UNIT 5

BUSINESS EXPANSION

The Business Guys

Chapter 18

Business Expansion Solutions

Reasons – Offensive, Defensive, Psychological

Strategies - Organic and Inorganic Growth (Franchise, Merger, Takeoever, Alliance)

Finance for Expansion

Short and Long Term Implications

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2021 Short – Q1

Match the two lists by placing the letter of the correct explanation under the relevant number below.
Column 1 is a list of business terms;
Column 2 is a list of possible explanations for these terms. **MS: 3,2,2,2,1**

Column 1: Terms	Column 2: Explanations
1. Merger	**A** This occurs when one company purchases more than 50% of the shares in another company.
2. Economies of Scale	**B** Two businesses work together on a project but remain separate legal entities.
3. Acquisition	**C** Purchasing a company and selling off its assets to increase return for investors.
4. Diversification	**D** Two or more businesses join together to create a new legal entity.
5. Strategic Alliance	**E** A business spreads risk by not being dependant on one market or one product.
	F The cost of producing each unit decreases due to an increase in production/bulk buying of raw materials.

1	2	3	4	5
D	F	A	E	B

2018 Q3 - Short

Circle the correct option in the case of each of the following statements.

(i) An acquisition (takeover), is a form of *inorganic growth*/ *organic growth*.

(ii) In a merger, *businesses trade under their own names*/ *a new legal entity is created*.

(iii) In a strategic alliance, businesses share expertise, and the agreement is *permanent*/ *temporary*.

(iv) Expansion can be financed by debt capital which *includes* / *does not include* ordinary share capital.

(v) Economies of scale are defined as *unit (average) cost* / *total costs* decreasing as output increases.

MS: 3+2+2+2+1

2012 Q7 (C)

Read the information supplied below and answer the question which follows.
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.* (20 marks)
MS: 2 @ 7 marks (3+3+1) 1 @ 6 marks (3+2+1)

1. The owner of SuperToys Ltd might have an **inbuilt desire** to grow an **empire** with *SuperToys Ltd* and realize their **entrepreneurial ambition**. Despite large sales, some entrepreneurs want to be the biggest and best business in their industry.

2. SuperToys may want to **diversify by spreading the risk** by involving a business in other **markets**, either new **product** ranges or new **territories**, **decreases the risk of failure** should one of their main markets fall in demand.
E.g. SuperToys will have UK sales to help profits if there is a fall in demand in Ireland for their products.

3. A business may purchase a business that supplies them to **protect** an **essential stock of supplies (raw materials…).**
This is called **reverse integration of the chain of supply**.
SuperToys Ltd could do this to protect their supply chain, guaranteeing a supply of stock for resale.

4. Some firms will look to expand in order to **remove a threat in their market** e.g. **takeover** a smaller competitors so they won't grow and take some of your sales, eliminating a competitor.
SuperToys Ltd could **merge** with or **take over** a competitor to remove a threat to its market share.

Other: Economics of Scale; acquire new products/technologies;

2020 Q5 (A) Read the information supplied and answer the questions which follow.

Apple takeover of Beats Electronics
In 2014, Apple confirmed an acquisition/takeover of headphone maker and music streaming service Beats Electronics for a reported fee of $3 billion dollars. As part of its business expansion, Apple conducted market research.
(i) Explain what is meant by a **takeover**.
(ii) Outline **two** advantages and **one** disadvantage of a takeover as a method of business expansion.
MS: (i) 5m (3+2) (ii) 3 x 5m (2+3)

(i) A takeover refers to one business **purchasing a controlling stake (50.1% or more of voting shares) in another business and 'acquires' it.**
Takeovers (or acquisitions) are often **hostile** and can go against the wishes of the existing owner.

(ii) Advantages
Acquire new product ranges from other firm
A firm will own the patent and production rights as well as branding of all the products from the firm they have taken over. It is an easy way to enter a new market by taking over an existing firm rather than trying to enter it with their own product.

Increase Market Share
By taking over a rival in your market, you reduce the competition and increase how much control you have over that market as your percentage of sales increases. This gives more power in setting prices as it reduces choice for consumers.

Other: Access to resources / expertise

Disadvantage

High Costs of takeover
Large legal fees are involved in the contract and process, so it requires a business to have access to a lot of capital.

