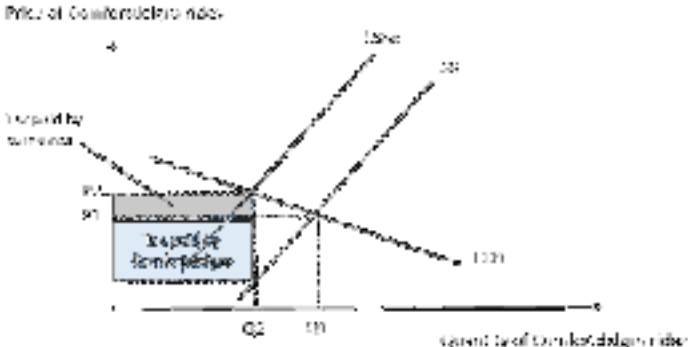


H2 P1 CSQ 1

Suggested Answers

(a)	Compare the changes in the motor vehicle population between taxis and rental cars from 2010 to 2016.	[2]
	Similarity: The motor vehicle population for both taxis and rental cars increased from 2010 to 2016. Difference: The motor vehicle population for rental cars increased at a faster rate as compared to that of taxis.	
	With reference to Extract 3,	
(b) (i)	Deduce the value of the cross elasticity of demand between Uber and Grab.	[2]
	Extract 3 states that “riders can easily flip between the apps”, indicating that they are close substitutes. Therefore the value of the cross elasticity of demand between Uber and Grab is positive and of a high magnitude ($EAB > 1$) due to the high degree of substitutability between the ride-hailing services that the 2 firms offer. If the price of Grab rides rise, the demand for Uber rides would rise more than proportionately.	
(b) (ii)	Explain how Grab’s plan to introduce new features may change the value of the cross elasticity of demand between Uber and Grab.	[2]
	Extract 3 states that Grab is “planning to introduce new features...which are intended to encourage safer driving behaviour.” Grab’s new features would cause the degree of substitutability between Grab and Uber to be reduced as consumers see Grab as a safer option as compared to Uber. This would cause the value of the cross elasticity of demand between Uber and Grab to be reduced but still be a positive value.	
(c)	With the aid of a diagram, explain whether ComfortDelGro or its consumers will bear more of the burden that arises from the introduction of the diesel tax.	[3]

	 <p>The introduction of the diesel tax will increase the cost of production for Comfortdelgro, reducing profit levels and causing supply curve to shift leftwards from SS to SS_{tax}.</p> <p>Demand for Comfortdelgro rides is relatively more price elastic compared to that of supply due to the availability of substitutes such as Uber services.</p> <p>Comfortdelgro has to bear a greater tax burden. (as shown by the larger area showing tax paid by Comfortdelgro)</p>	
(d)	Explain how inefficiency is worsened if Uber is successful in “eliminating the competition”.	[3]
	<p>If Uber is successful in “eliminating the competition”, this will increase its share of the market and increase its market power, bringing about greater market dominance, and causing a worsening of allocative inefficiency.</p> <p>With greater market power, Uber will be able to charge prices much higher than MC. Price will be more than marginal cost to a greater extent than before the competition was eliminated.</p> <p>There would be a rise in allocative inefficiency.</p>	
(e)	Discuss whether the entry of Uber will necessarily lower ComfortDelgro’s profits.	[8]
	<p>Introduction</p> <p>Profits consists of total revenue minus total cost. Therefore how ComfortDelgro’s profits are affected will depend on the effect of Uber’s entry on ComfortDelgro’s cost and revenue.</p> <p>Thesis: The entry of Uber would lower Comfortdegro’s profits</p>	

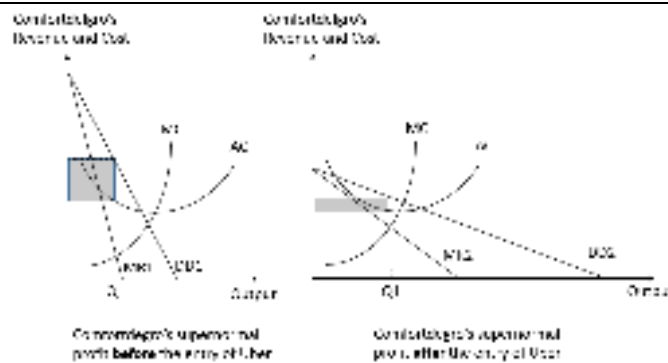


Figure 1

Figure 2

Due to Uber's entry, demand for Comfortdelgro's services becomes more price elastic due to an increase in the availability of substitutes that consumers have when deciding on which transport provider to use.

The slope of the demand curve changes from DD1 to DD2. Assuming that cost conditions for Comfortdelgro remains the same, supernormal profits have fallen as shown by the smaller shaded area as seen in Figure 2.

Antithesis: The entry of Uber would not necessarily lower Comfortdelgro's profits.

[students are expected to write any 2 anti thesis points]

As seen in extract 1, Comfortdelgro has taken steps to address the competition from Uber.

