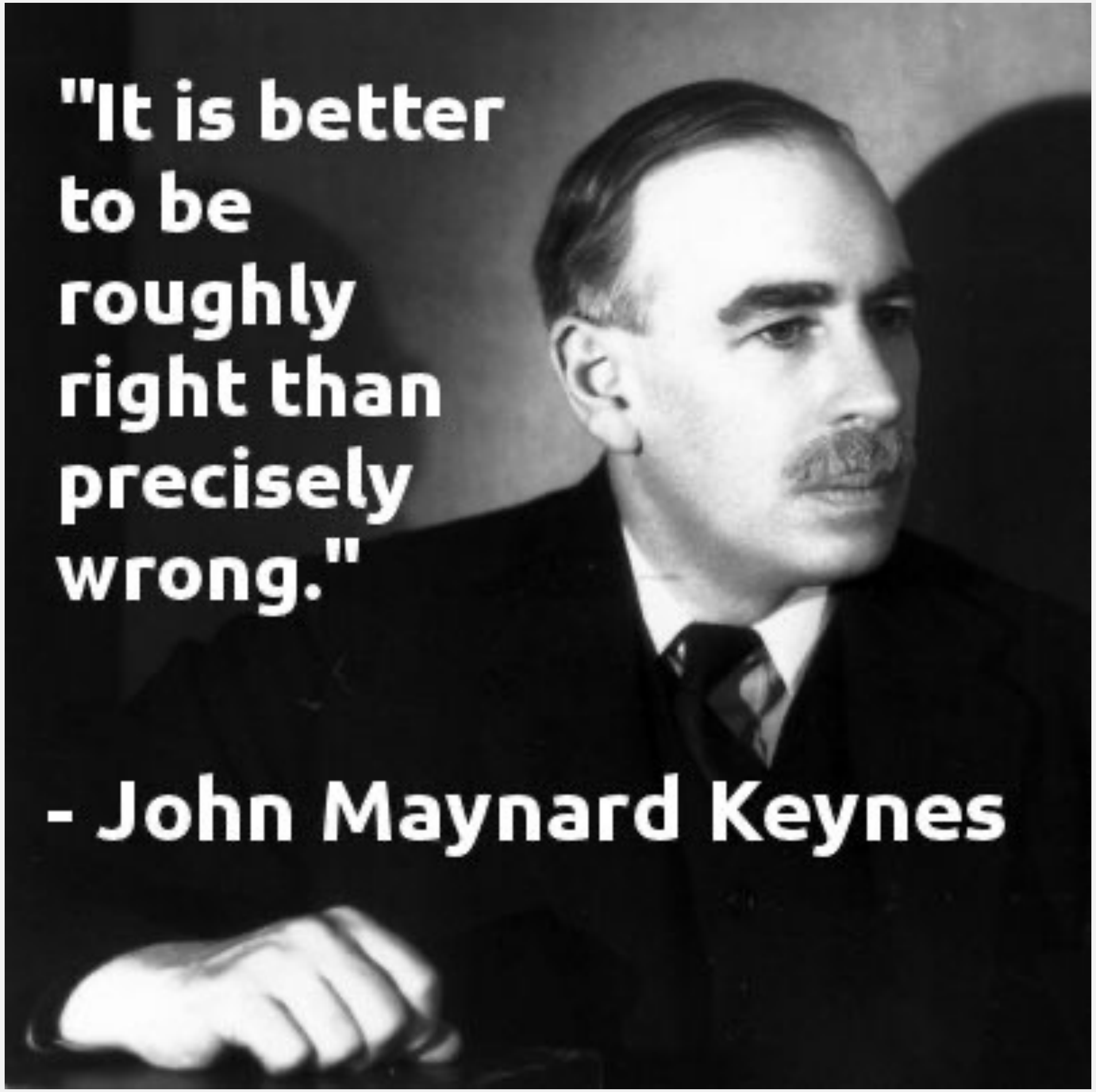

"It is better
to be
roughly
right than
precisely
wrong."
- John Maynard Keynes

FIRMS AND DECISIONS – SECTION A

1. Which of the following is likely to be fixed costs or variable costs for a chocolate factory over the course of a month?

(a) The cost of cocoa.

(b) An advertising campaign for a new chocolate bar.

(c) The cost of electricity for running the mixing machines.

d. Overtime pay.

e. Wear and tear on wrapping machines.

f. Interest on a mortgage for the factory: the rate of interest rises over the course of the month.

FIRMS AND DECISIONS – SECTION A

2. For each of the following examples,

(i) State if the economies of scale is internal or external

(ii) Identify the type of internal/external economies of scale

(a) Supermarkets such as Sheng Siong have larger bargaining power with suppliers.

(b) Listed companies can finance their operations through public issue of shares.

(c) Pharmaceutical firms make use of the talent pool and R&D infrastructure at Biopolis.

FIRMS AND DECISIONS – SECTION A

2. For each of the following examples,

(i) State if the economies of scale is internal or external

(ii) Identify the type of internal/external economies of scale

(a) Supermarkets such as Sheng Siong have larger bargaining power with suppliers.

Marketing Economies of Scale

Large scale buying and selling give the firm important savings in cost. Large firms have bargaining advantage and are accorded a preferential treatment by their suppliers because they buy raw materials and components in bulk. This allows them to dictate their requirements with regard to price, quality and delivery more effectively.

FIRMS AND DECISIONS – SECTION A

(b) Listed companies can finance their operations through public issue of shares.

Financial Economies of Scale

Larger firms are often given lower interest rates and larger loans because of better credit ratings and greater collateral. In contrast, smaller firms, especially new startups or small and medium enterprises (SMEs), often face higher rates of interest on loans because banks think it is riskier to lend to smaller companies.

Large firms also tend to be public limited companies. Such firms can raise capital more easily (cheaper) through the issuance of bonds (debt securities issued by borrowers such as firms seeking to raise funds from the financial markets) to the public. They are consequently better able to take advantage of financial economies of scale.

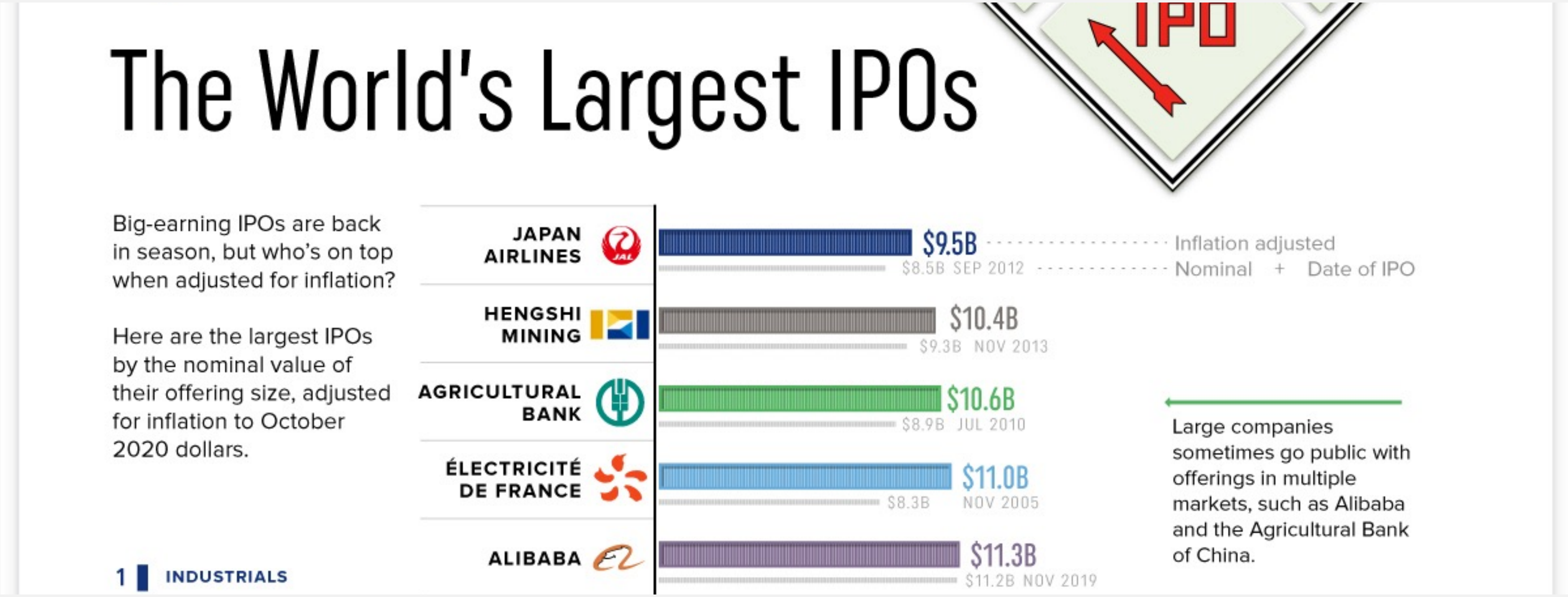
FIRMS AND DECISIONS – SECTION A

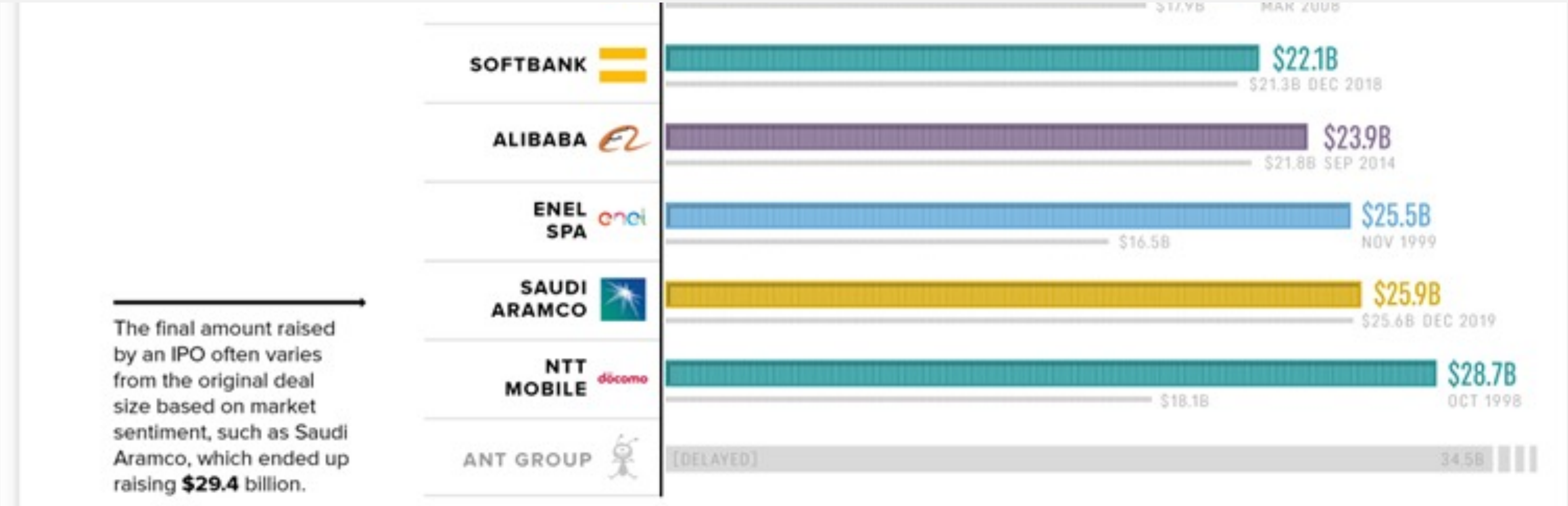
Comparing Unsecured Business Term Loans of DBS, OCBC, UOB, Standard Chartered, Maybank & Citi

	DBS* 0.4-0.8%	OCBC* 0.35-0.45%	UOB* 0.5%
Product Name	DBS Business Loan	OCBC Business Term Loan	UOB BizMoney
Max. Loan Amount	Up to S$500,000	Up to S$500,000	S$50,000 - S$350,000
Loan Tenor			
Interest Rate			

Deposit Amount	Rates (% p.a.)
First $10,000	0.050
Next $90,000	0.050
Next $250,000	0.050
Next $650,000	0.050
Remaining balance above $1,000,000	0.050

Product Name	red
Max. Loan Amou	00
Loan Tenor	
Interest Rate	


The World's Largest IPOs
IPO
Big-earning IPOs are back in season, but who's on top when adjusted for inflation?
Here are the largest IPOs by the nominal value of their offering size, adjusted for inflation to October 2020 dollars.
1 INDUSTRIALS
JAPAN AIRLINES
$9.5B
$8.5B SEP 2012
Inflation adjusted
Nominal + Date of IPO
HENGSHI MINING
$10.4B
$9.3B NOV 2013
AGRICULTURAL BANK
$10.6B
$8.9B JUL 2010
ÉLECTRICITÉ DE FRANCE
$11.0B
$8.3B NOV 2005
ALIBABA
$11.3B
$11.2B NOV 2019
Large companies sometimes go public with offerings in multiple markets, such as Alibaba and the Agricultural Bank of China.


SOFTBANK
$22.1B
$21.3B DEC 2018
ALIBABA
$23.9B
$21.8B SEP 2014
ENEL SPA
enel
$25.5B
$16.5B
NOV 1999
SAUDI ARAMCO
$25.9B
$25.6B DEC 2019
NTT MOBILE
docomo
$28.7B
$18.1B
OCT 1998
ANT GROUP
[DELAYED]
34.5B
The final amount raised by an IPO often varies from the original deal size based on market sentiment, such as Saudi Aramco, which ended up raising $29.4 billion.

RAFFLES

FIRMS AND DECISIONS – SECTION A

Pharmaceutical firms make use of the talent pool and R&D infrastructure at Biopolis.

Economies of Concentration / Agglomeration Economies

Agglomeration economies may also result from the clustering of businesses in a distinct geographical location e.g. software in Silicon Valley in the State of California or Singapore's twin hubs of biomedical and engineering research – Biopolis and Fusionopolis.

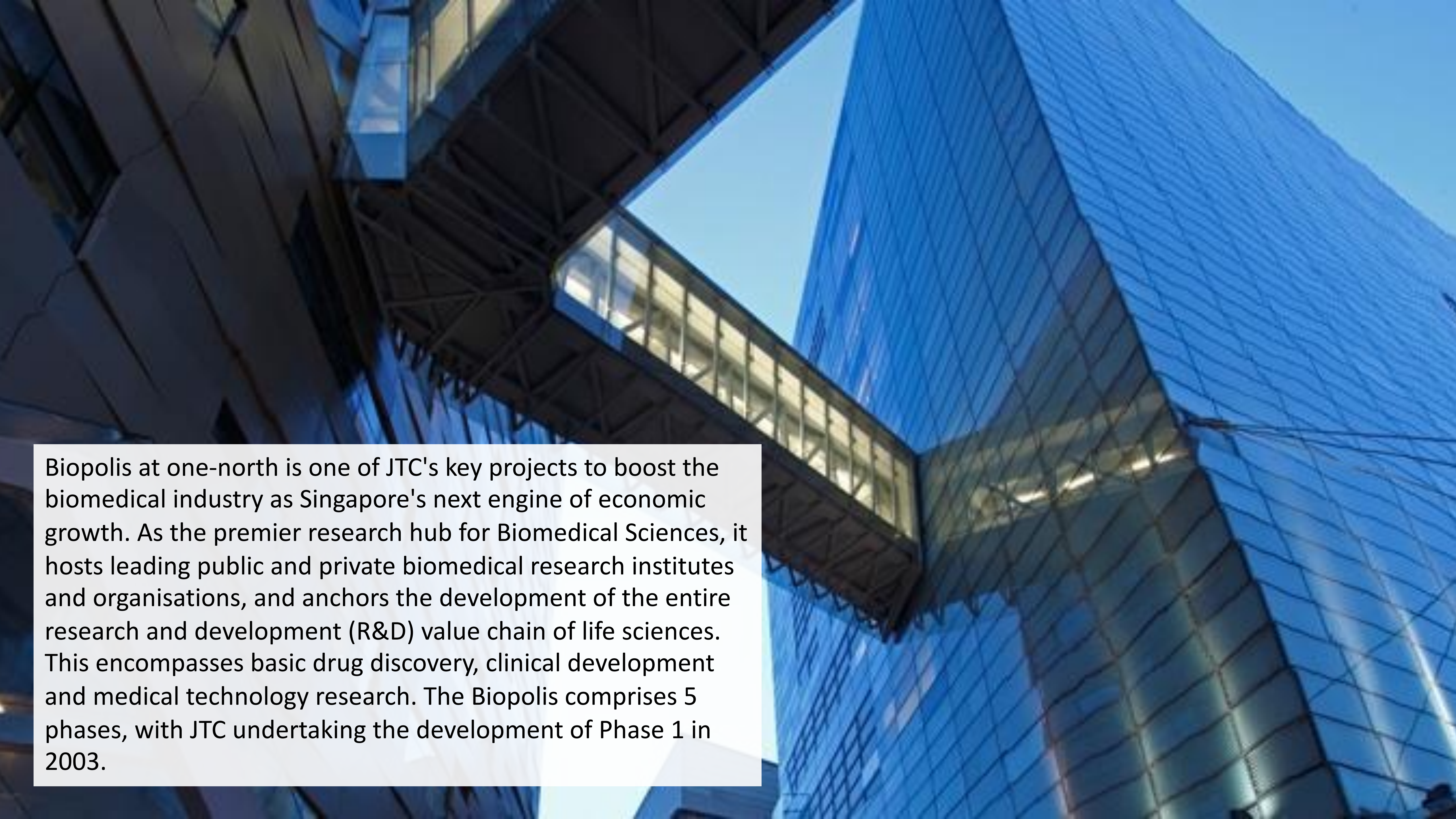
- Availability of Skilled Labour -When the demand for a particular type of skill is large enough, special educational institutions can be set up to train people in such skills. Firms can also join together to develop training facilities for their workers. This will help firms in the industry to reduce costs of training for their workers.

- Well-Developed Infrastructure - When many firms are concentrated in one area, governments may be encouraged to invest in infrastructure to cater to that industry. These include better connected roads, railway lines and airports for transport of finished goods or raw materials, or public utilities and other commercial facilities to support a larger work force. Such well-developed infrastructure can help improve productivity, which increases output per unit input and reduce average costs for individual firms.

Jurong Island is the cornerstone of Singapore's energy and chemicals industry and home to a vibrant portfolio of more than 100 leading global petroleum, petrochemical and specialty chemical companies.

Plug and Play

Jurong Island boasts a set of seamlessly integrated infrastructure solutions which includes service corridors, logistics and warehousing, as well as a comprehensive host of shared third-party utilities and services. These catalysed an integrated ecosystem where one's product becomes the feedstock of others by supplying "over the fence". With its dedicated "plug and play" infrastructure, companies are able to enjoy cost savings and at the same time build synergy through product integration.



Biopolis at one-north is one of JTC's key projects to boost the biomedical industry as Singapore's next engine of economic growth. As the premier research hub for Biomedical Sciences, it hosts leading public and private biomedical research institutes and organisations, and anchors the development of the entire research and development (R&D) value chain of life sciences. This encompasses basic drug discovery, clinical development and medical technology research. The Biopolis comprises 5 phases, with JTC undertaking the development of Phase 1 in 2003.

FIRMS AND DECISIONS – SECTION A

2. For each of the following examples,

(i) State if the economies of scale is internal or external

(ii) Identify the type of internal/external economies of scale

(d) A wafer fab producer benefits from R&D findings by leading players in the industry.

(e) Retailers make use of large-scale IT network systems to keep track of inventory flow.

(f) Firms employ specialists to improve the efficiency of different stages of production.

FIRMS AND DECISIONS – SECTION A

(d) A wafer fab producer benefits from R&D findings by leading players in the industry.

Economies of Information

Firms in an industry may share common R&D knowledge or facilities. Increased information flows about R&D processes have allowed for firms to share information on cost-saving technologies. This may also improve the productivity of individual firms and reduce average costs. Firms can also tap on the research of universities nearby that are likely to tailor their research toward the industry. Many scientific and trade journals that are published in the region will likely provide information to all the firms which relate to new markets, sources of raw materials and latest techniques of production.

FIRMS AND DECISIONS – SECTION A

Retailers make use of large-scale IT network systems to keep track of inventory flow.

Technical Economies of Scale

These refer to gains in productivity/efficiency from scaling up production.

Factor Indivisibility

Some inputs are of a minimum size and cannot be divided into smaller units i.e. they are indivisible. Purchasing such factors of production may not be feasible if a firm’s output is small as it means operating below the factor’s maximum capacity. For example, a larger supermarket might invest in database technology that improves stock control and reduces transportation and distribution costs. This might not be economical for a smaller grocer to do. In industries like mining and agriculture, heavy equipment such as drills, excavators and harvesters can significantly improve output and reduce average costs of production, but are only bought by large firms that can spread the equipment cost over a larger output.

The Times’s printing plant in College Point, Queens

FIRMS AND DECISIONS – SECTION A

(f) Firms employ specialists to improve the efficiency of different stages of production.

Managerial Economies of Scale

Managerial economies of scale are also related to specialisation and division of labour. The difference is that specialisation occurs on a supervisory level. Just as workforce specialisation increases productivity by training employees on a specific step in the production process, managerial scale economies increase productivity by employing specialists to supervise production systems. Better management and increased investment in training managers and the use of specialist equipment, such as networked computers can improve communication, raise productivity and thereby reduce unit costs.

Managerial scale economies also extend to human resources management. HR specialists raise productivity and reduce unit costs by creating efficient and cost effective hiring and labour search processes.

FIRMS AND DECISIONS – SUPPLEMENTARY NOTES

3. Firm ABC is a textile company. Explain with the aid of diagrams, the possible impact of the scenarios below on Firm ABC's cost curves (indicate whether ATC and/or MC have shifted and in what direction and explain why).

Identify if it is revenue or cost that changed. If cost, identify if it is fixed or variable.

(a) The government reduces its rental charges for SMEs such as Firm ABC.

(b) The government imposes a levy on foreign labour.

(c) Quotas on imports are relaxed, allowing cheaper imported textile to enter the country.

(d) The country experiences double-digit economic growth.

