**Business Expansion**

**The growth of any business is called expansion. Management must make decisions as to how this expansion will take place and how it is to be financed.**

**This expansion may be ORGANIC or INORGANIC.**

**Organic Growth**

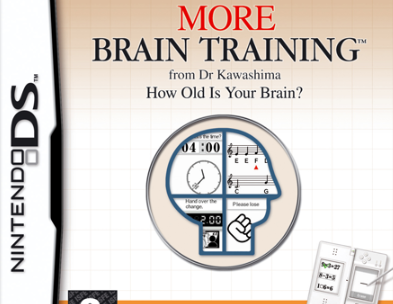
**Organic Growth is the natural expansion of a business as it makes profits and then ploughs these back into the business.**

**The profits retained by are used to buy machinery, equipment, premises, etc. Organic growth happens within the business & does not involve outside firms.**



**Organic Growth Strategies**

**Increase Sales:**

**I** **f the company sells more of its products they will have a larger profit. This can be achieved through better marketing and improving the product. It can also be achieved by finding a new target market or exporting to different markets. Example: Nintendo released the Brain Training game, this led to Nintendo appealing to a new target market of older people**

**New Product Development:**

**By adding to its product portfolio a business can increase its consumer base and invest into new markets. Exanple: Coca-Cola brought out Coke Zero in 2005 for a male alternative to Diet Coke as traditionally they shied away from that as an alternative to regular coke**

**Exporting:**

**Businesses only operating in the Irish market could consider expanding business operations to oversees, the major benefit being the increase in sales, but they would need to be aware of added costs, possible trade barriers etc..**

**Franchising:**

**The original owner of the company gives permission to other entrepreneurs to copy his business identically. The franchisee pays the franchiser (original owner) a fee. Consistency is very important. Example: McDonalds.**

**Benefits of Franchising as a form of Expansion**

* **It is a form of expansion which requires low capital investment by the franchisor as the capital used to expand the business comes from franchisees. Very suitable/popular in the current economic climate as a form of expansion.**
* **Franchising permits a more rapid expansion. By using the franchisees' capital, the franchisor is able to establish a large number of outlets in a short period of time. Rapid expansion can be achieved without incurring the overheads and costs associated with opening company-owned restaurants**
* **The return on investment is much higher for a restaurant that expands through franchising. Because there is less capital employed, the franchisor's profits are generated on a much lower capital investment. Although the revenue from franchised restaurants may be less than that received from company-owned restaurants, a higher percentage of the revenue is profit.**
* **A franchise system requires less management than a company owned chain of restaurants. Hiring, training, motivating and retaining competent staffing are all functions handled by the franchisee, not the franchisor**
* **There is low risk to the franchiser as should the franchisee not adhere to the conditions of the contract it could be cancelled**

**Drawbacks of Franchises as a Method of Expansion**

* **Control is lost over the day-to-day management of the franchise businesses.**
* **The reputation of the whole business could be affected by the actions of one franchisee /poor quality standards/staff problems**

**Inorganic Growth**

**Takes place when a firm takes an interest in buying other firms.**

**Reasons for this are as follows:**

* **Owners wish to expand the firm at faster rate**
* **The business is at a standstill at present & expansion will help it prosper**

