

How do businesses start, grow, and sometimes stay small?

Syllabus section 1.3: Enterprise, business growth and size

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Running case: Westbridge Bags · 55 minutes

How this topic is examined

Paper 1 • Short answer and data response

Define [2] • Identify [2] / [4]

Outline [4] • Explain [6]

Explain two... Which is most important? [6]

Do you think... Justify your answer [6]

Paper 2 • Case study

Explain four... [8]

Consider... Which should the business choose? Justify your answer [12]

Typical questions on this topic

Define 'entrepreneur', 'business plan' or 'diseconomies of scale'. [2]

Identify two / four ways to measure the size of a business. [2] / [4]

Explain two characteristics of a successful entrepreneur. Which is most important? [6]

Explain four ways a business plan could help the owner. [8]

Explain two reasons why a business might remain small. Which is most important? [6]

Do you think internal or external growth is better? / Should it take over the other business? [6] / [12]

By the end of this lecture you can...

- 1 Explain the characteristics of a successful entrepreneur and why governments support start-ups.
- 2 Explain what a business plan contains and how it helps.
- 3 Compare ways of measuring business size and their limitations.
- 4 Explain why businesses grow, and compare internal and external growth.
- 5 Explain economies and diseconomies of scale.
- 6 Explain why some businesses stay small and why new businesses are more likely to fail.

Starter: remember Lecture 1?

Q1 Define 'added value'.

Q2 Hannah chose a sewing machine over product photos. What was the opportunity cost?

Q3 Why does the tertiary sector grow as incomes rise?

Q4 Name one thing a person needs to start a business, apart from money.

Q5 Is a bigger business always a better business? Say yes or no, and give one reason.

Westbridge Bags is growing: now what?

The situation

Westbridge Bags now employs 6 people and sells 20,000 bags a year.

Orders are rising faster than one workshop can handle.

Hannah could open a second workshop, or merge with a rival, Firth Bags.

Questions we will answer today

- 1 What made Hannah a successful entrepreneur?
- 2 Would a bank lend to her without a business plan?
- 3 How do we know if Westbridge is “big”?
- 4 Should she grow internally or merge with Firth?
- 5 Could growing too big make costs rise?

Case study: Westbridge Bags, two years on

Where the business is now

Hannah started Westbridge Bags as a sole trader, using her own savings, to make durable, affordable school bags in a rented workshop.

Two years later Westbridge employs 6 people and sells 20,000 bags a year at \$28 each, online and through school-supplies shops. Several schools now want bags in their own colours.

The workshop is full. A bank will only lend if Hannah shows it a business plan.

Hannah has two options: open a second workshop, or accept an offer to merge with Firth Bags.

Compare the two businesses

	Westbridge	Firth Bags
Employees	6	15
Bags sold a year	20,000	18,000
Selling price	\$28	\$22
Sells to	Parents, schools	Big stores

Notice: Firth has more employees but sells fewer bags.

The entrepreneur

Definition A person who organises, operates and takes the risk for a new business venture.

Risk taker

invests savings with no guaranteed return

Creative

spots gaps in the market, new ideas

Hard-working

long hours in the early years

Independent

makes decisions alone

Self-confident

persuades banks, customers, staff

Good communicator

negotiates with suppliers and lenders

The business plan

Definition A written document describing a business, its objectives and strategies, the market it operates in and its financial forecasts.

Main sections

Business description and objectives

Market research and the market

Marketing plan

Production / operations

Human resources (staffing)

Finance: forecasts, cash flow, finance needed

How it helps

- Persuades banks and investors to provide finance
- Sets clear objectives to measure progress
- Forces the owner to think through risks
- Helps decide between options

Limitation

It is only a forecast: conditions can change.

Why and how governments support start-ups

Why governments help

- New businesses create jobs and reduce unemployment
- They increase output and economic growth
- More competition means more choice and lower prices
- Small firms can grow into large firms and exporters
- More businesses means more tax revenue

How governments help

- Grants and low-interest loans
- Free advice and training for owners
- Cheap premises in business parks or incubators
- Lower taxes for new businesses
- Less paperwork to register a business

Check 1

1

Define 'entrepreneur'.

Answer: A person who organises, operates and takes the risk for a new business venture.

2

Give two ways a business plan helps Hannah get a bank loan.

Answer: It shows forecasts of revenue and profit, and shows she has planned for risks.

3

State two reasons why a government supports new businesses.

Answer: To create jobs and to increase economic growth (or competition, tax revenue).

How do we measure the size of a business?

