



Business Economics

01 June 2016

Marking Scheme

This marking scheme has been prepared as a **guide only** to markers. This is not a set of model answers, or the exclusive answers to the questions, and there will frequently be alternative responses which will provide a valid answer. Markers are advised that, unless a question specifies that an answer be provided in a particular form, then an answer that is correct (factually or in practical terms) **must** be given the available marks.

If there is doubt as to the correctness of an answer, the relevant NCC Education materials should be the first authority.

Throughout the marking, please credit any valid alternative point.

Where markers award half marks in any part of a question, they should ensure that the total mark recorded for the question is rounded up to a whole mark.

Answer any FIVE (5) questions

Marks

Question 1

- a) Explain the TWO (2) assumptions that profit maximisation is based upon. **2**
- ***A firm's owners are in control of day-to-day decision making (1 mark)***
 - ***Those owners always desire more profit than less (1 mark)***
- i) At what level of output is profit maximised? **2**
Where marginal revenue equals marginal cost. (1 mark for each)
- ii) Explain the organisational form/ownership type that undermines the assumption of profit maximisation and why this is a problem. **5**
The dominant organisational form in many countries is the public limited company (PLC), (1 mark) which undermines the first assumption (1 mark)
PLCs are owned by shareholders, but run by professional managers. (1 mark)
Managers may have different objectives from shareholders (1 mark)
They are able to pursue these because of the lack of involvement of shareholders (1 mark).
- b) *Theories about firms' objectives can be grouped into theories about goals that are maximised and goals that are not maximised.*
- i) Outline three examples of goals that are not maximised. **3**
- ***Satisficing***
 - ***Coalitions'/stakeholders' objectives***
 - ***Contingency theory***
- ii) Explain what is meant by constrained sales revenue maximisation **3**
Shareholders may require at least a certain level of profit (1 mark), out of which they would receive dividends, (1 mark) and so sales revenue can only be maximised subject to this constraint (1 mark).
- c) Outline a goal maximisation strategy where the aims of shareholders and managers are both served. **3**
- ***Marris took the view that, rather than shareholder and management interests being opposed, both would be served by growth (1 mark)***
 - ***Managers seek growth in sales (1 mark)***
 - ***Shareholders seek growth in the value of the company and hence their shares (1 mark).***
- i) Highlight a practical problem with this strategy. **2**
- ***Marris saw this as constrained by the need to distribute a reasonable proportion of profit as dividends to shareholders (1 mark) i.e. a need to maintain a low ratio between retained and distributed profits (1 mark).***

Total 20 Marks

Question 2

- a) Outline TWO (2) methods that have been suggested to determine if owner-control is present in a PLC. 4
- ***Berle had assumed owner-control was present if owners had a 20% shareholding in a public limited company (plc) (2 marks)***
 - ***Other research suggested that effective owner-control might be exercised with a shareholding of just 5%,if coalitions between shareholders could easily be formed (2 marks)***
- i) Explain the alternative control where owner-control is not present. 1
- ***Berle argued that where there was less than 20% accrued shareholding, manager control was in place (1 mark).***
- ii) Why would pension funds be interested in the effectiveness of the management of organisations? 1
- Pension funds are dependent for their income, at least in part, on their investments in company shares. The income from such investments is dependent upon the profitability of the companies concerned."***
- iii) Outline a consequence of the high levels of institutional ownership of a firm. 1
- High levels of institutional ownership increases the influence of owner objectives and the corresponding role of profit objectives in firm behaviour.***
- b) Explain whether short or long term profit maximisation is most important to a firm and support your view with evidence. 2
- ***Basic theory has suggested many firms may be willing to sacrifice short term profit in pursuit of long term profit (1 mark)***
 - ***Financial Times (1998) found 76 out of 77 Finance Directors of FTSE 100 companies prioritised the long term performance of their company rather than its short term performance (1 mark). Other evidence acceptable (1 mark).***

- c) Describe the correlation in the table below between executive pay and the performance of their companies. Comment whether research supports or contradicts this.

Rank	Sales Revenue Maximizers	Highest paid CEOs
1	ABC Motors	Top Bank Corporation
2	City Industrials	Internet Networks
3	Speedy Motors	Home Furnishings
4	Soft Chocs	Delphi Oracle
5	Cola Co	Worldwide Financials
6	Trendy Music	Cool Cosmetics
7	Worldwide Food Group	Global Auctions
8	Wellbeing Healthcare	First Educations
9	United Football Club	Global Drinks Inc
10	First Pharmaceuticals	Italian Goldmines

Award 2 marks for describing the correlation and up to 2 marks for commenting whether or not research supports or contradicts this.

