



# Expanding the business

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## Learning objectives

In this chapter you will learn about:

- 1 How businesses expand – organically and inorganically
- 2 Sources of finance for business expansion
- 3 Effects of business expansion

## Reasons for business expansion

- Gain control of new products
- Block competition
- Diversification
- Eliminate competition
- Gain control of new technology
- Gain control of raw material supplies
- Increase market share
- Obtain a dominant position
- Take advantage of economies of scale

## How businesses expand

### Organic growth (internal)

This is a gradual growth that is produced from within the firm. Some or all of the firm's profits are reinvested in the business to ensure future growth. Organic growth is achieved by increasing product sales.

### Methods of organic growth

- Developing **new products** to increase sales
- Increase **exports** of products to new markets
- **Franchise** the business idea to new countries globally



### Franchising

A firm develops a **successful business model** for making and selling its product and has a recognised **brand name**. The company allows firms in other countries to use its name and business model (franchise) for a fee which is usually a percentage of their sales.

### Benefits of franchising for expansion

- The franchiser does not have to find finance to expand its business.
- Each new franchise provides an ongoing annual income.
- The risk in each new franchise is borne mainly by the franchisee.
- The potential to expand the business is great.
- The franchiser can keep control of the business through detailed legal contracts.

### Drawbacks of franchising for expansion

- The rate of profit will be less for the franchisor to allow some profit to the franchisee.
- There is risk of bad franchisees damaging the reputation of the brand.

## Inorganic growth (external)

This type of growth is achieved by joining the firm with another firm or by the takeover of another firm. This results in growth by sudden leaps as a result of **mergers, takeovers/acquisitions or joint ventures/strategic alliances**.

### Merger

Two companies agree voluntarily to join together their business to form one company.

### Takeover/acquisition

One company takes ownership and control of another company without having the agreement of the target firm. The target firm resists the takeover.

### Benefits of mergers and takeovers

- These are quick ways of expanding the size of a business.
- The new firm will control more of the market and will benefit from this.
- The average costs of the bigger firm may be reduced, leading to greater profitability.
- This can be good ways of expanding into a foreign market.

### Drawbacks of mergers and takeovers

- They can be very expensive to carry out.
- The enlarged firm may make some of the staff redundant, leading to conflict.
- There may be problems joining the two operations together. If there is a **hostile takeover**, the new business may have difficulties getting the staff to work together.

## Joint ventures/strategic alliances

Two separate firms agree to work together in partnership on a particular project over a period of time. Sometimes a new company jointly owned is set up to carry out the joint venture project. This can lead to changes in many areas.

- **Consumers:** There are lower prices due to economies of scale. There are also wider ranges and choices of products.
- **Employees:** Organic growth leads to increased employment and promotional opportunities. Expansion and increased profits may lead to pay increases.

- **Financial structure:** When firms grow into multinationals, each country may become a profit centre. The profits centres are controlled from the financial head office. As firms get bigger, finance is easier to get.
- **Investors:** Organic growth can lead to increased profits, increased dividends and share price. This is welcomed by existing shareholders. Lending banks are also pleased by growth in profits as interest and loan repayment are more secure.
- Mergers and takeovers can lead to uncertainty and big changes in **share price** (either up or down).
- **Organisational structure:** With international growth, change to geographic structures is more likely. Extra management layers may be added to the business structure.
- **Product mix:** Expansion may happen due to introduction of new products.
- Takeovers and mergers may result in the acquisition of **new products** to add to the range.
- Bigger firms invest more in **research and development** so that they can develop new products for the market.

### Benefits of strategic alliances

- Firms can work together for their mutual benefit.
- Firms can benefit from the strengths of the other.
- Working together can be much better than competing and can increase profitability.
- The risk of investment is spread.

### Drawbacks of strategic alliances

- Neither firm has full control of the project.
- Disputes may arise when decisions have to be made.

**Top Tip!**

Ensure you can explain and give examples of organic and inorganic growth.

## Controls on expansion

The **Competition Authority** was set up by the government to ensure that consumers and other businesses are protected from unfair practices by market-dominant firms, e.g. charging high prices, restricting supply, exerting pressure on customers or trying to force smaller competitors out of the market.

**EU competition** policy also ensures that companies do not abuse a dominant position in their market.

## Finance for expansion

- Equity capital
- Debt capital
- Retained earnings

### Equity capital

Shareholders invest money in the business by buying ordinary shares in the business with the hope of earning a profit. Shares owned carry voting rights in the decisions of the company. Some of the profits may be paid out to the shareholders in the form of dividends.



