

Examiners' Report
June 2015

GCE Economics 6EC03 01

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June 2015

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Introduction

This penultimate paper in the Curriculum 2000 model followed the same patterns and expectations as in recent papers. Candidates did not face any particular problems and could complete the paper in the time available. Most candidates have grasped the exam technique that is expected.

The quality of answers in terms of economic knowledge seemed similar to 2014.

The most popular optional question was 10 over question 9 by a ratio of 4.4:1.

There were questions from centres about 10(b), where bicycle manufacturers may or may not have been taken to mean e-bike manufacturers. There were examples of both in the data, so both approaches were allowed and the question was easier to evaluate for this reason.

Question 1

Many if not most answers began with a definition of demerger, although the definition was incorporated as part of the question. There was a mark for explaining the *effects* of a demerger, e.g. increasing the level of competition within the industry, however candidates should be advised to avoid defining any or all the terms in a question in a scattergun approach.

The concept of contestability must be related to the barriers to entry or exit that might be reduced if this were to be the case. Many candidates said that more competition means higher competitiveness, but the link is not necessarily true. Very few answers were developed to give sufficient economics rationale for this knockout.

The most effective response was to explain the role of the competition authorities, and then apply this to the context, e.g. limited choice for banking customers, that is, to give their reasons for acting. Many answers went on to explain how a demerger might benefit consumers.

The most common incorrect answer was A, with candidates seeing diseconomies of scale as a reason for demerger without considering the function of the competition authorities.

This answer appears as if it has more in it than it actually has.

- 1 In 2013 the UK competition authorities forced LloydsTSB Bank to de-merge by forming two separate companies. 631 retail bank branches were rebranded as TSB, and 1 300 branches as Lloyds Bank.

Which one of the following is the most likely reason for this decision by the competition authorities?

(1)

- A There are diseconomies of scale in the retail bank sector
- B The level of contestability was high in the retail bank sector
- C There was increased consumer surplus gained through horizontal integration
- D There was a decrease in price gained through vertical integration
- E LloydsTSB had a high market share in the retail banking industry

Answer E

Explanation

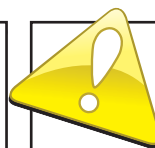
(3)

A demerger is the separation of a firm into smaller firms.
The UK competition authorities seek to promote consumer choice and a fair price for consumers by maintaining competition.
Legal monopoly - Over 25% market share
To be separated LloydsTSB was considered a monopoly as it had too much market share and market power with its 1,931 bank branches altogether.
Monopoly is where one firm dominates the market.



ResultsPlus Examiner Comments

1 mark awarded for correct Key
Definition of demerger simply rewords the question - not allowed and no mark was awarded.
Role of competition authorities was awarded 1 mark.
Reason to split up - too much market share and market power was awarded 1 mark
Summary: a total of 3 marks was awarded for correct key and explanation.



ResultsPlus Examiner Tip

There is only ever one definition mark and definitions are not required for full marks on any question. It is therefore unwise to define terms that have already been defined in the question as they are unlikely to score a mark.

This is an effective answer.

- 1 In 2013 the UK competition authorities forced LloydsTSB Bank to de-merge by forming two separate companies. 631 retail bank branches were rebranded as TSB, and 1 300 branches as Lloyds Bank.

Which one of the following is the most likely reason for this decision by the competition authorities?

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Answer

E

Explanation

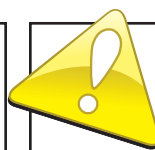
(3)

Market share is how much power an individual firm has in the total market
Competition Commission aims to promote competition.
A demerger is when one firm breaks down to form 2.
It is not B as due to ~~By~~ Lloyds TSB having a high % of the total market share then it may create some form of barrier to entry and prevent new firms from entering the market as they may have had the advantage of economies of scale so reducing contestability. (Total for Question 1 = 4 marks)



ResultsPlus
Examiner Comments

Key correct (1) Marks awarded for market share (1)
Role of competition authorities (1) There is also a mark for the knockout of B because contestability is defined in terms of barriers to entry (1) 1+3 = 4



ResultsPlus
Examiner Tip

Knockouts can be used up to 2 times, and they must give economics rationale that adds to the answer, not simply reversing the key.

Question 2

As with question 1 many candidates started this answer with a definition of average costs, where the marks could be achieved by explaining 'pricing below average cost' or for 'barriers to entry'. It should be remembered that there is only ever one definition mark available, and if other analysis is offered then a definition is not required. The problem that many candidates seem to find is that they fill up much space with the definitions and feel that they have answered the question. Clearly there is opportunity cost to defining every individual term at the expense of addressing the economic issues raised by the question.

This question was open to answers based on predatory pricing based on operating below AVC as a short term means of trying to remove competition in order to raise prices in the future, and also open to answers based on limit pricing as a tactic to prevent new entrants with higher costs from entering the industry. However, it was difficult to understand why a firm operating limit pricing could withstand loss making without some element of predatory pricing, and it must be that these firms will raise prices in the future, so limit pricing on its own needed a little more explanation to earn the full marks than a straightforward predatory pricing explanation. Limit pricing could of course still earn full marks if explanations were in line with the mark scheme. However it should be noted that while limit pricing tends to be anti-competitive, it is not automatically illegal. The point might be made in teaching that limit pricing may be judged to be illegal but it depends if it actually substantially lessens competition in the long run.

There is no mark for defining AC in the mark scheme. There is only one definition mark.

2 Several firms have priced tablet computers below the average cost of production. The most likely reason for this pricing policy is to

(1)

- A increase diseconomies of scale
- B increase barriers to entry
- C create a cartel
- D achieve short-term break-even output
- E achieve short-term profit maximisation

Answer

B

Explanation

Average cost = $\frac{\text{Total cost}}{\text{Output (quantity)}}$. Barriers to entry ^{are when} ~~occur~~ firms seeking to enter the a market are impeded from doing so because of large prices they would have to pay. By setting price below AC, the firms are engaging in predatory pricing to force competitors out and prevent new firms entering so that they can (as the new firms would have lack economies of scale or significant reserves and be unable to compete at such a low price) to protect or increase their market share so they can reap greater profits in the long run. (3)



ResultsPlus

Examiner Comments

1 mark awarded for correct Key
Definition of barriers to entry was awarded 1 mark
Predatory pricing is correctly explained and awarded 1 mark
Reasons/benefits of this - increased market share in long run was awarded 1 mark
Summary - a total of 4 marks was awarded for correct key and explanation.



ResultsPlus

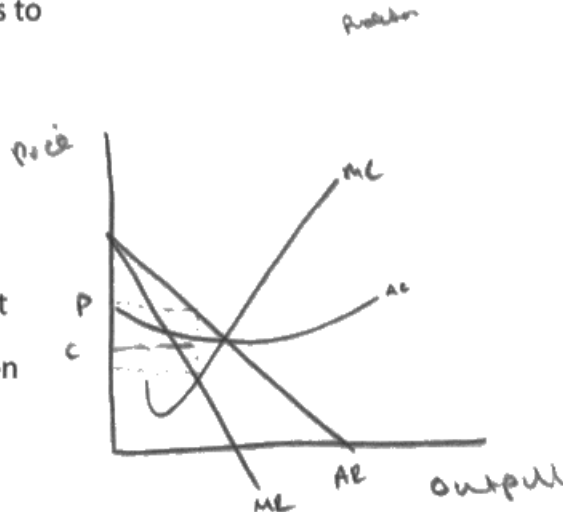
Examiner Tip

Look at Question 10(c) for the OECD definitions of Predatory and Limit Pricing (in the mark scheme). Note also that Limit Pricing is not automatically illegal although it can be said to be seen to have an anti-competitive motive.

2 Several firms have priced tablet computers below the average cost of production. The most likely reason for this pricing policy is to

(1)

- A increase diseconomies of scale
- B increase barriers to entry ✓
- C create a cartel
- D achieve short-term break-even output
- E achieve short-term profit maximisation



Answer

B

Explanation

(3)

By pricing the tablet computer they are increasing barriers to entry as this is an example of limit pricing. limit pricing is when firms set their prices low in order to prevent new firms from being able to join the market, firms do this in order to maintain market share.

cannot be E as profit maximisation occurs when $MC = MR$ and so \hat{P} is therefore set above average c .

(Total for Question 2 = 4 marks)



ResultsPlus
Examiner Comments

Key correct (1) Limit pricing to keep competition out (1) Knockout allowed as prices would be higher (1) 1+2=3



ResultsPlus
Examiner Tip

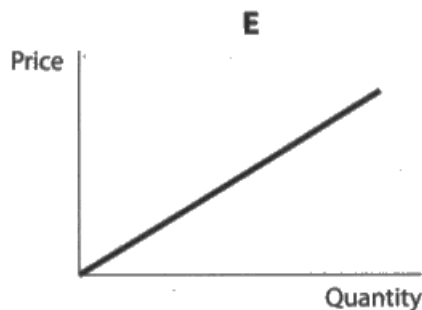
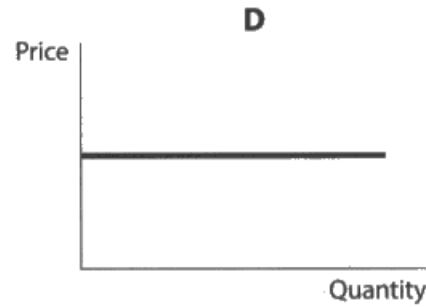
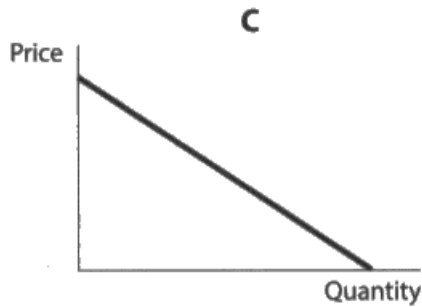
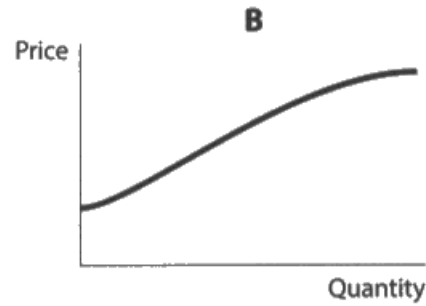
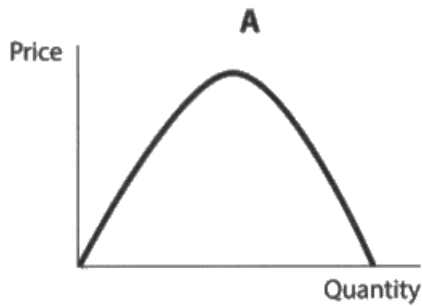
The most effective answers involved a diagram showing P less than AVC and a shading of the loss area.