- **Not one of the firms appearing in the lists of top 10 companies in terms of sales revenue growth also appear in the list of the highest paid CEOs (2 marks)**
- **Most research studies have found little if any link between remuneration of top managers and the profit/sales performance of their companies e.g. Storey (1995) found no relationship between the pay of top managers and their companies' ratio of average pre-tax profits to total assets (i.e. a form of rate of return or profitability measure)**
- **Similar results were obtained in studies of US companies.**
- **Other research acceptable (2 sources = 2 marks)**

- d) Why would firms run by managers be likely to maximise sales revenue rather than profit? 2

Baumol suggested this as top managers' salaries and other perks are dependent more on sales revenue than profit. (2 marks)

Marks
5

- e) Describe FIVE (5) findings identified by Conyon and Gregg (1994) relating to determinants of executive remuneration.
- ***Most strongly related to sales growth relative to competitors***
 - ***Only weakly related to long term shareholder returns***
 - ***Not at all related to short term accounting profit***
 - ***Some evidence also to suggest that executive remuneration in terms of shares has little effect in making profit a higher profile objective***
 - ***Growth in sales from takeovers was better rewarded than internally generated growth despite the former yielding less profitability***
 - ***Also a strong link seems to exist between firm size in terms of asset value and executive remuneration (1 mark each up to a maximum of 5)***

Total 20 Marks

Question 3

- a) Explain the use of barometric forecasting techniques and provide TWO (2) examples of leading indicators. 8
- ***These examine the relationships between causal or coincident events to predict future events (1 mark). This approach is based on the logic that key current developments can serve as a barometer of the future (1 mark). This approach assumes the key developments can be identified, measured and recorded as a statistical time series (1 mark). Leading indicators are an example of this approach. (1 mark)***
 - ***Common leading indicators of future changes in levels of economic activity include new building starts, new orders for machines, tools etc. Birth rates are a good leading indicator of the demand for primary school places 4 or 5 years later. Stock market indices are a useful precursor of a recession (award up to 2 marks for each example, to a maximum of 4 marks).***
- b) Identify and briefly explain FOUR (4) separate but related concepts of a market. 4
- ***Potential market - households or organisations which indicate some interest in the product, but by may not purchase, not all will have the necessary income and access to the product (1 mark)***
 - ***Available market - households or organisations which have the interest, necessary income and access to the product; rare to make sales to all of these (1 mark)***
 - ***Served market - households or organisations upon whom a firm decides to focus (1 mark)***
 - ***Penetrated market - households or organisations who actually buy the product (1 mark)***
- c) Explain the purpose of market surveys and highlight FOUR (4) important aspects of them. 6
- To determine customer perceptions and purchasing intentions (2 marks). Important aspects include:***
- ***Number of potential buyers and the related issue of how easy, cost effective etc. it is to get a representative unbiased sample for reliable findings***
 - ***Clarity of buyer intentions***
 - ***Willingness of buyers to disclose intentions***
 - ***Buyers' propensity to carry through on their intentions (1 mark for each aspect up to a maximum of 4 marks)***
- d) Highlight TWO (2) problems of using salesforce opinions. 2
- ***Lack of awareness of relevant issues by sales force***
 - ***Incentives to give inaccurate responses (1 mark for each)***