### Benefits of equity capital

- There is no cost to the firm.
- The finance is available continuously.
- No collateral is required.

### Drawbacks of equity capital

- The control over the business is diluted (spread out).
- The expectations of shareholders can be high.
- The cost of issuing the shares is high.

### Debt capital

These are long-term loans from banks used to finance expansion. Interest must be paid each year at agreed rates. Some fixed assets may be used to provide security for the loan to the bank. The loan must be repaid over a number of years or on an agreed date.

### Benefits of debt capital

- The debts do not affect the ownership control over the business.
- The cost of getting a loan is low.
- The interest cost can be used to reduce tax liability.

### Drawbacks of debt capital

- **Non repayment** may lead to the bank taking the company to court.
- **Control** over company fixed assets may be lost if they are used to secure the loan.
- Repayment of the loan plus interest may cause **cash flow problems**.

### Retained earnings

The profits earned by the business are kept and reinvested to expand the business for the future.

### Benefits of retained earnings

- There is no interest cost to the firm.
- The control of the firm and its assets is not affected.

### Drawbacks of retained earnings

- The shareholders who want to receive cash dividends each year may be unhappy.

#### Top Tip!

You should be able to discuss the benefits of each type of finance for expansion and make a comparison between any two forms of finance.

### Effects of expansion

Business expansion creates changes for:

- Consumers
- Employees
- Financial structure
- Investors
- Organisational structure
- Product mix.

#### Top Tip!

An Applied Business Question (ABQ) is compulsory on the exam every year. Below is an ABQ based on Units 3, 4 and 5. This ABQ relates to exam years 2016, 2021, 2026.

### Exam question

- 1 Read the information supplied and answer the question that follows.

*Clothes-4-Us Ltd established its first retail store in the City of Galway in 1990. Its mission statement focuses on providing 'fashionable fast-moving clothing' as well as 'value for money' for young fashion-conscious consumers. Its founder, Aoife Coyle, was determined from a very young age to become an entrepreneur and she chose the fashion industry because of her love of clothes. Under her guidance the business has expanded and now employs 600 staff in 20 retail stores located in prime sites throughout Ireland. The business continues to grow steadily. Strong performance in the Irish market and many years of profitability have encouraged Aoife to expand her successful business model into the UK clothing market. Monthly meetings are held to manage the growth and expansion of the business. Strategies have been put in place in the event of possible disruptions in the supply of essential stocks from global suppliers. Recently it was decided to undertake an advertising campaign on UK television to coincide with the opening of the company's first store in London's Oxford Street.*

*Oliver Quinn, the Human Resource Manager, has played a central role in the steady growth of Clothes-4-Us Ltd. He continues to effectively manage employee numbers. For the planned opening of the store in London, Oliver advertised job opportunities on the company's website and included an online application form. With increasing competition in the market coupled with recessionary times, Aoife and Oliver recognise the necessity to invest in staff training. A comprehensive induction programme is provided throughout the company, and personnel from the human resource department meet employees annually to review their progress. Employees at Clothes-4-Us Ltd are well rewarded and there are opportunities for promotion for those who achieve their sales targets.*

*Aoife is concerned that the business may lose market share because of increased competition from rival 'copycat' fashion multiples. She has begun visiting the company's stores unannounced to monitor sales, employee behaviour and customer trends. In addition, the marketing department is carrying out regular consumer surveys. Fashion magazines with their coverage of the latest designer 'catwalk' fashion trends from Milan, Paris and London are closely monitored. The company's daily sales records and data from the Central Statistics Office (CSO) on market size and consumer expenditure patterns are continually analysed. Aoife believes that a renewed emphasis on its unique selling point (USP) of fashionable budget clothing, targeted at the young fashion-conscious consumer, will position Clothes-4-Us Ltd as the market leader. With this in mind the business had updated its slogan to 'Affordable Fashion', which it will use for its advertising campaign in the UK market.*

(a)

(i) Define the management activity of 'planning'.

(ii) Illustrate how different types of planning benefit Clothes-4-Us Ltd. (20 marks)

(b) Evaluate the effectiveness of the human resource department at Clothes-4-Us Ltd. (30 marks)

(c)

(i) Explain the term 'market research'.

(ii) Analyse how desk and field research can contribute to the continued success of Clothes-4-Us Ltd. (30 marks)

(2011, 80 marks)

## Sample answer

(a)

(i)

Planning is the setting down of specific goals and objectives and the putting in place of strategies that allow you to achieve the stated goals and objectives of the business.

