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Examiners' Report
June 2012

GCE Economics 6EC03 01

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Introduction

The supported choice questions, after question 3, often challenged candidates which I believe to be due to this examination paper tackling parts of the specification that previous examination papers have not (such as the law of diminishing returns). The data questions were accessible, although question 10 was far more popular than question 9. The reason for the avoidance of question 9 was certainly not the context – supermarket questions are normally very popular. The deterrent was the unfamiliar question area in 9(c) (monopsony) and 9(d) (size of firms), on high mark-based questions.

The quality of answers on the longer questions was in line with recent sessions, and the question types are well rehearsed. Even the questions on price and non-price strategies (10(d)) elicited answers that went further than advertising and branding, but the drawback on question 10(d) was that many could not answer the question set but rather answered a general question that had been rehearsed (there was need to discuss **revenue** and **petrol prices**). Most of the longer answers made a considerable attempt at evaluation, although there were problems in keeping balance and structure in the weighing up of issues.

There was evidence of timing problems, with too much time being spent on the supported choice questions at the expense of the 16-mark essay at the end. The 12 and 16 mark mini essays tended to be effective discriminators.

Question 1

Most candidates got the right option (E: horizontal), but many lacked good application, as candidates simply repeated that both companies were in the 'building maintenance' industry, rather than giving examples (relevant raw materials, capital equipment etc) that would be involved. Candidates could be more aware that different reasons need to be given for each incorrect option, for example in excluding C and D because neither is vertical only counts as one incorrect option and not two. Different reasons need to be given if more than one incorrect option is to be awarded as separate marks.

Question 1 was generally tackled well with the majority of candidates correctly identifying and defining horizontal integration. Most went on to gain full marks by giving benefits of integration.

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 2010 the assets of ROK, a building maintenance firm, were acquired by Balfour Beatty, which also maintains buildings as part of its operations. This type of integration of business assets is:

(1)

A Satisficing

B Privatisation

C Backwards vertical

D Forwards vertical

E Horizontal

Answer E

Explanation

(3)

Horizontal integration is when two firms in the same industry and ~~scane~~ same stage of production merge. Both ROK and Balfour are in the building maintenance industry, therefore they have horizontally intergrated. Intergration is done in order to increase size and output and lower costs through economies of scale.

It is not C or D because vertical integration both backwards and forwards is when a firm merges in the same industry but at a different stage of production.

(Total for Question 1 = 4 marks)

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Examiner Comments

The marks for this response were awarded as follows:

E (1). Definition of horizontal integration (1). Economies of scale (1). Incorrect option identified C/D (1). 1+3= total of 4 marks for this question.

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Examiner Tip

Incorrect options C and D only counts as one mark for this question, as the reason given (vertical not horizontal integration) is the same in almost all cases.

Many tried unsuccessfully to give application in their answers.

Section A: Answer all the questions in this section.

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1 In 2010 the assets of ROK, a building maintenance firm, were acquired by Balfour Beatty, which also maintains buildings as part of its operations. This type of integration of business assets is:

(1)

A Satisficing

B Privatisation

C Backwards vertical

D Forwards vertical

E Horizontal

Answer E

Explanation

(3)

Horizontal integration is when two firms merge who are from the same industry in the same stage of production. As both of these firms are in the maintenance sector of the building industry, this example is horizontal integration.

It is not C, as backwards vertical is integration of 2 firms from the same industry but from different stages of production, while these two firms are in the same stage.

(Total for Question 1 = 4 marks)

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

E (1). Definition of horizontal integration (1). Although there are attempts at application, by mentioning the words "maintenance" and "building industry", this is merely repeating the question. The candidate would need to refer to ladders, bricks etc to gain an application mark (0) Incorrect option C (1). Total mark 3/4.

ResultsPlus
Examiner Tip

When you see 'building maintenance' think what building repairs might need. Ladders, cement, rawl plugs?

Question 2

It was helpful to show the inter-relationship between the industry and firm diagrams, or the short and long run diagrams for the firm. For example by drawing the diagrams next to each other horizontally, the price-taker nature of firms in perfect competition could be emphasised.

Most candidates understood the nature of perfect competition. A significant number mistook the industry's rise in supply for individual firms output so chose option E but gave a full and correct explanation. Although the diagrams were accurate, few candidates gained full marks by diagrams alone.

2 A firm operating under conditions of perfect competition is making supernormal profits. What is likely to happen to this firm in the long run?

(1)

A The price of its product will rise

B It will leave the industry

C Both its output and price will fall

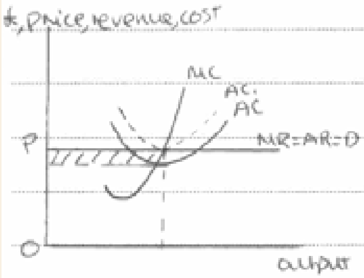
D Its output and price will remain unchanged

E Its output will rise and its price will fall

Answer D

Explanation

(3)



Perfect competition is when there ~~is~~ are many firms in the market with a small market share and there are no barriers to entry or exit. This means that firms will see supernormal profits being made ~~£~~, and enter the industry. This will increase the supply in the market and average cost will shift upwards to where P = MC ~~and~~ which is where the firm is allocatively efficient and only normal profits are made.

(Total for Question 2 = 4 marks)

ResultsPlus
Examiner Comments

This response did not label one as market and one as firm, but the concept that supply was increasing for the whole market was clear from the line below. 3 marks for diagram, and text repeats this.Total marks 4/4.

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Examiner Tip

A diagram alone can earn all 3 explanation marks.

Candidates giving the wrong key (usually E but often D as here) had often confused firm output (which decreases), with industry output (which increases). Approaches were equally sufficient to achieve full explanation marks through either diagrammatic or written analysis (or a combination of the two). Many responses only gave a firm-level diagram, without an accompanying industry-level diagram, and this could earn two marks, although the third mark for describing new entry into the industry was usually achieved. Labelling on diagrams was fairly poor overall, and although marks could still be awarded, well labelled diagrams could in fact earn all of the available marks.

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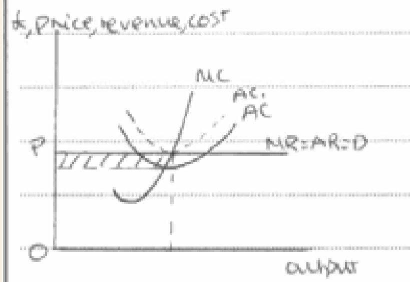
Explanation

(3)



Perfect competition is when there ~~is~~ are many firms in the market with a small market share and there are no barriers to entry or exit. This means that firms will see supernormal profits being made ~~£~~, and enter the industry. This will increase the supply in the market and average cost will shift upwards to where P = MC ~~and~~ which is where the firm is allocatively efficient and only normal profits are made.

(Total for Question 2 = 4 marks)

ResultsPlus
Examiner Comments

A two-part diagram showing a firm experiencing falling prices and output as more firms enter the industry could be annotated to earn the full 3 explanation marks.

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Examiner Tip

Maximum of 2 marks (on most questions) if the key is wrong, so much time can be wasted trying to pick up impossible marks.

Question 3

As with question 1, less able candidates did not pick up the available application marks, either by calculating an n-firm concentration ratio, or by explicitly referring to examples from the energy industry in their discussion of how vertical integration would function as a barrier to entry. Candidates should exercise some caution when assuming that vertical integration would lead to economies of scale; although some economies of scale may exist (such as financial or managerial); others are unlikely to occur (bulk-buying/purchasing etc.) Similarly, many candidates simply stated that vertical integration would lead to an increased market share, without explaining why this would occur (e.g. forcing competitors out of the industry by denying them access to raw materials or consumers). There seemed to be little appreciation of the difference between horizontal and vertical integration in these two respects.

Most answers correctly identified and defined vertical integration but a significant number failed to gain full marks as their explanation was weak.The role of the regulator was covered well but few answers calculated the concentration ratio.Most candidates correctly identified and defined vertical integration but a significant number failed to gain full marks as their explanation was weak. The role of the regulator was covered well but few candidates calculated the concentration ratio.

