**2. According to Euromonitor International, Singapore's grocery retail market was worth S$4.3 billion in 2016, with the online grocery retail market valued at S$96 million.**

1. **Distinguish the characteristics of firms operating in oligopolistic and monopolistically- competitive markets. [10]**
2. **Discuss how increased competition in online grocery retailing would affect the survival of traditional supermarket chains like NTUC FairPrice and Cold Storage. [15]**

# Suggested Approach for Q2(a)

* *Identify the characteristics that define a market structure*
* *For each characteristic, explain how oligopolistic firms differ from monopolistically-competitive firms*
* *Illustrate with relevant examples how the two market structures differ in the characteristics*

## INTRODUCTION

The different types of market structure can be distinguished by their characteristics. The basic characteristics that are useful to distinguish the different market structures are number and size of firms, nature of product, and barriers to entry.

## BODY

1. **Barriers to entry**
   * Barriers to entry is a characteristic to distinguish between firms in the oligopolistic and monopolistically-competitive markets. While significant barriers to entry are present in oligopolistic markets, there is relative freedom of entry into and exit out of monopolistically- competitive markets.
   * In the supermarket industry, strong barriers to entry exist in the form of substantial investments in basic infrastructure (e.g. stores, distribution centres and logistics networks), access to finance (e.g. to fund advertising and promotions), business management capabilities and retail expertise (e.g. managing a chain of stores, having the expertise to manage a diverse range of employees, being nimble with strategies to compete and to grow). High fixed costs involved in running a chain of stores (rentals, wages, utilities, etc.) are a major consideration for any potential entrant into the market.
   * On the contrary, bubble tea stores are almost anywhere and everywhere in Singapore because of the relative ease of entry. Apart from a small store space, the equipment, ingredients and expertise needed to run a bubble tea store are not too difficult to acquire. This is especially so in a franchising model whereby the franchiser licenses its know-how, procedures, intellectual property, use of its business model and brand, and the rights to sell its branded products and services to a franchisee. Many entrants into the bubble tea business are either franchisees or overseas ventures of big bubble tea brands from Taiwan.

## Number and size of firms

* + Due to relatively strong barriers to entry, an oligopolistic market is dominated by a small number of large firms while a monopolistically-competitive market is characterised by a large number of small firms (but not as large a number as in perfect competition).
  + For example, traditional supermarket chains belong to an oligopolistic market structure. In Singapore, most of the supermarket stores belong to 3 major groups namely NTUC FairPrice, Dairy Farm International Holdings (DFI) and Sheng Siong. Leading grocery retailer, NTUC

FairPrice has a market share of 34% with 136 supermarket stores (FairPrice, Finest, Xtra) and 183 convenience stores (Xpress, Cheers) under its name. Meanwhile, competitor DFI has 126 supermarket stores (Cold Storage, Market Place, Jasons, Giant) and around 400 convenience stores under the 7-Eleven brand.

* + A good example of a monopolistically-competitive market structure is the bubble tea industry. These stores are easily found at every neighbourhood corner. There are chains like Koi, LiHo, Sharetea, Each A Cup and itea, sharing the market with many other Taiwanese brands like Gong Cha, Playmade, R&B Tea, Yuan Cha, Chatime and Woobbee. As recent as Jun-July 2018, we saw new openings by Taiwanese big names, i.e. Ten Ren at ChinaTown point and TP Tea with its 24-hour bubble tea shop at Changi Airport.

## Nature of product

* + We can also distinguish between oligopolistic and monopolistically-competitive firms in terms of their products. While products sold by firms in oligopolistic market structure can be either identical/homogeneous (e.g. steel) or differentiated (e.g. cars), those sold by monopolistically- competitive are generally close substitutes.
  + In our example of supermarket chains, the products sold at their stores are similar e.g. rice, sugar, washing detergent, toiletries, dried food, fresh produce. They are usually differentiated by the brand names and even then, certain brands are found in all supermarkets, e.g. Royal Umbrella rice, SPIN detergent, Scotts toilet roll, etc.
  + In the monopolistically-competitive bubble tea market, the products are similar but not identical. For instance, the drinks come in various bases such as brewed tea (black tea, red tea, green tea, oolong, etc.), milk tea, cheese tea, fruit tea and juices. There is even one which has differentiated itself with alcohol bubble tea. In terms of toppings, bubble tea competitors have gone beyond the basic bubbles (tapioca pearls – different size, colour and flavour) to a wide range including jelly, fruits, beans, pudding, jam and mochi.
  + Product differentiation in monopolistically-competitive firms is usually superficial, i.e. not significant enough to eliminate other brands as substitutes. Because the different bubble tea brands are close substitutes, they have positive and high values of cross elasticities of demand. The goods perform the same basic functions but have differences in qualities (e.g. quality of tea used), style, reputation, appearance and location to distinguish them.
  + Supermarket chains differentiate themselves in terms of branding and services rendered. For instance, DFI (so does FairPrice) has different store formats to cater to different income groups

