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Examiners' Report
June 2014

GCE Economics 6EC03 01

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Introduction

The June 2014 6EC03/01 Business Economics and Economic Efficiency exam was the penultimate paper in the 2008 Specification, and it followed the same patterns and expectations as in recent papers. Students did not face any particular problems and most could complete the paper in the time available. There were very few rubric errors, and most students have grasped the exam technique that is expected. The standard of language and understanding were high, and the students had been prepared well for the paper, but there were many problems with illegibility of handwriting and the increased use of pens which showed through to the reverse side of the exam paper making them very hard to read. There were no reported errors on the paper, and the rubric was adhered to by almost all candidates. The main comments from the team leaders were that students that use standard theory and apply it to the context given can earn the marks efficiently. There is not a great deal of asymmetric information when it comes to what the students know and what the examiner is looking for.

The most popular optional question was 9 over question 10 by a ratio of 2:1. This proved to be a centre specific choice, however, as revealed on the scripts which went onto extra pages, and those centres which were well rehearsed on price discrimination were strongly in favour of question 10, and a good knowledge of the theory and evaluation on specific areas helped candidates to perform well.

The mean at 52.4 was up 5.7 raw marks on June 2013 (46.7). The two main explanations for the rise in the mean are that there was no January 2014 exam for England and Wales. In previous years more than half of the entries were in January, and the percentage retaking in the June session was high (approximately 20%). In this session the number of retakes was below 1%. The second explanation is that the supported choice questions were far more accessible than in June 2013 and June 2012, with a mean of above 3 out of 4 on all but two questions, and on these the mean was almost 3.

The standard deviation of the paper fell by 1.4 to 10.4. This may be explained largely by the relative accessibility of the supported choice questions, and also the lack of a 'tail' on the 16 mark questions. Most students could perform well on the high mark-based questions, meaning that there was not the usual spread of marks at the bottom end of the range. This reasoning explains the significant rise in the E grade from 27 in June 2013 to 34 in June 2014.

In terms of context the paper was extremely accessible with some observant and interesting answers being given. There was much evidence of past papers being used as a guide, and many very informed answers on PFI (question 8) and patents (9(b)) were particularly well answered by those who had prepared rigorously. There were no questions explicitly demanding game theory, but many students used this effectively in their extended answers. The mean mark on the supported choice was higher than at any other time on the 2008 Spec., with a mean score per question of over 3 out of 4 marks.

Question 1

The opening question on integration was clearly liked by candidates, although a significant number of candidates did select C (forward vertical merger).

Mean score out of a total of 4 marks **3.18**

Standard deviation based on 4 marks **1.21**

Some candidates chose A, because both firms are involved in production involving milk, but the careful reading of question and basic understanding of the fundamental area of the specification did obviate most problems on this question.

The misapprehension seems to have arisen from the word 'seller' in the description of Proper Welsh Milk, as these candidates thought that any seller must be a retailer, i.e. stage of production immediately before the consumer, rather than a primary product producer. It is important to observe that on a paper entitled Business Economics the centrality of the concept of inter-business trade.

1 Dairy Crest Group is a British food producer which uses a large amount of milk in its production processes to make dairy products. In March 2013, Dairy Crest Group bought Proper Welsh Milk, a firm which specialises in selling fresh milk. This takeover could lead to advantages of

(1)

A horizontal integration

B backward vertical integration

C forward vertical integration

D conglomerate integration

E external economies of scale

Answer C

Explanation

(3)

Integration is vertical as DLC are in the same industry but different production process. It is forward because they are now closer to the consumer. An advantage is that they now have a guaranteed buyer of their produce.

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Examiner Comments

Here the score is 0 + 1, for the sense of vertical integration only.

ResultsPlus
Examiner Tip

For a second mark the answer could have knocked out A or D with this level of understanding of the question.

The most secure way to score a third mark was to explain a benefit of the merger to Dairy Crest Group, for example that they could gain secure control of milk supplies, or cut the cost of milk.

1 Dairy Crest Group is a British food producer which uses a large amount of milk in its production processes to make dairy products. In March 2013, Dairy Crest Group bought Proper Welsh Milk, a firm which specialises in selling fresh milk. This takeover could lead to advantages of

(1)

A horizontal integration

B backward vertical integration

C forward vertical integration

D conglomerate integration

E external economies of scale

Answer $\boxed{B}$

Explanation

(3)

Backward vertical integration is when a firm merges with another firm that is ~~tt~~ closer to the raw materials of the production process in the same industry.

Dairy crest group would benefit by having more control over the production process and can prevent ~~access~~ other firms from having access to the milk.

Not Horizontal integration because that is when firms in the same ~~time~~ ~~Stock~~ stage of the production process merge.

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Examiner Comments

A good answer, efficiently picking up 1 + 3 marks.

ResultsPlus

Examiner Tip

Many candidates were able to secure knock-out marks through giving correct definitions of horizontal (A) and conglomerate (D) mergers, but it should be observed that knock out marks are only awarded if they offer new economic analysis, and they are never earned for simply reversing a key.

Question 2

Candidates who chose the correct key were generally able to secure two explanation marks by giving a characteristic of perfect competition, and by drawing a diagram for a firm, illustrating a perfectly elastic demand/AR/MR curve. Very few mistook the market structure, and almost all could give at least one characteristic of the model, although many wasted time by writing everything they knew.

Mean score out of a total of 4 marks **3.16**

Standard deviation based on 4 marks **1.03**

Many drew a short run diagram for one firm, which was a good way to start the question.

2 A cherry grower finds it impossible to influence the market price of her produce. Which of the following conditions would most clearly indicate that she operates in a perfectly competitive market?

(1)

A She produces at an output at which marginal cost is less than marginal revenue ✗

B Marginal cost is equal to total cost at every level of output ✗

C Marginal cost is equal to average cost at every level of output ✗

D She produces at the same output in the short run as in the long run ✗

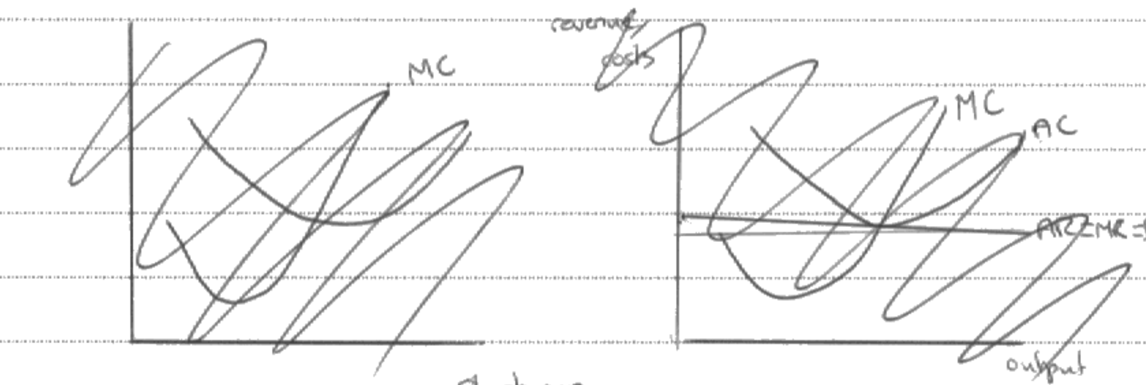
E Average revenue equals marginal revenue at every level of output ✓

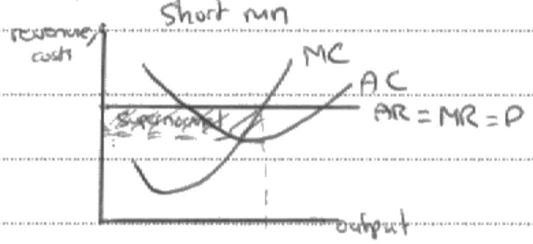
Answer ☐

Explanation

(3)

In a perfectly competitive market there are many firms in the industry selling homogenous products. These firms are price takers





Marginal revenue is ~~Δ revenue~~ Δ revenue ÷ Δ output
In the short run firms can make super normal profits
~~So~~ but in the long run firms make normal profit.

ResultsPlus

Examiner Comments

This candidate crossed out the long run diagram, which could have earned another mark. This gets 1 + 2, for the characteristics of perfect competition (1) and the diagram showing the horizontal AR=MR.

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Examiner Tip

It's best to draw a diagram showing the firm and the industry as a whole, with the changes that occur in the long run.

A small number of candidates also drew an industry diagram showing how the price was set, and this was an effective way to show the changes in the long run (and thereby also a knockout of D). Candidates found it difficult to secure knock-out marks for this question. The most popular option to attempt to knock-out was D, but explanations for this tended to be incomplete, and often assumed that firm output would be lower in the SR than in the LR, when it could be lower or higher, depending on whether the firm was earning SNP or a loss in the SR. A minority of candidates earned an application mark by, for example, explaining the homogenous nature of cherries, for example saying that the cherry seller might not be able to identify her own cherries if brought back to the market.

