**Week 6 Instructions**

**Revise** your Week 3 economic analysis (*see below*). Using the feedback provided by your facilitator to evaluate the challenges of expanding your company's production to a foreign market. This will require you to revise previously recommended pricing and non-pricing strategies for your company's product based on the selected country's economy's stage in the business cycle and the projected economic conditions. Discuss the evidence that supports your recommendations.

**Select** a foreign market in which to expand your chosen product.

**Write**a 1,750-word paper (including any material you include from your Week 3 assignment – *see below*) detailing your findings. The use of tables and/or charts to display economic data over the time period discussed is highly encouraged.

* Describe current global economic conditions and their effect on local macroeconomic indicators in your selected country. Consider forecasts for population growth, GDP growth, GDP per capita growth, export growth, and sales growth.
* Evaluate the competitors' existing production in the chosen country.
* Evaluate forecast sales in the selected country.
* Determine the type of economy that exists in your selected country - closed, mixed, or market.  What is the difference between these types of economies and how might this affect your expansion?
* Describe how your chosen country's current credit market conditions affect demand for your product or service and your planning or operating decision for your production in that country.
* Analyze the role of the selected country's central bank on that country's economy.
* Evaluate the availability, education, and job skills of the work force in the selected country. Discuss the additional challenges of international production, such as political stability, availability of government financing or other incentives, threat of capital controls, and exchange rate risks.
* Discuss any additional supply chain challenges you anticipate if attempting to sell your product made in your chosen country to countries outside of that market.
* Discuss any comparative advantages your company will have over competitors in that country.
* Recommend either for or against expanding your company's production into your chosen country based on your research.

**Cite**a minimum of three peer reviewed sources not including the textbook.

**Format**your assignment consistent with APA guidelines

**Websites to use:**

 <https://www.wto.org/english/news_e/archive_e/stat_arc_e.htm>

<http://www.worldbank.org/en/publication/global-economic-prospects>

<http://www.worldbank.org/en/publication/global-economic-prospects/summary-table>

<http://datatopics.worldbank.org/hnp/popestimates>

<http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>

# Week 3: Market Structure and Pricing Power

# Student

# ECO/561

April 18, 2016

Dr. M.T.

This is the feedback I received from the professor regarding my assignment:

*Very good paper - probably one of the best in the class. I loved that you performed extensive quantitative analysis of demand and pricing. Students tend to only perform qualitative analysis on this paper, which is a mistake - so well done.*

I have always been interested in the automobile industry and love the look, smell, and feel of new cars. Therefore, the industry I selected to investigate is the automobile industry (luxury car/economy car). The auto industry is an oligopoly in which firms try to minimize the effects of price-based competition. The automakers have realized that price-based competition does not lead to increases in the size of the marketplace. In the past, car makers have tried to avoid price-based competition, but recently, the competition has intensified. Price competition takes place in the form of rebates, preferred financing, and long-term warranties (Pinske, Bohnsack, & Kolk, 2014). The impact is that the profit margins of auto companies have suffered.

**Economy Cars**

The elasticity of demand for economy cars is high. The customers are likely to switch brands if the prices are greater than those of the competitors. The elasticity of demand for economy vehicles can be seen from the prices of cars. The Chevrolet Spark LS is priced at $12,890, Nissan Versa is $12,800, Mitsubishi Mirage DE is $13,790, Kia Rio LX is $14,700, Ford Fiesta S $14,650, Chevrolet Sonic LS is $14,990. The low range in which economy cars are priced shows that in the economy car segment, the elasticity of demand is high. Even in this range there is some differentiation such as the miles per gallon each car achieves.

**Luxury Cars**

In comparison to the economy car segment is the luxury car segment. The elasticity of demand for luxury cars is low. The prices of cars in this division are as follows: P1 made by McLaren is priced at $1,155,000, 918, Spyder built by Porche is priced at $929,995, Wraith from Rolls-Royce has a price of $298,225, FF from Ferrari has a price of $302,450, Phantom from Rolls-Royce is $485,275, and Aventador from Lamborghini is approximately $555,795.

**Elasticity of Demand - Price Analysis**

The analysis of the prices in the two segments shows that in the luxury car segment there are large differences in prices. This analysis indicates that the elasticity of demand in this sector is very low. It can be estimated to be 0.2. In this segment, there are a limited number of cars produced, and they have such features that attract customers who want to buy them at any cost. Also, in this segment, the price of the vehicle does not matter to those making the purchase. Luxury car owners are concerned with the exclusive features of the car. For example, in 2015 Porche only produced 918 of the model 918 Spyder of which only 250 were sold in the U.S. market. The exclusiveness of the car has a unique appeal in the luxury car segment.

In contrast to the luxury car segment, the elasticity of demand in the economy car segment is high. It is estimated to be 3. Inflation in price must be backed by an increase in fuel economy; otherwise, the vehicle will not sell. In the auto industry, if a car is not appropriately priced, the car fails. An example of this is the Cadillac ELR which was priced at $75,000; it was not appropriately priced. The price of $75,000 was perceived to be very high for the ELR, which is in the hybrid car segment resulting in the car not meeting Cadillac’s expecting sales figures.

