

Exercise walk-through

3.5

Firms and production

IGCSE Economics

Firms and integration

Original bakery cases: classify before revealing

A bakery joins (A) another bakery, (B) its flour mill, (C) shops selling its bread, or (D) a clothing producer. Which kind of integration is each?

Firms and integration – worked reasoning

Partner	Classification	Possible benefit and limit
Another bakery	Horizontal	Bulk buying may lower cost; fewer rivals may reduce choice.
Flour mill	Backward vertical	More control of flour supply; managing milling may be difficult.
Bread shops	Forward vertical	Control of outlets; retailing requires different skills.
Clothing producer	Conglomerate	Spreads risk across industries; neither business is guaranteed success.

Classify the relationship between businesses, then explain a benefit. A merger joins firms; a takeover gives one firm control of another.

Three kinds of merger

Horizontal merger

A **horizontal merger** : two firms at the same stage of the same industry – market share, and economies of scale.

Vertical merger

A **vertical merger** : a supplier or a customer – securing an input, or a route to market.

Conglomerate merger

A **conglomerate merger** : unrelated industries, joined to spread risk.

Barriers to entry

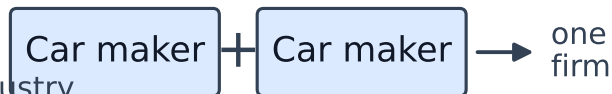
Barriers to entry – high set-up costs, patents, brand loyalty – can protect a firm from new rivals; gains from a merger are not guaranteed.

A firm's **objectives** are not only profit: **growth** , **survival** and market share each justify a different merger.

Firms and integration, in detail

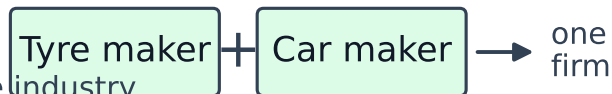
Horizontal

same stage, same industry



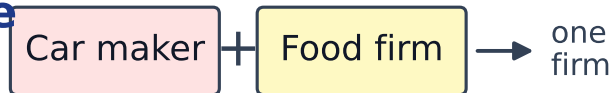
Vertical

different stages, same industry



Conglomerate

different industries



Exam: horizontal = same stage; vertical = supply chain; conglomerate = different industries

Firms grow by joining together:

horizontal – two firms at the **same** stage of one industry.

vertical – **different** stages of the same industry.

conglomerate – **different** industries altogether.

Business failure

Original case: a small bakery

Its monthly sales revenue is £4,000 and production costs are £4,500. It also owes a £2,000 equipment payment tomorrow, but has only £300 cash available and no agreed loan.

Diagnose first: Which facts show a loss? Which show a cash problem?

Exercises 2.1-2.3

2.1 State the difference between labour-intensive and capital-intensive production. [2]

2.2 Define the term *productivity*. [2]

2.3 Define the term *economies of scale*. [2]

Exercises 2.1-2.3

2.1 State the difference between labour-intensive and capital-intensive production. [2]

2.1

- **labour-intensive** uses mostly labour; **capital-intensive** uses mostly machines (K)
-

2.2 Define the term *productivity*. [2]

2.2

- **productivity** is **output per worker** (or per machine) in a set time (K)
-

2.3 Define the term *economies of scale*. [2]

2.3

- **economies of scale** are the fall in **average cost per unit** as a firm increases its output (K)

Exercises 3.1-3.2

3.1 Economies of scale mean that, as a firm produces more, its:

[1]

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A average cost per unit falls

B average cost per unit rises

C total cost falls

D revenue falls

3.2 Explain two ways a firm could raise its productivity.

[4]

Exercises 3.1-3.2

3.1 Economies of scale mean that, as a firm produces more, its:

[1]

☐

A average cost per unit falls

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C total cost falls

D revenue falls

3.1 A

- economies of scale mean **average cost per unit falls** (K)
- B is diseconomies; C confuses total with average; D is not the definition

3.2 Explain two ways a firm could raise its productivity.

[4]

3.2

- for **each** of two ways: $K + A_n$
- e.g. **training**: skilled workers make more and fewer mistakes → output per worker rises
- e.g. **better machines**: modern equipment does more in the same time → output per worker rises

Exercise 3.3

3.3 Analyse why a firm's average cost may fall and then rise as it grows larger. [6]

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3.3

- as a firm grows it gains **economies of scale**: bulk buying, large machines, cheaper borrowing → average cost **falls** ($K + A_n$)
- if it grows too large, **diseconomies of scale** set in: hard to manage, slow messages, workers feel less important (A_n)
- average cost **rises again** – there is a lowest-cost size (A_n)