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Economics

Advanced

**Unit 3: Business Economics
and Economic Efficiency**

Tuesday 6 June 2017 – Afternoon

Time: 1 hour 30 minutes

Paper Reference

6EC03/01

You do not need any other materials.

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **all** questions in Section A and **one** question from Section B.
- Answer the questions in the spaces provided
– *there may be more space than you need.*

Information

- The total mark for this paper is 72.
- The marks for **each** question are shown in brackets
– *use this as a guide as to how much time to spend on each question.*
- Questions labelled with an **asterisk** (*) are ones where the quality of your written communication will be assessed
– *you should take particular care on these questions with your spelling, punctuation and grammar, as well as the clarity of expression.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Check your answers if you have time at the end.

Turn over ►

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QUESTION 4 BEGINS ON THE NEXT PAGE.



- 4 Lottie runs a tanning shop and the following table shows her costs and revenues for one treatment at different price levels. Some parts of the table are left blank for your own calculations.

| Number of customers per day | Price (£) | | | Total costs (£) | Marginal costs (£) |
|-----------------------------|-----------|--|--|-----------------|--------------------|
| 0 | 20 | | | 30 | |
| 1 | 18 | | | | 2 |
| 2 | 16 | | | | 3 |
| 3 | 14 | | | | 4 |
| 4 | 12 | | | | 6 |
| 5 | 10 | | | | 10 |

At what price range would Lottie maximise her profits?

(1)

- A £20 or higher
- B £18–£20
- C £16
- D £12–£14
- E £10

Answer



Explanation

(3)

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(Total for Question 4 = 4 marks)

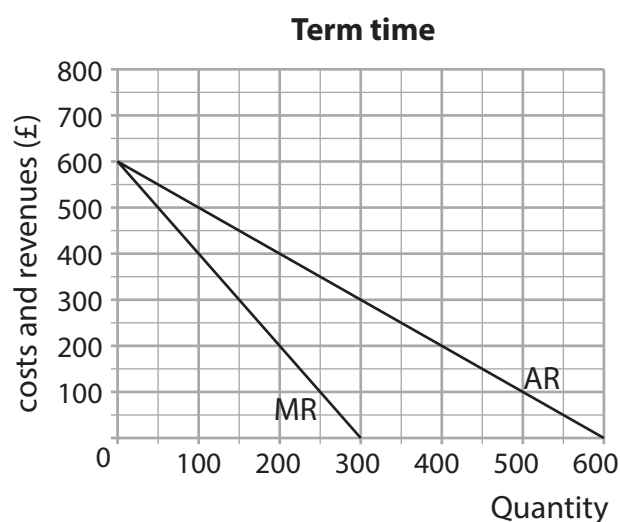
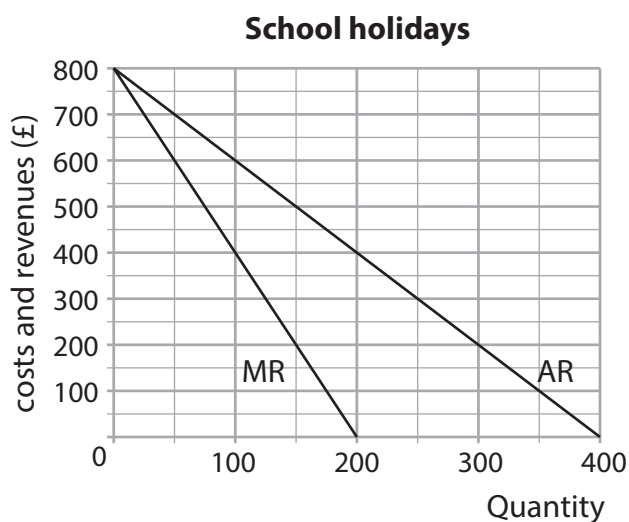


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- 5 A monopolist supplier of holidays to a small island resort splits the market into two sub-markets: one for school holidays and the other for term time. The diagrams show the average revenue (AR) and the marginal revenue (MR) curves for holidays in the two sub-markets.

