**HCI CSQ 2021 –**

B (ii) Using a diagram, explain how ‘undercutting Amazon sellers’ membership fees to attract vendors’ by Alibaba (extract 2) is likely to affect Amazon’s profit in the Europe market. (4)

Structure of discussion:

1. Economic causation – apply economic principles to the context of the question

2. Draw diagram

3. Description of diagram

4. Analysis

Suggested Answer:

1. Economic Causation

Reduction in Alibaba seller’ membership fees is a price strategy that will undermine Amazon as there will be a high degree of market competition for Amazon. As a result, this would decrease the market demand for Amazon, and this would cause a fall in total revenue. The market competition would also mean a higher degree of substitution, contributing to the demand curve to be more price elastic. Consequently, the production equilibrium changes and this would cause a fall profit as the revenue falls and the cost condition is held constant.

2. Draw diagram

As seen from the diagram, the Amazon is producing at the output level at Qm based on profit maximization rule based on MR equals to MC as it is making supernormal profit at this level as the price is at Po and output is at Q1. The act of Alibaba causes an increase in market competition and this would shift the MRo and ARo to MR1 and AR1 as the degree of substitution has increased. This will cause the shift in production equilibrium where the price and output level changes from Po and Qo to P1 and Q1. Consequently, Amazon’s profit falls from supernormal profit to normal profit.

**Other ways on how the question is asked:**

**Using a diagram, explain why the firm justifies its actions to increase production in the oil industry.**