Economics Questions By Topic:

Contestability (3.4.7)

A-Level Edexcel Theme 3

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SECTION B

Read all extracts/figures before answering.

Write your answers in the spaces provided.

1 Apple and Samsung

Extract 1 Jury awards over $1billion in patent victory to Apple

Apple has won a powerful victory in its US patent battle with Samsung, after a jury found that the South Korean electronics firm breached design patents. The jury awarded $1.05 billion in damages to Apple because they found that Samsung had copied features such as 'rubberbanding' scrolling, its sleek glass front, its touchscreen features such as 'tap to zoom' and 'bounce back' scrolling, its edge-to-edge glass front, rounded corners and app icons.

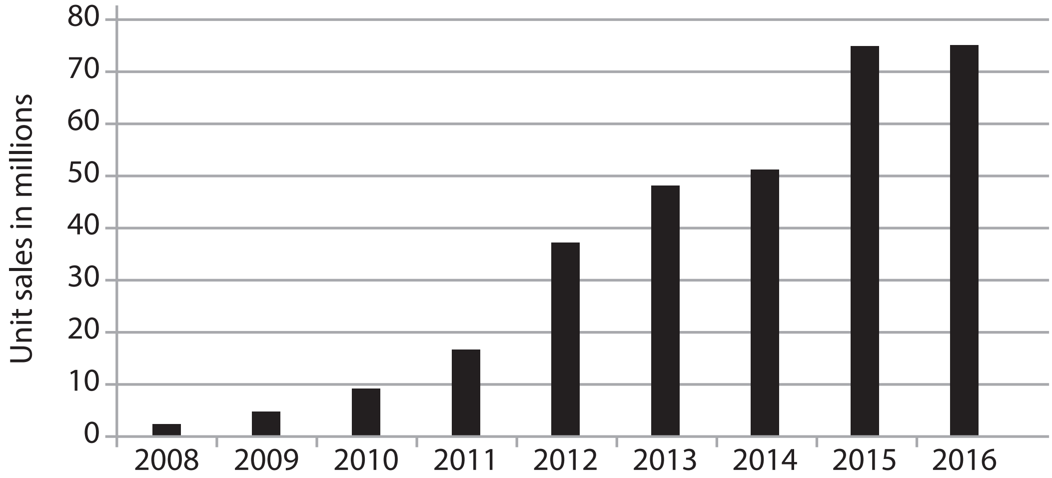
The verdict that consumers could be confused between the two companies' products will send shockwaves through the smartphone industry, with implications for other handset makers that use Google's Android operating system. Analysts point out that the US ruling will have a global effect, because smartphone makers will be unwilling to create different products for different markets, to continue to innovate, to offer choices and to lower prices for the consumer.

(Source: © The Financial Times Ltd, 25 August 2012)

Figure 1 A Samsung Galaxy and an Apple iPhone

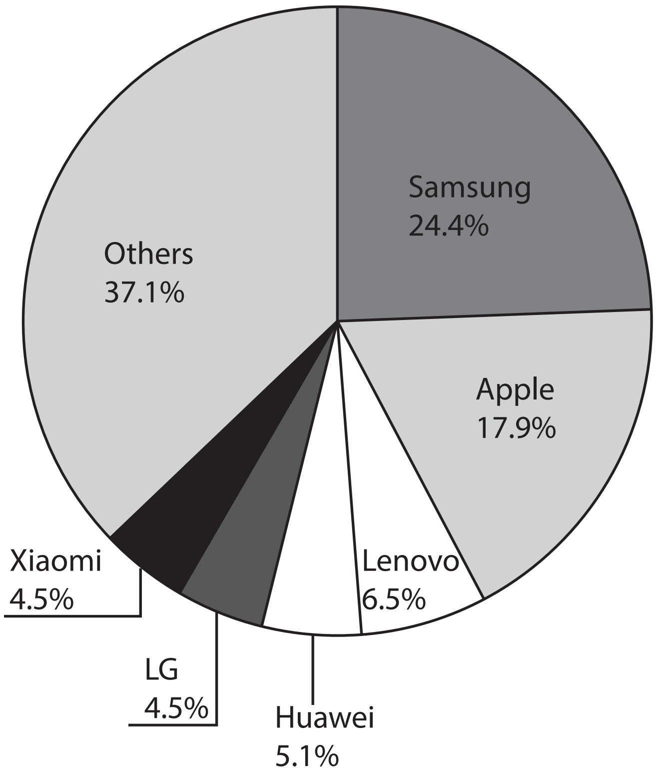
(© Pieter Beens/Shutterstock)