Many answers knocked out E effectively, in that loss making was likely to be the maximum profit point $MC = MR$.

Question 3

Although very simple in concept, this question did cause confusion for those who described a perfectly competitive industry (option C) and those who referred to total revenue rather than average revenue (choosing E for perfectly competitive firm). It was an effect discriminator with many knowing the conditions for perfect competition and also the long run diagram, but not able to explain why the price is 'taken'. This was the highest scoring question with over 3.5/4 on average.

- 3 Which one of the following diagrams could depict average revenue for a firm operating in a perfectly competitive market?



(1)

Answer

D.

In a perfectly competitive market there is no price setting power for the firms, the price is dictated by the market. There are many buyers and many suppliers. As the price is dictated by the market $MR=AR$ and AR will be a straight horizontal line. The answer is not C because this would resemble a market where firms have some price setting power. The product is homogenous. (Total for Question 3 = 4 marks)



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Examiner Comments

1 mark awarded for correct Key
 No price setting power (i.e. a price taker) was awarded 1 mark
 Characteristic of perfect competition was awarded 1 mark
 Horizontal was awarded 1 mark
 Knockout of C as price setting power was awarded 1 mark
 Summary - a total of 4 was awarded for correct key and explanation

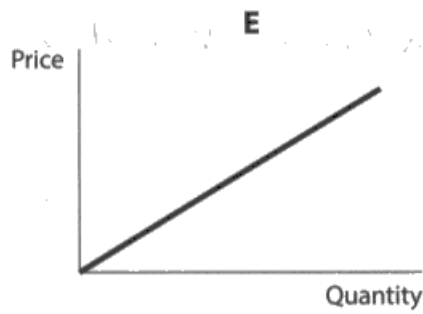
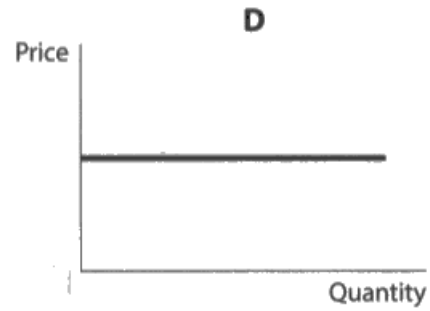
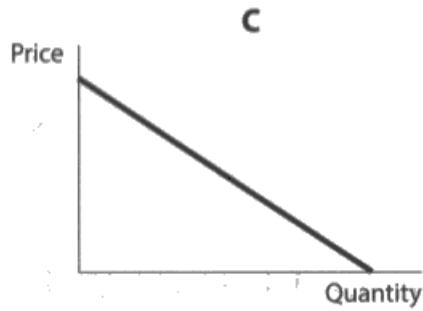
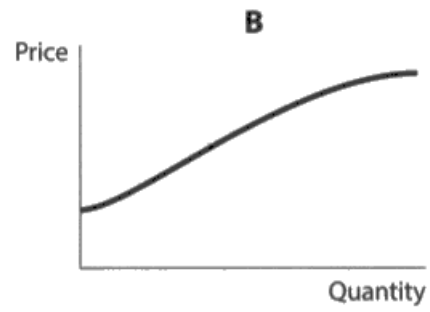
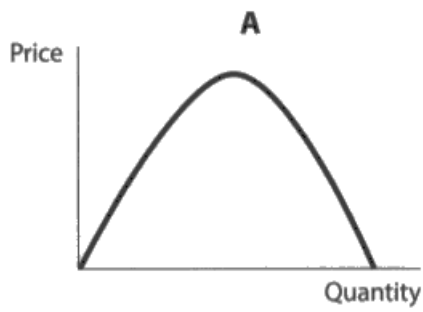


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Examiner Tip

The knockouts were a very effective way for finding the final marks for many candidates. Many chose C as imperfect or monopoly power, A for total revenue for a price maker and E for price taking. The most innovative answers also used B showing total costs and E as a supply curve. This was an effective question because it was clear what had to be done to earn the available marks.

3 Which one of the following diagrams could depict average revenue for a firm operating in a perfectly competitive market?



(1)

Answer

D

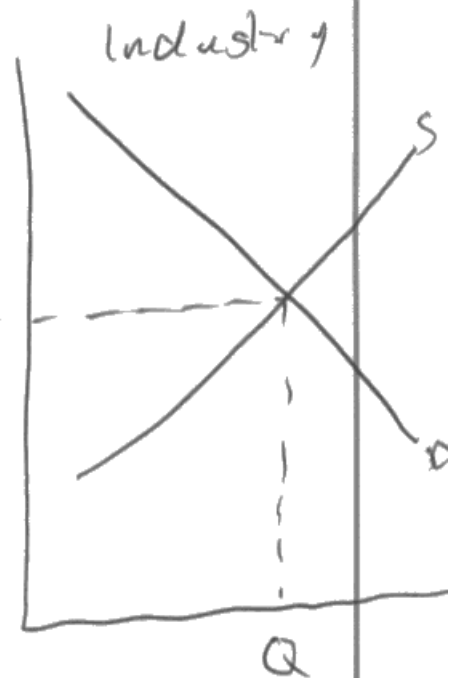
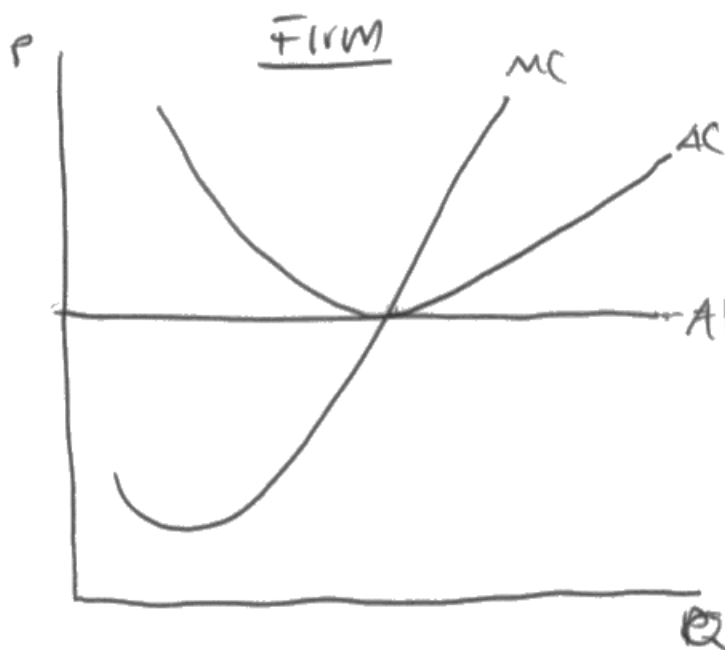
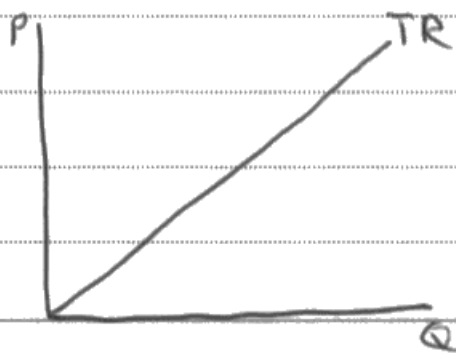
Explanation

There is also a perfect knowledge of other firms prices and produced (3)

Perfectly competitive market is where there are lots of small firms who have homogeneous products and are price takers. There is no brand loyalty and so each unit is sold for exactly the same price meaning that because $AR = \frac{TR}{Q}$ the average revenue will remain constant.

In the long run, firms enter or leave the market as there are no barriers to entry or exit so only normal profit made

(Total for Question 3 = 4 marks)



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Examiner Comments

Key correct (1) Characteristics (1) $AR = TR/Q$ is a good definition mark for AR (1) Diagram gains second available point on the mark scheme (1 + 1) and there is a knockout mark (1) but the answer already scores full marks 1 + 3 = 4



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Examiner Tip

The key concepts were to use the concept of an industry dictating the price, that the firm itself is a price taker, the concept of a horizontal demand curve rather than a straight line, and the sense of being elastic.

Question 4

The most efficient and effective answer for this question was to give a distinguishing characteristic of monopolistic competition accompanied by the long run equilibrium. An effective drawing showing normal profit and the long run position lined up with $MC=MR$ would earn two marks. Other effective approaches were to discuss the entry of new firms attracted by profits, and the erosion of the profits in the long run.

Many answers were an attempt to knockout A or B (perfect competition) but a common misconception is that all firms in perfect competition make supernormal profit in the short run – where clearly they can also make a loss.

An effective knockout often used was for C, incorporating a definition of monopsony.

There was an issue about the word *similar*. For some this clearly means *the same*, or identical. Similar is a word that might be explored in detail in lessons, in that it implies that some characteristics are the same but not all. For some candidates, 'similar' means 'the same' or homogenous, and there were many who chose option B for this reason.

