Write your name here

Surname	Other names

Pearson Edexcel GCE

Centre Number

Candidate Number

Economics

Advanced

Unit 3: Business Economics and Economic Efficiency

Tuesday 3 June 2014 – Morning
Time: 1 hour 30 minutes

Paper Reference
6EC03/01R

You do not need any other materials.

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **all** the questions in Section A and **one** question from Section B.
- Answer the questions in the spaces provided
  – *there may be more space than you need.*

Information

- The total mark for this paper is 72.
- The marks for **each** question are shown in brackets
  – *use this as a guide as to how much time to spend on each question.*
- Questions labelled with an **asterisk** (*****) are ones where the quality of your written communication will be assessed
  – *you should take particular care on these questions with your spelling, punctuation and grammar, as well as the clarity of expression.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Check your answers if you have time at the end.

Turn over ▶

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P 4 3 5 3 9 A 0 1 3 6

PEARSON

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 include diagrams in your answers.

1 Arnold Clark Automobiles is a car retail firm that sells many Ford cars in its showrooms. If the Ford Motor Company, a motor car manufacturer, buys a majority shareholding in Arnold Clark Automobiles, Ford could gain advantages of

(1)

A horizontal integration

B backward vertical integration

C forward vertical integration

D conglomerate integration

E external economies of scale

Answer ☐

Explanation

(3)

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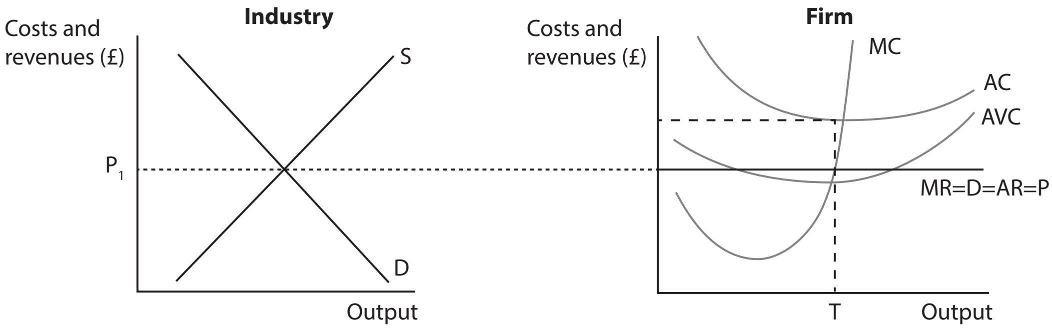
(Total for Question 1 = 4 marks)

2 The diagrams represent the revenue and cost conditions for an industry and one individual profit maximising firm within the industry. You may annotate the diagrams in your answer.



Output T indicates that the firm is making

(1)

A normal profit and price and output will remain unchanged

B supernormal profit and price will fall as new firms enter the industry

C a loss and will shut down in the short run

D a loss and will continue producing in the short run

E supernormal profit and price will rise in the long run

Answer ☐

Explanation

(3)

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(Total for Question 2 = 4 marks)

3 The table gives information about the short run output, costs and revenue of a profit maximising firm making playground equipment. Two columns have been left blank for your own workings.

Output per week	**Total revenue (£'000s)**		**Total cost (£'000s)**	
0	0		10	
1	20		14	
2	38		19	
3	54		28	
4	68		42	
5	80		63	
6	90		93	

Which **one** of the following would be consistent with this information?

(1)

A At output level 1 average fixed cost is lower than at output level 4

B At output level 2 a profit of £9 000 is made

C At output level 4 marginal cost equals marginal revenue

D At output level 5 marginal revenue is greater than marginal cost

E At output level 6 average total cost is lower than output level 4

Answer ☐

Explanation

(3)

(Total for Question 3 = 4 marks)

4 A firm producing car tyres sells the largest amount possible consistent with earning normal profits. The short run objective of the firm is most likely to be

(1)

A revenue maximisation

B profit satisficing

C sales maximisation

D predatory pricing

E maximisation of shareholder dividends

Answer ☐

Explanation

(3)

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(Total for Question 4 = 4 marks)

5 Two petrol stations located on the same main road are struggling to stay in business in the face of aggressive competition from local supermarkets. They tacitly agree not to compete on price but offer loyalty schemes. Which **one** of the following conditions would make their survival more likely?

