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 27 May 2025

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.

Turn over ▶

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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 Integris, a UK-based management services business, was founded in 2021 as a result of the merger of several businesses providing similar services. This enabled it to benefit from internal economies of scale.

Which **one** of the following is an example of internal economies of scale?

- ☒ **A** Availability of a skilled labour force
- ☒ **B** Access to transport links
- ☒ **C** Lower corporation tax
- ☒ **D** Purchasing supplies in bulk

(Total for Question 1 = 1 mark)

2 A monopoly sets its price at the output where average revenue is equal to average cost.

Which **one** of the following best describes this firm's objective?

- ☒ **A** Revenue maximisation
- ☒ **B** Profit maximisation
- ☒ **C** Sales maximisation
- ☒ **D** Profit satisficing

(Total for Question 2 = 1 mark)

3 In 2024, the Government of Japan decided to subsidise construction companies to modernise old homes in the city of Kyoto.

Ceteris paribus, which **one** of the following is the most likely impact of this policy?

- ☒ **A** The price elasticity of supply of construction workers would increase
- ☒ **B** The demand for construction workers would increase
- ☒ **C** The skills of construction workers would decrease
- ☒ **D** Wage rates for construction workers would decrease

(Total for Question 3 = 1 mark)

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4 The table shows the total costs of a garment manufacturer at different levels of output.

Output	Total costs ($)
0	100 000
6 000	160 000
12 000	210 000
18 000	250 000
24 000	280 000

Which **one** of the following is the average variable cost if the garment manufacturer is producing 12 000 items?

- ☒ **A** $8.33
- ☒ **B** $9.17
- ☒ **C** $10.00
- ☒ **D** $17.50

(Total for Question 4 = 1 mark)

5 The table shows the price for an adult ticket at a particular cinema in Dhaka in 2024.

Time	Price (BDT)
Afternoon	300
Evening	450

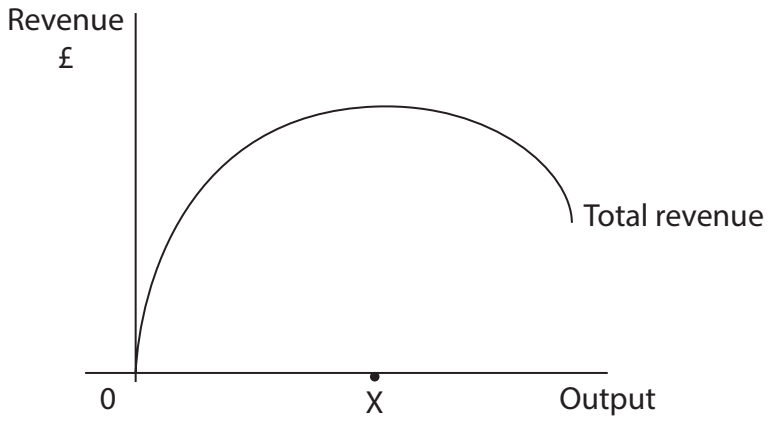
Which **one** of the following best describes the reason for this price difference?

- ☒ **A** Demand is more price elastic in the afternoon
- ☒ **B** Demand is more price inelastic in the afternoon
- ☒ **C** Supply is perfectly elastic in the evening
- ☒ **D** Supply is more elastic in the evening

(Total for Question 5 = 1 mark)

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6 The following diagram shows the total revenue curve for an imperfectly competitive business in Nepal selling mobile phones.



Which **one** of the following can be deduced from the diagram at an output of 0X?

- ☒ **A** Marginal revenue is zero
- ☒ **B** Marginal revenue is negative
- ☒ **C** Marginal revenue is equal to one
- ☒ **D** Marginal revenue is maximised

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B

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

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

7 (a) With reference to Figure 1, calculate the percentage change in bicycle sales between 2022 and 2023.

You are advised to show your workings.

(2)

(b) With reference to the first two paragraphs of Extract B, explain what is meant by 'a reduction in contestability'.

