

Section A

Answer ALL questions in this section.

Write the letter of your chosen answer in the box and then explain your choice in the space provided.

You are advised to spend 35 minutes on this section.

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

1. In June 2005 the European Commission reported that the Coca-Cola Company frequently imposed exclusivity arrangements with retailers to stock only their soft drinks. A motive for Coca-Cola to act in this way is to
- A increase the choice of soft drinks to consumers
 - B obtain benefits associated with horizontal integration
 - C diversify into unrelated markets
 - D obtain benefits associated with vertical integration
 - E reduce concentration in the soft drinks market

(a) **Answer**

(1)

(b) **Explanation**

(3)

Q1

(Total 4 marks)



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2.

Output of Boats	Total Revenue £	Average Revenue £	Marginal Revenue £
0	0		
1	20,000		
2	38,000		
3	54,000		
4	68,000		
5	80,000		

The table shows a small boat builder's total revenue as output increases. Which of the following best characterises such a firm? (You may use the right-hand columns to show your workings.)

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

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q2



3. Rail Fare Rises for 2006

Train company	Average price rise of season ticket (%)	Average price rise of cheap day return ticket (%)
Central Trains	3.9	4.4
Midland Mainline	3.9	6.0
Silverlink	3.9	6.1
Virgin West Coast	3.9	5.9
Retail Price Index (% change)	2.9	2.9

Source: *www.strategicrailauthority.org.uk*

The table shows rail fare increases for selected train operating companies in 2006. Season tickets are subject to price controls by the rail regulator according to the RPI + K formula, where K is +1%. However, cheap day return tickets are **not** subject to price controls. It can be inferred from the table that

- A** the value of K is greater than the rate of inflation
- B** removing price controls will protect the consumer surplus
- C** the real price of season tickets have decreased
- D** cheap day return tickets are more expensive than season tickets
- E** the permissible price increase of season tickets is above the rate of inflation

(a) **Answer**

(1)

(b) **Explanation**

(3)

(Total 4 marks)

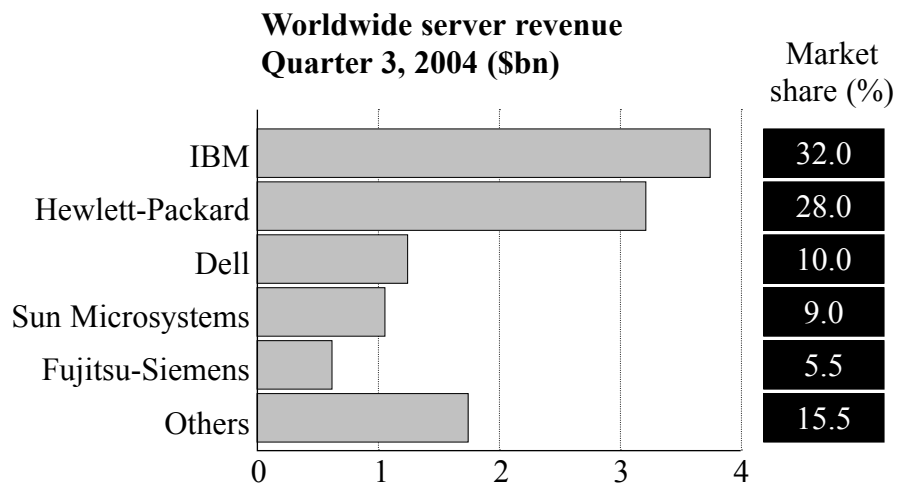
Q3



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4. Worldwide Computer Server Revenue and Market Share (Quarter 3) 2004



Source: *Financial Times*, 23 December 2004

The chart shows the global revenue and market share for major companies in the computer server market. From the data it can be inferred that

- A** the market for computer servers is monopolistically competitive
- B** the five firm concentration ratio is 74.5%
- C** the market for computer servers is perfectly competitive
- D** the price and output decisions of IBM will affect the price and output decisions of other firms in the market
- E** there is a low market concentration ratio

Please write your answer and explanation on the next page.



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blank

(a) **Answer**

(1)

(b) **Explanation**

(3)

(Total 4 marks)

Q4



5. A perfectly competitive firm is making supernormal profits. Which of the following applies to such a firm?

	Time Period	Productive Efficiency	Allocative Efficiency
A	Short-run	No	No
B	Long-run	Yes	No
C	Short-run	Yes	Yes
D	Long-run	Yes	Yes
E	Short-run	No	Yes

(a) **Answer**

(1)

(b) **Explanation**

(3)

(Total 4 marks)

Q5



6. HMV, which owns Waterstone's bookstores, was given permission by the Competition Commission to take over Ottakar's bookstores in May 2006.

