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Examiners' Report
June 2010

GCE AS and A Level Business Economics and Economic Efficiency 6EC03

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Introduction

This was the second exam paper for the new syllabus. Candidates were required to answer eight supported choice questions (1+3 marks for each question) and one data response question for 40 marks (out of 2) out of a total of 72 for the paper. The mean rose by 1.2% to 48.6 when compared with January 2010 when the A and E boundaries were 53 and 32 respectively.

Overall mean mark of the paper: 48.6

Overall standard deviation from the paper: 10.4

Possible reasons for the increase in the mean

- Most candidates attempted every question
- The data was particularly accessible to the students and most could use it in a way that drew on the available application marks

Question 1

Most candidates chose the correct key. A basic answer is likely to have an explanation of the role of the European Commission, and further marks were often gained by using the data and showing why the behaviour either reduces competition or harms consumers. The best answers discussed reasons for the fine, either as a punishment or a deterrent.

Contestability tends to be a big distractor.

1 Intel is the world's largest microchip manufacturer, supplying over 75% of the market. In May 2009 it was fined $1.44bn by the European Commission. It claimed that Intel gave secret payments to computer makers to use only Intel chips and paid a major retailer to stock only computers with its microchips. The most likely justification for this fine is that:

(1)

A it ensured Intel would make a loss

B the market for microchips is contestable

C it would increase Intel's producer surplus

D Intel was abusing its market power

E the market for microchips has a low concentration ratio.

Answer $\boxed{B}$

Explanation

(3)

Given that there are competitors in the market the actions taken by intel ~~were~~ had a negative effect on competition and intel used its large concentration ratio to force competitors out of the market, this ultimately would have led to a reduction of consumer surplus and an allocatively inefficient equilibrium

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Examiner Comments

Has reduction in competition (1 mark) and affect on other firms (1 mark)

(Total for Question 1 = 4 marks)

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Examiner Tip

Use the data, and show why the action of Intel deters other firms.

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(1)

A it ensured Intel would make a loss

B the market for microchips is contestable

C it would increase Intel's producer surplus

D Intel was abusing its market power

E the market for microchips has a low concentration ratio.

Answer D

Explanation

(3)

The European Commision acts in the public interest ~~to ma~~ seeks to prevent anti-competitive practises. Intel was abusing its power by restricting the stock of computers to only their microchips. It also made illegal payments. These are detrimental to consumer welfare and is the reason they were fined. E is wrong because the market for microchips is highly concentrated and as a result Intel has a lot of market power. ~~Some of its behaviour~~ The fine is supposed to deter firms from engaging in restrictive practices.

(Total for Question 1 = 4 marks)

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Examiner Comments

This is illustrating the knock out rule 1+3 marks

Question 2

Many scored full marks by identifying economies of scale and applying them to the US rail passenger industry.

Many answers at this level offered D as the suggested option, but could still gain a mark by discussing economies of scale or sunk costs in the rail industry in the US.

Most candidates chose C correctly.

2 In May 2009, British Airways (BA) quoted the following prices for a flight from London to Toronto, Canada:

Date of flight	Price
1 August 2009	£407
1 October 2009	£204

Source: www.britishairways.com/travel/fx/public/en

The most likely explanation of this pricing strategy is:

(1)

A more spare capacity on BA's planes on 1 August 2009

B higher costs of flying planes in October than in August

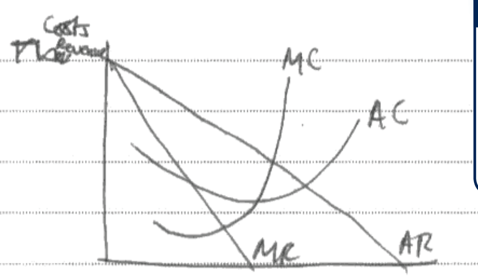
C that there is a difference in price elasticity of demand in August and October

D the expectation that some airlines will go bankrupt between August and October 2009

E an expectation that the world recession will be over by October 2009.

Answer $\boxed{C}$

Explanation



Prices on the 1st of August are more price inelastic because more people are on holiday and the demand for flights are higher in August than in October.

(Total for Question 2 = 4 marks)

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Examiner Comments

Use of the data is generously awarded, although many did not refer to lower PED in August, but rather just 'higher demand' which was not enough for the mark.

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Examiner Tip

This answer does relate the August demand to a low PED. The diagram for once adds nothing. Total 1 + 1

Candidates often referred to price discrimination, but many then devoted the rest of their answer to the conditions for discrimination. Many others discussed elasticity, but a fair number got the definition the wrong way around, which is not acceptable at A2 level.

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D the expectation that some airlines will go bankrupt between August and October 2009

E an expectation that the world recession will be over by October 2009.

Answer $\boxed{C}$

Explanation

(3)

Price discrimination is when firms charge different prices for different groups of consumers, for the same product, for reasons not associated with the cost. The answer is C, because with price discrimination, factors such as peak and off-peak occur, especially with the sales of ticket. As August is known to be holiday season, the ~~ea~~ demand will be inelastic hence consumers will pay the high price to travel, while October is off-peak season; therefore the ~~deman~~ demand is ~~in~~ elastic.

...l for Question 2 = 4 marks)

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Examiner Comments

Observation of price discrimination 1 mark
Application of elasticities 1 + 1 = 2 marks

Question 3

Many answers at this level offered D as the suggested option, but could gain a mark by discussing economies of scale or sunk costs in the rail industry in the US.

Most recognised economies of scale, and concluded that these acted as a barrier to entry. Those who drew the LRAC correctly scored the marks more easily. There was encouragingly a good deal of reference to the concept of 'natural monopoly' and this was very often put into the context of the US passenger rail industry.

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Examiner Comments

Many chose D instead of the correct option B.

3 Amtrak is the sole provider of long-distance rail passenger travel in the US. The most likely reason why Amtrak has no competition is that:

(1)

A sunk costs are low ✗

B there are falling long run average costs in the US rail passenger industry ✗

C demand for rail travel is increasing ✗

D x-inefficiency is high

E consumers' surplus is always higher when there is a sole provider of a product or service. ✗

Answer D

Explanation

(3)

If the competion commision have a high x-efficiency this would mean that profits are capped, making the industry more competitive for new firms to join, this is why there is no competition.
A is wrong because if sunk costs are low this attracts competition, however this isn't possible as to build a competing rail service would cost highly.

(Total for Question 3 = 4 marks)

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Examiner Tip

Some marks can still be earned, as in this case, by reference to the sunk costs (ruling out option A). 0 + 1 mark.

