3.1-MONEY AND BANKING

3.1.1: Money

Forms of money:

- Coins [legal tender]
- Notes [legal tender]
- Bank accounts

[Legal tender: It refers to any form of payment, which, by law, has to be accepted as settlement of a debt.]

Functions of money:

- It is a medium of exchange
- It is a measure of value
- It is a store of value
- It is a standard for deferred payments.

Characteristics of money:

- It has to be generally acceptable and people should be prepared to accept it in exchange for products and to settle debts
- It should be portable for example, should be light to carry around
- It should be divisible into different denominations
- It should be recognisable, for instance have distinct features on them known to the population
- It should be limited in supply, example,the central bank should print it's set number
- It should be homogeneous as all banknotes of the same value are identical

Note:

Money as a medium of exchange:

• money is generally accepted as a means of payment for most goods and services/avoids the need for a double coincidence of wants or barter.

Money as a store of value:

• people can save money because it keeps its value. Savings enable use of money in the future. Money will not deteriorate with time and so will be acceptable in the future, though inflation will erode its real value.

Note: Cash (notes and coins) is money because:

- Cash is money as it carries out the functions of money
- Cash acts as a medium of exchange and is generally accepted as payment for products
- Cash acts as a store of value and people can save their cash in order to use it in the future
- Cash acts as a unit of account/measure of value and price of products is expressed in
- terms of the cash needed to purchase them

Following are the advantages banknotes have as a form of money:

- It is generally acceptable) and people are prepared to accept them in exchange for products and to settle debts.
- It is portable as banknotes are light to carry around
- It is divisible as notes of different denominations
- It is recognisable as notes have distinct features on them known to the population
- They are limited in supply as the central bank prints a set number of notes
- They are homogeneous as all banknotes of the same value are identical

3.1.2 Banking

[The role and importance of central banks and commercial banks for government, producers and consumers.]

Central bank:

- It is a bank that is responsible for overseeing the banking system as a whole
- It does not usually accept deposits from customers
- It is usually owned by a government.

Following are the various roles of the central bank in an economy:

- banker to the government
- banker to the commercial banks
- lender of last resort
- management of the national debt
- holding foreign currency and gold reserves
- issues bank notes
- implements monetary policy/sets interest rates
- regulates and supervises the banking system.

Importance of central bank in an economy:

- It operates monetary policy, issues notes and coins/controls the money supply, sets interest rates, seeks to maintain price stability/control inflation /influencing saving/spending , controlling total demand, keeping inflation low is important in terms of e.g. maintaining competitiveness
- It regulates the banking sector, seeks to ensure commercial banks will pursue sound policies, acts as a lender of last resort to prevent banks going out of business , a strong banking sector is important for e.g. promoting investment
- It acts as banker to the commercial banks, commercial banks can hold accounts at the central bank, these can be used to draw out cash when needed and to settle debts with other banks .
- It acts as banker to the government, operates accounts which receive government tax revenue and from which the government can make payments, manages the national debt by issuing government securities/bonds , paying interest on government securities.

COMMERCIAL BANK:

Meaning: It is a financial institution that offers services to people/households/firms.

Role of the commercial bank:

- accept deposits
- lend to customers
- enable customers to make payments
- travellers cheques/foreign currency
- deposit important documents
- source of financial advice.

Importance of the role of commercial bank in an economy:

- They play a key role in channelising funds from the savers to borrowers.
- Banks take in funds by accepting deposits
- Banks use the funds mainly to grant loans
- They provide consumers with essential services and also help create capital and liquidity in the market

Additional Information:[Important for solving papers]

Difference between central bank and commercial bank:

- it is one of the functions of a central bank to issue notes and coins. A commercial bank is usually not allowed to issue notes and coins
- the customers of the central bank are commercial banks and the government people and firms are the customers of commercial banks
- the central bank implements monetary policy , while the commercial banks are affected by the monetary policy
- the central bank is government owned while the commercial banks are usually in the private sector

Firms may find it difficult to obtain loans from commercial banks.

- Banks may be concerned that firms may not be able to repay the loan ,may not expect to make a profit .
- The firms may already have debts and banks may not want to increase them .
- The firms may not be able to offer collateral due to lack of wealth
- firms have low-credit rating .
- Small/new firms may be less well-known to banks and may be regarded as a greater risk
- The economy may be deteriorating / in recession so banks may avoid risks
- Banks may not have sufficient funds to lend may not have attracted household savings
- The central bank may be trying to reduce bank lending
- e.g. by raising the rate of interest .
- Interest rates may be too high making repayment terms too expensive
- The central bank may be trying to reduce bank lending e.g. by imposing limits on loans

3.3-HOUSEHOLDS

3.2.1. the influences on spending, saving and borrowing
[Including income, the rate of interest and confidence– between different households and over time.]

SPENDING:

Motives for consumer spending:

- to satisfy needs e.g food, shelter
- to satisfy wants e.g. luxury goods
- fear of future price rises
- to gain satisfaction from that consumption

Following factors affect a person's spending:

- the need/want for the products
- disposable income/wealth: Spending will be greater in amount when income/wealth is higher as purchasing power will be higher
- anticipated inflation rate in the future :people will spend more when they expect prices to rise/or spend less if they think inflation will be eliminated
- confidence : during boom times/when people expect employment to remain high they will spend more
- interest rate : a high interest rate will discourage borrowing/encourage saving and so reduce spending.
- other factors affecting pattern of spending, e.g. married/single, age, time of year, e.g. Christmas, new technology
- Expansionary fiscal / monetary policy may increase spending

SAVING:

Factors that affect a person's saving:

- availability of appropriate savings scheme
- interest rates, especially real interest rates
- advertising of/knowledge about what is available at financial institutions
- confidence/trust in financial institutions
- size of real disposable income
- rate of inflation
- wealth
- save for a future purchase, e.g. a house
- precautionary factors, e.g. 'saving for a rainy day'
- satisfaction of wants and needs
- tastes and preferences of consumers
- consumer confidence/expectations about future changes in the economy, e.g. risk of
- unemployment.

[Note: Savers may lose if the inflation rate exceeds the interest rate/the real value of their saving will fall.]

BORROWING:

Following factors affect borrowing in an economy:

- interest rates: Borrowers may gain if the inflation rate exceeds the interest rate/the real value of what they repay may fall.
- confidence levels
- wages / incomes

Borrowing differs between individuals:

- some individuals run into financial difficulties
- some individuals are spending 'beyond their means'
- some individuals may be more aware of what is available from financial institutions
- some individuals may be better able to pay the money back
- some individuals may be able to provide more security
- some individuals may have a need of money for a very short period of time, e.g. until the next pay day
- some individuals may have a greater need for something, e.g. a car or a holiday and borrow for the medium term to pay for it
- some individuals may wish to buy a house and may borrow for a long period of time, e.g.a mortgage to purchase a house which is often for 25 years.

Note:

Here is why, the different income groups might have a different pattern of spending and saving:

The spending patterns of the poor:

- tend to spend a higher proportion of their income
- tend to spend a higher proportion on essential items, e.g. food
- tend to spend a lower proportion on luxury goods, e.g. holidays
- tend to buy items of lower quality.

The spending patterns of the rich:

- tend to spend a lower proportion of their income
- tend to spend a lower proportion on essential items, e.g. food
- tend to spend a higher proportion on luxury goods, e.g. holidays

Difference between spending and borrowing:

- Saving is income minus spending / putting money in the bank while borrowing is money obtained from a lender.
- Saving involves spending less than income, whereas borrowing means spending more than income.
- Savings increase wealth while borrowing increases debt.
- Savings earn interest while, borrowing incurs charges / interest.
- Savings allows spending later , while borrowing allows spending now.

Reasons why borrowing may decrease.

- a rise in the rate of interest will increase the cost of borrowing
- a reduction in the availability of loans will make it more difficult to borrow
- a rise in income may reduce the need to borrow
- an increase in the state provision of health care/education may mean that people do not have to borrow to cover health care/education expenses
- a reduction in the price of expensive items e.g. houses, cars may mean that people can buy the items without borrowing
- a reduction in confidence about the future may mean that people will be afraid they will not be able to repay loans
- a change in age structure , the young may borrow more than those of middle age
- a change in social attitudes : it may become less acceptable to borrow
- an increase in government subsidies to firms may reduce the need for firms to borrow from banks

APPLICATION BASED QUESTIONS:

1. Explain two non-wage factors that influence an individual's choice of occupation.[4]

- Short working hours would increase leisure time
- Job security reduces stress
- Promotion chances increase wages in long run
- Fringe benefits such as SPA, gym, travel allowance etc
- Qualifications / skills / education allow an individual to choose an appropriate occupation

2. (a) Sometimes it is said that a person chooses a job because of non-wage factors. Explain, using three examples, the meaning of non-wage factors. [4]

(a) A non-wage factor is a non-remuneration payment .

Examples of non-wage factors affecting the choice of a job :

• length/number of holidays
• working conditions/environment
• hours of work
• promotion/career prospects
• travelling distance
• size of company
• social/canteen facilities
• provision of insurance scheme
• company car.

3. Discuss to what extent non-wage factors are likely to be more important than wage factors in influencing a woman's choice of occupation.[8]

[Up to 6 marks for a discussion of possible wage factors:]

Possible wage factors include:

• wages/salaries
• overtime pay
• bonuses
• commission.

Possible non-wage factors include:

• job satisfaction
• working conditions
• working hours
• holidays
• pension provision
• fringe benefits
• job security
• promotion prospects

• location/transport
• safety and security, especially at night for women
• gender stereotyping/perception of others.

[Note:

- **No single argument should be awarded more than 3 marks.**
- **Up to 2 marks for a supported conclusion.**
- **Maximum 6 marks for a generic answer which does not cover a woman's choice.]**

4. Analyse why there are often differences in the earnings of workers in the public sector and workers in the private sector.