Total 20 Marks

Question 4

- a) Define what is meant by the term *Multinational Corporation* and give TWO (2) methods by which they can come about. 4
A company which owns or controls production or service facilities in a country other than its home country. (1 mark)
It does more than just export from its home country or license overseas production by others (1 mark)
Such overseas production facilities may be:
- ***Acquired via takeover (1 mark)***
 - ***Invested in from new (1 mark)***
- i) Outline TWO (2) ways of ranking multi-national corporations. 2
There are two main ways of ranking MNCs:
- ***The value of foreign assets they own or control (1 mark)***
 - ***Their trans-nationality index. (1 mark)***
- ii) Outline a general motive for a company to become a multi-national corporation. 2
A dominant motive is to generate greater or more secure long term profits, (1 mark) e.g. by strengthening market position. (1 mark)
- iii) Distinguish between TWO (2) types of orientation for multi-national corporations. 4
- ***Cost-oriented MNCs (1 mark) whose main motivation is to reduce costs (1 mark)***
 - ***Market-oriented MNCs (1 mark) whose main motivation is to move into new markets and increase sales (1 mark).***
- b) Outline THREE (3) enabling technologies for multinational corporations, give an example for each. 6
- ***Improved communications, e.g. cheap air travel, internet etc (2 marks)***
 - ***Globalisation of consumer markets, e.g. through TV and internet leading to convergence of tastes (2 marks)***
 - ***New organisational technologies, e.g. divisional organisational structures making managing complex global operations more feasible (2 marks)***
- c) Outline ONE (1) advantage and ONE (1) disadvantage of exporting rather than producing overseas. 2
Exporting allows a firm to concentrate production at home and reap economies of scale (1 mark)
However, it needs to bear the transport and tariff costs of exporting (1 mark)

Total 20 Marks

Question 5

a) Explain the following demand function 7

$$Q_d = f(P_o, P_s, Y_d, T, A, I)$$

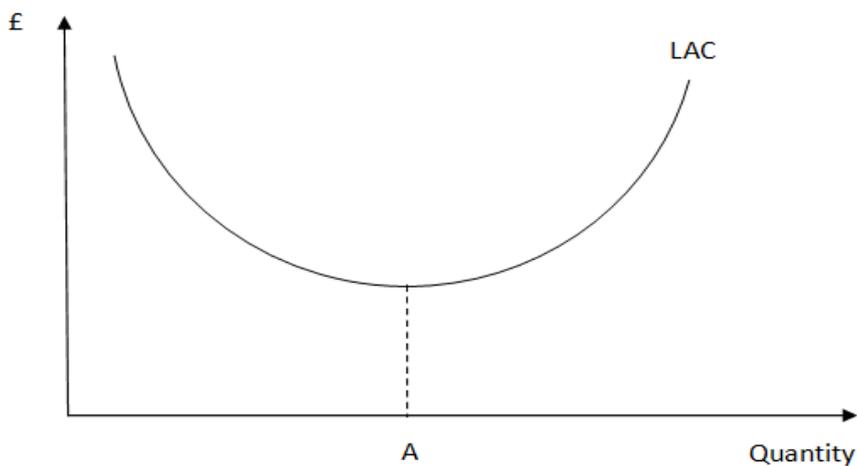
- ***Qd = Quantity demanded for product i is a function of (1 mark):***
- ***Po = Price of product (o) (1 mark)***
- ***Ps = Price of substitutes (1 mark)***
- ***Yd = Income (1 mark)***
- ***T = Tastes (1 mark)***
- ***I = Rates of Interest (1 mark)***
- ***A = Advertising (1 mark)***

i) Explain the concept of *diseconomies of scale*. 2

This reflects the belief that above a certain level of output for a single firm, managerial costs per unit of output are likely to rise.

ii) Draw and label a long run cost curve, which shows economies of scale 3

occurring up to a certain level of output, after which their effect is outweighed by diseconomies of scale.



- ***Curve (1 mark)***
- ***Labelled axis (1 mark)***
- ***Quantity axis (1 mark)***

iii) Identify what has been described as the simplest approach to estimating demand. 2

One can attempt to estimate price elasticity of demand along an arc of a demand curve (1 mark), by observing the response of demand to a price change and assuming that both readings of price and quantity combinations are on a single demand curve. (1 mark).

b) Outline SIX (6) factors that determine the intensity of rivalry within an industry.
Intensity of rivalry between existing firms in the industry is seen as being determined by:

- ***The rate of industry growth***
- ***The level of fixed costs in the industry***
- ***Patterns of capacity expansion***
- ***Product differentiation***
- ***Switching costs***
- ***Number of existing firms and their relative size***
- ***Diversity of existing firms***
- ***Corporate stakes***
- ***Size of exit barriers (any six, 1 mark each up to a maximum of 6 marks)***