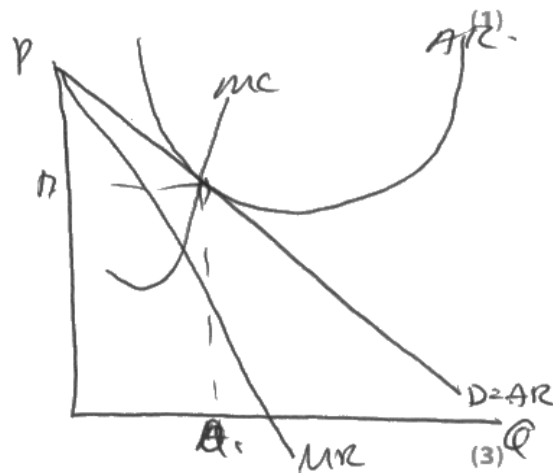
- 4 Shoe repairing firms in a large city are providing similar services, and they are making normal profits. Customers tend to be loyal to certain firms. The market structure most resembles

- A perfect competition in the short run
- B perfect competition in the long run
- C monopsony in the short run
- D monopolistic competition in the long run
- E oligopoly in the short run

Answer

D

Explanation



Monopolistic competition is a market structure with differentiated products and low barriers. Because of the low barriers in the short run a firm in monopolistic competition will make supernormal profit. Big firms will see this and may enter the market because of its low barriers and reduce any any supernormal profits.



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Examiner Comments

1 mark was awarded for correct key
Differentiated products was awarded 1 mark
Supernormal profit attracts new entrants - awarded 1 mark
Diagram (1 mark awarded) as $AR=AC$ (the output does not line up with $MC=MR$ therefore the second mark is not awarded)
Summary - a total of 4 marks was awarded for correct key and explanation



ResultsPlus
Examiner Tip

The diagram could be used to show normal profit as here ($AR=AC$) but this diagram is not going to be as effective as one which lines up the normal profit point with $MC=MR$.

4 Shoe repairing firms in a large city are providing similar services, and they are making normal profits. Customers tend to be loyal to certain firms. The market structure most resembles

(1)

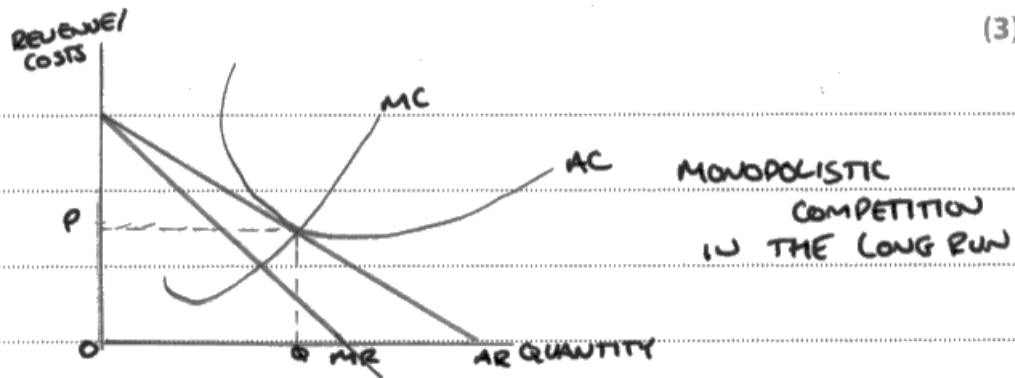
- A perfect competition in the short run
- B perfect competition in the long run
- C monopsony in the short run
- D monopolistic competition in the long run
- E oligopoly in the short run

Answer

D

Explanation

(3)



- It is not A or B as there is no brand loyalty in perfect competition due to homogeneous product.
 - D as monopolistic competition in the long run makes normal profits and have consumer loyalty due to brand differentiation.
 - Not E as oligopolys are interdependent.
- (Total for Question 4 = 4 marks)



ResultsPlus
Examiner Comments

An effective knockout often used was for C, incorporating a definition of monopsony.

There was an issue about the word *similar*. For some this clearly means *the same*, or identical. Similar is a word that might be explored in detail in lessons, in that it implies that some characteristics are the same but not all. For some candidates, 'similar' means 'the same' or homogenous, and there were many who chose option B for this reason.



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Examiner Tip

Here the diagram is still not fully effective but the candidate can find the marks another way.

Question 5

Most candidates chose B and could explain with straightforward reasoning that a process of undercutting prices will lead to an increase in sales. Marks were scored explaining undercutting and the interdependence/oligopoly of the firms.

The explanation marks proved to be more difficult, but the most effective answers involved a use of game theory payoff matrices. The main weakness in this question was a confused pay-off matrix.

- 5 Early in the morning on 19 September 2013, Microsoft revealed that the price of its new games console Xbox One would be £429 in the UK. Later that day, Sony announced that its new PlayStation 4 games console would be sold for £349 in the UK.

One possible reason why Sony chose to price its product significantly lower than Microsoft was because

(1)

- A it had first mover advantage
- B it wanted to undercut Microsoft and take a large market share
- C it wanted to benefit from relatively price-inelastic demand
- D it was colluding with Microsoft
- E it had higher sunk costs in developing the new games console

Answer

B

Explanation

Microsoft and Sony are in oligopoly market. They are large interdependent firms dominate the market with high barrier to entry. ⁽³⁾ If Sony reduce their price to be lower than Microsoft they will gain more profit as show on the table. However, this is not very good because can cause price war in long term as Microsoft will try to get low their price to get more ~~revenue~~ profit.

		Microsoft	
		High	Low
Sony	High	100, 100	120, 80
	Low	90, 80	50, 50

(Total for Question 5 = 4 marks)



ResultsPlus

Examiner Comments

1 mark awarded for correct key

Interdependence was awarded 1 mark

Payoff matrix shows Sony benefitting from lower price, bottom left of matrix - 1 mark awarded

Long run equilibrium, both firms worse off - 1 mark awarded BOD as the top right box of the matrix is wrong

Summary - a total of 4 marks was awarded for correct key and explanation



ResultsPlus

Examiner Tip

The main problem with payoff matrices is the lack of clarity about which payoff accrues to which party. Some answers provided left right results which could conceivably correlate with left above. However the most difficult to interpret was the payoff matrices with a diagonal line from top right to bottom left, meaning it was very unclear as to which payoff related to which firm. Many payoff matrices showed the relevant payoff to each firm in the box itself, which was easy to understand and therefore very effective for earning marks.

- 5 Early in the morning on 19 September 2013, Microsoft revealed that the price of its new games console Xbox One would be £429 in the UK. Later that day, Sony announced that its new PlayStation 4 games console would be sold for £349 in the UK.

One possible reason why Sony chose to price its product significantly lower than Microsoft was because

(1)

- A it had first mover advantage
- B it wanted to undercut Microsoft and take a large market share
- C it wanted to benefit from relatively price-inelastic demand ✗
- D it was colluding with Microsoft ✗
- E it had higher sunk costs in developing the new games console ✗

Answer

B

Explanation

(3)

The market could be an oligopoly market or a duopoly market. Price undercutting is when a firm lowers its price relative to a competitor in order to increase demand for its product and gain market share.

	High	Low
High	120	150
Low	80	100
Microsoft	High	Low
Low	70	150

Option D is wrong as a collusion with Microsoft means prices will be set similarly.



ResultsPlus
Examiner Comments

1 mark awarded for correct key
 No marks for oligopoly definition as not on mark scheme
 Explanation of the reason for undercutting - awarded 1 mark
 Use of payoff matrix - 1 mark for short term gains and 1 mark for long term lower payoffs. (BOD as diagonal lines are unhelpful). There is also a mark for the knockout but full marks already awarded
 Summary - a total of 4 marks was awarded for correct key and explanation



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Examiner Tip

Many candidates missed the identification of first mover disadvantage but did observe that there are benefits to being a second rather than a first mover in this context.

Question 6

This was a question with unique context, but was clearly enjoyed by the majority of candidates.

Most answers were correct and included a definition of a concentration ratio, a use of the data and a knockout, although the explanation of market power was quite weak in some cases.

Most also observed that the firms were operating in an oligopoly.

- 6 The table below gives the 4-firm concentration ratio in a selection of industrial sectors in the USA.

Sector	4-firm concentration ratio
Food manufacturing	16.8
Metal household furniture manufacturing	27.6
Motor vehicle manufacturing	81.2
Breakfast cereal manufacturing	82.1
Malt manufacturing	91.4
Guided missile and space vehicle manufacturing	95.3

(Source: US census www.census.gov/prod/ec02/ec0231sr1.pdf)

What can be inferred from this information?

(1)

- A The metal household furniture sector is more concentrated than the breakfast cereal sector
- B There are no barriers to entry in food manufacturing
- C There are external diseconomies of scale in motor vehicle manufacturing
- D Four firms have significant market power in the manufacture of motor vehicles
- E The guided missile and space vehicle sector is monopolistically competitive

Answer

D

CR₄ are the top four firms within an industry - holding the majority of market share. If over 50-60%, then the market structure is an Oligopoly.

D is correct as the top 4 motor vehicle manufacturing firms have 81.2% of market share, which is significant, and due to being over 50-60%, is an oligopoly.

E is incorrect as CR₄ = 95.3% which means the top 4 firms have 95.3% market share between them.

(Total for Question 6 = 4 marks)



ResultsPlus

Examiner Comments

1 mark awarded for correct key
 Definition/formula of concentration ratio - awarded 1 mark
 Oligopoly - awarded 1 mark
 Use of data in industries to explain market power - awarded 1 mark
 Knockout of E is applied correctly (1 mark) although all marks now awarded
 Summary - a total of 4 marks was awarded for correct key and explanation



ResultsPlus

Examiner Tip

The most effective way to gain the final mark was to argue that various options were wrong, using the data to argue the reverse was true.
 Marks were gained by many in discounting options A and D accurately.