Many answers at this level offered B as the suggested option, and could apply their understanding to the US rail industry.

3 Amtrak is the sole provider of long-distance rail passenger travel in the US. The most likely reason why Amtrak has no competition is that:

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A sunk costs are low

B there are falling long run average costs in the US rail passenger industry

C demand for rail travel is increasing

D x-inefficiency is high

E consumers' surplus is always higher when there is a sole provider of a product or service.

Answer B

Explanation

(3)

Amtrak are a Monopoly meaning they benefit from economies of scale. Economies of scale when the cost of production falls as output rises. This means there are huge barriers to entry. Answer A is incorrect as sunk costs will be high.

(Total for Question 3 = 4 marks)

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Examiner Comments

Short answers can be very effective.

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Examiner Tip

EOS 1 mark
barriers to entry 1 mark
Knock out 1 mark

Question 4

Satisficing is probably best seen as a mix between 'satisfying' some stakeholders, such as managers who might have pay related to sales, and 'sufficing' the shareholders. There is a 'divorce' between the controllers and owners of some firms.

Only few candidates had the ability to identify stakeholders other than the shareholders, and the successful answers were limited on a centre-basis rather than individual students.

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Examiner Comments

Here the diagram adds nothing. Total zero.

4 A firm engaged in 'satisficing' behaviour is most likely to:

(1)

A maximise profits

B maximise revenue mR=0

C maximise sales

D minimise costs

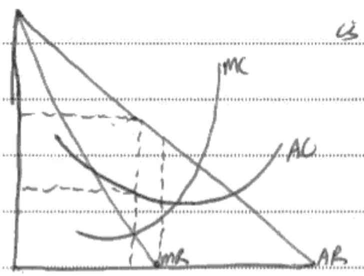
E produce at an output different to that of a profit maximising firm.

Answer B

Explanation

(3)

Revenue maximismising is when MR=0 . Price Satisficing is a mangeria behaviour the omey



l for Question 4 = 4 marks)

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Examiner Tip

All parts of the specification will be examined at some point. This is clearly a new area!

4 A firm engaged in 'satisficing' behaviour is most likely to:

(1)

A maximise profits

B maximise revenue

C maximise sales

D minimise costs

E produce at an output different to that of a profit maximising firm.

Answer E

Explanation

(3)

To satisfie would mean that a company would produce enough profit to satisfy the shareholders. e.g enough profit to pay for dividends. They won't wish to profit maximise or minimise costs as this may cost a lot in the short run and is not wanted by managers. They will produce at an output with minimal profit for dividends.

(Total for Question 4 = 4 marks)

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Examiner Comments

This earns full marks.

Question 5

Most chose the correct key, but an A grade answer is likely to have the correct diagram.

Many identify AR=AC but some said MR=0. A diagram makes for an easy 2 marks, or a reference to changes in the long run.

5 A firm might aim to maximise sales rather than profits in the short run because:

(1)

A it knows its marginal cost and marginal revenue

B it is in a market with no other competitors

C it wishes to deter the entry of new firms

D supplies of raw materials are limited

E there are substantial barriers to entry in this industry.

Answer C

Explanation

(3)

In a market similar to ~~perfect~~ monopolistic competition there are low barriers to entry, therefore should the profit motive be high enough new firms will enter the market, firms ~~&~~ may the decide to adopt a sales revenue as its objective taking up ~~and~~ any spare capacity in the market detering entrance from other firms.
sales maximisation occurs where AC = AR

(Total for Question 5 = 4 marks)

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Examiner Comments

Formula AC=AR 1 mark
Increased market share 1 mark

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C it wishes to deter the entry of new firms

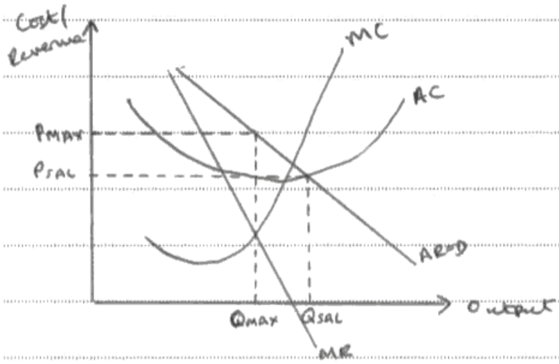
D supplies of raw materials are limited

E there are substantial barriers to entry in this industry.

Answer $\boxed{C}$

Explanation

(3)



Profit Maximising is producing at a level of output where MR=MC. Sales maximising is where AR=AC. This reduces their profit, which would deter the entry of new firms, as excess profits act as a signal to new firms to enter the market and compete the profit away, may be low barrier to entry. Less profits, less of a signal.

(Total for Question 5 = 4 marks)

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Examiner Comments

This shows an extremely good answer.

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Examiner Tip

Correct diagram
Condition Profit/sales max
Lower profits deter new entrants

Question 6

Most scored some marks here, in understanding that price caps are imposed to protect the consumer. Many chose E instead of B, and some marks could be earned using some appropriate economic analysis.

The diagram, as shown in the mark scheme, was rarely seen but was awarded generously.

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Examiner Comments

Diagram gets two marks -
profit box not entirely correct but benefit of doubt.
1 mark for price cap.

6

Year (July)	Making a call (€ per minute)	Receiving a call (€ per minute)
2009	0.46	0.22
2010	0.43	0.19
2011	0.34	0.11

Source: *The Guardian*, 'EC wants price caps to prevent mobile phone bill shock', 24 September 2008

The table shows the maximum prices for making and receiving mobile phone calls permitted by the European Competition Commission. The most likely reason for these price caps is that the Commission believes that in this industry:

(1)

A contestability is too high

B excessive profits are being made

C consumer surplus is too high

D it is unnecessary to intervene since sufficient price competition exists between mobile phone companies

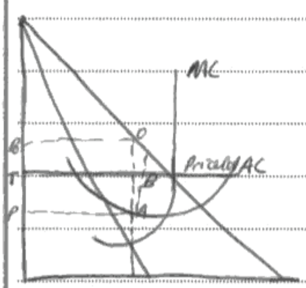
E investment needs to be encouraged.

Answer $\boxed{B}$

Explanation

(3)

European competition commission intervene if there is a potential ~~new~~ monopoly. A price cap is a limit on the amount ~~that~~ the firms can price.



