Examiners' Report
January 2012

GCE Economics 6EC03 01

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January 2012

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Introduction

The paper was perceived as being very difficult on SCQs, and a lot of economic theory was required. In question 6 41% chose the correct answer and fewer than 5% appeared to favour B or C. Question 10 (yogurt) was more popular (ratio 2:1) and but question 9 elucidated some most excellent and thoughtful responses, with deep reflection on the issues. Questions 9c, 10b and 9d proved to be very challenging conceptually. The candidates who had good exam technique and timed themselves carefully always scored better for so doing.

Question 1

Many candidates were confused between 'monopsony' and 'monopoly', and either defined the latter instead of the former in their answers, or appeared to have read option A as saying 'monopoly'. Candidates who attained high marks in this question tended to give both a correct definition of monopsony and explained the role of the Competition Commission correctly. They also made reference to the supermarkets' **exploitation** of their market power, while less able candidates simply repeated the fact that the supermarkets were 'paying very low prices to some suppliers' from the question itself. Very few candidates included any application to the specific context of purchasing grocery supplies in their response.

Here is a good example, with points clearly made - in fact there is more than enough here.

SECTION A: Answer all the questions in this section.

You should spend 35 minutes on this section. Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

1 In August 2009 the Competition Commission published a Groceries Supply Code of Practice. Large supermarket chains were paying very low prices to some suppliers. Which type of market power does this suggest the large supermarket chains have?

(1)

A Monopsony

B Monopolistic competitive

C Perfectly competitive

D Natural monopoly

E Competitive monopoly

Answer A

Explanation

(3)

The roles of the Competition Commission are to promote competition, prevent anticompetitive practice and protect consumer welfare (public Interest)

Monopsony power refers to a type of economies of scale (purchasing economies) where longrun average cost is decreasing with the rise of output.

The ~~super~~ large supermarket chains such as Tesco can bulkbuy ~~ma~~ raw materials ~~from~~ with a very low ~~b~~ wholesale price from farmers.

Monopsony: there's only one buyer of raw materials from suppliers in the market, which will force suppliers to take whatever price ~~the~~ it makes.

ResultsPlus
Examiner Comments

Explanation of role of CC (1). Definition of monopsony (1). Application to Tesco in bulk buying at low prices (1). Implicit consequences for farmers (1).

ResultsPlus
Examiner Tip

Learn monopsony as distinct model.

Definition (1).

Restriction of supply (1).

Impact on profit (1).

SECTION A: Answer all the questions in this section.

You should spend 35 minutes on this section. Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

1 In August 2009 the Competition Commission published a Groceries Supply Code of Practice. Large supermarket chains were paying very low prices to some suppliers. Which type of market power does this suggest the large supermarket chains have?

(1)

A Monopsony

B Monopolistic competitive

C Perfectly competitive

D Natural monopoly

E Competitive monopoly

Answer A

Explanation

(3)

Monopsony is where there is only one consumer of the good. Therefore the producers and suppliers are restricted to who they want to supply to. Therefore the supermarket chain, being the sole consumer, can dictate the price and lowering the price to ~~a~~ its suppliers reduces ~~the~~ ~~f~~ its costs allowing for~~a~~ greater profit.

ResultsPlus
Examiner Comments

1 + 3

ResultsPlus
Examiner Tip

Make sure there are 3 parts to the answer, at least.

Question 2

Many candidates gave definitions and examples of 'variable costs' in response to this question; however they needed to define or give a formula for '**average** variable costs' in order to earn a definition mark, as this was the relevant economic variable mentioned in the correct key.

Most candidates are aware of the concept of the short run shut-down condition, but less able candidates struggled to explain it, particularly in relation to the ideas of loss minimisation and making a contribution to fixed costs (both of which would have gained marks).

A good number of candidates attempted diagrams and when done correctly these provided an excellent explanation of the correct key. The most common mistakes were confusions over the shape and labelling of the A(T)C and AVC curves. Candidates should use their diagrams to maximum effect by illustrating and labelling all relevant variables, for example, many correctly drawn diagrams could have earned more marks if they had also shown the loss area and/or the contribution area. Some credit was given for candidates who drew a perfectly priced elastic demand/average revenue curve, however given the context of the question, this was incorrect and candidates do need to be more aware generally of the need to consider different topics from the specification at the same time when answering questions (i.e. market structure as well as shut-down conditions).

Many used an effective knock out of C (short run not long run) as a way to pick up marks here, or referred to the shut down point as a formula or diagram.

2 General Motors made a loss of \$4.3billion in 2009. Under which one of the following conditions are firms such as this likely to keep operating?

(1)

A The market is highly contestable

B They are covering average variable costs in the short run

C Total revenue is less than total cost in the long run

D They are covering marginal costs in the short run

E There are low sunk costs in the industry

Answer B

Explanation

(3)

Average variable costs $= \dfrac{\text{total variable costs}}{\text{total output}}$

The shut down point of a firm is when AVC > AR. A firm will keep operating in the short run if AR > AVC.
However they might shut down in the long run as fixed costs aren't covered.

Cant be C because if total costs exceed total revenue in the long run will force a company to leave the market.

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Examiner Comments

4 marks. Correct key 1 mark.Formula for AVC 1 mark. Shut down point is AVC > AR 1 mark. Shut down in long run because fixed costs aren't covered 1 mark.

ResultsPlus
Examiner Tip

Use a formula or diagram.

Contestability is always a good distraction.

2 General Motors made a loss of $4.3billion in 2009. Under which one of the following conditions are firms such as this likely to keep operating?

(1)

A The market is highly contestable

B They are covering average variable costs in the short run

C Total revenue is less than total cost in the long run

D They are covering marginal costs in the short run

E There are low sunk costs in the industry

Answer A

Explanation

(3)

Because they're making a large loss and the car industry is highly competitive. It's not B as they're obviously not covering average variable costs if they're making a loss. It's not C because if this was true GM would have had to declare bankrupcy by now, which they haven't.

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Examiner Comments

Knock outs don't help if they don't add any economic insight.

ResultsPlus

Examiner Tip

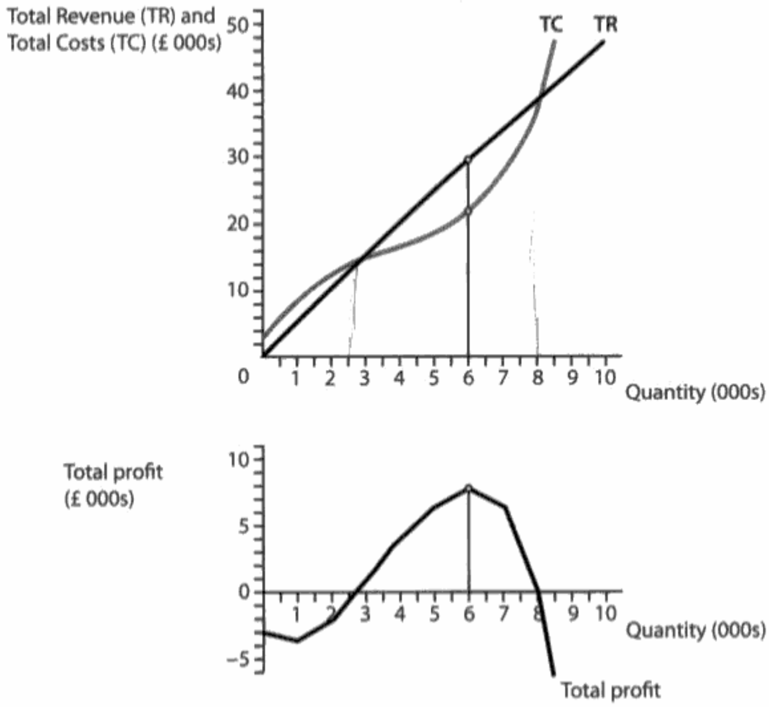
Try to refer to the relevant part of the specification and use the economists' toolkit.

