

Cambridge AS & A Level · Business 9609 · Notes

Size of business AS

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What you need to know

By the end of this topic you should be able to:

1. **Judge how well each method measures the size of a business:** revenue, number of employees, capital employed, market capitalisation, market share and others, and why one measure on its own can mislead.
2. **Explain the advantages and disadvantages of being a small business.**
3. **Explain the strengths and weaknesses of family businesses.**
4. **Explain why small businesses matter to the economy:** jobs, competition, new ideas, and support for large firms.
5. **Explain the part small businesses play in some industries,** where many small firms work alongside a few large ones.
6. **Explain why and how a business might grow internally** (organic growth).
7. **Describe the types of external growth:** horizontal, vertical (backward and forward) and conglomerate mergers and takeovers, and friendly mergers and hostile takeovers.
8. **Analyse the impact of a merger or takeover on stakeholders.**
9. **Explain why a merger or takeover may or may not achieve its objectives.**
10. **Explain why joint ventures and strategic alliances matter as ways of growing externally.**

The types of business ownership (sole trader, plc, joint venture as a legal form) are in the earlier topic, business structure. Economies and diseconomies of scale are explained in detail in the operations topics; here you only need them as reasons for and against growth.

Understand it

Measuring the size of a business

There is no single "size" number. Each measure tells you something different:

Measure	What it is	Good for	Weakness
Revenue (sales turnover)	Value of sales in a year	Comparing firms in the same industry	A retailer of costly goods (cars) looks bigger than one selling cheap goods, though it may sell far fewer items
Number of employees	People working for the business	Easy to find and understand	Capital-intensive firms (robot car plants, internet firms) look small; part-time and outsourced workers distort it
Capital employed	Long-term finance invested in the business	Shows the resources used	Labour-intensive service firms (cleaning, consultancy) look small
Market capitalisation	Share price $\times$ number of shares	Comparing public limited companies	Only for companies with shares on a stock exchange; changes daily with the share price
Market share	The firm's sales as a percentage of all sales in the market	Shows power within its market	A firm with a big share of a tiny market is still small
Others	Output, number of outlets, number of customers, floor space	Simple, industry-specific	Each fits only some industries

Profit is not a measure of size. It measures performance: a huge business can make a loss and a small one a big profit. Examiners never accept profit as a size measure.

Why one measure can mislead: two businesses can rank in opposite orders on different measures.

	Robot parts maker	Office cleaning firm
Employees	40	400
Revenue	30 million dollars	8 million dollars
Capital employed	50 million dollars	1 million dollars

On employees the cleaning firm is 10 times bigger; on capital employed the parts maker is 50 times bigger. So compare firms with **the measure that suits their industry**, or **several measures together**.

Using data from a case: a business's revenue rose from 4.0 million dollars to 5.0 million dollars over two years, a rise of $\frac{5.0 - 4.0}{4.0} \times 100 = 25\%$, while its employees fell from 50 to 45, a fall of $\frac{50 - 45}{50} \times 100 = 10\%$. By revenue it grew; by employees it shrank, perhaps because it bought machines. Market share works the same way: a firm selling 18 million dollars in a market worth 240 million dollars has a share of $\frac{18}{240} \times 100 = 7.5\%$.

Small businesses

What counts as "small" depends on the country and the industry, but small businesses usually have few employees, low revenue, one or a few sites, and an owner who runs them day to day.

Advantages of being small:

- **Flexibility:** the owner can change products, prices or opening hours quickly when customers or the market change, with no layers of managers to consult.
- **Personal service:** the owner knows customers by name, so service builds loyalty and repeat sales.
- **Niche markets:** small firms can serve a small group of customers (hand-made, local, specialist products) that large firms ignore, often at higher prices.
- **Low overheads:** small premises and few managers keep fixed costs low.
- **Easy control and communication:** few staff, so decisions are made and passed on quickly, and the owner can check quality.