– its Giant brand targets the lower income segment or the budget-conscious customers, Cold Storage stores target the middle to upper income group, while Market Place and Jason’s cater to the high and upper middle income customers.

## CONCLUSION

The characteristics of oligopolistic firms result in them having a relatively more price inelastic demand than firms in monopolistically-competitive markets. Differences in their characteristics in turn determine these firms’ behaviour and performance in the markets in which they operate.

# Suggested Approach for Q2(b)

* *Unpack key terms, i.e. ‘increased competition’ and ‘survival’*
* *Establish the relationship between online grocery retailers and traditional supermarket chains*
* *Explain how increased competition in online grocery retailing would affect traditional supermarket chains – both negative and positive effects*
* *Use criteria to assess the overall impact of online grocery retailing might have on traditional supermarket chains*

## INTRODUCTION

Increased competition in online grocery retailing implies that there are more online sellers of groceries (increase in supply). This in turn implies increased competition for traditional supermarket chains because of the substitutability of grocery items sold by online retailers and traditional supermarkets. How this increased competition affect the survival of traditional supermarkets would depend on how these supermarkets respond to competition in a changing retailing environment.

## BODY

**THESIS ARGUMENT: Increased competition in online grocery retailing would adversely affect the survival of traditional supermarket chains like NTUC FairPrice and Cold Storage**

* With rising popularity in online grocery retailing, traditional supermarkets could see a fall in their revenue and market share. Reasons for rising online grocery sales include the following:
  + Convenience of being able to shop anytime and anywhere
  + Less hassle shopping online, e.g. no need to deal with crowds or standing in line – what is usually purchased online is not something which is immediately needed, hence consumers are willing to wait days for their delivery rather than time queueing at supermarkets
  + Less ‘overhead expenses’ when shopping online (shopping at physical stores could involve stopping by for a meal, impulse purchases, parking fees, transportation costs, etc.)
  + Ease of online grocery shopping – not only via the computers but also phone apps as well
* With more online grocery retailers competing for the consumer dollar, there are many perks such as free shipping and free returns which further enhance perks of online shopping as mentioned above, especially for working adults who may not have the time to shop at supermarkets during weekdays.
* Due to increased competition from online grocery retailers, the market share of traditional supermarkets is likely to decline. The demand for their groceries could fall and also become more price elastic in light of close substitutes provided by online grocery retailers. Given the high fixed costs of supermarkets, and assuming no fall in average costs, any fall in revenue would therefore result in lower profits.

## COUNTER ARGUMENT: Traditional supermarket chains may continue to survive and even thrive despite competition from online grocery retailers

* All is not doom and gloom for traditional supermarkets despite increased competition in the grocery retailing market. Despite growing online grocery sales in recent years, traditional supermarkets still take up more than 90% of the market. There is still optimism that supermarkets will remain strong in the next few years. As consumers continue to make use of all grocery retail channels (modern or traditional), any grocery retailer that is able to identify areas of consumer demand will be the biggest beneficiaries – be it online or traditional stores.
* Traditional supermarkets can continue to survive amidst rising competition from online grocery retailers if they successfully carry out targeted strategies to improve their profits. These strategies can be directed at managing costs, or to sustain a strong growth in revenue.

