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Original origami artwork: Mark Bolitho
Origami photography: Pearson Education Ltd / Naki Kouyioumtzis

ISBN 978 1 446 91442 7
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8 Paper 3: The economic environment and business 

9 Paper 3 Mark Scheme 

10 Paper 3 Mark Scheme
Introduction

The Pearson Edexcel Level 3 Advanced GCE in Economics B is designed for use in schools and colleges. It is part of a suite of GCE qualifications offered by Pearson. These sample assessment materials have been developed to support this qualification and will be used as the benchmark to develop the assessment students will take.
General marking guidance

• All candidates must receive the same treatment. Examiners must mark the last candidate in exactly the same way as they mark the first.
• Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than be penalised for omissions.
• Examiners should mark according to the mark scheme – not according to their perception of where the grade boundaries may lie.
• All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate’s response is not worthy of credit according to the mark scheme.
• Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification/indicative content will not be exhaustive.
• When examiners are in doubt regarding the application of the mark scheme to a candidate’s response, a senior examiner must be consulted before a mark is given.
• Crossed-out work should be marked unless the candidate has replaced it with an alternative response.
Instructions

- Use black ink or ball-point pen.
- Fill in the boxes at the top of this page with your name, centre number and candidate number.
- Answer all questions.
- Answer the questions in the spaces provided – there may be more space than you need.

Information

- The total mark for this paper is 100.
- The marks for each question are shown in brackets – use this as a guide as to how much time to spend on each question.

Advice

- Read each question carefully before you start to answer it.
- Try to answer every question.
- Check your answers if you have time at the end.
Answer ALL questions.

SECTION A

Read the following extracts (A to D) before answering Question 1.

Write your answers in the spaces provided.

Extract A

Fairtrade UK sales

Fairtrade is about better prices, decent working conditions, local sustainability and fair terms of trade for farmers and workers in the developing world. It requires companies to pay sustainable prices (which must never fall lower than the market price). In 2012, farmers and workers from some of the world’s poorest countries received £80m in Fairtrade premium to invest in business, social and environmental projects in their communities. Fairtrade products are now sold in more than 125 countries; 78% of consumers recognise the Fairtrade Mark and globally it is the most widely-recognised ethical label.

Fairtrade products cover a wide range of goods, including coffee, tea, cocoa, sugar, honey, bananas, flowers, wine, cotton, fresh fruit and fruit juices.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total UK Fairtrade retail sales (£m)</td>
<td>63</td>
<td>92.3</td>
<td>140.8</td>
<td>195</td>
<td>286.3</td>
<td>493</td>
<td>712.6</td>
<td>843.4</td>
<td>1 173.8</td>
<td>1 294.1</td>
<td>1 530.2</td>
</tr>
<tr>
<td>Year-on-year growth (%)</td>
<td>25%</td>
<td>47%</td>
<td>53%</td>
<td>38%</td>
<td>47%</td>
<td>72%</td>
<td>45%</td>
<td>18%</td>
<td>39%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>GDP % growth per annum</td>
<td>2.3</td>
<td>3.9</td>
<td>3.2</td>
<td>3.2</td>
<td>2.8</td>
<td>3.4</td>
<td>-0.8</td>
<td>-5.2</td>
<td>1.7</td>
<td>1.1</td>
<td>0.2</td>
</tr>
</tbody>
</table>
Average banana price available to producers compared to Fairtrade Minimum Price in 2012 US$ per kg

<table>
<thead>
<tr>
<th></th>
<th>Colombia</th>
<th>Dominican Republic</th>
<th>Ecuador</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.80</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0.70</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0.60</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0.50</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0.40</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0.30</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>$0.20</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0.10</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0.00</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Extract B

Hello, we’re innocent

Launched 14 years ago, Innocent is the UK and Europe's number one smoothie brand. The company has grown from three to 250 people who work across Europe (with products available in 15 different countries).

We sure aren’t perfect but we’re trying to do the right thing

We strive to do business in a more enlightened way, where we take responsibility for the impact of our business on society and the environment, aiming to move these impacts from negative to neutral or (better still) positive. As of 2006, we are proud to say that all our bananas come from Rainforest Alliance accredited farms. We donate 10% of profits to charity, mainly to the innocent foundation, which funds NGOs in the countries where fruit is sourced.

Fruit is at the heart of our business. Without great fruit, we’re nothing. So we take it pretty seriously. Our fruit comes from all over the world, from thousands of different farms of all types and sizes – large plantations, co-operative groups, tiny family farms and even from the Amazon rainforest. Not only do we want our fruit to taste great, we also want to make sure we buy it from suppliers who look after both their workers and the environment. Of course, we can’t promise our suppliers are perfect. We’re certainly not perfect, so we can’t expect them to be either. But we do ask that they abide by fair, minimum standards, and work to improve their social and environmental performance year-on-year.

(Source: http://www.innocentdrinks.co.uk/us/being-sustainable)

Extract C

Innocent unveils advert as part of £3.5m ‘Chain of Good’ campaign

The marketing campaign celebrates the ‘Chain of Good’ that begins with an Innocent drink and aims to highlight the charitable donations it makes and how that money helps people around the world. A 60-second advertisement tells the story of Joseph, a boy whose family was helped directly by Innocent’s partnership with international development charity Send a Cow. The marketing push comes on the back of a year which saw Innocent’s business grow 7.4%.

(Source: http://www.thedrum.com/news/2014/01/06/innocent-launches-35m-chain-good-campaign)
### Extract D

**UK average monthly wholesale prices of home-grown seasonal produce (pence per kilo)**

<table>
<thead>
<tr>
<th>2013</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
</tr>
</thead>
<tbody>
<tr>
<td>FRUIT (p/kg)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Blackberries</td>
<td>960.00</td>
<td>594.83</td>
<td>502.73</td>
<td>391.70</td>
<td>481.00</td>
<td>741.33</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Blackcurrants</td>
<td>444.38</td>
<td>405.97</td>
<td>399.87</td>
<td>360.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cherries</td>
<td>289.53</td>
<td>262.95</td>
<td>274.83</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Apples</td>
<td>104.93</td>
<td>110.86</td>
<td>126.63</td>
<td>126.44</td>
<td>138.27</td>
<td>83.66</td>
<td>67.01</td>
<td>64.37</td>
<td>67.04</td>
</tr>
<tr>
<td>Raspberries</td>
<td>842.01</td>
<td>644.38</td>
<td>543.07</td>
<td>668.57</td>
<td>685.80</td>
<td>761.22</td>
<td>640.59</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strawberries</td>
<td>407.53</td>
<td>300.52</td>
<td>235.93</td>
<td>214.36</td>
<td>202.00</td>
<td>252.07</td>
<td>180.06</td>
<td>212.92</td>
<td></td>
</tr>
</tbody>
</table>

© Crown copyright 2014
1 (a) Calculate the percentage year-on-year growth for total UK retail sales of Fairtrade products in 2012 (Extract A). You are advised to show your working.

(b) Using Extract A, explain one effect of the 2008 recession on total Fairtrade sales in the UK.
(c) Explain one benefit to consumers of buying Fairtrade products.  

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(d) Using Extract A, analyse one benefit to banana producers in Ecuador of supplying the Fairtrade market.  

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(e) Using Extract D, discuss the possible impact of changing UK fruit prices on Innocent’s profitability.

(8)
(f) Assess the benefits to Innocent of insisting that their suppliers ‘look after both their workers and the environment’. (Extract B, line 14)
(g) Assess the importance of profit maximisation to Innocent.
(h) Assess the likely impact on local communities and consumers of the continued success of Innocent.
SECTION B

Read the following extract (E) and Figures 1 and 2 before answering Question 2.

Write your answer in the spaces provided.

Extract E

<table>
<thead>
<tr>
<th>Indicators</th>
<th>March 2014</th>
<th>Percentage rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Numbers employed (aged 16+)</td>
<td>30 191 000</td>
<td>72.3%</td>
</tr>
<tr>
<td>Numbers unemployed (aged 16+)</td>
<td>2 326 000</td>
<td>7.2%</td>
</tr>
<tr>
<td>Youth unemployment (aged 16 to 24)</td>
<td>912 000</td>
<td>19.8%</td>
</tr>
<tr>
<td>Claimant count level</td>
<td>1 175 000</td>
<td>3.5%</td>
</tr>
<tr>
<td>Job vacancies</td>
<td>588 000</td>
<td></td>
</tr>
</tbody>
</table>

Unemployment by duration for March 2014

- Over twelve months: 828 000
- Between six and twelve months: 389 000
- Up to six months (1.1 million)

Figure 1
Job Seekers Allowance by age and sex for February 2014

- Aged 50+ (Women), 76,700
- Aged 50+ (Men), 140,300
- Aged 18–24 (Men), 191,000
- Aged 18–24 (Women), 104,000
- Aged 25–49 (Women), 237,700
- Aged 25–49 (Men), 422,800

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Figure 2
2 Evaluate two possible economic policies that could be used to address the problems suggested in Extract E. (20)
TOTAL FOR SECTION B = 20 MARKS
SECTION C
Read the following extracts (F and G) before answering Question 3.
Write your answer in the spaces provided.

