

and become much bigger. There are some strong motives for growth.

- **Survival.** In some industries firms will not survive if they remain small. Staying small might mean that costs are too high because the firm is too small to exploit economies of scale. In addition, small firms, even if they are profitable, may face a takeover bid from a larger firm.
- **Gaining economies of scale.** As firms grow in size they will begin to enjoy the benefits of economies of scale. This means that unit production costs will fall and efficiency and profits will improve.
- **To increase future profitability.** By growing and selling larger volumes, a firm will hope to raise profits in the future.
- **Gaining market share.** This can have a number of benefits. If a firm can develop a degree of monopoly power through

growth, it might be able to raise price or control part of the market. Some personnel also enjoy the status and power associated with a high market share. For example, it could be argued that Richard Branson enjoys the publicity which goes with leading a large company like Virgin.

- **To reduce risk.** Risk can be reduced through diversification. Branching into new markets and new products means that if one product fails success in others can keep the company going. For example, tobacco companies have diversified into breweries to guard against a fall in demand for cigarettes.

## Methods of growth

There is a number of ways in which a company might grow.

**Internal growth** is when a firm expands without involving other businesses. **ORGANIC GROWTH** means that the firm expands by selling more of its existing products. This could be achieved by selling to a wider market, either at home or abroad. It is likely that internal growth will take a long time for many businesses, but will provide a sound base for development. A quicker alternative is **external growth**. This can be by **ACQUISITION** or **TAKEOVER** of other businesses or by **MERGING** with them. A takeover is when one company buys control of another. A merger usually means that two companies have agreed to join together and create a new third company. In practice these terms are often used interchangeably. In recent decades merger activity has increased greatly leading to a concentration of ownership in many industries. This is discussed in more detail in the unit titled 'Mergers and takeovers'.

It has also been suggested that companies can attempt to grow in one of three ways. Companies can grow by acquisition. For example, AXA, the insurance business, has grown by taking over foreign firms in the US, UK and Japan. However, some companies that have attempted to grow by acquisition have become bigger but not better, and ultimately failed as a result.

Some companies grow by innovating and providing new products. Examples may be Microsoft and Intel. A problem for such companies is that rivals start to copy their ideas, which may slow down growth.

Companies that grow by robust growth might include Coca-Cola and Procter & Gamble. They have long-term growth as an objective, take consumers' needs into account, are prepared to invest in information technology and value the skills of their workforce.

## Reasons for the survival of small firms

Despite the advantages of large-scale production, many firms choose to remain small. Also, small firms sometimes have advantages over larger ones.

**Personal service** As a firm expands it becomes increasingly difficult to deal with individuals. Many people prefer to do business with the owner of the company directly and are prepared to pay higher prices for the privilege. For example,

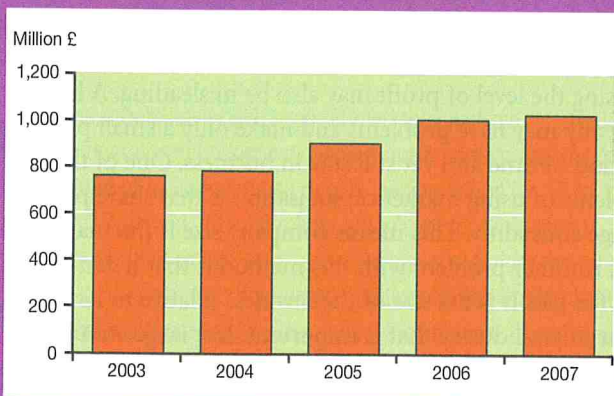
### Question 1.

QinetiQ is a leading international defence and security technology company. It develops innovative technology-based solutions and products and provides technology-rich support services for major government organisations, such as the UK MOD and the US DoD, and for commercial customers around the world. As a leading supplier of defence research to the UK Government, it has built up significant intellectual capital and expertise.

In 2007, QinetiQ generated a turnover of £1,149 million and made a profit of £94.0 million before tax. The value of capital employed by the company was £477.4 million (net assets). The company places a great deal of value on its staff and in 2007 employed more than 13,000 people.

