Economics Questions By Topic:

Oligopoly (3.4.4)

A-Level Edexcel Theme 3

0207 060 4494
www.expert-tuition.co.uk
online.expert-tuition.co.uk
enquiries@expert-tuition.co.uk
The Foundry, 77 Fulham Palace Road, W6 8JA

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SECTION A

Write your answers in the spaces provided.

1 The following table shows global sales of PCs by company in 2015.

Company	**Sales of PCs (million)**
Lenovo	57 182
HP	53 534
Dell	39 049
Apple	20 794
Acer Group	19 680
Others	86 461
Total	**276 700**

(Source: IDC, reported in *The Times*, 14th January 2016)

Calculate the five-firm concentration ratio. You are advised to show your working.

(2)

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(Total for Question 1 = 2 marks)

2 The following table shows the sales (millions) of tablet computers in quarter 3, 2012 and quarter 3, 2013:

Sales of tablets (millions)		
Manufacturer	**Quarter 3, 2012**	**Quarter 3, 2013**
Apple	14.0	14.1
Samsung	4.3	9.7
Asus	2.3	3.5
Lenovo	0.4	2.3
Acer	0.3	1.2
others	13.5	16.8
Total	**34.8**	**47.6**

(Source: http://appleinsider.com/articles/13/10/30/ipads-marketshare-drops-11-in-q3-on-lack-of-new-models-android-posts-significant-gains)

(a) The 3-firm concentration ratio in quarter 3, 2012 was 59.2%.
Calculate the 3-firm concentration ratio in quarter 3, 2013 in this market.
You are advised to show your working.

(2)

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(b) It can be deduced from this data that the tablet computer market is:

(1)

A monopolistically competitive

B perfectly competitive

C oligopolistic

D a natural monopoly

Answer ☐

(c) Explain **one** barrier to entry that is likely to exist in the tablet computer market.

(2)

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(Total for Question 2 = 5 marks)

3 The following matrix shows the possible revenue outcomes (£ per day) for two firms tendering for contracts to supply in-service training programmes to local authorities. Assuming Hanna Ltd and Jax Ltd have colluded, and agreed a price that will give each a revenue of £1000 per contract, what subsequent actions would lead to a revenue of just £800 per contract?

(1)

		Hanna Ltd	
		High price	Low price
Jax Ltd	High price	1000 / 1000	1200 / 600
	Low price	600 / 1200	800 / 800

A Both firms set a high price

B Hanna Ltd sets a high price and Jax Ltd sets a low price

C Jax Ltd sets a high price and Hanna Ltd sets a low price

D Collusion breaks down

E The firms engage in tacit collusion

Answer ☐

Explanation

(3)

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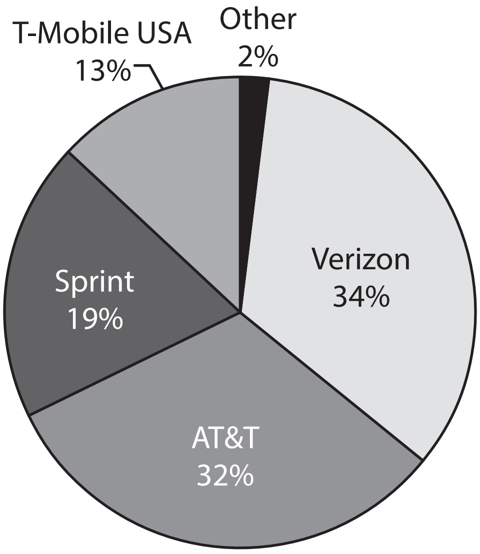
(Total for Question 3 = 4 marks)

4 The diagram shows the market share of the cell [mobile] phone market in the USA.



In August 2014, after a failed attempt at a merger, a price war broke out between T-Mobile USA and Sprint. Under which market conditions are such price wars most likely to occur?

(1)

A Monopolistic competition in the short run

B Monopolistic competition in the long run

C Markets where there is a low concentration ratio

D A low degree of interdependence between firms

E Oligopoly

Answer

Explanation

(3)

(Total for Question 4 = 4 marks)

5 Several firms have priced tablet computers below the average cost of production. The most likely reason for this pricing policy is to

(1)

A increase diseconomies of scale

B increase barriers to entry

C create a cartel

D achieve short-term break-even output

E achieve short-term profit maximisation

Answer

Explanation

(3)

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(Total for Question 5 = 4 marks)

6 Shoe repairing firms in a large city are providing similar services, and they are making normal profits. Customers tend to be loyal to certain firms. The market structure most resembles

(1)

A perfect competition in the short run

B perfect competition in the long run

C monopsony in the short run

D monopolistic competition in the long run

E oligopoly in the short run

Answer ☐

Explanation

(3)

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(Total for Question 6 = 4 marks)

7 Early in the morning on 19 September 2013, Microsoft revealed that the price of its new games console Xbox One would be £429 in the UK. Later that day, Sony announced that its new PlayStation 4 games console would be sold for £349 in the UK.

One possible reason why Sony chose to price its product significantly lower than Microsoft was because

(1)

A it had first mover advantage

B it wanted to undercut Microsoft and take a large market share

C it wanted to benefit from relatively price-inelastic demand

D it was colluding with Microsoft

E it had higher sunk costs in developing the new games console

Answer ☐

Explanation

(3)

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(Total for Question 7 = 4 marks)

8 The table below gives the 4-firm concentration ratio in a selection of industrial sectors in the USA.

Sector	**4-firm concentration ratio**
Food manufacturing	16.8
Metal household furniture manufacturing	27.6
Motor vehicle manufacturing	81.2
Breakfast cereal manufacturing	82.1
Malt manufacturing	91.4
Guided missile and space vehicle manufacturing	95.3

(Source: US census www.census.gov/prod/ec02/ec0231sr1.pdf)

What can be inferred from this information?

(1)

A The metal household furniture sector is more concentrated than the breakfast cereal sector

B There are no barriers to entry in food manufacturing

C There are external diseconomies of scale in motor vehicle manufacturing

D Four firms have significant market power in the manufacture of motor vehicles

E The guided missile and space vehicle sector is monopolistically competitive

Answer

Explanation

(3)

(Total for Question 8 = 4 marks)

9 Supermarkets selling freshly baked bread are operating in an oligopoly. They tend to keep prices stable for a popular, frequently compared product, an 800 gram white loaf. One reason for this might be

(1)

A supermarkets know that the pricing decisions of one supermarket will impact on those of other supermarkets

B supermarkets are independent and base their prices on costs alone

C there is heavy regulation in the industry to prevent tacit collusion

D supermarkets are unable to engage in non-price competition

E if prices were cut by one supermarket then the others would leave prices unchanged

Answer ☐

Explanation

(3)

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(Total for Question 9 = 4 marks)

10 In January 2010 the Office of Fair Trading (OFT) referred the UK's local bus services to the Competition Commission over concerns about pricing. It had received complaints about the "predatory behaviour" of existing firms, designed to exclude new entrants from the market. Which characteristic was likely to have been observed?

(1)

A Prices equal to marginal cost

B High prices in the short run

C Prices set above average costs in the short and long run

D Revenue maximisation pricing

E Prices set below average variable costs in the short run

Answer ☐

Explanation

(3)

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(Total for Question 10 = 4 marks)

11 Game theory can be used to explain the breakdown of a cartel. Which of the following is the most likely cause of such a breakdown?

(1)

A A possibility of an individual member gaining short term profits

B An aim of reaching long term equilibrium

C Economies of scale

D Satisficing behaviour

E Reduced risk of collusive behaviour being investigated

Answer ☐

Explanation

(3)

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(Total for Question 11 = 4 marks)

12 The following matrix shows the possible revenue outcomes of two firms tendering building services to the government. Assuming Hanna Ltd and Jax Ltd have agreed a pricing strategy that will give each a revenue of £1000, what change in pricing strategy would increase the revenue for Hanna Ltd?

(1)

		Hanna Ltd	
		High price	Low price
Jax Ltd	High price	£1000 £1000	£1200 £600
	Low price	£600 £1200	£800 £800

A Both firms set a high price

B Hanna Ltd sets a high price and Jax Ltd sets a low price

C Jax Ltd sets a high price and Hanna Ltd sets a low price

D Both firms set a low price

E The firms engage in tacit collusion

Answer ☐

Explanation

(3)

(Total for Question 12 = 4 marks)

13 Firms tendering for a private finance scheme from the government verbally agree with each other to fix a higher price than if there were independent bids. This is an example of:

(1)

A tacit collusion

B overt collusion

C symmetric information

D monopolistic competition

E regulatory capture.

Answer ☐

Explanation

(3)

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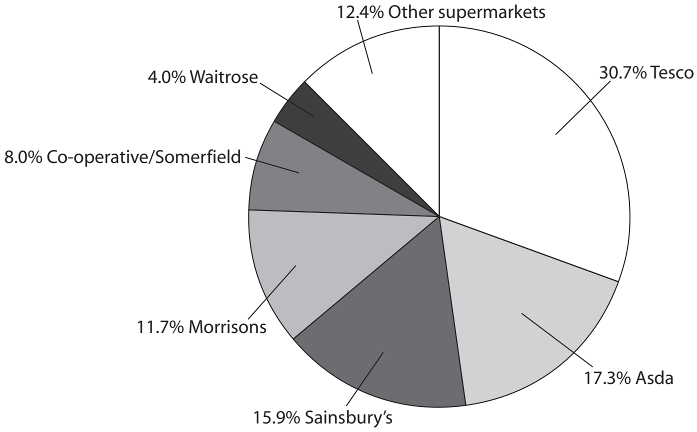
(Total for Question 13 = 4 marks)

14 The following pie chart shows market shares in the UK grocery industry in 2009.



Source: adapted from http://www.tnsglobal.com/news/news-56F59E8A99C8428989E9BE66187D5792.aspx

Which of the following statements is true in the UK grocery market?