Question 3

Few candidates managed to annotate the diagrams in any meaningful way and indeed there was a fairly common misunderstanding that the area of length 0 to 6,000 units and height the difference between the TR and TC curves represented the total SNP made in the top diagram, which was obviously incorrect.

Only the more able candidates were able to identify the link between the linear TR curve and perfect competition/price-taker.

3



The diagrams show the costs, revenue and profit for a profit maximising firm.
What can be inferred from these diagrams?

(1)

A The firm operates in a perfectly competitive market in the short run

B The firm will produce at a quantity of 6,000 units in the long run

~~**C**~~ There are barriers to entry and exit

D The firm will produce at **any** output between 2,650 and 8,000 units

~~**E**~~ The firm is making a loss

Answer $\boxed{A}$

Explanation

(3)

A perfectly competitive market is one where there are no, or low barries to entry, where goods are homogenous and where there is perfect knowledge. We can see in the diagram that the firm profit maximises at a quantity of 6000 however in a perfectly competitive market firms are only able to ~~profit maximise~~ gain supernormal profit in the short run because in the long run firms will be attracted to the ~~the~~ industry because of the supernormal profit which will ~~to~~ mean that ~~in the~~ all of the firms in the industry will then only be able to make normal profit which is why the diagram shows that profits fall after peaking.

ResultsPlus
Examiner Comments

1 + 3

Once the answer is right, the subsequent marks were easy to earn.

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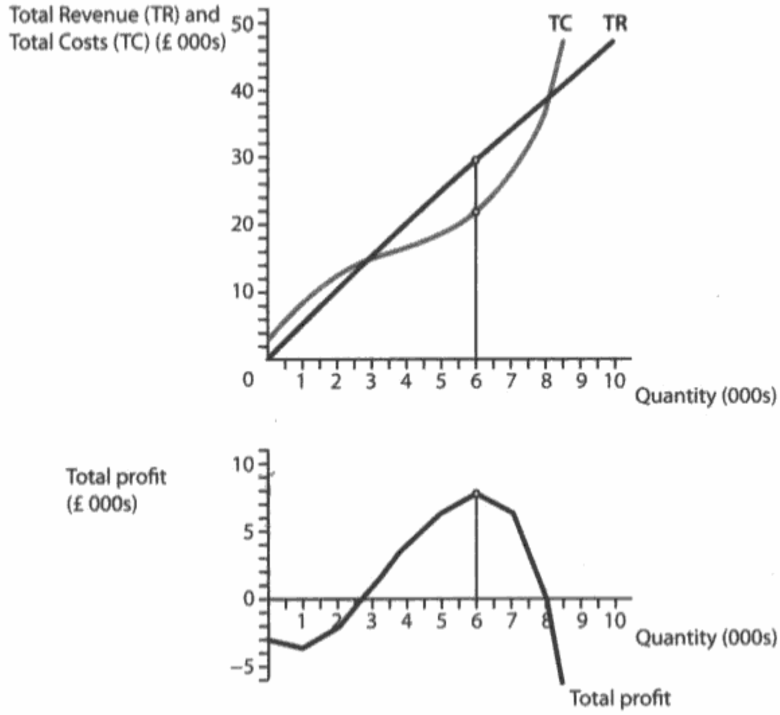
Examiner Tip

Look carefully at the gradient of TR.

Relatively few candidates managed to get the correct answer to this question, with a majority of candidates opting for answer B. This meant that they were limited to a maximum mark of 2/4 and indeed this was easily the mode mark, as most were able to identify the profit-maximisation condition and site some relevant data from the diagrams.

3



The diagrams show the costs, revenue and profit for a profit maximising firm. What can be inferred from these diagrams?

(1)

A The firm operates in a perfectly competitive market in the short run ✗

B The firm will produce at a quantity of 6,000 units in the long run

C There are barriers to entry and exit ✗

D The firm will produce at **any** output between 2,650 and 8,000 units

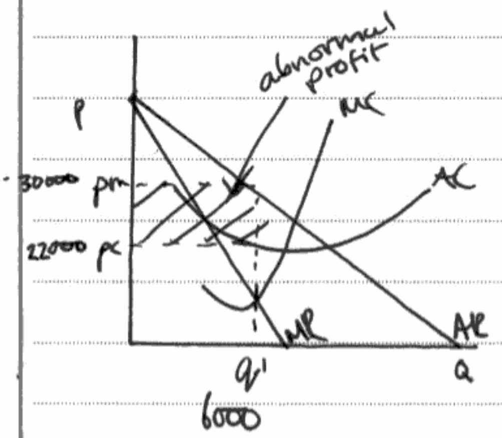
E The firm is making a loss ✗

Answer B

Explanation

(3)

- A profit maximising firm produces at mc = mr, which in this case is at 6000 units to make an abnormal profit of £8000.



ResultsPlus Examiner Comments

0 + 2

ResultsPlus Examiner Tip

The data mark is the easiest to earn.

Question 4

Candidates mostly answered this question well and showed a good understanding of payoff matrices, collusion and the incentive to cheat.

Never leave the key box empty.

4 The following matrix shows the possible revenue outcomes of two firms tendering building services to the government. Assuming Hanna Ltd and Jax Ltd have agreed a pricing strategy that will give each a revenue of £1000, what change in pricing strategy would increase the revenue for Hanna Ltd?

(1)

		Hanna Ltd	
		High price	Low price
Jax Ltd	High price	£1000 / £1000	£600 / £1200
	Low price	£1200 / £600	£800 / £800

A Both firms set a high price

B Hanna Ltd sets a high price and Jax Ltd sets a low price

C Jax Ltd sets a high price and Hanna Ltd sets a low price

D Both firms set a low price

E The firms engage in tacit collusion

Answer ☐

Explanation

(3)

~~Game theo~~ A zero sume game theory is when the gains of one firm is the losses of another. Game theory is a strategy where both firms does not know ~~#~~ what their rivals are doing and the posible outcomes. A tacit collusion is when the firm ~~Illea~~ collude illegally.

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Examiner Comments

Does not attempt to answer a key (0). Has some sense of rationale of interdependence (1). Collusion is illegal (1).

ResultsPlus

Examiner Tip

Use the data and describe what happens

Data reference, in the form of saying that Hanna's revenue would rise to £1,200/by £200 was well done. The strongest candidates displayed a good familiarity with the language of game theory, being able to, for example discuss the 'first mover advantage' that Hanna was able to exploit, or identifying the game structure as that of the 'prisoner's dilemma'.

4 The following matrix shows the possible revenue outcomes of two firms tendering building services to the government. Assuming Hanna Ltd and Jax Ltd have agreed a pricing strategy that will give each a revenue of £1000, what change in pricing strategy would increase the revenue for Hanna Ltd?

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		High price	Low price
Jax Ltd	High price	£1000 £1000	£1200 £600
	Low price	£600 £1200	£800 £800

A Both firms set a high price

B Hanna Ltd sets a high price and Jax Ltd sets a low price

C Jax Ltd sets a high price and Hanna Ltd sets a low price

D Both firms set a low price

E The firms engage in tacit collusion

Answer $\boxed{C}$

Explanation

(3)

Game theory is the analysis of how interdependant firms in an ~~m~~ oligopolistic market make decisions and how their decisions affect other firms. It is C because if Jax Ltd set a ~~lo~~ high price their revenue would fall to £600 as long as Hanna Ltd set a ~~l~~ low price which would make Hanna Ltd's profit rise to £1200. It is not D~~8~~ because if both firms set a low price their revenues would both fall to £800

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Examiner Comments

Shows rise in Hanna's revenue (£1200) (1). Jax keeps price high (1). Knock out (1).

ResultsPlus

Examiner Tip

Note that credit is given for identification of the Nash equilibrium, however this was in no way required, as it is not included in the specification for this unit.

