Centre No.						Paper Reference							Surname	Initial(s)
Candidate No.						6	3	5	4	/	0	1	Signature	

Paper Reference(s)

6354/01

Edexcel GCE

Economics

Advanced

Unit 4 – Industrial Economics

Tuesday 14 June 2005 – Morning

Time: 1 hour 15 minutes

Examiner's use only

Team Leader's use only

Question Number	Leave Blank
Section A	
Section B	
Total	

Materials required for examination	**Items included with question papers**
Nil	Nil

Instructions to Candidates

In the boxes above, write your centre number, candidate number, your surname, initial(s), the paper reference and your signature.
The paper reference is shown above.
Answer **ALL** questions in Section A in the spaces provided in this question paper.

- For each question there are five suggested answers: A, B, C, D or E.
- When you have selected your answer to the question, write the chosen letter in the box provided.
- You can only offer one answer to each question.
- After making your selection you should offer an explanation of why you have made that choice. Your explanation may include a diagram.

Answer **ONE** question from Section B in the spaces provided in this book.

Information for Candidates

There are 28 pages in this question paper. All blank pages are indicated.
The total mark for this paper is 80.
The marks for the various parts of questions are shown in round brackets: e.g. (**2**).

Advice to Candidates

You are advised to divide your time equally between Section A and Section B.
You will be assessed on your ability to organise and present information, ideas, descriptions and arguments clearly and logically, taking into account your use of grammar, punctuation and spelling.

Printer's Log. No.
M21514A
W850/S6353/57570 7/5/6/6/6/4/2/

M 2 1 5 1 4 A 0 1 2 8

Turn over

edexcel

Leave blank

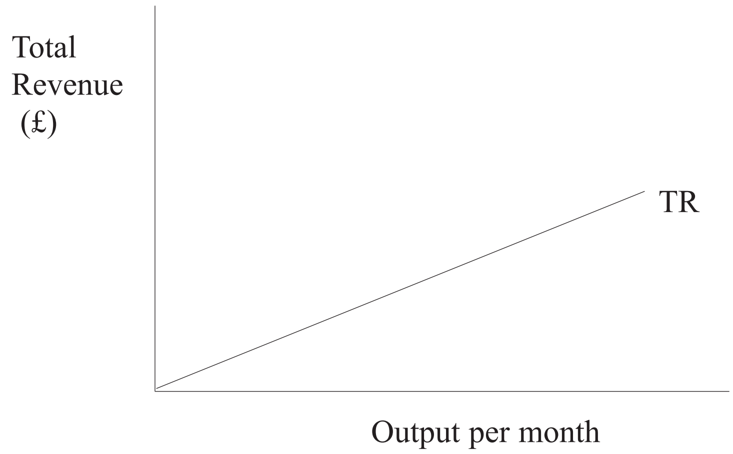
SECTION A

Answer ALL questions in this section.

You are advised to spend approximately 35 minutes on this section.

You are encouraged to use a diagram in your explanation where appropriate.

1.



The diagram shows a firm's total revenue as output increases.
Which of the following best characterises such a firm?

	Average Revenue	Marginal Revenue
A	Constant	Constant
B	Rising	Rising
C	Rising	Constant
D	Constant	Rising
E	Falling	Falling

Answer **(1)**

Explanation

....

....

....

....

....

....

(3)

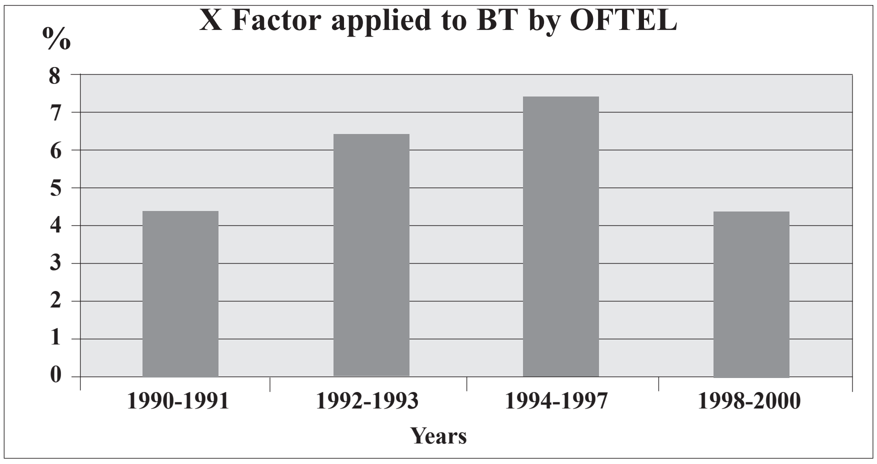
Q1

(Total 4 marks)

M 2 1 5 1 4 A 0 2 2 8

Leave blank

2.



The graph shows the values of X applied by the industry regulator OFTEL when price capping telecommunications company BT, according to the *RPI minus X* formula.