(4)

(c) With reference to Extract B and your own knowledge, analyse **two** reasons why some bicycle retailers remain small.

(6)

(d) With reference to Figure 1, Extract A and Extract B, examine **two** reasons why some bicycle retailers were forced to close.

(8)

(e) With reference to Extract C, discuss methods that Halfords could use to increase its profitability.

Illustrate your answer with a costs and revenues diagram.

(14)

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7 (a) With reference to Figure 1, calculate the percentage change in bicycle sales between 2022 and 2023.

You are advised to show your workings.

(2)

Change in sales = 1.87 million − 2.04 million = −0.17 million

Percentage change = (−0.17 ÷ 2.04) × 100

= −8.33%

(b) With reference to the first two paragraphs of Extract B, explain what is meant by 'a reduction in contestability'.

(4)

A contestable market is one where barriers to entry and exit are low and sunk costs are small, so new firms can easily enter (hit and run competition) and the threat of entry keeps prices and profits down. A reduction in contestability means barriers to entry and exit have increased, so it is harder for new or small firms to enter the market and compete.

In Extract B, the rise in online shopping first gave small bicycle retailers a chance to gain market share, but the larger businesses quickly dominated the online market by investing heavily in advertising and branding and by offering online discounts. This created brand loyalty and high sunk advertising costs that small retailers cannot match, raising barriers to entry.

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(c) With reference to Extract B and your own knowledge, analyse **two** reasons why some bicycle retailers remain small.

(6)

1. Niche market with limited demand. Extract B says small retailers offer unique expertise and specialist services such as bike fitting and a niche range of bicycles, for example e-bikes or triathlon bikes. These meet the specific needs of a small group of customers, often in a local area, so total demand is limited. There is not enough demand to grow, and staying small lets them give the personal, flexible service that customers value and adapt quickly to changes such as the growing demand for e-bikes.

2. Dominance of larger firms and lack of finance. A few large businesses such as Halfords, Evans Cycles and Wiggle dominate the market, and they benefit from economies of scale and spend heavily on advertising, branding and online discounts. Most of the 2 234 UK retailers are independently owned and find it hard to raise finance, because banks see them as risky and they lack assets to use as collateral. Without finance they cannot afford the high costs of advertising or expansion, so they cannot compete on price and win market share, and therefore remain small.

In addition, many owners may simply be satisficing: their objective is to earn enough profit to run a business they enjoy, rather than to grow.

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(d) With reference to Figure 1, Extract A and Extract B, examine **two** reasons why some bicycle retailers were forced to close.

(8)

1. A fall in demand. Figure 1 shows that bicycle sales fell from 3.30 million in 2020 to 1.87 million in 2023, a fall of 1.43 million or 43.3%, and Extract A says 2023 sales were the lowest in over 10 years. As the global health crisis eased, people returned to their old routines and other forms of transport, and high inflation reduced real incomes, so consumers cut spending on non-essential goods such as bicycles. Lower demand reduces the revenue of retailers, so average revenue falls below average cost and they make losses. In the long run, a firm that cannot cover its average costs will leave the market, and if price falls below average variable cost it will shut down even in the short run. High inflation also raised costs such as rent and wages, widening the losses.

2. Price competition from large retailers. Extract B says the fall in demand left retailers with many unsold bicycles, so the large businesses cut their prices to sell the excess supply. Large firms such as Halfords benefit from economies of scale, for example purchasing bicycles in bulk, so their average costs are lower and they can still make a profit at a lower price. Small retailers with higher average costs could not match these prices, so they lost customers to the large firms, and they were also unable to compete with the large firms' heavy online advertising and discounts. With falling sales and revenue below costs, many were forced to close.