Disadvantages of being small:

- **No economies of scale:** small firms buy in small amounts and can't spread fixed costs over much output, so **unit costs are higher** and they find it hard to match large firms' prices.
- **Weak bargaining power** with suppliers and retailers.
- **Hard to raise finance:** banks see small firms as risky, so loans cost more or are refused; there are no shares to sell to the public.
- **Owner overload:** the owner may do production, marketing and accounts alone, works long hours and may lack some skills.
- **Vulnerable:** a small customer base or one product means one lost customer or a new rival can threaten survival.

Why a business may choose to stay small: the owner wants to keep **control** and a good work-life balance; does not want the **risk** or the debt of growing; fears **losing quality** or the personal service that is its unique selling point; or there is **not enough demand** (a niche market) or **finance** to grow.

Family businesses

A **family business** is owned and run by members of one family, often passed on between generations. Many small businesses are family businesses, but some large companies are too.

- **Strengths: trust and commitment:** family members work hard and share the long-term aims; **long-term outlook** rather than pressure for quick profits; **quick decisions** and loyalty; skills and customer relationships passed on between generations; a family name can give a strong reputation.
- **Weaknesses:** **conflict** between family members spills into the business; **favouritism:** family members get jobs or promotions they lack the skills for, which demotivates other staff; **succession problems:** no clear or willing person to take over; **lack of finance and outside skills**, because the family won't let outsiders in.

Small businesses in the economy

Small businesses matter far more than their individual size suggests:

- **Jobs:** in most countries they employ a large share of workers, often in towns and villages where large firms don't operate.
- **Competition and choice:** they compete with large firms, keeping prices down and offering products large firms don't.
- **Innovation:** entrepreneurs try new ideas, and some small firms become tomorrow's large businesses.
- **Supporting large firms:** many supply parts or services to large businesses (a car maker buys from hundreds of small suppliers).
- **Taxes and local income:** their owners and workers spend locally and pay taxes.

Against this: each small firm employs few people, many fail in their first years, and large firms often pay higher wages and more tax per worker.

Industrial structure: in some industries (hairdressing, restaurants, building, repairs, many professional services) **most firms are small** even though a few large chains exist, because customers want personal service, the market is local, and economies of scale are small. In others (car making, oil, airlines) a few huge firms dominate because the costs of entry are so high, and small firms survive mainly as suppliers or in niches.

Why businesses grow

Businesses grow to **cut unit costs** through economies of scale, **increase market share** and market power, **spread risk** across more products or markets, raise **profit** and the owners' status, and **survive** against larger rivals. But growth can bring **diseconomies of scale** (slower communication, weaker control, lower motivation), higher debt and loss of the personal touch.

Internal (organic) growth

Organic growth is growth from within, using the business's own resources: selling more of its products, opening new outlets, building a new factory, or launching new products. It is often paid for from **retained profit**.

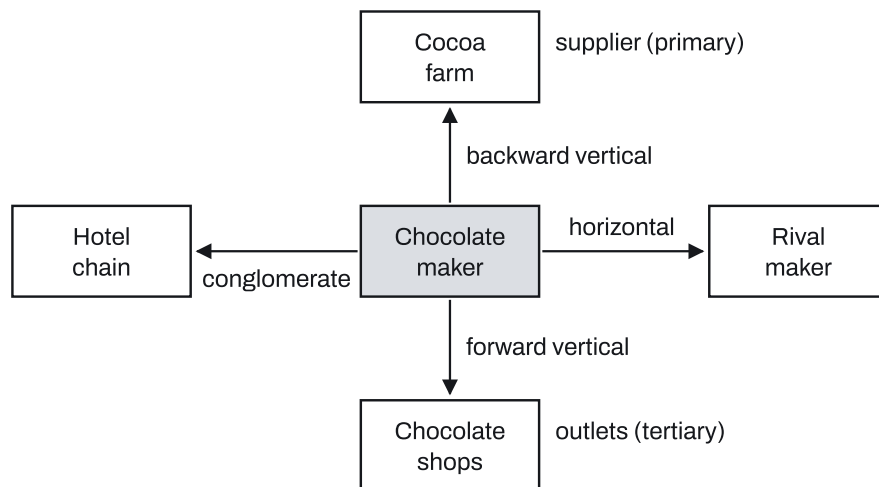
- **Advantages:** **lower risk**, because it builds on what the business already does well; **keeps control** with the existing owners; **no culture clash** with another business; usually **cheaper** than buying a business; less debt, so finance stays stable.
- **Disadvantages:** **slow**, so rivals may grow faster and take the market; limited by the funds the business itself generates; growth may need skills the business doesn't have.