(1)

A It is monopolistically competitive

B It has a low level of concentration

C The four firm concentration ratio is 75.6 per cent

D It is perfectly competitive

E The three firm concentration ratio is 60.4 per cent.

Answer

Explanation

(3)

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(Total for Question 14 = 4 marks)

15 Game theory can be used to illustrate which of the following examples of competitive behaviour?

(1)

A Price leadership in perfect competition

B Revenue maximisation in monopolistic competition

C Limit pricing in monopolistic competition

D Tacit collusion in oligopoly

E Price discrimination by a monopolist.

Answer ☐

Explanation

(3)

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(Total for Question 15 = 4 marks)

16 A firm might aim to maximise sales rather than profits in the short run because:

(1)

A it knows its marginal cost and marginal revenue

B it is in a market with no other competitors

C it wishes to deter the entry of new firms

D supplies of raw materials are limited

E there are substantial barriers to entry in this industry.

Answer ☐

Explanation

(3)

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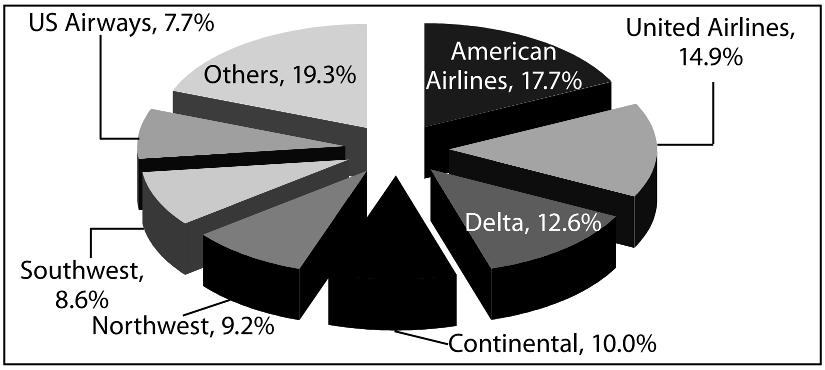
(Total for Question 16 = 4 marks)

17 The following chart shows the percentage market shares of the US Airline Industry in 2006.



(Source: Adapted from 'Up in the Air' by David Jonas 31 March 2007
http://www.procurement.travel/news.php?cid=airline-procurement-strategy.Mar-07.31)

Which of the following can be deduced from the above information?

(1)

A The four firm concentration ratio is 64.5 per cent

B The US airline industry is monopolistically competitive

C The US airline industry is highly concentrated

D The US airline industry is a natural monopoly

E There are low sunk costs in the US airline industry.

Answer

Explanation

(3)

(Total for Question 17 = 4 marks)

18 The grid below shows the possible pricing strategies of two ice-cream companies Juju and APJ. Assuming that demand is price inelastic, which of the following strategies shown in the grid would maximise the revenue of the two firms?

(1)

		Juju's price	
		High	Low
APJ's price	High	**A**	**B**
	Low	**C**	**D**

A Both firms set a high price

B APJ sets a high price and Juju a low price

C Juju sets a high price and APJ a low price

D Both firms set a low price

E Both firms set a price to increase consumer surplus.

Answer

Explanation

(3)

(Total for Question 18 = 4 marks)

END OF SECTION A

SECTION B

Read all extracts/figures before answering.

Write your answers in the spaces provided.

Question 19

Markets for food and drinks high in fat, salt or sugar (HFSS)

Figure 1: UK market share of potato crisps, 2017

Firm	Brand	Size	Market share of firm	Market share of product	Price (£)
Walkers	All Walkers		*55.3%*		
	of which: *Regular Standard*	35 g		28.1%	0.45
	Regular Max	50 g		7.4%	0.63
	Sensations	40 g		2.0%	0.59
	Doritos	40 g		4.7%	0.45
	Other			13.1%	
KP	KP	50 g	*22.7%*		0.52
Tayto	Golden Wonder		*4.2%*		
		<40g		3.1%	0.38
		40g+		1.1%	0.72
Other	Other		*17.8%*		

(Source: adapted from https://academic.oup.com/restud/article/3108825/The-Effects-of-Banning-Advertising-in-Junk-Food 6 April 2017)

Extract A

The effects of a total ban on advertising of HFSS foods

Food and drinks which are high in fat, salt or sugar (HFSS) tend to be sold in highly concentrated markets. Tough new rules banning advertisements for HFSS products, such as those for confectionery, fizzy drinks and potato crisps, come into effect in July 2017 as a means to reduce consumption. The rules apply to media targeted at under-16s and will mean a major reduction in the number of advertisements children see for HFSS products in posters near schools, in films targeted at children, on catch-up television and in social media if it is directed at children.

There are three main factors that will determine the effectiveness of the intervention: first, whether advertising acts to expand the market share or steal rivals' market share. Secondly, how firms in the market adapt their behaviour in response to the ban. Thirdly, what substitute products do consumers turn to if they opted out of the targeted market.

Results from a recent survey in the UK suggest that the total quantity of crisps sold would fall by around 15% in the presence of an advertising ban, or by 10% if firms respond with price cuts, since the ban acts to make the market more competitive and firms respond to the ban by, on average, lowering their prices.

The survey showed that following a ban, consumers are more likely to switch to another junk food than to a healthy food, which (in addition to the pricing response of firms) acts to partially offset any health gains from the policy.

(Source: adapted from The Effects of Banning Advertising in Junk Food Markets, Dubois, Pierre; Griffith, Rachel, Review of Economic Studies Copyright © 2017, Oxford University Press https://academic.oup.com/restud/article/3108825/The-Effects-of-Banning-Advertising-in-Junk-Food 6 April 2017 and https://www.asa.org.uk/news/tougher-new-food-and-drink-rules-come-into-effect-in-children-s-media.html 30 June 2017)

Extract B

Taxing HFSS foods and subsidising healthy eating widens inequality

Since low-income groups spend a higher proportion of their income on food and tend to eat less healthily, they are the main targets of taxes on products that are high in fat, salt or sugar (HFSS). Subsidies on healthy food are seen as an alternative policy approach to encourage healthy eating. While data on the impact of such policies are scarce, a recent study on the distributional impacts of HFSS taxes and healthy food subsidies found that these actually widened health and fiscal inequalities. The policies tend to be regressive and favour higher-income consumers. Taxes on unhealthy food increase prices which have a greater impact on low income groups rather than higher income groups. Lower income groups prefer to buy HFSS food.

Subsidies encouraged all income groups to buy more fruit and vegetables. However, those on higher incomes proved more responsive and the average share of budget spent on healthy food actually increased for the higher income groups who were more likely to buy the subsidised healthy food and then spend the savings they had enjoyed on yet more healthy food. The diets of the higher income groups before the subsidy tended to be healthier. The choices of the higher income groups are more responsive to price changes. By contrast, lower income groups, if they responded to lower prices, often used the money saved to buy unhealthy items or something else entirely. The long-term benefits of a healthier diet are harder to grasp for consumers when information gaps exist. Often the immediate boost of a tasty treat is more appealing. Taxes and subsidies do not change that. Other strategies are needed to promote healthy eating, especially education.

(Source: adapted from Economist 5 October 2017 https://www.economist.com/news/finance-and-economics/21730033-study-suggests-lower-income-families-end-up-paying-more-their-food-taxing-fat and https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3031005 The Economic Journal September 2017 Vol 127 Issue 604)

Extract C

Tax on fatty foods in Denmark is an economic disaster

Denmark introduced a specific tax on saturated fat in October 2011. Recognised as a world-leading public health policy, it was abandoned just 15 months later having been both an economic and political disaster.

Indirect taxes of this sort are invariably regressive, disproportionately affecting the elderly and the poor. The specific tax led to prices rising on average 15% for highest-fat products, yielding a total decrease of 5% in the intake of saturated fat from products such as minced beef and cream. 80% of Danish consumers did not change their shopping habits at all. The behavioural change was economically damaging as consumers switched to cheaper brands and crossed the border to Sweden and Germany to do their shopping. Danish tax revenue fell as a result.

(Source: adapted from https://iea.org.uk/in-the-media/press-release/evidence-shows-a-fat-tax-would-hit-poorest-the-hardest 25 May 2013 and https://www.cambridge.org/core/journals/public-health-nutrition/article/effects-of-the-danish-saturated-fat-tax-on-the-demand-for-meat-and-dairy-products/984CF03634C819D50E66C7B5DC5209DA/core-reader)

(a) With reference to Figure 1 and Extract A, explain what is meant by a 'highly concentrated' market for potato crisps (Extract A, lines 2–3).

(5)

(b) In Extract A, lines 15–16, it was suggested that some firms may respond to the advertising ban by cutting the prices of their products.

Using game theory and the information provided in Figure 1 and Extract A, discuss the effects **on firms** of cutting prices in an oligopolistic market.