Source: adapted from QinetiQ, *Annual Report and Accounts, 2007*.

Figure 1: QinetiQ revenue 2003 - 2007



- Using evidence from the case determine whether QinetiQ is a small, medium or large business.
- During 2007 QinetiQ's share price hit a high of 218p and a low of 161p. The number of shares issued by the company is 660,000,000. (i) Calculate the market capitalisation of QinetiQ based on these two share prices. (ii) Using your answers in (i) explain why market capitalisation may not always be a useful measure of business size.

## Business size

people may prefer to deal directly with one of the partners in an accountancy practice.

**Owner's preference** Some entrepreneurs may be content with the current level of profits. Some will want to avoid the added responsibilities that growth brings. Others will want to remain below the VAT threshold or will not want to risk losing control of their business.

**Flexibility and efficiency** Small firms are often more flexible and innovative. They may be able to react more quickly to changes in market conditions or technology. Management can make decisions quickly, without following lengthy procedures.

**Lower costs** In some cases small firms might have lower costs than larger producers in the same market. For example, large firms often have to pay their employees nationally agreed wage rates. A small firm may be able to pay lower wages to non-union workers.

**Low barriers to entry** In some types of business activity like grocery, painting and decorating, gardening services and window cleaning, the set up costs are relatively low. There is little to stop competitors setting up in business.

**Small firms can be monopolists** Many small firms survive because they supply a service to members of the local community which no other business does. People often use their local shop because it provides a convenient, nearby service, saving them the trouble of travelling.

## The popularity of small firms in the economy

During the past twenty years there has been a growth in the number of small businesses in the UK. Self-employment has also grown. What factors have led to these trends?

- Rising unemployment has had an important impact. People with redundancy payments have had the capital to set up in business. In some cases unemployed workers saw self-employment as the only means of support.
- The government and local authorities introduced a number of measures to encourage the development of small businesses. **Business start-up schemes** provided funds for small businesses for an initial period. Business Links provide advice on running businesses and obtaining finance. European initiatives have included loans from the European Investment Fund and finance for training from the European Social Fund.
- There have been changes in the structure of the economy. The expansion of the tertiary sector has contributed to the growth in small businesses. Many services can be undertaken more effectively on a small scale.

The growth in the number of small firms has had several effects on the economy.

- Increased flexibility. Smaller firms can adapt to change

more quickly because the owners, who tend to be the key decision makers, are close at hand to react to change. For example, a customer may insist that the extension to her house is finished one week before the agreed time. The business owner can put in the extra hours required and perhaps encourage employees to help out. Business owners may also react quickly when some new technology becomes available. This increased flexibility might help the UK economy win more orders from abroad.

- It could be argued that wage levels might fall as a result of more smaller firms. Employees in small businesses often negotiate their own wage rates with the owner. Since they are not in a powerful position on a one-to-one basis, there may be a tendency for initial wage rates and future wage increases to be relatively lower. This will help to keep business costs down.
- More casual and part-time work may have been created. Small firms are often reluctant to employ full-time staff because it is more expensive. For example, part time workers may not be entitled to the same level of holiday pay as full-time workers. Casual and part-time staff also help to improve flexibility. When a business is quiet it can lay off casual staff to reduce costs.
- Staff loyalty may have been improved. In small businesses, relationships between the owners and other staff may be

## Question 2.

According to the Sunday Times Fast Track 100, OceanTime 2000 (Ot2k) was the second fastest growing private limited company in 2007. Sales have grown 206% a year from £700,000 in 2003 to £20.1m in 2006. The company employs 78 people.

