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Examiners' Report
June 2011

GCE Economics 6EC03 01

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Introduction

The Paper was perceived as being difficult, but the mean was only very slightly lower than in June 2010. This was in part because the mark scheme allowed a wide selection of answers, and 0 + 3 on questions 1 and 2. Also the marking of Q9 was made to be more generous by the use of the mark scheme, in order to compensate for what was perceived to be more challenging questions. Candidates should attempt to make their handwriting legible. Candidates are penalised if their meaning cannot be clearly understood. Q10 attracted almost 70% more answers than Q9. One might guess that a number of candidates felt more familiar with the market for chocolate than the market for pharmaceuticals: there seemed little benefit in terms of the quality of their answers, after adjustments within the mark scheme.

Question 1

Candidates recognised characteristics of a perfectly competitive industry very well and the majority knew and could explain the shut down point. Those who included a diagram did not explain its use very clearly at all. Slightly more than half got this right. Surprisingly, very few definitions of AVC or AR. Not that many diagrams either (and very few GOOD diagrams). Hence candidates found it hard to get full marks if they had also not started with a characteristic of PC.

Section A: Answer all the questions in this section

You should spend 35 minutes on this section. Use the data to support your answers where relevant. You may annotate and use diagrams in your answers.

1 Firms are leaving a perfectly competitive industry. This suggests that for these firms:

(1)

A average revenue exceeds marginal revenue

B marginal revenue exceeds average revenue

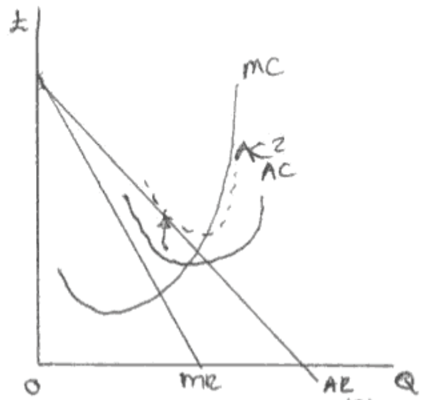
C average fixed cost exceeds average revenue

D average variable cost exceeds average revenue

E average costs equal average revenue.

Answer C

Explanation



(3)

Perfectly competitive industries entice companies in due to lower barriers of entry until only normal profit is being made. Normal profit is needed to keep firms in business, so if it is not being made firms will leave the industry. The answer is not 'E' as this would be an example of a firm making normal profit

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Examiner Comments

Characteristic of perfect competition, that there are no barriers (1 mark). Firms are not making normal profit so they leave (1 mark). Knock out (1 mark). Total 0 + 3.

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Examiner Tip

A common mistake was to choose Key C; however the mark scheme was accessible for candidates to obtain 3 full marks. Knockouts were commonly used.

Short answers can be effective!

Section A: Answer all the questions in this section

You should spend 35 minutes on this section. Use the data to support your answers where relevant. You may annotate and use diagrams in your answers.

1 Firms are leaving a perfectly competitive industry. This suggests that for these firms: (1)

A average revenue exceeds marginal revenue

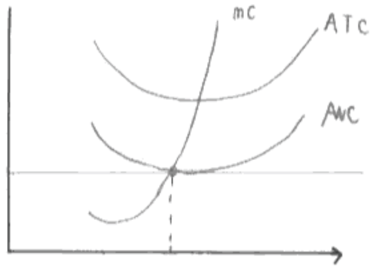
B marginal revenue exceeds average revenue

C average fixed cost exceeds average revenue

D average variable cost exceeds average revenue

E average costs equal average revenue.

Answer $\boxed{D}$



Explanation (3)

A firm will leave the industry when the ~~AR~~ average revenue could not cover the average variable cost (AVC). If the firm is operating at a loss but could cover the AVC, it can still stay in the market as it could give some contribution to fixed cost.

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Examiner Comments

Diagram - 1 mark (shut down point). AR less than AVC/there is a loss - 1 mark. Making contribution to fixed costs - 1 mark. Total 1 + 3.

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Examiner Tip

This answer shows excellent understanding of why firms might leave an industry in the short run.

Question 2

There seemed to be overwhelming confusion between tacit and overt collusion – many describing the features of overt but referring to it as tacit. A common mistake was to choose Key A. Some candidates were referring to the conditions in which collusion is more likely, that is, oligopoly which did at least provide a sense of the interdependence and therefore collaboration being likely.

2 Firms tendering for a private finance scheme from the government verbally agree with each other to fix a higher price than if there were independent bids. This is an example of:

(1)

- **A** tacit collusion
- **B** overt collusion
- **C** symmetric information
- **D** monopolistic competition
- **E** regulatory capture.

Answer ~~B~~ A

Explanation

(3)

This is a case of ~~overt~~ tacit collusion, because the firms have agreed among themselves to collude by fixing a higher price in order to gain extra ~~profits~~ revenue from the private finance scheme. However this is not agreed ~~and~~ formally and is not legally binding. This means that it is more difficult for the Competition Commission to monitor.

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Examiner Comments

Incorrect answer, but...1 mark for the cooperation point (...have agreed among themselves...")1 mark for rationale of higher prices "to gain extra revenue"1 mark for difficult to monitor.

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Examiner Tip

Probably more than half got this wrong. Even those with the right answer struggled with 'open' and/or 'verbally agree'. Some 'rationale' and 'illegal', but few answers that managed the full four marks.

Here is a good example.

2 Firms tendering for a private finance scheme from the government verbally agree with each other to fix a higher price than if there were independent bids. This is an example of:

(1)

A tacit collusion

B overt collusion

C symmetric information

D monopolistic competition

E regulatory capture.

Answer $\boxed{\cancel{B}}$ A

Explanation

(3)

This is a case of ~~overt~~ tacit collusion because the firms have agreed among themselves to collude by fixing a higher price in order to gain extra ~~profits~~ revenue from the private finance scheme. However this is not agreed ~~and~~ formally and is not legally binding. This means that it is more difficult for the Competition Commission to monitor.

ResultsPlus
Examiner Comments

Overt means 'open' not formal, whereas tacit means 'quiet' - that is, unspoken. Hence this is the correct answer.

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Examiner Tip

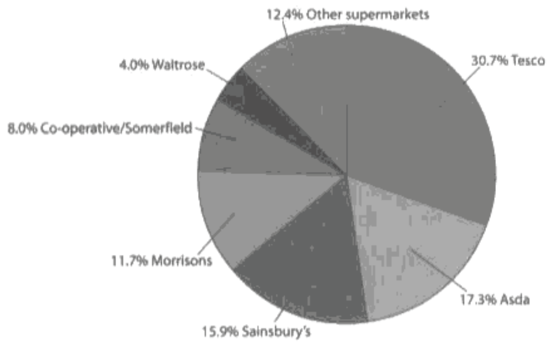
Correct key for 1 mark. 1 mark for definition. 1 mark for illegal. 1 mark for competition policy power (10% fines).

Question 3

The majority of candidates answered this question well with nearly all gaining marks for method and/or definition of a concentration ratio.

Usually the method mark would have added value.

3 The following pie chart shows market shares in the UK grocery industry in 2009.



Source: adapted from http://www.tnsglobal.com/news/news-56F59E8A99C8428989E9BE66187D5792.aspx

Which of the following statements is true in the UK grocery market?

(1)

A It is monopolistically competitive

B It has a low level of concentration

C The four firm concentration ratio is 75.6 per cent

D It is perfectly competitive

E The three firm concentration ratio is 60.4 per cent.

30.7
17.5
15.9
64.1
12.4
76.5

Answer $\boxed{A}$

Explanation

(3)

This is a monopolistic market as tesco has 30.7% of the market share, and its closest competitors have 17.3% and 15.9% Therefore it is a monopoly in a sense that tesco dominates however not fully. It is not C as the three firm concentration is 76.5%

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Examiner Comments

Total 0 + 1. 1 mark for monopoly. The 'other supermarkets' included in calculation.

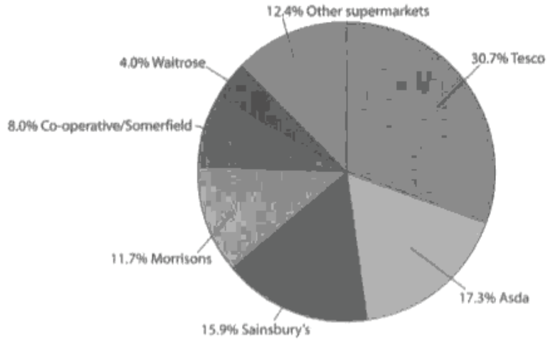
ResultsPlus

Examiner Tip

Remember to look out for 'Others'!

