

Exercise walk-through

3.6

Firms' costs, revenue and objectives

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

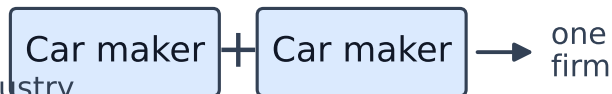
Barriers to entry – high set-up costs, patents, brand loyalty – can protect a firm from new rivals; gains from a merger are not guaranteed.

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

Firms and integration, in detail

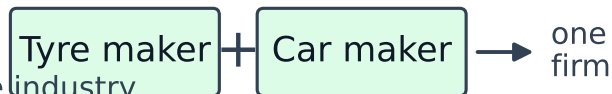
Horizontal

same stage, same industry



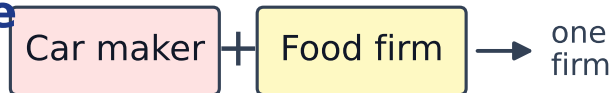
Vertical

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 a *fixed* and a *variable* cost. [2]

2.2 A firm sells 500 units at \$8 each. Calculate its total revenue. [2]

2.3 State the formula for *profit*. [1]

Exercises 2.1·2.3

2.1 State the difference between a *fixed* and a *variable* cost. [2]

2.1

- a **fixed cost** does not change with output (rent); a **variable cost** changes with output (materials) (K)

2.2 A firm sells 500 units at \$8 each. Calculate its total revenue. [2]

2.2

- total revenue = price $\times$ quantity

$$500 \times \$8 = \$4000$$

(K)

2.3 State the formula for *profit*. [1]

2.3

- **profit** = total revenue – total cost (K)

Exercises 3.1·3.2

3.1 A firm has total revenue of \$10,000 and total cost of \$7,000. Its profit is: [1]

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A \$3,000

B \$7,000

C \$10,000

D \$17,000

3.2 Explain why a new firm might aim for **survival** rather than maximum profit. [4]

Exercises 3.1·3.2

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A \$3,000

B \$7,000

C \$10,000

D \$17,000

3.1 A

- profit = \$10,000 – \$7,000 = **\$3000** (K)
- B is total cost; C is total revenue; D added the two

3.2 Explain why a new firm might aim for **survival** rather than maximum profit. [4]

3.2

- a new firm is still building customers and may make **losses** at first (K)
- it has little cash and many rivals, so its first aim is to **stay open** (An)
- once established, it can aim for profit and growth (An)

Exercise 3.3

3.3 Analyse how a firm could increase its profit.

[6]

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[6]

3.3

- profit = revenue – cost, so raise **revenue** (sell more, or raise the price if demand is inelastic) **or** cut **costs** (K)
- raising the price too far may lose sales if demand is elastic; cutting costs too far may harm quality (An)
- the best route **depends on the market** (An)