Figure 2 iPhones sold in the first quarter of each year, globally (millions)



(Source: http://ichef-1.bbci.co.uk/news/624/cpsprodpb/C553/
production/_87951505_iphonesales.png)

Figure 3 Global market share of smartphones, 2015



(Source: http://cdn2.dazeinfo.com/wp-content/uploads/2015/04/
worldwide-smartphone-shipments-share-Q1-2015.png)

Extract 2 Apple: the only way is down?

If Apple's revenue was compared to a country's GDP, it would be only slightly smaller than that of Denmark. Impressive though this may be, Apple's record-breaking profits are under threat if Chinese growth slows down. To date, Apple has sold more iPhones in China than in the US. This quarter's recent profits – $18 billion for the first quarter of 2015 – reflect Apple's ability to maintain profit margins even while selling phones in China at reduced prices in order to enter that market. The iPhone and iPad are superb devices, but they are not so radically different from those made by rivals. It is economies of scale that preserve Apple's position, while others struggle to innovate, design and produce in such numbers.

Competitors envy those profit margins, and talk about 'democratising' technology, which means bringing prices down to make equally beautiful devices attainable for all. It is, for now at least, a very optimistic view. That's largely because the iPhone combines the 'cool' factor with superior design and, unless Apple's image is ruined, it will continue to be more attractive to millions of consumers than any other phone. No other manufacturer, whether South Korea's Samsung or China's Xiaomi, has managed to break into the high-cost, high-margin market in the same way as Apple. The same is true with the iPad, and the same is likely to go for the Apple Watch.

What, however, happens next? No company has ever sustained such world-beating performance for years on end, and when it comes to technology new trends come and go from various companies all the time. Statistics suggest Apple's sales and profits are likely to be affected by the global slowdown in growth, most particularly that of China, and turbulence in world markets.

But there are two key things to consider: first, there is a new technology landscape that makes monopolies more likely than ever. We are all likely to use one search engine online. We are similarly loyal to operating systems and devices with which we are familiar. Apple has built its success on repeatedly delighting consumers and reinforcing their loyalty. The bond between Apple and consumers looks stronger than ever, and the company's financial performance simply reflects that. This problem makes it difficult for regulators to determine appropriate competition policy.

Second, is a point that doesn't get made often enough: Apple's iPhone is the device that drives its profits, and the iPhone 6 may be the best iPhone ever made but it is an evolution of the original 2007 device. Its new Watch is an exciting prospect, but the phone itself remains the driver of profits. As more and more competitors catch up, Apple's ability to maintain its lead is likely to rely on ever more marginal improvements. At which point marketing is all that's left – and how many consumers will value marketing over the pound in their pocket? A new technological breakthrough may be needed to maintain Apple's dominance in the future.