Question 5

Most candidates found this a relatively straight-forward question and were able to achieve a good mark, particularly through an explanation of the likely motives for the takeover and/or an explanation that this was an example of conglomerate integration. Definitions of 'diversification' were, however, less well done, and too many candidates missed picking up an application mark by explaining the lack of crossover between poultry/pharmaceuticals and football. As always, the best answers were those that were specific to the context of the question, and, for example gave the possible motives for the takeover as entering new geographical markets (India/UK) either to gain extra revenue or reduce risk, the likely resultant publicity/prestige from owning a football club, or even the fact that poultry and football tickets are likely to have very different income elasticities of demand and hence provide good 'hedges' against the risk of changing average incomes.

Some candidates had not heard of diversification but could deduce the meaning.

5 In November 2010, the Indian poultry and pharmaceutical company Venky's bought Blackburn Rovers Football Club in the UK for £23 million. One likely motive for this takeover was to benefit from

(1)

A technical economies of scale

B diversification

C price discrimination

D forward vertical integration

E increased market share

Answer B

Explanation

(3)

Diversification is when a firm in one business sector takes over a firm in a completely unrelated sector. One possible motive for diversification is that it allows firms to cross subsidise. If one firm is performing well and one isn't then the profits from the good firm can be used to improve the worse off firm

ResultsPlus
Examiner Comments

Definition of diversification (1).Possibility of cross subsidisation (1).

ResultsPlus
Examiner Tip

Use the context (football and chickens here) to explain the process.

Here's full marks.

5 In November 2010, the Indian poultry and pharmaceutical company Venky's bought Blackburn Rovers Football Club in the UK for £23 million. One likely motive for this takeover was to benefit from

(1)

A technical economies of scale

B diversification

C price discrimination

D forward vertical integration

E increased market share

Answer B

Explanation

(3)

As the poultry, pharmaceutical and football club industry have very little in common a company owning them has better secruity against any changes in the market as they will have ~~the~~ no effect against the other two industries ~~to~~ ensuring they will ~~alw~~ theoretically always have income from somewhere this is diversification. and taking over the football club was a form of conglomerate integration as it ~~transfer~~ is from a compleatly different market to poultry and phamaceuticals.

ResultsPlus
Examiner Comments

Conglomerate integration (1). Still get income ie cross subsidise (1). Application -little crossover (1).

ResultsPlus
Examiner Tip

The candidates must not feel they have to use all the lines for SCQs. No more than 4 minutes on each SCQ question

Question 6

Whilst many candidates were able to give a characteristic of monopolistic competition as a market structure in response to this question, it would have been good to see more candidates doing this.The most common error, however, was to simply state/discuss what productive and allocative efficiency are, without explaining why monopolistic competition is inefficient in both of these respects in the long run. As with previous questions, candidates must be prepared to **apply** the economic theory they have learnt to any particular question, rather than relying on stating general formulae and definitions to gain marks.

Where drawn, diagrams usually showed the long run monopolistically competitive equilibrium correctly (i.e. AR=AC at the output level where MR=MC), but few candidates went on to make reference on their diagram to the conditions for allocative and productive efficiency not being met.

6 A firm selling snack food at a music festival is operating in market conditions of monopolistic competition. It is likely to be

(1)

A allocatively efficient in the short run and productively efficient in the long run

B allocatively efficient in the long run and productively efficient in the long run

C both allocatively and productively efficient in the long run

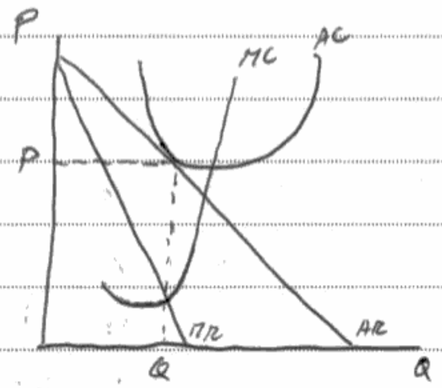
D neither allocatively nor productively efficient in the long run

E both allocatively and productively efficient in the short run

Answer D

Explanation

(3)



The firm will not sell at P=MC in the long run nor produce at the bottom of its AC curve

Allocatively efficient means that the firm is producing at P=MC

Productively efficient means that they are producing at the bottom of their average cost curve.

The firm will produce at MC=MR and will make normal profits in the long run selling at P=AR=AC

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Examiner Comments

This earns the full 1 + 3 marks. The diagram earns a mark, then the description on the right shows that neither of the efficiency points are being met. The definitions alone do not earn marks (below the diagram) but full marks have already been earned.

ResultsPlus
Examiner Tip

Stress the NOT being met, in terms of the efficiency points.

Diagrams don't always add value.

6 A firm selling snack food at a music festival is operating in market conditions of monopolistic competition. It is likely to be

(1)

A allocatively efficient in the short run and productively efficient in the long run

B allocatively efficient in the long run and productively efficient in the long run

C both allocatively and productively efficient in the long run

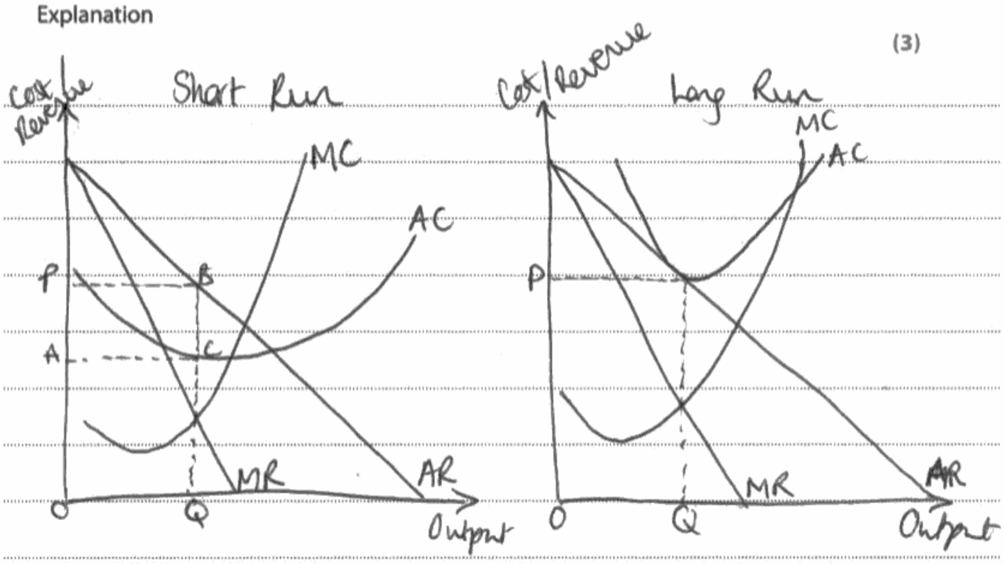
D neither allocatively nor productively efficient in the long run

E both allocatively and productively efficient in the short run

Answer D

Explanation

(3)



Productive efficiency - lowest point on AC curve
Allocative efficiency - P=MC.

Monopolistic competition - many small firms selling the same good which is slightly differentiated.

(Total for Question 6 = 4 marks)

ResultsPlus
Examiner Comments

Definition (1). Diagram is incorrect and no marks were awarded for definitions of efficiencies.

ResultsPlus
Examiner Tip

Learn to draw the monopolistic competition diagram for the long run extremely carefully indeed.

Question 7

Where drawn correctly and labelled fully, a diagram was sufficient to earn 3 marks here. Some candidates did this very well, however others appeared to be unclear as to the fact that a change in variable costs will change both average costs and marginal costs for a firm and hence both curves need to be shifted on any diagram. Some candidates also found it difficult to illustrate the profit areas on their diagrams correctly, particularly when diagrams had been drawn very small, or imprecisely, (eg without a ruler, or curves labelled ambiguously). Of course, candidates could also achieve full marks through an equivalent verbal analysis.