Growing too fast is a risk even with organic growth: **overtrading** (taking on more orders than the working capital can pay for, so cash runs out), quality slips as the owner can't check everything, and a niche firm can lose the special image that customers paid for.

External growth: mergers and takeovers

- A **merger** is when two businesses agree to join together to form one business.
- A **takeover** (acquisition) is when one business **buys a controlling interest** (more than half the shares) in another.
- A **friendly merger** (or friendly takeover) has the agreement of both boards of directors.
- A **hostile takeover** is buying control of a business **against the wishes of its directors and owners**, usually by buying its shares on the stock exchange. Only public limited companies can be taken over this way.

External growth is **fast**: the factories, staff, customers and brands are already there.



Types of integration (by how the two businesses are related):

Type	Joins with	Main benefits	Main risks
Horizontal	A business at the same stage of production in the same industry (a rival)	Bigger market share, less competition, economies of scale, cut duplicate costs	Competition authorities may block it; job losses; culture clash
Backward vertical	A supplier : an earlier stage of the same supply chain	Control over the cost, quality and delivery of materials; supplier's profit margin is kept; can cut rivals' supplies	The new business may be inefficient; less choice of supplier
Forward vertical	A customer or outlet : a later stage of the same supply chain	Secure outlets; control over how its products are sold and priced; can keep rivals' products off the shelves	Needs retail skills it doesn't have; shops may need to stock rivals' products to attract customers

Type	Joins with	Main benefits	Main risks
Conglomerate (diversification)	A business in an unrelated industry	Spreads risk across markets	Managers lack experience of the new market; few cost savings

Impact of a merger or takeover on stakeholders

Stakeholder	Possible gains	Possible losses
Shareholders	Higher profit and share price if savings are made; the target's shareholders are paid a premium for their shares	Lower profit if the merger fails; their shares may be diluted
Employees	Promotion chances, job security in a bigger firm	Redundancies where jobs are duplicated, new managers and culture, relocation
Managers	Larger business to run, higher pay	Lose their jobs or power in the merged firm
Customers	Wider range, lower prices from economies of scale	Higher prices and less choice if competition falls
Suppliers	Bigger orders	Squeezed prices by a more powerful buyer; replaced if the new owner has its own supplier
Government and community	A stronger firm and more tax	Local job losses, less competition

Why mergers and takeovers may not achieve their objectives

Many mergers fail to deliver what they promised. Reasons:

- **Culture clash:** the two businesses work in different ways (management style, attitudes to risk), so staff are unhappy, and good staff leave.
- **Savings are overestimated:** the cost cuts and extra sales expected (synergies) don't appear.
- **Paying too much:** the buyer pays more than the business is worth, often borrowing to do it, so interest costs rise.
- **Poor integration:** no clear plan for joining systems, brands and teams; poor communication.
- **Diseconomies of scale:** the bigger business is harder to control.
- **External changes:** competitors react, a recession hits, or technology changes.

They are **more likely to succeed** when the buyer researches the target carefully, the two cultures fit, there is a clear plan for integration, and the merger is **friendly**, because both sides cooperate. Even a friendly merger can still fail for the reasons above.

Checking an objective with numbers: Firm X has revenue 120 million dollars and profit 9.6 million dollars, a profit margin of $\frac{9.6}{120} \times 100 = 8\%$. It merges with Firm Y: revenue 80 million dollars, profit 4 million dollars, margin 5%. Together: revenue 200 million dollars, profit 13.6 million dollars, margin $\frac{13.6}{200} \times 100 = 6.8\%$. So if X's objective is a **higher profit margin**, the merger alone makes it worse; it works only if the merger brings cost savings of more than $0.08 \times 200 - 13.6 = 2.4$ million dollars a year.