(Source: adapted from Matt Warman, 28 Jan 2015, *The Telegraph,* http://www.telegraph.co.uk/technology/apple/11373701/Apple-the-only-way-is-down.html)

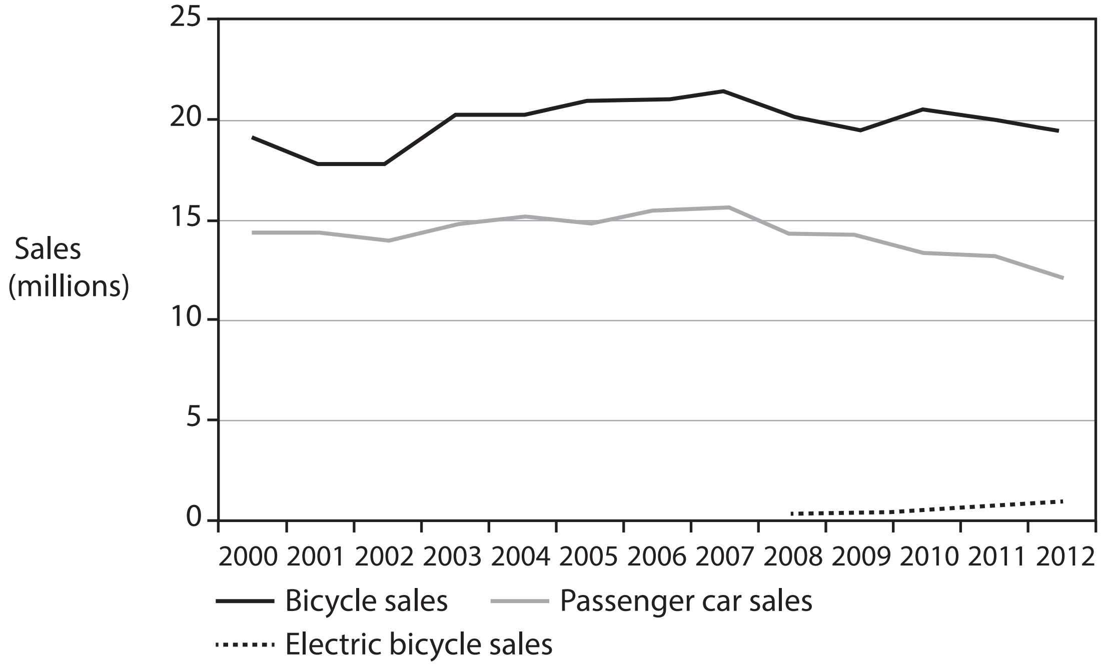
1 Discuss the level of contestability in the market for consumer technology products such as smartphones.

(12)

(Total for Question 1 = 12 marks)

2 Electric bicycles (e-bikes)

Figure 1 EU trends in Bicycle sales, passenger car sales and electric bicycle sales



Extract 1 Changing trends in private car and bicycle use in the EU

Electric bicycles (e-bikes) use batteries to add to a rider's own efforts with top speeds of up to 40kph.

Navigant Research, a market research company, sees trends that would suggest a possible correlation between increasing sales of e-bikes, as well as rentals, and declining car sales.

For every car sold in the EU, almost two bicycles are sold. E-bike sales are growing by 22% a year while car sales are declining by 2%.

The market for e-bikes is likely to grow to between 1.0 million and 1.2 million units in 2013. But the question remains: does this mean that Europeans are shunning cars for bicycles and e-bikes?

(Source: http://evworld.com/news.cfm?newsid=30212)

Extract 2 Downhill all the way

Electric cars are expensive and they stop dead if not recharged. These problems explain why the demand for electric cars remains low. E-bikes on the other hand can still be pedalled without a charged battery and are increasingly affordable. Faster e-bikes with more sophisticated electronic controls, such as those popular in China, may also be gaining ground.

In the Netherlands one bicycle in six sold is an e-bike. In Germany the cycle industry expects e-bike sales to grow by 13% in 2013, to 430 000 and to account for 15% of the market. In France sales of traditional bicycles fell by 9% in 2012 while those of e-bikes grew by 15%.

As more people move to cities, e-bikes are catching on, helping to reduce problems of parking, transport costs and global warming. China buys most of them and makes even more, with European sales of 1.5 million in second place. The global market is expected to be 40 million in 2015.

