



**Economics Questions By Topic:**

**Business Growth (3.1.1, 3.1.2, 3.3.3)**

**A-Level Edexcel Theme 3**

 0207 060 4494

 [www.expert-tuition.co.uk](http://www.expert-tuition.co.uk)

 [online.expert-tuition.co.uk](http://online.expert-tuition.co.uk)

 [enquiries@expert-tuition.co.uk](mailto:enquiries@expert-tuition.co.uk)

 The Foundry, 77 Fulham Palace Road, W6 8JA

# Table Of Contents

Section A .....	Page 1
Section B .....	Page 12

**SECTION A**

**Write your answers in the spaces provided.**

- 1** 'Bettys' is a luxury café, first opened in Harrogate in 1919 specialising in afternoon tea service. Since then it has opened a further five branches in Yorkshire. It has no plans to increase the number of cafés. The six branches have 2 million customers a year.

(Source adapted from: <https://www.forbes.com/sites/sarahturner/2018/03/22/the-famed-yorkshire-cafe-that-blends-nostalgia-with-profits-and-conservation/#7eb50cec7a4e>)

- (a) Explain **one** likely reason why this business has remained small.

(2)

.....

.....

.....

.....

.....

.....

.....

- (b) Explain why the previous expansion of this business could be described as 'organic growth'.

(2)

.....

.....

.....

.....

.....

.....

.....

- (c) Assume 'Bettys' merges with a major tea leaf supplier. Which **one** of the following is most likely to be an advantage as a result of this merger?

(1)

- A** External economies of scale will increase efficiency
- B** Greater control to lower prices of tea
- C** Industrial diversification increases risks
- D** Lower monopoly power in the café market

**(Total for Question 1 = 5 marks)**

**2** In 2016, the insurance group Esure undertook a demerger with its GoCompare price comparison website.

The most likely reason for this demerger was to:

(1)

- A** benefit from external economies of scale
- B** benefit from internal economies of scale
- C** focus more on its core business
- D** increase its market share

Following the demerger, GoCompare announced in 2017 a profit of £17.5 million, up 21.5% on 2016. Total revenue in 2017 was £75.8 million, up 4.1% on 2016.

(Source: adapted from <https://www.insuranceage.co.uk/insurer/3107496/profits-up-at-go-compare>)

**(Total for Question 2 = 1 mark)**

---



**4** In 2014 the luxury car maker Rolls-Royce Motor Cars Ltd gained full ownership of car engine supplier RRPS, after completing a buy-out costing £1.93 billion.

The benefits of this acquisition to Rolls-Royce are likely to be gained from

(1)

- A** a private finance initiative
- B** horizontal integration
- C** forward vertical integration
- D** backward vertical integration
- E** conglomerate integration

Answer

Explanation

(3)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

**(Total for Question 1 = 4 marks)**

5 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

Explanation

(3)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

---

(Total for Question 5 = 4 marks)





- 7 Carphone Warehouse, a phone retailer, and TalkTalk, a broadband provider, were previously jointly owned. In March 2010 they separated into two companies and were listed individually on the stock exchange. A potential benefit of this demerger is that (1)
- A Carphone Warehouse can reduce long run average costs
  - B Carphone Warehouse can gain technical economies of scale
  - C TalkTalk gains an exclusive retail outlet
  - D Consumers benefit from a decrease in contestability
  - E There will be an increase in external economies of scale

Answer

Explanation (3)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

---

**(Total for Question 7 = 4 marks)**

---

8 In 2010 the assets of ROK, a building maintenance firm, were acquired by Balfour Beatty, which also maintains buildings as part of its operations. This type of integration of business assets is:

(1)

- A Satisficing
- B Privatisation
- C Backwards vertical
- D Forwards vertical
- E Horizontal

Answer

Explanation

(3)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

**(Total for Question 8 = 4 marks)**



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

(1)

- A** To gain from the benefits of horizontal integration
- B** To gain from the benefits of backward vertical integration
- C** To gain from the benefits of forward vertical integration
- D** To gain from the benefits of conglomerate integration
- E** To avoid diseconomies of scale.

Answer

Explanation

(3)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

**(Total for Question 10 = 4 marks)**

**11** In May 2009 the German airline Deutsche Lufthansa AG took over Austrian Airlines. Which of the following was the most likely motive for this takeover?

(1)

- A** To avoid diseconomies of scale
- B** To gain from falling long run average costs
- C** To avoid an investigation by the Competition Commission
- D** To increase contestability
- E** To reduce unemployment.

Answer

Explanation

(3)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

**(Total for Question 11 = 4 marks)**

**END OF SECTION A**

## SECTION B

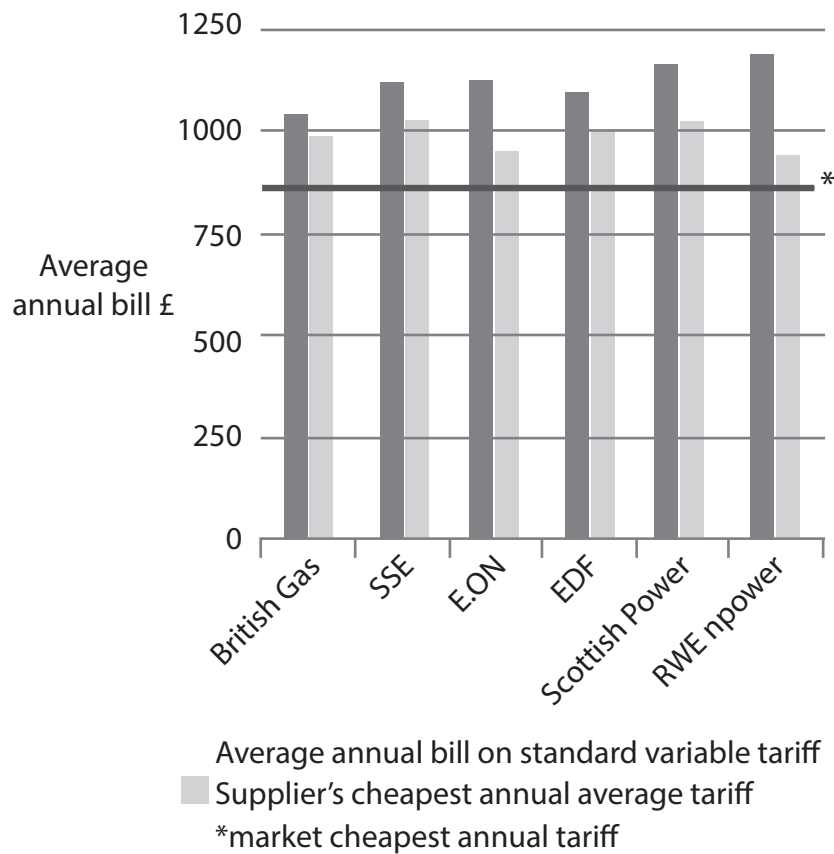
Read all extracts/figures before answering.

Write your answers in the spaces provided.

### Question 12

#### Energy and telecommunication markets in the UK

Figure 1: Average annual household bill from the Big Six UK energy suppliers, 2017



(Source: <https://www.lovemoney.com/news/67298/standard-variable-tariff-compared-cheapest-deal-provider-savings>)

**Extract A**

**Energy price cap to fix ‘broken’ market in UK**

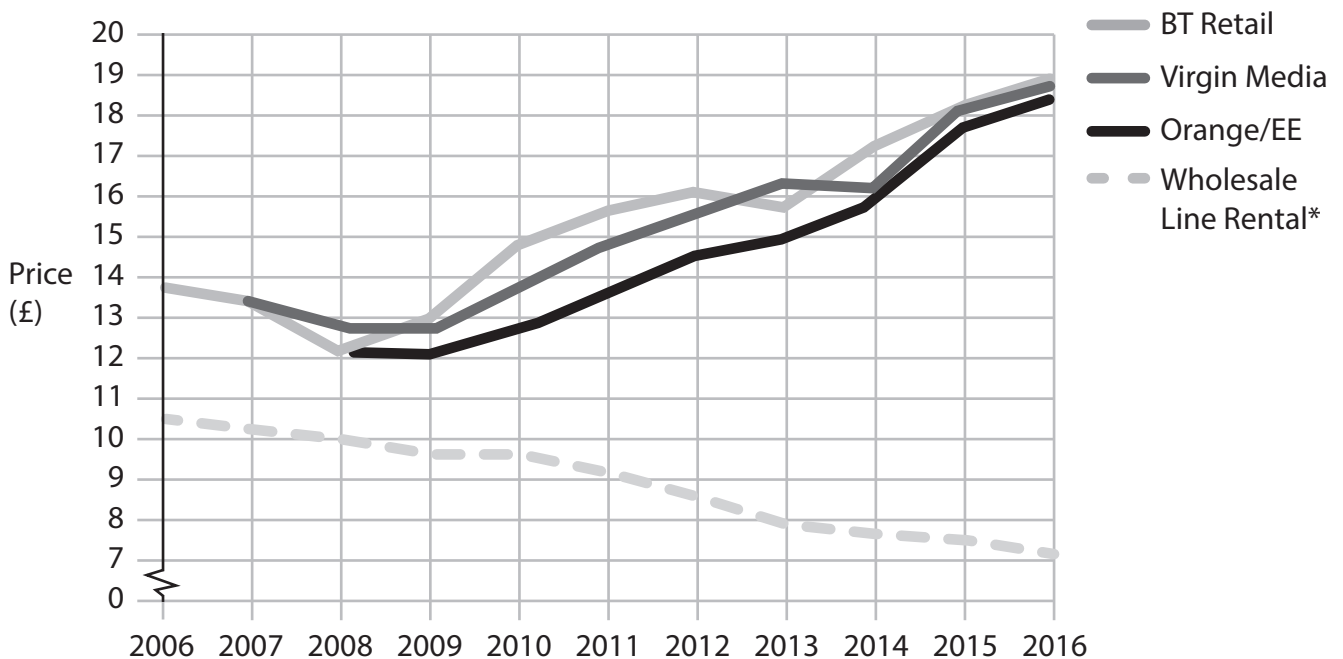
The Prime Minister recently said that the regulator Ofgem (Office of Gas and Electricity Markets) should limit electricity and gas suppliers’ most expensive tariffs.

