Exercise walk-through

Firms ▪ 3.4

eXercise

You must be able to

- state ways to measure the size of a firm and why some stay small
- describe horizontal, vertical and conglomerate mergers
- explain the causes of business failure

Method — How firms grow

- **Measure size by:** number of workers, capital used, or output.
- **Stay small** because: a small market, a personal product, the owner wants control, little finance.
- **Mergers: horizontal 横向** (same stage), **vertical 纵向** (different stages of one industry), **conglomerate 混合** (different industries).
- **Business failure 企业倒闭**: high costs, too few sales, poor management, too little cash.

Answer shapes: K + App + An + Ev (a justified judgement, for discuss questions).

Method — How firms grow

Horizontal

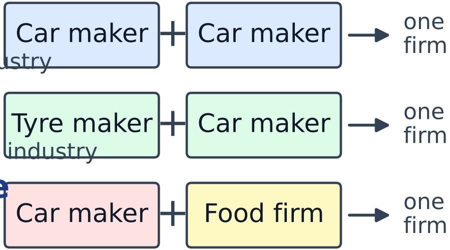
same stage, same industry

Vertical

different stages, same industry

Conglomerate

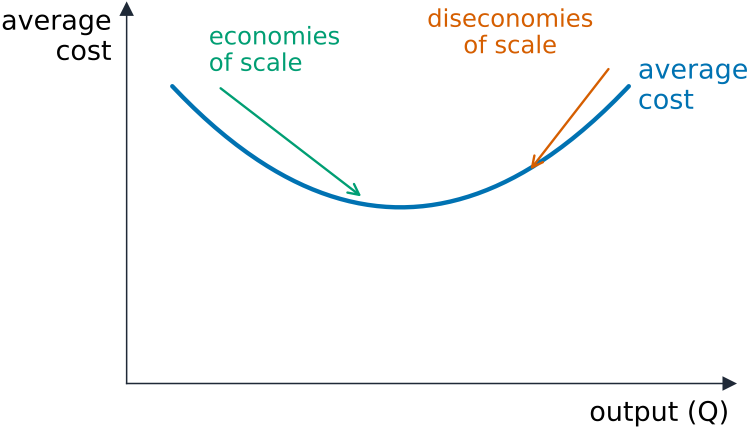
different industries



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

The three types of integration

Method — How firms grow



Average cost falls (economies of scale) then rises (diseconomies)

Practice 2.1 ▪ 2 marks

State two ways to measure the size of a firm.

Solution 2.1

Method: How firms grow

Worked steps

any two of: number of workers; amount of capital used; output $(1 + 1)$.

Practice 2.2 ▪ 2 marks

Define the term *horizontal merger*.

Solution 2.2

Worked steps

when two firms at the same stage of the same industry join (e.g. two car makers) (2 for a clear definition; 1 for a partial idea).

Practice 2.3 ▪ 1 mark

State one reason why a firm might stay small.

Solution 2.3

Method: How firms grow

Worked steps

any one of: a small market; a personal product; the owner wants control; little finance to grow (1).

Exam-style 3.1 ▪ 1 mark

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

A horizontal merger

B vertical merger

C conglomerate merger

D social enterprise

Solution 3.1

- **A** horizontal merger
- **B** vertical merger ✓
- **C** conglomerate merger
- **D** social enterprise

Worked steps

B. A car maker and a tyre maker are at different stages of one industry — a vertical merger.

Exam-style 3.2 ▪ 4 marks

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

Solution 3.2

Worked steps

[4] For **each** of two reasons: K 1 + An 1 — *too few sales / falling demand*: revenue does not cover costs → the firm makes losses and closes; *not enough cash*: even a profitable firm can run out of cash to pay bills → it is forced to stop trading.

Exam-style 3.3 ▪ 6 marks

Analyse why some firms stay small while others grow large.

Solution 3.3

Method: How firms grow

Worked steps

[6] K/App/An — firms stay small when the market is small or local, the product is personal (a hairdresser), the owner wants control, or finance is scarce → firms grow large when there is high demand and they want economies of scale, more market power and higher profit → so size depends on the market, the owner's aims, and the gains from being bigger.