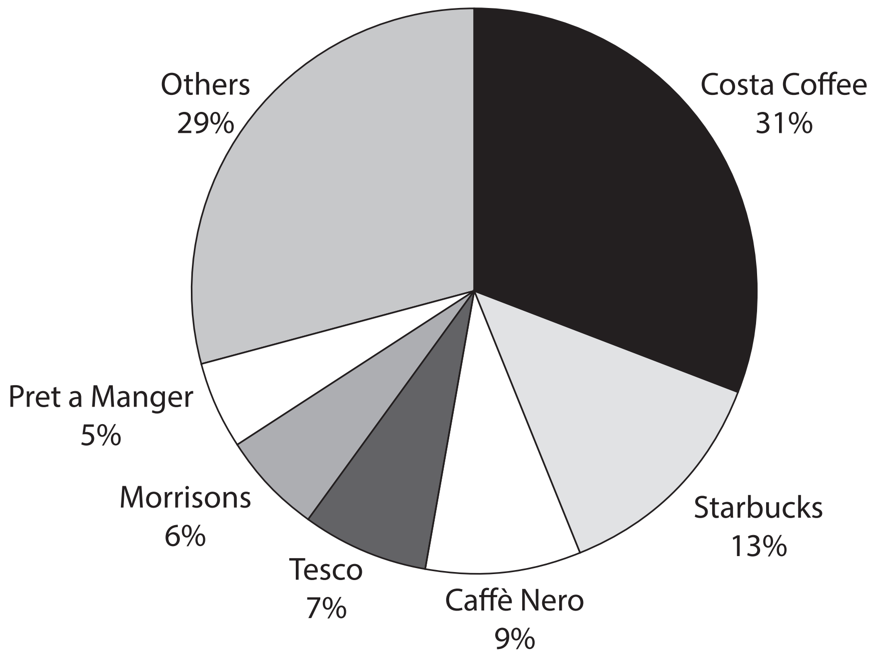
(12)

(Total for Question 19 = 17 marks)

Question 20

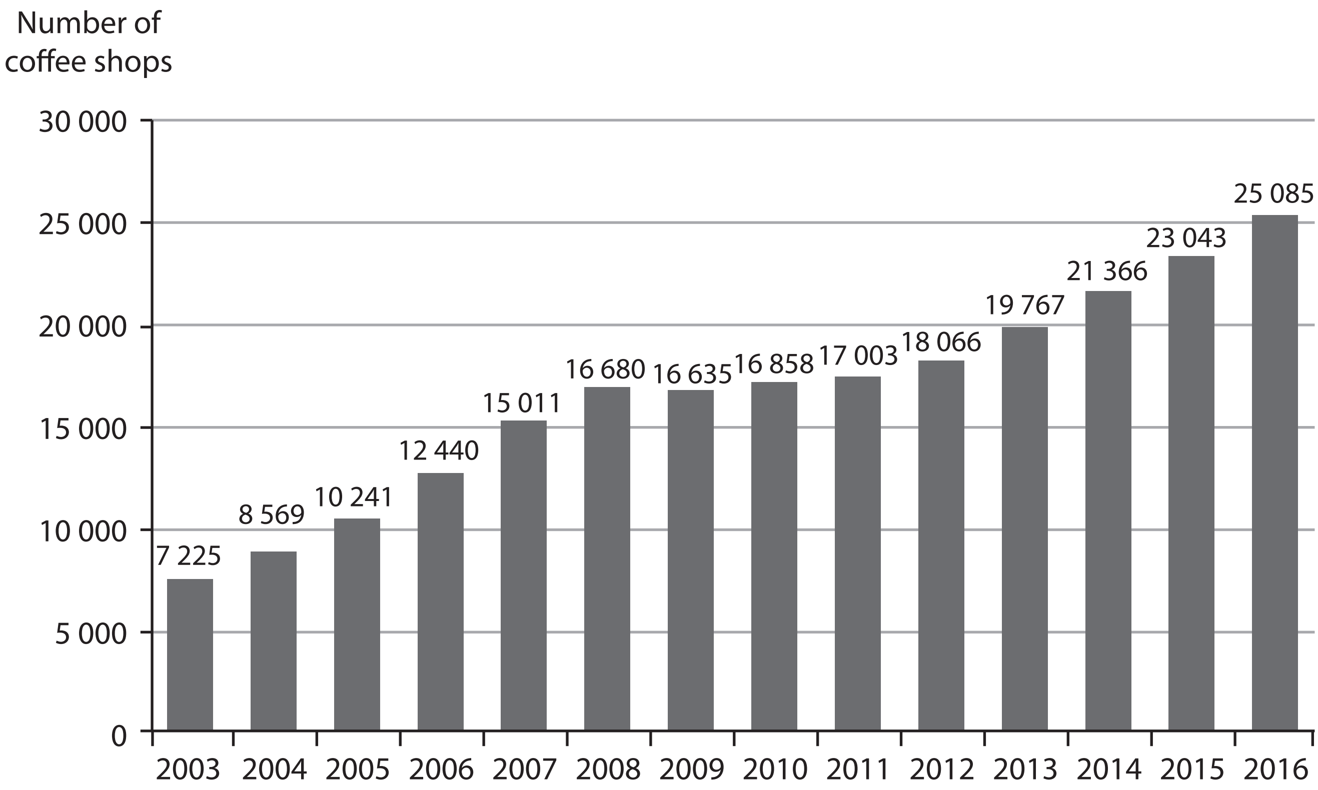
Branded coffee shops

Figure 1: Market share of UK branded coffee shops, 2015, percentages



(Source: http://metro.co.uk/2015/12/14/the-uks-most-popular-coffee-shop-has-been-revealed-5564569/)

Figure 2: Number of Starbucks coffee shops worldwide, 2003–2016



(Source: https://www.statista.com/statistics/266465/number-of-starbucks-stores-worldwide/)

Figure 3: Price comparison in selected London coffee retailers, February 2017

Coffee style	Starbucks	Costa Coffee	Caffè Nero	Greggs	McDonald's
Espresso Double	£2.00	£2.00	£1.70	£1.65	£0.99
Latte Medium	£2.60	£2.50	£2.50	£1.80	£1.79
Latte Large	£2.80	£2.70	£2.80	£2.10	£2.09

(Source: data collected from coffee shops in Holborn, London on 25 February 2017)

Extract A

Starbucks in Britain – a loss-making business?

Coffee shops are among the most profitable parts of the food and drink industry, and few are doing quite as well as Starbucks, a US-based transnational company. Starbucks may be complaining of adverse global market conditions but that did not stop the world's biggest coffee chain from reporting record annual profits in 2016. It made a profit of almost US$4.2 billion for the year, up 16% on 2015. That was mainly the result of a strong performance in its biggest market, America, where revenue rose 11%. The fastest growth was in the China and Asia Pacific region, with revenue up 23%. Howard Schultz, the CEO of Starbucks, said its Chinese coffee shops were the most efficient and profitable. While Starbucks still makes most of its profit in the US, Mr Schultz has said expansion in China will secure its future for "decades to come" and announced plans to more than double the number of shops in China to 5 000 by 2021.

However its British subsidiary, at first glance, appears to be doing less well. It has announced its first ever profit in Britain in 2015 – of just £1 million – despite opening its first coffee shop in the UK in 1998. It now has 849 UK outlets. The main reason why Starbucks has reported persistent losses in the UK is not due to a lack of demand for its coffee, but to minimise its tax bill. It is claimed that some of Starbucks' revenue earned in the UK is transferred to its Dutch subsidiary, which is charged lower rates of tax.

Starbucks is not finding life as easy in Britain as in the USA. It faces competition from home-grown chains such as Costa and Caffè Nero. Accusations of tax avoidance have also damaged Starbucks' sales to the benefit of its competitors. A survey found that a third less people rated Starbucks as their preferred coffee shop than they did before the tax-avoidance allegations were first published.

These issues have forced Starbucks to change its strategy. It has slowed down its expansion plans in the UK and has closed 67 underperforming coffee shops over the past year. It has also tried to repair its reputation by transferring its European headquarters from Amsterdam to London.

(Sources: adapted from *The Economist* 14 February 2015 http://www.economist.com/news/business-and-finance/21643271-tax and Starbucks company report 2016 and http://s21.q4cdn.com/369030626/files/doc_financials/2015/Starbucks-Fiscal-2015_Financial-Highlights.pdf)

Extract B

Tax on disposable coffee cups?

Two and a half billion disposable cups are thrown away every year in the UK, that is, seven million every day. Only one in 400 is recycled. The UK Environment Minister has suggested that a coffee cup tax could work in a similar manner to the plastic bag charge. The 5 pence a bag charge has led to an 85% reduction in the number of bags being given out since October 2015. It is estimated that introducing a tax on disposable coffee cups would cut usage by two billion every year. One environment spokesperson, Kate Parminter, said: "We've seen how dramatically a small charge has affected public behaviour when it comes to the plastic bags and it is clearly time to extend it to coffee cups. Most people purchase a tea or coffee and throw away the cup without even thinking about it, but a charge would increase our awareness of the environmental impact."

In response, another MP welcomed her comments but said he did not believe a tax was the solution. He said: "My initial reaction is charging 5p or 10p for the cup will not work. It will not encourage people to take their own cups in if a coffee goes up from £2.60 to £2.65. I suspect a more technological answer is what we need – either the composition of the disposable cups being changed so they're more easily recyclable, or changing the technology in the recycling."

Disposable coffee cups contain a plastic coating inside the cups which prevent them from becoming soggy, making them difficult to recycle. There are just two specialist facilities in the UK that have the required equipment to separate plastic from paper for recycling. Almost no recycled paper is used in the production of disposable cups, meaning that some 43 000 trees must be cut down annually to keep up with the demand. CO_2 emissions of around 83 000 tonnes are generated every year for their production.