P_0 OPA shows the abnormal profit made in the industry

A price cap would cap would reduce the amount. If the price cap was set at point T, then the new abnormal profit would be (T, B, PA)

(Total for Question 6 = 4 marks)

ResultsPlus
Examiner Tip

Diagrams never take marks away!

6

Year (July)	Making a call (€ per minute)	Receiving a call (€ per minute)
2009	0.46	0.22
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(1)

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B excessive profits are being made

C consumer surplus is too high

D it is unnecessary to intervene since sufficient price competition exists between mobile phone companies

E investment needs to be encouraged.

Answer B

Explanation

(3)

Price ~~caps~~ ~~are~~ ~~to~~ cap is a rate of return gained by a firm from their ~~[illegible]~~ supply ~~of~~ and ~~[illegible]~~ sales of goods. The answer is B, because, a monopoly firm may be ~~to~~ dominant, that they are taking most of the profits; therefore driving down the competition. Therefore with the introduction of price caps, it will reduce the number of monopolies. and encourage more competition; therefore profits are more shared out.

(Total for Question 6 = 4 marks)

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Examiner Comments

Consequence of monopoly power 1 mark

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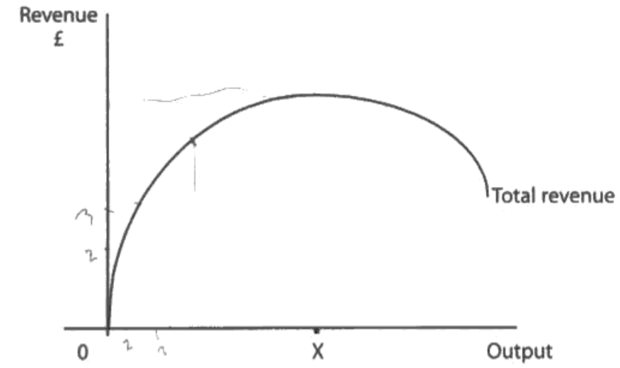
Examiner Tip

Use the data, and refer to economic concepts (such as RPI-X)and the role of institutions where possible.

Question 7

This is probably the most revealing question at the E grade boundary. The E grade pass will involve an understanding of revenue and not confuse it with costs. At A grade, there is a diagram with MR passing through the point X.

7



The diagram shows the total revenue curve of a firm. It can be deduced that:

(1)

A average revenue and marginal revenue will be upward sloping as output increases

B average revenue will be equal to marginal revenue as output increases

C average cost will be falling as output increases

D the firm will be making maximum profit at output 0X

E average revenue and marginal revenue will both be falling as output increases.

Answer A

Explanation

(3)

Average revenue is $\frac{TR}{Q}$ and marginal revenue is the extra revenue gained from an increase in output by one unit.

(Total for Question 7 = 4 marks)

ResultsPlus Examiner Comments

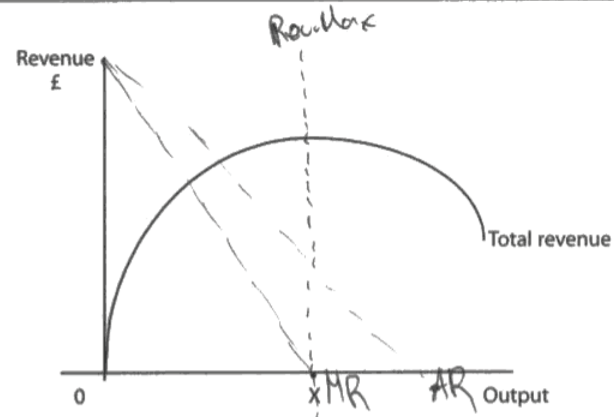
1 mark for AR formula OR for MR - there is only ever one definition mark for SCQs.

ResultsPlus Examiner Tip

Annotation marks are easy to earn.

A picture saves a thousand words! In this case it earns two marks because MR passes through X.

7



The diagram shows the total revenue curve of a firm. It can be deduced that:

(1)

A average revenue and marginal revenue will be upward sloping as output increases ✗

B average revenue will be equal to marginal revenue as output increases ✗

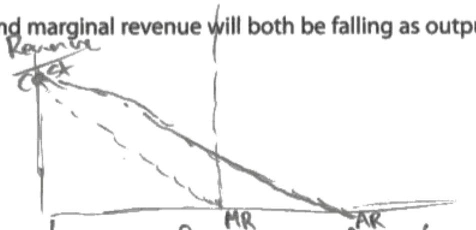
C average cost will be falling as output increases ✗

D the firm will be making maximum profit at output 0X ✗

E average revenue and marginal revenue will both be falling as output increases. ✓

Answer E

Explanation



(3)

The diagram shows downward sloping average revenue and marginal revenue curves therefore A is wrong. As output increases marginal revenue and average revenue are both falling. At OX revenue is maximised.

(Total for Question 7 = 4 marks)

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Examiner Comments

Diagram 2 marks because Rev max at OX
Knockout of A is basic but allowed

Question 8

Most A grade scripts will have an accurate diagram, often with the short and long run dynamic shown in the diagrams, showing the effect on the firm when firms enter or leave the industry.

Few actually explained allocative or productive efficiency, and although it was good to see formulae, there was only one definition mark available, and there has to be some application (for example to a diagram) or other spelling out of the concepts to earn marks for these.

The E grade answer may have selected C instead of A, and picked up some marks for partial understanding of the model. An N grade answer is more likely to offer B (monopoly) or E (oligopoly) which indicate a very limited understanding of Economics, if not sheer guesswork.

8 A profit-maximising firm will produce at the productively and allocatively efficient level of output in which of the following market conditions?

(1)

A Perfect competition in the long run

B Monopoly

C Perfect competition in the short run

D Monopolistic competition in the long run

E Oligopoly.

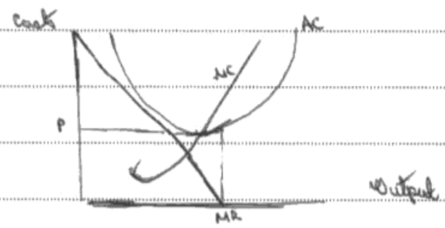
Answer $\boxed{C}$

Explanation

(3)

Allocatively efficient occurs when P = MR.

Productively efficiency occurs when AC = AR.



(Total for Question 8 = 4 marks)

TOTAL FOR SECTION A: 32 MARKS

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Examiner Comments

This earns no marks

ResultsPlus
Examiner Tip

Diagram must be accurate

This is an examiner's dream come true.

8 A profit-maximising firm will produce at the productively and allocatively efficient level of output in which of the following market conditions?