- 6 The table below gives the 4-firm concentration ratio in a selection of industrial sectors in the USA.

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What can be inferred from this information?

(1)

- A The metal household furniture sector is more concentrated than the breakfast cereal sector
- B There are no barriers to entry in food manufacturing ✗
- C There are external diseconomies of scale in motor vehicle manufacturing ✗
- ✗ D Four firms have significant market power in the manufacture of motor vehicles
- E The guided missile and space vehicle sector is monopolistically competitive ✗

Answer

A

● So metal household furniture is more concentrated.

Explanation

(3)

The n^1 ^{-firm} concentration ratio measures the proportion of market share owned by the largest n firms. The lower the n firm concentration ratio is, the more concentrated the market is.

This is because it shows that even the 4 largest firms only have a small market share and so there must be many firms. The answer is not D as the case may be that in the manufacture of motor vehicles, only one firm has significant market power and the other 3 do not.

● metal household furniture sector has ratio of 27.6% and motor vehicle manufacturing has 8.2% (which is more). ● (Total for Question 6 = 4 marks)



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Examiner Comments

Key incorrect - no mark awarded

The answer mistakes high and low concentration so all the application is the wrong way around. 1 mark awarded for definition of concentration ratio only

Summary - a total of 1 mark for definition of concentration ratio



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Examiner Tip

The main distracter was B, with candidates arguing that the food industry has no barriers to entry. A few candidates choose A and others chose E. Overall this was the second highest scoring question. However, with explanation marks relatively easy to pick up.

Question 7

The majority of candidates observed that this was a case of price discrimination and earned a mark for so doing. Some then went on to explain the conditions of price discrimination which helped to earn a further mark, although there was a need to relate these to the context. A very effective way to do this was in knocking out C, saying that if crossing between ticket holders is possible then price discrimination becomes ineffective.

This was another question when a diagram could pick up the marks very effectively and efficiently. Only the submarkets are required for the diagram, that is the 'advance' customers and the 'senior advance', but it was important to relate the elasticities in the diagram with the correct sub market.

A large number of candidates were attracted by B, with the problem that 'lower price elasticity' in the question is confused with the 'lower price' for senior citizens. There was a potential for lower PED to be a lower e.g. more negative number, although in this context it is usually 'nearer to zero' (but if this was made explicit by the candidate then the marks were awarded to the full).

A common knockout was E.

However by simply reversing the key there will be no credit, even with the emphasis 'would rather not do'. There must be some economics rationale in the knockout in order to earn the further mark. This was particularly noticed in the attempts at knocking out options D and E.

- 7 In December 2013, Virgin Trains quoted the following prices for a single train journey on 27 December at 07.55 hours between London and Manchester:

Passenger/ticket type	Price
Advance	£67.00
Senior citizen advance	£44.20

(1)

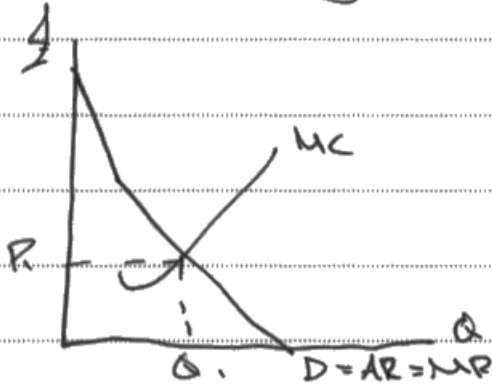
The most likely explanation of this pricing strategy is

- A to increase revenue
- B to take advantage of the lower price elasticity of demand for rail tickets of senior citizens
- C that it is easy for tickets to be bought by a senior citizen and used by any passenger
- D that the cost of providing seats for advance passengers is higher
- E to attract the attention of the competition authorities

Answer

B

Price 3rd degree price discrimination is when two different prices are charged to two different types of people.



E is incorrect as no firms want to attract the attention of competition authorities.

(Total for Question 7 = 4 marks)



ResultsPlus Examiner Comments

Key incorrect - no mark awarded

Price discrimination is identified but no further marks for commenting on the degree - 1 mark awarded

Diagram adds no helpful analysis - no mark awarded

Knockout is not adding anything - just reversing the key (no mark awarded)

Summary - 1 mark awarded for price discrimination



ResultsPlus Examiner Tip

A relevant diagram saves a thousand words.

- 7 In December 2013, Virgin Trains quoted the following prices for a single train journey on 27 December at 07.55 hours between London and Manchester:

Passenger/ticket type	Price
Advance	£67.00
Senior citizen advance	£44.20

(1)

The most likely explanation of this pricing strategy is

- A to increase revenue
- B to take advantage of the lower price elasticity of demand for rail tickets of senior citizens
- C that it is easy for tickets to be bought by a senior citizen and used by any passenger
- D that the cost of providing seats for advance passengers is higher
- E to attract the attention of the competition authorities

Answer

A

Explanation

(3)

The answer is A because price discrimination is being used. The product is identical however the PED of the two users is likely to be different as the "normal" advance buyers are likely to have a more inelastic PED than senior citizens. By pricing lower on a more elastic demand curve revenue will increase and by pricing higher on a more inelastic demand curve revenue will increase. The answer is not B because more elastic inelastic demand would have a higher price.

(Total for Question 7 = 4 marks)



ResultsPlus
Examiner Comments

This answer was effectively applied to the context

1 mark awarded for correct key

Price discrimination - 1 mark awarded

Advance customers 'more inelastic' than senior citizens - 1 mark awarded

Product identical but different sub markets - 1 mark awarded

Knockout mark also valid (1 mark) but max marks awarded

Summary - a total of 4 marks was awarded for correct key and explanation

Question 8

Most candidates chose the correct option and explained the need for a fine and the incentive to Network Rail although detailed application was rare. A number explained a natural monopoly even though not on the current specification, and this was useful to the extent that it showed why competition was not possible and therefore the need for performance targets.

This question is based on a Guardian article from 20 June 2012 which stated the ORR view that Network Rail was to blame for punctuality targets and was going to be fined £75bn, although some candidates were concerned that the network providers do not operate the trains.

As with other regulation questions the most effective approach tends to be to explain the role of the regulator, the reason the regulation is needed, the function of the regulatory tool (in this case performance targets) and the effects of intervention, e.g. the fine will have an impact of the decision making of the firm.

- 8** Network Rail is a firm responsible for maintaining the UK rail infrastructure. It faces a fine of £75 million, imposed by the Office of Rail Regulation (ORR), for failing to meet its punctuality target. Only 87% of long distance trains arrived on time in 2012–2013, missing the 92% performance target set by the ORR.

(1)

The intended purpose of such performance targets is to increase the

- A quality of service where lack of competition might lead to poor results -
- B contestability of the market where entry barriers are high <
- C x-inefficiency in the industry <
- D producer surplus of the firm where shareholders will benefit
- E government's revenue in the context of a fiscal deficit

Answer A

Explanation

(3)

Fines would discourage X-inefficiency as the damage to profits will encourage firms to ~~work~~ work better ^{so it} ~~is~~ not.
By imposing fines and reducing the firm's revenue profit it acts as a motive to provide better service out of fear it may happen again.

The regulator (OFRM) seeks to maximise consumer choice, and ensure a good quality service. Fines would ~~increase~~ decrease contestability as it would discourage firms from thinking about entering the industry due to ^{risk} of losses ^{in this way}.



ResultsPlus Examiner Comments

1 mark awarded for correct Key

Reason for the fine - reduce x-inefficiency - 1 mark awarded

Function of fine - encourage the better service (1 mark awarded)

Role of regulator - 1 mark awarded

Implication is that the contestability issue is a knockout of B - 1 mark awarded

Summary - a total of 4 marks is awarded for correct key and explanation.



ResultsPlus Examiner Tip

Always wise to explain why regulators exist, what they do and the intention behind their actions. It is also useful to observe whether or not there is an effect.

8 Network Rail is a firm responsible for maintaining the UK rail infrastructure. It faces a fine of £75 million, imposed by the Office of Rail Regulation (ORR), for failing to meet its punctuality target. Only 87% of long distance trains arrived on time in 2012–2013, missing the 92% performance target set by the ORR.

(1)

The intended purpose of such performance targets is to increase the

- A quality of service where lack of competition might lead to poor results ✓
- B contestability of the market where entry barriers are high ✗
- C x-inefficiency in the industry ✗
- D producer surplus of the firm where shareholders will benefit ✗
- E government's revenue in the context of a fiscal deficit ✗

Answer

A

Explanation

(3)

A monopoly is a market dominated by one firm. It has high barriers to entry.

As there are high barriers to entry in the UK rail service it is a monopoly. This means Network Rail experiences a lack of competition and this could increase x-inefficiency in the company. By setting the targets and fining them if not met, the ORR is incentivising them to reach the target and not under perform.

It cannot be C as this would look to reduce x-inefficiency, not increase it.



ResultsPlus Examiner Comments

1 mark awarded for correct Key

Lack of competition is the need for the target - 1 mark awarded

Function of target to incentivise - 1 mark awarded

No mark for monopoly or the knockout as these do not add relevant economics.

Summary - a total of 3 marks is awarded for correct key and explanation.



ResultsPlus Examiner Tip

Make sure that the knockout adds economic reasoning to the answer and does not simply reverse the key.

Question 9 (a)

Many candidates clearly identified horizontal integration and used the data to support their findings gaining full marks. The number of candidates achieving 3 marks did so due to limited use of data and there were many ways to earn these marks.

- (a) With reference to Extract 3, explain the type of integration involved between domestic formula milk producers in China.

(4)

Horizontal integration is taking place among domestic formula milk producers in China.

Horizontal integration is where firms in the same industry producing at the same stage of production merge together.

These integrations are supported by the Chinese government so the merged firms can benefit from the integration and drive away foreign competitors in the market.