Method	Strength	Limitation
Number of employees	Easy to compare	Capital-intensive firms employ few workers
Value of output / revenue	Shows how much it sells	Prices differ between industries
Capital employed	Shows the money invested	Labour-intensive firms need little capital
Market share	Shows position against rivals	Depends on how big the market is

Trap: profit is NOT a measure of size. A small business can make more profit than a large one.

Why do businesses want to grow?

Lower average costs
economies of scale

Higher market share
more power over prices

Higher profit
more sales and revenue

Survival
harder for rivals to force out

Status and ambition
owners' personal objectives

Spread risk
sell more products or in more markets

Internal (organic) growth: the business expands its own operations: more output, new branches, new products, new markets.

Westbridge: open a second workshop, make bags in schools' own colours, sell online to other countries.

External growth: mergers and takeovers

Merger: two businesses agree to join together as one. **Takeover:** one business buys a controlling share of another.



Horizontal: Same industry, same stage

e.g. Westbridge merges with Firth Bags

Vertical: Same industry, different stage

e.g. buys a cotton supplier (backward) or a shop (forward)

Conglomerate: Different industries

e.g. Westbridge buys a café

Internal or external growth?

	Internal growth	External growth
Speed	Slow	Fast
Cost	Lower, spread over time	High: buying a business
Control	Easier to manage	Culture clash, job losses
Risk	Lower	Higher if the takeover fails
Market share	Grows gradually	Removes a competitor at once

Examiner rule: economies of scale apply to BOTH methods, so they don't count as an advantage of either.

Check 2

1

Identify two ways to measure the size of a business.

Answer: Number of employees; revenue; capital employed; market share (not profit).

2

Westbridge buys the shop that sells its bags. What type of integration is this?

Answer: Forward vertical integration (external growth).

3

Give one advantage of internal growth over a takeover.

Answer: Easier to control, lower cost, lower risk.

Economies of scale: why bigger can be cheaper

Definition Factors that lead to a reduction in average (unit) costs as a business increases in size.

Purchasing

Bulk-buying discounts on fabric and zips

Marketing

Advertising costs spread over more bags

Financial

Banks lend more cheaply to large firms

Managerial

Can afford specialist managers

Technical

Can use large, efficient machines

Remember: total costs rise as output rises. What falls is the AVERAGE cost of each unit.

Diseconomies of scale: when bigger costs more

Average cost



economies of scale

diseconomies

Output →

Poor communication

More levels and sites, so messages are slow or distorted

Lack of coordination

Managers lose track of what each part is doing

Low morale

Workers feel unimportant, so productivity falls

Slow decisions

More people must agree before anything changes

Definition: factors that increase average costs as a business grows beyond a certain size.

Why do some businesses stay small?

1

Owner's choice

wants control, less stress, a lifestyle business

2

Small or niche market

not enough customers to grow

3

Personal service

customers value knowing the owner

4

Lack of finance

banks won't lend enough

5

Avoid diseconomies

stays efficient and easy to manage

6

Lack of skills

owner cannot manage a large team

Which is most important? Usually the owner's own objectives, because many small firms could grow but choose not to. But if the market is tiny, growth is impossible whatever the owner wants.

Why do businesses fail?

Why businesses fail

- Poor management or planning
- Cash-flow problems: cannot pay bills
- Strong competition
- Changes in the market or economy
- Over-expansion: grow too fast

Why NEW businesses are more at risk

- Owner lacks experience
- No brand or loyal customers yet
- Hard to raise finance
- Little market knowledge
- Higher costs: no economies of scale

Link: a good business plan reduces several of these risks, but it cannot remove them.

Check 3

1

Define 'diseconomies of scale'.

Answer: Factors that cause average costs to increase as a business grows beyond a certain size.

2

Give two reasons why a business might stay small.

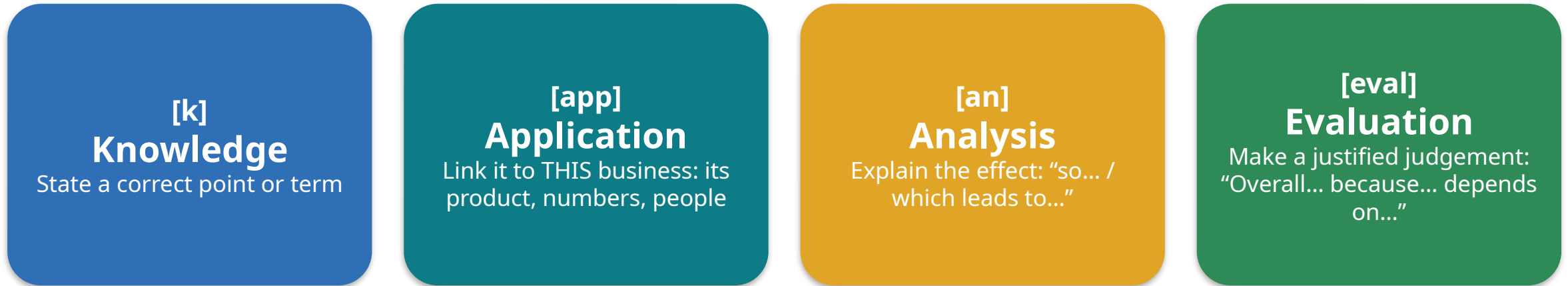
Answer: The owner wants to keep control; the market is small or niche (or lack of finance).

