Rewarding Learning

ADVANCED

General Certificate of Education

2023

Economics

Assessment Unit A2 1

assessing

Business Economics

AEC11

[AEC11]

TUESDAY 23 MAY, MORNING

TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **all** questions in Section **A** and **B** and **one** question in Section **C**.
You are permitted to use a calculator in this paper.

INFORMATION FOR CANDIDATES

The total mark for this paper is 90.

- Section A: 20 marks
- Section B: 40 marks
- Section C: 30 marks

Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time. In questions involving calculations, you are advised to show your workings.
Quality of written communication will be assessed in Questions **4**, **5(b)**, **(c)** and **(d)**, **6** and **7**.
Quantitative skills will be assessed where appropriate.

Section A (20 marks)

Answer all questions

1 Armagh apple farmer Pat McKinney grows apples which he sells to UK supermarkets and cider producers.

The table below shows how Pat McKinney's costs vary with the quantity of apples produced.

Quantity of apples (tonnes)	Total cost (£)
0	1,000
1	1,150
2	1,300
3	1,440
4	1,540
5	1,690
6	1,940
7	2,350
8	2,800

(a) Using the information in the table above, calculate the **total fixed cost** of producing 3 tonnes of apples. [2]

(b) Using the information in the table above, calculate the **average variable cost** of producing 4 tonnes of apples. [2]

(c) Using the information in the table above, identify the output level at which productive efficiency is achieved. [2]

2 Sports Direct and JD Sports are two of the UK's most successful "athleisure" retailers, with highly profitable stores in most UK cities. However, their approach to sales is very different. Sports Direct has traditionally competed by selling last season's lines at a significant discount while JD Sports has competed by offering the most recent exclusive lines at premium prices.

With reference to the information above, explain the difference between price and non-price competition. [4]

3 In 2019 Brompton Bicycle Limited, the UK's largest producer of folding bikes with a market share of 38%, reported that it generated £32.5 million in revenue from the sale of its iconic folding bike. These impressive figures were 15% higher than the previous year despite the fact that the volume of sales remained relatively flat over the same period.

(a) Using the information above, calculate the size of the UK folding bike market in 2019. [2]

(b) Explain how Brompton Bicycle Limited was able to increase sales revenue by 15% in 2019 despite the volume of sales remaining flat over the same period. [2]

4 Delicious Dinners is a catering company which has the contract to act as sole supplier of school meals to all secondary schools in a particular area. The education authority has become concerned about the potential abuse of this monopoly position, and has decided to implement a new strategy whereby it reviews the contract and invites tenders every year in an attempt to make the market contestable.

With the aid of an appropriate diagram, explain why Delicious Dinners might change its price and output decisions as a result of this new education authority strategy. [6]

Section B: Case study

Answer all questions (40 marks)

The following passages were compiled in December 2020. Read them carefully and answer the questions which follow.