Under the planned new legislation, the energy bills of 11 million households will be capped for as long as five years. The government claimed this cap could save households up to £100 a year. This legislation would force Ofgem to change the licence conditions for energy suppliers so that they are required to cap electricity and gas prices. The measure will apply to anyone on a standard variable tariff, the expensive plans that customers are moved to when cheaper, fixed-price deals end. Ofgem will need to consult energy companies on how the cap is calculated, the government said. The Prime Minister repeated her claim that she had to act because the ‘market is broken’, a charge the big energy companies reject. “I have been clear that our broken energy market has to change – it has to offer fairer prices for millions of loyal customers who have been paying hundreds of pounds too much,” she said. 5 10

However, Michael Lewis, chief executive of E.ON said “the government must guard against any unintended consequences that undermine customer service and push up prices as a whole. A price cap will not be good for customers. It will reduce competition and innovation”. Smaller suppliers such as First Utility said the Big Six had only themselves to blame for the cap, because they had kept millions of people on standard variable tariffs. 15 20

(Source: adapted from ‘UK puts energy efficiency at heart of climate change strategy’, Adam Vaughan, Copyright Guardian News & Media Ltd 2017 <https://www.theguardian.com/money/2017/oct/12/may-energy-price-cap-ofgem-electricity-gas-tariffs>)

**Figure 2: The monthly rental cost of a telephone landline**



\*Wholesale line rental – the rental price BT Openreach charges telephone service providers

(Source: <https://www.ofcom.org.uk/about-ofcom/latest/features-and-news/landline-prices-review>)

## Extract B

### BT profit rises

BT Group, which includes BT Openreach and BT Retail, reported a rise in profit as revenue increased following the integration of the consumer mobile business, EE. BT finalised the takeover of EE in August 2016, and the integration has resulted in BT controlling 35% of the mobile consumer market. The profit of the UK-based telecommunication group in its second quarter 2017 rose to £566 million. 5

BT Group chief executive Gavin Patterson said: "We will operate a multi-brand strategy with UK customers being able to choose a mix of BT, EE or Plusnet services, depending on which suits them best. The acquisition enables us to offer great value bundles of services and customers are set to be the winners as we compete for their business". 10

(Source: adapted from [www.marketwatch.com](http://www.marketwatch.com) (Oct 27 – 2016) and <http://home.bt.com/news/bt-life/bt-to-retain-ee-brand-as-acquisition-confirmed-11364037422234>)

## Extract C

### BT to slash landline charges for 1 million customers

Rental charges for landline-only customers – households with a telephone-only contract but no BT broadband – will fall from £18.99 to £11.99 per month after the regulator attacked existing deals as 'poor value for money'. This rental reduction will save a million landline-only customers £84 a year. 5

The regulator Ofcom (Office of Communications) said it stepped in because these bills for landline-only customers – nearly two-thirds of whom are over 65 – have "soared" in recent years. This is despite BT and other landline providers benefiting from significant cuts in the wholesale line rental cost of providing the service by BT Openreach. Many landline-only customers are elderly, and have been with BT for decades. Ofcom has focused on BT because it accounts for two-thirds of the UK's 1.5m landline-only customers. 10

A spokesperson for Ofcom said "This position [of dominance] has allowed BT to increase prices without much risk of losing customers, and other providers have followed BT's pricing lead. We expect BT's price cut to mean other providers will follow suit". Ofcom said that over three-quarters of BT's landline-only customers have never switched provider, which has left them a prime target for price rises. The regulator said that all major landline providers have increased their line rental charges by between 23% and 47% in recent years, while their own costs for providing the service have fallen about 27%. Ofcom said it is also looking at measures to help people shop around for better deals with more confidence. 15  
20

(Source: adapted from 'BT to slash landline charges for 1m customers', Mark Sweney, Copyright Guardian News & Media Ltd 2017 <https://www.theguardian.com/business/2017/oct/26/bt-to-slash-landline-charges-for-1m-customers>)



**12** With reference to Extract B, examine the likely benefits to consumers of the integration between BT and EE.

(8)

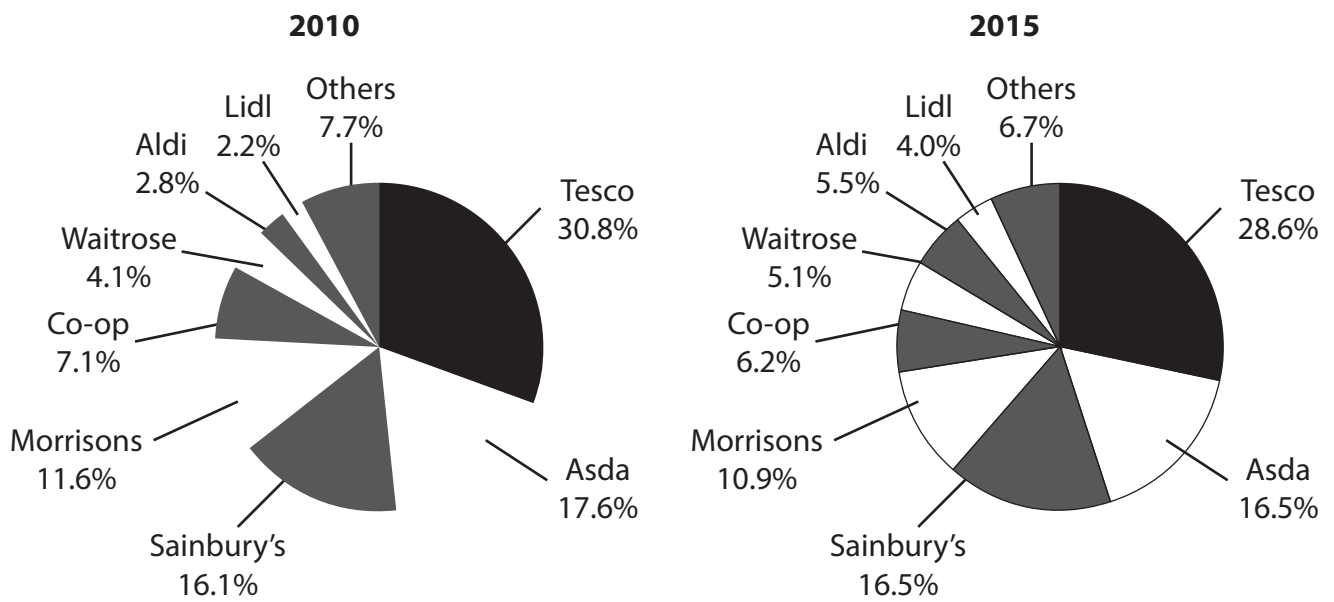
A series of horizontal dotted lines for writing the answer.

**(Total for Question 12 = 8 marks)**

### Question 13

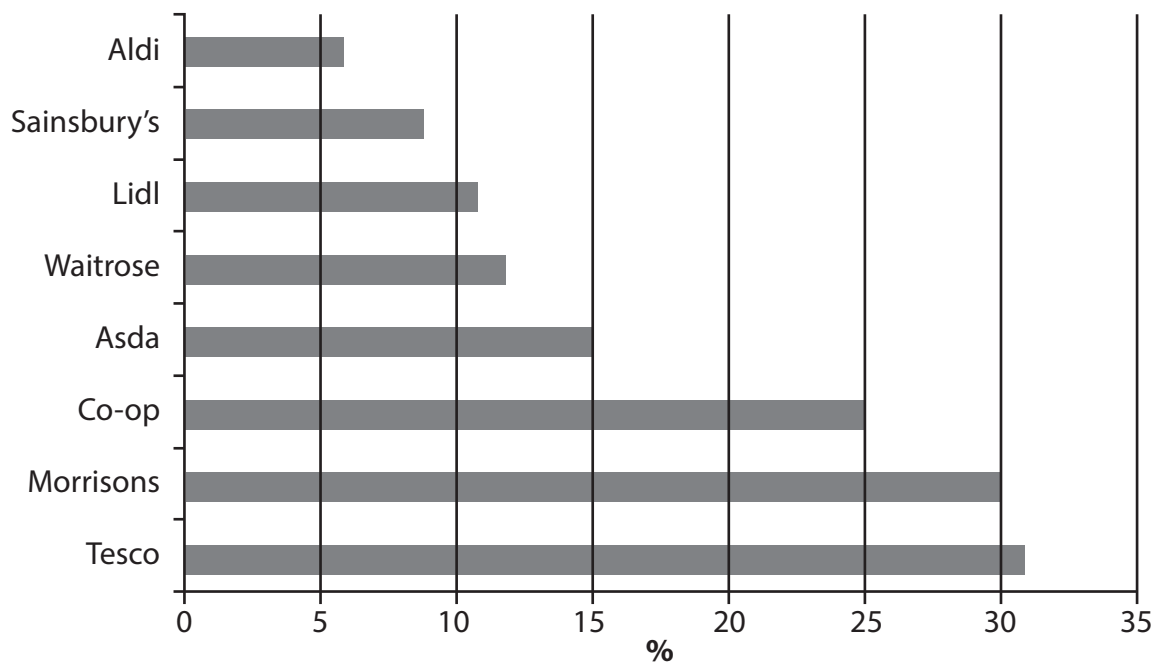
#### Supermarket price war, food waste and possible mergers

Figure 1: Market shares by total revenue in the UK supermarket sector, 2010 and 2015



(Source: Kantar worldpanel, <http://www.kantarworldpanel.com/en/grocery-market-share/great-britain/snapshot/11.10.15/>)

**Figure 2: Proportion of food suppliers reporting that the following supermarkets fail to meet the Groceries Code of Conduct, 2015.**



(Source: YouGov poll of more than 1100 food suppliers to supermarkets. Reported in The Times, 23 June 2015)

**Extract A**

**Supermarket price war puts pressure on their food suppliers**

The number of food suppliers (to supermarkets) struggling to remain in business has increased by more than 50% over the past year as supermarkets engage in an intense price war. It has never been tougher for the UK's food suppliers according to a study by accountants Begbies Traynor. It blames aggressive price-cutting by the supermarkets and delays in payments to food suppliers as the main causes of the difficulties. Further problems include food suppliers being forced to pay excessive amounts for packaging specified by supermarkets and funding in-store promotions. Almost 90% of struggling food suppliers are small and medium-sized businesses.

5

The price war has contributed to food prices paid by consumers falling by 1.7% over the past two years.