## STRATEGIES TO REDUCE COSTS

* + Supermarkets still have the **benefits of scale** which online grocers may not enjoy. Because of the many stores in their chains, traditional supermarkets have a greater scope to enjoy economies of scale from bulk purchases, marketing and advertising, etc. They have also made efforts to reduce fixed costs, for instance having self-checkout lanes to reduce queuing time at the cashiers. Such measures save on manpower costs, which is a major fixed cost item and an item which can only see rising cost given our tight labour market. The benefits of internal economies of scale can be passed on to consumers in terms of competitive prices.
  + Supermarkets have also expanded their range of **house-brand and private-label items**. House- brand items are cheaper than other labels as supermarket chains cut down on intermediary costs and advertising. Surveys by marketing research agency, Nielsen, have shown that consumers are increasingly more receptive to house brands as supermarkets shed their image of house brands being low quality and inferior to other name labels. FairPrice and Cold Storage each has more than 2,000 house-brand items and Giant has more than 1,500. According to FairPrice, their house-brand items are priced 10-15% lower than comparable products; the sub-brands under the HouseBrand umbrella include FairPrice Housebrand, FairPrice Gold, Pasar, Home Proud and Budget. In 2017, amidst concerns that prices of infant milk formula have increased at twice the pace of median income, FairPrice launched its FairPrice Gold house-brand formula milk for children up to the age of three. Sourced from Australia, the formula milk costs only about half the price of some premium brands.

## STRATEGIES TO BOOST REVENUE

* + ***Partnerships with firms in complementary business:*** Traditional supermarkets like FairPrice, Cold Storage, Giant and Sheng Siong already offer online shopping for their groceries. If they can enhance this **online channel** to increase overall sales, they can compete better with online-only grocery retailers such as Redmart, Fresh by honestbee, Gofresh and EAMART. FairPrice has also partnered honestbee, a concierge/delivery services company for an added platform to market their products. This means that consumers can also shop for FairPrice groceries on the honestbee website. In light of growing interest in online shopping, traditional supermarkets can also strengthen their foothold in grocery retailing by **teaming up with tech giants or e-commerce firms** to explore new platforms for them to widen their consumer base.
  + ***Strengthening their foothold on food groceries:*** While online grocery shopping has gained popularity, and there are specialised online stores for meats, fishes, fruits and vegetables, consumers generally still **prefer to purchase food groceries at physical stores**. Supermarkets remain the popular choice for food groceries, especially for working adults who find it more convenient than going to the wet market during the weekend. Therefore, supermarkets should continually raise standards on freshness to ensure that consumers continue to make in-store purchases.
  + ***Improving the overall shopping experience and service quality:***
    - To entice a bigger crowd and to secure a loyal customer base, supermarkets can also improve the overall **shopping experience**. For example, they can hold events like product launches, food fairs, chef demonstrations, in-store competitions, etc.
    - Supermarkets have also introduced **other shopping perks** such as the ‘click-and-collect’ mode of shopping for consumers who prefer to save time by ordering online but still prefer to collect the purchases themselves.
    - The impact of online grocery retailing is probably felt the most in bulk purchases (e.g. packaged drinks, personal-care and home-care products) which can be heavy to lug home. Supermarkets have tried to work around this by offering free **delivery services**, or at minimal charges, for purchases above a certain amount. This helps to retain customers who prefer to shop at the physical stores.
    - Other attractions could be bundling of online-offline promotions whereby purchases made online would entitle the consumers to enjoy certain promotional offers when they make in-store purchases.

## CONCLUSION/SYNTHESIS

* The extent of supermarkets’ ability to survive depend on the success of the strategies explained above. Market research by Euromonitor International and securities firms have shown that online grocery retailers have not been able to break into the dominance of traditional supermarket chains in Singapore. While online grocery retailing has caused an impact, they are not seen to be a significant threat for the supermarkets in the next few years.

