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The big picture

As of 2021, Alphabet Inc. was one of the top five most valuable companies in the world in terms of market capitalisation (the total value of a company's shares). Alphabet was created in 2015 when Google founders, Larry Page and Sergey Brin, decided to reorganise Google Inc. in order to better manage its various businesses, such as Google (cloud applications), Waymo (https://waymo.com/) (autonomous transportation), Nest (https://store.google.com/us/category/connected_home?hl=en-US&GoogleNest&utm_source=nest_redirect&utm_medium=google_oo&utm_campaign=homepage) (smart homes), Sidewalk Labs (https://www.sidewalklabs.com/) (smart cities).

The creation of Alphabet was just the latest step in the fast-moving growth of Google since its founding. Page and Brin began developing an internet search engine while they were students. They founded Google as a company in 1998, setting up business in a garage and hiring their first employee. A year later, Google moved from the garage to a more typical office space with eight employees. By 2004, the company had over 800 employees working in California and in offices all over the world, and they sold shares to the public for the first time through an initial public offering (IPO). By 2021, Alphabet had over 150 000 employees working in areas as diverse as biotechnology, the internet of things, robotics and self-driving cars.

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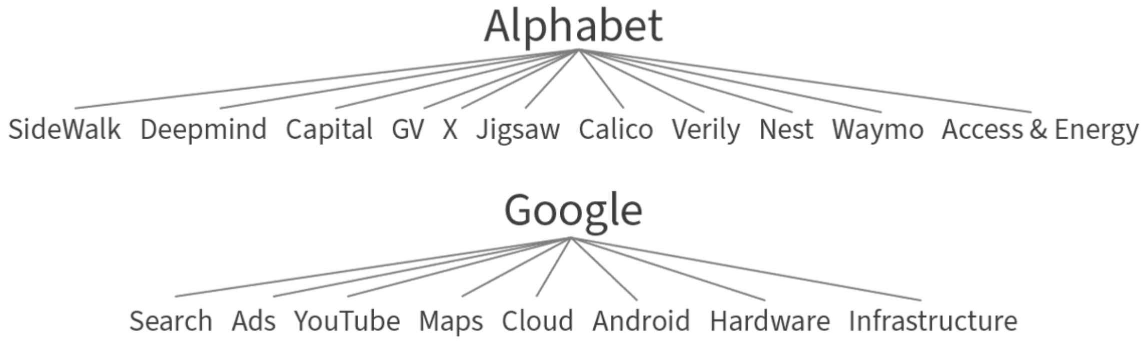

Figure 1. An overview of Alphabet's structure.

More information for figure 1

The diagram illustrates the structure of Alphabet and Google. At the top, Alphabet is shown as the parent company with branches connecting to its subsidiaries: SideWalk, Deepmind, Capital, GV, X, Jigsaw, Calico, Verily, Nest, Waymo, and Access & Energy. Below, Google is shown as a subsidiary of Alphabet, with its own branches leading to different divisions: Search, Ads, YouTube, Maps, Cloud, Android, Hardware, and Infrastructure. The diagram depicts the hierarchical relation between Alphabet and Google, emphasizing the breadth of their business areas.

[Generated by AI]

Not many companies grow and change at the speed of Google. However, all organisations must develop in order to respond to changes in the external environment and inside their own organisations (Section 1.1.6 (/study/app/business-hl/sid-351-cid-762729/book/tool-swotsteeple-analysis-id-36504/)) and to the interests of their stakeholders (Subtopic 1.4 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-36525/)).

This subtopic explores how organisations change and develop. It starts by describing the meaning of growth, and by evaluating some of the advantages and disadvantages of growth. It then explores various internal and external strategies for growth, as well as the reasons for businesses to stay small. It concludes with a new way of thinking about growth, where organisations strengthen the business ecosystem around themselves in order to grow in resilience rather than in size.

Theory of Knowledge

Most businesses assume that growth — in number of sales, customers, revenues, profits or employees — is a key objective of their work. At a national level, politicians usually use growth in gross domestic product as a key measure of economic success.

However, this growth goal is coming under increasing criticism. Infinite growth on a finite planet is not possible. And the pursuit of growth has done much damage to people, the planet and even to businesses and economies of entire countries.

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- How do assumptions frame the approaches we take in the human sciences?
- How do we need to change our assumptions about growth in business to ensure we act responsibly towards people and the planet?

Learning objectives from the IBDP Business Management guide with assessment objective level:

- **Describe** internal and external economies and diseconomies of scale (AO1)
- **Distinguish** between internal and external growth (AO2)
- **Discuss** reasons for businesses to grow and to stay small (AO3)
- **Examine** external growth methods (AO3)
- **Apply** an Ansoff Matrix analysis in a given context (AO2)
- **Apply** a Force Field analysis in a given context (AO2)

Reasons for growing

Reasons for businesses to grow Reasons for businesses to grow

As you learned in Subtopic 1.3 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-36515/), growth is a common business objective. For some businesses growth creates new opportunities to increase market share and make more profit. However, expanding the business can also bring both risks and negative impacts in terms of environmental and social sustainability. This section analyses the reasons for growth as well as the positive and negative impacts resulting from the expansion of a business.

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Figure 1. Growth is a common business objective.

Credit: boana, Getty Images

What is growth?

Growing a business means expanding the business. However, growth can be measured in different ways.

- **Growth in sales revenue**: increasing the money earned from selling the product; this is calculated by multiplying the prices of products by the number of products sold.
- **Growth in profit**: increasing the amount of money left over after costs of production have been subtracted from revenues.
- **Growth in market share**: increasing the percentage of a given market represented by a business's sales.
- **Growing impact**: increasing the positive social and environmental consequences of the actions of the business.

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- **Growing a resilient business ecosystem**: generating opportunities for other businesses to grow and to strengthen their relationships with a wide range of stakeholders, distributing more of the value of the business to them.

There are a number of advantages and disadvantages of business growth. You will learn more about some of the global impacts of this growth in Subtopic 1.6 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-36543/), which explores multinational companies (MNCs).

Advantages of growth for a business

There are a number of advantages to growing as a business. For example:

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- A business can achieve economies of scale to reduce costs. This will be explored further in Section 1.5.2 (/study/app/business-hl/sid-351-cid-762729/book/internal-and-ext-economies-id-36534/).
- As businesses grow, new customers and markets are reached, increasing market share, sales revenue and profit. A large market share can be obtained by using creativity to develop unique and desirable products for consumers. Additionally, companies can expand into new markets where there is a particular need for the product or service that the company is offering.
- Being a large business allows the company to influence the prices of products and services.
- Businesses that are able to grow are in a better position to face competitors and external changes in the business environment. Larger businesses may be able to reduce risk and increase stability.
- Businesses that are growing often attract talented employees because they can offer good salaries, diverse experiences and opportunities for professional growth.

Figure 2. Growing businesses often attract talented, ambitious employees.

Credit: Nitat Termmee, Getty Images

Disadvantages of growth for a business

There are also some disadvantages of growth for a business. Some of these are caused by the increasing complexity and management problems that arise in larger organisations. For example:

- There may be problems with cash flow. In order to expand, a business may need a large amount of money, which can be difficult to obtain. Businesses may take out loans and then need to pay large interest payments for years to come.
- There may be problems with quality. Increased output, particularly if not well planned, can impact the quality of the product negatively. This can add to the costs of production and

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lower sales revenue.

- Related to the previous issue is the problem of loss of control of the business. As businesses grow, tasks and organisational structure become more complex.
- Finally, larger businesses may face higher labour turnover if human resources are not managed well. If a business grows and it does not recruit additional skilled workers, productivity and motivation of the current staff may fall and employees may decide to leave the business.

Figure 3. Growing too fast can cause declines in quality and control.

Credit: Westend61, Getty Images

Theory of Knowledge

When Google was first started, the company motto was 'Don't be evil' (https://www.vox.com/recode/2021/2/16/22280502/google-dont-be-evil-land-of-the-giants-podcast). This phrase was even included in the company's Code of Conduct. Many people joined the company in its early days because they saw it as a pure force for good in the world.

However, as Google (now Alphabet) grew, the behaviour of the company changed, as did the public perception of it. The company faces legal battles associated with its size. Governments claim that the company has been stifling competition with its monopoly power and there are proposals to break it up. Others are upset with the company's lack of action around the spread of misinformation. Even inside its own walls, Google/Alphabet faces criticism of its handling of claims of inappropriate behaviour and its lack of diversity in the workplace.

This case raises a number of interesting questions related to the Theory of Knowledge concepts of ethics and perception. Here are some links to further information.

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- Does growth and increased power inevitably lead to unethical behaviour? (https://hbr.org/2019/04/the-psychology-behind-unethical-behavior)
- Do our own perceptions of large, powerful organisations change as they grow? Why do we often root for the underdog? (https://freakonomics.com/podcast/nsq-ep-79-tktk/)

Advantages of growth nationally and globally

When companies grow, they impact the economy of their country and the global economy in various ways.

