Exercise walk-through

Size of business ▪ 1.3

eXercise

You must be able to

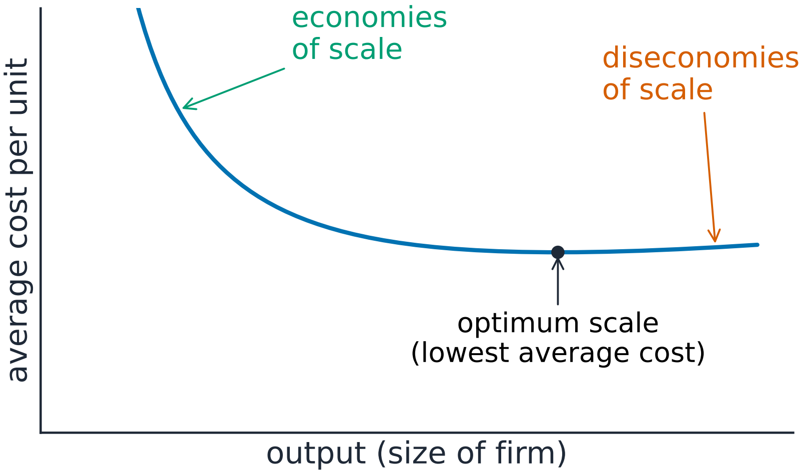
- state ways to measure the size of a business
- describe internal growth and the three types of integration (horizontal, vertical, conglomerate)
- analyse benefits of growth and evaluate whether a firm should grow

Method — Growth and economies of scale

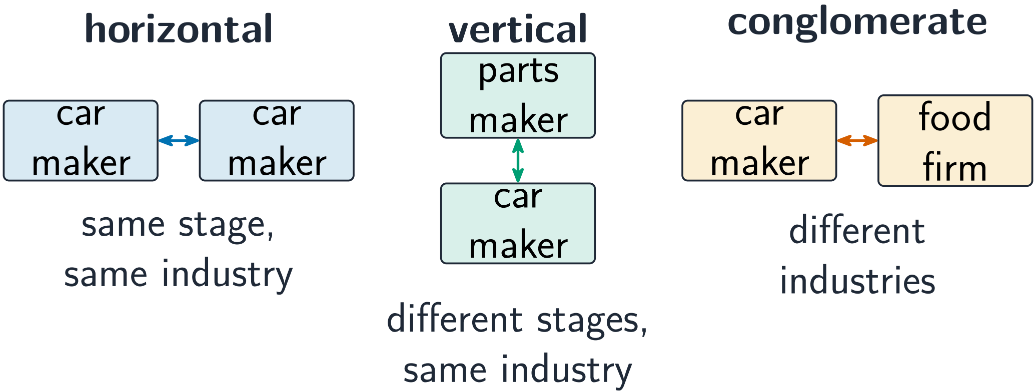
- **Economies of scale:** cost savings as a firm grows — purchasing, technical, financial, managerial, marketing.
- **Internal growth** (organic, lower-risk) vs **external growth** (a **merger/takeover**) — classified by **integration**:

Answer shapes: an **Analyse two benefits of growth [8]** answer needs, per benefit, AO1 (name) + AO2 (apply) + AO3 (a reasoning chain). An **Evaluate [12]** answer weighs the gains of size against the diseconomies, then judges *in context*.

Method — Growth and economies of scale



Method — Growth and economies of scale



The three types of integration when one firm joins with another

Practice 2.1 ▪ 2 marks

State two ways to measure the size of a business.

Solution 2.1

Method: Growth and economies of scale

Worked steps

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

Practice 2.2 ▪ 2 marks

Define the term *economies of scale*.

Solution 2.2

Method: Growth and economies of scale

Worked steps

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).

Practice 2.3 ▪ 2 marks

State the difference between horizontal and vertical integration.

Solution 2.3

Method: Growth and economies of scale

Worked steps

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).

Exam-style 3.1 ▪ 3 marks

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

Solution 3.1

Worked steps

[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 $\rightarrow$ lower cost per unit $\rightarrow$ it can cut prices or earn more profit (2 developed / 1 limited).

Exam-style 3.2 ▪ 8 marks

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

Solution 3.2

Method: Growth and economies of scale

Worked steps

[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 $\rightarrow$ guaranteed quality and delivery time $\rightarrow$ smoother production. *Forward (customer)*: own retail outlets $\rightarrow$ control over how the product is sold and priced $\rightarrow$ higher sales and margin. Maximum 4 per benefit, 8 total. (General growth benefits such as "larger workforce" do not answer a *vertical* merger question.)

Exam-style 3.3 ▪ 12 marks

‘A business should always try to grow as large as possible.’ Evaluate this view.

Solution 3.3

Method: Growth and economies of scale

Worked steps

[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.