(1)

A Perfect competition in the long run

B Monopoly

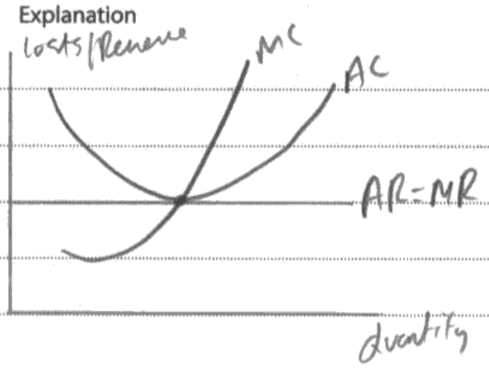
C Perfect competition in the short run

D Monopolistic competition in the long run

E Oligopoly.

Answer $\boxed{A}$

Explanation **(3)**



Allocatively efficient is when P=MC. Productively efficient is when AC is minimised. Profit max is when MC=MR. In the long run perfect competition, firms will enter the market until all profit is competed away. B is wrong because monopolies are ~~all~~ allocatively inefficient and productively inefficient and produce supernormal profit

(Total for Question 8 = 4 marks)

TOTAL FOR SECTION A: 32 MARKS

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Examiner Comments

1 correct key
1 MC-=MR
2 diagram marks (for horizontal AR and LR tangency)
Plenty more here!

Question 9a

Most candidates obtained 2 or more marks. There were some difficulties in application, and often candidates were referring to a different industry (e.g. brewery industry) or explaining and defining forward and vertical without referring to the electricity market or failing to mention what forward involves, that is, closer to the customer.

Many identified this as forwards vertical integration, but some with very limited understanding of the electricity generation and distribution process argued that this was backwards vertical integration, reasoning that distributors were suppliers rather than customers. This could earn 3/4 marks.

This is a good example.

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Examiner Comments

1 mark - "forward"
1 mark - "vertical"
2 marks - full application to electricity

(a) Briefly explain the form of integration described in lines 25–26.

(4)

This describes a forward vertical integration which is when ~~two~~ two firms in the same industry but at two different stages of production merge together. It is a forward ~~ve~~ integration as the electricity generating companies own the distributing companies which is the next stage of production.

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Examiner Tip

Remember that 2 of the four marks for the data response 'starter' question are for application.

Here there is only the sense of vertical, and only 2 marks can be achieved.

(a) Briefly explain the form of integration described in lines 25–26.

(4)

The form of integration described in lines 25-26 was vertical integration, by German electric companies owning their own distribution networks they have acquired a part of the chain of production in their good. ~~attach~~

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Examiner Comments

1 mark for vertical, but no sense of 'forward'
1 mark for application, but no sense of 'forward' in application.

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Examiner Tip

Use the data!

Question 9b

The vast majority of candidates included an acceptable definition of a cartel. The best answers then analysed two relevant pieces of evidence for the existence of a cartel and then added two evaluation points. A high proportion of candidates therefore had no difficulty obtaining the 8 marks. A significant number failed to provide any evaluation and were therefore limited to only 4 marks. The evaluation points were usually based on the problems, referred to in the text, of finding evidence that cartels are in operation and of establishing guilt. The best students suggested other problems (for example, other costs might have increased, high prices and lack of competition do not necessarily mean a cartel is operating).

This does have some evaluation, but only one attempt - but 50% of the marks must be evaluation.

(b) Assess the evidence that the electricity generating companies in Germany are operating as a cartel.

(8)

A Cartel is when firms act together to raise prices by reducing output. This also restricts competition. With the exception of OPEC, ~~than~~ the operation of cartels is illegal.

The extract states that electricity generating companies have been 'shutting down power stations simultaneously to limit supplies'. This could be regarded as collusive behaviour as supply is being restricted, thereby increasing the price of electricity. However, this may be hard to prove as it may be justified that the power stations were ~~[illegible]~~ unnecessary for the electricity ~~firms~~ generating companies.

Additionally, the electricity prices should be falling due to the 'abundance of cheap coal'. Therefore costs of production should be falling.

~~As well as this, the electricity industry is likely to be a natural mono~~

By restricting output firms have kept electricity prices higher - showcasing that they may be operating as a cartel.

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Examiner Comments

Definition and application good, with it 'being hard to prove' being a good evaluative point drawn from the Extract.

Question 9c

A high proportion of candidates were able to make good use of Game Theory in their answers, with the inclusion of an accurate two firm pay off matrix. There were a number of very good answers which also explained the matrix clearly and applied it to the question. There seemed to be very few answers in which candidates did not even attempt a discussion of Game Theory, or at least the Kinked Demand theory as an application of Game Theory.

A range of other forms of competition were discussed, most commonly types of price competition (limit pricing, predatory pricing etc) and non price competition (advertising, mergers, innovation etc). The better answers did attempt to apply their knowledge to the electricity generation market. Weaker answers found this difficult and this lead to some unconvincing answers. One student suggested that ‘improved packaging’ would be an appropriate strategy. There was a similar division on the evaluation points. Of the better answers, some were very good, suggesting that there might be problems differentiating the service provided or that the firms might try to establish their ‘green’ credentials as a form of differentiation. In other cases the evaluation was unimaginative and undeveloped, often not going much beyond advertising ‘costing a lot’ and ‘often not working’ and therefore being ‘a waste of time’. The ability to really engage with the data and apply concepts and understanding to it seemed to what marked out the best answers.

This gains all the Game Theory marks, with clear explanation and a correct pay-off matrix. The strategies are explained clearly.

*(c) Apart from operating as a cartel, discuss the ways in which firms might compete in the German electricity generating market. Refer to game theory in your answer.

(12)

Using the game theory the electricity companies could agree to set prices in order that they all gain from an increase in revenue due to the lack of options available ~~from the~~ for consumers, however, operating in a cartel does involve its risk as shown in the game theory below.

E.on	RWE: High prices	RWE: Reduce prices
Reduce prices	E.on ↑ Rev Rwe ↓ Rev	E.on ↓ constant Rwe ↓
High prices	both Revenue ↑	E.on ↓ Rev RWE ↑ Rev

As shown in the illustration above, it is key that parties in the cartel can trust each other ~~because~~ one could break the aggreement and operate at a lower price that way taking customers away from rivals costing them a loss, like the example between british air ways and virgin atlantic.