Other: Hostile conflicts

2011 Q6 (A) Read the information supplied and answer the questions which follow.

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.

(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)

MS: (i) 2@ 5 marks (2+2+1) (ii) 3 @ 5 marks (2+2+1)

(i) A merger is a **voluntary amalgamation** of two or more individual firms for their mutual benefit. A **single new legal entity is formed** once it is approved by shareholders and neither has control over the other.
e.g. Avonmore Plc and Waterford Plc merged to form Glanbia.

A takeover can be **hostile** (when the company being acquired doesn't want to be) or **friendly**. It occurs when **one business owns/buys 51% of the shares in another** company. The acquiring company absorbs the other company, which loses its identity after the acquisition and becomes part of the acquiring company.
e.g. Eircom took over Meteor mobile phone company for €420 million.

(ii) 1. A merger allows a business to grow its market share much **quicker** than growing **organically**. E.g. Kilronan could grow sales much faster by merging rather than trying to grow just using **advertising campaigns.**

2. Merging with a competitor means the business will now have access to their **product range and brands**, boosting **customer loyalty** and making it **easier** to **launch new products** in to the market.
If Kilronan merged, they would add new brands and products to their range, instead of spending **money** and **time** in their **R&D** to create new products.
Other: Diversification; Economies of Scale; New tech/markets

3. When businesses come together there could be a **clash of cultures** as employees might not be used to **norms** in their old entity.,

If Kilronan merged with another business different **work practices** and **management styles** and **systems** used could lead to a lack of cohesion.

Other: Industrial Relations problems (redundancies); Duplication of resources/costs

2018 Q5 (A)

Read the information supplied and answer the question which follows.
Supermac's *is an Irish fast food franchise which was set up in Ballinasloe 40 years ago by Pat McDonagh. In May 2017* ***Supermac's*** *took home the award for "Franchise of the Year" at the Irish Franchise Awards.* ***Source: www.hospitalityireland.com***
Outline the advantages **and** disadvantages for a business in the fast food sector of choosing franchising **as a method of business expansion**. (20 marks)
MS: 2@7(4+3) 1@6(3+3) At least one of each required.

Advantages

Low Capital Investment Required By Franchisor

The business owner can grow the amount of stores they have without having to spend a lot of money on property/ fast food machinery etc.. as the franchisee will be the one purchasing these to open their store.

An owner (franchisee) will be more attentive than a manager

A manager has less invested in the success of the business so, a franchisee would likely require less supervision as they should be more motivated.

4

Quick/Fast Expansion

Franchisees are going to finance the opening of new restaurants so the existing business doesn't need to increase Debt or Equity in order to expand which could be slow and limited. 3

[Taken from 'What It Takes' – use 'NOTES10' for 10% now

Other: Economies of scale benefit; allows for rapid expansion; higher profit levels from less investment; low risk as contract can be cancelled if franchisee is underperforming

Disadvantages

Control is lost over the day-to-day management of the franchise businesses

The franchisor has to let the franchisee get on with their own store and isn't their manager, so have less control once they are adhering to the terms.

Reputational Damage From One Franchise

The reputation of the whole business could be affected by the actions of one franchisee who may have poor quality fast food or staff problems

Other: Training and mentoring is needed (cost/time); Needs monitoring

2010 Q6 (A)

Read the information supplied below and answer the questions which follow.

Marie Nolan is the owner of 'Marie's Pizzas' a successful pizza restaurant with a home- delivery service. Demand for take-aways has increased, as more people are eating at home due to the economic downturn. Marie is planning on expanding her business through franchising and her accountant recommends that a business plan should be prepared before going ahead.

Evaluate franchising (benefits and risks) as a method of expansion for the Pizza business. (20 marks)

MS: 3 @ 5 marks (2+3) min 1 benefit/1 risk; Evaluation 5m (2+3)

Benefit: Low Investment Required

It is a form of expansion that doesn't require as much **capital investment** as e.g. a merger or takeover. Lots of capital used to expand the business comes from **franchisees**, not the franchisor.

This is why it's so **popular** with **smaller start ups** like Pizza businesses and why it would suit Marie.