Extract F

Nationwide House Price Index 1977–2013

Real House Prices
Base: 2013 Q4
Trend from 1975 to present
Trend = c.2.8% per annum

Real UK Average Annual Earnings (based on KAB9)

UK house prices increased by 1.4% in December 2013 and were 8.4% higher than December 2012. House prices were still around 5% below the 2007 peak. The average price of a house in the UK was £175,826 in early 2014. Earnings adjusted for inflation have fallen since 2008.

(Sources: http://www.nationwide.co.uk/hpi/datadownload/data_download.htm; http://3.bp.blogspot.com/-zZySwFAB_qU/T-yuKXBFMYI/AAAAAAAAAzw/vxRtBATDqMc/s1600/120628-2.jpg)
Extract G

House prices ‘risk becoming unsustainable’

Surveyors have warned that house prices risk becoming unsustainable in some areas because low home supply is failing to meet high demand in the market. In December 2013, The Royal Institution of Chartered Surveyors measured the strongest level of sales in six years. Its report predicts prices will rise by 5% on average in each of the next five years. The general view is that this will be largely driven by demand exceeding supply.

The Government’s ‘Help to Buy’ scheme offering state-backed mortgages to people with 5% deposits was launched in October. Figures showed that the number of mortgages handed out to first-time buyers was at a six-year high in November and is expected to continue to grow in 2014. Some housing market experts have urged stronger action by the government.

3 Using Extracts F and G, evaluate the possible impact of changes in the housing market on the UK economy.

(20)
<table>
<thead>
<tr>
<th>Question Number</th>
<th>Answer</th>
<th>Mark</th>
</tr>
</thead>
</table>
| 1(a) | **Knowledge/understanding 1, Application 3**<br>**Knowledge/understanding:** 1 mark for<br>• formula for percentage year-on-year growth:<br>\[
\frac{2012 \text{ Total Retail sales} - 2011 \text{ Total Retail Sales}}{2011 \text{ Total Retail Sales}} \times 100 \text{ (1)}
\] | (4) |
|             | **Application**<br>\[
1530.2 - 1294.1 (1) \times 100 = 18\% (1)
\] | |
<p>|             | NB if the answer given is 18% award 4 marks. | |
| 1(b) | <strong>Knowledge/understanding 1, Application 2, Analysis 1</strong>&lt;br&gt;<strong>Knowledge/understanding:</strong> 1 mark for identifying that total sales have risen (1).&lt;br&gt;<strong>Application:</strong> up to 2 marks are available for contextualised answers, e.g. sales have gone up from 712.6 to 843.4 (1); an increase of only 18% compared to 45% in 2008 (1).&lt;br&gt;<strong>Analysis:</strong> 1 mark for giving a reason/cause/consequence, e.g. although total sales have risen the rate of increase has declined significantly (1). | (4) |</p>
<table>
<thead>
<tr>
<th>Question Number</th>
<th>Answer</th>
<th>Mark</th>
</tr>
</thead>
<tbody>
<tr>
<td>1(c)</td>
<td>Knowledge/understanding 1, Application 2, Analysis 1</td>
<td>(4)</td>
</tr>
<tr>
<td></td>
<td><strong>Knowledge/understanding:</strong> 1 mark for identifying a benefit, e.g. satisfying an ethical objective (1).</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Application:</strong> up to 2 marks are available for contextualised answers, e.g. Fairtrade products are more expensive (1); some of this extra price will go to the producer (1).</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Analysis:</strong> 1 mark is available for developing a reason/cause/consequence of buying Fairtrade products, e.g. which can be spent on community projects (1).</td>
<td></td>
</tr>
<tr>
<td>1(d)</td>
<td>Knowledge/understanding 2, Application 2, Analysis 2</td>
<td>(6)</td>
</tr>
<tr>
<td></td>
<td><strong>Knowledge/understanding:</strong> up to 2 marks for identifying a benefit, e.g. receiving a higher price (1) benefits both producers and communities (1).</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Application:</strong> up to 2 marks is available for contextualised answers, e.g. the Fairtrade premium is roughly $0.07 per kg (1); calculating a percentage/read the difference from the chart (1).</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Analysis:</strong> up to 2 marks are available for developing a reason/cause/consequence of supplying Fairtrade bananas, e.g. leading to increased profits (1) reduces uncertainty and the impact of world banana price fluctuations (1).</td>
<td></td>
</tr>
<tr>
<td>Question Number</td>
<td>Indicative content</td>
<td>Mark</td>
</tr>
<tr>
<td>-----------------</td>
<td>--------------------</td>
<td>------</td>
</tr>
<tr>
<td>1(e)</td>
<td>Knowledge/understanding 2, Application 2, Analysis 2, Evaluation 2</td>
<td>(8)</td>
</tr>
</tbody>
</table>

- Profitability is a measure of how profitable a business is and is determined by the cost of the inputs and the value of sales revenue.
- Likely impact on average and marginal costs for Innocent.
- The impact may depend on whether Innocent change their prices to reflect changing costs.
- Costs to innocent will include the various fruit it needs to go into the fruit smoothies but this cost may be a small proportion of the total cost so the impact may not be very great.
- Extract D shows the various prices of fruit grown in the UK.
- There are huge fluctuations in the cost of fruit, e.g. blackberries cost 960p in June and then fall to 741p in November.
- A simple calculation using data from Extract D may be performed to demonstrate the impact on costs and profits for innocent.
- Extract D indicates the seasonal nature of fruit growing as some fruits cannot be grown in the UK during some months, which may have an impact on costs and profitability for Innocent.
- Innocent may have to import fruit in the months when fruit is unavailable in the UK adding to its overall costs.
- Some fruit could be stored over a period of time for use in the smoothies.
- Innocent may see its costs, and therefore profits, fluctuate as fruit prices are not stable throughout the year but it will depend on what proportion fruit costs are of total costs.
<table>
<thead>
<tr>
<th>Level</th>
<th>Mark</th>
<th>Descriptor</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td></td>
<td>A completely inaccurate response.</td>
</tr>
<tr>
<td>Level 1</td>
<td>1–2</td>
<td>Isolated elements of knowledge and understanding, using little or no relevant evidence. Arguments and chains of reasoning may be attempted. Limited attempt to address the question.</td>
</tr>
<tr>
<td>Level 2</td>
<td>3–5</td>
<td>Elements of knowledge and understanding, using limited relevant evidence. Arguments and chains of reasoning are developed. Judgements may be attempted.</td>
</tr>
<tr>
<td>Level 3</td>
<td>6–8</td>
<td>Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen. Arguments are developed, using logical, coherent chains of reasoning. A balanced awareness of competing arguments.</td>
</tr>
</tbody>
</table>

**Demonstrating application (AO2) in responses**

Where questions specifically stipulate the use of data or information provided in a stimulus, students:

- must directly reference, interpret or analyse the information provided in the stimulus
- in addition, may select examples from their own knowledge but these must be relevant and directly connected to the context/issues set out in the stimulus.