On evaluation I believe firms would compete using strategies, ~~and~~ such as price and non price. by using price strategies electric companies may

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Examiner Comments

There are two attempts at evaluation, but there was clearly an opportunity cost for writing so much on the KAA.

be able to give consumers better deals than rivals, therefore gaining more customers however, on evaluation, in oligopolies, firms are reluctant to impose price strategies in order to compete in fear of invoking a price war amongst rivals, which may have a detrimental effect on the company, in this case the electricity providers.

Another way in which German electric companies could ~~a~~ compete is through a non-pricing strategy. This may be through ~~spend~~ innovation and providing alternate in providing energy. however, on evaluation, investing into renewable and alternate electrical generation may harm the german electrical company implimenting it since ~~it~~ ~~has~~ investing in research and development cost money it appears as a sunk cost because it can never be recovered if the electric company decides it want to leave the market, which in the long run may bear to much risk and cost. since it is not ~~the~~ definite it will benefit from its innovation.

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Examiner Tip

It is worth spending time doing a clear pay-off matrix.
For 12 mark questions make two or three evaluation points.

This is an example which earns full marks.

*(c) Apart from operating as a cartel, discuss the ways in which firms might compete in the German electricity generating market. Refer to game theory in your answer.

(12)

Game theory would suggest electricity firms to engage in a price war, if they cannot trust, or do not know, the actions of competitors. As such, firms may compete in non-price factors such as quality, after-care, or branding.

		RWE (x)	
		£10	£5
EON (y)	£10	£100 profit	X: 120 Y: 80
	£5	Y: 120 X: 80	£90 profit

The high concentration of the electricity market, (2 firm ratio = 60%), and high barriers to entry (restricted distribution and information access), suggest an oligopolistic nature to the market. Firms are thus interdependent, and their actions will affect price/output decisions of competitors. Game theory can be used to predict outcomes if agents do not collude. Firms are likely to match price cuts because market share and revenue will be lost otherwise – shown in the bottom left quadrant, where E.ON has cut prices, whilst RWE hasn't. As such, firms are likely to match cut prices, engaging in a price war to maintain ~~revenue~~ market share, leading to a fall in overall revenues (bottom ~~left~~ right quadrant). If firms cannot trust one another, this nash equilibrium is likely, as it is the dominant strategy – that is, both maximax and maximin strategies result in the same outcome. Maximax is maximising maximum benefit, whilst maximin is maximising minimum benefits.

However, this is not certain as collusion does occur, and a high concentration ratio makes this more plausible. But as a price war is damaging to profits, firms are more likely to compete on non-price factors. By branding goods to reduce homogeniaity, or offering better customer service, a firm will differentiate its product, and attempt to reduce its elasticity by creating brand ~~po~~ loyalty - a form of monopoly power.

However, such competition, price or non-price relies on consumers being homo-economus, and having access to relaubent information on prices. If consumers are unlikely to continually change supplier, perhaps because electricity is seen as a necessary good, and one which is not advertised to the same extent as consumer goods - firms may not feel pressure to compete massively on price, or quality.

ResultsPlus

Examiner Comments

6 KAA for good game theory which illustrates various ways to compete.
2 marks for firm understanding of game theory see line 10-11
2 marks for matching price cut as a strategy
2 marks for firms trusting each other, i.e interdependence
2 marks for accurately labelled pay-off matrix, and there are other marks available for non price competition, although KAA 6 already awarded

EV
2ev collusion is still occurring
1ev monopoly of power - firm trying to reduce elasticity but not well developed so only 1 mark page 2 line 4
3ev missing information - last paragraph is a good example
6 KAA + 6 ev = 12 marks

Question 9d

This question worked well, producing a range of marks. There were some excellent answers that took the potential problems given in the passage, analysed clearly how they might be expected to reduce profits and then discussed what this reduction profits depended on or why it might not be seen in practice (e.g., weaknesses of regulation, the ability of the market leaders to fight off competition from companies entering the renewable energy sector or to involve themselves in it etc). In the middle range were candidates who lost marks because they could not explain clearly how the various problems would actually affect profits or could only make the odd evaluation point. Some answers included no evaluation. A small number gained very low marks because they had difficulty with the text and only included one or two potential problems with no real evaluation.

Typical evaluation points were that 'fines were too low', 'sell off doesn't affect market power', regulatory capture, and the possibilities of increased profits if the reduction of monopoly power reduced diseconomies of scale.

This is a typical answer which uses plenty of relevant Economics, but fails to evaluate.

*(d) With reference to the last two paragraphs, evaluate the factors which might reduce the profits of Germany's electricity generating companies.

(16)

One of the factors which might reduce the profit ~~margin~~ of Germany's electricity generating companies are leave fines imposed by government, due to ~~uncompetitiveness~~ uncompetitiveness in the market. This heavy fines would have some impact on the cashflow of firm. It means that that ~~costs~~ TC will ~~go~~ increase and therefore profit will get smaller, because
Profit = TR − TC, and TC were higher in our case. Furthermore, demand for the electricity is not likely to be changed so it means that constant fines will reduce significantly profits of electricity German generating companies.

Another fact, is that Germany's government might use the experience of it's international collegues and as a result ~~the~~ by regulations they'll force some companies to sell off their distribution networks. This will further reduce the profit margins of German electricity supplying companyes, Because they'll have to change their plans, (agree new prices for distribution etc.) and ~~also also time needs to be taken in order to~~ ~~to~~ also it's a question of time lags (companies might lose time for because of red tape and bureaucracy). Moreover, companies will lose ~~some~~ an advantage over smaller companies as a result of losing ~~distribution~~ companies. These were the factors which might reduce the profits of Germany's electricity generating companies in the short term.

In the longer term, however, there are ~~even~~ others factors ~~higher withs to loose~~ . which can lead to bigger reduction of the profits for electricity generating companies. Firstly ~~it~~ it's connected with an ambitious plan to increase the share of electricity from renewable resources. As a result, it can significantly reduce the dominance of the Germany's four biggest electricity generating companies. Which also may ~~to~~ might result a decrease in the price for energie in Germany, which are the highest at Europe.

ResultsPlus

Examiner Comments

3 marks heavy fines increases costs and squeezes profits
3 marks selling off distribution networks
2 marks renewable energy no connection to profit
8KAA
0EV
8KAA + 0EV = 8 marks

(Total for Question 9 = 40 marks)

This is one of the many good answers that were seen.

*(d) With reference to the last two paragraphs, evaluate the factors which might reduce the profits of Germany's electricity generating companies.

