



Edexcel A - A Level Economics

Theme 3 – Business behaviour and the labour market

3.1 Business growth Revision Notes

Contents

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3.1.1 Sizes and types of firms

Why some firms grow and others stay small

Businesses come in all shapes and sizes, from small local bakeries to massive global corporations like Apple. Some firms aim to expand rapidly, while others intentionally stay small. Here's why...

Why Some Firms Choose to Grow

- **More Influence & Recognition** – Some business owners dream of building a **big-name** brand. **Airbnb** expanded from a small apartment rental idea to a global travel giant, earning billions.
- **Bigger Profits** – Growth often leads to **higher revenue**. A company like **Nike** expands by entering new markets and increasing sales worldwide.
- **Stronger Market Power** – Large firms aim to **dominate the industry** and control pricing. **Google** is a great example, with its near-monopoly on internet searches.
- **Lower Production Costs** – Bigger companies benefit from **economies of scale**, meaning the cost per unit drops as they produce more. For example, **Coca-Cola** makes billions of drinks, so they buy ingredients in bulk at lower prices.
- **New Opportunities & Diversification** – Growth allows businesses to **expand into new industries**. **Amazon**, which started as an online bookstore, now sells everything from groceries to streaming services.
- **Easier Access to Investment** – Bigger businesses are more likely to attract **investors and loans**. For example, **Tesla** raised billions to fund its research and development.



3.1.1 Sizes and types of firms

Why some firms grow and others stay small

Why Some Businesses Stay Small

- **Personal Touch & Customer Loyalty** – Small businesses often **focus on relationships**. Think of a **local bakery** that knows its customers by name and customises orders.
- **Financing Barriers** – Many small businesses struggle to **get loans**, making expansion difficult. A small **handmade jewellery store** may not have the funding to open multiple locations.
- **Specialised (Niche) Markets** – Some businesses sell **unique, high-quality products** to a small audience. For example, a **bespoke furniture shop** focuses on handcrafted pieces rather than mass production.
- **Avoiding Management Problems** – Rapid expansion can create **diseconomies of scale**, where operations become inefficient. Many **craft breweries** prefer to stay small to maintain quality control rather than mass-produce beer.
- **Easier to Adapt & Change** – Small businesses are **more flexible** and can **quickly adjust** to trends. A small **independent fashion brand** can switch styles faster than a massive clothing retailer.
- **Work-Life Balance** – Not every business owner wants to work 24/7. Some prioritise a **comfortable lifestyle** over rapid growth. A **local coffee shop owner** may prefer a stable income over managing multiple locations.

3.1.1 Sizes and types of firms

The divorce of ownership from control

As businesses grow, the original **owners (or shareholders)** often **step back** from daily operations and hire professional **managers** to run things. This creates a **separation** (almost like a "**divorce**") between the people who **own** the company and those who **manage** it.

The Principal-Agent Problem

This "divorce" can cause a **conflict of interest**, known as the **Principal-Agent Problem**.

- **Principals** = The owners/shareholders who want **higher profits** 💰
- **Agents** = The managers/workers who want **higher salaries** 💰 and maybe an easier work life.
- ◆ **Example 1:** The owners of a **supermarket chain** want to **increase profits**, but the managers might **hire more staff** to make their jobs easier, increasing costs instead.
- ◆ **Example 2:** The owners of a **car dealership** might focus on **high-value luxury cars**, while managers may prefer **selling more lower-value cars** to boost sales numbers (even if it means lower profit per sale).

The Information Gap Problem

The issue gets worse when **managers have more information** than the owners, a problem called **information asymmetry**. Since managers are in control of daily operations, they can **hide details or make decisions that benefit themselves more than the business**.

- ◆ **Example:** A **restaurant owner** trusts the **general manager** to run the place, but the manager **hires unnecessary staff** to reduce their own workload, increasing costs for the owner.



3.1.1 Sizes and types of firms

The divorce of ownership from control

How to Fix It?

One way businesses try to **align interests** is by giving **managers a financial stake** in the company.

- ✓ **Share Options:** If managers get **company shares**, they will **care about profits** just like the owners.
- ✓ **Performance-Based Bonuses:** Rewarding managers for **actual profit growth** instead of just sales numbers.
- ◆ **Example:** A **tech company** like **Apple** gives executives stock options so that they **think like owners** and work to increase long-term value.

3.1.1 Sizes and types of firms

Public and private sector organisations

When it comes to running businesses and services, there are two main types of organisations: **Public Sector** and **Private Sector**.

Public Sector: Run by the Government

These are organisations **owned and operated by the government** to provide essential services to the public. Their goal is **not to make a profit**, but to **serve society**.

