Please check the examination details below before entering your candidate information

Candidate surname: StemUp Model Solution

Other names:

Centre Number

Candidate Number

Pearson Edexcel International Advanced Level

Tuesday 28 May 2024

Afternoon (Time: 2 hours)

Paper reference **WEC13/01**

Economics

International Advanced Level
UNIT 3: Business behaviour

You must have:
Source Booklet (enclosed)

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 Section B.
- Answer **TWO** questions in Section 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.
- Check your answers if you have time at the end.

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SECTION A

Answer ALL questions in this section.

Questions must be answered with a cross in a box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

1 In 2021, Koji Sato, the CEO of Toyota, stated that technical economies of scale were one of the main reasons for the company's success.

Which **one** of the following results from technical economies of scale?

- ☐ **A** An increase in purchasing economies
- ☐ **B** A decrease in advertising costs
- ☐ **C** An increase in short-run average costs
- ☒ **D** A decrease in long-run average costs

(Total for Question 1 = 1 mark)

2 The table shows the costs for a small hairdressing business as it increases the number of haircuts.

Number of haircuts	Total fixed costs ($)	Total variable costs ($)	Marginal cost ($)
1	50	12	
2	50	18	
3	50	26	8
4	50	36	

Which **one** of the following is the marginal cost of increasing the number of haircuts from 2 to 3? You may use the blank column for your workings.

- ☐ **A** $4.00
- ☒ **B** $8.00
- ☐ **C** $8.66
- ☐ **D** $12.50

(Total for Question 2 = 1 mark)

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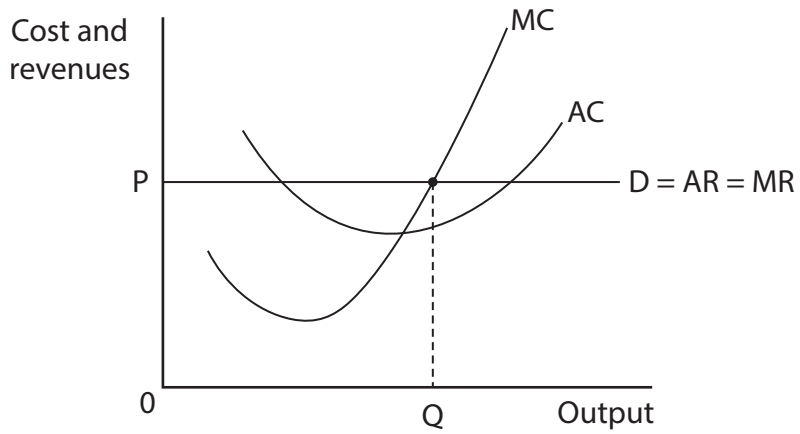
3 In 2022 the pharmaceutical company GlaxoSmithKline (GSK) demerged from the consumer health business Haleon. GSK's shareholders believed that the businesses would be able to work more successfully as separate companies.

Which **one** of the following is the most likely reason why GSK decided to demerge from Haleon?

- ☒ **A** To benefit from external economies of scale
- ☒ **B** To diversify the business
- ☒ **C** To achieve diseconomies of scale
- ☒ **D** To focus on its core business

(Total for Question 3 = 1 mark)

4 The diagram shows the short-run costs and revenues for a farmer producing wheat in India.



Which **one** of the following is most likely to occur in the long-run?

- ☒ **A** Additional wheat farmers will enter the market
- ☒ **B** Some wheat farmers will leave the market
- ☒ **C** The wheat farmer will make supernormal profit
- ☒ **D** The wheat farmer will make a loss

(Total for Question 4 = 1 mark)

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5 A profit maximising firm decides to change its objective to revenue maximisation.

Which **one** of the following combinations is the most likely impact of this decision?

		Supernormal profit	Price
☒	**A**	No change	No change
☒	**B**	Increase	Increase
☒	**C**	Decrease	Decrease
☒	**D**	Increase	No change

(Total for Question 5 = 1 mark)

6 A 2022 study found that the geographical mobility of labour in the USA has been decreasing for the last 30 years.

Which **one** of the following is most likely to cause a **decrease** in the geographical mobility of labour?

