

# Economics for Managers

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Session 12-14 | 24-Aug-2019

**GAURAV GUPTA**

# Welcome Back: today's agenda

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1. Group Assignment applying economics to the world around us
2. Finish our discussion on Supply Decisions- production, costs & market structure
  - Simulation on market structure
  - Case studies on market power
  - Case study on Indian Aviation industry
3. Bringing together Demand, Supply, Competition and Regulation
  - Case study on Indian Automobile industry
  - Incidence of tax
  - Externalities



# Why do auto-drivers choose to stand idle for hours yet refuse to accept rides at 'meter' fares?

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- Why is it puzzling/ interesting?
  - meter runs at ~Rs 12/km whereas taxis are cheaper
- Possible explanation(s): auto-drivers understand economics very well
  1. Such behaviour is usually seen when/ where demand is high (Manyata Tech Park)
  2. Can exploit consumers' willingness to pay/ Inelastic demand
  3. They sell their products in smaller units (shorter distances) vs cabs
  4. Fixed costs in the business are low. Even per unit variable costs are low. Breakeven faster.
  5. Supply curve is possibly backward bending
    - they don't want to work after having made the minimum they set out to make?
    - think of it as indifference curve with work & leisure

# Possible explanations (cont.)

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6. Incentives- there is no strict implementation of rules governing the permit to drive (penalty).
7. They have collective bargaining power in terms of union/ area-specific auto drivers.
8. Opportunity cost of drivers' time is low- they have little education to get them a job elsewhere or they only have low wage alternatives. Or they consider driving other types of vehicles more painful!

# Market Simulation

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- We need four groups as below:
  - 1 – accountant
  - Group 1: One person
  - Group 2: Three people
  - Group 3: Five people
  - Group 4: All remaining



# Instructions

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- You all get a product each to sell
  - I am the only buyer in this simulation, and my motive is to spend the least amount possible.
  - You are interested in selling more than taking the inventory home.
- All groups live on different planets. So, act independent of what others are doing outside your group.
- Group 1 is single member. So, obviously, you have no company to talk to!
- Only Group 2 members can talk to each other.
- Group 3 members can strictly not talk to each other.
- Group 4 members can strictly not talk to each other.

# Let's start...

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- Take a piece of paper.
- You can sell your respective product for any price between Rs1-20 (i.e. the max you can charge is Rs 20).
- Follow the instructions on the previous slide!
- Take 45-60 seconds to write the price you choose on your paper.

# Next

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- Now show your best prices only to me:
- Group 1
- Group 2
- Group 3
- Group 4



# Key questions

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- If all products are identical what will happen to the pricing of the product?
- If there are many small independent firms what power do they have over the price?
- When items are differentiated what power do the producers have over price?
- What is the difference between an oligopoly and monopolistic competition?  
Which is better for consumers?
- What gives monopolies their power?

# Case studies

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- **NYC Taxi permits**

- What is the main reason for increase in price of medallions?
- Who ends up paying a high price?

- **Competition in the US Meat Industry**

- How were changes on the demand side negatively impacting Tyson's business?
- How were changes on the supply side negatively impacting Tyson's business?
- How did Tyson manage to get to its current position of strength?
- How many companies dominate the US Meat market?
- How has that position impacted consumer prices?

# What is your assessment of the Aviation Industry ?

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## **Airlines**

- Demand
- Supply: production, costs
- Regulations
- Level of competition & source of market power
- Are airlines likely colluding or are in cut throat competition?

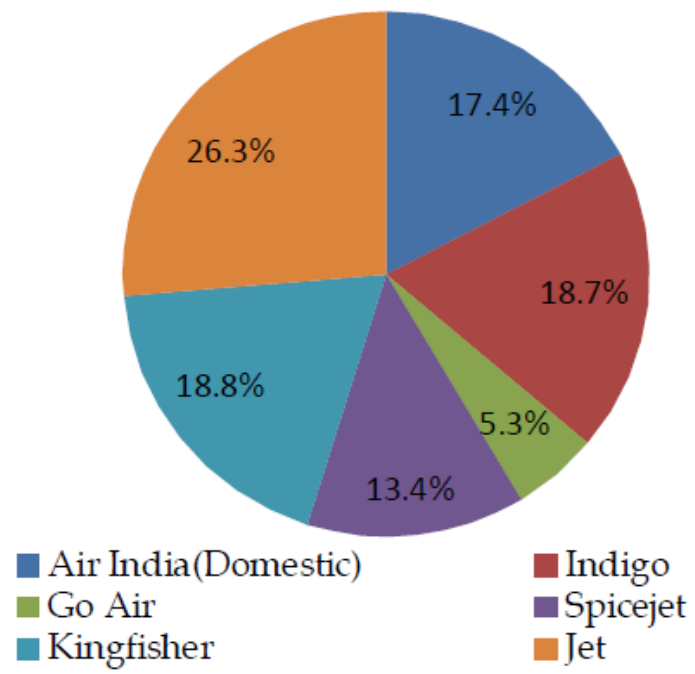
## **Airports**

- Demand
- Supply
- Level of competition & source of market power



# Market Shares

Figure 1: Market Share by Airlines



Source: DGCA

# Bringing together Demand, Supply, Competition & Regulation- Case of Indian Automobile Industry

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- What market structure best describes competition in the auto sector?
- What regulations are impacting or likely to impact the auto industry?
- What is the likely impact of regulation on BS IV vehicles- demand or supply?
- Are the car companies colluding or fighting for market share?
- What factors on the demand side are impacting the auto sector?
- What factors on the supply side are impacting the auto sector?

# Bringing together Demand, Supply, Competition & Regulation

## Case of Indian Automobile Industry

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- What is the role of overall environment?
- What is the likely impact of OLA/ Uber- in terms of demand & supply curves?
- Is entry/exit easy in the auto industry?
- Despite the slowdown in auto industry, how are companies able to launch & sell new models?
- Who is likely bearing the increase in taxes?
- What are some costs the auto industry never pays for?



# End of first half of the course

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- We switch to Macro from the next session
- And you will see fundamental tools from Micro useful at an aggregate level too