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Mark Scheme (Results)

January 2018

Pearson Edexcel IAL
In Economics (WEC03)
Paper 01 Business Behaviour

edexcel

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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

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Section A: Essay questions

NB: Use levels based mark scheme (20 marks) to mark this section.

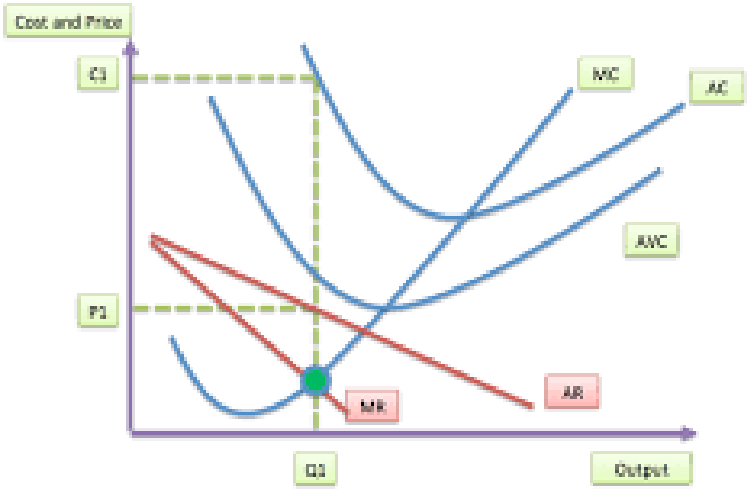
Question Number	Answer	Mark

1	**Indicative content**
	
	<u>The size of the market may be a major constraint on growth because:</u>
	
	• Lack of scope for growth within the market
	
	• Many other firms are competing in the market
	
	• New entrants in the market - market share is falling
	
	• The market is small - localised market, niche etc.
	
	• The market is shrinking - falling demand (leftward shift in demand curve)
	
	<u>Other constraints</u> may also be important to the business
	
	• The **objectives** of the owners/managers
	  • Owner(s) may be satisfied with keeping the business small – growth is risky, expensive, time-consuming etc. Profit satisficing
	
	  • Lack of managerial skills
	
	• **The macroeconomic climate**
	  • Slow growth or recession in the economy
	  • Low effective demand, low consumer purchasing power
	  • Future uncertainty in the economy – economic, political etc.
	  • High interest rates
	  • High inflation rates
	  • High unemployment rates	

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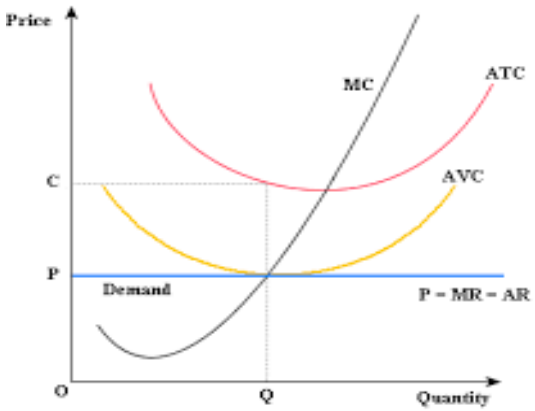
	• **Government legislation/regulations** - Laws on mergers/takeovers - Red tape • **High costs of growth** - legal and administration costs - costs of merger or takeover bids • **Lack of availability of required labour** • **Limited access to finance -** - relatively small amount of retained profits - banking sector may be unwilling to lend **-** small firms have fewer options when raising external finance **Evaluation** <u>Size of market may **not** be a major constraint on business growth because</u>: • The market is growing - increased market demand (rightward shift in demand curve); new product with considerable scope for market growth • The business is content to operate within a market niche - applies particularly to small firms • The business is able to expand its market through marketing - advertising, branding, promotion • The business is a monopolist and controls the market • The business can grow by merger/takeover • The business is a conglomerate operating in different markets to avoid the constraint of any one market • The business is a TNC operating internationally to avoid limitations in the size of any one national market **Other constraints may also be evaluated** **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	**(20)**

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Question Number	Answer	Mark
2	**Indicative content** Definitions: • Average Cost of production - total cost/output • Price = Average Revenue - total revenue/output • Shut down point - where the firm cannot cover its costs • Distinction between fixed and variable costs • The decision on whether to shut down or not depends on whether losses arise in the short run or long run • **The firm may stay in business in the short run as long as AVC is covered**. A contribution may be made towards covering fixed costs **SHORT RUN** Monopoly (monopolistic competition) diagram showing loss  At MC = MR, (output Q2), the firm is not covering AVC and will shut down	

