

RVHS Prelims II H2 Econs Paper 1 – CSQ 1 [Suggested Answers for other JCs]

Developments in the supermarket industry

a) (i) With reference to Table 1, compare the changes in market share of the 'Big Four' supermarkets with that of the discounters between 2011 and 2013. [2]

- Decrease in market share for the Big Four whereas the discounters saw an increase in market share [1]
- Larger percentage change in market share of discounters compared to that of Big Four [1]

a) (ii) Describe the market structure operating in the UK grocery sector in 2013. [2]

- Oligopoly [1]
- From Table 1, 4 dominant firms ('Big Four' Supermarkets take up 75.3 % of the market share)

b) Explain one reason for the changes observed in (a)(i). [2]

- From extract 1, recession in the 1990s caused a change in shopping habits, with shoppers now more willing to shop around in search of a bargain → raise demand for groceries from the discounters [1]
- Assuming no change in market demand, the total size of the market remains the same. As shoppers switch from shopping in Big 4 supermarkets to shopping at the discounters → increase in the market share for the discounters vs a fall in market share for the Big Four. [1]

Alternative:

- Shift in shopping habits as hinted in extracts 1 and 4 implies that consumers prefer to shop at smaller outlets since this helps them save time and probably allows them to spend time with their families [1]
- Change in taste and preference may make them switch from shopping at Big Four supermarkets to shopping at discounters → fall in market share of Big Four [1]

c) Extract 4 notes that since the early 1990s, one of the key routes to success for supermarkets is the ability to open more and bigger shops. Explain why this may be the case. [6]

"Success for supermarkets" could refer to an increase in profits (TR-TC). This can be achieved through increasing total revenue or reducing average cost.

Revenue Advantage

- Setting up more shops in different areas → more accessible to consumers → increase in the number of customers → TR increases.
- Bigger shops are more likely to carry a larger variety of products → increase the sources of revenue

Cost Advantages

- **Marketing EOS-** To stock up the numerous big shops, supermarkets will have to purchase in bulk → larger discount compared to supermarkets with smaller scale of operation → Lower AC
- High advertising cost spread cross more shops and greater amount of output → lower advertising cost per unit

- **Technical EOS-** Warehousing cost vary less than proportionately with the volume of the warehouse → to double the amount of storage, it may not be necessary for the firm to double the size of warehouse → Lower average cost for supermarkets with more and larger shops
- **Managerial EOS-** Supermarkets with a large scale of operation is able to practise functional specialisation by employing specialists → Can allocate workers to tasks according to their skills, as compared to the case of supermarkets with smaller scale of operation → raise productivity and lowers average costs

Level	Descriptors	Marks
L3	Well-developed explanation of why the key routes to success depends on the ability to open more and bigger shops <ul style="list-style-type: none"> - Both revenue and cost advantages - Contextualised 	5-6
L2	Undeveloped explanation of why the key routes to success depends on the ability to open more and bigger shops. <ul style="list-style-type: none"> - Either revenue or cost advantage - Superficial explanation - Generic 	3-4
L1	A smattering of valid points	1-2

- d) Extract 2 notes that online grocery retail is set to rise in the near future. Discuss whether all grocery retailers in the UK should venture into this aspect and how this might affect consumer welfare. [8]

Issue 1: Should all grocery retailers in the UK venture into online retail?

Thesis: Yes, Grocery retailers should venture into online retail. Why?

- ***Change in taste and preference in favour of online shopping***
From Extract 2, online shopping for groceries is predicted to have a “126% increase in sales over the next five years.” This is partly due to a change in consumers taste and preferences in favour of online shopping for food and groceries. Instead of having to travel to the physical store during its opening hours, consumers can now make purchases anywhere, anytime as long as they have smartphones, tablets and internet access → increase the popularity of online grocery shopping → increase in demand → grocery retailers earn higher revenue

Anti-thesis: grocery retailers should NOT venture into online retail. Why?

- ***It is costly to venture into online retail***
Firms that venture into online retail will incur higher operating costs. E.g. cost of setting up the infrastructure, maintain websites as noted in Extracts 2 and 3. → expensive to maintain especially for stores which run on low-cost model which thrive on driving out complexity

Synthesis:

- Grocery retailers should only venture into online retail if the increase in revenue outweighs the increase in cost of venturing online
- With shoppers defecting to their competitors' stores, 'Big Four' such as Morrisons which has yet to venture into online retail should tap on the growing market to offset its falling market share as seen in Table 1.
- On the other hand, the discounters should not venture online as it increases the complexity of their operations, drive up operating costs and may result in rising prices of goods

Issue 2: With grocery retailers venturing into online retail, how might it affect consumer welfare?

Consumer welfare is affected by changes in price, quantity, quality, innovation and variety of goods and services.

Thesis: Consumer welfare may increase. How?

- **Greater variety in terms of more options of shopping/ Increase in convenience**
According to Extract 2, consumers are “fed up with spending their precious time off trudging the long aisles.” Online retail provides consumers with more variety and options of shopping → greater convenience → increase their welfare
- **Prices can be lowered due to IEOS**
In expanding into online retail, there might be cost savings for the grocery retailers → Internal economies of scale is the cost savings accrued to the firm as a result of its own expansion → If the cost savings are passed on to the consumers in the form of lower prices, this results in greater consumer surplus and implies that consumer welfare has also increased

Anti-thesis: Consumer welfare may decrease.

