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QEM 5023 Business Economics/GECO5213 Economics for Managers

Mid Examination

Question 1

Malaysia.kinokuniya.com……., We get the price elasticities of demand for group A is 1.25 and price elasticities of demand for group B is 0.625.

Answer the following TWO (2) questions:

a) ***With the price elasticity of demand for group A and group B. Explain how the discount will affect total revenue from each group.***

The answer to this question is as follows.

With group B (0.625), it is considered inelastic, and a discount will lead into lower revenues. With group A (1.25), it is considered elastic, and a discount will increase the revenue.

With group B (0.625), revenue will decrease by 10 percent. With group A (1.25), revenue will increase by 90 percent.

b) ***Suppose Malaysia.kinokuniya.com knows which group each customer belongs to when he logs on and can choose whether to offer the 10% discount. If Malaysia.kinokuniya.com wants to increase its total revenue, should discounts be offered to group A or to group B, to neither group, nor to both groups?***

The answer to this question is as follows.

Discount should not be offered to group B (0.625) but should be offered to group A (1.25) if the sales margin is sufficient.

Question 2

(1) A monopolist always produces a quantity at which the demand curve is elastic. Explain with a diagram and show the average and marginal cost for the monopolist.

If the monopolist is operating in the inelastic range of its demand curve, then it is not maximizing profits. The firm could earn a higher profit by raising price and reducing output. It will continue to raise its price until it is in the elastic portion of its demand curve. A profit-maximizing monopoly firm will therefore select a price and output combination in the elastic range of its demand curve.

The next figure shows on the hand of a relevant example.

Price	$10	9	8	7	6	5	4	3	2	1	0
Quantity	0	1	2	3	4	5	6	7	8	9	10
Total revenue	$ 0	9	16	21	24	25	24	21	16	9	0

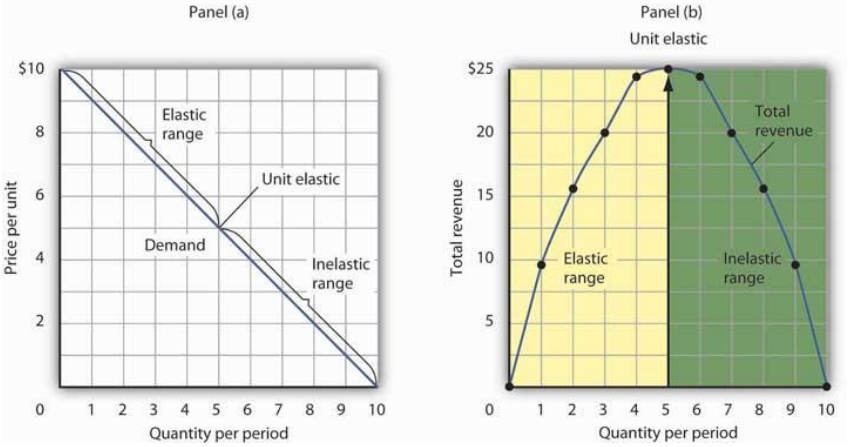

Figure 1

Figure 1

Suppose a monopolist faces the downward-sloping demand curve shown in **Panel (a).** To increase the quantity sold, it must cut the price.

Total revenue is found by multiplying the price and quantity sold at each price.

Total revenue, plotted in Panel (b), is maximized at $25, when the quantity sold is 5 units and the price is $5. At that point on the demand curve, the price elasticity of demand equals 1.

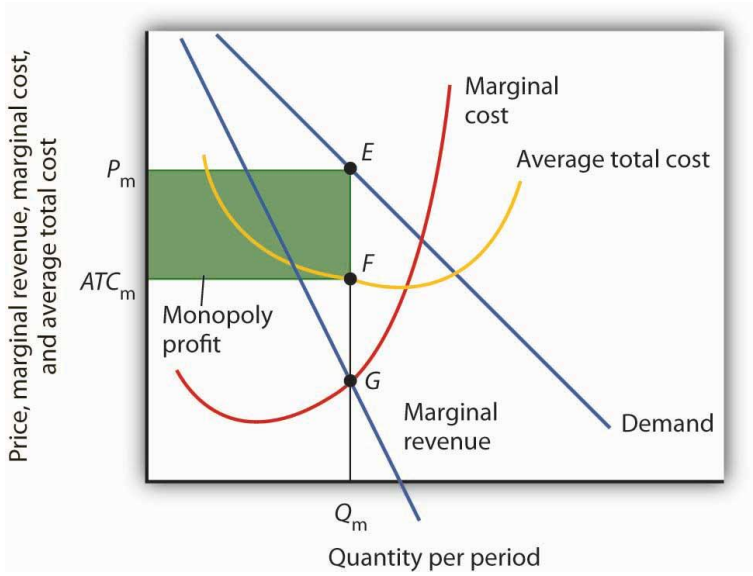

Figure 2

Figure 2 Average total and marginal costs for the monopolist

A monopoly firm's profit per unit is the difference between price and average total cost.