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Perfect competition diagram



- At output OQ the firm can survive as it just covers its AVC at price P

- In the short run, if price (AR) is below AVC the firm will shut down

LONG RUN

- In the long run, if AR is below ATC then the firm will shut down (the firm is making a loss or earning less than its normal profit AR ≤ AC)

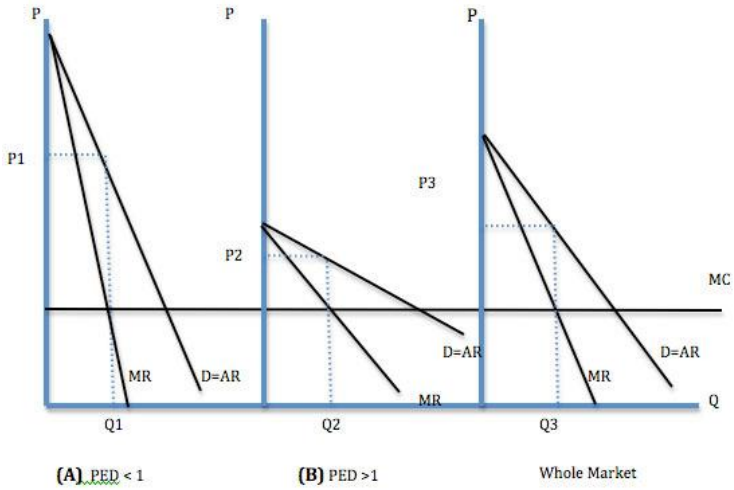
- In the long run survival depends on making at least normal profit (AR = AC), so loss makers will exit the industry. So shut down point is anything below normal profit (AR = AC)

- Perfect competition & monopolistic competition - firms would need to profit maximise (MC = MR), in the long run to avoid losses

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	Evaluation A firm may be able to price below AC because: • It is a monopolist and deliberately selling at below its AC i.e. a predatory pricing strategy to eliminate rivals from the market • Financial support is provided by the government - e.g. grants, subsidies • It is in the public sector and is financed by the government • It receives cross-subsidies as it is part of a conglomerate or group of companies • It is a start-up business and so some time is required before it expects to make a profit as it becomes more established in the market and revenue rises In the long run the firm manages to reduce its costs e.g. improving productivity In the long run the firm successfully increases revenue For private sector firms the distinction between short and long run is critical. Most are likely to shut down in the long run if costs are not covered **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	**(20)**

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Question Number	Answer	Mark
3	**Indicative content** Define price discrimination (third degree) – where a firm is charging different prices to different users for the same product/service • Conditions necessary for price discrimination: -monopoly power -different PED's for different consumer groups -supplier is able to split, and maintain separation of, the distinct consumer groups • Examples – airlines, railways, energy providers, cinema tickets  Diagrammatic analysis (assuming profit maximisation) -Output Q1 and higher price P1 where demand is inelastic -Output Q2 and lower price P2 where demand is elastic -Higher total profit (from markets A and B) when compared with whole market • Consumers with inelastic demand will be paying higher prices - (Market A) e.g. transport or energy costs at peak times	

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	• Extraction of consumer surplus to increase producer surplus • A significant number of different prices can be confusing and potentially costly for consumers who may inadvertently not choose the lowest price – problem of asymmetric information • More market power of incumbent firm(s) may result in higher barriers to entry and prevent/restrict competition • Monopoly firm less likely to invest/increase efficiency because of complacency and lack of competition **Evaluation** • Consumers with elastic demand will be paying lower prices (Market B) e.g. travellers during off peak times, student discounts • More choice of products/service – e.g. makes it financially viable for the firm to supply goods/services during off peak times • Higher profits may encourage further investment by firm which can improve quality and possibly lower prices • The opportunity to cross-subsidise • The firm's ability to price discriminate will be diminished where: - there are price controls set by regulatory bodies -there is media/consumer groups/government pressure opposing price discrimination - new firms enter the market **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	**(20)**

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Question Number	Answer	Mark
4	**Indicative content** Forms of government intervention to protect employees may include: • Equal opportunity laws – equal pay, anti-discrimination • Employment rights – part-time employees' rights, maternity & paternity leave, holiday entitlements, redundancy etc. • Health & safety laws and regulations • Minimum wage legislation **Impact on business behaviour:** • Business objectives may alter e.g. – more emphasis on social responsibility • In relation to legislation, businesses will need to conform with the law which may involve having to make adjustments or changes to current employment practices: - rights for disabled workers - fairer recruitment processes - improved safety procedures - increase in wage rates Any of the above may lead to **increased costs** for businesses • Impact of rising costs may be: - businesses raise prices - substitute capital for labour - reduce profit margins - reduce other costs - reduce investment - relocate to economies with less government intervention • May be a rise in business corruption, unofficial business activity to avoid tougher laws	

