



Rewarding Learning

ADVANCED
General Certificate of Education
2014

Economics

Assessment Unit A2 1

Business Economics

[AE211]

TUESDAY 13 MAY, MORNING



TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **Question 1** and **one** question from **Questions 2, 3 or 4**.

INFORMATION FOR CANDIDATES

The total mark for this paper is 80.

Quality of written communication will be assessed in **all** questions **except 1(a)**.
Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time.

Question 1

These articles were composed in November 2012. Please read them carefully and answer the questions which follow.

Case study: Rise and fall of technology giants

Source 1: Creative destruction and the slide of Nokia

After being the top seller of mobile phones in the world for 14 years, with a market share that once stood at over 40%, Finnish company Nokia has hit a downward spiral that has led to shrinking sales, falling market share, plant closures and thousands of job losses.

While still being the world's second largest maker of cell phones, Nokia has fallen out of the top five in the lucrative and growing market for smart phones, trailing behind brands such as HTC and China based ZTE.

To help stem the tide Nokia has recently announced that it is teaming up with software giant Microsoft to use Windows as the platform for its new range of smart phones. It is hoped that this move will help rejuvenate the company and allow it to claw back some lost ground.

Not everybody is convinced, however, with many calling it a make-or-break moment for Nokia. Critics of the company's smart phone range, argue that they lack the wow factor of rivals such as Apple and Samsung. The decline of Nokia is a perfect illustration of what Austrian economist Joseph Schumpeter called "creative destruction", where formerly dominant companies are pushed out of a market by new, innovative and dynamic entrepreneurs. Todd McCann, an independent technology analyst, stated recently, "Nokia are shedding customers, and unless they can stem the tide soon, they will go the way of other, once famous companies, such as JJB Sports, Compaq and HMV".

Source: adapted from various sources November 2012

Source 2: Creative destruction and the rise of Apple

In the past 20 years technology giant Apple Inc has transformed itself from a computer company on the brink of collapse to the world's most valuable publicly traded company. On August 10th 2012 Apple's share price closed at a record \$655.15, leaving it with a market capitalisation of just over \$622bn. This is the highest nominal market capitalisation ever reached by a publicly-traded company and surpasses the record set by Microsoft in 1999.

Apple's performance is testament to the growing influence of digital technology in the global economy and to the company's ability to woo fashion-conscious consumers with its innovative range of MP3 players (iPod), electronic tablets (iPad) and most importantly smart phones (iPhone).

As **Fig. 1** below shows, Apple sold 26 million iPhones between April and June 2012. These sales give Apple a 7.2% share of the mobile phone market. While this is less than a third of the market share enjoyed by market leader Samsung, Apple still pulls in over 50% of the total profit that global cell phone sales generate.

Global mobile phone sales (Q2: 2012)		
Company	Units (millions)	Market share %
Samsung	93.0	25.7
Nokia	83.7	23.1
Apple	26.0	7.2
ZTE	16.5	4.6
LG	13.1	3.6
Others	129.7	35.8

Fig. 1: Market share (by volume) of global mobile phone market

© Strategy Analytics

Todd McCann, a technology analyst stated, "These impressive profits, from a relatively small market share, are a reflection of Apple's ability to secure significantly higher hand-set prices than any of its rivals. Apple seems to have the ability to earn what can only be described as supernormal profits, not only on its iPhones but on its full range of products. In 2011, the last full year for which results are available, Apple posted net profits of \$26bn on revenues of \$108bn making it one of the most profitable companies in the world.

Source: adapted from various sources November 2012

Source 3: Apple and Samsung in patent war

A US court has ordered Samsung to pay Apple over \$1bn after ruling that it had infringed several of the iPhone maker's software and design innovations. The patents include one that relates to the front face design of the iPhone while the others relate to user interface elements such as "tap and zoom" and the "bounce back" function. Apple's lawyer Harold McElhinny told the court that Samsung employed a short cut in its production design. "Samsung was able to copy and incorporate the results of Apple's four year investment in hard work and ingenuity without taking any of the risks".

However, Apple has not been so successful in its legal battles elsewhere. Apple and Samsung have brought legal cases against each other in more than 10 countries, each accusing the other of violating patents. Apple has lost a series of these cases recently, most notably in the Netherlands, Australia and the UK.

A Samsung spokesman, speaking after a court finding in its favour in the UK, stated, "We continue to believe that Apple's registered design features and patented technology can be found on numerous examples of previous products. If Apple continue to make excessive legal claims on such generic designs, innovation in the industry could be harmed and consumer choice unduly limited".

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Source 4: Working conditions in the spotlight

Check the back of an iPhone and you are likely to see the words “Designed by Apple in California. Assembled in China”. The people who manufacture the iPhone and other bestselling Apple products such as the iPad work for Taiwanese company Foxconn.

For years Foxconn has managed to remain below the radar despite employing close to a million workers worldwide. However, that anonymity was blown away in 2010–2011 when news of a spate of suicides among staff at its Chinese plants made headlines around the world. Unofficial reports into the suicides have suggested that they were partly a result of the harsh working conditions endured by Foxconn employees.

Initially both Apple and Foxconn stated that the working conditions in its plants were not responsible for the deaths, and pointed out that pay and working conditions in their factories were often better than the local average. However, they soon responded to the negative publicity by raising wages, shortening working hours and installing suicide nets around its factory living quarters!

At the same time New York based campaign group, China Labour Watch (CLW) has accused Apple’s main rival Samsung of having “illegal and inhumane” working conditions in its Chinese plants. The CLW report highlights a range of labour violations such as, workers being forced to work over 100 hours overtime per month, workers having to stand for up to 12 hours a day, a lack of worker safety and verbal and physical abuse.

Samsung have strongly denied the accusations and has promised to carry out more rigorous checks on its 250 plants, to ensure individual plant managers do not violate the company’s employment practices.

However, trade unionist Paul Kerr claimed that reports of worker abuse are only the tip of the iceberg. “Companies such as Apple and Samsung are more concerned about their brand image and reputation in western economies than they are about workers’ rights or environmental standards in China and elsewhere. Global companies such as these, which are used to operating in free markets, are certain to pursue the maximisation of profits over their social and environmental responsibilities”.

© Adapted from BBC News bbc.co.uk 2014

- (a) Explain the term “creative destruction” as used in Sources 1 and 2. [5]
- (b) Explain how an economist would determine if Apple were earning supernormal profits. [10]
- (c) Examine the case for protecting the intellectual property rights of firms through the use of patents. [10]
- (d) Critically examine the view that globalised companies such as Apple and Samsung are certain to pursue the maximisation of profits over their social and environmental responsibilities. [15]

Essays:

Answer **one** question from **Questions 2, 3 or 4**.

2 Big is beautiful!

- (a) Explain why firms often strive to produce on a larger scale. [15]
- (b) Critically examine the view that the advantages associated with large scale production mean that small firms will become a thing of the past. [25]

3 Contestable markets more efficient than competitive markets

- (a) Explain the difference between a perfectly competitive market and a perfectly contestable market. [15]
- (b) Critically examine the view that contestable markets lead to a more efficient allocation of resources than any other market structure. [25]

4 Tesco market power remains despite fall in market share

- (a) Explain the difference between market power and market share. [15]
- (b) Critically examine the range of policies a government could use to reduce the market power of a company such as Tesco. [25]

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