(Sources: adapted from http://www.independent.co.uk/news/uk/politics/disposable-coffee-cups-could-be-taxed-like-plastic-bags-environment-minister-says-a6938126.html 05/09/16 and https://www.cchdaily.co.uk/lib-dems-call-5p-plastic-bag-tax-coffee-cups)

Extract C

German city of Freiburg takes action on cutting the use of disposable coffee cups

The 'Freiburg cup', made from dishwasher-proof plastic, can be reused hundreds of times. Cups are issued with a one-euro deposit, and can be returned to any of the participating coffee shops in the German city. The cups, which are provided to coffee shops by local councils, are washed in the cafés and bakeries that have signed up to the scheme before being reused. 56 coffee retailers have signed up, and 10 000 cups are being used.

One of the main obstacles facing a wider-reaching scheme, however, is the number of café chains in Germany that are unwilling to use unbranded multi-use cups, particularly Starbucks and McDonald's. Starbucks already offers a discounted coffee for customers with a multi-use cup, but only if it is bearing the unmistakable Starbucks logo.

(Source: adapted from http://www.dw.com/en/germanys-love-for-coffee-to-go-leaves-environmental-groups-demanding-action/a-36689719)

(a) With reference to Figure 1, briefly explain the market structure that best describes the UK branded coffee shop market.

(5)

(b) With reference to Figure 3 and other information provided, discuss the price and non-price strategies that Starbucks may use to increase profitability.

(12)

(Total for Question 20 = 17 marks)

21 Theatre and cinema markets

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.

(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.

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.

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.

(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.

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

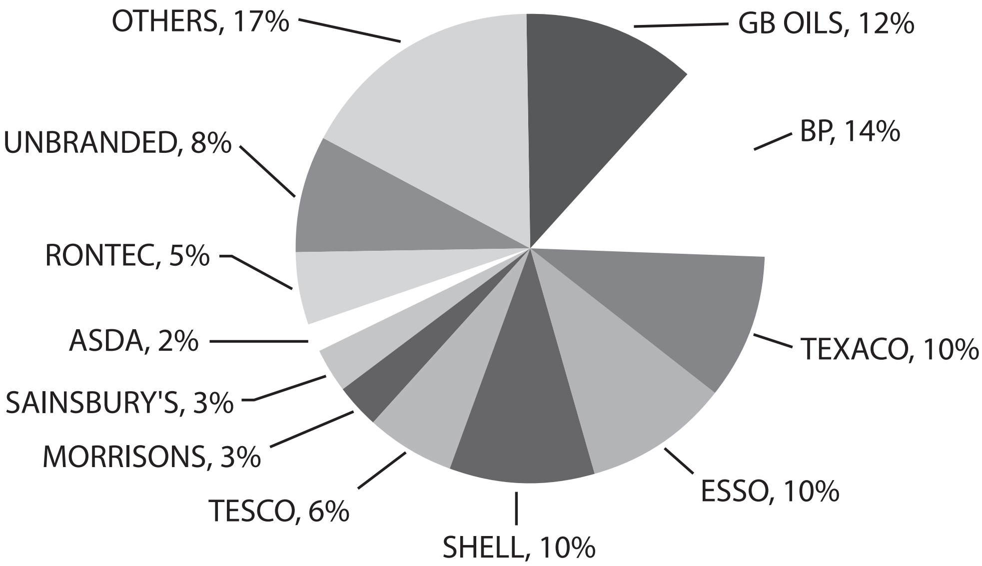
21 Apart from price discrimination, assess **one** pricing and **one** non-pricing strategy Cineworld could adopt to increase sales.

(10)

(Total for Question 21 = 10 marks)

22 Motor Fuel Prices

Figure 1 UK petrol retail market share



(Source: http://i.dailymail.co.uk/i/pix/2013/01/15/article-016f425cb000005dc-950_634x373.jpg, accessed 1 April 2016)

Extract 1 Predatory pricing of petrol

Supermarket price wars are putting Britain's small petrol stations out of business at a rate of one a day. Sainsbury's, Tesco, Asda and Morrisons have embarked on a war to attract hard-hit consumers, and the price of fuel has been central to their campaign. Morrisons is offering loyalty points on its new fuel card while Asda has launched a price comparison app for mobile phones to convince shoppers it has the cheapest fuel. Both Sainsbury's and Tesco have offered money-off vouchers for petrol customers.

The Retail Motor Industry Federation (RMI), a trade association representing the interests of 6 000 small petrol stations, is hoping that the inquiry by the Competition and Markets Authority (CMA) will support its members, who believe that unfair and predatory pricing by the supermarkets and some major oil companies is making it impossible for them to compete. There are now about 8 000 small petrol retailers compared with 21 000 two decades ago and 40 000 in 1966. It predicts that in five years there will be very few independent petrol retailers left.

The CMA inquiry comes at a time when the supermarkets have proved particularly effective at building up a huge stake in the petrol market. In 2015, supermarkets accounted for 50% of total fuel sales from just 1 316 sites compared with 37.4 % in 2010. The CMA said the fuel market for Britain's 33 million motorists is worth around £32 billion a year, and accounts for 5p in every £1 of household expenditure.

Households are keen to save even one or two pence a litre, particularly those families whose livelihoods depend on the use of a car.

The RMI has been gathering evidence from its members to support the argument that the supermarkets have been involved in unfair pricing. Small garages typically make only 5p in profit on a litre of petrol, while major supermarkets were using tactics described as 'loss leading'. It is also blaming the major oil companies for unfair dual pricing. That means they sell to their own garages at one price and then to an independent retailer down the road at a higher price. There is evidence of 'price co-ordination' – otherwise known as price-fixing.

When the price of crude oil goes up, the prices motorists pay go up almost immediately – but when the oil price falls, retail fuel prices don't reflect that fall as markedly.

Andy Peake, Asda's Petrol trading director, said: "We welcome the CMA's decision to look into petrol and diesel prices. At Asda we are committed to doing everything we can to bring motorists the lowest possible fuel prices. Our preference would be that everyone is charged a national price for fuel, that way drivers would be treated as equals regardless of where they live."

(Sources: adapted from http://www.dailymail.co.uk/news/article-2198634/Energy-giants-face-petrol-price-probe-Market-risk-manipulation-warns-watchdog.html and http://www.thisismoney.co.uk/money/cars/article-2200297/Small-petrol-retailers-devastated-aggressive-supermarket-pricing.html)

Extract 2 Petrol retailers turn to coffee to drive sales

Caroline Harris, marketing director at Costa Enterprises, says: "There is a considerable amount of profit to be made by selling a product that has become an indispensable part of many people's daily routine. Petrol retailers can capitalise on this growing demand by offering their passing trade quality branded coffee 'on the go'. What's more, Costa has been voted the nation's favourite for the third year running making the beverage range and offer from Costa a 'must stock'."

She says research from Allegra shows the two key factors that determine consumers' choice in coffee are convenience and quality. Consumers increasingly expect to be able to grab a cup of coffee on the go wherever they are, which is good news for petrol station forecourts, as it almost guarantees a captive audience for coffee. "The research shows that 'quality' has grown in importance for consumers and should therefore be an absolute must in attracting and retaining customers. Customers are more likely to revisit and recommend a consistently good product, which will in turn drive sales for the forecourt operator."

Meanwhile, in specific research on buying behaviour, Costa found that 'buying a coffee' is the main reason for 29% of visitors to a forecourt, and a third of these people, importantly, ended up buying unplanned items as a result. Furthermore, 85% of forecourt customers stated that they are now looking to purchase 'quality' coffee that they can 'grab and go' when out and about.

Says Harris: "It also identified that Costa Express brings drivers into the forecourt. 57% of the people asked said that Costa Express increases the likelihood of them visiting a forecourt, with over a third saying they would go out of their way to visit a site with Costa Express and 91% choosing Costa Express because 'the coffee always tastes great'."

Starbucks coffee is also available on many petrol station forecourts. Euro Garages is now extending its partnership with the use of Starbucks 'On The Go' machines. With 57 sites already boasting these machines, customers who are busy and on the move can now purchase their Starbucks beverages to take away. "Plans are in place to rollout the Starbucks On The Go machines throughout the 120 forecourt locations," explains Salim Hasan, head of operations at Euro Garages. "The Starbucks On The Go offer now completes the forecourt consumers' coffee experience and they can now choose whether they want to sit and enjoy their beverage in the comfort of a store, use the drive-through facility or simply pick up a drink while in the forecourt."

(Source: adapted from http://www.forecourttrader.co.uk/news/fullstory.php/aid/7515/Brands_mean_growth.html 02 September, 2013)

(a) With reference to Figure 1, what can be deduced about the market structure of petrol retailing in the UK?

(4)

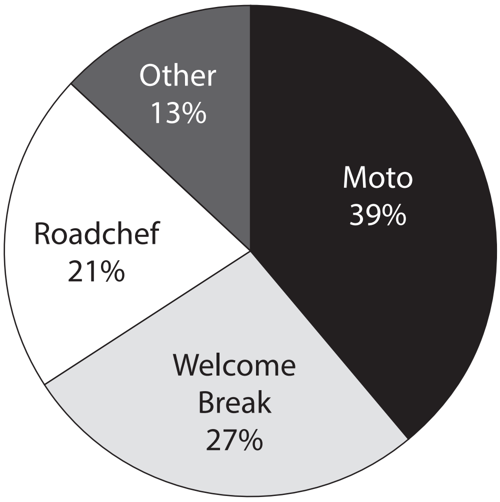
*(b) Evaluate strategies that petrol retailing firms could use to increase profit.

