# Question 3

The economic downturn has forced many food and beverage outlets to compete more aggressively as customer tighten their belts. The Hard Rock Café is usually advertising a recession menu – two set lunches for the price of $12.80 for the price of one – on Mondays to Tuesdays. Even hawker stalls and coffee shops, stalwarts of good, cheap fare, have had to shave up to $1 off to $3.50 meal.

(The Strait Times, 21 Aug 2001)

b) Discuss the relevance of these concepts in explaining the aggressive competition among food and beverage outlets.

aggressive competition – decrease price

**Introduction**

Definition of PED, XED and YED

Requirement of the question – state that these concepts can be used to explain why the hawkers decrease price so as to increase their total revenue.

Main body

**1) Explain why the hawkers and hard rock café will decrease price based on the concept of PED.**

* **The hawkers and hard rocks are decreasing price as they know that their market demand is price-elastic which will increase their total revenue.**
* **Economic causation – gain in revenue due to increase in quantity demand is greater than the loss in revenue due to decrease in price.**
* **Draw diagram**
* **Description of diagram -**
* **Explain why the PED is price elastic?**
* **Presence of many substitutes – the meal is very easily produced by the producers – not much knowledge is needed – low barriers to entry – presence of many hawkers and restaurants**
* **Low degree of necessity – can consume goods at different places – most stalls fail to create consumer loyalty – consumes are willing to switch to other choices when there is a decrease in price**
* **Time period for consideration of purchase is not short because consumers plan for their consumption of food**

**As seen from the diagram, the decrease in price of the food from Po to P1 will lead to a more proportional increase in quantity demanded for food as the demand curve is price elastic. This will cause a gain in revenue due to increase in quantity demanded greater than the loss in revenue due to decrease in price. Consequently, the total revenue for food will increase when price decreases when the demand for food is price elastic.**

**2) Explain why the hawkers and hard rock café will decrease price based on the concept of XED.**

The value of XED is positive and large, implying that there is a high degree of competition – high degree of substitution

The hawkers and hard rock café will have to decrease price to minimize the loss of customers seen in terms of decrease in market demand

Why XED is large and positive?

* Low barriers to entry – low skills required/ very easily emulated by the competitors – many substitutes (market is broadly defined)
* Highly competitive market – recession – low market demand for meals

**EVALUATE THE SUBSTITUTABILITY OF HAWKERS AND HARD ROCK cheaper to replace hard rock with hawker food**

**3) Explain why the hawkers and hard rock café will decrease price based on the concept of YED.**

The value of YED is positive for hard rock café but may be negative for hawker food as the proportion of income spent for the hard rock café is large while the proportion of income spent on the hawker stalls is small.

**Economic recession** – reduce disposable income for the consumers of hard rock café – proportion of income spent on the good is larger – become more price sensitive

**Decrease price will raise their purchasing power** – decrease price sensitivity – proportion of income spent on consumer can become smaller – increase their demand

**For hawker stall owners, the recession will lead to rise in demand for their goods as they are mainly classified as inferior goods for most consumers – there is a less need for them to decrease price as the consumers are price insensitive to their demand.**

**Why these concepts of elasticity of demand is not relevant in explaining the aggressive competition?**

* Used to explain why concepts of elasticity are irrelevant
* Magnitude of the value of PED and PES will vary as time span is longer
* Ceteris paribus condition is not possible in reality, and thus, the complexity of the economic environment will affect the value PED and PES simultaneously
* Social variables will distort the implication of the value of PED as the consumer with similar proportion of income spent on a good will have different response to change in quantity demanded because of their family background
* Concepts of elasticity cannot account for social variables which will distort the value (e.g. marriage status will distort price sensitivity), as concept of elasticity of dd/ss is an economics concept