



A-Level Economics Case Studies:

Theme 3



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

www.expert-tuition.co.uk



A-Level Economics Case Studies: *Contestability*



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

www.expert-tuition.co.uk

Summary

- Walking/bus tours around London are examples of contestable markets as barriers to entry and exit are low.
- Online music industry is another example of a contestable market with low barriers to entry and exit.



Case Study 1 - Walking bus tours

1. An example of a contestable market is walking/bus tours around London. There are very low barriers to entry - all you need is a bus or a few board signs to advertise your service. If firms are not making sufficient profit, they can easily exit the market.

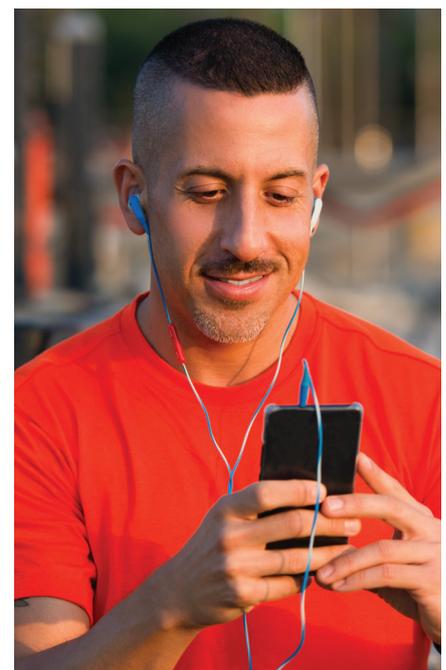
2. The local council could introduce barriers to entry by, for example, forcing firms to secure expensive licenses to be able to offer such tours.



Case Study 2 - Online music downloads

1. Another example is online music downloads - thanks to improvement in technology and a fall in the cost of internet, the online market industry is more contestable than ever.

2. Today, consumers have the choice of purchasing physical CDs or downloading their favourite tracks from a multitude of online retailers including, iTunes, Amazon, Spotify etc. There are very low barriers to enter or exit the market which makes it highly contestable.





A-Level Economics Case Studies:

Mergers



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

www.expert-tuition.co.uk

Summary

- **Horizontal Merger** - In 2015, the Travel booking site, Expedia, bought Orbitz World for \$1.34bn.
- **Horizontal Merger** - In 2015, BT bought EE, a mobile network firm, creating a communication giant covering landlines, broadband, mobile and TV.
- **Vertical Merger** - In 2014, Nutella acquired a Turkish hazelnut producer, Oltan, as the price of nuts spiked due to poor weather conditions.



Case Study 1 - Horizontal Merger - Expedia Travel Booking

1. In 2015, the Travel booking site, Expedia, bought Orbitz World for \$1.34bn. Earlier in the month, Expedia had bought another travel booking site, Travelocity, for \$280m.
2. Expedia made the acquisitions to increase its market share, remaining competitive and boost profits. It also gives Expedia greater access to customer info all around the world.



Case study 2: Conglomerate Merger - BT merges with EE

1. In 2015, BT, a landline operator, bought EE, a mobile network firm, creating a communication giant covering landlines, broadband, mobile and TV. The stock market responded positively by sending BT shares up 4.5%, to the highest since 2001.
2. The combination of EE and BT will provide customers with innovative, seamless services of fibre broadband with wi-fi and advanced mobile capabilities.
3. BT says that within four years, the deal will be saving it £360m a year in terms of operating costs and capital investment. Furthermore, by combining the two businesses, it should be able to generate an extra £1.6bn a year in sales.



Case study 3: Backward Vertical Merger - Nutella acquires Oltan

1. In 2014, Nutella acquired a Turkish hazelnut producer, Oltan, as the price of nuts spiked due to poor weather conditions. Oltan is one of the world's leading companies in the production and marketing of hazelnuts. Oltan had revenues of more than \$500 million, exporting to the European Union and other important markets.
2. The acquisition would help reduce Nutella's costs as well as guarantee the supply of good quality hazelnuts, a key ingredient for the chocolate manufacturer.