2 A cherry grower finds it impossible to influence the market price of her produce. Which of the following conditions would most clearly indicate that she operates in a perfectly competitive market?

(1)

A She produces at an output at which marginal cost is less than marginal revenue

B Marginal cost is equal to total cost at every level of output

C Marginal cost is equal to average cost at every level of output

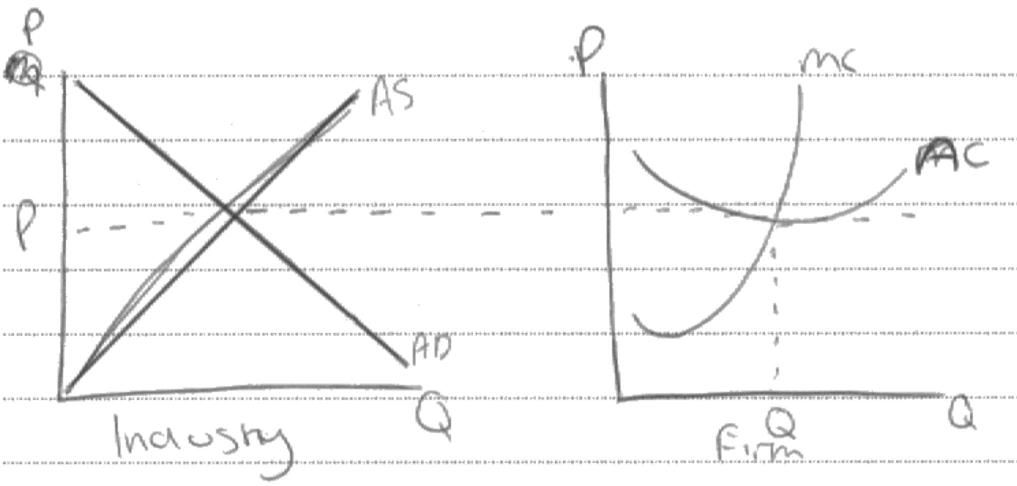
D She produces at the same output in the short run as in the long run

E Average revenue equals marginal revenue at every level of output

Answer C

Explanation

(3)



Perfect competition is a model where there are lots of ~~big~~ buyers and sellers, all with perfect knowledge, with no barriers to entry or exit

Not A as Normal profit is made in perfect competition, and MC < MR = Supernormal profit.

ResultsPlus

Examiner Comments

This diagram is not adequate as there is no AR extrapolated and indeed AS and AD are used rather than S and D. The key chosen is incorrect, showing real misunderstanding.

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Examiner Tip

Make sure the knockout gives some precise economics, not vague use of terms as in the example here. This just earns 0 + 1 for the characteristics of perfect competition only.

Question 3

Candidates found this a slightly more challenging question, both in terms of selecting the correct key, and gaining explanation marks, although there was a great deal of interest in talking about football and share prices.

This is a good example of how to score the marks.

3 The management at a famous football club aim to promote the firm's success in matches as their primary objective. The firm's shareholders indicate at a meeting that they will accept low dividends on their shares on the condition that the club invests in new players. This indicates that the

(1)

A management is aiming for short-term gains in share prices

B management is profit satisficing

C management is profit maximising in the short run

D firm cannot make supernormal profits in the long run

E average variable cost of players is equal to the marginal revenue gained from their employment

Answer B

Explanation

(3)

~~Stated~~ Profit satificing is making just enough profit to keep shareholders happy while allowing other motives to be persued in this case investing in new players. It is not profit maximising in the short run as this would increase shareholders dividens and may have a opportunity cost of buying a new player.

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Examiner Comments

Just enough to keep shareholders happy - 1

Pursue other objectives - 1

Knock out of C with explanation - profit maximisation raises share prices/new players will eat into profits - 1

1 + 3

ResultsPlus
Examiner Tip

Explanations of profit satisficing were often too vague to be awarded a mark, saying simply that it meant that firms did not profit maximise, rather than referring to the level of profits which would be minimally acceptable to shareholders. This is a much more effective way to achieve two marks in just one sentence at the outset.

Very few candidates seemed to be familiar with the ideas of the principal-agent problem, or the divorce of ownership and control which leads to it. In terms of achieving knock-out marks, candidates found it very challenging to explain the expected relationship between dividends and share price when trying to knock-out option A.

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D firm cannot make supernormal profits in the long run

E average variable cost of players is equal to the marginal revenue gained from their employment

Answer ~~B~~ E

* Variable cost - a cost that ~~[illegible]~~ varies directly with output

Explanation

* Fixed cost - cost doesn't vary directly with output

(3)

* Profit satisficing - management (~~[illegible]~~) - (~~[illegible]~~) are making enough profit to keep shareholders happy, ~~[illegible]~~ spending on other objectives, (~~[illegible]~~ ~~players~~).

Answer can't be A, as ~~[illegible]~~ shareholders willing to except low dividents so are not focussed on ~~would operate at [illegible]~~ gains in share prices. Dividents is ~~[illegible]~~ profit made by a firm thats paid out to its shareholders.

Answer can't be C, as they would operate at MC=MR and focus on profit now.

Short run - when at least one factor input of production is fixed. Answer is E, as as long as new players cover there average variable costs they are contributing to the fixed cost of buying them - shut down point.

ResultsPlus

Examiner Comments

This answer gives over too much to definitions and knockouts, with a maximum of 0+2 marks because the key is incorrect.

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Examiner Tip

A diagram is often the most effective way to pick up marks, and the space does not have to be filled with text. There is usually a maximum of one mark for a definition.

Question 4

This question was well answered, as candidates were able to earn marks for giving the condition for sales maximisation and for illustrating this on a costs/revenue diagram, even if they could not complete all three columns correctly.

AR was the column most often completed correctly, while TC proved more challenging. Candidates should remember that they can take a calculator into the exam, as a notable number did seem to struggle with the long division calculation that didn't result in a whole number result.

4 The table gives weekly information about the possible short run output, costs and revenue of a firm making military equipment. Some cells have been left blank for your own workings.

Output per week	Total revenue (£millions)	Average revenue (£millions)	Total cost (£millions)	Average cost (£millions)	Marginal cost (£millions)
0	0	-	10	-	-
1	40	40		25	15
2	60				9
3	78				18
4	96				44
5	105				54

Which level of weekly output would mean that the firm is sales maximising?

(1)

A 1

B 2

C 3

D 4

E 5

Answer $\boxed{B}$

Explanation

(3)

Sales maximisation is when you are the selling the highest level of output possible. The answer is B because marginal costs reaches the lowest point of 9

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Examiner Comments

This was one of the few answers that scored zero. Note that the definition of sales maximisation does not have the sense of a normal profit constraint.

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Examiner Tip

Very few entered no numbers at all in the table as seen here, there is no negative marking if the numbers are wrong, so an attempt should always be made.

Most candidates correctly calculated the Average Revenue column of the table and full marks were often obtained by completing the table alone. This was a high scoring question.

4 The table gives weekly information about the possible short run output, costs and revenue of a firm making military equipment. Some cells have been left blank for your own workings.

Output per week	Total revenue (£millions)	Average revenue (£millions) TR/Q	Total cost (£millions) FC+VC	Average cost (£millions) TC/Q	Marginal cost (£millions) ΔTC/ΔQ
0	0	-	10	-	-
1	40	40	25	25	15
2	60	30	34	17	9
3	78	26	52	17.3	18
4	96	24	96	24	44
5	105	21	150	30	54

Which level of weekly output would mean that the firm is sales maximising?

AC=AR **(1)**

A 1

B 2

C 3

D 4

E 5

Answer D

Explanation **(3)**

Sales max is AC=AR which is at output of 4 units

Average rev = TR/Q
Total cost = FC+VC
Average cost = TC/Q
Marginal cost = ΔTC/ΔQ

ResultsPlus
Examiner Comments

1+3 scored on the first page alone.

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Examiner Tip

Identification of sales maximisation as AC=AR gained one mark for the majority of students whichever key was selected.

Question 5

The majority of candidates were able to select the correct key, and offer some definition of oligopoly and/or explain that firms were interdependent in oligopoly. An effective approach was to draw and explain the rationale behind the kinked demand curve, although this is just one of many possible models to use. Doing so provided candidates with a useful framework for their responses, as otherwise many candidates referred simply to other firms 'changing' (or not changing) their prices when one firm 'changed' their price; this was obviously insufficient, as the asymmetric responses of competitors is the basis of the kinked demand curve.

Most candidates started off with a description of oligopoly and included the interdependence trait to gain two marks. An explicit knockout of Option E gave the third mark although a correctly labelled kinked demand curve or pay off matrix was also used to gain full marks, as seen here. Very few candidates selected an incorrect option.

