

Edexcel (A) Economics A-level

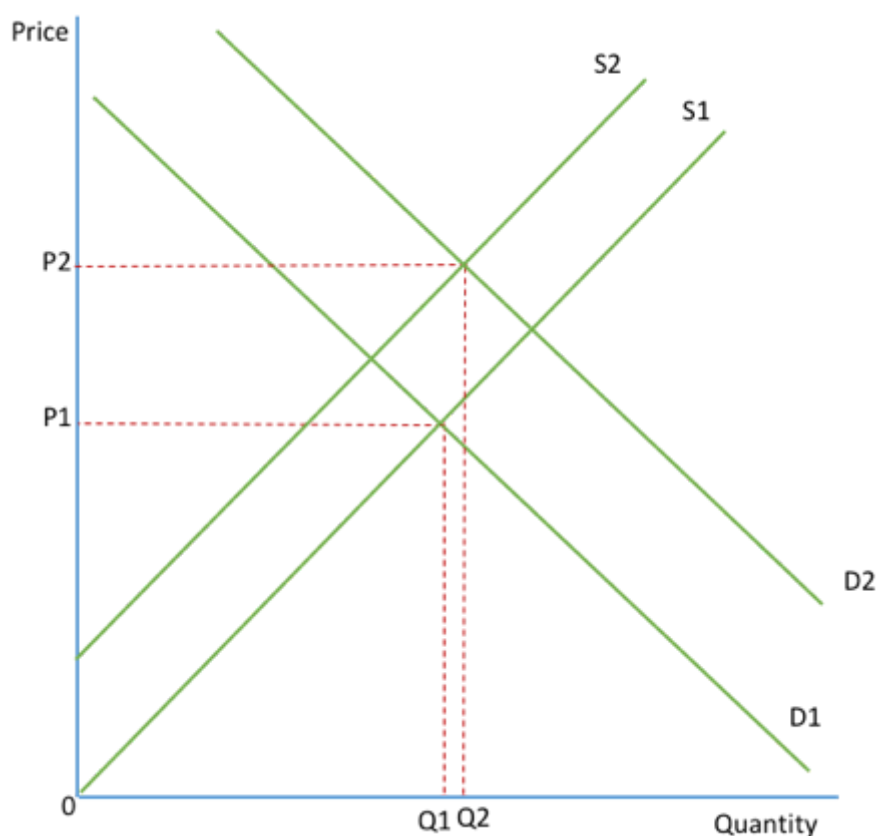
A-level Paper 1: Markets and Business Behaviour

Example answers

Specimen paper

6a) Explain why the price of the ‘average top-price ticket has risen by almost £10’ (Extract A, line 2). Use a supply and demand diagram in your answer. (5)

The average top price ticket has risen for two reasons. Firstly, there is increased demand since there are “record numbers of people wanting to buy tickets”. This means demand increases from D1 to D2. Moreover, there has been a decrease in supply. This is because costs have increased so they want to supply less at the same price, as a result supply moves from S1 to S2. Overall, this means prices rise from P1 to P2.



Teacher's comments: 5/5

b) Examine two reasons why Cineworld plans to merge with CCI. (8)

A merger is when two companies join together under common ownership. Firstly, Cineworld plans to merge to allow it to grow into new markets. CCI owns 100 cinemas in seven different countries (Extract B) and so by merging with CCI, Cineworld is able to operate in these countries. It would be difficult for Cineworld to expand into these countries by themselves due to lack of knowledge and so the merger is important in terms of growth. This growth is likely to increase revenue and profit in the long run.

On top of this, they plan to merger because other firms have grown overseas, for example Odeon has cinemas in seven countries. Therefore, Cineworld may have felt they had to merge in order to keep up with their competitors in terms of market share and economies of scale. If its competitors are much larger, they can experience economies of scale which make the competitors more

competitive with lower prices and so could force Cineworld out of business as customers may switch. Hence, it can be seen not as an opportunity to grow market share but to keep its current size.