(16)

(Total for Question 22 = 20 marks)

23 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)

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.

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.

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.

(Source: adapted from 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.

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.

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?'

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

23 With reference to the information provided, briefly explain why motorway services operators can charge high prices for petrol.

(4)

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(Total for Question 23 = 4 marks)

24 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.

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.

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.

(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.

"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.

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.

"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.

(Source: http://uk.reuters.com/article/2013/08/07/uk-china-milkpowder-idUKBRE97602U20130807 and China fines milk formula makers in pricing probe 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.

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.

(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)

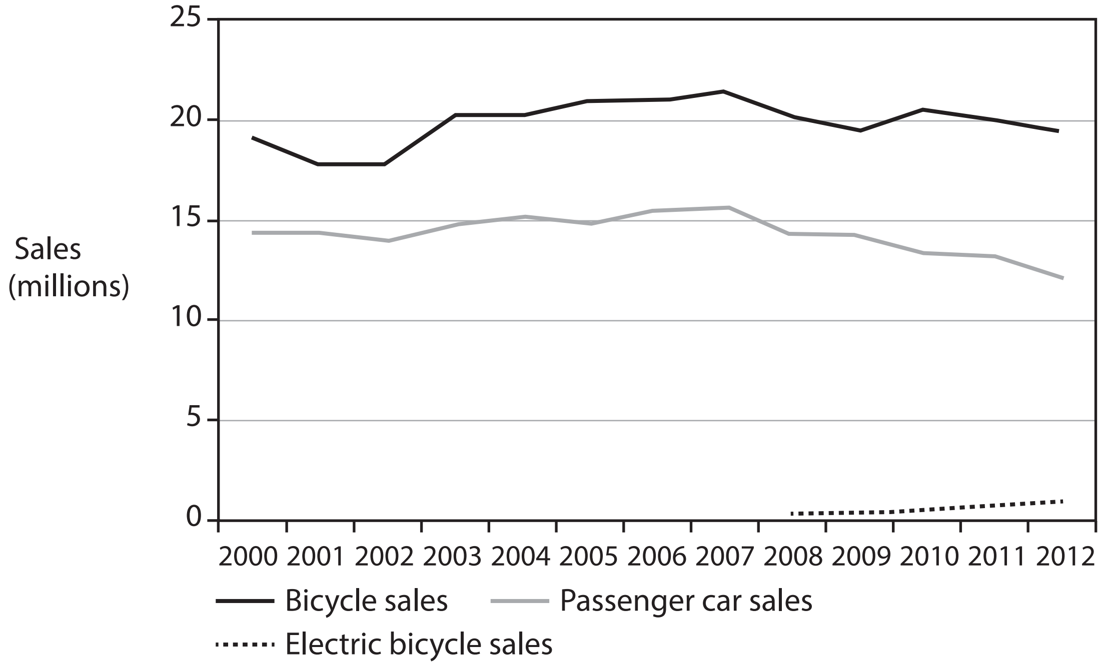
24 Discuss why 'price-fixing and anti-competitive behaviour' by foreign formula milk producers in China may have been possible (Extract 1, line 7).

(12)

(Total for Question 24 = 12 marks)

25 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)

(a) With reference to Extract 3, explain the market structure of batteries used in the manufacture of e-bikes.

(4)

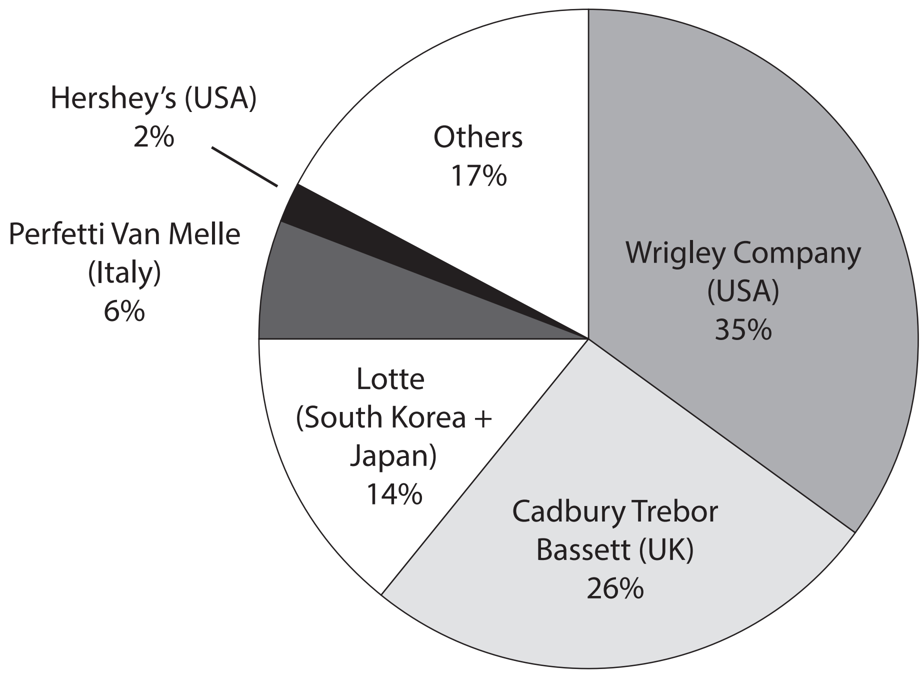
*(b) With reference to the information provided, discuss pricing and non-pricing strategies that e-bike manufacturers might use to increase sales.

(12)

(Total for Question 25 = 16 marks)

26 The chewing gum market

Figure 1 Global market shares for chewing gum manufacturers



Extract 1 British designers create non-stick chewing gum that dissolves

Chewing gum is a problem worldwide and has even been banned in some countries. Normal chewing gum is made from synthetic latex, which is resistant to the weather and is strongly adhesive. A piece of gum costs around 3 pence to make, but it costs an estimated 10 pence to scrape it off the pavement using freezing machines, corrosive chemicals or even high-pressure steam hoses. The UK Government currently spends £150 million each year removing chewing gum from the streets using chemicals.

Recently a non-stick chewing gum that dissolves within just 24 hours has gone on sale in the US. The gum, developed in Britain, contains a special polymer which makes it far less sticky. 'Rev7' has the same taste and texture as normal chewing gum, but is water soluble and can be easily removed from clothes using soap and water. This ability to retain water also results in a longer lasting flavour which improves the experience for consumers. It is also more effective when used as a nicotine gum, designed to help smokers give up cigarettes, because it releases the nicotine in a more controlled way. Tests show that most of the gum can be removed by conventional street cleaning. Any gum washed into the drains will degrade into minerals, biodegradable products and inert materials.

Designer Terry Cosgrove, a scientist at Bristol University, said: "The motivation to invent the product came from seeing chewing gum on the streets in this country and in America. It's everywhere. The materials developed can be used for lots of other uses such as anti-graffiti paint and bacterial protection. But because chewing gum is such an enormous problem at the moment we decided to target this as our main area. This is like a dream come true for me, seeing academic research result in a real commercial product." He reportedly offered the product design to Wrigley's, the current market leader in chewing gum, but no agreement was made.

Instead, Revolymer was set up in Wales in 2005 based on technology developed by Cosgrove at the University of Bristol. Revolymer was awarded patents relating to the Rev7 polymer technology, and the firm was aided by a grant of £1 million given in 2006 by the Welsh Assembly Government and the South West Regional Development Association to support the development of removable chewing gum. "There are also several other exciting ventures in the pipeline" said Cosgrove.

(Sources: adapted from www.telegraph.co.uk 5 October 2010 and
www.revolymer.com/history March 2013)

Extract 2 Rev7 is withdrawn from US market

Revolymer is to stop directly selling its 'Rev7' confectionery gum in the US at the start of 2013. The US gum market as a whole is shrinking and there is a challenge to Revolymer's patent for nicotine gum products by other gum manufacturers. The firm said the shut-down of sales of Rev7 in the US is set to incur a one-off cost of £360 000 but the annual cost base of its US operation is £500 000 which it said would not be incurred in the future.

Its Rev7 gum has recently been launched in Ireland in partnership with the Topaz service station network as an initial test market for the rest of Europe.

Revolymer is seeking more commercial partnerships for its nicotine gum. The first product resulting from such a partnership was launched in Canada in 2012. In a statement, Revolymer said: "Management continues to believe that Revolymer's strategy of licensing its technology to commercialisation partners, rather than seeking to market its own products, will generate significant shareholder value."

(Source: adapted from www.insidermedia.com 20 December 2012)

(a) Using the data in Figure 1, explain the market structure in the global market for chewing gum.

(4)

*(b) Discuss strategies that could be used by existing chewing gum manufacturers in response to the entry of a new competitor such as Revolymer.

(16)

(Total for Question 26 = 20 marks)

27 Camera retailing

(Source: metro.co.uk)

Extract 1 Peter Jones reopens Jessops

Jessops, the photography retailer, made a surprise return to the high street in March 2013 when Peter Jones, one of Britain's best-known entrepreneurs on the BBC programme *Dragons' Den*, relaunched the chain 11 weeks after it collapsed. Jessops, which was founded in Leicester in 1935, reached shut-down point in January 2013. Jessops suffered both from consumers' shift to buying cameras on the internet and their increased reliance on cameras built into mobile phones. Mr Jones became Chief Executive of Jessops after buying the firm from its administrators PricewaterhouseCoopers. Mr Jones made his money from the telecoms industry and operates some stores for Vodafone and has online retail investments. He has invested £4 million in Jessops and will reopen around 40 shops, far fewer than the 187 shops the retailer had before.