5 Supermarkets selling freshly baked bread are operating in an oligopoly. They tend to keep prices stable for a popular, frequently compared product, an 800 gram white loaf. One reason for this might be

(1)

A supermarkets know that the pricing decisions of one supermarket will impact on those of other supermarkets

B supermarkets are independent and base their prices on costs alone

C there is heavy regulation in the industry to prevent tacit collusion

D supermarkets are unable to engage in non-price competition

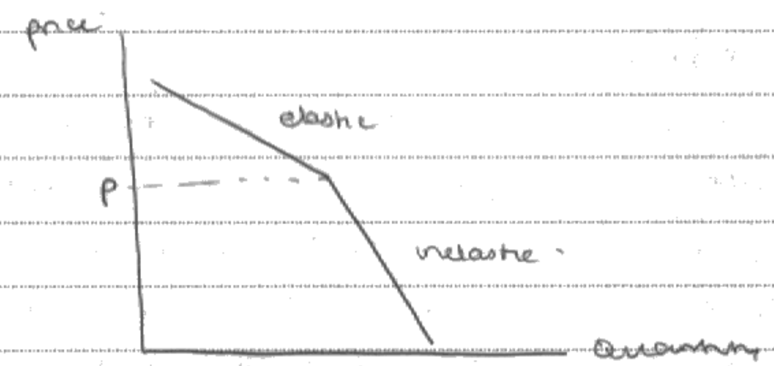
E if prices were cut by one supermarket then the others would leave prices unchanged

Answer $\boxed{A}$

Explanation

(3)

An oligopoly market is where few firms dominate the market.
The concentration ratio is high.
In an oligopoly firms are interdependent on ~~another~~ each other so
if one firm changes its price others are likely to follow.



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Examiner Comments

Kinked demand curves - even very simple ones such as this - can illustrate the sticky prices effectively.

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Examiner Tip

Labelling the elastic and inelastic parts of the demand curve is very effective.

A few answers were based on the choice C. The question seemed to confuse candidates in the use of the negative 'prevent', and there was clearly a belief by some that the concept of tacit collusion would be one that could earn marks.

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(1)

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~~B~~ supermarkets are independent and base their prices on costs alone

C there is heavy regulation in the industry to prevent tacit collusion

~~D~~ supermarkets are unable to engage in non-price competition

~~E~~ if prices were cut by one supermarket then the others would leave prices unchanged

Answer $\boxed{C}$

Explanation

(3)

Oligopoly market is where a few firms dominate the market. There is inter dependant ~~interdependence~~.
Tacit Collusion is an unspocken agreement, price leadeship occurs. It is illegal. Regulation is in place to protect the publics interest.
E is incorrect because if one firm lowers prices others will lower them to in order to not loose out on demand.
B is incorrect as firms collude in oligopoly markets.
D is incorrect as advertising occurs in supermarkets which is non-price competition.

(Total for Question 5 = 4 marks)

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Examiner Comments

This did score 0 + 2, although there is more than one way to earn the marks. Remember that the score is capped at 0+2 with the incorrect key.

ResultsPlus
Examiner Tip

The candidate hadn't ruled out A as we see the answer is also circled. Careful reading of the question would have made this an easier choice.

Question 6

Despite a correct definition of contestability many candidates referred only to competition when developing answers to this question. The role of the regulator was a common mark but distractors were weak and rarely scored marks.

6 Barr and Britvic are two of the three largest soft drink firms in the UK. In February 2013, the proposed takeover by Barr of Britvic was referred to the Competition Commission for investigation. There were likely to have been concerns that the takeover would lead to

(1)

~~**A**~~ economies of scale

B an increase in consumer surplus

C a decrease in contestability

D a reduction in external economies of scale

E a signal for more firms to enter the industry

Answer ~~A~~ D

Explanation

(3)

The role of the Competition Commission is to promote competition amongst firms. External Economies of scale are reductions to long run average costs due to the increase of the size of the industry. Such merger will increase the contestability of the market (thus eliminating option "C") and also result to an increase market share for the merged firm. Such firm might eventually become a monopolist acting as a barrier to entry and thus deterring entrance of new firms and forcing other to leave the industry, reducing the size of the industry and thus external economies of scale.

(Total for Question 6 = 4 marks)

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Examiner Comments

Economies of scale, whether internal or external, do seem to attract most interest as incorrect answers. There is a case to be made that economies of scale can act as a barrier to entry, but in the context of this question it is most unlikely to have been the reason to prevent a takeover, unless linked to contestability, which is indeed the better answer of C.

Question 7

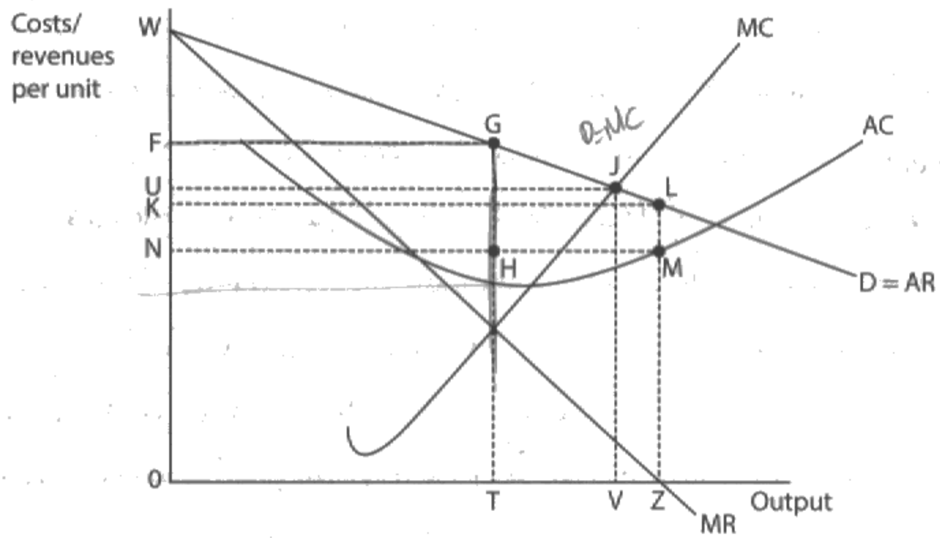
This question proved to be an accessible question and tested a wide range of skills and concepts. Only a few answered the question as if for a profit maximising firm, and the majority read the question and applied it effectively to sales maximisation. Unlike previous years, very few candidates now confuse sales maximisation with revenue maximisation, and indeed most could rule out this key and apply the concept effectively either by using the diagram or the formula MR=0. The question had one of the highest means.

Mean score out of a total of 4 marks **3.14**

Standard deviation based on 4 marks **1.16**

Surprisingly few candidates annotated the diagram and a correct knock-out of Option D was very rare, but illustrated here. Marks were gained by most from the definition of allocative efficiency and explanation of monopoly with a correct knock-out of Option C being a popular way to gain full marks.

7 The diagram shows the costs and revenues for a firm with monopoly power.



Which of the following statements is true?

(1)

A At output T the firm is revenue maximising TR MAX, MR=0

B At output V the firm is allocatively efficient

C At output Z the firm is productively efficient

D At profit maximising output the supernormal profits are KLMN

E At output Z the price is zero

Answer B

Explanation

(3)

Allocatively efficient occurs when scarce resources are allocated to the production ~~of~~ of goods ~~&~~ and services consumers most values. It happens where price equal marginal cost and thus output V is where P=MC and it is allocatively efficients. Answer A is wrong because revenue maximising is where total revenue is maximum and since marginal revenue it is the gradient of ~~—~~ total revenue it means that MR=0 but on the graph output T doesn't show revenue maximisation but profit maximisation. Answer E is wrong since at output Z the price is K

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Examiner Comments

This scored 1+3, although there is far more than required here for the full marks.

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Examiner Tip

Annotation of the diagram, in this case a line through FGH and a new line adding in the SNP for a profit maximising firm, and the identification of P=MC, are effective ways to score marks.

Candidates found it very difficult to achieve full explanation marks for this question without giving one or two knock-outs. The majority of those who selected the correct key were also able to give the condition for allocative efficiency, although far fewer were able to link this to what it meant for consumer/producer/societal welfare.

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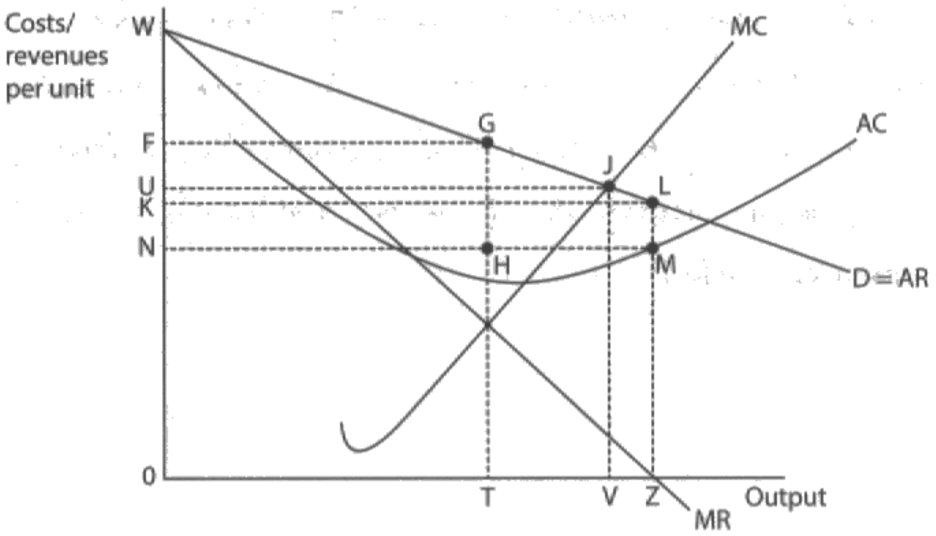

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C At output Z the firm is productively efficient

D At profit maximising output the supernormal profits are KLMN

E At output Z the price is zero

Answer ~~B~~ C

Explanation

(3)

Answer A~~D~~ is wrong because ~~there a supernormal profit~~ at output T, the firm is profit maximising. At output Z, the firm is producing the maximum output it can, by the given amount of resources. This is because if they produced any ~~one~~ more output, MR will become negative. So the firm is productively efficient ~~as~~ where MR=0.