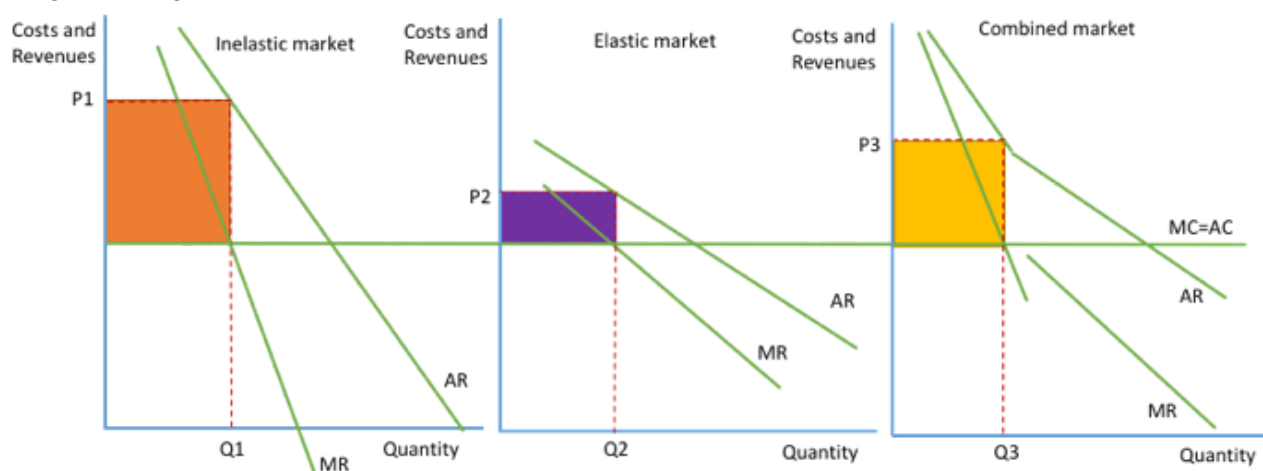
The most important reason is likely to be to expand into new markets, since there are limits in growth opportunity in the UK markets, as seen by the fact they had to sell three cinemas. If they are unable to expand naturally, the firms will use mergers in order to grow. The lack of growth in the home market may also be the cause of their competitor's presence in other markets.

Teacher's comments: 7/8

Evaluate in terms of 1% fall, is that significant? Was it a one off year?

c) With reference to Figure 1, discuss the likely impact of price discrimination on Cineworld's profit. Include an appropriate diagram in your answer. (12)

Price discrimination is when one firm is able to charge different groups different prices. The firm is using third degree price discrimination.



The impact of price discrimination is to increase profits, as shown in the diagram. The final diagram shows the profit that would be made in a combined market, and this is smaller than the combination of profits in the two separate markets. Therefore, the use of price discrimination means firms can make larger profits. They charge higher prices to the inelastic market, such as the adults, and lower prices to the elastic market, the children. Adults are assumed to be inelastic as they have higher incomes and so spend a smaller percentage of income on cinema than children. Moreover, adults are only likely to go when they want to see the film, whilst children may go simply for a social activity, which has many substitutes. We assume the firm is constant cost to make the diagram simpler.

However, the impact of price discrimination will depend on the ability of firms to price discriminate. In order to price discriminate, there are three conditions which must be met: there must be at least two separate markets which can be separated, the ability to on sell must be prevented and markets must have different elasticities. The markets are clearly separate, and the use of ID means that they can be separated fairly easily, and can prevent on selling. However, the elasticities may not be that different. Firstly, there are other cinemas which the consumers may use and so if adults are

charged huge prices then they may decide to go to a different cinema. This will mean that Cineworld may lose profit due to the price discrimination strategy. They will also lose out on any other revenue gained, for example sales of popcorn. Some may argue Cineworld should keep prices cheap to encourage people to come and then spend their money on other goods. This shows the impact of price discrimination also depends on the actions of competitors, since it is an oligopoly. If other firms price discriminate, it is likely to be more successful for Cineworld.