ResultsPlus Examiner Comments

2 marks for theory

2 marks for application:

'Supported by Chinese government' (subsidy point)

And 'driving away foreign competitors' (reason for subsidy)



ResultsPlus Examiner Tip

Try to use two pieces of data or two quotes for a part (a) question and to pick up the two application marks.

Some used the wrong form of integration, as here.

- (a) With reference to Extract 3, explain the type of integration involved between domestic formula milk producers in China.

(4)

Inner Mongolia Yili Industrial Group and China Mengniu Dairy are merging through vertical integration as the two businesses are operating in the same market. This will result in an large economy of scale which will reduce the fragmented market from 200 to 50 as the brand gets bigger and more popular. Further due to government support of \$4.9 billion the firm will have an advantage because of the merger and government support.



ResultsPlus
Examiner Comments

There are still application marks to be earned and this earns 2/2 application marks.



ResultsPlus
Examiner Tip

Remember to consider the **stage** of the production process.

Question 9 (b)

Many candidates demonstrated a sound knowledge of 'subsidies' and were able to extend their definition with valid reasoning and appropriate comments. However, there is a significant problem with candidates wanting to use a demand and supply diagram even though a cost and revenue diagram was required.

Stronger candidates provided an appropriate diagram. Some candidates failed to show a shift at all, some just shifted the AC not the MC even though a clear reference was made to per unit subsidy in answers, and vice versa with AC and MC shifting when the subsidy was a fixed sum unrelated to output. The new profit area was identified correctly by a minority of candidates, with many finding difficulty in locating the new AC associated with the new $MC=MR$. Most candidates did gain some evaluation marks, particularly in relation to size of the subsidy, the fact that they were intended for encouraging mergers and the cost and possible diseconomies of scale associated with mergers.

(b) With reference to Extract 3 and your own knowledge, examine the likely impact of government subsidies on the profits of Chinese formula milk producers.

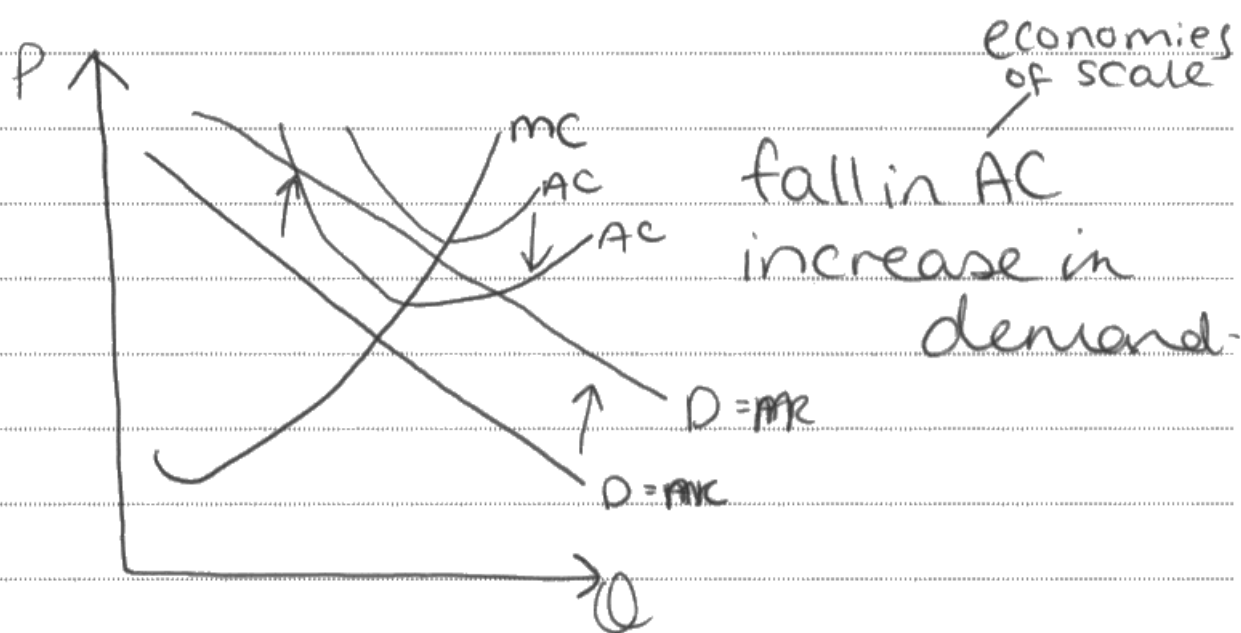
Use a cost and revenue diagram in your answer.

(8)

Government subsidies are when the government give money rather than loan it to firms. This can be done to help boost firms and encourage their growth or it can be to encourage some form of change within the industry which some firms may be hesitant in pursuing alone. In this case the government is aiming to "reduce the number of domestic formula milk producers" in the market "from 200 to 50".

One likely impact of these subsidies on profits is that they're likely to increase. The firms may use the money to pay towards

their costs and reduce their price. This could lead to an increase in D which can lead to an increase in profits. Also profits may increase in the long run as firms grow through merging and so becoming more dominant in the industry, allowing (as Extract 3 mentions) an increased ability to compete with international rivals.



ResultsPlus
Examiner Comments

Knowledge, Application and Analysis:

Definition (just) – 1 mark

Link to lower costs and higher profits – 1 mark

Diagram gains no marks

- no $MC=MR$ identified after shift

- no larger profit/smaller loss area 2/4 marks

Evaluation:

Consideration of the long run effects as LRAC falls - economies of scale (2 marks)

Total 4/8 marks



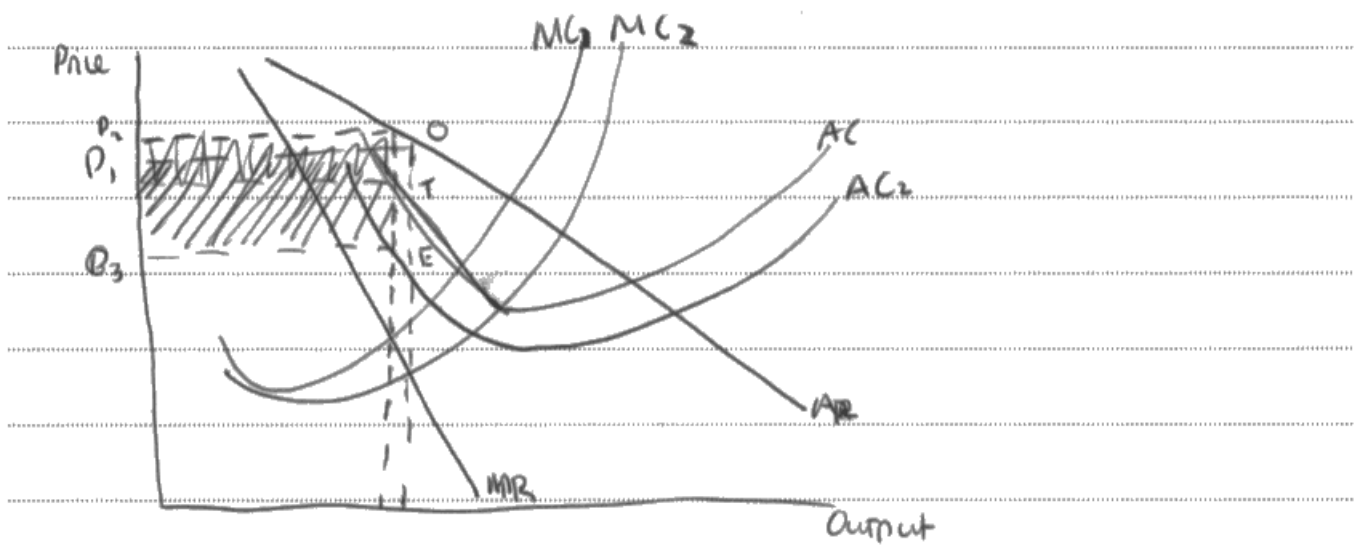
ResultsPlus
Examiner Tip

The diagram is the key discriminator on these questions and examiners take great pains to mark these accurately.

(b) With reference to Extract 3 and your own knowledge, examine the likely impact of government subsidies on the profits of Chinese formula milk producers.

Use a cost and revenue diagram in your answer.

(8)



- the subsidy is going to decrease cost of production for firms, decrease AC and shift MC. The profit maximizing output will be increased and the Chinese profit would also increase.

Price will decrease from P_2 to P_1 and profits for firm will increase from $P_2 O, T, P_1$ to $P_3 E, T, P_1$.

The subsidy will also be used to 'support merger'. This means that firm will benefit from merger with increasing economies of scale and investment in branding. This will increase the ability of companies to compete, leading to higher market shares and high profit in the long term.

However, it depends on how firm use the subsidy. Subsidies could just be used to retain profit, not increase investment and the cost of production.



ResultsPlus Examiner Comments

Although difficult to read this is a useful practice question:

Theory of subsidy 2/2 marks

- decrease costs of production
- profits would increase

Diagram 1/2 marks as new profit area not shown with new demand curve

Evaluation:

2e - An attempt to question whether investment will increase long run profitability or merely short term. This earns 2 marks. If it had been developed e.g. with a diagram there would have been scope to go further.

1e (top second page) - depends on how the subsidy is used 3/4 marks

Total 6/8 marks



ResultsPlus Examiner Tip

Evaluation is a fundamental skill and on these 8 mark questions is worth 50% of the marks. So make two attempts and try to develop them beyond a simple comment or observation. Depth and breadth are key.

Question 9 (c)

The understanding of 'price fixing and anti-competitive behaviour' was evident in the answers marked, although many did not explain why it was possible but rather what forms it might have taken. The most commonly used reasons were because of the oligopoly nature of the foreign milk producing firms, the inelastic nature of demand owing to the melamine crisis and the lack of regulatory power of Chinese authorities for firms outside China. The question scored particularly weakly, especially in relation to the equivalent question in 10(c) (on pricing and non-pricing policies) and it was assumed that this question was chosen by candidates wanting to avoid the 16-mark question 10(d) on contestability. However there were some excellent answers; candidates using game theory in their explanation were generally able to provide solid answers with clear evaluation. Where candidates had a clear knowledge and understanding of the text provided they were able to evaluate the key points made and secure these marks.