3 In a review in March 2011 Ofgem, the energy regulator, reported that it had concerns over the vertically integrated energy markets. The figure below shows the UK market share of the largest vertically integrated energy firms:

	Percentage of UK market (volume of sales)
EDF Energy	24%
E.ON	12%
RWE npower	10%
SSE	10%
ScottishPower	9%
Centrica	6%

(Source: © Crown Copyright)

The most likely reason for Ofgem's concerns is:

(1)

A There is a low level of producer surplus

B Vertical integration tends to decrease the concentration ratio

C Centrica is too small to achieve economies of scale

D Vertical integration can create a barrier to entry

E EDF Energy is a legal monopoly

Answer D

Explanation

(3)

Vertical integration increases control of the market and means a high market share. EDF Energy is not a legal monopoly as its share must exceed 25%. However Ofgem's role is to act as the surrogate for competition and keep barriers to entry low thus the high share of EDF Energy is a case for concern.

(Total for Question 3 = 4 marks)

ResultsPlus

Examiner Comments

The marks for this response were awarded as follows:

Vertical integration was not defined, but it was explained in terms of the firms being able to control the market (1). Allow the indentification of incorrect option E by implication, for comment that 24% was not enough for a legal monopoly (1). Role of Ofgem (1). Total marks 4/4.

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Examiner Tip

Make sure the definitions of vertical and horizontal integration refer to the same final product/stages in a production process. Vague answers don't pick up marks.

Definitions of vertical integration were often incomplete, for example in stating that it was between two firms at different stages of production, without the sense that there was the same final product.

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ScottishPower	9%
Centrica	6%

56%

(Source: © Crown Copyright)

The most likely reason for Ofgem's concerns is:

(1)

A There is a low level of producer surplus

B Vertical integration tends to decrease the concentration ratio

C Centrica is too small to achieve economies of scale

D Vertical integration can create a barrier to entry

E EDF Energy is a legal monopoly

Answer ~~C~~ B

Explanation

(3)

Vertical integration is when firms operate at a different stage of production. economies of scale is when there is a reduction of long run average costs as output increases.

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Examiner Comments

The marks for this response were awarded as follows:

Definition of vertical integration too vague - didn't say the firms were in the same production process/industry/final product (0). Definition of economies of scale was not relevant as it related to the wrong answer (option C) (0). Total marks 0/4.

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Examiner Tip

Option E was identified as the incorrect option for a mark in many answers.

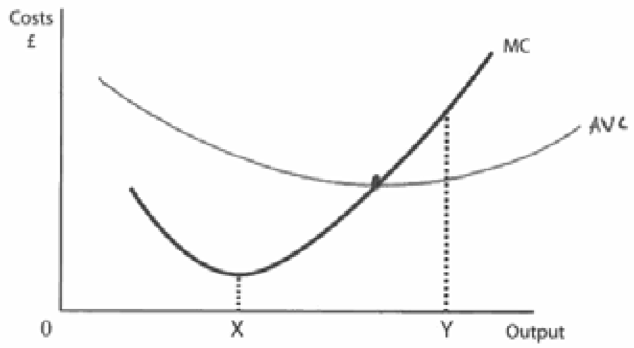
Question 4

The more able candidates not only explained the Law of Diminishing Returns, but were also able to apply this to a context of their choice (usually increasing amount of labour being added to a fixed quantity of land or capital). Again, option E was successfully given as incorrect for a mark in many answers, although few seemed to understand that marginal costs could be rising or falling when there are economies of scale – the dynamic being that if marginal cost is **below** long run average costs, long run average costs will fall.

This question generated some fairly poor answers, which often showed little appreciation of the relationship between the shapes of the AC and MC curves (for example failing to realise that MC could be rising while AC is falling, as long as MC is beneath AC), and the distinction between the short run and the long run.

4 Which of the following best explains the shape of the short run marginal cost curve between X and Y?

(1)



A The law of diminishing marginal returns

B The law of increasing marginal product

C Average costs are rising

D Average variable costs are rising

E Economies of scale

Answer D

Explanation

(3)

Marginal costs are the costs associated with producing one extra output. Average variable costs are the costs which are incurred by changing output. So it would affect Marginal costs.

The law of diminishing returns affects marginal revenue so cannot be A.

Cannot be Economies of scale as that is a long run concept not short run.

(Total for Question 4 = 4 marks)

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Definition of marginal cost (1). Diagram and analysis of average cost was wrong/not relevant (0). Allow economies of scale although the letter is not given for E - it was excluded on the valid grounds that economies of scale are a long run concept (1). Total 2/4.

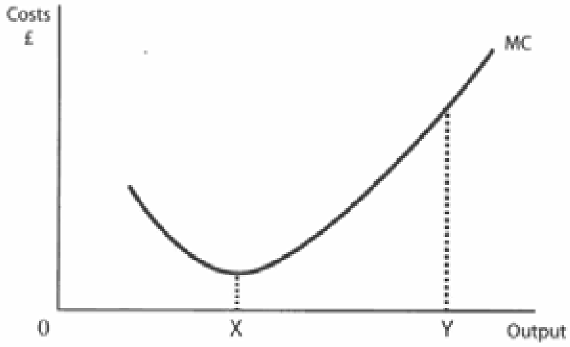
ResultsPlus
Examiner Tip

Fundamental concepts such as MC are often the hardest things to grasp in Economics.

This was one of the better answers seen.

4 Which of the following best explains the shape of the short run marginal cost curve between X and Y?

(1)



A The law of diminishing marginal returns

B The law of increasing marginal product

C Average costs are rising

D Average variable costs are rising

E Economies of scale

Answer A

Explanation

(3)

The law of diminishing marginal returns is when less productivity per unit of output is seen when a fixed factor is overused. For example ~~was~~ if a factory built for 50 workers, has 1000 people working in it then the ~~marginal cost is going to be higher than if it~~ efficiency will decrease. It can't be C as the graph shows marginal cost not average cost.

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Examiner Comments

The marks for this response were awarded as follows:

Fixed factor (1) with more factors applied (1). Point that efficiency falls was not quite right - average costs might actually be falling as MC rises (0) Didn't identify the incorrect option (0). Total 3/4.

ResultsPlus
Examiner Tip

Make sure that the identification of an incorrect key gives valid and well-reasoned Economics.

Question 5

The majority of candidates completed the table but there were several typical errors.

Basic errors in arithmetic did cost some candidates a mark (particularly calculating 11 x 0 for the total revenue when sales were zero). Most candidates answered this question by calculating MR and MC, and then equating the two, but a minority calculated the profit earned at each level of output (from TR-TC), and then identified the maximum level at an output between 3 and 4. Full marks were available for either approach. Less able candidates did confuse this with a question on fixed/variable costs, and completed one of the blank columns with figures for fixed costs, and were then unsure as to how to proceed. Alternatively, there were attempts to fill out the total cost column from marginal cost which revealed profound misunderstanding.

A high number of candidates included a completed Total Profits column (or as here, TR-TC) anddefined profit maximisation correctly.

5 Lizzie runs a hairdressing shop and the following table shows her costs and revenues in a fixed time period when she changes her prices for a haircut. Some parts of the table are left blank for your own calculations.

Quantity	Price (£)	Rev - costs	Total revenue	Total costs (£)	Marginal costs (£)
0	11	-5	0	5	–
1	10	1	10	9	4
2	9	8	18	10	5
3	8	13	24	11	6
4	7	15	28	13	8
5	6	15	30	15	10

At what range of output would Lizzie achieve profit maximisation?

(1)

A 0 – 1

B 1 – 2

C 2 – 3

D 4 – 5

E She cannot make supernormal profits at any output.

Answer D

Explanation

(3)

Profit = Revenue - Costs. At quantity of 4-5, her profit is £15 at both which is the largest profit she can make. Profit maximisation is where MC = MR. Not A as she is making a loss at 0, and a profit of -1 at 1.

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Examiner Comments

The marks for this response were awarded as follows:

1 for total revenue column1 for MC=MR1 for valid knock out of ACap at 2 if key was incorrect. Notice that the total costs and total profit (labelled correctly as rev - costs) columns were incorrect. Total marks 2/4

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Examiner Tip

Put the headings in the table.

Candidates who were able to complete the table with relevant columns scored very highly on this question.

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Quantity	Price (£)	Total revenue (£)	Marginal Revenue (£)	Total costs (£)	Marginal costs (£)
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3	8	24	6	20	6
4	7	28	4	28	8
5	6	30	2	38	10

At what range of output would Lizzie achieve profit maximisation?

(1)

A 0 – 1

B 1 – 2

C 2 – 3

D 4 – 5

E She cannot make supernormal profits at any output.