Comfortdelgro has introduced CabRewards, where points earned can be used to redeem a variety of rewards, such as taxi vouchers or free transfers to the airport. This could change the preferences of consumers to choose Comfortdelgro and lead to an increase in demand for their services. Total revenue would increase.

Comfortdelgro also started its flat taxi-fare option, "which costs slightly less in general compared with metered trips or those booked on ride-hailing apps." This would effectively be a fall in price of Comfortdelgro rides if consumers use this option. With demand being price elastic due to high availability of substitutes, the fall in price would lead to a more than proportionate rise in quantity demanded. Total revenue would rise.

Furthermore, a reduction in Comfortdelgro's fleet will also reduce its cost of production. For example, there would be less cost incurred due to vehicle maintenance and fuel.

A rise in total revenue and a fall in cost of production due to Comfortdelgro's strategies could indicate that the entry of Uber will not necessarily lower ComfortDelgro's profits.

	<p>Conclusion</p> <p>The extent to which Uber's entry affects ComfortDelgro's profits will depend on several factors such as the time period. If Uber is unable to continue offering incentives to consumers if its funds are used up in the long run, ComfortDelgro may then be able to gain back market share and increase revenue and profit.</p> <p>Mark Scheme</p> <table border="1"> <tr> <th>Level</th><th>Descriptor</th><th>Marks</th></tr> <tr> <td>L2</td><td>For a response that addresses both how profit may or may not be affected.</td><td>4-6</td></tr> <tr> <td>L1</td><td>For a one-sided response For a response that lacks rigour</td><td>1-3</td></tr> <tr> <td>E</td><td>For a stand with justification</td><td>1-2</td></tr> </table>	Level	Descriptor	Marks	L2	For a response that addresses both how profit may or may not be affected.	4-6	L1	For a one-sided response For a response that lacks rigour	1-3	E	For a stand with justification	1-2	
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(f)	Discuss the factors that Uber would consider when deciding on its strategies to compete with its rivals.	[10]												
	<p>[students need to explain at least 3 factors]</p> <p>Introduction</p> <p>There are several factors that a firm would consider when deciding on its strategies to compete with its rivals. The strategies would involve pricing and non-price behaviour.</p> <p>Factors that Uber would consider:</p> <p>1. Amount of funds available [constraint]</p> <p>If a firm has a large amount of funds, it will be better able to make use of strategies such as engaging in a price war. The objective would be to compete via price competition in order to drive out its competitor from the market. Thereafter the firm would gain a larger market share and would be able to charge higher prices. Having more funds than the competitor would allow it to sustain the price war for a longer period as losses would be expected in the short run. Extract 3 states that Uber has between \$6.5bn and \$7bn of unrestricted cash in the bank. This availability of these funds would allow Uber to decide on whether or not to engage in a price war, which it did as shown in Extract 2.</p> <p>2. The objectives of the firm</p> <p>There can be various objectives of a firm. For example, Extract 2 mentions that Uber is a "high-revenue growth company" which may indicate that its objective is to maximise revenue, rather than profit. Since their objective is to maximise revenue, they would produce up to the point where $MR=0$. This would mean that their pricing would be</p>													

lower than if their objective was profit maximisation where $MC=MR$ and price would then be set higher.

3. The cost considerations

One of the factors that the firm would consider when deciding its strategy is how the strategy would affect its costs. For example, the firm would be willing to engage in a price war in order to gain market share as this would give it a larger output and thus help the firm achieve internal economies of scale, lowering average cost of production. Extract 2 states that “as revenues grow economies of scale will kick in”. Thus they would be more willing to engage in a price war even though it results in losses in the short run. Examples of internal EOS include managerial EOS, where specialists can be employed to manage the firm. In other words, division of labour can be introduced into tasks of management. Different experts can be employed to take charge of planning, accounting, sales promotion and personnel management. Extract 3 states that “as Uber grows, the overhead becomes less expensive on a per-ride basis.”

Evaluation: However the extract also states that “that story is tough to tell with Uber” which may indicate that the firm is not able to gain the economies of scale that it expects. One other outcome could be that instead of gaining EOS, Uber has diseconomies of scale instead.

4. Actions of competitors

Uber needs to consider the actions of its competitors such as Grab or ComfortDelgro. In such an oligopolistic market, firms such as Uber and Grab are highly rival, conscious and mutually interdependent. Extract 3 states that Grab is planning to introduce new features such as more sophisticated technology to improve safety. In order to remain competitive, Uber would also therefore need to respond by engaging in research and development in order to improve the quality of its services.

Conclusion

Uber has to consider the various factors in order to decide on its strategies. As there could be a limit to the amount of funds Uber has as well as a limit to how much EOS can be gained, the best way that Uber can compete against its rivals would then be to focus on research and development so as to increasingly differentiate its services and therefore be less vulnerable to the actions of competitors.

Mark Scheme

Level	Descriptor	Marks
L2	For a range of factors that are well developed	5-7
L1	Limited number of factors considered Factors not fully explained	1-4
E	For a reasoned judgement	1-3

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