☒ **A** An increase in the skills of the workforce

☒ **B** An increase in relocation grants provided by the government

☒ **C** An increase in average house prices and rents

☒ **D** An increase in the availability of affordable housing

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B

Study Figures 1 and 2 and Extracts A, B and C in the Source Booklet before answering Question 7.

Write your answers in the space provided on the following pages.

7 (a) With reference to Figure 1, calculate the change in Uniqlo's total costs between 2021 and 2022. Show your workings.

(2)

(b) With reference to the first paragraph of Extract A, explain what is meant by the term 'organic growth'.

(4)

(c) With reference to the second paragraph of Extract A, analyse **two** reasons why Uniqlo has been very successful in establishing itself in international markets.

(6)

(d) With reference to Extract B, examine the likely impact of a reduction in Uniqlo's costs of production on its total profits.

Illustrate your answer with an appropriate diagram.

(8)

(e) With reference to Extract C, Figure 2 and your own knowledge, discuss the likely barriers to entry for a business wishing to enter the global fashion retail market.

(14)

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7 (a) With reference to Figure 1, calculate the change in Uniqlo's total costs between 2021 and 2022. Show your workings.

(2)

Total costs = total revenue − profit

2021: 2 132 − 1 073 = 1 059 billion yen

2022: 2 301 − 1 206 = 1 095 billion yen

Change = 1 095 − 1 059 = an increase of 36 billion yen

(Percentage change = 36 ÷ 1 059 × 100 = 3.4% increase)

(b) With reference to the first paragraph of Extract A, explain what is meant by the term 'organic growth'.

(4)

Organic growth is when a firm expands internally, using its own resources such as reinvested profits, for example by opening more stores, hiring more workers or increasing output, rather than by merging with or taking over other firms (integration).

Uniqlo was set up in Japan in 1984 and, in the 2000s, grew organically by starting to sell in other countries such as the USA, China, the UK, Australia and South Korea. It did this by opening its own new stores in large cities within each country, not by buying existing retailers.

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(c) With reference to the second paragraph of Extract A, analyse **two** reasons why Uniqlo has been very successful in establishing itself in international markets.

(6)

1. Price competition. Uniqlo competes with other brands such as Zara and H&M by offering lower prices for its casual, affordable clothing. Because its clothes are cheaper, consumers in new countries are more able and willing to buy them, and consumers who are price sensitive switch from rivals to Uniqlo. Demand for Uniqlo's products increases, so it gains market share quickly when it opens stores in a new international market.

2. Non-price competition. Uniqlo offers innovative products that meet consumers' needs, such as ultra-lightweight and heat-generating fabrics (HeatTech), works with well-known designers and celebrities such as Alexander Wang, invests heavily in advertising and was the first in the market to use fast-moving digital images in its stores. This differentiates its products from those of rivals and raises brand awareness, so demand for Uniqlo's clothes increases and becomes more price inelastic. Consumers become brand loyal, and Uniqlo can grow its sales in new countries without having to cut its prices further, which helps it to stay profitable.