However, the number of retailers fell by only 2.1% between 2022 and 2023, to 2 234, so most bicycle retailers did not close. The closures may also be a short-run problem: sales of e-bikes increased in 2023 and Mintel forecasts a 12% increase in bicycle sales in 2024 as consumer spending recovers, so specialist retailers that adapt to the e-bike market are likely to survive. The second reason is probably more significant for small firms because the fall in demand affected all retailers, but only the small ones were unable to compete on price.

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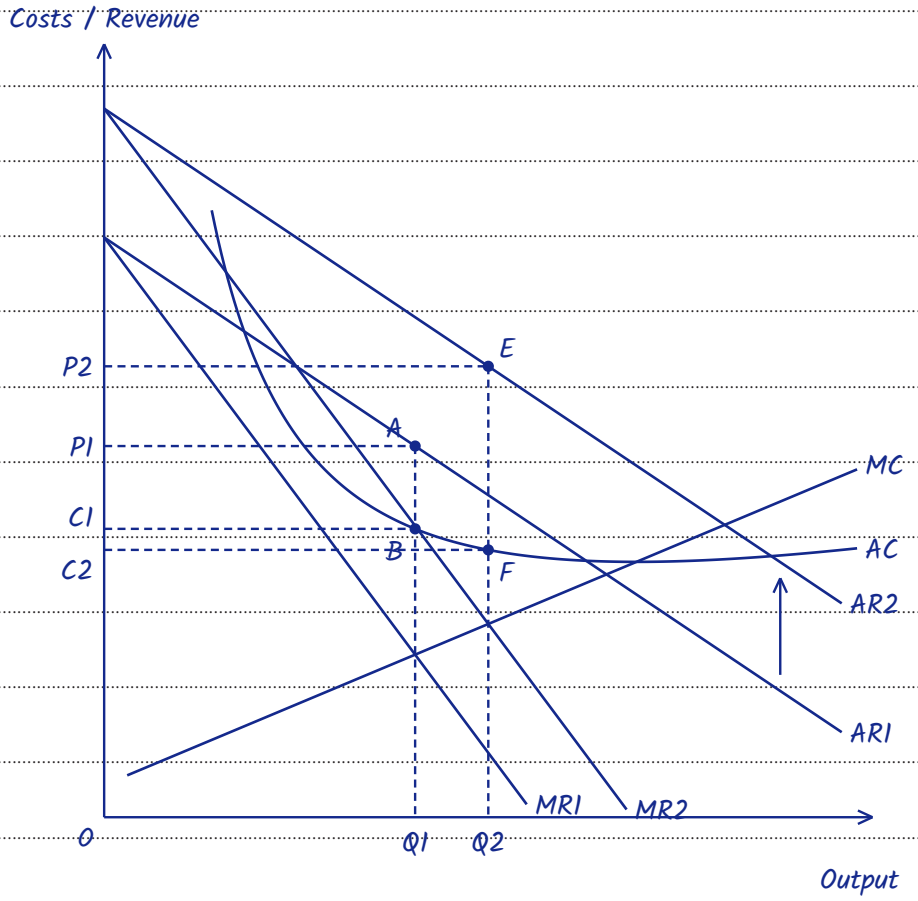
(e) With reference to Extract C, discuss methods that Halfords could use to increase its profitability.

Illustrate your answer with a costs and revenues diagram.

(14)

Profit is total revenue minus total cost. Halfords' profit before tax fell by 18% in the first quarter of 2024 because revenue fell and total costs rose by 12.7%, so it needs methods that raise revenue or reduce costs.

1. Expanding sales of e-bikes and e-scooters. Halfords is already the market leader for e-bikes and these are growth areas, since e-bike sales rose in 2023 while other bicycle sales fell. Investing in research and development and a wider range of models increases demand for its products and makes demand more price inelastic, as consumers see them as different from rivals'. This is shown in the diagram.



The rise in demand shifts AR1 to AR2 and MR1 to MR2. Halfords maximises profit where MR =

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MC, so output rises from Q1 to Q2 and price from P1 to P2. Supernormal profit increases from P1 A B C1 to P2 E F C2, as both the profit per unit (AR – AC) and output are higher, and average cost falls as fixed costs are spread over more units.