Differences in the earnings of workers in the public sector and workers in the private sector may be due to the following reasons:

- demand for workers may be higher in one sector, higher demand results in higher
- earnings
- supply of workers may be lower in one sector, lower supply results in higher earnings
- job security may be greater in one sector, this may encourage higher supply and so
- lower earnings
- pensions provided by one sector may be worth more, as a result people may be
- prepared to work for lower earnings
- trade unions may be stronger in one sector, this will give workers stronger bargaining
- power, which may push up earnings
- public sector may be more likely to comply with minimum wage legislation, this could
- raise average earnings in the sector
- there may be more overtime available in one sector, pushing up earnings
- skill/qualifications required may be higher in one sector, reducing supply, raising
- earnings
- risks involved in jobs in one sector may be higher, reducing supply, raising earnings
- status of working in one sector may be higher, increasing supply, reducing earnings

5. Describe how an individual's earnings are likely to change over their lifetime.[3]
An individual's earnings are likely to change over their lifetime due to the following reasons:

- relatively low earnings to begin with
- gradual increase in earnings as more experience is gained
- earnings will reach a maximum as a person reaches their full potential
- earnings will fall; after employment ends, reliance on pension

6. Analyse why economics graduates are paid well [6]

- Graduates are skilled / more knowledgeable and have high levels of qualifications/training/education and hence are more productive / efficient
- The demand for their services is high , the demand is inelastic as supply is low and long period of training required is required.
- Graduates tend to work in jobs with high pay/position/responsibility/stress For example , An economics degree is held in high esteem as a qualification.

7. Explain why a skilled worker is likely to be paid more than an unskilled worker:

- for skilled workers, it is a reward for higher level of skill, training and qualifications
- they are skilled and hence are likely, therefore, to have a higher level of productivity
- such workers are relatively scarce/in shorter supply compared to unskilled workers
- it is less easy to recruit skilled than unskilled workers

8. The demand for workers with a particular skill has increased significantly in the last few years. Explain, using a demand and supply diagram, how this is likely to affect the equilibrium wage and the equilibrium quantity of such workers.[6]
(b) Diagram:

- labels (wage/price of labour, quantity, demand, supply)
- shift of the demand curve to the right
- change in equilibrium position (both wage and quantity increase)

Explanation:

- the effect of the increase in demand would shift the demand curve to the right
- raising the equilibrium wage
- and equilibrium quantity

9. (d) Discuss whether a rise in the wages paid by an industry will encourage more people to work in that industry.

Reasons why more people may be encouraged:

- higher wages enable workers to enjoy more goods and services and this increases their living standards
- higher wages enable people to borrow more and the banks are more likely to lend to high earners
- higher wages will enable workers to save more and increase ability to, e.g. finance children's education/provide for retirement
- higher wages may motivate some workers to work in the industry and hence increase workers' self esteem
- workers will be encouraged to switch from other industries to undertake training to work in the industry in-order to gain the necessary qualifications to work in the industry

Reasons why more people may not be encouraged

- wages may still be below those in other industries
- earnings may be higher in other industries because of, e.g. higher bonuses or overtime payments
- workers may not be aware of the wage rise
- workers may lack the appropriate skills/qualifications
- workers take into account other factors/non-pecuniary factors
- workers may not work in that industry if, e.g. working hours are longer, holidays are shorter, worse working conditions, less chance of promotion, lower pensions, fewer fringe benefits, less job security, less job satisfaction, industry is based some distance away

10. In England football stadiums are usually built and financed by the private sector, but in some countries the stadiums are built and financed by the government. Many football stadiums in the English Premier League are full on match days. In the short run the supply of seats is perfectly inelastic. The football clubs could actually raise prices, still sell their tickets and so raise their profits. Premier League footballers currently receive very high wages.
Analyse why Premier League footballers receive very high wages.[6]

- ✓ High demand for the services of footballers as many people want to watch football matches in stadiums and on television
- ✓ Football clubs receive high incomes, compete for players

- ✓ These footballers have to be skilled and as not many possess the skills and hence are in low supply.
- ✓ Premier League players may have strong bargaining power through strong professional organisation/trade union/agents
- ✓ To compensate for negative aspects of the job e.g. risk of personal injury (1) other relevant example

11. (a) Explain what is meant by specialisation and the division of labour.[4]

- Specialisation is the concentration on a particular part of production, and division of labour is where the labour is divided into separate tasks, and the product is passed along production line or service conducted by specialist teams and for which particular training is required.

12. Despite the potential advantages of specialisation, explain why a country may choose not to specialise. [5]

- there may be increasing costs of production from diseconomies of scale
- high transport costs may not make it worthwhile
- there may be exhaustion of resources
- may want to avoid risk of relying on a few products.

FACTORS AFFECTING INDIVIDUAL CHOICE OF OCCUPATION

FACTORS AFFECTING INDIVIDUAL CHOICE OF OCCUPATION:

- **WAGE FACTORS:** [MONETARY OR PECUNIARY FACTORS] Wages refer to pay or salary. The total pay a person receives is called as earnings. Earnings may include the basic pay, overtime, bonus and commission,

- **NON-WAGE FACTORS:** A non-wage factor is a non-remuneration payment. For example, it may include job satisfaction, working conditions, holidays, pensions, fringe benefits, job security, career prospects, size of firm and location.

WAGE DETERMINATION

FACTORS DETERMINING THE WAGES:

- Demand and supply of labour
- Relative bargaining power of employers and workers
- Government policies
- Public opinion
- Discrimination

DEMAND AND SUPPLY OF LABOUR:

- When the demand is very high, but the supply of skilled and qualified workers is low, then the wages tend to be higher for such jobs.
- Also , as for the unskilled workers, not many would like to take up jobs involving sweeping floors, cleaning toilets etc. So the wages for such work also can be high.
- Jobs involving emergency services that have limited number of staff ,also pay them higher wages, in-order to retain them.
- When people are highly skilled, they are likely to have a higher level of productivity and hence get paid higher.
- Skilled workers are relatively scarce/in shorter supply compared to unskilled workers. Also it is less easy to recruit skilled than unskilled workers. Hence they get paid higher wages.

RELATIVE BARGAINING STRENGTH:

- Wages tend to be higher where the workers have a strong bargaining power as compared to employers, especially when workers are members of trade union or other professional organisations that can bargain collectively on the worker's behalf.
- The bargaining strength exists because of the special skills possessed by skilled workers and the inability to replace them with skilled workers of equal or better calibre. Also , industrial action by such skilled workers sometimes has serious consequences. Some examples of such skilled workers are doctors, pilots etc.
- The unskilled workers can easily be replaced and they usually are not attached to any strong union or other professional bodies. This reduces their bargaining power.

GOVERNMENT POLICIES:

- The unskilled workers can easily be replaced and they usually are not attached to any strong union or other professional bodies. This reduces their bargaining power
- It affects the wages of public sector.
- It's policies also affect the wages in the private sector.
- Particular government policies have direct effect on certain occupations. The demand for driving instructors has gone up as in-depth knowledge of RTO rules has become mandatory even to obtain a learning licence.
- Government labour market policies such as NMW or national minimum wage ensures that all workers are paid , at or above the NMW. On the other hand it may also hold down wage rises of the public sector in-order to reduce inflatory pressure

PUBLIC SECTOR/PRIVATE SECTOR:

- demand for workers may be higher in one sector, higher demand results in higher
- earnings
- supply of workers may be lower in one sector, lower supply results in higher earnings
- job security may be greater in one sector, this may encourage higher supply and so
- lower earnings
- pensions provided by one sector may be worth more, as a result people may be
- prepared to work for lower earnings
- trade unions may be stronger in one sector, this will give workers stronger bargaining
- power, which may push up earnings
- public sector may be more likely to comply with minimum wage legislation, this could
- raise average earnings in the sector
- there may be more overtime available in one sector, pushing up earnings
- skill/qualifications required may be higher in one sector, reducing supply, raising
- earnings
- risks involved in jobs in one sector may be higher, reducing supply, raising earnings
- status of working in one sector may be higher, increasing supply, reducing earnings

DISCRIMINATION:

- Discrimination refers to treating a group of workers unfavourably in terms of professional training, wage rates, promotion opportunities, not wanting to recruit female workers etc

WOMEN ON THE WHOLE IN MOST PARTS OF THE WORLD RECEIVE LESSER PAY DUE TO THE FOLLOWING REASONS:

- In some countries, women are less qualified then men.
- They are less likely to belong to professional organisations or trade unions.
- They tend to be more heavily concentrated in low paid jobs
- They are still discriminated against

REASONS FOR DIFFERENCES IN EARNINGS

EARNINGS: Earning refers to the Income / money received by a factor of production , received from working / payment to workers . It includes wages/salaries , overtime payments / bonuses / commission and also income from other sources e.g. undertaking financial investment / renting / running a business .

REASONS FOR DIFFERENCES IN EARNINGS:

- **CHANGES IN DEMAND FOR LABOUR:**
  1. **If demand for labour increases, the wages, bonuses, overtime pay, etc all might be pushed up.**
  2. **Demand for labour may increases if:**
  - ✓ The demand for a product increases [derived demand]
  - ✓ A rise in labour productivity
  - ✓ A rise in the price of capital
- **CHANGES IN SUPPLY OF LABOUR:**
  1. **Demand for labour may change if:**
  - ✓ There is a decrease in the labour supply for a particular occupation or labour sector.
  - ✓ A fall in the labour force
  - ✓ A rise in the qualification or the length of training required for a particular job,this will reduce the number of people eligible for the job
  - ✓ A reduction in the wage or non-wage benefits for a job, would decrease the number of people willing to do that job
- **CHANGES IN THE STAGES OF PRODUCTION:**
  - ✓ People in the primary sector are paid less than those in the secondary or tertiary sector as the depth of skills and qualification is higher in these sectors.
  - ✓ With the development of economy, the demand for primary sector jobs decreases
- **CHANGES IN THE BARGAINING POWER:**
  - ✓ A change in the unions bargaining power or willingness to take industrial action many affect earnings.
- **CHANGES IN PUBLIC OPINION:**
  - ✓ A change in the public opinion may bring about a change in the earnings. With changing social attitudes with regards to jobs taken up by women, either women tend to lose jobs or get more jobs.
  - ✓ If some professions tend to be considered as important , then the wages attached to them see a fall.
- **CHANGES IN INDIVIDUAL EARNINGS**
  - ✓ relatively low earnings to begin with
  - ✓ gradual increase in earnings as more experience is gained
  - ✓ earnings will reach a maximum as a person reaches their full potential
  - ✓ earnings will fall; after employment ends, reliance on pension

DIVISION OF LABOUR/SPECIALISATION

SPECIALISATION AND DIVISION OF LABOUR:

SPECIALISATION: It is the process by which individuals, firms and economies concentrate on producing those goods and services in which they have an advantage and the production processes are broken up into a sequence of different tasks.

ADVANTAGES OF SPECIALISATION TO WORKERS:

- Workers become quicker at producing goods (more productive)
- An increase in productivity causes the cost if production to decrease (lower average costs)
- Production levels are increased.
- Specialised workers tend to get higher pay.
- Workers' specific skills will be improved.
- More motivation from job satisfaction.