(1)

A Increasing willingness of consumers to use loyalty schemes rather than respond to price alone

B Tighter government regulation to prevent collusion

C Increasing monopsony power over petrol suppliers by local supermarkets

D Demand for petrol becoming more price elastic

E Reductions in barriers to entry into the petrol retailing market

Answer ☐

Explanation

(3)

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(Total for Question 5 = 4 marks)

6 Shoe repair firms are operating under conditions of monopolistic competition. Which **one** of the following is most likely to exist in the long run?

(1)

A Allocative efficiency in the market

B Collusion between firms

C Productive efficiency in all firms

D High levels of regulation

E Normal profits

Answer

Explanation

(3)

(Total for Question 6 = 4 marks)

7 Market shares of US office stationery suppliers, 2012

Staples	39.9 %
Office Depot	19.2 %
OfficeMax	15.7%
Others	21.9%

(Source: Echo Research data)

In February 2013, Office Depot agreed to a merger with OfficeMax to create a US stationery retailer with combined sales of $18 billion, subject to approval by the Federal Trade Commission, the US competition authority. The most likely reason why such a merger might be blocked is to

(1)

A enable a firm to gain technical economies of scale

B increase barriers to entry

C increase the concentration ratio

D encourage investment in the industry

E prevent exploitation of consumers

Answer ☐

Explanation

(3)

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(Total for Question 7 = 4 marks)

8 The following matrix shows the possible profit outcomes (£ millions) of two firms selling breakfast cereals.

		Harker Ltd	
		High price	**Low price**
Bensel Ltd	**High price**	£100 / £100	£160 / £20
	Low price	£20 / £160	£60 / £60

Initially, Harker Ltd. and Bensel Ltd. colluded to set a high price. However, Bensel has just decided to break this agreement and under-cut the price. Which **one** of the following is the most likely consequence of this? Harker will

(1)

A experience an increase in profits

B reduce its price and both firms will make lower profits

C charge low prices and Bensel will charge high prices

D experience an increase in producer surplus

E experience diminishing marginal returns

Answer ☐

Explanation

(3)

(Total for Question 8 = 4 marks)

TOTAL FOR SECTION A = 32 MARKS

Section B: Answer either Question 9 or Question 10.

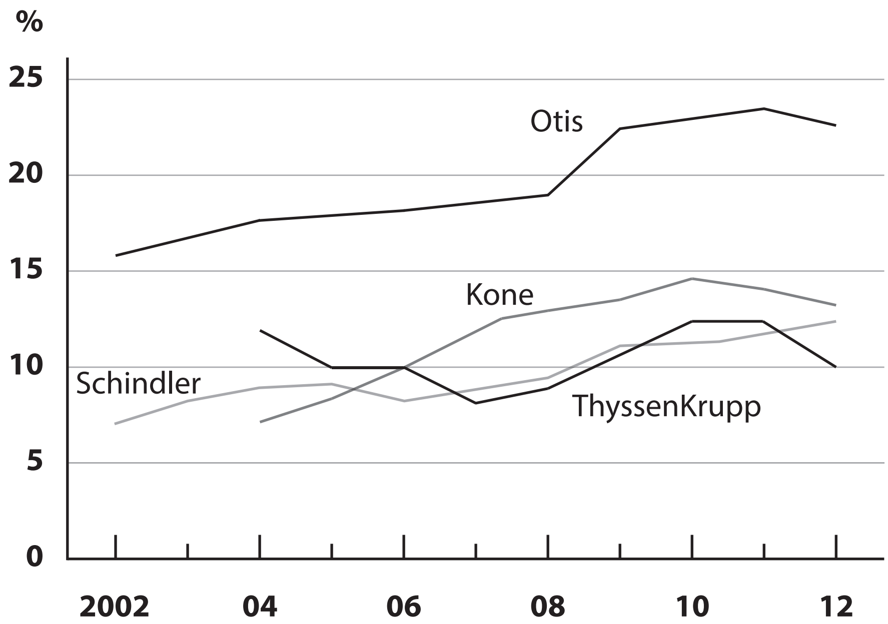
If you answer Question 9 put a cross in this box ☒ .