Joint ventures and strategic alliances

- A **joint venture** is when two or more businesses agree to work together on a **particular project**, sharing the capital, costs, risks and profits, while each **keeps its own identity**. They often set up a new business for the project, owned jointly. Unlike a merger, the businesses do not become one.
- A **strategic alliance** is a looser agreement to cooperate (share research, distribution or marketing) without setting up a new business; each business stays fully independent.

Why they matter:

- **Shared costs and risks** of a large or uncertain project.
- **Pooled resources and expertise:** one partner's technology with the other's local market knowledge.
- **Fast entry** to a new market, often abroad, where local partners may be required by law.
- Less costly and easier to end than a merger, and each side **keeps control of the rest of its business**.

Drawbacks: **profits are shared**; partners can **disagree** over aims, culture or management; the partner may impose **conditions** (only using its products, sharing technology), so the business loses some control; a partner's failure or bad publicity harms both.

Key facts and formulas

There is no formula list for this subject in the exam. "Learn it" means you must remember it.

Formula or fact	Status
Market share = $\frac{\text{firm's sales}}{\text{total market sales}} \times 100$	Learn it
Market capitalisation = share price $\times$ number of shares	Learn it
Percentage change = $\frac{\text{new} - \text{old}}{\text{old}} \times 100$	Learn it
Profit margin = $\frac{\text{profit}}{\text{revenue}} \times 100$	Learn it
Profit is a measure of performance, not of size	Learn it

Formula or fact	Status
Organic growth: from within, using own resources; external growth: merger, takeover, joint venture, alliance	Learn it
Horizontal: same stage; backward vertical: a supplier; forward vertical: a customer or outlet; conglomerate: an unrelated industry	Learn it
Takeover: buying a controlling interest; hostile takeover: against the target's wishes	Learn it

How to do it

We have tagged 24 questions on this topic (2021–2025), across Papers 1, 2 and 3. Five of them have parts of more than one type, so the counts add up to 29.

Question type	Questions
Analyse or evaluate external growth (merger, takeover, integration, joint venture)	8
Analyse or evaluate the advantages or disadvantages of being a small or family business	6
Analyse or evaluate internal (organic) growth and the risks of growing	4
Define a growth or size term	4
Measure the size of a business	3
Explain the factors affecting the scale of operation	2
Analyse or evaluate the role of small businesses in the economy	2

The marks are for four skills: **K** (knowledge: a correct point or definition), **App** (application: using the business in the question or a real example), **An** (analysis: a chain of consequences) and **Eval** (evaluation: a supported judgement). Below, (K), (App), (An) and (Eval) after a sentence show the mark it earns.

1. Analyse or evaluate external growth (8 questions)

"Evaluate whether a joint venture / the planned merger is the most appropriate way for [business] to grow / will achieve its objectives" [12] (Paper 2). Marks: 2 K, 2 App, 2 An, 6 Eval.

- K:** show you know the **specific** method. Joint venture: two or more businesses, a shared project, each **keeps its own identity**, shared profit, losses and risks, pooled resources. Merger: two businesses agree to become one. Name the type (horizontal, vertical, conglomerate) if the case shows it.
- App:** use the case facts throughout: who the partner is and what it brings, what the owner wants (to keep control?), the objectives stated, any numbers (combined revenue, profit margins, market shares).
- An:** one developed chain **for** ("the partner already has shops in the new country, so the business can sell there without renting its own premises, so it reaches customers sooner and its revenue rises faster") and one **against** (shared profit, loss of control, the partner's conditions, culture clash, the cost of the merger,

diseconomies of scale).

4. **Eval:** answer the question directly and say **what it depends on:** how much the owner values control, the choice of partner and its conditions, whether the objectives can be met another way (**organic growth**, a merger, an alliance), and how fast the business needs to grow. For "will the merger achieve its objectives", take **each objective in turn:** a merger may raise market share at once but lower the profit margin unless costs fall.

