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Write your name here

Surname	Other names

Pearson Edexcel
International Advanced Level

Centre Number | Candidate Number

Economics

International Advanced Level
Unit 3: Business Behaviour

Thursday 15 January 2015 – Morning
Time: 2 hours

Paper Reference
WEC03/01

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 **two** questions from 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 80.
- The marks for **each** question are shown in brackets – *use this as a guide as to how much time to spend on each question.*
- In your responses, you should take particular care with your punctuation and grammar, as well as the clarity of your 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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SECTION A

Answer TWO questions from this section.

You should spend 60 minutes on this section.

You should include diagrams in your responses where appropriate.

1 Discuss the factors that determine a firm's average cost of production in both the short-run **and** long-run.

(20)

2 To what extent would a monopolistically competitive market be more beneficial to firms **and** consumers than a perfectly competitive market?

(20)

3 Discuss how the degree of market contestability might affect the behaviour of a firm.

(20)

4 Evaluate the measures a government could use to promote the international competitiveness of businesses in its country.

(20)

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Do not use pencil. Use black ink or ball point pen.

Put a cross in the box ☒ indicating the question from Section A that you have chosen for your FIRST essay. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

You must answer TWO essays in this section. Please start your second essay response on page 8.

Essay Choice 1:

Question 1 ☐ **Question 2** ☐ **Question 3** ☐ **Question 4** ☐

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Put a cross in the box ☒ indicating the question from Section A that you have chosen for your SECOND essay. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Essay Choice 2: (This must be different from your first essay response)

Question 1 ☐ **Question 2** ☐ **Question 3** ☐ **Question 4** ☐

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TOTAL FOR SECTION A = 40 MARKS

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QUESTION 5 IS ON THE NEXT PAGE.

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SECTION B

Answer EITHER Question 5 or Question 6.

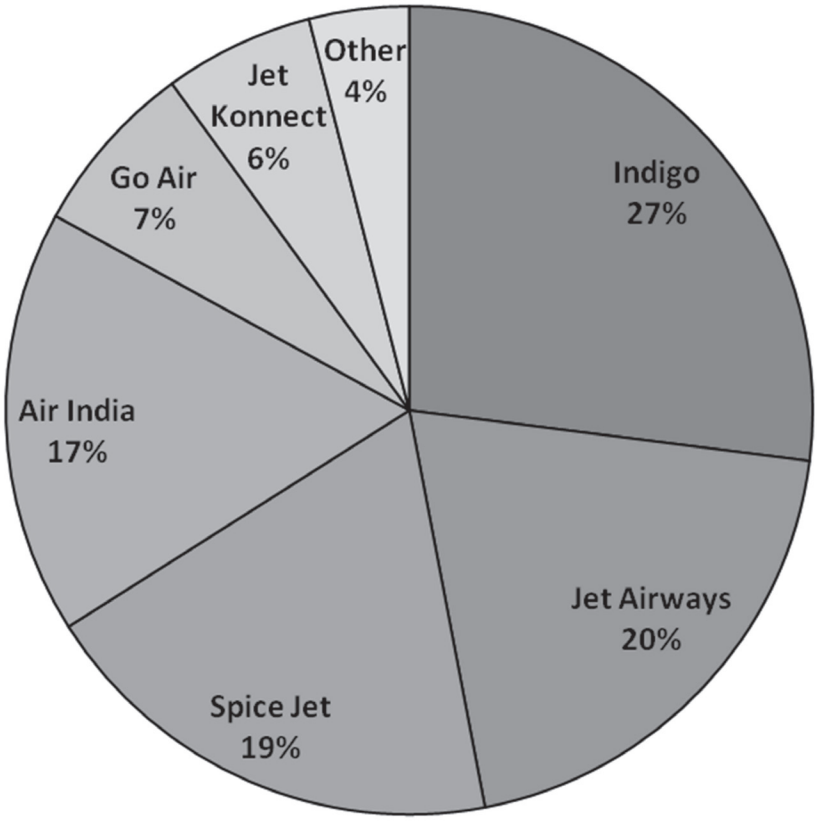
If you answer Question 5 put a cross in the box ☒ .

Question 6 starts on page 26.

You should spend 60 minutes on this section.

5 Market structures and prices: Air fares and diesel fuel

Figure 1 Domestic market share of Indian airlines 2013



(Source: CAPA – Centre for Aviation, DGCA)

Extract 1 Air fares drop, airlines prepare for price war

The Indian domestic airline market is starting yet another price war. Airlines are offering large discounts, as high as 58%, on internal domestic flight tickets. Jet Airways and Air India have launched this latest price war and low-cost airlines are being forced to match this sharp cut in fares.

Jet Airways' market share has not changed since 2012 at a time when Indigo has seen its market share rise from 20% to 27%. A small airline has already shut down and there are fears that this latest round of fare reductions might see other casualties in the market. Some observers think that the fare reductions represent predatory pricing by some of the bigger airlines in the market.

The bigger airlines argue that their lower fares are needed to fill up empty seats at a time when the recovery in the economy is still very slow. Aeroplanes flying at well

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below full capacity will result in losses. Fixed costs are high, whereas the marginal cost of carrying extra passengers is very low.