Question 10 starts on page 24.

You should spend 55 minutes on this section.

9 The elevator (lift) market

Figure 1 Profit margins for elevator supply companies



(Source: Company reports)

Figure 2 Percentage shares of global elevator supply market

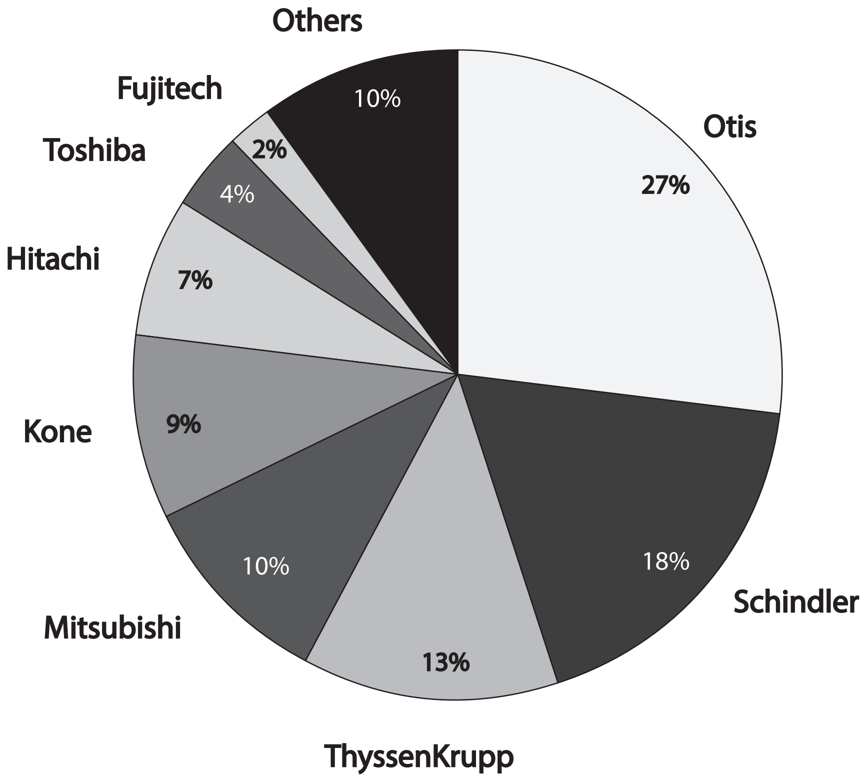
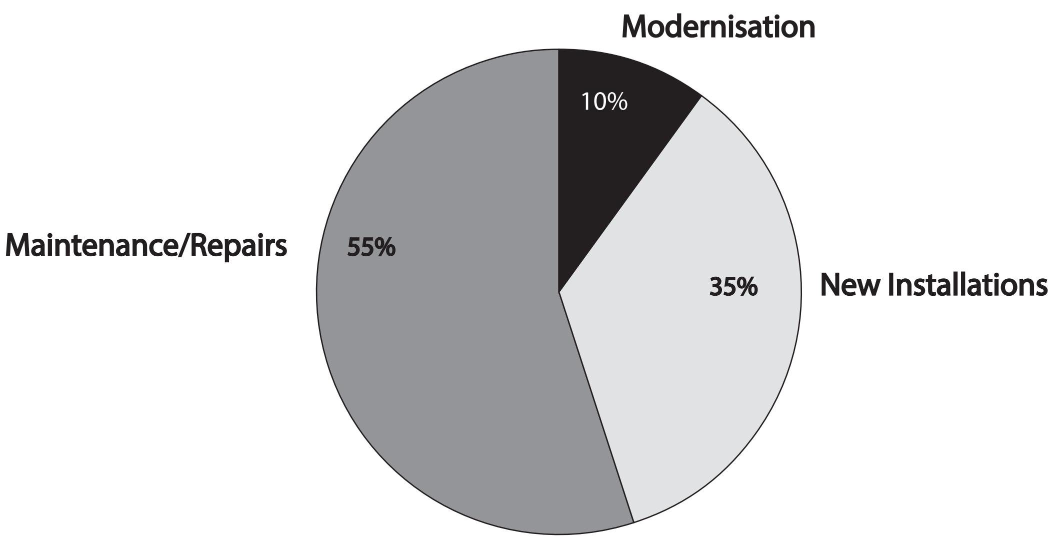