10

The market shares of the big four supermarkets – Tesco, Asda, Sainsbury's and Morrisons – are under pressure as shopping habits change. Many consumers are switching from one main weekly shop to shopping more frequently at local discount stores such as Aldi and Lidl or purchasing goods online from other grocery retailers.

15

The big four supermarkets have responded by putting more pressure on their suppliers despite an investigation by the Groceries Code Adjudicator (GCA). The GCA has the power to fine supermarkets up to 1% of their annual sales revenue if they break the Groceries Code of Conduct. A YouGov study found considerable differences between the supermarkets in meeting the Code with Aldi performing well but Tesco badly. Despite the Groceries Code, many food suppliers are reluctant to complain for fear of losing contracts with the supermarkets.

20

(Source: adapted from 'Supermarket price war takes toll on UK food suppliers'. Rupert Jones, The Guardian, 20th July 2015)

## Extract B

### Food waste in the supply chain

A report from the British Retail Consortium reveals that supermarkets are directly responsible for around 0.2 million tonnes of food waste every year. This is due to the expiry of use-by-dates and poor handling of stock.

However, 4.1 million tonnes of food waste occurs annually in the food supply chain before it even reaches the supermarkets, indicating the existence of information gaps. The supermarkets are cooperating with food suppliers and farmers to try to reduce this waste. This involves improving forecasts for supply and demand of food and increasing the reliability of transportation and storage. 5

Consumers, the final stage of the supply chain, waste a further 7 million tonnes of food each year. This suggests irrational behaviour. Supermarkets are also working with consumers to reduce the waste by providing advice on how to store and use leftover food. The development of packaging designs to keep food fresher for longer is one of the innovations under way to reduce waste. 10

(Source: adapted from 'Supermarkets tally up food waste bill'. Will Nicholls, in Businessgreen, 19th January 2015. <http://www.businessgreen.com/bg/news/2390792/supermarkets-tally-up-food-waste-bill>)

## Extract C

### Proposed merger activity in the supermarket sector

Analysts at Société Générale, an investment bank, have recommended a merger between Sainsbury's and Morrisons. They claim it would lead to increased economies of scale and market power for the combined business. Such a merger between the third and fourth largest supermarkets in Britain would have been unrealistic a few years ago due to concerns of its impact in reducing competition. However, the chances of getting permission from the Competition and Markets Authority have increased following the growth of Aldi and Lidl. Giant mergers have been approved in other sectors such as Lloyds-HBOS (banking) and British Telecom-EE (telecommunications). 5

The suggested merger would have its challenges. There is considerable overlap between the locations of the stores and the enlarged company would require the rationalisation and co-ordination of hundreds of thousands of employees. A new expensive IT system is likely to be required and the underlying difficult market trends would remain in the food retailing industry. 10

(Source: adapted from 'Tesco-bury and AS-Morrisons. Could Britain's supermarkets be about to merge?' Graham Ruddick, in The Telegraph, 16th December, 2015. <http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11699724/Tesco-burys-and-AS-Morrisons.-Could-Britains-supermarkets-be-about-to-merge.html>)



A large rectangular area with rounded corners, containing 25 horizontal dotted lines for writing.

Handwriting practice area with 25 horizontal dotted lines.

**(Total for Question 13 = 15 marks)**



## 14 Extract A

### West End ticket prices reach all time high

The price of West End theatre tickets in London has reached an all-time high. In the past year alone, up to January 2013, the average top-price ticket has risen by almost £10 and now stands at £81.05. In January 2013, London theatres announced record numbers of people wanting to buy tickets for shows. Costs of running the theatres have also risen because there are restoration costs to pay and energy costs have increased. This rise in costs is despite some of the theatres in the West End receiving subsidies.

5

(Source: adapted from 'West End theatre tickets more expensive than ever, says The Stage,' by Matt Trueman, *The Guardian*, 5 April 2013  
<http://www.theguardian.com/stage/2013/apr/05/west-end-ticket-price-discrepancy>)

## Extract B

### Cineworld merger with Cinema City International (CCI)

The UK's biggest cinema chain by market share is to enter seven overseas markets through a £900m merger. Cineworld announced that it has agreed to merge with CCI which owns 100 multiplex cinemas in seven countries Bulgaria, Czech Republic, Hungary, Israel, Poland, Romania and Slovakia. The deal is expected to be promoted as a merger of equals although Cineworld is larger than its new partner. The planned merger with CCI follows a fall of 1% in the revenue earned by cinemas in the UK and Ireland in 2013 to £1.17bn.

5

In 2013, Cineworld was ordered by competition regulators to sell three cinemas following its takeover of the Picturehouse chain. This underlined the difficulty of finding new growth opportunities in the company's home market, which was one factor prompting a search for international expansion opportunities.

10

Cineworld's UK-based rivals have also grown overseas, with Odeon UCI having a presence in seven countries, while Canadian-owned Vue Entertainment has cinemas in Portugal, Taiwan, Germany and Denmark.

The combined group is to be run by CCI's chief executive, although other senior management will be drawn from the ranks of both companies and the board will have more Cineworld board members.

15

(Source: adapted from 'Cineworld Targets Europe With £900m Merger,' By Mark Kleinman, Sky News, 9th January 2014  
<http://news.sky.com/story/1192823/cineworld-targets-europe-with-900m-merger>)

## Extract C

### Cineworld investigation by Competition Commission (competition regulator)

Cineworld had to sell cinemas in three towns after the Competition Commission (CC) concluded that its acquisition of the Picturehouse chain would lead to higher prices for customers in Aberdeen, Bury St Edmunds and Cambridge. While Cineworld operates mainly in large out-of-town-centre cinemas, Picturehouse's cinemas tend to be smaller and located in city centres.

5

The CC has concluded that the acquisition could lead to a substantial lessening of competition in the cinema market in Aberdeen, Bury St Edmunds and Cambridge – where Cineworld and Picturehouse face limited competition.

(Source: <http://www.competition-commission.org.uk/media-centre/latest-news/2013/aug/cineworld-could-have-to-sell-cinemas>)

Adult (19–59 yrs)	£9.60
Child (2–14 yrs)	£6.80
Student (15–18 yrs)	£7.30
Senior (60+ yrs)	£7.30
Family of 4	£29.80

**Figure 1**

**Cineworld (London) cinema ticket prices after 5pm**

**14** Examine **two** reasons Cineworld plans to merge with CCI.

(8)

A series of horizontal dotted lines for writing the answer.

**(Total for Question 14 = 8 marks)**

## Question 15

### Hand car wash (HCW) firms in the UK

#### Extract A

#### What is the true human cost of your £5 hand car wash (HCW)?

The UK's hand car washes (HCWs) are extremely price competitive, but they have also been linked to modern slavery. Are they ever fair for workers?

There is little agreement about how many HCWs there are in the UK. Estimates range from 10 000 to 20 000. This lack of accurate information about the industry makes government regulation very difficult. Automated car washes, with their fierce rotating bristles, used to be the first option for drivers in a hurry. Now there is more choice. While the economy slows and incomes fail to keep up with inflation, demand for HCWs has grown. Many people see paying £5 for a car washed by someone else, rather than cleaning it at home, as a small expense which yields a high utility. But what is the true cost of a £5 car wash – and what should we be paying?

The growth of HCWs is partly the result of changes in the structure of industry in the UK. Many petrol stations have closed as drivers fill up at supermarkets. Garages and their forecourts have closed as cars become more reliable and locked into service agreements. The available sites for HCWs have therefore increased significantly and rents have fallen.

HCW entrepreneurs have identified available land and have benefitted from changes in the labour market, partly as a result of EU migration. UK drivers are now able to obtain cheap and effective hand car washing. For many migrants, car washes are a first job. "They accept car washing for a short period while they improve their language skills and move into other industries," says Ian Clark, a professor of work and employment at Nottingham Business School. "But there are also car-wash workers without networks who are in a dead end, working there for long periods."

Many drivers are only interested in getting the cheapest wash. If the price is very low, it probably means that workers are receiving less than the minimum wage and working in poor conditions. Crude calculations illustrate the problem. A £5 HCW employing five workers for 10 hours a day would need to wash 79 cars a day to just cover the wage costs. This assumes the workers are paid the minimum wage. This is one car every seven and a half minutes. Even if the profit can be higher on valet services, the price of which can be as little as £12 for a full inside-and-out clean, it's hard to see how a car wash price as low as £5 pays a living wage. This ignores all other costs which HCWs incur such as business rates and rent.

Evidence from car-wash workers is limited but Clark and others have been able to build a picture of some of the tougher conditions on drenched forecourts. "Like nail bars and small garment manufacturers, car washes are what we call 'hard-to-reach places,'" Clark explains. As part of the research, Clark and his team spoke to workers from 45 HCWs in the Midlands.

Clark and his team met and observed workers who lacked waterproof boots or trousers, or hi-vis jackets and gloves. "They're spraying around hydrochloric acid solution for alloy wheels, breathing in the vapour and fumes," Clark says. Some workers were paid a little over half the minimum wage.

(Source adapted from: <https://www.theguardian.com/world/2018/jul/16/true-human-cost-5-pound-hand-car-wash-modern-slavery>)

## Extract B

### Government intervention in the HCW industry

There are three main areas of government intervention that might impact on labour intensive firms such as HCWs:

First, there is the planning issue which focuses on the impact on the environment, for example, the disposal and recycling of waste water and chemicals. There could be planning regulations to prevent the use of tarmac rather than concrete on forecourts. Tarmac allows waste water and chemicals to seep into the sub soil. It could also be a requirement to have a sludge trap to stop the waste entering waterways. 5

Second, there is the health and safety issue for workers. Prolonged exposure to chemicals and lack of protective clothing puts the health of workers at risk. Performance targets could involve minimum levels of protective clothing and rest breaks for the workers. 10

Third, there is the issue of tax. The informal nature of the business type makes tax evasion easier.

