Economics of Strategy 7th edition Dranove Test Bank

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File: ch02, Chapter 2: The Horizontal Boundaries of the Firm

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
Learning Objective: Define economies of scale and scope and the role of indivisibilities
AASCB: Analytical
AICPA: Measurement
IMA: Quantitative Methods

Heading: Economies of Scale and Scope – 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

Learning Objective: Describe the relationship between economies of scale and indivisibilities
AASCB: Analytical
AICPA: Measurement
IMA: Quantitative Methods

Heading: Economies of Scale and Scope – Definition of Economies of Scale
Level: Medium

3. Which of the following is generally a way that LBOs can help a firm realize its potential value?
a) The synergies created allow for cost savings
b) The transaction reduces the disparity between a firm's actual and potential share price
c) The acquisition reduces the likelihood of competition in the industry
d) The transaction requires debt repayment with future free cash flow leaving management no discretion

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over the investment of these funds
e) The buyout gives an opportunity to adjust the management structure and makeup

Ans: d
Learning Objective: Identify forces that keep managers focused on shareholder benefits
AASCB: Reflective Thinking
AICPA: Strategic/Critical Thinking
IMA: Strategic Planning

Heading: The Market for Corporate Control and Recent Changes in Corporate Governance
Level: Easy

4. 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

Learning Objective: Define economies of scale and scope and the role of indivisibilities
AASCB: Analytical
AICPA: Leverage Technology to Develop and Enhance Functional Compentencies
IMA: Business Applications

Heading: Economies of Scale and Scope – Definition of Economies of Scope
Level: Easy

5. What measure, that depends on how much of a firm's revenues are attributable to product market activities that have shared technological characteristics, production characteristics, or distribution channels, is used to determine how diversified a firm is at a given time?
a) Integration level
b) Rumelt score
c) Conglomerate level
d) Activity share
e) Relatedness

Ans: e

Learning Objective: Explain the value of complementarities and strategic fit
AASCB: Communication
AICPA: Communication
IMA: Strategic Planning

Heading: A Brief History

Level: Medium

6. 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

Learning Objective: Identify sources of diseconomies of scale
AASCB: Analytical
AICPA: Resource Management
IMA: Cost Management

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

7. 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

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Analytical
AICPA: Measurement
IMA: Quantitative Methods

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

8. Examining which of the following is broadly considered one of the easiest ways to measure diversifying activity?
a) Joint Ventures
b) Mergers and acquisitions
c) Internal Business Development
d) Strategic Alliances
e) Collaborative agreements

Ans: b

Learning Objective: Define Diversification
AASCB: Reflective Thinking
AICPA: Industry/Sector Perspective
IMA: Investment Decisions

Heading: A Brief History
Level: Medium

9. What force does Manne indicate constrains the actions of managers so that they stay focused on the goals of owners?
a) Market for corporate control
b) SEC
c) Corporate board
d) Corporate governance
e) CEO

Ans: a

Learning Objective: Identify forces that keep managers focused on shareholder benefits
AASCB: Ethics
AICPA: Leadership
IMA: Performance Measurement

Heading: Managerial Reasons for Diversification – The Market for Corporate Control and Recent Changes in Corporate Governance
Level: Medium

10. 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

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Analytical
AICPA: Resource Management
IMA: Business Economics

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

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11. 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

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Analytical
AICPA: Industry/Sector Perspective
IMA: Decision Analysis

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

12. Which of the following is not generally a potential benefit of diversification?
a) Control systems rewarding/penalizing division managers based on business unit objective
b) Economies of scale and scope
c) Economizing on transaction costs
d) Diversifying shareholder portfolios
e) Identifying undervalued firms

Ans: a

Learning Objective: Explain why firms diversify
AASCB: Reflective Thinking
AICPA: Decision Modeling
IMA: Decision Analysis

Heading: Why Do Firms Diversify? – Efficiency Based Reasons for Diversification
Level: Easy

