**Economics Essays – Chapter 5 – The private firm as producer and employer**

**Part A – Types of Businesses**

**Essay Question 1**

(a) Describe the main features of (i) a co-operative and (ii) a public corporation. [4]

(b) Firms can grow large through integration. Explain, with the aid of examples, the difference between horizontal and vertical integration. [4]

**Essay Question 2**

There is a wide variety of different types of business organisation operating in South Africa, including co-operatives, public limited companies and public corporations. Some of the companies are monopolies.

(a) (i) Identify two features of a co-operative. [2]

(ii) Give examples of two types of co-operative. [2]

(b) Explain the differences between a public limited company and a public corporation. [6]

**Essay Question 3**

Partnerships are owned by only two people while public companies are owned by the government. Explain whether the above definitions are correct. [4]

**Essay Question 4**

Firms can vary greatly in size from a sole proprietor to a very large monopoly.

(a) Describe the advantages and disadvantages of a sole proprietor business organisation. [4]

**Essay Question 5**

Car production is an important economic activity in many countries. Much of this production is undertaken by large multinational companies. These firms aim to increase both productivity and production.

Describe two reasons why car production is usually undertaken by large multinational companies. [4]

**Essay Question 1**

**(a) Describe the main features of (i) a co-operative and (ii) a public corporation. [4]**

Main features of a co-operative:

* it is owned by the workers/customers
* it is run for the benefit of the workers/members
* the workers/customers are often shareholders in the business
* equal voting for members
* sharing resources
* reference to limited liability

Main features of a public corporation:

* it is a state-owned public enterprise/nationalised industry
* it is accountable to a government
* there are no shareholders
* may act in the public interest

**(b) Firms can grow large through integration. Explain, with the aid of examples, the difference between horizontal and vertical integration. [4]**

Horizontal integration:

* two (or more) firms come together that are producing similar goods/services at the same stage of production.
* Examples could include banks, motor car manufacturers, breweries.

Vertical integration:

* Two (or more) firms come together that are at different stages of production.
* There could be forward vertical integration where a firm takes over another firm at a later stage of production e.g. an airline taking over a travel agency or a brewery taking over a public house.
* There could be backward vertical integration where a firm takes over another firm at an earlier stage of production to secure supplies, e.g. a tyre company taking over a rubber plantation or a brewery taking over hop fields.

**Essay Question 2**

**There is a wide variety of different types of business organisation operating in South Africa, including co-operatives, public limited companies and public corporations. Some of the companies are monopolies.**

**(a) (i) Identify two features of a co-operative. [2]**

* owned and controlled by members
* each member has an equal share in this: one member, one vote

**(ii) Give examples of two types of co-operative. [2]**

* producer
* worker
* farming
* consumer/retail
* banking/financial
* insurance

**(b) Explain the differences between a public limited company and a public corporation. [6]**

A public limited company:

* part of the private sector
* companies exist to make profit
* controlled by shareholders
* has limited liability

A public corporation:

* part of the public sector
* may make a profit, but not necessarily the main aim
* may have objective to serve public/community interest in one way
* controlled by the state/government.

**Essay Question 3**

**Partnerships are owned by only two people while public companies are owned by the government. Explain whether the above definitions are correct. [4]**

Incorrect.

Partnerships are not necessarily two people, they may consist of all the people working in the organisation.

Public companies are not owned by the government.

Public companies issue shares and are owned by the private sector.

**Essay Question 4**

**Firms can vary greatly in size from a sole proprietor to a very large monopoly.**

**(a) Describe the advantages and disadvantages of a sole proprietor business organisation. [4]**

Advantages

* owner is in complete control/takes all the important decisions
* quick to make decisions/flexible
* easy to set up/low start-up costs/no complicated paperwork
* all profits go to the sole trader
* personal contact with customers/workers

Disadvantages

* owner does not have the legal protection of limited liability/the debt is unlimited
* owner may have to work long hours
* expansion can be very difficult due to lack of finance
* lack of continuity
* success may be limited by lack of skills of owner/poor health of owner

