Section 2: Business growth

Chapter5 Growth

Key terms

1. Diseconomies of scale: rising long-run average costs as a business expands beyond its minimum efficient scale.
2. Economies of scale: the reduction in average costs experiences by a business as output increases.
3. External economies of scale: the reductions in costs to all businesses from the industry grows.
4. Indivisibility: the physical inability, or economic inappropriateness, of running a machine or some other piece of equipment at below its optimal operational capacity.
5. Internal economies of scale: when production rises leading to lower average cost.
6. Minimum efficient scales: the output that minimizes long run average cost.
7. Organic growth; a business growth strategy that involves a business growing gradually using its own resources.
8. Inorganic growth; a business growth strategy that involves two or more businesses joining together to form one much larger one.
9. Venture capitalist: provider of funds for small- or medium-sized companies that may be considered too risky for other investors.

1. Growth - If a business is growing, it can generate more revenue and own more assets.

2. Objectives of growth

1) Economies of scale.

↳ A reduction in average cost when output increases.

↳ When firms become larger, they can take advantage of economies of scale (AC)

1.1 Internal economies of scale

When production rises, it leads to lower average cost(AC))

1. Technical : A large firm can invest in technology and capital, resulting in lower AC

2. Managerial : A large firm is more able to employ supervisors, which makes business more efficient, resulting lower AC.

3. Purchasing : A large firm can buy raw materials in bulk; each unit cost falls.

4. Financial : A large firm can borrow more money from banks at lower interest rate than a small firm.

5. Risk-bearing: A large firm can expand its product range. Therefore, they can spread

the cost of uncertainty. If one part is not successful, they still have other parts to fall back on.

1.2 External economies of scale.

The reductions in costs that any business within an industry might benefit from the industry grows.

1.) Labour; when an industry grows, there are a lot of local schools, training institutionoffer courses which are aimed at the need of the local industry.

2.) Commercial and support services can be offered e.g. distribution service.

3.) Cooperation; firms in the same industry are more likely to cooperate in R&D.

2) Increased market power

- When business become larger, they could be dominant from and able to dominate stakeholder

3.) Increased market share and brand recognition

- When business grow, the Market share of business is likely to grow.
- As the brand become stronger, a business may be able to charge high price.

4.) Increased profitability

- Large businesses tend to make more profits than smaller firms.

3. Distinction between inorganic and organic growth.

- Organic growth; a business growth strategy that involves a business growing gradually using its own resources.

- Inorganic growth; a business growth strategy that involves two or more businesses joining together to form one much larger one.

↳ e.g. horizontal integration, vertical integration