A-Level Economics Case Studies:

Demergers



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

www.expert-tuition.co.uk

Summary

- Vertical demerger - In 2015, Ebay demerged Paypal, to boost revenues and profits.
- Conglomerate demerger - In 2018, Whitbread (owner of the Premier Inn Hotel chain) demerged Costa (sold to Coca Cola).
- Horizontal demerger: In 2013, Lloyds demerged TSB.

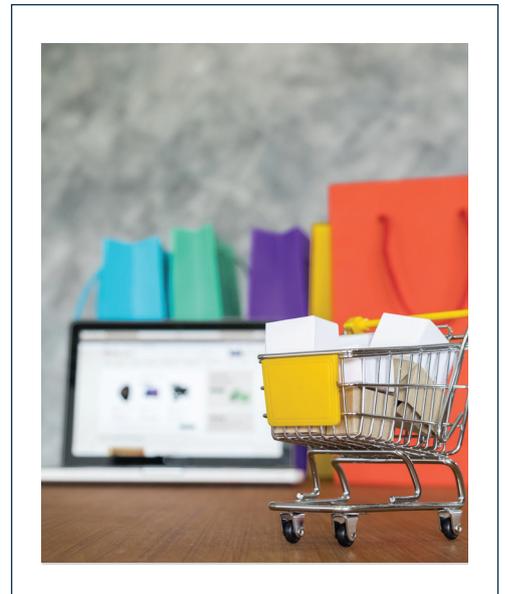


Case Study 1 – Vertical demerger of Ebay and PayPal

1. In July 2015, PayPal, a leading digital-payment service, split from eBay, an e-commerce giant, and started trading as a separate company. The demerger cost hundreds of millions of pounds (spending on new offices, software, etc).

2. eBay bought PayPal for \$1.5 billion in 2002 – an example of a forward vertical merger. But PayPal is now the bigger and stronger of the two companies. Today, PayPal is worth around \$45 billion, with eBay valued at around \$30 billion.

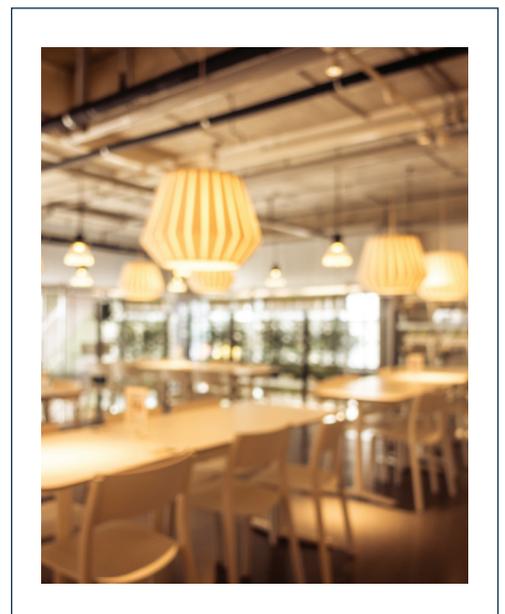
3. Splitting benefited both firms. For PayPal, acting independently, has allowed it to expand to other sites beyond eBay, increasing revenues and profit. Consumers have also benefited as more sites use PayPal as a payment method which is more convenient.



Case Study 2 – Conglomerate demerger of Whitbread and Costa

1. In 2018, Whitbread, owner of Premier Inn Hotel chain, sold Costa to Coca Cola for £3.9bn. Whitbread CEO Alison Brittain said the sale would allow the firm to focus on and grow its other business – the Premier Inn Hotel Chain. Shareholders benefited the most from the sale of Costa, which was bought by Whitbread in 1995 for only £19m.