DISADVANTAGES OF SPECIALISATION TO WORKERS:

- They may not find another job easily . So they are at risk. The workers may not find it easy to transfer their skills to another job should they lose their jobs or might be at a risk of long term unemployment
- They may not find where key strengths lie, while concentrating on a particular task . This may mean that workers do not find out what they are best at.
- They might possess limited skills
- Boredom might set in: Performing the same task each day can become tedious
- They might become demotivated as they may feel less appreciated
- They may face an increased risk of being replaced by machines as breaking down a process into its separate parts may make it easier to mechanise
- They could suffer disruption caused by absent fellow workers. They may have to cover for absent colleagues / example of impact on the workers.

DIVISION OF LABOUR: It is where the labour is divided into separate tasks, and the product is passed along production line or service conducted by specialist teams and for which particular training is required.

ADVANTAGES TO WORKERS FROM DIVISION OF LABOUR:

- It saves time
- It increases skills
- It increases productivity
- It increases wages

DISADVANTAGES TO WORKERS FROM DIVISION OF LABOUR:

- Leads to increased boredom
- Workers end up with limited skills
- They feel lack of motivation
- There is lack of occupational mobility
- Overdependence on others

ADVANTAGES TO FIRMS USING DIVISION OF LABOUR:

- Division of labour involves workers specialising and this can increase output or increase productivity and the costs of production may be reduced e.g. lower costs of training e.g. less equipment needed
- Specialisation can increase quality and lower costs can enable to charge lower prices and hence demand may rise and subsequently the revenue/profits may increase

RELATION BETWEEN DIVISION OF LABOUR AND FIRM'S COST OF PRODUCTION:

- division of labour involves workers specialising in particular tasks . The workers may become bored and they might may make mistakes, resulting into the products getting rejected , subsequently causing a fall in productivity.
- there may be a high turnover of workers and this will increase the cost of hiring workers
- workers may not be employed on tasks they are best at and this will mean productivity will be below potential
- if key workers are sick or leave then it may be difficult to cover for their absence and this can disrupt the production process
- more specialised workers may demand higher wages , thereby increasing labour costs .

Trade unions

KEYPOINTS:

➢ **Define a trade union[2m-Board Question]**: It is an association [or body/group/organisation] (which represents its members by protecting workers' rights or seeks to improve workers' pay and or working conditions

Describe the functions of a trade union. [6m-Board Question]

Functions of a trade union:

- they exist to protect the interests of their members
- gain appropriate wage/salary increases
- idea of collective bargaining
- job security
- working conditions/health and safety
- dismissal/redundancy.
- possible influence on government policies at national level.

Discuss whether trade unions always have a harmful effect on the wider economy. [6]

Advantages of a trade union to the workers and government/economy:

- can work with employers, not always against them
- can work with government, e.g. to support legislation.

Disadvantages of a trade union to the workers and government/economy:

- there might be industrial action
- powerful unions/industrial action could lead to disruption of the economy
- this could lead to a firm going out of business, causing an increase in unemployment
- this could affect output and damage reputation of country
- powerful trade unions could lead to higher wages
- making products uncompetitive in world markets.

Explain the benefits that an individual may get from being a member of a trade union. [4]

[Benefits] of a trade union to an individual:

- collective bargaining to improve pay
- working on behalf of members in terms of working conditions, pension entitlement
- protecting the rights of members, e.g. in a legal dispute
- acting on behalf of members in discussions with government.

Discuss whether a firm will benefit from encouraging its workers to join a trade union. [8]

Possible benefits[advantages] to the firms :

- Trade unions may encourage more workers to apply for jobs as they may expect better working conditions/job security .
- The trade union reduces costs of negotiating with workers as negotiations can take place with one organisation rather than possibly many individual workers.
- The trade union provides a channel of communication , so information on, e.g. new working practices can be spread more quickly .
- The trade union may promote training , increasing labour productivity and so lower costs of production .
- The trade union may reduce conflict as workers' discontents can be taken to management and possibly resolved .

Possible benefits[disadvantages] to the firms :

- The trade union may push up wages , as the union can use its power to bid up wage rates for its members . This will increase the firm's costs of production and reduce the firm's competitiveness.
- The trade union may reduce flexibility as a union may insist that its members only undertake the tasks in their job descriptions and are not to work outside the standard hours .
- The trade union may take industrial action , e.g. a strike will disrupt production (1) and lose customers/reduce revenue/profits (1).

[Note: If the question is on Discuss, then you must elaborate each point. Do not give list-like answers]

MORE APPLICATION BOARD EXAM QUESTIONS:

Discuss whether or not increasing the strength of trade unions will benefit an economy.[8]

Why increasing the strength of trade unions will benefit an economy:

- Stronger bargaining power with employers may improve working conditions of workers and increase health and safety
- May raise the wages of workers and may reduce poverty and may increase labour productivity through increasing worker morale motivation.
- It may counterbalance the power of employers by protecting the rights of workers
- May provide worker training thereby increasing skills[or productivity].

Why increasing the strength of trade unions might not benefit an economy:

- May lead to more industrial disputes e.g. strikes/go slows and reduce output
- May discourage investments or discourage MNCs which would damage long run economic growth.
- May cause inflation by raising labour costs and make products less internationally competitive by increasing a current account deficit/reducing a current account surplus.
- Higher wage costs could reduce profits and raise unemployment .

1. Identify **two influences** on the strength of a trade union's collective bargaining power.
   - Th two influences on the strength of a trade union's collective bargaining power include:
     size of membership
   - financial position
   - level of employment
   - government legislation
   - willingness to take industrial action

[Any 2 needed]

3.Explain the likely impact of trade unions on the welfare of their members.

- Increase or maintain wages of members
- Increase or maintain material standard of living .
- Improve or maintain working conditions e.g. improved safety / less stress.
- Protect workers' rights e.g. working hours / sick pay / paternity leave).
- Protect jobs [or reduce risk of unemployment].
- Provide training (or) helping employees find better jobs or better paid jobs

4.Analyse three reasons why trade union membership may decrease in a country. [6]

- trade union subscriptions may increase making it more expensive for people to join a trade union
- legislation may reduce the power of trade unions and this would make membership less valuable
- employers may not recognise trade unions/be reluctant to employ members of trade unions and this may make people reluctant to join as it would reduce their employment opportunities
- unemployment may mean that there are fewer people in employment to belong to trade unions and it will weaken the power of trade unions
- in a boom period/high level of economic activity , workers may gain wage rises/better working conditions without belonging to a trade union

- workers may be satisfied with pay and conditions and may not agree with actions of trade union
- government action to improve the pay and/or conditions of workers e.g. introduction of national minimum wage reduces the need for collective bargaining

5. Discuss whether the activities of trade unions are likely to increase or decrease a country's economic growth rate. [8]

why they are likely to increase it:

- Trade unions may cut firms' costs of production by reducing the time and effort involved in negotiating with workers . Lower costs can increase profits and higher profits can encourage expansion
- Trade unions may push up wages by boosting total (aggregate) demand in the economy
- Trade unions may help with training and education systems and such schemes may raise productivity . A higher productivity can cut costs of production and increase productive potential
- By promoting workers' rights , the trade unions may increase the motivation of workers and workers may gain more job satisfaction which will raise productivity

why they are likely to decrease it:

- Trade unions may push up wages and higher wages will increase firms' costs of production and this may encourage them to cut production
- Trade unions may engage in industrial action e.g. strikes and this will disrupt production and the sales may be lost
- The presence of trade unions may discourage MNCs setting up in the country and we know that the MNCs contribute to economic growth

CLASSIFICATION OF FIRMS

FIRMS CAN BE CLASSIFIED ON THE BASIS OF:

- **The stages of production**
- **Ownership of firms**
- **Size of firms**

CLASSIFICATION OF FIRMS BASED ON THE STAGES OF PRODUCTION:

Classification of firms based on their stages of production

Primary sector:
[RAW MATERIALS]
1. First stage of production
2. Examples : Industries such as extraction and collection of raw materials, fishing , farming

Secondary sector
[FINISHED GOODS]
1.Involves processing of raw materials into finished and semi-finished goods-both capital and consumer goods
2. Examples:Manufacturing/ Utilities/building/clothing/ steel industries

Tertiary Sector
[SERVICE SECTOR]
This includes industries producing services such as:
banking/insurance/tourism /Hospitality and leisure/Information technology/Financial services/Retail

Quarternery sector
1. It is a sub-section of the tertiary sector.
2. It includes all industries involved in the collecting /processing and transmission of information .
3. Examples: Education/Service sector/ Research and development

CLASSIFICATION OF FIRMS BASED ON OWNERSHIP OF FIRMS:

- In a mixed economic system: Most firms are in the private sector
- In a planned economy: Most firms are in the public sector[state owned]
- In a mixed economy: Firms are owned , some are partly in the private sector while others are in the public sector.

CLASSIFICATION OF SIZE OF FIRMS BASED ON THE SIZE OF FIRMS:

Explain two influences on the size of firms. [4]-Board question

The size of the firm is influenced by the following factors:

- The number of workers employed in the firm
- The value of the output produced by the firms
- The value of the financial capital employed by the firm
- Size of market : the higher the demand for the product or the greater the value of sales, the larger the firm is likely to be.
- availability of finance/capital : The firms that can borrow, sell shares or have high profits are able to expand
- type of business organisation : aa MNC will be larger than e.g. a sole trader
- influence of government policies :The government itself may run large state-owned enterprises/operate restrictions on mergers
- age of firms :The older firms tend to be larger than younger firms
- skills of entrepreneurs : The firms run by skilful entrepreneurs are likely to be larger than those run by less skilful entrepreneurs

  goals of entrepreneurs. The entrepreneurs may want the firm to remain small to keep control / may want it to be large to e.g. gain economies of scale.

SMALL FIRMS

THE ADVANTAGES OF SMALL FIRMS:[2M-Board Question]

- They can cater to tastes and preferences of consumers.
- They have a greater flexibility ands can adjust quickly to changes in market conditions as fewer people to consult
- They have a better communication with workforce because of simple structure of firm .
- They can provide a more personalised service and more contact with consumers so can meet specific needs .
- They can specialise in niche markets , but the demand for particular products/types of products may be low and a large firm may not cater for such a small market .
- They may have low transport costs as they might be located close to customers .
- They may receive government subsidises as the government might want to encourage new firms, because they generate jobs .
- They may be charged a lower rate of tax (e.g. corporation tax) thus reducing the firm's costs
- They are easy to set up initially and not much capital may be involved in the form of e.g. factory buildings
- They have a less likelihood of trade unions and wage costs will be lower.