Not all UK HCWs violate regulations. There are legitimate, regulated HCW firms as well as examples of good practice by independent outlets. One national supermarket, Tesco, has banned all independent hand car washes from its car parks. It is now in a partnership agreement with national car wash operator Waves. It uses a WashMark certificate of quality and compliance which was introduced by the industry to improve working conditions. Other major supermarkets are considering similar changes. One adviser believes £9 is a reasonable minimum price for a basic wash. Some pressure groups have developed a mobile phone app where evidence of unreasonable conditions can be reported by drivers. 15 20

Involving drivers in the issue, and making them demand fairer car washes, creates an incentive for good businesses to improve practices and come forward to get a WashMark certificate. 25

(Source adapted from: <https://www.parliament.uk/documents/commons-committees/environmental-audit/Hand-Car-Wash-evidence.pdf> research into HCWs by Professor Ian Clark, Nottingham Business School May 2018)

**15** Evaluate the microeconomic and macroeconomic factors which determine the number of firms in an industry. Refer to HCWs or another industry of your choice.

**(25)**

A series of horizontal dotted lines provided for writing the answer to question 15.

A large rectangular area containing 25 horizontal dotted lines, intended for writing or drawing.

A large rectangular area containing 25 horizontal dotted lines, intended for writing or drawing.

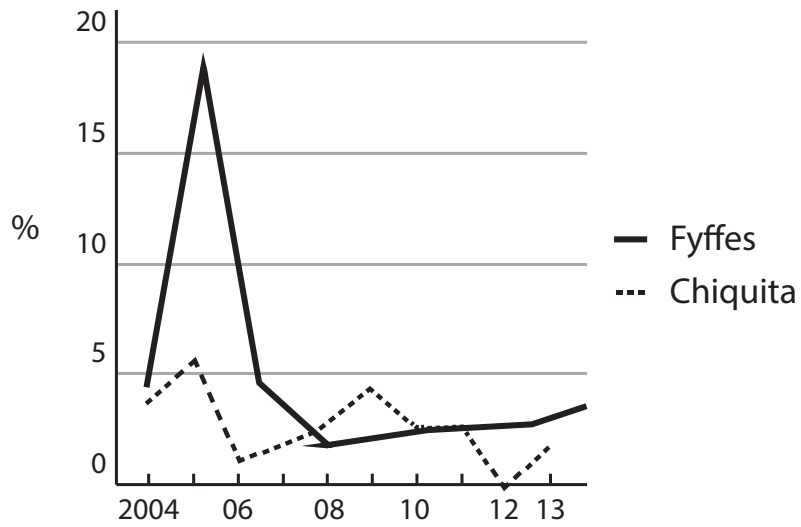


A large rectangular area containing 25 horizontal dotted lines, intended for writing or drawing.



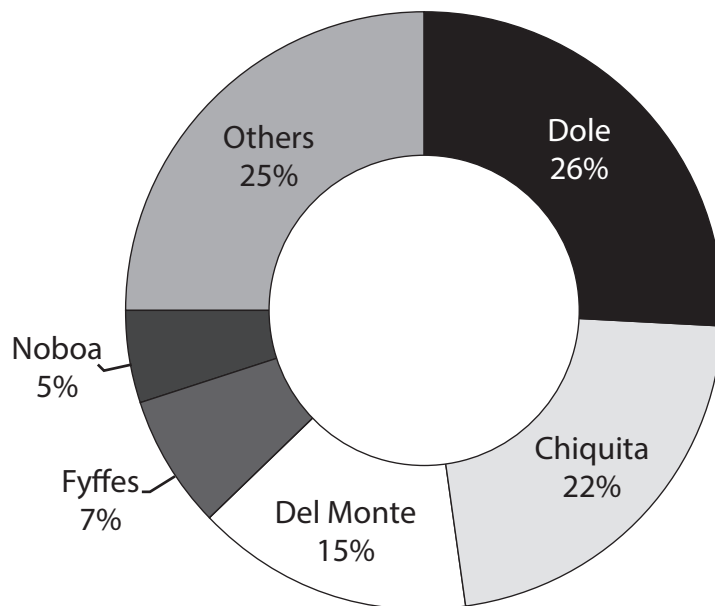
## 16 Bananas

**Figure 1 Fruit importers' profit margins, %**



(Source: <http://www.ft.com/cms/s/0/8537646e-a85b-11e3-8ce1-00144feab7de.html#axzz3SqiJkq3q>)

**Figure 2 Global market share of banana distributors (excluding supermarkets)**



(Source: <http://www.businessweek.com/articles/2014-03-10/with-chiquita-fyffes-merger-dole-will-no-longer-be-top-banana>)

## Extract 1 Supermarket pricing makes merger of Chiquita and Fyffes necessary

Bananas have become the biggest fruit on the planet in terms of production volume, as consumers eat ever more of them. Global banana production has doubled since 1990 to 100 million tonnes a year. A deal to create the world's largest banana distributing company was arguably made necessary by the low fresh fruit prices to be found on the shelves of any supermarket. By planning a \$1 billion merger, Chiquita of the US and Dublin-based Fyffes are attempting to address a retail price squeeze that is reducing their already low profit margins. Their profit margins have been shrinking: Chiquita's from 3.5% in 2004 to 0% in 2012, and Fyffes' from just under 5% to 3.5% over the same period, say their annual reports.

5

A banana price war between large supermarkets, which often sell the fruit as a loss leader, has hit profit margins for distributors. Large retailers are also using their purchasing power to force producers and distributors to absorb cost increases, which have been made worse by poor weather and crop diseases. Supermarkets are also increasingly sourcing their bananas directly from producers, damaging distributors' revenues, said Alistair Smith, a campaigner for social and environmental issues relating to the supply of bananas. In the UK, such direct sourcing accounted for more than half of the bananas traded. Smith said "The current low prices are not sustainable for the industry. They are damaging the industry and the people who work in it. The industry has been suffering from overcapacity for the past few years, so a merger of the two major players should resolve some of the volatility in the market."

10

15

20

Announcing the proposed merger, Ed Lonergan, Chiquita's Chief Executive, said: "We have always identified Fyffes as a fantastic partner. The tie up makes particular sense now as the banana market is the most competitive I have ever seen – there are so many players bringing bananas into every port in the world."

A merger is likely to give the combined company more negotiating power with suppliers, although the Fairtrade Foundation warns that the merger would only squeeze banana growers further. The merged company would have combined sales of \$4.6 billion. It would distribute about 160 million cases a year in total, compared with 117 million at Del Monte and 110 million at Dole.

25

Chiquita is the larger company, with annual revenues in excess of \$3 billion compared with \$1.5 billion at Fyffes. The merged company would have the scale to negotiate better deals with retailers. Chiquita and Fyffes hope to achieve \$40 million a year in pre-tax cost savings while gaining share in the melon, pineapple and packaged salads markets. Savings will come from logistics, for example putting more bananas on to fewer boats.

30

35

The high profile of these brands makes it likely that regulators will scrutinise the proposed merger as the new company would have almost 30% of the European market.

(Source: adapted from <http://www.ft.com/cms/s/0/c8463dac-a86f-11e3-b50f-00144feab7de.html#axzz3BffD7L9c> March 10, 2014 and <http://www.ft.com/cms/s/0/43b73338-a825-11e3-a946-00144feab7de.html#axzz3BffD7L9c> and 'Bananas: the right split' in the Lex column 14 March 2014)

**16** Assess the benefits that might arise as a result of the proposed merger between Chiquita and Fyffes. Use an appropriate diagram in your answer.

(16)

A large rectangular area containing 25 horizontal dotted lines for writing the answer.

A large rectangular area with rounded corners, containing 25 horizontal dotted lines for writing.

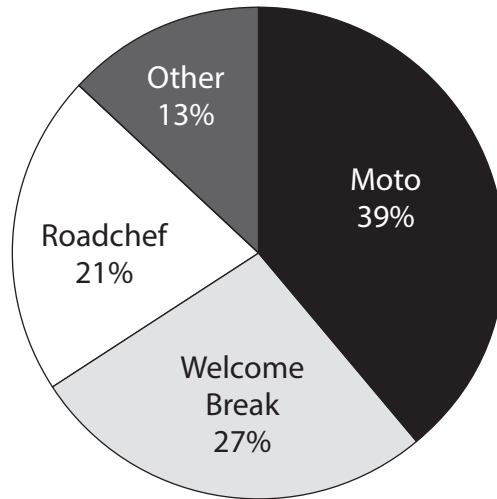
A large rectangular area with rounded corners, containing 25 horizontal dotted lines for writing.





## 17 Motorway Service Areas (MSAs) in the UK

**Figure 1 Market share of MSA sites in the UK (103 sites)**



(Source: Mintel, Operator reports, 2010, [http://reports.mintel.com/display/540116/?\\_\\_cc=1](http://reports.mintel.com/display/540116/?__cc=1))

### **Extract 1 Letter concerning monopoly pricing at Motorway Service Areas**

I am writing to bring to your attention the issue of petrol prices. Returning from Germany yesterday evening, I needed to buy petrol on the M25 and stopped at a service station, not wanting to add extra miles or risk getting lost by coming off the motorway. Normally the price is advertised in advance but in this particular case it wasn't. I was horrified to see that I was being charged £1.47 which as you'll know is more than 15 pence above the average rate across the country. I had no choice but to buy the petrol at this price. Everyone knows that petrol is more expensive at motorway services, but I am writing to ask you to consider putting a cap on the amount of profiteering by these firms selling petrol at inflated prices. In some European countries it is normal to see the price at a service station and the next two after that so you can make a choice as to where to stop and buy your petrol, but in this country it's a complete monopoly.

5

10

Letter to the Highways Agency November 2012

## Extract 2 Pricing at Motorway Service Areas

It's no secret that Motorway Service Areas manage to provide the seemingly impossible combination of being both notoriously expensive and notoriously poor quality. This is usually attributed to the fact that they are seen to have a captive market and a monopoly on the motorway, often being the only easily accessible facilities for at least 15 miles, the minimum distance permitted between MSAs. However, the gap between MSAs often exceeds 50 miles.

5

Before we start complaining about the prices of services, we should first work out what we're comparing them to. While the obvious comparison would be a supermarket or high street shop, a more accurate one would be an airport or railway station – places which are also under fire for their high prices. If services were making as much money as some people think they are, there would be more operators and applications for new services.

10

(Source: adapted from [www.motorwayservicesonline.co.uk](http://www.motorwayservicesonline.co.uk))

## Extract 3 Pressure on for motorway services operators with vast debts

How to get today's motorway users to spend money is a major problem that Roadchef and its rival operators Moto and Welcome Break have had to tackle. And with collectively hundreds of millions of pounds of debt on their balance sheets, the pressure is on.