◆ **Examples of public sector organisations:**

- **Healthcare Services** – e.g., **Medicare** or **NHS (National Health Service)**
- **Public Schools & Universities** – e.g., **Harvard was originally a public school**
- **Police, Fire Services & National Defence** – e.g., **Military, FBI**
- **Public Transport** – e.g., **New York Subway, TfL (Transport for London)**

💡 **Key takeaway:** Public sector organisations **prioritise public service** over making money. That's why things like education, law enforcement, and healthcare are often government-funded. This ensures access to essential services regardless of income.

💰 **Private Sector: Run by Individuals & Businesses**

The **private sector** is all about **making money**. These businesses are **owned by individuals or shareholders** rather than the government. Their goal? **Maximise profit**.

◆ **Examples of private sector businesses:**

- **Tech Companies** – e.g., **Apple, Microsoft, Netflix**
- **Retail Chains** – e.g., **Nike, Walmart, McDonald's**
- **Banks & Insurance Companies** – e.g., **Goldman Sachs, AIG**
- **Luxury Car Brands** – e.g., **Ferrari, Porsche**

💡 **Key takeaway:** Private sector companies **compete to make profits** and **improve efficiency**. This often leads to **higher productivity, innovation** and better products and services but also means **prices can be higher** for consumers.

3.1.1 Sizes and types of firms

Profit vs Not-for-profit organisations

Not all businesses exist to **make profits**. While most firms aim to make money, **some exist to serve a bigger purpose**.

Profit-Making Businesses (Private Sector)

Most companies in the **private sector** are **profit-driven**, meaning they exist to **make money** for their owners or shareholders. If they don't make enough profit, they might **struggle to survive** or even **shut down**.

◆ **Examples of Profit-Making Companies:**

- ✓ **Nike** – Sells sportswear and aims to maximize sales revenue.
- ✓ **McDonald's** – Focuses on keeping costs low and profits high.
- ✓ **Tesla** – Aims to grow, invest in new technology, and increase shareholder value.

💡 **Key Point:** Without profit, businesses **can't pay their workers, develop new products, or expand**.

💙 **Not-for-Profit Organisations (Serving a Purpose)**

Not all organisations care about making money. **Not-for-profits** focus on **helping people, supporting causes, or providing essential services** rather than generating income for owners.

◆ **How They Work:**

- ✓ They **sell goods or services**, but instead of **paying dividends to shareholders**, they **reinvest profits into their mission**.
- ✓ They often receive **donations, government support, or tax exemptions** to help keep running.

◆ **Example: The Red Cross** – Offers disaster relief, healthcare, and humanitarian aid.

💡 **Key Point:** Not-for-profits are still businesses in some ways, but their goal is to **make an impact, not to make money**.

3.1.2 Business growth

How businesses grow

Every business wants to **grow**, but not all growth happens in the same way. Businesses can expand **organically** (on their own) or **externally** (by merging with or acquiring other firms).

Organic Growth (Internal Growth)

Organic growth happens when a business **expands naturally** using its own resources. This is usually a **slower but more sustainable way** to grow.

How businesses grow organically:


- **Increasing market share** – Attracting more customers from competitors.
- **Launching new products** – Expanding the product range, e.g., Nike launching a new line of smart running shoes.
- **Opening new locations** – A local coffee shop opening more branches in different cities.
- **Expanding internationally** – A UK-based clothing brand launching stores in Europe.
- **Investing in technology** – A factory automating production to increase output.




3.1.2 Business growth


How businesses grow

Pros of Organic Growth


 **Less risk** – The business grows at its own pace, avoiding the **debt** and **complications** of takeovers.


 **Maintains control** – Owners **stay in charge** instead of merging with another company.


 **Builds strong customer relationships** – A business **stays true to its values** and grows a **loyal customer base**.

 **More sustainable** – No sudden jumps; it's a steady process that helps in the long run.

Cons of Organic Growth

 **Takes time** – Slow and steady means you might **miss out on big opportunities**.

 **Limited by resources** – Growth depends on **profits and reinvestment**, so it's harder to expand quickly.

 **Harder to compete with big firms** – Large companies growing through mergers can dominate the market faster.

3.1.2 Business growth

How businesses grow

Inorganic Growth (External Growth)

Inorganic growth happens when a business **joins forces with another company** through a **merger (combining two companies)** or a **takeover (one company buying another)**.

There are **three main types** of external growth:

1 Vertical Integration (Up or Down the Supply Chain)

A business merges or takes over another company in the **same supply chain** but at a **different stage**.

Forward Integration (Moving Closer to Consumers)

- ✓ A **book publisher** buying a **chain of bookstores** to sell directly to readers.
- ✓ A **coffee bean supplier** taking over a **café chain** to sell its coffee.