"Britain's high street is fighting back," Mr Jones said as he reopened a refurbished flagship Oxford Street store, adding that shops could compete with online traders if prices are competitive. "Who would *not* want to buy a camera from expert and enthusiastic staff?" he said. Stores will feature areas to try out products before buying. Customers will be able to create photo albums and take photography courses through the Jessops Academy. Staff will also turn photos into calendars and posters while you wait. Mr Jones said companies such as Apple had proved that customers would spend time and money in a welcoming environment with quality staff in busy locations. "It is very Apple-ish. We have learnt from other retailers, I believe Jessops is an iconic British brand which can lead the retail resurgence on Britain's high streets, powered by new innovations and world-leading, expert staff" he said. "Image is everything and, even in the mobile and tablet era, there's no substitute for a quality camera when it comes to taking the perfect picture."

Mr Jones has reduced fixed costs from £8 million to £1.5 million by cutting administration costs, closing stores and further rationalisation. Jessops will have outlets in centres such as London, Birmingham, Manchester and St Albans, with six opening immediately. Jessops will hire as many as 500 staff and many are drawn from the 1 400 who lost their jobs when it collapsed. "A lot contacted me on Twitter and asked for a job and it's great to have them," said Mr Jones.

Prices will be matched to those of Jessops.com and Mr Jones said it would be "competitive" with other online retailers such as Amazon. "We will make our profit margin on the accessories," he said. He said "click and collect" would be a powerful driver of sales and Jessops promised greater integration with its online presence, including an option to collect internet orders at store. "I think Amazon will start to lose their market share because they do not have a collect at store. Nobody likes waiting in for a delivery."

Mr Jones forecasts sales of more than £80 million in his first year and expects to take some 15% of the digital single lens reflex camera market in the UK. Revenue before Jessops shut was £304.6 million, but the firm is said to have made a loss of £12 million in the fifteen months up to its closure.

More than 10 000 jobs have been lost in retail this year as chains such as HMV and Republic have fallen into administration. However, Mr Jones is not the only person to see potential in the high street despite flat retail sales. Sports Direct bought fashion chain Republic while Gordon Brothers Europe, the private equity firm, this week bought Blockbuster UK, the entertainment group, out of administration and will keep half its 528 stores open, claiming it can "bring new life" to them.

(Source: adapted from By Andrew Bounds FT.com 28 March 2013, www.ft.com/cms/ and www.thisisleicestershire.co.uk)

27 Discuss strategies, apart from price discrimination, that high street retailers might use to increase profit in the face of greater competition from online retailers.

(16)

(Total for Question 27 = 16 marks)

28 Egg farming, egg distribution, food manufacturing and supermarkets

Extract 1 A letter from a chicken farmer

Our problems started four years ago when the big egg packaging and distribution firms merged, purchasing nearly 70% of the eggs produced. I lost £40 000 last year and I could see the profits of Noble Foods [the UK's biggest egg distributor] increasing. There was no competition anymore and prices paid to egg farmers stayed low, while everything else, like the cost of chicken feed, was going up. New EU regulations preventing the housing of hens in conventional 'battery' cages have meant installing new cages, costing over £14 per hen. Many egg farmers like me are unable to absorb the costs of buying the new cages and some egg farmers have left the industry. 750 000 hens have been slaughtered across the UK.

Extract 2 The egg distribution business - profile of Noble Foods Limited

Noble Foods, the UK's largest egg packaging and distribution business, operates 160 vehicles from seven sites, 365 days a year, employing over 150 full-time drivers in temperature controlled vehicles. Eggs are collected from over 325 individual farm producers located throughout the UK and transferred to a packing centre, where they are sorted and boxed for delivery to customers. Pre-tax profits at Noble Foods increased by £1.4 million in 2011.

(Source: © 2011 Noble Foods Ltd)

Extract 3 Increased costs of eggs for food manufacture

Eggs – both in liquid and powdered form – are used in a variety of food products from biscuits and cakes to pasta and mayonnaise. The reduced supply of eggs, caused by the new EU regulations, is damaging the profits of some food manufacturers. Several of them are closing down their production lines because they cannot afford the soaring cost of eggs from distribution firms. However, they cannot raise their prices because supermarkets refuse to pass on any increase to consumers.

Extract 4 British farmers forced to pay the cost of supermarket price wars

Farmers say they are being forced out of business by the unfair buying practices of supermarkets. Discounts such as "buy one get one free" are not a generous gift from the supermarket. There is public ignorance of how supermarkets buy produce and the system that allows them to offer lower prices while increasing their profits. Tesco's profits were above £3.5bn for the first time last year and Sainsbury's rose by nearly 13%. These results are achieved largely by getting suppliers to reduce their prices or not pass farmers' cost increases through to the supermarkets. Most sectors of British farming, from eggs to fruit, vegetables and pork, have had reduced prices paid for their produce in the past year, despite record increases in costs.

(Sources 1, 3 and 4: adapted from © The Guardian 2 July 2011, © The Observer and © Parliamentary copyright 2011)

Figure 1 Egg types in the EU

Types of eggs produced in EU	Minimum cage requirements per hen	Market share in UK, 2012 forecast
Hens in conventional cages, 'battery'	$550cm^2$	Banned January 2012 under new EU regulations
'Caged' hens in EU-compliant cages	$750cm^2$ and a minimum height of 45cm with nest area, perching space and a scratching area	49%
Barn eggs	$1110cm^2$ free to move in large indoor area	4%
Free range eggs	As barn, with daytime access to open air pen, $4m^2$	44%
Organic free range eggs	As free range, plus organic food (no artificial growth enhancers)	3%

Figure 2 UK egg market information 2011

Egg production	9 691 million eggs
Egg consumption	11 512 million eggs (32 million per day)
Consumers of eggs in the UK	
Retail (supermarkets etc.)	47%
Food Manufacturers	25%
Foodservice (hotels, restaurants)	28%

(Sources for Figure 1 and Figure 2: permission to reproduce granted by the British Egg Information Service, www.britegg.co.uk and © European Union, http://eur-lex.europa.eu/)

28 Assess reasons why supermarkets are not increasing the retail price of eggs to cover the increased production costs of egg farmers. Use game theory to support your answer.

(16)

(Total for Question 28 = 16 marks)

29 The UK household energy market

Extract 1 Price cuts by the 'Big Six' energy companies

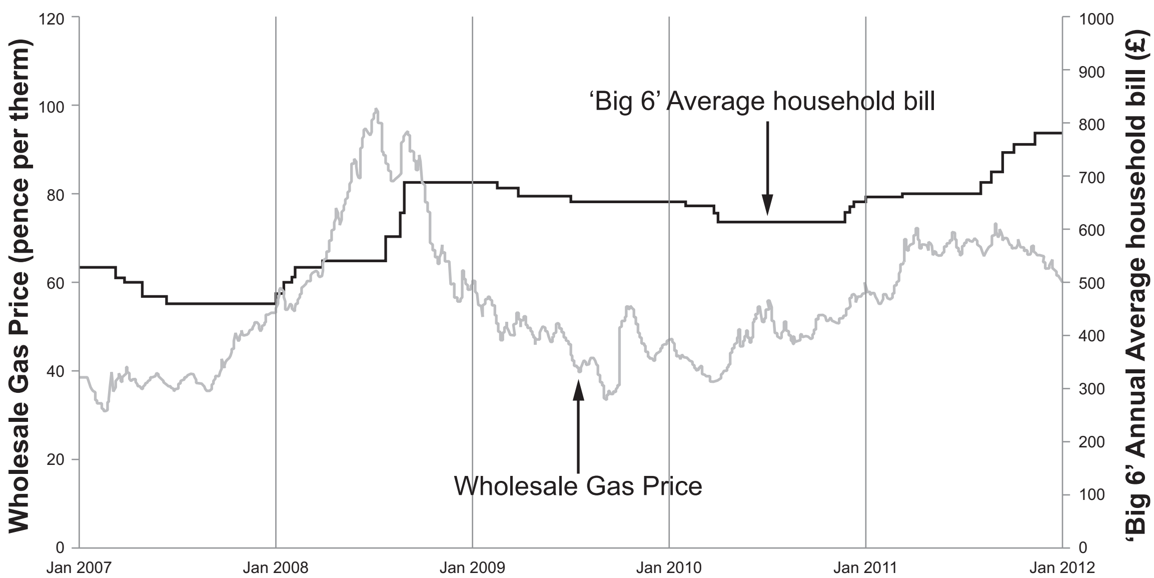
99% of all gas and electricity bought by households in the UK is supplied by the 'Big Six' energy firms, British Gas, Scottish and Southern Energy (SSE), Scottish Power, E.ON, EDF Energy and npower. The combined profits of the 'Big Six' reached £15 billion in 2011, up £2 billion on the previous year, with an average profit per customer of £80 a year.

British Gas, which supplies both gas or electricity to half of UK households, cut its electricity prices by 5% in February 2012 but kept gas prices unchanged. This was quickly followed by SSE cutting 4.5% from its gas prices. British Gas had been expected to cut prices after another of the 'Big Six' energy providers, EDF Energy, announced it would be reducing gas prices by 5% with effect from 7 February 2012.