Benefit: Owner rather than Manager

An **owner** will be more **attentive** than a **manager**. Rather than employing someone, the franchisee wants to succeed as they **own** it, so they should be more motivated to make higher profits as they've invested their own savings.

By franchising out Marie's Pizzas, Marie places the expansion of her business in the hands of people who are **motivated** to make it work.

Risk: Damage to Reputation

The **reputation** of the whole business could be affected by the actions of one franchisee /**poor quality standards/staff problems**. Maintaining a **brand's integrity** through the process may be difficult.

If Marie allowed a franchisee to set up but they delivered cold pizza or ran the franchise poorly, her own stores would also be negatively affected by this.

Evaluation: In my opinion, Marie franchising her idea is a must. It's the **quickest** and **cheapest** way to expand in this type of market (its already so popular e.g. Dominos, Four Star, Apache) and if she sets **appropriate rules**, then if a franchisee performed below **expected standards**, she could **cancel the arrangement** and continue to grow unaffected.

2019 Q6 (B)

(i) Outline the benefits and risks of a strategic alliance as a method of business expansion.
(ii) Explain one other method of business expansion.
MS: (i) 3@5 (2+3) (ii) 2+4+4

Benefits:

1. It is a voluntary amalgamation
This means that if one party isn't happy, then can back out of the arrangement more easily than if they had merged together.

2. Each party remains a separate legal entity
The parties don't become one new party so if one had troubles or went bankrupt it means the other party wouldn't be effected by it.

Two businesses can share their resources / benefit from economies of scale to enter in to new markets more easily than trying to expand themselves. Microsoft are now in the motor market in a alliance with VW.

[Taken from 'Getting A H1 in LC Business' – use 'NOTES10' for 10% now

Risks:

1. What is offered may be unequal.
Different parties in the alliance may not contribute the same amount or have as much enthusiasm for the project.

2. It is temporary so needs to be managed.
Managers need to make sure staff aren't alienated by this new alliance so that when the alliance ends they don't have low morale and can be relied upon.

(ii)

Acquisitions
One business purchases a controlling stake (51% or more of voting shares) in another business and 'acquires' it.
Acquisitions are often hostile and can go against the wishes of the existing owner.
Note: Make sure to give two points of information as well as the type.

2009 Q5 (A)

(i) Explain the term 'business alliance'.
(ii) Illustrate the advantages of an alliance as a form of business expansion.
(20 marks)
MS: 5m (2+3) 3 @ 5m (2+3)

(i) A business alliance is an **agreement** between **two or more businesses** to pool **resources** and/or **expertise** to **work together** over a specified **period of time** or to complete a **specified project**, while all parties **maintain their separate legal identities.**
They can benefit by using each-others skills, research, networks, resources…

(ii) **Less Risk**
As the businesses remain **separate legal entities**, in the case of the Alliance not being a success, it is easier to terminate the deal rather than having merged/taken over a business, which would have much **higher financial and time costs to wind down an unsuccessful expansion**.

E.g. Post Bank wasn't successful, so it was easier for Fortis and An Post to end their Alliance than if they had have merged initially.

Access to Markets/Networks
Businesses can **gain new customers** to their **brand** from **different markets** that may previously have **never** considered purchasing their brand.

E.g. From the Smart Car, Swatch and Mercedes combined, and some of Swatch's customers may now use a Mercedes product for the first time, and then continue to purchase them in the future.

Synergy
Two organisations might provide something that **complements** each others **resources/products**, resulting in them **both benefiting.**

E.g. An Post and Fortis. An Post provided physical spaces for Fortis to access the Irish current account market, and An Post gained from increased footfall and business in to their post offices.

2013 Q6 (B)

'For a business to survive it needs to grow and expand.'
Evaluate two methods of business expansion. (20 marks)
MS: 2 x (2+3+3+2) – State 2m Explain 6m (3+3), Evaluate 2m

Strategic Alliance
A business alliance is an **agreement** between **two or more businesses** to pool **resources** and/or **expertise** to **work together** over a specified **period of time** or to complete a **specified project**, while all parties **maintain their separate legal identities.**
They can benefit by sharing skills, research, networks, resources…

Evaluation: This can be great for PR if you complete a project with a cool or trendy business – Tayto and Butlers chocolate got lots of exposure for the crisp flavoured chocolate bar they worked on together.