Answer C

Explanation

(3)

Profit maximisation occurs where marginal revenue is equal to marginal costs and marginal costs are rising. At point C Marginal revenue is £6 and ~~cost~~ Marginal costs are £6 so that would be the profit maximisation point.

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Examiner Comments

The marks for this response were awarded as follows:

MC=MR (1) 3 correct columns of data - could score 1 + 1 + 1 but only 3 marks available. Total marks 4/4.

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Examiner Tip

This candidate scored full marks without even writing any explanation. Think of the opportunity cost.

Question 6

Very few candidates gained the definition mark here for defining AVC/AC, but scored very highly as there were many ways to earn the marks on this question.

As with previous questions, few candidates applied their answers to the context of bus services (although there were some excellent answers that did, for example suggest that operators may use cross-subsidisation from their national routes to finance losses incurred from predatory pricing on local routes, or vice versa, etc.). Candidates still need to appreciate that to gain marks from incorrect answers, the candidates need to make it clear why an option cannot be correct. For example a number of candidates wrote that 'it cannot be option A as that is allocative efficiency', without explaining why this was a relevant observation. A minority of candidates focused their answers on limit pricing, but were able to gain up to 3 marks in total if they selected the wrong key due to this confusion.

Most had an acceptable understanding of predatory pricing, and many referred to it being an illegal practice for an additional mark. The more able candidates showed an appreciation of the long run consequences that prices and profits would rise as levels of competition fell.

6 In January 2010 the Office of Fair Trading (OFT) referred the UK's local bus services to the Competition Commission over concerns about pricing. It had received complaints about the "predatory behaviour" of existing firms, designed to exclude new entrants from the market. Which characteristic was likely to have been observed?

(1)

A Prices equal to marginal cost

B High prices in the short run

C Prices set above average costs in the short and long run

D Revenue maximisation pricing

E Prices set below average variable costs in the short run

Answer E

Explanation

(3)

The role of the OFT is to promote competition and protect consumer interests. ~~The~~ Predatory pricing is pricing below average costs in the short run ~~th~~ with the intention of eliminating competition and accumulating more market share and having more bus passengers so that in the long run it can increase prices. A disadvantage of this for customers is that consumers will have a lack of choice in the long run.

(Total for Question 6 = 4 marks)

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Examiner Comments

The marks for this response were awarded as follows:

E (1). Role of OFT (1). Explanation of predatory pricing (1). Prices will rise in LR (1). Total marks 4/4.

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Examiner Tip

Give the **role** of regulatory bodies when they appear.

There was some confusion between limit pricing and predatory pricing here. Diagrams were rarely used, or indeed helpful, but most candidates explained the role of the regulator and described predatory pricing adequately.

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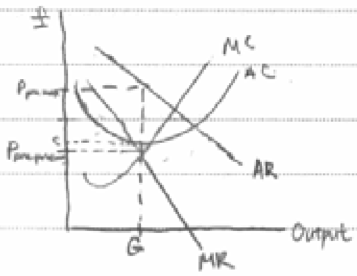
Answer E

Explanation

(3)



The firms set price below the cost to push competitor out of the market and to gain market power.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

E (1). No mark awarded for the diagram as loss was not shown (0). Explanation of predatory pricing (1). Total marks 2/4.

ResultsPlus
Examiner Tip

Make the diagram do some of the reasoning.

Question 7

Misreading the question led a number of candidates to choose Option E for this question. Payoff matrices were generally accurate but some candidates were merely repeating the key and not explaining the incentive to undercut members of the cartel.

Many candidates demonstrated a good understanding of the prisoner's dilemma, and were able to explain the reasons for the game's outcome well, with or without the payoff matrix as illustration.

7 Game theory can be used to explain the breakdown of a cartel. Which of the following is the most likely cause of such a breakdown?

(1)

A A possibility of an individual member gaining short term profits

B An aim of reaching long term equilibrium

C Economies of scale

D Satisficing behaviour

E Reduced risk of collusive behaviour being investigated

Answer ~~B~~ E

Explanation

(3)

Game theory suggest the cartel might not exist in the long run.

Cartel is the ~~[illegible]~~ communication and verbally agreement between firms.

		Firm A: ~~Increase~~ price	Firm A: cut price
Firm B	Incr price	£6 bn / £[illegible]bn	£10 bn / £2bn
	cut price	£2 bn / £10 bn	£5 bn / £5 bn.

~~If firm A cu~~

When they collude as a cartel, both firms may get a ~~better~~ profit shown at the upper-left quadrant. But there's incentive for firm A to cut price when others cooperate, and therefore gain a better profit shown at the upper-right quadrant. They don't trust each other, therefore the cartel breaks down by cutting both their prices.

(Total for Question 7 = 4 marks)

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Examiner Comments

The marks for this response were awarded as follows:

A (1). Definition of cartel (1). Payoff matrix (1). Explanation of instability (1). Total 1+3 = 4.

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Examiner Tip

This is a good payoff matrix.

A high proportion of candidates included a payoff matrix, although some the necessary labelling (two firms, and two strategies for each identified), or did not illustrate the incentive to cheat on the collusive agreement by making the lower price outcome provide a higher reward than the collusive outcome.

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A A possibility of an individual member gaining short term profits

B An aim of reaching long term equilibrium

C Economies of scale

D Satisficing behaviour

E Reduced risk of collusive behaviour being investigated

Answer $\boxed{A}$

Explanation

(3)

Game theory is linked to prisoners dilema.

		Steve			
		Confess		Ignore	
Al	Confess	~~10~~ 5	~~10~~ 5	20	0
	Ignore	20	0	10	10

Cartel is linked to collusion an agreement by firms to a fixed price

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Examiner Comments

The marks for this response were awarded as follows:

A (1). Payoff matrix is incorrect (0). Definition of cartel (1). Total marks 2/4.

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Examiner Tip

Make sure the payoff matrix works.

Question 8

This question proved to be very challenging, although a good number of short, textbook answers gained full marks. There were many candidates either selecting the wrong key, showing limited understanding of PFI, or simply repeating/paraphrasing the correct key in their explanation. The most significant misconceptions about PFI are that:

many candidates thought that the private sector firm *loaned* the money to complete the project to the government, which the government then *repaid* (sometimes reference being made to repayments with interest being charged)

few candidates understood that the government rents/leases the infrastructure from the private sector firm for a set number of years, and so payments made by the government are rent, not loan repayments (and in addition, the government may or may not own the infrastructure at the end of the set period)

many candidates were confused between PFI and contracting out, i.e. they wrote that in PFI the government pays for the project up-front, but employs a private sector firm to do the work, after considering different tenders.

Many candidates stated that private sector firms would have more experience in undertaking infrastructure projects.

Observations that the private sector tends to be more efficient than the public sector were not awarded a mark unless this was supported by reference to increased competition or the presence of a profit motive in the private sector.

8 In 2009 a 30-year private finance contract for widening and maintaining the M25 motorway was agreed. The contract was valued at £6.2 billion, with penalties if the consortium of companies did not achieve completion on time.

The main reason that the government used a private finance contract was likely to be because it:

(1)

A wanted to manage the project within the public sector

B cannot use performance targets in the public sector

C has limited experience of road building

D wanted to increase producer surplus

E wanted to commence a major project without raising the finance at the initial stage

Answer C

Explanation

(3)

Private finance ~~£~~ contracts are given out to private firms to increase productivity and efficiency as there is a strive for higher profits along with this the M25 ~~agreement~~ widening would need specialists who know what to do and minimise costs and provide a quality job ~~Service~~ because of their experience.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Wrong key. Private sector firms more efficient due to profit motive (1). Total marks 1/4.

The best answers to this question often made reference to current economic conditions, in terms of the government not being able to finance major infrastructure projects up-front due to current fiscal austerity measures, or the desire to decrease the UK's budget deficit and/or national debt. More able candidates in particular should be encouraged to apply their knowledge of contemporary economic events to questions where relevant, as this is a useful 'stretch and challenge' exercise.

In terms of obtaining marks from incorrect answers, candidates need to be aware of the need to do more than simply state the opposite of the incorrect key, for example, no mark was awarded for writing that 'the answer cannot be B, as performance targets are used in the public sector'. Instead, an example of this occurring or other supporting development had to be given.