**(b) Explain the different goals that such a business organisation might have. [5]**

* profit maximisation –trying to earn as much profit as possible
* profit satisfying – keeping shareholders happy whilst pursuing some other goals/no shareholders to satisfy if sole proprietor
* survival – especially during periods of low demand/recession
* sales revenue maximisation – can make it easier to raise revenue/sell in bulk
* growth increase pay of managers/increase market power
* ethical/community reputation create a good image which can attract consumers
* providing high quality goods and services to retain customer satisfaction

**(c) Analyse two reasons for the different sizes of firms in an economy. [4]**

* size of market/extent of demand if there is a large demand, the firm is likely to be large some firms are small because they are supplying a niche market
* capital to finance expansion some firms may find it easier to borrow from banks or sell shares
* type of business organisation , e.g. sole trader v public limited company
* preference of owner an owner may not want the stress of running a larger company
* age of the firms - firms tend to start relatively small

**Part B – Factors of Production & Economies of Scale**

**Essay Question 1**

(a) Explain why small firms continue to exist in most economies. [4]

(b) Discuss whether firms always benefit from growing larger. [8]

**Essay Question 2**

In Brazil, firms vary in size from the very small to the very large.

(a) Describe the main characteristics of a multi-national company. [4]

(b) Explain the reasons why small firms continue to exist in all economies. [6]

**Essay Question 3**

In the same industry there are often firms of different sizes. Sometimes a firm integrates with another firm.

(a) What is the difference between horizontal and vertical integration? [4]

(b) Contrast the characteristics of two types of business organisation. [6]

**Essay Question 4**

Partnerships are owned by only two people while public companies are owned by the government.

(a) Why do some firms remain small in size? [6]

(b) Explain two types of integration available to a firm. [2]

**Essay Question 5**

Car production is an important economic activity in many countries. Much of this production is undertaken by large multinational companies. These firms aim to increase both productivity and production. Distinguish between productivity and production. [4]

**Essay Question 6**

Sometimes in an industry a firm buys a smaller competitor which uses similar factors of production. At other times a firm buys another firm which supplies it with the raw materials and other inputs for its production.

(a) Explain what is meant by the factors of production. [4]

(b) Discuss the reasons why some firms remain small. [6]

(c) Identify the types of integration in the two situations described above. [3]

(d) Discuss whether such integration is always beneficial. [7]

**Essay Question 1**

**(a) Explain why small firms continue to exist in most economies. [4]**

* entrepreneurs want to work for themselves
* the market is too small (e.g. niche market)
* greater flexibility
* costs may be lower (e.g. non-unionised labour may be cheaper)
* provision of personal services
* may be able to benefit from external economies of scale (e.g. advertising)
* government support (e.g. subsidies)
* lack of capital

**(b)** **Discuss whether firms always benefit from growing larger. [8]**

Possible benefits:

* internal economies of scale, e.g. risk-bearing, administrative or managerial, technical, marketing, financial, increased dimension
* As the size of the firm increases, average long-run cost goes down
* external economies of scale, e.g. a pool of skilled labour, infrastructure, suppliers
* larger market share/control of market.

Possible disadvantages:

* diseconomies of scale, i.e. as the size of a firm increases, average long-run cost goes up
* lack of personal service

**Essay Question 2**

**In Brazil, firms vary in size from the very small to the very large.**

**(a) Describe the main characteristics of a multi-national company. [4]**

* it operates in more than one country (but this needs to involve more than just selling in different countries)
* it has production or service facilities outside its country of origin
* its headquarters are likely to be in one particular country
* they are some of the largest firms in the world, employing many thousands of workers
* they are responsible for about 65% of world trade.

**(b) Explain the reasons why small firms continue to exist in all economies. [6]**

* the size of the market may be small
* can cater for a variety of specialised tastes/orders (idea of niche)
* may produce expensive items with a very limited demand
* preference for personal service
* provide parts for larger manufacturers
* limited finance to grow any larger
* personal choice/preference of owners to remain small
* government assistance.