(Source: http://www.ft.com/cms/s/0/9ecf3158-e536-11e0-bdb8-00144feabdc0.html#ixzz2gIhjny30)

Extract 3 Global electric bike sales in high gear

Growing e-bike sales are turning bicycle manufacturers, long viewed as unexciting companies, into firms worth investing in. The market for bicycles has been mature for years. That started to change in 2008, as the new generation of e-bikes was launched. The smaller batteries and attractive designs began luring older customers away from push bikes.

"Over 90% of e-bike sales are to people over age 50, but I see the age slowly coming down, and more men buying," said Karel van Waselaer, CEO at Gazelle, a Dutch manufacturer. While there are e-bike specialists, such as Switzerland's Biketec and Germany's Sachs, most traditional brands are coming out with e-bike lines as well, for example, the major US bicycle manufacturer Cannondale introduced its own e-bike line in 2013.

E-bike specialists have not yet begun to squeeze out small competitors on price, largely because almost all brands source their electrical components such as batteries from the same few suppliers, chiefly Shimano of Japan and Germany's Schramm. "The battery is 25% of the total price of the e-bike," said Patrick Langley of industry research firm GFK.

(Source: http://www.ft.com/cms/s/0/9ecf3158-e536-11e0-bdb8-00144feabdc0.html#axzz2gIcm2IAW)

2 Discuss the level of contestability in the e-bike market.

(16)

(Total for Question 2 = 16 marks)

3 A crowded car industry

Figure 1 US car market, % market share 2010

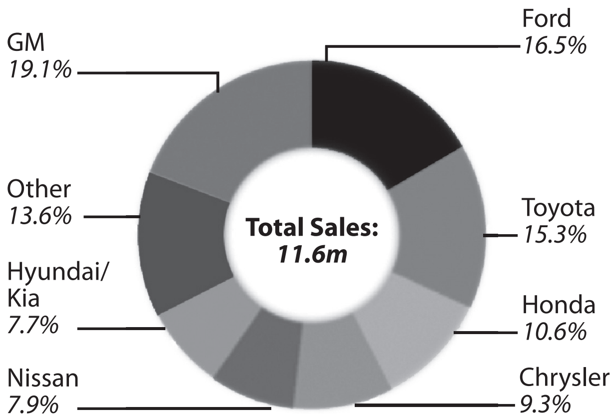
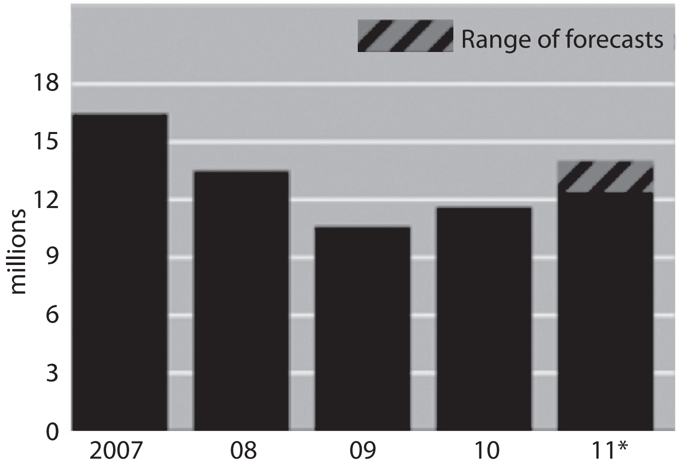


Figure 2 US car market, units sold (millions)



Extract 1 United States carmakers are back. Tough competition is waiting for them

Every year at the Detroit Motor Show there is a major display used by the main manufacturers of cars to bring new models to the US market. For the past two years it been a dismal affair, but this year the parties were in full swing again. Helped by government bail-outs and with debt burdens lightened by bankruptcy, Chrysler and General Motors (GM) are back on their feet. Ford, the other member of Detroit's Big Three, is thriving.