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The main reason that the government used a private finance contract was likely to be because it:
PF

(1)

A wanted to manage the project within the public sector

B cannot use performance targets in the public sector X

C has limited experience of road building

D wanted to increase producer surplus X

E wanted to commence a major project without raising the finance at the initial stage

Answer $\boxed{E}$

Explanation

(3)

~~B~~ This is an example where ~~Government the~~ Government ~~that had~~ enters a partnership with a private sector. This is called Public private partnership or public finance initiative. Private sector finances, ~~and ope~~, builds and operates the project in return for an annual payment from public sector. This helps reduce G's initial payment. ~~to the~~ as its shared. However, in LR, Government might end up paying more ~~to~~ for the projects that it would pay when the project was carried by its own.

(Total for Question 8 = 4 marks)

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

E (1). Explanation of PFI, project was built and operated by private sector (1) in return for an annual payment from government (1). It may cost the government more in the long run that if they had built it themselves (1). Total marks 4/4.

ResultsPlus
Examiner Tip

PFI definitions were largely vague. Be clear.

Question 9 (a)

All candidates were able to identify a likely benefit to Greencore from the merger. Rather than explaining why this was a benefit for the second available knowledge mark, less able candidates tended to simply quote an extended passage from the extract, which listed a number of different benefits. In this case, credit was only given for the best point made.

Some candidates were confused by the fact that the merger allowed Greencore to both negotiate better terms with their own suppliers (greater monopsony power/bulk-buying economies of scale), and negotiate better terms with their customers, the supermarkets (more monopoly power for Greencore/Northern Foods, less monopsony power for supermarkets).

This was a good answer.

(a) Using the evidence, explain one potential benefit to Greencore of the proposed merger with Northern Foods (Extract 1 lines 17–21).

(4)

The merging of the two firms would mean that it would ~~to~~ 'not be so easily bullied by retailers'. This is because the larger firm would control more of the market in supplying food to the supermarkets or other retailer stores eg. Tesco and therefore, they could demand a price that they wish their goods to be bought for rather than accepting what the retailers offer. Therefore, they may experience higher profits ~~an~~ due to ~~an~~ a higher price. This merging is an example of a horizontal merger where 2 firms merge at the same stage of production in the same industry.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Knowledge (2): Can demand a higher price for goods that it sells (1) thus increasing its profits (1). Application (2). "not so easily bullied by retailers" (1). Reference to customer as supermarkets, eg Tesco (1). Total 2+2 = 4.

ResultsPlus
Examiner Tip

The example of Tesco was a wise addition.

Most candidates started with an explanation of horizontal integration, rather than launching straight into one benefit.

The vast majority of candidates were able to include some application in their answers, although the reference to the merger yielding £40m in cost and tax savings, equivalent to 2% of joint sales, was misinterpreted by some as an *increase in sales* of £40 million or 2%. Candidates would therefore perhaps benefit from practice in precision in their application tasks.

(a) Using the evidence, explain one potential benefit to Greencore of the proposed merger with Northern Foods (Extract 1 lines 17–21).

(4)

A merger between Greencore & Northern Foods is an example of horizontal merger where ~~the~~ 2 firms merge at the same ~~in~~ stage of the production process. An advantage Greencore may recieve from this merger is an increased market share, with increased profits of '£40 million' (extract 1, line 19-20). furthermore ~~[illegible]~~ as it is a merger in the same stage of production, it does not need to spend money on set-up costs or training as it is the same expertise.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Knowledge (1): Increased market share. Application (1): Increased profit of £40m. Note that we do allow reference to either cost savings of £40m or profit rises of £40m, but not sales increases of £40m. Total 1+1 = 2.

ResultsPlus
Examiner Tip

2 marks are reserved for application on part a of all data response questions.

Question 9 (b)

A number of answers were based on a misreading of this question, and explained why losses had been made, rather than why these losses were to be turned into profits. Several of these candidates did return to the question and discuss profits, but at the expense of time for other elements of the question, notably the 4 evaluation marks.

Largely, candidates were able to gain one knowledge and one application mark by explaining the reason behind a fall in costs/rise in demand. Diagrams were reasonably well drawn, but the main issues here were:

written analysis failing to link to the diagram. For example, some candidates discussed reasons for a fall in costs, then illustrated a rise in demand, and vice versa. Similarly, there needed to be agreement between the written discussion of (variable and/or fixed) costs falling and whether both the AC and MC curves, or just the AC curve, was shifted on the diagram

axes and equilibria were often poorly labelled with several candidates making mistakes due to the labelling of the curves. This occured particularly where an increase in demand was shown, and the new MR curve intersected the old AR curve, as it was often unclear which label applied to which curve, and in some cases this resulted in candidates drawing the new equilibrium at the wrong output level.

candidates should be encouraged to illustrate both the old and new equilibrium on the same diagram, wherever possible, as this makes it much easier to see how the curves have shifted.

a minority of diagrams did not show the new profit area.

no marks at all were awarded for simple supply and demand diagrams.

The main issue here, however, was a lack of detailed evaluation in candidates' answers. Many candidates included no evaluation at all, while others provided one evaluative point worthy of 2 evaluation marks only.

Many candidates explained the move into profits through *both* an increase in demand, and a fall in costs. Evaluation marks were only awarded in this case if there was an element of prioritisation, or an issue of magnitude discussed (e.g. the fall in costs was a more significant reason than the rise in demand because...' or vice versa). No evaluation marks were awarded for answers simply saying that it might be because of one, or might be because of the other occurring.

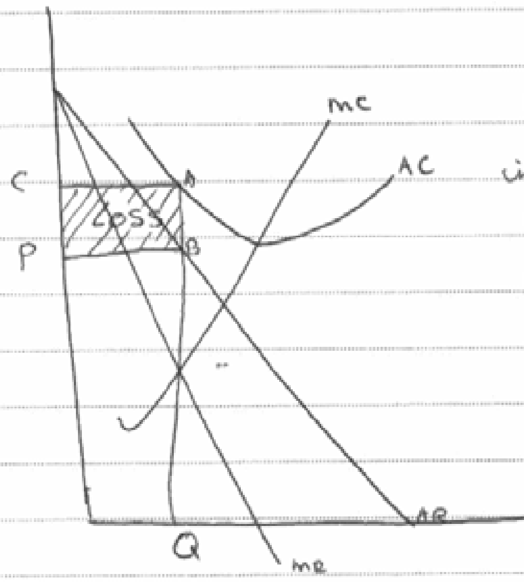
The best evaluation points made use of the information in the extracts/data or candidates' own knowledge to support the point, for example 'the expected profits may not be seen if the housing market downturn/high unemployment rates which have affected sales in Arizona and Nevada push into northern California, as the US economy is adversely affected by low growth in the EU/high commodity prices'. There were also discussions on price and income elasticity of demand and synopticity is fully awarded in answers.

Quite a number of candidates discussed more than one reason despite one appearing in bold in the question. Most candidates received the full 4 KAA marks. Several candidates had only shifted the AC curve despite their explanation discussing both fixed and variable costs. There were many cases where no evaluation had been attempted and so candidates could not be awarded more than 4 marks. Where evaluation did exist it was very seldom detailed enough to be awarded the full 4 marks.

(b) Using an appropriate diagram, discuss **one** reason why new 'Fresh & Easy' stores set up in the United States are likely to 'turn losses into profits by 2015' (Extract 2 line 11).

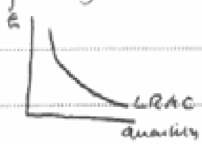
(8)

The loss of £165m in 2011 is due to increased costs of growing + changing location. These increase in costs come from legal fees, price of land to build supermarkets on + cost of building etc. This increases the average cost for Tesco / fresh + easy.