Where questions do not specifically stipulate the use of data or information provided in a stimulus, students:

- must select relevant examples from their own knowledge, these must be directly connected to the context/issues set out in the question, and
- may directly reference, interpret or analyse the information provided in any relevant stimulus.
<table>
<thead>
<tr>
<th>Question Number</th>
<th>Indicative content</th>
<th>Mark</th>
</tr>
</thead>
<tbody>
<tr>
<td>1(f)</td>
<td><strong>Knowledge/understanding 2, Application 2, Analysis 3, Evaluation 3</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Suppliers are businesses that provide goods and services to another business such as raw materials, components and finished goods.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• In the case of innocent, it has a wide range of fruit suppliers located all over the world. Innocent works closely with its suppliers to ensure the fruit farmer behaves responsibly and improves their social and environmental performance year on year.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• The benefit of this to innocent is that the fruit may be of a higher quality if high standards are enforced.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• The innocent brand prides itself on being environmentally friendly and leaving the planet a little bit better than it found it (Extract B) and this is part of its USP and how it differentiates itself from other smoothie brands.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• If this is followed through innocent’s supply chain, then consumers may be willing to pay a higher price for innocent smoothies if they know that money is going to charity or that the company is being environmentally friendly throughout all of its operations.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Demand for the innocent portfolio of products may be more inelastic and targets the growing number of consumers who are concerned with where their food comes from.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Insistence that its suppliers are responsible may result in higher costs for fruit farmers who then have to pass these additional costs on to innocent, which in turn has to increase the price of its fruit smoothies.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Additional monitoring and checking on their thousands of fruit farmers may add to the cost of production.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Many consumers may not care about their environmental claims and may be more concerned with the final selling price of the smoothies. There are cheaper substitutes available for those who are unconcerned about the welfare of the producers.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Much depends on the additional costs involved in the implementation of their values – in the short term it may be costly to ensure these standards are being kept but in the longer term, innocent may see its sales increase owing to the growing concern for the environment and how suppliers are treated in developing countries.</td>
<td></td>
</tr>
</tbody>
</table>

(10)
<table>
<thead>
<tr>
<th>Level</th>
<th>Mark</th>
<th>Descriptor</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td></td>
<td>A completely inaccurate response.</td>
</tr>
<tr>
<td>Level 1</td>
<td>1–2</td>
<td>Isolated elements of knowledge and understanding, using little or no relevant evidence. Arguments and chains of reasoning may be attempted. Limited attempt to address the question.</td>
</tr>
<tr>
<td>Level 2</td>
<td>3–4</td>
<td>Elements of knowledge and understanding, using limited relevant evidence. Arguments and chains of reasoning are presented but with limited attempt to address the question. Comparisons and judgements may be attempted.</td>
</tr>
<tr>
<td>Level 3</td>
<td>5–7</td>
<td>Accurate knowledge and understanding, supported by the use of relevant evidence to support the argument, clear chains of reasoning, with well-developed arguments. An awareness of the significance of competing arguments is present although this may lack balance.</td>
</tr>
<tr>
<td>Level 4</td>
<td>8–10</td>
<td>Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen, logical, coherent chains of reasoning, showing full understanding of the question. Arguments are developed and evaluated. A full and balanced awareness of the validity and significance of competing arguments.</td>
</tr>
</tbody>
</table>

**Demonstrating application (AO2) in responses**

Where questions specifically stipulate the use of data or information provided in a stimulus, students:

- must directly reference, interpret or analyse the information provided in the stimulus
- in addition, may select examples from their own knowledge but these must be relevant and directly connected to the context/issues set out in the stimulus.

Where questions do not specifically stipulate the use of data or information provided in a stimulus, students:

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### Question Number: 1(g)

**Indicative content**

- **Knowledge/understanding 2, Application 2, Analysis 4, Evaluation 4**

- Business objectives are the goals of an organisation and include profit maximisation, sales maximisation, revenue maximisation, survival and satisficing.
- Innocent will have shareholders who will want to receive a return on their investment in the form of dividends.
- It could be argued that innocent should aim to maximise profit to be successful and encourage further investment in the future.
- Extracts B and C state that innocent is very concerned with its impact on the environment and has its own foundation that gives 10% of its profits to charity.
- It can, therefore, be argued that innocent is not just concerned with making as much profit as possible and that it has ethical motives and objectives.
- It could be argued that innocent should aim to maximise profits so that it can give even more money to charity.
- In the short term, it does have to make a profit in order to survive but profit maximisation is not its main business objective in the long term.
- Many firms believe that demonstrating ethical principles is consistent with profit maximisation, as brand image is protected.

**Mark:** 12
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<th>Level</th>
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<th>Descriptor</th>
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<td>1–2</td>
<td>Isolated elements of knowledge and understanding, using little or no relevant evidence. Arguments and chains of reasoning may be attempted. Limited attempt to address the question.</td>
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<tr>
<td>Level 2</td>
<td>3–5</td>
<td>Elements of knowledge and understanding, using limited relevant evidence. Arguments and chains of reasoning are presented but with limited attempt to address the question. Comparisons and judgements may be attempted.</td>
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<tr>
<td>Level 3</td>
<td>6–9</td>
<td>Accurate knowledge and understanding, supported by use of relevant evidence to support the argument, clear chains of reasoning, with well-developed arguments. An awareness of the significance of competing arguments is present although this may lack balance.</td>
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<tr>
<td>Level 4</td>
<td>10–12</td>
<td>Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen, logical, coherent chains of reasoning, showing full understanding of the question. Arguments are developed and evaluated. A full and balanced awareness of the validity and significance of competing arguments.</td>
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**Demonstrating application (AO2) in responses**

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</table>
| 1(h)            | **Knowledge/understanding 2, Application 2, Analysis 4, Evaluation 4**  
• Extract C describes a campaign by Innocent – Chain of Good – which explains how buying an Innocent drink can benefit others in developing countries.  
• This suggests that the more consumers buy Innocent drinks, the more it can give to good causes around the world in order to reduce poverty.  
• The success of Innocent will help reduce poverty and support local fruit farmers around the world.  
• The impact on local communities will depend on how much is given in donations from the sale of drinks.  
• Consumers of Innocent are the people who purchase their products in the 15 countries in which they are currently sold.  
• The continued success of innocent may increase consumer choice as they may be able to offer a greater variety of products.  
• More retail outlets may stock Innocent products and consumers are able to purchase products that benefit communities in other countries.  
• Consumers will be happy only if the price and quality of the smoothies are maintained. As the company grows, it may lose sight of its USP and just become another food brand. | (12) |
<table>
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<td>2</td>
<td><strong>Knowledge/understanding 4, Application 4, Analysis 6, Evaluation 6</strong></td>
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<td></td>
<td>• Extract E suggests that male youth unemployment is a very significant problem.</td>
<td>2</td>
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<td>• The number of vacancies in Extract E suggests that structural unemployment and a skills mismatch are key issues.</td>
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<td></td>
<td>• Over 50% of people have been unemployed for six months or more (Extract E, Figure 1). Long-term unemployment is a particular problem because people lose their skills and work habit.</td>
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<td></td>
<td>• Extract E, Figure 2 shows that men aged 50+ make up a significant proportion (11.9%) of Jobseeker’s Allowance claimants.</td>
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<td>• Structural unemployment and associated occupational and geographical immobilities require supply-side policies.</td>
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<td>• Building more houses near to where jobs are created would reduce geographical immobilities, as would policies which attract industries to areas of high unemployment.</td>
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<td></td>
<td>• Encouraging FDI from foreign MNCs, so that demand for labour increases.</td>
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<td>• Structural unemployment is the result of workers being occupationally immobile – improvements in education and training will increase the human capital of these workers and therefore give them a better chance of taking the new jobs that become available in the economy. This will reduce structural unemployment.</td>
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<td>• There should be a focus on education, skills training and retraining.</td>
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<td>• This would make for greater flexibility and alleviate crucial skills shortages.</td>
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<td></td>
<td>• Government subsidies for those firms that take on the long-term unemployed will create an incentive for firms to increase the size of their workforce. Employment subsidies may also be available for overseas firms locating in the UK.</td>
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<td>• Reducing the real value of unemployment benefits might increase the incentive to take a job – particularly if the real worth of unemployment benefits is well below the national minimum wage rate. Targeted measures are designed to help the long-term unemployed find re-employment.</td>
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<td></td>
<td>• These policies are all very important but take time to have an effect and can also be quite costly.</td>
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</table>
### Question Number | Indicative content                                                                                                                                                                                                                                                                                                                                 | Mark |
|------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
|                  | • Fiscal policies/stimulus could be used in the short term to create jobs by increasing aggregate demand, assuming there is some spare capacity in the economy. These policies might involve lower interest rates or lower direct taxes.  
• Unemployment figures are kept low by the number of part-time jobs and zero-hours contract working, i.e. underemployment.                                                                                                                                                                                                                       | (20) |