The biggest impact on the opening day was made by a Volkswagen saloon, which is to be built in a new factory in Tennessee. This is causing some concern for local manufacturers. Europe's market-leading carmaker is taking aim at the heart of the American market for the first time in over 20 years. Its bold move is just one sign of breakup in a market once dominated by the Big Three and a small collection of Japanese rivals.

The recession sent car sales in America falling from 16.5 million in 2007 to just over 10 million in 2009 (see Figure 2). Since then, sales have risen. Sales in December 2010 were equivalent to an annual rate of 12.7 million cars, the best performance since 2008, with a predicted 10% rise in 2011. Analysts point to an improvement in the creditworthiness of buyers which increases the willingness of banks to lend. Americans are buying big, expensive vehicles again.

The 2008 crash allowed Chrysler, GM and Ford to strengthen management and push through changes that had long been blocked by unions. Capacity was cut drastically: Ford closed 17 factories and reduced employee numbers by over 40%. GM abandoned brands such as Hummer and Saturn to focus on Chevrolet, Buick and Cadillac, while Ford got rid of all brands except Ford and Lincoln. Health care for company pensioners, for a long time a problem for the firms' owners, was transferred to union-run trusts. New workers can now be hired at lower rates of pay than those forced up by the United Auto Workers (Union) during the boom years. Ford's chief executive says his company can compete on price with factories opened in weakly unionised southern states by Japanese, South Korean and German carmakers. Ford may have made as much as $10 billion in profit last year.

For the Big Three now read the Magnificent Seven. Toyota, Honda and Nissan have been joined by Hyundai and its sister brand Kia in a fragmented market where seven manufacturers each have more than 5% of the market (see chart). And Volkswagen is trying to join the club. Volkswagen and its Audi offshoot sold 358,500 cars in the United States last year. The firm aims to triple sales by 2018 and plans to spend $3 billion on marketing and opening more dealerships.

Competition is particularly fierce in the "mid-range" market, where Toyota's Camry, Nissan's Altima and Honda's Accord have long dominated. Since petrol prices first rose above $3 a gallon in 2005 Detroit has been trying to reconquer the mid-range car market instead of relying on sales of expensive gas-guzzlers. Ford is bringing in slightly Americanised versions of saloon cars that have been successful in Europe, while GM plans to do the same with versions of its German-designed Opels. Chrysler will import Italian technology from Fiat as the ties between the two companies strengthen.

They will face an old adversary. Quality problems at Toyota led to $48.8m in government fines and a recall of 4 million vehicles in America alone. Toyota's embattled chief executive, Akio Toyoda, making his first visit to the Detroit show, admitted that the firm "did receive damage". But it would be foolish to underestimate the ability of the world's biggest carmaker to put its house in order: it still has the most efficient system for product development and manufacturing, even if it must focus for the moment on quality control. For the first time it is offering customers discounts to increase sales.

The Japanese firm could learn a good deal from Hyundai and Kia. The South Korean firms suffered from reputations for poor quality when they entered the American market and relied largely on bargain prices to sell their vehicles. Under pressure from consumer magazines they gradually improved their quality and have won recognition from critics and customers. That jump in quality, as well as heavy marketing, has turned them into serious competitors. A glimpse of the next challenger came from BYD, a Chinese car manufacturer, which showed off an innovative, compact battery-powered car.

(Source for Figures and Extract: © *The Economist* Newspaper, *The Economist*, 13 Jan 2011)

3 To what extent does the evidence suggest that the US car market is contestable?

(12)

(Total for Question 3 = 12 marks)

4 Maintaining competition in markets

Extract 1 Reckitt could face £80m fine over Gaviscon 'market abuse'

The household goods giant Reckitt Benckiser (RB) has been accused by the Office of Fair Trading (OFT) of deliberately exploiting its 'dominant market position' to stop National Health Service (NHS) doctors from supplying generic (unbranded) versions of its Gaviscon indigestion medicine. When a patent ends, rival companies can legally copy the ingredients of the drug using the generic formula.