Variations you will meet:

- **"Analyse two benefits to a business of using a vertical merger for growth" [8]** (Paper 1): each benefit must be one that comes from **joining the supply chain:** control of supplies, quality and delivery (backward); secure outlets and control of how products are sold (forward); keeping the profit margin the supplier or retailer made; restricting rivals' supplies or outlets. **General benefits of growth or of a horizontal merger (economies of scale, a bigger workforce) earn nothing.** For each: 1 K + 1 App + 2 An.
- **"'Even a friendly merger ... may not be successful.' Evaluate this view" or "should a [manufacturer] use external growth?" [12]** (Paper 1): explain what a friendly merger is (both boards agree, unlike a hostile takeover); give reasons it can still fail (culture clash, overestimated savings, paying too much, poor integration, external change) and reasons it may succeed (cooperation, shared plans); judge which matter most for the industry named.
- **"Explain one disadvantage to a business of external growth" [3]** (Paper 1): one point (K), developed twice: "taking over another business is expensive (K), so the buyer may have to borrow (App), which raises its interest costs and its gearing (App)". Others: culture clash, loss of control, managers lack experience of the new business, diseconomies of scale, competition authorities may block it.
- **Older Paper 3 [10]: "Analyse two benefits of vertical integration" or "two disadvantages of a merger"** for a case business: two points, each fully applied and developed into consequences for profit or competitiveness.

2. Analyse or evaluate the advantages or disadvantages of being a small or family business (6 questions)

"Analyse one advantage and one disadvantage to [business] of being a small business" [8] (Paper 2).

For each point, 1 K + 1 App + 2 An:

1. **Advantage** (K): flexibility, personal service, niche market, low overheads, easy control.
2. **App:** a fact from the case: hand-made products, a loyal customer base, the owner doing every job.
3. **Chain** (An, An): "she can change a recipe within days when customers ask for it, so customers feel listened to, so they keep buying, which protects her sales against the big brands."
4. **Disadvantage**, the same way: high unit costs (no economies of scale), weak bargaining power, hard to raise finance, owner overload, few distribution channels.

Use the case's numbers where you can (break-even output, fixed costs). Don't judge which point is "worse": analyse questions give no marks for evaluation. And **write about the business in the case:** answers that fit any small business lose the application marks.

Variations you will meet:

- **"Evaluate the importance to [business] of being a small business" [12]:** weigh the benefits it gets from being small (personal service, creative freedom, quick decisions) against what it misses (economies of scale, finance), and judge what matters most **for its market**: in a niche market with skilled owners, small is a strength; against low-priced mass-market rivals, it may be a weakness.
- **Paper 1, "Explain one disadvantage of being a small business" [3]:** one point (K) + two linked steps (App, App): "it has no economies of scale (K), so it pays more per unit for materials than large rivals (App), so it must charge higher prices or accept a lower profit margin (App)."
- **"Explain one reason a business may choose to remain small" [3]:** owner wants control or a work-life balance; avoids the risk and debt of growth; fears losing quality or personal service (its USP); lack of demand or finance. Develop it in two steps.
- **"Explain one weakness of family businesses" [3]:** conflict, favouritism, lack of skills, succession problems, lack of outside finance, each developed: "jobs may go to family members without the skills for them (K), so key tasks such as finance are done badly (App), and non-family staff who were passed over lose motivation (App)."

3. Analyse or evaluate internal (organic) growth and the risks of growing (4 questions)

"Analyse two reasons why a business might decide to grow internally (organically)" [8] (Paper 1). For each reason, 1 K + 1 App + 2 An:

1. **Reason** (K): lower risk; keeps control; avoids culture clash; cheaper than buying a business; financed from retained profit, so no debt.
2. **App**: explain it or give an example: opening another shop, building another factory.
3. **Chain** (An, An): "it grows using its own retained profit, so it does not need new loans, so its gearing and interest costs stay low and it is less likely to run into cash-flow problems."

Variations you will meet:

- **"Analyse one advantage and one disadvantage of growing by launching a new product range" [8]** (Paper 2): advantage: new revenue, spreads risk, uses the existing brand; disadvantage: development and marketing costs, may fail, may take sales from existing products, stretches managers.
- **"Evaluate whether [business] should grow by opening a new factory" [12]:** use the case's investment cost, margins and demand; weigh more output, lower unit costs and control against the cost, risk if demand is weak, and the time it takes; consider alternatives (outsourcing, a joint venture).
- **"'The main reason niche businesses fail is that they grow too quickly.' Evaluate this view" [12]:** for: overtrading and cash-flow problems, falling quality, losing the niche image; against: other causes (poor cash-flow management, competition, lack of demand, poor management); judge what decides it.