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	Evaluation • Reputation of the business may be enhanced for those businesses which conform with the legislation and demand does not fall despite higher prices • Legislation applies to competitors as well, so may be no loss of market share • Depends on the extent of the change required – for some businesses the impact may be slight • Rising costs may be offset by a rise in labour productivity due to improved pay/conditions/employment opportunities. Hence little or no rise in unit labour costs • Depends on the influence of trades unions and other employee organisations • Depends on the extent to which laws and regulations are being enforced by the government • Short term/long term impact on business behaviour	**(20)**

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Section A Questions: Performance Criteria for Mark base 20		
Level 0	0	• No rewardable material
Level 1	1-4	• Displays knowledge presented as facts without awareness of other viewpoints • Demonstrates limited understanding with little or no analysis • Attempts at selecting and applying different economic ideas are unsuccessful • Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
Level 2	5-8	• Displays elementary knowledge of well learnt economic facts showing a generalised understanding together with limited analysis i.e. identification of points or a very limited discussion • Displays a limited ability to select and apply different economic ideas • Material presented has a basic relevance but lacks organisation, but is generally comprehensible. Frequent punctuation and/or grammar errors are likely to be present which affects the clarity and coherence of the writing overall.
Level 3	9-12	• Displays knowledge and understanding of economic principles, concepts and theories as well as some analysis of issues i.e. answer might lack sufficient breadth and depth to be worthy of a higher mark • Shows some ability to apply economic ideas and relate them to economic problems • Employs different approaches to reach conclusions • Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
Level 4	13-16	• Displays a good knowledge of economic principles, concepts and theories together with an analysis of the issues involved • Demonstrates an ability to select and apply economic ideas and to relate them to economic problems • Evidence of some evaluation of alternative approaches leading to conclusions • Material is presented in a generally relevant and logical way, but this may not be sustained throughout. Some punctuation and/or grammar errors may be found which cause some passages to lack clarity or coherence.

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Level 5	17-20	• Displays a wide range of knowledge of economic principles, concepts and theories together with a rigorous analysis of issues • Demonstrates an outstanding ability to select and apply economic ideas to economic problems • Evaluation is well balanced and critical leading to valid conclusions • Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

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Section B: Data response

Question Number	Answer	Mark
5 (a)	**Knowledge and Application (up to 4 marks)** **Knowledge** – up to 2 marks Oligopoly (1) With **one** characteristic of oligopoly for development mark e.g. Small number of dominant large firms (1) Interdependence of firms (1) There may or may not be a large number of smaller firms **(1)** Any other valid knowledge point **(1)** **Application –** up to 2 marks 4 dominant firms in the industry (1) Each one of the four largest firms have similar market shares (1) Calculation of concentration ratio: 3 firm 54% 4 firm 69% (2 marks for one accurate calculation) Rest of the smaller firms have 31% between them (1) Any other valid application point - up to 2 marks	**(4)**

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Question Number		Mark
5 (b)		**(12)**
Knowledge, application and analysis – indicative content		
	NAI may be able to compete by: • Offering different routes than the established airlines - providing more choice and convenience to consumers. Direct flights to smaller US cities • Competing on price - cheaper flights than the larger airlines • Keeping costs of production down allow even lower prices to lead to profitable operations - smaller aircraft, which are cheaper to buy and to operate - keeping wage costs down by being based in Ireland - offering a basic service to passengers e.g. meals, comfort, onboard entertainment • Having lower sunk costs - smaller aircraft • Once NAI gains a foothold in the market its reputation may grow which will attract more consumers • Possible support from government authorities to improve contestability in the market	

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Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of how a small firm may compete. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of how a small firm may compete with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of how a small firm may compete with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – indicative content		
	• NAI currently has a very small market share with just 1% of aircraft in the transatlantic market • Despite a reduction in sunk costs small airlines still face high fixed costs in setting up an airline firm e.g. buying planes, training staff. Significant economies of scale in this industry may not be achievable for a small business • The demand for a limited service airline may be very small on long haul flights • The threat of new competitors acts as a pressure on the larger airlines to: - lower prices - become more efficient - offer better service to customers • In the long run the small airlines may find it difficult to survive	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