- Higher levels of output produced by companies generate more tax revenue for local and/or national governments. This money can be spent in the construction of schools, hospitals and roads and for providing useful services for the whole community.
- Higher levels of output also reduce the rate of unemployment and increase incomes. This can occur locally, but also globally through the supply chains of larger businesses. This can also create incentives for workers to have better jobs and education.
- Related to the previous point, higher income levels can increase consumption and improve living standards at both the local and global level.

Making connections

The IBDP Economics course focuses its attention on economic growth, which comes about when individual businesses grow.

Countries' economies will grow and shrink over periods of time. This is known as the business cycle and was discussed in Section 1.1.5 (/study/app/business-hl/sid-351-cid-762729/book/tool-swotsteeple-analysis-id-36504/).

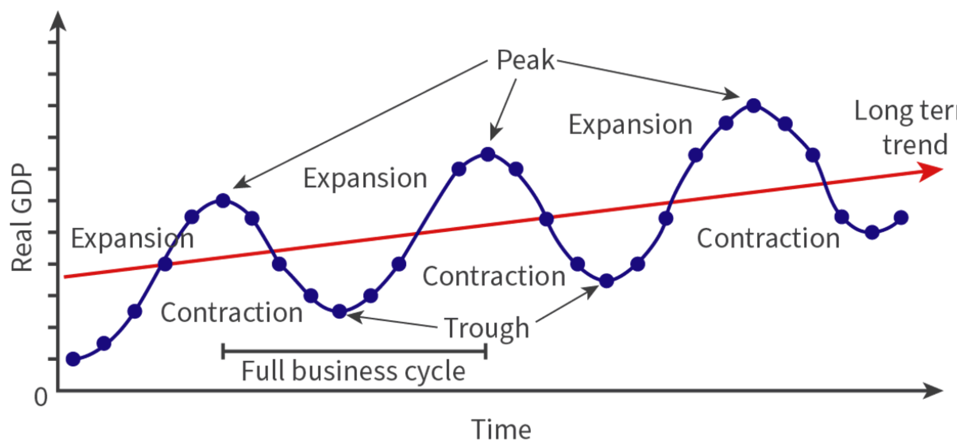

Figure 4. The phases of the business cycle.

More information for figure 4

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The graph illustrates the phases of a business cycle. The X-axis represents "Time," while the Y-axis represents "Real GDP." The graph features a sinusoidal blue line depicting the cyclical nature of economic activity. Key points on the graph are labeled to represent different phases: "Expansion" during upward slopes, "Contraction" during downward slopes, "Peak" at the highest points, and "Trough" at the lowest points. A red arrow labeled "Long term trend" is drawn upwards, indicating an overall positive trend in Real GDP over time. Below the graph, a horizontal bracket with the label "Full business cycle" spans from one trough to the next, illustrating the complete cycle of economic activities from expansion to contraction and back to expansion again.

[Generated by AI]

Expansion, or economic growth, is one phase of the business cycle. This occurs when the businesses of a country produce more goods and services in one time period than in a previous one. It is usually measured by changes in the real gross domestic product (GDP).

Disadvantages of growth nationally and globally

Despite the benefits that growth can bring to the economy of a country or region, there are always some costs to be considered.

One such problem is the increased pollution that can arise when businesses grow. From carbon emissions to wastewater, particulate matter and destruction of biodiversity, there are many negative environmental consequences, both locally and globally, of business growth. A related issue is the increased use of natural resources, which may be non-renewable. This can have wide-reaching negative global impacts.

There can be negative impacts for people too. As businesses grow and achieve economies of scale, they may be able to replace workers with machinery, particularly where workers have low skill levels. Efficiencies like this will mean that the growth in employment will be slower. Finally, as mentioned above, as businesses grow and become more complex, they may lose some control of their operations. Businesses with complex supply chains may not be able to monitor worker conditions and pay throughout the supply chain, resulting in exploitation of human labour.

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Figure 5. One disadvantage of business growth is the cost of pollution in the external environment.

Credit: Pidjoe, Getty Images

Activity

Learner profile: Inquirers; Thinkers
Approaches to learning: Research skills (information literacy); Thinking skills (critical thinking)

Using the information in this section, construct a mind-map to help you recall and visualise the advantages and disadvantages of business growth for a business itself, and for the local/global social and ecological domains.

3 section questions

Question 1

Juan is concerned about his ice cream business. The town where his business is located has many competitors. He is planning to open a new branch in a nearby town where there are no ice cream businesses. Which one of the following is an advantage of this strategy for Juan's business?

1. Finding a new market for his product to increase sales revenue ✓
2. Increasing the quality of his product
3. Increasing the rate of unemployment for the locality
4. Increasing traffic congestion

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Explanation

As businesses grow, new customers and markets are reached, which means an increase in sales revenue and profit.

Question 2

Which of the following is an important advantage of business growth?

1. The possibility to reduce external risks ✓
2. The reduction in the labour turnover
3. The possibility of losing control over supply chains
4. The possibility of having diseconomies of scale

Explanation

Reducing external risks and gaining stability is an advantage that companies can have when they grow. Businesses that are able to grow are in a better position to compete with others and may be more resilient to external disruptions.

Question 3

Business growth can bring costs both to a country and globally. One problem is:

1. Increase in pollution ✓
2. Increase in profits
3. Consumer choice
4. Greater employment

Explanation

As businesses grow, they can damage the environment and overuse natural resources. All the other responses are considered advantages to either the business or countries' economies.

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Internal and external economies and diseconomies of scale

Economies and diseconomies of scale Economies and diseconomies of scale

Businesses that are able to produce goods and services at a lower average cost than their competitors have an advantage in the marketplace because they can earn larger profits. They may also be able to lower prices for consumers while maintaining profits, which will enable them to increase their market share relative to competitors.

One of the factors that can impact the costs of a business is the size of its operations. In general, businesses producing a higher output will be able to produce a given good or service at a lower average cost. Think about making biscuits. A modern food processing plant producing millions of biscuits per year can produce biscuits at a lower cost per biscuit than you can at home in your kitchen. Economists use the term economies of scale to refer to this situation.

Credit: Anjelika Gretskaia, Getty Images

Credit: sykono, Getty Images

Figure 1. Businesses with a larger output can lower their average costs of production compared to smaller businesses.

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Economies of scale

Economy of scale refers to a situation where the unit (average) cost of production decreases as the level of output increases. Economies of scale can be either internal or external.

Internal economies of scale

Internal economies of scale are cost reductions that can be achieved inside the company when it expands its output. They may occur in different ways:

Purchasing economies of scale occur when a business buys inputs at a lower cost by purchasing larger amounts. For example, a food company buying thousands of eggs every week will be able to negotiate lower prices from suppliers compared to a small company buying a few dozen eggs at a time. This is also known as 'buying in bulk.'

Credit: jayk7, Getty Images

Credit: fotogaby, Getty Images

Figure 2. Purchasing large quantities of paper will reduce unit costs compared to buying small quantities of paper.

Marketing economies of scale occur when the cost of a marketing campaign is spread over a larger quantity of output, thus lowering the average cost of the campaign. It can be expensive to develop a marketing campaign. Also, larger corporations may be able to negotiate better rates for using a promotion platform if they buy more. Smaller firms may not be able to afford television advertising, for example, where costs are very high for a 30-second advertisement.

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Managerial economies of scale occur when the cost of hiring a manager is spread over a larger output. Lower costs of production also occur because businesses are able to hire specialists who are more efficient at completing their work. For example, it is unlikely that a sole trader responsible for the day-to-day operations of a business will have extensive expertise in each of the business functions. As the business grows, the sole trader may be replaced by a CEO who leads a team of specialists in human resources, finance, marketing and operations. Their combined expertise should, in theory, improve efficiency and decrease average unit costs.

Technical economies of scale occur when a large company is able to invest in equipment that makes the business more efficient and results in a lower average cost of production. An industrial mixer, for example, will reduce costs compared to mixing ingredients using a smaller, less sophisticated tool. However, this large investment in equipment may not be profitable until production reaches a certain level. As output increases, the cost of equipment can be spread over a higher quantity of output. The use of equipment allows production to become more automated and efficient, lowering unit costs.

Figure 3. A large mixer is expensive to buy, but can help a baker produce more bread at a lower unit cost.

Credit: maki_shmaki, Getty Images

Financial economies of scale occur when a large business takes out a larger loan for investment. Larger loans often have a lower interest rate. This means they cost less to repay, especially when the costs are spread over larger output. You will consider these issues further when you study sources of finance in **Subtopic 3.2**.

