

Exercise walk-through

5.1

Firms, costs, growth and competition

Pearson Edexcel · International A-Level · Economics

1

The method

Method — Worked example

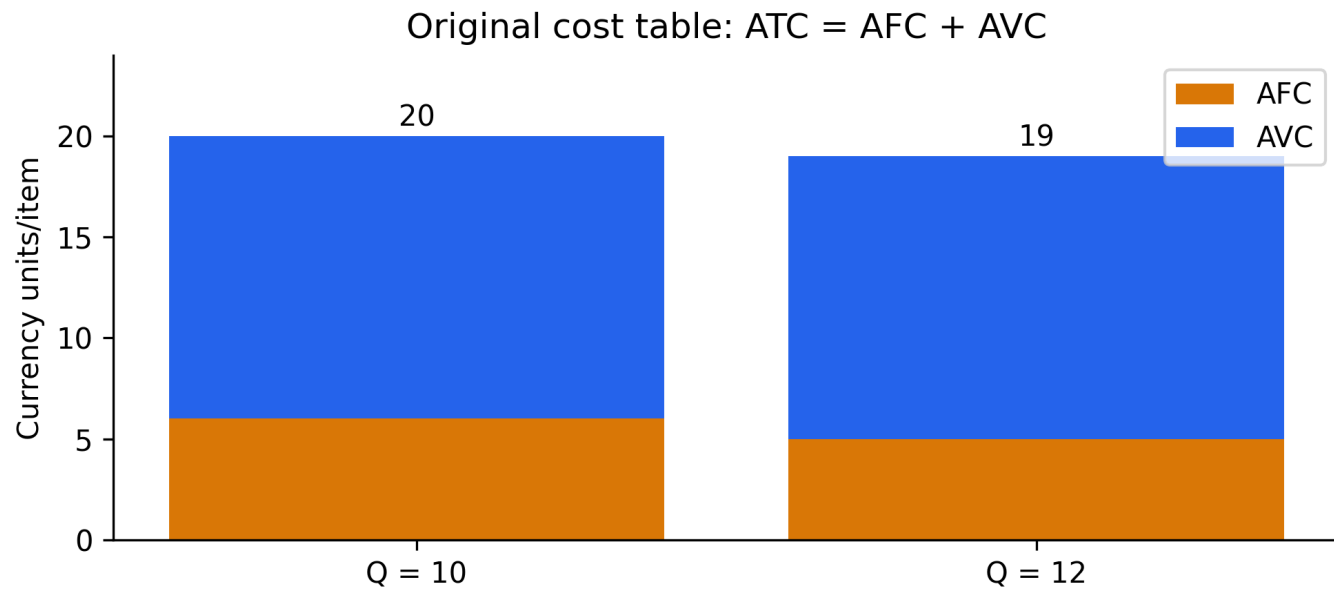
Total, average and marginal measures answer different questions. Profit=total revenue—total cost. Additional output is justified in a profit-maximizing model by incremental revenue and cost, subject to relevant conditions; higher sales do not guarantee higher profit. Size, ownership and integration affect finance, control, risk and coordination. Market power and contestability require evidence about alternatives and entry, not firm size alone.

In an original short-run table, fixed cost is 60 currency units. At $Q=10$ items, variable cost is 140; at $Q=12$, variable cost is 168. Calculate costs and interpret the change. $TC=TFC+TVC$; TC at 10=60+140=200 units. $ATC=TC/Q$; ATC at 10=200/10=20 units/item. At 12, $TC=60+168=228$ units and $ATC=228/12=19$ units/item. Interval $MC=\Delta TC/\Delta Q=(228-200)/(12-10)=14$ units/item.

$AVC=TVC/Q=140/10=168/12=14$ units/item. AFC falls from $60/10=6$ to $60/12=5$ units/item, lowering ATC . These are table intervals, not a claim about a smooth derivative or all output levels. Productivity and profit need their own measures.

Method — Worked example

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Exercises 2.1·3.1

2.1 For the worked case, state the method, show its application and give a limitation.[3]

3.1 A firm expands through acquisition and lowers unit costs but loses customers after quality problems. Evaluate growth rather than assuming economies of scale guarantee success. [3]

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2.1 $TC = TFC + TVC$; TC at 10 = $60 + 140 = 200$ units. $ATC = TC/Q$; ATC at 10 = $200/10 = 20$ units/item. At 12, $TC = 60 + 168 = 228$ units and $ATC = 228/12 = 19$ units/item. Interval $MC = \Delta TC / \Delta Q = (228 - 200) / (12 - 10) = 14$ units/item. $AVC = TVC/Q = 140/10 = 168/12 = 14$ units/item. AFC falls from $60/10 = 6$ to $60/12 = 5$ units/item, lowering ATC . These are table intervals, not a claim about a smooth derivative or all output levels. Productivity and profit need their own measures. Authored points for method, application and relevant qualification.

3.1 A firm expands through acquisition and lowers unit costs but loses customers after quality problems. Evaluate growth rather than assuming economies of scale guarantee success. [3]

3.1 Lower long-run average cost can improve competitiveness, but revenue depends on demand and quality. Acquisition can add finance, capacity and coordination risks; integration does not automatically improve management. Compare margins, quality, customer response, entry barriers and alternative organic growth. A small niche firm may rationally remain small. Supported IAL WEC13 targets in this topic are reused; its six still-unsupported objectives and all remaining IA2 gaps stay held, rather than being inferred from this case. Authored points for judgement, case-linked reasoning and justified qualification. Accept supported alternatives.