2. Focusing on its services business, such as bike servicing. Demand for servicing is less affected by economic downturns and poor weather, so revenue is more stable. Services also earn a high profit margin because they are labour based and have no stock of unsold bicycles.

3. Investing in its online presence to reach more consumers, increasing market share and revenue, and 4. increasing its price competitiveness. Halfords has about 20% market share, so it can buy in bulk and use these purchasing economies of scale to cut prices and win customers from smaller rivals. Halfords could also cut costs, for example by negotiating cheaper transport contracts, which would shift AC and MC down and raise profit.

Evaluation: the success of these methods depends on costs. Total costs rose by 12.7% because of the 10% rise in the national minimum wage and higher transport costs, which Halfords cannot control, and the service business is labour intensive so it is hit hardest by higher wages. Advertising and investment in e-bikes and online sales also raise costs in the short run, and there is a time lag before revenue rises, so profit may fall at first. Price cuts only raise revenue if demand is price elastic; if it is price inelastic, revenue and profit fall. It also depends on rivals: Evans Cycles and Wiggle may cut prices and invest online too, causing a price war. Finally, poor weather is outside Halfords' control.

Overall, expanding e-bikes, e-scooters and services is likely to be most effective, because these are growing and less seasonal markets where Halfords is already the leader, whereas price cutting risks lower margins while costs are rising. The impact is likely to be long-run rather

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than immediate.

(Total for Question 7 = 34 marks)

TOTAL FOR SECTION B = 34 MARKS

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SECTION C

Answer TWO questions from this section.

8 60% of the world's cocoa is produced by 2.5 million farming families in Ghana and Cote d'Ivoire. Much of this cocoa is sold to multinational companies for processing into chocolate. However, cocoa workers receive only 6% of the price of a bar of chocolate.

Evaluate measures that a government can use to protect employees **and** suppliers in a product market of your choice.

Illustrate your answer with an appropriate diagram(s).

(Total for Question 8 = 20 marks)

9 Sabesp is a natural monopoly supplying water in São Paulo, Brazil.

Evaluate the benefits of a natural monopoly supplying a product or service in an industry of your choice.

Illustrate your answer with an appropriate diagram(s).

(Total for Question 9 = 20 marks)

10 In 2024 Prembly Group, a digital security business based in Nigeria, merged with Peleza, a business specialising in making background security checks, based in Kenya.

Evaluate the benefits of the growth of a business by merger in an industry of your choice.

Illustrate your answer with an appropriate diagram(s).

(Total for Question 10 = 20 marks)

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Write the answer to your FIRST chosen question here.

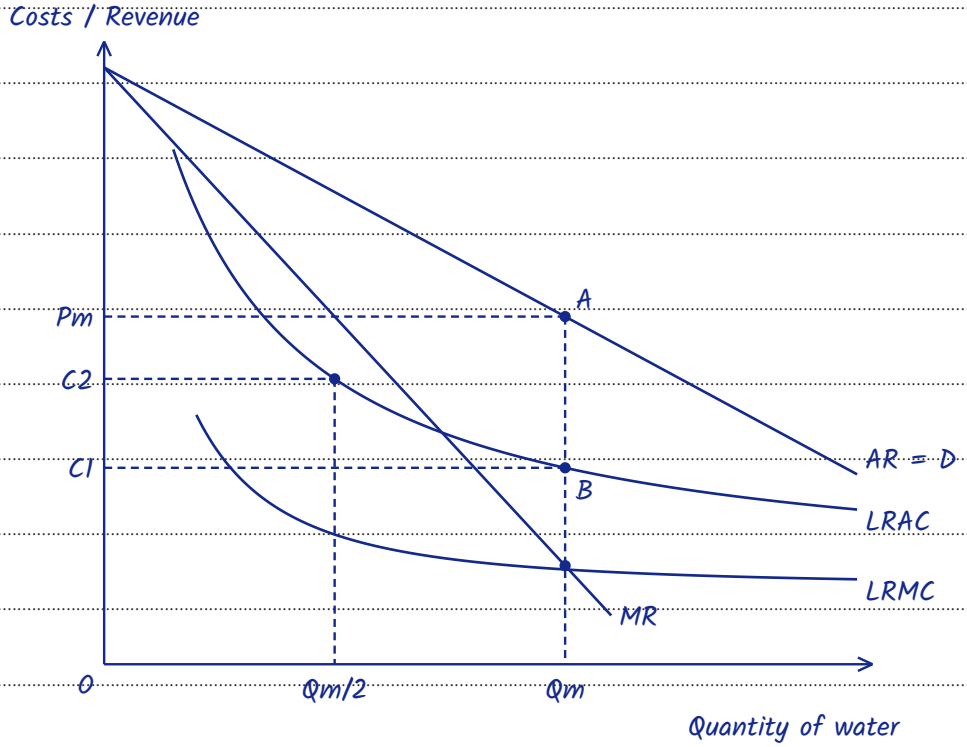
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Write the answer to your SECOND chosen question on page 23.