FIRMS AND DECISIONS – CASE STUDY 1

With reference to Table 2, identify an example of

(i) fixed cost [2]

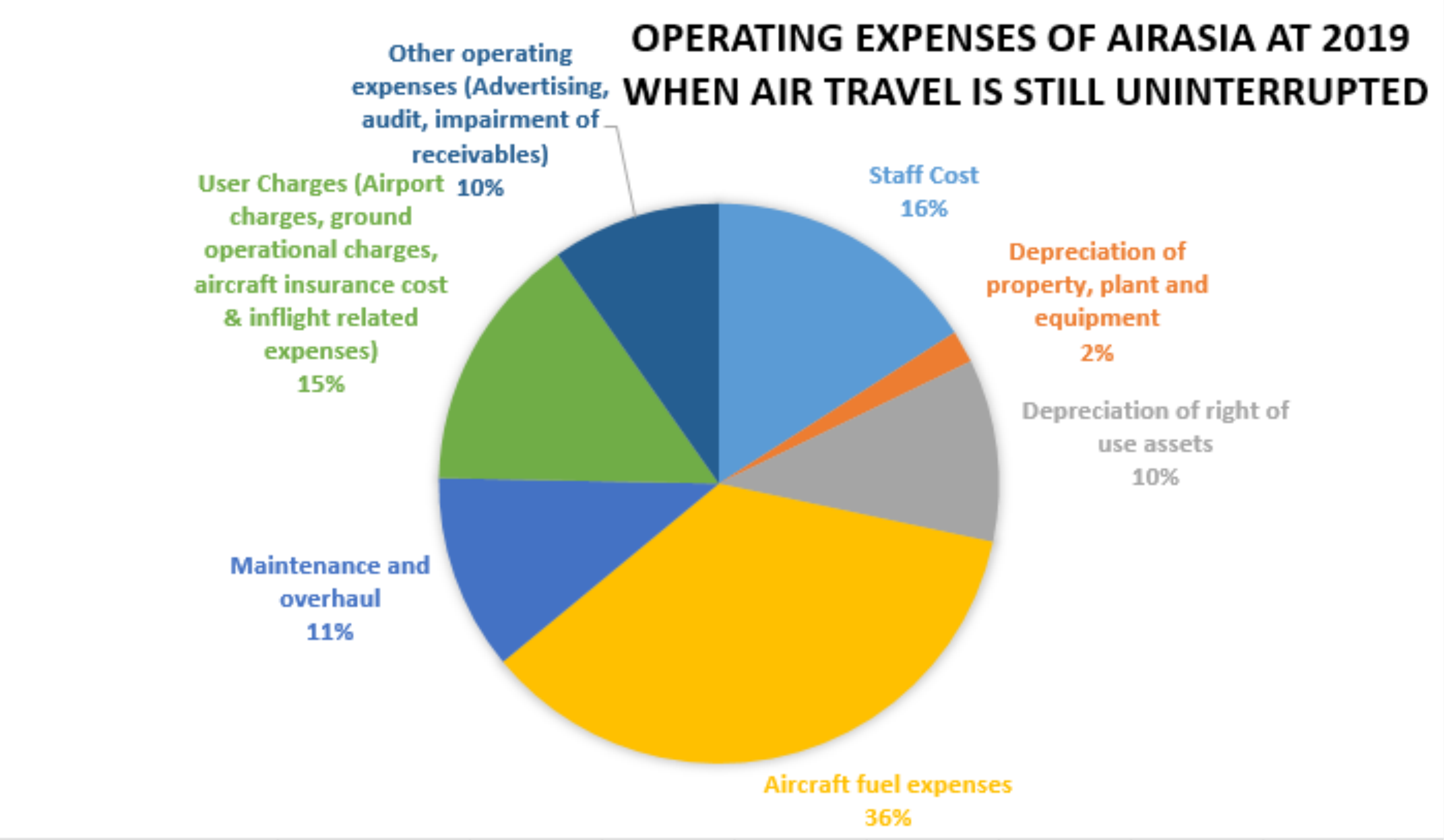
e.g. Contribution to airline overheads, including general administration, depreciation and interest payment because these costs do not change with output level

(ii) variable cost [2]

E.g. Flight crew, fuel and oil, landing fees, catering fees, payment for free gifts and ground services are variable costs because they vary directly with the no. of flights. Airline companies incur higher costs on these items when there are more flights.

"Explain your choice" requires students to weave the explanation into their examples. If student only defines fixed costs then states an example, maximum 1 mark.

FIRMS AND DECISIONS – CASE STUDY 1



FIRMS AND DECISIONS – CASE STUDY 1

b) Calculate the airline's profit per flight if all seats are sold.

- ✓ Profit is the difference between total revenue and total costs
- ✓ Total revenue = £220,300

  Total costs = £132,472

The airline makes a profit of £87,828

FIRMS AND DECISIONS – CASE STUDY 1

C i) Using Table 2, explain two possible cost advantages of being a large airline company such as British Airways.

Any 2 of the following types of internal Economies of Scale (iEOS)

- **Technical economies** e.g. fuel costs, landing fees and navigation charges incurred by large aircrafts increase less than proportionately to volume; therefore, unit cost decreases as output increases.
- **Marketing economies** e.g. bulk purchase of fuel and food on preferential terms, advertising cost increases less than proportionately to volume.
- **Financial economies** e.g. access to more sources of finance, borrowing on more favourable terms due to greater credit-worthiness as more assets are available as collateral.

FIRMS AND DECISIONS – CASE STUDY 1

C ii) Explain why despite the cost advantages of being large, there are smaller airline companies such as Ryanair which manage to keep costs low. [4]

Any 2 of the following:

- Use of Internet to cut manpower costs → reduce variable costs
- Cut operating cost by not offering free food or loyalty schemes → reduce variable costs
- Cut cost by using cheaper secondary airports → reduce fixed cost
- Using aircrafts of the same model. This would cut down on training costs → reduce long run average costs
- https://simpleflying.com/the-cost-of-flying/

FIRMS AND DECISIONS – CASE STUDY 1

D i) Using the concept of price elasticity of demand, account for the relative price of economy and business class tickets. [4]

To be revisited when we cover pricing strategies that firms can employ

Price discrimination – charging of different prices for the same product for reasons not due to cost differences.

Economy class – lower price, as consumers who purchase them are leisure travellers – thus, more price elastic in demand – reduction in price leads to a more than proportionate increase in qty demanded. – increase TR.

Business class – higher price, as consumers who purchase them are business travellers, thus more price inelastic in demand – increase price as it leads to a less than proportionate fall in qty demanded.

FIRMS AND DECISIONS – CASE STUDY 1

D ii) Explain two possible reasons why <u>air ticket prices</u> have fallen for British Airways.[4]

Air ticket prices for a firm – pricing decision by a firm.

Demand and cost factors?

Demand has fallen due to increased budget airlines competing in the market. AR, MR shifts left and becomes more price elastic.

Cost – cost has reduced for BA, this could be due to lower aviation fuel cost, thus MC, AC shifts down, resulting in lower profit max price.

FIRMS AND DECISIONS – CASE STUDY 1

e) Discuss whether the merger between British Airways and Qantas should be a matter of concern. [8]

Matter of concern – for whom? Consumers usually. Sometimes can view it via employees, or society (efficiency).

Thesis – yes, a matter of concern. (choose 1)

1. The merger results in synergy and removes duplication of services – Case stated merging many of the back office operations such as administration and ticket sales. This usually implies redundancy of some of the staff. – Rise in level of unemployment among the staff.

FIRMS AND DECISIONS – CASE STUDY 1

e) Discuss whether the merger between British Airways and Qantas should be a matter of concern. [8]

Matter of concern – for whom? Consumers usually. Sometimes can view it via employees, or society (efficiency).

Thesis – yes, a matter of concern. (choose 1)

2. 2 large firms merging, new firm becomes more dominant, larger market power. AR, MR shifts right, profit maximising price will increase.
3. Less choices as well – to prevent duplication of resources, some flights will be cancelled by one or the other to avoid competing with each other.

QANTAS

BRITISH AIRWAYS

FIRMS AND DECISIONS – CASE STUDY 1

e) Discuss whether the merger between British Airways and Qantas should be a matter of concern. [8]

Anti-Thesis – No, not a matter of concern. (choose 1)

1. Larger output, possible iEOS to be reaped. Administrative cost savings. Marketing iEOS. Thus, lowering of average cost. Beneficial for the merged firms in terms of higher profits.

   Benefit could be passed on to consumers if lower average cost leads to lower prices. Consumers of both airlines can benefit. Use LRAC diagram, or MC, AC diagram shifting down.

   Note: prior to merger, both airlines were already large firms.

QANTAS

BRITISH AIRWAYS

FIRMS AND DECISIONS – CASE STUDY 1

e) Discuss whether the merger between British Airways and Qantas should be a matter of concern. [8]

Anti-Thesis – No, not a matter of concern. (choose 1)

2. Other benefits:

- **Dynamic efficiency**

  Increased profitability – greater ability to engage in product innovation. Example – improving consumer experience, seamless check in, better quality seats etc.

- **Retain current jobs** – possible losses by either company, merger allows them to be profitable such that they will not shut down – alternative which is much worse since all jobs lost.

QANTAS

BRITISH AIRWAYS

FIRMS AND DECISIONS – CASE STUDY 1

e) Discuss whether the merger between British Airways and Qantas should be a matter of concern. [8]

Evaluation

Context

- **Competitive oligopoly** – airlines industry: sharp price increase at the disadvantage of consumers unlikely.

Govt recommended policies

- Govt can continue to deregulate the industry, allowing other competitors to come in. Threat of competition can thus ensure the benefits of the merger and minimise the disadvantage of monopolies. Theory of Contestable Market.

QANTAS

BRITISH AIRWAYS

RAFFLES

FIRMS AND DECISIONS – ESSAY1

Competition amongst airlines within the air passenger market is high and demand is rising but many airports are at or near full capacity. Both variable and fixed costs of production of passenger airlines continue to change over time. For example, airline jet fuel prices fell by 20.4% over the year ended 22 July 2016 while the price of passenger jet aircraft increased by around 1.1% between 2015 and 2016.

a) Using economic analysis, explain the impact of the above changes in costs on airline operators. [10]

b) Discuss how airlines would likely respond to the above developments. [15]

FIRMS AND DECISIONS – ESSAY1

a) Using economic analysis, explain the impact of the above changes in costs on airline operators. [10]

Identify the cost changes:
airline jet fuel prices fell by 20.4%
price of passenger jet aircraft increased by around 1.1%

Explain change in fixed and variable cost – link to price, qty, TR and profits.

R1: Explain impact of the fall in variable cost on profits. (Use of Diagram)

R2: Explain impact of the increase in fixed cost on profits. (Use of diagram)

R3: Weigh the extent of the fall in variable cost and increase in fixed cost on overall profits.

FIRMS AND DECISIONS – ESSAY1

a) Using economic analysis, explain the impact of the above changes in costs on airline operators. [10]

Introduction

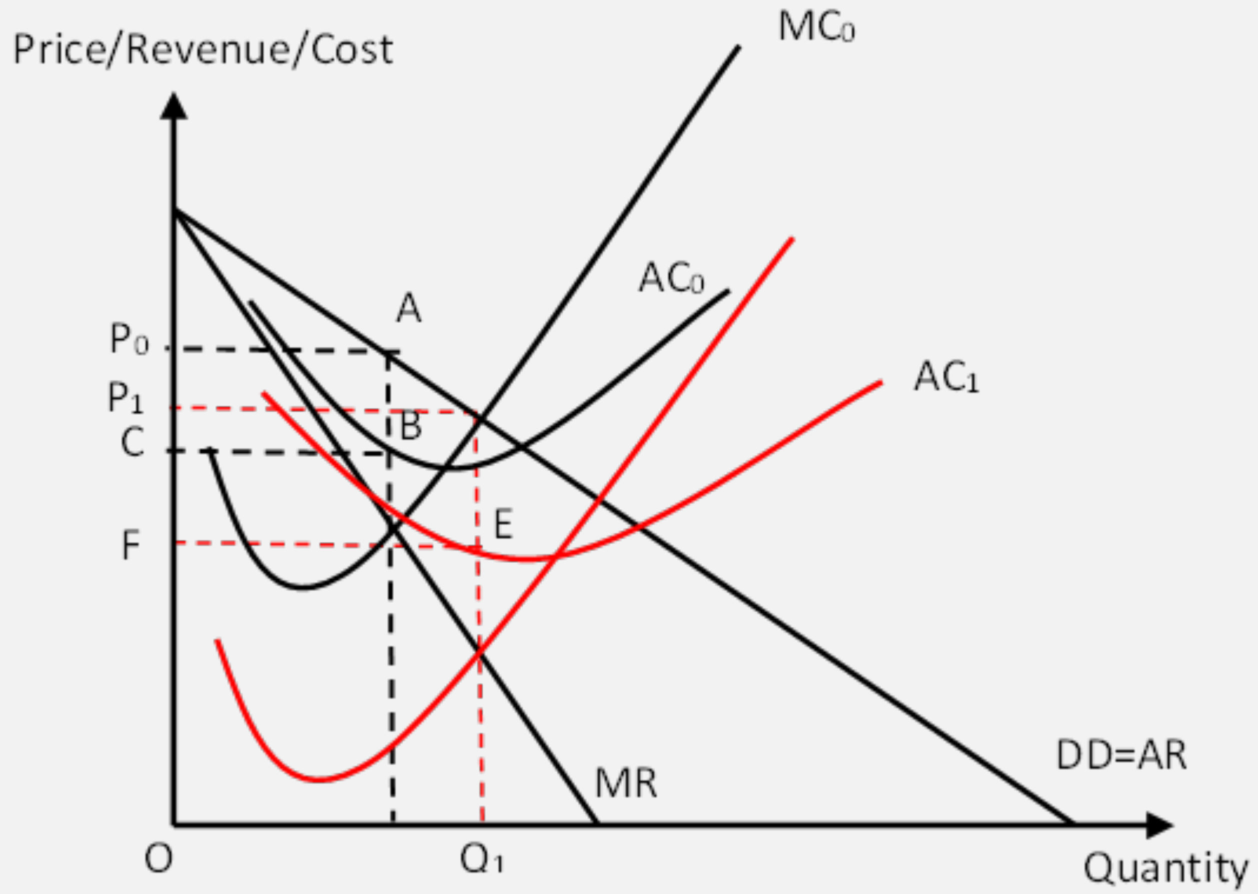
Both the fall in variable cost and rise in cost can impact the airline operators' profits.

<u>R1: Explain impact of the fall in variable cost on profits. (Use of Diagram)</u>

- The decrease in variable cost arising from falling jet fuel prices will lead to a decrease in per unit cost of producing an additional unit of airline service -> MC falls from MC_0 to MC_1. The AC will also fall from AC_0 to AC_1.
- When MC falls -> new profit max output is at Q_1 where MC_1 = MR -> Holding AR and MR unchanged, the profits increased from P_0ABC to P_1DEF.

FIRMS AND DECISIONS – ESSAY1

a) Using economic analysis, explain the impact of the above changes in costs on airline operators. [10]



FIRMS AND DECISIONS – ESSAY1

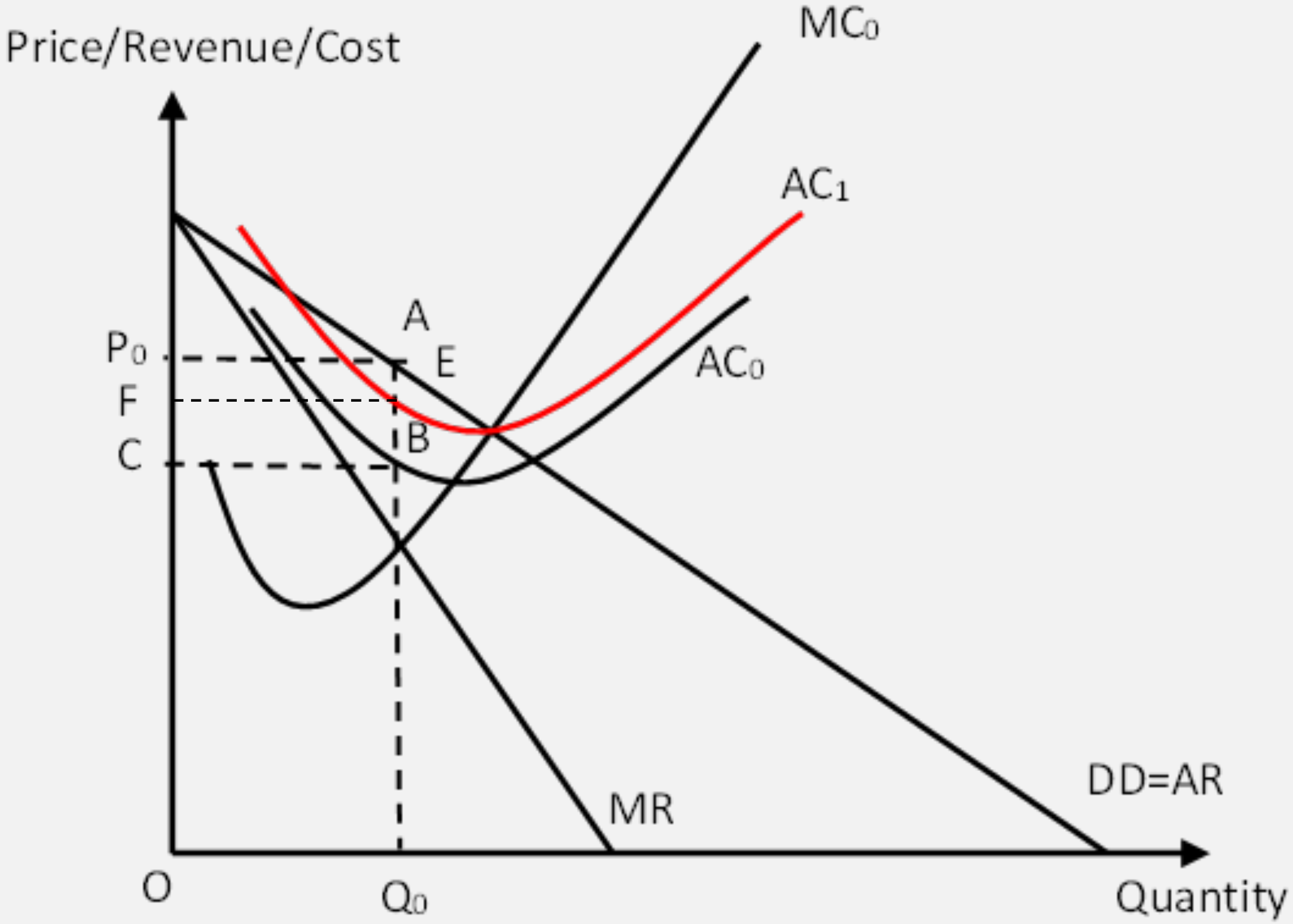
a) Using economic analysis, explain the impact of the above changes in costs on airline operators. [10]

<u>R2: Explain impact of the increase in fixed cost on profits.</u>

- Given that the price of passenger jet aircraft increased, the fixed cost of passenger jet operators increases as it is more costly to purchase aircraft. This increases the average cost of production -> AC shifts up from AC_1 to AC_2.
- Holding AR, MR and MC unchanged, at the initial profit max. output, the profits have fallen from P_0ABC to P_0AEF.

FIRMS AND DECISIONS – ESSAY1

a) Using economic analysis, explain the impact of the above changes in costs on airline operators. [10]



RAFFLES

FIRMS AND DECISIONS – ESSAY1

a) Using economic analysis, explain the impact of the above changes in costs on airline operators. [10]

R3: Weigh the extent of the fall in variable cost and increase in fixed cost on overall profits.

- Given that the fall in jet fuel prices (variable costs) = 20.4% is significantly larger than the increase in jet aircraft (fixed cost) = 1.1%, the fall in MC and net fall in AC likely will result in the overall profits to increase for airline operators.

Or

While the increase in fixed cost is smaller, but the cost of purchasing a plane is significantly higher that operational cost of jet fuel, thus in the short run, there could be a large fall in profits.

RAFFLES

FIRMS AND DECISIONS – ESSAY1

b) Discuss how airlines would likely respond to the above developments. [15]

Identify developments:
Cost – rise in fixed cost, fall in variable cost
Revenue – Rise in demand + (increasing competition)

R1: How to respond to cost changes – more specifically, higher fixed cost due to more expensive airplanes.

R2: How to respond to revenue changes – increasing demand for air travel or increasing competition from rivals.

FIRMS AND DECISIONS – ESSAY1

b) Discuss how airlines would likely respond to the above developments. [15]

R1: How to respond to cost changes – more specifically, **higher fixed cost** due to more expensive airplanes.

Cost reduction strategies:

Take advantage of Technical iEOS and focus on spreading this higher fixed cost across more units. Airlines like SIA can use larger planes like the Airbus A380 (takes 380 passengers) on the more popular routes. Law of Increased Dimensions would thus lower the average COP of passengers on the planes.

- Increasing frequency of flights, to spread out fixed cost.
- Banding – rival companies sharing flights – code share
- Process innovation – cost savings in other areas

SINGAPORE AIRLINES

FIRMS AND DECISIONS – ESSAY1

b) Discuss how airlines would likely respond to the above developments. [15]

R1: How to respond to cost changes – more specifically, **higher fixed cost** due to more expensive airplanes.

Cost reduction strategies: - Limitations

Not applicable for small firms – high cost of acquiring larger planes. Even for established brands like SIA, changing its fleet of airplanes type is costly as pilots, crew members will require training. Larger planes for popular routes may also face increasing competition and thus may not have the occupancy required to make profits.

Increasing frequency without considering demand may lead to sub normal profits on flights. On average, airlines need 70% occupancy to break even.

SINGAPORE AIRLINES

FIRMS AND DECISIONS – ESSAY1

b) Discuss how airlines would likely respond to the above developments. [15]

R1: How to respond to cost changes – more specifically, **higher fixed cost** due to more expensive airplanes.

Evaluation: Cost reduction strategies:

Changing the composition of its fleet of airplanes is not a short term strategy in reaction to higher plane prices. Airlines need to consider the long term impact of such decisions. Expected numbers for routes is certainly one of them.

In the short term, airlines may simply use their current fleet longer, or code share – band with other airlines to share planes.

SINGAPORE AIRLINES

FIRMS AND DECISIONS – ESSAY1

b) Discuss how airlines would likely respond to the above developments. [15]

R2: How to respond to **revenue changes – increasing demand** for air travel or increasing competition from rivals.

Revenue strategies:

Rising demand is usually linked to increasing income or improvement in taste and preferences.

With rising income levels, airlines could adopt strategies to cater to consumers with greater ability to spend and possibly more selective in their choices.

YED / PED –Product differentiation - better in-flight entertainment / quality of in-flight food, luxurious seats and exclusive lounge services – 2 ways to argue impact. YED – increase in DD for that airline will be greater than its rivals. Or non-px competition, rise in dd, more PED inelastic, allow a higher price to be charged.

FIRMS AND DECISIONS – ESSAY1

b) Discuss how airlines would likely respond to the above developments. [15]

R2: How to respond to **revenue changes – increasing demand** for air travel or increasing competition from rivals.

Revenue strategies: - Limitations

1) Profitable? Revenue increase > Cost increase.

Costly to make changes in quality of services. E.g. SIA spent $230m to upgrade all their B737-8 business class. This went into development, design, installation etc.

2) Temporary improvement in revenue – but concepts, ideas can be easily copied. Rival firms will pick up on these innovative ideas and provide similar options for their customers.

FIRMS AND DECISIONS – ESSAY1

b) Discuss how airlines would likely respond to the above developments. [15]

R2: How to respond to **revenue changes – increasing demand** for air travel or increasing competition from rivals.

Evaluation: Revenue strategies:

Depending on the cause of the rise in demand for air travel and its duration, firms may respond differently in reality. If the cause of the rise in demand is driven by positive economic growth prospects – then such trends is likely to remain so in the longer term and firms are more likely to implement them.

SINGAPORE AIRLINES

FIRMS AND DECISIONS – ESSAY1

b) Discuss how airlines would likely respond to the above developments. [15]

R2: How to respond to **revenue changes – increasing demand** for air travel or increasing competition from rivals.

Evaluation#3: Recommendation – Comparison CONTEXT!

With rising demand and lowering of variable cost (fuel), airlines have every reason to be optimistic and look at growth strategies to draw in customers.

With a competitive oligopoly market in airlines, the dominant strategy would be to distinguish itself from its rivals. SIA, Emirates, Qatar airlines have spend considerably amount of money to upgrade their economy, business and first class offerings in response to the above development.

FIRMS AND DECISIONS – ESSAY2

Bigger is better, or so it seemed to supermarkets all over the world over the last 30 years. Size seemed to offer all kinds of advantages, from cost advantages to offering a wider range of goods and services.

(a) Explain why supermarkets may enjoy lower costs. [10]

b. In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

FIRMS AND DECISIONS – ESSAY2

(a) Explain why supermarkets may enjoy lower costs. [10]

Introduction:

Context: Supermarkets – large output, sells thousands of different products.