13. Which of the following benefits of diversification explains the idea that mergers are more likely when there is an expectation of positive changes in market share?
a) Use of internal capital markets
b) Economies of scale and scope
c) Economizing on transaction costs
d) Diversifying shareholder portfolios
e) Identifying undervalued firms

Ans: b

Learning Objective: Explain why firms diversify

AASCB: Reflective Thinking
AICPA: Decision Modeling
IMA: Decision Analysis

Heading: Why Do Firms Diversify? – Efficiency Based Reasons for Diversification
Level: Medium

14. 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

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Analytical
AICPA: Strategic/Critical Thinking
IMA: Strategic Planning

Heading: Where do Scale Economies Come From? – Inventories
Level: Medium

15. Which of the following benefits of diversification explains the idea that combining unrelated businesses can allow firms to finance projects through cross-subsidization when they previously were unable to finance the same projects externally?
a) Use of internal capital markets
b) Economies of scale and scope
c) Economizing on transaction costs
d) Diversifying shareholder portfolios
e) Identifying undervalued firms

Ans: c

Learning Objective: Explain why firms diversify
AASCB: Reflective Thinking
AICPA: Decision Modeling
IMA: Decision Analysis

Heading: Why Do Firms Diversify? – Efficiency Based Reasons for Diversification
Level: Medium

16. 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

Learning Objective: Explain the value of complementarities and strategic fit
AASCB: Reflective Thinking
AICPA: Decision Modeling
IMA: Decision Analysis

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

17. 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

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Reflective Thinking
AICPA: Marketing/Client Focus
IMA: Strategic Marketing

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

18. Which of the following benefits of diversification explains the idea that a firm with many business lines can reduce swings in value because it receives only a small percentage of its revenue from any one of those business lines?
a) Use of internal capital markets
b) Economies of scale and scope
c) Economizing on transaction costs
d) Diversifying shareholder portfolios
e) Identifying undervalued firms

Ans: d

Learning Objective: Explain why firms diversify

AASCB: Analytical
AICPA: Strategic/Critical Thinking
IMA: Strategic Planning

Heading: Why Do Firms Diversify? – Efficiency Based Reasons for Diversification
Level: Easy

19. 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

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Analytical
AICPA: Strategic/Critical Thinking
IMA: Strategic Planning

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

20. What type of research looks at the changes in market valuations in response to the announcement of diversifying acquisitions to assess the success of diversification?
a) Event studies
b) Valuation studies
c) Diversification studies
d) Market studies
e) Acquisition studies

Ans: a

Learning Objective: Explain how managers can diversify without generating net benefits for shareholders
AASCB: Communication
AICPA: Communication
IMA: Strategic Planning

Heading: Performance of Diversified Firms – Valuation and Event Studies
Level: Hard

21. 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

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d) Incentive processes
e) All of the above

Ans: e

Learning Objective: Identify sources of diseconomies of scale
AASCB: Analytical
AICPA: Resource Management
IMA: Strategic Planning

Heading: Sources of Diseconomies of Scale
Level: Easy

22. Which of the following benefits of diversification explains the idea that corporate diversification can provide situations where an acquiring firm determines the stock price for firm they intend to acquire is too low?
a) Use of internal capital markets
b) Economies of scale and scope
c) Economizing on transaction costs
d) Diversifying shareholder portfolios
e) Identifying undervalued firms

Ans: e

Learning Objective: Explain why firms diversify
AASCB: Analytical
AICPA: Decision Modeling
IMA: Investment Decisions

Heading: Why Do Firms Diversify? – Efficiency Based Reasons for Diversification
Level: Easy

23. 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

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Analytical
AICPA: Strategic/Critical Thinking
IMA: Strategic Planning

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

24. Which of the following is not a way managers generally benefit from acquisitions?
a) Increased compensation
b) Consolidation of other senior executives
c) Shielding against risk
d) Political power
e) Social prominence

Ans: b

Learning Objective: Identify forces that keep managers focused on shareholder benefits
AASCB: Reflective Thinking
AICPA: Leadership
IMA: Performance Measurement