Well answered, knockout for E was often used, but it was not needed.

3 The following pie chart shows market shares in the UK grocery industry in 2009.



Source: adapted from http://www.tnsglobal.com/news/news-56F59E8A99C8428989E9BE66187D5792.aspx

Which of the following statements is true in the UK grocery market?

(1)

A It is monopolistically competitive

B It has a low level of concentration

C The four firm concentration ratio is 75.6 per cent

D It is perfectly competitive

E The three firm concentration ratio is 60.4 per cent.

Answer $\boxed{C}$

Explanation

(3)

The three firm concentration ration is 63.9. The four firm concentration ratio is 75.6 because the total market share off the top four firms adds up to 75.6. The government may see Tesco as having monopoly power as ~~[illegible]~~ Tesco's market share exceeded ~~8~~ 25% in 2009. Therefore, the UK grocery industry is not perfectly competitive. It is an oligopoly.

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Examiner Comments

Total 1 + 3. 1 mark for calculation three firm concentration ratio. 1 mark for definition. 1 mark for monopoly.

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Examiner Tip

Refer to the data. In this case noting that Tesco has a legal monopoly is worth 1 mark.

Question 4

With questions on this topic on recent papers, most candidates seem to have learnt the importance of vertical integration, and the forwards/backwards distinction. Nearly everyone (who answered it correctly) got 'vertical' and 'backward', often in one phrase: 'previous stage of production'. The third mark was often the rationale, and in particular the 'reliable supply' point.

4 Reliance Industries Ltd (RIL) is an energy group which refines oil into petrol in India. In 2002 it merged with a crude oil extraction firm. What might be RIL's reason for this merger?

(1)

A To gain from the benefits of horizontal integration

B To gain from the benefits of backward vertical integration

C To gain from the benefits of forward vertical integration

D To gain from the benefits of conglomerate integration

E To avoid diseconomies of scale.

Answer $\boxed{B}$

Explanation

(3)

RIL has merged with a firm at a different stage of production, this is therefore an example of vertical integration. Seeing as the firm taken over is moving further way from the consumer i.e at previous stage of production its an example of backward integration. Benefits gained from this include increased economies of scale and that they now can control their supply of oil and the supply of other firms. so minimise effects of rising oil prices for them.

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Examiner Comments

Economies of scale on their own is not enough for the rationale mark, and needs to be made relevant, for example by referring to managerial economies.

ResultsPlus

Examiner Tip

1 mark for definition. 1 mark for rationale. 1 mark for application to the oil industry (not that well done, but overall this is clearly a 4/4 answer).

Some still ignore the 'backwards'.

4 Reliance Industries Ltd (RIL) is an energy group which refines oil into petrol in India. In 2002 it merged with a crude oil extraction firm. What might be RIL's reason for this merger?

(1)

A To gain from the benefits of horizontal integration

B To gain from the benefits of backward vertical integration

C To gain from the benefits of forward vertical integration

D To gain from the benefits of conglomerate integration ×

E To avoid diseconomies of scale. ×

Answer $\boxed{B}$

Explanation

(3)

Vertical integration is a merger between two firms in the same industry but at different stages of the production process. Both of these firms are in the oil/energy industry but they both do different things within the industry.
Some of the benefits of vertical integration include an increase in economies of scale, and a wider access to the raw materials in manufacturing.

ResultsPlus

Examiner Comments

No sense of backwards. Vertical (1 mark). Economies of scale not justified, but access to raw materials is valid for a reason for the integration (1 mark).

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Examiner Tip

Use every word in the question.

Question 5

Very few candidates gave a clear answer as to why the answer was zero. They understood the definition of marginal costs and most explained fixed costs but answers tended to be muddled regarding the increase in marginal costs linked to fixed costs. A top level answer can use a diagram to show the answer in an efficient way.

5 If a firm's fixed costs increase by 20 per cent, marginal costs will increase by:

(1)

A zero

B 10%

C 20%

D 100%

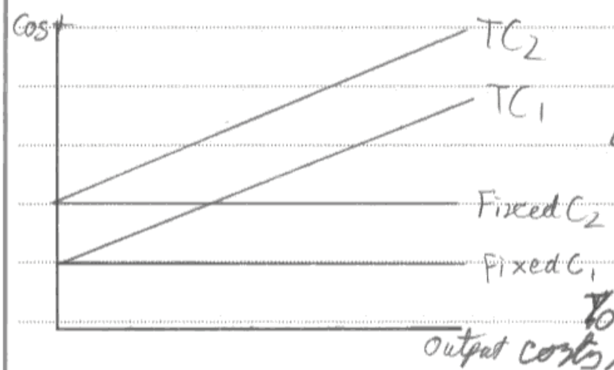
E 200%.

Answer $\boxed{A}$

Explanation

(3)

Fixed costs are the same regardless of output. Marginal cost is the cost of producing one more unit of output. $= \frac{\Delta TC}{Q}$ – this is the gradient of the TC line. You can see that even though fixed costs increase, the gradient of TC stays the same.



You would have to ↑ variable costs to change MC.

(Total for Question 5 = 4 marks)

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Examiner Comments

This collects all the marks.

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Examiner Tip

Draw a diagram. Marking is positive, so you cannot lose a mark. This one is very effective.

Quite a few candidates got this wrong but they often picked up the two marks for definitions of MC and fixed cost explanation. Even those who got it right often struggled to get full marks because it was quite difficult to explain without stating the obvious. Only a handful of answers used a numerical example properly, and many said that if dy/dQ=0 and dQ=0 then dy/0=0 which was not rational.

5 If a firm's fixed costs increase by 20 per cent, marginal costs will increase by:

(1)

A zero

B 10%

C 20%

D 100%

E 200%.

Answer $\boxed{A}$

Explanation

(3)

Marginal Costs are costs as a result of producing an extra unit of production

$$MC = \frac{\Delta TC}{\Delta Q}$$

MC = 0 when average cost are declining

– It's not E because that is unproportional

ResultsPlus

Examiner Comments

Count formula as definition mark - note correct use of 'change in' signs. Application is not correct. Knockout does not offer valid economic analysis.

ResultsPlus

Examiner Tip

Knock out marks were not easy to find for this question. There are plenty of other ways to get the marks.

5 If a firm's fixed costs increase by 20 per cent, marginal costs will increase by:

(1)

A zero

B 10%

C 20%

D 100%

E 200%.

Answer $\boxed{A}$

Explanation

(3)

Fixed Costs are those costs which are fixed and known of as start-up costs. This includes the cost of original investment, and the opportunity cost involved from foregoing the next best alternative.

Marginal Costs is the cost of producing one extra unit of output.

A firms fixed cost is not affected by Marginal cost as MC only relevant when there is variable costs.

* All costs are variable in long run.

(Total for Question 5 = 4 marks)

ResultsPlus

Examiner Comments

1 + 3 with key correct, definition of fixed costs, definition of Marginal cost, link to variable costs.

Question 6

Very few candidates used diagrams effectively, but using TC and TR it could be very effective. It was challenging for students to explain in words why an increase in FC will not influence MC. Most candidates obtained full marks by defining MC, explaining FC and giving an example of FC.

Most candidates got this right, but there was a significant minority who didn't, and of course they usually ended up with no marks because it's the sort of question where once you pick the wrong key you tend to be going completely the wrong way. Correct answers all had MC=MR, but often struggled after that. Very few definitions of marginal profit.

6 A profit maximising monopolist operates at the output level where:

(1)

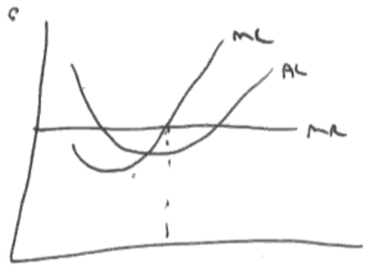
A average revenue equals average cost

B total revenue is at a maximum

C the price is equal to the marginal cost

D the price is equal to the marginal revenue

E the marginal profit is zero.