Lower cost – reference to internal Economies of Scale resulting in lower average cost compared to shops selling groceries at a lower output level.

Requirements: Explain 3 different types of iEOS. Illustrate with a diagram showing lower avg cost at higher output level.

FIRMS AND DECISIONS – ESSAY2

(a) Explain why supermarkets may enjoy lower costs. [10]

Definition of iEOS:

- These are cost savings that occur as a result of the firm's expansion / increasing the scale of production.

FIRMS AND DECISIONS – ESSAY2

a) Explain why supermarkets may enjoy lower costs. [10]

Body:

1) Technical EOS

Factor Indivisibility

- **Explain:** Some inputs are of a <u>minimum size and cannot be divided into smaller units</u> i.e. they are indivisible. These inputs are cost efficient when producing large quantities of output. Purchasing such factors of production may not be feasible if a firm's output is small as it means operating below the factor's maximum capacity.

- **Example:** A larger supermarket, like Fairprice Xtra, might invest in database technology that improves stock control and reduces transportation and distribution costs. This will help to reduce its average costs of production, as Fairprice Xtra can spread the expensive specialised equipment/technology cost over its larger output.

FIRMS AND DECISIONS – ESSAY2

a) Explain why supermarkets may enjoy lower costs. [10]

Body:

2) Marketing EOS

o Large scale buying gives Fairprice Xtra important savings in cost. They have bargaining advantage and are accorded a preferential treatment by their suppliers because they buy fresh food supplies and other grocery products in bulk. This allows them to negotiate for discounted prices for its purchases as well as dictate their requirements with regard to quality and delivery more effectively. Suppliers are eager to secure the bulk orders of large firms like NTUC Xtra as it contributes significantly to their revenue and profits. In this way, Fairprice Xtra enjoys lower costs due to the bulk discounts provided by suppliers.

o There are also economies in selling. This can result from bulk advertising and large-scale promotion, as the cost is spread over a larger volume of sales.

FIRMS AND DECISIONS – ESSAY2

a) Explain why supermarkets may enjoy lower costs. [10]

Body:

3) Financial EOS

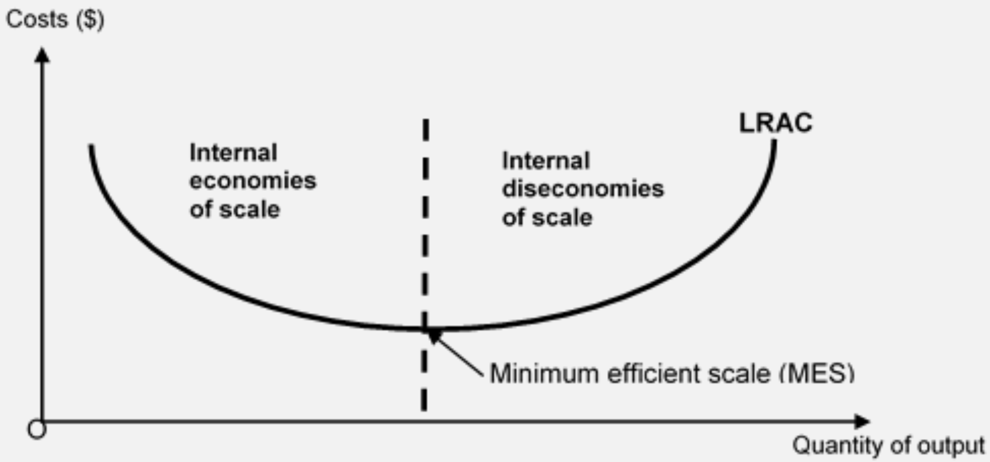
FIRMS AND DECISIONS – ESSAY2

a) Explain why supermarkets may enjoy lower costs. [10]

Body:

Combine with diagrammatic analysis:

With reference to the diagram below, the IEOS arising from Fairprice Xtra's large scale of production would result in the lowering of its LRAC. This is reflected by a **movement along downward-sloping portion of LRAC**



RAFFLES

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the extent to which larger supermarkets are less vulnerable to closure in a recession than small grocery shops. [15]

Question dissection:

Being large has significant **cost** (and revenue) advantages

Clarification:

Closure – due to subnormal profits

Profits made up of revenue and cost

Explain how recession can result in closure

Thesis: Small firms more vulnerable to closure than large firms.

Anti-thesis: Small firms not more vulnerable to closure than large firms

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the extent to which larger supermarkets are less vulnerable to closure in a recession than small grocery shops. [15]

Introduction – explain impact of recession

In a recession, purchasing power and income are falling – this causes a fall in demand for normal goods. When demand fall, Px and Qty falls, causing TR to fall.

Assuming TC unchanged, TR<TC will cause the firm to shut down as they are making **subnormal profits**.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the extent to which larger supermarkets are less vulnerable to closure in a recession than small grocery shops. [15]

Thesis: Small firms more vulnerable to closure than large firms.

1. **Supernormal profits** allow large supermarkets (Oligopolies) to continue to make at least normal profits even when demand for their products fall in a recession.

- Large firms likely to be making supernormal profits, where AR>AC, thus, when AR falls, supernormal profits have fallen, but AR may still be > AC.
- **<u>However,</u> small firms** are likely to be making only normal profits – AR=AC. Thus, when dd falls, AR<AC, and grocery stores will have to shut down as they are making subnormal profits.

RAFFLES

FIRMS AND DECISIONS – ESSAY2

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2. Large output, **lower average cost of production (iEOS)** allows large firms to engage in price competition in the midst of recession. The reduction in prices below the profit maximizing price can allow firms to attract consumers back to the supermarket and allow it to cover at least the variable cost.

   Smaller firms with higher avg COP will find it difficult to engage in price competition against large supermarkets. Thus, the prices offered by large supermarkets will cause the small grocery shops' customers to switch away.

FIRMS AND DECISIONS – ESSAY2

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3. **Resources** allow large supermarkets to engage in strategies that can dampen the fall in AR.

- Large supermarkets can engage in **advertising** which can keep consumers aware of new product launches, price promotion, freebies and collaboration with other big brands. All these may continue to entice customers to patronize the supermarkets.
- AR falls from recession, but the advertising may dampen the fall in AR, thus more likely to be still making normal profits.
- **Small grocery** stalls however, with their **limited resources** will find it difficult to engage in advertising – suffer larger fall in AR. Thus sub Profits

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the extent to which larger supermarkets are less vulnerable to closure in a recession than small grocery shops. [15]

Anti-thesis: Small firms not more vulnerable to closure than large firms

1. **Nature of the good** sold determines the direction and extent of fall in AR. Small grocery stalls may sell inferior goods or necessities on their shelves more than that of large supermarkets.

   If items sold are inferior goods, then the grocery shop may actually see an increase in demand as consumers switch away from purchasing at supermarkets and switch to these grocery shops.

   If majority of goods sold are essential and necessities, in comparison with supermarkets; the fall in AR for grocery shops may be of a smaller extent, thus possibility of still making normal profits.

FIRMS AND DECISIONS – ESSAY2

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Anti-thesis: Small firms not more vulnerable to closure than large firms

2. **Different cost structure** – Small grocery shops operate differently from large supermarkets and therefore may have a different cost structure. Implying that the avg COP of these shops may not be higher than supermarkets despite the smaller output.

   E.g. lack of credit card use to reduce transactional cost. No a/c or trollies which can increase variable and fix cost. Labour in small grocery stalls may be owners or family members, thus lowering variable cost.

   Thus, even if AR falls, the lower (or similar) avg COP could mean that supermarkets do not have a cost advantage and grocery shops can price competitively with the big firms.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the extent to which larger supermarkets are less vulnerable to closure in a recession than small grocery shops. [15]

Anti-thesis: Small firms not more vulnerable to closure than large firms

3. **Government aid (Cost)** – Government subsidies and support in the form of cash grants usually applies only to SMEs (Small Medium Enterprises) and thus, the total cost would be lowered further. This may allow small grocery stores to bear the fall in TR from the recession, allowing them to make at least normal profits. Large supermarkets may not be legible for such grants.

4. **Small grocery stores more nimble**, decision making faster and thus can anticipate the fall in AR, switch and diversify to other areas faster than large supermarkets. For instance, sales of essentials from regular – luxury items.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the extent to which larger supermarkets are less vulnerable to closure in a recession than small grocery shops. [15]

Evaluation / Synthesis

Stand: In most industries, the sales of normal goods meant that smaller firms with lesser resources, producing close to normal profits meant that any reductions in revenue will edge them closer to shutting down.

Context: While there are exceptions in how some competitive and smaller firms may be less vulnerable to survive a recession, they are often only due to extensive government aid which allow these firms to tide through a recession.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

R1: Cost factors can help small firms survive

1. Small firms (e.g. few provision shops) may **band together** to enjoy economies from bulk purchases, advertising and promotion.
    - Bulk purchase of items such as ?

- So? How does banding together help the survival of provision shops?
- Removes cost advantages of large firms, reduce price advantage of large supermarkets retains customers – allows the small grocery shops to price the same as large supermarkets when AC, MC shifts down.

RAFFLES

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

R1: Cost factors can help small firms survive

2. Lower costs as compared to large firms (different cost structure

Small neighbourhood provision shops save on costs through the following ways:

i. non air-conditioned - saving on electricity bills; no loyalty programmes

ii. Cash payment rather than NETS or credit cards – lower transaction fees.

iii. Pay relatively lower rental costs - located at HDB void decks (lower psf cost, thus avg cop lower)

iv. Usually, family owned thus saving on labour costs

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

R1: Cost factors can help small firms survive

Theoretical Analysis:

- Not operating on the same LRAC that supermarkets produce at.
- Lower and LRAC with MES at lower output likely – thus, both small grocery stall output as well as supermarkets will face similar avg COP, thus no cost advantage from supermarkets to price small grocery stalls out of the market.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

R1: Cost factors can help small firms survive

Balanced Argument:- why they may not survive

Banding together **requires coordination** among the small grocery shops. This takes time and effort among the firms to consolidate **what to order, the quantity to order** and more often than not, the benefits is likely to be less than the cost.

Supermarkets able to exploit significant iEOS, able to price their products much cheaper. Small stalls may not survive.

Evaluation:

The key cost factor that allows small firms to survive is likely that they operate on a much lower avg cost of production as these stalls do away with the frills that large supermarkets have.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

R2: Revenue factors can help small firms survive

i. Catering to a niche market - Products sold by neighbourhood provision shops are not sold at large supermarket e.g. special food items, spices etc.

- Specialty shops (Korean products, Japanese products, Indonesian products, Indian products, Philippines etc.)

ii. Provide convenience by their geographical location and proximity to housing estates. Located on the way back from work/school.

iii. Personalised services offered by the neighbourhood provision shops. Remembering your preference, knowing you by name.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

R2: Revenue factors can help small firms survive

Theoretical analysis

1) Raise demand for their products – specialty stores, thus ensuring that price and quantity sold of goods (TR) is enough to cover cost.

2) Price inelastic demand – thus, these shops are able to sell at a higher price (fall in qty dd is less than proportional) and earn higher revenue. Less substitutable to products sold in large supermarkets – e.g. paying for the convenience.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

R2: Revenue factors can help small firms survive

Balanced – why revenue adv of supermarkets are significant – thus small stalls cant survive.

1) Supermarkets have much greater revenue advantage – With vast resources, advertising (newspaper ads) can help them draw consumers away from small grocery stalls. Thus, demand may be too low for small grocery stalls to make at least normal profits.

2) Supermarkets also have a wide range of products such that small grocery stalls will find difficult to match.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

R2: Revenue factors can help small firms survive

Evaluation

The key revenue benefit that allows small grocery stalls to survive is likely due to the fact that household puts a premium on the convenience of shopping at these small localized shops.

This ensures a steady supply of loyal consumers who continue to patronize the stall and allows it to make sufficient revenue to cover the lower COP that it possesses.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

<u>Overall Evaluation- Recommendation</u>

- Which factor more critical?

Grocery stalls continue to co-exist beside large supermarkets. Considering the cost advantages that supermarkets have, it is likely a combination of both cost conditions (no frills) and revenue advantages (convenience as well as niche market) that allow them to co-exist.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

Overall Evaluation- Recommendation

- What else can small grocery stalls do to survive?

Small grocery stalls need to be creative to continue their survival. Banding or sourcing for cheaper products, or catering to diverse taste and preference by bringing in new products not seen in supermarkets.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

Synthesis – samples #1

In conclusion, it appears that large firms are advantageous due to the ability to reap economies of scale. They could abuse such cost savings to cut price and edge out competitors, making the survival of small firms more unlikely. However, the fact that these small neighbourhood provision shops are still co-existing with the large supermarkets is a testimony of their ability to survive. This is not surprising, because they respond very well in catering to the specific tastes of their consumers. Their ability to respond to change quickly also leads to a higher revenue, resulting in their survival.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

Synthesis – samples #2a

In reality, small firms like the neighbourhood provision shops continue to face limitations and hence a large number of them leave the market as they are unable to survive and co-exist with large firms:

- While small firms (provision shops) may co-exist with large firms (for supermarkets), it may prove to be more challenging for the former to survive **if** both are serving the same market / *location* or offering the same products/services. In other words, the survival of firms is dependent on the extent of the competitiveness and substitutability of their products/services.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

Synthesis – samples #2b

- The strategy of banding and joint ventures among the small firms involves cooperation → this may prove difficult due to possible conflicting aims of these firms or the lack of ability to communicate with one another may hinder the effectiveness of joint ventures.
- Banding together does not automatically mean that the group will have the expertise to source for cheaper raw materials and hence reap EOS. If they are unable to do so due to lack of such expertise, they may not be able to reap EOS and hence unable to compete with the larger firms (in terms of price) and survive.

FIRMS AND DECISIONS – ESSAY2

b) In view of the benefits of large scale production, discuss the survival of small grocery shops. [15]

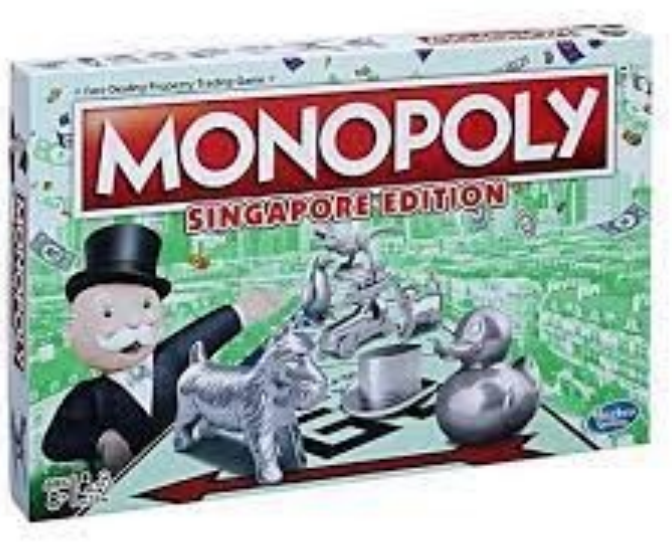
Synthesis – samples #3

In the case of **Singapore**, small neighbourhood provision shops are slowly losing their foothold in the face of stiffer competition from the larger supermarkets. For example, more NTUC Fairprice, Giant and Sheng Siong outlets are making their way into the neighbourhood and competing for the market share with the neighbourhood provision shops as they sell similar/identical products. The frequent sales and promotions undertaken (plus rewards scheme) by these large supermarkets would also draw the consumers away from the small provision shops, causing a significant decrease in their revenue and profitability. With such significant obstacles, many fail to make normal profits in the long run and hence exit the industry. It is less common to find such neighbourhood provision shops in our neighbourhood today.

FIRMS AND DECISIONS – ESSAY3

a) Explain how, in economic theory, a monopolist would determine the price that would maximize profits. [10]

b) Discuss whether firms in the real world set prices at profit maximising levels. [15]



FIRMS AND DECISIONS – ESSAY3

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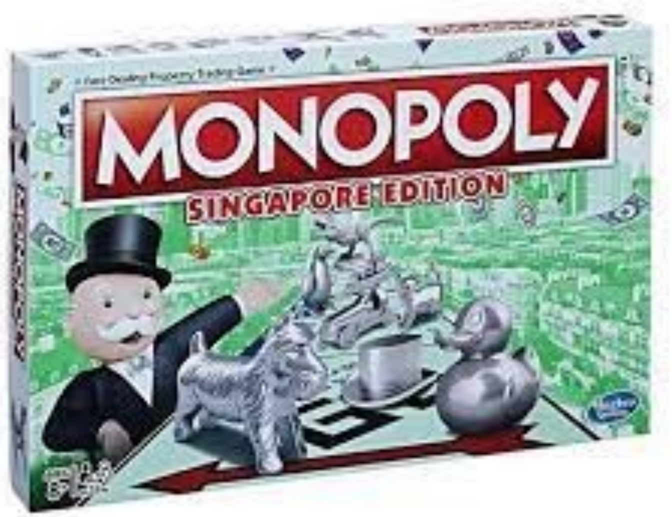


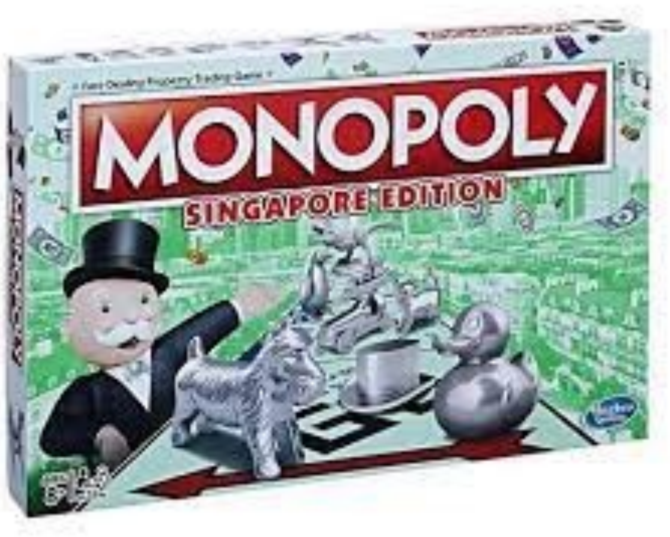
R1: Explain monopoly and its 4 characteristics and how these characteristics affect the slope of its average revenue curve

- A monopoly - sole producer of a unique good/svc. No close substitutes and complete barriers to entry (natural or artificial). For instance, Microsoft is a monopoly for computer OS.
- The demand curve facing the firm is the market demand curve. The negative slope of the demand curve implies that it faces a trade-off between the price it charges and the quantity it sells.
- The monopolist cannot raise price without losing quantity demanded or gain quantity demanded without charging a lower price. This means that in order to sell more of his products, he needs to reduce his price.

FIRMS AND DECISIONS – ESSAY3

a) Explain how, in economic theory, a monopolist would determine the price that would maximize profits. [10]

R2: Explain why the profit-max price level is at MR=MC AND explain why the profit-maximising price is at the AR curve.



- Define profits: profits =TR-TC
- Produce at the output where MC = MR. At the profit maximising output level, the firm will set the price P_e as seen from the AR / demand curve since the demand curve highlight the max. price that consumers are willing and able to pay for the good.
- Show (with the aid of a diagram), how any other output level is not profit max.

FIRMS AND DECISIONS – ESSAY3

a) Explain how, in economic theory, a monopolist would determine the price that would maximize profits. [10]

- At output where MC < MR

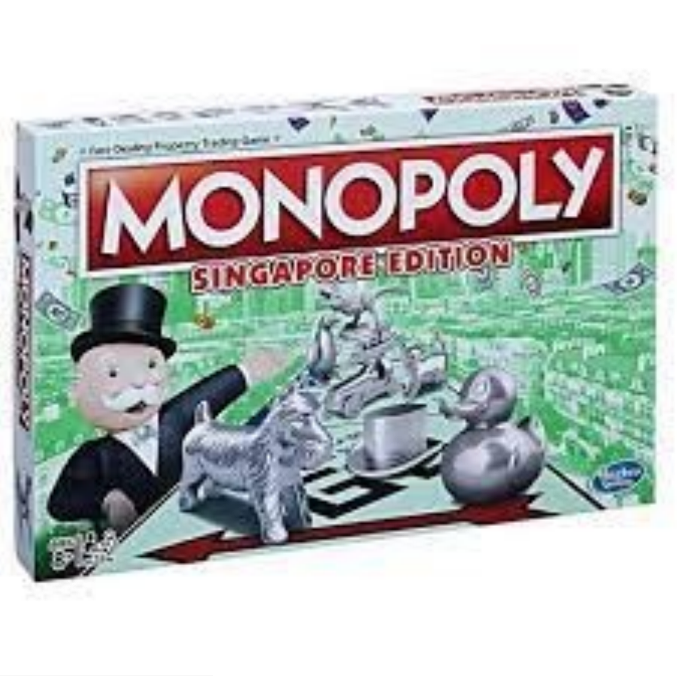
The last unit of output produced adds more to the firm’s revenue than it does to the firm’s costs. Firms that increase production will thereby enjoying higher levels of profits – increase production

- At output where MC > MR

The last unit of output produced adds more to the firm’s costs than it does to the firm’s revenue. Production of that unit actually reduces the firm’s total profits - should reduce production.

- At output where MC = MR

The last unit of output produced adds as much to the firm’s cost as it does to its revenue. It is not possible to increase profits further by either increasing or decreasing production - total profits are maximised.



FIRMS AND DECISIONS – ESSAY3

b) Discuss whether firms in the real world set prices at profit maximising levels. [15]

R1: Firms in the real world must set prices at profit-maximising levels

- Firms in certain **mkt structure must** set prices at profit max levels, while in **other mkt structures, it is not required**.

R2: Firms in the real world have incentive to set prices at profit-maximising levels

- Firms would **benefit by setting prices** at profit max levels but occasionally, they **may not have incentives** or **ability** to set prices at profit max levels.

FIRMS AND DECISIONS – ESSAY3

b) Discuss whether firms in the real world set prices at profit maximising levels. [15]

<u>**R1: Firms in the real world must set prices at profit-maximising levels**</u>

MPC firms must set prices at profit-maximising price levels to survive in the market in the long run because they can only make normal profits in the long run due to low barriers to entry.

FIRMS AND DECISIONS – ESSAY3

b) Discuss whether firms in the real world set prices at profit maximising levels. [15]

R1: Firms in the real world must set prices at profit-maximising levels

- AT: Oligopoly and monopoly can pursue other objectives and still survive because they can retain long run supernormal profits in the long run due to high barriers to entry.

Other objectives: Bring in 1 other

1. **Revenue maximisation**
2. **Growth maximisation**

FIRMS AND DECISIONS – ESSAY3

b) Discuss whether firms in the real world set prices at profit maximising levels. [15]

Evaluation 1: Firms in the real world must set prices at profit-maximising levels

- Must firms set prices at profit maximisation level? Depends on the industries they are at.

Remember - Important Rules on Essay

(a) 2 Requirements – ensure that you are answering the question clearly. Watch out for nuances, or hints in the question.

(b) 2 Requirements – answer both parts of the question.

Anti-thesis/ balanced argument required.

Evaluation marks: Total of 5 marks

Evaluation on 1st requirement – up to 2 marks

Evaluation on 2nd requirement – up to 2 marks

Evaluation with comparison on BOTH requirements – 1 mark

Any evaluation which is not substantiated will not get any credit.

FIRMS AND DECISIONS – ESSAY4

Expectations of quick service restaurants (QSRs) or fast-food chains are changing. Innovation is required to keep abreast of changing consumer taste and to maintain a competitive advantage in Singapore, a market known for its discernment of food.

