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Pearson Edexcel
Level 3 GCE

Centre Number

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Candidate Number

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Economics B

Advanced Subsidiary

Paper 1: Markets, consumers and firms

Monday 14 May 2018 – Morning

Time: 1 hour 30 minutes

Paper Reference

8EB0/01

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 Sections A, B and C.
- Answer the questions in the spaces provided
– *there may be more space than you need.*

Information

- The total mark for this paper is 80.
- The marks for **each** question are shown in brackets
– *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

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

Turn over ►

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Answer ALL questions.

SECTION A

Read the following extract (A) before answering Question 1.

Write your answers in the spaces provided.

Extract A

Student bodybuilders bulked up by selling proteins to gym fans

Elliot Dawes and Adam Rossiter were not typical university students. While most of their peers burnt the midnight oil studying or partying, their passion was to burn calories.

The friends were inspired to start a business after noticing that protein supplements for bodybuilders were significantly cheaper on American websites. The bank refused them a loan so they had to borrow £6 000 from their parents to set up their own website that sold imported products. "The products we were importing were in high demand, but not available in the UK and Europe," said Adam.

5

After graduating, Elliot trained to be a solicitor at Guildford College of Law while his future business partner, Adam, completed his degree.

10

In December 2005, they started their business *Sports Supplements Ltd (SSL)* selling the imported nutritional supplements under their brand name of Bulk Powders. Their immediate aim was to expand into America and more European countries. "The US is a huge market, but it also has a lot of risk. We have to do it methodically," said Elliot.

In 2015, SSL reported:

15

- profit for the year of £470 000
- sales revenue of £15.9m
- cost of sales of £10.28m.

The company earned a place on The Sunday Times Fast Track 100, the league table of private companies with the fastest growing sales over three years. Independent research found that the UK sports supplement and nutrition market is predicted to grow at an annual growth rate of 9% between 2013 and 2018, reaching a value of £471m.

20

Elliot and Adam own 98.8% of the shares in the company and their chairman, Robert Easton, owns the other 1.2%. They intend to keep the rest of the shares despite cash offers from other investors.

25

Elliot's advice for entrepreneurs is to overcome perfectionism: "You have to accept that your standards will never be replicated exactly by your employees, so recruit good people and lead by example." Adam added: "Don't be afraid to make mistakes; it helps you to build a better business."

(Source: © The Times / News Syndication)



1 (a) What is meant by the term 'entrepreneur'?

(2)

An entrepreneur is a person who organises the factors of production (land, labour and capital) to set up a business, taking all of the risks involved, with the aim of adding value and making a profit by providing a good or service.

(b) Calculate, to 2 decimal places, the gross profit margin for SSL in 2015. You are advised to show your working.

(4)

Gross profit margin = (sales revenue - cost of sales) ÷ sales revenue × 100

Gross profit = £15,900,000 - £10,280,000 = £5,620,000

Gross profit margin = £5,620,000 ÷ £15,900,000 × 100

= 35.3459...%

Gross profit margin = 35.35%



(c) Explain the opportunity cost for Elliot and Adam of setting up SSL.

(4)

Opportunity cost is the value of the next best alternative forgone when a choice is made. By setting up SSL, Elliot and Adam gave up the income they could have earned from paid employment.

Elliot had trained to be a solicitor at Guildford College of Law, so he sacrificed a well-paid career as a solicitor, and Adam could have used his recently gained degree to seek graduate employment.

This means they gave up secure employment and a regular, guaranteed income in exchange for an uncertain profit, as the business could have failed. The £6,000 borrowed from their parents could also have been used for something else, such as paying off student debt.



(d) Discuss the benefits of limited liability to Elliot and Adam when operating SSL.

(8)

Limited liability means that the shareholders of a company are only liable for the debts of the business up to the amount they have invested, so their personal assets, such as their homes and savings, are not at risk if the business fails. SSL is a private limited company (Ltd) with three shareholders.

The main benefit is reduced risk for Elliot and Adam. When they started in 2005 they were only risking the £6,000 they borrowed from their parents, so if importing protein supplements had failed they would not have lost their personal possessions. This made them more willing to take chances in developing SSL, for example their plan to expand into the risky US market, because the most they can lose is their investment in the company.

Limited liability also reduces risk for potential shareholders, so investors are more willing to buy shares. This means SSL has wider access to other types of finance. Elliot and Adam own 98.8% of the shares and the chairman, Robert Easton, owns 1.2%, and they have received cash offers from other investors, which shows that they could raise share capital to fund expansion if needed while keeping control.