Figure 3 Product structure of $28 billion global elevator supply market, percentages



(Source of Figures 2 and 3: ThyssenKrupp company reports)

Extract 1 ThyssenKrupp moves away from steel

ThyssenKrupp, a German manufacturer, needs to get out of steel production, at least partially, and it needs to do so fast. Last year, this business division generated €1.8 billion ($2.3 billion) in losses, which accounts for a large portion of the roughly €6 billion in debts the company has piled up.

Chief Executive Heinrich Hiesinger wants to transform ThyssenKrupp into a technology company, with the majority of its activity in other products, such as elevators. His predecessor built two new steel mills, one in Brazil and one in the US, in an attempt to put ThyssenKrupp into the same league as the world's largest steel producers. It has turned out to be the worst investment in the company's recent history, and the steel mills are now being sold at a loss.

ThyssenKrupp doesn't have sufficient funds to buy up new companies and expand its business into areas other than steel. Although a multinational company worth billions, it has been run as if it were a mid-sized family company. Important decisions used to be made by just three men conferring among themselves. As long as the shareholders received dividends, all seemed well. But small problems that were not dealt with have developed into a crisis that now threatens the company's very existence.

After taking up his post, Hiesinger realised that the company lacked some of the basic things it would need to operate efficiently as a technology company. There was no standardised accounting system or integrated control. Further, the company's main area of business, steel production, was run in such a way that the blast furnaces were kept operating day and night, regardless of whether they were making or losing money by doing so.

The low profit margin on elevator installations acts as a natural barrier to entry to other firms, and the area for revenue growth is in elevator maintenance. ThyssenKrupp's elevator installation division of the business earns 10% profit margins, although annual management contracts for elevators at €1500 to €4000 per elevator are far more profitable, at 30%. Elevators are becoming more standardised globally, making it easier to find economies of scale. The established network of repair technicians within central Europe makes the prospects attractive in the elevator sector, a market which other firms cannot enter because service contracts are agreed at the point of elevator installation.

(Source: © SPIEGEL International 2012.)

Extract 2 The European Competition Commission claim that an elevator operating cartel has increased prices

In 2007, after several years of difficult investigation, the European Commission imposed heavy fines on members of a cartel in the elevator and escalators market. The Commission fined Kone, Otis, Schindler and ThyssenKrupp a total of €992 million for operating cartels for the installation and maintenance of elevators and escalators in Belgium, Germany, Luxembourg and the Netherlands. The cartel members and their subsidiaries were found to have rigged bids for procurement contracts and other contracts for the sale, installation, maintenance and upgrading of elevators and escalators with the aim of freezing market shares and fixing prices. They were also found to have shared commercially sensitive and confidential information on bidding patterns and prices, although this was difficult to prove. In November 2012 the European Commission was allowed to claim compensation for losses to EU institutions resulting from this cartel.

(Source: www.mondaq.com)

(a) Using the data in Figure 2, explain the market structure in the global market for elevators.

(4)

(b) Assess the significance of barriers to entry into the global elevator market.

(8)

*(c) Using the data in Extract 1 and an appropriate diagram, examine the reasons why ThyssenKrupp 'needs to get out of steel production'. (Extract 1, line 1)

(12)

*(d) Evaluate the issues the competition authorities might face when attempting to regulate the elevator industry.

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(16)

(Total for Question 9 = 40 marks)

If you answer Question 10 put a cross in this box ☐ .