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R1: Identify the market structure that Fast-food chains in Singapore operate in and Explain the characteristics of the market structure.

R2: Explain how prices are determined in the Oligopoly mkt structure (competitive vs collusive) that FFC operate in.

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R1: Identify the market structure that Fast-food chains in Singapore operate in and Explain the characteristics of the market structure.

1) Few sellers leading to high market share per seller:

Market share of fast-food outlets in 2021, based on Singapore data on mkt share of FFC & QSRs:

- McDonald's: 18.5%
- KFC: 5.4 %
- Burger King: 2.4%
- Subway: 2.1%

The market is dominated by a few large brand names/firms due to **relatively high BTE**.

FIRMS AND DECISIONS – ESSAY4

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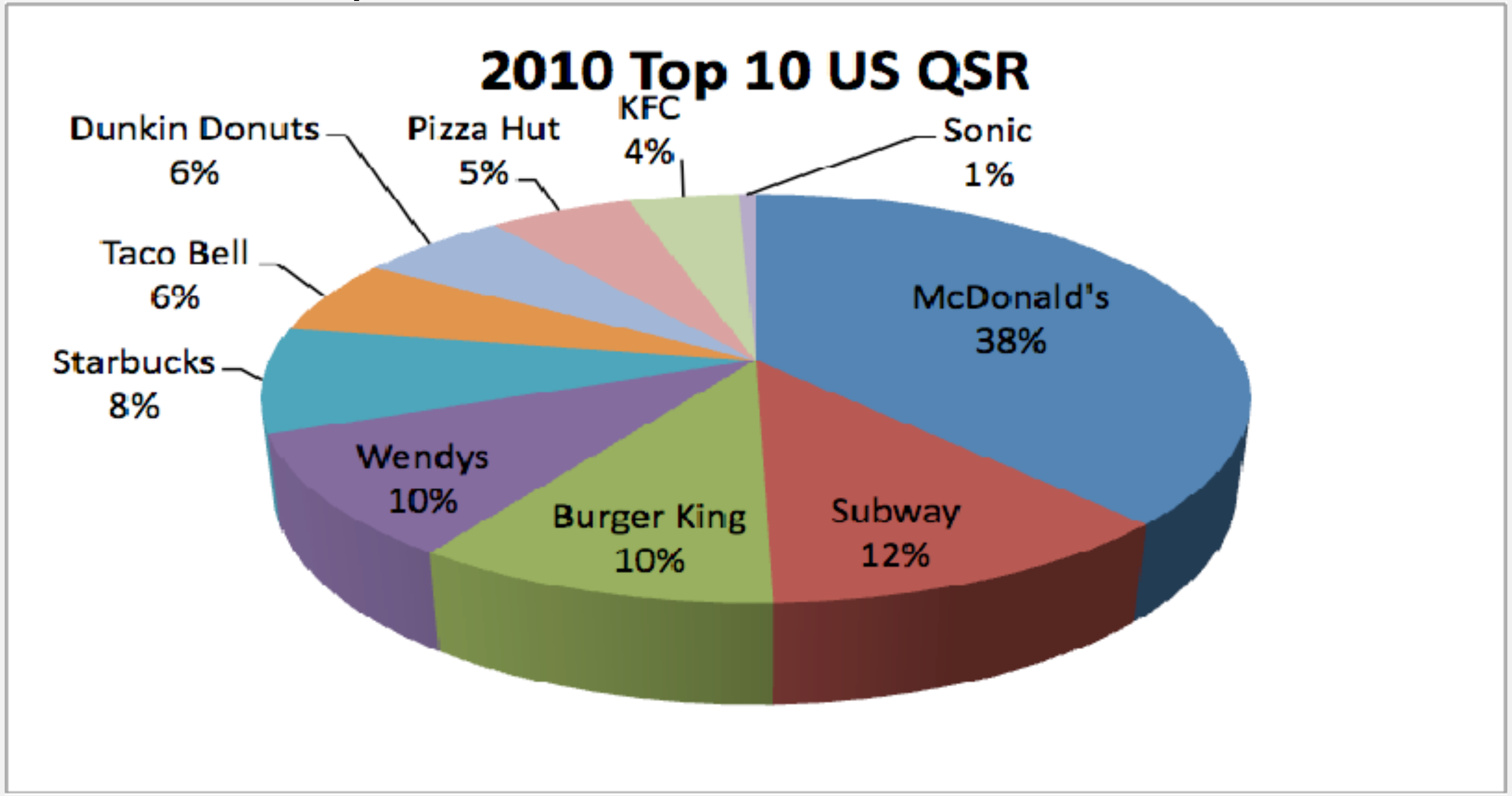


FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R1: Identify the market structure that Fast-food chains in Singapore operate in and Explain the characteristics of the market structure.

2) High Barriers to Entry & Exit (BTE):

Strategic BTE:

Advertising: McDonalds, KFC and Burger King spend huge amount of money on advertising and as well as showcasing new items on their menus. Eg. Mcdonald's collaboration/endorsement by Kpop group BTS in 2021, collaboration with Sg celebrity Ben Yeo on crispy Hainanese chicken burger in line with National Day celebration in 2021, "I'm lovin' it' advertising and jingles etc.

This creates brand loyalty among the consumers and thus less likely for new entrants to be able to attract consumers with their products.

RAFFLES

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R1: Identify the market structure that Fast-food chains in Singapore operate in and Explain the characteristics of the market structure.

2) High Barriers to Entry & Exit (BTE):

Structural BTE: Economies of scale:

-Marketing EOS: purchase of ingredients in bulk (potatoes for fries, meat patties etc) – lowers their AC, possibly charge a lower price, deter new entrants from entering - this will make it harder for new entrants to compete with dominant firms in the market.

High capital start-up cost: master franchise fees, franchise fees (eg. For Mcdonald's SGD1.65m to SGD 3m for set-up and/or franchising), rental cost esp in the case of SG as well as labour cost are exorbitantly high.

RAFFLES

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R1: Identify the market structure that Fast-food chains in Singapore operate in and Explain the characteristics of the market structure.

3) Nature/type of products:

- the products sold are relatively similar: burgers, fries and soft drinks but they use product differentiation to attract business to their chains (ie different recipes for their burgers, different focus on services and brand image for e.g. Mcdonald's focuses on the experience eg "Happy Meal", "Happy Box" etc, Subway focuses on healthier fast food, Burger King focuses on taste/flavour/size of the burger, KFC focuses on variations of fried chicken eg. the latest goldspice chicken etc)

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R1: Identify the market structure that Fast-food chains in Singapore operate in and Explain the characteristics of the market structure.

4) imperfect information wrt the prices that the rival firms will charge and the output decision.

- recipes, costing of ingredients, production methods – there are some level of imperfect information between firms.

Next part of the question: R2
The characteristics of oligopoly firms can influence price determination depending on whether they belong to competitive or collusive oligopoly mkt structure.

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R2: Explain how prices are determined in the Oligopoly mkt structure (competitive vs collusive) that FFC operate in. - **Competitive**

1) Few dominant Sellers → High degree of Mutual Interdependence

High degree of mutual interdependence between the oligopolistic firms which may lead to price rigidity. The theoretical analysis behind the kinked demand curve offers some insight as to why prices in an oligopoly tend to be sticky or rigid.

General principle – Rivals will match price reduction but not price increments – thus any price change will lead to fall in Total Revenue – explains reluctance to change prices.

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R2: Explain how prices are determined in the Oligopoly mkt structure (competitive vs collusive) that FFC operate in. - **Competitive**

Raising price: Rivals (e.g. KFC and Burger King) leave their prices unchanged (to gain customers), then quantity demanded for McDonalds output will fall more than proportionately to the increase in its own price.

When % qty dd falls > % price increase = TR falls.

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R2: Explain how prices are determined in the Oligopoly mkt structure (competitive vs collusive) that FFC operate in. - **Competitive**

Reducing price: Rivals will all follow and match the price reduction, Mcdonald's will not gain market share. Its sales will expand only in proportion to the expansion in the industry's sales.

Quantity demanded for its output increases less than proportionately to the fall in its own price = **TR** falls as well.

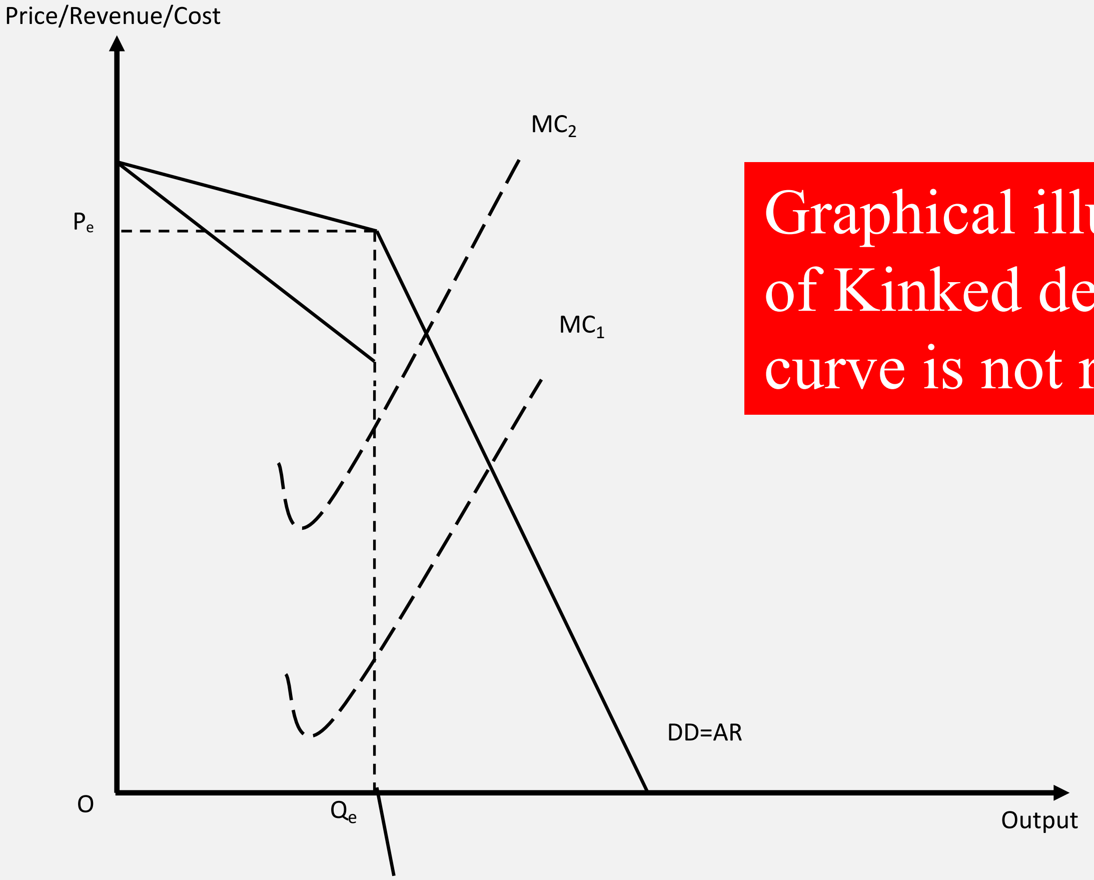
Conclusion: Raising price or reducing price leads to a fall in TR, thus this explains price rigidity in the competitive oligopoly market. Once price is set at profit maximizing output of MR=MC and at AR, there is a reluctance to change prices.

RAFFLES

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R2: Explain how prices are determined in the Oligopoly mkt structure (competitive vs collusive) that FFC operate in. - **Competitive**



Graphical illustration of Kinked demand curve is not required!

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R2: Explain how prices are determined in the Oligopoly mkt structure (competitive vs collusive) that FFC operate in. - **Collusive**

Imperfect Information → Tacit Collusion

Since each firm faces a considerable amount of uncertainty about actions and responses to their strategies, it is often difficult to predict the oligopoly's behavior.

Imperfect information may lead to tacit collusion where there are unwritten rules of collusive behaviour of firms agreeing to a certain price without explicitly saying so.

FIRMS AND DECISIONS – ESSAY4

a) Explain how the market structure in which fast food chains operate is likely to influence how prices are determined. [10]

R2: Explain how prices are determined in the Oligopoly mkt structure (competitive vs collusive) that FFC operate in. - **Collusive**

Imperfect Information → Tacit Collusion (Price leadership)

For example, Mcdonald's, KFC all offer value meals ranging that costs approx. $5. It is likely that McDonald's who controls the vast majority of the market share within the industry sets the price and the other companies followed.

Assumption is that the dominant firm knows the total market demand for the product and it also has knowledge about the marginal costs curves of the small firms. The dominant firm will decide on a profit maximising price and output while the rest of the smaller firms will follow the dominant firm's price and produce the remainder of the market output.

RAFFLES

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

R1: Analyse how innovation can be a strategy for FFCs to increase profits + limitations of innovation as a strategy to raise profits

E1: Judgment made wrt extent to which innovation is used effectively as a strategy for FFCs in SG in raising their profits.

R2: Analyse how another alternative strategy can help FFCs increase profits + limitations of the alternative strategy in raising profits.

E2: Judgment made wrt extent to which alternative strategy can be effectively used by FFCs in SG to raise their profits.

E3: Summative conclusion that **weighs the effectiveness of innovation against the alternative strategy** in helping FFCs in SG raise profits

RAFFLES

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

R1: Analyse how innovation can be a strategy for FFCs to increase profits + limitations of innovation as a strategy to raise **profits**

Explain how innovation benefits FFCs' profits:

Innovation can be either Product or Process innovation (**Choose 1**)

Product innovation - researching the market and the needs of customers and developing new better quality products

Application: Chicken McCrispy (crispier bite and a crunchier satisfaction) or Samurai Burger (signature Teriyaki sauce).

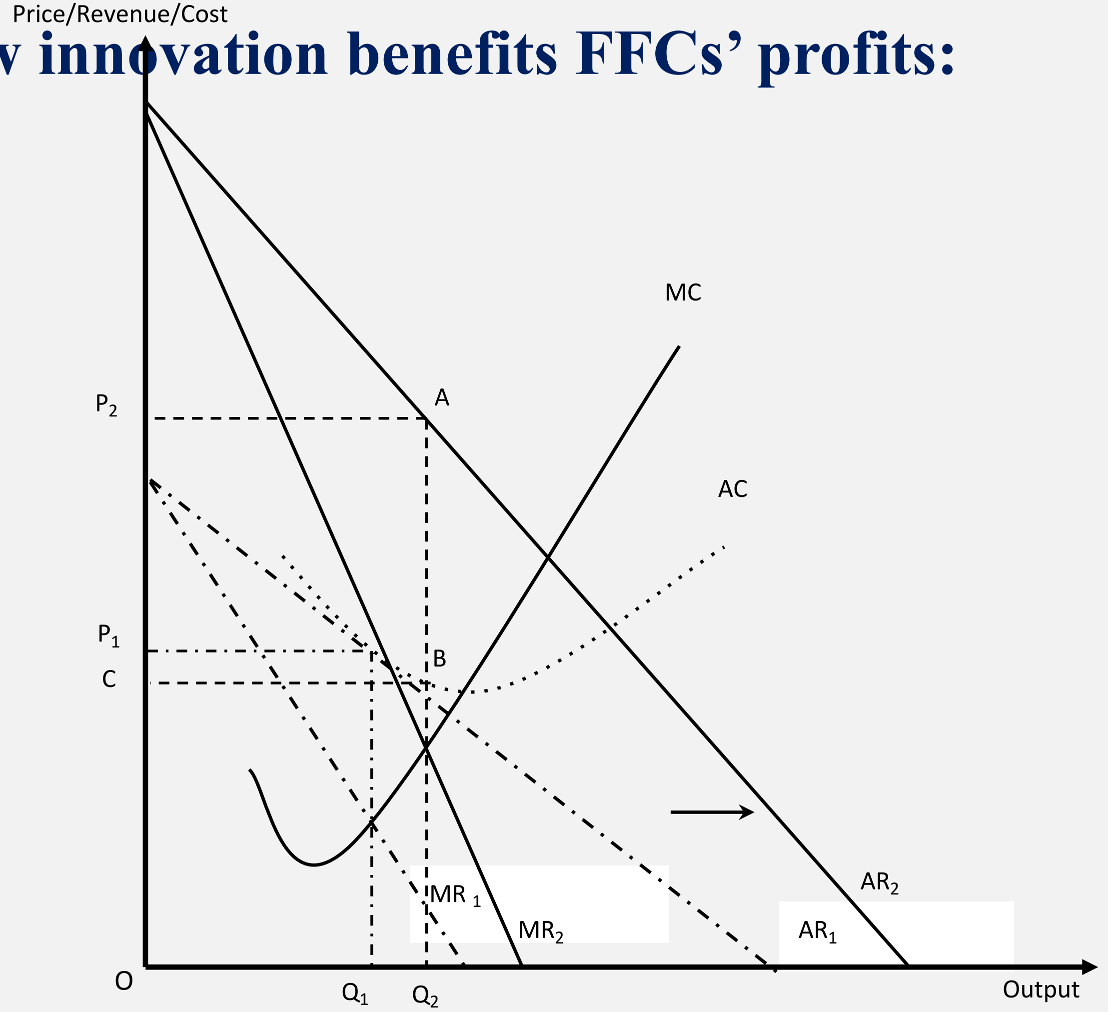
- **Key economic concepts** – Increase AR, make demand more price inelastic – shifts AR curve right and steeper..
- Diagram to show 1) Price increase 2) qty increase 3) profits increase.

RAFFLES

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

Explain how innovation benefits FFCs' profits:



RAFFLES

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

R1: Analyse how innovation can be a strategy for FFCs to increase profits + limitations of innovation as a strategy to raise profits

Explain how innovation benefits FFCs' profits:

Process innovation - food innovation process focuses on delivering the order quickly to customers, to eliminate/reduce labor and equipment costs in the individual stores.

Application: Using robots or self-ordering kiosks to increase efficiency in the production line to replace labour and speed up the process of delivering the orders.

- **Key economic concepts** – Reduce variable cost– shifts AC curve and MC down and to the right
- Diagram to show 1) Price fall 2) qty increase 3) profits increase.

FIRMS AND DECISIONS – ESSAY4

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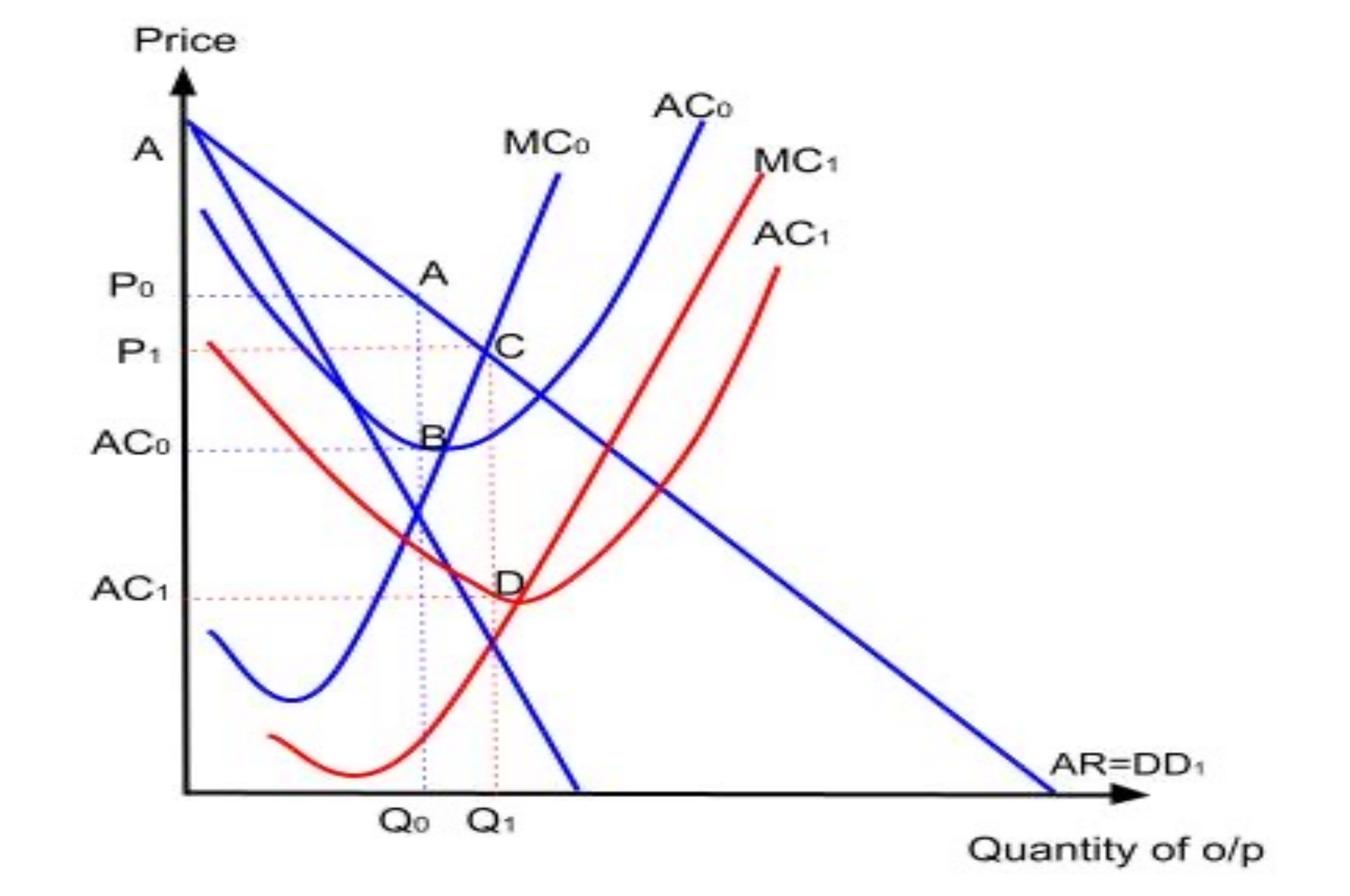
Explain how innovation benefits FFCs' profits:



RAFFLES

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

R1: Analyse how innovation can be a strategy for FFCs to increase profits + limitations of innovation as a strategy to raise profits

Limitations on how innovation benefits FFCs' profits:

General idea: higher cost than revenue = lower profits

Many examples of failed product innovations – McDonald's removed several new menu offerings a short time after their introduction. McLean Deluxe, Arch Deluxe, Mcspaghetti etc were flops in the past.

Product innovation cost money – research, consumer feedback, packaging, branding – advertisement.

Returns / revenue is low and does not cover the cost – thus, the company would see lower profits.

FIRMS AND DECISIONS – ESSAY4

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Limitations on how innovation benefits FFCs' profits:

General idea: higher cost than revenue = lower profits

Process innovation also incurs high costs plus, it may cause the customers to feel even more frustrated rather than improving customer experience and reducing employee turnover.

Eg. using the digital self-ordering kiosks in the ordering process could lead to a lack of emotional connection/human touch and it might be too hard to use for certain groups of people who are not tech-savvy. Drive less tech-savvy consumers away.

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

R1: Analyse how innovation can be a strategy for FFCs to increase profits + limitations of innovation as a strategy to raise profits

Evaluation 1: Context!

Success of innovation may be assessed on several factors:

1. Suitability of innovation to the nature of the product offered in relation to the location – Samurai Burger owing much to the receptivity of Japanese food in SG.
2. Circumstances influence the outcome – process innovation with respect to Self-service kiosk due to rising labour costs. Costly, but necessity in the wake of labour crunch – pays off in LR.
3. Ability to retrain and reallocate its labour resources that would be made redundant with the adoption of innovative practices.