Total 20 Marks

Question 6

- a) Explain the term externality, and distinguish between positive and negative externalities, using examples. 6
- **An externality is the cost or benefit that affects a party who did not choose to incur that cost or benefit. (2 marks)**
 - **Negative i.e. when an organisation imposes costs on others as a by-product of their activity e.g. pollution (2 marks)**
 - **Positive i.e. when an organisation imposes benefits on others as a by-product of their activity e.g. railways reducing road congestion and pollution (2 marks)**
- b) Using the concept of positive externalities make the case for public ownership. 4
- **Positive externalities can be used to make a case for public ownership as organisations which generate them are not rewarded by the market for doing so (2 marks)**
 - **Thus it is argued that firms producing positive externalities should be subsidised to encourage them to produce the amount of positive externalities that is best for society (2 marks)**
- c) Outline a reason for opposing private ownership of the means of production, distribution and exchange. 2
- It leads inequalities in society, resulting in unfair concentrations of wealth and power. (2 marks)**
- i) Outline two indirect strategies for privatising the public sector. 4
- **Restructuring of a public sector monopoly to allow competition where possible amongst privatised firms (2 marks)**
 - **The contracting out of public sector services to private firms is also a form of privatisation although normally the activity is subject to repeated rounds of tendering (and it is possible for the public sector producer to retain the service in the bidding process) (2 marks)**
- ii) Describe two supply side benefits of privatisation. 4
- **Privatisation leads to incentives for efficiency and provision of value for customers (2 marks)**
 - **Existence of profit motive - firm could go bankrupt as it does not receive government funds. Poor performance might lead to shareholders selling shares, reducing share price and making company vulnerable to takeover (2 marks)**
 - **Where competition could be introduced post privatisation, it acted as a stimulus to reduce costs and prices and maintain or increase quality to gain market share and profit from competitors (2 marks)**
 - **Such stimuli were argued to be likely to lead to more responsible behaviour by trade unions who had previously benefitted from working within public sector monopoly suppliers of necessity goods in many cases (2 marks) Any two benefits for a maximum of four marks.**

Total 20 Marks

End of paper

Learning Outcomes matrix

Question	Learning Outcomes assessed	Marker can differentiate between varying levels of achievement
1	1	Yes
2	1	Yes
3	3	Yes
4	2	Yes
5	3, 4	Yes
6	5	Yes

Grade descriptors

Learning Outcome	Pass	Merit	Distinction
Critically assess different approaches to the nature of the firm	Demonstrate an adequate awareness of issues associated with the subject and make some appropriate judgements; Demonstrate some sound critical skills	Demonstrate a sound awareness of issues associated with the subject and make consistently appropriate judgements; Demonstrate consistently sound critical skills	Demonstrate a detailed awareness of the complexity of issues associated with the subject and make highly appropriate judgements; Demonstrate highly developed critical skills
Critically examine the rationales for multi- national companies (MNCs) and the means by which they may emerge	Provide examination of the subject with some suitable examples and references; Demonstrate some sound critical skills	Provide detailed examination of the subject with adequate use of appropriate references and examples; Demonstrate consistently sound critical skills	Provide consistently critical and detailed examination of the subject with innovative use of highly appropriate references; Demonstrate highly developed critical skills

Grade descriptors continue on next page

Marks

Critically assess techniques available for demand and cost estimation and the analysis of competitive structure	Demonstrate an adequate awareness of issues associated with the subject and make some appropriate judgements; Demonstrate some sound critical skills	Demonstrate a sound awareness of issues associated with the subject and make consistently appropriate judgements; Demonstrate consistently sound critical skills	Demonstrate a detailed awareness of the complexity of issues associated with the subject and make highly appropriate judgements; Demonstrate highly developed critical skills
Critically assess techniques available for dealing with risk and uncertainty	Demonstrate an adequate awareness of issues associated with the subject and make some appropriate judgements; Demonstrate some sound critical skills	Demonstrate a sound awareness of issues associated with the subject and make consistently appropriate judgements; Demonstrate consistently sound critical skills	Demonstrate a detailed awareness of the complexity of issues associated with the subject and make highly appropriate judgements; Demonstrate highly developed critical skills
Critically assess the arguments for privatisation and regulation	Demonstrate an adequate awareness of issues associated with the subject and make some appropriate judgements; Demonstrate some sound critical skills	Demonstrate a sound awareness of issues associated with the subject and make consistently appropriate judgements; Demonstrate consistently sound critical skills	Demonstrate a detailed awareness of the complexity of issues associated with the subject and make highly appropriate judgements; Demonstrate highly developed critical skills