Answer $\boxed{D}$

Explanation

(3)

A profit maximiser is at the level MR=MC due to the fact that a monopolist operates at the price elastic demand of its MR it will mean that price will equal marginal revenue.

ResultsPlus
Examiner Comments

1 for MR = MC

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Examiner Tip

Few relevant diagrams were given for this question. The best answers did so good marginal analysis, but weaker ones struggled to do anything more that.

Here the knock out is wrong so earns no further marks.

6 A profit maximising monopolist operates at the output level where:

(1)

A average revenue equals average cost

B total revenue is at a maximum

C the price is equal to the marginal cost

D the price is equal to the marginal revenue

E the marginal profit is zero.

Answer $\boxed{E}$

Explanation

(3)

Profit maximisation occurs when marginal revenue = marginal cost.

MR = MC

MR - MC = 0

MR - MC = Marginal profit = 0

~~B, is wrong because~~

A, is wrong because when average revenue equals average cost there is productive ~~allocative~~ efficiency. and monopolies are inefficient.

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Examiner Comments

1 for MC = MR. 1 for MR - MC = 0 profit.

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Examiner Tip

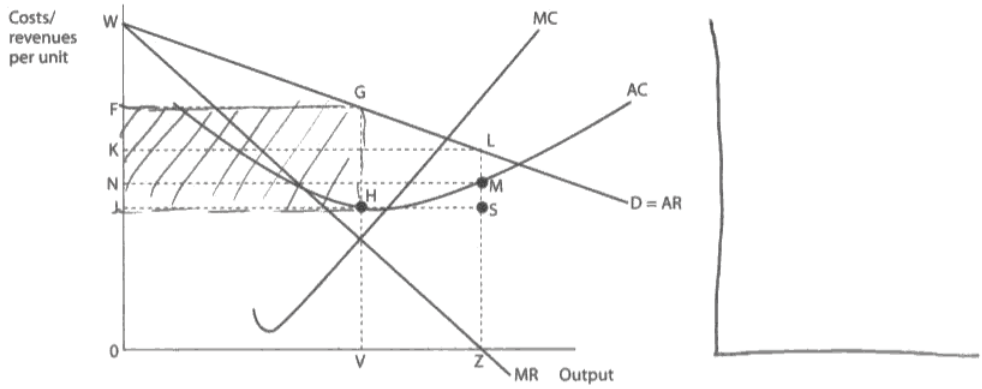
Define MP as it is in the question.

Question 7

Generally quite well done. Most got the key right, provided a characteristic, and then used the lack of barriers and profit motive to get the other two marks. About half the time the candidate spotted the right profit box, so like Q3 there were plenty of ways to get full marks, so most good answers did so.

Many candidates understood monopolistic competition and its characteristics and most could identify the area of supernormal profit on the diagram. They almost all recognised that new firms would enter the market and supernormal profit would be competed away.

7 The diagram shows a firm in monopolistic competition in the short run.



Which of the following statements is true?

(1)

A New firms will enter the industry in the long run

B Demand for this firm's products will increase in the long run

~~**C**~~ Collusion will occur

~~**D**~~ The supernormal profit level is NKLM

E The firm is producing where demand is price inelastic.

Answer $\boxed{A}$

Explanation

(3)

Assuming the firm is producing at MC=MR (Profit maximising) the level of supernormal profits is shown by FGJH. In monopolistic firms due to low barriers to entry and knowledge new firms will see this and join the market ~~thus increasing supply~~ in the long run. these super normal profits will then be competed away due to increased supply. SNPs are only maintainable in short run

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Examiner Comments

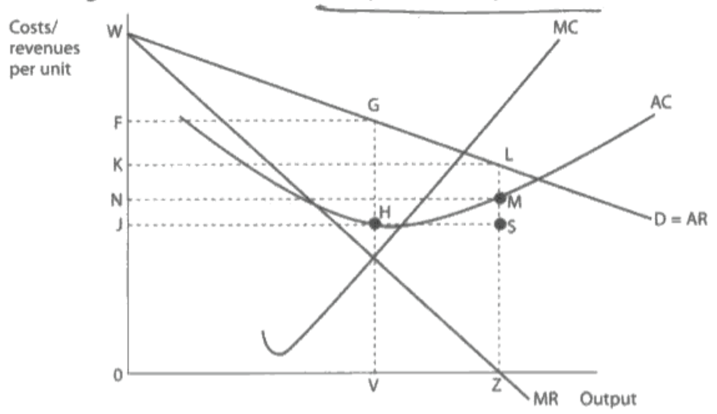
Supernormal profits = 1. Low barriers to entry = 1. Completed away = 1.

ResultsPlus
Examiner Tip

Use the diagram.

D was the most common distractor.

7 The diagram shows a firm in monopolistic competition in the short run.



Which of the following statements is true?

(1)

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B Demand for this firm's products will increase in the long run

C Collusion will occur

D The supernormal profit level is NKLM

E The firm is producing where demand is price inelastic.

Answer $\boxed{\text{D.}}$

Explanation

(3)

monoplistic competition is where there are many small firms with similar products. Symetrical knowledge exists in this industry. There are low barriers to entry and exit in this industry. An example of this maybe the fruit section in the farming industry. Supernormal profits are those which are 8% or above. Due to ~~ah~~ the industry having low barrier to entry and exit, firms may enter the market to make a quick profit. This is known as a "Hit and Run."

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Examiner Comments

1 mark for the definition.1 mark for the link between low barriers and gain profits

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Examiner Tip

Having seen that D relates to MR = 0 not MC = MR, use this in your answer.

Question 8

Not many candidates felt confident in answering this question and tried to use the wording in the question to form their answer – picking up on the "poor service" and "fines" without adding a great deal more in terms of understanding. Several took it upon themselves to attack banks in general for their "sloppy service" and unwillingness to lend money to people who really needed it! Most got it right, but it took some creativity to get full marks. Nearly everyone defined performance targeting as setting targets (no 'goals' or objectives').

8 On 1 November 2009 a new law in the UK gave financial regulators the power to impose fines on banks if they deliver poor service to customers. This method of government intervention in markets is a form of:

(1)

A price capping

B monitoring of prices

C public private partnership

D competitive tendering

E performance targeting.

Answer $\boxed{E}$

Explanation

(3)

This is a form of performance targeting. By giving regulatory power, the UK government will not have to concentrate on the services of banks because financial regulators will be doing so. Instead the government will be able to turn their focus to things such as fiscal policies, supply side policies and monetary policies.

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Examiner Comments

1 mark for correct key. No marks for explanation. Does not respond to the question.

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Examiner Tip

Knock out the obviously wrong responses, saying 'it's not A because ...'.

Better answers explained the deterrent effect of fines, or some other function of a fine.

8 On 1 November 2009 a new law in the UK gave financial regulators the power to impose fines on banks if they deliver poor service to customers. This method of government intervention in markets is a form of:

(1)

A price capping

B monitoring of prices

C public private partnership

D competitive tendering

E performance targeting.

Answer E

Explanation

(3)

- Regulators seek to maximise consumer wellfare by lowering prices or in this case improve service
- By imposing fines ~~ff~~ the banks have an incentive to improve quality of service
- Performance target might be to recieve less than 500 complaints - otherwise they will be fined.

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Examiner Comments

Key =1
customer welfare/ role of regulator =1
fines an incentive =1
eg of performance target/ improving quality =1

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Examiner Tip

Explain all the elements of the question that you refer to.

Question 9 (a)

Well answered by most. There is a clear understanding by candidates (from previous sessions) that 2 marks are allocated for data reference/application. Generally good understanding shown of patents and the reasons for their use. Most linked to material in the question but a significant number did not apply the theory to the case study.

(a) With reference to Extract 1, explain why governments allow patents to be granted.

(4)

Governments allow patents to be granted as a means of promoting investments in certain markets. By allowing a company to fully reap the benefits of its research for example by ~~allowing~~ granting Reckitt Benckiser ~~to~~ patent for indgestion medicine it is very likely that the firm will invest ~~more~~ into more research into indgestion medicine which has a very high external benefits

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Examiner Comments

2 marks for theory, 1 promotes investment, 1 reap the benefits of this research, 2 ap, 1 RB will be able to invest in research & 1 very high external benefits.

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Examiner Tip

Note that the application can be in any form - initially use the extract, but then there is scope to relate the answer to other parts of the specification, and in this unique case, Unit 1.

Most of the theory as well as the application marks are in the data provided.

