# Suggested Answer – CSQ 1

### With reference to Table 1, compare the change in market value of the different UK food retailers between 2018 and 2023. [2]

* + All food retailers are expected to see an increase in market value [1], with the market value of online retailers and discounters expected to increase by a larger magnitude compared to that of hypermarkets and supermarkets [1].

### Using a relevant elasticity concept, explain why “Aldi has sought to open hundreds of new shops” during the recession. [2]

* + Aldi is a budget supermarket which sells mainly sells canned food and value-for money products [0.5]. During the recession where income is falling, there will be a rise in demand for Aldi’s products [0.5] since they are perceived to be inferior goods (YED < 0) [0.5] compared to its rivals. As such, Aldi opened up more stores to cope with the expected rise in demand for its products, which may possibly lead to a rise in their total revenue [0.5].

### Explain how “peak time” pricing qualifies as a form of price discrimination. [4]

* + Price discrimination is defined as charging different consumers different prices for the same product not due to cost differences. Under the “peak time” pricing, price of items rise when demand is high and fall when demand is low.
  + This is a form of 3rd degree price discrimination as it satisfy all the 3 conditions needed for price discrimination to be carried out [0.5].
  + The different prices are not due to cost differences. This is because no matter the time that the product is being sold, the cost incurred by the supermarket such as labour costs, rental, and utilities is the same [1].
  + The supermarket owners are able to segment the market according to their PED whereby during peak time, the demand for certain items tend to be higher and more price inelastic compared to off-peak. For example, there is a lack of close substitutes for chilled food and drink items during heatwaves [1.5].
  + As the supermarkets operate in an oligopoly, each firm has the ability to set prices due to the market power which they possess [0.5].
  + Furthermore, as items such as ice-cream, ready-to-eat sushi, and yogurt have a very specific shelf-life or best-before-date beyond which they lose their freshness, consumers who bought them at a lower price cannot successfully resell these items to other consumers for consumption at a later time. Supermarkets are thus able to prevent resale of such perishable items by the consumer [0.5].

### Extract 3 mentions about the merger between Asda and Sainsbury. Explain how this might affect consumer welfare. [4]

Positive impact on consumer welfare

1. Given fewer retailers in the market and the possibility of Sainsbury-Asda accounting for a sizeable ‘60% of the market in the future’, the merger between Sainsbury and Asda may result in the merged firm operating on an even larger scale. Thus, there is a potential for even greater economies of scale (EOS) to be reaped [0.5]. Provided Sainsbury-Asda passes on the cost-savings to consumers [0.5], this could translate into lower prices for consumers [0.5], thereby increasing consumer surplus and thus, increasing consumer welfare [0.5].
2. With the merger and resulting larger market share, the firm may enjoy more profits [0.5]. If the firm chooses to plough back some profits to carry out research and development (R&D) or to innovate [0.5], for example, coming up with better products, automating production processes to improve productivity etc., this may translate either to lower prices or better- quality products, thereby offering consumers more choices [0.5]. If so, this improves consumer welfare [0.5].

Negative impact on consumer welfare

1. The merger between Sainsbury and Asda will likely reduce the degree of competition in the market [0.5]. With the resulting larger market share, the firm has greater market power [0.5] to dictate prices or restrict output to keep prices at a certain level [0.5]. If this leads to higher prices or artificially restricted quantity of goods/ services, then consumer welfare will be adversely affected [0.5].
2. Alternatively, the reduction in competition amongst firms [0.5] may cause the firm to be less committed to keeping costs under control or do less R&D than desired [0.5]. If this leads to higher prices or lack of improvement of service/ product quality [0.5], then consumer welfare will be adversely affected [0.5].

### While supermarkets such as Sainsbury have invested heavily in their online business, discounters such as Aldi have chosen to ignore it.

**Discuss whether Aldi should follow the example of Sainsbury and venture online. [8]**

Whether Aldi should follow the example of Sainsbury and venture online depends on whether the benefits of venturing online outweighs the costs incurred.

### Thesis: Yes, Aldi should follow Sainsbury and venture online

Venturing online will enable Aldi to increase its total revenue due to the rising demand for online grocery shopping. As seen from Extract 5, “online grocery sales have skyrocketed, with the United Kingdom forecasted to become the second largest online grocery market worldwide”. Due to the rising “convenience and speed” of online grocery shopping, there is a change in taste and preference of consumers towards online grocery shopping. Venturing online will allow Aldi to tap on more consumers, possibly increasing their total revenue and hence profits, assuming no change in cost. Furthermore, Extract 5 highlighted that number of online grocery retailers has increased so with these new firms entering the market to compete for market share, it seems more of a necessity rather than by choice that Aldi has to venture online to better capture more consumers or to at least protect their market share.

Venturing online will also possibly enable Aldi to lower its average cost due its ability to reap greater internal economies of scale. As a retailer of groceries, Aldi will be able to buy the groceries from the manufacturers at a larger scale (to cater to both physical and online stores), giving them stronger bargaining power and hence obtaining the groceries at a greater discount. The lowering of average cost, assuming no change in revenue, will increase profits for Aldi.