In 2007, Welcome Break, Britain's second-biggest motorway services operator, was on the brink of exiting the industry as it desperately tried to rearrange its £376 million debt. Roadchef, its smaller rival, was also struggling. Like Welcome Break its credit rating had been downgraded and it was in danger of breaching its debt arrangements. Roadchef was bought by Israeli property company Delek Group. Welcome Break and Roadchef, along with Moto, still have vast debts, with servicing costs in the range of £15 million and £78 million a year.

5

10

But why is there so much debt in these companies when motorists regard service stations as roadside goldmines for their owners because of 'captive' customers and high prices? One reason is the huge investment needed. Moto says its new service area at Wetherby, West Yorkshire, cost £24 million to build. There are also the high overheads caused by its many obligations. Service stations must be open 24 hours a day, 365 days a year. There is a legal requirement to provide free parking for at least two hours, toilets, hot food and drink. Yet they are still not allowed to market themselves as destinations in their own right, mainly because of fears that traffic building up on the slip roads could cause accidents on the motorways. And they are still not allowed to serve or sell alcohol, a high-margin product for retailers.

15

20

Does it matter that the service stations are massively indebted? According to one commentator, 'The attractive thing about these companies is that they generate a huge amount of cash. If you can use that to service the debt and still make a profit, what does it matter that you are not going to pay the debt off?'

25

(Source: adapted from <http://www.thisismoney.co.uk/money/markets/article-2018000/Pressure-motorway-services-operators-saddled-vast-debts> Sarah Bridge July 2011)

**17** Moto, Welcome Break and Roadchef control more than 85% of the market for MSAs. Discuss the possible reasons why a few firms dominate this industry.

**(16)**

Dotted lines for writing.

A large rectangular area with rounded corners, containing 25 horizontal dotted lines for writing.

A large rectangular area with rounded corners, containing 25 horizontal dotted lines for writing.

Handwriting practice area with 25 horizontal dotted lines.

**(Total for Question 17 = 16 marks)**

## 18 Price fixing in the baby milk powder market

### Extract 1 Soaring baby milk prices provoke price fixing claim

Firms producing baby milk powder, known as formula milk, are making huge profits on exports to China. In 2012, the total share of the top five foreign formula milk brands reached 60% of the Chinese market. A climate of panic among parents in China over the safety of domestically produced formula milk was pushing prices ever higher. The competition authorities in China have accused foreign firms of participating in a conspiracy to fix the price of formula milk. They are being investigated for alleged price-fixing and anti-competitive behaviour. 5

Wyeth Nutrition, which Nestlé bought in its \$11.9 billion takeover of Pfizer's baby food business, is accused along with other formula milk producers of "violating anti-monopoly laws via high prices and limited market competition" by the Chinese regulatory authority, the National Development and Reform Commission (NDRC). Wyeth Nutrition has been actively co-operating with NDRC's review of the industry, a spokeswoman from Nestlé said. 10

Parents, fearful that the local formula milk products may be counterfeit or otherwise tainted, go to extreme lengths to buy imported formula milk. This follows the scandal in 2008 when melamine, in domestically produced formula milk, killed six babies and caused sickness in 300 000 others. A tin of foreign-made formula milk that sells for £10 in Britain retails for as much as £30 in China. A flourishing black market has led to tins of milk powder being smuggled in from Europe and sold online. Prices have risen by 30% since 2008. "People are willing to pay that amount for a product from a brand they trust to have better safety, particularly when it involves children and babies," said James Roy, a senior analyst. He said that consumers are unhappy and that the government is responding by exerting pressure. He thought it unlikely that the companies were engaging in real price fixing. 15 20

(Source: *The Times*, 3 July 2013)

## Extract 2 Fines on foreign formula milk producers

China has temporarily banned some imports of formula milk. In August 2013, China's price regulator imposed fines equivalent to £71 million on five foreign formula milk producers following an investigation into price fixing.

Analysts said the investigation into formula milk pricing was part of a broader Chinese plan to boost consumption of local formula milk products. But they said the fines were unlikely to damage the reputation of the affected companies. If anything, foreign formula milk producers might increase their market share because of the price cuts resulting from the investigation. 5

"It will have an impact on domestic brands over the long term as the prices of high-end premium brands come down. Customers will tend to buy the foreign brands as the price gap between domestic and foreign brands narrows," said Jacqueline Ko, an analyst at Maybank Kim Eng Research. 10

Fonterra, one of the companies fined, said it would give additional training to sales staff and review its distributor contracts in the wake of its fine. "We believe the investigation leaves us with a much clearer understanding of expectations around implementing pricing policies," said Kelvin Wickham, a senior executive of Fonterra. 15

"There have been some small [price-fixing] cases previously, but nothing of this scale," said one lawyer who defended a company involved in the investigation. "There is real political momentum behind this. Inflation and product safety are at the top of the government's agenda." As China's economic growth rate threatens to slow below the official target of 7.5%, the Chinese government is concerned about growing public anger over the price and quality of essential goods and services such as formula milk. 20

(Source: <http://uk.reuters.com/article/2013/08/07/uk-china-milkpowder-idUKBRE97602U20130807> and <http://www.ft.com/cms/s/0/d40bda56-ff06-11e2-97dc-00144feabdc0.html?siteedition=uk#axzz2g1t7sgtP>)

## Extract 3 Chinese government to give \$4.9bn to domestic formula milk producers

Chinese formula milk producers, including Inner Mongolia Yili Industrial Group and China Mengniu Dairy, are set to get 30-billion yuan (\$4.9 billion) in official funds to support mergers. The plan is to reduce the number of domestic formula milk producers in the highly fragmented market over the next five years from 200 to 50. This will create stronger sector leaders to increase the ability of companies to compete with international rivals who dominate the premium end of China's \$12.4bn formula milk market. 5

Chinese formula milk firms would gain the support in the form of government subsidies, funds from China Development Bank and favourable tax policies, the China Business Journal said. The total amount would be about 30-billion yuan, it said. 10

(Source: <http://www.bdlive.co.za/world/asia/2013/09/23/state-to-give-chinese-milk-powder-makers-4.9bn>, September 23 2013, 09:05)



**18** With reference to Extract 3, explain the type of integration involved between domestic formula milk producers in China.

(4)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

**(Total for Question 18 = 4 marks)**

## 19 Brand loyalty in contrasting industries

### Extract 1 Know your customers



Long before focus groups, marketing surveys or loyalty programmes, businesses knew their customers because they saw them face to face. The corner shop owner knew who liked a particular brand of jam and kept it in stock for them. He knew when people tended to come in and kept his shop open to accommodate them. Stuart Aitken, the chief executive of Dunnhumby, a leading force in the growing field of data analysis, says he keeps this vision in mind as he uses the latest technology to provide companies with insights about their customers. "This is back to basics," he says. "What we're seeing is that businesses have driven down costs, they've got economies of scale, but they've forgotten who their customer is. What we do is allow businesses to reconnect with their customers, to become the corner store on a large scale."

5

10

As data management becomes more sophisticated and gives clearer pictures of customer behaviour, it is increasingly useful for business decision-making. The pioneers have reaped tremendous rewards. Tesco depended so heavily on the customer profiles delivered by Dunnhumby that it ended up buying the company. Dunnhumby used the data collected by Tesco's Clubcard programme to build detailed customer profiles. It now has detailed knowledge of 80% of its 15 million customers. Dunnhumby's work is widely credited with helping Tesco open a wide lead over its UK supermarket rivals.

15

(Source: adapted from © The Financial Times Ltd, Philip Delves Broughton, 7 March 2011)

## Extract 2 The hairdressing industry

70% of a hairdresser's customers can be described as fully loyal – customers who will continue to go to a particular stylist, even if there are cheaper or more convenient alternatives available. Research at the University of Melbourne in 2010 found that women are loyal to a particular stylist and, when a stylist leaves a salon, the customers are also likely to go elsewhere, creating problems for the business.

5

The research suggests that devising loyalty programmes, cutting prices or offering short-term financial inducements to customers may consequently be a waste of time. Customer loyalty is directly related to retaining employees says the research, something which is within the control of the service manager or owner. "Keep hold of your good staff and you are far more likely to prevent the customers you can't afford to lose from moving on," says Professor Lester Johnson.

10

(Source: adapted from © The Financial Times Ltd, Linda Anderson, 12 February 2010)

**Figure 1 Four-firm concentration ratios in selected industries, 2011**

Supermarkets	76.1%
Hairdressers*	Less than 5%

\*excluding franchise

(Source: © The Press Association, Reproduced with Kind Permission)

(a) Using evidence from Extract 1, explain **one** reason for the takeover of Dunnhumby by Tesco.

(4)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

**\* (b)** Assess the reasons why a few large firms dominate the food retailing industry but not the hairdressing industry.

(16)

A series of horizontal dotted lines for writing the answer.

Handwriting practice area with 20 horizontal dotted lines.

(Total for Question 19 = 20 marks)

## 20 Food manufacturing and retailing

### Extract 1 Northern Foods struggles to meet supermarket power

Food manufacturing is a brutal industry. A fresh burst of commodity inflation has raised input costs and the buying power of the big supermarkets makes it hard for food manufacturing firms to pass these extra costs on. The grocers' influence is a benefit to consumers: though dominated by a handful of big chains, Britain's retailing industry is competitive, and the margins squeezed from manufacturers are shared with shoppers. That buyer power is not such a blessing for suppliers, who struggle to hold on to any cost savings they make. Multinational firms, such as Nestlé or Unilever, possess the strength and the famous brands to fight back. Small suppliers seem powerless.

5

Northern Foods isn't small (it has almost 9,500 employees) and owns some sizeable brands, such as Fox's Biscuits; but the core of its business is supplying prepared foods to which supermarkets then attach their own labels. The firm led the way in chilled prepared meals, partnering with Marks & Spencer (M&S) in the 1980s. But as others caught up, Northern Foods found itself struggling against retailers who could quickly change suppliers if they wanted to pay less.

10

15

Northern Foods' response to its declining fortunes and slumping share price was to seek a merger. In November 2010 there was a proposed merger with Greencore, a Dublin-based food manufacturer. It would have yielded the merged company £40m a year, around 2% of joint sales, through cost and tax savings, and better terms with its own suppliers. Behind the push for a merger was a belief that a bigger, more diversified firm would not be so easily bullied by retailers.