Merger
A **voluntary amalgamation** of two or more individual firms for their mutual benefit.
A **single new legal entity is formed** once it is approved by shareholders and neither has control over the other.
The two or more firms now operate under the same business name and as one new company.

Evaluation: In my opinion, this can be a great way to remove competition by joining them, leaving the overall business stronger – Paddy Power and Betfair merged, so Paddy Power no longer compete with them. Paddy Power Betfair now has much more control over the overall market as one firm.

Takeover
They can be **hostile** (when the company being acquired doesn't want to be) or **friendly**.
It occurs when **one business owns/buys 51% of the shares in another** company. The acquiring company absorbs the other company, which loses its identity after the acquisition and becomes part of the acquiring company.

Evaluation: In my opinion, this can be very costly – when Ryanair were looking to take over Aer Lingus, they had to bid above the market price for the shares to encourage Aer Lingus shareholders to accept the takeover bid. They can fail badly if unsuccessful e.g. Google lost billions from the Motorola takeover.

2020 Q5 (C)

Evaluate debt capital versus equity capital as methods of financing expansion for a business.
MS: 4@4(2+2) EV (0,2,4)

Control

Debt: With a loan, the business will remain in full control of business decisions.

Equity: by selling shares, control will be diluted.

Evaluation: If an owner owns a large proportion of the business then using equity will mean they can raise capital without losing overall voting power

Cost

Debt: Fixed interest repayments plus instalments of the sum borrowed must be paid back regularly, regardless of whether the business is performing well or not.

Equity: The business can choose when to pay dividends to shareholders.

Evaluation: Equity is great here as if the business makes a loss shareholders may not mind not getting a dividend, but loan repayments have to be made to banks.

Collateral

Debt: Security, usually an asset like the business' premises, will be required by the lender, which is a risk for the business that they might lose an asset if they can't pay back the loan on time.

Equity: No security is required.

Evaluation: If a business doesn't have many assets they may find it harder to get loans

Gearing

Debt: There is an increased risk of bankruptcy if the business is more highly geared with debt capital as repayments have to be made.

Equity: Being lower geared is lower risk.

Evaluation: Business is less likely to go bankrupt if lower geared as they'll have fewer creditors, so less people looking to have the business liquidated to get paid their debts if it was in trouble.

Other: Tax Implications (interest repayments tax deductible, dividends aren't)

Also 2009 Q5 (B)

Evaluate Debt and Equity Capital as sources of finance for business expansion. (20 marks)
MS: 15 Marks (3 @ 5 Marks (2+ 3); Evaluation 5 Marks (2+ 3)

2013 Q6 (C)

Discuss the short-term and long-term implications of business expansion using the following headings:
Organisation Structure; Product mix; Profitability; Employment. (20 marks)
MS: 4 @ 5 marks (4+1)

Organisation structure
ST: A business may need a new organizational structure. There will be some **duplication** of **resources** e.g. after a merger there might be two CEO's so there may be **redundancies**.

LT: **Change** of structure. A **functional** structure may be replaced by a **geographic** structure to facilitate expansion into new geographic regions or a **product** structure to facilitate the increased range of products.

Product mix:
ST: As a business expands it will **gain new products** to sell e.g. Eircom took over Meteor and now have mobile phones as well as land line.
Any products acquired during growth that do not fit the company's business model may be **sold off**.

LT: As a business grows, there may be further investment in **R&D** and **product development** in order to satisfy the wide range of **market segments** the business is selling into.

Profitability:
ST: **Restructuring costs**. Initially profits may fall as a result of the increased expenditure on assets such as **machinery, buildings, IT, R&D, premises**…

LT: The business may develop **economies of scale** such as **bulk buying**, increased **market power**, **automation and elimination of duplication** leading to efficiencies and greater profitability.

Employment:
ST: **Redundancies** and **drop** in **staff morale** (**Fear of change,** uncertainty over jobs) after initial expansion as it may result in **rationalisation** as the business attempts to **remove wasteful duplication** of roles.
LT: Bigger businesses could attract **highly qualified personnel**. Employees may become **alienated** and **demotivated** in a very large business, leading to **inefficiencies**.