If the marginal cost of providing one holiday is £200 at any time of the year, what prices should the holiday firm charge in the two sub-markets to maximise profits?

(1)



| | Price in school holidays, £ | Price in term time, £ |
|----------|-----------------------------|-----------------------|
| A | 200 | 200 |
| B | 300 | 300 |
| C | 400 | 300 |
| D | 400 | 500 |
| E | 500 | 400 |

Answer



Explanation

(3)

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(Total for Question 5 = 4 marks)



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QUESTION 9 BEGINS ON THE NEXT PAGE.



SECTION B

Answer EITHER Question 9 OR Question 10.

If you answer Question 9 put a cross in the box .

Question 10 starts on page 26.

You should spend 55 minutes on this section.

9 Apple and Samsung

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

Apple has won a powerful victory in its US patent battle with Samsung, after a jury found that the South Korean electronics firm breached design patents. The jury awarded \$1.05 billion in damages to Apple because they found that Samsung had copied features such as 'rubberbanding' scrolling, its sleek glass front, its touchscreen features such as 'tap to zoom' and 'bounce back' scrolling, its edge-to-edge glass front, rounded corners and app icons. 5

The verdict that consumers could be confused between the two companies' products will send shockwaves through the smartphone industry, with implications for other handset makers that use Google's Android operating system. Analysts point out that the US ruling will have a global effect, because smartphone makers will be unwilling to create different products for different markets, to continue to innovate, to offer choices and to lower prices for the consumer. 10

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

Figure 1 A Samsung Galaxy and an Apple iPhone



(© Pieter Beens/Shutterstock)

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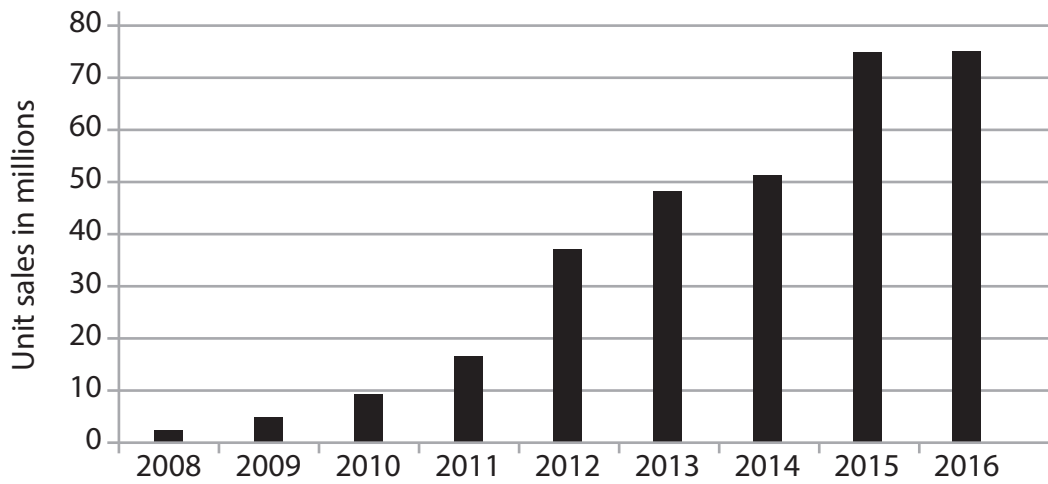