***c) Discuss why 'price-fixing and anti-competitive behaviour' by foreign formula milk producers in China may have been possible (Extract 1, line 7).**

(12)

One reason it may have been possible is due to the inelastic demand for the foreign milk formula. This is because of the safety concerns and panic over the use of domestic formula milk, following the issues faced in ~~2010~~ 2008. The foreign firms have then exploited this fear and decided to fix prices high, as they know they will still be paid. However, this may not have been the case as the black market for the milk formula is still around and so it is not as if the Chinese parents had no choice but to buy from the foreign firms.

~~Another~~

Another reason why anti-competitive behaviour was possible is due to the takeover of Wyeth Nutrition by Nestlé. This could have given them a market share which is unfairly

large and there is no body to stop this takeover. However, they wouldn't have been allowed to buy it if it was considered to give them a too large market share.

One last reason is that the foreign firms accounted for 60% of the market in 2012 and so this is such a large amount that the Chinese government were probably getting a large amount in tax revenue. This means they didn't want to do anything radical which may have affected this. However, it became too large of an issue for them to ignore so they had to fine the firms.



ResultsPlus
Examiner Comments

Knowledge, Application and Analysis 6/6 marks
2 marks - inelastic demand due to safety concerns
2 marks - weak competition authorities
2 marks - large market share, 60%
3 good points and all on mark scheme. 2 marks each
Evaluation 4/6
2e - black market exists so there is still a cheaper option
1e - competition authorities wouldn't have allowed it otherwise
1e - too large to ignore so the authorities had to fine the firms
(if given size of the fine this could have been 2 marks)
Total 10/12



ResultsPlus
Examiner Tip

This is a good and systematic answer.
However, the evaluation needs to go deeper.

*(c) Discuss why 'price-fixing and anti-competitive behaviour' by foreign formula milk producers in China may have been possible (Extract 1, line 7).

(12)

It has become possible because of speculation that domestic formula milk is dangerous. Extract 1 says 'This follows a scandal in 2008 when melamine in domestically produced formula milk killed 6 babies'. This sort of news puts doubt on the domestic product by the public and therefore increases the demand for imported formula milk. This increased demand for the imported milk will push up the price of them, Extract 1 says 'foreign-made formula milk that sells for £10 in Britain retails for as much as £30 in China' this suggests that the price has been driven up by demand for foreign formula milk. The Chinese government, who have seen these prices, have accused Nestle of price fixing without seeing the full picture. However it depends on how quality of domestic formula milk in China improves as to how much the future price of formula milk is affected. For example if another scandal were to happen then the price of imports would soar even more because those that were still buying domestically produced formula milk will move to imported, further increasing demand and therefore increasing price. If the quality of their product improves with the subsidies the Chinese government

plans to give them they may see a reduction in the reliance on imported formula milk and therefore prices may start to fall as domestically produced formula milk begins to substitute foreign milk.



ResultsPlus

Examiner Comments

This barely makes two points, in a rambling answer. 2+2=4 marks



ResultsPlus

Examiner Tip

Make sure the answer is structured, giving three reasons why price fixing might be possible and three why it might not be so easy, for example in future. Fewer good points could score at full marks, but three is a better approach to give breadth as well as depth.

Question 9 (d)

* (d) Evaluate the likely impact of the '£71 million' fines (Extract 2, line 2) on the price and availability of high quality formula milk.

(16)

Fines are deterrent for other firms to act accordingly to the rules and regulations imposed by the government or other authorities.

Availability of high quality formula milk will be affected. After being fined, firms will try to keep cost down and produce at a low rate so high profits will not attract authorities. Firms may produce through cheaper raw materials to keep cost down and to increase their producer surplus.

The prices are likely to be lower. Other firms may cut down prices to avoid any legal actions by the government and other regulatory authorities. Also the firms which were fined will reduce their prices. Consumers will then be benefited with low prices.

These fines were imposed to the five foreign formula milk producers. Domestic producers would be motivated to increase their supply and produce high quality products. This acts as a fact against the effect on prices and quality of formula milk.

Also as per the extract it states that these foreign firms may not be affected through the £71 million fines. Due to the reputation an FH holder for FHs goods the demand for it even after being fined may not be significantly affected.



ResultsPlus
Examiner Comments

This scores 8 marks, despite the fact that the candidate clearly knows how the answer would ideally be constructed. It is a superficial answer, picking up comments from the texts but failing to develop the ideas with any economic theory learnt in the classroom.

* (d) Evaluate the likely impact of the '£71 million' fines (Extract 2, line 2) on the price and availability of high quality formula milk.

(16)

The fines themselves are likely to lead to a rise in the price of high quality formula milk as the firms will need to gain the funds in order to pay off their fines or they will need ~~to~~ ^{the} money in order to cover the huge loss they've made in order to pay it off.

It is however likely that the availability will not change a great deal as China is a huge market for many foreign firms and they wouldn't be able to continue operating if they seized their supply to China.

On the other hand it is important to consider the magnitude of the fines, some firms may have only got 1 or 2 million and therefore can continue their supply as normal whereas a firm with fines in excess of 10 million may see a fall in production as they cannot afford to produce on such a large scale so availability will fall in the short run.

On the other hand completely the price of formula milk may fall as extract 3 line 8 states due to the investigation.

This price decrease may be because the firm feels a high price may encourage more firms but it may also be an attempt to save the consumer loyalty the firm has due to its high quality product.

After a price consumers may think about changing suppliers but a lower price may change that.

This is then likely to increase its availability because as the demand rises the firm will start to produce more and because some other firms are doing the opposite the market share may increase.

It is however important to consider that the firm having to charge lower prices may reduce the attractiveness of the Chinese market and therefore some firms may decide to leave the market. This will cause the availability of formula milk (high quality) to drop dramatically.

However this may benefit some firms which can then expand and take a more dominant market share.



ResultsPlus
Examiner Comments

2 - rising prices to cover higher costs
2e - may not change a great deal as they couldn't lose such a huge market
2e - magnitude of the fines
2 - prices may fall due to the investigation and attempts to save consumer loyalty (strong explanation)
2 - other firms might increase supply (weak explanation)
2 - firms may leave the market
Do not award the final evaluative point as repetition of previous point that other firms might expand their market share $8 + 4e = 12$ marks



ResultsPlus
Examiner Tip

This is a fairly strong answer, but falls into the trap of repetition. Make sure you have four distinct points if possible, or fewer much more well developed points.

Question 10 (a)

Candidates showed a good understanding of the market structure of batteries used in the manufacture of bikes and gained full marks as clear data relating to the names of the key firms and the reference to the 'same few suppliers' was evident. Less able candidates misread the question and discussed the e-bike market relating this to monopolistic competition.

- (a) With reference to Extract 3, explain the market structure of batteries used in the manufacture of e-bikes.

(4)

Extract 3 states that "almost all brands source their electrical components such as batteries from the same few suppliers." This entails that the market structure is that of an oligopoly with a small handful of interdependent firms.



ResultsPlus Examiner Comments

2/2 theory: Oligopoly (1 mark)

Interdependent (1 mark) 1/2 application:

Sourced from the same few suppliers (1 mark)

Total 2+1=3 marks



ResultsPlus Examiner Tip

Use two pieces of data to pick up the two application marks.

(a) With reference to Extract 3, explain the market structure of batteries used in the manufacture of e-bikes.

(4)

The supply of batteries is from Shimano of Japan and Germany's Schramm, meaning that it's an ~~monopoly~~ monopsony - with retailers getting their supply from one manufacturer (either the EU source - Germany, or Japan). This forms 25% of the price, and means that price will be higher due to a lack of choice of suppliers and reduced competition. This may be due to high barriers to entry, such as fixed costs, causing few firms to enter the market. A monopsony is when there is only one ~~buyer~~ seller of a good or service.



ResultsPlus
Examiner Comments

Theory

Monopsony (single buyer) is not valid (0 mark)

Application

Application relates to market power, so earns mark for dominant firms Shimano and Schram (1 mark) and higher price (1 mark) plus other references to data. See mark scheme.

0+2=2 marks



ResultsPlus
Examiner Tip

Think carefully about buying power (monopsony) and selling power (monopoly).

- * (a) With reference to Extract 3, explain the market structure of batteries used in the manufacture of e-bikes.

(4)

According to extract 3, almost the entire supply of batteries for electric bikes is controlled by a small collection of firms, "Chiefly Shimano and Schramm", this makes the market a duopoly, where two firms have a majority share of the market.



ResultsPlus Examiner Comments

Theory (2 marks):
Duopoly (1 mark)
Two firms control market (1 mark)
Application (2 marks):
Shimano and Schramm (1 mark)
Same few suppliers - small collection of battery firms implied (1 mark)
Total 4/4 marks



ResultsPlus Examiner Tip

This response is short and effective.

Question 10 (b)

It was clear a number of candidates read the question as the impact for those selling e-bikes rather than the impact on bicycle manufactures and as the mark scheme allowed this to be awarded this did not detriment those responding in this way.

Either AR would increase or decrease following the increase in demand for e-bikes. The question was clearly open to interpretations and both approaches were fully rewarded. There is evidence of both in the data. There is no advantage in saying that bicycle sales increase as against decrease, and the approaches are awarded as Knowledge, Application and Analysis (KAA) and Evaluation in either order. The way that the marks are awarded is to ensure that the candidate gets the highest possible mark for the approach given.