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Examiner Comments

C was also a common distractor, along with A and E.

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Examiner Tip

Annotate the diagram, and if notes are made, e.g. MR=0 at point Z, this can earn a mark.

Question 8

This was the lowest scoring supported choice question, although the mean was much higher than questions of a similar type in previous sessions.

Mean score out of a total of 4 marks **2.90**

Standard deviation based on 4 marks **1.27**

The main discriminator is to use the concept that the projects are **leased or rented** to the government once built by the private sector. A sense that the projects last 25-30 years also adds marks to questions such as this.

Candidates found it challenging to secure knock-out marks for this question, as they often did little more than negate the incorrect keys, for example writing that 'B is incorrect because the public sector can borrow more cheaply than the private sector can' without explaining why this is the case. Candidates should be reminded that they do need to provide adequate justifications for their knock-outs.

Explanations of the PFI were often too vague to be awarded a mark. Many candidates thought that the private sector either only financed, or only constructed the project, rather than both. Many candidates also thought that the government repaid the private sector firm over the contract term, or had to repay the cost with interest.

8 In March 2013, the government agreed to a £288 million Private Finance Initiative (PFI) hospital contract, to replace the Alder Hey Children's Hospital in Liverpool.

What is the most likely reason that a PFI hospital contract was used?

(1)

A This method would not lead to an immediate increase in government borrowing

B Private borrowers can borrow at a cheaper rate than the government can

C PFI contracts increase x-inefficiency

D It is easy to get out of a PFI contract once agreed

E The government has no experience of large-scale building projects

Answer C

Explanation

(3)

X-inefficiency is when ~~staff~~ workers or managers ~~the~~ become inefficient at servicing or producing a product. The government realised that so to help the hospital they gave 288 million. We can eliminate answer A because the government will be spending not borrowing.

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Examiner Comments

As with earlier questions, although it might be true that C is a consequence of PFI, this would not be a **reason** for PFI.

ResultsPlus
Examiner Tip

Careful reading of the question is key. This earns zero marks.

Here is an effective answer.

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What is the most likely reason that a PFI hospital contract was used?

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~~**B**~~ Private borrowers can borrow at a cheaper rate than the government can

~~**C**~~ PFI contracts increase x-inefficiency

~~**D**~~ It is easy to get out of a PFI contract once agreed

E The government has no experience of large-scale building projects

Answer A

Explanation There is no opportunity cost at the beginning for the government since expenses of projects are covered by the private companies

(3)

Private Finance Initiative is a type of ~~Private~~ public private partnership.

when ~~a~~ the government decides ~~to build~~ that a major project needs to be built it gives the project to a private company which is more expertise and after an agreed period the government takes back the hospital on a lease.

Answer B is wrong since government is more trustful organisation for the banks to give lower interest rates than of a private firm

Answer C is wrong since private firms are ~~more~~ known for their x-inefficiency since they are efficient. then ~~govt~~ public sector

(Total for Question 8 = 4 marks)

ResultsPlus Examiner Comments

There is some value in the knock out, in explaining why the government can borrow more cheaply than the private sector.

ResultsPlus Examiner Tip

Try to use the word lease or rent in PFI questions, and know who leases to whom.

Question 9 (a)

With a mean score of 3.65/4 this was the highest scoring question in any session for some years.

The majority of candidates were able to identify the market structure from the figure, and define/explain this to receive a second knowledge mark. For candidates stating that the global chewing gum market is an oligopoly, we were really looking for candidates to calculate an n-firm concentration ratio, rather than simply state market shares from the figure.

Here is a good, and fairly typical response.

(a) Using the data in Figure 1, explain the market structure in the global market for chewing gum.

(4)

Acording to the data in figure 1, the global market for chewing gum is in an oligopoly maket structure. Oligopoly market is where a few large fims dominate the market and each of those firms have a high concentration.

The conentration ration of the 4 largest firms in this Oligopoly market is 35% + 26% + 14% + 6% = 81%

These fims are interdependandt and thms changes of prices of one fim or changes in output of one fim will have an impact on the decisions of other fims.

ResultsPlus
Examiner Comments

Oligopoly identified - 1

Explanation of oligopoly (few large firms) - 1

Calculation of concentration ratio - 2

ResultsPlus
Examiner Tip

Use a concentration ratio wherever possible. Make sure you do not include 'others' in the calculation, however.

Some still forget to use the data, which is an ineffectual approach on a data response paper.

(a) Using the data in Figure 1, explain the market structure in the global market for chewing gum.

(4)

Oligopoly market is when few large firms dominate the market. They are interdependent. A change ~~of~~ in a firm will affect the other firms.

According to the figure1, ~~[illegible]~~ it shows that ~~5 firms was domina~~ it is an oligopoly because there are only few ~~F~~ firms ~~do~~ dominating the market

ResultsPlus
Examiner Comments

Oligopoly - 1

Explanation of oligopoly - 1

No use of data

ResultsPlus
Examiner Tip

2 marks for theory and 2 marks for application, on all 9(a) and 10(a) questions.

Question 9 (b)

Candidates generally seemed to have a good understanding of what patents are, and were able to explain one or two benefits of them, but some were confused by the subsidies also mentioned in the passage, and also the concept with government grants or production. We allowed very broad interpretations of the question, so awarded marks for benefits of patents to firms, to other stakeholders, or to the economy in general. Some candidates did not appreciate the need to evaluate their responses to this question (it was a 'discuss' question).

Here is an effective example.

(b) Discuss **two** benefits of awarding patents to new products developed by scientists.

(8)

~~The first benefit of an~~ Patents are a legal document, issued by the government allowing new innovative or proprietary innovations to be the only legal such products on the market for a set period in time. One benefit to this is ensuring that the firms and scientists who spent countless hours and huge amounts of money in research and development for the new product, receive the correct returns on their investment of time and money. By not allowing others to simply copy the products, and granting them a patent, then the government can ensure that firms and scientists still have an incentive to invest in research and development with increases their dynamic efficiency.

To evaluate however, when granting a patent for ten years, per say, the firm can very quickly become x-inneficient or complacent. This is because the firm is now basically a monopoly with no competitors and as a result this becomes, ironically, a disinsentive for further research and development, to improve quality, lower prices or become more efficient.

Another benefit to a patent, is that companies who are holders of patents will, as monopolies, be making huge abnormal profits which they can use to cross-subside other products in other industries or even put towards new product development, considering that they do not become x-inneficient. This is because, seeing as the patents are only in place for a certain amount of years, the firms will have to come up with new products for when the patent expires.

To evaluate this, the incentive to prepare for what happens once the patent expires depends largely on how long the patent is in place. A patent of 20/30 or even 50 years will not have the same effect on those for 5-10 years as they know that they wont have to deal with competitors for a long time.

ResultsPlus
Examiner Comments

Definition - 1

Provides return on investment & time/so creates incentive to invest - 2

Risk of x-inefficiency/creating a monopoly/leading to higher prices - 3e

Will lead to cross subsidisation/further R&D elsewhere - 1

Depends on the length of the patent - 2e

Total 4 + 4e = 8

ResultsPlus
Examiner Tip

Remember that 4/8 marks are evaluation, so make two evaluation points.

This answer illustrates a very common mistake made by candidates, in that they answered simply about the specific patent given to Rev7 and merely repeated the data about the benefits of non-stick gum and longer lasting nicotine gum. While some credit could be given for the concept of innovation and externalities, this would usually only run to one benefit.

(b) Discuss **two** benefits of awarding patents to new products developed by scientists.

(8)

One benefit for awarding patents to new products developed by scientist is that it makes the gum less sticky and this reduces the costs that government had to clean the streets in the country.

Another advantage is that the gum it is more effective when it used as a nicotine gum and the patents to new product were designed to help the smokers to give up cigarrettes because it realises the nicotine in a more control way.

An evaluation to the patents of the new products is that they will take a lot of time to be produced and create the new gum and will only have effect in the long run and not an effect in the short run.

It may be also more expensive to produce that type of gum with the new awarding patents and you also need skilled labour and this will increase the Average Costs of the firms.