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

A natural monopoly is an industry where long-run average costs (LRAC) keep falling over the whole range of market demand, because of very high fixed infrastructure costs and economies of scale. This means one firm can supply the whole market at a lower average cost than two or more firms could. Water supply is a classic example: Sabesp supplies water and sewage services in São Paulo, Brazil, through a single network of reservoirs, treatment plants and pipes.

The first benefit is lower average costs, which is productive efficiency. The network of pipes and treatment works has huge fixed costs, and a single firm can spread these over millions of customers. As shown in the diagram, if Sabesp supplies the whole market at Qm its average cost is C1, but if two firms competed and each supplied half the market (Qm/2), average cost would be much higher at C2.



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A profit maximising natural monopoly produces where MR = LRMC, at output Qm and price Pm, and makes supernormal profit of Pm A B C1. Because cost C1 is so much lower than C2, consumers can still pay less than if the market were shared by competing firms.

Second, a natural monopoly avoids the wasteful duplication of resources. If several firms each built their own water pipes under the streets of São Paulo, scarce land, capital and labour would be wasted on networks that do the same job, and the disruption from digging up roads would be repeated. One network means these resources can be used elsewhere in the economy, improving the allocation of resources.

Third, dynamic efficiency. The supernormal profit Pm A B C1 can be reinvested in new reservoirs, treatment technology and repairing leaking pipes. Because there are no rivals, Sabesp can plan investment over many years with less risk, and new technology lowers LRAC further and improves the quality and reliability of water for consumers in the long run. Sabesp may also have monopsony power when buying chemicals, pipes and energy, lowering its costs further, which can be passed on to consumers as lower prices.

Fourth, benefits to workers and society. A large, stable firm offers secure employment and training. If the natural monopoly is owned or regulated by the government, it can be told to set a lower price, to aim for high employment, and to supply poorer households at an affordable price, which matters because water is a necessity and has large positive externalities for public health.

However, the benefits depend on how the monopoly behaves. Without competition, a private natural monopoly can exploit consumers: at Pm price is well above marginal cost, so output is restricted, consumer surplus is lost and there is allocative inefficiency. Consumers cannot switch

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supplier if service is poor, so they have no choice. Demand for water is very price inelastic, so the firm could raise prices a lot without losing many customers. Also, regulators cannot simply force Sabesp to set price equal to marginal cost, because with LRAC still falling LRMC is below LRAC, so P = MC would mean a loss and the firm would need a subsidy.

The lack of competitive pressure can also cause X-inefficiency, where managers allow costs to rise above the lowest possible level, which cancels out some of the gains from economies of scale. There is also no guarantee of dynamic efficiency: a private firm may pay its supernormal profit to shareholders as dividends rather than investing in the network, and without rivals it has little incentive to innovate. The size of the cost advantage also depends on the size of the market: in a large city like São Paulo the economies of scale are huge, but they may be smaller in less populated areas.