(16)

Germany's electricity generators may see profits reduced by increased regulation. The competition authorities may increase windfall taxes on excess abnormal profits or impose huge fines on practices such as collusion and price fixing. The regulators may also consider price capping electricity in order to restrict the amount of profit firms can make - eg. using RPI - X to force efficiency gains and cost cutting. Therefore the regulator would act as a proxy competitor and thus force prices down, resulting in greater allocative efficiency and consumer surplus.

This may be successful in that firms would have a greater incentive to act legally. If RPI - X was used as price capping, the X value could be reduced to encourage further efficiency gains - giving firms an incentive as they want to make profits. However there is a significant risk of regulatory capture here. The German government will appoint experts in electricity generation and so they may act in the interest of producers, not consumers thus making regulation ineffective.

Meanwhile, the profits of these firms may be squeezed by forced reversals of integration - the data says distribution networks have been sold off already. This would increase small firms' ability to compete and thus reduce prices, squeezing abnormal profits made. However, this may be ineffective as even if the generators don't own the distributors, the high concentration ratio means they can still force prices down and thus out compete smaller firms. Furthermore this may damage consumers if economies of scale are lost. This may cause an increase in electricity prices as firms average costs increase, ~~thus~~ thus reducing consumer surplus. This is especially true if firms have their ~~are~~ profits and size reduced to such an extent that they become less internationally competitive.

Alternatively, profits may be squeezed by new competition from ~~the~~ 'renewable' sources. This may cause many businesses and consumers to substitute into these renewable energy sources and thus away from the current 4 dominating firms who rely on coal. Thus demand for the current firms which shift to the left and the market concentration ratio would be reduced (for electricity).

However this would depend on the PED of consumers demand for electricity. The data says renewable energy sources will have high sunk costs. These may act as a barrier to entry, and mean prices are relatively high. Therefore consumers may not ~~s~~ switch out of the current firms as they are already exploiting economies of scale, and so prices are lower than they could be.

However, even despite these possible ~~cost~~ constraints on electricity generators' profits the data rightly says ~~t~~ that these firms' profits look 'likely to keep on rising'. The market power of these firms and the recession since 2008-9 mean that regulators may be unwilling to overly punish these companies (an important source of economic activity in a struggling economy).

(Total for Question 9 = 40 marks)

ResultsPlus
Examiner Comments

3 marks for price capping Reference to RPI -X
3 marks for distribution networks, reducing prices
3 marks for new competition for renewable energy sources
EV
2ev regulatory capture
2ev ineffective high concentration ratio
3ev inelastic PED high barriers to entry
2ev recession
8 KAA + 8ev = 16 marks

Question Q10a

Many got full marks by either the monopoly route (they have to mention the legal definition) or the oligopoly route (where calculating the concentration ratio scored two application marks). There were some equally good duopoly answers. A surprisingly large number suggested monopolistic competition, which was not creditworthy.

(a) Briefly explain the market structure which best describes the UK instant coffee market.

(4)

Monopoly would be the best described market structure simply because Nescafé carries 51% market share. For a firm to be recognised as a monopoly, they carry up to a minimum of 25% market share. Nescafé is the most dominant in its market and can influence prices.

ResultsPlus

Examiner Comments

Monopoly: 1 mark
Explanation of legal definiton: 1 mark
Application 2 marks (only just)

(a) Briefly explain the market structure which best describes the UK instant coffee market.

(4)

the market structure that best describes the UK Instant coffee market is monopolistically competitive. many big firms own a large market share but there are also many small brands which can enter the market.

ResultsPlus

Examiner Comments

No marks for monopolistic competition even if the application seems appropriate

Question Q10b

There were some very good answers: many mentioned the cost differences, the recession, economies of scale and cross-subsidisation by Starbucks. But the question seemed to attract weaker answers which failed to make clear the possible reasons for the pricing strategy. Often they diverted themselves into discussions of why Via was being launched. There was also a tendency to reproduce large parts of the text in explanation, but without any supporting analysis or without clearly linking it to a 'likely reason'.

In evaluation, many did not discuss the price issue but discussed other issues.

*(b) Assess the likely reasons why Starbucks is charging a lower price for Via instant coffee than for filter coffee sold in its cafés.

(12)

~~As seen in extract 2, Starbucks has been working on Via~~

As Via is a new product in the American coffee market, Starbucks ~~would b~~ could be using the ~~wad~~ method of market skimming. Market skimming is when a new ~~ent~~ entrant to the market charges a price unsure ~~of~~ what to put the price at, first when eventually ~~it f~~ it finds the right price. As Via is a new entrant, it ~~may~~ may be charging a low price so as to attract consumers in a market where ~~instant cof co~~ coffee is low in demand. With a low price it ~~may~~ may ~~attract~~ attract consumers. As seen in extract 2, with the economic downturn, Via may attract many consumers, as its cheaper than ~~it~~ in the shops. However, extract 2 also conveys that its "regarded as being cheap and tasteless". For the low price to work (attract ~~m~~ consumers) it depends on if Via's cheap price and the economic downturn is able to provide ~~an incentive~~ a good enough incentive to ~~buy~~ buy instant coffee.

As seen in extract, Starbucks has been working on Via for almost 20 years. With R&D firms are able to eventually achieve low production costs. If Via were able to achieve low production costs compared to filter coffee, it ~~would~~ would mean lower prices passed ~~on~~ on to consumers. However, even with lower prices, it depends on the price elasticity of demand. If Via is ~~less~~ worth less ~~to~~ than filter coffee to the Americans, it would mean filter coffee would sell more than Via.

ResultsPlus
Examiner Comments

Two valid points with some evaluation but all shallow. 6 + 1e

This is a long answer, but no evaluation can be seen.

*(b) Assess the likely reasons why Starbucks is charging a lower price for Via instant coffee than for filter coffee sold in its cafés.

(12)

third degree.

This is an example of "price discrimination. ~~The same~~."