20

Yet it is far from clear that Northern Foods' main problem is insufficient scale. Other food manufacturers have thrived despite pressures on profit margins. Cranswick, a supplier of upmarket pork products to supermarkets, has a bigger stockmarket value than Northern Foods' with less than half the staff. Its revenues and share price have grown quickly in the past decade, as have those of Kerry Group, an Irish firm supplying the upmarket City Kitchen line of prepared meals for Tesco. The firm works closely with retailers to provide good service and improved products and is very disciplined in controlling costs.

25

The key to a good bargaining position for food manufacturing firms, it seems, is to make it costly for retailers to change suppliers. The more reliable the supply, the better the goods and the more tailored the service, the harder it is for retailers to switch. This requires constant effort: a firm that stands still is a target for the cost-cutting chains.

30

(Source: adapted from © *The Economist* Newspaper, 10 February 2011)



## Extract 2 Tesco pushes into northern California

In 2007 Tesco began its move into the United States by opening a chain of small-format grocery stores on the West Coast of the United States (Arizona, California and Nevada) under the brand name Fresh & Easy. Tesco has now begun its expansion into northern California, with the opening of its first two stores in the San Francisco Bay area, indicating the continued expansion of its loss-making US venture under new group chief executive Philip Clarke. A further 10 standard stores are set to open by April 2011. Fresh & Easy, which has more than 160 stores, is to open about two stores a week this year. The initial planned capital expenditure was up to £250 million per year. One of the key decisions for Mr Clarke will be deciding whether to continue with the Fresh & Easy chain, which made a loss of £165m last year, but is expected to break even by 2013, and turn losses into profits by 2015.

5

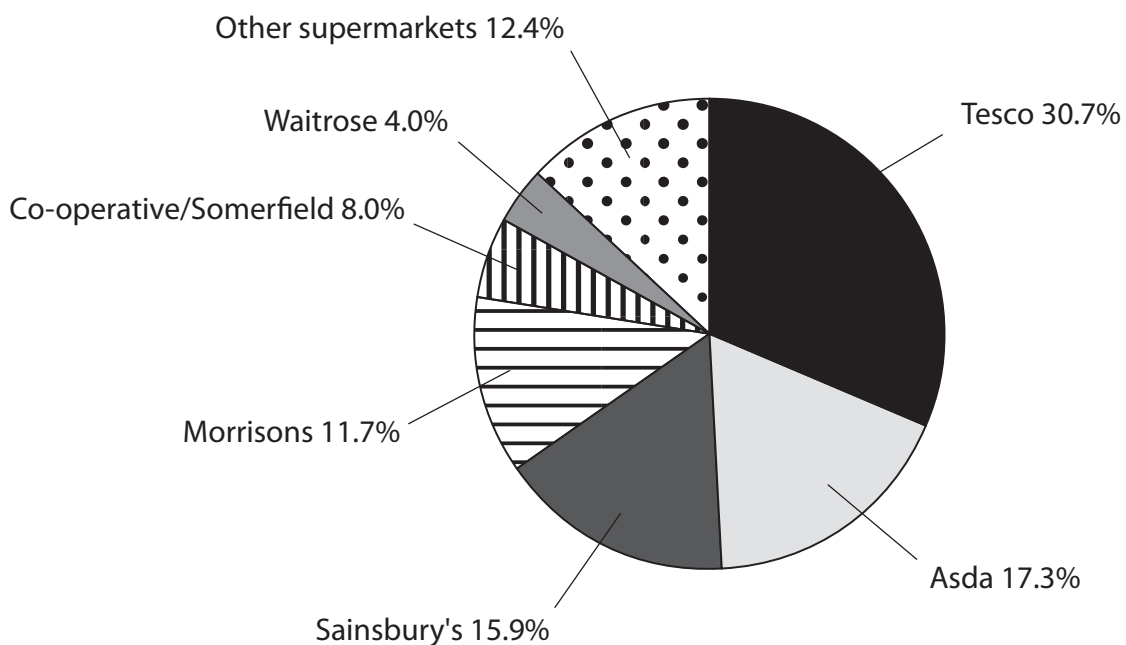
10

Tesco is planning to extend Fresh & Easy into smaller sized stores with the aim of attracting customers from larger out of town stores owned by competitors. Opening the northern California stores demonstrates that Mr Clarke is pushing ahead with expansion, despite the highly unusual decision last October to close 13 loss-making stores, primarily in Arizona and Nevada. These states have been hit by the US housing market downturn, shrinking populations, the high percentage of house repossessions and high unemployment rates.

15

(Source: adapted from © The Financial Times Limited, 3 March 2011)

**Figure 1 UK supermarket market shares by revenue, 2009**



(Source: © Kantar Worldpanel)

### Extract 3 Tesco's purchase of 77 One Stop stores angers rivals

One Stop, a chain of 598 convenience stores in the UK, was bought by Tesco in 2002 as part of its £377m acquisition of T&S Stores. Tesco has been forced to defend itself against allegations of high prices – despite its general claims that its huge scale means consumers benefit from the retailer offering the same prices nationwide.

A spokesperson for Tesco said “The ranges are quite different in One Stop. It is a separate business with a different supply chain and a separate business model with stores that are typically smaller than those running under the Tesco Express name”.

In clearing the original merger, the OFT said “Tesco has said that the transaction will bring consumer benefits as its Express store prices are lower than those of One Stop.” There are currently 1,183 Tesco Express stores, and Tesco controls 3.5% of the convenience store market. Tesco is the world's third largest retailer by revenue, after Walmart and Carrefour, and the second largest after Walmart by profit.

5

10

(Source: adapted from © Guardian News & Media Ltd 2010 16 December 2010)

(a) Using the evidence, explain one potential benefit to Greencore of the proposed merger with Northern Foods (Extract 1 lines 17–21).

(4)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

\*(b) With reference to supermarkets or another industry of your choice, assess reasons why some firms become very large and others remain small.

(16)

A series of horizontal dotted lines for writing the answer.

A large rectangular area with rounded corners, containing 25 horizontal dotted lines for writing.

Dotted lines for writing.

**(Total for Question 20 = 20 marks)**

---

## 21 The global yogurt market

### Extract 1 Yoplait, a French yogurt firm, has plenty of potential buyers

Five years ago the French Government was concerned over rumours that Danone, the world's biggest maker of yogurts, would be bought out by the US giant, PepsiCo. The French prime minister put Danone on a list of companies to be kept under French ownership. Now, however, Yoplait – the world's second-biggest yogurt firm – is on the market. PAI Partners, a French private-equity company, is selling 50% of the firm. The rest is held by Sodiaal, France's biggest dairy co-operative. Once again, bidders are interested.

5

Demand for yogurt is booming across the world. According to a recent study, it is the fastest-growing sector in the dairy industry. The Chinese have been converted to yogurt in part by the addition of small plastic spoons to pots. Even the United States of America is considered an emerging market when it comes to yogurt. The average French person eats 30kg of yogurt per year compared with only 10kg for Americans.

10

Although Yoplait is lagging behind Danone in almost all countries, the two are equally placed in America where Yoplait has had a business arrangement with General Mills for 30 years to sell their yogurts. This has been a great success, but General Mills and Yoplait are currently in disagreement over terms for the renewal of their agreement. Ken Powell, the chief executive of General Mills, does not appear keen to take control of Yoplait, but this could change if Yoplait were to move to dissolve the relationship.

15

The most likely buyer is Lactalis, a French firm that could take over Yoplait in partnership with Nestlé. It put in a \$1.76 billion bid for the whole company in November 2010. Other possible buyers include Unilever, a big Anglo-Dutch firm, and America's Kraft. A bid by PepsiCo cannot be ruled out. The maker of fizzy drinks and crisps wants to expand the healthier end of its range. Yoplait would be a perfect fit—as Danone would have been a few years ago.

20

(Source: adapted from *The Economist Newspaper* 20 November 2010)

### Extract 2 Product launch of Yoplait Greek yogurt

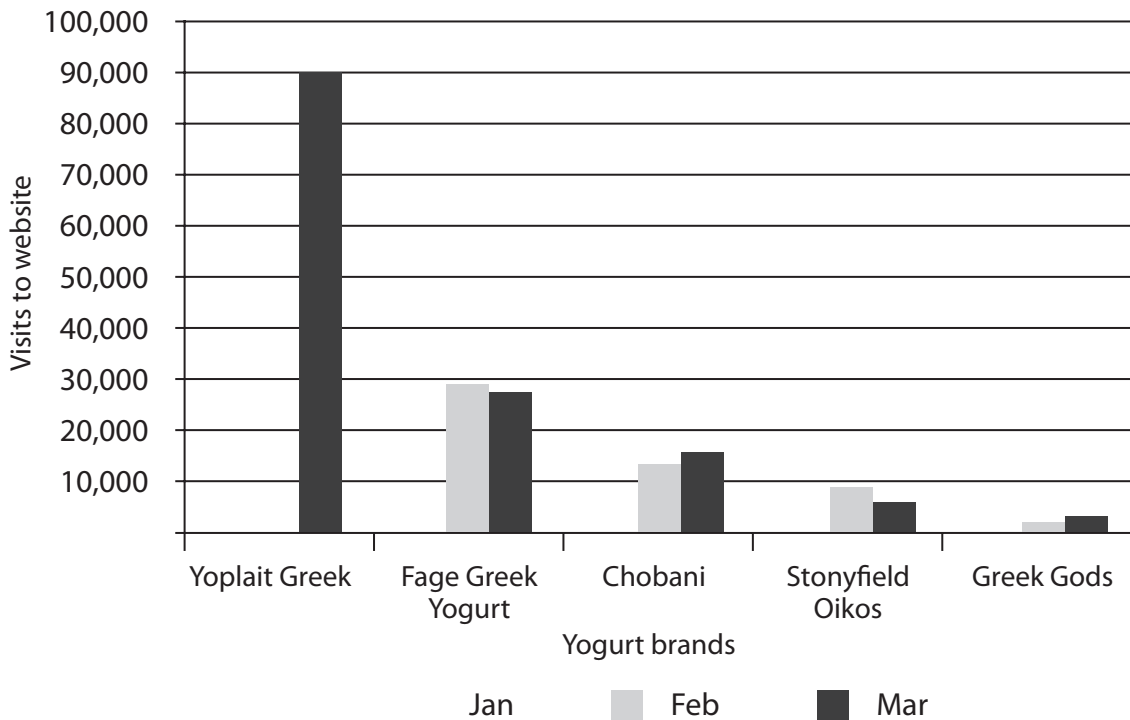
How do you launch a new product in the \$3.7 billion yogurt industry? That's a question that Yoplait recently tackled with the launch of *Yoplait Greek* in March 2010. Greek yogurt is yogurt that has been strained to remove the whey to make it thicker. The market for Greek-style yogurt already has several competitors including *Fage* and *Chobani*. However, *Yoplait Greek* managed to attract 90,000 customers to its website in its first month. This is more than three times the number of visitors to the next largest Greek-style yogurt website. See Figure 1.