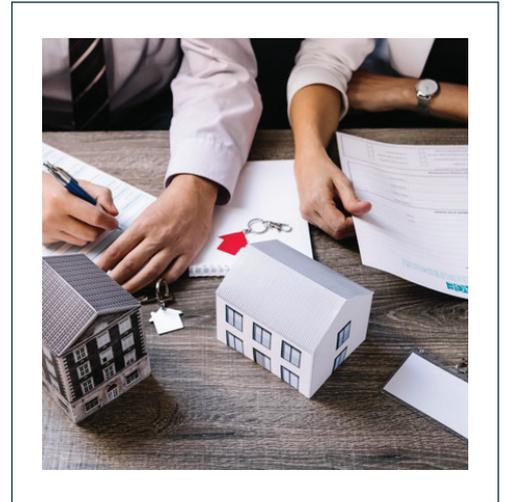
2. Whitbread said it will use the money to reduce its debt, cut costs, increase its contribution to the pension fund and return a “significant majority” to shareholders. The move will also help it to expand its Premier Inn chain in the UK and Germany.





Case Study 3 – Horizontal demerger of Lloyds and TSB

1. In 2013, Lloyds Bank split from TSB bank. The TSB network will be floated on the stock market as a separate bank.
2. More than 4.6m Lloyds customers have been transferred to the 631 branches being rebranded as TSB. Around 8,500 staff are also being switched to the new bank, with £30m spent on branding and advertising.
3. Lloyds has been forced to split off and rebrand the TSB branches by the EU as a result of the £20bn of taxpayer money pumped into the bank during the 2008 bailouts. It has pledged to turn TSB back to its heritage as a “local” bank.





A-Level Economics Case Studies:

Rising Cost of Production



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

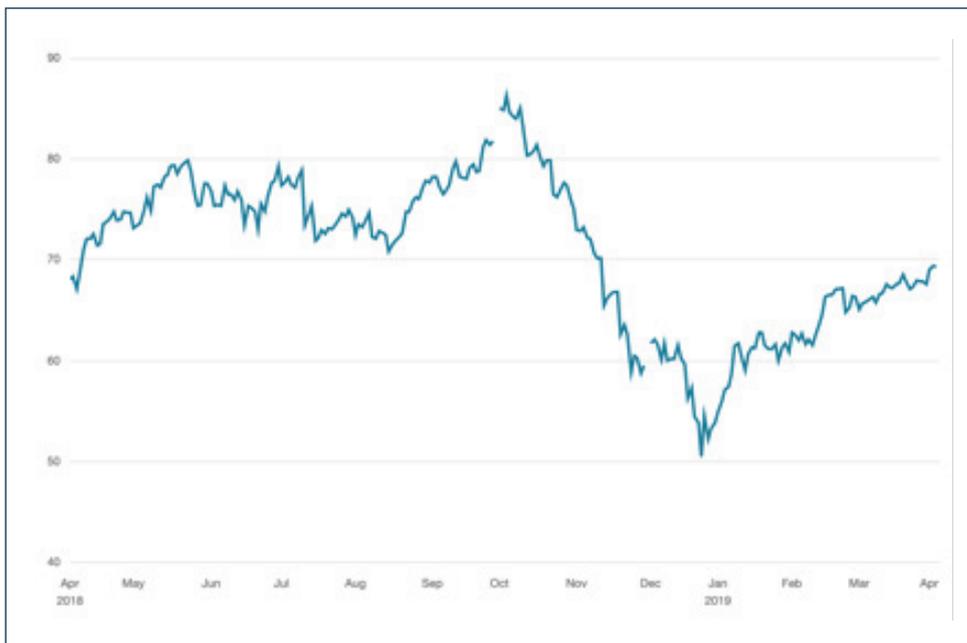
www.expert-tuition.co.uk

Summary

- Oil prices have increased by around 40% in the past six months.
- Chocolate prices per KG have increased from \$11 in 2010 to over \$15 today.