These problems can be reduced by regulation, for example a price cap (RPI – X) and quality targets, but regulation has its own problems such as asymmetric information and regulatory capture, where the regulator ends up acting in the interests of the firm rather than consumers.

In conclusion, a natural monopoly brings significant benefits in an industry like water, mainly lower average costs and the avoidance of wasteful duplication, so it is better than competition, which would raise costs. However, these benefits only reach consumers if the monopoly is effectively regulated or publicly owned, so that lower costs are passed on as lower prices and profits are reinvested. The most important factor is therefore the strength of regulation: with strong regulation the benefits outweigh the costs, but an unregulated private natural monopoly is likely to benefit its shareholders much more than consumers.

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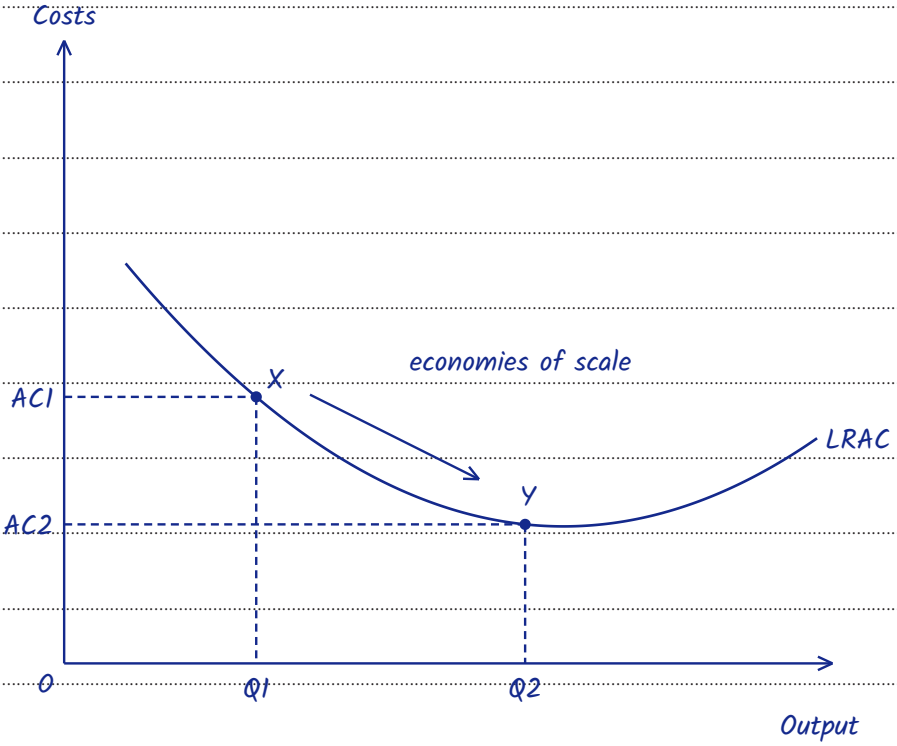
Write the answer to your SECOND chosen question here.

Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

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

A merger is when two firms agree to join together to form one larger business. The merger of Prembly Group, a Nigerian digital security business, with Peleza, a Kenyan business specialising in background security checks, is a horizontal merger, because both firms operate at the same stage of production in the digital identity and security verification industry, but in different countries. Growth by merger is external growth, which is much faster than organic growth from reinvesting profits.

The first benefit is economies of scale, which increase productive efficiency. A larger firm can spread its high fixed costs, such as software development, cyber security systems and data centres, over many more customers. Technical economies arise because the combined firm can use one verification platform for clients in both West and East Africa, and financial economies arise because a bigger firm can borrow more cheaply.



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As the merged firm grows from output Q1 to Q2, it moves down its LRAC curve from X to Y and average cost falls from AC1 to AC2. Lower costs raise profit per unit, and if they are passed on, businesses using Prembly's services pay lower prices.