THE DISADVANTAGES OF SMALL FIRMS:

- May be too small to take advantage of economies of scale , as a result ,prices are higher than larger firms and hence cannot compete on prices profit margins are lower .
- They have some difficulty raising finance and may not be able to sell shares .
- Banks may be reluctant to lend to them .
- Some small businesses may be sole proprietors and so may have unlimited liability and may risk losing personal wealth .
- They may lack a range of ideas which may reduce innovation and may lack variety of goods compared to large firms.
- Small firms may not be well-known and so may find it difficult to attract consumers .
- Small firms may find it difficult to attract specialist staff due to their less ability to pay high wages and offering less opportunities for promotion

THE CHALLENGES FACING SMALL FIRMS:

Explain two challenges facing small firms.[4]

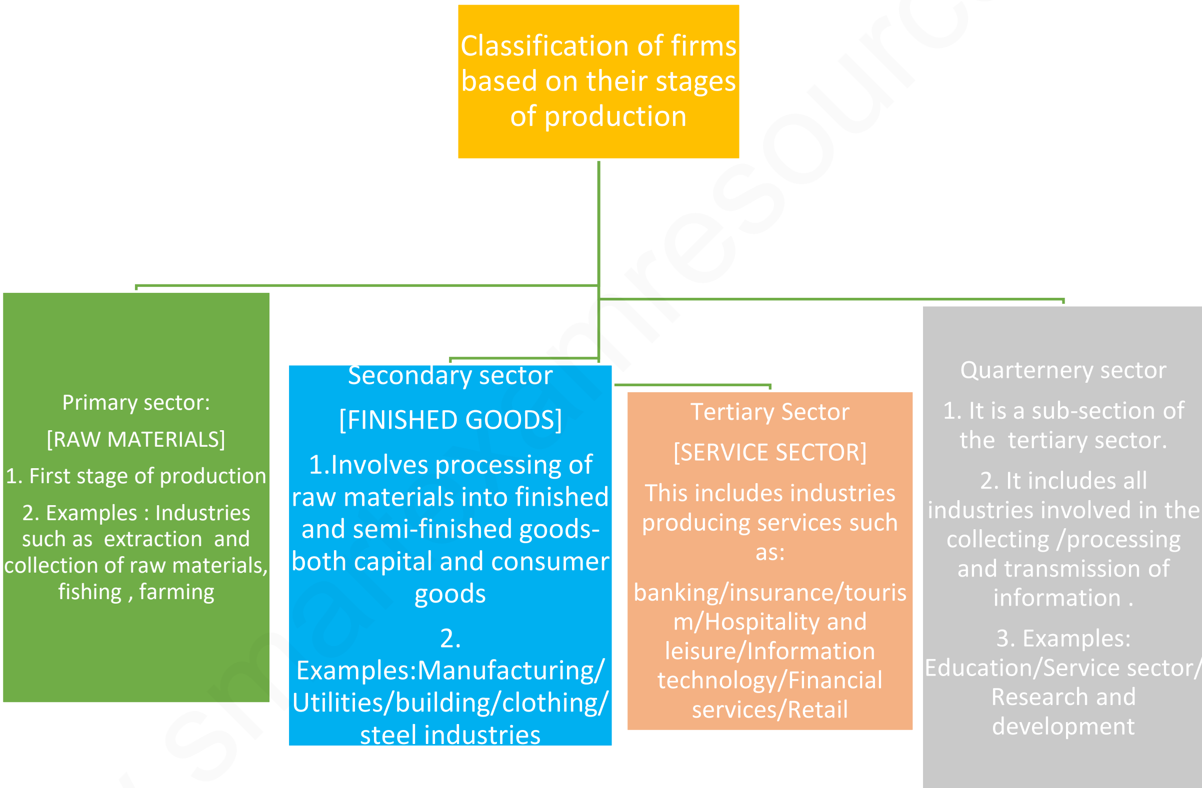
- Lack of finance/difficulty raising finance
- banks may be more reluctant to lend to small firms
- May not be able to take advantage of economies of scale and may have higher average cost .
- Not well known and it might be difficult to attract consumers .
- May face fierce competition from large firms which may lower their prices or spend more on advertising .
- Risk of failure due to inexperience of owners

THE REASONS SMALL FIRMS ARE LIKELY TO GROW LARGER:

The firms are likely to be small to begin with , example• The market will gradually expand • and the firm then becomes a company and so better able to finance expansion . e.g. Sainsbury's, Tesco

THE REASONS FOR THE EXISTENCE OF SMALL FIRMS:

- **The market may be too small or may be localised.**
- **The firm may be better able to satisfy the personal preferences of customers.**
- **The owners may be reluctant to expand.**
- **The small firms can combine to benefit from the economies of scale; e. in advertising.**



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BOARD EXAM QUESTIONS:

1.Discuss whether all small firms will eventually become large firms. [8]

Discussion could include:

Small firms likely to grow larger:	Reasons why small firms remain small:
• firms are likely to be small to begin with (acorn idea) • market will gradually expand • firm becomes a company and so better able to finance expansion • possible examples, e.g. Sainsbury's, Tesco	• market may be too small/localised • may be more flexible/better able to satisfy personal preferences of customers • owners may be reluctant to expand • small firms can combine to benefit from economies of scale, e.g. in advertising

2.Discuss whether small car manufacturing firms can compete with large car manufacturing firms. [6]

why they might:

- Small firms can specialise in luxury models and cater for a small market.
- They may provide specialist parts for bigger firms .
- Small firms can provide a specialised product and build cars to suit individual customer needs .
- Small firms may be subsidised or have taxes reduced by the government and reduce costs of production
- Large firms may experience diseconomies of scale, for example giving small firms a cost advantage.
- Small firms may experience external economies of scale .

why they might not:

- Average costs may be higher as the large firms may experience economies of scale
- Large firms may have brand loyalty and be well known due to a high spending on advertising and might have high spending on research and development
- Large firms may force small firms out of the market by lowering prices.

3. Discuss whether small firms can compete successfully against large firms. [8]

why they might:

- Small firms may provide a personal service and operate in a niche market and hence may be more in touch with consumers . They may be more adaptable/flexible in response to changes in consumer demand .
- Small firms may be subsidised by the government which would reduce costs of production thus allowing small firms to charge lower prices
- Small firms may be operating in an industry where economies of scale are not significant or there are diseconomies of scale , raising average cost
- Small firms may be able to take advantage of external economies of scale thus reducing average cost .

why they might not:

- Large firms may benefit from economies of scale and enjoy lower average costs .
- Large firms may take over small firms and may drive small firms out of business by charging lower prices
- Large firms may have more market power and) use barriers to entry and drive firms out of the industry by e.g. using predatory pricing
- Large firms may be better known and) have brand loyalty
- Large firms may have more finance which may enable them to purchase more efficient capital/machinery/technology and also spend more on advertising

4.Discuss whether people would prefer to buy a product from a small firm or a large firm. [8]

why they might prefer to buy from a small firm:

- Small firms may be flexible and quick to respond to changes in consumer demand as do not have to consult others
- Small firms may provide a personal service and can get to consumers and their requirements and adapt to particular requirements .
- Small firms may be specialised and produce high quality products
- Small firms may receive government subsidies thus enabling them to keep price low and quality high.
- Small firms are unlikely to experience diseconomies of scale

Up to 5 marks for why they might prefer to buy from a large firm:

- Lower prices due to lower costs because of economies of scale .
- They are better known brands due to advertising
- Thay might have a wider variety and a better quality .
- They might have better after sales due to more funds to invest.

5.Discuss whether a large firm will earn more profit per unit sold than a small firm. [8]

Up to 5 marks for why it might:

- Lage firms may be able to take advantage of economies of scale and lower average cost ,permitting a lower price to be charged raising sales and thus enabling more profit to be made even if the price charged is the same.
- Large firms may have funds available to spend on advertising and hence can create a brand image / brand loyalty , allowing the firm to raise price .
- Large firms may have more market power and may be able to keep competitors out of the market and create have high barriers to entry allowing the firm to raise price .

Up to 5 marks for why it might not:

- Large firm may experience diseconomies of scale and have higher average cost .
- Small firms may be subsidised by the government and have lower average cost.
- Small firms may be producing a new product for which there may be a high demand .
- Small firms may be in a niche market and consumers may be willing to pay a high price .
- Small firms may respond quicker to a change in demand ,reducing surpluses and shortages .
- Small firms may provide a personal service and develop a personal contact ,increasing demand and thus enabling a higher price to be charged .

6 Analyse the reasons why small shops may be easy to set up. [6]

- Small shops do not take much money to set up , so the costs initially will be low (low fixed costs).
- It may be possible to borrow the money or use savings
- There may be government subsidies designed to encourage the growth of small firms/shops and thereby lower costs of production
- Running a small shop does not require significant management skills and people do not need a high level of education to run a small shop
- Small shops involve less paperwork and regulations, thus reducing time and effort

7. Reasons for the continued existence of small firms: [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.

8.There are many large firms in most economies, but this does not mean that all small firms will become large. (a) Explain two reasons why a decision might be taken to change a private limited company into a public limited company. [4]

- The ability to raise more finance by selling shares on a stock exchange ,to the general public . This would enable a firm to finance expansion. This is different to a private limited company which cannot sell shares on a stock exchange
- Some public limited companies are listed on the stock exchange or several stock exchanges around the world and this would enable them to raise funds from a large number of sources and become better known .
- There is no maximum number of shareholders in a public limited company . A private limited company is likely to have a lower maximum number of shareholders, which limits the potential for growth and it is necessary to get other shareholders' permission to sell shares in a private limited company

9. Discuss the advantages and disadvantages of small firms. [8]

Advantages:

- Able to provide a personal / specialised service to meet individual requirements and thus produce unique goods .
- May be quick to respond to changes in consumer demand as owner can make decisions without consulting anyone .
- They have greater flexibility than bigger firms .
- More personal contact with staff and thus staff more motivated , resulting in higher productivity.
- They are easy to set up .
- They are able to cater for a small market and the demand for the product may be low .
- They may be able to cater for a local market and have greater knowledge of local market and have low transport costs .
- They may receive subsidies from the government ,making it easier to compete with bigger firms

Disadvantages:

- May be too small to take advantage of economies of scale , as a result prices are higher than larger firms and hence cannot compete on prices profit margins are lower .
- They have some difficulty raising finance and may not be able to sell shares .
- Banks may be reluctant to lend to them .
- Some small businesses may be sole proprietors and so may have unlimited liability and may risk losing personal wealth .
- They may lack a range of ideas which may reduce innovation and may lack variety of goods compared to large firms.
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- Small firms may find it difficult to attract specialist staff due to their less ability to pay high wages and offering less opportunities for promotion

INTERNAL AND EXTERNAL GROWTH OF FIRMS

FIRMS MAY GROW IN 2 WAYS:

- **Internal growth**
- **External growth**

INTERNAL GROWTH OF FIRMS

- Internal growth of firms is also called as the natural or the organic growth of firms.
- In this kind of growth the firm diversifies into other range of products or it increases the market for its existing products.
- Example: Mc Donalds with its outlets in different parts of the world

EXTERNAL GROWTH OF FIRMS

- It involves a merger or a takeover of firms.
- Mergers can be : horizontal mergers, vertical mergers, conglomerate mergers.