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

Alternative policy:

1) Price vs Non-price strategies

2) If innovation was argued in context of product innovation and thus <u>increase TR</u>, then alternative policy to demonstrate scope, could explain <u>cost reduction policy</u> that will increase profits.

E.g. Mergers/ vertical integration

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

R2: Analyse how another alternative strategy can help FFCs increase profits + limitations of the alternative strategy in raising profits.

Elaboration / Application:

Advertising to develop brand loyalty and brand connection with their customer base.

Advertising through various media platforms and social media can raise the awareness of the brands, new products that were developed eg. McDonald's uses toys and family as well as Kids' birthday parties as their main advertising commercial to invoke happiness and love when they eat McDonald's, increasing brand emotional connection. Tie ups with BTS is another example of non-price competition.

FIRMS AND DECISIONS – ESSAY4

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R2: Analyse how another alternative strategy can help FFCs increase profits + limitations of the alternative strategy in raising profits.

Theoretically analysis:

Diagrammatically, it is the same as product innovation.

Limitations of non-px competition like advertising

Aggressive advertising/wasteful advertising may lead to millions of dollars being spent on the campaign but if the campaign is not impressionable – does not generate sufficient revenue to cover cost.

Advertising efforts can backfire eg. distasteful ads that had backfired such as in the case of Burger King, where a new Vietnamese burger advert in New Zealand sparked a debate over whether the advert is harmless fun or culturally insensitive and racist.

FIRMS AND DECISIONS – ESSAY4

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Other non-price strategies can include Happy meal toys, Hello Kitty carrier, minion toys that created a frenzy among consumers.

Evaluation on Advertising and other non-px strategy

Well thought out campaign can be very effective. Look at **rebranding** of McDonald's to cater to a more diverse consumer group, the numerous tie ups with BTS, Hello Kitty, Minions, Pokemon. All of these were highly costly, but the crowd at these outlets showed that it is likely to be highly profitable. On top of that, it creates greater BTE against potential entrants.

FIRMS AND DECISIONS – ESSAY4

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R2: Analyse how another alternative strategy can help FFCs increase profits + limitations of the alternative strategy in raising profits.

Vertical integration (Backward integration)

Vertical integration involve merger/taking ownership (acquisition) with another firm involved in the previous/earlier stage of production ie. Suppliers of FOPs (such as beef patties, buns, potatoes) for example, upstream integration/backward integration reduce FFCs costs removing the transactional costs (3rd party suppliers) & markup costs it pays to its suppliers by producing its factor inputs directly.

Theory/Diagram- increase its profits by shifting AC and MC down.

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

R2: Analyse how another alternative strategy can help FFCs increase profits + limitations of the alternative strategy in raising profits.

Vertical integration (Backward integration)

Limitations:

- Complacency in suppliers and thus not innovating sufficiently.
- Acquiring a firm in a related industry (costly as well) but with insufficient knowledge and expertise when making critical decisions can lead to long term decline of the acquired firm.

RAFFLES

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

R2: Analyse how another alternative strategy can help FFCs increase profits + limitations of the alternative strategy in raising profits.

Vertical integration (Backward integration)

Evaluation#2

SR vs LR perspective. Such a strategy is likely to create a negative impact on profits in the SR due to the high initial cost of acquisition, over the LR however, FFC may become profitable from the synergy involved as well as the cost savings over the long term.

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

Overall evaluation – compare between the 2 strategies

1) Based on effectiveness: SR: advertising can help to promote new products, strengthen their positioning, improving brand loyalty.

2) In the LR, if there is no product innovation, some consumers will stop going back to the FFCs eventually, leading to a drop in revenue and then there will be a drop in profit. Without process innovation, the cost of running the business will remain the same. If competitors improve and cost drops, they can increase their market share by selling at a lower price and still be more profitable.

3) Most FFCs do not engage in vertical integration as they already have a low cost working relationship with suppliers.

4) Recommendation: Based on effectiveness, it seems that product innovation is the best strategy.

FIRMS AND DECISIONS – ESSAY4

b) Discuss whether innovation is the best strategy for fast food chains seeking to increase their profits. [15]

Overall evaluation – compare between the 2 strategies

1) Based on effectiveness: SR: advertising can help to promote new products, strengthen their positioning, improving brand loyalty.

2) In the LR, if there is no product innovation, some consumers will stop going back to the FFCs eventually, leading to a drop in revenue and then there will be a drop in profit. Without process innovation, the cost of running the business will remain the same. If competitors improve and cost drops, they can increase their market share by selling at a lower price and still be more profitable.

3) Most FFCs do not engage in vertical integration as they already have a low cost working relationship with suppliers.

4) Recommendation: Based on effectiveness, it seems that product innovation is the best strategy.

FIRMS AND DECISIONS – ESSAY5

FIRMS AND DECISIONS – ESSAY5

In the UK, train tickets may be obtained more cheaply if they are bought in advance. In August 2000 the railway companies jointly announced that these cheap tickets would be available only at major stations. Passengers living near smaller stations would, therefore, have to pay the full cost of the ticket.

a) Explain what is meant by price discrimination and discuss whether this is an example of price discrimination. [10]

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

FIRMS AND DECISIONS – ESSAY5

a) Explain what is meant by price discrimination and discuss whether this is an example of price discrimination. [10]

3 parts to this question:

1. Explain what is Price Discrimination
2. First example of price discrimination – Purchase in advance versus purchase on the day of use.
3. 2nd example of price discrimination – Cheap tickets only available at major stations and not at smaller stations.

FIRMS AND DECISIONS – ESSAY5

a) Explain what is meant by price discrimination and discuss whether this is an example of price discrimination. [10]

3 parts to this question:

1. Explain what is Price Discrimination

Charging different prices for the same good to different groups of buyers for reasons not associated with differences in costs (third degree price discrimination).

Conditions:

1. Seller must be able to set its price (seller must have monopoly power)
2. Seller must be able to segment the market into different subgroups with each subgroup having different price elasticities of demand
3. Seller must be able to prevent resale

FIRMS AND DECISIONS – ESSAY5

a) Explain what is meant by price discrimination and discuss whether this is an example of price discrimination. [10]

3 parts to this question:

2. **First example of price discrimination – Purchase in advance versus purchase on the day of use.**

1. Seller must be able to segment the market into different subgroups with each subgroup having different price elasticities of demand
   - **Time Period:** Advance ticket buyers have time to explore alternative modes of transportation, hence more price elastic demand for train tickets. In contrast, consumers who purchase tickets at the last minute do not have many alternatives to choose from and are hence less price-sensitive. As such their demand tends to be more price inelastic.
   - By charging higher price to PED<1 and lower price to PED>1, increase TR
2. No Cost difference – Same service provided

FIRMS AND DECISIONS – ESSAY5

a) Explain what is meant by price discrimination and discuss whether this is an example of price discrimination. [10]

3 parts to this question:

3. **<u>2nd example</u> of price discrimination – Cheap tickets only available at major stations and not at smaller stations.**

1. Seller must be able to <u>segment the market into different subgroups</u> with each subgroup having different price elasticities of demand
   - **No. of Subs:** Major stations are well connected, with bus options a main alternative hence more price elastic demand for train tickets. However, consumers who purchase tickets at smaller stations do not have many alternatives to choose from and are hence less price-sensitive. As such their demand tends to be more price inelastic.
   - By charging higher price to PED<1 and lower price to PED>1, increase TR
2. No/minimal Cost difference – Same service provided

FIRMS AND DECISIONS – ESSAY5

a) Explain what is meant by price discrimination and discuss whether this is an example of price discrimination. [10]

3 parts to this question:

3. <u>2nd example</u> of price discrimination – Cheap tickets only available at major stations and not at smaller stations.

May **not** be PD if **cost differences explain price differences.**

1. Selling tickets at different prices in different train station might not be price discrimination as <u>lower average cost of production</u> could be incurred at major train stations with high ticket sales (costs of ticketing booth and operation staff spread over greater sales quantity)

Distance (KM) 距离（公里） Jarak (KM) தூரம் (கிலோமீட்டர்)	Card Fare Per Ride (cents) 以车资卡付费的每趟车资（分） Tambang Kad Bagi Setiap Perjalanan (sen) பயணம் ஒன்றுக்கான அட்டைக் கட்டணம் (காசு)						Cash Fare Per Ride (cents) 以现金付费的每趟车资（分） Tambang Tunai Bagi Setiap Perjalanan (sen) பயணம் ஒன்றுக்கான அட்டைக் கட்டணம் (காசு)	
	Adults 成人 Orang Dewasa பெரியவர்கள்			Workfare Transport Concession Scheme (WTCS) 就业优惠车资计划 Skim Konsesi Pengangkutan Daya Kerja வேலைநலன் போக்குவரத்துச் சலுகைத் திட்டம்			Adults 成人 Orang Dewasa பெரியவர்கள்	
	MRT/LRT[1] (Tap in before 7.45am on weekdays)	Trunk Services / MRT/LRT	Express Bus Services	MRT/LRT[1] (Tap in before 7.45am on weekdays)	Trunk Services / MRT/LRT	Express Bus Services	Trunk Services / MRT/LRT	Express Bus Services
Up to 3.2[2]	42	92	152	18	68	118	170	250
3.3 – 4.2	52	102	162	26	76	126	190	250
4.3 – 5.2	62	112	172	34	84	134	190	250
5.3 – 6.2	72	122	182	42	92	142	190	250
6.3 – 7.2	81	131	191	49	99	149	210	250
7.3 – 8.2	88	138	198	55	105	155	210	250
8.3 – 9.2	94	144	204	61	111	161	210	265
9.3 – 10.2	98	148	208	64	114	164	230	265
10.3 – 11.2	102	152	212	67	117	167	230	265
11.3 – 12.2	106	156	216	70	120	170	250	280
12.3 – 13.2	110	160	220	73	123	173	250	280
13.3 – 14.2	114	164	224	76	126	176	250	280
14.3 – 15.2	118	168	228	79	129	179	250	280
15.3 – 16.2	122	172	232	82	132	182	260	295
16.3 – 17.2	126	176	236	85	135	185	260	295
17.3 – 18.2	130	180	240	88	138	188	260	295
18.3 – 19.2	134	184	244	91	141	191	260	295

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

Does not fit into a R1, R2 – Will look at content

Key Content areas

1. Link PD characteristics to <u>type of market structure</u>
2. Clarify yardsticks on what is/not beneficial to consumers – **Price, choice, quality of products, consumer surplus**. (Link to PD should be the priority)

Thesis: That mkt structure is NOT beneficial to consumers – Focus on PD

Anti-thesis: That mkt structure is beneficial to consumers – Focus on PD

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

1. Link PD characteristics to type of market structure

Recognize that monopoly power and higher price setting ability makes it more likely to be able to price discriminate

- Monopolies or Oligopolies will be the type of market structure in discussion here. Note that MPC firms may also have the ability to price discriminate if they are able to fulfill the conditions of PD.

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

Thesis: That mkt structure is NOT beneficial to consumers – Focus on PD

1. **Greater inequality** (Specifically for those PED<1) – due to higher prices. Exploitation of monopoly power to PD. Greater level of inequity as revenue is increased, transfer of consumer surplus of price insensitive group to the firm.

- **Application:** Higher prices for possibly the vulnerable group (lower income commuters staying outside the major stations) who may not have the ability to pay to stay closer to major stations.
- Other examples include cost of medicine in America whereby circumstances (insurance, drug patent system) make the price of prescription drugs in America more expensive than any way in the world.

RAFFLES

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

Thesis: That mkt structure is NOT beneficial to consumers – Focus on PD

Other disadvantages of monopoly?

2. **Less choices** – Monopolies or Oligopolies who have removed most of the competition will result in society being worse off due to lack of choices for the consumers.
   - Example: Microsoft is the dominant firm in computer's OS - Windows. Thus, computer users have little option but to opt for one as many programs are compatible with Windows and related programs are installed as a package which reduces the need for 3rd party programs.

RAFFLES

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

Thesis: That mkt structure is NOT beneficial to consumers – Focus on PD

Other disadvantages of monopoly?

3. **Less Innovation** – Being entrenched in the dominant position, monopolies are less likely to engage in product or process innovation. This meant lower degree of dynamic efficiency.

   - Example: Intellectual property rights in drugs development could curtail further investment into R&D as the pharmaceutical focuses on promoting the current set of drugs rather than develop better and newer drugs.

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

Anti-thesis: That mkt structure is beneficial to consumers – Focus on PD

1. **Lower prices** for price sensitive (PED>1) consumers. Occasionally, the ability to PD has led to greater benefits for consumers, especially the vulnerable and lower income groups. To generate higher revenue, monopolies may charge a lower price for consumers whose demand is px elastic. Though it is for his own benefit, this can have societal benefits for consumers who previously were unable to purchase the good.

- **Application:** Students offered lower prices for laptops, computer software (Microsoft) – granted greater access to technology for educational purposes. Medicine sold in other forms/packaging in developing economies – increase access to certain types of drugs which otherwise would not be affordable.

RAFFLES

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

Anti-thesis: That mkt structure is beneficial to consumers – Focus on PD

2. **Provision of service** to previously unavailable groups/consumers. Ability to charge higher prices may mean certain level of cross subsidization to continue provision of service to consumers who previously will not have the product.

- **Application:** Revenue earned from popular routes allow the service to be provided for less popular route (uniform pricing or PD). By charging higher prices for certain periods of travel (or certain stations) and thus enable the firm to make at least normal profit, this would be better off than zero provision of the service altogether.

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

Anti-thesis: That mkt structure is beneficial to consumers – Focus on PD

PD is beneficial (other considerations)

- PD may also enable manufacturing and retail firms to clear their existing stocks quickly when required – hence making better use of their shop or factory space.
- **Managing the flow customers** – PD according to the time of day means that the flow of customers into retail stores can be managed more effectively, which might provide a better experience for shoppers and spread out the work for staff. For example, having a ‘happy hour’ or ‘early bird’ prices may encourage shoppers to adjust their shopping times so that queues are shortened at more peak times, as well as ensuring that staff are better employed throughout the day. Other examples can include weekday vs weekend cinema ticket prices.

SECTION B: CASE STUDY 2 - SUPERMARKETS

a) Compare the change in retail sales in Singapore by type of outlet between 2000 and 2004. **[2]**

Diff.

Similarity and difference:

Similarity.

Similarity: From Table 5, retail sales increased for all types of outlets [1m].

Difference: Largest increase in supermarkets and smallest in departmental stores [1m].

FIRMS AND DECISIONS – ESSAY5

b) Identify the type of market structure that enables companies to practice price discrimination, and discuss whether that market structure is ever beneficial to consumers. [15]

Synthesis / Evaluation

"ever beneficial"? – any analysis to the **extent of when it may** or **may not** be beneficial is evaluation.

Factors that affect the extent:

1. **Nature of the good** - greater access for low income groups? – for instance, public transport, Medicine – healthcare, Education. While greater profits may be earned by these firms (debatable), the benefit of increased consumption by the lower income groups may make it an acceptable outcome.

2. **Govt intervention** -ensure the benefits of such large firms be enhanced, and the disadvantages be minimized. Increase contestability such that threat of competition will ensure that the prices charged are not exorbitant at the expenses of the consumers.

SECTION B: CASE STUDY 2

DD/SS, ↑

b) Explain **two reasons** why supermarkets are growing so quickly in China. **[4]**

Identify framework and question expectations:

DD/SS – growth in this case should be interpreted as increase in quantity. Can you interpret it as increase in total revenue?

To argue increase in revenue is possible, but increases the complexity which is not necessary to fulfill the 4 marks.

Demand factor

Supply factor

Explain how qty increased.

↑ Qty.

supermarkets? goods/svc.

RAFFLES

SECTION B: CASE STUDY 2

b) Explain two reasons why supermarkets are growing so quickly in China. **[4]**

Demand factor. Case-Analysis-Diagram (if diagram is used)

i. **Rising incomes** [increased income] –

Case Evidence: Rising incomes and an expanding urban middle class are setting the stage for China's development as a market for imported goods (extract 1)

Analysis: With rising income levels in China, there is a greater purchasing power among the consumers and with it greater ability to purchase goods such as food and similar services. With the rise in income also comes changes in taste and preferences, as Chinese consumers look to supermarkets which imports goods from oversea.

Diagram: Causing demand curve to shift right from D0 to D1.

SECTION B: CASE STUDY 2

b) Explain two reasons why supermarkets are growing so quickly in China. **[4]**

Demand factor. Case-Analysis-Diagram (if diagram is used)

ii. Gov intervention – Chinese gov shutting down traditional street markets

Case Evidence: Local governments are actively encouraging the transition to supermarkets by shutting down traditional street markets (extract 1).

Analysis: With the shutting down of traditional street markets, Chinese consumers are switching to supermarkets to purchase those goods and services. The removal of alternatives to purchase their daily products have meant more consumers buying them at supermarkets.

Diagram: Causing demand curve to shift right from D0 to D1.

SECTION B: CASE STUDY 2

b) Explain two reasons why supermarkets are growing so quickly in China. **[4]**

Supply factor. Case-Analysis-Diagram

I. Gov intervention – Case evidence: Lifting restrictions on foreign retailers (Ext 5) - reduced rules and limits allow for foreign retailers to expand.

Analysis: The lifting of restrictions on foreign retailers have allowed them to enter the Chinese market as well as expand the number of stores in the country (no. of firms increase).

Diagram: Causing supply curve to shift right from S0 to S1.

II. Consolidation (Ext 5) – Domestic retailers acquiring other retailers could give rise to iEOS and hence cost savings.

With demand and supply increasing, the quantity will definitely increased.

What if growth is defined as increased in total revenue. What else must you do?

SECTION B: CASE STUDY 2

c) i) Describe the type of market structure operating in the UK grocery store in 2004.**[2]**

Share of Grocery Sector (by value of total sales)	2004 (%)	2005 (%)
Tesco	28.1	30.5
Asda	16.6	16.7
Sainsbury	15.4	15.7
Morrisons	13.9	11.3

1 mark for identification

1 mark for using case material to justify accurately

It is an oligopoly [1m]. An oligopoly is characterized by a few large firms controlling most of the market. This can be seen from the high 4-firm concentration ratio (74%) in the UK supermarket market [1m].

SECTION B: CASE STUDY 2

c) ii) Explain how the firms in this market might compete against each other. [**4**]

Key word is compete – triggers "Price" and "non-price" competition.

Compare to "how firms may behave", which is broader and accepts a wider range of strategies

Compare that to 'how firms may remain profitable', which hints at

Cost as well as revenue strategies

SECTION B: CASE STUDY 2

c) ii) Explain how the firms in this market might compete against each other. [**4**]

In this competitive oligopoly structure, there tends to be price rigidity due to the mutual interdependence of supermarkets in the industry. There is no incentive for one supermarket to increase or decrease prices as increasing prices will result in a loss of market share to rivals and decreasing prices will lead to a price war between them (Kinked demand curve).

Therefore, firms could compete based on **non-price competition** such as product differentiation (e.g. advertising, better after-sales conditions, better quality service) to change consumer's perception into buying their products and reduce their PED and increase demand for their g&s.

[2m for explaining price rigidity due to mutual interdependence. 2m for identifying and explaining a form of non-price competition]

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Explain divestment: The forced selling off of stores

Explain benchmarks for consumer welfare: Price, Choice, Quality

Thesis: Divestment will increase consumer welfare.

Anti-thesis: Divestment will NOT increase consumer welfare

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Thesis: Divestment will increase consumer welfare.

#1: Reduce price:

Tesco has to sell off its stores and hence reduce its market share. The stores that are sold off would be bought by rivals. This should increase the degree of competition in the market, lowering the market power of Tesco.

Link to figure

increase in the price elasticity of demand and a fall in AR for Tesco.

Tesco would have to reduce its price from P0 to P1. The lower price would benefit consumers.

Draw and show me!

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Thesis: Divestment will increase consumer welfare.

#2: Improve choice

- encouraging growth of independent supermarkets and smaller convenience stores.

Ext 6 implies that independent supermarkets and smaller convenience stores have been driven out by Tesco. With divestment, ability to which Tesco can out-price independent supermarkets and smaller convenience stores will be reduced.

Small independent supermarkets are more likely to survive and therefore providing consumers with more choices with regards to the type of retail outlet.

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Thesis: Divestment will increase consumer welfare.

#3: Improve choice

- With the increase in competition due to divestment, supermarkets (including Tesco) will be more incentivized to differentiate their products (esp since this is an Oligopoly in which price competition is generally avoided).
- Use examples: providing fresher produce or better quality groceries which increases consumer welfare.

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Anti-Thesis: Divestment will increase NOT consumer welfare.

#1: Price may not fall if less iEOS is exploited

- With divestment and the consequent loss of iEOS, the loss of cost-savings by Tesco may be passed on to consumers as higher prices. With higher marginal cost of production, the profit maximizing price is now higher than before and thus consumers may be worse off.
- Draw the diagram that shows how with less iEOS exploited, higher MC for the firm and thus higher price of products.
- Or Draw the diagram that shows less iEOS, thus higher avg COP. Describe how higher avg COP would lead to higher prices.

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Anti-Thesis: Divestment will increase NOT consumer welfare.

#2: Price may not fall if rival firms grow bigger

- Divestment may not reduce prices in the supermarkets significantly if Tesco stores are bought by other dominant supermarket chains such as Asda, Sainsbury, or Morrisons.
- Market power of the other supermarket chains might increase, prompting them to increase their prices to maximize profits.
- Neither will choice of supermarkets increase significantly if the buyers of the stores are all existing large supermarket chains.

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Anti-Thesis: Divestment will increase NOT consumer welfare.

#3: Divestment may reduce quality of products.

- Ext 4 suggests that sale of imports require efficient systems for distribution. This may come in the form of refrigerated vans to transport fresh produce or storage systems that adjusts the temperature of the stored items.

- With divestment - make less LR supernormal profits - less able to invest in R&D to develop better refrigeration techniques to keep their produce fresher for longer periods of time.

- **Loss of Dynamic Efficiency**. It may also be less able to maintain its current systems adequately, resulting in a lowering of the quality of its products and hence, a loss of consumer welfare in the future.

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Synthesis:

Take a stand – justify your stand. Assess the different impact on the likelihood on price, choice, quality of the products based on context.

Homework- Optional Essay 2b

SECTION B: CASE STUDY 2

e) In the light of the data provided, if you were an economic advisor to the Singapore government, would you recommend that it should follow the example of the Chinese authorities and encourage supermarket development? Justify your answer. [**10**]

How to approach this question?

SECTION B: CASE STUDY 2

How to approach this question?