The £63 million takeover gives HMV 23.6 per cent of the UK book sales market.

The most likely reason the Competition Commission allowed the takeover is that

- A significant competition will remain in the market
- B fewer economies of scale would be achieved by HMV
- C it is in the interests of both firms
- D collusion between book stores, supermarkets and online retailers will increase
- E consumer surplus will fall

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q6



7. Estate agencies in the UK property market are often seen to operate under conditions of monopolistic competition. Which of the following will be true for an individual estate agency in long run equilibrium?

Efficiency	Type of Product
A Allocatively efficient	Differentiated
B Allocatively inefficient	Homogenous
C Productively efficient	Differentiated
D Productively inefficient	Homogenous
E Productively inefficient	Differentiated

(a) **Answer**

(1)

(b) **Explanation**

(3)

(Total 4 marks)

Q7



8.

Total output of furniture	Total costs (£)		
0	1,000		
1	1,400		
2	1,700		
3	1,900		

A firm producing hand-crafted furniture faces the costs shown above. (You may use the right-hand columns to show your workings).

The data illustrate that over the output range

- A total variable costs exceed total fixed costs
- B marginal costs increase
- C average costs exceed marginal costs
- D total variable costs decrease
- E average costs increase at a faster rate than marginal costs

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q8



9. Which of the following conditions is most likely to explain the existence of many painting and decorating firms in the building industry?

- A High sunk costs
- B High contestability
- C Significant scope for internal economies of scale
- D The existence of paint product patents
- E Limit pricing by leading painting and decorating firms

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q9



10. The internet websites Shopping.com, Shopzilla.com and PriceGrabber.com have grown rapidly over recent years. These websites provide consumers with price comparisons for many retail items including DVDs, computers and toys. The growth of such websites is likely to

- A reduce the extent of price discrimination among retail goods
- B enable retailers to capture more consumer surplus
- C increase production costs for retailers
- D disadvantage consumers
- E increase the producer surplus of retailers

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q10

TOTAL FOR SECTION A: 40 MARKS



SECTION B

Answer EITHER Question 11 OR Question 12.

Write your answers in the spaces provided.

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

You should spend approximately 35 minutes on this section.

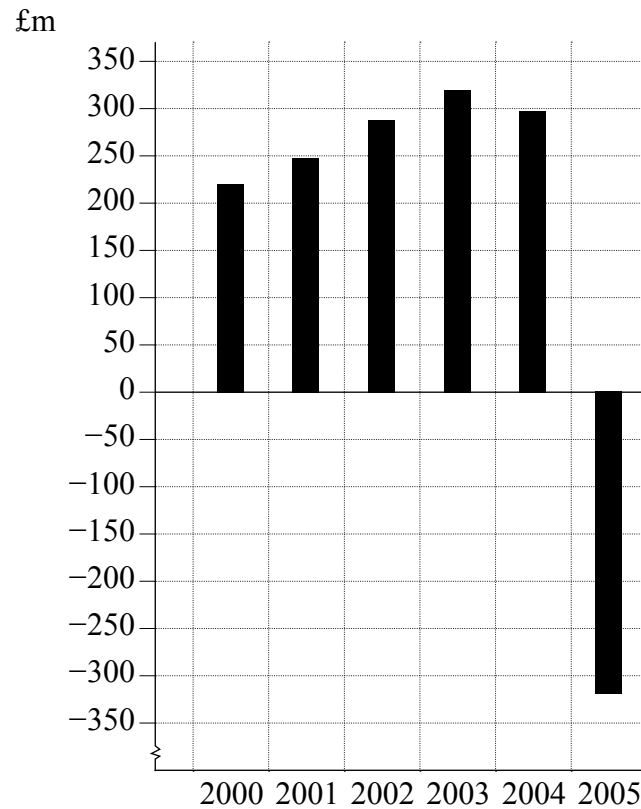
If you answer Question 11 put a cross in this box .

Question 11

Morrisons' Takeover of Safeway

Figure 1

Morrisons' Profits



Extract 1

Morrisons, the supermarket chain, reported a loss of £312 million in 2005 as it struggled with the heavy costs of integrating Safeway. This includes £271 million of one-off costs relating to the takeover. Its market share also fell from 14.4% to 12.2%, with rivals Tesco and Sainsbury being the main beneficiaries. Chairman Sir Ken Morrison, who created the company 50 years ago, has come under intense pressure to step down. 5

The £3 billion acquisition of the Safeway supermarket chain has been nothing but trouble for Morrisons, casting doubt on the ability of a company to take over one that is more than four times its size. Morrisons' situation has deteriorated further due to a fierce supermarket price war which looks set to continue.

