Moderated
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DJV02

KENYATTA UNIVERSITY

DEPARTMENT OF APPLIED ECONOMICS

DIGITAL SCHOOL OF VIRTUAL AND OPEN LEARNING

EAE 408: ECONOMICS OF INDUSTRY

SEMESTER II 2019/2020

DATE: **TIME: 2** Hours

INSTRUCTIONS

1) **Answer question one and any other two questions**
2) **Question one is compulsory and carries 30 marks**
3) **All other questions carry 20 marks each**

Question One

a) Briefly discuss the following terms as they are used in industrial organization:
   i. Market power **(4Marks)**
   ii. Market conduct **(3 Marks)**
   iii. Market performance **(3 Marks)**

b) Airtel formally known as Kencell was the first entrant into the telecommunication industry. Explain some of the strategies it would have employed to block the entry of the rivals in Industry ~~business~~ **(8 Marks)**

c) List and explain the broad categories of industrial economics **(4 Marks)**

d) Motives for product diversification depend on the type of product. Explain the motives for:
   i) Conglomerate diversification **(4 Marks)**
   ii) Lateral diversification **(4 Marks)**

Question Two

Suppose a contract pay a hospital manager *Wp* when hospital is profitable and *Wu* when hospital is unprofitable. Effort of the manager is unobservable but profitability is a signal used to incentivize the manager to put high effort. For a high effort manager the expected utility is greater or equal to 10 units. The manager by putting high efforts get paid *Wp* with probability 0.8 if hospital is profitable and is paid *Wu* with probability 0.2 if hospital is unprofitable. Further, if manager puts low effort the hospital profitability changes to 0.4 if hospital is profitable and 0.6 if hospital is unprofitable. The hospital owner is interested in a contract such that the manager puts high effort. The cost to hospital manager for high effort is 2 and for low effort is zero.

Required

How much should ~~he pay~~ be paid the manager for high effort and for low effort. Show all your workings **(20 marks)**

Question Three

a) The daily newspaper market in Kenya is mainly dominated by the Daily Nation, The Standard Daily, The Star, People Daily, Citizen.
   i. Using Bain's arguments explain the specific features of Kenya's daily newspaper type of market structure **(5 Marks).**
   ii. Explain why it is important for the companies producing the above daily newspapers to define their market **(5 Marks).**

b) Using a graphical approach of a Kinked demand curve, clearly explain an oligopolistic market behavior **(10 Marks)**

Question Four

a) Market concentration and concentration curve are the two main approaches of measuring merger. Hannah and Kay offer general conditions or requirements which should be satisfied by indexes if proper conclusions are to be arrived at. Briefly explain these conditions **(10 Marks)**

b) In the recent past in Kenya there has been a rising trend of firms spreading their operations of business over dissimilar economic activities, explain the reasons for this and give examples of such firms in Kenya with the dissimilar goods and services **(10 Marks)**

Question Five

(a) Explain the following terms as used in diversification approach to measurement of market structure
   (i) Counting
   (ii) Government Index
   (iii) Berry's Index **(3 marks)**

(b) Let the total market supply for the product be specified as Q units and let the demand function be

$$P = F(Q) = F(Q_1 + Q_2 + \ldots + Q_i + \ldots + Q_n)$$

Where P is price of product, Q_i is output of the i-th firm

(i) Give the expression of revenue for firm i **(2 marks)**

(ii) Assume a uniform price for the industry, which changes if, output of any big firm changes. Also define the market quantity of elasticity of demand (ε_q) as a percentage change in market price with amarginal per cent change in market quantity supplied. Derive the Hirshman-Herfindal index of concentration **(10 marks)**

(iii) How will you decide which industry is more concentrated than the other **(5 marks)**