5 Business in the Market Economy

Multiple Choice Answers

1	C	**6**	D	**11**	D
2	D	**7**	B	**12**	D
3	B	**8**	C	**13**	A
4	C	**9**	C	**14**	B
5	A	**10**	A	**15**	B

Short Answer Questions

Question 1

(a) Manucorp's productivity has deteriorated from year one to year two.

(b) Manucorp has not achieved economies of scale.

(c) Production refers to the total amount of goods and services produced, whereas productivity is the amount produced with a given quantity of resources, per unit of time.

(d) Firms can increase productivity through specialisation of its resources. Firstly, labour can be specialised by separating the production process into a series of sub-processes, so workers can specialise in a particular part of production. Secondly, many firms in the same industry can situate themselves close to one another in order to share common infrastructure requirements. This is called specialisation of natural resources. A firm could also increase its scale of production, allowing it to use specialised capital equipment.

(e) In the short term, increased productivity of labour may mean that firms will have less need for more workers, and the employment level will not rise. However as firms begin to see larger increases in production due to higher productivity, they may hire more workers, increasing employment. If however capital productivity rises, firms may substitute capital for labour, lowering the employment level.

Question 2

(a) Satisficing behaviour is when a firm seeks a balanced outcome of all its goals without attempting to maximise one particular goal. This is generally undertaken by established firms in a stable industry.

(b) A correct answer may include any two of the following:

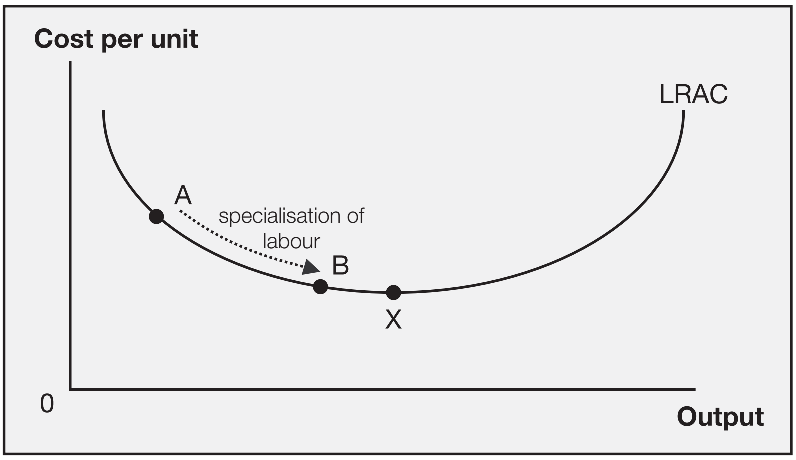
- A firm may raise its prices to receive more revenue from its sales, increasing profits.
- A firm may try to lower its costs of production, while keeping prices constant, allowing it to make a higher profit.
- A firm may try to increase its market share to sell more units. Profit per unit may remain the same, but total profit will rise.

(c) A firm may decide to specialise its production to use its factors of production more efficiently, and increase its output at a lower price. Specialisation firstly allows a firm to divide its labour more efficiently, and increase its scale of production, allowing for specialised capital equipment. This will lower business costs and result in higher profits. Specialisation also allows the firm to increase its output volumes, which can allow the firm to increase its market share.

(d) Technological change will generally result in lower prices in the economy. Technology firstly results in more efficient capital, allowing firms to lower prices, but also improvements in information communication technology will increase price information available to consumers, increasing the competition between firms and forcing prices down. New technologies can have a mixed impact on employment. Specialised skills are usually required to operate new technology, creating new jobs. However new technologies can make some jobs redundant as firms substitute more efficient capital for labour.

Question 3

(a) and **(b)**



(c) Internal economies of scale are cost saving advantages which result from the firm expanding the scale of its production, whereas external economies of scale are cost saving advantages resulting from positive outside influences, not the firm's own actions.

(d) A firm must firstly decide what to produce, and decides this based on the level of demand and competition in the industry, as well as its own factors of production. A firm then must decide how much to produce, based on demand and the scale of its production. Finally, firms must decide how to produce the product, which determines how the firm organises its factors of production.

(e) Advertising will communicate a firm's prices and product details to consumers. This may allow a firm to increase its market share through increased exposure to consumers. Advertising can also compromise consumer sovereignty, creating an additional desire to purchase the firm's products, also increasing market share. Advertising, however, can be a significant cost of a business, and if it is not effective at raising market share, the increased cost may harm the firm's profits. Finally, if the firm wishes to simply maintain its market share, through satisficing behaviour, it may be forced to advertise in response to heavy advertising from competitors to ensure that its product is still exposed to consumers.

Skills Revision

The classifications on page 53 should appear in the following order

1 Internal economies of scale

2 External diseconomies of scale

3 External economies of scale

4 External economies of scale

5 External diseconomies of scale

6 Internal diseconomies of scale

7 External economies of scale

8 Internal diseconomies of scale

9 Internal economies of scale

10 Internal diseconomies of scale

11 Internal economies of scale

12 Internal diseconomies of scale

13 Internal economies of scale

14 External diseconomies of scale