### Level | Mark | Descriptor                                                                                                                                                                                                                                                                                                                                                       |
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</tr>
<tr>
<td>Level 2</td>
<td>5–9</td>
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<td>10–15</td>
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<tr>
<td>Level 4</td>
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<td>Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen and fully integrated to support the argument, well developed and logical, coherent chains of reasoning, showing full understanding of the question. Arguments are fully developed and evaluated. A full awareness of the validity and significance of competing arguments, leading to nuanced and balanced comparisons, judgements or conclusions.</td>
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<tr>
<td>3</td>
<td><strong>Knowledge/understanding 4, Application 4, Analysis 6, Evaluation 6</strong></td>
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<tr>
<td></td>
<td>The changes in the housing market</td>
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<tr>
<td></td>
<td>- Long-term upward trend in house prices.</td>
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<td>- Short-term fluctuations creating instability (large differences between peaks and troughs in graphs in Extract F).</td>
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<td>- Fall in real earnings since 2008.</td>
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<td>- The increase in prices in 2013 of 8.4% indicates excess demand in the housing market.</td>
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<td>- Prices being 5% below their 2007 peak indicates there is still a risk for some people of experiencing negative equity.</td>
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<td>- Falling real earnings will reduce ability to set up and make mortgage payments, reducing owner occupation.</td>
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<td></td>
<td>The consequent impacts</td>
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<td></td>
<td>- House prices are settling above the level that is affordable for all those who want to buy or rent in specific locations, given their earnings levels.</td>
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<td>- This implies market failure: a freely functioning market is failing to deliver an efficient allocation of resources, with a resulting loss of economic and social welfare. There are not enough homes to satisfy demand at lower prices and excess demand has driven up prices.</td>
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<td>- These trends exacerbate inequalities and create social problems, including homelessness.</td>
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<td>- Pent-up demand will continue to push up housing prices.</td>
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<td>- Business may find it hard to recruit employees in areas with high housing costs.</td>
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<td></td>
<td>- People who cannot afford the high prices may suffer geographical immobility and remain unnecessarily unemployed. This is particularly likely to affect young people. Help to Buy may further increase the demand for housing, driving prices up even further.</td>
<td>(20)</td>
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<tr>
<td>Level</td>
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Instructions

- Use black ink or ball-point pen.
- Fill in the boxes at the top of this page with your name, centre number and candidate number.
- Answer all questions.
- Answer the questions in the spaces provided – there may be more space than you need.

Information

- The total mark for this paper is 100.
- The marks for each question are shown in brackets – use this as a guide as to how much time to spend on each question.

Advice

- Read each question carefully before you start to answer it.
- Try to answer every question.
- Check your answers if you have time at the end.
Answer ALL questions.

SECTION A

Read the following extracts (A to D) before answering Question 1.

Write your answers in the spaces provided.

Extract A

The UK Motorcycle Industry

Overall industry profitability has fallen since 2008, due to the global financial crisis, which led to a drop in demand. High purchase costs owing to record-high commodity prices also reduced profitability.

In 2012, UK output was only 69 300 motorcycles despite a maximum possible output of 82 500. Industry operating profit margins fell from an estimated 12.5% in 2007–2008, to approximately 6.0% in 2012–2013.

(Source: http://www.themanufacturer.com/articles/triumph-motorcycles-stalls-ahead-of-south-american-adventure/)

Extract B

Triumph Motorcycles expands in South America despite profit fall

Triumph Motorcycles, the UK’s leading motorcycle manufacturer, has invested heavily in research and design and overseas expansion in 2012 but, as a result, operating profit before interest and tax fell to £15.7m in 2012 from £22.3m in 2011. Group turnover for the year remains stable at £342.3m.

The company attributed the profit decrease to its increased level of investment on research and design operations, and product development which rose from £24m in 2011 to £26m in 2012.

The company also made a further investment in its growing South American operation. Costs associated with setting up manufacturing and sales operations in Brazil made up much of the remaining £7m drop in profits. Triumph Motorcycles says that so far South America has been an untapped market for the company and it is expecting strong performance in the region over the coming years.

The company released a statement saying that “The recent recession has caused many problems and Europe continues to be an area of concern,” as it looks to move into different markets. The company has expressed delight in the positive steps it has made into the US market where it saw sales increase by 23% from 2011.

Despite the spokesperson’s assertion that sales will be a “slow build up”, its first dealership in South America opened in Sao Paulo last week, selling 75 motorcycles in its first two days. The company has launched into 13 new geographical markets including Argentina, Brazil, Columbia, the Czech Republic, Hungary, Russia and Slovakia.

(Source: http://www.themanufacturer.com/articles/triumph-motorcycles-stalls-ahead-of-south-american-adventure/)
Extract C

**Selected economic indicators – Brazil**

GINI co-efficient = .55

Income share held by the top quintile = 58.6%

Income share held by the bottom quintile = 2.9%

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<th>Indicator</th>
<th>2012</th>
<th>2013</th>
<th>2015 (forecast)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment %</td>
<td>4.8</td>
<td>4.6</td>
<td>4.1</td>
</tr>
<tr>
<td>Index of unit labour costs</td>
<td>138</td>
<td>159</td>
<td>130</td>
</tr>
<tr>
<td>GDP in billions of Reals* (at constant prices)</td>
<td>129</td>
<td>126</td>
<td>155</td>
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<tr>
<td>GDP per capita in Reals* (at constant prices)</td>
<td>13 438</td>
<td>13 563</td>
<td>14 126</td>
</tr>
<tr>
<td>Interest rates %</td>
<td>10.75</td>
<td>11.00</td>
<td>16.75</td>
</tr>
</tbody>
</table>

*Real is the Brazilian unit of currency

(Source: adapted from http://www.tradingeconomics.com/forecasts)
**Extract D**

*Triumph Motorcycles plans world domination with new engine*

While *Triumph Motorcycles* is making big efforts in several new markets, including the very promising Brazilian one, the company’s future is in India, where it’s aiming for a slice of the massive new motorcycle market, where 13 million motorcycles are bought each year.

To do this, it’s working on a new range of motorcycles with smaller, less-powerful engines. While many manufacturers, including *Ducati*, *BMW* and *Harley-Davidson*, have begun selling their motorcycles with bigger, more-powerful engines in India, *Triumph* is the first manufacturer to create new, lower cost models for this market.

The numbers are on a whole different scale to what we’re used to. *Triumph* is building two factories in India, initially to put together motorcycles from kits made in *Triumph’s* Thai factories, but with full manufacture in mind at a later stage. And *Triumph* is looking at selling 250,000 machines annually in three years’ time, increasing to 500,000 soon after!

*Triumph* has two particular advantages in India. One is its big Thai manufacturing facility: Thailand has a trading agreement with India which means *Triumphs* made there avoid higher import tariffs. The second is the name: *Triumph* is still a well-known and respected brand in India, so the marketing is made far easier and more effective because of it.

1 (a) Using the information given in Extract A, calculate the capacity utilisation of the UK motorcycle industry in 2012–2013. You are advised to show your working.

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(c) Explain one reason why Triumph has invested heavily in research and design. (4)

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(e) Using a suitable diagram, discuss the likely impact on India of using ‘high import tariffs’ (Extract D).

(8)
(f) Assess the importance of a brand name to a business such as Triumph when entering a new market.

(10)
(g) Using Extracts B and C, assess Triumph’s decision to set up manufacturing and sales operations in Brazil.
(h) Assess the impact of the global recession on *Triumph*.

(Total for Question 1 = 60 marks)
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QUESTION 2 BEGINS ON THE NEXT PAGE.
SECTION B

Read the following extract (E) before answering Question 2.

Write your answer in the spaces provided.

Extract E

China’s loss is Mexico’s gain

Business managers look at all of the factors that go into the cost of production – wages, transportation, currency values, transit time – then decide on a location. After China joined the World Trade Organization (WTO) in 2001, hundreds of North American businesses relocated their factories there. The attractions of China were many: factory buildings, roads, internet connections, police protection and, above all, cheap labour. In the next decade, US investment in China more than quadrupled to almost $30bn; an estimated 30 000 US companies now either operate factories in China or set up contracts with others to produce parts.

More recently, problems have begun to appear. The long supply line between North America and the Far East involved rapidly increasing shipping costs as the price of fossil fuels rose. Production problems had to be handled long-distance and wages in China have crept relentlessly upward. Wages are now five times higher than a decade ago.

As a result North American firms that once operated in China are looking for production possibilities closer to home. Tennessee-based Meco Corp. which manufactures outdoor furniture and barbecues, operated in China for more than 10 years. It has recently invested $10m in factories in northern Mexico. Florida’s Jabil Circuit also recently moved operations from China to Guadalajara, Mexico, where it is manufacturing BlackBerries and other electronics. Canadian companies have taken full advantage of North American Free Trade Agreement (NAFTA) benefits, with some 2 500 Canadian businesses investing more than $11bn in Mexico since 2000.

(Source: adapted from https://globalconnections.hsbc.com/canada/en/articles/chinas-loss-mexicos-gain)
2 Evaluate the importance of labour costs for businesses when deciding where to locate production.

