

Exercise walk-through

1.3

Size of business

A-Level Business

The size of a business

No single measure – use more than one:

employees

revenue

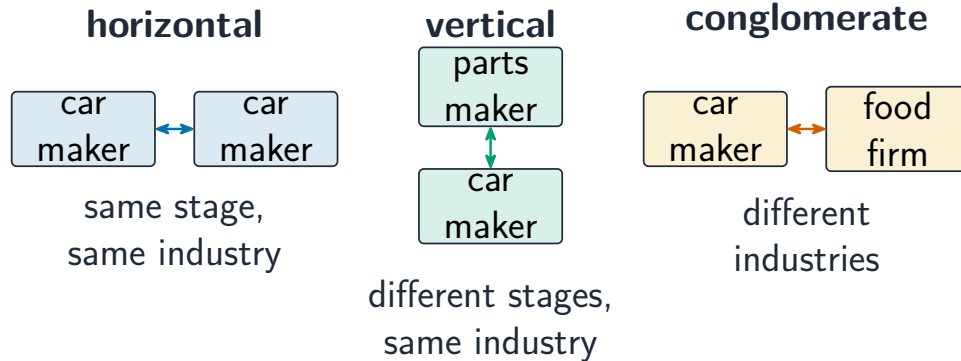
capital employed

market share

market capitalisation

Small businesses still matter – jobs, local service, quick to react, new ideas.

Business growth



Internal (organic) vs
external (merger / takeover).

- **horizontal** – same stage
- **vertical** – different stage
- **conglomerate** – diversify

How firms grow, and the four kinds of integration

organic growth

selling more, opening more sites – slow but controlled

a merger

two firms **agree** to join together as one

a takeover

one firm buys control of another, agreed or not

horizontal

same stage of the same industry – market share and scale economies

forward / backward

vertical: toward the customer, or toward the supplier – control of the chain

conglomerate

unrelated industries – **spreading risk**

Growth by acquisition is fast and risky; organic growth is slow and safe. Which suits the firm depends on how quickly the market is moving.

How a firm grows, and in which direction

Internal growth

Internal growth (organic): the business grows by itself – selling more, opening branches, adding products. Slower, and it keeps control.

External growth

External growth : it joins with another firm. Fast, and it buys capability it does not have.

Horizontal integration

Horizontal integration : joining a firm at the *same* stage of the same industry – two car makers.

Vertical integration

Vertical integration : a different stage of the same industry. **Forward integration** is towards the customer (buying a shop), **backward integration** towards the supplier (buying a parts maker).

Conglomerate

Conglomerate integration diversification : a different industry – risk spread by .

Growth also costs: higher average costs, harder communication, different company **cultures** that clash, and a need for a lot of finance. A **joint venture** gets some of that without the merger.

Economies of scale

Economies of scale lower **average cost** as a firm grows
(purchasing, technical, financial, managerial, marketing).

Grow too big $\Rightarrow$ **diseconomies** : poor communication, coordination,
motivation.

Exercises 2.1-2.3

2.1 State two ways to measure the size of a business.

[2]

2.2 Define the term *economies of scale*.

[2]

2.3 State the difference between horizontal and vertical integration.

[2]

Exercises 2.1-2.3

2.1 State two ways to measure the size of a business.

[2]

2.1

- any two of: number of employees; revenue (sales turnover); capital employed; market share; market capitalisation (1 + 1)

2.2 Define the term *economies of scale*.

[2]

2.2

- the cost savings (a fall in average cost per unit) a business gains as it grows larger (2 for a clear definition; 1 for a partial idea)

2.3 State the difference between horizontal and vertical integration.

[2]

2.3

- horizontal integration joins a firm at the **same** stage of the same industry; vertical integration joins a firm at a **different** stage of the same industry (2 for a clear difference; 1 for a partial idea)

Exercise 3.1

3.1 Explain one reason why a business might want to grow larger.

[3]

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3.1

- [3] **AO1** 1 – name a reason (lower average costs; bigger market share; more market power; higher profit; spread risk). **AO2** up to 2 – develop it, e.g. a larger firm buys materials in bulk
- lower cost per unit
- it can cut prices or earn more profit (2 developed / 1 limited)

Exercise 3.2

3.2 Analyse two benefits to a business of using a vertical merger for growth.

[8]

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3.2

- [8] Some understanding of *vertical* merger must be shown. For **each** of two benefits: **AO1** 1 + **AO2** 1 + **AO3** up to 2. Example chains – *backward (supplier)*: control of supply
- guaranteed quality and delivery time
- smoother production. *Forward (customer)*: own retail outlets
- control over how the product is sold and priced
- higher sales and margin. Maximum 4 per benefit, 8 total. (General growth benefits such as “larger workforce” do not answer a *vertical* merger question.)

Exercise 3.3

3.3 'A business should always try to grow as large as possible.' Evaluate this view. [12]

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3.3

- [12] **AO1** 2 / **AO2** 2 / **AO3** 2 / **AO4** up to 6. **For** growth: economies of scale, market power, higher profit, survival. **Against:** diseconomies of scale (poor communication, weak motivation), high finance needed, harder management, culture clash in a takeover. Judgement: growth helps up to the optimum size, but beyond it average costs rise – so the best size depends on the market and the firm's ability to manage scale; "as large as possible" is rarely right