Total profit equals profit per unit times the quantity produced.

Total profit is given by the area of the shaded rectangle.

(2) Why monopolist marginal revenue is always half of the demand curve? Explain with diagram.

A monopolist's marginal revenue is less than the price of its good because it must reduce their price to sell more of their products and because the demand curve is a downward slope.

When the demand curve is linear (1), the firm is a monopolist (2), and the firm must charge everyone the same price (3). **By then** is the slope of the marginal revenue curve twice that of the average revenue curve

The average revenue curve is simply the demand curve. This is because the monopolist charges for everyone the same price, and the demand curve represent the needed price to clear the market, for a given quantity. *The marginal revenue curve* is the derivative of the total revenue curve with respect to the quantity.

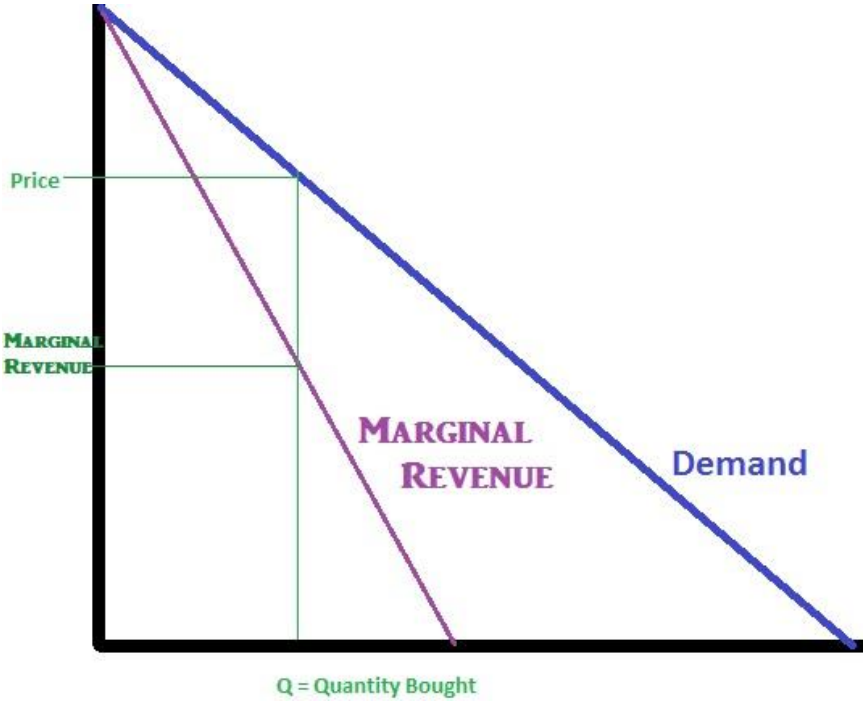

Figure 3

Figure 3

Linear Demand Curve and the monopolist (industry wide) marginal revenue curve associated with it.

Price is higher than Marginal Revenue since a decline in price sells a greater quantity but also reduce the price of the sales previously made at the higher price.

Under these constant values the slope of the Marginal Revenue Curve is twice as steep as the linear Demand Curve

Question 3

A firm that produces pulp also emits smelly pollution. The more pulp it produces, the more pollution it emits. The pollution primarily affects the people who live in the area.Suppose the pulp is sold in a perfectly competitive market and that the firm has linear marginal cost, which increases with production. Suppose also that the marginal cost of pollution, ME (marginal cost of externality), increases proportionally to the quantity produced, and its approximately 1/3 as large as the firm's marginal cost.

a. ***Draw a diagram with quantity of pulp on the X axis and cost/revenue on the Y-axis. Indicate the profit maximising choice of quantity given the assumptions.***

b. ***How should the social cost be represented in the graph? Show the socially optimal quantity.***