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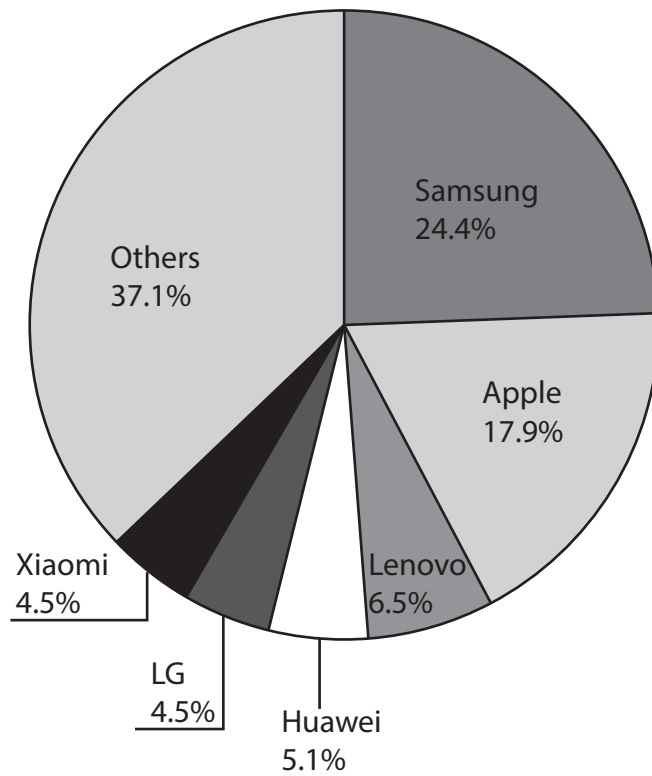
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Figure 2 iPhones sold in the first quarter of each year, globally (millions)



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

Figure 3 Global market share of smartphones, 2015



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



Extract 2 Apple: the only way is down?

If Apple's revenue was compared to a country's GDP, it would be only slightly smaller than that of Denmark. Impressive though this may be, Apple's record-breaking profits are under threat if Chinese growth slows down. To date, Apple has sold more iPhones in China than in the US. This quarter's recent profits – \$18 billion for the first quarter of 2015 – reflect Apple's ability to maintain profit margins even while selling phones in China at reduced prices in order to enter that market. The iPhone and iPad are superb devices, but they are not so radically different from those made by rivals. It is economies of scale that preserve Apple's position, while others struggle to innovate, design and produce in such numbers. 5

Competitors envy those profit margins, and talk about 'democratising' technology, which means bringing prices down to make equally beautiful devices attainable for all. It is, for now at least, a very optimistic view. That's largely because the iPhone combines the 'cool' factor with superior design and, unless Apple's image is ruined, it will continue to be more attractive to millions of consumers than any other phone. No other manufacturer, whether South Korea's Samsung or China's Xiaomi, has managed to break into the high-cost, high-margin market in the same way as Apple. The same is true with the iPad, and the same is likely to go for the Apple Watch. 10 15

What, however, happens next? No company has ever sustained such world-beating performance for years on end, and when it comes to technology new trends come and go from various companies all the time. Statistics suggest Apple's sales and profits are likely to be affected by the global slowdown in growth, most particularly that of China, and turbulence in world markets. 20

But there are two key things to consider: first, there is a new technology landscape that makes monopolies more likely than ever. We are all likely to use one search engine online. We are similarly loyal to operating systems and devices with which we are familiar. Apple has built its success on repeatedly delighting consumers and reinforcing their loyalty. The bond between Apple and consumers looks stronger than ever, and the company's financial performance simply reflects that. This problem makes it difficult for regulators to determine appropriate competition policy. 25

Second, is a point that doesn't get made often enough: Apple's iPhone is the device that drives its profits, and the iPhone 6 may be the best iPhone ever made but it is an evolution of the original 2007 device. Its new Watch is an exciting prospect, but the phone itself remains the driver of profits. As more and more competitors catch up, Apple's ability to maintain its lead is likely to rely on ever more marginal improvements. At which point marketing is all that's left – and how many consumers will value marketing over the pound in their pocket? A new technological breakthrough may be needed to maintain Apple's dominance in the future. 30 35

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



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- (a) With reference to Extract 2, explain what is meant by economies of scale. (4)
- (b) Examine the likely effect of a further slowdown in growth in China on the profits of Apple. Use a cost and revenue diagram to support your answer. (8)
- *(c) Discuss the level of contestability in the market for consumer technology products such as smartphones. (12)
- *(d) Evaluate the difficulties 'for regulators to determine appropriate competition policy' (Extract 2, line 29) in markets for consumer technology products such as smartphones. (16)



(a) With reference to Extract 2, explain what is meant by economies of scale.