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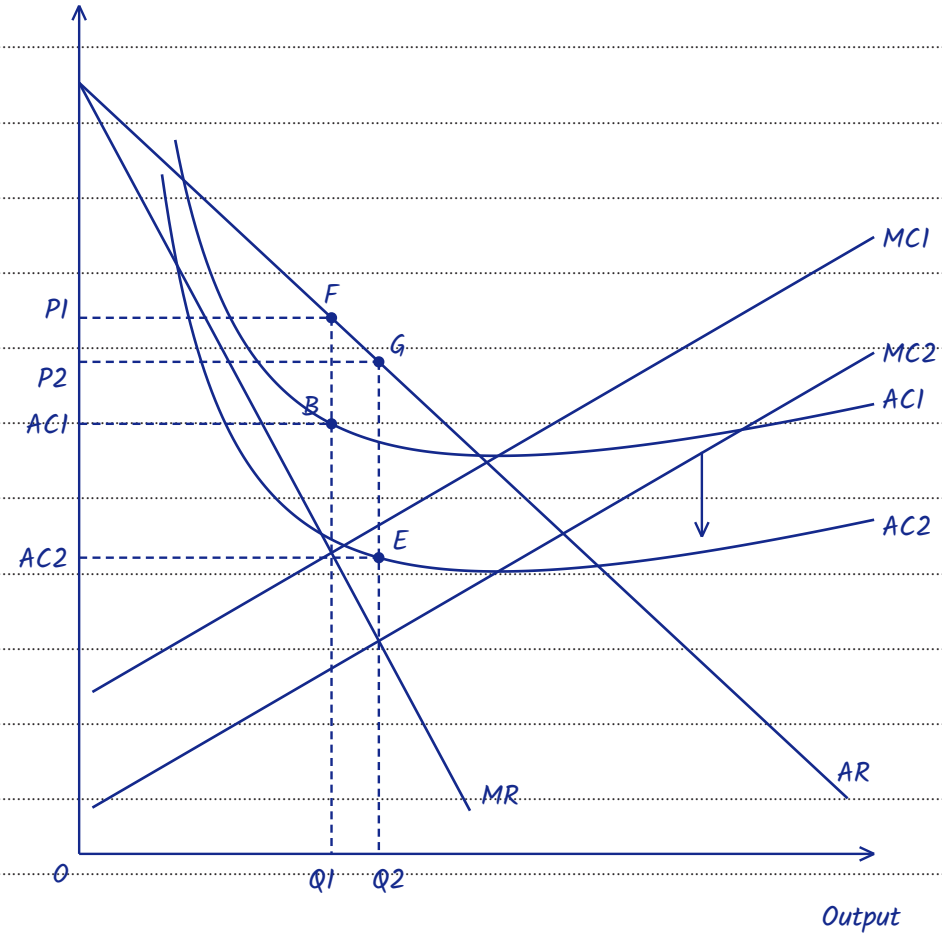
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(d) With reference to Extract B, examine the likely impact of a reduction in Uniqlo's costs of production on its total profits.

Illustrate your answer with an appropriate diagram.

(8)



Extract B says Uniqlo aims to negotiate lower prices from its suppliers for materials such as cotton and dyes, and is replacing workers by investing in technology and automation. Both reduce its variable costs per unit, so MC shifts down from MC1 to MC2 and AC shifts down from AC1 to AC2.

Uniqlo maximises profit where MR = MC. Originally it produces Q1 at price P1 and makes supernormal profit equal to the area P1 F B AC1. With lower costs, MR = MC2 at a higher output Q2, which it can only sell at a lower price P2. Supernormal profit rises to the larger area P2 G E AC2, because the fall in average cost is greater than the fall in price and more units

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are sold, so total profit increases.

However, the rise in profit may be limited. In March 2023 Uniqlo had to raise wages for some employees by 40% to attract highly skilled labour, and there was a global increase in the cost of raw materials. These shift MC and AC back up, which may cancel out the cost savings and reduce profits. Also, technology and automation are costly and take time to install, so in the short run costs may rise and the gain in profit may only appear in the long run. The overall impact depends on whether the savings from suppliers are larger than these cost increases.

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(e) With reference to Extract C, Figure 2 and your own knowledge, discuss the likely barriers to entry for a business wishing to enter the global fashion retail market.

(14)

Barriers to entry are obstacles that make it difficult or costly for new firms to enter a market and compete with the existing firms. High barriers reduce competition and allow established firms to keep high market shares and earn supernormal profit in the long run.

First, the established firms have huge economies of scale. Extract C states that Uniqlo, H&M and Zara have significant bargaining power over their suppliers, so they gain purchasing economies of scale and have low average costs. This lets them offer low prices. A new entrant, buying in small quantities, would have much higher average costs, so it could not match these prices without making a loss. Incumbents could also use limit pricing to deter entry.

Second, brand loyalty and heavy advertising. The profits the fast fashion firms make enable them to run extensive advertising campaigns, and their high-quality market research and innovative designs make their products desirable. Consumers are loyal to well-known brands such as Zara and H&M, so a new firm would have to spend heavily on marketing to persuade them to switch. Advertising is a sunk cost: if the new firm fails, this spending cannot be recovered, which increases the risk of entry and deters firms.