ResultsPlus
Examiner Comments

This is too much of a repeat of the text, and lacks economic analysis.

ResultsPlus
Examiner Tip

Watch the BBC's 'Dragon's Den' for the reiterated importance of patents.

Question 9 (c)

A notable proportion of candidates misinterpreted the evidence presented and argued that Revolymer had shut down because the one-off cost to exit the market was less than the annual cost base. While it is true that in the SR, a firm will shut down if AR<AVC, as in this case the fixed costs that equate to its losses will be less than its losses if it were to stay in the industry, this is not the same thing as was being referred to in the extract. Without any information on revenue, candidates were unable to correctly say that shutting down immediately would minimise Revolymer's losses, and so this was not a valid argument. Rather, we were looking for candidates to discuss the various reasons for falling demand in the US market as a whole, the high competition, challenges to Revolymer's patent or the apparently high cost base of operating in the US market.

Two marks were reserved for a diagram in this question. A good proportion of candidates were able to show a correct shift in the curves, but far fewer were able to show the firm making a loss after these shifts. Many candidates illustrated a fall in demand as a pivotal shift of the AR/MR curves, rather than a parallel inward shift. Although a mark was awarded for this, it often meant that the equilibria drawn did not illustrate what the candidate wanted or expected them to show.

Candidates found it difficult to evaluate their responses to this question. We did not award evaluation marks for simply suggesting other reasons that might have been behind the exit from the market (for example, 'it might have been because costs had risen, rather than demand had fallen…'). Additionally, many candidates failed to appreciate that the marks for this question were equally split between KAA and evaluation. This meant that responses tended to be unequally balanced, giving far more weight to KAA than to evaluation, and hence not attaining full marks.

The main discriminator on this question was the evaluation, for which 6 marks were reserved.

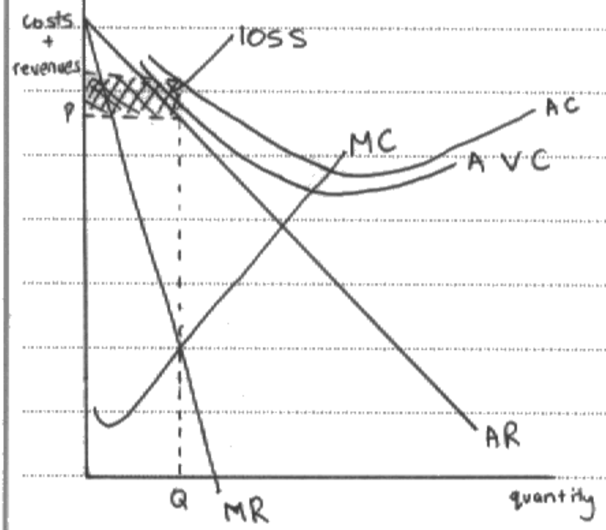
There was so much to write in terms of KAA from the passage and the required diagram that many answers did not provide enough evidence as critical judgement. It is advised to make two solid or three well explained evaluation points for a 12 mark question.

*(c) Using a cost and revenue diagram, discuss **two** reasons why Revolymer is to stop selling its Rev7 confectionery gum in the US.

(12)

6 6

The first reason for Revolymer to stop selling its Rev7 confectionary gum in the US is the fact that it has reached its shut down point. A shut down



point of a firm is when average revenue is not enough to cover even average variable costs of production. This means that revenue isn't covering anything and the cost of staying in business, which is £500 000 for Revolymer as seen from extract 2, is more than the cost of leaving the market all together, which is £360 000 in this case, as shown in the diagram.

Another reason that Revolymer could have to stop selling the Rev7 gum in the US is the fact that the "gum market as a whole is shrinking". This means that without doing anything Rev7 gum will contine to lose demand and as a result profit since it is apparent that demand for gum on the whole is shrinking, and soon enough they would have to leave the market in the US anyway, seeing as they are profit maximisers.

To evaluate this however, it is also possible that despite the US gum market on a whole shrinking, if Revolymer waited for enough firms to leave the ~~mar~~ industry because they are making losses, and cross-subsidieses the Rev7 gum from other profits then eventually only enough firms will be left in the market to meet demand and Rev7 will ultimately have more market share in the long run.

To evaluate further, this analysis takes into account certain factors, on the assumption of ceterus paribus that all other things remain the same. However, seeing that an economy is dynamic and ever changing it is very likely that any other economic objective could change (outside of the information given to us) ~~m~~ ~~making~~ causing these reasons for shutting down to change or even completely reverse and rendering them, effectively moot.

Finally, to evaluate further, whether or not the Rev7 gum is to stop being sold in the US because of a shrinking market also largely depends on the magnitude of how much and to what extent the market shrunk.

ResultsPlus
Examiner Comments

Diagram (correct loss area only, but no shift) - 1

AR does not cover AVC (1) with use of data (1)

Market is shrinking (1) leading to lower demand (1)

They may be able to cross subsidise lossed (1) and could lead to higher market share in the LR (1) - 2e

Other factors may be changing outside of the information given - 2e

The last point is a very weak point at evaluation, but the previous ev marks are also slightly generous

5/6 KAA + 4/6EV = Total 9/12

ResultsPlus
Examiner Tip

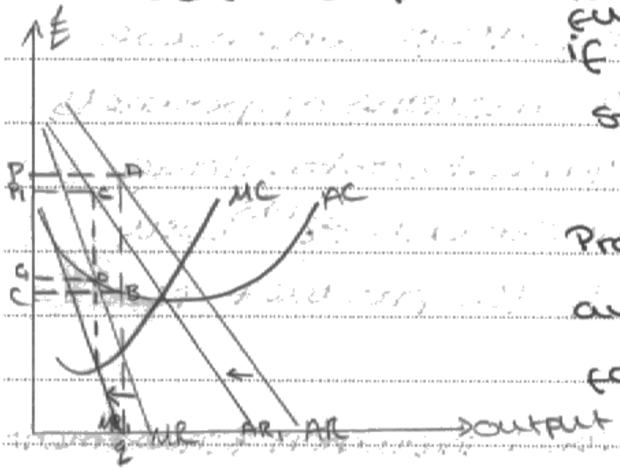
Diagrams need a shift and a new profit/loss area. There are normally two marks reserved for diagrams on these questions.

This is a very effective answer which scored full marks.

*(c) Using a cost and revenue diagram, discuss **two** reasons why Revolymer is to stop selling its Rev7 confectionery gum in the US.

(12)

Rev7 is a non-stick chewing gum that dissolves within 24 hours. One reason why Revolymer is to stop selling in the US in ~~2003~~ 2013, is because the US gum market as a whole is shrinking. Therefore there is less demand in the market. AR represents a combination of demand and price. Therefore AR will fall further if the firm choses to stay in the US longer.



Profits will fall from area PACB as price falls to P1 and cost increases from C to C1. Therefore it is less profitable for the firm to stay in the US.

However falling profits may not be the reason why Revolymer is stoping selling in the UK as this could be overcome by the firm reducing its costs, profit = TR − TC, this could be done by reconsidering how to combine factor inputs i.e. use more capital rather than labour as after the initial cost of the capital it will be cheaper as no salaries will have to be paid. The firm could also take part in schemes to boost demand such as a new marketing campaign for its product. Hence AR & MR will stop falling by as much or actually rise.

Also there is a challenge to Revolymer's patent for nicotine gum products by other gum manufacturers. The patent has acted as a barrier to entry to the gum market for Revolymer, during this time where it was able to make supernormal profits due to protection from the patent it may have developed X-inefficiencies, therefore if this patent were to be removed Revolymer may not be able to compete on a price basis. Therefore the firm may wish to move to another country less dominated by large gum manufacturers where competition is less than in the US.

However Revolymer could have overcome this by using non-price strategies to increase competition such as increased branding in its product / increasing the size of its product / loyalty schemes. Also the globe is dominated by large gum manufacturers as shown in figure one so Revolymer may not find another location where competition is less (however there may be different national figures as these are global figures).

ResultsPlus
Examiner Comments

The shift and new lower profit area is effectively shown for two marks, and there is plenty of evidence using the passage. There are three solid evaluation points.

ResultsPlus
Examiner Tip

A clear diagram showing the shift with arrows and labelling the areas with letters is a very effective tool.

Question 9 (d)

Candidates seem to be relatively familiar with this style of question, and as long as candidates had managed their time successfully, they tended to be able to produce decent answers.

There is, however, a good deal of confusion between predatory and limit pricing, and many candidates either confused them entirely, or lumped them together as one strategy. It would be beneficial for candidates to be clearer on the differences between the two.

Generally, discussions of pricing strategies allowed candidates to earn more marks than discussions of non-pricing strategies, as candidates were able to integrate more economic analysis into the former, while the latter tended to be very descriptive and un-technical. The most successful candidates either grounded their analysis of non-price strategies very securely in economic theory, or made sure to thoroughly apply the strategies to the chewing gum market. For example, when suggesting that firms could invest in R&D to develop new and/or improved products they wrote about inventing new chewing gum flavours, chewing gum with added vitamins etc.