Where candidates stated that as Next, Primark and Debenhams were oligopolists, they would each face a kinked demand curve and if the new and old MC curves intersected the MR curve within its discontinuity, the increase in variable costs could result in an unchanged equilibrium price and output level, but a lower level of SNP (or even a loss) and hence the answer was D, they were able to gain 4/4 marks for this question. However as the specification for this unit is clear that kinked demand curve analysis is not required, no elements of this way of approaching the question were required to earn full marks.

Start by questioning whether it's fixed or variable costs that change.

7 The price of cotton, a major cost component in the clothing sold by retailers Next, Primark and Debenhams, is predicted to rise significantly. What will be the effect on these firms, if other factors remain constant?

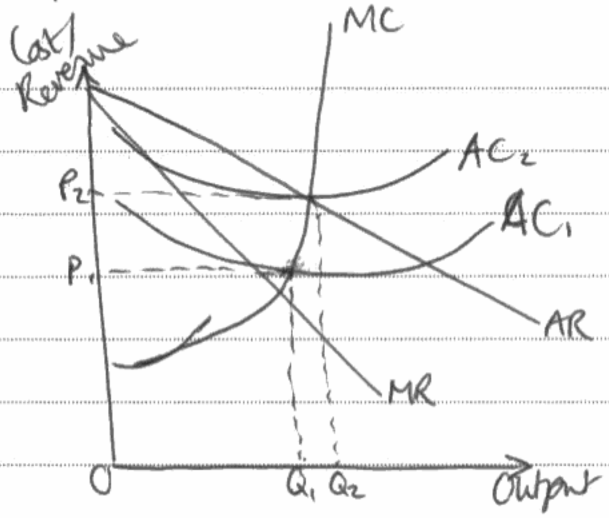
(1)

	Output	Profits
A	Rise	Rise
B	Constant	Constant
C	Fall	Fall
D	Constant	Fall
E	Fall	Constant

Answer $\boxed{C}$

Explanation

(3)



An increase in the price of cotton will lead to increases in average variable costs. This means prices will rise, output will fall, so profits will fall. There will ~~be~~ be an upward shift of AC and leftward shift of D=AR.

ResultsPlus
Examiner Comments

Identified rise in AVC (1). Diagram is incorrect as MC curve does not shift and equilibria are incorrect.

ResultsPlus
Examiner Tip

When MC shifts, find the new MC=MR.

There were marks for showing profit changes, where clearly labelled.

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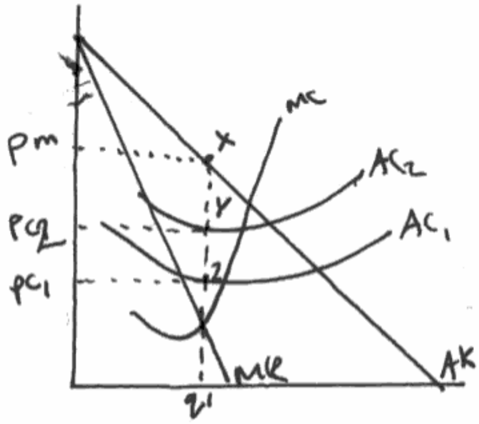
(1)

	Output	Profits
A	Rise	Rise
B	Constant	Constant
C	Fall	Fall
D	Constant	Fall
E	Fall	Constant

Answer D

Explanation



(3)

- These firms are profit maximisers so produce at mc=mr, which results at an output of q1

- The cost of production increases with the price of cotton to AC2 from AC1

- This results in a fall in abnormal profits from pm X Z pc1 to pm X Y pc2.

ResultsPlus
Examiner Comments

Explanation that profit falls with area (1). No marks for diagram as MC curve not shifted.

ResultsPlus
Examiner Tip

Use the context to decide which types of costs are involved.

Question 8

While most candidates were able to get the correct answer to this question, explanations were not, generally, well done. Many candidates appeared to be thrown by a question that was perhaps a little different to ones they had seen previously and forgot how to go about tackling supported choice questions. For example, many candidates did not pick up the relatively easy definition mark available for defining either 'monopoly' or 'market power', and very few candidates obtained the application/example mark. Similarly, a majority of diagrams did not show a horizontal AC=MC curve, with candidates tending to either ignore this part of the question entirely, or draw a horizontal AC curve and a parabolic ('tick-shaped') MC curve.

Usually a diagram helps, but most ignored the **constant average costs** (even though they were in bold in the question paper).

8 A large number of small bakeries in a competitive industry are taken over and combined to form a single monopoly supplier. Assuming **constant average costs**, what effect will this have on price and output?

$AC = \frac{TC}{Q}$

(1)

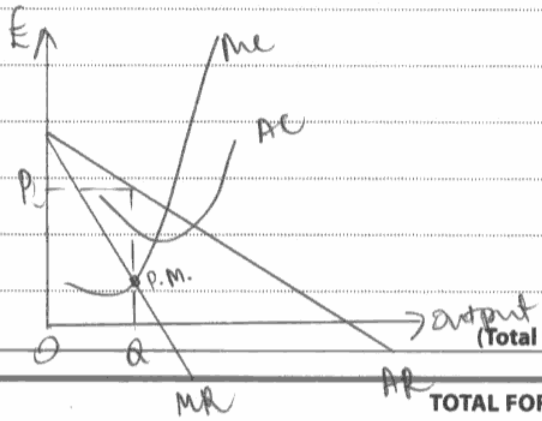
	Price	Output
A	fall	fall
B	no change	no change
C	rise	rise /
D	no change	fall
E	rise	fall /

Answer $\boxed{E}$

Explanation

(3)

A monopoly is a single firm in an industry who is a price maker, earns abnormal profit and profit maximises. Price will rise as a monopoly is a profit maximiser. ~~and~~ Output will fall as a monopoly can only either raise price or output and as prices rise, output will fall.



(Total for Question 8 = 4 marks)

TOTAL FOR SECTION A = 32 MARKS

ResultsPlus
Examiner Comments

Diagram does not show the competitive equilibrium. Definition of monopoly (1).

ResultsPlus
Examiner Tip

Use the diagram to show the changes. Arrows would help.

Again confusion about horizontal AR MR not AC MC.

8 A large number of small bakeries in a competitive industry are taken over and combined to form a single monopoly supplier. Assuming **constant average costs**, what effect will this have on price and output?

(1)

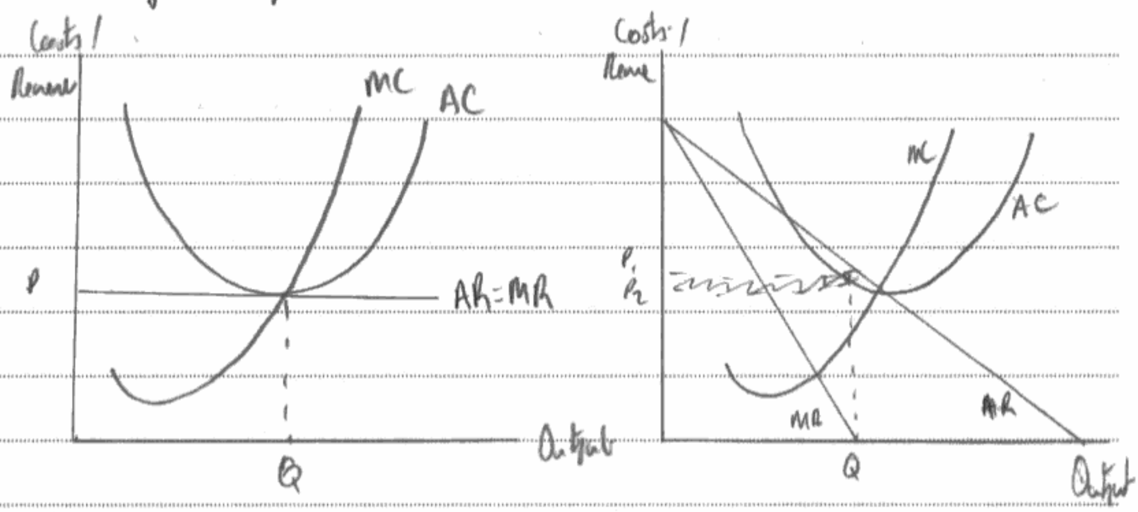
	Price	Output
A	fall	fall
B	no change	no change
C	rise	rise
D	no change	fall
E	rise	fall

Answer $\boxed{E}$

Explanation

(3)

Perfectly competitive markets produce at allocatively and productively efficient in the long run.
Monopoly is a single seller in a market.
perfect competition:



The diagrams above show changes that would occur.