Case Study 1 - Rising oil prices



1. In the past 6 months the oil prices has increased by 40% from around US\$50 to US\$70.



Case Study 2 - Rising Cocoa Prices

1. Over the last decade the price of cocoa, a key ingredient of chocolate, has been steadily increasing. As a result, chocolate prices per KG have increased from \$11 in 2010 to over \$15 today. This is shrinking chocolate makers' profit margins. They are responding by shrinking the size of their chocolate or switching to cheaper ingredients.
2. Another strategy some firms have employed to overcome shrinking profits is focusing on premium chocolate products and expanding their customer base. Lindt, has successfully implemented such a strategy.
3. Other firms have preferred to integrate vertically backwards by acquiring producers of cocoa. This helps protect the firm from price and quantity volatility in the cocoa market and ensures uninterrupted supply. For example, in 2014, Ferrero acquired a Turkish hazelnut producer in 2014 as the price of nuts spiked due to poor weather conditions



A-Level Economics Case Studies: *Collusion*



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

www.expert-tuition.co.uk

Summary

- In 2013, nine Japanese car part makers, including Hitachi and Mitsubishi, were fined \$740m for colluding and fixing prices.
- In 2014, some of the biggest Germany sausage producers for were fined \$374m for colluding.
- In 2014, German's three largest sugar companies were fined \$310m for colluding and price fixing.
- In 2014, Apple was fined \$450m, for colluding with five major US publishers to fix ebook prices.



Case Study 1 - Auto Sector Price Fixing Scheme

1. In 2013, the US government fined nine Japanese car part makers, including Hitachi and Mitsubishi, \$740m for colluding and fixing prices.

2. The Japanese car part makers were rigging (fixing) prices sold to US carmakers such as Ford and General Motors. This affected more than \$5bn worth of car parts sold to US manufacturers. More than 25m consumers as a result had suffered, paying a higher price for their cars.



Case Study 2 - German Sausage Producers Cartel

1. In 2014, some of the biggest sausage producers in Germany were fined \$374m for colluding. The cartel of 21 Sausage producers, including Boklunder and Wiesenhof, were given the name 'Atlantic Circle', after the Hotel Atlantic, where they initially met to discuss their covert agreement.

2. Pork is by far the most popular meat in Germany. On average, a German consumes 38kg of pig meat a year. Additionally, of the roughly 8.8m tonnes of meat produced annually in Germany, 5.5m tonnes were pork.



Case Study 3 - German Sugar Cartel

3. In 2014, German's three largest sugar companies were fined \$310m for colluding and price fixing. The three firms were accused of colluding to limit supply of sugar in Germany up until 2009, and therefore keep prices high.



Case Study 4 - Apple Fined for Fixing ebook Prices

1. In 2014, Apple was fined \$450m, for colluding with five major US publishers, including Penguin Group and Simon & Schuster, to fix ebook prices.

2. The US Justice department believed that the collusion led to some ebook prices rising to \$14.99 from \$9.99.





A-Level Economics
Case Studies:
Price Discrimination



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

www.expert-tuition.co.uk

Summary

- Airlines regularly implement **second degree price discrimination**. For example, Ryan Air and Easy Jet will charge a lower price the earlier a flight is booked.
- Example of firms employing **third degree price discrimination** include Vue Cinemas and National Rail, who charge Adults (inelastic PED) and Students (elastic PED) different prices.



Case Study 1 – Second Degree Price Discrimination

1. Second degree price discrimination occurs when firms charge different prices depending on the quantity consumed or the timing of the purchase.
2. Airlines regularly implement second degree price discrimination. For example, Ryan Air and Easy Jet will charge a lower price the earlier a flight is booked. This gives airlines the advantage of knowing how full their flights are likely to be and is a source of cash flow prior to the flight. Closer to the departure date, airlines tend to raise their prices, this is because consumers' demand for a flight becomes inelastic. Passengers who book later often regard their travel to be a necessity and are therefore willing to pay a higher price.