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External economies of scale

External economies of scale are cost-savings that occur due to external factors in the region or industry that are not under the control of the business. These may be due to the following:

- **Innovation:** This is when an industry becomes significant for society. Innovation allows businesses to collaborate with universities or other research institutions in order to improve and create new products, and at the same time reduce their own research costs.
- **Infrastructure:** A good transportation network supports quick delivery of products and helps workers arrive at work on time, increasing productivity.
- **Specialisation:** This takes place when companies, suppliers, and workers start to focus on a particular industry due to its size. As the number of companies in an industry increases, it becomes more profitable for suppliers to focus on supplying customers within that industry. It also becomes easier for specialised workers to find a job in their field because of the availability of jobs in the industry. This in turn makes it easier for companies to hire specialised workers, which can reduce costs associated with recruiting and training.

Exam tip

When suggesting how a business may achieve economies of scale, always consider the type of organisation and the industry.

Diseconomies of scale

Companies, or some of their operations, sometimes get so big that they become less efficient, leading to an increase in unit costs as output increases. Such cases are called diseconomies of scale. There are a number of internal and external factors that cause diseconomies of scale.

Internal diseconomies of scale

An internal diseconomy of scale is an increase in average unit cost, usually explained by the difficulty of managing internally large operations. Some examples of internal situations which can produce an increase in costs are:

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- **Managerial issues:** It can be difficult to efficiently run an enterprise once it gets too big. As we learned in subtopic 1.3 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-36515/), a strong vision and mission statement is required to keep the entire organisation working towards common objectives. Nonetheless, it is challenging for a single leader to set a direction and be followed by thousands of employees. There may even be rivalries between

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the different divisions of a large firm. A lack of coordination and cooperation can create inefficiencies and increase costs.

- **Increase in size of the workforce:** It can be challenging to control a large workforce. The growing size of the company may necessitate the creation of a complicated organisational structure, with many levels of hierarchy. A large number of managers between the CEO and employees can increase the expenses associated with salaries and wages. There could be overcrowding. Jobs in large firms may become so specialised that employees no longer see how their role fits into the company's operations as a whole. They may grow to feel alienated from decision-making.
- **Communication:** As organisations grow and become more complex, there may be several layers of management between the CEO and employees, making efficient communication more difficult. We will explore these issues in **Subtopic 2.6**. Communication challenges are amplified further when operations are spread globally.

Case study

Walmart was founded in 1962, as a discount retailer. Sam Walton, its founder, built his business based on the notion that low prices for customers would generate higher sales revenues. The company today operates more than 8 500 stores, with more than two million employees, and serves more than 200 million customers around the world.

Walmart's main strategy is to offer the lowest retail prices among its competitors and avoid the use of promotion. This strategy is supported by rapid expansion and strategic geographical locations. Ninety percent of the US population lives within 24 km of a Walmart store. Sophisticated use of technology allows the company to keep a dynamic inventory, reducing the working capital necessary and preventing excess stock. Walmart's large size gives it monopsony power in negotiations with some suppliers. This means it can put pressure on suppliers to lower the cost of the products that Walmart buys for its stores.

While Walmart's negotiating power with suppliers can mean lower prices for consumers, it puts enormous pressure on suppliers, who may have small profit margins. Because of Walmart's large size in many markets, these suppliers may have no other choice but to sell to the company. In addition, the very low prices for Walmart's products may cause other smaller retailers to go out of business. This in turn often leaves consumers with little choice but to buy from the large retailer. Thus, while Everyday Low Prices can be positive for consumers and economies, there are a number of ethical concerns associated with the strategy.

Questions

1. Define economy of scale. [2 marks]
2. Explain **two** economies of scale which Walmart experiences as a large firm. [4 marks]
3. Outline **one** ethical concern with Walmart's Everyday Low Prices strategy. [2 marks]

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Question 1

Economy of scale is a situation where the unit cost/average cost of production decreases as the level of output increases. Unit cost refers to the cost of producing a single unit of output.

Define is an AO1 level command term requiring the precise meaning of a term.

- One mark is given for a vague definition.
- Two marks are given for a complete definition.

No application to the stimulus material is required for definitions.

Question 2

Two economies of scale experienced by Walmart include:

- Purchasing economies of scale: By buying in large quantities, Walmart can negotiate lower unit costs for its products and therefore lower prices for consumers. The text mentions that Walmart has a powerful monopsony position in negotiations with suppliers.
- Technical economies of scale: Investing in new equipment and technology could produce a reduction in the unit costs. A good system between stores allows better communication, which allows a reduction in costs. The text mentions that technology helps Walmart manage its stocks, which can reduce the working capital and stock needed to operate.

Explain is an AO2 level command term requiring a detailed account including reasons or causes. Explain *how* or explain *why*.

- Other responses may be possible and, if appropriately explained and applied in context, may achieve full marks.
- To achieve full marks, you must always include theory and application to the case study in your responses.

Question 3

Walmart may use its power as one of the only purchasers in a market to put considerable pressure on suppliers to reduce the price of goods that the company buys for its stores. Since some suppliers have no choice but to sell to Walmart because of its dominance in the market, this can be seen as an unethical use of market power.

Walmart may use its power to lower prices so much that is drives out all local competition in certain geographic markets. This can mean that, in certain locations, Walmart is practically the only provider of consumer products, reducing consumer choice. In the face of reduced customer choice, Walmart may then have more pricing power, which can present ethical issues.

Outline is an AO1 level command term, requiring a brief account or summary.

- Only one point is needed to achieve full marks.

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- Other responses may be possible and, if appropriately explained and applied in context, may achieve full marks.
- To achieve full marks, you must always include theory and application to the case study in your responses.

External diseconomies of scale

External diseconomies of scale refer to the increased unit cost of production for a business due to the expansion of the industry in which the business operates. The expansion of the business and the industry as a whole can result in changes to the external environment (see STEEPLE factors in Section 1.1.6 (/study/app/business-hl/sid-351-cid-762729/book/tool-swotsteeple-analysis-id-36504/)). These external changes can increase average costs for the individual business.

There are a number of changes to the external environment resulting from industry expansion that can increase costs of production:

- **Limited natural resources:** When businesses grow their output, they need more inputs of natural resources. When this happens on an industry-wide scale, demand for raw materials may increase. Increased demand usually causes prices of raw materials to rise. This means that individual businesses may face higher costs of production. An example of this is when economies started to grow again in 2021 and 2022, after the COVID-19 pandemic began to subside. Businesses in certain industries, especially construction, faced higher costs of production for many inputs such as wood, copper and insulation. Demand for these resources had increased significantly.
- **Limited infrastructure:** When an industry expands, businesses will use infrastructure more often. They will send more lorries out on the roads for delivery; they will send more containers of products to ports; they will fill freight trains and ships with their products. This increased use of limited infrastructure can slow down deliveries and raise costs of production.
- **Increased regulation:** When an industry expands and has more power, governments will pay more attention to the businesses in that industry. Laws and regulations related to the industry may increase, which could increase costs of production. An example of this is in the technology industry, whose growth and power has raised concerns in society and government. Meta (formerly Facebook), Apple and Google all face increased regulation of their business activities in many countries, which will raise costs of production.
- **Pollution:** It is clear that the carbon dioxide emissions from business activity across all industries is causing climate change. Droughts, floods, storms and fires cost human lives and damage natural resources and infrastructure. The cost of production for firms will increase significantly in the future due to climate change

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(https://www.forbes.com/sites/rosecelestin/2021/03/05/climate-change-will-cost-companies-13-trillion-by-2026/?sh=4b7012bd6cdc).

Activity

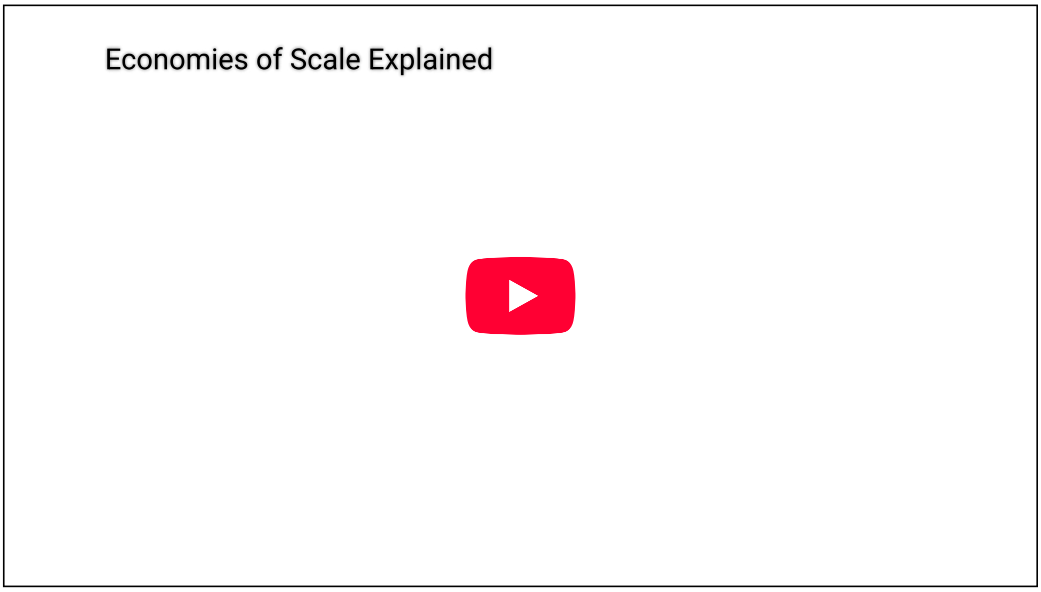
Learner profile: Principled; Caring
Approaches to learning: Research skills (information literacy); Thinking skills (critical thinking)

The online delivery service Amazon has grown enormously in the last decade. As a result, the company needs large warehouses close to large markets and ports where it receives its goods. The increased pressure on infrastructure can cause external costs for communities, in addition to the diseconomies of scale for Amazon.