However, limited liability has drawbacks. Suppliers and banks know they may not get all their money back if the business fails, so it may be more difficult for SSL to obtain loans or trade credit, which may explain why the bank refused them a loan. Elliot and Adam might have to give personal guarantees, which removes the protection. SSL must also register its accounts with Companies House, so competitors can see figures such as its £15.9m revenue.

Overall, the benefits are significant because limited liability protected Elliot and Adam's personal assets while SSL was a risky start-up, although the benefit is smaller now that SSL is established and profitable, with a profit of £470,000 in 2015.



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- (e) Elliot and Adam were refused a bank loan when they started their business in 2005.

With reference to Extract A, assess if the bank made the right decision.

(12)

Banks provide finance to new businesses through secured or unsecured loans, overdrafts or mortgages. A secured loan is guaranteed by an asset which the bank can take if the loan is not repaid. The bank assesses the risk of each loan and charges interest for its duration.

There are strong reasons why the bank made the right decision in 2005. Elliot and Adam were students with no experience of running a business, and there is no indication that they had any assets on which a loan could have been secured. The business idea involved importing products from American websites, so it faced risks such as exchange rate changes, import costs and the uncertainty of whether demand in the UK would last. Without detailed information, such as a business plan and cash flow forecast, to back up the proposal, the bank may have considered the loan too risky. If the venture had failed, the bank would have lost the money lent and would not have been able to offer that finance to alternative, less risky and more successful ventures, so lending would have had a high opportunity cost.

On the other hand, with hindsight the bank made the wrong decision. SSL has grown into a very successful company, with sales revenue of £15.9m and a profit for the year of £470,000 in 2015. It earned a place on The Sunday Times Fast Track 100 for the fastest growing sales over three years, and the UK sports supplement and nutrition market is predicted to grow at an annual rate of 9% to reach £471m by 2018. Adam said the products were in high demand but not available in the UK and Europe, which suggests a clear gap in the market. A loan would have been repaid with interest, so the bank lost a profitable, low-risk customer, and SSL may now take its business to another bank.



However, the growth figures relate to 2013 to 2018 and the bank's decision was made in 2005, so the bank did not have this information at the time. The extract also gives no details about the strength of the business plan or external factors at the time, which may have had a bearing on the decision. The bank may have reconsidered if Elliot and Adam had provided a percentage of the finance themselves, but we do not have enough detail about this.

In conclusion, the bank probably made the right decision based on the information available in 2005, because two inexperienced graduates with no collateral were a high risk. It was only the wrong decision in hindsight, once SSL's success became clear. Banks must judge risk at the time of lending, and they cannot lend to every idea that might succeed.

(Total for Question 1 = 30 marks)

TOTAL FOR SECTION A = 30 MARKS



SECTION B

Read the following extracts (B, C and D) before answering Question 2.

Write your answers in the spaces provided.

Extract B**People in the UK who let out their homes on *Airbnb* get a £1 000 tax break**

The Chancellor has announced a tax break for micro-entrepreneurs who use online platforms such as *Airbnb* (a digital marketplace enabling people to list or rent their accommodation for short periods of time). From April 2017, homeowners in the UK who let out their properties on *Airbnb* won't need to declare or pay tax on the first £1 000 they earn per year, creating incentives for new micro-entrepreneurs. 5

Airbnb offers over 1.5m listings in 190 countries and is set to expand significantly over the coming years. Listings range from just a space on the sofa to a spare room or the entire house, but hosts don't just promote a simple 'place to stay' on the site. Numerous types of unique accommodation are on offer to meet a wide variety of different consumer tastes. Reservations that can be made include boats, windmills, castles, lighthouses and even tree houses. Specialised tastes are met by hosts who share a common interest with their guests, offering use of bicycles, astronomy equipment or a specific range of cooking ingredients, to name only a few. Hosts can be selective in accepting guests so as to meet individuals with shared common interests. 10 15

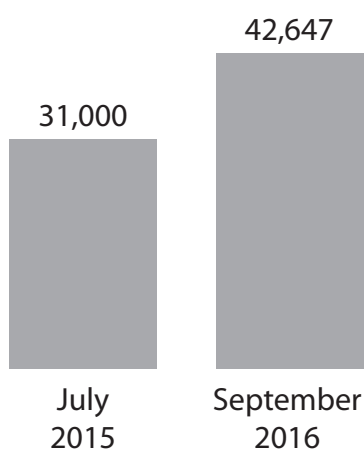
(Source: © Wrights Media)



Extract C

The *Airbnb* boom in numbers

Number of *Airbnb* listings in London



City listings

London now has more *Airbnb* listings than New York.