Case Study 2 – Third Degree Price Discrimination

1. Third degree price discrimination occurs when firms splits a market based on differing price elasticities of demand.
2. Example of firms employing third degree price discrimination include Vue Cinemas and National Rail, who charge Adults (inelastic PED) and Students (elastic PED) different prices. As a result, they are able to make more profits than they would if they charged both markets (students and adults) the same price.





A-Level Economics Case Studies:

Government Intervention & Competition



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

www.expert-tuition.co.uk

Summary

- In 2014, the CMA investigated the UK Energy Market in an attempt to increase competition and improve the consumer experience.
- In 2016, the CMA introduced measures to support consumers in the UK Energy Market, including, for example, supporting price comparison websites to help consumers identify the cheapest energy supplier.
- In 2018, the CMA announced further investigation into the tax audit market which is currently controlled by 4 big firms.



Case Study 1 - Energy Market

1. In 2014, the regulator of the energy market (OFGEM) referred the industry to the CMA for further investigation. OFGEM believed the market was not working effectively. OFGEM questioned whether there was enough competition in the UK Energy Market. OFGEM's concerns included: the structure of the market which allowed big companies (e.g. EDF) to be both generators of electricity and suppliers to household; and whether their tacit collusion between energy firms existed.
2. In 2016, the CMA found that customers had been paying £1.4bn a year more than they would in a fully competitive market. It also set out a wide range of reforms to increase efficiency and competition in the UK Energy Market. For example, the CMA will support price comparison websites to enable consumers to identify the cheapest energy supplier; and temporarily cap prices for customers on pre-payment meters.



Case Study 2 - the big four audit companies

1. In October 2018, the CMA announced that it believes there is insufficient competition in the tax audit sector, negatively impacting quality and prices. The market currently consists of a handful of firms - PWC, Deloitte, KPMG, Ernst and Young and there are high barriers to entry. The market has the characteristics of an oligopoly.
2. The big four audit companies conduct 97% of big companies' audit but the quality of the service is generally poor. The four firms prefer focus most of their efforts on consulting, which makes up more than 75% of their revenues.



3. The CMA is proposing measures to increase competition and quality in the audit market. For example, it suggests firms should split their audit and consulting operations and operate them as two distinct businesses. They also want to pressure big companies to instruct more small firms as their auditors.





A-Level Economics
Case Studies:
*Government
Intervention
and Mergers*



International House,
124 Cromwell Road,
Kensington, SW7 4ET

020 7060 4494

www.expert-tuition.co.uk

Summary

- CMA is currently investigating the proposed merger between Sainsbury's and Asda to determine whether it would harm consumers' interest.
- In 2018 the CMA blocked Fox Broadcasting Company's £11.7bn takeover of Sky. It concluded the takeover would have been against the public's interest.



Case Study 1: Sainsbury's Merger with Asda

1. In 2018, the British competition watchdog, the Competition and Markets Authority (CMA), launched an investigation into the proposed merger of Sainsbury's and Asda (their combined market share would be greater than 28%.)
2. The objective of the investigation is to determine whether the proposed merger would negatively affect competition and therefore harm UK consumers interests. For example, would the merger lead to less choice, higher prices or a fall in quality of goods and services?
3. The process has been criticised for being time consuming and complicated. The CMA may take too long, potentially derailing the merger which could have benefited consumers. This is also an example of government failure. Furthermore, the regulator suffers from a lack of information about the two firms in question. This is known as asymmetric information. This could affect the CMA's ability to make the right decision.



Case Study 2: Fox's takeover bid for Sky

1. In January 2018, the CMA ruled that the proposed £11.7bn Fox Broadcasting Company (owned by Rupert Murdoch) takeover of Sky is not in the public's interest.

The CMA concluded that the deal would give the Murdoch family “too much control over providers of media platforms and therefore too much influence over public opinion and the political agenda.”