Heading: Managerial Reasons for Diversification – Benefits to Managers from Acquisitions
Level: Medium

25. 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

Learning Objective: Describe the value of experience by reference to the learning curve
AASCB: Analytical
AICPA: Measurement
IMA: Quantitative Methods

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

26. 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

Learning Objective: Describe the value of experience by reference to the learning curve
AASCB: Reflective Thinking
AICPA: Interaction
IMA: Decision Analysis

Heading: The Learning Curve – Learning and Organization
Level: Medium

27. What institution within a firm must fail on some level for managers to be motivated to acquire another firm for the purposes of increasing their own compensation, shielding themselves against risk, or gaining prominence by running a larger firm?
a) Legal department
b) Corporate board
c) Mergers and acquisitions program
d) Firm bonus schedule
e) Corporate governance

Ans: e

Learning Objective: Explain how managers can diversify without generating net benefits for shareholders
AASCB: Ethics
AICPA: Leadership
IMA: Internal Controls

Heading: Managerial Reasons for Diversification – Problems with Corporate Governance
Level: Hard

28. 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

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Reflective Thinking
AICPA: Strategic/Critical Thinking
IMA: Strategic Planning

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

29. By satisfying which of the following conditions can shareholders prevent management driven acquisitions?
a) If shareholders could determine which acquisitions will lead to increased profits and which will not
b) If shareholders could direct management to undertake only those acquisitions that will increase shareholder value
c) If shareholders could provide management with the appropriate steps to conduct when performing acquisitions
d) a & b
e) None of the above

Ans: d

Learning Objective: Identify forces that keep managers focused on shareholder benefits
AASCB: Reflective Thinking
AICPA: Leadership
IMA: Corporate Finance

Heading: Managerial Reasons for Diversification – Problems with Corporate Governance
Level: Hard

30. Economies of scale are best described as which of the following?
a) The average cost remains constant as output increases
b) The average cost increases as output increases
c) The average cost declines 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: c

Learning Objective: Define economies of scale and scope and the role of indivisibilities
AASCB: Analytical
AICPA: Measurement
IMA: Quantitative Methods

Heading: Economies of Scale and Scope – Definition of Economies of Scale
Level: Easy

31. Consolidation of managers often occurs due to which of the following?
a) Increased compensation for senior managers
b) Lower costs in the vertical supply chain
c) Mergers and acquisitions
d) Increased political power of senior managers
e) Social prominence of middle magaers

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Ans: c

Learning Objective: Identify forces that keep managers focused on shareholder benefits
AASCB: Reflective Thinking
AICPA: Leadership
IMA: Performance Measurement

Heading: Managerial Reasons for Diversification – Benefits to Managers from Acquisitions
Level: Medium

32. Increased economies of scale and scope are helped by which of the following?
a) Umbrella branding
b) Market branding
c) Bundling
d) Negotiated branding
e) Strategic branding

Ans: a

Learning Objective: Identify six specific sources of economies of scale and scope
AASCB: Reflective Thinking
AICPA: Marketing/Client Focus
IMA: Strategic Marketing

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

33. Diversifying activity is most often measured by looking at which of the following?
a) Joint Ventures
b) Collaborative agreements
c) Internal Business Development
d) Strategic Alliances
e) Acquisition and merger activity

Ans: e

Learning Objective: Define Diversification
AASCB: Reflective Thinking
AICPA: Industry/Sector Perspective
IMA: Investment Decisions

Heading: A Brief History
Level: Medium

34. The minimum point on a U-shaped average cost curve is known as which of the following?
a) Efficient marginal cost (EMC)
b) Lowest price alternative (LPA)
c) Efficient production cost (EPC)
d) Minimum efficient scale of production (MES)
e) Minimum threshold cost (MTC)

Ans: d

Learning Objective: Describe the relationship between economies of scale and indivisibilities
AASCB: Analytical
AICPA: Measurement
IMA: Quantitative Methods

Heading: Economies of Scale and Scope – Definition of Economies of Scale
Level: Medium