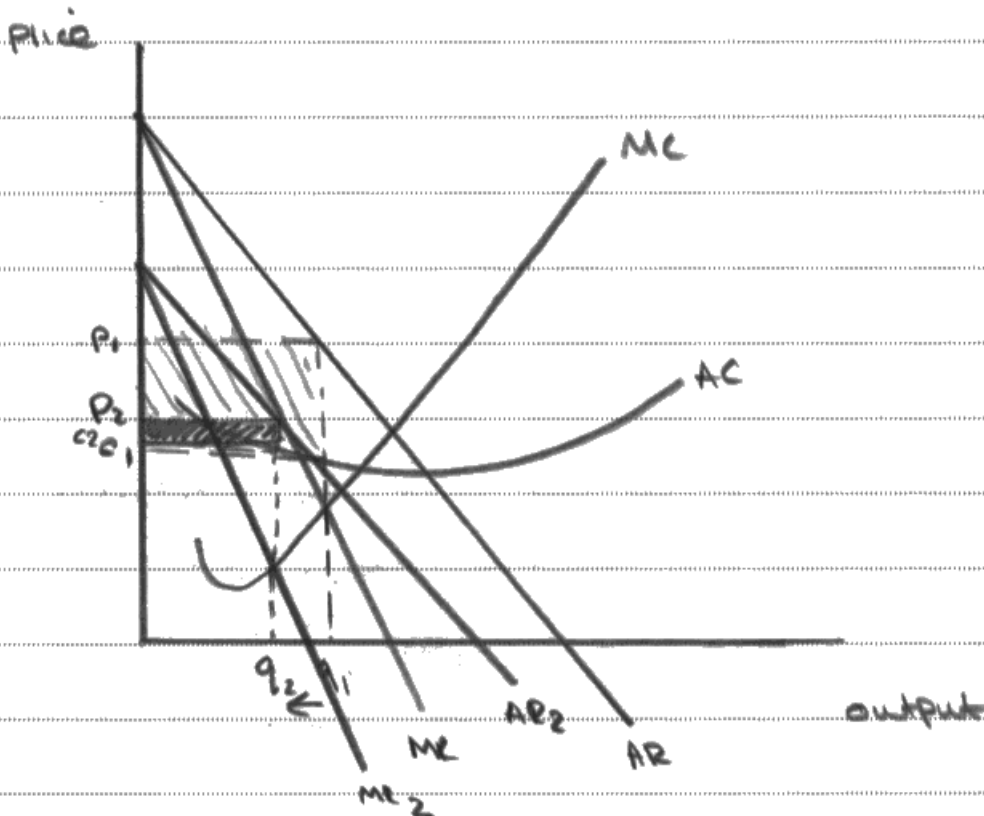
Generally candidates gained the knowledge marks and used data to support this gaining the two marks whilst stronger candidates provided an appropriate diagram. Some candidates failed to show a shift at all, some just shifted the AR not the MR and the new profit area was identified correctly by a minority of candidates, with many finding difficulty in locating the new AC associated with the new MC=MR. Most did gain some evaluation marks, particularly in relation to the cost of the batteries. Or in discussing whether the bicycle manufacturers also make e-bikes.

(b) With reference to the information provided, examine the likely impact of the increase in demand for e-bikes on the profits of bicycle manufacturers.

Use a cost and revenue diagram in your answer.

(8)

Bicycle manufacturing firm.



A likely impact of the increase in demand for e-bikes is that profits of bicycle manufacturers would decrease. This is because the increase in demand for e-bikes would mean that the demand for normal bikes would decrease, resulting in their output to fall and their price to fall resulting in a decrease in profit. In France the sales of traditional bikes fell 9% in 2012.

However decrease in profit may only be short term for bicycle manufacturers as many bicycle manufacturers are beginning to introduce their own line of e-bikes. For example Cannondale in the US has just introduced their own e-bike line. This will cause the demand for bike manufacturers to increase again restoring profits.

The extent to which the demand for bikes decreases is unlikely to be large, as the sales of bikes are still much larger than the sales of cars, this is due to people wanting to become more environmentally friendly. Therefore bicycles will still

remain competitive in the market as they are much cheaper than e-bikes and more environmentally friendly than cars \therefore profits may not decrease that much



ResultsPlus
Examiner Comments

Knowledge, Application and Analysis

Diagram 2 marks (shift and new smaller profit area)

Explanation 2 marks - decrease in demand/ decrease profit/data

Evaluation

Two good points made

2e - may introduce their own lines in the long term

2e - traditional bikes may still remain competitive

4+4=8 marks

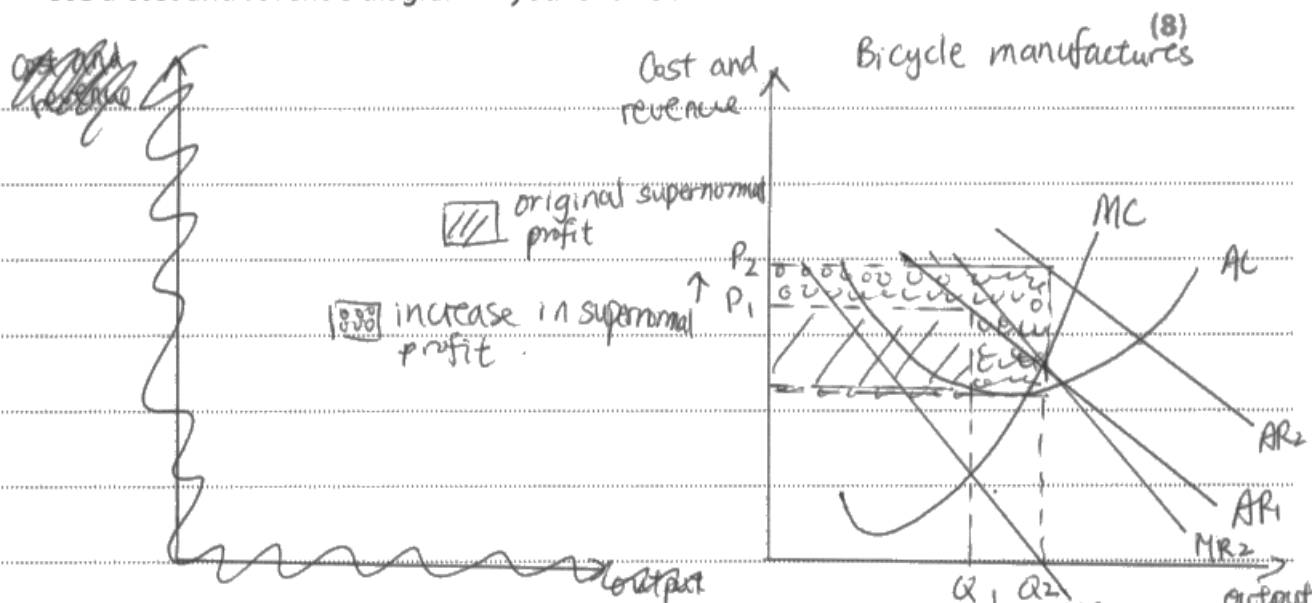


ResultsPlus
Examiner Tip

This is a good example of a well balanced answer and a clear diagram. However make sure the new AC is clearly distinguished from the old AC and the new profit area is based on the new AC not old.

(b) With reference to the information provided, examine the likely impact of the increase in demand for e-bikes on the profits of bicycle manufacturers.

Use a cost and revenue diagram in your answer.



As ~~price~~ demand increase, ~~the price of~~ demand (AR) curve shifts to the right and make price increase and quantity increase. Firms can then make more supernormal profit as shown in the graph. It can be referred to extract 1, Ebikes sales are growing by 22% a year.

However, a increase in supernormal profit might attract new entrants, so in the long run, super-normal profit is competed away and firms only make normal profit.

Also, price increase might make the firm itself less competitive because people tend to buy cheaper stuff. Bicycle manufacturers might to earn as much as they are expected. At the moment, they are ~~only~~ ^{mostly} people over ^{age} 50 buy ebikes which is not a big market.



ResultsPlus
Examiner Comments

Knowledge, Application and Analysis

Explanation 2 marks (make more supernormal profit, e-bike sales grown 22%, leading to price increase and quantity increase)

Diagram 2 marks (shift and larger profit area)

Evaluation No sense of the difference between bicycles and e-bikes and the evaluation is of very formulaic nature

1e - in the long run the profits could be competed away Last paragraph is irrelevant 4+1=5 marks



ResultsPlus
Examiner Tip

Try to think and respond to the data. The data itself provides the evaluation if used carefully enough. The answer is in the data.

Question 10 (c)

This was a popular question and the material as a whole has been very well rehearsed and the policies were well developed often very appropriately in the context of the data provided. There was good understanding of concepts evident, particularly of predatory and limit pricing, and where tied to the data this was often structured clearly with evaluation well developed. The context was in essence well applied throughout and many candidates gained higher marks by examining the policies chosen. Those candidates who presented a high number of policies in brief lost marks by failing to develop their explanations. Marks were capped for a few candidates who answered generically failing to use the context provided.

Price discrimination was commonly used as a policy, for example a lower price for over 50s was suggested by many owing to the reference to different markets in the data.

Some pricing policies were used with little success, such as price skimming, price penetration and cost plus pricing. The main weakness with these responses was the lack of analysis and weakness in application. It was not evident how evaluation could be effectively developed with these policies, although some did achieve this.

Probably the biggest weakness with the question was writing too much at the expense of question 10(d). There were many candidates who went onto extra paper, although this was not required in most cases (many had earned full marks before this paper was used) and the problem was that the next question was neither read properly nor considered carefully.

collusion predatory pricing
↑ ↑ limit pricing

*(c) With reference to the information provided, discuss pricing and non-pricing strategies that e-bike manufacturers might use to increase sales.

(12)

one non-pricing strategy e-bike manufacturers might use to increase sales would be to invest in advertising. This would inform consumers about the benefits of e-bikes and therefore increase their market share and so increase their sales.