5 Case study: Big Tech under the microscope

Source 1: Rise of the FAANGs

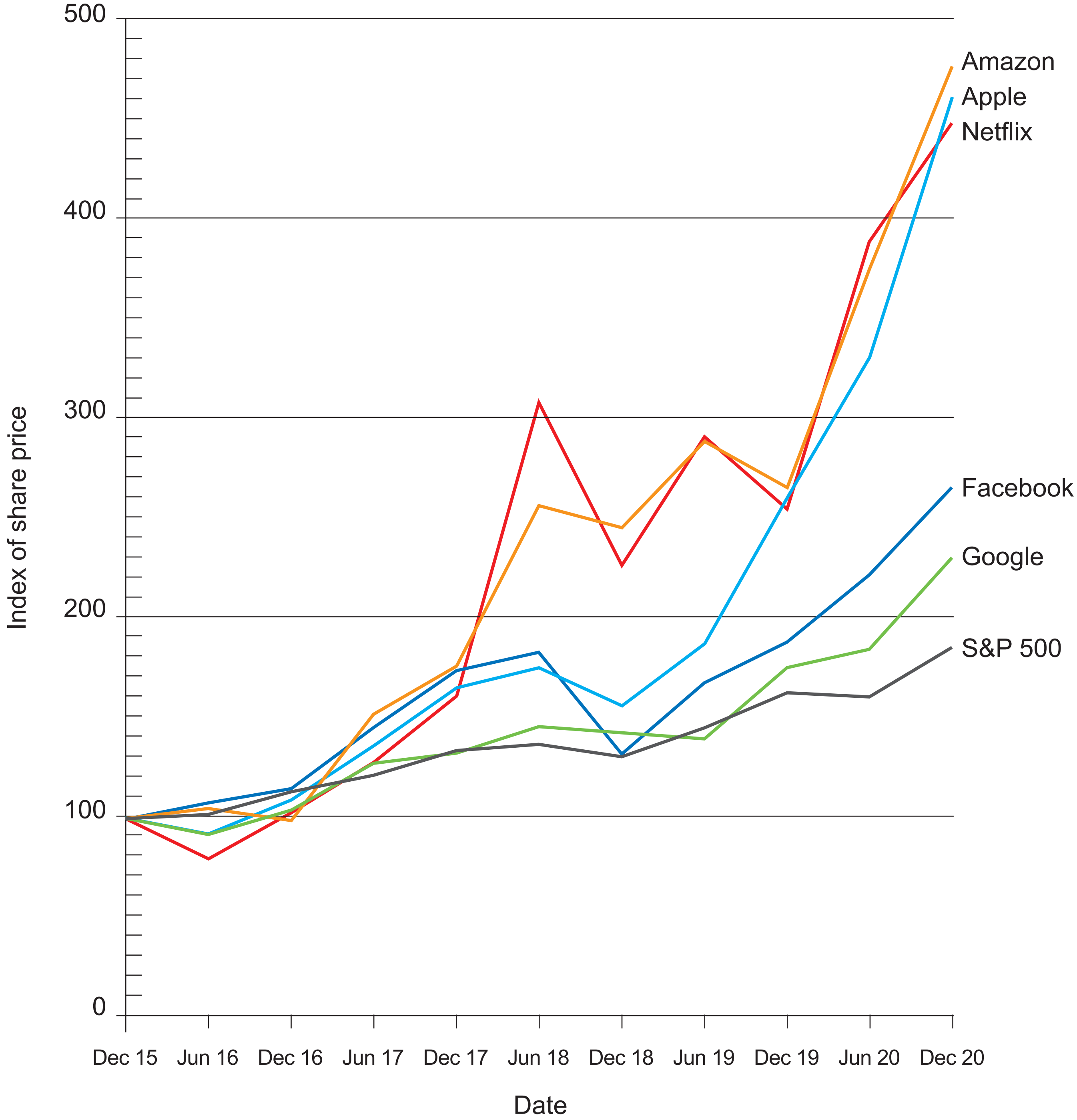

Fig. 1: Share price of the FAANGS and S&P 500 Dec 2015–Dec 2020: Dec 2015 = 100

It is hard to overstate just how central technology has become to our everyday lives. It has changed how we work, how we learn, how we communicate with our friends and family and how we shop.

Over the last few years, a number of US technology companies have embedded themselves seamlessly into the daily lives of people all over the world. The largest of these firms have become household names right across the globe.

This “Big 5”, collectively known as the FAANGs, are Facebook, Amazon, Apple, Netflix and Google. Between them, these companies have hundreds of millions of daily users which allows them to generate billions of pounds in annual profits. This in turn means that the total value of the FAANGs is a little under £5 trillion – or for comparison purposes, the total value of these five US companies is over twice that of the top 100 companies in the UK combined!

Fig. 1 opposite shows the growth in the share price of these firms compared to the average of the top 500 firms in the US (S&P 500) between December 2015 and December 2020.

This unparalleled growth and market value is even more significant when you consider that some of these companies did not even exist 25 years ago.

It seems that nothing can stop the growth of these firms. When coronavirus sent the globe into lockdown, many industries were hit hard. But the Covid-19 pandemic has rather perversely been good for these firms as they have become not just useful, but essential. Indeed, had it not been for the level of connectivity provided by the FAANGs, the impact of lockdown might have been much worse for all of us.

Source 2: Acquiring market power

While clever use of technology has undoubtedly been a major factor in the success of the FAANGs, so too has been their policy of rapid expansion through acquisition and takeover. Since it was formed in 2004, Facebook has acquired close to 100 companies, while Google has acquired close to 200 since it was founded in 1998. These acquisitions range from the purchase of small unknown companies, who typically provided essential services, to multi-billion dollar takeovers of rival firms.

Some of the most headline grabbing examples include:

- Facebook's acquisition of rival Instagram for $1 bn in 2012;
- Facebook's purchase in 2014 of rival messaging service WhatsApp for a staggering $16 bn; and
- Google's $1.65 bn purchase of YouTube in 2006.

At the time these takeovers were given the green light by regulators in the US, despite concerns raised by some that they were designed to stifle competition and increase market power.