The company has disposed of 179 former Safeway or Morrisons stores across the country – three times as many as the 52 demanded by the Office of Fair Trading to overcome local competition problems. These sales have left Morrisons with 434 stores and analysts believe the company may sell a further 75 outlets. 10

Morrisons remain optimistic, announcing that it will complete converting Safeway stores to its own format by the end of the year. 15

'It is clear that perfecting our game in the newly converted stores, being able to focus again on our core food business, rationalising the supply chain and bringing the head offices together into one place will provide real opportunities for significant improvement,' a company spokesman said.

The company expects a much improved performance in 2006 and forecasts full year profits between £50 million and £150 million. 20

Source: adapted from 'Expansion woes push Morrisons into the red', by Mark Tran, 20 October 2005 and 'Morrisons losing ground', by Julia Finch, 6 May 2005, *Guardian newspapers*; 'Morrisons still unable to explain £305 million forecast shortfall' by Sarah Butler, 21 October 2005, *Times newspaper*.



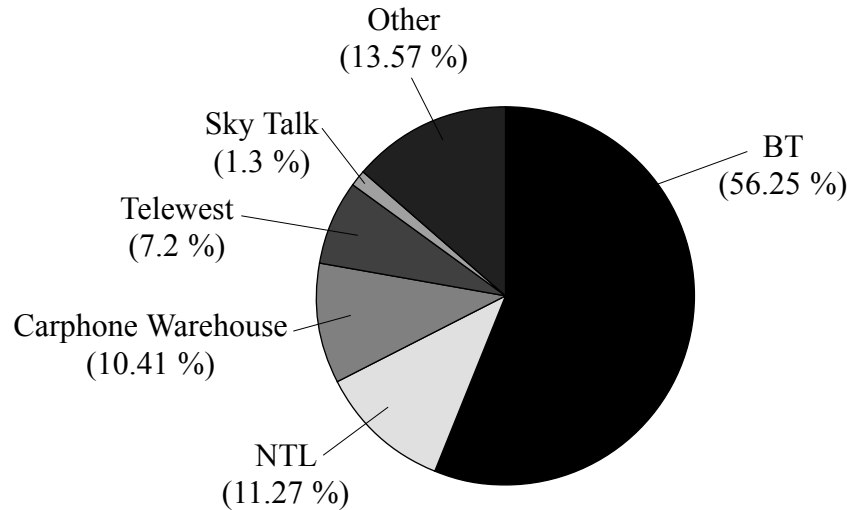
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If you answer Question 12 put a cross in this box .

Question 12 Regulation of British Telecom

Figure 1 Market share of UK domestic landline telephone customers



Source: adapted from 'Ofcom loosens its grip on BT', Elizabeth Judge, *The Times*, 22 March 2006

Extract 1

British Telecom (BT) announced yesterday its most dramatic restructuring since it was privatised. It placed the nation's 30 million phone lines and the 25,000 engineers that service them into a new division called Openreach. The move was forced upon BT by the industry watchdog Ofcom (Office for Communication Services).

The move is designed to break BT's monopoly power on land lines that connect the nation's homes and businesses to the phone network. This should make it easier for rivals to develop and deliver new products such as super-fast broadband, internet phone calls and video on demand by installing their own equipment on the lines. While it was a nationalised corporation, BT had undertaken an allocatively efficient pricing policy but privatisation changed its priorities to provide a profit for its shareholders.

Ofcom has also set a price cap on how much BT can charge its rivals for using its phone lines. It has set a maximum annual rental of £81.85 per line compared to the previous fee of £105.09.

The creation of Openreach, a separate division within BT with its own chief executive, is a response to two years of negotiations with Ofcom. The regulator had threatened to break BT up if the company could not deliver a new structure capable of treating rival companies in exactly the same way as BT's own retail business. However BT's rivals still need some convincing that the restructuring will operate in their interest. This follows years of complaints that BT has persistently obstructed competition.

It is likely that BT's rivals will consolidate through mergers in order to mount a proper challenge in the land line telephone market. In April 2006, the cable operator NTL acquired Virgin Mobile, becoming the largest competitor to BT.

Source: adapted from 'BT bows to regulator and spins off local loop', Richard Wray, *The Guardian*, 23 September 2005



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