- **Prices may increase**
As explained above, it may be costly to venture into online retail. If the retailers were to pass on the increase in costs to consumers in the form of higher prices, consumer welfare will decrease.

Synthesis:

- With more grocery retailers venturing into online retail, consumer welfare is likely to increase due to innovations afforded by online shopping. These benefits coupled with the gains in the additional shopping platform provided greater variety, choices and convenience of services to consumers.
- On balance, the benefits are likely to outweigh any potential increase in costs (in terms of higher prices charged by online retailers to offset the increase in cost of operating online platforms), although the latter (if any) are unlikely to be to a large extent given the fairly competitive grocery market.

Level	Descriptors	Marks
L3	<p>For a well-developed discussion of whether all grocery retailers should venture into online retail <u>and</u> how it might affect consumer welfare</p> <ul style="list-style-type: none">- Two sided analysis- Good scope of discussion by analysing how venturing into online retail might affect the retailer's cost <u>and</u> revenue. Able to analyse the impact on consumer welfare based on changes in price, variety and convenience.- Good rigour of elaboration.- Reference to case material in explanation.- Evaluative conclusion / making a stand for each part	7-8
L2	<p>For a developed explanation of whether all grocery retailers should venture into online retail <u>or</u> how it might affect consumer welfare</p> <p>OR</p> <p>For an undeveloped discussion of whether all grocery retailers should venture into online retail <u>and</u> how it might affect consumer welfare</p>	4-6

	<ul style="list-style-type: none"> - Analysis lacking in scope: Refer to <u>one</u> of these economic variables (cost, revenue) in the explanation of whether grocery retailers should venture into online retail. Considered <u>some</u> of these variables (price, quantity, convenience, variety, quality) in the explanation of how consumer welfare might be affected - Analysis lacking in rigour - Limited/Some reference to case material - Lack of concluding statement which makes a clear stand 	
L1	A smattering of valid points	1-3

(e) In the light of the market structure of the UK grocery retail sector, discuss the extent to which price competition is the only way for firms to survive. [10]

- The market structure of the UK grocery retail sector is that of an oligopoly, given the presence of dominant firms (Table 1; Big Four Supermarkets)
- Since these dominant firms 'share' the market, they are mutually interdependent
- As such, if a firm takes any action, its rivals will be affected and they will have to respond accordingly
- This means that firms in this market need to be conscious of what their rivals are doing i.e. rival conscious
- 'Survive' in this context could refer to earning at least normal profits (TR=TC) in the long run to remain in the industry

Thesis: Yes, price competition is one possible way for firms to survive. Why? How so?

① Especially for categories of products identified to have relatively price elastic demand, whether for discounters or Big 4 supermarkets

- Price competition → reduce price → quantity demanded will increase more than proportionately → rise in TR
- **As firms (discounters, upmarket grocers or Big 4) in the grocery retail sector sell a wide array of items, for certain categories of products identified to have relatively price elastic demand ($PED > 1$), firms can undertake price competition as a possible way to enjoy a (small) rise in TR and therefore survive**
- For maximum benefit/ effect, price competition should ideally be temporary (not for too long) and possibly applied on a selected categories of products rather than across all products

Anti-thesis: No, price competition is NOT the only way for firms to survive. Why?

① Price competition has limitations too/ may not help firms significantly

- As suggested in Extract 4, when 1 firm in the UK grocery retail sector adopts price competition, the rival firms in the market will likely follow suit, at least in the short run
- **In this case, even if firms reduce their price, the resulting increase in quantity demanded will not be very significant. As such, any resulting increase in total revenue will not be very significant too**
- Moreover, there is a limit to how low prices can go before firms start to incur losses
- In fact, **if such price competition is carried out for a long period of time, it is unlikely to be sustainable**

② Other ways (besides price competition) may also help firms survive. Such as?

- Besides price competition, firms can also adopt other strategies to survive. For e.g., they can choose to target specific market segments to secure their sources of revenue
- Specifically, as hinted in Extracts 1 and 4, discounters like Aldi have tried to provide high quality staples while more upmarket firms like Waitrose continue to target specific/ niche segments of the market
- Alternatively, firms (both discounters, upmarket or Big 4) can also undertake product differentiation, which comprise (i) product promotion and (ii) product development
- Doing so may help increase consumers' brand loyalty to their firm/ products and thus, even if firms were to raise prices, they may not necessarily see a fall in TR, much less having to resort to lowering price to survive
- Lastly, as 'survival' is related to both revenue and cost, besides raising revenue, firms can also try to reduce their average costs.
- Specifically, firms can try to reduce labor cost by introducing more self-checkout machines or review existing operations to see if they can reduce wastage of resources/ weed out spiralling operating costs

Synthesis:

- Whether it is Big Four supermarkets, upmarket grocers or discounters, price competition is definitely not the only way for firms to survive
- **Instead, they are likely to use a mix of strategies although at certain times, some types of firms may veer more towards adopting more of one strategy e.g. price competition over another**
- Finally, for firms to survive, they need to remain nimble enough to react quickly to changing economic conditions and consumers' shopping habits as well

Level	Descriptors	Marks
L3	Developed discussion of whether price competition is the only way for firms to survive <ul style="list-style-type: none">- includes alternative strategies that could be used- Able to relate to supermarket context- Consider different categories of goods or types of firms	8-10
L2	Undeveloped discussion of whether price competition is the only way for firms to survive OR Developed explanation of why price competition may or may not be a good way for firms to survive	5-7
L1	A smattering of valid points	1-4