Introduction:

Explain the Chinese authorities' approach in encouraging supermarket development:

1. Shut down wet markets
2. Lift restrictions on foreign retailers

Explain the benchmarks of efficiency and equity:

- AE, PE, DE, Choice, Equity

Thesis: Should follow Chinese example and encourage supermarkets

- increase the efficiency of its import distribution network - PE

Anti-thesis: Should not follow Chinese example and do not encourage supermarkets

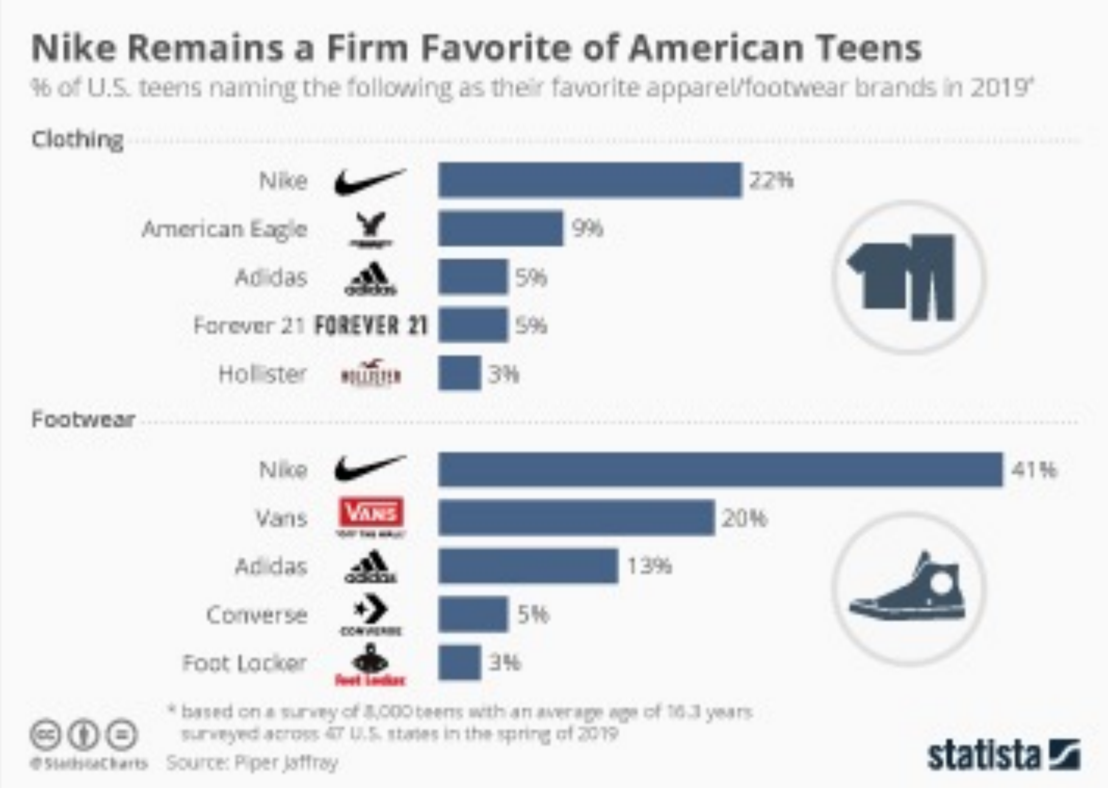
- Singapore's wet markets are clearly different from China's traditional street markets – choice, prices.

SECTION B: CASE STUDY 3 – ANTI-COMPETITIVE BEHAVIOUR

a) Explain one measure used by economists to assess the level of competition in an industry. [2]

Market concentration ratio, which is usually measured in terms of the market share held by the four or five largest firms in that industry.

The larger the market concentration ratio, the lower the level of competition in an industry.



SECTION B: CASE STUDY 3 – ANTI-COMPETITIVE BEHAVIOUR

a) Using Table 1, explain two possible changes in the market for pork that could account for the difference in the consumption of pork in 2018 compared to 2007 . [4]

Table 1: Consumption of selected meats in Singapore, 2007–2018 (thousand tons)

Meats	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Chicken	181	191	194	199	207	218	212	213	224	243	222	225
Beef	28	27	18	31	33	34	34	37	36	30	33	35
Pork	114	109	113	122	114	123	114	127	128	134	134	134

Identify that pork consumption has generally increased from 2007 to 2018 – Qty rise.

Demand rise

Or Supply rise

SECTION B: CASE STUDY 3 – ANTI-COMPETITIVE BEHAVIOUR

b) Using Table 1, explain two possible changes in the market for pork that could account for the difference in the consumption of pork in 2018 compared to 2007 . [4]

1) Economic growth led to a rise in disposable income and purchasing power.
Assuming that pork is a normal good, the rise in disposable income increases the demand for pork, DD shifts right, causing a shortage which exerts an upward pressure on price and in turn, quantity supplied of pork increases due to increased profitability. Hence consumption of pork increases, ceteris paribus.

SECTION B: CASE STUDY 3 – ANTI-COMPETITIVE BEHAVIOUR

b) Using Table 1, explain two possible changes in the market for pork that could account for the difference in the consumption of pork in 2018 compared to 2007 . [4]

2) There could be technological improvements which lowers the cost of production for rearing of pigs leading to an increase in profitability, hence sellers are willing and able to sell more pork at every price, increasing supply of pork (reflected by a rightward shift in supply of pork), causing a surplus which exerts a downward pressure on price and in turn quantity demanded increases, resulting in greater consumption of pork, ceteris paribus.

Since both demand and supply increases, the equilibrium quantity and in turn consumption of pork will definitely increase.

SECTION B: CASE STUDY 3 – ANTI-COMPETITIVE BEHAVIOUR

ci) What is meant by ‘producer surplus’ and ‘consumer surplus’? [2]

Producer surplus is defined as the difference between the amount a producer is actually paid and the minimum amount he must receive in order for him to be willing and able to produce a good

Consumer surplus is defined as the excess of what a consumer is willing and able to pay (i.e. the marginal benefit/utility derived) over what that consumer actually pays

SECTION B: CASE STUDY 3 – ANTI-COMPETITIVE BEHAVIOUR

cii) Extract 2 states that 'collusion restricted supply in the market and contributed to price increases of certain fresh chicken products'.

Using a diagram, explain how this collusion is likely to have affected the producer surplus and the consumer surplus in the market for these chicken products. [4]

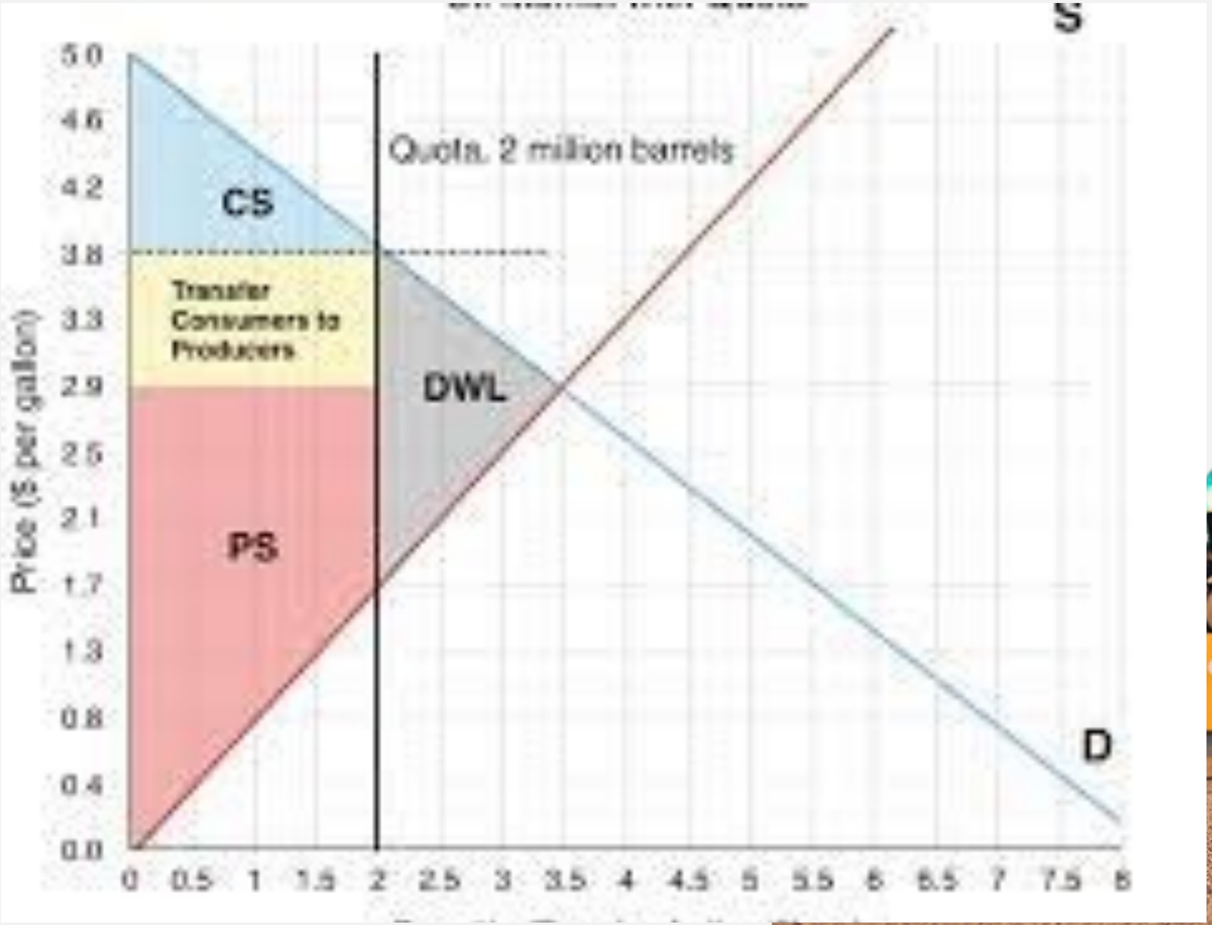
Collusion to restrict supply will reduce the amount of supply in the market. This is best represented by a quota diagram which shows a vertical SS curve below the market equilibrium quantity.

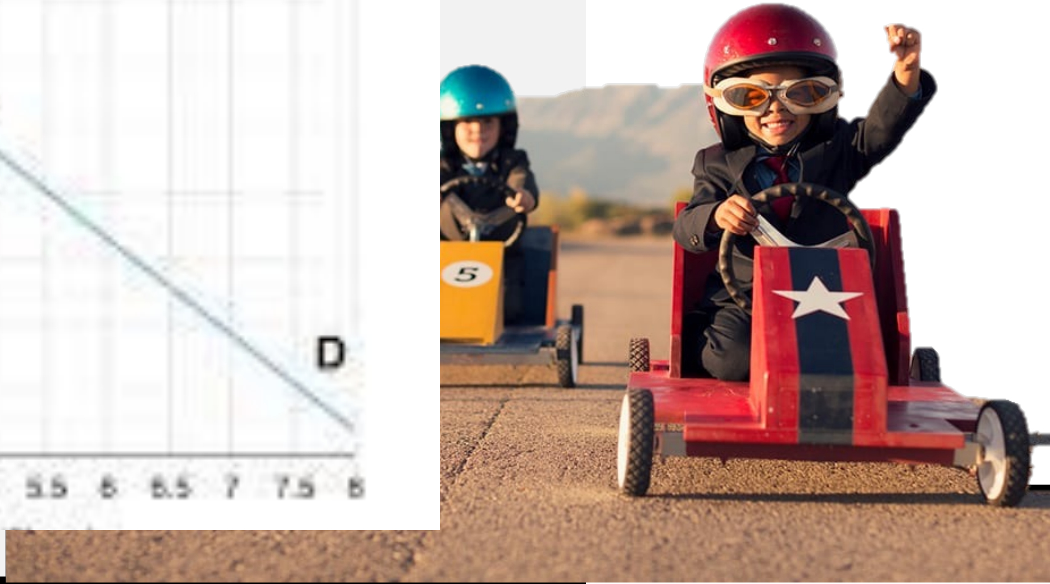
SECTION B: CASE STUDY 3 – ANTI-COMPETITIVE BEHAVIOUR

cii) Using a diagram, explain how this collusion is likely to have affected the producer surplus and the consumer surplus in the market for these chicken products. [4]

Identify that the consumer surplus would have fallen and that producer surplus would have risen.

What would the diagram look like if you had simply shifted the supply curve left?





SECTION C: ESSAY QUESTIONS

2. 'Recessions put weak firms out of business whilst strong firms use a recession to become more efficient'.

<u>Preamble Dissection</u>

Recessions – weak firms – out of business

Strong firms – more efficient.

Recession – Falling income, falling orders – falling demand (normal goods)

Weak firms – Small? Normal profits only?

Out of business – close down, shut down – make subnormal profits

Strong firms – large firms? Making supernormal profits

More efficient – allocative? Productive? Dynamic efficiency?

SECTION C: ESSAY QUESTIONS

a) Explain the relevance of different types of cost in the decision of a firm to close when faced by a fall in demand for its products.

Question a) dissection

Key words – different types of cost, decision to close when faced by a fall in demand

Different types of cost – fixed vs variable cost (SR), but in Long run, all costs are variable.

Approach:

Body #1: What happens in recession, when demand falls. In SR – Explain in SR, if can cover variable cost, will still continue operation

Body #2: In LR – As all cost becomes variable, needs to cover all cost.

SECTION C: ESSAY QUESTIONS

a) Explain the relevance of different types of cost in the decision of a firm to close when faced by a fall in demand for its products.

Introduction

-Variable costs: costs which vary directly with output produced. For example: labour costs.

-Fixed costs: costs which do not vary with output. For example: rental cost of factory building.

Body#1: What happens in recession, when demand falls – In SR

During a recession, goods which have a YED>0 (normal goods), will see demand fall. AR, MR shifts left.

SECTION C: ESSAY QUESTIONS

a) Explain the relevance of different types of cost in the decision of a firm to close when faced by a fall in demand for its products.

<u>Body#1: What happens in recession, when demand falls – In SR</u>

AR, MR shifts left.

- causes equilibrium price and quantity for the firm falls and total revenue falls ceteris paribus.

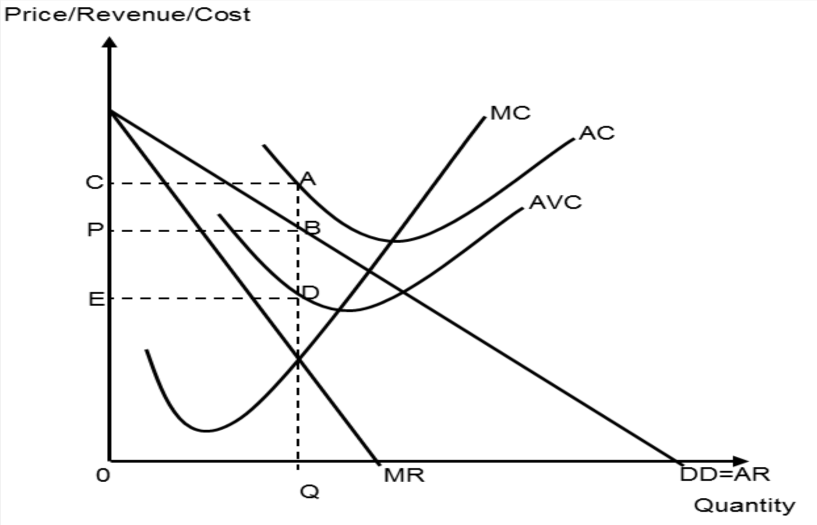
-If firm still manages to make supernormal or normal profits, that is TR ≥ TC, it is clear that they should continue operating

-If firm makes subnormal profits, they might / might not choose to shut down – depending on whether variable cost is covered.

SECTION C: ESSAY QUESTIONS

a) Explain the relevance of different types of cost in the decision of a firm to close when faced by a fall in demand for its products.

Body#1: What happens in recession, when demand falls – In SR



_Monopolist chooses to produce at an output level Q where MC = MR in order to maximise its profits

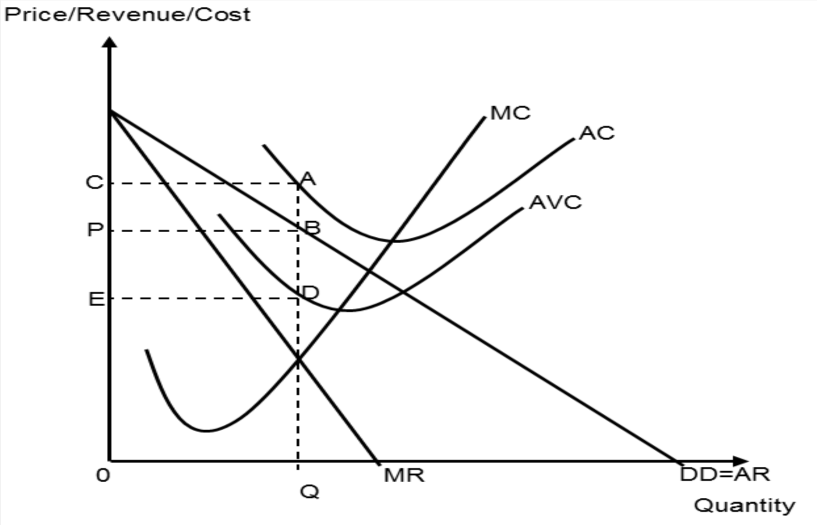
-At this output level it is making a loss of CABP as TC (CAQ0) exceeds TR (0PBQ).

-However, if the firm shuts down and ceases production, it will still have to incur a larger loss. Indicate where? Total Fixed Costs given by area ECAD. This area is a monetary loss to the firm. (Recall that fixed costs are incurred even if the firm produces 0 units of output)

SECTION C: ESSAY QUESTIONS

a) Explain the relevance of different types of cost in the decision of a firm to close when faced by a fall in demand for its products.

Body#1: What happens in recession, when demand falls – In SR



Key Point: even when making subnormal profit, but

- If TR>TVC – continue production as cost of shutting down (Fixed cost) is greater than cost of staying in operation
- If TR<TVC – better to shut down as cost of shutting down is less than staying open.

SECTION C: ESSAY QUESTIONS

a) Explain the relevance of different types of cost in the decision of a firm to close when faced by a fall in demand for its products.

Body#1: What happens in recession, when demand falls – In SR

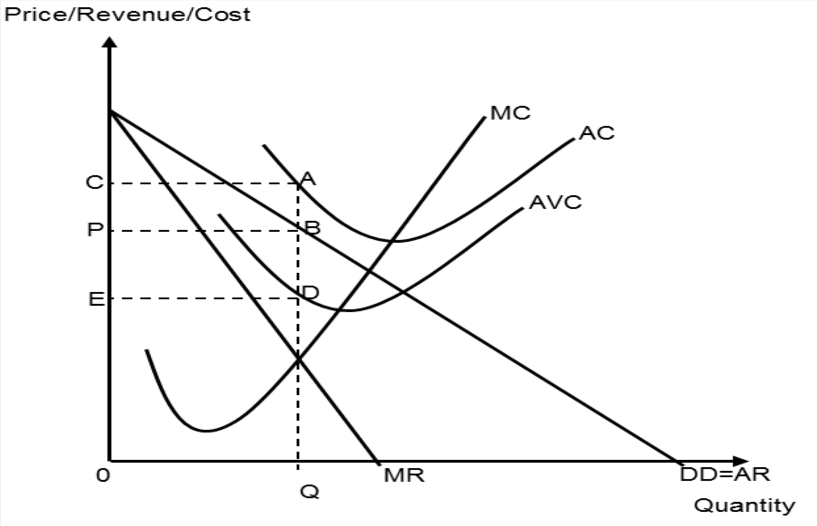
Draw a diagram that shows inability to cover variable cost in the short run and assess why the firm should shut down.

Compare subnormal profit of i) continue operation ii) shut down.

SECTION C: ESSAY QUESTIONS

a) Explain the relevance of different types of cost in the decision of a firm to close when faced by a fall in demand for its products.

Body #2: In LR – As all cost becomes variable, needs to cover all cost.



-In the long run, all cost are variable, so all cost are at AC. In this scenario, if demand falls and is unable to cover cost, making a subnormal profits of CABP will result in the firm shutting down in the LR.

Summary -Comparison Grid on Market Structures

	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Number of Producers				
Nature of Product				
Knowledge of Product / Industry				
Barriers to Entry				

Summary -Comparison Grid on Market Structures

	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Market Power				
Decision to Stop Production (SR / LR)				
Profitability in SR				
Profitability in LR				

Summary -Comparison Grid on Market Structures

	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Firm's Revenue Curves				
Industry Demand Curve				
Firm's Business Strategies				
Efficiency (Productive/ Allocative)				

Summary -Comparison Grid on Market Structures

	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Examples				

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

(a) (i) From Table 1, identify the country with the highest projected growth rate in online TV revenue. [1]

Top five countries by online TV & video revenues ($ million)					
Ranking	**Country**	**2017**	**Ranking**	**Country**	**2022**
1	USA	21,618	1	USA	33,094
2	China	4,670	2	China	12,222
3	Japan	2,944	3	Japan	4,409
4	United Kingdom	2,656	4	United Kingdom	4,249
5	Germany	1,337	5	Germany	2,301

- China has the highest projected growth rate in online TV revenue.

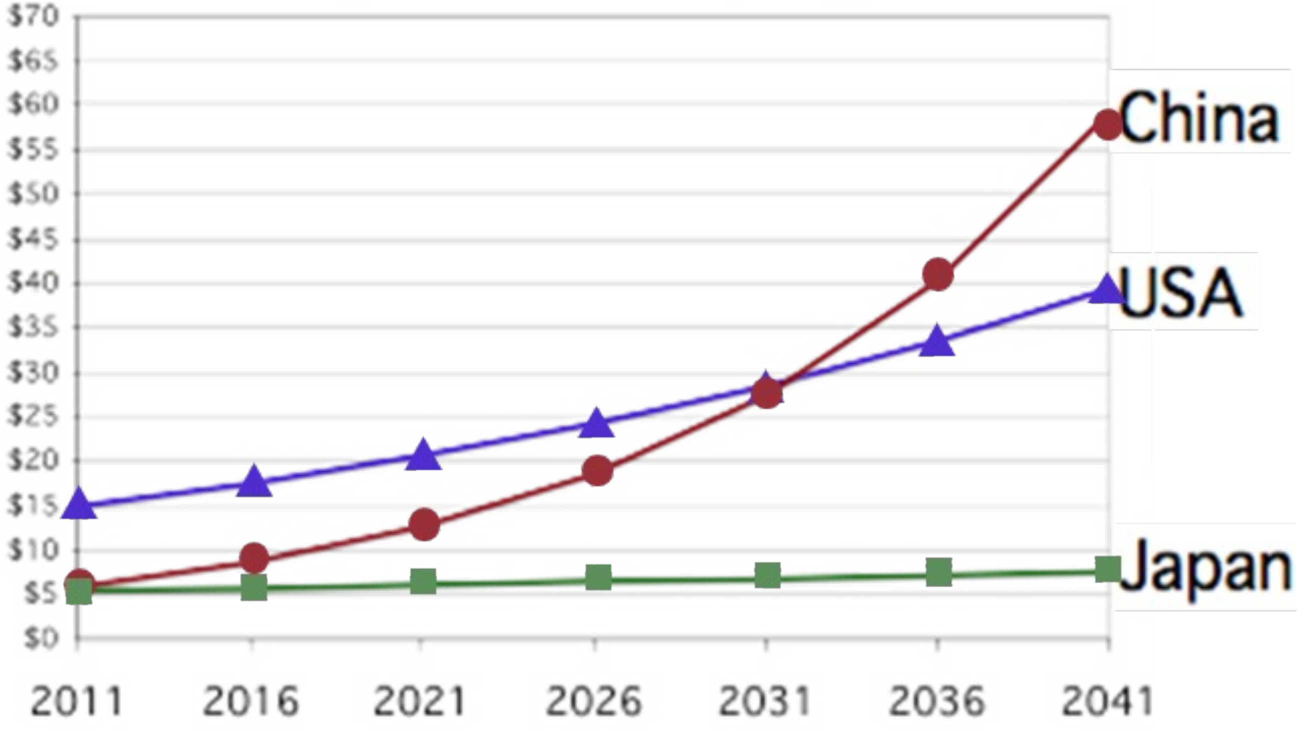
Examiners' Comments

A minority of students overlooked the keyword on growth rate and based their answer on the absolute growth instead and wrongly identified the US.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

(a) (ii) With reference to Figure 1 and the use of a relevant elasticity of demand concept, account for your answer in a(i). [3]

Figure 1: National Income Projection (trillions of $US)



Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

(a) (ii) With reference to Figure 1 and the use of a relevant elasticity of demand concept, account for your answer in a(i). [3]

- **YED** is a relevant concept as Figure 1 shows the **changes in income of countries**. YED is the responsiveness of demand to a change in income ceteris paribus, and online TV is deemed as a normal good with YED>0.
- For a given positive YED value, the demand for online TV will increase the most for China since Figure 1 shows that China has the highest projected growth in national income for the period. Because of the increase in demand, quantity traded increases (price is likely to increase as well) and China will experience the biggest increase revenue since it is the product of the price and quantity traded.
- **Is YED value for online TV higher in China compared to USA?**

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

b) With the aid of a diagram, account for the rise in OTT TV services. [5]

- Rise in OTT services refers to the increase in equilibrium quantity traded.
- This is due to an increase in **demand and supply** for OTT.

