

Exercise walk-through

3.4

Firms

IGCSE Economics

Firms and integration

Original bakery cases: classify before revealing

A bakery joins (A) another bakery, (B) its flour mill, (C) shops selling its bread, or (D) a clothing producer. Which kind of integration is each?

Firms and integration – worked reasoning

Partner	Classification	Possible benefit and limit
Another bakery	Horizontal	Bulk buying may lower cost; fewer rivals may reduce choice.
Flour mill	Backward vertical	More control of flour supply; managing milling may be difficult.
Bread shops	Forward vertical	Control of outlets; retailing requires different skills.
Clothing producer	Conglomerate	Spreads risk across industries; neither business is guaranteed success.

Classify the relationship between businesses, then explain a benefit. A merger joins firms; a takeover gives one firm control of another.

Three kinds of merger

Horizontal merger

A **horizontal merger** : two firms at the same stage of the same industry – market share, and economies of scale.

Vertical merger

A **vertical merger** : a supplier or a customer – securing an input, or a route to market.

Conglomerate merger

A **conglomerate merger** : unrelated industries, joined to spread risk.

Barriers to entry

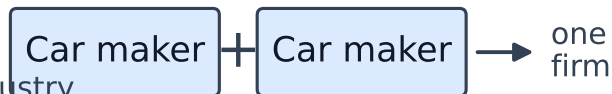
Barriers to entry – high set-up costs, patents, brand loyalty – can protect a firm from new rivals; gains from a merger are not guaranteed.

A firm's **objectives** are not only profit: **growth** , **survival** and market share each justify a different merger.

Firms and integration, in detail

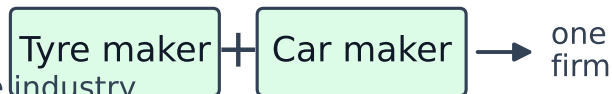
Horizontal

same stage, same industry



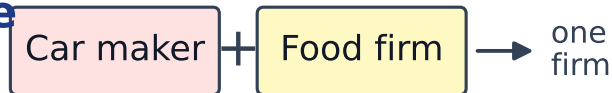
Vertical

different stages, same industry



Conglomerate

different industries



Exam: horizontal = same stage; vertical = supply chain; conglomerate = different industries

Firms grow by joining together:

horizontal – two firms at the **same** stage of one industry.

vertical – **different** stages of the same industry.

conglomerate – **different** industries altogether.

Business failure

Original case: a small bakery

Its monthly sales revenue is £4,000 and production costs are £4,500. It also owes a £2,000 equipment payment tomorrow, but has only £300 cash available and no agreed loan.

Diagnose first: Which facts show a loss? Which show a cash problem?

Exercises 2.1-2.3

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

[2]

2.2 Define the term *horizontal merger*.

[2]

2.3 State one reason why a firm might stay small.

[1]

Exercises 2.1-2.3

2.1 State two ways to measure the size of a firm. [2]

2.1

- any **two** of: **number of workers** / **amount of capital** / **output** (K, K)
-

2.2 Define the term *horizontal merger*. [2]

2.2

- a **horizontal merger** is when two firms at the **same stage** of the same industry join (e.g. two car makers) (K)
-

2.3 State one reason why a firm might stay small. [1]

2.3

- any **one** of: a **small market** / a **personal product** / the owner wants **control** / little **finance** to grow (K)

Exercises 3.1-3.2

3.1 A car maker joining with a tyre maker is an example of a:

[1]

☐

A horizontal merger

B vertical merger

C conglomerate merger

D social enterprise

3.2 Explain two reasons why a firm might fail and close down.

[4]

Exercises 3.1-3.2

3.1 A car maker joining with a tyre maker is an example of a:

[1]

☐

A horizontal merger

B vertical merger

C conglomerate merger

D social enterprise

3.1 B

- a car maker and a tyre maker are at **different stages** of one industry – a **vertical merger** (K)
- A is same-stage; C is unrelated industries; D is not a merger type

3.2 Explain two reasons why a firm might fail and close down.

[4]

3.2

- for **each** of two reasons: K + An
- e.g. **too few sales**: revenue does not cover costs → losses → the firm closes
- e.g. **not enough cash**: even a profitable firm can run out of cash to pay bills → it stops trading

Exercise 3.3

3.3 Analyse why some firms stay small while others grow large.

[6]

Exercise 3.3

3.3 Analyse why some firms stay small while others grow large. [6]

3.3

- firms stay small when the market is small, the product is personal, the owner wants control, or finance is scarce (K)
- firms grow large when demand is high and they want **economies of scale**, more market power and higher profit (An)
- size depends on the **market**, the **owner's aims**, and the gains from being bigger (An)