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Examiner Comments

Monopoly definition 1 mark. Diagrams are not correctly drawn.

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Examiner Tip

Apply to context and use common sense.

Question 9 (a)

This question was generally well answered, with candidates aware of the need to incorporate both theory (knowledge) and application into their answers. A number of candidates did not give enough application in their answers to achieve full marks, however. To do so, they must have either referred to two separate pieces of evidence from the sources, or given a well developed explanation of one piece of evidence.

The answer is based on theory.

(a) With reference to Extract 1, what is meant by *anti-competitive behaviour* (Extract 1 line 3)?

(4)

Anti-competitive behaviour refers to billeteral agreement of two or more companies reached in a smoke-filled room. ~~Rl~~ The agreement is to destory the existance of the competition in the market. Finally, the consumers will only have to purchase the goods or services supplied by these only few firms at higher prices.

ResultsPlus
Examiner Comments

'Smoke filled rooms' allowed even if an archaic concept.

ResultsPlus
Examiner Tip

Apply to context given.

Cooperation or collaboration was acceptable for collusion definition mark.

(a) With reference to Extract 1, what is meant by *anti-competitive behaviour* (Extract 1 line 3)?

(4)

Anti-competitive behaviour is where firms cooperate with each other, tacitly or overtly to decide upon pricing and output to each others benefit. This reduces competition in the market.

In this case Barclays and RBS have colluded to their benefit ~~so as they can~~ by seeing each others pricing strategies, and from that they are able to decide on their own, which would maximise benefits for both of them.

This type of behaviour is what the competition commission wishes to avoid and can fine companies for this.

ResultsPlus

Examiner Comments

Theory: Collusion (1). Reduces competition (1). Application: Sharing pricing strategies (1)

ResultsPlus

Examiner Tip

Remember that 2/4 marks are for application.

Here's a clear full mark answer.

(a) With reference to Extract 1, what is meant by *anti-competitive behaviour* (Extract 1 line 3)?

(4)

Anti-competitive behaviour is where firms behave in such a way that restricts competition. It is the role of regulators to increase competition to benefit consumers. One method is fines, RBS was fined £28.6 million for its behaviour. RBS was involved in price setting with Barclays so ~~that~~ to charge a high price for loans in order to increase revenue as consumers have no choice.

ResultsPlus
Examiner Comments

Theory: restricts competition (1). Accept consumers have no choice as public interest (1). Application: Fined £26 million (1). Price setting with Barclays (1).

ResultsPlus
Examiner Tip

Use the context to fully flesh out the explanation

Question 9 (b)

Most candidates were able to identify an appropriate reason for the increased profits from the text and to at least attempt a diagram to illustrate this. Where candidates identified a fall in costs, there was some difficulty in categorising a given cost as fixed or variable (admittedly there is a grey area here and marking took this into account) and also confusion as to the effect of a fall in fixed costs only (AC falls) and a fall in variable costs (AC and MC fall), hence how to illustrate this diagrammatically. There were fewer errors where candidates identified an increase in demand/average revenue as the reason; however in this case, candidates often did not develop the reason sufficiently to attain the 2 marks available.

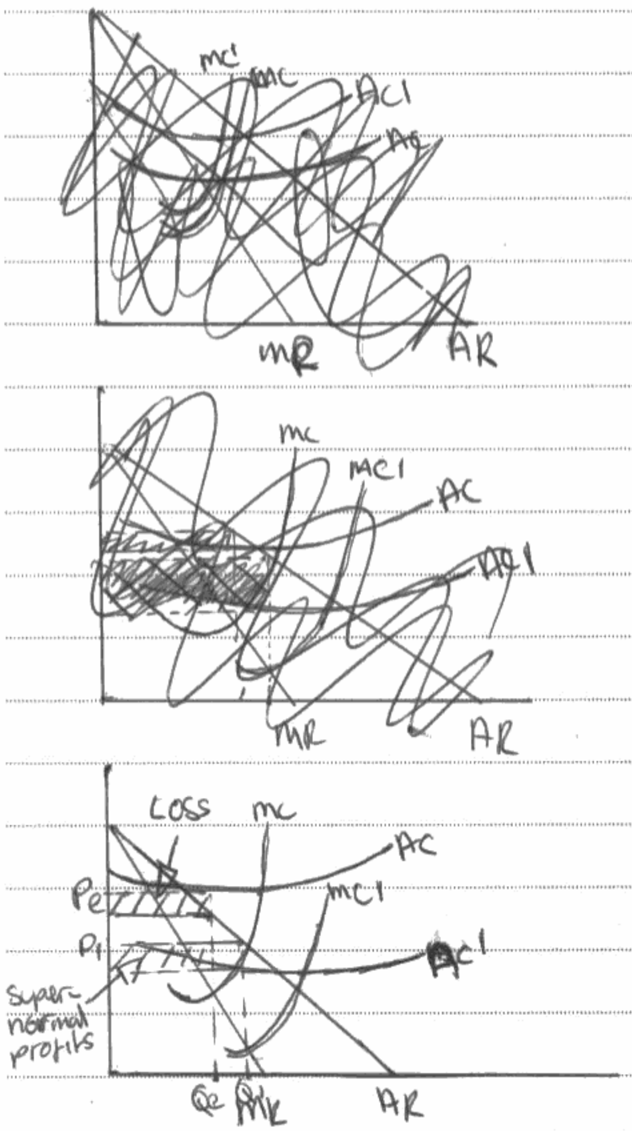
The majority of candidates were aware of the need to evaluate their answers, although a good number did not attempt any evaluation here. There was also a tendency for evaluative comments to be shorter and less detailed than the preceding analysis and hence candidates tended to earn fewer marks for evaluation than for KAA.

Candidates were not expected to know that bonuses are paid out of profits, rather than representing a cost to the firm, as this is not part of the specification and hence attempts at evaluation that included this misunderstanding were still able to gain marks.

Most answered using shifts in costs.

(b) Using an appropriate cost and revenue diagram, assess **one** likely reason why banks' profits rose in the UK in 2010 (Extract 2 paragraph 1).

(8)



This shows a fall in Average costs "benefits from staffing reductions"

ResultsPlus

Examiner Comments

KAA 4. Diagram - fall in MC/AC and higher profits (2). Analysis - fall in AC from staffing reductions (2). Comment on dividends not relevant.

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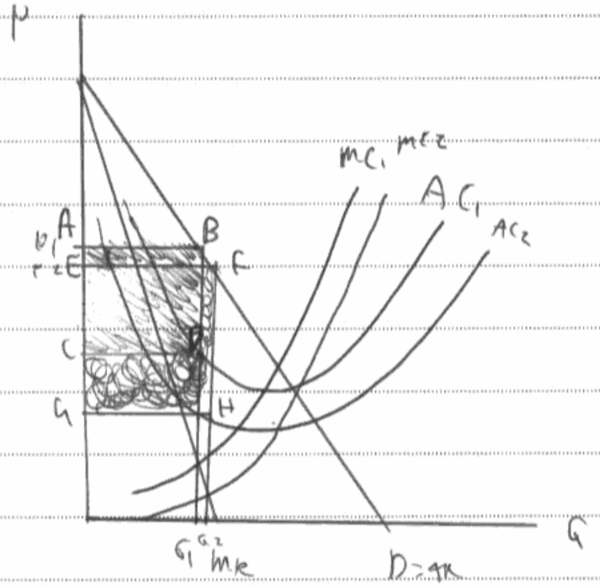
Examiner Tip

It is a good idea to shade the profit areas, as shown in the answer.

