

Kellogg's recent acquisition of Pringles potato chips for US\$2.7billion made it second only to PepsiCo Inc in the highly concentrated global snack food market, which consists of major players such as PepsiCo's Frito-Lay, Kraft's Nabisco and Diamond Foods.

(a) Explain what is meant by productive efficiency and allocative efficiency. [10]

Do only part (b)

(b) Discuss whether having large companies like Kellogg and PepsiCo Inc in the snack food industry could be beneficial to society. [15]

### Suggested answer

#### 1. Introduction

- Clarify that large firms such like Kellogg and Pepsico Inc in the snack food industry command a large proportion of the market share and have relatively high market power operating in an oligopolistic market structure → they have the ability to set price and are price setters → can bring about beneficial as well as undesirable impact to society.
- The creation of Kellogg/Pringles will make it the market leader.
- Identify the benchmarks used to assess desirability of such large companies
  - Society's perspective: Efficiency (allocative, productive and dynamic) and Equity
  - Consumers' perspective: Price/Qty, consumer choice, quality of product/service
  - Producers' perspective: ability to raise TR to increase profits, cost savings

#### 2. Body

R1: Discuss whether large companies can be beneficial to society based on AE, PE → draw links to consumers

R2: Discuss whether large companies can be beneficial to society based on DE → draw links to consumers

**R1: Discuss whether large companies can be beneficial to society based on AE, PE → draw links to consumers**

**Thesis: Large companies such as Kellogg/Pringles and Pepsico Inc can be beneficial to society due to PE**

#### 1. Lower prices and higher output produced for consumers

- Large firms can reap significant IEOS due to their large scale of production
  - Define IEOS – elaborate with examples
- Use of theoretical framework (**diagram**) to illustrate & explain in relation to being closer to MES → more PE
- Link benefits to consumers as result of cost savings from above

**Anti-thesis: Large companies such as Kellogg/Pringles and Pepsico Inc may not be beneficial to society**

#### 1. Consumers pay a higher price & greater inequity

Explain how merger lead to ability to price way above MC & greater inequity

#### 2. Explain allocative inefficiency to society using the diagram drawn for point 1.

#### 3. Explain how large firms are X-inefficient due to complacency.

### **Evaluation: Possible Suggestions**

EV about prices:

- Will the larger firm pass on cost savings or charge way higher prices? Explain your stand

EV about AE & PE

- Provide insight on how extent of allocative inefficiency may not be as large?
- Provide insight on how they might be productive efficient or X-inefficient on the whole?

**R2: Discuss whether large companies can be beneficial to society based on DE → draw links to consumers**

**Thesis:**

1. Explain how large firms can achieve dynamic efficiency and link benefits to consumers

**Antithesis:**

1. Explain how innovation may be limited

### **Evaluation:**

- Provide insights on whether dynamic efficiency will be achieved on the whole in snack industry.

### **Conclusion/Synthesis**

- Weigh the pros and cons → make a judgement as to whether large firms especially those in the snack food industry are beneficial to society (*do the pros outweigh the cons? Do all consumers benefit or only some groups*)
- Use case evidence if any to back up those points. Have there be significant improvement in innovation, quality and lowering of price in the snack food industries?
  - Have there been increased in outreach such that healthier products are created?
  - Have prices increased or lowered with the formation of Kellogg/Pringles?
- Role of the government