Economics 380: Midterm Solutions 1

12 October, 2005

1. “Five” forces analysis of Hewlett Packard. Since HP is a diverse firm, we have to choose a market. I’ll consider the market for imaging.

(a) Substitutes. Inside the market: other printer firms, such as Lexmark and Dell. Outside the market: monitors one can write on, email (you no longer have to print forms and post them).

(b) Buyers. Firms and individuals. Individuals have little bargaining power; large firms are in a much better position.

(c) Suppliers. Components that go into a printer. Delivery firms. With a few exceptions, I would imagine these have little bargaining power.

(d) Rivals. Lexmark and Dell. HP makes a lot of money on cartridge refills, so they also have to worry about other suppliers in their market.

(e) Entrants. Entrants are more likely in the cartridge refill market, since margins are high and entry costs relatively low. HP should also look out for Asian firms. It is probably a question of time before the printer becomes a commodity, like the PC.

(f) Compliments. Compliments to the actual printer include a computer, paper, and refills.

2. This is a form of second-degree discrimination between agents since supermarkets are providing a better service to people who buy fewer items. Likely reasons:

(i) Customers with few items are often in a rush and so more sensitive to queue length than customers doing their weekly shopping.

(ii) This strategy also enables supermarkets to eat into the corner store market.

One drawback is that people sometimes buy fewer products than they would have otherwise.

3. Gap and Banana Republic.

(a) Both horizontal and vertical elements. With shirts, Banana Republic is higher quality than Gap. However, many students would never wear these clothes.

(b) Some considerations:

(i) If they merged the products, they would lose customers at the extremes (e.g. business men and some students), but may attract some more customers from the middle (e.g. families).

(ii) This shift will also put the combined firm into closer competition against department stores, but also create room for entry in the extremes.

(ii) The joint shop may be worse than the sum of its parts since customers could no longer guarantee a certain style. For example, Banana Republic thrives on men who trust the shop’s taste, knowing everything looks reasonable together. On the other hand, if the shop size rises,
the combined shop may be able to compete with larger department stores. (Although this isn’t such a great strategy these days).

4. Training courses:
(i) Acmesoft. Since Acme is the only firm who uses this programme the investment is specific and employees will underinvest. Having Acme pay for part of the investment will encourage investment.
(ii) Excel. Since Excel is used by all firms, the investment is general and the employee will capture all the gains from learning this programme.