External growth enables a firm to increase it's size more quickly than internal growth.

MERGERS

Mergers are the reasons for the external growth of firms, while internal growth occurs due to increase in sales and greater share of market.

DIFFERENT TYPES OF MERGERS

The following are the different type of mergers:

1. **Horizontal mergers**
2. **Vertical mergers**
3. **Conglomerate mergers**

Horizontal merger:

Definition: Horizontal integration is a merger or a takeover between firms producing the same product at the same stage of production.

Examples of horizontal mergers:

- Car firms that have combined, e.g. Tata Motors and Jaguar.
- Two banks that have combined- Vijaya Bank and Dena Bank got merged in Bank of Baroda
- Two telecom companies -Idea and Vodafone
- Sporting goods-The merger of Adidas with Reebok

Advantages of horizontal integration:

- Achieving economies of scale by lowering the total cost of business.
- The range of products offered to the customers by the merged firms increases without having the need to invest in new resources.
- In the long run , the market share can be increased .
- Efficiency can be increased by reducing the total cost of operations.
- Reduced competition leads to market benefits.

Disadvantages of horizontal integration:

- Leads to the creation of monopoly
- Results in reduced flexibility in market innovations
- The overall workload of the firm's top management increases and the end result is decreased efficiency .
- A company may fail to gain the anticipated synergies of merger and it may become tough to maintain the expected value to be gained from the strategy of horizontal integration.
- Strict regulatory investigation acre conducted by regulatory bodies who closely investigate the horizontal integrations to prevent monopoly

- Positive synergies do not always yield from the integration and value addition as per expectation .**Synergies** can be **negative** (dis-**synergies**) if a **merger** is poorly executed resulting in the reducing of the value of the whole business. Few hurdles could be : overlapping of personnel or products , Managing the larger size merged firm could become practically difficult.

Advantages [Benefits] of horizontal mergers to consumers:

- They may enable the firms to take greater advantage of economies of scale .This will reduce average cost of production, and this may lower prices to consumers .
- They may enable the firms to earn more profit which they can spend on research and development , thus increasing innovation and thereby raising the quality of the product

Disadvantages of horizontal mergers to consumers:

- They may result in the firms experiencing diseconomies of scale . This will increase average cost of production, and this may raise prices to consumers .
- The firms may gain greater market share and move it closer to monopoly and this may result in higher prices
- The reduction in competition may discourage research and development and this may reduce innovation and consequently reduce quality

Vertical merger:

Definition: In this type of merger, two or more firms from the same industry but different stage of production merge

- 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.

Examples of vertical mergers:

- A tea company taking over a tea plantation ,
- A brewery taking over a public house
- A tyre company taking over a rubber plantation
- A brewery taking over hop fields.

Advantages [Benefits] of vertical mergers

- Costs are reduced and the quality of inputs in the production process improved
- Better control over retail distribution channels
- Improved access to key raw materials even at the expense of rival business.
- Ensures supply of raw materials at a reasonable price/reduces the chain of production “cuts out the middle man” as the firm can directly provide raw materials for manufacture
- may restrict access of competitors to raw materials which may make their prices higher or restrict their output.
- ensures outlets for products ,which ensures products get to market
- ensures products are well displayed and promoted which can increase demand
- may enable economies of scale to be gained e.g. financial economies.

Disadvantages of vertical mergers

- May actually increase cost of inputs
- Suppliers have less incentives to be efficient
- Ties a company into old, obsolescent and high cost technology
- Loss of flexibility
- Compounding of risk
- Developing new competencies may lead to a compromise on existing competencies

Conglomerate mergers:

Definition: In this type of merger, two or more firms from different industries merge .

Advantages [Benefits] of conglomerate mergers to consumers:

- Diversification of business: Moving into different markets reduces risks
- Gain synergies
- Utilisation of excess cash
- Improved customer base
- Utilisation of human resources
- Economies of scale

Disadvantages of conglomerate mergers to consumers:

- No past experience
- Shift in focus
- Governance issue

In general , the following can be said to be the advantages and disadvantages of mergers

	Advantages	Disadvantages
1	Bigger firms are more efficient	An increase in the monopoly power leads to higher prices
2	Lower prices form the efficiency of scale and synergy	A firm with monopoly power may become inefficient
3	More investments and research is possible due to higher profits	Two very different firms may struggle to merge
4	Unprofitable firms can be saved from going out of business	Consumers are left with less choice
5	Duplication is avoided in natural monopoly	Results in the loss of jobs
		Diseconomies of scale may be the result

Application based questions:

1.Discuss whether consumers benefit from horizontal mergers. [8]

A horizontal merger is a merger between two firms at the same stage of production producing the same product

Or

A horizontal merger is a merger when two or more firms from the same industry and the same stage of production merge

why it might:

- They may enable the firms to take greater advantage of economies of scale .This will reduce average cost of production and this may lower prices to consumers .
- They may enable the firms to earn more profit which they can spend on research and development , thus increasing innovation and thereby raising the quality of the product

why it might not:

- They may result in the firms experiencing diseconomies of scale . This will increase average cost of production, and this may raise prices to consumers .
- The firms may gain greater market share and move it closer to monopoly and this may result in higher prices
- The reduction in competition may discourage research and development and this may reduce innovation and consequently reduce quality

2.Car production in the United States has changed dramatically during the last forty years. The managers of the firms have decided to use more advanced machinery and fewer employees to produce the cars.

(b) Most car producing firms are now very large.

Explain how they may have benefited from: (i) horizontal integration [4] (ii) vertical integration. [4]

(i)Horizontal integration: is when firms engaged in the same stage of production of a good combine .Examples of car firms that have combined, e.g. Tata Motors and Jaguar.

(ii) Vertical integration: is when firms engaged in different stages of production combine .

- Forward integration involves going forward to a retail outlet, e.g. where a car producer owns/controls dealerships
- Backward integration involves going backward to the supply of raw materials, e.g. where a car producer owns/controls supplies of raw materials/parts.

The benefits will relate to the possible advantages of economies of scale in reducing the costs of production

3. Firms can grow large through integration. Explain, with the aid of examples, the difference between horizontal and vertical integration.

Markscheme:

horizontal integration: In this type, 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: In this type, 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.

4.Using examples, distinguish between vertical, horizontal and conglomerate integration. [5]

vertical integration is the joining of two firms at different stages of production in the same industry e.g. a tea company taking over a tea plantation , or forward vertical integration, forwards towards consumers (later stage of production), e.g. a brewery taking over a public house

horizontal integration joins together firms at the same stage of production, e.g. two banks

conglomerate integration joins together firms in different areas of activity to spread interests and risks over different industries e.g. the Indian company Tata which produces motor vehicles and tea

5. Discuss whether or not a merger would make it easier for a firm to achieve its goals.

why it would be easier:

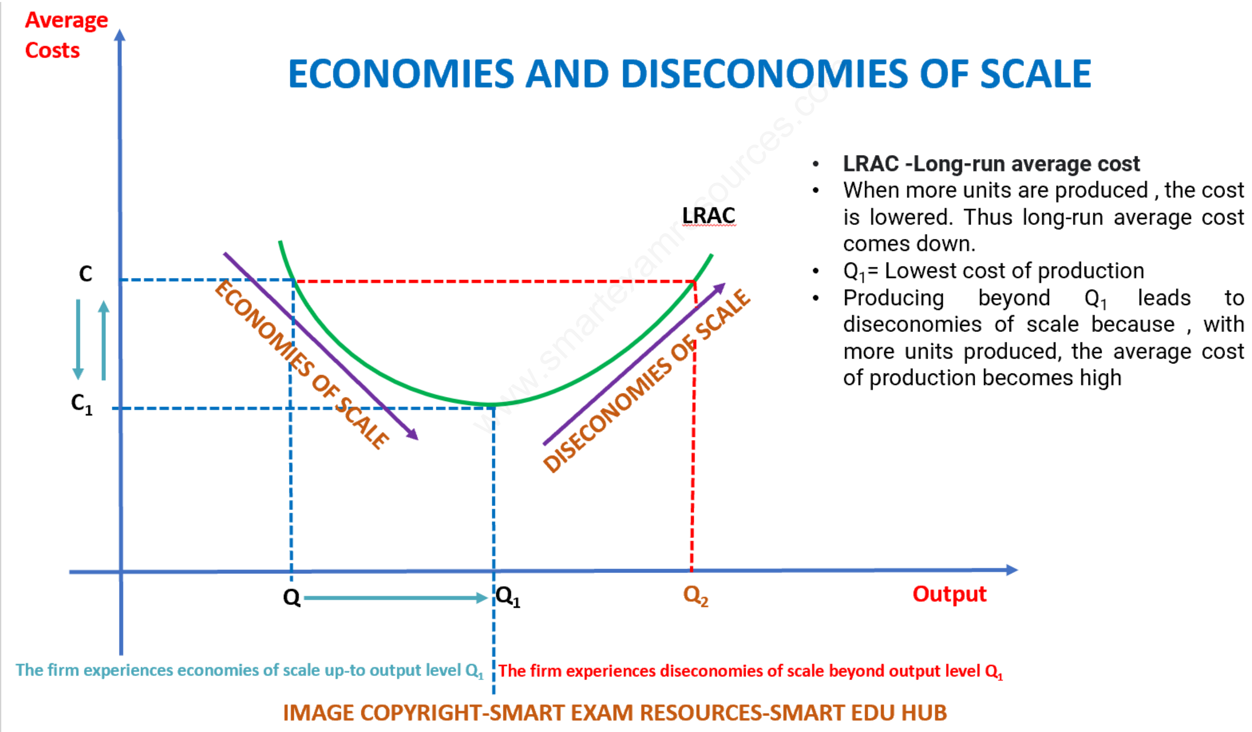
- It could be a horizontal merger ,enabling easier exploitation of economies of scale , leading to lower average costs. Lower prices lead to more demand and higher profits
- It could be a vertical merger reducing the costs of obtaining materials , making it easier to distribute the firm's products. Reduced competition / monopoly is also a quick way to grow
- the firm can set higher prices without losing too many customers **, thus** reduced risk
- The loss of one part of the business could be offset by the other , thus it is easier for the firm to survive

why it would not be easier:

- Reduced competition may cause complacency and may fail to control of cost
- The merged firm may experience diseconomies of scale and average cost may increase as output increases ,leading to higher prices and reduced demand and lower profit.
- Large firms may lose customers due to lack of personal touch .
- Cost of integrating firms such as redundancies / fall in morale.
- Government may no longer support large firms (government support small firms) , removing tax advantages and subsidies

ECONOMIES AND DISECONOMIES OF SCALE

- **Economies of scale** occur when the cost per unit of production (Average cost) decreases because the output (sales) increases, it is called a as economies of scale.
- Economies of scale highlight the advantages that a company obtains due to the use of a modern technique
- The quantity of output decreases the per unit fix cost decreases and the average variable cost decreases.
- Increase in the scale of production results in greater operational efficiencies and synergies.
- **Diseconomies of scale** occur When the cost per unit of production (Average cost) increases because the output (sales) increases, it is called as diseconomies of scale.