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Question Number		Mark
5 (c)		**(12)**
Knowledge, application and analysis – indicative content		
	• Definition of collusion – incumbent firms agreeing to restrict competition (formally or informally) • Collusion can be tacit (e.g. price leadership) or overt (e.g. price fixing). Extract 2 suggests price fixing • May be a rational strategy for airline firms to: - Keep air fares artificially high (removing unprofitable flights and slowing growth) - Achieve higher net profit margins - twice as high as the world average - Satisfy their biggest shareholders - Avoid price competition/price wars - Create more entry barriers to make the market less contestable (new entrants 'actively discouraged') - Achieve a more secure and larger market share - Maximise joint profits by restricting airline capacity - It may be rational if any potential fines and legal costs are likely to be lower than the extra profit gained	

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Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the reasons for collusive behaviour. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the reasons for collusive behaviour with some application. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the reasons for collusive behaviour with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – indicative content		
	• Collusion has led to US Government investigation • The investigation may result in huge fines being imposed • Airlines face high legal costs • Collusion may be difficult to sustain in the long run – firms may ultimately break away and charge lower prices • Adverse publicity following investigations could cause longer term damage to the reputation of airlines and lead to a fall in consumer demand **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.
0	0	No evaluative comments.

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Question Number		Mark
5(d)		**(12)**
Knowledge, application and analysis – indicative content		

Methods of government control: Various forms of competition policy may include;

- Laws against collusion – with bans and fines imposed
- Laws and controls over monopoly power and merger and takeover activity e.g. any future mergers in the US airline industry
- Placing limits on profit levels or profit margins
- Deregulating the industry – lowering barriers by allowing new companies to enter the industry e.g. new airlines operating on transatlantic routes
- Financial incentives for new entrants, especially smaller firms-e.g. low interest loans, subsidies
- Regulating prices –e.g. price controls, setting a maximum price



- Higher tax rates on profits - e.g. a windfall tax on excessive airline profits

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	Policies may result in: A more competitive market: • Fewer barriers to entry so more contestable and an incentive for new entrants • Fewer businesses leave the market - so more consumer choice • Increase in consumer surplus and lower producer surplus or consumers gain from lower prices (price ceiling and greater competition) • Increased economic efficiency of firms - productive, allocative and dynamic; reduced x-inefficiency of firms	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the effectiveness of government policies to control anti-competitive business behaviour. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the effectiveness of government policies to control anti-competitive business behaviour, with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the effectiveness of government policies to control anti-competitive business behaviour, with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

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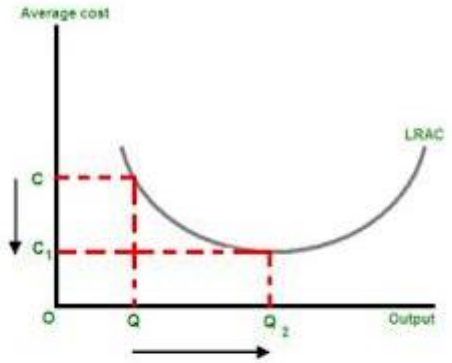
Evaluation – indicative content		
	• Measures may have a damaging effect on firms' profits and cause some firms to exit the market - leading to less consumer choice • Limits on profit might reduce investment/ damage efficiency • Maximum prices may create shortages in the market (see diagram where shortage = Q1Q3) • Effectiveness depends on how extensive government measures are and how businesses respond to those measures, e.g. what maximum price is set, what level of fines is imposed? • Market power of firms may weaken the impact of government controls • Difficulty in proving cases of collusion (especially tacit) • Fines imposed may not be a deterrent if benefits of collusion outweigh financial costs for firms (e.g. large US airlines) • Encouraging new firms to enter the market may have little effect where incumbent firms are large and powerful (e.g. the major US airlines) • Regulatory capture	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

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Question Number	Answer	Mark
6 (a)	**Knowledge and Application (up to 4 marks)** **Knowledge** – up to 2 marks • Identifying **conglomerate (1)** • A firm acquires a number of other unrelated businesses to form a large diversified organisation (or other acceptable definition) **(1)** **OR** • Identifying **horizontal (1)** • A firm undertakes a merger/takeover with a firm in the same industry at the same stage of production (or other acceptable definition) **(1)** **Application –** up to 2 marks Conglomerate: CNCC is a chemical company (1) and it is buying a tyre manufacturer (1) It produces brake hoses and conveyor belts (1) CNCC's produces a range of different products (1) Horizontal: CNCC is already a tyre producer in China (1) and it is buying up Pirelli, another tyre producer (1) This now gives CNCC 10% of the global tyre market (1) Any other valid application point - up to 2 marks	**(4)**