5

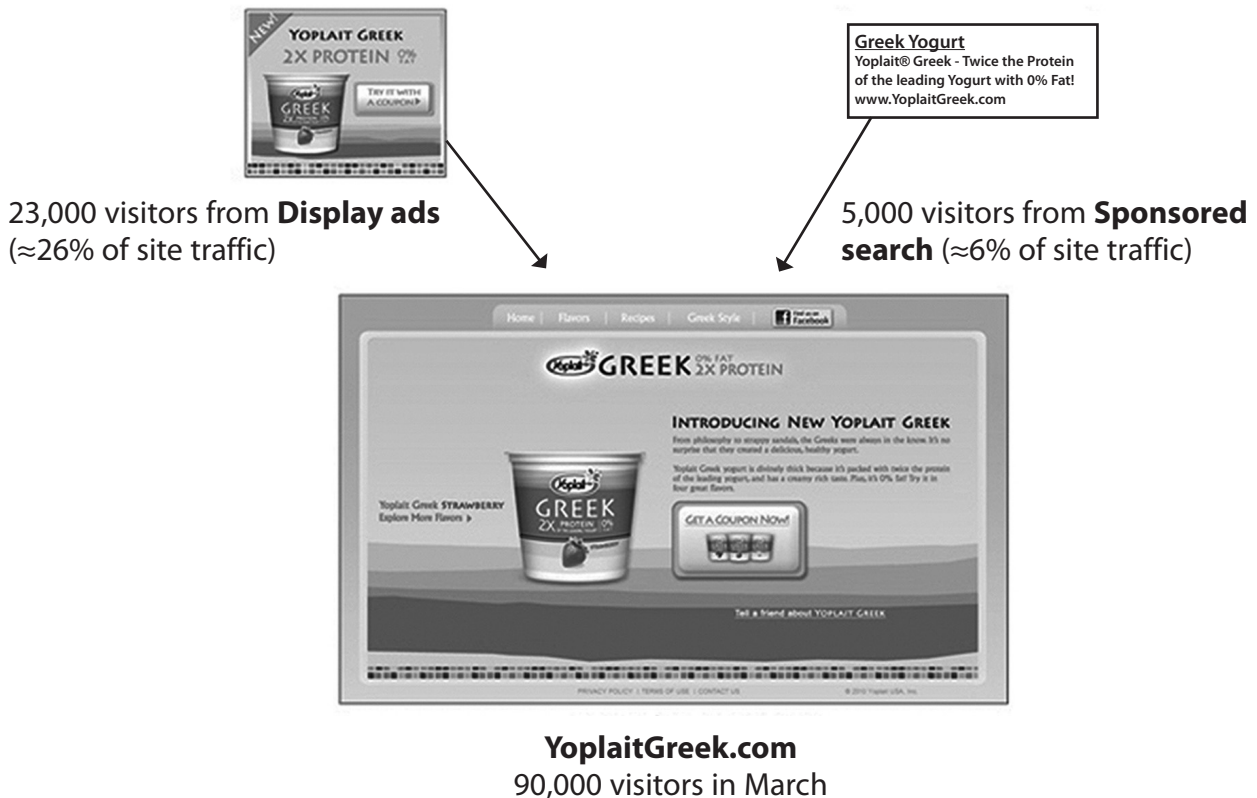
*Yoplait Greek* used a combination of online display and search engine marketing to raise awareness of the product and attract consumers to its website. Display advertisements were placed on social networking sites such as *Yahoo* and *Facebook* to generate awareness. *Yoplait Greek* also had top sponsored search ranking on keywords "yogurt" and "Greek yogurt". The offer to download a coupon was featured prominently on every page on the site. Of the consumers who visited *YoplaitGreek.com* in March, 45% downloaded a coupon.

10

**Figure 1**  
**Number of visits to Greek-style Yogurt websites, January to March 2010**



**Figure 2**  
**Website visitors to YoplaitGreek.com, March 2010**



(Source for Extract 2 & Figures 1 & 2: <http://blog.compete.com/2010/05/03/using-the-online-channel-for-cpg-product-launch-yoplait-greek/>)



**21** Assume Yoplait is taken over by PepsiCo. Assess the possible benefits to PepsiCo **and** consumers of this acquisition.

(12)

A series of horizontal dotted lines for writing the answer.

Handwriting practice area with 20 horizontal dotted lines.

**(Total for Question 21 = 12 marks)**

## 22 Chocolate Manufacturing and Retailing

### Extract 1 Profits rise at Thorntons

Mike Davies, Thorntons' chief executive of the UK's remaining large chocolate manufacturer, reported 25% higher profit, despite a small fall in total sales. As well as from its own shops, Thorntons sells chocolates through its website and to other retailers, such as supermarkets. Sales to other retailers rose by 6.5% to £34.6 million in the 26 weeks to 9 January 2010. In boxed chocolate, Thorntons' sales have grown 82% in the past two years, compared with a 7% decline recorded by Cadbury.

5

The company hopes that a new range of products will help it to become profitable in the second half of the year, which includes the summer months. Thorntons usually records a loss in the second half of the year, because customers eat less chocolate in warmer weather.

10

Source: [http://business.timesonline.co.uk/tol/business/industry\\_sectors/retailing/article7031407.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/retailing/article7031407.ece)  
*The Times* February 18, 2010 'Thorntons plays hard ball on the high street as profits rise' Marcus Leroux

## Extract 2 Kraft takes over Cadbury to become world's biggest confectioner

Kraft's offer to buy Cadbury was accepted by Cadbury's board on 19 January 2010. Kraft, the US food giant, will pay £11.7 billion for Cadbury in cash and shares, some 50% more than the firm's value before the bidding started in September.

Kraft's acquisition may be a good deal for both companies. Kraft has little presence in Britain's confectionery market, where Cadbury is strong, but it has thriving businesses in mainland Europe and Russia where Cadbury has made minimal progress. Cadbury is strong in India and various Commonwealth countries, and has a booming chewing-gum business, particularly in Europe and Latin America, an area where Kraft has little expertise. Between them they can make up lost ground in China, where Mars holds the upper hand. The deal is also set to yield cost savings of £414m a year for the combined firm, operating at a larger scale in emerging markets. This is a good deal for most Cadbury's workers. However, the fact that so much of the deal is financed by debt is a negative: borrowing that looks cheap today could double in price tomorrow. That would eat up the cost savings on marketing and administration already factored into the purchase price, and perhaps force undesirable cuts to operations. Cadbury is already efficient: under its current management it has reduced costs significantly, for example, by off-shoring more of its operations. 5 10 15

Three-quarters of mergers result in a fall in short run profits. In such a sensitive consumer sector, the risks of a culture clash and brand destruction are high. That is what happened to Terry's, a smaller York-based chocolate company bought by Kraft in 1993. Terry's has lost visibility in Britain since production was relocated to central Europe in 2005. The same problem could await Cadbury. 20

There are understandable fears that foreign owners will be more likely than domestic ones to axe British jobs or use British profits to pay off their global debts. But all successful big firms, British and foreign alike, respond to the demands and opportunities of the global marketplace these days, and, as Cadbury's current managers have shown, their behaviour is rarely determined by their nationality. 25

The management practices of multinational companies tend to be better than the average in any country they operate in. In theory, then, Kraft's takeover of a British firm should bring better management to Britain. One problem: Cadbury is itself a multinational, and in no need of lessons from Kraft. 30

Source: adapted from <http://bit.ly/89Azni>

'Cadbury goes American. Is this healthy for British manufacturing?' *The Economist* Jan 19th 2010 and <http://bit.ly/aaFiRe> Jan 21st 2010 'Manufacturing blues: Another one bites the dust' Jan 21st 2010

## Extract 3 Kraft to close Cadbury plant it offered to keep open

Kraft Foods has gone back on its promise to keep open a Cadbury factory in Somerdale near Bristol, just weeks after the British chocolate maker accepted its £11.7 billion offer. The plant, which employs 400 staff, will be closed in 2011. The Unite union said: "This sends the worst possible message to the 6,000 other Cadbury workers in the UK and Ireland. It tells them that Kraft cares little for their workers." 5

Source: <http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/7199322/Kraft-to-close-Cadbury-plant-it-offered-to-keep-open.html> Amy Wilson and Jonathan Russell 09 Feb 2010

**22** With reference to the information provided, evaluate whether Kraft’s takeover of Cadbury is likely to increase economic efficiency.

**(16)**

A series of horizontal dotted lines for writing the answer to question 22.

Lined writing area with horizontal dotted lines.

(Total for Question 22 = 16 marks)

## 23 Iberia and BA merger

### Extract 1 Uniting in the sky – Iberia and BA at last agree to get together to sort out their problems



Like two drowning men, Iberia and British Airways (BA) have long seen each other as potential means of staying afloat. The rate at which the airlines have been sinking at last forced them into each other's arms on November 12th 2009, when a merger was agreed. BA made big pre-tax losses in the year to the end of March as it suffered from the credit crisis and the global economic slump. Iberia actually managed a small profit in 2008. Just as the terms of the merger were agreed Iberia announced a loss in the latest quarter, which includes the usually profitable summer months. BA said that it had lost £292m in the first half of the year, which includes the summer period.

5

These airlines are not alone in their concerns. The total losses for the world's airlines this year are estimated to be £17.6 billion. By agreeing to merge, the two firms will join the trend for big European airlines to get bigger. This has become an attractive means to make substantial cost savings as they compete against low-cost rivals and try to cope with a dramatic fall in numbers of the profit-making business passengers. The two companies estimate that within five years the new group will save some £429m a year by cutting overlapping routes, and by combining maintenance, office functions and business-class lounges. They may also have more buying power when it comes to negotiations to buy new planes from Boeing and Airbus.