**The main INOrganic Growth Strategies are:**

* **Acquisition/Takeover**
* **Merger**
* **Strategic Alliance**

|  |  |
| --- | --- |
| Acquisition/Takeover | Is where one company takes over another by buying 51% of its shares. This is with or without consent of existing staff. As a result they gain the major control of firm. The seller will want as much as possible for the business & the buyer will want to pay as little as possible. The actual price will be somewhere in between.  The company that has the majority shares is called the holding company, and the company that has been acquired is called the subsidiary.  Some takeovers can be hostile, when the directors of a takeover refuse to sell.  New products, economies of scale, and diversifying of new products to spread the risk for a business are typical examples of benefits to a takeover.  The expense, Industrial Relations Issues, and staff redundancies can be drawbacks.  Example- Glazers took over Manchester United FC. |
| Merger | Where two firms come together by mutual agreement to run their businesses as one. A merger is very like a takeover, but the main difference is that a merger is usually more friendly arrangement. There is hopefully synergy- as both businesses do better together than they would on their own.  Merging will allow a business to grow market share much quicker than growing organically, as well as being more competitive in the market. There can be increased economies of scale and increased products and profits.  There may have to be staff redundancies however, as well as conflict in roles and decision making for managers and staff.  Example- Glenbia PLC was founded following the merger of Avonmore and Waterford Foods to grow the scale of their operations |
| Alliance | This involves two or more firms combining their skills & resources in a particular line of activity. Alliances are popular because the companies co-operate with each other in relation to market information, new technology, human resources etc. Both parties work together while maintaining their separate legal entities.  There is an increased likelihood of success as businesses share knowledge and resources, and it can open up new markets to both firms which can increase sales.  Decision making can be slow however due to a number of different businesses involved in the alliance an there may be disagreements between business in areas such as costs and leadership.  Example: SWATCH and Mercedes formed a strategic alliance to develop SMART CARS |

**Reasons for Expanding**

**Defensive Reasons**

**Economies of scale/Reduce Costs:** Businesses may wish to expand to drive down costs. A large production plant will reduce per unit costs of production (production economies). This is how Henry Ford dominated car manufacturing at the start of the twentieth century by mass-producing the 'Model T'. Closer to home, Ryanair is expanding rapidly and was recently able to order 100 jets from Boeing at discounts of nearly 40% (purchasing economies).

**Diversification:** This involves firms entering new markets, spreading risk, creating new products or buying businesses in an unrelated market in order to reduce dependency on one product or market. AIB bought over banks in the American and Polish markets to reduce their dependency on the Irish market.

**Protect Raw Materials:** Safeguarding sources of raw materials or channels of distribution -e.g., Eircell/Vodafone buying chains of mobile phone retailers

**Aggressive Reasons**

**The elimination of competition:** A firm may buy out a competitor in order to enter a new market (Tesco's purchase of Quinnsworth) or to increase its market share (the merger of Compaq and Hewlett Packard).

**To increase profits:** By expanding firms increase their talent, product range and sales, they reduce their costs, make better use of their resources and make more money.

**To acquire new assets:** A firm may have assets that are not fully used, e.g. people, land equipment or cash. As part of a larger firm, better use may be made of these assets. As a result firm can become more profitable. An example would be Adidas acquiring Reebok for 3.1 billion dollars in 2006

**Synergy:** This occurs when the sum of two or more firms joined together will be greater than the efforts of the firms operating separately. The merging of Irish Life and Irish Permanent meant that Irish Life gained access to a large customer base that would have to take out life insurance when taking out loans for their homes

**Psychological Reasons**

**Challenge and Ambition:** In this case, the businessperson needs to grow the business to satisfy their needs for esteem and self-actualisation. Richard Branson will always be associated with the growth of Virgin from a record store to a global brand capable of selling a wide variety of products

**Finance for Business Expansion**

**Sources of Finance- Think back to long term finance in 5TH Year**

1. Retained Earnings

Are profits, which are ploughed back into the business to create growth? This form of finance is suitable for organic growth as the pace of the expansion can be matched to the funds available. They are used to finance the purchase of new buildings or equipment. They have no direct cost for a company but take a long time to build up.

2. Equity Capital

This is money imputed into the firm by the individual shareholders. As the firm makes money, the shareholders receive a % dividend on their investment. However if the firm’s profits are low, the individual dividend will be low.

3. Loan/Debt Capital

Is the long-term finance provided by financial institutions? Long-term loans are called debentures. When applying for a loan to finance expansion, a company has to supply the bank with accounts showing the present state of the business. Also needed are cash flow forecasts, costings, and research.