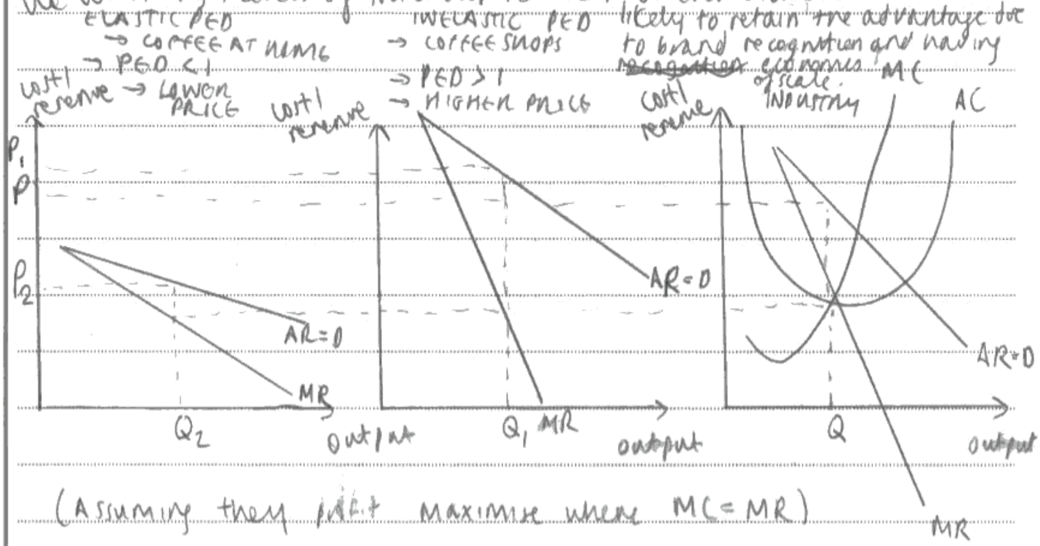
When out and about, consumers have no access to hot water or an ability to make coffee for themselves, therefore they are willing to pay $4 for a latte, having an inelastic price elasticity of demand. At home however, demand is more elastic and sensitive to prices changes, therefore by costing less than $1 per coffee cup, Starbucks can capitalise on this customer base.

The advantages of this strategy are that Starbucks can profit maximise at two different levels of output, therefore maximising the profits they are able to make, in their current market and ~~in the small 10%~~ in a way being the pioneer into the home US coffee market which currently stands at only 10%. By being the first they are able to take advantage of their brand recognition through economies of scale, dominating this market.

They are able to price discriminate since they have high market power and its high levels of abnormal profit act as barriers to entry. It also benefits from ~~and~~ two clear different consumer bases with different elasticities. It would almost be impossible for people to resale between the two markets - when in town there is no access to hot water, therefore they are forced into going to a pricey coffee shop. It is important to consider however that if in response to ~~the mass~~ the selling of Via, US customers would substitute out of going to coffee shops and prefer to stay at home, as they do in the UK, with its huge instant coffee market. Their sales in their ~~stores of a~~ coffee shops may therefore suffer.

It is important to consider that the relative success of Via may be particularly high due to the poor economic climate, where people are substituting out of leisure time and into work, and buying less luxury items. Starbucks as a result of this may have found their sales drop as going for coffee is likely to have an inelastic price elasticity of demand.

It is important to consider ~~starbucks ...~~ that companies would enter the market after starbucks due to seeing its abnormal profits, resulting in an oligopolistic market like the UK with high levels of interdependence, however Starbucks would be likely to retain the advantage due to brand recognition and having ~~recognition~~ economies of scale.



(Assuming they profit maximise where MC=MR)

ResultsPlus
Examiner Comments

3 marks for "elasticities" (top of 1st page plus diagrams on 2nd page)
1 mark for "economies of scale" (middle 1st page)
1 mark for "poor economic climate" (middle 2nd page)

Question Q10c

Students were very knowledgeable in their understanding of contestability. In this question many students actually embarked on the evaluation element first and disagreed that the market was contestable. A very high scoring question, good application and very well evaluated.

This is one of the few answers that had no evaluation attempt at all.

(c) To what extent is the UK market for instant coffee contestable?

(8)

The UK market for instant coffee is not very contestable. Nescafé have monopoly power. Therefore, the barrier to entry will be very high, including high sunk costs such as advertising. Firms such as Nescafé and Kenco would have large advertising campaigns which costs ~~ath~~ huge amounts to ensure potential entrants would not enter the market.

Also, the firms already in the market would have greater knowledge of the market, as well as benefiting from ~~for fat~~ Economies of scale, falling long run average costs.

ResultsPlus

Examiner Comments

2x2 marks were awarded for identification of points, but there is no evaluation.

ResultsPlus

Examiner Tip

It does not matter whether the conclusion is that the market is or is not contestable. What matters is that both views are expressed!

Answers can hardly be expected to do better than this.

(c) To what extent is the UK market for instant coffee contestable? (8)

Points:
- contestable explanation

Pros
- there are smaller firms
- premium and specialities
- Ethical trading

Cons
- seem to be quite high barriers to entry / exit
- monopoly existence

The UK market for ~~coppe~~ instant coffee at first glance seems to be non-contestable as there is a clear dominant firm (Nescafé) in the market and there are also several other large firms in the market who ~~capture~~ capture most of the market share (76%). This shows that there are quite high barriers to entry and exit and a contestable market is defined as having seemingly low barriers to entry and exit. There also does not seem to be a high ~~amo~~ amount of 'hit and run' entry into the market despite its extensive supernormal profit which enable Nescafé to make an investment of £17 million into the company and the high demand (over 80%) of ~~coffee~~ total coffee market) of instant coffee in the UK.

However, this might be changing as UK instant coffee drinkers have a change of tastes and fashions such as health, well being and the view of ethical trading which might bring ~~ex~~ specialised coffee manufacturers such as Café direct which ensures ethical trading / fair trade coffee to be sold. As people become more aware and more interested in the premium and speciality varieties, potential coffee manufacturers could promote a niche market and effectively capture market share.

Overall, the ~~main~~ UK market for instant coffee seems to be undergoing a change which could ~~eventually~~ lead to an opening of the market to new potential ~~cust~~ firms who are offering a change or an improvement to the market.

ResultsPlus

Examiner Comments

Plenty of points from the data, and two good evaluation points, 2 + 2 + 2e + 2e

Question Q10d

A small number made no attempt to apply their answers to both the UK and the US markets. Also, a surprising number failed to apply it to the manufacturers of instant coffee. A list of learned points was sometimes reproduced without much thought. Among the suggestions for methods of competition the least convincing was probably ‘free delivery’. Another favourite was ‘exploiting economies of scale’, without any explanation of what this would involve. With a bit of thought this could have been a relevant point (via mergers and economies of scale that might be passed on in lower prices) but it needed some development. Instead there was often a lengthy discussion of different types of economy of scale.

Here is a good answer which earns 6/8 KAA, capped because it ignores the UK/US distinction. Full marks for evaluation.