***Just for info****: Research by securities firm Maybank Kim Eng showed that growth of online grocery sales has dropped from 56% in 2016 to 35% in 2017. This was largely attributed to the slower growth in sales of RedMart, Singapore’s leading online grocery retailer. While revenues grew, RedMart also experienced rising costs (online space and tech maintenance, warehouse space, labour for logistics and delivery, advertising on multiple social media channels) and made losses in 2015 and 2017. [Statistics: warehouse space rose from 3,000 sq ft in 2011 to 150,000 sq ft in 2017; office space from 200 sq ft to 18,000 sq ft; staff strength from 3 to 1,200.]*

* While online grocery retailing appears to be still at an infancy stage and has several obstacles to overcome, it certainly has the potential to be a more popular channel in the future. Therefore, traditional supermarket chains should not be complacent but take this transition period as an opportunity to adapt to evolving consumer behaviour.
* Shopping remains very convenient in Singapore, with the proliferation of HDB and mall supermarkets. Although housing estates are densely packed, last-mile logistics is expensive and reducing delivery cost is key to profitable last-mile fulfilment *(note: last mile is the last leg of the delivery process from the distribution centre to the end user)*. Traditional supermarkets can take advantage of this (which is a big cost concern to online grocery retailers) to grow their scale further in order to improve efficiency in their operations, and hence improving profit margins.
* The modern grocery retail market is dynamic. Consumers’ needs are frequently changing, especially in light of a globalised world where increased physical and virtual connectivity allow firms the opportunities to meet consumers’ expectations and stay ahead of the competition. Against this backdrop, traditional supermarkets must continue to look for innovative ways to thrive. One possible path is for the traditional and online channels to converge, i.e. going the omni-channel route, a type of retailing which integrated the different methods of shopping available to consumers.

# Essay Question 2

# Many firms have been aggressively expanding overseas. This expansion not only involves selling products in new markets, but also includes offshoring their production. Such expansion has not been welcomed by domestic firms in these overseas markets.

1. **Explain why domestic firms might fear such expansion by foreign firms. [10]**

# Discuss the view that the best strategy for domestic firms to respond to increased competition from foreign firms is to cultivate brand loyalty. [15]

Introduction

As mentioned in the preamble, many firms have been expanding overseas and this has caused tremendous issues for domestic firms. These either involve a fall in revenue or an increase in costs of production, which has negatively affected the profits of domestic firms.

# Fall in profits due to fall in total revenue

1. With the expansion of foreign firms into domestic markets, this has resulted in a fall in demand for the goods and services produced by domestic firms. For example, the entry of Taobao (via both Lazada as well as the Taobao platform) into the Singapore market for electronics has resulted in many consumers who previously purchased from domestic firms such as Courts, to **switch towards purchasing from these foreign substitutes**. The fall in demand has led to a fall in total revenue for domestic firms, resulting in a fall in profits.
2. Many of these foreign competitors are also producing at a much larger scale as they cater a bigger market in their own countries. Thus, many of the foreign competitors are able to enjoy economics of scale which cannot be enjoyed by relatively domestic firms in countries such as Singapore. The ability to produce at a lower average cost than their domestic rivals has allowed these **foreign firms to better engage in price competition** due to their cost advantage to chase out these domestic rivals from the market. This can be done by setting a price below the average cost of the domestic firm but yet higher than the average cost of the foreign firm, allowing the foreign firm to continue making supernormal profits. For example, the initial entry of Chinese bike sharing companies, such as Ofo and Mobike, has driven domestic firms such as Obike to such down, as they are unable to compete with the prices offered by Ofo and Mobike.The entry of foreign firms also increases the number of substitutes available to domestic consumers. Thus, the **demand for a domestic firm’s goods/services will become more price elastic**. This means that should that be an increase in cost, for example due to increase in rent or labour costs, the domestic firm will be **less able to pass on the cost increase** by raising prices as this will result in a more than proportionate fall in quantity demanded, and a fall in total revenue.

# Fall in profits due to increase in costs of production

1. As stated in the preamble, foreign firms have also been offshoring their production overseas. For example, Apple has offshore production of some components of iPhones to countries such as China and Taiwan. Such actions by foreign firms will drive up the demand for factors of production, such as land and labour, in these countries, and results in an **increase in costs of production in the form of higher wages and rent**. This has reduced the profits that can be earned by domestic firms, who may not even be selling the same goods and services as these foreign firms, but uses the same factors of production.
2. For domestic firms who are in direct competition with these foreign firms, the fall in demand as explained earlier, will result in a fall in the scale of production. This will **reduce the ability of domestic firms to exploit internal economies of scale** and results in an increase in average cost of production. Thus, profits will fall.

In conclusion, domestic firms fear expansion by foreign firms as they are likely to bring about a fall in revenue as well as increased costs**.**

# Suggested Answer for Part b

In view of the expansion by foreign firms as explained above, domestic firms can respond by building brand loyalty or by other means.