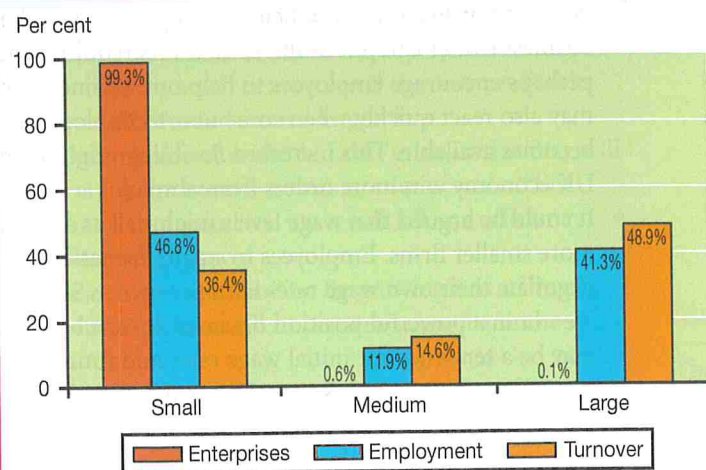
Hurricanes in the Gulf of Mexico, the high oil price, and a shortage of diving vessels have boosted demand for this Great Yarmouth firm. Trading as Ot2k, the company provides diving, survey and remote-operated-vehicle services to the oil, gas and wind-power industries. A recent project involved inspecting gas installations in Morecambe Bay for Centrica. Founded by Jonathan Soar, Bob MacMillan and John Doherty in 1999, the company recently raised £50m from investors. The full range of services provided by Ot2k included the following.

- Diving - Offshore & Inshore
- Remotely Operated Vehicles - Inspection & Workclass
- Survey - Geophysical & Geotechnical
- Vessel Chartering & Management
- Turnkey Subsea Intervention Packages
- Project Management
- Engineering & Fabrication Services
- Hyperbaric Medical Support

Source: adapted from [www.fasttrack.co.uk](http://www.fasttrack.co.uk).

- Explain why Ot2k is a medium-sized company.
- What evidence is there to suggest that Ot2k has grown quickly?
- Explain two possible reasons why Ot2k has grown so quickly.

**Figure 2: Share of businesses, employment and turnover by size of business 2005**



Source: adapted from [www.phoenixrg.co.uk](http://www.phoenixrg.co.uk).

quite good because they are dealing with each other at a personal level. This might improve motivation and productivity as well as staff loyalty.

- Trade union membership may have declined. In small businesses where relatively fewer workers are employed, trade union membership tends to be lower. This might have implications for the rights of workers in small businesses. It might lead to claims that in some cases, staff

are being exploited by small business owners.

- Consumers might benefit from the growth in the number of small firms. More small firms often results in more competition and a wider choice in the market. For example, there has been a growth in the number of computer software producers in recent years. This has led to a variety of 'games' and programs for business and personal use.

The contribution made by SMEs (Small and Medium-sized Enterprises) in the UK is shown in Figure 2.

There were an estimated 4.3 million business enterprises in the UK at the start of 2005, an increase of 59,000 (1.4 per cent) on the start of 2004. Almost all of these enterprises (99.3 per cent) were small (0 to 49 employees). Only 27,000 (0.6 per cent) were medium-sized (50 to 249 employees) and 6,000 (0.1 per cent) were large (250 or more employees). At the start of 2005, UK enterprises employed an estimated 22 million people, and had an estimated combined annual turnover of £2,400 billion. Small and medium-sized enterprises (SMEs) together accounted for more than half of the employment (58.7 per cent) and turnover (51.1 per cent) in the UK. Small enterprises alone (0 to 49 employees) accounted for 46.8 per cent of employment and 36.4 per cent of turnover.

## KEY TERMS

**Merger** – the joining together of two businesses, usually to create a third new company.

**Organic growth** – growth achieved through the expansion of current business activities.

**Takeover or acquisition** – the purchase of one business by another.

## KNOWLEDGE

1. How can the size of a firm be measured?
2. How is market capitalisation calculated?
3. Why might profit be a misleading measure of a firm's size?
4. State five reasons for growth.
5. What is the difference between internal and external growth?
6. Buying firms to grow quickly can sometimes be a problem. Explain this statement.
7. Explain five reasons why small firms survive.
8. What effect will the growth in the small firms sector have on the flexibility of employers?
9. Look at Figure 2. (i) Which type of firms generate the most turnover in the UK? (ii) Which type of firms employ the most people in the UK?

