Edexcel (B) Economics A-level

Theme 2: The Wider Economic Environment

2.1 Business Growth and Competitive Advantage

2.1.1 Growth

Notes

Objectives of growth:

○ To achieve economies of scale (internal and external)

Internal economies of scale:

These occur when a firm becomes larger. Average costs of production fall as output increases.

Examples of internal economies of scale can be remembered with the mnemonic **Really Fun Mums Try Making Pies**

Risk-bearing: When a firm becomes larger, they can expand their production range. Therefore, they can spread the cost of uncertainty. If one part is not successful, they have other parts to fall back on.

Financial: Banks are willing to lend loans more cheaply to larger firms, because they are deemed less risky. Therefore, larger firms can take advantage of cheaper credit.

Managerial: Larger firms are more able to specialise and divide their labour. They can employ specialist managers and supervisors, which lowers average costs.

Technological: Larger firms can afford to invest in more advanced and productive machinery and capital, which will lower their average costs.

Marketing: Larger firms can divide their marketing budgets across larger outputs, so the average cost of advertising per unit is less than that of a smaller firm.

Purchasing: Larger firms can bulk-buy, which means each unit will cost them less. For example, supermarkets have more buying power from farmers than corner shops, so they can negotiate better deals.

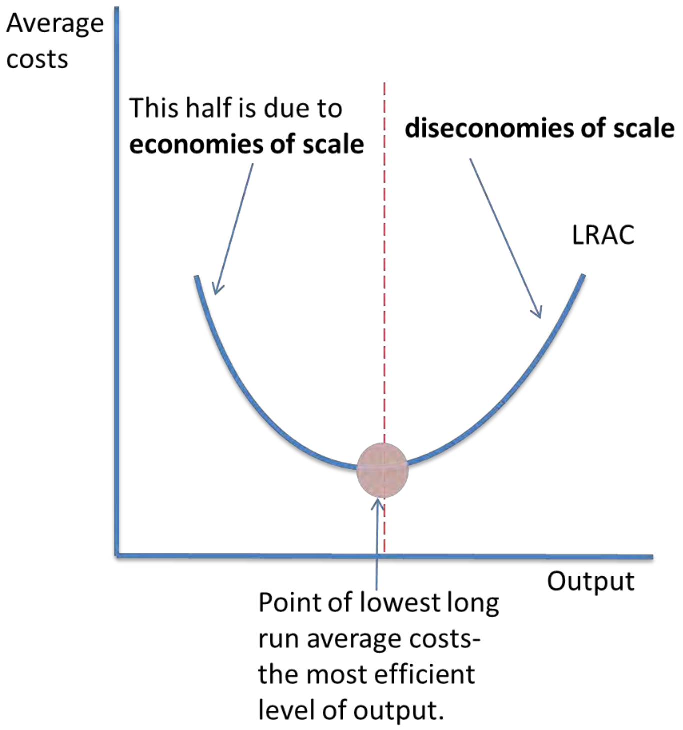
External economies of scale:

These occur within the industry.

For example, local roads might be improved, so transport costs for the local industries will fall.

Also, there might be more training facilities or more research and development, which will also lower average costs for firms in the local area.

Long run average cost curve:



Initially, average costs fall, since firms can take advantage of **economies of scale.** This means average costs are falling as output increases.

After the **optimum level of output,** where average costs are at their lowest, average costs rise due to **diseconomies of scale.**

The point of lowest LRAC is the **minimum efficient scale.** This is where the optimum level of output is since costs are lowest, and the economies of scale of production have been fully utilised.

- ### Increased market power over consumers and suppliers

Market power: large firms have more dominance over the market, which allows them to gain price setting powers and discourage the entrance of new firms. They might also gain monopsony power, which can allow them to buy their stock at a lower price. After Kraft's takeover of Cadbury in 2009, there was been an increased product range, exploitation of brand recognition and evidence of reduced competition.

○ Increased market share and brand recognition

A firm has competitive advantage over another when its products are deemed to be better than its competitors by customers.

A firm can gain competitive advantage using price, quality, cost or through a niche market. Essentially, the firm has a unique feature which allows it to stand out and be superior to its competition.

A firm gains a cost competitive advantage when it can lower its average costs and create maximum value to consumers. For example, it might have a skilled workforce, cheap raw materials or effective technology. However, it is hard to maintain a cost competitive advantage, so firms have to offer consumers other benefits, in addition to a low price. This could be a strong brand reputation and loyalty, or exceptional customer service.

When firms increase their brand loyalty, demand becomes more inelastic. It is hard for new firms to gain consumer loyalty, when one firm's brand name is already strong.

○ Increased profitability

Profit motive: By growing, firms get the opportunity to earn higher profits. Growing also allows firms to take advantage of economies of scale, providing they do not grow so large that they experience diseconomies of scale.

Problems arising from growth:

○ Diseconomies of scale

These occur when output passes a certain point and average costs start to increase per extra unit of output produced.

Examples include:

Control: It becomes harder to monitor how productive the workforce is, as the firm becomes larger.

Coordination: It is harder and complicated to coordination every worker, when there are thousands of employees.

Communication: Workers may start to feel alienated and excluded as the firm grows. This could lead to falls in productivity and increases in average costs, as they lose their motivation.

○ Potential skills shortages

Skills shortages could impact the productivity of workers, the cost of their wages and the international competitiveness of firms. This might lead to higher wages since firms have to compete to attract scarce employees. This is because the demand for labour exceeds supply.

The role of corporate culture

Corporate culture includes: shared values of a firm or workplace; the implicit beliefs and norms that influence all aspects of working life within a firm; and the day-to-day behaviour of employees.

Some firms might try and ensure their employees are well looked-after. When employees are happy, they are more likely to be productive and do a good job. It also increases loyalty towards the employer, so the employee is less likely to leave the job. Google is renowned for their employee perks such as on-site physicians and travel insurance. A strong corporate culture can help determine the success of a firm in the long run. It could help make the company stronger and more productive.