(20)
SECTION C

Read the following extracts (F and G) before answering Question 3.

Write your answer in the spaces provided.

Extract F

Inflation 2000–2013
Percentage change over 12 months

Extract G

Inflation falls below bank’s target

The Consumer Prices Index (CPI) fell for the seventh month in a row in January 2014, to 1.9% according to the Office for National Statistics (ONS). Inflation has now fallen below the Bank of England’s 2% target for the first time in more than four years.

Experts believe the decline signals the start of a run of below-target inflation in what will come as welcome respite for households struggling with their finances.

It is hoped that inflation will continue to fall during 2014, leaving it on course to be overtaken by wage growth, which has been lagging behind rises in the cost of living.

Christian Spence, Head of Business Intelligence at Greater Manchester Chamber of Commerce, said: “Both businesses and consumers will be pleased to see inflation continuing to ease. The low level of inflation will also give confidence that the Bank of England’s position on keeping the Bank Rate at 0.5% for some time is achievable, maintaining stimulus until the economic recovery is firmly embedded.”

(Source: http://www.manchestereveningnews.co.uk/business/business-news/inflation-falls-below-banks-target-6721102)
3 Using Extracts F and G, evaluate the potential effects of inflation on firms in the UK since 2000.

(20)
<table>
<thead>
<tr>
<th>Question Number</th>
<th>Answer</th>
<th>Mark</th>
</tr>
</thead>
<tbody>
<tr>
<td>1(a)</td>
<td></td>
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</tbody>
</table>

**Knowledge/understanding 1, Application 3**

**Knowledge/understanding:** 1 mark for formula

\[
\frac{\text{current output}}{\text{maximum possible output}} \times 100 \quad (1)
\]

**Application:** up to 3 marks

Current output = 69,300 \( (1) \)
Maximum possible output = 82,500 \( (1) \)

\[
\frac{69,300 \times 100}{82,500} = 84\% \quad (1)
\]

NB if the answer is just 84 (%) give 4 marks

Three marks max for 0.84.

(4)
<table>
<thead>
<tr>
<th>Question Number</th>
<th>Answer</th>
<th>Mark</th>
</tr>
</thead>
</table>
| 1(b)            | **Knowledge/understanding 1, Application 2, Analysis 1**<br><br>**Knowledge/understanding:** 1 mark for identifying that profitability has fallen or 12.5% profit margin has reduced to 6.0% (1).  
**Application:** up to 2 marks are available for contextualised answers, e.g. fixed costs would now be divided by 69 300 rather than 82 500 (1) so average fixed costs go up as would average total costs (1).  
**Analysis:** 1 mark available for developing the connection, e.g. unused capacity means that fixed costs are spread over a smaller output meaning profitability per motorcycle would fall (1). | (4) |
<table>
<thead>
<tr>
<th>Question Number</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1(c)</strong></td>
<td><strong>Knowledge/understanding 1, Application 2, Analysis 1</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Knowledge/understanding:</strong> 1 mark for identifying a reason, e.g. to develop new and innovative products to remain competitive (1).</td>
</tr>
<tr>
<td></td>
<td><strong>Application:</strong> up to 2 marks are available for a contextualised answer, e.g. <em>Triumph</em> faces competition from other manufacturers such as <em>Ducati</em> and <em>BMW</em> (1); <em>Triumph</em> is developing a new, small motorcycle specifically for the Indian market as a result of research and design (1).</td>
</tr>
<tr>
<td></td>
<td><strong>Analysis:</strong> 1 mark for developing the reason, e.g. new and more innovative motorcycles would give <em>Triumph</em> a competitive advantage and increase sales and profitability (1).</td>
</tr>
<tr>
<td><strong>1(d)</strong></td>
<td><strong>Knowledge/understanding 2, Application 2, Analysis 2</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Knowledge/understanding:</strong> up to 2 marks for identifying an implication for <em>Triumph</em>, e.g. pricing is an important part of <em>Triumph</em>’s marketing strategy; without knowledge of likely PED any price change can be risky (1). Knowing the PED means that the relative risk and impact on revenues can be taken into account when considering pricing strategy (1).</td>
</tr>
<tr>
<td></td>
<td><strong>Application:</strong> up to 2 marks for a contextualised answer, e.g. identifying that a PED of -0.7 is inelastic (1) and will lead to a fall in sales which is proportionately less than the change in price (1).</td>
</tr>
<tr>
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<td><strong>Analysis:</strong> up to 2 marks available for explaining the implications on <em>Triumph</em>’s pricing strategy, e.g. a PED of -0.7 means that if <em>Triumph</em> decides to increase prices there will not be a significant reduction in sales (1) it will lead to an increase in total revenue (1) or <em>Triumph</em> would not benefit from discounting as this would reduce total revenue (1).</td>
</tr>
<tr>
<td>Question Number</td>
<td>Indicative content</td>
</tr>
<tr>
<td>-----------------</td>
<td>--------------------</td>
</tr>
<tr>
<td><strong>1(e)</strong></td>
<td>Knowledge/understanding 2, Application 2, Analysis 2, Evaluation 2</td>
</tr>
</tbody>
</table>

- Import tariffs are designed to protect domestic industries from foreign competition.
- A tax is placed on the import to increase its price and reduce consumption.
- India is still a developing economy, with infant industries in many areas struggling to be competitive, this is especially so in the case of high-tech, high-value goods such as cars and motorcycles.
- By imposing high tariffs domestic substitutes are more appealing, which protects jobs and businesses.
- If they are high enough, tariffs may persuade businesses such as *Triumph* to set up production in India which has several advantages such as job creation, technology/skills transfer, taxes and beneficial effects on balance of payments.
- However, only a few businesses might do this. Many may simply accept that India is a difficult market to penetrate and look elsewhere.
- Consumers in India get less choice and may have to settle for inferior domestic substitutes.
- Indian producers are sheltered from competition and have little incentive to improve and become competitive and so India’s development slows.
<table>
<thead>
<tr>
<th>Level</th>
<th>Mark</th>
<th>Descriptor</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>A completely inaccurate response.</td>
<td></td>
</tr>
<tr>
<td>Level 1</td>
<td>1–2</td>
<td>Isolated elements of knowledge and understanding, using little or no relevant evidence. Arguments and chains of reasoning may be attempted. Limited attempt to address the question.</td>
</tr>
<tr>
<td>Level 2</td>
<td>3–5</td>
<td>Elements of knowledge and understanding, using limited relevant evidence. Arguments and chains of reasoning are developed. Judgements may be attempted.</td>
</tr>
<tr>
<td>Level 3</td>
<td>6–8</td>
<td>Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen. Arguments are developed, using logical, coherent chains of reasoning. A balanced awareness of competing arguments.</td>
</tr>
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**Demonstrating application (AO2) in responses**

Where questions specifically stipulate the use of data or information provided in a stimulus, students:

- must directly reference, interpret or analyse the information provided in the stimulus
- in addition, may select examples from their own knowledge but these must be relevant and directly connected to the context/issues set out in the stimulus.

Where questions do not specifically stipulate the use of data or information provided in a stimulus, students:

- must select relevant examples from their own knowledge, these must be directly connected to the context/issues set out in the question, and
- may directly reference, interpret or analyse the information provided in any relevant stimulus.
<table>
<thead>
<tr>
<th>Question Number</th>
<th>Indicative content</th>
</tr>
</thead>
<tbody>
<tr>
<td>1(f)</td>
<td><strong>Knowledge/understanding 2, Application 2, Analysis 3, Evaluation 3</strong></td>
</tr>
</tbody>
</table>

- A brand is the perception that consumers have of a product or service and is usually associated with a name, logo or reputation.
- As long as the brand has positive connotations then it is likely to be useful when entering a new market.
- If consumers are familiar with the brand then any new products introduced by the company are likely to carry the same positive qualities in the minds of the consumer.
- Branding could be expected to make demand for a product more price inelastic so the entry price does not have to be as low.
- Branding may reduce the likely threats from substitutes.
- This appears to be the case in *Triumph*'s Indian strategy as Extract B states.
- Even if the brand does not already exist in a market it may already be known by some people.
- However a brand name alone does not guarantee success no matter how well known. The other elements of the marketing strategy have to be in place.
- *Triumph* is designing new smaller motorcycles for the Indian market to suit the needs of Indian consumers and they will be cheaper than rivals' models, which could be crucial in a developing market such as India.
- Suitable promotion appropriate to the culture would be needed as would an effective distribution and back-up service network.
- Whilst a brand is important and can form an important element in a marketing strategy, branding is not essential.
- Previously unknown Chinese brands such as *Huawei* and *Haier* have successfully entered western markets based on their pricing strategies and their products alone.

