Growth of Firms

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Production

What is Production?

Production refers to manufacturing of goods and provision of services by firms to profitably satisfy consumer wants/needs.

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Business Objectives

Why businesses want to satisfy customer wants?

Private businesses want to earn return on their investment hence there are certain business objectives that management is expected to achieve.

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Business Objectives

Some of most important business objectives are as follow:

Profit maximization: All businesses want to maximize their profits in the long run. Shareholders want to maximize their return on their investments.

Survival: During the early years of establishment businesses just want to ensure their survival. Hence they do not adopt strict profit maximization strategies.

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Business Objectives

Increasing Market Share: Having more dominant position in industry is important for higher future profits and therefore businesses want to increase their market share.

Increasing Brand Loyalty: Having healthier image in consumers' minds is another business objective. It helps achieve higher sales and therefore profits.

Citizens' welfare: Social enterprises like Edhi, Shaukhat Khanum just work for less-privileged / poor citizens' welfare.

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Scale of Production

The level of production undertaken by any business is known as scale of production.

Larger businesses have larger scale of production and vice versa.

Businesses' scale of production can be gauged through following indicators:

Capital Employed: number of capital units being utilized by any business

Number of Employees: larger businesses are expected to have larger pool of human resource and vice versa.

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Scale of Production

Market Share: percentage of total industry sales that is captured by certain business. Larger businesses have more market share and vice versa.

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Market Share

Market Share refers to percentage of total industry sales that is captured by certain business. Market Share = (Firm Sales \ Industry Sales) * 100

Industry refers to collection of firms that produce similar products. For instance all businesses producing laptops will make laptop industry.

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Productivity

Productivity refers to efficiency with which any input / resource produces good(s).

Productivity = Output \ Input

Labor Productivity refers to number of units of output produced by typical labor input.

Capital Productivity refers to number of units of output produced by typical capital input.

Firms prefer more productive inputs / factors of production over less productive ones.

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Choosing Ideal Input Combination

Businesses need to choose ideal input combination to minimize their cost and hence to maximize their profits.

This is done through comparing inputs' productivity and compensation paid to them.

If capital is more productive than labor then it will be used in abundance. Similarly if capital is cheaper than labor then it will be used in abundance.

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Why some businesses stay small?

Not all businesses expand as expected.

Following are some of the reasons behind some businesses staying small:

Limited Finance: limited access to capital proves major constraint for businesses' expansion.

Small Market: firms operating in small industries are often small.

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Why some businesses stay small?

Providing customized goods / services: firms producing customized products are forced to keep their size small to ensure higher customer satisfaction.

Providing outsourcing services to larger businesses: small businesses providing outsourcing facilities to larger firms have limited growth potential.

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Growth Strategies

How do businesses grow?

All businesses can expand using two possible options namely Internal and External growth.

Internal Growth refers to businesses reinvesting their profits to expand.

External Growth refers to businesses relying on take-over or merger for expansion. External Growth is also referred as Integration.

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Types of Integration

Horizontal Integration: when two businesses of exactly similar nature merge with each other. For instance any bank merging with another bank. Such integration is also known as Amalgamation

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Types of Integration

Vertical Integration: when two businesses in same industry but in different stages of supply chain merge with each other. If any business merges with its supplier of raw material it is known as Backward Vertical Integration.

If any business merges with its seller then it is known as Forward Vertical Integration.

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Types of Integration

For instance car manufacturer merging with tyre manufacturer is known as Backward Vertical Integration. On the other hand car manufacturer merging with car showroom business is known as Forward Vertical Integration.

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Types of Integration

Lateral Integration: when two businesses of completely different nature merge with each other. For instance car manufacturing business merging with furniture manufacturer. This type of integration helps businesses to diversify hence reducing business risk. Such integration is also known as Conglomerate Integration.

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Types of Cost

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What is Cost?

- All expenses made by businesses to produce their products.

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Fixed Cost

- Fixed Cost: is any cost component that does not change with the level of output produced. Eg salaries, rent, office electricity.