Supply factor (Case – Analysis – Diagram)

1. Increase in the number of OTT providers

- "Every major TV operator has launched or is in the midst of launching and scaling up their direct-to-consumer streaming offerings. Consumers now have more choice than ever -- from DirectTV Now, FuboTV, Sling TV, PlayStation Vue and YouTube TV, to name just a few….Philo is another recent entrant that offers 30-plus entertainment channels. Disney has plans to launch two streaming services and may develop even more following its 21st Century Fox deal."- Extract 2
- Analysis: As the number of firms in the market increase, supply increases and shifts the SS curve to the right from S1 to S2.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

b) With the aid of a diagram, account for the rise in OTT TV services. [5]

- Rise in OTT services refers to the increase in equilibrium quantity traded.
- This is due to an increase in **demand and supply** for OTT.

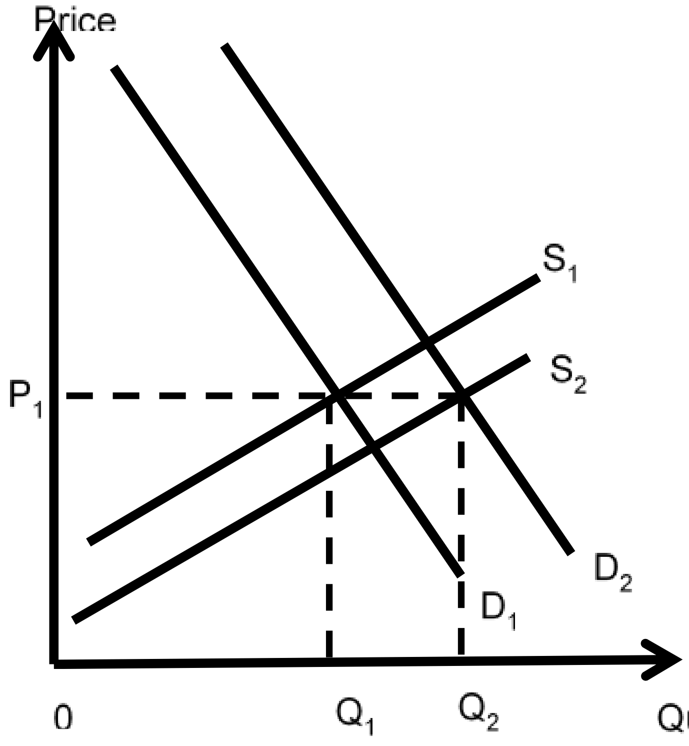
Demand factor **(Case – Analysis – Diagram)**

- Changes in tastes and preference towards OTT due to better variety of programs and greater convenience in assessing the content
- "Affordable and convenient, these services have won over many television fans who prefer them to the limited offerings on Mediacorp's free-to-air channels and the cumbersome subscription packages offered by pay-TV operators StarHub and Singtel" - Extract 2
- Analysis: Changing tastes and preferences towards OTT increases demand which shifts the DD curve to the right from D1 to D2.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

b) With the aid of a diagram, account for the rise in OTT TV services. [5]

Market for OTT services



<u>Price mechanism:</u>
Assuming that the increase in DD and SS is equal, at P1, quantity supplied and quantity demanded increased from Q_1 to Q_2, and the equilibrium quantity traded increases from Q_1 to Q_2 indicating the growth in OTT TV services.

Note: responses which analysed ↑DD > ↑SS or vice versa were equally accepted.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

Clarification:

What are the **challenges** faced by incumbents (existing firms)?

1. New entrants (other telcos) and 'frantic jostling for market share'. (Ex. 3)
2. Change in tastes and preferences in favour of OTT- 'these services have won over many television fans who prefer them to the limited offerings on Mediacorp's free-to-air channels and the cumbersome subscription packages offered by pay-TV operators StarHub and Singtel.' 'No less important to viewers is quality content. No one wants to watch rubbish on their phones even if it is for free.' (Ex. 2)

Analysis: Demand falling, more price elastic demand - TR falling.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

What were **strategies** mentioned in the case material?

1. **Price war** – to drive competitors out
2. **Product development** – to create better products than competitors so that they will not switch, stay with incumbents.
3. **Diversification** – venture into other businesses

Approach:

Case evidence – use analysis to show how this allows increase in revenue or profits (no dd/ss analysis here, it should be firm analysis) – limitations behind such a strategy (can be from knowledge or case evidence).

Synthesis

Section B: Case study 3 OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

1. Price war (Ex. 3)

- **Objective:** To drive new entrants out and increase market share.
- **Analysis:**

o Given the large market share of the incumbent "SingTel has close to 50% market share in Singapore" - likely to enjoy substantial EOS

o Incumbents set price lower than profit- maximising level based on consumers' willingness to pay.

o Price might be set at the minimum point of LRAC (limit pricing) or below it (predatory pricing). As a result, quantity demanded will increase and incumbent can increase its market share. Drive out new entrants.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

1. Price war (Ex. 3)

Limitations

- o If new entrants match price cut - "And new entrants come prepared for a price war the incumbents can ill afford" – (Ext. 3) - demand curve is relatively price inelastic - fall in TR when price drops in a **price war**.
- o P<AC - **Subnormal profit**
- But if the incumbent is better able to survive the price war, the exit of new entrants will increase the market share of incumbents - increase in DD - increase in TR and profits.

Evaluation? What will influence the outcome?

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

2. Product development

a. Streaming service

'If convenience is what the cord-cutters want, then convenience is what StarHub, Singtel and Mediacorp have given them. StarHub has introduced **StarHub Go, which is an on-demand streaming service** with Netflix-like pricing.' (Ex. 2)

b. Original content

'Both StarHub and Singtel have been **producing their own programmes**. Pay-TV channels, too, have to produce strong content to remain relevant.' (Ex. 2)

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

2. Product development

Analysis:

o Both measures address the challenges mentioned in the case, i.e., the tastes and preferences of consumers for selective OTT content.

o This will lead to an increase in demand (D1/AR1 to D2/AR2) and reduce PED where D2/AR2 is less price elastic

o Increase in profit max output from Q1 to Q2. The higher scale of production also leads to potential cost-savings through iEOS which is represented by a movement along the LRAC from point E to B. - Increase profit max price from P1 to P2

o Increase TR.

o Increase profit from normal to supernormal (P2ABC).

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

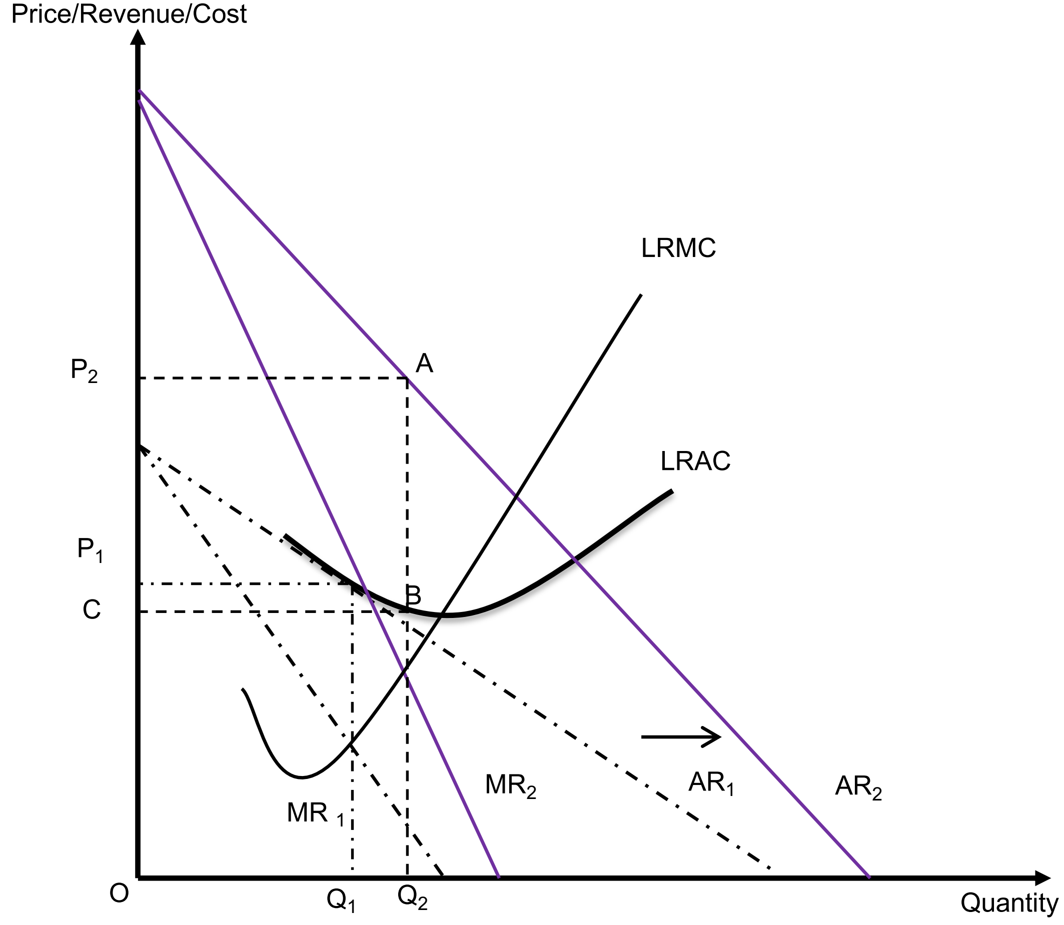
2. Product development

Limitations (a)

- Revenue likely to dip with streaming service since they are forced to adopt 'Netflix-like pricing'. No longer long term contracts.
- High CED with other OTT competitors - susceptible to losses from price wars initiated by rivals.

Limitations (b)

- Additional cost to produce original content, results in lower profit in the short-run.
- Uncertainty as to whether content produced will appeal to the tastes and preferences of consumers – revenue might not increase.



Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

3. Diversification

'The most obvious route so far is diversifying away from the traditional telco space'

And incumbents have already made a play for the enterprise segment, in areas such as cyber security, digital advertising and data analytics.'

'Singtel has close to 50 per cent market share in Singapore and this means it has access to the usage patterns and data of all its users.' (Ex 3)

Analysis

- Venturing into new markets can offset some of the loss in revenue from traditional telco space by creating new revenue stream - increase in overall DD for their product - increase in TR and profits.
- Furthermore, diversification allows the incumbents reap cost-savings from risk-bearing iEOS.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

3. Diversification

Limitations

o While this creates new revenue streams, it does not directly address the fall in revenue from the core business of the incumbent telcos.

o Possible regulation by government for violating privacy agreements through sale of private customer information.

- Uncertainty of diversification in which incumbents may not have the expertise or knowledge to thrive in that industry.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

Diversification that worked!

Johnson & Johnson

We think of Johnson & Johnson as the maker of Band-Aids, baby shampoo, and other home health products, but this company does so much more. In addition to producing a wide range of prescription and over-the-counter drugs, it has a robust medical device segment featuring instruments used in major surgeries. Johnson & Johnson also has a sports performance research institute for athletes.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

3. Diversification

3M

At this point, most people don’t even remember what 3M stands for. Founded in 1901 and formerly known as the Minnesota Mining and Manufacturing Company, it’s now a huge conglomerate that makes everything from Post-It notes to semiconductors.

This Minneapolis-based company has more than 60,000 products for both businesses and consumers and boasts more than $30 billion in annual revenue.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

3. Diversification

The Walt Disney Co.

This company is more than just Mickey Mouse. Disney has theme parks and resorts. It has movies, including all of the Marvel superhero and Star Wars franchises. It owns ABC and the ESPN networks and recently launched a direct-to-consumer video service.

As of June 2018, it was looking for approval to acquire the film and TV assets of 21st Century Fox. It's also one of the most recognizable brands overseas. No wonder it reported a whopping $55 billion in 2018.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

3. Diversification – Unsuccessful stories which are numerous!

Coca-Cola – Wine making

Quaker Oats – Venture into fruit Juice business with Snapple

https://www.channelnewsasia.com/news/video-on-demand/inside-the-storm?cid=fbins Companies that failed.

Should Diversification be the strategy of choice?

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

c) Discuss how a rational incumbent telco firm should respond to the challenges mentioned in the case. [10]

Conclusion and Evaluation:

- Incumbents can respond to the challenges in a variety of ways
  - Weigh between strategies
- Success depends on
  - The quality of product development by incumbents i.e., whether customers are convinced.
  - Government's willingness to protect our local telco's due to national interest.
  - Access to alternative OTT services by households e.g. ability incumbents/regulators to block copyrighted content.
- Due to globalisation, it is inevitable that incumbent telco's margins will probably be eroded as the government might not be keen to sustain protection due to the benefits of having a competitive telco space. The responses are unlikely to increase the profit of incumbents although they will be able to limit their losses at best.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

d) i) Define cross elasticity of demand. [1]

CED is a measure of responsiveness of the quantity demanded of a good in response to changes in price of another good, ceteris paribus.

Examiners' Comments

- No cet. par. condition stated, hence no marks awarded.
- Some did not use exact terms to define CED such as 'responsiveness'.
- Some stated the formula instead of the definition.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

d) i) Account for the likely CED value between OTT TV and cinema movies. [2]

- CED likely to be **positive and magnitude may less than one.**
- CED>0 – the two are substitutes and fulfil the same need for entertainment, therefore when "Netflix and iTunes showed up" providing entertainment at a cheaper price, quantity of Netflix and iTunes entertainment programmes demanded increased, resulting in fall in demand for cinema entertainment manifested in the "dip in cinema attendance" in Extract 4.
- |CED|<1 – the degree of substitutability is low as the entertainment provided by OTT services cannot closely substitute the experience of being in a cinema, where the screens are bigger, resolution is clearer, and sound system is better. Furthermore, the content offered in cinemas may be different from those offered by OTT services.

*Acceptable for students to argue |CED|>1 if they can justify why they are close substitutes.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

d) i) Account for the likely CED value between OTT TV and cinema movies. [2]

Examiners' Comments

- \- A minority of students made careless mistakes by indicating a negative CED value for substitutes.
- \- Some students were able to give exact values of CED e.g. 3.2, 5.6 – very impressive but it is not possible to compute given the lack of data.
- \- Some students did **not** give a reason to justify the magnitude for the closeness of the relationship.
- \- While a reason from the case may have been provided, it was merely lifted and not explained.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

e) Discuss whether the pricing strategy of cinema operators is a case of price discrimination.[8]

	Weekday	Weekend
Adult	$9.50	$13
Student	$7	$13
Gold Class	$29	$39

Define price discrimination: the selling of the same product to different groups of consumers different prices, not justified by differences in costs.

Clarify pricing strategies (any 2):

- o PAdult > PStudent
- o PWeekend > PWeekday
- o PGold Class > PStandard

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

e) Discuss whether the pricing strategy of cinema operators is a case of price discrimination.[8]

Thesis: The pricing strategies may be a case of price discrimination

<u>Conditions for price discrimination are met</u>

o Market power - cinema operators exist in oligopoly and can set their own prices; prices may be raised without quantity demanded falling to zero

o Separable markets -by age, by day, by cinema

o No arbitrage - student verification needed for student tickets, weekday tickets cannot be used on weekends (dates printed), standard ticket holders enter different cinema from gold class holders

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

e) Discuss whether the pricing strategy of cinema operators is a case of price discrimination.[8]

Thesis: The pricing strategies may be a case of price discrimination

Differences in PED can explain price discrimination - the lower the PED, the higher the price since decrease in quantity demanded, therefore firms can earn greater revenue. Use determinants of PED to explain the differences.

- PAdult > PStudent

Adults have greater income, therefore proportion of income spent on movies is lower. PED_{Adult} is lower, thus, operators will earn a higher profits should they charge adults a higher price and students a lower price.

- PWeekend > PWeekday

Greater habituality of going to the movies during weekends compared to during weekdays. Peak load pricing, higher price for busy period. (not the most convincing probably!)

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

e) Discuss whether the pricing strategy of cinema operators is a case of price discrimination.[8]

Thesis: The pricing strategies may be a case of price discrimination

Differences in PED can explain price discrimination - the lower the PED, the higher the price since decrease in quantity demanded, therefore firms can earn greater revenue. Use determinants of PED to explain the differences.

o PGold Class > PStandard

Consumers choosing gold class tend to be of higher income levels; therefore proportion of income spent on movies is lower and DD is more price-inelastic.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

e) Discuss whether the pricing strategy of cinema operators is a case of price discrimination.[8]

Antithesis: The pricing strategies may not be a case of price discrimination

[However, some differences in cost can explain the differences in price]

o PWeekend > PWeekday

- Cinema employees may be paid higher wages during the weekends, therefore the **average costs of movie** screening during the weekends is **higher**

o PGold Class > PStandard

- Additional services such as waitressing of food and provision of blankets are included in the gold class experience, and these increase the average cost. Quality of the product is not the same, different experience. Thus, not price discrimination (at least not pure price discrimination).

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

e) Discuss whether the pricing strategy of cinema operators is a case of price discrimination.[8]

Conclusion and Evaluation

Assess which is more likely to be PD, which is least likely:

- The differences in prices paid by adults vs students is clearly a case of price discrimination since the service of movie screening is exactly the same, the cost of production is the same, and the only difference is the PED of the consumer groups

Assess whether the differences in price is able to explain the difference in cost:

- However, because there are some differences in costs of producing movie screening services during weekdays and weekends, it is difficult to conclude that the differences in prices is a case of price discrimination. If the differences in prices are far greater than the differences in costs, then this may be a case of price discrimination.

Section B: Case study 3: OTT Disrupts Telco Market (Y5 H2 Common Test 1 2018)

e) Discuss whether the pricing strategy of cinema operators is a case of price discrimination.[8]

Conclusion and Evaluation

- As for the differences in gold class vs standard tickets, the case is not clear as well because the two may be considered different goods since the experience of being in a gold class theatre is markedly different from being in a standard theatre. Furthermore, there are clear differences in costs, where the cost of providing gold class movie screening is much higher, and this may be able to justify the higher price.

Essay – Question 3

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

Approach to the question:

Anti-trust video

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

(a) Question dissection:

Explain key differences between oligopoly and MPC.

- **4 key characteristics (compare between the 2 with examples)**
- **Different outcome from the 4 key characteristics**
  - **LR profitability**
  - **LR pricing**

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]

(a) Main Body of analysis

1. In terms of number and size of firms (mutual interdependency between firms vs independence)

Oligopoly	MPC
Small number of large firms A few dominant firms with large market share. (3-4 firm concentration ratios) Dominant firms like Caltex (oil industry) with thousands of employees worldwide, annual revenue generated could be in the billions of $$	Large number of small firms Multitude of small firms operate within the industry with no particular firm holding significant market share. Example, hawker stalls in Singapore, whereby a couple of helpers are hired, annual revenue is relatively low.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]

(a) Main Body of analysis

2. In terms of nature of product

Oligopoly	MPC
<u>Homogeneous/Differentiated</u> Some oligopolies produce largely homogeneous products – oil industry. Other oligopolies have actual and perceived differences between them. For instance, car manufacturers – different technology goes into the car (Tesla vs Proton).	<u>Differentiated</u> Largely differentiated, but degree of differentiation is likely small compared to oligopolies where product differences may be significant. Hawker stalls – taste and quality differs, but may be relatively similar.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]

(a) Main Body of analysis

3. In terms of knowledge of product

Oligopoly	MPC
<u>Imperfect knowledge</u> While both consist of imperfect knowledge, the degree of imperfection differs. There could be significant imperfection of knowledge on how the product is produced (consumers' perspective) as product (e.g. cars) may be complex.	<u>Imperfect knowledge</u> For MPC, the degree of imperfection may be rather low. Consumers may be unaware of the preparation of the food in hawker stalls, but there is a degree of basic knowledge of the items. Similarly, other firms may have an estimation of the preparation.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]

(a) Main Body of analysis

4. In terms of Barriers to Entry

Oligopoly	MPC
<u>Significant BTE</u> Both artificial and natural BTE may exist to prevent entry of new comers. Natural – significant iEOS to be exploited that favours the incumbent who is producing at MES. New entrants find it difficult to compete in price as their avg COP is much higher.	<u>Low/no BTE</u> Low/no BTE that allows free entry and exit of firms in the industry. Natural – MES may be achieved at low output levels, thus ensuring that new entrants may be able to compete (in price) with incumbents easily.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]

(a) Main Body of analysis

4. In terms of Barriers to Entry

Oligopoly	MPC
Significant BTE Natural – Start up cost is extremely high. Only companies with the resources (financial) are able to enter. Millions or billions of dollars required before entering oil industry as a retailer. An off shore oil rig costs $300m. The production line for cars goes to the millions.	Low/no BTE Natural – Low start up cost. Financial and skills required to start a hawker stall can be quite low. Cost of equipment, rental of stall would be in the thousands, rather than hundred of thousands $.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]

(a) Main Body of analysis

4. In terms of Barriers to Entry

Oligopoly	MPC
<u>Significant BTE</u> Artificial – Government may have regulations preventing the entry of new firms. Telcos in Singapore requires licenses issued by the government. Drilling rights for oil in oil rich countries require permits by the government.	<u>Low/no BTE</u> Artificial – while some regulation is required, it is relatively easier to comply and achieve. F&B license issued by the government can be obtained if a hawker meets food safety standards.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]

(a) Main Body of analysis

5. In terms of Outcomes (Profitability)

Oligopoly	MPC
Due to significant BTE, an oligopoly earning supernormal profits may continue to do so in the LR as new entrants may be prevented from entering the industry to erode them. An oil company with rights to drill and sell oil in a country may continue to have that right.	Lack of BTE means that if a MPC firm is making supernormal profits, new entrants will enter and compete, causing the profits to fall to normal profits in the LR. Example, a successful hawker stall may see increased competition and have its profits eroded.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]

(a) Main Body of analysis

6. In terms of Outcomes (Pricing)

Oligopoly	MPC
?	?

The implications of these differences were drawn out by only a small number of candidates, who were able to explain pricing decisions, the effect of entry and exit etc. in an analytic manner.

Where diagrams were presented, the AC curve was frequently omitted. In the case of monopolistic competition the AC curve is important to show the long-run equilibrium solution where normal profit is made, and it could be argued the AC curve is also important to show long-run abnormal profits inoligopoly.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

b. Question dissection

- **Clarify what is meant by market behaviour:**

o Behaviour of firms include - How they compete/strategies

- Preference for price vs non-price strategies

Pricing – 1) Price competition / price wars – Predatory pricing

- 2) Price discrimination – charging different consumers different prices for the same product for reasons not due to cost differences.

Non – price competition:

1) Product differentiation via – i) advertising (perceived) , ii) innovation (via R&D - actual / pdt innovation), iii) product proliferation

- Incentive to merge or collude

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

b. Main Ideas

Thesis: Oligopolies best explain their market behavior

Anti-thesis: MPC best explain their market behavior

o Behavior – economic theory - examples. Need to provide a lot of examples.