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1(g) Knowledge/understanding 2, Application 2, Analysis 4, Evaluation 4

- GDP is expected to be 155bn reals in 2015, an increase of 23% indicating growing levels of disposable income.
- However, GDP per capita is increasing only to 14 126 reals, an increase of 4.2%.
- This suggests that gains in income are unequal and this is borne out by the Gini coefficient of .55 and that the top 20% have 58.6% of the wealth.
- This may be in Triumph’s favour as their motorcycles could be considered as luxury goods and therefore likely to be income elastic.
- Interest rates are forecast to rise significantly and this may affect demand if motorcycles are bought on credit.
- Producing in Brazil may be a good move as unit labour costs look set to decrease from 159 to 130 despite a slight fall in unemployment to 4.1%.
- Triumph is investing in South America; a region that has hitherto not been part of the company’s market.
- To create a manufacturing capacity and distribution network takes time and money and represents a large undertaking on Triumph’s behalf.
- This has been reported as causing a £7 million drop in profits for the company and in the short term is damaging to the company, particularly given the problems in European markets caused by the recession.
- However, South America is a developing region: Brazil is growing rapidly and other markets, such as Argentina and Chile, are recovering from recent problems.
- Triumph may want to look at how Brazil compares to other South American countries and consider a wider range of indicators.
- The forecast is up to 2015 only and does not give long-term information.
- Products such as motorcycles will appeal to consumers with growing incomes and for Triumph the potential long-term gains may be worth short-term costs.

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<td>Knowledge/understanding 2, Application 2, Analysis 4, Evaluation 4</td>
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<td></td>
<td>• The recent recession and the financial crisis of 2008, affected many businesses, including Triumph.</td>
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<td>• A recession means that there has been at least two consecutive quarters of negative GDP growth. For many consumers this means falling incomes and/or lack of confidence, leading to a reduction in spending, particularly on income elastic products.</td>
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<td>• Extract A suggests that motorcycles in general have had a tough time with profit margins falling from 12.5% to 6.0%.</td>
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<td>• Extract A suggests there is spare capacity in the UK motorcycle industry which may impact on the size of the workforce, unit costs and on the ability to maintain prices.</td>
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<td>• Triumph may not have been affected as much as other brands because it is from the UK and has a loyal customer base.</td>
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<td>• Although in Extract B it is clear that the recession has caused problems for Triumph. The degree of problems will depend on the YED for Triumph motorcycles.</td>
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<td>• However, the recession mainly affected Europe. Other markets may not have been so badly affected, if at all. The USA, which was affected by the recession, saw sales increase by 23% from 2011.</td>
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<td>• Other areas such as India show huge potential for growth and may be the key to Triumph’s future. Brazil is described as ‘promising’.</td>
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<td>• If Triumph had relied just on Europe then the recession may have had a serious damaging impact, but because Triumph is expanding and spreading risk by entering new markets and developing new products the impact may have been only a short-term minor problem.</td>
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<td><strong>Knowledge/understanding 4, Application 4, Analysis 6, Evaluation 6</strong></td>
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<td>- Labour costs refer to the costs of wages and salaries as well as other benefits. In addition, a firm can incur labour costs if training is needed.</td>
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<td>- For many businesses the labour costs can be the biggest item of expenditure and reducing these costs by moving to a cheaper location can be an important factor.</td>
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<td>- Even if labour costs are not the largest production cost, there may be parts of the production process that are very labour intensive.</td>
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<td>- Many businesses offshored production to China in the 90s to take advantage of the large and cheap labour force.</td>
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<td>- However, wages in China have increased fivefold and this may well discourage firms from locating there.</td>
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<td>- It is not just the cost of the labour that matters, and it may be that the skills of the workforce are more important.</td>
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<td>- Businesses such as Dyson acted on this reasoning; it wanted cheaper labour and so left the UK but went to Malaysia for their skills, rather than the cheapest source of labour.</td>
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<td>- Many IT companies outsource to India because of the technical skills of the workforce there.</td>
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<td>- For other businesses, other factors override the issue of labour costs.</td>
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<td>- Rising fuel and transportation costs are becoming increasingly important.</td>
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<td>- For Zegna, the Italian designer label, actually making the clothes in Italy is important to its customers and one of the key elements of its marketing mix.</td>
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<td>- In the extract, Meco and Jabil Circuit have both moved to Mexico.</td>
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<td>- Many car manufacturers such as Honda and Volkswagen are increasing production in Mexico because it is a member of NAFTA and so has free trade with, and proximity to, the large markets of North America.</td>
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<td>- The degree to which labour costs are important is determined by a range of factors and will depend heavily on the nature of the product or service. These factors may include how labour intensive production actually is, or how skill intensive; changes in other costs, such as energy and transportation, and whether there is value in proximity to markets. Where markets require speedy responses to market change, offshoring may be less profitable.</td>
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Question Number | Indicative content |
--- | --- |
3 | **Knowledge/understanding 4, Application 4, Analysis 6, Evaluation 6**

- Inflation is a sustained rise in the general price level of an economy, or a fall in the value of money. The UK government uses a range of policies to try and control the rate of inflation. In terms of its monetary policy it aims for a target rate of 2%.
- Firms have faced a low inflation environment for most of this period. From 2000 to 2004 it was below the target of 2%.
- Any national average figure hides regional differences, e.g. wage cost inflation will differ by region in the UK.
- There was a spike in 2008, when inflation reached 5% and then a sudden fall in 2009 as the recession took hold.
- This was followed in the same year by a sharp rise back to 5% and then it was not until 2012, that it fell below target rate again.
- The impact of inflation depends on the changes in the price of their inputs, e.g. commodity price increases have been higher than average.
- If Aggregate Demand (AD) is too high then it begins to exceed Aggregate Supply (AS) the overall level of supply in the economy. Production cannot keep up with demand and costs rise as resources become scarcer and attract a higher price.
- Long-term stability has reduced uncertainty for business, making it easier to plan the hiring of resources.
- Short-term price volatility could have increased costs that were passed on in the form of higher prices or reduced profit margins depending on the competitiveness of the market they operate in and the number of substitutes for their product/service.
- If the inflation was imported (2009 onwards) this may imply rising raw material or input costs which firms could not avoid. The UK in recent years has suffered from imported inflation which means that the price of key imports, such as food and oil, has gone up due to global factors.
- As consumers have to pay increased prices for essentials such as energy and food, spending on other firms’ products/services is likely to have dropped.
- This is a more likely cause of the price rises 2008–2012, because demand pull inflation would be unlikely in a recession if there is spare capacity in the economy.
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<td>• Monetary policy can be used to control inflation but Extract F suggests that the bank rate hasn’t changed which means that borrowing costs for firms would be relatively low and consumer credit would also be low. This will have no impact if the availability of credit is more important than the cost of credit.</td>
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<td>• Neither policy will be effective if the inflation is caused by anything other than rising AD.</td>
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<td>• Business investment will depend on expectations of future inflation as well as future demand. If inflation were to continue to fall this might signal that demand is weak and deter investment.</td>
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<td>• Expectations about inflation are also important because if people expect inflation to get worse they may demand even higher wages and therefore increase costs for firms.</td>
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<td>• Export competitiveness should be helped by low inflation although what happens to the exchange rate is also important.</td>
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You do not need any other materials.
Investigating the Economic Environment and Business

Context

This year the context is the Indian economy.

Research

To prepare for this year's context, you should research:

• growth indicators, such as GDP and GDP per capita over the last ten years
• macro-economic indicators, such as employment and investment over the last ten years
• changes in interest rates and exchange rates over the last ten years
• structural change in the Indian economy and key growth sectors
• the business environment and the ease of doing business, including political and cultural factors.

You cannot take any of your research or investigation data carried out as part of the pre-release into the examination.
Investigating the Economic Environment and Business Context

This year the context is the Indian economy.

Research

To prepare for this year's context, you should research:

• growth indicators, such as GDP and GDP per capita over the last ten years
• macro-economic indicators, such as employment and investment over the last ten years
• changes in interest rates and exchange rates over the last ten years
• structural change in the Indian economy and key growth sectors
• the business environment and the ease of doing business, including political and cultural factors.

You cannot take any of your research or investigation data carried out as part of the pre-release into the examination.
Answer ALL questions.

SECTION A

Read the following extracts (A to C) and Figures 1 and 2 before answering Question 1.

