Edexcel (B) Economics A-level

Theme 2: The Wider Economic Environment

2.1 Business Growth and Competitive Advantage

2.1.2 Methods of growth

Notes

Organic growth (also called 'internal growth)

This is when firms grow by expanding their production through increasing output, widening their customer base, by developing a new product or by diversifying their range. Firms might use market penetration to sell more of their products to existing consumers. They might also invest in research and development, technology, or production capacity. This will allow sales to increase and the volume of output to expand.

For example, Apple has grown through creating new products such as iPads and iPhones.

Firms can grow **inorganically** through merging with, acquiring or taking over another firm.

Advantages and disadvantages:

- This is a long term strategy, and it is significantly slower than growing inorganically. This could mean competitors gain more market power by expanding in the meantime. It could also make shareholders unhappy if they want faster growth.
- Firms might rely on the strength of the market to grow, which could limit how much and how fast their can grow.
- It is less risky than inorganic growth.
- Firms grow by building upon their strengths and using their own funds, such as retained profits, to fund the growth. This means that the firm is not building up debt, and the growth is more sustainable.
- Moreover, existing shareholders retain their control over the firm, which might reduce conflicts in objectives that are possible when there is a takeover.

Forward and backward vertical integration

Vertical integration occurs when a firm merges with or takes over another firm in the same industry, but a different stage of production.

Forward vertical integration occurs when the firm integrates with another firm closer to the consumer. This involves taking over a distributor. For example, a coffee producer might buy the café where the coffee is sold.

Backward vertical integration occurs when a firm integrates with a firm closer to the producer. This involves gaining control of suppliers. For example, a coffee producer might buy a coffee farm.

Advantages and disadvantages:

- Firms can increase their efficiency, through gaining economies of scale, which could reduce their average costs. This could result in lower prices for consumers.
- Firms can gain more control of the market. Backwards integration can mean that firms can control the price they pay for their supplies, and they could raise the price for other firms. This could give them a cost advantage over their competitors.
- Firms have more certainty over their production, with factors such as quality, quantity and price.
- The disadvantages associated with diseconomies of scale could be considered.
- Vertical integration can create barriers to entry, which might discourage or limit the entrance of new firms. This could lead to a less efficient market, since the firm has little incentive to reduce their average costs when their market share is high.

Horizontal integration

This is the merger of two firms in the same industry and the same stage of production. For example, if a car manufacturer merges with another car manufacturer, they will have horizontally integrated.

Advantages and disadvantages:

- Firms can grow quickly, which can give them a competitive edge over other firms in the market. However, this could lead to monopoly power and there is the potential of lower inefficiency as a result.
- There could be disagreements in the objectives of the two firms which merged.
- Firms can increase output quickly, so they can take advantage of economies of scale.
- The two firms will have expertise in the same industry, so the merged firm can gain advantages, such as in marketing.

Conglomerate integration

This is the combining of two firms with no common connection. For example, Associated British Foods owns Primark and Patak's, which produces curry pastes and pickles.

Advantages and disadvantages:

- It can help both firms become stronger in the market, than if they were individual.
- The conglomerate can reach out to a wider customer base, and market competition could be reduced.
- The advantages of economies of scale, and particularly risk bearing economies of scale, can be considered.
- There is a risk of spreading the product range too thinly, and there might not be sufficient focus on each range. This might reduce quality and increase production costs.