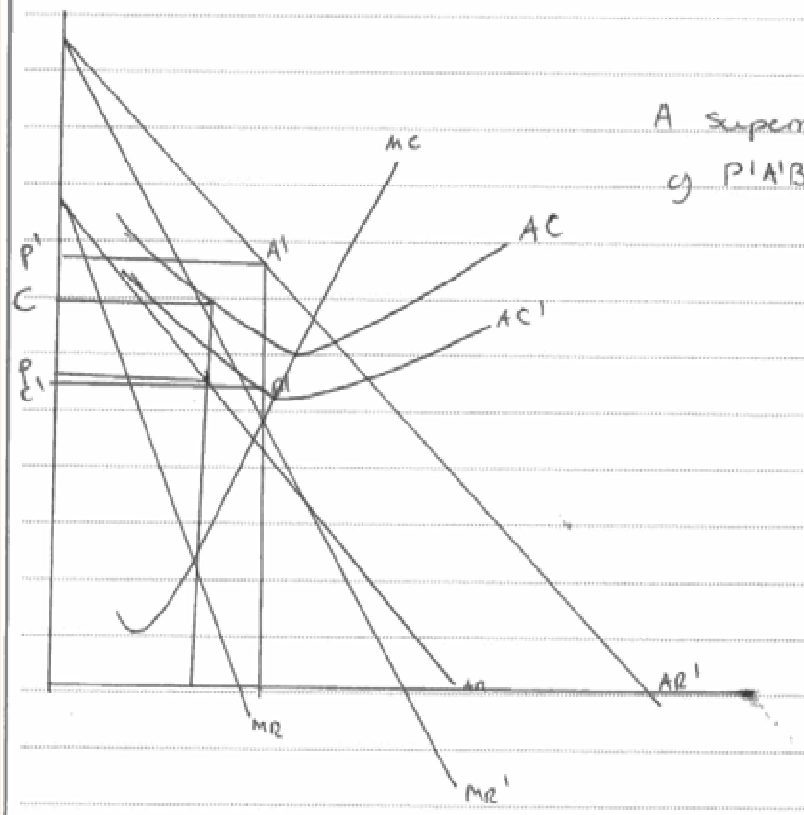
Due to the increase in costs and fairly low demand - due to the high concentration of supermarkets within the ~~US~~ US, Tesco have made a loss in the short run

This loss CABP will reduce by 2013 and turn into profit by 2015 because Long run average costs fall



and demand should increase due to an increase in brand loyalty from increasing the amount of shops.

when average costs fall and demand increases supernormal profits can be achieved



A supernormal profit of P'A'B'C' is made

However an increase in demand is difficult to achieve, and will mainly be based on non-price factors such as place, product and promotion, Particularly place for supermarkets

ResultsPlus

Examiner Comments

The marks for this response were awarded as follows:

KAA (4): Increase in demand (1) due to higher brand loyalty and advertising (1). Diagram on second page (2) - note that the original profit area is incorrect, but the mark is awarded for the new profit area, which is correct. Marks can be awarded for diagrams that show both a fall in costs and an increase in demand. EV (1): However, increase in demand may be hard to achieve because they will have to rely on non-price competition (1EV). 4 KAA + 1EV.

ResultsPlus

Examiner Tip

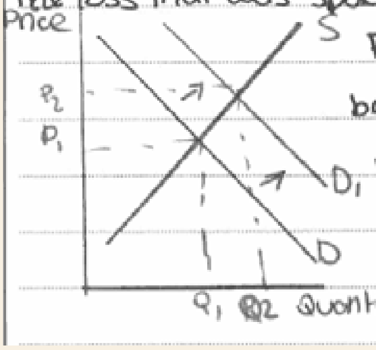
Show shifts and new profit/loss area.

Still some D and S diagrams.

(b) Using an appropriate diagram, discuss **one** reason why new 'Fresh & Easy' stores set up in the United States are likely to 'turn losses into profits by 2015' (Extract 2 line 11).

(8)

The concept of turning 'Fresh and Easy ~~stores~~ into smaller sized stores with reference to extract 2 means that tesco's are breaking up. Tesco's expansion into the USA involves foreign territory where they ~~have~~ lack the expertise and knowledge to run the company and ~~has~~ make supernormal profits. Therefore, through the firms growth, they have the ability to employ managers and specialists into different aspects of the stores to increase output ~~&~~ increase the demand for those goods as they are more attracted to consumers because the seller is an expert and he/she is a professional. If the smaller stores are specialised and run by someone who knows the market in USA, the loss that was spoken about will be turned into a profit.



From the diagram, quantity will increase, because of the increased demand, which will lead to an increase in price, so unfortunately, in the long-run, diseconomies of scale may occur.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

KAA (2): Increase in demand (1) due to being able to employ specialist managers with more market knowledge (1). No marks for S/D diagram. EV (1): But DEoS may occur (1) - point not expanded upon. 2 KAA + 1 EV.

ResultsPlus
Examiner Tip

Remember that evaluation is 50% even on an 8-mark question.

Question 9 (c)

Candidates needed to show awareness that the market shares by revenue shown in Figure 1, or suggestions as to the market structure of the supermarket industry are most obviously evidence of the level of monopoly power that exists, rather than the level of monopsony power. They can function as evidence of the latter, but candidates really needed to present them in this way to achieve maximum credit for such observations. The less able candidates appeared to be more generally confused between monopsony and monopoly.

Less able candidates tended to copy a lot of the points made in the extracts into one long paragraph, without including their own analysis to explain how the evidence was answering or addressing the question.

*(c) Using examples from the Extracts, assess the degree of **monopsony** power in the groceries market.

(12)

Monopsony power is where the ~~re~~ is one buyer.

Supermarkets have alot of power when it comes to dealing with suppliers as they are looking for the lowest cost and high quality. Fluctuating commodity prices, increases the monopsony power of supermarkets as it is difficult for the supplier to pass costs on.

Although suppliers of food such as Nestlé or Unilever have famous brand names and power to succeed, smaller companies struggle very much.

Supermarkets could quickly change suppliers if they wanted, giving suppliers no confidence ~~and~~ or security. As supermarkets are in an oligopoly market structure the ~~main~~ ones with high market share are very powerful.

However, if supplies increase their size, they have a better chance in surviving. Also, supplying at the best quality posibly and having high reliability levels, reduces supermarkets monopsony power as switching to another suplier would be costly.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Definition of monopsony (1). Supermarkets have a lot of power (1) Suppliers of famous brands do not struggle (2 EV). Supermarkets can quickly change suppliers (2). Suppliers could increase their size (1 EV) Suppliers can increase their quality (2 EV). 4 KAA + 5 EV.

ResultsPlus
Examiner Tip

To gain high marks, answers to this questions needed to make extensive use of the extracts/data provided, and to separate the data into arguments for and against the existence of monopsony power.

To gain high marks, answers to this question needed to make extensive use of the extracts/ data provided, and to separate the data into arguments for and against the existence of monopsony power.

*(c) Using examples from the Extracts, assess the degree of **monopsony** power in the groceries market.

(12)

~~Monopsony is a single buyer. and ~~for~~ a firm with the monopsony power has the market power over the suppliers Therefore monopsony power can allow the ~~firm~~ to enjoy the economies of bulk buying~~

Monopsony power is when a firm is a single buyer and they have the power to negotiate price with the suppliers.

In the groceries market there are big supermarkets such as Tesco and Asda which owns the majority of the market shares. As these Oligopolistic firms pass on this low cost to the consumers, consumers then enjoy the consumer surplus. Therefore makes ~~a~~ small retailer's products appear more expensive

However monopsony power reduces the ~~producer~~ producer's surplus in the supplier's point of view. If the suppliers increase the price the retailers could easily turn to other suppliers with cheaper price. Therefore the low price remains

There is relatively high monopsony power in the market. Looking at the Figure one the C4 ratio is 75.6. Tesco itself owns 30.7% of the market share. This in theory is monopoly. It shows that eventhough the Northern food merges with the Greencore it maybe very hard.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Definition of monopsony (1). Oligopolistic nature of supermarkets (1). Supermarkets can turn to other suppliers (2). Concentration of supermarket industry (1). No evaluation. 5 KAA + 0 EV.

ResultsPlus
Examiner Tip

There was a need to make balanced arguments for and against a proposition, as 50% of the marks for this question were awarded for evaluation.

Arguments that suggested 'monopsonies are good/bad', or arguments that considered the costs/benefits of monopsonies to any stakeholder were given no credit. The question asked candidates to consider the *degree* of monopsony power present in the market only.

This was clearly the first time a large question on monopsony had been attempted by most candidates.

*(c) Using examples from the Extracts, assess the degree of **monopsony** power in the groceries market.

(12)

Monopsony power is the power derived from being the sole/largest demander for a good.

Supermarkets have significant monopsony power in relation to their suppliers. Particularly small scale suppliers such as farmers + producers such as Northen Food find it difficult to hold on to any cost savings they make. This is particularly the case when suppliers have one large buyer (the monopsony power holder) who can change suppliers quickly - usually based on price.