**Essay Question 3**

**In the same industry there are often firms of different sizes. Sometimes a firm integrates with another firm.**

**(a) What is the difference between horizontal and vertical integration? [4]**

Vertical back, vertical forward and horizontal integration

**(b) Contrast the characteristics of two types of business organisation. [6]**

Compare the size in terms of market, employment, output, the organisation, the structure, the method of raising finance

**Essay Question 4**

**Partnerships are owned by only two people while public companies are owned by the government.**

**(a) Why do some firms remain small in size? [6]**

Small firms usually have many competitors.

Competition may well allow reduced prices and wider choice, competition appears to give consumers more of what they want. As a result consumers go to small firms.

Small firms can also give personal service and provide specialist products.

Small firms may not advertise much and may not reach a large market.

They may prefer to remain small. They may not have profit maximising or growth aims.

**(b) Explain two types of integration available to a firm. [2]**

Horizontal, vertical backward, vertical forward, lateral, conglomerate

**Essay Question 6**

**Sometimes in an industry a firm buys a smaller competitor which uses similar factors of production. At other times a firm buys another firm which supplies it with the raw materials and other inputs for its production.**

**(a) Explain what is meant by the factors of production. [4]**

**(b) Discuss the reasons why some firms remain small. [6]**

Discussion of reasons for small firms

Market, finance, service, recently established, location.

**(c) Identify the types of integration in the two situations described above. [3]**

Horizontal integration

Vertical integration

Backward integration

**(d) Discuss whether such integration is always beneficial. [7]**

Explanation and discussion of economies of scale, discussion of economies; diseconomies.

Benefits

Greater efficiency, economies of scale, security of supply, helps company and consumer

Drawbacks

Less competition, higher prices, reduced choice, harm the consumer while diseconomies of scale harm the firm and consumer.

**Part C – Cost of Production**

**Question 1**

The following incomplete tables show a firm’s various costs of producing up to 6 units of output. Fill in as much of the table as possible. If you cannot determine the number in a box, explain why it is not possible to do so.

**(a)**



**(b)**

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**Essay Question 1**

Car production is an important economic activity in many countries. Much of this production is undertaken by large multinational companies. These firms aim to increase both productivity and production.

Using an example of each, explain the difference between fixed costs and variable costs in car production. [4]

**Essay Question 2**

Explain how a profit-maximising firm sets price and output. [4]

**Question 1(a)**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Q** | **TC** | **TVC** | **TFC** | **AC** | **MC** | **AVC** |
| 1 | **100** | 80 | 20 | 100 | 80 | 80 |
| 2 | 180 | **160** | 20 | 90 | 80 | 80 |
| 3 | - | - | **20** | - | - | - |
| 4 | 380 | 360 | 20 | **95** | - | 90 |
| 5 | 550 | 530 | 20 | 110 | **170** | 106 |
| 6 | 740 | 720 | 20 | 123.3 | 190 | **120** |

**Question 1(b)**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Q** | **TC** | **TVC** | **AFC** | **AC** | **MC** | **AVC** | **TFC** |
| 1 | 100 | 40 | 60 | **100** | 40 |  40 | 60 |
| 2 | 110 | **50** | **30** | 55 | 10 | 25 | 60 |
| 3 | 120 | 60 | 20 | 40 | **10** | 20 | 60 |
| 4 | 180 | 120 | 15 | 45 | 60 | **30** | 60 |
| 5 | 250 | 190 | 12 | 50 | 70 | 38 | 60 |
| 6 | **330** | 270 | 10 | 55 | **80** | 45 | 60 |

**Essay Question 1**

**Car production is an important economic activity in many countries. Much of this production is undertaken by large multinational companies. These firms aim to increase both productivity and production.**

**Using an example of each, explain the difference between fixed costs and variable costs in car production. [4]**

 **Fixed cost** is defined as the cost of production that is incurred due to the use of fixed factors and they do not vary with the level of output of the firm. One example of fixed cost in car production is the rental cost of the factory to produce cars. The rental cost will not vary with the output level of cars.

 **Variable cost** is defined as the cost incurred due to the use of variable factors and the cost will vary with the level of output. An example of variable cost in car production is the wage paid to a car mechanic. The wage rate will vary with the output level of cars.