Third, the size and financial strength of the incumbents. Figure 2 shows that Zara and company is the largest global fashion retailer by market value, followed by Uniqlo, with a value of thousands of billions of yen. This gives them easy access to finance for investment in stores, technology and design. Competing in stores globally requires very high start-up costs for premises and stock, and new firms may struggle to raise the capital and to set up a fast, reliable supply chain that can respond quickly to the latest trends.

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However, barriers to entry in this market may be lower than they appear. In China, Uniqlo had the largest share of the clothing market, but this was only 1.4%, and the rest of the market is made up of many small firms. This suggests that small firms can enter and survive, and that brand loyalty to any one firm is weak. Capital requirements are also lower than in industries that need large factories, because clothing can be bought from suppliers.

In addition, online selling has greatly reduced barriers. A new firm can sell through its own website or online marketplaces and advertise cheaply on social media, avoiding the high cost of physical stores. Fast-changing trends reduce brand loyalty and give new entrants with fresh designs an opportunity, and they can target niche markets, such as sustainable or luxury clothing, where they do not compete directly with Uniqlo and Zara on price. Legal barriers are also low because designs are hard to protect with intellectual property rights.

Overall, the barriers to entering the global fashion retail market as a large-scale, low-price competitor to Zara, Uniqlo and H&M are high, because of their economies of scale, bargaining power and brand loyalty. However, the barriers to entering the market as a small online or niche firm are low, so the market is contestable at a small scale. The strength of the barriers therefore depends on the scale at which a firm wants to compete and whether it sells online or through stores.

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TOTAL FOR SECTION B = 34 MARKS

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SECTION C

Answer TWO questions from this section.

8 In 2023 the US Department of Justice began an investigation into claims that Google had used its market power to limit competition and to increase the amount charged to advertisers.

Evaluate policies that a government could adopt to control monopolies.

Illustrate your answer with an appropriate diagram(s).

(Total for Question 8 = 20 marks)

9 In 2023 the highest-paid lawyers in Switzerland earned, on average, three times more than the lowest-paid lawyers.

Evaluate possible reasons for wage differentials in an occupation of your choice.

Illustrate your answer with an appropriate diagram(s).

(Total for Question 9 = 20 marks)

10 In July 2023 the Competition and Markets Authority fined Leicester City Football Club £880 000 for colluding with JD Sports. The club was found guilty of price fixing and restricting the selling of Leicester City-branded clothing in the UK.

Evaluate the likely effects of collusion on businesses **and** consumers in an industry of your choice.

Illustrate your answer with reference to game theory.

(Total for Question 10 = 20 marks)

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Write the answer to your FIRST chosen question here.

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Write the answer to your SECOND chosen question on page 22.

Chosen question number: **Question 8** ☒ **Question 9** ☐ **Question 10** ☐

A monopoly is a market with a single dominant supplier protected by high barriers to entry; in practice a firm has monopoly power if it controls a high share of the market (over 25% in the UK). Google has around 90% of the global search market, so advertisers who want to reach internet users have few alternatives. Monopoly power lets a firm set prices, restrict output and limit competition, which is why the US Department of Justice began investigating claims in 2023 that Google had used its market power to raise the amount charged to advertisers.

Governments can use several policies to control monopolies.