4. Define a growth or size term (4 questions)

[2] (Paper 1 part (a)): 2 marks for a precise definition, 1 for a partial one.

Term	Full definition (2)	Partial (1)
Hostile takeover	Buying control of a business against the wishes of its owners or directors	"Taking control of another business"
Takeover	Buying a controlling interest (more than half the shares) in another business	"Buying another business"
Organic growth	Growth from within the business , using its own resources, such as opening new outlets	"A business getting bigger"
Scale of operation	The size of a business's output , set by the resources it uses	"How big a business is"

The full mark always needs the feature that sets the term apart: "against its wishes" for hostile, "controlling interest" for a takeover, "from within" for organic.

5. Measure the size of a business (3 questions)

"Identify one method of measuring the size of a business" [1]: one word or phrase: revenue, number of employees, capital employed, market capitalisation, market share, output, number of outlets or customers. **Never profit.** Give one answer only: only the first is marked.

Variations you will meet:

- **"Explain one way to measure the size of [business]" [3]** (Paper 2): name the measure (K), then use the case data twice or **calculate** with it (App, App): "its number of employees rose from 60 to 72, a rise of 20%, so by this measure it is getting bigger."
- **"Analyse two limitations of using the number of employees to measure the size of a business" [8]** (Paper 1): capital-intensive firms (robot factories, internet businesses) look small; part-time, outsourced or multi-skilled staff distort the count; it ignores revenue, assets and market share. Develop each: "so a car maker with 300 workers and robots appears smaller than a clothing factory with 800 machinists, so investors or the government comparing firms may be misled."

6. Explain the factors affecting the scale of operation (2 questions)

"Explain two factors that could influence the scale of operation of a business" [3] (Paper 1) or "Analyse two factors" for a case business [8] (Paper 2). Factors: the **owner's objectives** (stay small or grow); **finance available**; **size of the market and demand** (niche or mass market); the **chance of economies of scale** in the industry; **competition**; technology and capital needed. Two clearly explained factors earn 3; for [8], apply each to the case and chain it to output, costs or profit.

7. Analyse or evaluate the role of small businesses in the economy (2 questions)

"Analyse the role of small businesses in a country's economy" [8] or **"Evaluate whether small retail businesses have an important role in the economy" [12]** (Paper 1):

1. **K and App:** jobs (especially local), competition and choice, innovation and future large firms, supplying large businesses, niche products, taxes. Give examples: a village shop, a florist, a local car repairer.
2. **An:** chain each role to the economy: "small shops employ local people, so incomes in the town rise, so more is spent in other local businesses."
3. **Eval:** weigh against their limits (few jobs each, many fail, large firms pay more tax per worker) and judge it **depending on the industry and the country:** small firms matter most where personal service and local markets count; large firms where economies of scale do.

Worked examples

Example 1

- (a) Define the term conglomerate integration. [2]
- (b) Identify one limitation of market capitalisation as a measure of the size of a business. [1]
- (c) Explain one strength of a family business. [3]
- (a)** When a business joins with (merges with or takes over) another business (1) in an unrelated industry, often to spread risk (1).
- (b)** It can only be used for companies whose shares are traded on a stock exchange. (1)
- (c)** Family owners share long-term aims and are not under pressure for quick profits (K). For example, a family-owned hotel can accept lower profit for two years while it refurbishes its rooms, because the family plans to pass it on to the next generation (App), so the hotel improves its quality and reputation, which brings more repeat bookings in the long run (App).

Example 2

Lena's Loaves (LL) is a small bakery owned by Lena. She bakes bread by hand each morning from local organic flour and sells it from her one shop and to three local cafés. Customers say her bread is the best in town. Lena works 70 hours a week. She pays 0.90 dollars per kilogram of flour, while a national supermarket chain nearby pays 0.60 dollars per kilogram and sells cheaper bread.

