

**ADVANCED SUBSIDIARY GCE
ECONOMICS**

The Market System

WEDNESDAY 4 JUNE 2008

2881

Afternoon
Time: 1 hour

Additional materials (enclosed): Designated Answer Booklet 2881/AB

Additional materials (required):
None



INSTRUCTIONS TO CANDIDATES

- Write your name in capital letters, your Centre Number and Candidate Number in the spaces provided on the Answer Booklet.
- Read each question carefully and make sure you know what you have to do before starting your answer.
- Answer **all** the questions.
- Write your answers in the separate Answer Booklet provided.
- The spaces should be sufficient for your answers but if you require more space use the lined page at the end of the Answer Booklet and number your answers carefully.

INFORMATION FOR CANDIDATES

- The number of marks for each question is given in brackets [] at the end of each question or part question.
- The total number of marks for this paper is **45**.
- The quality of your written communication will be taken into account in marking your answer to the question labelled with an asterisk (*).

This document consists of **4** printed pages.

Answer **all** parts of this question in the accompanying answer booklet.

Crunch Time for Apple

Following its successful launch in Summer 2005, when sales far exceeded forecast, senior executives of Sony took the decision to increase output of its new Hard Disc Walkman at the manufacturing plant in China. This plant also makes Mini-disc players for the Japanese-owned multinational company.

On the surface, this was bad news for the US-owned Apple Corporation which, until the launch of Sony's new Hard Disc Walkman, had a large market share for music download devices with its iPod range of products. Apple's immediate reaction was to do nothing, in part because the market was growing and also because it had just launched its own new product, the Nano iPod. 5

The launch of Sony's Hard Disc Walkman created tensions amongst high street retailers. Independent market research estimated that the cross elasticity of demand for Sony Hard Disc Walkmans with respect to a change in the price of iPods was +0.2 for the established iPod Mini, and +1.8 with respect to a change in the price of the newer Nano iPod. This research confirmed a growing market size and a desire on the part of affluent young consumers to buy new products because of their 'fashion value'. 10 15

Given its strong sales, Sony has tended to give priority of supplies to its own franchised retailers (Sony Centres) and major high street retailers. This has not been popular with other retailers who have seen this as unfair and a way of keeping prices and profits at a high level for both the manufacturer and selected retailers. 20

- (a) Sony's manufacturing plant in China can produce Hard Disc Walkmans and Mini-disc players. Assume that the productive capacity is currently divided equally between both products and that senior executives want to see this changed to 80% Hard Disc Walkmans and 20% Mini-disc players.
- (i) Define the term 'opportunity cost'. [2]
- (ii) Using production possibility diagrams:
- Show the opportunity cost involved in this proposed change in production; [4]
 - Show how the production possibility curve might change if Sony were to increase the productive capacity for Hard Disc Walkmans leaving Mini-disc productive capacity unchanged. [2]
- (b) Using supply and demand diagrams explain how the market for Sony Hard Disc Walkmans might have changed following:
- (i) Increased output from its Chinese factory (line 2–3); [4]
- (ii) The launch of Apple's new Nano iPod (line 9). [4]
- (c) (i) State what is meant by the term 'cross elasticity of demand'. [2]
- (ii) After studying the market research data (lines 11 to 14), a UK retailer that is not a Sony stockist was convinced that it needed to reduce its prices of both types of iPod in order to compete. Comment on whether or not you agree with this policy. [6]
- (d) (i) Explain what is meant by the term 'barrier to entry'. [2]
- (ii) State and explain **two** barriers to entry that might apply to a firm seeking to enter the music download device market as a **retailer**. [4]
- (e) (i) State **three** characteristics of an oligopolistic market. [3]
- *(ii) With the help of the information provided, discuss the extent to which the **manufacture** of music download devices is an oligopolistic market. [12]

[Total marks: 45]

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