(4)

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(b) Examine the likely effect of a further slowdown in growth in China on the profits of Apple. Use a cost and revenue diagram to support your answer.

(8)

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* (c) Discuss the level of contestability in the market for consumer technology products such as smartphones.

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* (d) Evaluate the difficulties 'for regulators to determine appropriate competition policy' (Extract 2, line 29) in markets for consumer technology products such as smartphones.

(16)

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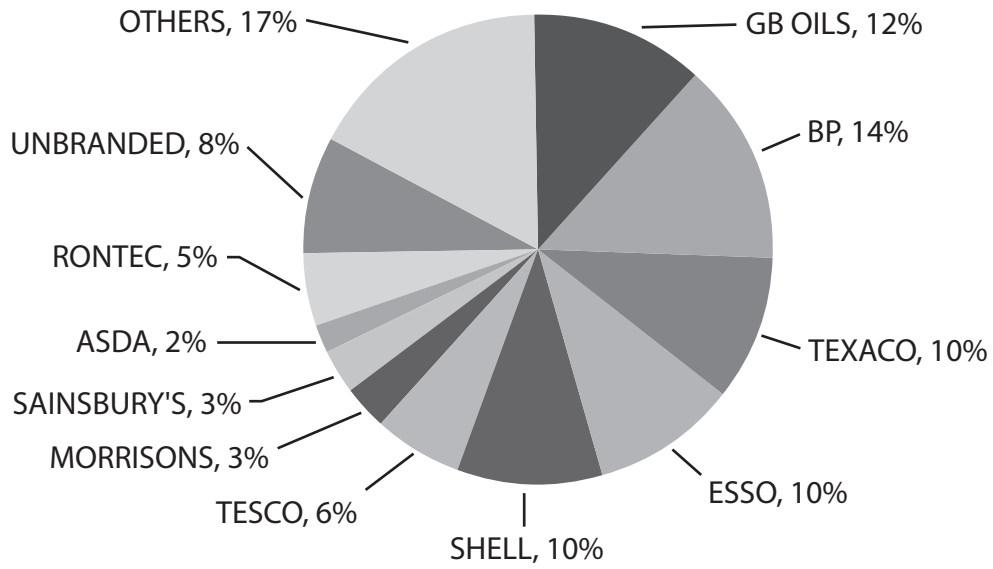


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If you answer Question 10 put a cross in the box .

10 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)

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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. 5

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. 10

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. 15

Households are keen to save even one or two pence a litre, particularly those families whose livelihoods depend on the use of a car. 20

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. 25

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. 30

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." 35

(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'." 5

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." 10

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. 15

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'." 20

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." 25 30

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



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- (a) With reference to Figure 1, what can be deduced about the market structure of petrol retailing in the UK? (4)
- (b) Discuss the likely impact on economic efficiency of the suggestion that “everyone is charged a national price for fuel” (Extract 1, line 35). (8)
- * (c) Using an appropriate cost and revenue diagram, examine whether the number of independent petrol retailers in the UK will continue to fall. (12)
- * (d) Evaluate strategies that petrol retailing firms could use to increase profit. (16)



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

(4)

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(b) Discuss the likely impact on economic efficiency of the suggestion that “everyone is charged a national price for fuel” (Extract 1, line 35).

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* (c) Using an appropriate cost and revenue diagram, examine whether the number of independent petrol retailers in the UK will continue to fall.

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

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TOTAL FOR SECTION B = 40 MARKS
TOTAL FOR PAPER = 72 MARKS



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