(Source: adapted from Inside Airbnb/The Sunday Times/Airbnb/PricewaterhouseCoopers)

Extract D

Brighton boom

In 2015, Brighton-based Amanda Sagar was looking for short-term, flexible work but had no idea it would rapidly escalate into running her own business employing eight people.

Amanda answered an advert on the *Gumtree* website for someone to manage and clean a property nearby that was listed on *Airbnb*. As she accepted the job, she had a light-bulb moment: others must need this service. She placed her own advert offering *Airbnb* management and was flooded with inquiries.

"Quite by accident, I filled a gap in the market I didn't know existed. Within a week, I had to employ someone else. This summer, we tripled our turnover and now I employ eight people," she says.

The success of Amanda's business, *Airhead*, is a sign of the *Airbnb* boom in Brighton. While London has been the UK's *Airbnb* capital, the seaside town of Brighton is England's second most popular destination for short-term lets. London restricts *Airbnb* to a maximum 90-day short-term rental period. So far Brighton has less regulation than London and Amanda has found an under-served market.

(Source: adapted from <https://www.ft.com/content/f500e932-baff-11e6-8b45-b8b81dd5d080>)



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2 (a) What is meant by the term 'regulation'?

(2)

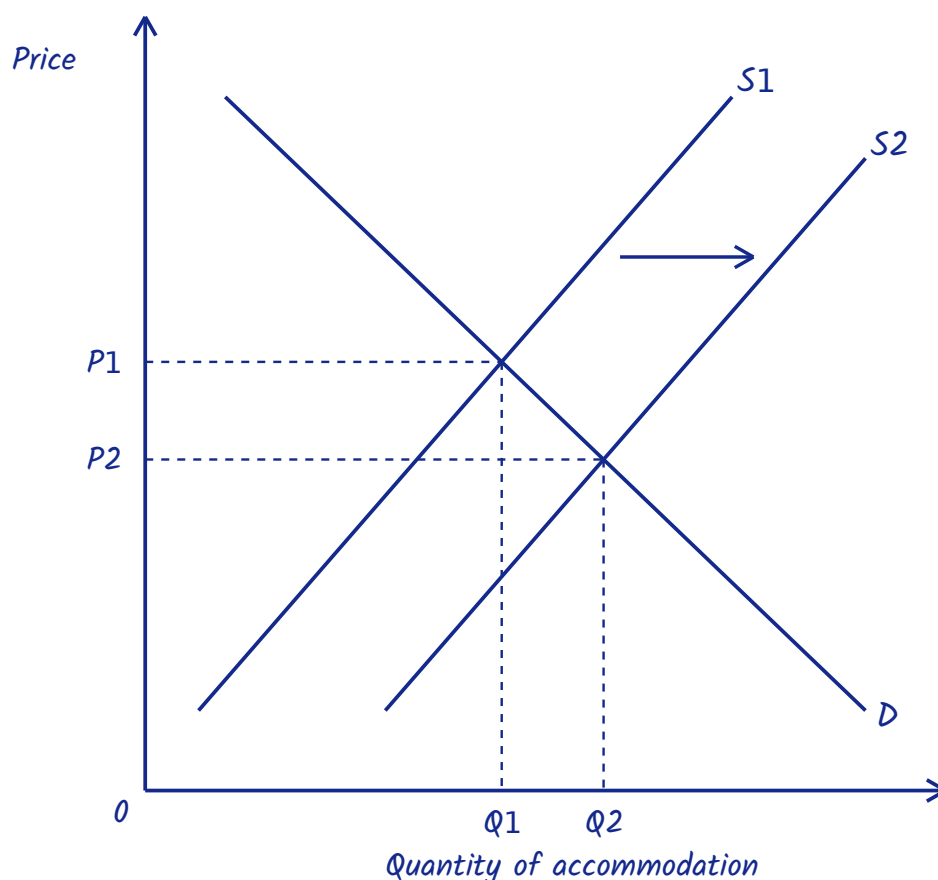
Regulation means rules or laws made by governments or other authorities in order to control or affect market activities and the behaviour of firms and consumers, for example London's 90-day limit on Airbnb short-term lets.

(b) Tax breaks have been introduced to micro-entrepreneurs who offer accommodation.