Some good evaluation here.

(b) Using an appropriate cost and revenue diagram, assess **one** likely reason why banks' profits rose in the UK in 2010 (Extract 2 paragraph 1).

(8)



Old profit area is shown by ABCD, and ~~new~~ new ~~profit~~ profit area is shown by EFGH the new profit area is larger, due to falling AC and MC costs as a result of staff reductions. ~~They will~~ ~~this~~ This will act as a reduction to ~~both~~ ~~total cost and as a~~ AC and as a result the difference between AC and AR will increase which will increase profits. However in evaluation, we don't know the long term effects of this situation. The combined profits of 8.4 billion between the banks is only for the first half of the year, and over a small period of time it is hard to make accurate assumptions.

These profits may be reduced again as a result of another economic downturn. ~~[illegible]~~ Chancellor Osborne is also putting pressure onto the banks to take out proportions from revenue, and use it to provide loans for small business, as a result, AR will decrease in the long run, and profits will be reduced. ~~[illegible]~~ However, the magnitude by which they will be reduced is debatable, and we don't know the extent of how ~~much~~ big a proportion of revenue they are planning to cut.

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Examiner Comments

KAA 4. Diagram - fall in AC/MC and higher profits (1). Analysis - fall in cost from staffing reduction (1). Evaluation 4.

Only first half information on profits provided -more information needed (2). Pressure from the government may lead to lower revenue by forcing them to lend to small/medium sized business sector (2).

ResultsPlus
Examiner Tip

Always use AC/MC AR/MR for diagrams showing profits.

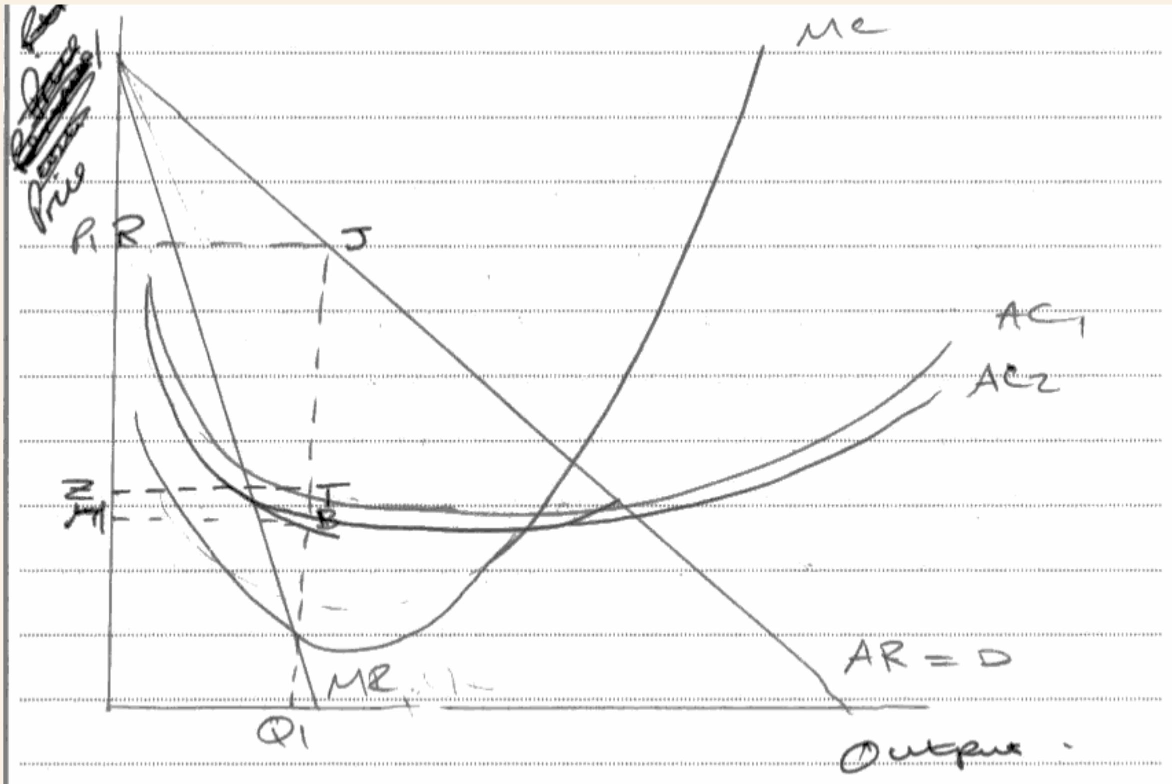
Regulation was taken in a very broad sense and candidates were encouraged to think widely.

*(c) Assess the likely impact on economic efficiency in the UK banking industry of increased regulation of UK banks.

(12)

As the regulation of banks increases the X-inefficiency of banks is likely to ~~...~~ fall, meaning they are able to supply at lower price for the same output. X inefficiency is the difference ~~#~~ ~~#~~ of the bottom of the ~~AC~~ average cost curve and the cost they actually incur.

If the banks are increasingly regulated, it will provide an incentive for banks to cut the costs and produce at a more productively efficient level. This will mean a fall in the total costs for banks, which can increase supernormal profits ~~T~~ or a reduction in the price level.



Initially a supernormal profit is being made of RJTZ with AC1.
If the bank increase productive efficiency they can obtain a supernormal profit increase of ZTBM

ResultsPlus
Examiner Comments

KAA 3. Forces ex-inefficiency to fall (1). Role of regulator (1). Diagram - backs up concept of efficiency (1). Evaluation - no marks.

ResultsPlus
Examiner Tip

50% of the marks are for evaluation.

Question 9 (d)

As with question 9(c), many candidates found this a challenging question and given this, there was a tendency to write answers that did not answer the question as set. For example, many candidates wrote about why Barclays may have used the pricing information in the first place, rather than discussing reasons for Barclays' changing behaviour (i.e. reporting RBS to the competition authorities).

Where pay-off matrices were drawn and explained correctly, candidates achieved good KAA marks. However, many attempts at pay-off matrices either contained no numerical pay-offs at all, were not applied to the context of the question in any way, or did not actually illustrate the prisoner's dilemma, although the candidate had obviously intended them to do so. Very few candidates referred to the idea of first mover advantage, although this would have been useful here and is mentioned explicitly in the unit specification.

Less able candidates also struggled to evaluate their answers to this question effectively. Whilst this might be expected, given that evaluation is the highest level skill being assessed, there does seem to be a need for candidates to recognise that in questions requiring evaluation, half of the total available marks for that question are being awarded for evaluation, and hence approximately half of their answer should be evaluative in content.

This tackles the question from a different perspective - the reasons for the changing behaviour seen as 'reasons for cutting prices' - permitted, of course.

*(d) With reference to Extract 1, assess reasons for Barclays' changing behaviour. Refer to game theory in your answer.

(16)

		Barclay. High price	Barclay. Low Price
RBS.	High price	A. Barclay £100 million RBS £100 million	Barclay £120 million RBS £ ~~80~~ 60 million
	Low price	Barclay £60 million RBS £120 million	Barclay & RBS £80 million.

Game theory is used to explain why two firms will collude each other to gain ~~a~~ high profit and why later two firms will break the collusive agreement.

- At first, Barclay and RBS collude each other (A), then they share information for loan pricing and pricing structure for ~~ne~~ new facilities. Then both of them can gain high revenue.
- But later, since the ~~the~~ collusion is illegal, it might fined 10% of TR of the banks ~~to~~ from OFT. Barclay abandon its agreement. ~~Then Barclay~~. It ~~report~~ might also be afraid of being sent to the prison by illegal collusion, so it change its behaviour.
- In addition, Barclay might wants to maximax its own individual profit (B). When it lower its price and RBS's price is high. It will gain more revenue

down as B, it will hard for OFT to find the evidence that Barclay ~~charge~~ determine its price through knowing the information of RBS. therefore it changes its behaviour.