However, RB withdrew Gaviscon Original from the NHS prescription database with the effect that open competition was delayed until 2007. This meant that when doctors tried to prescribe the original product, they could only find the new Gaviscon Advance on the database. This new drug is patent-protected until 2016. An industry informant claimed that generic copies of Gaviscon Original could have saved the NHS about £40 million since 1999, when the patent ended.

If it is found to have abused its power, the OFT could fine RB – which also makes the painkiller Nurofen and the dishwasher powder Finish – up to 10 per cent of its annual sales, which came in at £7.78bn in 2009. The accusation by the OFT is significant because Gaviscon is a major contributor to RB's revenues.

While Gaviscon Original is still available as an over-the-counter product, Reckitt has previously commented that it was the second largest prescribed brand on the NHS. Reckitt said: 'Reckitt Benckiser believes it competes fairly and within the letter and spirit of the law. RB has stated that up to 80% of its revenues and profits from pharmaceutical sales could be lost after the launch of generic competitors.'

Other OFT Investigations

The Office of Fair Trading's assault on the medicines market is the latest example of its increasingly aggressive interventions under chief executive John Fingleton. Since arriving at the OFT in 2006, Mr Fingleton has stepped up the regulator's activities, launching a string of investigations into industries ranging from housebuilding to supermarkets to banking. 'The OFT recently announced a review of barriers to entry, exit and expansion in the retail banking market. We are now talking to various companies about how well some financial markets work. Except where there are serious breaches of the law, the OFT's preference is to seek ways for market problems to be resolved by companies themselves rather than by imposing solutions.'

There have been some OFT failures, for instance the attempt to regulate the banks regarding unauthorised overdraft fees failed when the High Court ruled that the charges were beyond the control of the OFT. However, a string of investigations is continuing, into both market abuse cases and more straightforward competition matters. The OFT is seeking, for example, the right to consider the merger of T-Mobile and Orange in the UK, rather than leaving the decision to Europe's competition watchdogs.

Source: The Independent Online February 24 2010 James Thompson http://www.independent.co.uk/news/business/news/reckitt-could-face-16380m-fine-over-gaviscon-market-abuse-1908493.html' and http://www.telegraph.co.uk/finance/businesslatestnews/7535749/Are-City-markets-working-for-business-and-the-economy.html, 30 March 2010

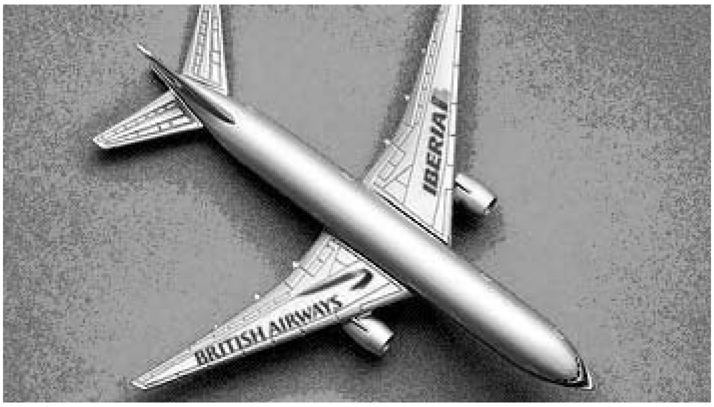
4 To what extent does the threat of competition affect a firm's behaviour? Answer either with reference to the healthcare product industry or to an industry of your choice.

(16)

(Total for Question 4 = 16 marks)

5 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.

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.

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.

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.

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.

Source: adapted from Economist.com *'Uniting the Sky'* Nov 13th 2009, 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.

"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.

5 Assess the likely impact on contestability of the airline industry resulting from the mergers and agreements referred to in the evidence.