Using a supply and demand diagram, illustrate the likely impact of this on the market for accommodation offered by micro-entrepreneurs.

(4)

The tax break lowers hosts' costs and raises the reward from letting, so supply shifts right from S_1 to S_2 ; price falls from P_1 to P_2 and the quantity of accommodation rises from Q_1 to Q_2 .



- (c) Calculate, to 2 decimal places, the percentage change in the number of *Airbnb* listings in London between July 2015 and September 2016 (Extract C). You are advised to show your working.

(4)

$$\text{Percentage change} = (\text{new number} - \text{original number}) \div \text{original number} \times 100$$

$$\text{Increase} = 42,647 - 31,000 = 11,647 \text{ listings}$$

$$\text{Percentage change} = 11,647 \div 31,000 \times 100$$

$$= 37.5709...\%$$

$$\text{Percentage change} = +37.57\% \text{ (an increase)}$$



(d) Extract B gives examples of standard and unusual Airbnb accommodation.

Discuss the extent to which the type of accommodation might determine the price set by Airbnb hosts.

(8)

Airbnb hosts set their price by considering the demand for their accommodation and the prices of close substitutes. The type of accommodation is important because it affects how differentiated the product is and how price inelastic demand is.

Standard accommodation, such as a space on the sofa or a spare room, has many close substitutes from other hosts and hotels, so demand is price elastic and hosts must set a low, competitive price. In contrast, Extract B shows numerous types of unique accommodation, such as boats, windmills, castles, lighthouses and tree houses, which meet a wide variety of consumer tastes. Because these have few substitutes, demand is more price inelastic, so hosts can charge a much higher price without losing many guests. Hosts who share a common interest with guests, offering bicycles, astronomy equipment or a specific range of cooking ingredients, add value for specialised tastes, so they can also charge a premium, especially in an area with few competitors.

However, the type of accommodation is not the only factor. Location is very important: a standard flat in central London or near Brighton's seafront may command a higher price than a tree house in a remote area. Size, seasonality and special events also matter, as prices rise in summer or during festivals when demand increases. With 42,647 listings in London, competition from other hosts limits prices, and the £1,000 tax break may increase supply and push prices down.

Overall, the type of accommodation has a significant effect on price for unusual properties with a unique selling point, but for most standard accommodation, location, seasonality and the level of competition are likely to be more important in determining price.



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(e) With reference to Extract D, assess Airhead's potential for growth.

(12)

Business growth means an increase in the size of a firm, measured for example by turnover, number of employees or market share. Firms grow when the markets they serve grow, as rising demand creates more opportunities to sell.

Airhead has strong potential for growth. The extracts show an increase in demand for Airbnb: listings in London rose from 31,000 in July 2015 to 42,647 in September 2016, and Airbnb is set to expand significantly. As Airbnb grows, the number of hosts needing their properties managed and cleaned will grow, so Amanda Sagar is likely to be able to expand Airhead along with it. Airhead has already shown rapid growth:

Amanda tripled turnover this summer and now employs eight people, having started only in 2015. Brighton is England's second most popular destination for short-term lets after London, and as a seaside town it is likely to continue to attract visitors.

Airhead also has few barriers to growth in its local market. Amanda filled a gap in the market she didn't know existed, and there is currently no known competition in

Brighton to take away market share. Brighton has less regulation than London, where

Airbnb lets are limited to 90 days, so hosts in Brighton can let all year, creating more demand for management services. The £1,000 tax break from April 2017 may increase the popularity of hosting on Airbnb further, creating more customers for Airhead.

However, there are threats. Visitor trends may change, leaving Brighton a less popular destination, and tourism is seasonal, so demand may fall in winter. The success of

Airhead is likely to attract new businesses, as barriers to entry for a cleaning and management service are low, so competition could reduce Airhead's market share and

prices. Brighton's council could introduce regulation like London's 90-day limit, which would reduce the number of short-term lets and have a negative knock-on effect for

Airhead. If Airhead expands into other towns and cities, competition may be higher, and



managing staff in several locations is harder.

Overall, Airhead's potential for growth is high in the short run because demand for Airbnb in Brighton is rising quickly and it has first-mover advantage with a good reputation. In the long run its growth depends on whether regulation stays relaxed, how quickly competitors enter, how fast Airhead grows to afford to challenge competition elsewhere, and on the ambitions of the owner, Amanda Sagar, who started the business only looking for flexible work.

(Total for Question 2 = 30 marks)

TOTAL FOR SECTION B = 30 MARKS



SECTION C

Read the following extract (E) before answering Question 3.