- It might be a price strategies for Barclay. such as predatory pricing or sales maximisation. ~~price~~ When it operates the bank not at the profit maximisation point but others, the price will fall then more customers are attracted by the lower price. Therefore, it can gain more market share and rival out the competitor.
- However, it might cause a price war for lowing the price. There are five big brands of Banking in the uk. When others see Barclay lower its price, it will follow or even set the price lower than Barclay which harm to all banks in the uk. And in the short run, it ~~And it is hard~~ to ~~not~~ will cause a loss since lower price (below AC), it must make sure Barclay has so much funds to cover the losses.
- It might be limit pricing which is used to deter new entrants and make barriers to entry. Barclay wants to lower price to make the profit seems low. Because of the supernormal profit is very high. others will enter

into market and gain the "hit and run" profit.
Therefore, limit pricing can be a barrier to entry, then less competitors in the industry.
- However, Banks industry ~~has~~ has already a high barriers to entry, is non-contestable market because of the high sunk cost and brand loyalty. Barclay doesn't need to cut down the price to deter new entrants because it is already hard to enter the bank industry. Consumers are more willing to choose Barclay, HSBC which is high reputation instead of new entrants.

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Examiner Comments

KAA 8. Development of game theory (pay-off matrix). Fines may deter anticompetitive behaviour. Higher pay-off by breaking the agreement. Predatory and limit pricing are allowed as reasons.

This is outside the mark scheme (OMS) but is valid as reasoning. Evaluation 4. Predatory pricing, sales maximisation, limit pricing in disguise (2).

This approach has been allowed because it is valid, may lead to a price war/lower profits (2)

ResultsPlus
Examiner Tip

Use a pay-off matrix, but apply it to the context.

Good use of data in pay-off matrix here.

*(d) With reference to Extract 1, assess reasons for Barclays' changing behaviour. Refer to game theory in your answer.

(16)

Covert collusion, is where the company colludes privately. Collusion is where the dominant companies in the market choose to price fix.

		Royal Bank of Scotland	
		Price Fix	tell regulator
Barclays	Price fix	+£60 million for Barclays and RBS	+£100 million for RBS -£28.6 million for Barclays
	tell regulator	+£100 million for Barclays -£28.6 million for RBS	+ £20 million for RBS and Barclays.

this is what happened in 2010.

If Barclays were to remain price fixing, they would get an even amount of profits as RBS, however, if they were to tell the regulator ~~that was going to happen~~ that RBS were going to price fix, then RBS would be fined up to 10% of there turnover and Barclays would be in a more dominant position in the market.

Also if RBS had ~~first~~ ~~&~~ whistle blew first, ~~then~~ then Barclays would have to pay out a heavy fine and to ensure this didn't happen, Barclays got there first.

~~However, If Barclays should kept to the agreement~~

However, Game theory is illegal, and can take up to 10% of turnover away.

The role of the regulator is to promote competition in the market.

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Examiner Comments

All KAA marks awarded.

ResultsPlus
Examiner Tip

The evaluation can involve development of game theory, which this candidate could have considered.

Question 10 (a)

Most candidates correctly identified that this was an oligopoly and were able to define this term, or give a characteristic of this market structure to earn a second theory mark. Credit was also given to candidates who wrote that it was a monopoly, as long as they were able to justify their answer.

Despite the instruction in the question 'Using the information provided...', too many candidates either gave a purely theoretical answer and hence were awarded a maximum of 2/4 marks, or did not include sufficient application in their answer to earn the 2 marks available for this. To do so, candidates must have either referred to two separate pieces of evidence from the sources, or given a well developed explanation of one piece of evidence.

(a) Using the information provided, explain the market structure in the supply of yogurt.

(4)

The market structure suggested is an oligopoly as although Danone and Yoplait are the two biggest companies there are also brands such as Fage and Chobani taking a percentage of the market suggested in source 2. An Oligopoly is where there is a low concentration ratio of firms within a market making only a few Companies own the majority. ~~The~~ typically oligolopolies have high barriers to entry this would appear to be the case in the yogurt industry as a heavey emphasis is put on advertising such as websites as shown in figure One's annalyasis of website views.

B
I
S
4

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Examiner Comments

2 marks for theory (1 mark for oligopoly, 1 mark for “a few firms own the majority”; even though there is a mistake with “low concentration ratio” - positive marking).2 marks for application (2 marks for the discussion of Figure 1).

ResultsPlus
Examiner Tip

Most of the first five lines are wasted here. The comments written in different handwriting suggests the student came back at the end and added more - a very wise policy.

(a) Using the information provided, explain the market structure in the supply of yogurt.

(4)

A duopoly, or a high 2-firm concentration ratio. The extracts mention no other large yogurt firms dominating the yogurt market, apart from Danone (the largest) and Yoplait (the second largest). The only other yogurt firms mentioned (Fage Greek, Chobani, Stonyfield Oikos and Greek Gods) only produce Greek yogurts, which is only a fraction of the total yogurt market.

ResultsPlus
Examiner Comments

2 + 1 ap

ResultsPlus
Examiner Tip

Try to use the numbers as well as listing off brand names.

Question 10 (b)

Most candidates found this a relatively straightforward question to answer and much use was made of relevant macroeconomic arguments (lost tax revenue, unemployment, lower economic growth, trade balance deterioration etc). Candidates often simply stated these reasons however, without developing them sufficiently or explaining why/how they might occur and in this case, answers took on the form of more of a list of possible negative consequences for the French economy, than a **discussion** of **two** separate reasons.

The vast majority of candidates were aware of the need to evaluate their answers, but there was a tendency for evaluative comments to be shorter and less detailed than the preceding analysis and hence candidates tended to earn fewer marks for evaluation than for KAA.

Most answers had two reasons as requested.

(b) Discuss **two** reasons why the French government may intervene to prevent the acquisition of Yoplait by an overseas firm.

(8)

One reason could be to keep french workers in employment, as if a takeover occurs the new firm may save costs such as wages and move production from france ~~to~~ in order to reduce costs. This ~~+~~ is likely as china is seen as an emerging market, so this could be seen as a ~~perf~~ perfect chance to move some of the firms to china in order to gain a large market share. However if the firm did create unemployment for the workers of Yoplait then this could result in brand destruction, where the reputation of the firm is damaged, which could result in a fall in revenue.

Another reason could be so competition within the market is not reduced, which could lead to higher prices and a monopoly market structure with a firm controlling the market.

ResultsPlus
Examiner Comments

KAA 4. Protect domestic employment (2). Retain competition in the market, in the interest of consumers (2). Evaluation 1. Hint of evaluation in that the aim of protecting domestic employment is particularly likely, given the low production costs and emerging consumer market in China.

ResultsPlus
Examiner Tip

Half the answer should be devoted to evaluation.

Many did not take the view that the government is not the manager of firms. There were some fairly limited views of how changes in ownership will affect firms.

(b) Discuss **two** reasons why the French government may intervene to prevent the acquisition of Yoplait by an overseas firm.

(8)

The government ~~and~~ may intervene to prevent ~~to~~ the takeover of Yoplait by an overseas firm. This is because the French government want to remain the ownership control of the company. If ~~the~~ Yoplait be acquisited by other overseas firm, therefore there will appear ~~be~~ many branches ~~&~~ over the world, which is harder to control and manage the costs of production. The big firm ~~might be in fear of the Secondly.~~

Secondly, Following the extract 1, Yoplait has been in good arrangement ~~to~~ General Mills to sell their products for 30 years. ~~The~~ within the period of time, because of their big brand name. The firm then makes profit inside French and have motivation to pursue their stage of production. ~~It~~ There might be a chance that Yoplait can not make profit ~~into~~ out the oversea firms since there are many big rivals overseas.

