

3.1.1 Sizes and types of firms

Why do some firms remain small while others grow?

Firms do not all follow the same growth path. Some expand into large national or multinational businesses, while others stay small by **choice** or due to **constraints**.

Reasons why firms grow

Firms may choose to grow because of owners or shareholders . For example shareholders want the firm to make a profit maximise (where $MC=MR$) as will receive a % of profit as dividends .

Firms may also choose to grow because of managers . This is due to managers bonuses are usually linked to quantity of sales thus meaning managers may pursue objectives like sales maximising (where $MC=AC$)

Expansion may create economies of scale, reducing long-run average costs (LRAC). This can thus improve competitiveness and profits .

Larger firms can diversify products, spreading risk and reducing reliance on a single market or revenue source. For example virgin media , airlines , money etc (think risk bearing economies of scale)

Reasons why firms remain small

Small firms may struggle to access external finance (short trading history, no collateral), limiting investment and expansion (Great link to UK as we can be described as a debt-fuelled economy rather than organic growth , for example

Growth can cause diseconomies of scale, where LRAC rises due to coordination and communication problems (This can be combatted via efficient management)

Firms in niche markets face limited demand, restricting growth potential.

Finally, due to the owner's objectives. Some owners prioritise **satisfying** (good enough profit) over growth, valuing lifestyle, control, or other stakeholder goals.

Divorce of ownership from control and the principal agent problem

As firms grow, shareholders (owners) often appoint managers to run the business day-to-day. This creates a divorce (separation) between ownership and control. This separation can lead to a principal–agent problem.

The principals (shareholders) may want profit maximisation as when firms make large profits shareholders receive larger dividends, but the agents (managers) may pursue other

objectives such as maximising sales as incentivised as their personal bonuses can be linked to sales .

As managers run the business day by day there is a degree of asymmetric information leading to the "principal agent problem" .

This can be solved by offering managers share options as more likely to act in the interests of shareholders (as now essentially are both a shareholder and manager, A* evaluation).

Types of firms

Public sector vs private sector

Public sector firms are government owned, funded by taxation, and mainly focus on service provision rather than profit. For example the BBC .

Private sector organisations are owned by **private individuals**. Ownership can range from sole traders and partnerships to limited companies owned by shareholders.

Most private sector firms aim to make profit.

Profit vs not-for-profit

For profit organisations operate to generate profit.

Not-for-profit organisations operate to provide a service or meet a need rather than distribute profit to owners. They may still sell goods and services, but any surplus is typically reinvested to support their objectives (e.g charities).

In the UK, charities are regulated and may receive tax exemptions on some direct taxes.