Write your answers in the spaces provided.

Extract A

What is wrong with India’s economy?

For the financial year that ended on 31 March 2013, India’s GDP grew by less than 5% – the slowest in a decade. In an attempt to boost the economy, the government has reduced restrictions on foreign direct investment (FDI) in various sectors, especially telecommunications.

In two other areas – economic inequality and the international exchange rate of the Indian rupee – India’s economy appears to be worse off than where it was two decades earlier.

India’s current account deficit reached $33bn (£22bn) in the quarter ending December 2012, a record level of 6.7% of GDP. The deficit is also the principal reason why the Indian rupee has dipped to an all-time low against the US dollar over the last month.

(Source: http://www.brameshtechanalysis.com/2013/07/what-is-wrong-with-indias-economy/)

Slipping Growth (in %)


Figure 1

GDP Growth 2006–2013
Extract B

The biggest losers in India’s economic slowdown

One of the big successes of India’s economic growth has been its positive impact on poverty reduction. The percentage of the country’s population living below the poverty line declined from 37.2% in 2005 to 29.8% in 2010 (the last year when exact numbers were available). That equates to 52 million Indians who have been lifted above the poverty line. Encouraging as those gains are, the country still counts over 320 million poor among its citizens.

Poverty reduction in India is sensitive to economic growth. That is why the current slowdown is troubling – India’s growth trend over the next few years will have a direct impact on how many people can be raised from extreme poverty.

Economic growth in itself doesn’t guarantee poverty reduction; growth must also be evenly distributed to raise incomes at every level. As the country’s economy has grown, so has income inequality. In India, the Gini coefficient increased from 0.34 in 1994 to 0.39 in 2011.

Extract C

Food and fuel prices push Indian inflation higher

Inflation has remained a primary concern for the central bank, the Reserve Bank of India, over the last few months. The bank raised its benchmark interest rate again to 7.75% from 7.5% late last month in an effort to control rapidly rising inflationary pressures.

![Inflation rate graph](Source: CEIC, Kotak Economic Research)

**Figure 2**

Rise in inflation momentum

India’s inflation rate increased to 7% in October 2013, the highest in eight months, driven primarily by higher fuel and food prices. The Government reported that prices for fuel and power rose 10.3% in October while food prices were 18.2% higher than a year ago.

Higher inflation puts pressure on policy makers trying to battle slow growth in the economy. They are faced with a dilemma: raising interest rates may reduce inflation, but could further restrict growth.

“Inflation continues to accelerate, and food inflation is again at work, although food prices are likely to fall in the coming months as supply improves,” said Leif Lybecker Eskesen, chief economist at HSBC Global Research.

India’s inflation rate rose by more than was expected in recent months as a weaker currency brought higher import costs.

1 (a) Using a suitable diagram, discuss why ‘food prices are likely to fall in the coming months’ (Extract C, lines 7–8).

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(b) Assess the likely impact on the Indian economy of the change in the Gini coefficient between 1994 and 2011 (Extract B).

(10)
(c) Assess the likely impact of further increases in interest rates on the level of inflation in India.

(12)
(d) Evaluate the benefits for the Indian economy of allowing increased levels of foreign direct investment (FDI).

(20)
SECTION B

Read the following extracts (D to F) and Figure 3 before answering Question 2.

Write your answers in the spaces provided.

Extract D

Big mover

Named after founder Lord Joseph Cyril Bamford, JCB is among the world’s largest construction equipment makers with operations in close to 150 countries. It is currently investing to gain a bigger share of India’s $6.5bn construction market which is expected to be worth $23bn by 2020. JCB is currently the biggest player in this market segment. “Anybody who needs to dig earth comes to us,” says Vipin Sondhi, MD and CEO, JCB India.

In 2012, JCB accounted for close to half of the Indian market for backhoe loaders (pictured) – over 24,000 of the 49,000 sold were JCB. In India JCB already has three manufacturing facilities, two in Pune and one at Ballabgarh. One of the Pune factories just makes components for the 18 JCB factories across Asia, Europe, North America, and South America, where it recently expanded into Brazil.

While JCB is the market leader in India, it trails its rivals in other emerging markets. JCB faces immense competition from other international manufacturers, such as Caterpillar, Case New Holland and Chinese producer, Sany.

(Source: http://www.businessworld.in/news/business/infrastructure/big-mover/1224297/page-1.html)

Extract E

JCB’s organic growth

Its bright yellow diggers have become one of Britain’s most recognisable global brands. Lord Bamford, the chairman of privately owned JCB says the earthmoving equipment maker’s achievements come from adopting a philosophy similar to Germany’s Mittelstand – the network of family-owned small to medium sized businesses that are the backbone of the economy.

In 2011, the company had a turnover of £2.75bn and made an operating profit of £355m. In 2012, turnover was down slightly at £2.7bn and operating profit was £365m.

(Source: http://www.ft.com/cms/s/0/4acbcbea-63ef-11e3-b70d-00144feabdc0.html#axzz2spmu3eNx)
Extract F

Collapsing Asian currencies

The Indian rupee reached an all-time low of 68.85 against the US dollar on August 28, 2013. The rupee plunged by 3.7% on the day in its biggest single-day percentage fall in more than two decades. Since January 2013, the rupee has lost more than 20% of its value, the biggest loser among the Asian currencies.

Several emerging market currencies are also experiencing sharp decline. The South African Rand and the Brazilian Real touched four-year lows against the US dollar in June 2013. Except the Chinese Yuan (Renminbi) and Bangladeshi Taka, most Asian currencies have witnessed sharp depreciation since the beginning of 2013.

![Major currencies' movement against the $](http://www.globalresearch.ca/collapsing-asian-currencies-why-is-the-indian-rupee-depreciating/5350017)

2  (a) Using an appropriate calculation, discuss the implications for JCB of the change in their operating profit margins for 2011 and 2012 (Extract E).
(b) Assess one strategy JCB might adopt to increase market share in emerging markets. (10)
(c) Assess JCB’s decision to grow organically.

(12)
(d) With reference to Extract D and Extract F, evaluate the likely impact on JCB of the change in the value of the Indian rupee.

(20)
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<td><strong>Knowledge/understanding 2, Application 2, Analysis 2, Evaluation 2</strong></td>
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- Constructs a labelled demand and supply diagram with correct axes, D and S curves, equilibrium price and quantity shown.
- Shows a shift of the supply curve to the right, causing a movement along the demand curve, causing a change in equilibrium price and quantity.
- Explains that the supply of food is improving and that this means more is available causing a fall in food prices and an increase in Q traded.
- Food supply is unpredictable and affected by factors such as the weather which can drastically affect supply and therefore the extent of the price change.
- Demand factors may also influence food prices.

![Diagram](image.png)
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<td>Level 3</td>
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<td>Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen. Arguments are developed, using logical, coherent chains of reasoning. A balanced awareness of competing arguments.</td>
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**Demonstrating application (AO2) in responses**