Planning forces a business to consider its future and how it will achieve continued success. Plans give business purpose and direction and reduce risk and uncertainty.

(ii)

1

### Mission statement

This is a visionary statement outlining who the business is, what the business does and where the business is going. It gives an insight to the stakeholders into what makes a business 'tick'.

*Link to text*

Clothes-4-Us's Mission Statement emphasises fashionable fast moving clothing as well as value for money.

2

### Strategic planning

This is long-term planning covering a period of five years or more. It is usually drawn up by top management and it outlines how the long-term goals of the firm are to be achieved.

Strategic planning benefits Clothes-4-Us Ltd because it prioritises goals and objectives and encourages strategic thinking among senior management.

It is also useful for measuring and controlling the performance of management.

Its goals are consistent with the mission statement of the business.

*Link to text*

Aoife Coyle plans to expand her successful business model into the UK clothing market.

3

### Tactical planning/operational

This is short-term planning which breaks the strategic plan into shorter more manageable periods. They deal with the 'now' part of the plan. It is usually drawn up by middle-level managers.

Tactical plans benefit Clothes-4-Us Ltd because they facilitate the attainment of the overall strategic plan/long-term goals.

*Link to text*

Recently it was decided to undertake an advertising campaign on UK television to coincide with the opening of the company's first store in London's Oxford Street.

or

Monthly meetings are held to manage the growth and expansion of the business.

4

### Contingency planning

This is back-up planning to cope with emergencies/unforeseen events and unexpected circumstances. Contingency plans benefit Clothes-4-Us Ltd by preventing disruptions to business and thereby preventing loss of profits and possible business collapse.

*Link to text*

Strategies have been put in place in the event of possible disruptions in the supply of essential stocks from global suppliers.

(b)

1

### Manpower planning

This involves having the right people with the right skills in the right place at the right time throughout the business. It involves doing a human resource audit and estimating future human resource needs.

The human resource manager must audit present manpower resources, forecast manpower needs, and then make a plan to either increase/decrease manpower.

*Link to text*

He continues to effectively manage employee numbers.



2

### Recruitment/selection

Recruitment and selection is concerned with finding or attracting potential candidates with the appropriate skills and then picking the most suitable candidates for employment.

The human resource manager must draw up a job description and person specification and then advertise the position. The applicants must be screened (short-listed). Selection is usually by means of an interview process.

#### Link to text

*Oliver advertised job opportunities on the company's website and included an online application form.*

3

### Training/development

Training is concerned with improving the employees' ability to perform their job in an effective manner. Training allows employees to do their work better. The company invests in training, leading to better knowledge and skills among employees. This results in better customer service and a better shopping experience for customers.

Induction training helps new employees fit into the workplace (learn about the job/the policies/rules of the company, etc.). Other types of training include internal/external training.

Development prepares the employees for new responsibilities and greater challenges in the workplace. It also helps employees self-actualise.

#### Link to text

*A comprehensive induction programme is provided throughout the company.*

or

*Aoife and Oliver recognise the necessity to invest in staff training.*

### Performance appraisal

This is the process of **evaluating the performances, progress, contribution and effectiveness** of an employee. It ensures high performance standards in the business, leading to organisational success. It provides for two-way communication and clarification of objectives/feedback is provided for employees on performance to enable improvements to be made.

A meeting is held with the employees to review their progress and set targets for the future. Regular reviews are vital to the performance appraisal process.

#### Link to text

*Personnel from the human resource department meet employees annually to review their progress.*

5

### Rewarding

Rewarding employees is concerned with paying employees (monetary/non-monetary) well for work well done, leading to a motivated workforce. It may include wages, salaries, bonuses, benefit in kind, share options, pension plans, promotion, etc.

The human resource manager negotiates each employee's remuneration package and keeps it under review.

#### Link to text

Employees at Clothes-4-Us Ltd are well rewarded and there are many opportunities for promotion for those who achieve their sales targets.

(c)

(i)

Market research is the systematic **gathering, recording and analysing of facts about some element of the marketing mix** in order to **identify and satisfy customer needs in an informed and effective manner**.

It ensures that the right goods are produced at the right time for the right market at the right price.

Reasons for market research include: competition/new opportunities/business growth/decision-making/risk minimisation, etc.

(ii)

### Desk research

Desk research involves accessing **information that has already been gathered**.

It is secondary research and can be both internal and external.

Desk research is relatively cheap, which keeps costs down, thereby ensuring a competitive business.

Different types of desk research include the internet, internal sales reports, trade reports, Central Statistics Office publications, newspapers, etc.