Cars in the mid-price range consist of some hybrid cars such as the Ford Fusion priced at $25,650, Chevrolet Spark EV at $25,179, Honda Civic Hybrid at $24,735, and the Toyota Prius at $24,200. This segment indicates that the elasticity of demand is high. The elasticity is estimated to be 2. The cars manufactured by different companies have different features, designs, and interiors but are priced close to one another. This differentiation indicates intense price competition. The companies may try and differentiate their vehicles a little, but the prices are close to those of competitors (Rubenstein, 2001). In other words, the demand curve in this segment is close to being horizontal. The following are examples in this price segment - Ford C-Max Hybrid priced at $24,170, Mitsubishi i-MiEV at $22,995, and Honda CR-Z $20,145. These prices also indicate that there is intense price competition in this sector. The high elasticity of demand, also explains why the Cadillac ELR priced at $75,000 failed.

When the price elasticity is high, most car makers are price takers. They cannot individually influence the price in the market. They separate their products to a limited extent, and this explains some price differences. For example, Toyota Prius C was priced at $19,540 in 2015 whereas Kia Optima Hybrid was priced at $25,990. One may say that in these segments there is an element of monopolistic competition. Monopolistic competition is a type of imperfect competition in which many producers sell products that are differentiated from one another. For instance, there are some differences between Kia Optima Hybrid and Toyota Prius C. In monopolistic competition; cars are distinguished from one another so that each car is not a perfect substitute for the other. In this situation, the competitors take the price charged by competitors as given and ignore the impact of its prices on the prices of other firms. Unlike perfect competition, the firms have spare capacity. Car manufacturing companies have extra capacity. The auto industry elasticity is affected by the availability of substitutes. There is a variety of cars available in the economy segment. Further, substitution can also take place when people take a bus, train, or airplane instead of taking a car.

**Key Impacts**

One of the key impacts on the auto market is the effect of oil prices. In June 2014, the global oil price was $103 per barrel. The price plummeted to less than $28 per barrel in February 2016. The change in gasoline prices affects the type of cars purchased. When oil prices are low, customers buy more large vehicles like trucks and sport utility vehicles. The point is that there is a high cross-elasticity between the price of gasoline and the auto industry. When the price of oil increases, there is a higher demand for fuel efficient cars. Furthermore, the income elasticity in the auto industry is also high and has a critical impact on the market. When the incomes of consumers increase, they tend to buy more hybrid, electric, or environment-friendly cars. When incomes decrease, auto-buying customers tend to buy low priced, fuel efficient vehicles. The impact of income elasticity was observed during the recent recession when the demand for low priced and highly fuel efficient vehicles remained high, but the demand for environment-friendly vehicles did not increase.

**Pricing Decisions**

Pricing decisions affect the volume of cars produced. Higher volumes lead to lower marginal costs and higher market share. The point is that with an increase in volume, the company can offer more competitive prices. Even though the marginal revenue decreases, the market share and production volume increase. The example is that of Toyota Prius C that was priced at $19,650 in 2015. Prius has been able to achieve economies of scale, its marginal costs have declined, and its market share has increased.

Below is an example of a cost/revenue schedule for a mid-price range vehicle.



By lowering the price of the Prius, it has been able to capture a larger share of the market. The following graph demonstrates how demand shifts based on the pricing set for a vehicle.



**Price of automobile**

**Product Differentiation**

Adding features, improving fuel efficiency, and improving the design of the vehicle all effect product differentiation in the auto industry (Freedman, 2010). Market segments in the auto industry are well defined, and each segment has a distinct price band in which all are successfully selling cars. The auto industry is highly competitive. In the past, there was the Big Three oligopoly but with the entry of Honda and other foreign companies, every segment has several competitors. The foreign companies use technology and innovation to differentiate their cars and increase their market share.

**Non-Pricing Strategies**

Other alternative non-pricing strategies can be used to increase barriers to entry such as heavy investment of capital, the use of technology, management skills, as well as complying with consumer trends and tastes. Consumer sales are the largest source of revenue for most car makers. In addition, access to large distribution centers and large advertising expenditures building up brand recognition are non-pricing strategies that can be used. When Honda and Toyota opened their factories in the U.S., the first aspect that had an impact on pricing was the fact that both these foreign companies had relatively low fixed costs. They did not employ large workforces like The Big Three manufacturers. They were not tied down by union agreements that required them to pay large fixed sums at regular intervals. The low fixed costs made the foreign companies very flexible. They could change their production plan in response to shifts in the marketplace. This flexibility helped them price their cars low and in turn, they captured a sizeable portion of the U.S. market. Low fixed costs have been the key to success in the auto markets.

**Conclusion**

In summary, as an oligopoly, the auto manufacturing companies earn low returns due to extraordinary competition. Automakers understand that price-based competition does not inherently result in increases in the extent of the marketplace. In the past, automakers have tried to circumvent price-based competition, but recently the competition has grown through the use of rebates, preferred financing, and long-term warranties. Automobiles have an overwhelming effect on our everyday lives. For this reason, automakers must take consumer confidence into account to ensure long-term success.

References

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