Students who wrote about the kinked demand curve, and what it might imply about the likely effectiveness of pricing as opposed to non-pricing strategies in oligopolies tended to do so fairly well, and it does seem that this part of the specification is increasingly well understood by candidates.

However, references to game theory, and in particular drawing pay-off matrices was not so well done, and a good number of supposed representations of the prisoner's dilemma did not actually have this structure. Many candidates wanted to write about collusion as a possible strategy, but were unsure as to how this could be used as a response to new entrants into the market (usually collusion would aim to raise prices/joint profits in the SR, whereas candidates appreciated that here higher prices would make it easier for new entrants to join), so explanations often became rather confused on this point.

This is a weak answer, not giving clearly defined theory.

*(d) Discuss strategies that could be used by existing chewing gum manufacturers in response to the entry of a new competitor such as Revolymer.

(16)

In an oligopolistic market structure
the market is dominated by few large industries
The market has high Concentratio Ratio
and also high barriers to entry & exit which
make the entry of new firms very difficult
and impossible. Examples of entry barriers
are economies of scale, brand loyality
predatory and limit pricing and high capital
cost and sunk costs. In an oligopoly the
type of good produce could be homogeneus
and differentiated. The firms decide to

compete in non price factors rather than price factors in order to have price stability.

One strategy that could be used by existing chewing gum manufactures in response to the entry of a new competitor is to collude. Collusion is an agreement made by two or more firms to divide the market supply, restrict output and receive profit maximisation. ~~in the~~ This will reduce competition in the industry and the firms that collude could create strategy like dominant firm price leadership which could make the existence of the new firm very difficult. Another ~~price~~ strategy that the firms in an oligopoly could make is to produce pricing strategy like predatory and limiting pricing which reduces the prices below the average costs in order to make short run losses and make the new firm unable to compete and leave the industry. Excessive advertising also is another strategy and this will increase their market share.

In evaluation the Competition Commision will try to prevent the collusion and find evidences to stop the collusion and fine the firms heavily. Also it will also take time for firms to collude and make strategies and this will give extra time for the new firm to achieve economies of scale and be able to compete with them accordingly.

The new firm may ~~enteer~~ enter in the market by cross subsidisation so it will be able to respond in changes in prices and make losses without shuting down. ~~E~~ Also the size of change in price it will influence the firm.

ResultsPlus
Examiner Comments

Collusion & explanation - 2
Predatory/limit - 1 (as techniques not distinguished)
Advertising - 1 (not sufficient explanation)
Competition Commission may investigate - 2e
New firms could still enter if cross subsidising - 1e
Total - 4 + 3e = 7

ResultsPlus
Examiner Tip

Give four strategies, at least one price and one non-price. Make sure that they relate to contestability not competitiveness or revenue, for this question.

This answer is far better.

*(d) Discuss strategies that could be used by existing chewing gum manufacturers in response to the entry of a new competitor such as Revolymer.

(16)

One strategy that may be used by other gum manufacturers is ~~price~~ predatory pricing. This is when manufacturers cut prices below average costs of production in order to have lower prices. This means that as the market is an oligopoly, people or consumers are likely to switch to the cheaper product in the market. Therefore gum competitors such as Revolymer will not be able to compete as they cannot produce at quantities like this.

However this may not be the case as Rev7 have entered a market where they are the only ones with the disposable gum. This means that Rev7 are in fact in a niche market. This means that even if other firms lower their prices the competitor may not be pushed out as they have the power in their smaller niche market. As a result predatory pricing may push other firms out as Rev7 is a gum unlike these this means it will not be pushed out of the market.

Another strategy ~~is~~ that may take place is overt collusion. ~~To~~ This is open or spoken collusion. If gum manufacturers choose to use this and set lower prices this will increase profits for the company. as shown by Figure 1 in the diagram if both

Figure 1

		Hershey H	Hershey L
Wrigley	H	Wrigley £1m / Hershey £1m	Wrigley £0.8m / Hershey £1.5m
	L	Wrigley £1.5m / Hershey £0.8m	Wrigley 0.9m / Hershey 0.9m

companies set a lower price they may earn profits of £0.9m that Rev7 cannot compete with, as consumers go for the lower price. this means companies like Revlyner will be pushed out of the market.

However this is illegal. This means if the competition authority hear about it they may fine the companies causing them to loose profits. therefore there is an incentive to break the collusion and gain higher profits and so Revlyner may not be effected as much as they thought. This is because they will not loose profits if the collusion is broken but the other companies will.

Another strategy that may be used is a price war. This is where ~~the dominan~~ one firm sets a lower price which leads to another firm retaliating. this may cause Revlyner to leave the market as they are not able to compete with the lower prices. Therefore Rev 7 will not make profits and will have to leave the market.

However companies can only reduce their prices so much before ~~leaving~~ making no profit. Therefore firms may choose not to take part in this retaliation as they will not make profits. As a result firms such as Revlymer will not leave the market as they will not be pushed out if they firms are already charging the lost price possible.
One final thing that the competitors could do to push them out is non-price competition. This is like advertising etc where brands are able to gain consumers by using this. This means firms will be pushed out as they are not able to compete with the high sunk costs that non-price competition comes with.
Another strategy is price limiting. This is when companies make normal profit ~~at [illegible]~~ so that they .

ResultsPlus
Examiner Comments

Predatory pricing & exp - 2

Niche market - 3e (focusing specifically on the text and points out that the strategy may not be appropriate where the entrant operates in a different segment - hence not in direct competition)

Collusion & pay off matrix -2 (though a confused explanation with a matrix showing them worse off at low/low price)

Illegal & may break down - 2e

Price war & explanation - 2 (though very similar to the first point)

Some may not participate - 1e

Advertising & explanation - 2

Total 8 + 6e = 14

ResultsPlus
Examiner Tip

Use four distinct paragraphs and evaluate as you go along, in depth and in different ways each time.

Question 10 (a)

A diagram is effective in the question, to illustrate the difference between AVC and AC, and their importance for shut down.

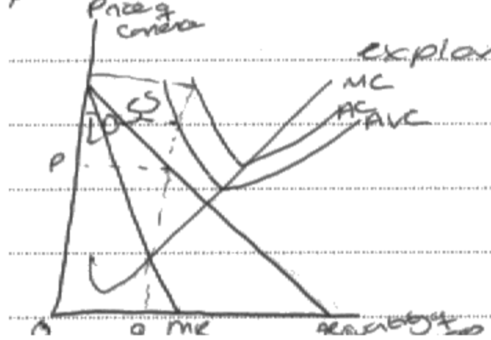
The use of data here is actually relating to variable costs (camera parts) and a figure is given.

Most answers did not achieve any application marks, and the mean was 1.86/4.

(a) Using examples from the data, explain what is meant by a 'shut-down point' (Extract 1 line 4).

(4)

Shut down point is when the average variable cost exceeds the average revenue, and the firm is no longer loss minimising but making a high loss. Jessops reached shut down point in January 2013, as the variable costs of camera parts where not ~~[illegible]~~ covered by the price, which explains why Jessops shut down, as it made a loss of £12million in the 15 months up to closure.



ResultsPlus
Examiner Comments

AVC exceeds AR - 1

Diagram 2 - AVC above price + loss area

Could not cover variable costs of cameras - 1

Loss of 12million - 1

This earns the max 4, and is one of few that did so.

ResultsPlus
Examiner Tip

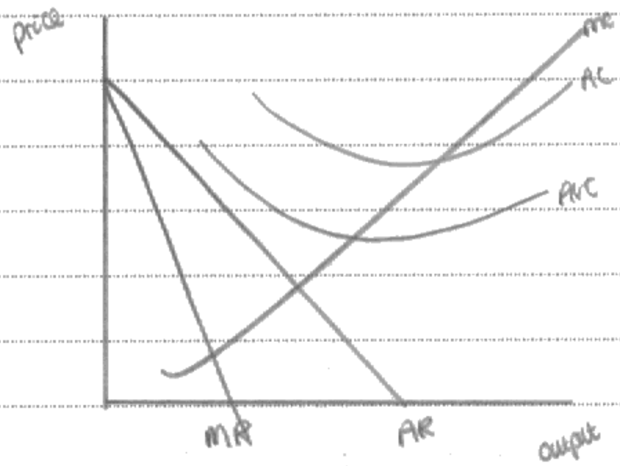
Choose the data carefully when so much is provided.

The data required for the question was not **why** there is a loss, but what the loss is. The why element is in question 10(b) and the candidates often found themselves repeating factors.

(a) Using examples from the data, explain what is meant by a 'shut-down point' (Extract 1 line 4).

(4)

Shut down point occurs when a firm is no longer able to cover variable costs in the short run, and is thus forced to shut down. The diagram illustrates that Average variable costs exceed Average Revenue. Extract 1 states that Jessops reached shut down point in January 2013, when Revenue fell as a result of switching consumer choice.



ResultsPlus
Examiner Comments

No longer able to cover the VC = 1

Diagram 0 (as no actual price/output is identified)

Make sure you annotate MC=MR and find the loss area.