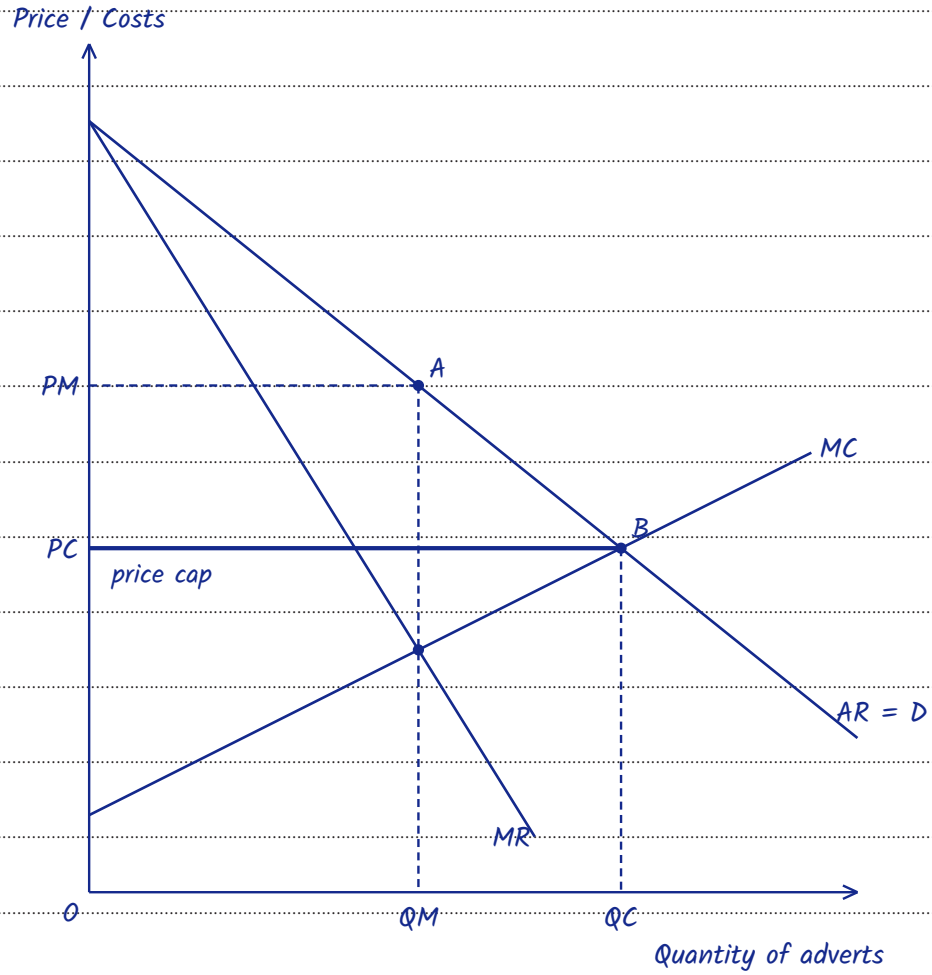
1. Profit regulation. The regulator limits the rate of return on capital the monopoly may earn. This stops it from exploiting consumers to earn excessive supernormal profit, so it must lower prices or reinvest profits, improving allocative efficiency and consumer welfare. A windfall tax on monopoly profits works in a similar way and encourages the firm to invest rather than keep profit.

2. Performance targets and quality standards, backed by fines. The monopoly must meet set criteria, for example on service quality or transparency of advertising prices, and competition authorities can impose large fines for abuse of a dominant position or for missing targets. The European Commission fined Google €4.34 billion in 2018 for abusing its dominance with Android, which aims to deter anti-competitive behaviour.

3. Price regulation (a price cap). The regulator sets a maximum price the monopoly can charge,

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for example a cap on the price per advert, or an RPI – X formula. This is shown below.



Without regulation the monopoly maximises profit where MR = MC, producing QM at price PM (point A), where P > MC, so it is allocatively inefficient and there is a deadweight welfare loss. If the price is capped at PC, where AR = MC, the firm cannot charge more than PC, so its AR curve becomes horizontal at PC up to point B, and MR = PC over this range. It now maximises profit at QC, so output rises from QM to QC and the price falls from PM to PC. Supernormal profit falls, consumer surplus rises and the deadweight loss is removed. With RPI – X, the real price must fall by X% each year, which forces the firm to cut costs and reduces X-inefficiency.

4. Merger control and promoting competition. Laws can block mergers and takeovers that would increase monopoly power, for example preventing Google from buying rival advertising technology firms, and the authorities can break the monopoly up, for instance separating Google's search

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business from the advertising exchange it runs. Deregulation, or subsidies and tax incentives for new firms, lower barriers to entry and make the market more contestable, so the threat of entry keeps prices close to costs. Finally, a government could nationalise a monopoly so that it is run in the public interest rather than for profit, leading to lower prices.