(a) With reference to Extract 1, explain why governments allow patents to be granted.

(4)

A patent is where other firms in an industry can't copy the product or the formula for the market for many years, normally around 20 years, after this they can copy the product.

Government allow these as it is extremely expensive to fund the research and development into products, such as medicinal products in ~~Extracts~~ 1, so firms can make back the loss of money due to these investment.

It encourages firms and acts as an incentive to be more innovative, benefiting the public with better and more efficient goods.

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Examiner Comments

2 marks for theory, 1 cannot copy (barrier to entry), 1 timeframe, 1 ap (brief mention of medicine and research and development).

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Examiner Tip

Perhaps the television programme "Dragons' Den" helps the average candidate know about patents?

Question 9 (b)

The most popular economic effects were the fall of prices and increased choice. A lot of answers included possible reduction in quality. Other economic effects were rarely seen. NHS was rarely mentioned as a customer, other than when quoting from the text the £40 million could have been saved. Most candidates did not allow for the special nature of medication as a product when looking at the issue of quality. Instead they discussed it as if it was any other product bought in the open market. Few mentioned wider implications and consequences of the government saving the money and spending it on something else. Most candidates could pick up a couple of points (usually lower prices and increased choice). Evaluation was obviously not so common, but the better candidates found it quite easy. On balance, this question was a bit easier than 10b because in the latter they were required to discuss just one point. It’s much easier to do two points less well. Also, it’s easier to evaluate two points rather than one.

(b) Assess the economic effects on consumers of increased competition from generic (unbranded) products within the healthcare market.

(8)

An increase in competition may for existing firms to make efficiency savings. This will then enable them to lower there LRAC. This can lead to cheaper prices for consumers.

However because the business is reducing costs and making efficiency savings. The quality of the goods may be affected. and get worse.

An increase in competition may also be an incentive for businesses to increase the quality of there goods to ensure consumers stick with there product.

However with the increase in competition firms may now have lower supernormal profits, schumpeter view that these profits would then be reinvested. Therefore businesses will have less money to spend on research and development. So quality may get no better.

An increase in competition, would also give consumers more choice. Therefore they could find a product that works better for them.

However firms may retaliate like Reckitt, taking there existing product of the market and replacing with a new product which is patented. This stops other firms copying there ingredients.

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Examiner Comments

KAA - 3, EV - 4, 2 marks for lower price point, 1 mark for ID of choice point, 3EV (2 for quality issues in paragraph two with a further evaluation mark added to this in paragraph four) & 1EV for retaliation.

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Examiner Tip

Evaluation is 50% of the marks for all questions apart from the 4-markers.

Most candidates were able to present satisfactory arguments and evaluate them – the better candidates making arguments about allocative efficiency and consumer surplus. Only the very best candidates thought explicitly to separate the UK market into the prescription and the OTC markets, two markets where some of the arguments (e.g. about the strength of brand names) would be different.

(b) Assess the economic effects on consumers of increased competition from generic (unbranded) products within the healthcare market.

(8)

Increased competition from generic products within the health care market would effect consumers in many ways.

Firstly there would be more consumer choice, before when Gaviscon Advance was the only medicine that doctors could ~~be pescribtem~~ prescrible when they looked for the original product, consumers were limited and had no choice but to buy Gaviscon Advance. With increased competition, they will have a range of different products to choose from with ranging prices.
Increased competitions will also lead to firms lowering their prices in order to compete with rival firms. This will be beneficial to consumers as prices will be lower and there is less chance of price discrimination.
However, with more firms competing, the quality of the product could be effected, especially if prices have gone ~~down~~ down considerably. This means they will have a smaller profit margin and therefore less money to cover costs, which results in firms cutting costs. Therefore, consumer welfare could fall.

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Examiner Comments

KAA - 4, EV - 2, 2 marks for the choice point, 2 marks for the lower price point. One good evaluation point on the effect on quality. No second EV point.

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Examiner Tip

There is also an understanding of increased competition, but KAA is limited to 4 marks.

Question 9 (c)

Many included patent law as one of government competition policies. Very popular were price capping (of only marginal relevance), nationalisation, subsidies to start-ups, taxation... but also the 25% market share limit and collusion investigations which at least had some validity. Most answers included an explicit definition of competition policy. There was not much evidence of understanding the exact distinct roles and powers of CC and OFT. The fines for price fixing and predatory pricing were seen often.

Weaker responses tended to describe institutions and their procedures – and, sometimes, case studies – without actually evaluating the success of government policy in promoting competition between firms. Amongst these, a large proportion wanted to write about price-capping often appearing ignorant of the natural monopoly context in which regulators apply such devices as a proxy for competition. Many candidates failed to understand the ploy by which RB had successfully denied the NHS the benefit of generic versions of Gaviscon for 8 years, but some of the better candidates were able to use the case study appropriately in their evaluation of policy success (although none actually compared the potential size of the fine with the alleged £40m benefit to RB of the ploy). A surprising number of candidates seemed to calculate 10% of £7.78bn as £80m - a misreading of '80%' in the next paragraph one wonders.

It was not uncommon for candidates to misread the data and to assert that the OFT had fined RB 10% of £7.78bn or had prevented the T-Mobile/Orange merger – both assertions falsified by actual events after the piece was written. Sometimes, it was not clear whether a candidate was, in fact, writing with knowledge of the outcome of the OFT investigation into the Gaviscon case (but none cited the £10.2m fine actually imposed). Very few candidates failed to refer to the data or to their own knowledge and suffered the resulting 4/6 kaa mark cap. A number of candidates were able to draw convincingly on their own knowledge of case studies. Case studies involved mainly Gaviscon patent situation and the banking charges failure. Other case studies, i.e. of their own choice, were only seen few times.

*(c) With reference to the information provided and your own knowledge, to what extent is the government's competition policy successful in promoting competition between firms?

(12)

~~According to extract the office~~ The office of fair trading's role is to act as a surrogate for competition and ~~acts as a~~ protects consumer interests. The extract says that the OFTs interventions are becoming increasingly agressive and widespread. This can be seen as successful because there is contraversy surrounding their lax attitude and factors such as regulatory capture. By increasing its investigations and punishments (fines) other firms will be dettered from acting anti competitively. However their ~~are~~ is always the risk of failures such as that of the unauthorised overdraft fees. Anti-competive behaviour is extremely difficult to prove and therefore mistakes can be made all too easily. In the case of gaviscon their prescence is deemed as a success especially as the NHS could have saved £40 billion in the time that the alledged anti-competitive behavior has occured and the NHS is vital to consumers. If the firm is proved guilty the next issue is the size of the fine. It must be big enough to

outweigh the firms gains through their act,
if the fine is less their anti-competitive
behaviour becomes worth it. They are planning
fine Reckit Benckiser 10% of annual sales
which seems alot considering gaviscon is
not their only product although it
is a major contributor to the firms revenues.

ResultsPlus

Examiner Comments

5 KAA, 5 EV, 1 for Role of competition policy, 2 for deter anti-competitive behaviour, 2 for success of 10% fines, 2 EV for regulatory capture, 1 EV for risk of failure (also 1 EV for difficult to prove), 2 EV for whether the fine is big enough.

ResultsPlus

Examiner Tip

You are required to use the information provided AND your own knowledge. So you will have to know of some real life examples.

Average to weaker candidates saw the question as an excuse to show off everything they knew about CP without addressing the point on its **success**. Even the stronger candidates tended to stray away from the concept of success/failure.

Patents

*(c) With reference to the information provided and your own knowledge, to what extent is the government's competition policy successful in promoting competition between firms?

(12)

~~By placing fines on firms that are colluding~~

Competition within firms provides incentives to produce effectively and use resources to full extent. Patents, which are allowed by the government, increase competition between firms to be the first mover in innovation.

If firms are found to be colluding or taking part in cartels then the firms can face large fines. Anti-competitive behaviour can have large ~~fine~~ ~~effects~~ results for firms.

Extract 1 says: 'increasingly aggressive interventions' There is to be a review of barriers ~~of~~ to entry, exit and expansion. This may cause firms to compete with each other instead of practising in anti-competitive behaviour as there may be greater repercussion in anti-competitive behaviour.

Large firms, however, may choose to act in an anti-competitive way as the fine the may recieve as a result of it might not ~~have~~ impact on them to greatly due to their size. They may continue practising anti-competitive behaviour such as ~~b~~ increasing barriers to entry by an increase in advertising, limit pricing and vertical integration.