10

15

The deal will put the firms back into the big leagues of European aviation. Their combined revenues will put them closer to Air France-KLM, the product of a similar deal in 2004 and Germany's Lufthansa, which has expanded its operations with a series of smaller takeovers of Swiss and Austrian airlines since 2005. Iberia and BA will combine their businesses but maintain separate corporate operations. This will allow them to maintain their roles as the national flag-carriers in Spain and the UK while keeping valuable bilateral international landing rights that go along with that status.

20



One reason for keeping pace with European rivals is that size will become an important factor if consolidation among airlines goes global. The two airlines are already seeking permission from the competition authorities in America and in Europe for an agreement with American Airlines, which would see all three co-ordinating over costs and revenues on transatlantic routes. However, BA may be required to give up landing slots at Heathrow, a price it has been unwilling to pay in the past. 25 30

A protectionist stance in America over the country's troubled airlines has kept a law in place that prevents foreign airlines from owning more than 25% of an American rival. The European Union is pressing for this restriction to be lifted, though there is little sign that it might happen soon. 35

Source: adapted from Economist.com 'Uniting the Sky' Nov 13th 2009, [http://www.economist.com/businessfinance/PrinterFriendly.cfm?story\\_id=14887815](http://www.economist.com/businessfinance/PrinterFriendly.cfm?story_id=14887815).

### **Extract 2 Strike action in response to BA crew reductions and cost cuts**

British Airways was preparing for what could be a damaging strike after workers voted to walk out for nearly two weeks. The airline plans to reduce generous staff levels and benefits for Heathrow-based cabin crew.

The union said 80 per cent of its more than 12,000 BA members had voted, recording a 92.5 per cent vote in favour of a strike. The airline has said the move would cause chaos for hundreds of thousands of passengers. 5

"We're hoping that the size of this vote will make the company think again," said a spokesperson for the union, who added that it would not back down unless BA gave way on the crew reductions that prompted the strike.

Source: <http://www.ft.com/cms/s/0/75a53942-e8aa-11de-9c1f-00144feab49a.html>.

(a) Using the evidence, explain the type of integration involved in the agreed merger between BA and Iberia.

(4)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

\*(b) Evaluate the likely benefits of the agreed merger between BA and Iberia.

(16)

A series of horizontal dotted lines for writing the answer.

A large rectangular area with rounded corners, containing 25 horizontal dotted lines for writing.

Handwriting practice area with 25 horizontal dotted lines.

**(Total for Question 23 = 20 marks)**

## 24 The German Electricity Market

### Extract 1 Electricity prices in Germany

On 22 April 2009, just days after Germany's competition regulator said it had started an investigation into electricity generating companies, RWE, Germany's second largest electricity generating company, predicted that its profits are likely to go up in 2010 and 2011. The regulator is trying to work out why energy prices in Germany are high, and in some cases rising, even though oil and gas prices have fallen sharply. It suspects electricity generating companies may have been keeping prices artificially high by, for instance, shutting power stations simultaneously to limit supplies. Finding evidence of anti-competitive behaviour may be difficult, and proving it even more so. However, it will be clear to the regulator that Germany's electricity market is not working efficiently. An attempt to liberalise the market over the past decade seems only to have worsened many of its problems.

5

10

The first sign that the market is not working is in Germany's electricity prices, which are among the highest in Europe, even though it has an abundance of cheap coal. Moreover, Germany's electricity prices have remained persistently high even at a time when they would be expected to fall. Analysts at Credit Suisse, an investment bank, estimate that the slowing economy should reduce electricity demand by about 5%. Coal prices have dropped by 50% from 2008. Yet there is little sign that either falling demand or lower input costs are leading to cheaper electricity.

15

The main reason Germany's electricity market is not working well is the lack of competition. The biggest four electricity generating companies in Germany produce more than 80% of its electricity. The top two, E.ON and RWE, produce more than 60%. Liberalisation has, if anything, reduced competition. Germany had eight big generating companies in 1997, but that number has since fallen to four because of mergers and acquisitions.

20

A second problem is that Germany's biggest electricity generating companies also own the networks that distribute electricity. Critics argue that this gives them a huge advantage over smaller electricity generating companies, which may struggle to gain fair access to the networks or market information.

25

Change is, however, coming for two reasons. The first is that regulators in Germany have come to realise that the electricity market is not competitive. They have the power to impose very heavy fines for anti-competitive practices. The European Commission is also having some success in forcing firms to sell off their distribution networks. For example, at the end of 2008, E.ON agreed to sell its long-distance distribution network after being investigated by the European Commission.

30

Over the long run, there are ambitious plans to increase the share of electricity from renewable sources, which have high start-up costs. This may reduce the dominance of the country's four biggest electricity generating companies. Germany hopes to get as much as 30% of its electricity from renewable sources by 2020. However, despite increased competition from renewable energy providers, Germany's electricity prices are likely to keep on rising.

35

40

Source: The Economist, 25 April 2009 'Power to the people (at a price)'

**24** Briefly explain the form of integration described in lines 25–26.

(4)

.....

.....

.....

.....

.....

.....

.....

.....

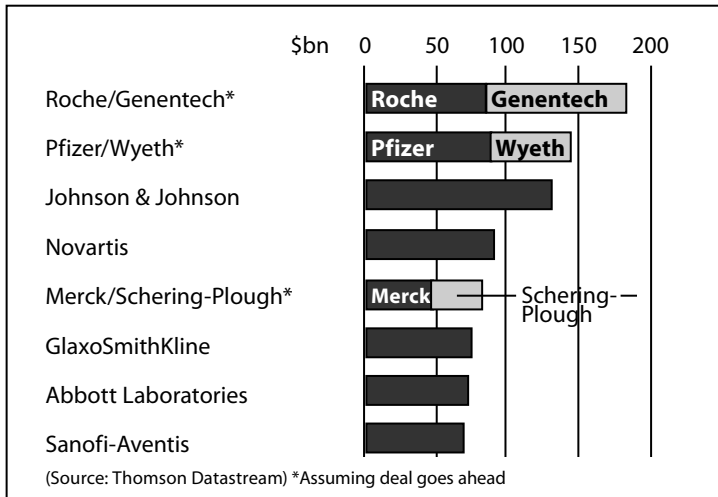
.....

.....

**(Total for Question 24 = 4 marks)**

## 25 The Pharmaceutical Industry

**Figure 1: Global Pharmaceutical Companies by market capitalisation, March 2009, \$bn**



### Extract 1 Merck's manoeuvres

In recent times there has been a series of mergers between pharmaceutical companies. Merck, a US company, has agreed to take over Schering-Plough; Pfizer is acquiring Wyeth; and Roche, a Swiss pharmaceutical company, is paying \$46.8bn for 44% of Genentech, an American firm.

Big drugs companies hope mergers and takeovers will solve their various problems: the lack of new blockbuster drugs coming through their research pipelines; competition from generic (non-brand name) drugs as patents expire, the global economic crisis, and an over-dependence on sales in America, where health-care reforms are likely to reduce profit margins. However, the evidence suggests that many of the supposed benefits of pharmaceutical mega-mergers fail to materialise: bigger firms are no better at innovation, and are often worse. But bosses are pressing ahead anyway.

The main attraction of buying Schering-Plough is that Merck will double (to 18) the number of drugs it has in late-stage development. Merck will also strengthen its international and over-the-counter sales, both areas where Schering is strong (70% of its revenues come from outside America). In addition, Mr Clark promises that there will be cost savings of \$3.5 billion a year after 2011. But this sounds unlikely, given that both companies are already cutting costs heavily. And if the two firms' research teams are so complementary and do not overlap much, as Merck claims, who is going to get sacked?

The deal does at least answer critics who complained that Merck was not acting as vigorously as competitors in buying rivals and moving into new markets. But it also represents a change in strategy for Merck, which unlike many of its competitors has stayed on the sidelines during the industry's previous waves of mega-mergers. Instead, the company has always preferred to grow by developing new products in its laboratories. The task for Mr Clark, who will become boss of the new company, will be to make the deal go smoothly, despite his lack of experience with big mergers.

Source: Adapted from 'Merck's manoeuvres' published in *The Economist*, 13 March 2009.



## Extract 2 Letter from the Consumers Union to Federal Trade Commission in the USA

Dear Sir:

On behalf of the Consumers Union, we urge you to review carefully the competitive and innovation consequences of the proposed Pfizer-Wyeth pharmaceutical company mergers. Our members consistently tell us that high and ever-rising health care costs are a major household fear, and high brand name prescription drug prices are a particular concern. 5

We urge the Federal Trade Commission to review this proposed merger and its impact on

- long-run competition in the pharmaceutical industry and its likely impact on drug prices; 10
- innovation and the development of new, breakthrough drugs.

The merger will result in thousands of employee redundancies. What percent of those lay-offs are in research and development, and are those lay-offs strictly in areas where the two companies were duplicating research, or are new and unique lines of research being terminated? 15

We are faced with continual abuses of good public policy by many in the industry. For example, some firms use payments to buy delays in the entry of competitive generic drugs into the market.

We hope that you will consider a major study of the entire pharmaceutical industry. Why are prices for consumers so high, why has the breakthrough drug pipeline slowed down, and what policies should we pursue as a nation to encourage the more rapid discovery of affordable medicines? Is this merger between Pfizer and Wyeth good or bad for the goal of affordable, new, life-saving drugs? 20

Thank you for your consideration of these views.

Sincerely, 25  
William Vaughan  
Health Policy Analyst  
Consumers Union

Source: <http://www.consumersunion.org/pub/campaignprescriptionforchange/009344.html>.

\* (a) Discuss the benefits that Merck might expect to gain through the takeover of Schering-Plough.

(12)

A series of horizontal dotted lines for writing the answer.

A large rectangular area with rounded corners, containing numerous horizontal dotted lines for writing.

Blank lined page for writing.

**\*(b) To what extent would further mergers and takeovers in the pharmaceutical industry be in the best interests of consumers and employees?**

**(12)**

A series of horizontal dotted lines for writing the answer to the question above.

(Total for Question 25 = 24 marks)

END OF SECTION B