Skim the article ''Pollution is everywhere': how one click shopping is creating Amazon warehouse towns (https://www.theguardian.com/us-news/2021/dec/11/how-one-click-shopping-is-creating-amazon-warehouse-towns-were-disposable-humans)'.

- Explain how the growth of Amazon has impacted communities near its large warehouses. You may wish to discuss this in class or with a partner.
- How can Amazon reduce the costs to communities of its explosive growth?

The video below summarises economies and diseconomies of scale.



Video 1. A summary of economies and diseconomies of scale.

3 section questions

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Question 1

Many state-owned enterprises are considered inefficient. There are many reasons for this, but one explanation is that their large size makes them difficult to manage, raising unit costs of production. What is the term that describes this increase of costs with size?

1 Diseconomies of scale ✓

2 Economies of scale

3 Large businesses

4 Market share

Explanation

The term diseconomies of scale refers to the increase in unit cost of production as output increases, and may be caused by the difficulty of managing large entities.

Question 2

1 Technical ✓ economies of scale result from the fact that better equipment and facilities can result in a reduction in unit costs.

Accepted answers and explanation

#1 Technical

General explanation

Technical economies of scale occur when better and larger equipment can reduce the unit costs of production.

Question 3

A typical internal diseconomy of scale that can face a growing company is:

1 Communication issues ✓

2 Bulk buying

3 Limited natural resources

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4 Traffic congestion

Explanation

When a company grows, it tends to increase the number of levels of hierarchy and this can produce problems in communication and some employees might feel isolated. Bulk buying is an economy of scale and limited natural resources and traffic congestion are considered external diseconomies of scale.

1. Introduction to business management / 1.5 Growth and evolution

Internal growth

Internal and external growth Internal and external growth

If a business wishes to grow, it can do so through internal or external growth. This section analyses the characteristics of internal growth.

Figure 1. Internal growth means expanding the business with its own resources.

Credit: Maskot, Getty Images

Companies who are interested in growing can choose to do so internally. Internal growth, also called organic growth, refers to expansion that is carried out by the organisation itself, without working with a partner. For example, a restaurant owner who hires new employees, adds new tables to the restaurant or even opens a second restaurant in another location is engaging in internal growth.

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Benefits of internal growth

There are a number of benefits of internal, rather than external, growth for a business.

- **Internal growth is less expensive than external growth:** When businesses grow internally, it costs less and they often decide to use internal sources of finance, such as retained profit, for expansion. If they avoid using external sources of finance, such as bank loans, they can avoid interest rate payments or giving up equity in the business. You will learn more about the advantages and disadvantages of internal and external financing in **Subtopic 3.2**.
- **Internal growth is less risky than external growth:** When a business grows with its own resources, no other party is involved. This means that managers have more control over the resources used to grow and the way in which the business chooses to grow.
- **Internal growth maintains more control of the business than external growth:** With internal growth, as there is no need for external sources of finance, the owner of the company can keep control over the decisions of the company.
- **Internal growth can respect the company's values more than external growth:** With internal growth, the culture of the company can be maintained since there is no risk of a third party changing it or imposing different values.

Limitations of internal growth

There are also a number of limitations with internal growth.

- **Internal growth is slower than external growth:** Growing only with the resources of the company may take a long time and, in the meantime, larger competitors might enter the market.
- **Internal growth can cause cash flow problems:** Growth can be expensive and if businesses do not see an increase in revenues right away, they may have cash flow problems.
- **Internal growth can be limited:** If a business operates in a small market, it may not be able to reach a size that results in acceptable profits. In addition, the growth of a business is limited by its own financial resources.

Activity

Learner profile: Thinkers
Approaches to learning: Research skills (information literacy); Thinking skills (critical thinking)

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Using the information above, create a summary table for yourself of the benefits and limitations of internal growth. Use keywords rather than full explanations to synthesise the information.

Strategies for growing internally

In order to grow internally, companies can implement the following strategies:

- **Increasing production and gaining market share:** Businesses can increase the output of their current products if the market demands it. They can also increase their share of the existing market through pricing changes, improved promotion or improved distribution.
- **Developing new products:** Using market research, businesses can develop new products or improve their existing products to satisfy the target market and increase sales revenue.
- **Finding new markets:** Businesses can sell their existing products or services in a new location or to a new group of people. Establishing new markets is one of the most cost-effective internal growth strategies, since it does not involve new product research, development and production.

These strategies are explored more fully in Section 1.5.7 (/study/app/business-hl/sid-351-cid-762729/book/tool-ansoff-matrix-id-36539/) (the Ansoff matrix).

Case study

In 2019, Coca-Cola introduced a new product to its portfolio: AHA Sparkling Water (https://www.coca-colacompany.com/news/aha-adds-to-coke-sparkling-water-portfolio). This product is available in eight flavour pairings with no sweeteners, no calories and no sodium, but some flavours have caffeine. The new product is aimed at consumers who want to drink a sparkling beverage that is not a cola product. Sparkling water has been a growing market for Coca-Cola, so this is a new twist on that product.

Questions

1. Describe the internal growth strategy that Coca-Cola is using with its AHA product. [2 marks]
2. Explain **two** benefits for Coca-Cola of growing the business through AHA. [4 marks]

Question 1

Coca-Cola is using the growth strategy of product development. Product development refers to a situation where a business develops a new product to satisfy existing target markets. The case study points out that 'sparkling water has been a growing market for Coca-Cola', so AHA flavoured sparkling water is a new version of the product aimed at its existing sparkling water market.

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Describe is an AO1 level command term requiring a detailed account. Describe *what* something is.

- To achieve full marks, you must always include theory and application to the case study in your responses.

Question 2

Benefits for Coca-Cola growing the business through AHA include:

- Reducing risks by enlarging the product portfolio with more sparkling water, which is a growth market.
- Using economies of scale to reduce average costs of production. Coca-Cola is a large company and can use its current economies of scale to lower costs of production for a new product that is similar to its existing products.
- Using pricing power to increase revenues, since Coca-Cola is a large company and can influence the beverage market.

Explain is an AO2 level command term requiring a detailed account including reasons or causes. Explain *why*, explain *how*.

- Two points need to be made. Each should be developed in a short paragraph that includes an explanation of theory and application to the case study. Other responses are possible and would be rewarded if appropriate.
- To achieve full marks, you must always include theory and application to the case study in your responses.

3 section questions

Question 1

A disadvantage of internal growth is:

1 Growth is likely to be slow ✓

2 Loss of control

3 Culture clash

4 Very high levels of risk

Student view
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Internal growth means growing only with the resources of the company, which may be a slow process. During this time, big competitors might enter the market. The other responses are all problems associated with external growth.

Question 2

Which of the following is not a strategy to grow internally?

1 Joining with another business ✓

2 Creating new products

3 Entering into other markets

4 Using promotion

Explanation

Internal growth refers to the ability and decision of the company to grow with its own resources, without involving a third party.

Question 3

Another name for internal growth is 1 organic ✓ growth.

Accepted answers and explanation

#1 organic

General explanation

Internal growth is the same as organic growth. Organic growth is the growth a company achieves by increasing output and enhancing sales internally.

1. Introduction to business management / 1.5 Growth and evolution

External growth

Internal and external growth Internal and external growth External growth methods External growth methods

Student view

In contrast with internal growth methods, external growth methods involve another organisation. Partnering with another business can allow companies to realise their strategic objectives more quickly and efficiently. There are several different forms of external growth.

Figure 1. External growth means expanding the business with the help of other businesses.

Credit: laflor, Getty Images

Mergers and acquisitions (M&As) and takeovers

The terms mergers, acquisitions and takeovers can be confusing because they are often used interchangeably. The nuances in terminology will be discussed below.

Mergers, acquisitions and takeovers result in a fundamental change in structure to the companies involved. They cannot be reversed easily if things go wrong. Therefore, they are riskier strategies compared to strategic alliances and joint ventures, which will be discussed later in this section. Many observers have noted that between 70% and 90% of mergers and acquisitions fail. Thus, companies that engage in external growth with a large partner must proceed with caution.