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Question Number		Mark
6 (b)		**(12)**
Knowledge, application and analysis – indicative content		
	Benefits to CNCC: • Gains ownership of Pirelli - a major global name and fifth largest global tyre producer • Increases its global presence - raises share of global tyre market to 10% • Potentially increases its revenues and profit • CNCC already produces tyres and related products so there is likely to be synergy e.g. shared expertise • May give CNCC more market power - both as a buyer and a seller • The takeover removes a major competitor from the market • Achieves further economies of scale – e.g. diversification  CNCC's output rises from OQ to OQ_2 following takeover and LRAC falls from 0C to $0C_1$ • Diversifies market into other geographical regions	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the likely benefits of a takeover. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the likely benefits of a takeover with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the likely benefits of a takeover with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

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Evaluation – indicative content		
	• Initial costs of the takeover- US$7.9billion which may prove to be an overvaluation or very costly for CNCC • Potential diseconomies of scale- CNCC grows larger than MES; output above OQ_2 on diagram e.g. different systems in place, employee dissatisfaction • Distance, language and cultural barriers • Job losses were being considered at Pirelli- CNCC may have bought a company which was facing financial difficulties • Many takeovers are ultimately unsuccessful	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

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Question Number		Mark
6(c)		**(12)**
Knowledge, application and analysis – indicative content		
	Factors which should be considered: • Would the takeover be in the best interests of consumers, employees, suppliers, the economy as a whole? • What were the <u>employment</u> implications? E.g. on O_2 staff and HW staff • What would have been the implications for <u>competition</u> and market share? HW market share would have risen to 36.5%. Monopoly power may have serious adverse effects – high prices, less choice, strict conditions on suppliers, fewer jobs etc. 'Which?' was concerned about the HW bid for O_2 • What would have been the implications in relation to increased foreign ownership? • What would have been the implications for the macro economy? E.g. trade, inflation, growth • What would have been the implications for investment?	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the factors considered when deciding whether a takeover should be permitted or not. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the factors considered when deciding whether a takeover should be permitted or not with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the factors considered when deciding whether a takeover should be permitted or not with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

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Evaluation – indicative content		
	• EU allowed other takeovers by HW of O2 Ireland and Orange Austria even though the number of operators was reduced to 3 in each case. However, conditions were imposed on each deal • Asymmetric information - EU regulators may not have had access to perfect information • Possible government failure • Concerns relating to quality of service to consumers may have been overestimated • HW's claim regarding benefits to the UK economy have been underestimated by the competition authorities	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

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Question Number		Mark
6(d)		**(12)**
Knowledge, application and analysis – indicative content		
	Definition of pressure group – an organised group that seeks to influence government policy or protect or advance a particular cause or interest <u>Pressure group activities may include</u> • Pressure on governments to restrict growth of TNCs through blocking takeovers • Adverse publicity against TNCs e.g. concerns over growing influence of Chinese TNCs in Africa. Concerns over human rights - child labour, low wages and environmental issues - pollution. Articles published in magazines and online - e.g. by Which? in UK • Trade union actions e.g. strikes and protests • Consumer campaigns e.g. Fair Trade, boycotts <u>Influence on TNC operations</u> • Actions of trade unions and human rights groups may mean that TNCs have to comply with tighter laws and regulations –improved safety standards, higher wages etc. • Pressure groups may create public opposition to TNCs activities, adverse media coverage, e.g. Which is the largest consumer group in UK • TNCs may alter behaviour in order to improve public image and avoid a potential loss in profit • May make it more difficult for TNCs to acquire companies overseas • May reduce opportunities for TNCs to carry out transfer pricing in order to avoid national taxes on profits	

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Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the possible influence of pressure groups on TNCs. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the possible influence of pressure groups on TNCs with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the possible influence of pressure groups on TNCs with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

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Evaluation – indicative content		
	Influence of pressure groups depends on different factors which may include: Size of group - local, national or international, degree of media coverage, TU strength, government support, willingness of TNCs to comply. Which? may possibly be influential in UK due to its size and scope. May not be true for other countries • Some TNCs are very powerful and it will often require concerted joint international action e.g. European Union decisions rather that a national government • Governments may be concerned of the threat of TNCs pulling out of the economy – negative consequences on jobs, incomes etc. so may not take action against TNCs • Trade unions may be weak or illegal in some countries • CNCC is a TNC owned by the Chinese Government. It may be more powerful than any pressure group • HW has been taking over companies in various parts of Europe. Pressure groups may have difficulty in persuading various national governments to take action	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

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