However, the cuts were smaller than expected. The average standard tariff for a customer buying both gas and electricity from the same supplier will remain on average £1 250 a year (doubled since 2005). The price cuts will only reduce bills by between £24 and £28 per year for the average household. 5.5 million households will remain in fuel poverty, meaning that they are spending at least 10% of their income on power.

(Source for Figure 1 and Extract 1: adapted from © The Guardian News and Media Limited, 2012)

Figure 1 A comparison of wholesale and retail price of gas



Extract 2 Energy regulator tells firms to cut their prices or face tough controls

A price cap, RPI-X, on energy bills could be introduced for the first time since 2002, according to the regulator Ofgem. There are rising concerns that customers are being exploited by the 'Big Six' energy firms. The energy firms will have to simplify their pricing structures (tariffs) this year. If this fails the whole industry will face a Competition Commission inquiry which could force a break-up of its dominant players. Ofgem said: "Parliament has given us the task of trying to create an effective market where competition is the downward pressure on prices. We think that's the way to go, although we haven't ruled out regulation, particularly for more vulnerable customers, if our reforms don't work." Energy campaigners are calling for a windfall tax on excessive energy profits and for the money to be used to help in the fight against fuel poverty by making homes more energy efficient.

Rising global demand for energy and the end of cheap North Sea gas are responsible for most of the increases but consumer groups also believe suppliers are keeping bills artificially high. One of the 'Big Six', the French-owned EDF Energy, reported a near trebling of its annual profits to €3 billion (£2.5 bn), with profits from its British operations rising 8.5%. EDF Energy is currently the subject of two Ofgem investigations into poor customer service and inappropriate selling methods. Ofgem is currently consulting on forcing the 'Big Six' to set uniform standard charges to allow consumers to compare raw costs, or unit prices, more easily. Ofgem is also intending to sweep away the hundreds of different tariffs operated by the companies into just two types – standard and innovative. In 2008 Ofgem ran a nine-month inquiry after all the energy companies raised their prices within a few weeks of each other. No evidence of collusion was found but action was proposed to ensure that smaller independent companies are not kept out of the supply market. The price movements look like tacit collusion but the regulatory authorities lack the power to prove this.

Ofgem's faith in an unregulated free market has been shaken by the failure of the 'Big Six' to embrace its previous reforms of bills and tariffs. Although it says it is "encouraged" by recent attempts by some suppliers to simplify charges, it is closely monitoring their performance and failure to comply will trigger a full Competition Commission inquiry. Companies need to narrow the widening gap between wholesale and household energy prices. "Consumers are right to ask whether the market structure is right and whether regulation of prices is the answer," said Ian Marlee, a senior Ofgem official.

(Source: adapted from Martin Hickman © The Independent, www.independent.co.uk and © http://www.regulation.org.uk/energy.shtml)

29 With reference to the information provided, what market structure best describes the supply of household energy in the UK?

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(Total for Question 29 = 4 marks)

30 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."

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.

(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.

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.

(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)

30 With reference to an industry of your choice, examine strategies firms might use to increase consumer loyalty. Use game theory to support your answer.

(12)

(Total for Question 30 = 12 marks)

31 A crowded car industry

Figure 1 US car market, % market share 2010

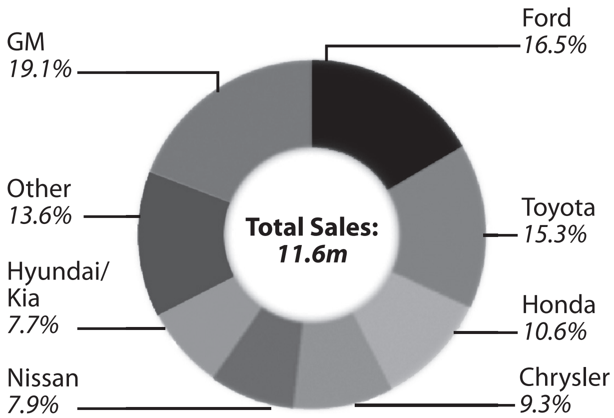
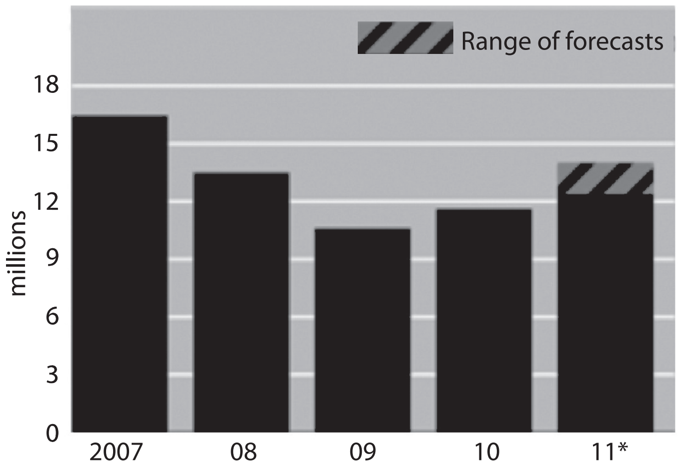


Figure 2 US car market, units sold (millions)



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)

(a) With reference to Figure 1, briefly explain the market structure in the US car market.

(4)

*(b) Using evidence from a range of manufacturers referred to in Extract 1, assess pricing and non-pricing strategies car manufacturers might use to increase total revenue, when petrol prices are rising sharply.

(16)

(Total for Question 31 = 20 marks)

32 The UK Banking Sector

Extract 1 RBS fined £28 million for sharing price data

Royal Bank of Scotland (RBS) was fined £28.6 million in March 2010 for breaking competition law in the first big case brought against a financial services company, and one of the largest against a company for anti-competitive behaviour. RBS admitted that staff involved in making loans to big law and accounting firms had illegally given pricing data to corresponding staff at Barclays. Barclays had used the information provided by RBS to determine the pricing on its own loans before it reported the lawbreaking to the authorities in 2008. RBS had provided Barclays with broad information about the loan market, as well as specific details of the proposed pricing structure for two new loan facilities. These disclosures took place at a number of social, client and industry events and through telephone conversations between October 2007 and March 2008.

The breach in competition laws occurred before RBS was bailed out by the government, and it is now 70% owned by taxpayers. RBS said yesterday that it was a "deeply regrettable and isolated case".

No action is to be taken against Barclays, as a reward for having acted as an informant within the industry, voluntarily disclosing its part in the affair to the competition authorities.

(Source: © The Financial Times Limited 2010, adapted from 'RBS fined £28 million for price sharing data', by Michael Peel and Sharlene Goff)

Extract 2 Fresh bonus fears as bank profits rise

The UK's five biggest banks – HSBC, Barclays, Lloyds Banking Group, Royal Bank of Scotland and Standard Chartered – have revealed that they made combined profits of £8.4bn in the first half of 2010. This performance is likely to be taken as proof that UK banks have recovered from the credit crisis and benefited from staffing reductions. However, there are concerns that these higher profits will lead to executives claiming greatly increased pay packages. The banks' share prices have jumped this year – RBS is up more than 70%, Lloyds is up nearly 37% – which could trigger the end-of-year bonuses to senior banking staff. Barclays is expected to disclose a bonus-to-salary ratio in line with the 38% paid last year – the highest of the UK banks.

Under pressure from the Bank of England and the Financial Services Authority, banks last year cut dividends and reduced bonuses as a proportion of revenue. The Chancellor said "we will not tolerate banks piling the pressure on the small to medium-sized business sector. The banks have an economic obligation to assist that sector. Every small and medium-sized company that I have visited in recent weeks has had some problem with their bank – either they have found it difficult to renew their overdraft or the bank demanded additional collateral, often someone's house. The danger is, particularly next year when there is a huge amount of refinancing required, that small and medium-sized businesses will suffer from a lack of access to short term loans."

(Source: © copyright Telegraph Media Group Limited, 31st July 2010)

Extract 3 Other views on bank bonuses

The Deputy Prime Minister, Nick Clegg, said last week that the Government will "not stand idly by" if bonuses are too high. This needs to be more than just words. Ministers need to prevent the payouts being made, or at the very least ensure that awards are made entirely in shares (which will have the effect of increasing the capital reserves of banks), rather than cash. And those banks that still insist on resisting ministerial pressure must face a further tax as punishment.

(Source: © *Independent*, www.independent.co.uk/opinion/leading-articles/leading-article-time-for-ministers-to-call-the-banks-bluff-2165552.html, 21st December 2010)

32 With reference to Extract 1, assess reasons for Barclays' changing behaviour. Refer to game theory in your answer.

(16)

(Total for Question 32 = 16 marks)

33 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.

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.

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.

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.

(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.

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.