EFFECT OF INTERNAL AND EXTERNAL ECONOMIES ON A FIRM/INDUSTRY AS THE SCALE OF PRODUCTION CHANGES:

When some firms grow, following may be the result:

- **Economies of scale:** Financial, administrative/managerial, technical, risk-bearing and marketing
- **Diseconomies of scale:** Poor management, problems of communication and poor industrial relations

TYPES OF ECONOMIES OF SCALE:

- **Internal economies of scale**

- **Marketing economies:**
  This includes the buying economies and selling economies
  Buying economies: Large firms buy raw material in bulk and hence enjoy special discounted prices and also receive better services and quality of raw material.
  Selling economies: The processing cost, packaging and transporting costs get reduced with an increase in the number of orders. This is because the cost is now spread over many units .
- **Managerial economies:** Large firms employ specialist staff in key positions. They more effectively manage areas of the company. For example, a seasoned sales executive has the skill and experience to take care of big orders. With their skills and experience, they are able to reduce cost of production and raise demand and revenue.
- **Labour economies:** As a company gets larger, it can benefit from the division of labor. By allocating workers to specific tasks, they can do more effectively and efficiently. For example, Apple splits its operations down into design, hardware, software, manufacturing, marketing, production, and assembly.
  Each employee has a different role that they specialize in. That allows them to master a specific skill, benefiting the company through greater efficiency
- **Financial economies**: It is easier and cheaper for large firms to raise finance. Even banks tend to offer large loans as these firms are reputed and have valuable assets to offer as collaterals. Interest rates are kept low for them to attract the large firms into opting for larger loans. Larger firms can raise finance by selling shares. More people are willing to buy their shares due to their large firm size and market reputation.
- **Technical economies:** Technical economies arise due to the large scale production because there is a mechanical advantage in the use of large machines. Technical economies may arise due to large size of the plant because it requires less energy, less staff, and proportionately less cost of installing the plant.
- **Research and development economies:** Larger firms can invest in research and development as through their research new in demand products can be created and thus more revenue can be generated.
- **Risk bearing economies:** Risk-bearing economies of scale allows a firm to spread risk by having a number of different products to fall back on. If there is a reduction in

demand for one, it is easier to make cost savings by reducing production of that item. This is because the firm has other products that it can continue to sell.

- **Internal diseconomies of scale**

- **Difficulties in controlling the firm**
- **Communication problem**
- **Poor industrial relations**

- **External economies of scale: External economies of scale refer to factors that are beyond the control of an individual firm, but occur within the industry, and lead to such a cost benefit.**

- **A skilled labour force:** A firm can employ workers who have been trained by other firms in the economy
- **A good reputation:** Different regions can gain reputation for high quality production. SO for instance, when it comes to the art of perfumes, no country ranks more highly than France. Many of the greatest names in the perfume industry, Chanel, Christian Dior or Estée Lauder are French, and in terms of international perfume sales, France is leader, with 30% of the world market.
- **Specialist suppliers of raw materials and capital goods:** When an industry becomes large enough, it makes way for ancillary industries that supply for the needs of this industry. For example, the GE is an ancillary industry that produces engines for the aircraft industry.
- **Specialist services:** Universities and colleges may run courses for workers in large industries. Example the Post graduate management programmes etc.
- **Specialist markets:** Some industries have specialist selling places and arrangements. Example: Insurance markets.
- **Improved infrastructure: The growth of industries may encourage government and private sector firms to provide better transport, health care, electric connectivity**

- **External diseconomies of scale**

- **Congestion**
- **Increased journey time**
- **Higher transport costs to firms**
- **Reduced workers' productivity**
- **Increased competition for resources**
- **Increase in the price of capital equipment and labour**

NOTE:

1.Benefits to a large firm from the economies of scale in the television manufacturing industry:

- **Internal economies of scale**
    - Bulk buying
    - Managerial
    - Technical, Specialisation,indivisibilities,linked processes
    - Financial economies
    - Risk bearing economies
- **External economies of scale**
    - Availability of skilled labour
    - Existence of ancillary industries

2. Some large firms might benefit from reducing their size:

Economies of scale:

- internal, e.g. technical, marketing, financial, risk-bearing economies
- external, e.g. available infrastructure, pool of skilled labour, local suppliers.

Diseconomies of scale:

- internal, e.g. poor communications, low morale
- external, e.g. congestion, higher transport costs.

3. Small stores sometimes find it difficult to compete with larger super markets because:

- **Large stores can lower the prices due to economies of scale.**

APPLICATION BASED QUESTIONS:

1. **Discuss whether some large firms might benefit from reducing their size. [6]**

Economies of scale:

- internal, e.g. technical, marketing, financial, risk-bearing economies
- external, e.g. available infrastructure, pool of skilled labour, local suppliers.

Diseconomies of scale:

- internal, e.g. poor communications, low morale
- external, e.g. congestion, higher transport costs.

[Discuss in detail on points mentioned above]

2. **Distinguish between internal and external economies of scale. [4]**

Internal economies of scale:

- reductions in long-term average costs as the scale of production and output of the firm increases, e.g. marketing, administrative, technical, risk-bearing and financial economies.

External economies of scale:

- falls in long-run average costs for a firm when the industry in which the firm operates grows in size
- e.g. availability of skilled labour, ancillary firms, infrastructure.

An answer which focuses on one type of economy of scale can gain no more than 2 marks. [4]

3. **Discuss the extent to which different firms can be affected by diseconomies of scale. [6]**

Internal diseconomies of scale:

- ineffective management as management becomes more complex
- firm could become slower in responding to changes in market conditions
- communication problems
- poor industrial relations
- motivation problems

External diseconomies of scale:

- congestion/increased journey times
- increased competition for resources, putting up price of labour

[Note: Up to 4 marks for a discussion of diseconomies of scale. Up to 2 marks for discussion of extent e.g. it may be more of a problem with large firms than small firms. Note: maximum of 6 marks]

4. Analyse any tow internal diseconomies of scale that a large firm may experience. [6]

Managerial diseconomies:

- If there are more layers of management in a large firm it may take longer to make decisions .
- There might result communication problems if there are more layers of communication
- If the communication is indirect then the messages may be misinterpreted or may take time to reach recipients.

Labour diseconomies :

- Workers may feel less appreciated or have low morale and so may become demotivated which could reduce labour productivity or efficiency
- Poor industrial relations: Industrial action e.g. strikes may occur due to the time it takes to address workers' grievances and may result in more people to argue with

5. Define economies of scale.[2].

Economies of scale refers to a fall in average costs resulting from an increase in output or the scale of production.

6. Farms in the USA are getting larger. One dairy farm in the state of Indiana has over 38 000 cows. Farms in the USA compete with farms in both developed and developing countries. The value of the farms' exports of milk appears in the trade in goods section of the current account of the USA's balance of payments.

Analyse the economies of scale from which a farm may benefit. [6]

- Buying (purchasing) economies: e.g. buying seed in bulk at reduced price.
- Technical economies: Using up to date or more efficient equipment e.g. combine harvesters.
- Managerial economies: Employing specialist workers e.g. farm managers.
- Financial economies: Borrowing at a lower rate of interest or finding it easier to obtain a loan.
- Risk bearing economies: A farm may grow a variety of crops.

7. Explain, giving examples, the difference between an internal economy of scale and an external economy of scale.[4]

- Internal economy is the benefit a firm gains from itself e.g. buying economies
- External economy is the benefit a firm gains from the industry e.g. ancillary industries

8. Explain how some large firms can experience economies of scale, while others face diseconomies of scale. [6]

- Economies of scale refers to a fall in average costs resulting from an increase in output or the scale of production.
- As a firm grows in size it leads to reductions or increases in average total cost in the long run

This is why the large firms may experience internal economies of scale:

- ✓ technical economies: large firms can employ large-scale capital equipment
- ✓ financial economies: large firms could raise finance more easily/more cheaply
- ✓ marketing economies: a large firm is able to have a wider marketing campaign
- ✓ buying economies: large firms can buy in bulk to reduce costs
- ✓ managerial economies: a large firm can employ specialised staff
- ✓ risk-spreading economies: diversification into different markets

This is why the large firms may experience internal economies of scale:

- ✓ ancillary services or industries : These may develop to support the large firms
- ✓ specialised labour : firms can recruit staff from other firms in the industry
- ✓ infrastructure : firms can benefit from transport or communication links provided to support the industry

Large firms may be able to spread fixed costs over a greater amount of output and thus experience economies of scale.