# Thesis: Building brand loyalty can help domestic firms respond to increased competition from foreign firms

**How building brand loyalty works:**

Domestic firms can build brand loyalty through generating actual or perceived differences. For example, domestic firms can engage in advertising campaigns to market the superior quality of its products to those produced by foreign firms. For example, domestic Singapore banks such as DBS, OCBC and UOB still maintain a strong brand loyalty among local consumers as their historical performance have been more stable, as compared to foreign banks which have generally taken a greater blow during the 2008 Global Financial Crisis. **Developing a strong brand loyalty will reduce the degree of substitutability and cross price-elasticity of demand (XED)** the domestic firms’ products with respective to the foreign substitutes.

First, this will mean **a smaller fall in demand** due to the entry of foreign firms, as consumers are less likely to switch their consumption patterns due to the strong brand loyalty.

Second, reducing the XED value will also make the domestic firm less susceptible to the foreign firm’s pricing strategy, since a fall in price of the foreign firm’s products will only result **in a less than proportionate fall in demand.** Thus, profits will only be reduced to a smaller extent.

# Anti-Thesis (1): Building brand loyalty has its limitation in helping domestic firms respond to increased competition from foreign firms

1. **Building brand loyalty takes time.** In today’s globalised world, the entry of foreign firms into different markets is happening rapidly. It is almost impossible for any domestic firms to have sufficient time to build brand loyalty, especially for newer domestic firms. Even though building brand loyalty can help to address the issue, it often takes too long to be effective.
2. **Building brand loyalty involves costs.** Marketing and advertising involves large costs, especially when competing against the marketing and appeal of global giant firms. Thus, engaging in efforts to build brand loyalty may result in a greater fall in profits.
3. **Building brand loyalty does not address the increase in costs of production that comes about from increased foreign competition.** As explained in part (a), the entry of new firms can bring about an increase in costs of production as they are competing for the same FOPs.

# Anti-Thesis (2): Other strategies may be better in helping domestic firms respond to increased competition from foreign firms

1. **Mergers with other domestic firms.** For domestic firms operating in smaller consumer markets such as Singapore, they are unlikely to be able to enjoy the same level of EOS as larger foreign competitors. Thus, one possible strategy to address this issue is for the smaller domestic firms to **merge so that they are able to enjoy cost savings from the ability to enjoy economies of scale**. This will enable these domestic firms to better engage in price competition with these foreign firms.
2. **Expansion overseas.** Another way to respond to the entry of foreign firms is for domestic firms to expand overseas instead. This is especially so if the domestic firms see that prolonged competition (both price and non-price) with foreign firms will result in large costs being incurred and profits being negatively affected. Thus, expansion overseas will allow domestic firms to **generate revenue that could mitigate the loss of revenue from the entry of foreign firms**. For example, as the financial sector gets more saturated in Singapore, domestic banks have started to expand overseas, especially in fast developing countries such as China and Vietnam.
3. **Limit Pricing.** For domestic firms in bigger countries, such as US and China, with a large consumer market, they are likely to be able to enjoy EOS to a greater extent. For these firms, they are able **to set limit pricing (pricing below the profit maximizing price) in order to deter foreign firms** from entering the domestic market. Such actions might send the signal to foreign firms that domestic firms are willing to reduce price and endure subnormal profits in the short run if these foreign firms enter the market.

# Evaluation

* Which strategy is the best will depend on the market in question. For example, in markets where the domestic firms is already well established, building on its brand to develop consumer brand loyalty is a viable strategy since the marginal costs of doing so is relatively low.
* However, in markets where the domestic firms are either relatively small and not well established, it is unlikely that developing brand loyalty will help a firm to deal with increasing foreign competition in the short run. In these cases, mergers of these domestic firms will likely be a more effective strategy. Such mergers will also allow the domestic firms to possibly expand overseas.

**Essay Question 3**

**Industries, from transport to retail, are being disrupted by new technologies and digital applications. Digital entrants are challenging the incumbents and threatening their bottom lines.**

1. **Explain how advancement in technology may affect a firm’s profits. [10]**
2. **Discuss the extent to which the behaviour of firms is affected by contestability of market.**

[15]