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<td></td>
<td>• The change in the Gini coefficient indicates increasing income inequality because it has increased from 0.34 to 0.39.</td>
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<td>• Increasing inequality means that the gap between the richest members and the poorest members is widening; the Gini coefficient is now 0.39 in India – by comparison the Gini coefficient in UK is 0.32.</td>
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<td>• Income inequality refers to the unequal distribution of wealth and income amongst the population.</td>
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<td>• Income inequality has doubled in India since the early 1990s. The richest 10% of Indians earn approximately 12 times as much money as the poorest 10%, compared to roughly six times in 1990. Increasing inequality of income can be seen as both a social and economic problem and can result in social unrest.</td>
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<td>• Problems for India include that the wealth created by economic growth is not finding its way down to all of the less well-off, some of whom remain close to living in poverty with poor health and poor or no education.</td>
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<td>• This holds back India’s future growth and hinders the development of an internal market.</td>
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<td>• However, it does not necessarily mean that the poorest are getting poorer, just the gap getting wider.</td>
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<td>• Growth may well be a necessary condition for reducing poverty and in India it has indeed brought millions out of poverty.</td>
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<td>• Interest rates are a component of monetary policy and are used to control inflation by affecting AD.</td>
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<td>• Increasing interest rates may cause consumers to borrow and spend less and businesses to borrow and invest less, which in turn may reduce AD and cool inflationary pressures.</td>
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<td>• The change from 7.5% to 7.75% is only a small one and may have little impact.</td>
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<td>• In the short run, changes in interest rates may have little impact; it takes time for the cumulative effect to be felt.</td>
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<td>• Changes in interest rates affect the level of aggregate demand which may not be the cause of the current inflation.</td>
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<td>• This is because the inflation is imported in the form of higher fuel prices of 10.3% and higher domestic food prices of 18.2%. Higher interest rates are likely to have little or no impact on reducing these prices.</td>
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<td>• However, not all the inflation may be caused by imported factors and increased interest rates may help somewhat.</td>
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<td>• Although the currency is weak at the moment increased interest rates may cause an appreciation of the rupee and lessen the inflationary pressures.</td>
<td>(12)</td>
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<td><strong>Knowledge/understanding 4, Application 4, Analysis 6, Evaluation 6</strong></td>
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<td>• The level of FDI is a controversial area for India.</td>
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<td>• Increased levels of FDI may bring foreign businesses such as <em>Wal-Mart</em> in to India in search of new markets or looking to base production there.</td>
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<td>• This may have a range of impacts on India.</td>
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<td>• Jobs may be created both directly and indirectly which sets in motion a positive multiplier effect. The FDI that comes with the new businesses is likely to boost incomes that, in turn, will be spent in other local businesses to their benefit.</td>
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<td>• Some of the many traditional small shops that currently sell to local people may disappear as customers use modern retailers such as <em>Wal-Mart</em>.</td>
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<td>• However, local businesses may face increased competition and a fall in sales, unemployment may rise.</td>
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<td>• Indian construction firms may well receive a boost as the new stores are built. Local businesses such as transport, banks or maintenance may receive contracts.</td>
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<td>• Local suppliers may see an increase in orders if the incoming businesses source within India.</td>
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<td>• Skills and technology transfer may take place.</td>
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<td>• Tax revenues may increase, giving a boost to India’s government run services.</td>
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<td>• Profits may be repatriated and taxes avoided. Workers may get only menial or poorly-paid jobs, externalities may be created.</td>
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<td>Isolated elements of knowledge and understanding, using little or no relevant evidence. Arguments and chains of reasoning may be attempted, but fail to connect causes and consequences. Limited attempt to address the question.</td>
</tr>
<tr>
<td>Level 2</td>
<td>5–9</td>
<td>Elements of knowledge and understanding, using limited relevant evidence. Arguments and chains of reasoning are presented, but connections between causes and consequences are incomplete. Limited attempt to address the question. Comparisons, judgements or conclusions may be attempted, but are unsupported or generic.</td>
</tr>
<tr>
<td>Level 3</td>
<td>10–15</td>
<td>Accurate knowledge and understanding, supported by use of relevant evidence to support the argument, developed chains of reasoning, showing understanding of connections between causes and consequences. Arguments are well developed and partially evaluated. An awareness of the significance of competing arguments is present although this may lack balance. A conclusion may be attempted but may not show awareness of the significance of competing arguments.</td>
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<tr>
<td>Level 4</td>
<td>16–20</td>
<td>Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen and fully integrated to support the argument, well developed and logical, coherent chains of reasoning, showing full understanding of the question. Arguments are fully developed and evaluated. A full awareness of the validity and significance of competing arguments, leading to nuanced and balanced comparisons, judgements or conclusions.</td>
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<td><strong>Knowledge/understanding 2, Application 2, Analysis 2, Evaluation 2</strong></td>
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<td></td>
<td>- operating profit margin = ( \frac{\text{operating profit}}{\text{total revenue}} ) x 100</td>
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<td>- 2011 ( \frac{355\text{m}}{2\text{ 750m}} ) x 100 = 12.9%</td>
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<td>- 2012 ( \frac{365\text{m}}{2\text{ 700m}} ) x 100 = 13.5%</td>
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<td>The operating profit margin has increased between 2011 and 2012.</td>
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<td>- More profit is made from a lower turnover, this may mean better use of resources/reduction in costs and indicates <strong>JCB</strong> is increasing in efficiency.</td>
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<td>- However, this is only a small change over a small period of time and may not be significant in the long run.</td>
<td>(8)</td>
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### Question 2(b)

**Knowledge/understanding 2, Application 2, Analysis 3, Evaluation 3**

**NB A range of strategies may be suggested here, reward any plausible line of argument.**

- Ideas might include pricing, promotion or adaptation of the product, e.g. it could use penetration pricing as in markets such as Brazil, it faces intense competition from *Sany* in China.
- Low prices may attract new customers and *JCB* will hope to build market share and a reputation to ensure future sales.
- The outcome will depend on the PED in individual markets.
- This will affect profitability.
- In the event that sales revenue falls, *JCB* will have to rely in the short term on sales in more established markets to generate profits.
- It may not be easy because *Sany* are from China and are also likely to benefit from low assembly/manufacturing costs.
- If PED is high, this could be a successful strategy.

(10)

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<td></td>
<td>• Organic growth means using your own resources to grow and does not involve takeovers or mergers. <em>JCB</em> is a family firm and privately owned.</td>
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<td>• Growing inorganically may mean losing some degree of control and would go against the company ethos.</td>
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<td>• Organic growth implies a possibly slow but steady expansion without overextending and taking risks. Over 50% of all mergers and takeovers fail to yield anticipated benefits and can be risky.</td>
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<td>• <em>JCB</em> has concentrated on its engineering and focuses on a few key areas, again organic growth maintains this approach.</td>
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<td>• However, the global construction market is a dynamic and rapidly expanding market.</td>
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<td>• Organic growth can be slow and <em>JCB</em> may miss out on key opportunities.</td>
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<td>• Entering new markets means having to compete against other firms to get established which can be difficult and costly.</td>
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<td>• Inorganic growth can be rapid and taking over competitors is a good way of not only gaining entry to a market and an established customer base but reduces the competition at the same time.</td>
<td>(12)</td>
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- **JCB**
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| 2(d)            | **Knowledge/understanding 4, Application 4, Analysis 6, Evaluation 6**  
|                 | • If the rupee depreciates then imports into India will be more expensive and exports from India will be cheaper in terms of foreign currencies. This can have a range of impacts on JCB.  
|                 | • If it imports components and raw materials into India it may well face an increase in costs of production.  
|                 | • Much will depend on what proportion of its imports is sourced abroad. A small increase in costs may be absorbed without problem and even if prices are raised the impact on demand will depend on the PED for its products.  
|                 | • It has a strong brand and is the market leader in India and so it may not be too damaging.  
|                 | • Exports of JCB equipment from India may become more competitive as foreign countries give up less of their own currency to buy and so sales may increase.  
|                 | • By comparison to the US dollar, the Indian rupee has depreciated by slightly more than the Brazilian real (-12.86% compared to -9.51%).  
|                 | • This should make JCB slightly cheaper in Brazil. However, Sany, which is Chinese, will increase in price to the Brazilians because the yuan has hardly changed against the US dollar (+0.30) and other currencies.  
|                 | • Much depends on the size of the depreciation and how long it lasts, currencies are volatile and in a year the position could be reversed.  
<p>|                 | • JCB may have minimised the impact by using forward markets to reduce risk. | <strong>(20)</strong> |</p>
<table>
<thead>
<tr>
<th>Level</th>
<th>Mark</th>
<th>Descriptor</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>A completely inaccurate response.</td>
<td></td>
</tr>
<tr>
<td>Level 1</td>
<td>1–4</td>
<td>Isolated elements of knowledge and understanding, using little or no relevant evidence. Arguments and chains of reasoning may be attempted, but fail to connect causes and consequences. Limited attempt to address the question.</td>
</tr>
<tr>
<td>Level 2</td>
<td>5–9</td>
<td>Elements of knowledge and understanding, using limited relevant evidence. Arguments and chains of reasoning are presented, but connections between causes and consequences are incomplete. Limited attempt to address the question. Comparisons, judgements or conclusions may be attempted, but are unsupported or generic.</td>
</tr>
<tr>
<td>Level 3</td>
<td>10–15</td>
<td>Accurate knowledge and understanding, supported by use of relevant evidence to support the argument, developed chains of reasoning, showing understanding of connections between causes and consequences. Arguments are well developed and partially evaluated. An awareness of the significance of competing arguments is present although this may lack balance. A conclusion may be attempted but may not show awareness of the significance of competing arguments.</td>
</tr>
<tr>
<td>Level 4</td>
<td>16–20</td>
<td>Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen and fully integrated to support the argument, well developed and logical, coherent chains of reasoning, showing full understanding of the question. Arguments are fully developed and evaluated. A full awareness of the validity and significance of competing arguments, leading to nuanced and balanced comparisons, judgements or conclusions.</td>
</tr>
</tbody>
</table>