Not surprisingly, the acquiring firms often express different motivations for the purchases. These motivations include bringing essential services in-house, creating synergies, and talent acquisition. Facebook CEO Mark Zuckerberg claimed that "we buy companies to get great people. One of the best ways to get great people is to focus on acquiring great companies with great founders".

Source 3: Not all prices are created equal

It is not just the "Big 5" technology firms who are benefiting from the move online; firms right across the spectrum are mimicking the "Big 5" and harnessing technology in an attempt to become more competitive and profitable. One popular strategy used by online retailers is a form of price discrimination known as personalised pricing, where retailers use information mined from your search history to determine a specific price to offer you. The information used includes the postcode you are searching from, whether you are using an Apple device or a PC, and your shopping and browsing history. If you are shopping on a Mac in a wealthy postcode and have a history of hitting the "buy" button quickly, chances are you will be offered a higher price for the same goods than someone else in a less wealthy area browsing on their PC.

Pat Adams, an e-commerce analyst, stated: "The potential gains to both revenue and profit from personalised pricing are impressive. Companies which invest in the sophisticated digital equipment required to analyse big data can achieve what was once only a theoretical idea, perfect price discrimination!"

However, Neil Mellor, a consumer rights campaigner, stated: "Personalised pricing may just be the straw that breaks the consumer's back. When consumers realise that price discrimination is occurring, they object. When consumers start objecting in big numbers, then regulators start to act, particularly if they feel that firms are using personalised pricing to limit entry into the market or destroy competitors."

Source 4: Regulators bite back

Competition regulators in the EU and the US are taking a closer look at the market power enjoyed by “big tech” companies. In the summer of 2020 the bosses of Facebook, Apple, Amazon and Google were forced to testify before the United States Congress as part of a wider investigation into their market dominance.

By October, the US Department of Justice was suing Google, accusing the firm of stealing content created by smaller firms and violating US competition policy to construct and maintain monopoly power on internet searches and online advertising.

Then, in December, the US Federal Trade Commission sued Facebook, accusing the social media group of taking illegal actions to buy up rivals and stifle potential competition. Officials accused Facebook of taking a “buy or bury” approach to crush smaller rivals and snuff out competition, all at the expense of everyday users.

In Europe, the European Commission has accused Amazon of unfairly using access to data on its platform to undermine competition. Essentially, the Commission argues that Amazon studies which products sell well on its platform, creates its own version of these products (under its Amazon basic brand), and undercuts the original seller.

If found guilty of the various charges, the firms could face an array of different penalties including fines, punitive taxation, closer regulation of their activities, and legislation forcing the firms to break themselves up into smaller, separate component parts.

Not surprisingly, the CEOs of these companies are defending their actions vigorously. A spokesman for Facebook stated that “competition laws exist to protect consumers and promote competition, not to punish successful businesses”.

Competition lawyer Paul Maxwell stated: “If they have inadvertently violated some competition regulations, the FAANGs should pay their fines and adjust their business practices accordingly. However, they should resist forcibly any attempt to break up their companies, not only for their own sake, but for the sake of the wider economy. Attempting to break large successful companies up into smaller competing entities is the least effective policy available to competition authorities.”

(a) Using the information in **Fig. 1**, compare the trends in the share price of the FAANGs to the S&P 500 between December 2015 and December 2020. [4]

(b) Analyse why firms such as the FAANGs often pursue rapid expansion through acquisition and takeover. [9]

(c) Critically examine the likely impact of personalised pricing on firms and consumers (Source 3). [12]

(d) Evaluate the view that breaking up large successful companies is the least effective policy available to competition authorities. [15]

Section C: Essay section

Answer one question (30 marks)

6 In recent years, several economists have been calling for deregulation of the UK banking market. They argue that the emergence of online-only banks and the development of crowdfunding and peer-to-peer lending platforms has made the market much more contestable. Others, however, have pointed out that despite this supposed increase in contestability, the market is still dominated by a few big firms that earn significant levels of supernormal profit at the expense of customers.

Critically examine the view that the theory of contestable markets is no more realistic than traditional models of firms' behaviour. [30]

7 A recent study by Harvard University in the USA looked at profitability in organisations of different sizes. It reached a conclusion that contradicts what is being taught in most introductory economics courses. The study suggested that the single biggest factor in explaining why large firms are more profitable is not because they have more pricing power, but rather because they are much more efficient.

Critically examine the view that economic efficiency is more likely to be achieved in highly concentrated markets than in highly competitive ones. [30]

THIS IS THE END OF THE QUESTION PAPER