Second, faster access to new markets and a wider product range. Instead of slowly building a customer base in Kenya, Prembly instantly gains Peleza's clients, brand and local knowledge, while Peleza gains access to Nigeria, Africa's most populous country. Each firm can sell the other's service to its existing customers, so revenue increases. Operating in several countries and offering more services spreads risk, a risk bearing economy of scale, because a fall in demand in one market can be offset by growth in another.

Third, synergies and skilled workers. Combining Prembly's digital security technology with Peleza's expertise in background checks can create a more complete product than either firm could offer alone, so the merged firm's profit may be greater than the sum of the two separate profits. The merger also creates a larger pool of skilled employees, filling skill gaps and raising productivity, and higher profits can be reinvested in research and development, improving dynamic efficiency and the quality of security services for consumers.

Fourth, increased market share gives the firm more pricing power and the ability to compete against large international rivals in the verification industry, which a small firm alone could not do. Workers may also benefit from more secure jobs and better career opportunities in a larger business.

However, the benefits may be smaller than expected. As the firm grows beyond the minimum efficient scale, it may suffer diseconomies of scale: managing staff in Nigeria and Kenya can cause communication and coordination problems, so LRAC rises rather than falls. Culture clashes

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between the two businesses, with different management styles, languages and regulations in West and East Africa, may lead to conflict and delays, so the expected synergies never appear. Many mergers fail to increase profits for these reasons.

Mergers are also costly: legal and financial costs and the cost of integrating different IT systems may be high, and if the merger is financed by debt, interest payments put a strain on the business. Managers may lose focus on the core business while dealing with the merger. In addition, consumers only benefit if cost savings are passed on. If the merged firm gains a dominant position it may raise prices and reduce choice, causing allocative inefficiency, and competition authorities may then investigate or block the merger, which is expensive. The benefits also depend on the time period: integration costs fall in the short run, while economies of scale and synergies take years to appear.

In conclusion, growth by merger offers clear benefits, mainly rapid access to new markets and economies of scale, and these are likely to be significant for Prembly and Peleza because their services are complementary and they operate in different countries, so there is little overlap and little risk of dominance. However, the size of the benefit depends on how well the two businesses integrate and manage cultural differences. If this is managed well, the long-run benefits to the firm and its customers are likely to outweigh the short-run costs.

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TOTAL FOR PAPER = 80 MARKS

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Afternoon (Time: 2 hours)

Paper reference **WEC13/01**

Economics

International Advanced Level

UNIT 3: Business behaviour

Source Booklet

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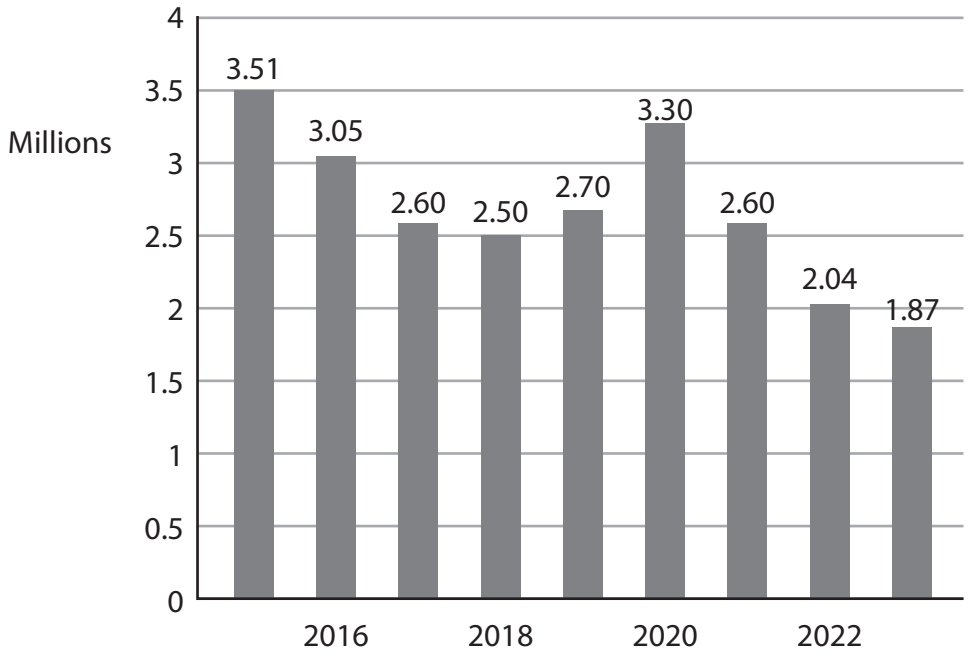
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Sources for use with Section B