### Anti-thesis: No, Aldi should not follow Sainsbury and venture online

As seen from Extract 4, “Tesco, Sainsbury and others have spent hundreds of millions of pounds on sophisticated internet operations” and that “profit margins in the supermarket business are notoriously low, but even lower online”. Venturing online requires substantial cost outlay e.g. cost of setting up online platform, maintaining it as well as owning a fleet of vans for delivery as seen from Extract 4. If Aldi cannot recover these back in the form of higher total revenue, their profits may fall. In addition, the increase in total revenue from online sales may not be significant, judging from Extract 4 which states that online sales may cannibalize sales at physical stores. This could simply be a case where total revenue earned from one area is simply transferred to another, resulting in no additional net increase in total revenue at all.

*However in the long run due to advancement in technology, cost of venturing online can be lowered and Aldi would be able to make use of the cheaper technology to provide online platforms for consumers too. This can make venturing online more profitable for Aldi.*

Furthermore Aldi’s has been recognised as a discounter, they need to keep cost low and continue to promote itself as a budget supermarket to the consumers. Maintaining both online and physical stores may be too costly which may end up causing them to have to raise the price of their goods in order to earn sufficient profits. This can cause Aldi to lose its ability to maintain as a budget supermarket.

Besides going online, Extract 4 has also highlighted that Aldi has adopted other ways to attract more consumers e.g. focusing on quality so that they can tap on the middle class shoppers and revamping physical stores to attract more consumers. Thus Aldi need not necessarily tap on the online shoppers.

### In view of the market structure of the UK supermarket industry, discuss why non-price competition strategies are preferred over price competition strategies. [10]

**Introduction – Identify correct market structure and justify [1m]**

The different supermarket firms, Sainsbury, Tesco, Aldi and Lidl each control a significant portion of the market, thus, it can be said that they operate in an oligopoly. This is evident from Extract 1, where it states that the retailers are part of the “big four” supermarkets. Extract 3 also states that the supermarkets each control about 30% of the market share. In an oligopoly, the decisions of one firm affects its competitors, leading to mutual interdependence and rival consciousness.

### Explain why price competition is NOT preferred. [3m]

As mentioned in Extract 1, price competition only leads firms to suffer a loss of profits, especially if undertaken for an excessive period of time as **there is no advantage or disadvantage for the firms in this oligopolistic market structure to change price**. When Aldi tried to undercut the prices of the big four supermarkets to obtain a greater market share, it is likely that the other firms would follow suit to some extent. This is because if they do not do so, they may lose a significant share of the market as consumers switch over to consuming products from Aldi. In this case, although, due to the law of demand, there may be a rise in quantity demanded for Aldi’s products. However, the increase may be less than proportionate due to the retaliatory actions from its rivals, thus, total revenue will not increase, instead, it would fall.

Conversely, if Aldi were to raise prices, other firms will not follow. This means that the firm may suffer a more than proportionate fall in quantity demanded, leading to a fall in total revenue. Taken together, this means that there is no incentive for firms to raise or lower prices to bring about a rise in total revenue. Thus, price competition is not preferred – prices may be rigid in such a market structure.

Moreover, there is a limit to how low prices can go as each firm must price above average cost to avoid earning subnormal profits**. In the short run, the firms may reduce prices below average cost as part of a price competition strategy, but it will be unsustainable in the long run, especially so if the firms do not have sufficient financial reserves**.

That being said, some firms may resort to price competition once in a while, as part of promotional gimmicks or only for certain items which they feel may have a relatively more price elastic demand. Price competition in such situations may seem acceptable as the firm may enjoy temporary increase in quantity demanded and possibly total revenue. During these times, other firms are recommended not to undercut each other, but instead, wait it out before they make changes to their pricing.

### Explain why non-price competition is preferred. [3m]

Thus, oligopolists tend to prefer non-price competition. Non-price competition offers an avenue for the firms to differentiate themselves from their rivals, increasing their market power and increasing their ability to increase prices without a substantial fall in quantity demanded. **This is because with an increase in product differentiation, consumers will be less likely to switch to rival firms with an increase in price. This can be done through enhancing the shopping experience as attempted by Aldi in Extract 4, where they revamped their stores.** This is a form of product development, the product being the retail experience, where Aldi sought to reinvent the layout of the stores. This will make the demand for its products more price inelastic.

Similarly, the strategy by supermarkets to offer online shopping is also a form of non-price competition which increases the convenience for consumers. In Extract 5, **it can be seen that more and more consumers are completing their shopping on their smartphones and tablets. It also helps the firm to reach out to more consumers, consumers that would avoid retail shopping altogether and only do online shopping. This would lead to an increase in demand**. These strategies would enable the firm to increase prices without suffering a fall in total revenue.

Other forms of competition

### Evaluation and Synthesis [3m]

Essentially, **price competition is a lose-lose situation**. Price wars can be very costly for all producers involved, and usually when prices are lowered, consumers would expect them to stay low, leaving little opportunity for producers to regain profit in the long run.

On the other hand, non-price competition **may bring about innovation and additional consumer choice, leading to a net increase in societal welfare**. Firms have more options to choose from when pursuing non-price competition. In the case of supermarkets, the extracts have shown them trying ideas such as revamping their stores, changing the product offerings, and even offering online shopping and delivery.

Ultimately the firm should consider the costs and benefits of each strategy before embarking on it, and although non-price competition is preferred, its costs and benefits are likely to be harder to estimate.

**g) Explain how a successful advertising campaign will help Aldi raise its profit but may not be able to sustain the profit level in the long run. (10)**

**h) Explain and evaluate how society can raise their welfare when the government intervenes to minimize market power of the firms to attain economic efficiency. (10)**