However, each policy has limitations. Price caps and profit regulation suffer from asymmetric information: the regulator relies on the firm for cost data, and the firm has an incentive to overstate its costs to win a generous cap. If the cap is set too high, consumers (here advertisers) still pay high prices; if it is set too low, the firm may not cover its costs and could cut investment or even leave the market, a government failure. Price controls may also lead the firm to cut costs by reducing quality. Profit regulation reduces the incentive to be efficient, because any cost savings only reduce allowed profit, so X-inefficiency may increase. These policies are also hard to apply to Google, because much of its service is free to users and advertising prices are set in online auctions that change every second.

Performance targets and quality standards raise the monopoly's costs of production, and these may be passed on to consumers as higher prices. Firms may also focus only on the measured targets. Fines are only effective if they are large enough to deter: for a firm earning profits of tens of billions of dollars a year, even a fine of several billion may be seen as a cost of doing business. Regulators may also lack the resources and legal powers to investigate a global technology firm, and cases such as the US investigation take many years, by which time the market has changed.

Breaking up a monopoly may lose economies of scale and network effects. Google's search engine improves because so many people use it, so splitting it could raise average costs and reduce quality, harming dynamic efficiency. Nationalisation removes the profit motive and may cause

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inefficiency, and is unrealistic for a global firm like Google. There is also a risk of regulatory capture, where the regulator comes to act in the interests of the monopoly rather than consumers, for example because of lobbying.

In conclusion, no single policy is perfect. For a natural monopoly such as water or electricity, price regulation with quality standards is usually most effective. For a technology monopoly such as Google, where prices are hard to cap, competition policy is more suitable: large fines, blocking anti-competitive acquisitions and, if necessary, separating its advertising business to increase contestability. The success of any policy depends on the regulator having good information, enough resources and powers, and on international cooperation, since Google operates in many countries.

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Chosen question number: **Question 8** ☐ **Question 9** ☐ **Question 10** ☒

Collusion is when firms agree to cooperate on prices, output or market sharing instead of competing. It is most likely in an oligopoly, a market dominated by a few large interdependent firms, such as UK sportswear retailing, where JD Sports and a small number of rivals have high market shares. Overt collusion is a formal agreement (a cartel) and is illegal. In 2023 the Competition and Markets Authority fined Leicester City Football Club £880 000 for colluding with JD Sports to fix prices and restrict the sale of Leicester City-branded clothing.

Game theory explains the incentive to collude. Suppose two sportswear retailers, Firm X and Firm Y, each choose to charge a high or a low price for replica kits. The payoff matrix shows their profits (£m), with Firm X's profit first:

		Firm Y
	High price	Low price
Firm X: High price	£20m, £20m	£8m, £28m
Firm X: Low price	£28m, £8m	£12m, £12m

Without collusion, each firm has a dominant strategy to charge a low price. If Y charges a high price, X earns £28m by going low rather than £20m; if Y charges a low price, X earns £12m

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by going low rather than £8m. The same applies to Y, so the Nash equilibrium is low price, low price with £12m each (joint profit £24m). This is the prisoners' dilemma: both would be better off if they both charged a high price. By colluding, they move to high price, high price and maximise joint profit at £40m, so each firm's profit rises from £12m to £20m.

Effects on businesses. The colluding firms act like a single monopolist: they restrict output and set the joint profit maximising price where MR = MC, so they earn higher supernormal profit and producer surplus rises. Collusion also reduces uncertainty, because prices and output are agreed, so there is no risk of a price war and firms can plan investment with less risk. Restricting supply, as with Leicester City clothing, creates a barrier to entry, protecting the firms' market power. Non-colluding retailers, however, are harmed, as they cannot compete on price or obtain the branded products, and new firms find it harder to enter.

Effects on consumers. Prices are set above the competitive level, so consumer surplus falls and part of it is transferred to the firms as producer surplus. Output is restricted, creating a deadweight welfare loss, so the market is allocatively inefficient (P > MC). Consumers also have less choice, for example fewer places to buy Leicester City shirts, and without competitive pressure the firms may become X-inefficient and have less incentive to improve quality or service.