The UK bicycle industry

Figure 1 Number of bicycles sold in the UK, millions, 2015–2023



Extract A The UK bicycle market

The UK bicycle market is facing a challenging period with declining sales. In 2023, sales were at their lowest in over 10 years. Since 2020, this decline was mainly caused by:

- a decrease in consumer demand after the boom in bicycle sales during the global health crisis
- high inflation rates.

However, in 2023, sales of some types of bicycles increased. For example, electric bikes (e-bikes) are becoming a more popular choice. Mintel, a market research business, forecast a 12% increase in bicycle sales in 2024. This increase in demand is expected to be caused by a combination of factors, including a recovery in consumer spending and significant price reductions by retailers.

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Extract B Competition in the UK bicycle market

There were 2 234 bicycle retailers in the UK in 2023. This was a decrease of 2.1% compared with 2022. The majority of these retailers are independently owned. However, a few large businesses dominate the market, including Evans Cycles, Chain Reaction Cycles, Wiggle and Halfords.

A rise in online shopping has been a challenge for many small-scale bicycle retailers. Online sales initially provided an opportunity for small-scale businesses to increase their market shares. However, the larger businesses quickly dominated the online market by investing heavily in advertising and branding, and by offering online discounts. These strategies have resulted in a reduction in contestability.

In 2023, an increasing number of bicycle retailers shut down. As the global health crisis eased, people started returning to their old routines and the demand for bicycles decreased. This left retailers with many unsold bicycles. To sell the excess supply, the large businesses reduced their prices. As a result, many small-scale retailers could not compete with these lower prices.

However, there are still opportunities for small-scale bicycle retailers to succeed. These businesses offer unique expertise and specialist services such as bike fitting and selling a niche range of bicycles. Some of these businesses have also been successful in adapting quickly to the growing demand for e-bikes.

Extract C Halfords

Halfords is the largest bicycle retailer in the UK, with a market share of approximately 20%. It has been successfully selling new and innovative products, such as electric scooters (e-scooters). Halfords is also a market leader for e-bikes.

In the first quarter of 2024, Halfords' profit before tax fell by 18% compared with the previous year. Revenue fell because poor weather caused a decrease in sales of bicycle products. Total costs had also increased by 12.7%. This was mainly caused by:

- a 10% increase in the national minimum wage
- significant increases in transport costs.

Halfords aims to overcome these challenges and continue to grow its business by:

- focusing on its services business e.g. bike servicing, which is less affected by economic downturns
- investing in its online presence to reach more consumers
- increasing its price competitiveness
- expanding its sales of e-bikes and e-scooters.

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Acknowledgements

Figure 1 adapted from:

https://www.statista.com/outlook/mmo/bicycles/united-kingdom#unit-sales

Extract A adapted from:

https://bicycleassociation.org.uk/news/press-release/22/22-BA-2023-Annual-Market-Report-confirms-worst-mechanical-bike-sales#:~:text=It%20is%20likely%20to%20take,digits%20between%202024%20to%202026.

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Extract B adapted from:

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https://www.bikes.org.uk/small-bike-shops-can-compete-online/

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Extract C adapted from:

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