Mergers

A merger takes place when two businesses agree to form a new business together. A merger may occur between firms that are considered equals in terms of power, where both businesses make changes to accommodate the fusion. But they can also occur between firms that are not equals, where one business dominates and requires that the other business change more substantially in the merger process.

Mergers are not always a success. Perhaps the best-known example of a merger that went badly is that of AOL–Time Warner. The 'perfect marriage' of old and new media did not realise its potential and the companies finally separated in 2015.

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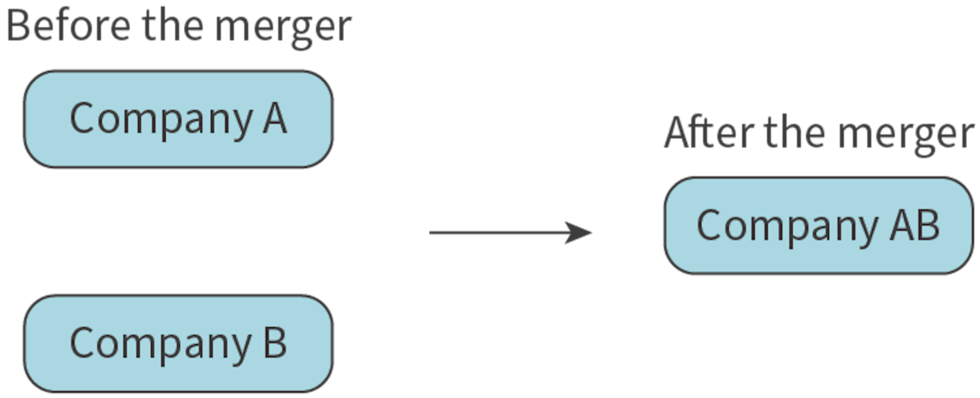

Figure 2. A merger is where two companies agree to fuse together.

More information for figure 2

The flowchart illustrates the merger process of two companies, labeled "Company A" and "Company B," combining into "Company AB." The diagram consists of two main sections, "Before the merger" and "After the merger." In the "Before the merger" section, there are two separate labeled boxes: "Company A" at the top and "Company B" below it. An arrow points from these two boxes to the single box labeled "Company AB" in the "After the merger" section, indicating the fusion of the two companies into one. This flowchart effectively shows the transition from two independent entities to a single, merged entity.

[Generated by AI]

Acquisitions

An acquisition on the other hand implies that one company purchases another company with permission of the board of directors. This is illustrated in **Figure 3**. Company A has acquired an ownership interest in Company B. Company A thereby becomes the parent company and Company B becomes its **subsidiary**. In some cases, Company A acquires 100% of Company B. In other cases, the parent company acquires a majority stake (over 50%), rather than 100% of the subsidiary. In any case, both companies continue to exist as legal entities, but A 'controls' B due to its ownership interest. An example of this is Pixar Animation Studios, which has been a subsidiary of The Walt Disney Company since 2006.

Acquisitions can be large or small operations. Meta (formerly Facebook) has purchased many smaller companies such as Instagram and WhatsApp in order to access technology and know-how that it did not have 'in house'. These were major investments for Facebook at the time; the company paid nearly 19 billion USD for WhatsApp. However, this was still a small sum compared to the value of Facebook itself. So had the acquisition been a failure, it would not have seriously jeopardised the future of Facebook.

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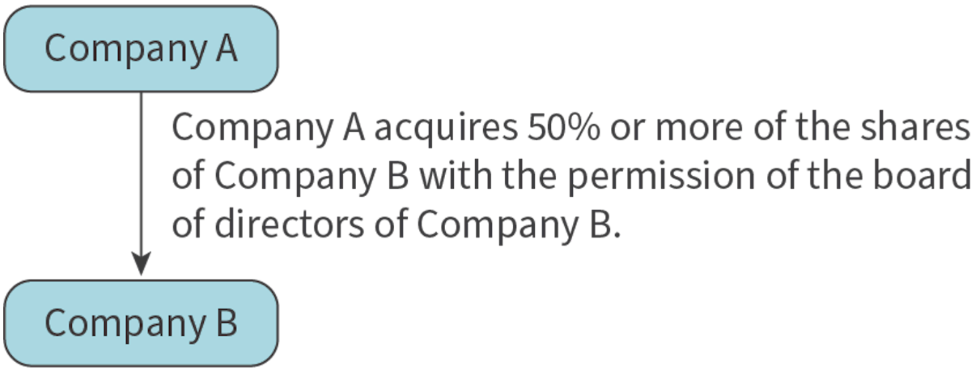

Figure 3. An acquisition, where Company A acquires Company B.

More information for figure 3

The diagram shows a flowchart with two rectangular nodes. The top node is labeled "Company A," and the bottom node is labeled "Company B." An arrow connects the two nodes, pointing downward from Company A to Company B. To the right of the arrow, there's a text box that reads: "Company A acquires 50% or more of the shares of Company B with the permission of the board of directors of Company B." This flowchart represents the process of Company A acquiring a controlling interest in Company B.

[Generated by AI]

Takeovers

A takeover occurs when one company purchases another company without permission of the board of directors or the company. The purchasing company will usually try to purchase a majority of shares of the other company, either directly from shareholders or through stock markets. They may also try to take control of the board of directors with the approval of shareholders. This is called a proxy fight. Needless to say, for the purchasing company, a takeover will be more difficult and risky than an acquisition.

Concept

Change

Changes to a business often occur during a mergers, acquisitions and takeovers. Depending on the process, companies may be asked to change their values, culture, and/or business structure. Most of the time, the company that owns more than 50% of the shares will ask the other to adapt and change.

However, acquisitions and takeovers, where one company is dominant, do not necessarily require that the companies adapt to each other. It is possible for one company to completely own another and for the business being taken over to stay the same as it was before.

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On the other hand, one business acquiring 50% ownership of another could require more substantial changes in the business being taken over. In a takeover or an acquisition, as opposed to a merger, one company is always dominant. This means there is always a possibility that the company being taken over or acquired has to adapt to the dominant firm.

Activity

Learner profile: Knowledgeable; Inquirers
Approaches to learning: Thinking skills (critical thinking); Research skills (information literacy)

In 2012, two South American airlines, LAN Airlines S.A and TAM Linhas Aereas S.A, merged into one business called LATAM. Currently, LATAM is the largest airline in South America, flying to five continents, with more than 45 000 employees and 310 aeroplanes.

- How might a merger of these two airlines enable them to experience economies of scale?
- Can you think of other examples of companies from your country which have merged, or where an acquisition/takeover has occurred?

Joint ventures

A joint venture is a new enterprise undertaken jointly by two or more businesses which otherwise hold onto their distinct identities. Joint ventures are a more flexible form of external growth than mergers, takeovers and acquisitions. The separate business entity can be dissolved at the end of a project, without compromising the businesses of the parent companies.

The companies involved in a joint venture split the costs, risks, control and profit that the project produces according to an agreement made by the parties. One example of a joint venture is the formation of Galvani Bioelectronics (https://galvani.bio/), a joint venture of the drug company GlaxoSmithKline (GSK) and Verily, a company owned by Alphabet. The joint venture is set to last for seven years, during which time Galvani Bioelectronics aims to combine GSK's knowledge of life sciences with Verily's experience and skill with software and electronics in order to develop bioelectronic medicines to treat chronic diseases.

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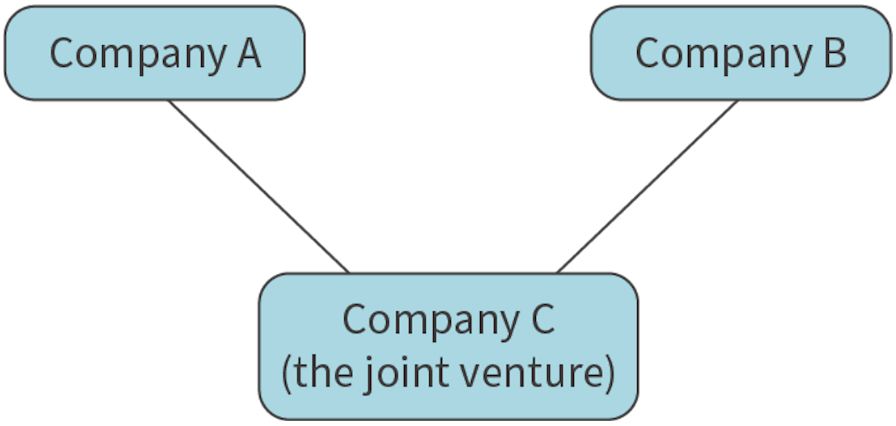

Figure 4. One possible configuration of a joint venture.

More information for figure 4

The diagram illustrates a simple joint venture model. It features three main components positioned as follows:

- At the top left, there is "Company A," represented in a rectangular box with a line connecting it to the bottom component.
- At the top right, "Company B" is shown, also in a rectangular box, linked downward with a line to the same bottom component.
- At the center bottom, there is "Company C (the joint venture)," displayed in a larger rectangular box. This is the joint venture created by Company A and Company B.