However an increase in advertising may be ineffective as if one firm implements advertising this will lead to all other

firms also implementing advertising and therefore resulting in no investment to advertising being ineffective. This can be demonstrated by the game theory.

	no advertising	advertising	
no ad.	100 100	120 60	initial benefit from advertising as gain market share and so increase rev.
with adv.	120 60	80 80	

nash equilibrium: all firms advertising which removes benefits, therefore cost of advertising causes loss.

$$\text{sales manipulation} = MC = MR$$

one pricing strategy e-bike manufacture might use to increase sales would be to predatory price. This is when firms cut their ^{prices} costs in order to limit the entry of new firms, resulting in enabling them to maintain market share and increase sales.

However this strategy is illegal and so may result in attracting attention from the competition commission which could result in them being fined.

Another pricing strategy e-bike manufactures might use to increase sales would be to sales maximise. This occurs when $AC=AR$ and is when firms try and sell as many units of output without making a loss. Firms do this in order to gain market share so that in the long run they can increase their prices. In short run would increase sales

However e-bike manufactures might not be able to sales maximise as they may need to focus on other factors such as profit maximisation in order to satisfy shareholders.



ResultsPlus
Examiner Comments

This response scores 11/12 marks
It is a good example of an effective pay off matrix used well.



ResultsPlus
Examiner Tip

Use a pay off matrix to make your answer really clear.

*(c) With reference to the information provided, discuss pricing and non-pricing strategies that e-bike manufacturers might use to increase sales.

(12)

E-bike manufacturers may use non pricing strategies such as advertising in order to gain brand loyalty. This would increase sales as more people become aware of the e-bike firms.

However the costs of advertising are very high and this could increase average costs so much that it may cause firms to lose profits. Also increased advertising may not guarantee increased sales.

E-bike manufacturers could also decrease ~~the~~^{the} cost of the e-bikes in order to attract more customers and increase sales. ~~The~~ According to extract 2 they are already more affordable than ^{electric} cars so to decrease the prices ~~it~~^{it} could cause more[^] people to switch from cars to bikes as a cheaper alternative increasing sales.

~~Another non-price strategy could be that e-bike manufacturers could decide to set~~

Another non-price strategy could be that e-bike manufacturers offer rewards for buying their product possibly in the form of a

~~loyalty~~ coupon or voucher to buy more in the future
However this could not be effective because generally once people invest in buying assets like electric bikes they tend not to buy them again for a long time



ResultsPlus

Examiner Comments

- 2 - advertising
- 2e - cost of advertising
- 2 - decrease cost (price) of e-bikes
- 1 - loyalty scheme (no development)
- 1e - loyalty schemes are not really applicable to e-bikes (lacks development)
- 5 + 3e = 8 marks



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Examiner Tip

This is one of the lower scoring answers. Make three points, using as much theory as possible. Make three good evaluation points and extend them using as much data as possible.

Question 10 (d)

The majority of candidates defined contestability correctly, and although not awarded as a 'definition mark' did form the basis of a clear argument for and against contestability in the market. Knowledge and understanding was evident and there was extensive use of the passage; high barriers to entry were identified because of the skills and design needed for the new e-bikes, the strength of some of the established firms, the prediction of high profitability of 'firms worth investing in' and the high sunk costs. The high contestability was implied by the lack of large scale brands, a niche or expanding market, the 'green' nature of the product implying government support and the fact that many traditional bike manufacturers are moving into the market. One of the most common points was that smaller firms 'had not yet been squeezed out on price' because of the cost of the batteries. This was an effective way to use the data provided to develop the evaluation.

However, a number of candidates focussed on competitiveness resulting in no marks being awarded whilst others appeared to have 'run out of time' with brief, almost bullet point answers evident. Many candidates scored much less well on 10(d) than 10(c), and this was due to lack of time being reserved for reading and thinking about the final question, and in some cases only one or two points of relevance being made.

*(d) Discuss the level of contestability in the e-bike market.

(16)

The level of ~~contestability~~ contestability in ~~the~~ a market measures ~~the~~ ease that new firms can enter it. This is based ~~on~~ on barriers to entry, and in particular sunk costs. The e-bike market is relatively contestable, as due to being relatively new, ~~there are~~ firms such as Bikesec and Sachs haven't ~~had~~ had enough time to establish a large amount of consumer loyalty. This ~~means~~ means new entrants do not have to spend millions on advertising, a significant cost to ~~the~~ market, as there are few real established e-bike firms. However, ~~these~~ traditional bicycle manufacturers with e-bike ranges, such as Cannondale, benefit from being an already recognisable brand and so consumers may ~~feel~~ feel more comfortable buying from a company they already know which means new entrants would face the sunk cost of significant advertising costs.

The level of contestability can also be said to be ~~low~~ ^{high} as all brands source their electrical components from the same supplier. This means no firms benefit from backward vertical integration which would ~~also~~ raise sunk costs and lower contestability as the firm would have a guaranteed source of supply that other firms would be deprived of. However, as the batteries for e-bikes are sold in an oligopoly market structure, there are only a few dominant firms and so any future mergers would drastically lower contestability. These batteries are 25% of the cost of the bikes and so ~~as~~ ^{pre-existing} firms such as Btwin and Sachs grow to the size where they can merge with the suppliers, sunk costs will rise and contestability will fall and so the high contestability of the e-bike market is unsustainable unless new ~~firms~~ ^{firms} enter the battery industry.

Contestability ~~is also said to be~~ ^{is also} ~~due~~ ^{high} due to the large and growing demand. This creates for a very large market which firms have so far been unable to exploit. The increased global demand means that manufacturers in different countries can ~~also~~ create e-bikes to satisfy demands. There significance in helping reduce environmental problems ~~and~~ ~~may~~ ^{may} see them subsidised by governments to apportion the demand for ~~the~~ solutions to pollution. This allows for many more firms to have the chance to take advantage of the expanding market ~~and~~ which slows a high

contestability. However, demand is based in Europe and China which means contestability may be lowered if ~~the~~ local manufacturers secure these markets. The cost of expanding into countries with a higher demand will rise in the long term as more firms lead to ~~the~~ dominance of this relatively new market.

The introduction of patents may work to ~~raise~~ raise barriers to entry if firms find ways to improve the quality of their product through innovation. This would present a legal barrier for new entrants. However, there is a limit to what a firm can patent and the basic structure would be similar in most firms.



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Examiner Comments

2 - new firms have had no time to develop loyalty

2e - some bike firms are existing brands e.g. Cannondale

2 - all buy the same batteries and no vertical integration

2e - could change in the long run if the suppliers merge

The third point is not valid as it relates to demand not contestability. There is a point about subsidies, but this is embedded in an ineffective argument (BOD - 1)

1e - local manufacturers can secure market in China

2e - patents could appear in time and create a legal barrier - however there is a limit to what you patent (further development of their evaluation) - this could have been awarded as 1 + 1 if seen as KAA + EV (mark both ways an award the highest)

Knowledge, Application and Analysis

2+2+1+0

Evaluation 2+2+1+2

Total - 12 marks



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Examiner Tip

This is an untidy answer, not just visually but also in its construction. An orderly approach on the big essays should be practised over the year.

This answer confuses contestability with competition.

*d) Discuss the level of contestability in the e-bike market.

(16)

Contestability is how much competition there is in the market - e.g. how many firms may be supplying e-bikes.

The level of contestability in the e-bike market is increasing. Extract 3 states "most traditional brands" are releasing e-bikes. This means there is an increasing ^{Contestability} ~~competition~~ in the market, therefore firms may have a decreased market share as there is competition, and more firms contesting.

However, if some suppliers were in the market first, they may have already established a customer base, so consumer loyalty suggests that these suppliers ^{may} have the highest market power.

There may be more suppliers in the market but the suppliers with the highest market share may be down to quality. Extract 3 shows that there are specialists in the e-bike market, such as Bikelec and Sachs. If their quality and innovation is higher, then more people are likely to buy from them.

However, it depends on the magnitude of the quality, as if it is not a great deal better than people buy other branded e-bikes so competition may increase.

As more countries are bringing out their e-bike, e.g. USA, Netherlands and Germany in extract 3, competition will increase as not all products will be the same / homogenous, so people can venture out into differing products.

However, in the SR the contestability in the market may not be that high, but in the LR, as sales are expected to grow by 13% in Germany and 15% in France, then contestability will grow.

Traditional bike sales are falling by 9% in France, so e-bikes can be able to contest with normal bikes.

Fig 1 shows that although e-bike sales are still below 1 million, their sales are increasing, whereas bicycles and passenger car sales are increasing.

In the SR, e-bikes are still selling less,
but they can ↑AD and then overtake in
the LR.



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Examiner Comments

There are just 2 marks available,
for data use (BOD).



ResultsPlus

Examiner Tip

The answer to the 16 marker is key in
terms of discrimination. Choose carefully
between questions 9 and 10 and make
sure the questions are carefully read
before the data is approached.

Paper Summary

Based on their performance on this paper, candidates are offered the following advice:

- There were no questions of game theory in the paper, but many candidates used this effectively in their extended answers. The candidates that use standard theory and apply it to the context given can earn marks efficiently.
- Overall the paper was seen as accessible, and the mean reflected in the higher standard of performance. It was interesting data, and the fact that no candidates were likely to have studied the contexts of baby milk or e-bikes meant that the candidates were forced to use the data. In most cases this was done very effectively, and made the answers interesting to read.
- The main problem was illegibility in many cases and diagrams being drawn indistinctly. Candidates are reminded that it is hard for examiners to award marks where the arguments cannot be followed, although every attempt is made to do so.
- Read the question instructions carefully to make sure your answer remains relevant throughout.

Grade Boundaries

Grade boundaries for this, and all other papers, can be found on the website on this link:

<http://www.edexcel.com/iwantto/Pages/grade-boundaries.aspx>

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