(12)

(Total for Question 5 = 12 marks)

6 Newspapers online

Extract 1 Did you pay to read this?

Until recently, there were two types of newspaper website: those that made you pay to read many of the articles (*The New York Times*, *The Wall Street Journal* and the *Financial Times*) and those that didn't.

That is changing. *The New York Times* has announced that almost all its online material would now be free. FT.com has moved to a system of free access for occasional visitors. The theory is that increased advertising revenue will replace subscription revenue. Online advertisers are charged only 20% of the print edition equivalent, and the placing of adverts is tailored to readers' profiles.

The big question is whether online advertising makes more money than subscriptions. Research by the University of Chicago Business School on what the profit-maximising price would have been for online access suggests that washingtonpost.com would probably have made more money by charging a few dollars a month back in 2001 or 2002, when it offered free access. But by 2004, as the online advertising market improved, charging for access no longer increased total revenues.

Source: adapted from FT.com 20 October 2007 *Undercover Economist: Did you pay to read this?* Tim Harford.

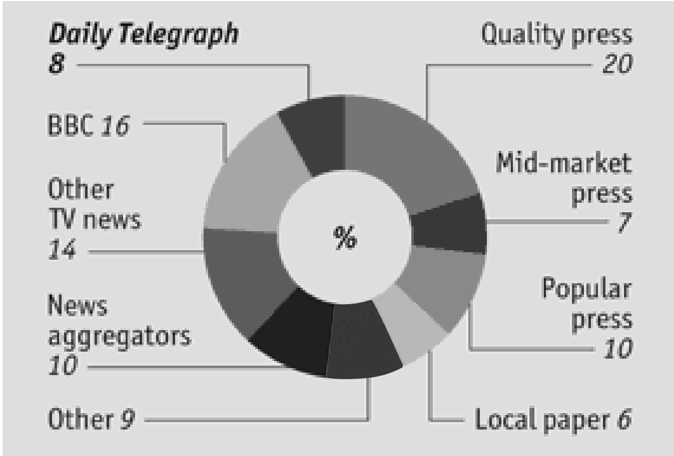
Extract 2 More bad news for the newspaper business

The decision to give away newspaper content free online is increasingly viewed as one of the world's worst-ever business decisions. But any newspaper firm which wants to undo this error has a problem. If one newspaper starts charging, readers may migrate to those that remain free. If, on the other hand, a lot of papers begin charging at the same time, readers might be pushed into paying. This plan has always seemed optimistic. A study released this week suggests it may be completely wrong.

Oliver & Ohlbaum, a media consultancy, asked people what newspaper they tended to read and whether they subscribed to it (most get their papers from shops). Then they asked readers about where they went for news on the internet. The results were consistent: when it comes to online news, Britons are shamelessly disloyal.

The theory underlying most papers' online strategies is that people will buy a favourite newspaper and then go to its website for breaking news and extras such as blogs. But fans of the *Daily Telegraph*, for example, the most popular quality daily paper, got just 8% of their online news from its website (see Figure 1). They spent twice as much time visiting the BBC's news website and more than twice as much reading other quality papers.

Figure 1 Percentage of time spent reading online news sources by *Daily Telegraph* readers



Source: Oliver & Ohlbaum Trends November 2009, used in *The Economist*, 3 December 2009.

The survey also contained bad news for those publishers hoping to co-ordinate attempts to charge. When *Guardian* readers were asked whether they would pay £2 a month to read their favourite paper online, 26% said yes. But what if all newspapers charged? The proportion prepared to pay for the *Guardian* might have been expected to rise. Instead it fell to 16%. This seems odd, until one considers readers' disloyalty. Readers protested at the prospect of having to pay repeatedly to continue to access a wide variety of news sources. The questions are hypothetical, and people may react differently if and when charges for online news are introduced. However, this survey will hardly encourage newspaper owners to charge for online services.