An airline official said, "to break-even on the Delhi/Mumbai route, an airline needs to sell its tickets at an average price of between Rs 5 500 and Rs 6 000. The price of last minute tickets in the sector should be approximately Rs 9 000 to achieve this average fare price. With these latest fares, we are only going to see more losses". 15

(Source: adapted from http://www.indianexpress.com/news/lean-season-sees-air-fares-drop-airlines-brace-for-price-war/1150488/2)

Extract 2 The South African oil market

The South Africa Competition Commission (SACC) has called for six oil companies, two South African producers, Sasol and Engen, and four subsidiaries of major transnational oil companies, (Shell, BP, Chevron and Total), to appear before the South African Competition Tribunal on charges of collusion. An investigation, which began back in 2009, revealed that the six companies may have kept diesel fuel prices artificially high. 5

The SACC accused the firms of "extensive exchanges of commercially sensitive information", such as monthly fuel sales, to enable them to "track each other's sales and to align their strategies in the market". The investigation found that confidential information exchanges had been occurring since the 1980s. 10

The companies were also accused of colluding to influence the regulations which are applied to South Africa's fuel market, in an attempt to raise barriers to entry for potential new firms.

The SACC recommended that each company be fined 10% of total turnover from their South African business for the last financial year. 15

(Source: adapted from http://www.newstatesman.com/business/business/2012/10/shell-and-bp-accused-collusion-south-africa)

(a) With reference to Figure 1, explain the market structure of the Indian domestic airline industry.

(4)

(b) With reference to Figure 1, Extract 1 and your own knowledge, discuss whether a price war in the Indian domestic airline industry will result in more airlines shutting down.

(12)

(c) With reference to Extract 2 and your own knowledge, to what extent is collusive behaviour rational for firms in the South African oil market?

(12)

(d) Discuss the likely impact of government policies aimed at controlling anti-competitive business behaviour. Refer to the South African oil industry or to an industry of your choice.

(12)

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(a) With reference to Figure 1, explain the market structure of the Indian domestic airline industry.

(4)

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(b) With reference to Figure 1, Extract 1 and your own knowledge, discuss whether a price war in the Indian domestic airline industry will result in more airlines shutting down.

(12)

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(c) With reference to Extract 2 and your own knowledge, to what extent is collusive behaviour rational for firms in the South African oil market?

(12)

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(d) Discuss the likely impact of government policies aimed at controlling anti-competitive business behaviour. Refer to the South African oil industry or to an industry of your choice.

(12)

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If you answer Question 6 put a cross in the box ☒ .

6 The supermarket industry

Extract 1 Supermarkets are merging again

The food retail industry went through a phase of mergers and takeovers in the late 1990s when nearly 3 500 stores were purchased, representing more than $67 billion in annual sales. This was partly a reaction to the growing market share of Wal-Mart.

Many mergers and takeovers are again planned in the USA grocery market. Recently, supermarket giant Kroger announced that it was buying the grocery chain, Harris Teeter, for $2.4 billion. Cerberus Capital Management, a private investment firm, has bought five smaller grocery chains.

Following the recent recession, and new competition from cut price stores, supermarket owners need to look elsewhere for growth. "I think the supermarkets realise that business isn't growing very much," says food retail analyst Scott Mushkin. He suggested there are two ways to make a grocery chain more profitable – it either grows organically, or by mergers and takeovers.

According to a 2010 study undertaken by South Dakota State University, chains with a larger market share have lower prices. However, they also reduce the number of promotions they offer after a merger. This makes it harder for lower-income shoppers, who might have to put more effort into keeping their expenditure costs down by shopping around more for bargains.

(Source: adapted from http://www.washingtonpost.com/blogs/wonkblog/wp/2013/07/28/supermarkets-are-merging-again what-does-that-mean-for-your-grocery-bill/)

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Extract 2 Supermarkets using their monopsony power

Most bananas and pineapples are grown on large plantations in developing countries produced for, or owned by, big fruit companies including Chiquita, Del Monte and Dole. These companies are under pressure from supermarkets to supply cheap fruit.

Five supermarket chains control between 70–80% of the grocery retail sector in the UK, Germany and France. These supermarkets can achieve substantial profits by paying very low prices to the fruit producing companies. Supermarket price wars push prices ever lower. The resulting lower profit margins force the fruit producing companies to pay lower wages. This further worsens the living standards of fruit workers who are already experiencing poor working conditions, labour right abuses, inadequate health and safety standards. There is also weak environmental protection in the fruit industry.

Supermarkets use their buying power not only to impose low prices on their suppliers but also to demand retrospective discounts, delay payments and threaten to stop buying from suppliers. As grocery market share becomes concentrated in the hands of fewer retailers, suppliers have little option but to accept such conditions.

Existing competition policy at national and European Union (EU) level does not cover abuses of buying power and their impact on non-EU suppliers, especially in the developing world. The European Commission is developing a Code of Practice that will encourage supermarkets to improve their global buying practices and employee working conditions.

The pressure group, Make Fruit Fair, wants supermarkets to pay fair prices to their suppliers.

(Source: adapted from http://www.bananalink.org.uk/stop-supermarkets-abusing-their-buyer-power-make-fruit-fair)

(a) With reference to Extract 1, briefly explain the difference between organic growth and a takeover.

(4)

(b) With reference to Extract 1 and your own knowledge, assess the likely benefits to a supermarket and its customers following a horizontal merger.

(12)

(c) With reference to Extract 2 and your own knowledge, discuss the impact of supermarket buying power on their suppliers.

(12)

(d) With reference to Extract 2 and your own knowledge, evaluate whether governments should intervene to protect the interests of suppliers and their employees.

(12)

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(a) With reference to Extract 1, briefly explain the difference between organic growth and a takeover.

(4)

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(b) With reference to Extract 1 and your own knowledge, assess the likely benefits to a supermarket and its customers following a horizontal merger.

(12)

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(c) With reference to Extract 2 and your own knowledge, discuss the impact of supermarket buying power on their suppliers.

(12)

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(d) With reference to Extract 2 and your own knowledge, evaluate whether governments should intervene to protect the interests of suppliers and their employees.

(12)

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(Total for Question 6 = 40 marks)

TOTAL FOR SECTION B = 40 MARKS
TOTAL FOR PAPER = 80 MARKS

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