However, at the current time, the contract agreement between these two firms are not running good. Therefore the firm might lose its profitability ~~be~~ if they do not offer other oversea firms to merge with itself. It might be; ~~It~~ There might be better managerial and performance. Hence the firm can reduce their long run average costs (economies of scale) to boost their profit.

ResultsPlus

Examiner Comments

1 + 0

ResultsPlus

Examiner Tip

This is a question about governments intervening in markets (last section of spec.) but a very wide variety of macro responses were allowed.

Question 10 (c)

Most candidates answered this question well and succeeded in analysing the effects of the takeover on both PepsiCo and consumers. However, candidates were often not sufficiently clear in their discussions of the effect on market share: as PepsiCo were previously not in the yogurt market, it is not quite correct (certainly in the short run) to say that the takeover will increase their market share and hence increase their market/price-setting power in either the yogurt market, or the markets that they were previously in.

As with question 10(b), evaluation was less well done than the lower level skills. Whilst this might be expected of the highest level skill being assessed, there does seem to be a need for candidates to recognise that in questions requiring evaluation, half of the total available marks for that question are being awarded for evaluation and hence approximately half of their answer should be evaluative in content. Too often a single sentence of evaluation is tagged onto the end of a paragraph as an almost throwaway comment. Similarly, higher marks would have been awarded for evaluative comments that were specific to the arguments made, rather than simply generic comments.

Most answers, such as this one, included comments on firms and consumers, but less analysis for consumers.

brand image)

*(c) Assume Yoplait is taken over by PepsiCo. Assess the possible benefits to PepsiCo **and** consumers of this acquisition.

(12)

Brand image maybe increased as they are now seen to be envolving themselfs in a healthier industry.
The nature of the move as it is a conglomerate merge from two compleatly ~~if any~~ different industries which if anything compeat with each other gives PepsiCo more security in the market as if there should be a sudden drop in demand for unhealthy goods they have the security of having profits also comming from the yogurt industry secruing the profits more. *
Due to the large name of PepsiCo they will be able to take advantage of economies of scale for things such as packaging thereby lowering its costs ~~and~~ which then maybe passed onto the consumer. ~~and~~ However PepsiCo may not chose to lower prices for consumer and only owns 50% of the company.
* However given they are all in the snak industry this may not happen and

a change in the market may actually effect all three industries leading to bigger loses.

Having part ownership of a European company may also offer security as ~~if~~ it offers a different economy, consumers and currency providing an alternative should anything happen to the American market. However PepsiCo products are sold world wide so they may already have this security.

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Examiner Comments

KAA 4. On Pepsi, 2 for diversification and 1 for economies of scale. On consumers, 1 for ID of lower prices. EV 3. EV for prices not passed on (1). EV for "only owns 50% of the company" (1). EV for all in the snack industry (1). EV for "already secure" (1). Best three points only, hence 3EV.

ResultsPlus

Examiner Tip

For a 12 mark question, the best three pieces of evaluation will be awarded - so if you give more than three you are wasting time. Better to go into more depth on the ones you have already.

Question 10 (d)

This was the more accessible of the 16 mark questions, but many lacked the exam technique to gain all of the available marks.

*(d) With reference to Extract 2, discuss how the launch of the new product *Yoplait Greek* yogurt may influence the behaviour of rival firms.

(16)

Yoplait Greek yogurt is a new Greek yogurt produced by Yoplait in March 2010. As the greek yogurt industry is an oligopoly, the firms are interdependent, so the actions of one firm will directly affect the actions of another firm.

So to get a foot-hold in the highly concentrated Greek yogurt market Yoplait used a "combination of online display and search engine marketing to raise awareness of the product" They did everything possible to attract awareness of their product and in ~~Jan~~ March 2010 they had 3x as many visits on their website than any other greek yogurt producer.

As this is an oligopolistic market other firms such as "Fage Greek yogurt" will react to this instantly as the firms are interdependent.
First of all the other competitors will either use some pricing or non-pricing strategies.
As "Fage" has been the main yogurt producer it probably has a large amount of available ~~m~~ money. So they might respond by lowering their prices even to the point where they are making a loss to try and drive this new threat out of the market. (predatory pricing)
Secondly they could also use another pricing strategy called limit pricing. This is where they lower their prices to the level of output where AC=AR, (so they are making normal profit) to first of all hopefully

drive this new competitor away and keep out any other possible entrants.

Furthermore other Greek ~~firm~~ yogurt producing firms may react by using non pricing decisions.
For example "Chobani" and "Fage" might collude to make tactics to lower prices and drive this new competitor "Yoplait" out of the market.
Secondly they might decide to increase their marketing, ie advertise more, to raise the awareness of their product, reducing the demand for this new Yoplait product.
In addition they might decide that the best way to deal with this new threat is ~~two~~ to merge and then force Yoplait out of the market.

However the other firms may not react at all as they want to avoid having a price war with each other which reduces the market price for greek yogurt and their own profits.

Secondly they will probably avoid using the predatory pricing and collusion tactics as they are illegal and could result in the firm getting ~~p~~ forced out of the market by regulators.

Although limit pricing keeps out competitors in the long run, in the short run it reduces the profits the firm could make so they might decide against using that choice.

Probably the most likely reaction of the other firms would be to increase their marketing as this will not lead to a price war, isnt an illegal activity, and shouldnt lead to a damaging price war.

ResultsPlus
Examiner Comments

It is best to make no more than four points, but make them really well, then the same with evaluation. Throwaway comments will earn just 1 mark.

ResultsPlus
Examiner Tip

Quality of written communication is important here and while there are many good points, more could be made of each one.

Most candidates were able to suggest various valid pricing and non-pricing strategies which competitors could use in response to the launch of Yoplait Greek, however obvious problems with timing meant that some answers had to be curtailed.

Candidates struggled to develop their points sufficiently to gain more than 1 or 2 marks, particularly with regards to non-pricing strategies, for example advertising, or use of coupons. More generally, answers tended to lack depth and length, for example, if suggesting price discrimination as a pricing strategy, very few candidates used a diagram to illustrate how this would work and use of game theory (although in no way required) was minimal.

***(d) With reference to Extract 2, discuss how the launch of the new product *Yoplait Greek* yogurt may influence the behaviour of rival firms.**

(16)

The new product Yoplait Greek may force rival firms to lower their prices in order to gain a higher market share. This is because as soon as the Yoplait Greek website was launched in March 2010, visits to the other websites generally fell. For example, Stonyfield Oikos had 17,000 visits in January 2010, but in March 2010 it had only 6,000. However, this may only be temporary, because Yoplait Greek launched a huge advertising campaign when their website was launched, so in future months its percentage share of all website visits may fall, when free coupons aren't being offered. However, it may transpire that the yogurt is not a success and not to the consumers tastes, and in this case the rival firms will regain their market share, so no action will be necessary.

If the Yoplait Greek yogurt is a huge success, then firms may have to leave the market altogether, as demand will be too low because

Yoplaits market share will be too high due to it's ability to take advantage of economies of scale as it is a larger company. There are quite high barriers to exit as the firms will have many ~~workers~~ workers and machinery, so in order to leave the industry, the firms will ~~t~~ have to have high sunk costs, or sell their machinary. ~~to~~ However there are low sunk costs in general in the yogurt ~~indust~~ industry. So this makes it easier to leave.

ResultsPlus
Examiner Comments

The pricing strategies of limit pricing and predatory pricing were not always well understood or explained and particularly there seems to be confusion between the two for a good number of candidates.

ResultsPlus
Examiner Tip

Not all candidates incorporated data use into their answers, despite the instruction to do so in the question and hence their KAA marks were capped at 6/8.

Paper Summary

While the mean has risen (48.7 from 47.1 Jan 2011), it is not felt that this suggests a higher standard of work than in 2011. The SD also rose to 10.2 from 9.6, with a significant proportion underprepared for this examination, along with ever higher numbers even more fully prepared and able to achieve consistently well across all the concepts on the paper. Some candidates were clearly writing at an exceptionally high level.

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