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| ***Business size – comparisons*** |

**Introduction:**

* ***How do we evaluate businesses?***
* ***The difference between the sole trader and the huge public limited company***

Businesses vary hugely in size: from the **sole trader** with **one worker** to the multinationals with **hundreds** of **thousands** of workers (100, 000s).

Measuring the size of businesses is an inexact science but we often try to **gage/measure** some understanding so that comparisons can be made.

Why do we need to **understand** and **compare**?

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| What do **investors** need to know?  Why do **governments** need to know? |

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| How do **businesses** differ? |

**Measuring business size:**

* *Governments may need to assist ‘small firms’ – so what is a ‘small firm’?*
* ***Investors*** *may need to decide which company to invest in. So how do they decide?*
* *Which business is* ***growing****? Which business is* ***shrinking****?*
* *Customers may want to buy from* ***big*** *firms as they offer* ***stability****, stronger brands with continuity or from small* ***localised*** *firms with a more* ***personal*** *service.*

**The two challenges are:**

1. *Different ways of* ***measuring*** *and* ***comparing*** *businesses and they often give different comparative results.*
2. *No* ***internationally*** *agreed definition of what a small, medium or large business, although number of employee is common (what about an automated company with few workers and high output?)*

Different measures of size:

1. **Number of employees**

* Easy to **understand** but can **mislead** with highly **automated** firms

Example:

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| Two soft drink firms in town:   * One uses traditional methods to produce 300,00 litres per week with 108 staff * The other it totally automated and produces 1,000,000 litres per week with just 10 staff |

The **EU** has criteria for measuring business size:

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|  | *Employees* | *Sales turnover* | *Capital employed* |
| **Micro firm** |  |  |  |
| **Small firm** |  |  |  |
| **Medium firm** |  |  |  |

1. **Sales turnover:**

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Often used with **comparing** firms in the **same** industry. It’s more difficult and less effective when measuring **different** industries. Some may produce **high value** goods like jewellery and some might be in **low value production** such as cleaning services.

The level of **turnover** – **ann\_\_\_\_\_l sales** – is the most **widely** used indicator of a firm’s size. It suggests the **ability** to obtain finance and benefit from economies of scale.

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Which has the largest sales?

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There are **limitations** of using as a measure of size:

* *An organisation’s turnover varies from greatly year to year*
* *Firms that have similar* ***turnover*** *figures may have quite different profits because profit margins vary between industries*
* *Turnover is not necessarily an indicator of* ***market share*** *or* ***market value***

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1. **Capital employed**

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Generally, the larger the business enterprise, the greater value of **capital** **needed** for long-term investment, or the greater capital employed.

Difficulties arise from comparing different industries with different **capital** **needs** such as a hairdresser or optician.

* They may employ the **same amount of staff** but an optician may need expensive diagnostic and eyesight measuring machines.

Capital employed shows **net investment** and is compared with profit to assess **profitability**. It can be a difficult figure to measure – firms in the same industry may use difference **bases** for valuing assets, which affects **capital employed figures** and can lead to **inaccurate** comparisons.

1. **Market capitalisation**

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Market **capitalisation** can be used only for businesses that have shares **‘quoted’** on the stock exchange *(public limited companies)*. It is calculated by this formula:

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| **Market capitalisation** = *current share price* **x** *total number of shares issued* |

As share prices tend to change every day, this form of comparison is **not** a very **stable** **one**.



**Forbes Global 2000** are the biggest, most powerful **listed** companies in the world.

Their justification for using a composite **ranking** is simple: **One** metric alone can give a false impression about corporate size. Our ranking of the world’s biggest companies departs from lopsided lists based on a single metric, like sales. Instead we use an equal weighting of **sales**, **profits**, **assets** and **market value** to rank companies according to size.

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| Do you agree with their assessment? |

1. **Market share**

Market is a ***relative*** measure. If a firm has a **high market share**, it must be among the leaders in the industry and comparatively large. However, when the size of the total is small, a high market share will not indicate a very large firm.

x 100

**Is it easy to measure a market?**

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| Consider the case of XiaoMi smartphones and Apple’s iPhones:   * Who has the biggest market share in China?   We may draw conclusions as to the largest company but in this case, perhaps market share is an important indicator for strategy and of course, stakeholders.  Further, we may also consider a **niche market**: a company may have 90% market share but the actual total market is only small.   * We have 90% of the market share – but the market is only worth $1M * Are we a large firm? |

1. **Profit**

Profit is a good indicator of **relative** **success** and that a company with higher profits than others may be classed as a larger company. Different industries have typically different **profit margins**. Some industries rely on quality whereas some on quantity (volume) – sell few at a high price or sell many at a low price. Wal-Mart operates on profit margins of around 3.5%: but it sells huge amounts of goods so that the total profits are large. There is usually a **trade-off** between quantity and quality. Look up ‘Risk-bearing theory of profit’.

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**Which company has the largest profits?**

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**Other measures:**

* Hotels typically measure the **number of beds** or guest rooms
* Retailers could use the number of **shops**
* Retailers also use **total floor space** as a measure (and sales/per m2)

*Which form of measurement is the best?*

There is **no ‘best’** measure:

* What is being measured?
* Comparative or absolute?
* Company or Industry?
* Perhaps make a comparison based on two of the criteria

**Activity 3.1**



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***Worksheet summary quiz and activity:***

1. Why is **business size** so subjective and hard to do?

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1. List three **stakeholder groups** that might wish to compare the size of one business to another and why

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True or False (mark an **X**)

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|  | **True** | **False** |
| 1. Each industry is different, so they have different **metrics** for success. |  |  |
| 1. If a firm has a **large** market share, it **must** be a large company. |  |  |
| 1. Limited companies (Ltds) are often measured by their market capitalisation. |  |  |
| 1. Governments need to know the size of firms for forecasting tax revenues. |  |  |
| 1. Different countries have different criteria for firm size. |  |  |

**Summary of the worksheet in your own words (in English and Chinese):**

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*Vocabulary check:*

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| **English** | **Chinese** |
| **Relative** |  |
| **Objective** |  |
| **Comparative** |  |
| **Absolute** |  |
| **Quoted** |  |