Firms may choose to merge with one another instead of the more competitively aggressive takeover. By merging, firms will immediately gain more market share, They will also increase is size and have a greater range of products. Mergers of firms may result in the other firms in the market increasing their competition by developing new products and becoming more efficient.

ResultsPlus

Examiner Comments

4 KAA, 2 for colluding/face large fines, 2 for increasingly aggressive interventions for fear of fines, 2EV, 2 for if large enough might not consider the fine.

ResultsPlus

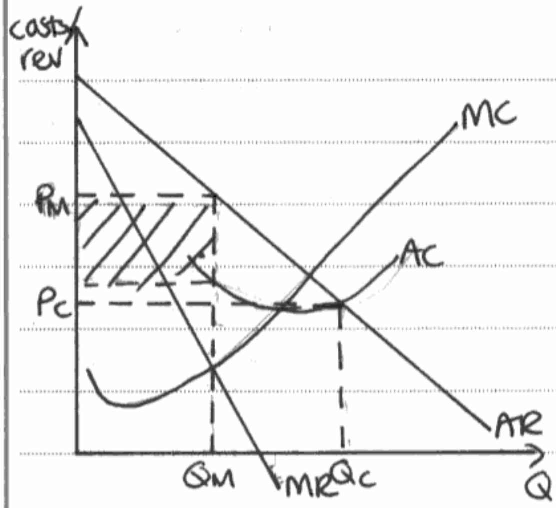
Examiner Tip

As usual on the DR questions, evaluation was not extensive and rarely stretched to 6 marks.

Question 9 (d)

*(d) To what extent does the threat of competition affect a firm's behaviour? Answer either with reference to the healthcare product industry or to an industry of your choice.

(16)



The threat of competition affects a firm's behaviour as they try to increase the barriers to entry into the industry in order to prevent new firms entering. This could be done by increasing research and development for example. The healthcare industry would increase research to develop a new breakthrough drug. ~~This prevent~~ Monopolistic firms are able to do this as they are achieving supernormal profits (as shown in diagram above, at PmQm) (which attracts new firms) therefore they are able to use that profit to re-invest. This prevents the threat of new competition as ~~they know~~ new firms know they will have to invest at relatively the same level in order to have any chance of competing. ~~This would be quite risky for existing firm to do however as new firms may contin~~

The same could be done, with an increase in advertising of the product. However this could be quite a risk as the advertising may not be successful and so money would have been wasted, bringing a high cost. Additionally, it may not actually put off a new firm from entering in which case again money will have been wasted.

Predatory pricing may also be carried out at ~~a~~ the threat of new competition. This is where the existing firm sets prices below variable costs* for the short term. This ~~entices~~ causes new firms to feel pressurised into setting their prices equally low. However as a new firm they will not have the existing profit to cover the costs and so will push ~~out~~ the new firm out of the market. ~~This will mo when~~

*to the price of a competitive firm (Pc)

After, the existing firm will raise ~~the~~ their ~~profit~~ prices to the profit-maximising level in order to recoup their losses. This may actually benefit the existing firm as they ~~will~~ may make additional revenue and may have gained new customers who came in when the prices are low. However the customer may not continue to buy the product after the prices have been raised. ~~Which means~~ Therefore the consumer benefits only in short-run whereas the firm may benefit in the long run.

However, the threat of competition may not actually affect the firm's behaviour. They may continue at their level of price or output as they have the confidence that they have customers who are loyal to their brand. For example, the healthcare brand Nivea has been producing for over 100 years and so ~~they~~ will have built up a loyal customer base who ~~will~~ would not switch if new competition came in. Additionally some firms may welcome the threat of new competition as it enables them to be more efficient. For example they will become more dynamically efficient as innovation will be needed to produce new products. Also they will become more allocatively efficient as they will move closer to AC = AR (Pc Qc).

(Total for Question 9 = 40 marks)

ResultsPlus

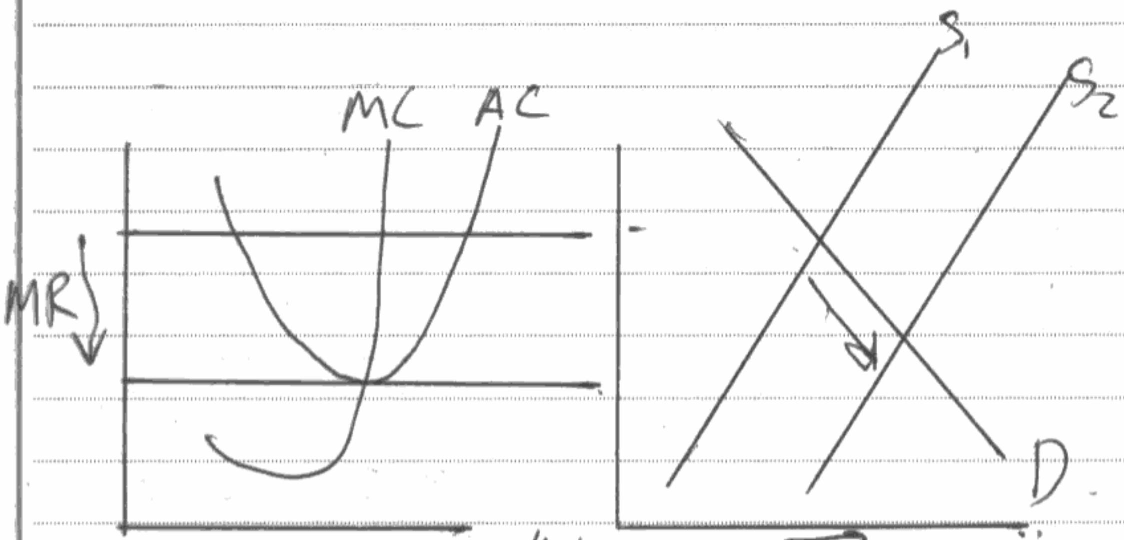
Examiner Comments

KAA - 8, EV - 8, Excellent answer. KAA points include R&D/innovation, advertising and predatory pricing. EV points include the problems of advertising, the long run implications of predatory pricing and the issue of firms NOT reacting to the threat of competition.

*(d) To what extent does the threat of competition affect a firm's behaviour? Answer either with reference to the healthcare product industry or to an industry of your choice.

(16)

The threat of competition may affect the firm in several ways. The main way is that it will result in them reducing prices due to competition ~~and~~.



competition causing price to fall.

However firms may agree on a price and start price setting which results in higher prices and less consumer surplus.

secondly it may result in firms trying to become more allocatively and productively efficient in producing better goods ~~as~~, for example if 2 shoe companies such as adidas and Nike compete the one that makes the better good will make more money.
However many people that buy Nike and Adidas are very brand loyal, therefore ~~if~~ if price rises or decreases due to competition it won't really affect how much money they make therefore may not ~~Thirdly~~ really affect their behaviour.
Thirdly it may result in competitive pricing, this is good in the short run for consumers but in the long run bad as they may lower prices so much it stops other smaller companies entering the market. This may happen if there is more competition.

ResultsPlus

Examiner Comments

KAA - 4, EV - 5, 2 marks for the lower price point (repetition at the end). 2 marks for the increased efficiency/quality point. 2EV for the collusion point. 2EV for the loyalty point. 1EV for the long run effects at the end.

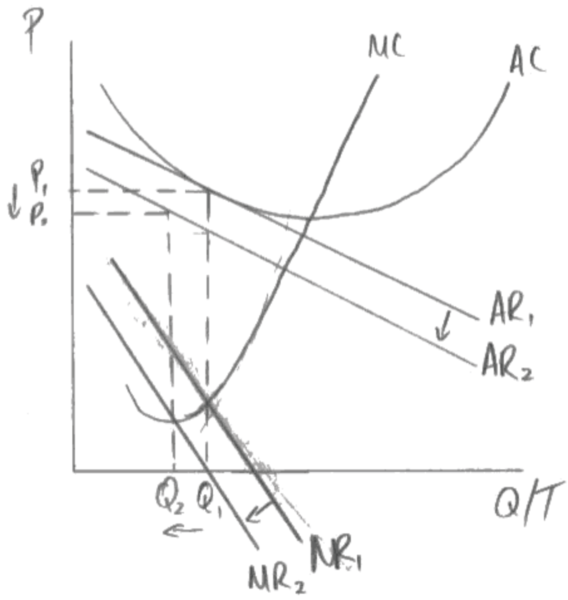
Question 10 (a)

Although some of the candidates found the diagram difficult, the explanation marks were easy! Most got the non-diagram marks and then the diagrams were variable. The majority of candidates were able to present an appropriate diagram and related it to the summer market for chocolate – although a few did fail to take account of the fact that there were application marks on offer here. A disappointing number, however, were unable to illustrate the loss area required - some of these even showing a profit – whilst not a few candidates seemed unable to present an appropriate diagram at all.