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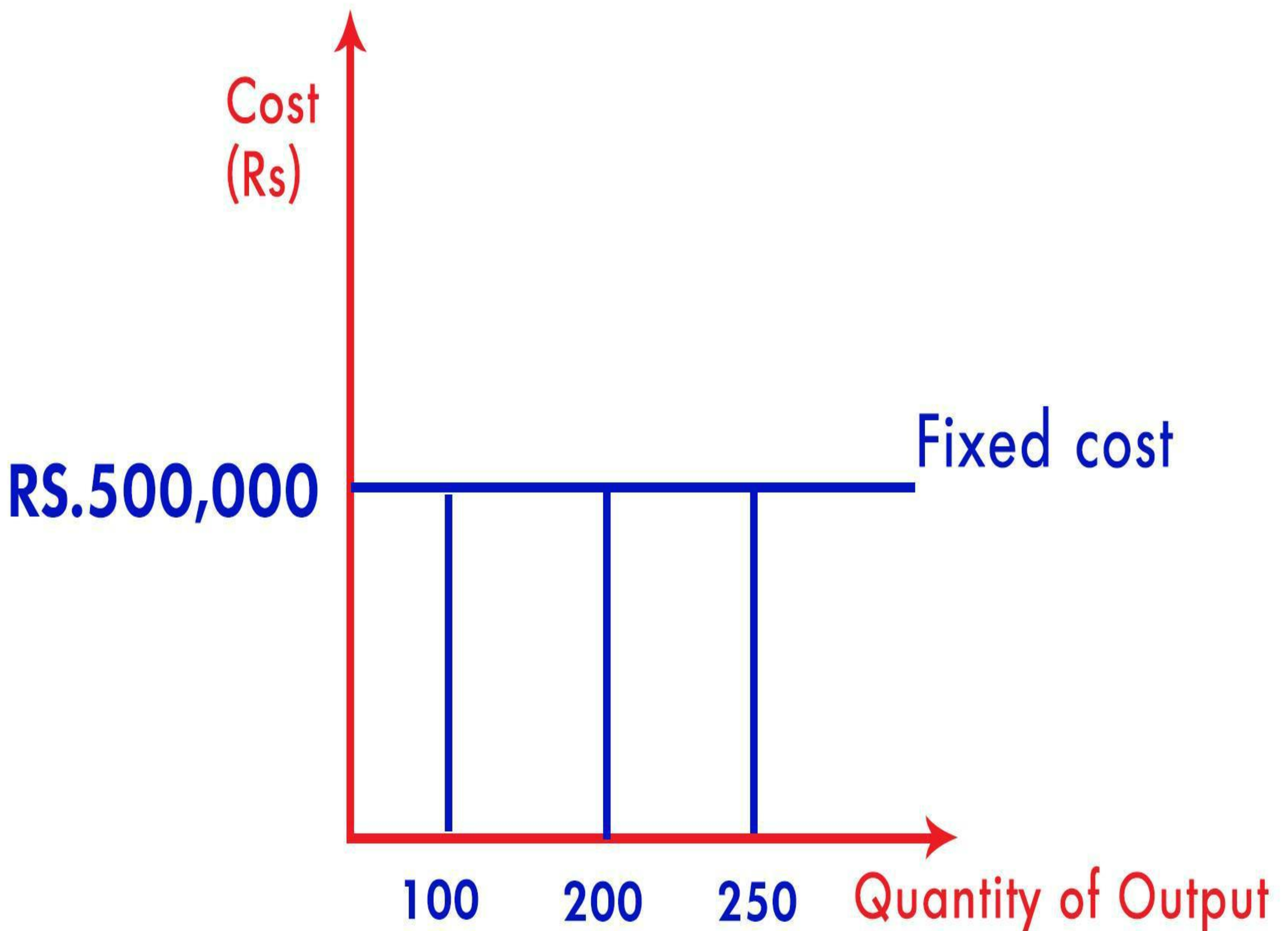
Fixed Cost



As can be seen from the graph on the left, regardless of the output produced by the firm the fixed cost has stayed constant at Rs 500,000.

Variable Cost

- Variable Cost: any cost component that increases with the level of output produced. E.g raw material for production businesses, labor directly involved in manufacturing of the product etc.