**Essay Question 2**

**Explain how a profit-maximising firm sets price and output. [4]**

A firm will abide to the notion of profit maximisation to determine the price and output level, in which it is at the level of output where marginal revenue (MR) is equal to the marginal cost (MC).

The firm will increase production when MR is greater than MC since additional net profit is attained. The firm will decrease production when MR is less than MC where additional loss is incurred. Hence, the production equilibrium is attained.



As seen from the diagram, the profit-maximising level is attained at the output level Q1 and price P1, where MC is equals to MR.

**Part D – Market Structures**

**Essay Question 1**

Discuss whether a monopoly is always in the best interest of consumers. [7]

**Essay Question 2**

Perfect competition is one type of market structure with a number of distinctive characteristics. It is often compared favourably with monopoly.

(a) Analyse three characteristics of perfect competition. [6]

(b) Distinguish between a firm that is a price-taker and one that is a price-setter. [4]

(c) Discuss whether pricing and output policies in perfect competition are more favourable to the consumer than those in monopoly. [10]

**Essay Question 3**

Discuss whether the disadvantages of a monopoly always outweigh the advantages. [8]

**Essay Question 1**

**Discuss whether a monopoly is always in the best interest of consumers. [7]**

Explain how a monopoly is beneficial to consumers

* Lower prices of goods and services due to economies of scale
* Higher quality of products due to R&D
* Maintain high employment level due to higher resistance to economic downturns

Explain how a monopoly is detrimental to consumers

* Deterioration in quality of products due to rising complacency – absence of competition
* Consumer exploitation seen in terms of higher prices due to market dominance

**Essay Question 2**

**Perfect competition is one type of market structure with a number of distinctive characteristics. It is often compared favourably with monopoly.**

**(a) Analyse three characteristics of perfect competition. [6]**

* **Large number of firms –** The output of every firm is too insignificant to affect prices and each firm is a price taker
* **Homogeneous/Identical product –** Products are perfect substitutes and demand is perfectly elastic
* **Perfect information** **–** Firms know the level of profit being made in the market while consumers are aware of the price level being set
* **No barriers to entry** – Firms will enter the industry if supernormal profits are made, whereas firms will leave the industry when subnormal profits are made

**(b) Distinguish between a firm that is a price-taker and one that is a price-setter. [4]**

Price taker

This would apply to a firm that is in a perfectly competitive market structure where the price is determined by market conditions. One firm’s output is too small to influence market price.

Price-setter

This would apply to a firm that is in a monopoly market structure a monopoly firm is able to use its market power to determine the price it wishes to charge. A monopoly’s output is the industry’s output.

**(c) Discuss whether pricing and output policies in perfect competition are more favourable to the consumer than those in monopoly. [10]**

Explain why perfect competition is more favourable than monopoly policies

* Price may be lower due to competitive pressure driven down to a level which just covers costs
* Output may be higher as firms will not be restricting output to drive up price
* Firms are likely to be responsive to changes in consumers’ demand trying to gain a competitive edge
* Firms may innovate perfect knowledge spreads information about new methods/ products competitive pressure may force firms to innovate

Explain why monopoly is more favourable than perfect competition policies

* Monopoly likely to be a larger firm more able to take advantage of economies of scale – Provide examples to show how economies of scale lower average costs of production may lead to lower prices
* Monopoly may earn supernormal profits these may be used to innovate monopoly
* May feel safer innovating knowing that it can protect any resulting supernormal profits
* Innovation can lower prices and improve quality of products

**Essay Question 3**

**Discuss whether the disadvantages of a monopoly always outweigh the advantages. [8]**

Explain the Disadvantages of Monopoly

* High prices and low quality of products due to lack of competition
* Slow response to changes in consumer demand
* Large quantity produced may lead to the experiencing of diseconomies of scale which raise costs of production and increase prices

Explain the Advantages of Monopoly

* Economies of scale
* Supernormal profits may be used to finance R&D which will increase efficiency and raise quality of products and lower prices
* Maximise resource allocation by avoiding duplication, such as the provision of public transportation and water supply
* State monopoly may base decisions on social costs and benefits, thus increasing efficiency