However, the effects may be smaller or more short-lived than this suggests. The payoff matrix shows that each firm can raise its profit from £20m to £28m by secretly cutting its price, so there is a strong incentive to cheat. Collusive agreements are therefore unstable and often break down, leading to sudden price wars, so the benefits to businesses may only last in the short run. Leniency schemes, where the first firm to report a cartel can avoid a fine, add to this incentive to break the agreement.

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Collusion is also illegal, so if firms are caught they face heavy fines and damage to their reputation. Leicester City had to pay £880 000, which may outweigh the extra profit, and fans may boycott the club's products. The size of the effect on consumers depends on price elasticity of demand: if there are close substitutes, such as other sportswear brands or second-hand shirts, consumers can switch, so the colluding firms cannot raise prices much. However, loyal football fans have very inelastic demand for their club's kit, so in this case the harm to consumers is likely to be significant.

Some effects on consumers may be positive. Higher supernormal profit can be reinvested in research and development, new products and better stores, increasing dynamic efficiency, and stable prices help consumers plan their spending. Some forms of cooperation, such as sharing research costs or agreeing common industry standards, can benefit both firms and consumers. However, there is no guarantee that profits are reinvested rather than paid to shareholders. Finally, high profits may attract new entrants, such as online retailers, which can break the collusive agreement.

In conclusion, the benefits of collusion go mainly to the colluding businesses, because producer surplus rises at the expense of consumer surplus, while consumers face higher prices and less choice. The effects on businesses are likely to be short-run, because agreements are unstable and attract fines, as Leicester City found. The harm to consumers is greatest when demand is price inelastic, as for football kits, and smallest when substitutes are available, so price fixing is generally harmful and right to be punished, whereas cooperation limited to research or standards may be beneficial.

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Tuesday 28 May 2024

Afternoon (Time: 2 hours)

Paper reference **WEC13/01**

Economics

International Advanced Level

UNIT 3: Business behaviour

Source Booklet

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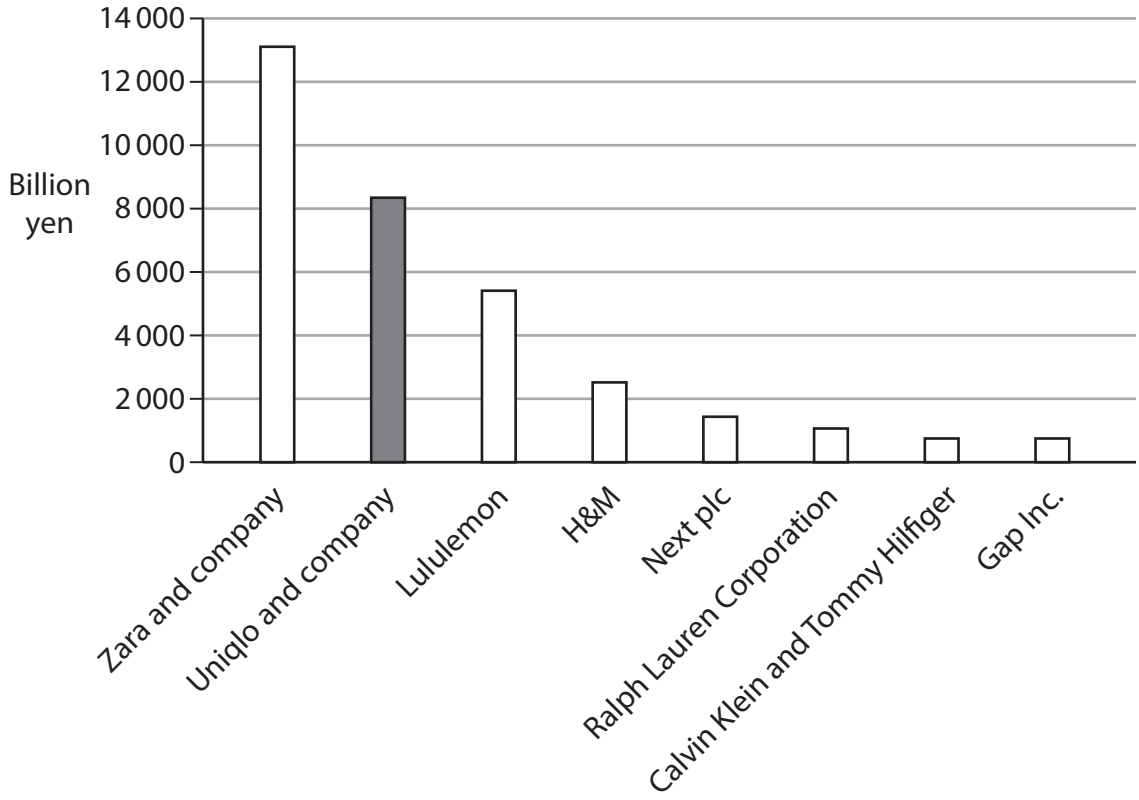
Sources for use with Section B