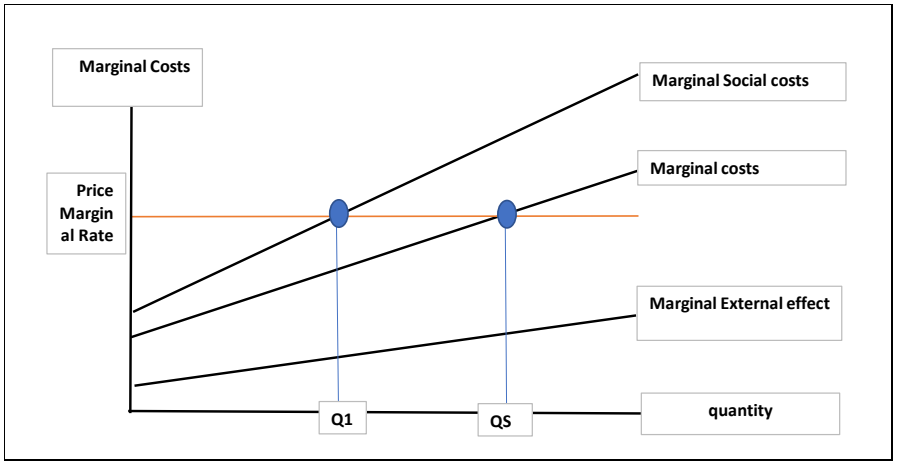

Figure 4

Perfectly competitive market and therefor the demand curve is horizontal, and the marginal rate is equal to the price. The marginal costs curve is linear and increasing, Production is at level QS. Taking in the external effect, **at level Q1 is the socially optimal quantity found.**

Figure 4

Question 4

Read the case study "PRICE CUTS FOR MEDICINES: CHEMISTS AT RISK AS PRICES ARE SLASHED" and answer the following questions:

a. What kind of market structure is involved for the sale of medicines and vitamins?

Since the law has changed, it is seen to be in the transit period from oligopoly to perfect competition market.

b. What can be said about barriers to entry in this market?

Even though it is seen in the transit period, and it takes time for the industry player to response to the changes, the significant barriers to entry for pharmaceutical and drugs industry are as follows:

i. Economic of Scale – Well established distribution network and appropriate infrastructure is crucial and challenging for new company, giving existing established companies substantial advantage.

ii. Regulation and Approval – Obtaining pre-requite regulatory approval before marketing and distributing a new pharmaceutical products or drugs is a long drawn and extremely expensive, especially for new companies.

iii. Investment Capital – Starting a pharmaceutical manufacturing company requires large investment in infrastructure, and R&D with the possibility of not earning revenue for over a decade.

iv. Intellectual Property and Patents – Patent consider as legal and strategic safeguard for established companies and help them stop new companies from entering the market without a completely new pharmaceutical drug.

c. Explain the disadvantages of the abolition of resale price maintenance for this market.

Barriers are primary in place to support the manufacturer in upholding its market share and sales volume related. It encourages ongoing research and developing of medical science. God knows how the world was screaming for a COVID vaccine.

Ongoing RD is capital intensive and if their market share and sales volume are secured, investors are more willing to invest.

And talking of COCID Vaccines, the few oligarchs **were not really willing** to share their patents with other players (manufacture with infrastructure) **for the sake of speeding vaccinations for mankind its survival.** Again, it comes to light that the answer to the market is to strength the knowledge and infrastructure of the regulators and to enforce those medicals can be produced by more then just the patent holder his factories only.

Secondary to control sales prices and to uphold the good name and service related. Hmmm…. The market was incomplete, solutions too expensive and an average pharmacist will not advice any alternative solutions if not on stock. There is not something existing as self-regulating industry, seeking for integrity, its plain business.

Abolition of barriers will redirect the market into complete competition and more factories, developers and resellers from different kind will change the investors landscape, prices, and conditions for the better. It may lead into equity questions in the board of excising elite manufactures (oligarchs) but it would be naïve to believe that the world is depending on a few elite players their money, their competences, and their willingness to invest in the future.

In every disadvantage are advantages hosted. Its good to shake the oligarchs ‘orchards’ and to get more views in the dark rooms of the medical industry. Its good to be on the road to complete competition and to give new elan (there is a lot of motivated talent in the street) the chance to breath and to develop the industry for fair paid medical solutions.

d. How does the rise of the Internet affect this situation?

I do not know which situation this question refers to. Internet in its character breaks **barriers**, firewalls are needed in case some want to avoid intruding. On internet can the same honest and **huh free advice** coming from the pharmacist be found and not just limited to an advice related to a ‘solution on stock of the pharmacist`. On internet stocks are **seldom sold out**, and all **suppliers with relevant background information can be found**, descriptions can be downloaded. Consequently, holding all suppliers under one mouse click, questions and demands will find **it balance in fair pricing and delivery conditions,** medicals can be **purchased online or in the nearest drugstores.**

Its strength the knowledgably position of the consumer and it makes possible to ask critical questions before buying.

Lacking critical consumers gave a way too much space to the oligarchs as they truly and shamefully have **enriched themselves** for the account of people who yet can get a Nurofen painkiller for half of the price and are finally released from an industry that has become a pain in the ass of the consumer.

With all discussion and uproar, the industry is enforced to cope with consumers their interest and not the interest of their own sales buddies. **Consumer protection** is not solely depending on networks around factories but is highly **depending on education of the consumer.**

But then again, it is not clear to which situation the question refers too.

Nornatasha Ahmad