Write your answer in the space provided.

Extract E**Green and clean**

Following market research, Paul Wilson started *Will's Wheelie Wash* in Macclesfield in 2009. He is currently expanding the business of cleaning all types of wheelie bins in Cheshire. It costs £4.00 for one wash every month or customers can pay in advance and get 12 washes for the price of 11. One-off cleans are £10.00.

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Will's Wheelie Wash only uses bio-degradable detergents, deodorisers and disinfectants and coordinates their cleaning to coincide with the bin collection day. Customers simply leave their bins out as normal. *Will's Wheelie Wash* will follow the waste collection vehicle on its round, cleaning, deodorising and disinfecting the bins.

Unlike some other wheelie bin washers, *Will's Wheelie Wash* takes care not to waste water, using state-of-the-art equipment to minimise the impact on the environment. A specially built machine has been designed to cope with two domestic bins or one commercial bin at a time. All bin washing is done at the rear of the van and all the water used is recycled via an onboard filtration system, to minimise the use of water. *Will's Wheelie Wash* is an environmentally aware company.

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(Source: © 2009-16 Will's Wheelie Wash)



- 3 Evaluate the importance of market research to the success of a business such as Will's Wheelie Wash.

(20)

Market research is the process of gathering and analysing information about customers, competitors and the market in order to understand customer needs and reduce the risk of business decisions. It can be primary research, collected first hand by the business through surveys, interviews or observation, or secondary research, using information already collected for other purposes, such as council data on the number of households. Research can be quantitative, giving numerical data, or qualitative, giving opinions and reasons.

Market research appears to have been very important to Will's Wheelie Wash, as Paul Wilson started the business in Macclesfield in 2009 following market research. Research would show whether there is enough demand for bin cleaning in the area and how much customers are willing to pay. The price of £4.00 per month, with 12 washes for the price of 11 and one-off cleans at £10.00, may have been set after finding out what customers would pay and what competitors charge. Setting the right price matters because too high a price would lose price-sensitive households, while too low a price would not cover costs.

Research also helps a business design a product that meets customer needs, which gives it a competitive advantage. Will's Wheelie Wash coordinates cleaning with the bin collection day, following the waste collection vehicle so that customers simply leave their bins out as normal. This convenience suggests research found what customers wanted. It uses only bio-degradable detergents and recycles all its water through an onboard filtration system, unlike some other wheelie bin washers. This suggests research gave an insight into customer preference for environmentally friendly services, allowing the business to differentiate itself as environmentally aware and perhaps charge more than rivals. Research may also have shown demand from commercial customers, which



explains a machine designed for one commercial bin at a time. By reducing the risk of launching an unwanted service, research helps a small business avoid wasting its limited finance and supports its expansion across Cheshire.

However, market research has limitations. It is costly and time-consuming, and at only £4.00 per month Will's Wheelie Wash would need a lot of customers to recoup the costs of research. A small business may only be able to afford a small sample, which may not be representative of the general population in the Macclesfield area, so results could be biased and lead to poor decisions. Customers may also say in a survey that they would pay for an environmentally friendly service but not actually do so. Research quickly becomes out of date: research from 2009 may not reflect the market now, and rivals may set up in the Cheshire area and reduce the effectiveness of the research.

Furthermore, other factors may be equally or more important to success. A business such as this could have started and been successful without formal market research, relying on the owner's knowledge of the local area and word of mouth. Its success also depends on the quality and reliability of the service, efficient use of the van and specially built machine, advertising, and a good reputation. If Will's Wheelie Wash has built a good reputation, customers may continue to use the service even if a competitor sets up locally. Due to the specialised concept, it may expand quickly enough to compensate for the cost of the research. External factors, such as changes in council bin collection schedules or a recession reducing spending on non-essential services, are outside the business's control.

In conclusion, market research is important to the success of a business such as Will's Wheelie Wash, especially at the start, because it reduces the risk of entering a market without enough demand and helped it set its price and design its environmentally aware service. However, it does not guarantee success. Its importance depends on the quality and size of the sample, whether it is kept up to date as competitors enter, and on



external factors. For a small local service business, cheap primary research such as talking to households, combined with a reliable service and a strong reputation, is likely to matter more than expensive research, so market research is a necessary but not sufficient condition for success.

(Total for Question 3 = 20 marks)

TOTAL FOR SECTION C = 20 MARKS
TOTAL FOR PAPER = 80 MARKS

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