Teacher's comments: 11/12

d) Apart from price discrimination, assess one pricing and non-pricing strategy Cineworld could adopt to increase sales. (10)

In order to increase sales, Cineworld could use predatory pricing. This would mean setting prices as low as possible and mean making a loss in the short run. The aim would be for other firms to go out of business, either because they don't lower their prices so lose customers or because they are unable to sustain losses. This would clearly increase sales in the short run since low prices would mean more people go to the cinema. It is also likely to increase sales in the long run since it would force other firms out of the market and mean that Cineworld experiences higher market share, so will get a large percentage of sales. However, the problem with this is that the firm may be unable to sustain the losses and may end up being forced out of the industry themselves. Odeon and Vue are both large firms and so this strategy may be unsuccessful since it will be difficult to force them out of the industry. On top of this, predatory pricing is illegal and so Cineworld could be heavily fined.

A non-pricing strategy they could use could be advertising. This would increase demand for their cinema by making it attractive to consumers and so therefore this will increase sales. This method will be particularly important in the new market in order to make themselves known to the public. However, the problem with this is that there is little difference between Cineworld and its competitors and so advertising may just encourage people to visit the cinema, not necessarily Cineworld. Similarly, advertising is very expensive so it will lower profit and there is no guarantee it will work. A successful advertising campaign will increase sales but adverts are not always successful.

Teacher's comments: 9/10

A good answer- but how much advertising is really done by cinemas

e) Discuss the likely impact of 'a substantial lessening of competition in the cinema market in Aberdeen, Bury St Edmunds and Cambridge' (Extract C, line 6-7). (15)

The lower level of competition is likely to raise prices and lower quality for consumers. This is because firms know consumers have nowhere else to go and so will visit the cinema even if prices are higher and service is poor. However, the demand for cinemas is likely to be elastic since it is not a necessity and online streaming/DVDs mean that substitutes are available. Therefore, prices

can't rise too high or service become too bad since this will mean that no one attends the cinemas at all.

Moreover, lower competition is likely to raise revenue for firms. Prices are higher, and they may sell more goods since they have a larger market share than before, so therefore revenues will rise. This is likely to increase profit, assuming costs do not drastically increase.

The impact will depend on the reaction of the firm. If firms use their increased market share to exploit their economies of scale, then their AC curves will fall. This will mean that profit will rise since total costs fall. It may also mean that prices fall as the economies of scale are also likely to cause a fall in marginal cost. However, the firm may not exploit the economies of scale and they could become inefficient since they feel they have no need to be competitive. The reaction of the firm may depend on the contestability of the market. If it is contestable, firms realise they have to stay competitive and efficient to prevent new firms entering the market so this would mean that the AC will fall. However, the cinema market is likely to have low contestability as there are high start-up costs and big brands. This does not necessarily mean that AC will rise, as firms will want to remain efficient to keep profits high.

On the whole, the fall in competition is likely to cause higher prices and lower quality for the consumer since the firm is more able to exploit the consumer- but the elasticity of demand is likely to mean there will not be that much change. On top of this, they are likely to increase their profit due to the higher prices and higher market share and because they are unlikely to want costs to rise, since this will reduce their profit.