Analyse one advantage and one disadvantage to LL of being a small business. [8]

Advantage: flexibility and personal service. A small business can respond quickly to its customers (K). Lena serves her customers herself and supplies only three cafés (App), so when a café asks for a new loaf she can bake it the next morning without consulting anyone, so the cafés stay loyal and keep ordering from her rather than the supermarket (An), which keeps LL's revenue steady and lets her charge more for a product the supermarket does not offer (An).

Disadvantage: no economies of scale. A small business buys in small amounts, so its unit costs are higher (K). Lena pays 0.90 dollars per kilogram of flour, and the supermarket pays 0.60 dollars, a third less (App). So each of Lena's loaves costs more to make (An), and she cannot match the supermarket's prices, so price-conscious customers may switch to cheaper supermarket bread, reducing LL's sales and profit margin (An).

Each point earns $K + \text{App} + 2 \text{An}$, so $4 + 4 = 8$.

Example 3

Kora Cycles (KC) is a private limited company that assembles electric bicycles. It makes 20,000 bicycles a year, and each one costs 1,200 dollars to make. KC buys all its frames from one supplier, FrameWorks (FW), at 150 dollars each. Last year FW delivered late six times because it served a larger customer first, and KC's assembly line stood idle for 15 days. KC's directors have two objectives for the next three years: to **secure a reliable supply of frames** and to **cut the cost of making each bicycle by 10%**.

FW's owners have offered to sell FW to KC for 9 million dollars. KC would borrow the money at 8% interest a year. Two of KC's competitors also buy their frames from FW.

	FW
Frames sold a year	50,000 (20,000 of them to KC)
Cost of making one frame	120 dollars
Revenue	7.5 million dollars
Profit	1.5 million dollars

Evaluate whether KC should take over FW. [12]

Knowledge. Buying FW would be backward vertical integration, because FW is a supplier at an earlier stage of KC's own supply chain (K). A takeover means KC buys a controlling interest in FW, so KC's directors would decide what FW makes and for whom (K).

Securing supply. As FW's owner, KC could make FW put KC's orders first (App), so the six late deliveries and 15 idle days would not happen again, so KC could deliver bicycles to its retailers on time and stop losing sales to rivals (An).

Cutting unit costs. KC would pay FW's cost of 120 dollars a frame instead of 150 dollars, saving 30 dollars a bicycle, or $30 \times 20,000 = 600,000$ dollars a year. But $\frac{30}{1,200} \times 100 = 2.5\%$, only a quarter of the 10% target (App). And the loan costs $0.08 \times 9 = 0.72$ million dollars a year in interest, more than the 0.6 million dollars saved on KC's own frames, so the takeover pays for itself only if FW keeps selling to other makers. FW's profit margin is $\frac{1.5}{7.5} \times 100 = 20\%$, and KC buys only $\frac{20,000}{50,000} \times 100 = 40\%$ of its frames, so 60% of FW's sales are to other businesses. The two rivals may not want to buy frames from a competitor and could switch suppliers, so FW's fixed costs would be spread over fewer frames, so each frame would cost more than 120 dollars to make and the saving would shrink (An).

Judgement. The takeover is very likely to meet the supply objective, because KC would control FW's production plan directly (Eval). It cannot meet the cost objective on its own: frames give a 2.5% cut against a 10% target, so KC still needs other savings, such as cheaper motors or a faster assembly line (Eval). Whether it is worth 9 million dollars of debt depends on whether FW keeps its other customers, whose frames earn most of FW's profit, and on whether KC's managers, who have never run a frame factory, can manage FW well (Eval). A cheaper alternative is a long-term contract with FW, or a second supplier, with penalties for late delivery, which would secure supply without the debt (Eval). On balance, KC should take over FW only if a reliable supply is its top priority and FW's other customers agree to stay; otherwise a long-term contract meets the supply objective at far lower risk, and KC should look elsewhere for most of its cost cut (Eval).

The marks: 2 K, 2 App, 2 An (a developed chain on each objective), and 6 Eval for a supported judgement in context that takes each objective in turn and compares the takeover with another option.