(a) Using an appropriate cost and revenue diagram, show why 'Thorntons usually records a loss in the second half of the year' (Extract 1, lines 8–9).

(4)

Thorntons being the only remaining ~~retail~~ large ~~retailer~~ manufacturer of chocolate means that it must have monopoly power. Monopolistic firms make ~~super~~ normal profits when producing at MC=MR, Q_1 with a price set at P_1. If demand falls, $AR_1 \rightarrow AR_2$, marginal revenues also fall from $MR_1 \rightarrow MR_2$. The output drops from Q_1 to Q_2 & price falls from P_1 to P_2. In this situation, average total costs are higher than ~~to~~ average revenues which leads to a loss.



ResultsPlus
Examiner Comments

demand falls =1
no reason given
Diagram shows AR and MR shift = 1

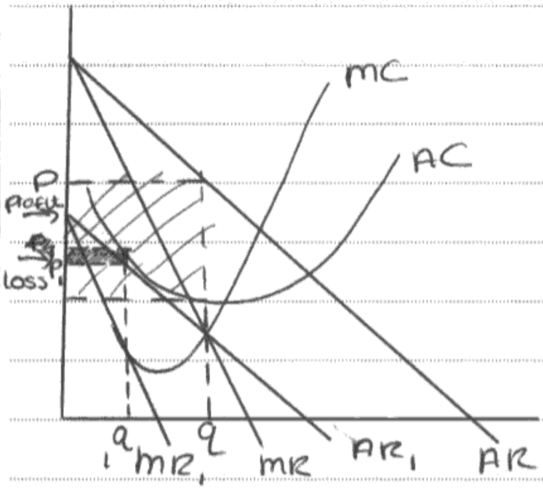
ResultsPlus
Examiner Tip

Some diagrams were very hard to read – and it would be good to have all diagrams with the MC curve cutting the AC curve at its minimum.

Here's how to get full marks. You don't need to write too much. Accurate diagrams are the key.

(a) Using an appropriate cost and revenue diagram, show why 'Thorntons usually records a loss in the second half of the year' (Extract 1, lines 8–9).

(4)



In the summer months Thortons experiences a fall in demand for Chocolate as people eat less chocolate in warm whether.

ResultsPlus
Examiner Comments

Fall in demand = 1, reason = 1, diagram shift = 1, area of loss = 1.

ResultsPlus
Examiner Tip

Use a different angle for shading the profit and loss, if you are going to shade both.

Question 10 (b)

A number of candidates were able to examine and evaluate a factor fully. Cost was the most popular factor to examine and evaluate. Contrastingly, others looked at the possibility of price discrimination usually choosing to illustrate the arguments with diagrams – although not a few attempts at such diagrams were flawed (typically with regard to output levels and/or profit areas).

There was a sloppy tendency (for which no penalty as such in the mark scheme) when writing about price discrimination to use the terms 'price-elastic' and 'price inelastic' instead of 'more price-elastic' and 'less price-elastic': MC would have to be negative for a profit-maximiser to price a product at a price-inelastic point on the demand curve. A few candidates failed to observe the '**one**' in bold type - and at some opportunity cost in their answers. Note a few candidates failed to offer anything for evaluation marks.

Some candidates misinterpreted the question and/or Extract 1, and attempted inappropriately to compare supermarkets with the Thorntons website. A lot of candidates gave two reasons instead of one. The main reasons mentioned were costs differences but also the price discrimination with price elasticities. Only several answers included a not very good price discrimination diagram.

(b) Examine **one** reason why Thorntons is likely to sell its chocolates at a higher price in its retail shops than through its website.

(8)

~~Thorntons sell a higher prices to retail shop like supermarket e.g. Sainsbury's and Marks & Spencer. It is because of patent Thorntons has already got the the brand image and reputation of itself in the market. Whenever retail shops have to sell products of Thorntons, it has to be buy in higher price because~~

Thorntons sell its chocolates at a higher price because there is a fixed cost of the ~~p~~ retail shops. Electricity, rent, labour wages and production costs are included in the ~~p~~ chocolates. It is very likely to push up the price because those fixed costs above ~~are highly~~ needs to be paid every month. So the cost of fixed costs ~~a~~ is included in the chocolates. Whereas ~~throug~~ it is cheaper throughout its website because no other costs ~~is add~~ are added. except packaging and production costs e.g. manufacturing chocolate and buying cocoa. It is also efficient in website. ~~the company~~ Thorton's only has to take orders and ~~send~~ deliver. However, it ~~doesn't~~ is not significant in the long term because there is a small fall in total sale and higher prices may not attract all of the consumers. The loss is recorded in the second half of the year because consumers eat less chocolate in warmer weather. So the higher price of products might lead to a loss in some circumstances.

ResultsPlus

Examiner Comments

3KAA, 1 for cost differences, 1 for application to retail markets, 1 for application to online markets, 2 EV, 1EV for 'except packaging and production.' 1EV for long term changes in behaviour because of price differences.

ResultsPlus

Examiner Tip

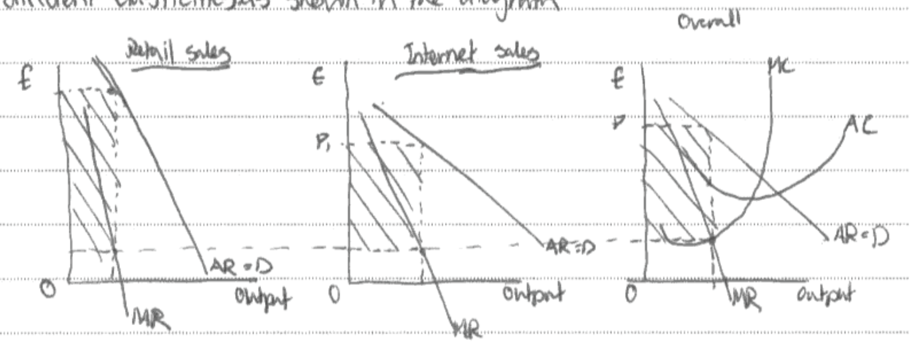
The evaluation for this question was not well done and few gained more than 2 marks. The aim is to go deeper in your evaluation.

Similar in fairness to Q9b, except the 'one reason' constraint. Not that many PD diagrams and often done incorrectly, as here. Often the evaluation was missing; because they had got to the end of the page with the (overly big) diagram and so assumed they had written enough!

(b) Examine **one** reason why Thorntons is likely to sell its chocolates at a higher price in its retail shops than through its website.

(8)

A barrier to entry is anything that prevents potential companies entering the industry. In this case, it is the chocolate manufacturing and retail industry. It is therefore likely that thorntons use of the marketing mix (4p's) gives them a superior advantage to a company who potentially wishes to join the industry as a competitor. One of the 4p's is promotion which in turn has led to charging a lower price on the web compared to retail prices, using limit pricing techniques. With reference to extract 1, "sales have grown by 82% in the past two years" suggesting there may have bee an increase in sales online. This also reflects the powers that Thorntons has as a ~~monopoly~~ firms with a monopoly power to some extent as they are able to price discriminate due to consumers having different elasticities as shown in the diagram.



By splitting the market in pricing, it has led to more sales and profit than overall. This is something new entrants cannot exploit due to lack of economies of scale in marketing. However this does not mean that firms cannot enter in the long terms and perhaps compete with Thorntons and Cadbury in the market.

ResultsPlus

Examiner Comments

4KAA, 2 diagram (incorrect labelling profit areas, no labelling of output or price) BOD, 2 price discrimination (2 conditions) + application PEDs in diagram, 1EV There might be changes in the long run.

ResultsPlus

Examiner Tip

Those that attempted EV found it quite easy, although as it was discussion on just one factor, perhaps a little harder than in 9b to get two good EV points.