ResultsPlus
Examiner Tip

2 marks for theory and 2 marks for application, on all 9(a) and 10(a) questions.

Read the next question to ensure the 10(b) part is not given in part 10(a).

Question 10 (b)

Candidates seemed to understand the mark allocation of this question, and what was expected of them clearly. The vast majority were able to give one or two likely reasons, and at least attempt to draw a diagram to illustrate the effect of these.

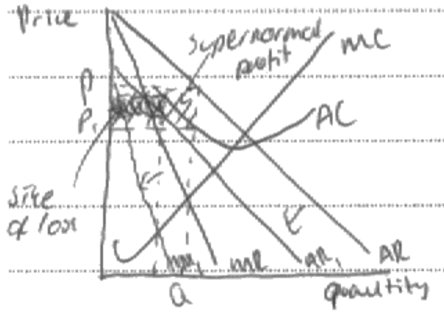
Shifts in curves were better done than the resulting loss area, although as for question 9(c), candidates tended to draw just the AR shift (not MR) and failed to find the new MC=MR as a result.

Many also shaded the loss area using a horizontal line from the MC=MR node - always to be avoided. Candidates seemed to understand the need to evaluate their responses, although were sometimes unable to interpret the information given in the extract clearly enough to support them in this.

This is an example of good KAA, and a reasonable attempt at evaluation.

(b) Using the data in Extract 1 and an appropriate diagram, discuss why Jessops was making a loss before it went into administration.

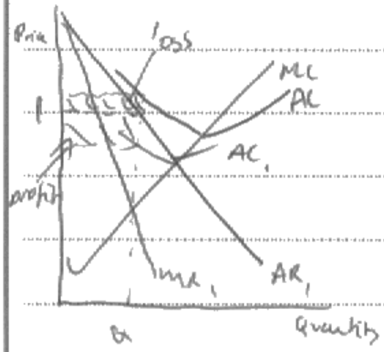
(8)



A reason why Jessops was making a loss before it went in to administration may have been due to a decrease in demand due to a greater reliance on cameras built into phones and the increase in sales of cameras on the internet reducing demand ~~from~~ AR to AR_1 and MR to MR_1, reducing price to P_1 from P below the average cost converting ~~the~~ supernormal profit to a loss which is said to have been £12 million in the fifteen months up until closure.

However, this would have depended on the magnitude in the decrease of demand, revenues were at £304.6 million and so would indicate consumers were still purchasing a lot from Jessops and so the loss may have been due to other factors ~~such~~ such as increased costs.

Also, this could have been offset by ~~an increase in~~ a decrease in costs in other areas of the company, for example increased redundancies.



ResultsPlus
Examiner Comments

Diagram 2 marks - on the first page it is 'size of loss' (incorrect) but on the second there is a correct loss area given. The data is used effectively so maximum 4 KAA awarded.

Costs are used to show that the magnitude is not as first considered, and this was a typical effective approach for 2 marks. Just stating that costs had risen was KAA, but here it is clearly used as a magnitude point, and therefore counts as evaluation.

4+2e=6

ResultsPlus
Examiner Tip

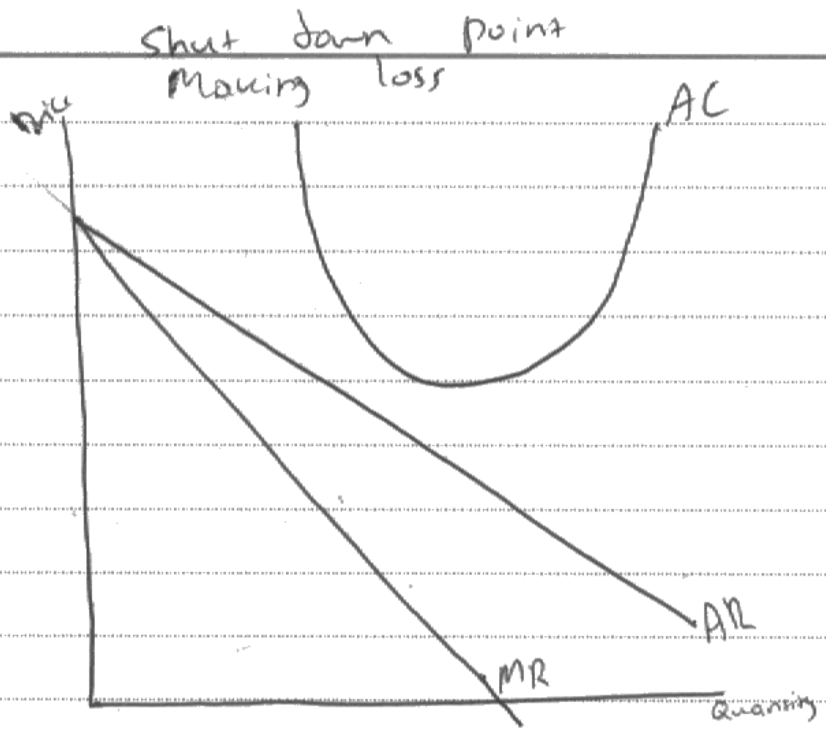
Spend time considering evaluation points. You can find lists of evaluative approaches in any good exam guide.

This is a good example of diagrams that do not work - there is no MC=MR, and no loss area.

(b) Using the data in Extract 1 and an appropriate diagram, discuss why Jessops was making a loss before it went into administration.

(8)

~~[illegible]~~ Jessops was making a loss before it went to administration as people were buying cameras from the internet and the increased number of cameras into mobile phones. Those two are the reasons why Jessop was making loss and was very closed and near the shut down point.



This is the diagram for making a loss as the firm cannot earn the average cost.

ResultsPlus
Examiner Tip

Learning shifts in AR/MR and AC/MC earns marks many times over on this paper.

Always find MC=MR for the quantity - but NOT for anything on the vertical axis.

ResultsPlus
Examiner Comments

There are just 2 marks given here, for use of the data.

Question 10 (c)

This proved to be a very challenging question, which candidates struggled to achieve high marks on. The key to achieving good marks for KAA seemed to be defining price discrimination and including a diagram to illustrate third degree price discrimination, as up to 3 marks were awarded for these. We were then looking for candidates to explain whether or not the conditions required for successful third degree price discrimination could be met for a firm that was selling both online and on the high street. The better candidates were able to explain why customers in the two different places might have different PEDs, but even the best struggled to give much relevant analysis beyond this.

Less able candidates tended to misinterpret the question entirely, and explain possible reasons for different prices being charged online and in shop (e.g. different costs of production). Alternatively, candidates explained whether or not online OR high street retailers could successfully price discriminate (e.g. offering student/OAP discounts in store etc.), but did not really engage with the central idea of the question, that was to what extent selling both ways affected the firm's ability to do so.

As the question referred to price discrimination broadly, some more able candidates were able to get good mileage out of a discussion of which forms of price discrimination might be more or less possible (first, second or third degree). However, simply describing these forms were of no value to the answer.

Evaluation tended to be even less well done than analysis. Only the best candidates were able to expand on the point that likely cost differences between selling in store and online meant that this didn't really qualify as price discrimination, or were able to discuss how it might not be possible to prevent market arbitrage, and/or the effect of the internet on reducing asymmetric information generally.

This is fairly typical for 10(c), as a long answer with almost no relevant content.

*(c) To what extent is price discrimination possible for firms selling products both on the internet and in high street shops?

(12)

Price discrimination is when a seller sells the same product at a different price to different ~~xxxx~~ customers. Price discrimination could help many firms to make abnormal profits as they have 3 degrees to deal with customers. The first degree is to sell ~~at~~ the highest price that a customer is able to pay. Furthermore the second degree is to charge as many as purchased. One example is the electric bill. It is counted as much electricity as you used. The third degree is to divide customers in differing groups and charges them differently. An example for this could be the airline ticket. Firms can sell products on internet by using price discrimination as they are doing now by booking an airplane ticket. Also the first degree could help the firm to sell on high street jobs as customers could pay the best available value of money they are able to buy a specific product.

ResultsPlus
Examiner Comments

1 mark for the concept of price discrimination

1 mark given for application, but there is really no economic theory and very little context from the passage.

ResultsPlus
Examiner Tip

This answer could have been drawn out from basis knowledge of the three conditions of price discrimination, and clear reading of the helpful passage.

