

File: ch02, Chapter 2: Economies of Scale and Scope

Multiple Choice

1. Which of the following is a characteristic of economies of scale?

- a) The average cost declines as output increases
- b) The average cost increases as output increases
- c) The average cost remains constant as output increases
- d) The average costs are cheaper when a firm produces a wider variety of goods
- e) The average cost curve takes the form of a U-shape

Ans: a

Heading: Where Do Economies of Scale Come From? – Definition of Economies of Scale

Level: Easy

2. What is the minimum efficient scale (MES) of production?

- a) The point on an average cost curve where the cost per unit begins to decline more rapidly
- b) The minimum point on a U-shaped average cost curve
- c) The minimum level of production at a plant for it to be considered profitable
- d) The level of production for a small sized plant
- e) The threshold at which capacity is constraining for a firm's production

Ans: b

Heading: Where Do Economies of Scale Come From? – Definition of Economies of Scale

Level: Medium

3. Which of the following best describes economies of scope?

- a) The average cost declines as output increases
- b) The average cost increases as output increases
- c) The average cost remains constant as output increases
- d) Savings are achieved when a firm produces a wider variety of goods
- e) Savings are achieved when a firm produces a decreased variety of goods

Ans: d

Heading: Where Do Economies of Scale Come From? – Definition of Economies of Scope

Level: Easy

4. Which of the following is not a major source of scale or scope economy?

- a) Indivisibilities and the spreading of fixed costs
- b) Increased productivity of variable inputs (mainly having to do with specialization)
- c) Movement of production from smaller to larger facilities

- d) Inventories
- e) Engineering principles associated with the “cube-square rule”

Ans: c

Heading: Where Do Scale Economies Come From?

Level: Medium

5. Which of the following is not a product specific fixed cost?

- a) The cost to manufacture a special die to make an aircraft fuselage
- b) The cost of developing graphics software to facilitate video game development
- c) The cost of a one-week training program preceding the implementation of a specific management initiative
- d) The time and expense required to set up a textbook before printing it
- e) The cost of administrative expenses

Ans: e

Heading: Where do Scale Economies Come From? – Indivisibilities and the Spreading of Fixed Costs

Level: Medium

6. What kind of economies come from reductions in cost due to adoption of technology that has high fixed costs, but lower variable costs?

- a) Short-run economies of scale
- b) Short-run economies of scope
- c) Long-run economies of scale
- d) Long-run economies of scope
- e) Partially automated economies

Ans: c

Heading: Where do Scale Economies Come From? – Indivisibilities and the Spreading of Fixed Costs

Level: Hard

7. What kind of economies come from reductions in average costs due to increases in capacity utilization?

- a) Short-run economies of scale
- b) Short-run economies of scope
- c) Long-run economies of scale
- d) Long-run economies of scope
- e) Fully automated economies

Ans: a

Heading: Where do Scale Economies Come From? – Indivisibilities and the Spreading of Fixed Costs

Level: Hard

8. What are economies of density as referred to in the airline industry?

- a) Reducing the size of an aircraft used to increase load factor
- b) Economies achieved by an airline flying from spoke to spoke in a hub-and-spoke network
- c) Economies of scope along a given route
- d) Economies of scale along a given route
- e) Reductions in average cost as traffic volume decreases

Ans: d

Heading: Example 2.1 Hub-and-Spoke Networks and Economies of Scope in the Airline Industry

Level: Medium

9. What term for production describes a situation where factories and assembly lines represent a significant percentage of total costs?

- a) Materials intensive
- b) Labor intensive
- c) Capital intensive
- d) Research intensive
- e) Time intensive

Ans: c

Heading: Where do Scale Economies Come From? – Indivisibilities and the Spreading of Fixed Costs

Level: Easy

10. According to Smith's theorem, which of the following statements would be true in medical markets for thoracic surgery?

- a) When demand for thoracic surgery is high, the market will not support a specialized surgeon
- b) When demand for thoracic surgery is low, the market will not support a specialized surgeon
- c) The average cost curves for thoracic and general surgeons are both upward sloping
- d) The cost curve for a thoracic surgeon will start out lower than the cost curve for a general surgeon due to the greater investment of time
- e) General surgeons incur lower training costs than do thoracic surgeons and are thus more efficient in performing thoracic surgery

Ans: b

Heading: Example 2.2 The Division of Labor in Medical Markets

Level: Medium

11. How does carrying inventories contribute to economies of scale?

- a) Increases the interest on the expenses to produce the inventory
- b) Inventory depreciates in value while waiting to be used or sold
- c) Increases the storage facilities necessary
- d) Increases competition with rivals for customers
- e) Minimizes the chance of stock-out

Ans: e

Heading: Where do Scale Economies Come From? – Inventories

Level: Medium

12. Which of the following does not benefit from the cube-square rule's contribution to economies of scale?

- a) Automotive production
- b) Oil pipelines
- c) Warehousing
- d) Brewing beer
- e) Boiler energy production

Ans: a

Heading: Where do Scale Economies Come From? – The Cube-Square Rule and the Physical Properties of Production

Level: Easy

13. Which of the following is not a benefit Ace captures through a cooperative of stores while maintaining independent store ownership?