Teacher's comments: 12/15

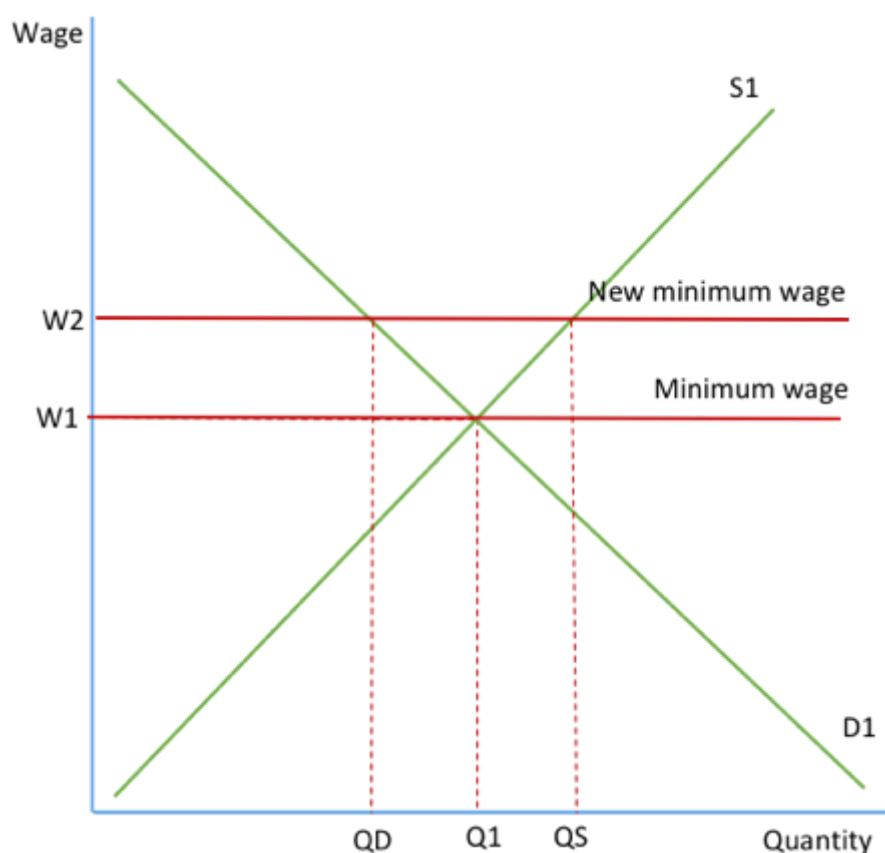
8) Evaluate the likely microeconomic impact of an increase in the National Minimum Wage (25).

National minimum wage is a wage set by the government which employees can not pay their workers less than. There are different wages for different age ranges, with over 25s receiving the National Living Wage. The aim of an increase in the minimum wage is to raise the wages of the lowest earners and help reduce poverty amongst the poorest households. It is able to do this since each workers receives more money when the national minimum wage increases. However, the reduction in poverty will only occur if it rises by more than inflation. If the wage rises by 3% whilst inflation is 5% then the impact will actually be to decrease household's real incomes since their costs have risen. Moreover, it may have very little impact in households where those on minimum wages are the secondary earners and their income just supplements the earnings of the main earner.

On top of this, the national minimum wage may increase the motivation of workers. Workers may feel more valued in the job if they are receiving a higher wage and therefore they will work harder. This will raise their productivity, leading to lower prices/higher output for the firm. This will increase their competitiveness and mean they receive higher profits. However, this argument assumes all workers are motivated by money, which not all of them are. Moreover, these workers are still

receiving the minimum wage and so are unlikely to be much more content, meaning their motivation is unlikely to increase. Overall, there is probably likely to be little impact on contentedness and motivation.

On the other hand, there are some negative impacts of the increase. The biggest one is the potential loss of jobs. The increase in the minimum wage will cause a contraction in the demand for labour and mean the number of jobs falls from Q_1 to Q_D . This loss of jobs will mean that some households will become worse off since they no longer have a job, and this may mean any positive effects of the increase in the national minimum wage for one family will be counteracted by the negative effects for another. The more elastic the curves, the greater the effect on the jobs will be, meaning some industries will see bigger job losses than others. Moreover, the level of job losses, and whether there are any at all, depends on where the wage was set before and where it has now been increased to. If the wage was set below equilibrium before, and it's still below now, there will be no effect. The bigger the increase and the higher it rises above equilibrium, the higher the loss of jobs. Again, this means it depends on the industry and there will be different effects in different industries.



Additionally, another impact could be a loss of competitiveness for firms. As labour becomes more expensive, business costs rise and therefore prices are likely to rise. This makes the firm's goods uncompetitive in the global market and so will reduce their sales. This, along with rising costs, will reduce their profit. However, it can be argued that if labour is actually more motivated and productive then the firm will be more efficient and could keep costs down or may produce a higher quality. This would mean that they do not lose out to other firms. The effects of this would also depend on wages in other countries, since if they also rose there would be no difference. Similarly

it depends on the price elasticity of demand since if it was elastic, higher prices are likely to increase profit.

Overall, an increase in the national minimum wage should hopefully help to reduce poverty by increasing the earnings of individuals. However, there is also likely to be a loss of jobs and so this could counteract the fall. The size of the increase is hugely important in the significance of its impacts, and there will be different impacts in different markets.

Teacher's comments: 22/25