Question 10 (c)

A common mistake was to refer to the merger between Kraft and Cadbury rather than a further policy after the merger took place, or a payoff matrix between Kraft and Cadbury (not Mars). Most payoff matrices were correctly applied and included a dominant strategy with clear strategies labelled. Best answers included a payoff matrix and the use of a kinked demand curve to explain why pricing strategies are less likely to occur.

Further comments:

The concept of market share was generally not understood - let alone any distinction as to whether share by volume or share by value. In effect, most candidates wrote about sales revenue, and, fortunately, the mark scheme was generous in this respect.

One or two candidates mistakenly wrote about boosting quoted stock prices.

Only a very small number of candidates recognised that, if firms in collusion (or in a price war) increase (or decrease) their sales revenue by the same proportion, then their market shares vis-a-vis each other do not change.

Some candidates recognised that it is unlikely that Kraft and Mars would be the only players in any market. Hershey and Thorntons did get the odd mention, but Nestle none at all.

10c was a question where most of the candidates had the required knowledge of Economics but many struggled to put it together into a coherently argued piece.

In this respect, the strongest candidates tended to begin with possible pricing strategies and then to evaluate their use with game theory before moving on to non-price strategies.

A number of candidates began with game theory and identified collusion as the optimum pricing strategy but made no link with market share. Only a firm facing a less price-elastic demand for its brands than its competitors faced for theirs would gain market share (by value) by colluding with them to raise price.

When candidates considered price-elasticity of demand, they tended not to distinguish between the price-elasticity of demand for equivalent chocolate products and the price-elasticity of demand for a particular brand name.

A number of candidates described at length the different markets in which Kraft, Cadbury and Mars dominated coupled with an assertion sometimes backed by argument as to how this would increase Kraft's share in competition with Mars.

Only a few candidates suffered a 4/6 KAA cap for failing to refer to game theory. The most popular reference to game theory involved a pay-off matrix. These were often well applied and explained, but some were inherently flawed whilst others seemed to be to be verbatim reproductions of exemplar material barely related to the context in question and/or without an explanation in answer to the question.

More than one candidate wrote about a firm called Mars.Refer (sic)! Perhaps the dot.com revolution has something to answer for here.

This question was similar to Q9d, although the Game Theory element gave the candidates something on which to 'hang' their answer. Some candidates had clearly prepared a matrix for this question; the weaker candidates stuck in down and struggled to use it well in terms of the question; the better candidates wove it well into their analysis and got 6 KAA easily (and then went on to advertising, etc., without getting further KAA marks). Evaluation was better than in most questions as there was lots to say about the problems within the Game Theory set up (although that was often part of the GT analysis rather than separate EV) and it was easy to evaluate the other points. In fact, often the 12/12 answers did struggle with GT but picked up the EV marks criticising the other points made.

*(c) Assess how the newly combined Kraft and Cadbury food company could increase its share of the chocolate market in competition with Mars. Refer to game theory in your answer.

(12)

Cadbury is a British chocolate firm and so has a great deal of experience in the British market and has a large market share in Britain. Cadbury is also strong in India and various Commonwealth countries, as well as parts of Europe and Latin American. Kraft has experience in American markets and has thriving buissnesses in mainland Europe and Russia, where cadbury has not targeted before, and so the takerover by kraft may expand Cadbury's market share in these countries. Mars has a large share of the Chinese chocolate market, and the combined Kraft and Cadbury food company may be large enough to target China's chocolate market and compete with Mars.

However, it is possible that the takeover causes cadbury to loose market share in Britain and Latin America because kraft has little experience in these markets and may choose to focus on the markets they know and emerging markets. The potential conflicting cultures of the two firms may lead to dilusion of the Cadbury brand, in a similar way to what happend when kraft took over Terry's (another British chocolate brand). Therefore, market share would fall and the combined firm would be less able to compete with mars because without the strong brand image of cadbury, mars would be more competitive. However, kraft would try to avoid this because the strong and popular brand image is what attracted kraft to cadbury in the first place.

The combined firm may be more competitive because of reduced costs gained from economies of Scale and Synergy which enables kraft to make redundancies where there is repeated management. kraft are expecting cost savings of £414 million a year. However, this may not happen because synergy levels may not be as great as expected because of the conflicting cultures of the firms, or because of how the deal is financed by debt and the cost of borrowing could increase.

~~Competitivity may also be reduced by a fall in the quality in the products because~~

ResultsPlus
Examiner Comments

There are a large number like this. They concentrate on who has large market share and where, they don't really get down to 'ways to increase market share'. 2KAA - 2 for combined firm might be more competitive which may result in reduced cost and synergies. 4EV - 2 for clash of cultures, lack of synergies & 2 for deal is financed by debt.

ResultsPlus
Examiner Tip

Use a pay-off matrix in the context of the question.

A lot of pay-off matrices were seen but the comments on them were poor in most cases. Most understood that the price was would lead to mutual destruction and that collusion is more likely. The main way the newly combined company was going to increase the market share was by taking advantage of each other's respective markets. This sometimes led to confused discussion half way through. Non-price competition was popular.

*(c) Assess how the newly combined Kraft and Cadbury food company could increase its share of the chocolate market in competition with Mars. Refer to game theory in your answer.

(12)

In oligopolistic industries firms are interdependent and often engage in game theory to try to get the best possible outcome for themselves but by basing the decisions it makes on how they think the other firm will react.

Kraft Cadbury \ Mars	low price	high price
low price	£300000 £300000	£800000 £400000
high price	£400000 £800000	£1000000 £1000000

The firms could compete by charging prices that they think will give them the best outcome. Both firms should set a high price in order to obtain the largest revenue. However game theory often fails because the firms don't trust each. One expects the other to try to undercut them therefore they both end up charging a low price.

Kraft and Cadbury could use the cost savings it is set to make in order to compete by setting low prices in comparison to Mars. Kraf/Cadbury are set to make huge savings of £414 million which could make a significant impact upon prices if they passed them onto consumers. Economies of scale in advertising and managerial economies of scale could be achieved by spreading fixed costs over more units of output. This may ~~be~~ reduce Mars' ability to compete because they may not be able to match the cost savings of Kraft/Cadbury. On the other hand because so much of the deal is financed by debt, if the cost of borrowing were to increase, the cost savings could be diminished making it harder to compete with Mars.

Kraft/Cadbury could compete with Mars in non-price ways by using their branding or by increasing advertising. The firms were both well known before the merger with very strong brands therefore the merger could result in them being successful because they have consumer loyalty. However Mars already has a very strong brand too therefore this may not be of huge benefit to Kraft/Cadbury. Increasing advertising although it'd increase competition, it may not be the best option in the short run for Kraft/Cadbury because three quotes of mergers result in short run profits therefore the newly merged firm may not be able to ~~[illegible]~~ fund lots of advertising. Dilution of the Kraft/Cadbury brand may occur.

Kraft/Cadbury may be able to compete against Mars in China (where Mars has the upper hand) because Kraft is already successful in Europe and Russia and Cadbury is strong Europe and Latin America. The two firms could ~~see~~ achieve synergy as they are both strong in different areas and compete against ~~them~~ Mars in China with their existing expertise.

ResultsPlus
Examiner Comments

Game theory and price competition =5 (3+2), non price =2, Max 6KAA marks awarded. EV 6 (Max), debt issues =2, brand loyalty =2, cost of advertising =2. There are more evaluation points if needed, but just award the best three.

ResultsPlus
Examiner Tip

Best answers included the clash of cultures, the cost of financing the debt and the legal consequences of collusion in evaluation.

Question 10 (d)

This question was answered very well. EOS were the main factors, especially marketing and management EOS. Good efforts were made to define allocative and productive efficiencies. On the other side, DOS and the lack of synergy whilst quoting the extract were the main ways to evaluate. X inefficiency was seen in few answers. Overall the provided information was used well here.

There was a pleasing number of candidates who were able to write well, often with appropriate diagrams, about different kinds of economic efficiency although weaker candidates would sometimes muddle the definitions of each and a few mistakenly interpreted the question as asking whether the merger would prove profitable for Kraft. A few candidates failed to refer to the data and suffered a kaa cap of 6/8. Many candidates referred to the minimum efficient scale of output in their answers but few understood the concept properly the others seeming to believe that to produce any quantity above this output immediately involved rising unit costs. It was good to see some candidates showing an understanding that economies and diseconomies of scale (caused as they are by two quite different sets of factors) can both occur simultaneously and that the issue is which at any level of expansion is the greater. Only a few candidates had allowed themselves too little time for this 16-mark last question.