Information needed before any loan is granted includes:

* Purpose of loan
* Capacity to repay
* Amount of loan
* Security offered
* Duration of loan

4. Grants

Enterprise Boards and provide finance to help businesses grow and develop with capital that they will not have to pay back to get the business developing and growing

\*\*\*2009 Q.5. Evaluate Debt and Equity Capital as sources of finance for Business Expansion\*\*\*

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| --- | --- | --- |
|  | **Debt Capital** | **Equity Capital** |
| **Amount** | Large amounts available | Large amounts available |
| **Control** | No direct loss in control, however assets may be used as collateral | Control may be lost due to the issuing of shares as shareholders now have a say in running your business |
| **Cost** | Loan interest must be repaid, regardless of how profitable the business is | Can be cheap as only pay dividends when profits made. Businesses must be careful as shareholders may go elsewhere if they do not get a sufficient return |
| **Risk** | If a business cannot make their repayments, creditors may seek for the business to be wound up to pay debts | A business that uses more equity than debt for finance is lowly geared, and so less likely to become bankrupt |
| **Collateral** | The business will have to provide | No collateral provided |
| **Tax** | Interest payments are tax deductible and can be used to reduce tax liability | Dividends paid to shareholders are not tax deductible |

**Evaluation of Debt and Equity Capital as sources of finance**

In my opinion, to decide if a business should seek more capital investment should depend on how highly geared it is. Cash flow is essential for business operations, so if more debt decreases cash flow, I would choose equity to expand even if it means losing more control in the business.

Implications of Business Expansion

Organisational structure

In the short term, an expanding business may retain its organisational structure – especially if it is expanding organically. However, it needs a clear line of authority and a definite chain of command to manage the changes.

In the long term, the business is likely to need some re-structuring to manage its expanded size efficiently. An expanding business may need to change from a functional structure to a product or geographical structure. It is easier for top management to monitor individual units when they are separated into distinct divisions. Also, product or geographical divisions can respond more quickly to conditions in their own markets.

Product mix

In the short term an expanding business develops products to suit a range of market segments. There should be an increased product mix as the business grows.

In the long term there will also be a wider product mix because of continuing market research and product development. In an expanding business, the product mix could grow beyond the business’ original core products. In the long term, the business will have to decide on new products, markets, promotion, distribution, brand names and possibly the company’s identity.

Profitability

In the short term, profits might decrease as the business absorbs the cost of expansion, e.g. researching, developing and launching a new product or acquiring a company.

In the long term profits should increase with the success of expansion. These profits are usually the result of economies of scale and the increased market power that the expanded company will have.

Employment

In the short term, people will need to be trained, promoted, recruited and perhaps, made redundant. In the short term employment will increase as the business grows. More staff will be needed to cope with the greater work load.

In the long term an expanded business will inevitably employ more workers. However, the workforce may have experienced some losses through rationalisation – especially following a merger or takeover.

Customers

In the short term, customers will enjoy a bigger range of products in a business with lower prices due to economies of scale

In the long term, although customers enjoy more products, they may lose the personal service that was offered by small businesses and so may go elsewhere

IMPORTANCE OF IRISH BUSINESS EXPANSION

Domestic market

1. Both employment and government tax revenue increase as business expands

2. As business expands, it gets stronger making it possible to survive

3. Increased competition with Irish and European firms make it possible for higher quality good be produced

4. Larger firm exports more of their produce which in turn increases profits and consequently employment

Foreign market

1. Profits earned by Irish firms abroad are repatriated and benefit Irish shareholders

2. Expansion leads to the development of Irish TNC’s

3. The quality of management improves abroad because of the need to develop new skills

4. Irish firms selling in EU markets must meet the standard of other EU firms in terms of efficiency, reliability, delivery etc. this will then have a significant knock on effect in Ireland where customers will benefit from a top quality service

*Businesses need to be aware that wary that some expansions may be restricted if the Irish government or EU believe that it is not in the best interest of consumers.*

*For example, in Ireland, restrictions on expansion is regulated by the CCPC, where mergers and takeovers above a certain value are examined, and if it believed that it will have a negative effect on the Irish Market, (e.g. Monopoly), it may be denied*