Common mistakes

- **Profit as a measure of size.** Examiners report it as the most common wrong answer: profit measures performance, not size. "Market size" is also wrong: it measures a market, not one business.
- **Giving several answers to "Identify one".** Only the first is marked, and a paragraph wastes time.
- **General growth benefits for a vertical merger.** In "benefits of a vertical merger", economies of scale or a larger workforce earn nothing; the benefit must come from owning a supplier or an outlet.
- **Confusing a joint venture with a merger.** In a joint venture each business **keeps its own identity**; in a merger they become one. Examiners report answers that blur the two, and only answers that clearly show the difference get full marks.
- **Advantages when disadvantages are asked** (and the other way round). Examiners report candidates explaining the advantages of small businesses when asked for disadvantages, which earns nothing.
- **Generic answers.** "Small businesses have limited finance" fits any business; tie the point to the case (her one rented workshop, his redundancy money).
- **Judging in an analyse question.** "Analyse" gives no marks for deciding which point is worst; spend the time developing the chains.
- **One-step explanations.** In Paper 1 [3] questions, many answers explain the point once and stop at 2 marks; the third mark needs a second linked step.
- **Repeating the case without using it.** Copying out the data is not application; show how the fact changes the argument.
- **Describing instead of analysing** the role of small businesses: list fewer roles and chain each to an effect on jobs, income or competition.

How to get the marks

- **Command words.** *Identify*: name it, one answer. *Define*: the exact meaning, with the feature that sets it apart. *Explain*: a point, then why or how, with context. *Analyse*: points developed into chains of cause and effect. *Evaluate* or *Discuss*: both sides, then a supported judgement.

- **Paper 1 [3] "explain one...":** one point identified, then developed in two linked steps. If two are asked, explain both; a list of two earns 1.
- **8-mark analyse questions:** exactly two points (or one advantage and one disadvantage, as asked), each with K, App and a chain of at least two links ending in an effect on the business (costs, revenue, profit, control, survival). A two-sided point ("...although this only works while demand keeps growing") also counts as developed analysis.
- **12-mark evaluate questions:** 2 K, 2 App, 2 An, 6 Eval. One good chain each way is enough analysis; spend the rest on weighing. Answer the question directly, use the case's numbers (combined revenue, market shares, margins), compare with **other ways to grow** (organic growth, a merger, a joint venture), and say what the decision depends on.
- **Name the method precisely.** In a growth question, say which type of integration it is (horizontal, backward or forward vertical, conglomerate) and use its own benefits and risks.
- **Calculations** (market share, percentage change, combined margins): show the working; the method earns marks even if the arithmetic slips.

Quick check

1. Define the term horizontal integration. **[2]**
2. A car maker buys (a) a tyre manufacturer, (b) a chain of car showrooms, (c) another car maker, (d) a hotel chain. Name the type of integration in each case.
3. A clothing retailer has sales of 6 million dollars in a market worth 75 million dollars. Calculate its market share.
4. Business A (revenue 50 million dollars, profit margin 10%) merges with business B (revenue 30 million dollars, profit margin 4%). Calculate the combined profit margin, assuming no cost savings.
5. Explain one reason a sole trader may choose not to merge with a larger business. **[3]**

Answers

1. When a business joins with (merges with or takes over) another business (1) at the same stage of production in the same industry, such as a rival (1).
2. (a) backward vertical; (b) forward vertical; (c) horizontal; (d) conglomerate.
3. Market share = $\frac{6}{75} \times 100 = 8\%$.
4. Profits: $0.10 \times 50 = 5$ million dollars and $0.04 \times 30 = 1.2$ million dollars, so 6.2 million dollars in total.
Combined margin = $\frac{6.2}{80} \times 100 = 7.75\%$, lower than A's 10%.
5. The sole trader would lose control (K). After the merger, decisions about products and prices would be shared with the larger business's directors (App), so the owner could no longer offer the personal service or specialist products that their loyal customers pay for, and those customers might go elsewhere (App).

Past questions to try

- 9609/11/O/N/25 Q5: part (a), two benefits of a vertical merger.
- 9609/13/O/N/24 Q5: reasons for organic growth, then whether a friendly merger can still fail.
- 9609/11/M/J/24 Q5: limits of counting employees, then the role of small retailers in the economy.
- 9609/13/O/N/23 Q1: defining organic growth and why a business may stay small.