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

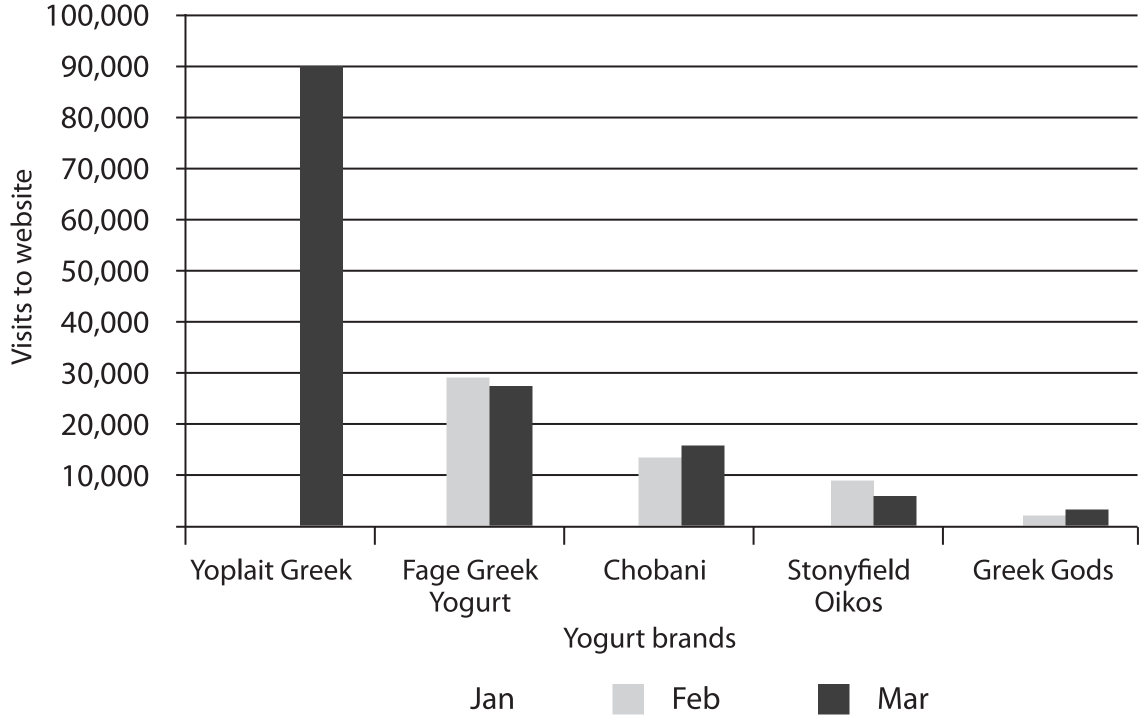
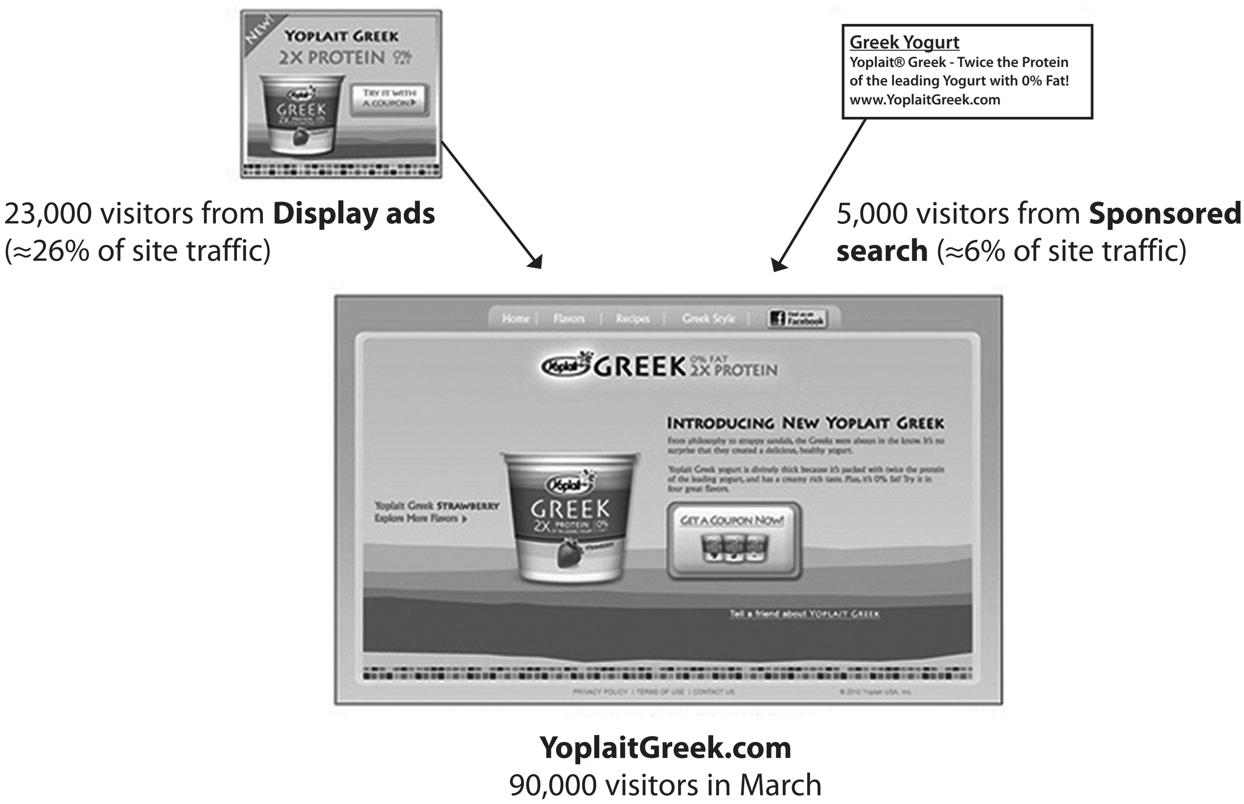


Figure 2
Website visitors to YoplaitGreek.com, March 2010



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

(a) Using the information provided, explain the market structure in the supply of yogurt.

(4)

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*(b) With reference to Extract 2, discuss how the launch of the new product *Yoplait Greek* yogurt may influence the behaviour of rival firms.

(16)

(Total for Question 33 = 20 marks)

34 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.

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.

Source: 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.

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.

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.

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.

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."

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

34 Assess how the newly combined Kraft and Cadbury food company could increase its share of the chocolate market in competition with Mars. Refer to game theory in your answer.

(12)

(Total for Question 34 = 12 marks)

35 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.

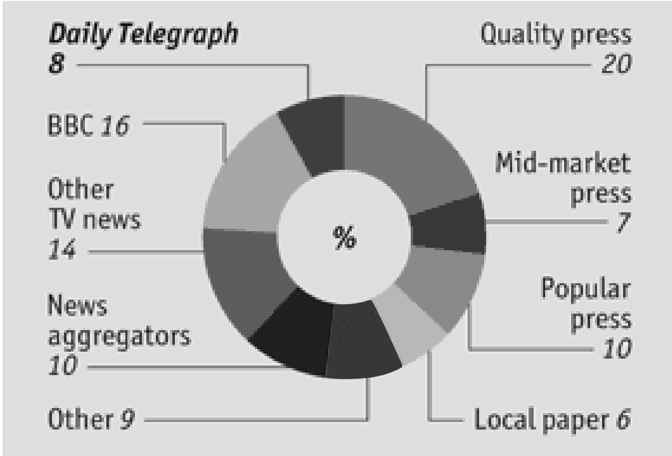
Extract 2 More bad news for the newspaper business

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.

35 Evaluate price and non-price strategies newspaper organisations may pursue to increase profitability.

(16)

(Total for Question 35 = 16 marks)

36 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.

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.

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.

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.

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.

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.

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

(a) Assess the evidence that the electricity generating companies in Germany are operating as a cartel.

(8)

*(b) Apart from operating as a cartel, discuss the ways in which firms might compete in the German electricity generating market. Refer to game theory in your answer.

(12)

(Total for Question 36 = 20 marks)

37 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.

(a) Briefly explain the market structure which best describes the UK instant coffee market.

(4)

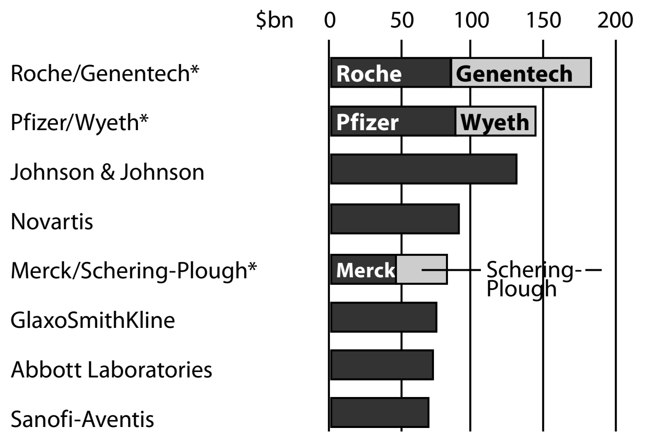
*(b) Assess the methods by which the manufacturers of instant coffee might compete with each other in both the UK and the US.

(16)

(Total for Question 37 = 20 marks)

38 The Pharmaceutical Industry

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



(Source: Thomson Datastream) *Assuming deal goes ahead

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.

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;
- 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?

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?

Thank you for your consideration of these views.

Sincerely,
William Vaughan
Health Policy Analyst
Consumers Union

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

a) What does the information provided suggest is the market structure of the pharmaceutical industry? Explain your answer.

(4)

(b) Evaluate **one** pricing and **one** non-pricing strategy that Merck could adopt to increase sales.

(12)

END OF SECTION B **(Total for Question 38 = 16 marks)**

SECTION C

Write your answers in the spaces provided.

39 In October 2017 Scania, the Volkswagen-owned truck maker, was fined €880 million (£771 million) by the European Commission for colluding with five other truck manufacturers over a 14-year period. The firms had agreed to coordinate prices after experiencing additional costs of meeting emission regulations.

With reference to an industry of your choice, evaluate why some firms engage in collusive behaviour.

(Total for Question 39 = 25 marks)

END OF SECTION C