This is how the large firms may experience internal diseconomies of scale:

- ✓ ineffective management: firm becomes too large to control and coordinate activities
- ✓ poor industrial relations: greater likelihood of industrial action e.g. strikes

This is how the large firms may experience external diseconomies of scale:

- ✓ pressure on infrastructure: This results in congestion
- ✓ pollution: if heavy industry is concentrated in one area it may increase in cost of production
- ✓ increased competition: Firms may face increased competition from other firms in the industry

DEMAND FOR THE FACTORS OF PRODUCTION

- **The factors of production employed depend upon the type of product being produced.**
- **Completely changing the factors of production might not be practical in some cases.**
- **By combining the right factors of production, it is possible for firms to achieve the highest possible productivity.**

CAPITAL GOODS: **A capital good is a human made good used to produce other goods and services**

FOLLOWING ARE THE FACTORS THAT INFLUENCE HOW MUCH THE FIRMS SPEND ON CAPITAL GOODS

- **The amount of profits earned: high profits provide the finance and incentive to invest**
- **The size of the firm: large firms are able to finance large scale capital investment**
- **The type of firm: e.g. a steel producing firm will use a higher value of capital goods than a flower seller**
- **Interest rates: low interest rates allow firms to borrow cheaply for investment**
- **Inflation: a low rate of inflation gives firms confidence to invest**
- **Economic stability: a stable economy gives firms confidence to invest**
- **Corporation tax: a lower rate of corporation tax provides the finance and incentive to invest**
- **Advances in technology: This may encourage firms to replace existing machines**
- **Expectations: if firms anticipate selling more in the future, they may expand**
- **Price of labour: a rise in wages may cause firms to replace labour with capital**

FOLLOWING ARE THE FACTORS THAT INFLUENCE THE DEMAND FOR LAND:

- **Productivity:** **Demand for land depends on productivity. For example, the most fertile land will have greatest demand and will receive the highest rent.**
- **Shops in the centre of a city, which has the greatest number of customers will also be in high demand.**
- **Certain natural resources, although scarce are in high demand due to their multiple uses. One of them is water, which is used for farming, cooking, bathing, industrial process, electricity generation etc.**

LABOUR-INTENSIVE & CAPITAL-INTENSIVE PRODUCTION

- **LABOUR INTENSIVE PRODUCTION: This is where a lot of labour is employed compared with the amount of capital**
- **CAPITAL INTENSIVE PRODUCTION: This is where a lot of capital is employed compared with the amount of labour**

REASONS WHY SOMETIMES PRODUCTION IS VERY LABOUR INTENSIVE:

- **There could be a high proportion of labour relative to capital**
- **Labour may be in plentiful supply in the economy and so is relatively cheap**
- **Other factors, e.g. capital, may be less available perhaps because of expense**
- **Sometimes jobs require labour/good, or service cannot be mass produced e.g. car repairs as opposed to car production.**
- **The production of some goods and services requires personal attention e.g. hairdressing**

REASONS WHY SOMETIMES PRODUCTION IS VERY CAPITAL INTENSIVE:

- **Labour might have become relatively less expensive; this could be because of an increase in supply forcing wages down**
- **The company could be moving away from mass production towards more specialised production**
- **The capital equipment could have become less reliable and, therefore, more expensive to maintain**
- **The power of the trade unions could be less than it was in the past, making it more difficult for them to have a significant effect on wages**
- **Capital equipment might have been disposed due to financial problem**

LABOUR INTENSIVE PRODUCTION		
	ADVANTAGES	DISADVANTAGES
1	Employees can be creative and use their own initiative	It is expensive and takes time to recruit, select and train employees
2	Labour is usually readily available	Employees require specialised skills which can take time to learn
3	No need for expensive equipment	Quality of work may vary depending on who is doing it
4	Lower start-up costs than capital intensive	Staff illness or absence

CAPITAL INTENSIVE PRODUCTION		
	ADVANTAGES	DISADVANTAGES
1	Operates 24/7	Large initial outlay to purchase machines
2	Higher volume of goods can be produced	Cost of repairing and maintaining equipment
3	Removes human error	Only suitable for standardised production
4	Machines can do work that could be dangerous to humans	Production time is lost if machines break down
5	Quality of output is standardised and consistent	Can cause unemployment

APPLICATION BASED QUESTIONS:

1. Why is meant by labour-intensive industry? [2]

An industry which has a high proportion of labour compared with the proportion of the other factors of production used is called as a labour-intensive industry.

2. Discuss to what extent production should be encouraged to move from being labour-intensive to being capital-intensive. [10]

- **Definition of terms:**
- **labour-intensive production is where a lot of labour is employed compared with the amount of capital**
- **capital-intensive production is where a lot of capital is employed compared with the amount of labour**
- **Move to being more capital-intensive:**
  - **advances in technology should increase productivity But it will depend on the price of capital in relation to the price of labour . The price of labour will reflect the supply of labour available in a particular economy (e.g. price of labour in a country with a large population, such as China, compared to price of labour in a country with a small population, such as Singapore)**
  - **profits made by firm to supply funds to buy capital equipment from retained profits**
  - **ability of firm to borrow the required funds may generate unemployment in the short run Ultimately, the decision will depend on the relative productivity and costs of the different factors of production.**

    [An answer which offers a one-sided argument, stressing the move from labour-intensive to capital-intensive production, but which does not address 'to what extent', can gain no more than 7 marks (inclusive of the 2 marks for the definitions of 'labour-intensive' and 'capital-intensive').] [10]

3. Explain two reasons why production by a firm might be changed from capital intensive to labour intensive. [5]

- **labour-intensive production is where a lot of labour is employed compared with the amount of capital**
- **capital-intensive production is where a lot of capital is employed compared with the amount of labour.**

Reasons:

- **labour has become relatively less expensive; this could be because of an increase in supply forcing wages down**
- **the company could be moving away from mass production towards more specialised production**
- **the capital equipment could have become less reliable and, therefore, more expensive to maintain**
- **the power of the trade unions could be less than it was in the past, making it more difficult for them to have a significant effect on wages**
- **disposal of capital equipment due to financial problems**

PRODUCTION AND PRODUCTIVITY

PRODUCTIVITY:

Productivity is the output produced per factor/input, e.g. per worker, per machine, per hectare of land, per period of time, e.g. per hour, day, week or month

PRODUCTION:

Production is the total output per period of time, e.g. per hour, day, week, month or year

PRODUCTIVITY MAY INCREASE IF:

- improved education/training: With improved education/training , skills may be raised and when the number of skilled workers increase, they can produce more
- increased investment /advances in technology: More up to date capital goods are likely to produce more
- increase in wages: Workers may be motivated to work harder
- increase in monetary rewards
- shorter working hours: This may increase the energy that the workers will possess while working as they will be less drained out
- higher unemployment: higher unemployment may mean that those who retain their jobs may be more the more skilled workers
- greater specialisation: This may make workers more efficient

PRODUCTIVITY MAY FAIL IF:

- Productivity may fall as the result of a decline in the quantity or quality of education/training and the workers will be less skilled
- A decline in investment will result in the workers working with less equipment
- A decline in wage rates will reduce workers' motivation
- Worse working conditions will reduce job satisfaction
- A rise in working hours will make the workers more tired
- Work may become more repetitive / less interesting which may result in
- workers becoming bored
- Change in average age of workers e.g. older workers may be less up to date with new technology or the younger workers may have received less training and thus be less experienced
- Higher tax rates in a country may reduce workers' motivation
- Poorer healthcare in a country may reduce the workers' physical strength and mental alertness

APPLICATION BASED QUESTIONS

1. Distinguish between productivity and production

Up to 2 marks:
Productivity is the output produced per factor/input, e.g. per worker, per machine, per hectare of land , per period of time, e.g. per hour, day, week or month
Up to 2 marks:
Production is the total output per period of time, e.g. per hour, day, week, month or year

2. Analyse the causes of an increase in labour productivity.[6]

An increase in labour productivity may be due to:

- **Improved education/training: workers will be skilled/specialised and hence capable of producing a higher output per hour**
- **Advances in technology: better quality of capital goods with more and better capital goods workers can produce more**
- **Better working conditions: The contented workers may be more productive .**
- **Better health: Healthier workers can produce more**
- **Higher wages: This may motivate workers more**
- **Fall in employment: The less productive workers tend to lose their jobs first , the more productive workers will remain**

3. Explain one reason why traffic congestion can reduce labour productivity.[2]

Congestion may reduce the health of workers. The workers will arrive tired and stressed and this is likely to lead to more days of absence from work and reduce their output per hour .When they arrive late to work , their output per day will decline as they spend less time working.

3.7-FIRM'S COST, REVENUE AND OBJECTIVE

3.7.1 Definition of costs of production:

- **Total cost:** the total amount that has to be spent on the factors of production used to produce a product is referred to as total cost.
- **Fixed cost:** Cost which do not change with output in the short run are called as fixed cost
- **Average total cost:** it is the total cost / output.
- **Average fixed cost:** It is the total fixed cost divided by output
- **Variable cost:** It is the cost that changes with output
- **Average variable cost:** It is the total variable cost divided by output

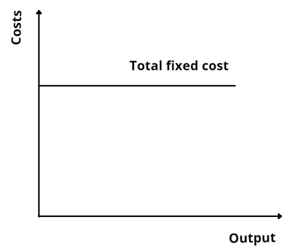
3.7.2 Calculation of cost of production:

- Calculation of average total cost (ATC))=TC/OUTPUT
- Calculation of average fixed cost (AFC)=TFC/OUTPUT
- Calculation of average variable cost (AVC)=TVC/OUTPUT

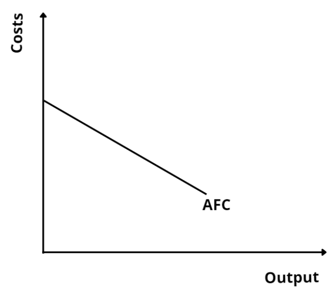
Output	TC($)	ATC($): TC/OUTPUT	TFC($)	AFC($) TFC/OUTPUT	TVC($)	AVC($) TVC/OUTPUT
0	20	-	20	-		
1	30	30/1=30	20	20/1=20	40	40
2	50	50/2=25	20	20/2=10	70	35
3	90	90/3=30	20	20/3=6.67	90	30
4	100	100/4=25	20	20/4=5	120	30
5	150	150/5=3	20	20/5=4	175	35

Graphs:

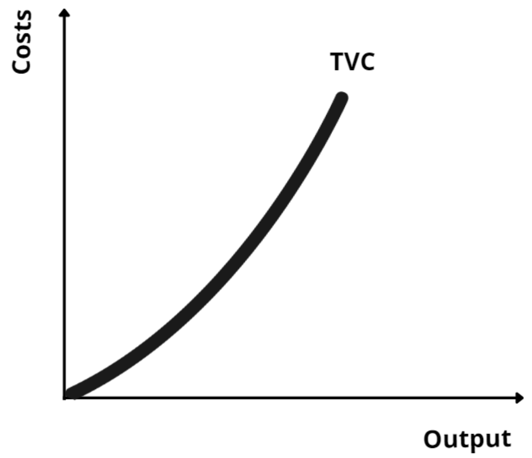
Total fixed cost:



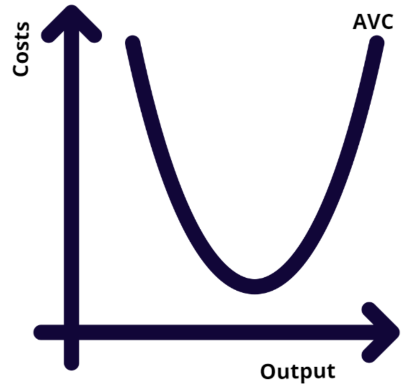
Average fixed cost:



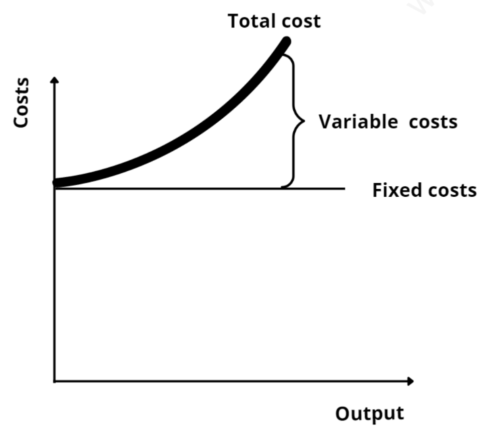
Total variable cost:



Average variable cost:



The composition of total cost:



3.7.3 Definition of revenue:

Revenue: Revenue is the money generated from normal business operations, calculated as the average sales price times the number of units sold.

Total revenue: The total amount of money received from selling a product(TR)

Average revenue: The total revenue divided by the quantity sold.(ATR)

3.7.4 Calculation of revenue:

Quantity sold	Total revenue (TR)($)	Average revenue (AR)($)
1	20	20/1=20
2	40	40/2=20
3	60	60/3=20
4	80	80/4=20
5	100	100/5=20
6	120	120/6=20
7	140	140/7=20

3.7.5 Objectives of firms:

The following are the objectives of firms:

Survival: The initial objective of every form is to survive. It is only survival that will help it to create its identity and compete in the long run. Even large forms make a struggle to survive, during difficult time when demand falls

Social welfare: [ethical/environmental considerations/corporate social responsibility] State owned enterprises are entrusted with the objective of improving social welfare. These are the firms that are more likely than the private sector firms, to base their production decisions on social cost and benefits. Example, keeping price of prices of products and services to make them affordable to the poor.

Profit maximisation:

The principle pf profit maximisation is as under:

- seeking to earn as much profit as possible
- profit is the difference between total revenue and total cost
- profit maximisation[sales revenue maximisation] is where there is the greatest difference between total revenue and total cost
- high profits can be used for reinvestment
- high profits can be used to pay high dividends
- may be achieved by lowering costs with an example
- may be achieved by raising revenue with an example

The extent to which profit maximisation is the objective of co-operative

- It operates in the private sector
- It does aim to make a profit
- The profit is distributed to the workers/members
- Profit may be earned by raising revenue/lowering cost etc.

The extent to which profit maximisation is the objective of public corporation

- It operates in the public sector
- It does not aim to make a profit
- It's aim is to work in the public interest.

Growth of firm/increase in market share:

If a firm grows in size, it may be able to take advantage of economies of scale. This would reduce average cost of production. If prices are unchanged, profits will be higher. A larger firm may have a larger share of the market / more customers. This will increase the firm's revenue. A larger firm may have more market power and this may enable it to raise price

- **Satisficing**: Satisficing behaviour is an alternative business objective to maximising profits. It means a business is making enough profit to keep shareholders happy or it's sufficient for investors to maintain confidence in the management they appoint.

improvement of reputation/brand loyalty

More on profit:

Profit=Revenue-Cost

Cost=Revenue-Profit

Effects of changes in profits:

An increase in profit:

- This encourages more firms to enter a competitive market.
- This also provides firms with more finance to update their capital equipment and expand their business.

A firm becomes more profitable, it is able to obtain external Finance. Shareholders want to buy shares in profitable firms and banks are usually willing to give them loans.

- Such firms are also able to recruit top managers and directed.

A decrease in profit:

- Initially it has little impact on the behaviour of firms, if they feel that this decrease in profit will be short-lived.
- If the fall in profit continues for a longer period of time, then some firms may cut back on production, while others might cease production

Ways of increasing profits:

- Reduce cost of production: this can be done by reducing wastage and inefficiency and also by increasing the productivity of the factors of production. Also another way is to increase the size of the firms through merger or takeover.
- Raise revenue: This can be done by changing prices and by increasing the demand for their products. The demand can be increased by improving the quality of their products, diversify and be more responsive to changes in the consumer demands, by improving their market research. Another way of increasing profits is through a successful advertising campaign in which revenue increases more than the cost and hence raises profit.

MARKET STRUCTURE

KEY TERMS:

- **NORMAL PROFIT**
  This refers to the minimum amount of profit required to keep the firm in the industry in the long run
- **SUPERNORMAL PROFIT**
  This refers to the profit above that needed to keep a firm in the market in the long run
- **BARRIER TO ENTRY:**
  It refers to anything that makes it difficult for a firm to start producing athe product
- **BARRIER TO Exit:**
  It refers to anything that makes it difficult for a firm to stop making the product

3.8.1-COMPETITIVE MARKETS

THE characteristics of perfect competition are as follows:

- there are a large number of sellers
- there are a large number of buyers
- all firms produce an identical or homogeneous product
- there are no barriers to entry or exit
- perfect knowledge
- price taker
- all firms have access to the same information
- abnormal/supernormal/subnormal profits can only be made in the short-run
- in the long-run, only normal profits are made.

[Note: A list-like answer can gain no more than 2 marks.]

ADVANTAGES OF A PERFECT COMPETITION IN COMPARISON TO MONOPOLY:

- price will tend to be lower than in monopoly
- output will tend to be higher than in monopoly
- normal profits only will be made in the long-run

ADVANTAGES OF MONOPOLY IN COMPARISON TO A PERFECT COMPETITION:

- abnormal/supernormal profits can be used to finance research and development
- large size can lead to economies of scale and lower costs and prices.

BOARD QUESTIONS:

1.Explain two characteristics of perfect competition. [4]

MARKSCHEME:

- many buyers and sellers so no one buyer or seller can influence price
- no barriers to entry and exit so any new firm can start producing the product/nothing which makes it difficult for a firm not currently making the product from starting to make it/no restrictions on firms in the industry stopping producing the products
- firms are price takers and their supply is such a tiny proportion of total supply that changes in it will have no effect on price
- homogeneous product/all the products are the same so the products of different producers are perfect substitutes for each other
- perfect information : The buyers and sellers are fully aware of price and profits earned in the market

2. Discuss whether price is likely to be higher in a monopoly than in a perfectly competitive market. [8]

Up to 5 marks for why it might:

- lack of competition (1) gives a monopoly market power (1) if profit maximisers (1) may push up price (1) by restricting supply (1)
- lack of consumer choice/consumers can switch to rival producers in a perfectly competitive market (1) an increase in demand raises price (1) which will encourage new firms to enter the industry (1) reducing price (1)
- demand is often inelastic, e.g. water (1) increased demand raises price by greater proportion (1)
- a monopoly may be experiencing diseconomies of scale (1) example of diseconomies of scale (1) this will raise average costs of production (1)

Up to 5 marks for why it might not:

- a monopoly may be able to take advantage of economies of scale (1) example of economies of scale (1) with lower average costs, price may be lower (1) whilst still enabling a monopoly to enjoy high profits (1)
- with high profits, a monopoly may be able to spend more on research and development/new technology (1) this can reduce costs of production (1) enabling a monopoly to charge a lower price (1)
- a monopoly may be state-owned (1) it may choose to charge a low price to ensure everyone can afford it (1)
- private sector monopolies may not be profit maximisers (1) they may charge a lower price (1) in order to grow the business (1)
-
- monopolies may still face overseas competition (1) keeping prices down (1)

3. Describe the characteristics of perfect competition. [4]

- In a mixed economic system: Most firms are in the private sector
- In a planned economy: Most firms are in the public sector[state owned]
- In a mixed economy: Firms are owned , some are partly in the private sector while others are in the public sector.

Explain two characteristics of perfect competition. [4]

MARKSCHEME:

Many buyers and sellers (1) making each firm a price taker/a very low market concentration ratio (1).

Free entry and exit (1) absence of barriers to entry and exit/results in only normal profits being earned in the long run (1).

Homogeneous product (1) an absence of anything that differentiates the product e.g. branding / demand for one firm's product will be perfectly elastic (1).

Perfect knowledge (1) firms and buyers aware of profits/prices (1).

MONOPOLY MARKETS

CHARACTERISTICS OF A MONOPOLY:

- large profits can be reinvested to improve the quality of products, such as expenditure on research and development
- there may be opportunities for economies of scale
- this could lead to a lowering of cost and, possibly, price
- avoids wasteful duplication of capital equipment

ADVANTAGES OF A MONOPOLY:

- large profits can be reinvested to improve the quality of products, such as expenditure on research and development
- there may be opportunities for economies of scale
- this could lead to a lowering of cost and, possibly, price
- avoids wasteful duplication of capital equipment

DISADVANTAGES OF A MONOPOLY:

- they can be inefficient (either productively or allocatively efficient
- price will tend to be higher than in perfect competition
- output will tend to be lower than in perfect competition
- products may be of poor quality as a result of lack of competition
- abnormal profits in the long run

COMPARING MONOPOLIES AND PERFECT COMPETTION:

- many buyers and sellers in perfect competition but only one seller in monopoly
- barriers to entry and exit in a monopoly but free entry and exit in perfect competition perfect information in perfect competition but not monopoly
- firms in perfect competition are price takers and monopolies are price makers
- in perfect competition the products made by the firms are exactly the same
- monopolies make abnormal profits whereas firms in perfect competition only make abnormal profits in the short run

BOARD EXAM QUESTIONS:

1. **Explain two advantages a firm may gain from being a monopoly.**
   - May be able to charge high prices / price maker (1) due to lack of competition (1) enabling it to earn a high profit (1]
   - May produce at lower costs (1) due to economies of scale / charge lower prices (1).
   - May produce high quality products (1) as high profits enable it to invest and innovate (1).
   - May be able to compete with foreign firms (1) gain a wider market / export more (1).
   - May have stronger bargaining power with suppliers (1) keeping costs low (1).