Which of the following can be inferred from the graph?

A Throughout the period shown BT has been allowed by the regulator to make real price increases.

B Throughout the period OFTEL believed there was room for BT to make efficiency improvements.

C Throughout the period shown BT's profits have been taxed at annual rates greater than 4%.

D After the 1990-1991 capping period BT was allowed by the regulator to raise its prices by more than 4% in nominal terms.

E After the 1994-1997 capping period OFTEL allowed BT to raise its prices by more than 4%.

Answer **(1)**

Explanation

....

....

....

....

....

....

(3)

Q2

(Total 4 marks)

Leave blank

3. A profit maximising monopolist switching to a policy of revenue maximisation will

A reduce output and raise price.

B raise output and raise price.

C raise output but leave price unchanged.

D leave output unchanged but reduce price.

E raise output and reduce price.

Answer **(1)**

Explanation

....

....

....

....

....

(3)

Q3

(Total 4 marks)

Leave blank

4. The 1998 Competition Act introduced new powers for the Office of Fair Trading to fine firms abusing a dominant market position up to 10% of their annual turnover. In which of the following is such abuse most likely?

A Industries where there are low levels of market concentration.

B Markets that are highly contestable.

C Perfectly competitive industries.

D Firms in monopolistic competition.

E Firms where there is a tradition of sharing future price information with competitors.

Answer **(1)**

Explanation

....

....

....

....

....

(3)

Q4

(Total 4 marks)

Leave blank

5. Firms in the UK hairdressing market are best described by the model of monopolistic competition. Which of the following will be true for such a firm in long run equilibrium?

	Allocative Efficiency	**Average Revenue**
A	No	Perfectly elastic
B	No	Downward sloping
C	No	Zero
D	Yes	Perfectly elastic
E	Yes	Downward sloping

Answer **(1)**

Explanation

....

....

....

....

....

(3)

Q5

(Total 4 marks)

Leave blank

6. In 1999 Reckitt & Colman merged with the Dutch company Benckiser. The resulting company makes fifteen core products as diverse as *Dettol* antiseptic, *Finish* dishwasher soap powder and *Disprin*, the leading brand of aspirin. The firm has a policy of acquiring established brands rather than developing its own.

This information suggests that the company's bid for the *Wilkinson Sword* brand of razors was part of a strategy of

A horizontal integration.

B vertical integration.

C conglomerate integration.

D increasing its expenditure on research and development.

E raising marketing expenditure on new brands.

Answer **(1)**

Explanation

....

....

....

....

....

(3)

Q6

(Total 4 marks)

Leave blank

7. Spending by firms on internet security is expected to soar over the next few years as a result of recent outbreaks of computer viruses such as '*MyDoom*'. This expenditure can best be classified as

A a rise in variable costs.

B a rise in fixed costs.

C a reduction in revenue.

D a fall in marginal costs.

E a rise in normal profits.

Answer ☐ **(1)**

Explanation

....

....

....

....

....

(3)

Q7

(Total 4 marks)

Leave blank

8. Which of the following is the most likely consequence of an oligopolistic market structure?

A Periods of tacit collusion.

B An absence of non-price competition.

C A tendency of firms to make only normal profits in the long run.

D A falling concentration ratio over time.

E Productive and allocative efficiency.

Answer **(1)**

Explanation

....

....

....

....

....
(3)

Q8

(Total 4 marks)

Leave blank

9. Under the Enterprise Act 2002, the Office of Fair Trading has the power to refer any merger involving more than 25% market share to the Competition Commission for investigation. The investigation is likely to recommend that the merger is **not** allowed to take place if it is likely to result in

A a share price thought to be too high by many potential shareholders.

B a substantial reduction of competition within any market or markets in the UK for goods and services.

C increased consumer benefits such as lower prices and greater choice of product.

D a reduced market concentration ratio in the relevant industry.

E greater contestability in the relevant industry.

Answer **(1)**

Explanation

....

....

....

....

....

(3)

Q9

(Total 4 marks)

Leave blank

10. A monopoly attempting to prevent new entrants into the industry is most likely to adopt a policy of

A predatory pricing.

B cost-plus pricing.

C pricing to maximise supernormal profits.

D limit pricing.

E pricing to minimise sunk costs of production.

Answer ☐ **(1)**

Explanation

....

....

....

....

....

....

....

....

(3)

Q10

(Total 4 marks)

TOTAL FOR SECTION A: 40 MARKS

Leave blank

SECTION B

Answer EITHER Question 11 OR Question 12.

Indicate which question you are answering by marking the box (☒). If you change your mind about an answer put a line through the box (☒) and then indicate your new question with a cross (☒).

You should spend approximately 35 minutes on this section.

If you answer Question 11 put a cross in this box ☐.

Question 11 Price Discrimination and the Internet

Extract 1

Since the internet makes it easier to compare prices, the consensus – based on the model of perfect competition – has been that sellers' ability to charge different amounts to different buyers will be eroded. Not so, argues Andrew Odlyzko of the University of Minnesota: his analysis suggests that the new era of internet technology will usher in an unprecedented level of price discrimination.

