K J SOMAIYA INSTITUTE OF MANAGEMENT STUDIES & RESEARCH
(Autonomous)
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MHRDM -2018-21

MANAGERIAL ECONOMICS

(End semester Examination)

Semester- I

November 22 , 2018

Max. Marks: 50

Duration: 3 Hrs.

Note:

I. **Answer any three questions from Section A. Answer each question in about 50 lines. Each question carries equal (10) marks.**
II. **Answer any ONE from Section B, which carries (20) marks.**
III. **Space used for diagrams, tables, etc. would NOT form part of the space limit stated above. It is suggested, therefore, to draw diagrams neatly, wherever applicable.**

SECTION-A (Attempt any Three)

1. Why the practicing managers require to study Managerial Economics as part of their Management Masters' course curriculum? Use 3-4 specific uses that you recall from the contents that made you a better decision maker as a result of studying this course.

2. How the recent developments in Internet-based marketing and personal loans are affecting the traditional ways of looking at demand and supply for typical consumer goods/ services? Take two examples of such goods or services and elucidate your answer.

3. What is a market structure? What are the benefits of understanding it? Compare and

contrast the market structures of perfect competition and monopoly by comparing any six major aspects of the two.

4. Use separate diagrams and explain the three possibilities of supernormal profits, normal profits and losses (bearable) for the representative firm under a perfect competition. Why would firms prefer to stay in the business without shutting down their operations if they faces minor losses in short run?

5. State the various cost concepts and explain their relevance to managerial decision-making. What are the economies and diseconomies of scale that provide a typical average cost curve to be U-shaped?

SECTION- B (attempt any One)

1.

Advertisers are Taking on Competitors by Name…. and Being Sued

Way back, many decades ago, one remembers a slat ad which took on its competitors by demonstrating its free flowing ability, while the salt from the competitive pack (with only the brand name blurred) fell out of the pack in untidy lumps, distinctly unpourable. That was perhaps, one of the first popular instances of competitive advertising.

Comparative advertising has always existed, and continues to exist. Showing your competitor in a poorer light than yourself might be the easiest way to get your advantages across to the paying public in advertising, but doing this in a way that actually shows the competitive packaging (even if the name is blurred out) is considered downright déclassé within the ad community. Having said that one needs to remember that all advertising is intrinsically competitive, with the purpose of advertising being to show a product in a more positive light when compared with a competitor. It is easy to pull down a competitive product or service, but more difficult to constantly upgrade your offering and deliver more value to the consumer, and communicate that in the right way.

However, there are some brands which survive by taking potshots at each other- the cola wars are famous in advertising. Perhaps the earliest instances of comparative advertising in India was when Lalitaji told us that 'Surf ki kharidari mein hi samajhdari hai' in an oblique reference to the 'sasta' Nirma. In more recent times, Maruti Udyog Ltd served a legal notice on arch rival Hyundai Motor India Ltd stating that the latter had printed incorrect information about its latest car Swift in an advertising

brochure. Rin openly showed the Tide package in a comparative ad, raising ethical hackles all around in the advertising community. In a shock, the ad actually showed the comparative product without bothering to blur the brand name as it is the norm in comparative advertising, and had as a disclaimer a flash and go line which said that this had been confirmed by an independent laboratory testing. The claim in Rin ad is simply that of a whiter wash- 'Tide se kahin behatar safedi de Rin' which is rather what every detergent manufacturer does. The shock factor here is the showing of the rival product, packaging, logo, et al. Tide went to court and got the Rin ad withdrawn. Sometimes, comparing a rival product unfairly can result in a legal case, as did happen with Complan versus Horlicks. The advertising and counter advertising between these two brands got so confusing that at the end of the day it was unclear which brand had which differentiator. Although such actions are less sportsmanlike and may result in legal suits, advertisers have been willing to take on competitors by name because the technique seems effective.

- Question: If you are promoter of a business that sells a consumer good, would you encourage your sales team to take names of your competitor/s and canvass against their product or restrain from doing so? Justify your answer.

(adopted from Dominik Salvatore and SK Rastogi (2016) Managerial Economics, OUP, pp 384-385)

2.

Non-clearing Financial and Other Markets

In economic theory, we study that an excess demand for a commodity is automatically eliminated by a price rise and an excess supply is eliminated by a price decline. Markets clear by quantity responses to price changes resulting from disequilibrium. Some real-world markets, however, do not clear and do not seem to move toward clearing. For example, financial markets (especially credit markets) often do not clear. That is, we often observe excessive demand or excessive supply of credit that persists over time. A non-clearing market can also exist in labour, commodities, and other markets.

A **non-clearing market** arises when economic agents react to both price signals (as in traditional theory) and to quantity signals. In particular, economic agents sometimes deliberately create a disequilibrium situation because of the advantages that they can extract from the persistence of a surplus or a shortage of the commodity or service that they sell or buy. One of the main insights of non-clearing markets theory is that a dis-equilibrium in one market can actually create desirable *spillover effects* in a related market.

For example, ticket prices for concerts by a superstar, such as Mariah Carey or Jennifer Lopez, are often deliberately set below the equilibrium price so as to create a shortage (i.e., excess demand) for tickets.

Long lines form in front of ticket booths long before the tickets go on sale, fans talk about the hot concert coming up, and an aura of anticipation and success is created. Promoters play this price game in the expectation that all the “hype” about the concert and the free publicity that it gets will lead to much greater sales of the star’s recordings, and that these spillovers will more than make up for the loss of revenue by pricing concert tickets below the equilibrium level. The same occurs in pricing admission tickets to Disneyland or meals at a chic restaurant. Lines in front of the new restaurant and word of mouth are the best and cheapest forms of advertising that the restaurant could have. Most people believe that if it is difficult to get into the restaurant, it must be great.

These and other examples of non-clearing markets do not mean that the traditional theory of clearing markets is wrong, but only that the traditional theory is not applicable in some cases where shortages or surpluses are deliberately created and tend to persist over time. The theory of non-clearing markets acknowledges this fact and tries to explain it. In the ticket example above, it is clear that excess demand for tickets is fully and voluntarily planned by the price-maker or promoter as a way to increase overall or combined revenues from the concert and the sales of the star’s recordings.

Questions

1. Why and how can disequilibrium (excess demand or supply) persist in a market economy?
2. Why would a firm set a price for the product or service it sells below equilibrium if this means selling a smaller quantity at a lower price (and hence making a lower profit, or even incurring a loss, than by selling the product or service at the equilibrium price)?
3. What determines if the firm gains (and therefore has an incentive) to set the price below the equilibrium level?
4. If firms playing this game (i.e., setting the price below the equilibrium level) benefit, why would your firm or any firm also adopt this strategy and also earn a higher profit?
5. If your firm could set the price of the product or service it sells below the equilibrium price and increase its profit, would you, as the CEO of the firm, adopt this strategy? Should the government introduce legislation to make this practice illegal?

(adopted from Dominik Salvatore and SK Rastogi (2016): Managerial Economics, OUP, p 72)

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