The global fashion retail market

Figure 1 Uniqlo's total revenue and profit, billion yen, 2020–2022

Year	Revenue (billion yen)	Profit (billion yen)
2020	2 008	975
2021	2 132	1 073
2022	2 301	1 206

Figure 2 Global fashion retailers, ranked by market value, billion yen, February 2023



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Extract A Uniqlo's successful growth strategy

Uniqlo is a Japanese fashion retailer. The company was set up in 1984 and it initially focused on the manufacturing and selling of casual, affordable clothing in Japan. In the 2000s Uniqlo started to sell in other countries such as the USA, China, UK, Australia and South Korea. Uniqlo expanded through a process of organic growth. The company opened stores in large cities within each country.

Uniqlo has been very successful in establishing itself in international markets. The business competes with other brands such as Zara and H&M by offering lower prices. Uniqlo has also used non-price competition to offer innovative products that meet its consumers' needs, such as ultra-lightweight and heat-generating fabrics (HeatTech). It also works with well-known designers and celebrities, such as Alexander Wang. The business has invested heavily in advertising and it was the first business in this market to use fast-moving digital images in its stores.

Extract B Uniqlo's revenues and costs

Between 2021 and 2022 Uniqlo's revenue increased by 7.9%. Demand for its products has steadily increased. One reason is that global financial pressures have caused consumers to demand quality items at lower prices.

In 2023 two factors may contribute to a reduction in Uniqlo's costs of production. It aims to negotiate lower prices from its suppliers, including for materials such as cotton and dyes. It is also replacing workers by investing in technology and automation.

However, in March 2023 Uniqlo had to increase wages for some employees by 40% in order to attract highly skilled labour. In addition, there was a global increase in the costs of raw materials.

Extract C The global fashion retail market

Uniqlo, H&M and Zara compete in the 'fast fashion' retail market. Fast fashion is where the businesses respond to the latest trends by supplying new affordable fashion items to the market very quickly. The retailers all offer low prices because they have significant bargaining power over their suppliers. They also provide desirable items because of their high-quality market research and their innovative designs. The businesses compete both online and in stores globally. The profits they make enable them to engage in extensive advertising campaigns.

In 2021 China was Uniqlo's largest international market with 917 stores. Uniqlo had a 1.4% share of the Chinese clothing market, larger than any other business. The rest of the market is made up of many small firms.

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Acknowledgements

Figure 1 adapted from: https://www.fastretailing.com/eng/ir/news/2204141800.html

Figure 2 adapted from: https://www.fastretailing.com/eng/ir/direction/position.html

Extract A adapted from:

https://www.uniqlo.com/eu/en/info/about.html

https://www.economist.com/business/2023/04/20/uniqlos-success-mirrors-the-growth-of-japans-industrial-giants

https://martinroll.com/resources/articles/strategy/uniqlo-the-strategy-behind-the-global-japanese-fast-fashion-retail-brand/

https://www.indigo9digital.com/blog/uniqlostrategy

Extract B adapted from:

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Extract C adapted from:

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