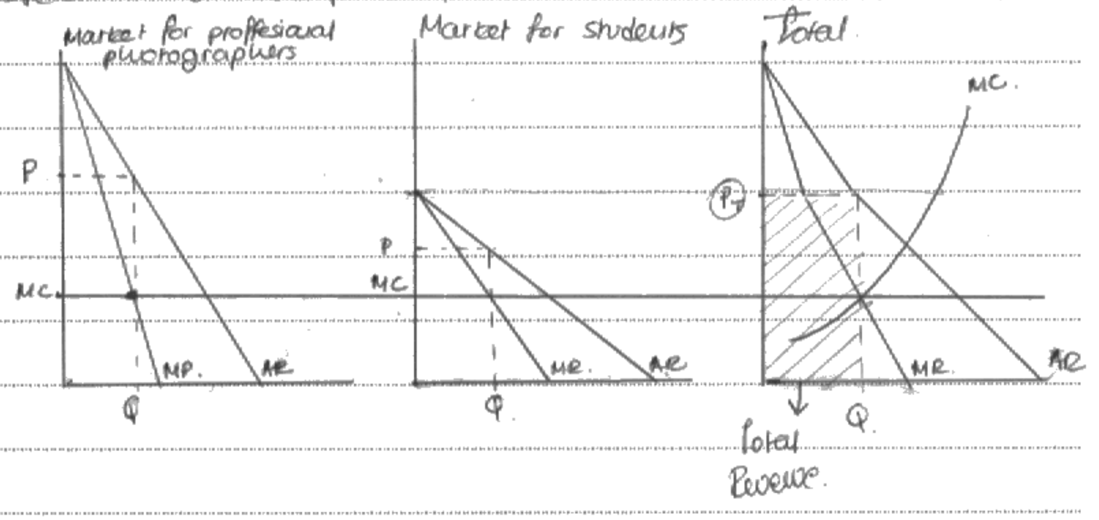
This is one of the few good answers.

*(c) To what extent is price discrimination possible for firms selling products both on the internet and in high street shops?

(12)

Price discrimination is when firms ~~pro~~ charge different customers different prices for the same product for reasons other than cost reasons.

There are some certain conditions for price discrimination to take place one, is that there must be different price elasticities of demand (PED) at different markets. In the case of the camera industry, sellers such as Jessops can offer a reduction in price for a group of consumers, for example student. Students in many stores enjoy a discount, for example 10% off. This is likely to attract more students who are likely to have a ~~big~~ high PED. Professional photographers on the other hand have a low PED since they need cameras for their job so they will buy it irrespective of the price.



One other condition for price discrimination is that there must be no seepage between markets. In this case, students need to show their student card in shop or online in order to get the discount. Thus someone who is not a student and ~~cannot~~ does not have a student card cannot benefit from the discount. So there is no seepage.

However, some extend of seepage may exist in this case. Students may use their student cards to buy cameras for other people (friends, relatives) when in reality they are not allowed the discount. This is much easier online when the age of the buyer is not ~~seen~~ revealed. So ~~other people~~ anyone can use the student card in the expense of the retailer who loses revenue.

Also, price discrimination may affect negatively the demand from proffessional photographers. They are charged a higher price in order to 'subsidise' the discount given to the other market. Thus, they may be able to find other suppliers who charge the same price for everyone and this enjoy a lower price. In this case, price discrimination is not successful.

ResultsPlus
Examiner Comments

The definition and diagram alone earn 1+2 KAA marks

The passage is well used, and the conditions for price discrimination are applied.

The only real weakness is brevity of evaluation (4/6 marks).

ResultsPlus
Examiner Tip

Evaluate your own evaluation if unsure of what to say.

Question 10 (d)

The main issue here was that candidates did not take note of the fact that this question was asking about strategies which would increase **profit**. Therefore candidates did need to explicitly explain how a strategy would have this effect to earn good marks. The most common area where this was a factor was pricing strategies that involved price cuts. We were looking here for candidates to say that either price elastic demand would mean an increase in revenue following a price cut, leading to increased profits (although as one of many evaluation approaches either the game theory matrix or the kinked demand curve model might suggest that this is unlikely in an oligopoly), or that once a competitor had been knocked out of the market, the incumbent firm would be able to raise prices back up, increasing profits in the LR.

Comments on the relative strength of explanations of price/non-price strategies, and the use of the kinked demand curve model, and game theory as for 9(d) above.

There was a repeated mistake in that many descriptions of the powers of the competition authorities said that the CMA or its predecessors could fine firms up to 10% of profits rather than revenue, and many thought investigation is automatic for firms merging if they reached 25% or more market share. Clearly there are many cases where investigation does not even begin.

A further point to note for teaching in the future is that while the newly formed CMA (Competition and Markets Authority) had replaced the CC and the OFT at the time of the exam, this information was not required for the exam. It did, however, make for interesting reading for those who did mention the recent development, and the sense of the new powers the CMA could wield. In future years both the old and new institutions will be recognised by the examiners, but it would undoubtable benefit students if they have knowledge of recent changes.

This is an effective answer, using the pay off matrix to demonstrate problems of advertising, when trying to reduce contestability.

*(d) Discuss strategies, apart from price discrimination, that high street retailers might use to increase profit in the face of greater competition from online retailers.

(16)

One way high street retailers might increase profits ~~by~~ is by using pricing strategies, such as predatory pricing. Predatory pricing is when a firm sets a price low enough, usually below their AVC, to drive out firms in the market. By setting a low enough price, it may drive out online retailers as they cannot compete with these low prices. Therefore in the long run, ~~profit~~ once firms have left, the high street retailer will be able to increase their profits.

However in the short run, the firm will be making a loss. In Jessops case this caused them to shut down as they were unable to survive. Also online retailers do not have high start up costs and so their cost base will be very small, enabling them to also lower their prices in retaliation. This may cause a price war.

Another way high street retailers may increase profits is by using non-pricing strategies, such as advertising or promotions. Advertising will increase a brands awareness, and act as a barrier to entry to online firms who are trying to enter.

High street retailers.

Online retailers	High Advertising	Low Advertising
High Advertising.	Both high market share	High street - low share online - high share.
Low Advertising.	High street - high share online - low share	Both lower market share

If both retailers were to advertise they would both increase their market share. But if the high street retailer was to advertise first with high amounts of advertising, they would benefit from first mover advantage, leaving them with high profits.

However if the online retailers were to then advertise, this would bring market share back to normal and the firms would just see an increase in costs. Also, advertising is a sunk cost, leading to lower profits if ineffective.

Another way retailers may increase profits is to collude with one another. ~~If the~~ If two firms collude using tacit collusion, which is an unwritten and unspoken agreement, then firms can ~~s~~ set the same prices and output. Together the firms can increase their market share and increase their total profits. Collusion also acts as a barrier to entry, discouraging online firms to enter.

However this is illegal and if caught out by competition regulators they may be fined. This would increase a firms costs and cause profits to fall.

Another strategy retailers may use is to merge, for example Sports Direct and Rebublic. By merging the firms can benefit from economies of scale, which will lower their costs in the long run. This could mean they charge lower prices to consumers and so this deters new online entrants from the market as they will be unable to match these low prices. Also by merging the firms can increase their profits.

However if the firm grows too large, it may suffer from diseconomies of scale whereby it becomes inefficient and starts wasting money, may be through disorganisation. Therefore the firm will start to lose profit.

ResultsPlus
Examiner Comments

This earns 8KAA + 7eval - it clearly is a strong answer, but the evaluation on the second page after the pay off matrix is very brief ('advertising is a sunk cost') and needs more development.

ResultsPlus
Examiner Tip

Pay off matrices can be very effective, for pricing or non-pricing policies. Note that numerical values do not have to be given, although they can be more efficient for the candidate.

This demonstrates a typical weak response. There are no paragraphs, and hence the points come across as undeveloped points. The answer strays into issues of unemployment, which are not relevant to the question. The student has also run out of time.

*(d) Discuss strategies, apart from price discrimination, that high street retailers might use to increase profit in the face of greater competition from online retailers.

(16)

Advertising campaigns could be effective in increasing demand significantly so as to raise profits. Other non-pricing strategies can be equally successful such as training the staff to be more helpful and enthusiastic as seen in the data and this can help increase sales and demand which can increase profits. Also lowering costs by laying off staff might be able to help raise profit margins but this would lead to an increase in unemployment. Prices may fall if staff is laid off so this could benefit consumers and increase demand but whether society will be better off when unemployment will increase is arguable. Advertising campaigns may require a lot of funds while it is difficult to compete with online ~~adv~~ retailers in this method since advertising online takes place at a large scale and ~~a~~ captures a wider range of consumers so high street retailers could focus on advertising their produces online.

ResultsPlus
Examiner Comments

Three points made 1 + 2 + 1 and two attempts at evaluation 1e + 1e

Total 6 marks

ResultsPlus
Examiner Tip

On a 16 mark question, the QWC marks are awarded in the sense that a clearly set out answer with paragraphs and structure can earn marks efficiently. This is a good example of the opposite.

Paper Summary

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

- write legibly, and use continuous prose
- aim to develop arguments rather than making lists
- predatory pricing and limit pricing are not necessarily going to raise profits for a firm - in fact, quite the reverse in the short term. Also consider the fact that limit pricing is sometimes advised by the government, and is not therefore automatically illegal
- the CMA has replaced the CC and the OFT. While not needed in this session it would be wise to know this in the future
- firms sell to other firms. This is not retail but wholesale.
- use a calculator
- use a diagram if provided
- draw a diagram if possible
- a minute a mark is a good rule of thumb for timing.

Grade Boundaries

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

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

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