However this is not always the case for smaller firms, such as Cranswich. This firm has a large stock market share than Northen Foods and is smaller. Monopsony power of supermarkets in relation to this firm is less significant. This is because the quality of product + service given means ~~Tesco~~ supermarkets now relies on the supplier rather than the other way around. It would be too costly for the supermarket to change.

Brand loyalty also makes monopsony power a lot less significant. MNCs such as Nestle or kraft/cadbury's as suppliers are able to negotiate with grocers much easier due to their huge demand. Supermarkets, in fact, have little/no bargaining power with the big firms as their customers demand the brands and will therefore come to the shops to have these brands

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Definition of monopsony (1). Small suppliers find it more difficult (1 EV). Supermarkets can change suppliers quickly (2). Cranswick do not have this problem (3 EV). Brand loyalty reduces supermarkets' monopsony power (2EV). 3 KAA + 6 EV.

ResultsPlus
Examiner Tip

Ensure the arguments for and against are equally balanced.

Question 9 (d)

Candidates who made no reference to any industry were capped at 6/8 KAA marks, however this cap was only applied to a minority of candidates. More able candidates applied each point made to the same industry; whereas less able candidates tended to use a wide variety of different industries to illustrate points (the question asked candidates to make reference to a single industry).

A range of good points were made on this question. The application was well done and it was good to read about a range of industries. Where candidates found it difficult to achieve marks it was because the points they made were not detailed in their explanation and so were awarded 1 mark per point rather than 2 or 3.

*(d) With reference to supermarkets or another industry of your choice, assess reasons why some firms become very large and others remain small.

(16)

Some supermarkets are very large such as Tesco, Asda and Sainsbury's but others are just individual shops. Companies such as Tesco now have huge financial backing due to their scale and popularity. Tesco is aiming to get bigger with its new stores in America branded ~~the~~ Fresh and easy. A reason they may want to get even bigger is that they see a gap in the market in America of small stores instead of the huge out of town malls.

Some firms choose to get large to compete and to try and gain market share but firms could also remain small if they dont think they can compete.

Some firms may become large to try and gain monopsony power to push their costs down and to try and increase their profits. A firm could then get greedy to try and gain even greater profits and go into other countries.

Small firms may ~~so~~ stay small as they cannot access the finance they maybe require to grow their company. With the credit crunch it is very difficult to gain finance.

A small firm may also not want to risk what they already have if they want to be large.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

KAA (5): "huge financial backing" (1). "they see a gap in the market"(1) to gain market share (1) to gain monopsony power (2). EV (3): small firms cannot access finance (2e) avoidance of risk (1e). 5 KAA + 3 EV.

ResultsPlus
Examiner Tip

Use an industry of your choice - there is no preference for or necessary advantage in using the context provided.

A good answer.

*(d) With reference to supermarkets or another industry of your choice, assess reasons why some firms become very large and others remain small.

(16)

Reasons to be large
- econ of scale
- branding
- merges - reduce duplicate costs

Reasons to be small
- niche market - organic
- Family owned firms.

Firms can vary in size for numerous reasons, many of which are apparent in the supermarket industry.

~~An [illegible] for firms to be~~ Firms aim to increase in size to obtain larger economies of scale, and thus reduce their average cost, which allows for greater abnormal profits. Supermarkets can benefit from producing on a large scale by achieving purchasing economies of scale through the use of bulk-buying. Managerial economies of scale can also be achieved by the use of delegation of detail to secretaries and functional specialisation.
However, if a firm grows too large diseconomies of scale can occur, for example confusion amongst layers of management and general 'sloppy' behaviour in the form of x-inefficiency.

reducing demand.

On the other hand, some firms in the supermarket industry remain small. This can firstly be if the firm is in a niche market, such as a specialist organic supermarket, where the size of the market is limited, this means that the firm will be naturally small as any expansion in the AC could exceed the size of the market. If the minimum efficient scale of a firm does exceed the size of the market, then it may be a natural monopoly and regulation is required, although this is only the case in a few markets.

Firms may also be small due to the preferences of the owner, for example if ~~it~~ is a family run.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

KAA (6): bulk buying economies of scale (2) managerial economies of scale (2) reducing duplicate costs (2). EV (8): diseconomies of scale (2ev) mergers maybe unsuccessful (2ev) niche market and discussion of minimum efficient scale (3e) family run firms (2e). 6KAA + 8EV.

ResultsPlus
Examiner Tip

The essay plan helped.

Question 10 (a)

This question was well answered, with almost all candidates correctly stating that the market structure was an oligopoly, and managing to give a characteristic/definition of oligopoly. The vast majority of candidates appreciated the need to include some application in their answers too, and most commonly they used Figure 1 to calculate an n-firm concentration ratio. Candidates needed to look at the data closely, as a good number of calculations did not include GM's market share, possibly because they were used to pie charts in which the largest company's market share segment began at the 12 o'clock position.

A good, efficient answer.

(a) With reference to Figure 1, briefly explain the market structure in the US car market.

(4)

The US car market is an oligopoly market. From the figure 1, the CR7 concentration ratio (which is the market shares hold by the largest few firms in the market) is 86.4%. It is highly ~~conc~~ ~~concentrad~~ concentrated. This also prove that there are a few dominant ~~dominant~~ firms coexist which small firms in the market.

ResultsPlus

Examiner Comments

The marks for this response were awarded as follows: Oligopoly (1) CR7 (2). A few dominant firms (1).

ResultsPlus

Examiner Tip

Work out the CR if you can.

A more typical answer.

(a) With reference to Figure 1, briefly explain the market structure in the US car market.

(4)

The US car market is an aligopoly, with a few large firms, 7 as shown in figure one, they are interdependent, sell similar yet differentiated products and there are high barries to entry. GM owns the largest part of market share at 19.1% whilst ~~Hyan~~ Hyundai/Kia own the smallest percentage of 7.7%. The cars all have different, unique characteristics which set them apart, showing the market is oligpolistic.

ResultsPlus

Examiner Comments

The marks for this response were awarded as follows:

Oligopoly (1). A few large firms (1). GM market share (1).

ResultsPlus

Examiner Tip

Note Hyundai/Kia do not have the smallest market share, so no data mark for this.

Question 10 (b)

As with 9b a number of answers were based on a misreading of this question, and explained why losses had been made, rather than why these losses were to be turned into profits. Several of these candidates did return to the question and discuss profits, but at the expense of time for other elements of the question, notably the 4 evaluation marks.

Largely, candidates were able to gain one knowledge and one application mark by explaining the reason behind a fall in costs/rise in demand. Diagrams were reasonably well drawn, but the main issues here were:

written analysis failing to link to the diagram, for example, some candidates discussed reasons for a fall in costs, then illustrated a rise in demand, and vice versa. Similarly, there needed to be agreement between the written discussion of (variable and/or fixed) costs falling and whether both the AC and MC curves, or just the AC curve, was shifted on the diagram

labelling: axes and equilibria were often poorly labelled, and several candidates lost marks owing to the labelling of the curves. This occured particularly where an increase in demand was shown, and the new MR curve intersected the old AR curve, as it was often unclear which label applied to which curve, and in some cases this resulted in candidates drawing the new equilibrium at the wrong output level

that candidates should be encouraged to illustrate both the old and new equilibrium on the same diagram, wherever possible, as this makes it much easier to see how the curves have shifted

a minority of diagrams did not show the new profit area

no marks at all were awarded for simple supply and demand diagrams.