Source: adapted from *The Economist* print edition 'The promiscuity problem', 3 December 2009.

Figure 2 Newspaper sales (hard copy) circulation, daily

Title	2001	2005	2009
The Financial Times	478 161	422 519	426 676
The Telegraph	1 022 263	920 745	783 210
The Times	734 220	686 327	617 483
The Sun	3 636 561	3 382 509	3 146 006
Total of all daily newspapers (rounded)	15 500 000	13 300 000	13 000 000

Source: Audit Bureau of Circulations http://www.abc.org.uk/ accessed via http://en.wikipedia.org/wiki/List_of_newspapers_in_the_United_Kingdom_by_circulation#Circulation_1950.E2.80.931999.

6 To what extent might the contestability of the markets for online news and printed newspapers differ?

(12)

(Total for Question 6 = 12 marks)

7 The market for instant coffee

Figure 1: UK Instant coffee market shares, 2007–8

Coffee brand	Market share (%)
Nescafé	**51**
of which Nescafé original	25
Nescafé Gold Blend	13
other Nescafé	10
Nescafé Decaffeinated	3
Kenco	**17**
of which other Kenco	6
Kenco Really Smooth	4
Kenco Really Rich	4
Kenco Decaffeinated	3
Douwe Egberts	**5**
Carte Noire	**3**
Others (including supermarket own label brands)	**24**

Source: http://www.brandrepublic.com/InDepth/Features/790070-Insight-Coffee---Inst

Extract 1 Changing Tastes

The rise of the coffee shop has brought urban café culture to the UK. While consumers are connoisseurs of brewed and filter coffee on the high street, they are, however, opting for convenience at home, where instant coffee still dominates.

Amongst instant coffees, there is a growing willingness among consumers to trade up to premium and speciality varieties. Growing awareness of health, wellbeing and ethical trading are also affecting consumers' purchasing decisions, and, therefore, the market.

Instant coffee accounts for more than 80% of the total UK market for coffee. Nescafé leads the field, and last year announced a £17 million promotional investment in its instant range.

Source: Ahttp://www.brandrepublic.com/InDepth/Features/790070-Insight-Coffee---Inst

Extract 2 Can instant coffee give Starbucks a boost?

In the US, instant coffee is regarded as being cheap and tasteless. The global instant coffee market is worth $17.7 billion, just $700 million of which is sold in America. Instead, Americans drink brewed and filter coffee – 65 billion cups of it a year.

Starbucks, best known as 'the home of the $4 latte', is gambling its luxury image by entering the instant coffee market with a new brand called Via, which can be sold through supermarkets and other outlets. At first, Via will come in packets of twelve individual servings, costing less than $1 per cup. This is much more than other instant coffees, but much less than a cup of coffee at one of Starbucks' cafés. As John Quelch, a Harvard Business school professor said: "Instant, soluble coffee has long been an unspeakable wasteland. Conventional wisdom would be that no premium brand should go near it".

But Howard Shultz, the chief executive of Starbucks, believes that with a superior instant coffee, he can take a share of the consumers who currently drink brewed and filter coffee at home. Starbucks says it has patents that should prevent competitors from quickly copying Via, which will go on sale in the US in June 2009. The opportunity may, however, be biggest in other countries: in the UK over 80% of the coffee sold is instant, compared with just 10% in America.

Mr Shultz insisted that the Via instant coffee brand was an innovation Starbucks had been working on for almost 20 years. It was just fortunate that the creation was perfected in time for the economic downturn. However, Starbucks also faces increased competition. For example, McDonald's is heavily promoting its McCafé espresso-based drinks.

(Source: Adapted from *The Times Online*, 17 February 2009 (http://business.timesonline.co.uk/tol/business/industry) and *The Economist*, 21st February 2009.

7 To what extent is the UK market for instant coffee contestable?

(8)

(Total for Question 7 = 8 marks)

END OF SECTION B