3

Name one purchasing economy and one diseconomy of scale.

Answer: Bulk-buying discounts; poor communication (or low morale, slow decisions).

How you earn the marks



Identify (two/four)	[2]/[4]	1 per point; only the first answers are marked
Explain (two)	[6]	k + app + an for each point
Explain two... Which is most important?	[6]	2 k + 2 an + 2 eval: you MUST choose one
Do you think... Justify	[6]	2 k + 2 an + 2 eval. No application marks
Paper 2: Explain four	[8]	4 points + 4 explanations in context
Paper 2: Consider... Which?	[12]	Levels: discuss each option in context, then justify and say why the other is rejected

Worked answer: Explain [6]

Exam-style question Explain two diseconomies of scale which might affect RLT as it grows. [6]

The business: RLT makes wooden furniture. In ten years it grew from 1 workshop and 18 workers to 3 factories and 240 workers. The MD finds it hard to know what is happening in each factory, and some workers say they feel ignored.

Diseconomy 1: Communication becomes poorer as the business grows (k), because RLT now has three factories and 240 employees (app), so messages are delayed or misunderstood, mistakes increase and the cost of each chair rises (an).

Diseconomy 2: Workers feel less motivated in a large business (k), as some RLT workers say they feel ignored (app), so productivity may fall and more workers may leave, raising recruitment costs (an).

Don't write: "RLT buys timber more cheaply". That is an ECONOMY of scale, so it scores 0 here.

Worked answer: Do you think... Justify [6]

Exam-style question Do you think it is better for a business to use internal growth or external growth when planning to expand? Justify your answer. [6]

Note: This is a general question, so there is no business to apply your answer to. Focus on analysis and a clear judgement.

Internal growth is easier to control (k) **because the business grows at its own pace, so it is less likely to suffer poor communication** (an). **External growth is faster** (k) **and removes a rival at once, increasing market share** (an).

Overall, external growth is better if a business must grow fast and can afford it. With limited finance or management experience, internal growth is safer, because a failed takeover could threaten the whole business. (eval ×2)

Mirror trap: “internal is slow” + “external is fast” is ONE point, not two. Give a different idea for each side.

Where students lose marks

✗ Profit as a measure of size

Use employees, revenue, capital employed or market share.

✗ Economies vs diseconomies mixed up

Bulk discounts LOWER cost; poor communication RAISES it.

✗ Half a definition

Diseconomies need “grows” AND “average cost rises”.

✗ Lists, not explanations

“Risk taker” alone is 1 mark; explain why it matters.

✗ Mirror statements

“Slow vs fast” is one point. Find a second idea.

✗ No choice in “most important”

You must pick ONE and say why it beats the other.

Exam drill: try it under time

Exam-style question

RLT makes wooden furniture. Ten years ago it had 1 workshop and 18 employees. It now has 3 factories, 240 employees and revenue of \$14.5m (up from \$0.9m).

- (a) Define 'diseconomies of scale'. [2]
- (b) Identify two ways to measure the size of a business. [2]
- (c) Identify four reasons why a business might remain small. [4]

Timing rule

About 1 minute per mark.

(a) + (b): 4 minutes

(c): 4 minutes

Swap and mark each other's answers.

Homework: Explain two characteristics of a successful entrepreneur. Which is likely to be the most important? Justify your answer. [6]

Exit ticket

- 1 Identify two ways to measure the size of a business. [2]
- 2 Explain one diseconomy of scale Westbridge might face with two workshops.
- 3 Give one reason why a new business is more likely to fail than an established one.

Next lecture: Types of business organisation, and business objectives and stakeholders.

Summary: key terms from Part 2

Entrepreneur	Organises, operates and takes the risk	Business plan	Objectives, market, strategy, forecasts
Measures of size	Employees, revenue, capital, market share	Internal growth	Expanding own operations
External growth	Merger or takeover	Horizontal integration	Same industry, same stage
Vertical integration	Same industry, different stage	Conglomerate	Different industries
Economies of scale	Average cost falls as size grows	Diseconomies of scale	Average cost rises beyond a certain size
Business failure	Poor planning, cash flow, competition		