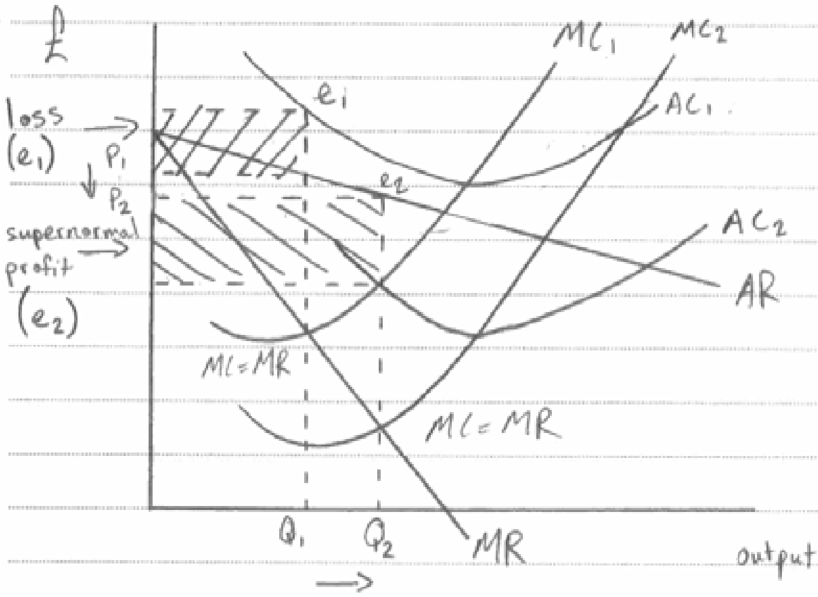
The main issue here, however, was a lack of detailed evaluation in candidates' answers. Many candidates included no evaluation at all, while others provided one evaluative point worthy of 2 evaluation marks only.

This was a good answer but gave no evaluation.

(b) Using an appropriate diagram, discuss **one** reason why General Motors and Ford have been able to turn losses in 2008 to profits in 2010.

(8)

Ford and GM both experienced huge losses in 2008 as a result of the recession. In order to make profits again, "capacity was cut drastically": Ford closed 17 factories and cut its workforce by 40%. This led to a huge fall in costs, and a large gain in profits since profit is the difference between costs and revenues.



After having reduced costs, the firm is able to move from equilibrium e_1 to e_2, leading to a rise in profits.

ResultsPlus
Examiner Comments

A maximum of KAA 4 for diagram and explanation were awarded.

ResultsPlus
Examiner Tip

Do not spend too long on application for these 8 mark questions.

This good answer started with a plan. Good sign.

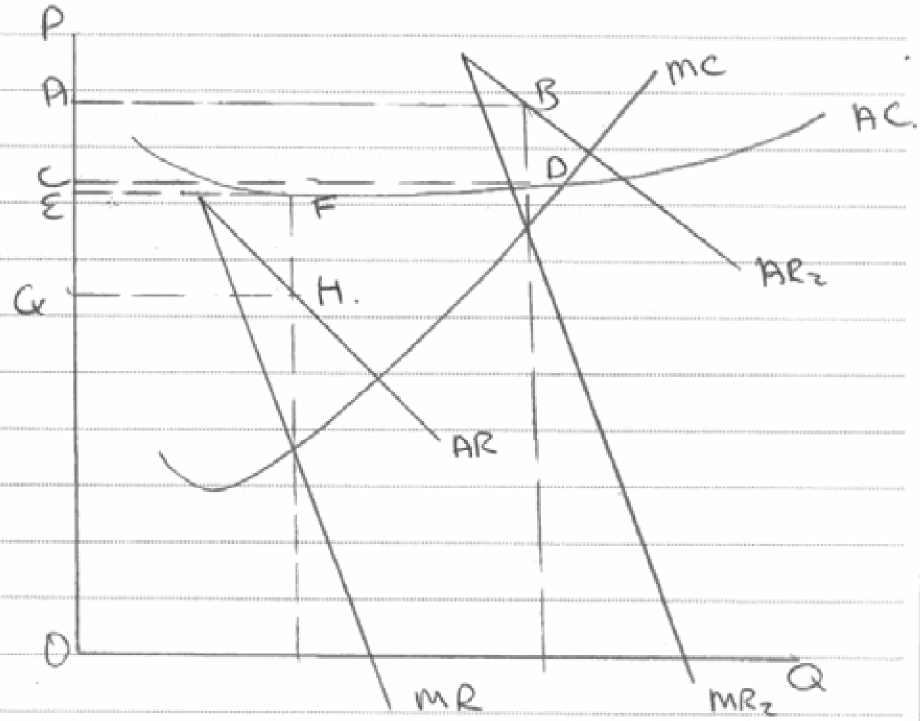
(b) Using an appropriate diagram, discuss **one** reason why General Motors and Ford have been able to turn losses in 2008 to profits in 2010.

(8)

Plan - Demand. → ~~[illegible]~~ Time lags, pre credit

→

General motors and Ford have been able to turn losses (TC > TR) into profits (TR > TC) due to an increase in demand as a result an improvement of 'credit worthiness' of buyers. This increase ~~of~~ in the ease with which customers can borrow has meant



as the diagram illustrates ~~profits~~ a
the loss of EFGH has become a
profit of ABCD two years later.
However ~~then~~ it is
worth noting that as
figure 2 illustrates, the
car companies have not retur-
ned to their pre-global recession
sales of 2007. There is reason
to believe that it is too soon
to say whether this will
lead to a sustained in profits
as. ~~and~~ Therefore information
on the savings ratio and US
household levels of debt
would be useful in determining
the accuracy of the forecast.

ResultsPlus

Examiner Comments

The marks for this response were awarded as follows:

Increase of demand (1). Improvement in credit worthiness (1). Diagram (2). Not back to pre recession sales (1 EV). Need more information (2EV). 4 KAA + 3 EV.

ResultsPlus

Examiner Tip

Large diagrams are good.

Question 10 (c)

Most candidates were able to give a definition of contestability, and to make some attempt to apply this to the US car market, although they did often struggle to either make enough points in their arguments, or to develop each point sufficiently to achieve full marks. There was a good deal of relevant material in the extracts, and candidates that scored highly tended to make good use of this, rather than simply relying on a candidate's own knowledge of the industry.

Less able candidates often confused contestability with competitiveness, and so considered the degree of the latter in the market, rather than the former. Such discussions were not awarded any marks, however candidates who considered market share or the level of concentration and then went on to link this to the ability of incumbents to limit price, or the need for entrants to spend large amounts on advertising and marketing in this situation where the incumbent's brands will be well-known, did receive credit.

Answers did need to be well balanced to gain high marks, but KAA marks were awarded for arguments that the market was contestable, *or* that it was

not contestable, and in either case, evaluation marks were awarded for arguing the opposite point of view, or for discussing the significance of the arguments made.

*(c) To what extent does the evidence suggest that the US car market is contestable?

(12)

Contestability is the ease of entry and exit into and from a market.

Figure 1 shows that the market is highly concentrated with firms having a high market share. This is a barrier to entry, as the incumbent firms are likely to be benefiting from economies of sale, - as the scale of production increases average costs fall. Another barrier to entry is a possibility of brand loyalty towards the large incumbent firms. Lastly, incumbent firms will have a technological advantage in the production of cars and will have access to better production techniques. These points all reduce the contestability of the US car market.

A further point that reduces the contestability of the market is the existence of high sunk costs. Specialist equipment needed to produce cars is likely to be expensive and have little resale value. Also, as shown in extract 1, lines 34-35 there is a lot of marketing and advertising in the market. This is another sunk cost.

However there does appear to be a gap in the market, especially for cars that don't use much petrol. Extract 1 lines 57 - 58 shows that chinese car firm BYD is entering the market with a niche product - the battery powered car.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Definition of contestability (1). Economies of scale (2). Brand loyalty (1). Technological advantage (2). Maximum KAA achieved. Gap in the market (2 EV). 6 KAA + 2 EV.

ResultsPlus
Examiner Tip

Less able candidates tended to present one-sided answers only.

Best to make fewer, deeper points than to list every point that can be made.

*(c) To what extent does the evidence suggest that the US car market is contestable?

(12)

A Contestable market is a market where there is low sunk costs, which mean the costs that cannot be recovered when the firm exits the market, low entry and exit barriers and the industry accepts hit and run firms.

For the US car market, ~~the car~~ concentration ratio is quite high. The four firm concentration ratio is 61.5%. There are entry barriers such as brand loyalty built up by existing firms such as GM and Toyota. However, if new firms improve their quality of cars, they would still be able to achieve recognitions. There is an example in Extract 1, paragraph 8, about the korean firms. They received recognition from critics as they had gradually improved their quality.

Also, we could see that for paragraph 7 in extract 1, government regulation is another entry barrier as ~~the they can be~~ firms can be fined if there is quality problems.

There are high sunk costs in this industry as firms had to advertise to promote their ~~car~~ cars. Advertising costs can be ~~so~~ high. However, firms might be able to sell off their brand name when they exit the market as they might have gained brand loyalty through advertising. ~~Sunk costs can also include~~

~~As the sunk costs can be high~~

Machinery costs can be high, but firms might be able to sell the machines when they leave the market.