- a) Access to same distribution channels as large retailers
- b) No central office providing direction
- c) Quantity discounts
- d) Local tailored product offerings
- e) Location in Small neighborhoods

Ans: b

Heading: Example 2.3 – The Ace Hardware Corporation

Level: Medium

14. Which of the following is not a reason a supplier might seek to sell in bulk?

- a) Each sale incurs a fixed cost in writing a contract
- b) The purchaser is likely to switch over a small price due to the gains over the large number of units ordered
- c) Each sale involves setting up a different production run
- d) The cost of delivery is a fixed on a per unit basis
- e) The supplier fears uneven sales

Ans: c

Heading: Special Sources of Economies of Scale and Scope – Economies of Scale and Scope in Purchasing

Level: Easy

15. How does umbrella branding aid economies of scale and scope?

- a) Increases effectiveness of advertising due to a greater presence
- b) Increases effectiveness of advertising due to national advertising

- c) Increases effectiveness of advertising due to offering a broad product line under one name
- d) Increased cost effectiveness through purchasing as a cooperative
- e) Increased cost effectiveness through bulk purchasing

Ans: c

Heading: Special Sources of Economies of Scale and Scope – Economies of Scale and Scope in Advertising

Level: Medium

16. Which of the following practices does not contribute to the strategic fit of Southwest Airlines?

- a) No in-flight catering
- b) Use of multiple types of planes
- c) No use of congested airports
- d) Re-engineered boarding process
- e) No first class section on plane

Ans: b

Heading: Special Sources of Economies of Scale and Scope – Complementarities and Strategic Fit

Level: Easy

17. Which of the following is a source of diseconomies of scale at a large firm?

- a) Labor costs
- b) Spreading specialized resources too thin
- c) Conflicts of interest
- d) Incentive processes
- e) All of the above

Ans: e

Heading: Sources of Diseconomies of Scale

Level: Easy

18. Why might a large firm actually be at an advantage over a smaller firm with respect to labor?

- a) Large generally pay a compensating differential to attract workers
- b) Worker turnover is generally lower
- c) Large firms enjoy better scale economies when negotiating with health insurance companies for health benefits
- d) Large firms are generally less attractive to qualified, upward mobile workers
- e) Large firms often have to draw workers from a greater distance to fill their ranks

Ans: b

Heading: Sources of Diseconomies of Scale – Labor Costs and Size

Level: Medium

19. What is the approximate observed median learning curve slope for typical firms?

- a) .6
- b) .7
- c) .8
- d) .9
- e) 1.0

Ans: c

Heading: The Learning Curve – The Concept of the Learning Curve

Level: Hard

20. What might cause a firm to want to increase production past the point where additional revenues offset additional costs?

- a) The firm is enjoying the benefits of the learning curve
- b) Future production costs will be higher
- c) Managers are being rewarded on the basis of short-run profits
- d) The firm relies on direct growth incentives
- e) The firm wants to violate the rule of equating marginal revenue equal to marginal cost

Ans: a

Heading: The Learning Curve – Expanding Output to Obtain a Cost Advantage

Level: Hard

21. In the BCG Growth Share Matrix, what is a cash cow?

- a) A product in a growing market with high relative share
- b) A product in a stable or declining market with high relative share
- c) A product in a growing market with a low relative share
- d) A product in a stable or declining market with low relative share
- e) A product losing money for a company

Ans: b

Heading: The Learning Curve – The Boston Consulting Group Growth/Share Paradigm

Level: Hard

22. Why is firm specific learning better in general for an organization?

- a) Encourages individuality among workers within the organization
- b) Keeps unionized workers happy
- c) Allows workers to acquire skills they can then “shop around”
- d) Ensures worker knowledge is tied to current employment
- e) Increases complexity and creativity in the organization

Ans: d

Heading: The Learning Curve – Learning and Organization

Level: Medium

23. If a firm enjoys lower costs due to a complex labor-intensive process, which of the following statements would then be true?

- a) Cutbacks in volume will always raise unit costs
- b) The firm is unconcerned with labor turnover
- c) An example of this process could be the practice of anti-trust law
- d) The firm's average cost rises due to moving down the learning curve
- e) The process is likely a repetitive manufacturing process such as two-piece aluminum can manufacturing

Ans: c

Heading: The Learning Curve – The Learning Curve versus Economies of Scale

Level: Easy

24. By using instrumental variables, what was Ramanarayanan able to suggest regarding the learning curve?

- a) High quality surgeons receive more referrals and can be choosier with their patients thus experiencing better outcomes
- b) Surgeons who treat more patients after the retirement of a colleague experience better outcomes
- c) Surgeons who treat more patients after the retirement of a colleague experience the same outcomes
- d) Surgeons who treat more patients after the retirement of a colleague experience worse outcomes
- e) Each additional surgery performed by a surgeon increases the probability of patient mortality

Ans: b

Heading: Example 2.6 Learning by Doing in Medicine

Level: Medium

Short Answer

25. Suppose the cost of advertising in a local newspaper is \$5 per thousand papers. If the circulation for the paper is 1.5 million and the cost of preparing an ad for a company is \$2500, what is the advertising cost per potential customer?

Ans: \$.0067 per potential customer, or \$6.67 per 1000 customers

Heading: Special Sources of Economies of Scale and Scope – Economies of Scale and Scope in Advertising

Level: Medium