The lines indicate how Companies A and B have combined resources or efforts to form Company C, representing their joint venture.

[Generated by AI]

Strategic alliances

A strategic alliance is a situation where two or more businesses work together to achieve a common objective but do not create a new enterprise in the process. Strategic alliances are the loosest and least risky form of external growth. As with joint ventures, the members of the strategic alliance share the costs of the product or service that is developed. In some cases, forming a strategic alliance can be the beginning of cooperation between two companies, which later results in an even closer working arrangement through the creation of a joint venture or even a merger.

An example of a strategic alliance is Oneworld (https://www.oneworld.com/), formed by 14 airlines with the aim of providing travel to more than 1000 destinations in more than 170 territories as well as offering passengers an excellent flying experience. Customers who use

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airlines in this alliance can enjoy benefits of the partnership, such as their frequent flyer miles being valid for other airlines in the group.

Activity

Learner profile: Thinkers; Inquirers
Approaches to learning: Thinking skills (critical thinking, transfer); Research skills (information literacy)

ICICI Bank, India's largest private sector bank and Vodafone India, one of India's largest telecom service providers, made a strategic alliance to launch M-Pesa (https://www.vodafone.com/about-vodafone/what-we-do/consumer-products-and-services/m-pesa). M-Pesa is a money transfer and payment service that is now widespread in low-income countries.

This video shows the big impact that this strategic alliance had in Kenya, where M-Pesa originated.

Video 1. The impact of the strategic alliance M-PESA in Kenya.

- Why would a strategic alliance be an appropriate strategy for a service like M-Pesa?
- Research one other example of a strategic alliance and explain its purpose.

Evaluation of external growth

Table 1 shows some advantages and disadvantages of mergers and acquisitions, joint ventures and strategic alliances.

Student view

Table 1. Advantages and disadvantages of mergers and acquisitions, joint ventures and strategic alliances.

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Advantages	Disadvantages
Often faster than internal growth.	Often riskier than internal growth, especially if borrowing on a large scale.
Potential for economies of scale.	Can be hard to realise cost reductions if the firms are too different or do not understand each other well.
Can create synergies, increase employee talent pool, widen range of expertise.	Possibility of culture clash between organisations.
In the case of merger, acquisition or takeover, a competitor may be eliminated.	In the case of joint ventures and strategic alliances, proprietary information and technology could be lost.

International Mindedness

External growth is always risky because of the need to integrate the company processes and business cultures of two or more organisations. External growth strategies can be particularly difficult when two companies from different countries decide to integrate. Cultural differences can create conflict that is very difficult for integrated companies to resolve.

Franchising

Franchising refers to an arrangement between two parties: the franchisor and the franchisee. The franchisor (also written franchiser) is usually a company with a successful and proven business model that wishes to expand. It is of course possible to do so through internal growth by setting up new outlets. But it may be advantageous for the franchisor to seek partners who would like to open, own and run these outlets themselves. In exchange, these partners, called franchisees, pay fees and royalties to the franchisor. Royalties are usually calculated as a percentage of revenues.

There are many advantages to this arrangement for the franchisor. Firstly, the franchisor's need for financing is reduced because franchisees usually finance the new outlets themselves. Because franchisees own and keep the profits from their outlets, they may be better and more motivated managers than employees working for a large company. Franchisees also provide local knowledge in operating their businesses. This can be particularly helpful in the case of international expansion.

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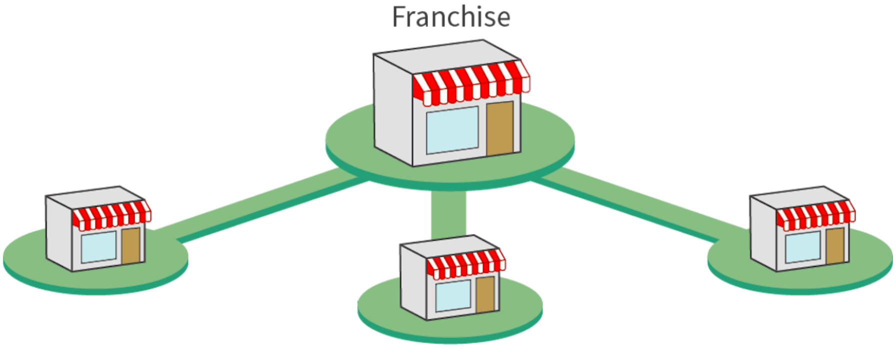

Figure 5. Franchising refers to an arrangement between two parties: the franchisor and the franchisee.

More information for figure 5

The image is a diagram illustrating the concept of franchising. In the center, there is a large franchise store representing the franchisor. It is connected by lines to three smaller stores, depicting franchisees. The central store is raised on a green circular platform, emphasizing its role as the main entity. Each smaller store is also on a green circular platform. Above the central franchise, the word "Franchise" is displayed, indicating the overall theme of the diagram. The smaller stores are identical to the central store, symbolizing how franchisees replicate the business model of the franchisor.

[Generated by AI]

Franchisees also benefit from the arrangement. They receive the support of the franchisor in running the business. This help can range from legal advice to access to managerial software to best practices in food hygiene. Franchisees receive training and access to a proven business model and recognised brand. This limits the risk of becoming an entrepreneur. Franchisees can also benefit from economies of scale compared to individuals running smaller businesses.

The franchise model also has potential pitfalls, for both the franchisor and the franchisee. The franchisor loses direct control over individual outlets and must trust that its franchisees will maintain company standards. A single mistake at a single outlet can damage the reputation of the entire company.

Activity

Learner profile: Knowledgeable
Approaches to learning: Thinking skills (critical thinking)

Consider whether the following statements about franchising are true or false. Provide a response for each one and, for every false response, explain why it is false.

1. Setting up as a franchise allows the franchisor to expand their business more quickly.

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2. One of the main disadvantages of the franchise for the franchisee is know-how that they receive when entering new markets.
3. The franchisee only needs to pay a one-time fee to the franchisor.
4. The franchisee can create new products and processes.
5. The franchisor has complete control over the franchise outlets.
6. By using franchising, franchisees take on lower risks when running their business than they would with starting a business from scratch.

1. True
2. False
   This is one of the main **advantages** for the franchisee, who receives all necessary know-how when starting their business.
3. False
   The franchisee has to pay the franchisor fees **and** royalties every year.
4. False
   In a franchise, there are no real possibilities for innovation.
5. False
   The franchisor loses considerable control over the franchise outlets because they are owned and run by franchisee.
6. True

3 section questions

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Question 1

Which of the following would be considered external growth for a bank?

1 Merging with another bank ✓

2 Opening a bank branch in a new country

3 Offering a new financial service for actual customers

4 Developing savings accounts for children

Explanation

External growth means to expand by merging with or taking over other businesses.

Question 2

Which of the following is a form of external growth that is quite flexible because a new company is created and it can be dissolved without too much impact on the parent companies?

1 Joint ventures ✓

2 Organic growth

3 Strategic alliances

4 Mergers and acquisitions

Explanation

Strategic alliances are flexible but do not involve the creation of a new company. Mergers and acquisitions cannot be easily reversed. Organic growth is not a form of external growth; it is another name for internal growth.

Question 3

A typical advantage of external growth is:

1 The possibility to grow more quickly ✓

2 The possibility of a culture clash

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view

3 The possibility to lose some proprietary information and technology

4 The possibility to have new competitors

Explanation
When businesses merge with or take over other businesses, they have extra resources to grow more quickly than when they depend on their own resources.

Small businesses

Reasons for businesses to stay small Reasons for businesses to stay small

Even though growth is a common business objective, some companies may decide to stay small and focus on satisfying their customers with excellent customer service and quality products.

Figure 1. Many smaller businesses are comfortable with the amount of profit they are making.
Credit: Willie B. Thomas, Getty Images

Reasons for staying small

After studying business growth, it might seem that big is always better, and that small businesses do not stand a chance. This is actually *not* the case; many smaller organisations thrive alongside their larger competitors. You can probably observe this fact yourself by thinking about the shops in your own neighbourhood. Smaller organisations can do well because there are many advantages of operating on a smaller scale.

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Here are some reasons why businesses might choose to remain small, some of which are distinct advantages of small businesses:

- **Avoiding risk, maintaining control:** Sometimes owners are not interested in growing because they do not want to take large risks or lose control over the business. They focus on achieving only the profits they need to survive and be comfortable. This is sometimes known as satisficing.
- **Small market size:** Even though increasing market share is one of the most common business objectives, there can be highly specialised professionals who only serve customers in the local area or a niche market and do not want to expand their services to other places or groups of people.
- **Limited access to sources of finance:** Often small businesses find it difficult to gain access to sources of finance in order to expand; this can be a hurdle keeping business small.
- **Sustainability:** Some small businesses may be concerned about environmental sustainability and they do not want to overuse resources.
- **Strong social networks:** Some businesses may decide to stay small in order to engage with other stakeholders, including customers and employees, in a positive way through strong networks, focusing on sociocultural sustainability and receiving mutual benefits, which builds resilience.