As ~~...~~ sunk costs are quite high and economies of scale is required in the industry, the market does not really support hit and run of firms.

The incumbents might have better control over raw materials, it can make it really hard for new firms to compete with low prices as their costs of production might be higher.

~~The market~~ There is no market which is 100% contestable. ~~It depends on~~ It only depends on the degree of the contestibility of the market.

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:

Definition of contestability (1). Brand loyalty (1). Government regulation (1). Advertising (1). Machinery costs (1). Economies of scale (1). Control of raw materials (2). Award definition and 3 best arguments = 5 KAA. Firms can improve quality (2 EV). Firms can sell brand name (2 EV). Firms can sell machines (1 EV). 5 KAA + 5 EV.

ResultsPlus
Examiner Tip

Only 3 arguments will be awarded. If there are more than 3 we will award the best 3, for a 12 mark question.

Question 10 (d)

Some candidates did not answer the specific question asked, but instead simply discussed different pricing and non-pricing strategies.

Given that the question made reference to the context of sharply rising petrol prices, two KAA marks were reserved for application to this context. It was not sufficient to simply paraphrase this in the opening line of an answer, although this was as far as many got in addressing this element of the question. However, good answers that did discuss how firms may develop new models that would be more fuel efficient, or move their advertising and marketing focus away from 'gas-guzzlers' to smaller/more efficient/hybrid/battery powered cars, could be awarded these marks for an implicit application to context.

Similarly, the question specifically asked for strategies that would increase total revenue, and hence strategies that would not achieve this were not given credit. For example, the pricing strategies of offering discounts, limit pricing and predatory pricing, or cost-cutting measures, were not awarded marks unless they made explicit links to either total revenue rising as consumers have price elastic demand for cars, or total revenue rising in the long run, as competitors were forced out of the market and so prices then rise.

KAA marks were capped unless candidates considered both pricing and non-pricing strategies that may be used, although collusion was accepted as either type of strategy, depending on how it was presented. Although this question did not specifically ask for it, credit was given for a game theory analysis of effects on total revenue of collusion, for example in terms of setting prices, or of agreeing advertising levels. Alternatively, a prisoner's dilemma-type payoff matrix or kinked demand curve theory was used on occasion as evaluation to suggest that pricing strategies are less likely to be used in an oligopoly, and so non-pricing strategies would be more usual and successful. Candidates who made this kind of point correctly, and in a good level of detail, were often awarded four evaluation marks for this single argument.

Price discrim (e.g Toyota discounts) ~~Perceived~~ Quality (Royal mail) Toyota

*(d) Using evidence from a range of manufacturers referred to in Extract 1, assess pricing and non-pricing strategies car manufacturers might use to increase total revenue, when petrol prices are rising sharply.

(16)

~~One pricing strategy firms ma~~

Total revenue is average revenue ~~divi~~ × Quantity. One pricing strategy to increase total revenue ~~may~~ is revenue maximisation. rather than profit maximising (MC=MR). This is when MR=0 and is used to gain market share and hopefully increase long run profits. The problem with this, however, is that it generates lower profits than MC=MR and may be undertaken by managers who are satisficing rather than looking to optimise profits.

A non pricing strategy that firms such as Kia/Hyundai are using is advertising. A successful advertising campaign ~~too~~ attracts consumers, shifting out AR and MR and therefore increasing revenue. ~~The first problem w~~ This has been very effective in the past and Toyota plans to spend \$3 billion on marketing and opening more dealerships by 2015 ~~with~~ with the hope of increasing brand awareness and revenue. One problem with this is that ~~it~~ to be successful, the advertising team needs to be good, otherwise demand will not increase and costs will go up. The other problem is ~~the~~ involves game theory. ~~If the market~~

		Toyota	
		No adverts	High advertising
Ford	No adverts	1000, 1000	1200, 800
	High advertising	800, 1200	900, 900

Co operative

← Nash equilibrium

If both firms spend on adverts, costs increase but revenue stays constant. This will occur if one firm attempts to increase SR profits but in oligopoly, other firm will follow due to interdependence

Firms may undertake price discrimination e.g. Toyota offering discounts. This relies on having two markets with varying PED. Will not be profitable if cost of preventing arbitrage is greater than increased profits but will increase revenue still.

Firms may increase quality of goods to prevent fires and deter bad brand image, however might be more effective to spend on advertising (e.g. Royal mail delivery times)

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:
KAA (6): Revenue maximisation pricing (2). Advertising, with application (2). Price discrimination (1). Increase quality (1). No reference to an increase in petrol prices, and hence would have been capped to 6/8 KAA marks. Ev (4): Revenue maximisation lowers profits (1 ev). Advertising may not be successful (1 ev). If firms agree not to advertise, there was an incentive to cheat (1 ev) - note that the payoff matrix is incorrect. Price discrimination may not be successful (1 ev). 6 KAA + 4 ev. Overall, this is a very piecemeal answer, which didn't really focus on increasing revenue.

ResultsPlus
Examiner Tip

Where more than four pricing or non-pricing strategies are given (or more than four pieces of evaluation are given), we just award the best four.

Only 4 strategies were awarded. If there were more than 4, then the best 4 are awarded only.

*(d) Using evidence from a range of manufacturers referred to in Extract 1, assess pricing and non-pricing strategies car manufacturers might use to increase total revenue, when petrol prices are rising sharply.

(16)

Detroit reconquer the mid-range car market instead replacing the high ~~price cars~~ ~~The~~ price - gas cars. If petrol price increase, people may not want to buy car because it cost petrol. A concentration on cheap-gas car will increase demand for ~~this~~ ~~these~~ kind this kind of cars and ~~hence recover the revenue losing from increase petrol price~~ hence increase revenue.

Ford and GM bring the new version from foreign countries. This will attract consumers to purchase and increase total revenue.

Firms may cut costs hence cut price to compete with each other. If the price of car decrease, there are more incentive for consumers to buy cars - price war

Firms may encourage firms to buy cars by give some discount ~~or give some~~ by loyalty cards or give some gifts. This may increase the interest of consumers to buy cars.

However, ~~it dep~~ consumer may not interest on gifts and if the size of discount is too small that consumers will think is not worthy to buy at a ~~even high pri~~ situation which have a high petrol price.

~~Fo~~ If firms cut price by cutting costs to compete, this may result a price war and hurt any body's profits. So firms may not choose the compete on price. They may keep price stable or collude.

It also depends on the size of rising price of petrol. ~~If the size is rising pr~~
If the change of price is small, there will not be too much impact on demand for cars.

The new version ~~fo~~ bringing from abroad may not be successful. ~~Bf~~ Household may not accept the is new version. Hence the revenue will not increase

ResultsPlus
Examiner Comments

The marks for this response were awarded as follows:
KAA (7): Reference to petrol price increasing (2). Concentration on efficient cars (2). New versions from foreign countries (1). Do not award cut costs or prices as no link to revenue (0). Loyalty cards/gifts (1). Keep price stable (1). Collude (1). Award for best strategies only.
Ev (5): May not be effective (1 EV) - QWC was poor here and this should be taken into account when awarding. Price war (2 EV). Depends on the size of petrol price rise (1 EV). Households may not accept foreign versions (1 EV). 7 KAA + 5EV.

ResultsPlus
Examiner Tip

Less able candidates often tended to focus on non-pricing strategies, and struggled to include much economic analysis in their discussion of these. While good marks could be achieved for, say increased advertising as a non-pricing strategy, candidates did need to develop this point in more economic depth than simply suggesting different media that could be used, and saying that it would increase demand.

Possible points could be a consideration of the effects of advertising on consumers' price and/or income elasticity of demand for cars, particularly during a period of stagnant economic growth in the developed world, and hence how it would affect total revenue. Also, a consideration of the need for potential entrants/competitors to also spend more on advertising to compete, and the effects of this on the level of sunk costs in the market, and hence on its contestability/the incumbent's market share, and therefore total revenue.

Paper Summary

The A grade was set at 55/72 and E at 27/72.

The overall entry was smaller than the January 2012 entry, and many were re-takes from the January session, which might explain a certain decline in the average quality seen in this session as the mean fell. Question 10 had a higher mean score overall but a lower score on part d than on Question 9.Exact figures for the overall mean on the paper and per question can be found on Results Plus.

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