Backward Integration (Going Up the Supply Chain)

- ✓ A **car manufacturer** buying a **tire company** to secure its supply of tires.
- ✓ A **fast-food chain** purchasing a **potato farm** to control its source of fries.

✓ Pros of Forward Integration

- ✓ **Higher profit margins** – The company **keeps all revenue** rather than paying retailers/distributors.
- ✓ **More control over branding & sales** – The business decides how its products are marketed, priced, and sold.
- ✓ **Better customer experience** – The company can directly manage service quality and improve brand loyalty.
- ✓ **Less dependency on third-party retailers** – No need to rely on external stores that might push competitor products.



3.1.2 Business growth

How businesses grow

✗ Cons of Forward Integration

- ⚠ **High costs** – Opening retail stores or distribution centers requires **big investments**.
- ⚠ **Risk of inefficiency** – Managing retail operations is different from manufacturing; poor management can hurt profits.
- ⚠ **Retail market competition** – Competing with established retailers might be difficult.
- ⚠ **Consumer preferences change** – If customers prefer online shopping, owning physical stores could be risky.

✓ Pros of Backward Integration

- ✓ **Lower production costs** – No need to pay suppliers, making production **cheaper**.
- ✓ **Better supply chain control** – Reduces risks of **delays or shortages**.
- ✓ **Higher product quality** – The company can ensure **better materials** rather than relying on external suppliers.
- ✓ **Competitive advantage** – Owning the supply source can prevent competitors from getting the same materials.

✗ Cons of Backward Integration

- ⚠ **Expensive to set up** – Buying farms, factories, or suppliers requires **huge investment**.
- ⚠ **Less flexibility** – If market trends change, the company is **stuck with its own supply chain**.
- ⚠ **Risk of inefficiency** – Just because a company **buys a supplier** doesn't mean it knows how to run it efficiently.
- ⚠ **Higher operational complexity** – Managing farms, factories, or raw material production **adds another layer** of complexity to the business.

3.1.2 Business growth

How businesses grow

Inorganic Growth (External Growth)

2 Horizontal Integration (Merging with a Competitor)

A business expands by **merging with or buying a direct competitor** in the same industry.

- ✓ **Netflix buying another streaming service** to expand its movie library.
- ✓ **Coca-Cola acquiring a smaller soft drink brand** to dominate the market.

Pros of Horizontal Integration

- ✓ **Less competition** – Fewer rivals means **more market power**.
- ✓ **Instant access to new customers** – The merged companies combine their customer bases.
- ✓ **Economies of scale** – Larger businesses can **reduce costs** by producing more at lower expenses.

- **Example: Facebook acquiring Instagram** helped it dominate social media.

Cons of Horizontal Integration

- ⚠ **Mergers don't always work** – Different business cultures can clash.
- ⚠ **Risk of monopoly concerns** – Governments may block mergers that **reduce competition too much**.
- ⚠ **Job losses** – Merging companies may cut jobs to **avoid duplication**.

3.1.2 Business growth

How businesses grow

Inorganic Growth (External Growth)

3 Conglomerate Integration (Diverse Business Expansion)

A business **buys a company in an entirely different industry** to **reduce risk** and **diversify income streams**.

- ✓ **Amazon acquiring Whole Foods** (tech company buying a supermarket chain).
- ✓ **Disney purchasing Marvel Studios** (entertainment giant expanding into superhero movies).

Pros of Conglomerate Integration

- ✓ **Reduces risk** – If one industry struggles, the company has **other sources of income**.
- ✓ **Expands brand recognition** – Moving into **new markets** brings more customers.
- ✓ **Cross-industry innovation** – Different sectors can bring fresh ideas.

Cons of Conglomerate Integration

- ⚠ **Harder to manage** – Different industries require **different expertise**.
- ⚠ **Risk of losing focus** – Running too many different businesses can **weaken the core brand**.
- ⚠ **Employees may feel disconnected** – Too much diversification can make workers feel like **just another cog in the machine**.

3.1.2 Business growth

Constraints on business growth

Not every business has the chance to grow into a massive corporation like Amazon or Apple. There are several **roadblocks** that can slow down or completely stop a company from expanding.

1 Market Size: Are There Enough Customers?

Some businesses **serve a niche market**, meaning they have a **limited number of potential customers**. The more niche the product, the harder it is to grow.

◆ **Example:** A luxury watchmaker selling \$50,000 watches has a much **smaller target audience** than a fast-food chain selling \$5 burgers. The watch company may struggle to expand simply because **there aren't enough buyers**.

✦ **Challenge for large firms?** Even **big companies** eventually hit a ceiling in their home country. To grow further, they often **expand internationally**, which brings **new risks** like different regulations, cultural preferences, and economic conditions.