Thanks to the internet, he argues, lots more opportunities for price discrimination are emerging. The most obvious example is airlines. Airline websites now discriminate in extraordinarily refined ways, setting fares that vary by the date of booking and the time of the flight.

Some manufacturers are starting to do the same: Dell Computer, Mr Odlyzko notices, charges different prices for the same product on its web pages, depending on whether the buyer is a state or local government, or a small business. And such discrimination is being extended to other parts of the economy.

Of course, not all products and services can be priced in such ways. For example, drug companies have been unwilling to set prices for AIDS drugs that discriminate in favour of poor countries. But in the air travel industry, government security now requires that a passenger's name matches that on the ticket, making the market ideally suited to price discrimination. The internet allows companies to collect data to see who is likely to pay what, and also to monitor whether secondary markets are developing.

Price discrimination, points out Mr Odlyzko, makes economic sense. A company can maximise its revenue if it can extract from each customer the maximum amount that person is willing to pay. And some consumers will enjoy lower prices and be better off as a result.

(Source: adapted from *The Economist*, 18 October 2003)

Leave blank

(a) (i) Explain **three** of the assumptions behind the 'model of perfect competition.' (*lines 1 and 2*).

(6)

Leave blank

(ii) Using your own knowledge, identify **one** product for which price discrimination has become harder following increased internet usage. Justify your answer.

(4)

(b) (i) With reference to the extract, examine why price discrimination may be more likely in the airline industry than in the market for medicinal drugs.

Leave blank

(8)

Leave blank

(ii) Using an appropriate diagram(s), examine why a firm that can identify two sets of consumers with different price elasticities of demand may find it profitable to price discriminate.

(8)

Leave blank

(iii) Outline **two** possible advantages of price discrimination to consumers.

(6)

Leave blank

(c) Assess the impact on market contestability of increased use of the internet.

M 2 1 5 1 4 A 0 1 8 2 8

Leave blank

(8)

Q11

(Total 40 marks)

Leave blank

If you answer Question 12 put a cross in this box ☒.

Question 12 Elizabeth Shaw Chocolates Plan for Expansion

Extract 1

Elizabeth Shaw is a company best known for its after-dinner mints and liqueur chocolates. It makes more than 90,000 sweets every hour. The business was in decline three years ago when Malachy McReynolds led a management buyout. The directors now own most of the company. Elizabeth Shaw quickly introduced new products, including Vodka Shots (milk chocolate shells filled with truffles and vodka) to appeal to people between the ages of 18 and 35.

After the buyout, work methods were updated and a programme of advertising and promotions was launched. Now the business has turned the corner. Last year its profits before tax were £180,000 on sales of £13.1m, compared with a loss of £490,000 in 2001 on sales of £11.9m.

The challenge for McReynolds is to boost growth further. 'We have to decide whether we expand the brands or look for another route,' he says. There are two segments to the business. The liqueur chocolate market in the UK is worth £14m and Elizabeth Shaw has 50% of this with its Famous Names brand. Expansion here would be difficult.

An alternative would be to expand in the market in which the company is better known: mint chocolates – the company's share here is currently 10%. However, 'this market is dominated by the large players such as Nestlé and has been fairly static for years', says McReynolds. Currently the firm finds it difficult to command shelf space in supermarkets in the face of the extended product ranges of its larger rivals.

Many Elizabeth Shaw products are bought as gifts, with a surge in sales during the period leading up to Christmas. McReynolds is thinking of expanding in this area – 'we do have the spare capacity to handle the Christmas gift market at our factory'. Overseas markets are another challenge. Currently, just 10% of the company's output is exported. 'We are out to build a sustainable brand presence,' he says 'and I would like to think the name could become as well known as Cadbury.'

(Source: adapted from *The Sunday Times*, 19 October 2003)

Leave blank

(a) Outline **one** reason why a small company such as Elizabeth Shaw might seek to expand its market share.

(4)

(b) With reference to the extract, assess the extent to which the UK chocolate industry is a contestable market.

Leave blank

(10)

Leave blank

(c) Using an appropriate diagram, examine how a ‘programme of advertising and promotions’ (*lines 7 and 8*) might have contributed to an increase in Elizabeth Shaw’s profits.

Leave blank

(10)

(d) To what extent is a company owned by its directors following a management buyout likely to pursue different objectives than a large public limited company such as Nestlé?

(6)

Leave blank

(e) Examine **two** possible reasons why small chocolate companies such as Elizabeth Shaw find it difficult to expand when faced with large multinational rivals.

Leave blank

(10)

Q12

(Total 40 marks)

TOTAL FOR SECTION B: 40 MARKS

TOTAL FOR PAPER: 80 MARKS

END

BLANK PAGE

BLANK PAGE

M 2 1 5 1 4 A 0 2 8 2 8