Concept

Creativity and Sustainability

Creativity involves generating new ideas and considering existing ideas from new perspectives.

When the companies decide to stay small, they need to be creative to find ways to satisfy their customers and compete against larger businesses that may have lower average costs of production. The creativity of many small businesses in towns and cities is the key to customer loyalty.

Small businesses may develop stronger relationships with other stakeholders and receive mutual benefits. This is called sociocultural sustainability, which occurs when businesses that provide for human needs are interdependent with the communities they serve. This interdependence builds resilience.

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Figure 2. Small businesses are likely to be closer to their customers and form strong networks improving sociocultural sustainability and resilience.

Credit: SDI Productions, Getty Images

On the other hand, being a small business can have disadvantages. Small businesses tend to have higher costs of production because they cannot take advantage of the economies of scale available to larger businesses. This can lead to lower profits. Access to finance can be difficult too, as some external sources of finance may believe that it is too risky to invest in a smaller business. Finally, small businesses may have trouble recruiting and retaining skilled workers, since larger businesses may be able to offer higher salaries, greater benefits and more professional development.

Making connections

In the IBDP Economics course, students learn about monopolies. A monopoly is where one company has a dominant position in a market. While this can be an advantage for the monopoly firm, in terms of pricing power and high sales revenues, this can reduce the participation of small businesses in the market. In many cases, this pushes out or prevents the formation of small businesses and the creativity they often bring to an industry.

Activity

Learner profile: Inquirers
Approaches to learning: Thinking skills (critical thinking, transfer)

This infographic shows some information about small businesses in the USA.

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Figure 3. Fast facts on US small businesses.

Source: Statista (https://www.statista.com/chart/21412/small-business-facts-in-america/),

More information for figure 3

This infographic provides an overview of key statistics related to U.S. small businesses. It contains several sections each with an icon and corresponding statistics.

1. **Businesses with fewer than 500 employees:** Represented by a storefront icon, there are 20.7 million such businesses.
2. **Total number of employees:** An icon depicting people indicates there are 135 million employees.
3. **Total annual sales:** A shopping cart icon shows total sales of $8.8 trillion.
4. **Annual sales per business:** Represented by a basket icon, each business has $427,430 in annual sales.
5. **Annual wages per business:** A money bag icon indicates $360,686 in annual wages per business.
6. **Annual salary per employee:** A piggy bank icon shows an average salary of $60,310 per employee.

Data covers the period from Q4 2018 to Q4 2019 and sources Dun & Bradstreet.

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Consider a particular business in your neighbourhood or city. Discuss with a partner the advantages and disadvantages that this particular business might face.

Case study

Some years ago, Jessica opened her business, Jessica's Salon (JS). She offers hairdressing for women. Her customers are happy with her service. She offers various services, including nail treatments, facials and skincare treatments. She was able to hire three new employees. She is very ambitious and she wants to expand her business quickly.

Jessica is considering both internal and external growth for the expansion of JS. One possibility is for Jessica to rent an empty salon that is not very well located, where she will be the only manager and keep control over the decisions. Her second option is to buy 60% of a popular salon located in a busy street from the original owner, who is unwell and wants to reduce his work in the business. Jessica would take over the existing business and staff.

However, Jessica's customers are concerned about the growth of the business. They have strong relationships with Jessica and her team, considering the business a part of the character of the neighbourhood. They believe that both alternatives are going to negatively impact the excellent customer service that JS currently offers.

Questions

1. Define external growth. [2 marks]
2. Explain **two** reasons for Jessica to grow the business. [4 marks]
3. Distinguish between internal and external growth. [4 marks]

Question 1

External growth is the expansion of a business involving another business. This could be through a merger, acquisition or takeover.

Define is an AO1 level command term requiring the precise meaning of a term.

- One mark is given for a vague definition.
- Two marks are given for a complete definition.
- No application to the stimulus material is required for definitions.

Question 2

Reason 1: To look for stability
As JS is a small business, opening a new salon can give more stability in economic terms and compensate for any problem tha can occur with the existing salon. Multiple salons can build resilience.

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Reason 2: To increase profit
Opening a new branch will allow JS to sell more and increase profit. This will probably not be possible in the first year. But after that period of time, with Jessica's experience, numbers can improve very quickly.

Explain is an AO2 level command term, requiring a detailed account including reasons or causes. Explain *how* or explain *why*.

- Two reasons need to be explained. You should write visibly separate short paragraphs that each explain a reason (theory) and use information from the case study (example) to support the response.
- Other responses may be possible and, if appropriately explained and applied in context, may receive full marks.
- To achieve full marks, you must always include theory and application to the case study in your responses.

Question 3

Internal growth refers to the ability of the business to grow with its own resources. In the case study, the internal growth strategy would be for Jessica to take over an empty salon where she would build a second outlet of her own. This would enable her to maintain control over the operations and business culture of the new enterprise.

External growth is the ability to expand involving other businesses. In the case study, the external growth strategy would be for Jessica to buy a 60% share of another salon that is already operational. One way in which this is different from internal growth is that Jessica would not have full control over the operations or business culture of the other salon and this could cause her problems in the future.

Distinguish between is an AO2 level command term requiring that you make clear the differences between two or more concepts or items.

- Other responses may be possible and, if appropriately explained and applied in context, may receive full marks.
- To achieve full marks, you must always include theory and application to the case study in your responses.

3 section questions

Question 1

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Some business owners prefer to balance their earnings with lifestyle considerations and may not seek to grow their companies. This observation is described by what term?

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Satisficing

Accepted answers

Satisficing

Also accepted

satisficing

Explanation

Satisficing describes the behaviour whereby owners are not attempting to maximise profits, but instead are seeking to optimise profits along with other objectives.

Question 2

What is a common reason for businesses to stay small?

1 Limited access to finance ✓

2 Communication problems

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3 Economies of scale

4 Expanding market share

Explanation

Limited access to sources of finance: most of the time, small businesses find it difficult to have access to sources of finance in order to expand.

Question 3

An important advantage of being a small organisation is:

1 Close relationships to customers and strong networks ✓

2 Economies of scale

3 Easy recruitment and retention of skilled workers

4 Easy access to financial resources

Explanation

Small businesses are near to the customers and they may be able to understand their needs better than large businesses.

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1. Introduction to business management / 1.5 Growth and evolution

Extending sustainability: Generative/Regenerative business

Reasons for businesses to grow Reasons for businesses to grow

Teacher instructions

"Generative" or "regenerative" businesses are **not examinable IB terms**. This short section enriches understanding of **sustainability and CSR** by showing how some organizations go beyond reducing harm to actively strengthen their communities and ecosystems.

Generative (also called regenerative) business practices are an extension of sustainable and CSR-focused approaches. This is ***not required IB syllabus content*** *but illustrate how businesses can go beyond sustainability and CSR by supporting mutual well-being and ecosystem health.*

Growth does not always have to be about a business expanding its size. Some businesses work to grow and develop the ecosystem in which they operate by being generous with those in their networks. They create opportunities for growth and development for stakeholders around them. Businesses who engage with their networks in this way are acting like nature. This is called biomimicry.

The Biomimicry Institute (https://biomimicry.org/) has proposed ten Unifying Patterns in Nature (https://toolbox.biomimicry.org/core-concepts/natures-unifying-patterns/). These are principles that generative (regenerative) businesses can follow to improve sustainability, in particular to support the local-social and local-ecological elements of the matrix you learned about in Section 1.3.4 (/study/app/business-hl/sid-351-cid-762729/book/ethical-objectives-and-corp-social-resp-csr-id-36520/) on corporate social responsibility (CSR).

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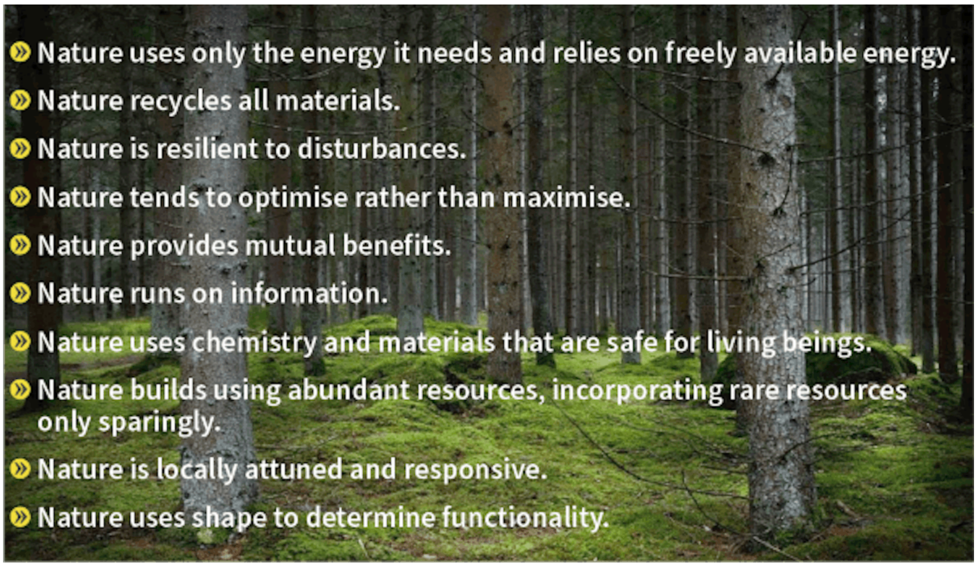

Figure 1. Businesses can act more like nature, developing strong healthy ecosystems .