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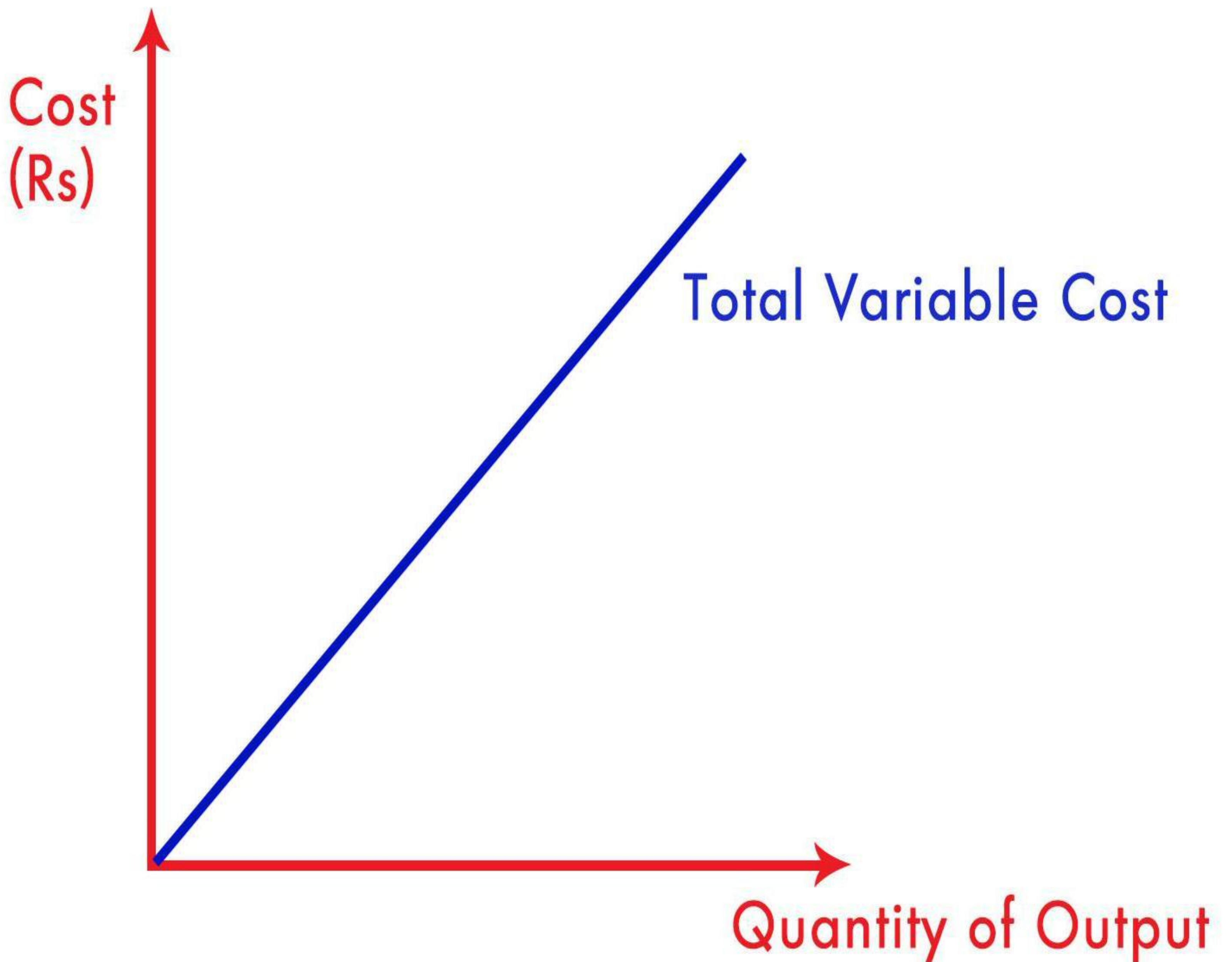
Variable Cost



As can be seen from the graph on the left, total variable cost is directly proportional to the quantity of output produc

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Economies of Scale

1. Purchasing Economies of Scale: when any business scale of operation increases it buys larger quantities of raw material for which the supplier is expected to give them more discounts reducing the average total cost.
2. Technical Economies of Scale: is when a business buys machinery to assist in its operations. For this the cost will definitely increase for the business but the investment is expected to increase the output even more.

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Factors Causing Economies of Scale

- Financial Economies of Scale: larger businesses are expected to raise a loan at lower interest rate than smaller businesses because they have lower risk and secondly bank will make more profit on a larger amount of loan compared to smaller amount of loan.

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Factors Causing Economies of Scale

- **Managerial Economies Of Scale:** larger businesses can afford to hire experts which help business generate high sales and so helps to reduce the company average total cost.
- **Risk Bearing Economies of Scale:** larger business produce multiple brands / products which might be using the same machinery and production process making the company receive cost advantages.

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Factors causing Diseconomies of Scale

1. **Miscommunication between larger organizations:** it will be more difficult to coordinate between different departments and offices located across the globe. Due to slower decision making given the difficulty it is faced in coordinating with different offices across the globe it can result in inefficiency.

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Factors causing Diseconomies of Scale

2. Demotivation of employees: is likely to happen when they are part of a larger organization which comprises of a lot of employees and this can negatively affect the workers' motivation.

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