10 Supermarkets

Extract 1 Tesco to open Harris + Hoole coffee shop in flagship store

Tesco is opening its first Harris + Hoole coffee shop inside one of its most important London stores. The supermarket giant has secured planning permission to install a branch of the coffee shop chain inside its 'lifestyle store' near London Bridge station. Harris + Hoole (H+H) promotes itself as an independent family business but is, in fact, 49% owned by Tesco.

H+H is also preparing to open another of its coffee shops next door to Tesco Express in Imperial Wharf, west London, in a property owned by Tesco. A Tesco spokesman said "We think our customers will love Harris + Hoole's freshly roasted coffee and great quality cakes and pastries and look forward to its opening later this year."

H+H, named after coffee-loving characters in the Diary of Samuel Pepys, does not mention Tesco's ownership stake in stores or on its menus, and promotes itself as a small, family run business.

(Source for text/image: adapted from Rupert Neate *The Guardian*, 5 February 2013
source: adapted from www.guardian.co.uk, 5 February)

Extract 2 Philip Clarke, Chief Executive at Tesco, writing on Tesco website

You might have seen some recent press coverage about our investment in the start-up coffee shop business, Harris + Hoole. We've always been upfront about our investment in H+H. We like backing great brands, helping them to grow and to realise their potential. We've done it with suppliers for years. Great ideas can find it hard to get backing these days, so we're pleased to be in a position to help entrepreneurs achieve their vision.

Some people have asked why it's not branded Tesco. The H+H brand is part of its value – its distinctiveness and appeal. So what's in it for Tesco? I've talked a lot about loving the stores we have, making them an appealing destination for customers to come to.

(Source: adapted from www.tescoplc.com)

Extract 3 Supermarket firms look to co-trading to reinvigorate their future

Britons are falling out of love with hypermarkets as the higher price of petrol puts them off driving to big out of town stores. With many budgeting carefully, they are also keen to avoid the temptations of a hypermarket, with its mix of food, fashion and furniture. At the same time, more and more non-food items, such as electricals, are moving online. UK online grocery sales by value are forecast to rise almost 100% to £11.1 billion over the next five years. Sales by discount stores such as Lidl are forecast to increase 65% to £12.4 billion, while convenience store sales are expected to rise 29% to £43.6 billion. However, sales at supermarkets and hypermarkets, defined as stores of more than 25 000 square feet (2 323 square metres), are forecast to rise by just 6.4% to £76.9 billion, and some, such as Tesco, announced a fall in profits in 2012, for the first time in 20 years.

One idea being proposed is to bring in brands from outside the supermarket sector to use surplus space and make the giant sheds more enticing to shoppers. According to Andy Clarke, Chief Executive of Asda, this could mean "mini high streets indoors". Tesco recently bought Giraffe, the family-friendly restaurant chain, for £50 million. Neil Saunders, Managing Director of Conlumino, a retail research group, says: "It's very much shop-in-shop. For me it's a recognition that there is a lot of surplus space in supermarkets that is not terribly productive."

The movement of non-food products from supermarket shelves to internet browsers presents grocers with surplus capacity in their biggest stores. Mr Clarke says Asda could go further and is considering letting space to non-competing local suppliers, or associated retailers, such as shoe repairers, hairdressers, travel agents and pharmacies. Although Sainsbury's does not have many hypermarkets, it already has more than 270 pharmacies in its stores, as well as about 10 private dental practices and 40 doctors' surgeries in stores or on land it owns. And it is not just supermarkets that are exploring using their stores more creatively. Kingfisher, the DIY chain, has determined that its UK business, B&Q, could take the same amount of money with about 20% less space. Asda has already agreed to lease more than half of a large B&Q store in Kent.

(Source: adapted from Andrea Felsted www.ft.com, 1 April 2013)

(a) Explain the likely impact on average costs of surplus capacity in hypermarkets.

(4)

(b) Assess the benefits that the H+H business might gain through its Tesco connection.

(8)

*(c) Using the data in Extract 3 and an appropriate diagram, assess reasons why Tesco's profits fell in 2012.

(12)

*(d) Evaluate pricing **and** non-pricing strategies that supermarket firms might use to increase revenue.

(16)

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(16)

(Total for Question 10 = 40 marks)

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

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