

Edexcel (B) Economics A-level
**Theme 2: The Wider Economic
Environment**

**2.1 Business Growth and Competitive
Advantage**

2.1.4 How the digital economy affects markets and firms

Notes

Market information in the digital economy:

○ **Price comparison sites**

Price comparison sites have helped to increase the quantity of knowledge consumers have about a good or service. This has helped to reduce some of the asymmetry of information between consumers and suppliers. For example, consumers can make comparisons on an independent website between suppliers of insurance policies, so they know exactly what else is available on the market and whether they are getting the best deal or not.

○ **Viral marketing and social media**

This is a method of marketing where firms cause viewers of a promotion to share it with friends. This creates a campaign for the firm which might end up going viral via email, social media or text.

Firms can use platforms such as Facebook and Twitter to promote their products, increase awareness of their brand and increase sales. This can also serve as a way to get feedback from customers for what a firm should do next in terms of improving their products. Other platforms, such as LinkedIn can be used as a way of creating contacts around the world.

The supply-side:

○ **Micromarketing**

Micromarketing contrasts mass marketing and it can be associated with e-commerce. This is where advertising is focussed on a small group of consumers. For example, users of social media are likely to have been in the target audience of micromarketing. It includes special offers and voucher codes, which are aimed towards individuals.

○ **Online retailing and online distribution**

Large online stores such as Amazon, Asos and eBay are good examples of online retailing.

Since online retailing has become so widespread, there has been an increase in demand for staff with digital skills. This could cause a problem for some firms, since there could be a skills shortage, and it could be expensive for businesses to train staff.

The demand-side:

- **Satisfying consumers with the long tail and wider geographical markets**

The long tail theory suggests that consumers get a wider choice with online retailing. Firms can gain revenue by selling a wider range of products, but fewer of each, rather than more of a narrower range of products.

The long tail describes how firms sell a large number of niche products, which satisfy individual consumer's needs, but only a small quantity of each product. Examples of businesses applying this include Amazon and Apple.

When the costs of storing and distributing a product are high, only the most popular products can be sold. However, when the costs are low, which is particularly the case for online retailers, a wider range of products, including the more unpopular items, can be stocked.

Online retailing grants firms the potential to access the worldwide market, and it gives consumers the potential to choose from the worldwide market.

The costs of production and distribution are low and falling, particularly online. Businesses are not restricted by the physical space available in a shop or the costs involved with a shop.

Small firms might supply niche products, such as The Cambridge Satchel Company. They might be able to access a wider geographical market by selling online rather than in a physical shop.

Impact on markets and firms:

- **Impact on costs, prices, profit and loss; Firm creation and destruction in a new business environment**

The increasing popularity of the digital economy has affected how consumers access and consume products. It has also influenced the price and choice that consumers get.

The digital economy has been blamed for the loss of famous brands, such as Blockbuster, Peacocks, Comet and Virgin.

Technological change can result in improvements in efficiency and productivity, which could lower costs of production for firms. The quality and quantity of goods and services produced might develop.

For example, mobile phones have become cheaper to produce, which is why their price has fallen. More importantly, their quality has improved significantly. This is due to improvements in technology.

Technological change can lead to the development of new products, the development of new markets and may destroy existing markets. For example, the development of DVDs, then blu-rays, and now the rise of downloadable films, has essentially destroyed the market for VHS video tapes. This is one of the contributing factors towards Blockbuster's disappearance from the market. Consumers started renting films online rather than as a physical disk, so Blockbuster lost sales.

The digital economy has opened up existing markets to new competition. On one hand, this opens up firms to new opportunities, more sales and higher profitability. On the other hand, some firms have faces falling profits, they have struggled to compete and they face failure. It can be argued that the process of creative destruction has been accelerated.