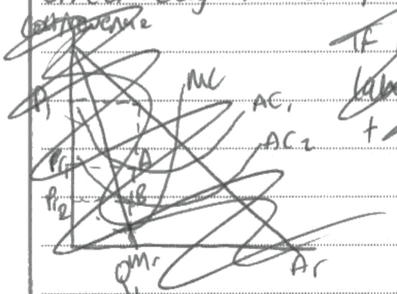
*(d) Assess the methods by which the manufacturers of instant coffee might compete with each other in both the UK and the US.

(16)

There are price and non price ways to compete in the instant coffee market.

One way is through prices. If Nescafe ~~[illegible]~~ ~~[illegible]~~ reduce prices of their instant coffee ~~[illegible]~~ and its competitors are unable to match it, then Nescafe can gain more revenue and more profit and market share (increasing its dominance in the market). If nescafe can make efficiency savings, this will allow them to effectively lower prices. ~~and they will~~

~~If it reduces its costs by reducing labour costs, then it will be able~~



However, as this market is oligopolistic, firms are interdependant so a price cut by Nescafe is likely to cause a price war. This is good for consumers as consumers will get a better deal on instant coffee prices which will increase consumer surplus. However, industry revenues will plummet ~~and~~ as ~~[illegible]~~ Nescafe, Kenco, Starbucks etc may predatory price in order to drive out competition

This would not be in the interest of firms as it could damage balance sheets and disrupt potential investments.

Firms are more likely to use non price competition as price competition will not benefit ~~all~~ firms from falling revenue and profits.

Advertising is a non price method instant coffee industry could compete. Nescafe spend £17m on promotional investment and other firms could retaliate trying to match expenditure. ~~Therefore~~ If Kenco are unable to match expenditure, this may lead to falls in market share for Kenco as ~~it~~ its customers may ~~a~~ start to buy Nescafe. However, this depends on the effectiveness of the advertising as some firms may be able to spend less on advertising and still increase market share. Also, the effects of advertising are hard to measure as it is difficult to say an increase in market share is as a result of higher spending ~~on~~ on advertising by Starbucks. Other factors could influence the change in market shares

Another way of non price competition is through spending on research and development. ~~[illegible]~~ If Starbucks ~~[illegible]~~ were able to spend large amounts of money developing the Via Coffee and doing substantial market research, this may make the quality of Via Coffee stand out and create a brand loyalty base. If it ~~ab~~ is able to ~~com~~ outcompete Kenco and Nescafe on quality instant coffee this may lead to a rise in market share and rise in profits.

However, this may be expensive and take time as the text says 'Via coffee was an innovation Starbucks had been working for 20 years'

In conclusion, I feel non price competition is a more effective way to compete as its less damaging to ~~the~~ individual firms ~~but if a firm has enough cash reserves they~~ and it is unlikely big firms such as Starbucks and Nescafe will go out of business from a price war so ~~price competition~~ trying to drive out competitors in this way (i.e predatory pricing) is ineffective.

(Total for Question 10 = 40 marks)

TOTAL FOR SECTION B: 40 MARKS

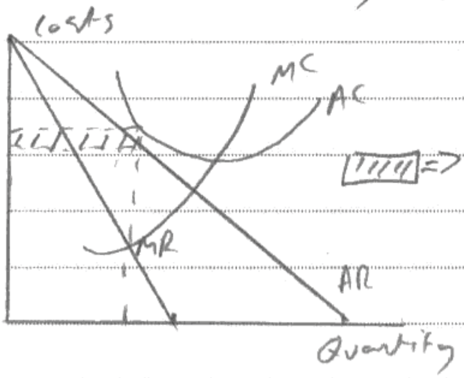
TOTAL FOR PAPER: 72 MARKS

Another good answer making the same mistake.

*(d) Assess the methods by which the manufacturers of instant coffee might compete with each other in both the UK and the US.

(16)

One method firms can use to compete is predatory pricing. Predatory pricing is when you set price below average cost in the short run, to destroy competition and raise prices later. This will increase their market share in the long run and establish market dominance. However, this would incur massive losses initially resulting in the firm possibly needing financial help. This strategy also depends on the ~~#~~ competitors ability to match the low prices, if they can also lower ~~output~~ price, the strategy has failed and the industry as a whole would fail. Also, predatory pricing is considered illegal and therefore would result in fines (10% of turnover) and possible jail sentences (up to 5 years) in the UK. The price also depends on the Average cost of coffee, if the firm is currently not making much revenue (Profit-cost), the price cut will not be as effective. It will probably drive out smaller firms, but larger firms will survive such as nescafe as they have large economies of scale, lower ~~#~~ average cost, and can cross subsidise to to cover any potential losses



They could also use a non-pricing strategy to boost market share. They can start to advertise heavily, which will create awareness and lead to products being commercially recognised and ~~easily~~ lead to possible brand loyalty. However this would result in massive sunk costs and some of the advertising campaign money is wasted due to ~~to~~ it being advertised to the wrong market. This leads to an opportunity cost as well, the money could be spent elsewhere to lower LRAC or to produce new innovative products. This also depends on the competitors ability to produce a campaign. A campaign that can challenge Nescafe would require lots of capital and resources.

Another way they can compete is through providing offers and discounts. This will result in more people choosing their product, increasing market share, and they can then raise prices once brand loyalty has been established.

(Total for Question 10 = 40 marks)

TOTAL FOR SECTION B: 40 MARKS
TOTAL FOR PAPER: 72 MARKS

ResultsPlus
Examiner Comments

Predatory pricing/below average cost/increase market share 3 marks
Advertise/create awareness/brand loyality 3 marks
discounts/offers 2 marks
KAA capped at 6 NO reference to US and UK markets

Ev
Competitors ability 2 mark
Considered illegal/fines of 10%/possible jail\sentence 4 marks
opportunity cost/sunk cost 2 marks

KAA 6 + EV 8 = 14

The Data Response questions were chosen in a ratio of 1:2 for the German Electricity market (Question 9) and the Instant Coffee market (Question 10). The Question 9 data was unfamiliar territory for many students, and the game theory question may have been off-putting. However there were some excellent attempts at explaining game theory using pay-off matrices, and the problem with that was the opportunity cost in terms of evaluation on 9c.

GCE2008 A2 Unit Grade boundary model

Grade	Max. Mark	*A	A	B	C	D	E	N	N
Raw mark boundary	72	62	55	48	41	35	29	23	0

Uniform Mark Scale boundaries

Grade	Max. Mark	*A	A	B	C	D	E	N	N
Raw mark boundary	80	72	63	54	45	36	27	18	0

a* is only used in conversion from raw to uniform marks. It is not a published unit grade.

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