Behavior	Economic Analysis	Examples
Price strategy – Px war	Firms in oligopolies sometimes engage in price war (Predatory – selling below cost) to drive out close rivals or prevent new entrants. They sell below cost such that consumers flock to their business, making rivals make large losses. When rivals leave, they raise prices back up.	Grab vs Uber. Uber entered in 2013, Grab in 2014. Uber is valued at 75.5bn in 2020 IPO. 2018 – Uber left the industry, Grab acquired the remaining assets.

Discuss? MPCs tend to avoid px competition as their profit margins are low and prices are already low, close to AC.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

b. Main Ideas

Thesis: Oligopolies best explain their market behavior

Anti-thesis: MPC best explain their market behavior

o Behavior – economic theory - examples. Need to provide a lot of examples.

Behavior	Economic Analysis	Examples
Price strategy – Px Discrimination	Charging different prices to different consumers for the same product for reasons not due to cost difference. By charging those with PED<1 a higher price and PED>1 a lower price, the firm is able to increase total revenue.	Bus companies charge different prices to adults and students. Cinema operators do that as well, on top of different prices for weekday vs weekend tickets.

Discuss? MPCs can also charge different prices, not restricted to olig. E.g. hair saloons adult, student prices.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

b. Main Ideas

Thesis: Oligopolies best explain their market behavior

Behavior	Economic Analysis	Examples
Non-Price strategy – R&D	Extensive product as well as process innovation seen in olig. Pdt innovation in the form of R&D to improve quality of bus or train rides. Increase demand, demand more price inelastic – thus TR increases.	Bus companies charge different prices to adults and students. Cinema operators do that as well, on top of different prices for weekday vs weekend tickets.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

b. Main Ideas

Thesis: Oligopolies best explain their market behavior

Behavior	Economic Analysis	Examples
Collusion	Maximise group's joint profits – price fixing. All setting a higher price and avoidance of price competition (formally) between rivals. Anti-competitive behaviour. Dominant oligopoly model – where oil companies tend to follow one another's prices. When 1 raise price, others raise. When 1 reduce, others also follow. Similar to banks when offering savings plans (interest rates) to customers.	Bus operators providing services to Malaysia found guilty of price fixing. - While formal collusion is a behaviour that is favoured by companies. Anti-competition laws by governments throughout the world prevent that being prevalent.

Behavior	Examples
Mergers and acquisitions	Being larger gains higher iEOS, benefits the firms. Merger between large companies within the oligopoly – POSB + DBS. UOB + OUB.

explain their market behavior.

b. Main Ideas

Thesis: Oligopolies best explain their market behavior

Behavior	Economic Analysis	Examples
Mergers and acquisitions	Acquiring rivals in the same industry (horizontal integration) is common in oligopolies. By being larger, firms gain in both revenue and cost aspects. Greater extent of iEOS can be gained, lowering avg cost and thus increasing profits.	Grab acquires Uber, takes over their SEasia assets, increase their factors of production, produce at higher levels of output. DBS merge with POSB UOB acquired Overseas Union Bank

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

b. Main Ideas

Anti-Thesis: Some retailers' behavior fits that of MPC.

Behavior	Economic Analysis	Examples
Relatively stable price, price kept low.	Insignificant market share – thus, low levels of interdependence. One firm's action has little impact on the others. Low price setting ability, and free entry and exit ensures that profits are close to normal profits. Thus, prices are low (low market power) and tend not to engage in price competition (close to normal profit).	Hawker food prices are relatively similar. $3.50 plate of chicken rice in a hawker centre. Drinks are similarly priced $1 for a cup of coffee.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

b. Main Ideas

Anti-Thesis: Some retailers' behavior fits that of MPC.

Behavior	Economic Analysis	Examples
Some degree of non-price competition	Due to reluctance and inability to engage in price competition, MPCs desire to increase profits will focus on non-price competition. By differentiating their products from their rivals, they hope to raise demand and thus increase TR and profits.	Unique flavours – ice cream parlors with local flavours – teh terik, durian etc. Hair salons giving out flyers, announcing freebies or promotions like visit 10 times, 11th time is free. Hair salons also differentiate their products – some are simple no frills, some are more luxurious. Note: Degree of non-price competition differs significantly from oligopoly.

Section C: Essay Questions

Retailers in Singapore supply a wide range of services and products in a variety of market structures.		
(b)	Consider different retailers in Singapore and discuss which of these two market structures best explain their market behavior.	[15]

b. Synthesis

Nevertheless, there were a small number of excellent responses, including one that compared online blog-shops with petrol retailers. This response gave excellent insights into both types of retail business and linked the discussion to the good comparative theory that had been presented in part (a). This was followed by some good evaluation.

Section C: Essay Questions

a) Explain what is meant by price discrimination and discuss whether this is an example of price discrimination. [10]

Key areas of content.- Apply to the case example

1. Seller must be able to set its price
2. Seller must be able to separate his market and keep the parts separate.
3. PED of each market must differ. (Link to the 2 forms of PD).

    2. It is possible that there are more alternative mode of transport to major stations compared to the less accessible smaller stations. As such the demand for train services to/from major stations is more price elastic compared to the demand for train services to/from smaller stations.

Section C: Essay Questions

The Government has introduced greater contestability in the bus service industry. Competition for the market where operators compete periodically for the right to operate the bus services will spur operators to fulfil service obligations or risk being replaced when their term is up. The Government will also own all bus infrastructure, such as depots, buses and the fleet management system. Source: Ministry of Transport (Singapore)

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

b) Discuss the consequences of the above measures on commuters and bus service operators. [15]

Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Clarify: Primary objective of a potential entrant is to **maximise profit** - a profitable opportunity must exist in the market in order for a potential entrant to consider contesting the market. A rational firm will weigh the **benefits and costs** before deciding to contest a market.

Ways to split the question up:

#1: Revenue factors and cost factors – but there are several factors that will affect both revenue and cost.

#2: Barriers to Entry and Barriers to Exit

Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Body: Explain factors affecting contestability:

1: Revenue Factors – i) Size of market and number of firms in the market

- If there is a large domestic market and only a handful of firms providing service in the market, these incumbents are likely to make supernormal profits. This would create incentives for potential firms to enter and seek to enjoy part of the profits.
  - For instance, entrance of Krispy Kreme into the Singapore donut market. Only small artisan shops exist, J Co came in earlier and was dominating the market.
- If there is **small domestic market**, the total revenue earned by each firm (including the new entrant) might not be sufficient to cover the total cost. The potential entrant will consider this before deciding to contest the market and will choose not to enter in the end.

Section C: Essay Questions

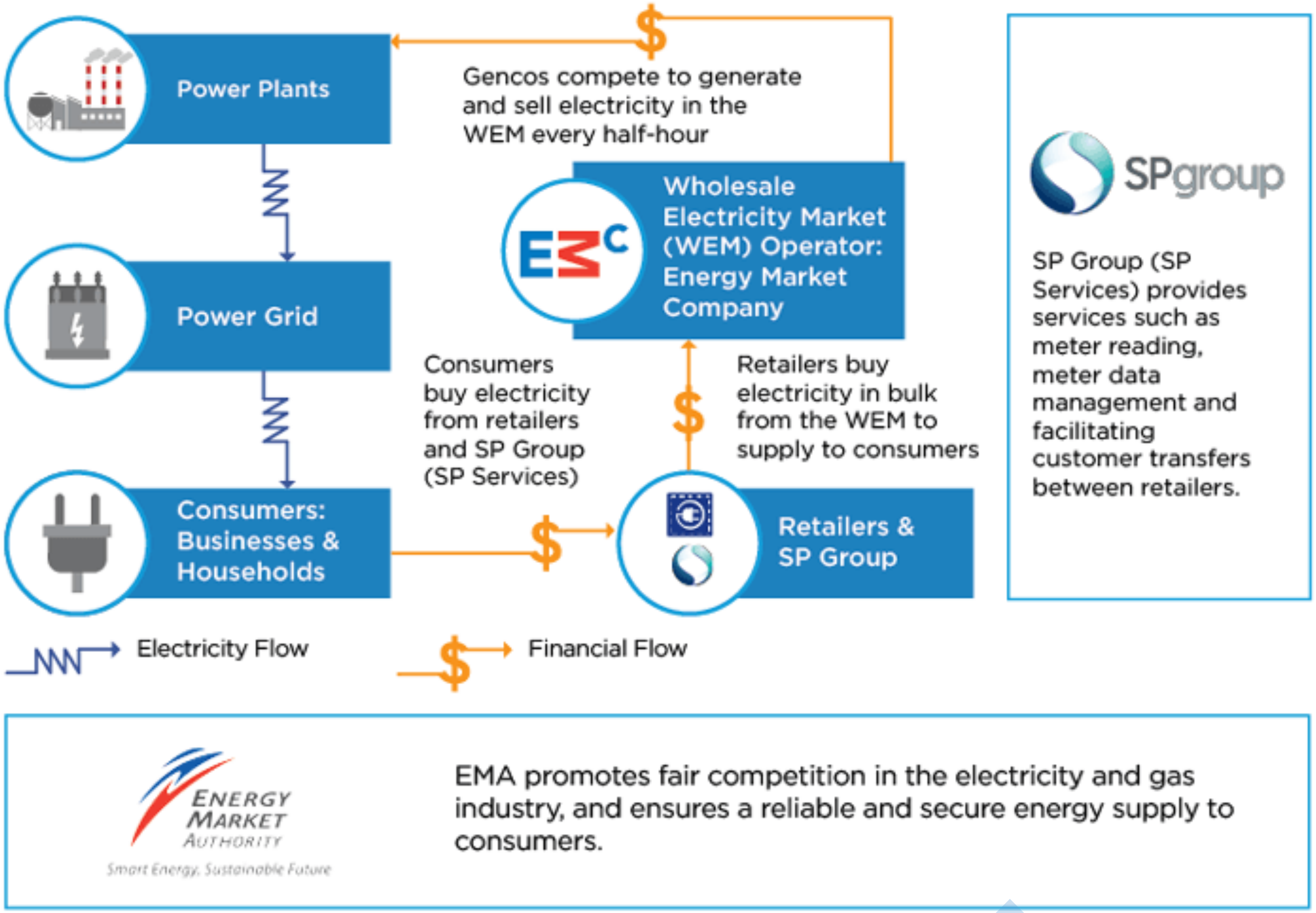
a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Body: Explain factors affecting contestability:

1: Revenue Factors – ii) Customer loyalty – strategic barriers

- For homogeneous products e.g. electricity, the market may face less customer loyalty and therefore easier to provide a substitute.
  - Since 1 November 2018, the Open Electricity Market was rolled out progressively to all consumers across Singapore by zones. Consumers can now choose who they wish to buy electricity from. There are currently 12 electricity retailers in Singapore. 28 retailers were originally given licenses to see to consumers.

How The Electricity Market Works



Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Body: Explain factors affecting contestability:

1: Revenue Factors – ii) Customer loyalty – strategic barriers

- For differentiated products, a gap or a niche market may be available for a new entrant. In the past, Jaben and Stereo saw an opening to create a specialty shop for audiophiles. Stereo was especially successful for a while with people lining up to purchase from the shop due to their high level of expertise and the way they put people at ease.
- However, when there is a brand loyalty for a particular product's

brand, new entrants may find it difficult to break into the market.

E.g. Virgin Cola trying to enter the Cola market in 1984 to great fanfare. Richard Branson drove a Sherman tank at Times' square and smash a wall of Coca-cola and Pepsi.

Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Body: Explain factors affecting contestability:

1: Revenue Factors – iii) Artificial barriers - Statutory

Administrative/Legal Barriers

- Assuming that the market is large enough, the potential entrant must determine if it would succeed in its bid to **attain a license** to compete in the market if it believes a profitable opportunity exists. This might be difficult as it needs to have sufficient resources at hand to come up with a quality proposal that would be accepted by the authorities.

Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Body: Explain factors affecting contestability:

1: Revenue Factors – iii) Artificial barriers - Statutory

Administrative/Legal Barriers

- The market could also be protected by the government e.g. banking or telco sectors. A foreign MNC might **face administrative hurdles** when it decides to enter a new market. FTAs might reduce such barriers paving the way for the market to be contested. US-SG FTA signed in 2004.
- Currently, there are 28 banks, offering the full range of services and operating under the Banking Act in Singapore. Five of them are registered and owned by the local 3 local banking groups, and the remaining 23 banks are branches of banks registered abroad. Six of the 23 branches of foreign banks have the privilege to implement a full range of banking services.

Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Body: Explain factors affecting contestability:

1. Revenue factors – Likelihood of incumbents reacting to entry (Mutual dependence)

- For oligopolistic markets, **rival consciousness will lead incumbent firms to compete will new entrants** via limit or predatory pricing or extensive advertising. Intensive competition will increase the cost and reduce the revenue of potential entrants, increasing the risk of subnormal profits.
- In contrast to MPC markets, e.g. **hawker stalls, there is less likelihood** of incumbent stalls changing their price in response to a newcomer hence reducing the risk of losing revenue.
- Hence a potential entrant would consider whether it is **able to survive the price and non-price competition before deciding to enter**. If it does not have a relative cost-advantage, it might decide against entering the market.

Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Body: Explain factors affecting contestability:

2. Cost Factors - Natural Barriers to Entry

High capital outlay might increase the cost of entry because the firm will need to raise the money e.g. cost of bus fleet for a bus service provider. Small firms might find it difficult to finance the cost of the investment e.g. unable to raise equity. Such firms could be discouraged if the setup cost is high in the market.

- An Airbus A380 has a retail price tag of $400m.

Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Body: Explain factors affecting contestability:

2. Cost factors - Barriers to Exit

High sunk costs will increase the cost of failure. For instance high infrastructural cost with no resale value or advertising or R&D expenditure will increase the risk of entry since the firm will face high losses if it does not succeed in competing with the incumbents and needs to exit the market.

- **If barriers to exit are low** e.g. retail durian market, a potential entrant may consider **hit and run** entry during the durian season.

- High renovation cost (which is usually a cost that cannot be retrieve and thus a sunk cost) can dissuade a potential entrant from entering the market.

Section C: Essay Questions

a) Explain the factors a potential entrant would consider when deciding to contest a market. [10]

Overall, a firm will consider if benefits (potential revenue to be earned) will be greater than cost (explicit and implicit cost) of entering the market. If benefits>cost – enter the market. If benefits < costs – do not enter the market.

Section C: Essay Questions

- **b) Discuss the consequences of the above measures on commuters and bus service operators. [15]**

Introduction:

Clarification of the measure (s) to increase contestability

1. Reduction in barriers to entry.
2. Ownership of bus fleet, depot and infrastructure by the government.

b)Discuss the consequences of the above measures on commuters and bus service operators. [15]

Thesis #1: Positive impact of Reduction in BTE

Application: (understanding the policy)

- Operators compete periodically for the right to operate services through the use of government contracts. Removal of a guaranteed position whereby they will be the designated bus service provider meant that when putting in offers for the right to provide service, Operators will put forward a competitive price.
- Poor performance also meant the removal of the right to provide bus services, thus operators have greater levels of incentives to ensure service standards are up to scratch. This could be in the form of more punctual bus timings. Bus drivers could also be better trained to ensure customer service as well as greater understanding of passengers.

b)Discuss the consequences of the above measures on commuters and bus service operators. [15]

Thesis #1: Positive impact of Reduction in BTE

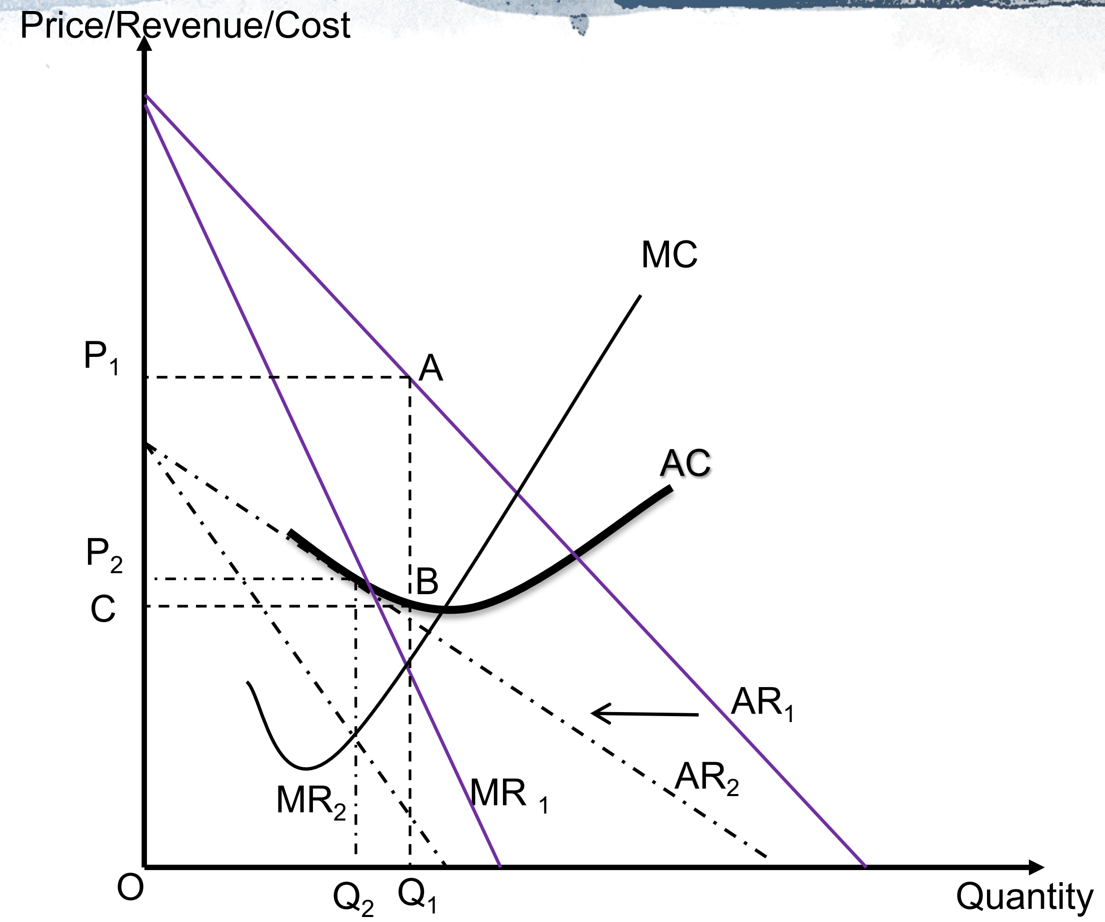
Theoretical Framework:

- Market is more fluid with new firms entering and inefficient firms leaving when their term is up. Demand (AR) is likely to be more price elastic (AR2). Incumbent’s market share is likely to fall to Q2 due to new entrants for different routes.

Outcome:

- Commuters: Lower prices for consumers. Improvement in quality of services
- Optional: (new) Bus operators: Other bus operators have opportunities to compete in the market.

b)Discuss the consequences of the above measures on commuters and bus service operators. [15]



b)Discuss the consequences of the above measures on commuters and bus service operators. [15]

Anti-Thesis #1: Negative impact of Reduction in BTE

Theoretical and Application:

- Greater level of competition leads to smaller profits for incumbents. To win bids to take over particular routes, operators may cut cost by various ways. Drivers might be poorly paid and impatient with commuters. Cost cutting measures implemented by incumbents and new entrants.
- The potentially lower levels of profit might drive operators to seek other forms of revenue via advertising e.g. hanging brochures on handrails to the inconvenience of customers.

Outcome:

- Commuters: Poorer experience.
- Bus operators: Lower profits

b)Discuss the consequences of the above measures on commuters and bus service operators. [15]

Thesis #2: Positive impact of Govt ownership of bus fleet

Application:

- The government will own bus infrastructure – This removes one of the natural barriers to entry of new firms as they no longer require huge resources (purchase of hundreds of buses) to enter and compete. Also, this allows operators to focus on the provision of a service, rather than worry about fixed cost and long term profits.

b)Discuss the consequences of the above measures on commuters and bus service operators. [15]

Thesis #2: Positive impact of Govt ownership of bus fleet

Theoretical analysis:

- Fall in fixed and sunk costs (e.g. bus depots) for firms - AC shifts down (not shown on diagram). MC may or may not fall depending on whether fleet management system is seen as a fixed or variable cost.

Outcome less obvious here:

- Commuters: Central planning of fleet management could also increase efficiency and consistency of bus arrivals. Consumers have better information via apps such as MyTransport SG.
- Operators: Higher profits. New entrants and existing operators experience lower average cost of production since the government takes control of fleet management, depots and bus fleet. Profit increases cet. par. Operators focus on service, rather than maintenance and replacement of buses.

b)Discuss the consequences of the above measures on commuters and bus service operators. [15]

Anti-Thesis #2: Negative impact of Govt ownership of bus fleet

- Assumption that the government knows best. Would government be able to respond quickly to changing demand from population and increase bus fleet size? If slow to gauge demand changes, then there could be over crowding and less enjoyable commuting experience.

b)Discuss the consequences of the above measures on commuters and bus service operators. [15]

Conclusion and Overall Evaluation:

- Net effect on profit depends on
- Extent of fall in cost compared to fall in revenue.
- The number of licenses LTA decides to issue.
- Consumers are more likely to enjoy lower prices because of increased contestability. Moreover LTA is likely to regulate bus fares making it difficult for operators to unilaterally increase prices.
- Given that the government of SG is generally efficient, the likelihood of inefficiency from government failure is low. This means that the centrally controlled aspects of bus travel will continue to improve, leading to quality travel experiences for commuters.
- While teething problems may occur initially, it is likely to be win-win situation for all parties in the long-run.

- https://www.channelnewsasia.com/news/singapore/the-big-read-bus-contracting-model-benefit-drivers-commuters-12202716
- https://www.mot.gov.sg/transport-matters/public-transport/Detail/why-bus-contracting/

QUICK REVIEW OF QUESTIONS WE MISSED: – CASE STUDY 1

e) Discuss whether the merger between British Airways and Qantas should be a matter of concern. [8]

1) What needs to be clarified?
   - Concern for whom? Consumers, employees, society? What is the yardstick?
2) What happens in a merger?
   - Merger – larger more dominant firm
3) What is the thesis and anti-thesis?
   - Thesis – Yes, a matter of concern
   - AT - No

QUICK REVIEW OF QUESTIONS WE MISSED: CASE STUDY 2

c) ii) Explain how the firms in this market might compete against each other. [**4]**

Key word is compete – triggers "Price" and "non-price" competition.

Compare to "how firms may behave", which is broader and accepts a wider range of strategies

Compare that to 'how firms may remain profitable', which hints at

Cost as well as revenue strategies

SECTION B: CASE STUDY 2

c) ii) Explain how the firms in this market might compete against each other. [**4**]

Avoidance of Price competition (2 marks)

In this competitive oligopoly structure, there tends to be price rigidity due to the mutual interdependence of supermarkets in the industry. There is no incentive for one supermarket to increase or decrease prices as increasing prices will result in a loss of market share to rivals and decreasing prices will lead to a price war between them (Kinked demand curve).

Preference for non-price competition (2 marks)

Therefore, firms could compete based on **non-price competition** such as product differentiation (e.g. advertising, better after-sales conditions, better quality service) to change consumer's perception into buying their products and reduce their PED and increase demand for their g&s.

SECTION B: CASE STUDY 2

d) Discuss the policy of divestment in the case of Tesco explaining clearly how this might affect consumer welfare. [**8**]

Explain divestment: The forced selling off of stores

Explain benchmarks for consumer welfare: Price, Choice, Quality

Thesis: Divestment will increase consumer welfare.

Anti-thesis: Divestment will NOT increase consumer welfare