1. There was a pleasing number of candidates who were able to write well, often with appropriate diagrams, about different kinds of economic efficiency although weaker candidates would sometimes muddle the definitions of each and a few mistakenly interpreted the question as asking whether the merger would prove profitable for Kraft.·

2. A few candidates failed to refer to the data and suffered a kaa cap of 6/8.·

3. Many candidates referred to the minimum efficient scale of output in their answers but few understood the concept properly the others seeming to believe that that to produce any quantity above this output immediately involved rising unit costs. ·

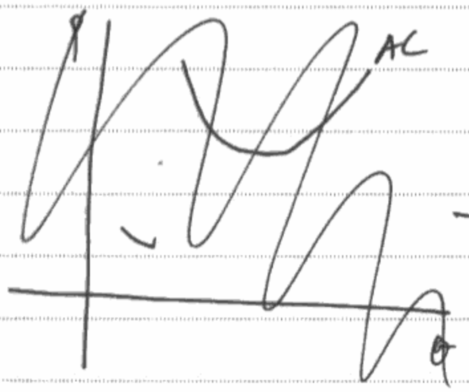
4. It was good to see the odd candidate showing an understanding that economies and diseconomies of scale (caused as they are by two quite different sets of factors) can both occur simultaneously and that the issue is which at any level of expansion is the greater.·

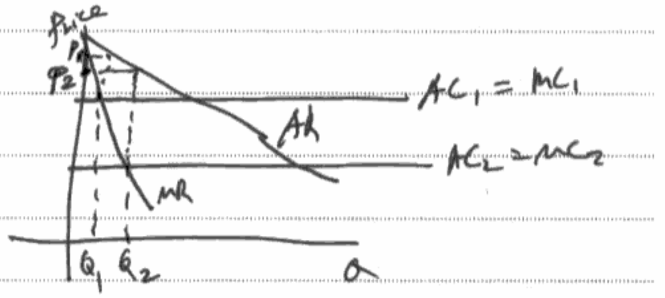
5. Only a few candidates had allowed themselves too little time for this 16-mark last question.

*(d) With reference to the information provided, evaluate whether Kraft's takeover of Cadbury is likely to increase economic efficiency.

(16)

Kraft's take over of Cadbury is horizontal integration.
~~Firms~~ The firms are in the same industry or market which is oligopolistic.
Firm may be able to exploit economies of scale, as its size become larger from the take over.





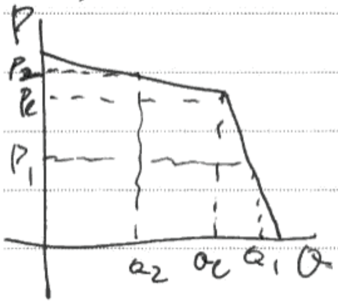
Firm may be allowed to reduce the price from P1 to P2 and increase the outputs from Q1 to Q2, demonstrating that firm's ~~ha~~ increased its efficiency.

Also, consumer surplus may ~~will~~ ~~has~~ increased as well as producer surplus increase.

The economies of scale may be marketing and purchasing economies of scale.
Firm may ~~need~~ be able to bulk buy, so purchasing economies of scale can be exploited and firm may need

Less marketing cost per product ~~~~ unit
therefore marketing economies of scale can be used.

However, firm may not be efficient, because
firstly, firm is in the oligopolistic market.



Firm may have a price inelastic demand when reducing the price and price elastic demand when increasing the price due to ~~same~~ other large competitors.
Therefore firm may not change the price and output.
~~Secondly~~

Secondly, firm may have a conflict ~~be dentre~~ ~~the~~ between two different workforce.
~~E~~ Therefore efficiency may decrease, then the cost per unit may increase.
Also the conflict may demotivate workforce, then the quality of goods and service may be affected negatively, ~~lead~~ possibly leading to a fall in ~~mean~~ sales as well as market share.

Labour turnover ↑ cost ↑

ResultsPlus
Examiner Comments

5KAA, 1 id of EoS , 1 definition (below the diagram), 2 bulk buying EoS, 1 marketing EoS, 2EV - 1EV synergy (conflicting workforces) & 1EV effecting quality of goods (but not linked to efficiency).

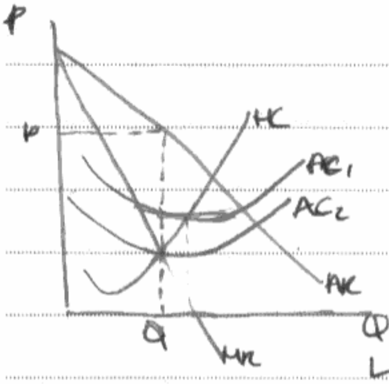
ResultsPlus
Examiner Tip

A fairly easy question but as well as "economies of scale" there were quite a few other points from the text, so basically quite easy to get 8 KAA. The evaluation was reasonable as well, although the weaker candidates always struggle to get 4 EV points out.

A good response here.

*(d) With reference to the information provided, evaluate whether Kraft's takeover of Cadbury is likely to increase economic efficiency.

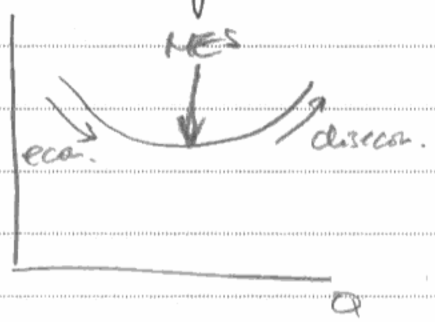
(16)



The takeover is likely to lead to an increase in productive efficiency, which is where AC=MC. Due to economies of scale, merging may mean they benefit from lower LRAC as outputs increase. Synergy will also mean they can cut costs as the companies put together is worth more than the individual parts. This may occur through shutting down parts of the firms that overlap, for example by closing the factory in Bristol, which Kraft did in 2010. However, this leads to a feeling of lower job security in workers and those in other factories may try and find other jobs for fear of being made redundant by Kraft.

By lowering their costs, Kraft and Cadbury's average costs move from AC_1 towards AC_2, where AC=MC and so they are more productively efficient. However, diseconomies of scale may mean that the merged firm suffers communication problems or lack of coordination, reducing efficiency and increasing average costs. This would cause the firm to move away from AC_2, where they are productively efficient. The

~~effect of economies on the~~ The effect of economies or diseconomies of scale would depend how far ~~they~~ Cadbury was from the minimum efficiency scale before merging. If they were already at the MES, ~~they~~ merging and becoming larger would mean they suffer diseconomies of scale, whereas if they ~~were before~~ had not yet reached it, they may enjoy more economies of scale ~~from~~ from the merger.



Allocative efficiency is producing what consumers what consumers want and occurs when P=MC. By merging, they may ~~also increase~~ be able to invest more money into researching and developing new products, hence increasing consumer choice. ~~They~~ This would increase allocative efficiency. However, ~~they may~~ Kraft may spend the extra profits on ~~their~~ subsidising and developing another company that it owns. This would ~~...~~ not affect allocative efficiency in the chocolate market, but may do it in another food market.

Another factor affecting ~~its~~ economic efficiency is ~~the~~ the amount of profit satisficing which the managers engage in. This is the divorce of control ~~of~~ and ownership, where managers only seek to meet shareholders' targets ~~and do~~ rather than maximising profit. As the firm becomes larger and enjoys lower costs, these may not be spent on improving products, rather on bigger bonuses and other such luxuries for the managers.

ResultsPlus

Examiner Comments

7KAA - 1 identification productive and allocative efficiency, 2 EoS, 2 synegies& 2 consideration allocative efficiency/new products, more chose. 7EV - 1EV job insecurity, 2EV DoS, 2EV reference to minimum efficient scale & 2EV divorce of control and ownership.

ResultsPlus

Examiner Tip

Economic efficiency was usually referred to in terms of allocative, productive and dynamic efficiency. The question was accessible to many candidates since the extract provided guidance on some ways in which efficiency could be gained.

Paper Summary

Although an intellectually stimulating paper, most notably on the Supported Choice Questions, it was a very effective discriminator. Questions were perceived as 'new' although many had been adapted from very old sources.

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