2 Access to Finance: Can You Get the Money? 💰

Small businesses often **struggle to get loans** because banks **see them as risky**. Lenders worry about whether a new or small firm can **repay the loan**, so they **charge higher interest rates** or deny the loan altogether.

◆ **Example:** A new bakery wants to open more stores, but the bank **rejects its loan request** because it hasn't been around long enough to prove its stability. Without funding, the bakery can't expand, even though demand is high.

✦ **Why do big firms have an advantage?** **Larger, well-established businesses** can **secure loans more easily** because they have a **track record of success** and valuable assets to use as security.



3.1.2 Business growth

Constraints on business growth

3 Owner Objectives: How Big is Big Enough?

Not every business owner **wants to grow indefinitely**. Some prefer to keep their business **small and manageable** to maintain a certain **work-life balance**.

◆ **Example:** A local coffee shop owner may **choose not to expand** into a chain because they enjoy **personal interactions with customers** and don't want the stress of managing multiple locations.

✦ **Lifestyle businesses** prioritize **quality of life over profits**. Growth might be possible, but **the owner doesn't want it**.

4 Government Regulations: The Red Tape 🏛️

Governments regulate businesses to protect consumers, workers, and competition. While these rules are necessary, they **can limit business growth** by adding extra costs or restrictions.

◆ **Example 1:** A **fast-food chain** wants to sell larger sodas, but **new health laws** limit soft drink sizes. This **prevents expansion** in that product line.

◆ **Example 2:** A **gambling company** wants to advertise more, but strict **age restrictions** make it harder to reach new customers.

✦ **For large firms, competition laws** can **stop monopolies** from forming. If a giant company tries to **buy too many competitors**, the government might block the deal to keep the market **fair and competitive**.

3.1.3 Demergers

When a company **splits into separate parts** (that's a *demerger*), it doesn't just affect the business itself, it impacts everyone connected to it.

Impact of demergers

Impact on the Firm (the Business)

✔ Better Branding

A company that splits can create two clearer, more focused brands. When eBay spun off PayPal into a separate company, both were able to focus on what they did best, eBay on e-commerce, PayPal on payments.

✔ Cutting off weak limbs

If a fashion brand sells off its underperforming cosmetics arm, it no longer has to worry about that side draining money.

✔ Faster Decision-Making

Smaller businesses often have fewer layers of management. This makes them more agile and responsive to market changes.

✔ Lower operating costs

Smaller companies often find it easier to manage their processes. There's less overlap, fewer departments, and decisions can be made faster.

✔ Attract New Investors

Some investors may only want to put money into a specific type of business.

✔ Potential for higher profits

If the core business is stronger on its own, profits can actually rise after the split. Investors often like this, just like when Time Warner split off AOL, and both companies' shares increased.

⊘ **However**, it can also mean the business loses some of its market power or brand synergy. For example, losing shared tech or marketing services could raise costs.



3.1.3 Demergers

Impact of demergers

Impact on Employees

✔ New Leadership Opportunities

Demergers often create more leadership positions as each new business needs its own senior team.

⊘ Job uncertainty or loss

When Kraft split into Kraft Foods and Mondelez, some departments were no longer needed in both companies, this led to job cuts.

🎯 Clearer career paths

In smaller, more focused businesses, it's easier to stand out. Promotions may be more accessible without a large corporate ladder to climb.

✔ More Autonomy in Roles

In a smaller company, employees often wear multiple hats. This can be empowering and offer faster skills development, especially for junior staff.

⊘ Relocation or Department Changes

Employees might be moved to different offices or departments depending on how the split is handled, creating personal disruption.

3.1.3 Demergers

Impact of demergers

Impact on Consumers

More Competition in the Market

Demergers can break up a dominant player, giving smaller firms a chance and potentially leading to more consumer choice.

Improved product quality & service

When HP split into HP Inc. (printers & PCs) and Hewlett Packard Enterprise (cloud & servers), each company focused better on its customers' specific needs, leading to product improvements.

Lower prices

If the new company becomes more efficient, it might pass on the savings through better pricing (though this doesn't always happen).

Specialised Products or Services

With a tighter focus, the new businesses may tailor their offerings more closely to niche customer needs, like when Philips spun off its lighting division (Signify), which could then specialise purely in smart lighting innovation.

Reduced range of products

If one company previously offered a wide range under one brand (e.g. Nestlé), a demerger could mean fewer choices if some parts are sold off.

Customer confusion

After a demerger, it may be unclear who to contact for help or support, especially if the branding or service quality changes.

Loyalty Programme or Warranty Issues

For example, if a company splits, customers might lose access to loyalty points, or warranties might be unclear about who's responsible.



3.1.3 Demergers

Impact of demergers

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