The company must seek to protect its market share/keep out competition so as to continue as a 'high volume, low margin' business. Desk research can provide information on competitors.

Contribution: Consumer spending patterns (facts/figures).

The daily sales records of Clothes-4-Us Ltd would indicate whether consumer spending patterns have changed and the CSO would provide global figure on trends in the fashion industry, competitor behaviour, and population details of towns (age, gender, family structure, etc.) where branches could be set up. Quantitative type data is provided.

*Link to text*

*Fashion magazines with their coverage of the latest designer 'catwalk' fashion trends from Milan, Paris and London are closely monitored.*

or

*The company's daily sales records and data from the Central Statistics Office (CSO) on market size and consumer expenditure patterns are continually analysed.*

#### Field research

Field research involves going into the marketplace to gather **first-hand/new business information**. It is primary research which is carried out by making direct contact with customers/potential customers.

It tends to be expensive and time consuming but provides specific information on the target consumer behaviour.

Methods include: surveys, observation, questionnaires and customer panels.

**Surveys** involving personal interviews and/or questionnaires with a sample of the population can be very effective tools in accessing and collecting detailed information about consumer's tastes, behaviours, attitudes in the marketplace, etc.

**Observation** involving viewing consumers in action, e.g. the number of customers selecting a particular product during a particular period in the store. Also, observation in the store may indicate long queue times and lost sales. This could then be rectified in order to satisfy customer needs and ensure continued business success.

#### Consumer attitudes and opinions

Field research in Clothes-4-Us Ltd ascertains attitudes and opinions of its customers and they can make specific changes to their stores/products/staff based on the feedback received.

This type of research allows the company to satisfy its customer needs more effectively, encouraging customer loyalty and increasing the profits of the business.

Qualitative-type data.

*Link to text*

*The marketing department is carrying out regular consumer surveys.*

or

*She (Aoife) has begun visiting the company's stores unannounced to monitor sales, employee behaviour and customer trends.*

#### Marking scheme

(a)

(i)

- Definition: 6 marks (6 = 3 + 3) – explanation and development

(ii)

- Two types of planning: 2 x 7 marks (7 = 2 + 3 + 2)
- 2 marks for stating the type
- 3 marks for benefit/explanation
- 2 marks for relevant link/quotation from text

(b)

- Three functions of HR department: 3 x 9 marks (9 = 3 + 3 + 3)
  - 3 marks for naming the function
  - 3 marks for evaluating the function
  - 3 marks for relevant link/quotation

(c)

(i)

- Explanation: 6 marks (6 = 3 + 3)
  - 3 marks for definition
  - 3 marks for development

(ii)

- Desk research: 12 marks (12 = 6 + 6)
  - 6 marks for explanation
  - 6 marks for contribution
- Field research: 12 marks (12 = 6 + 6)
  - 6 marks for explanation
  - 6 marks for contribution

## Questions

### Higher Level long questions

- 1 SuperToys Ltd, a large retail chain with 45 shops throughout Ireland, had sales of €100 million in 2011. It has just commissioned a firm to design and manufacture a new range of soft toys for babies. These will be available for sale in its shops from summer 2013. SuperToys Ltd plans to open its first shop in the UK in 2014. Discuss the possible reasons for business expansion and growth at SuperToys Ltd.

(2012, 20 marks)



- 2 In what ways might the expansion of a business affect (a) employees (b) consumers (c) profits?
- 3 Kilronan Ltd produces a range of chilled food products. Made from natural ingredients, the firm's award-winning products have become household names. It is now one of the leading brands in Ireland and supplies all the major supermarket chains. Kilronan Ltd is considering either a 'merger' or a 'takeover' as a method of expansion within the Irish market. It is also considering how it will finance growth.

(a)

- (i) Illustrate the difference between a merger and a takeover as methods of business expansion
- (ii) Discuss the benefits and risks of a merger as a method of expansion for Kilronan Ltd. (25 marks)

(b)

Distinguish between debt capital and equity capital as sources of finance for the expansion of Kilronan Ltd. (2011, 15 marks)

## Key-points!

- Reasons for expanding a business
- Sources of finance for expansion
- Effects of expansion

## Key-definitions!

**inorganic growth:** Expansion of a business by joining together with other organisations or by co-operating with external organisations.

**merger:** When two businesses join together to form a new business.

**organic growth:** When a business expands from within by increasing sales and reinvesting its profits in developing new products for the future.

**strategic alliance (joint venture):** When two firms make an agreement to work together on a particular project while the companies still remain independent as businesses.