Recreated with kind permission of the Biomimicry Institute (http://toolbox.biomimicry.org/core-concepts/natures-unifying-patterns)

A number of the ideas from **Figure 1** have already been touched on in this book. For example, in Section 1.5.5 (/study/app/business-hl/sid-351-cid-762729/book/small-businesses-id-36537/), you learned that many small businesses aim to satisfice. This means to optimise profits while considering other objectives, rather than to maximise profits. You also learned how small businesses may be better attuned and more responsive to customers in their local environment. Throughout, you have been learning that businesses need to meet human needs within planetary boundaries, being mindful of scarce resources and using safe materials to improve sustainability. You have also seen many times that businesses need to be resilient to be able to cope with the many disturbances that come their way from the external environment. In Section 1.3.7 (/study/app/business-hl/sid-351-cid-762729/book/tool-circular-business-models-id-36523/), you learned about circular business strategies, which mimic nature's natural recycling of materials. Finally, you were also exposed to generative businesses in the video from Kate Raworth in Section 1.3.5 (/study/app/business-hl/sid-351-cid-762729/book/strategies-and-tactics-id-36521/).

This section focuses on the idea that businesses can work to provide mutual benefits to themselves, other stakeholders and businesses within their sphere of influence. There are many examples of these relationships in nature. For example, a hummingbird feeds itself and pollinates flowers at the same time. The relationship helps both species survive and thrive. The same can be true for businesses that provide mutual benefits and support a healthy ecosystem.

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Figure 2. Like a hummingbird and flower, it is possible for businesses to cultivate mutual benefits in their ecosystem.

Credit: Larry Keller, Lititz Pa., Getty Images

There are a number of characteristics of generative (regenerative) businesses. They share their know-how with other businesses, providing opportunities for others to learn from their experience. They nurture a network of relationships between their stakeholders, so that the interaction and interdependence support widespread thriving. They create a shared purpose and deliver value in many forms to their stakeholders, rather than just financial value (profits) to owners/shareholders. They actively seek to improve and restore the health of individuals, communities and the planet, not simply to do less harm.

Examples of generative (regenerative) business practices include:

- A technology firm making its code open source so that others can learn from and improve it,or designing its platforms so that other businesses can connect with them.
- A local bakery regularly offering free bread-baking classes for the community.
- A multinational food manufacturer providing financial support for farmers to transition to regenerative agriculture (https://regenerationinternational.org/why-regenerative-agriculture/).
- A school offering empty classrooms free (at weekends and during school holidays) to local non-profit organisations who need space to run their programs.

Student
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Activity

Learner profile: Caring
Approaches to learning: Social skills

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For each of the four examples above, consider how the business itself could benefit from its contribution to other stakeholders, creating a healthy and resilient business ecosystem.

The concept of generative (regenerative) business also challenges an assumption in economics and business that fierce competition between organisations is the best way to maximise benefits for all. Instead, generative (regenerative) business recognises that positive feedback loops can develop between organisations and individuals, increasing innovation through sharing, cooperation and support.

Concept

Sustainability

Generative (regenerative) businesses aim to support the well-being and development of different stakeholders connected to the business, contributing to sociocultural sustainability. They distribute value widely and create a network of mutual benefit; a healthy economic and social ecosystem that is more resilient when changes occur in the external environment.

2 section questions

Question 1

1 Generative ✓ businesses aim to strengthen their ecosystem by being generous with the stakeholders connected to the business.

Accepted answers and explanation

#1 Generative

General explanation

Generative businesses take inspiration from nature by acting to provide mutual benefits to themselves and to others within their ecosystem so that all stakeholders thrive. This builds resilience and optimises well-being.

Question 2

Student view

Which of the following would **not** be considered a generative (regenerative) business practice?

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1 A private school starts to charge fees to external music teachers for using its classrooms after school to deliver music instruction, when previously the teachers could use the rooms for free to deliver their services. ✓

2 A sewing supplies shop offers free sewing lessons to customers on a regular basis.

3 A restaurant partners with a local farm using regenerative agriculture to supply its produce at somewhat higher than normal market prices.

4 A cloud storage firm writes its code to enable third-party apps to connect easily with its platform.

Explanation

By charging fees to music teachers who deliver their services in school classrooms, the school is trying to extract as much value out of the teachers as possible. An example of acting as a generative (regenerative) business would be for the school to provide the rooms for free. This would help to support music teachers, but also provide a benefit to the school as more teachers would be willing and able to provide the instruction, and the student and parent community would be more satisfied.

Tool: Ansoff matrix

Tool: Ansoff matrix Tool: Ansoff matrix Tool: Ansoff matrix Tool: Ansoff matrix

As you have learned in Subtopic 1.5 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-36532/), many organisations aim to expand, in a traditional sense, by growing revenues and profits. Most of them are interested in developing rather than staying still and, in doing so, they have many possible options.

The potential avenues for growth were classified by Igor Ansoff, a Russian–American mathematician and business strategist. Ansoff grouped the different options for growth into four categories, based upon combinations of two criteria: products and markets. The four options are often depicted in a matrix like the one in **Figure 1**. This is known as the Ansoff matrix. The matrix can be used with both internal and external growth strategies.

Student view

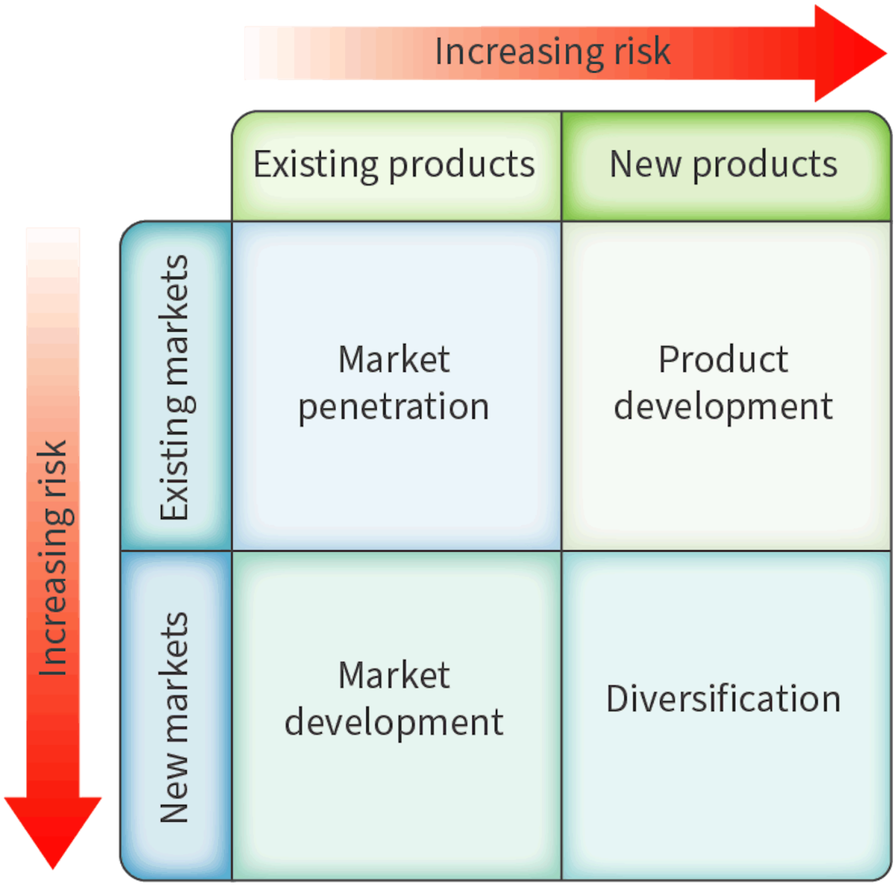

Figure 1. The Ansoff matrix describes potential revenue growth strategies.

More information for figure 1

The image is a diagram known as the Ansoff Matrix, which illustrates growth strategies for businesses based on products and markets. It is a 2x2 grid. The horizontal axis represents products, with 'Existing products' on the left and 'New products' on the right. The vertical axis represents markets, with 'Existing markets' at the top and 'New markets' at the bottom. The four quadrants within the grid are labeled with different strategies: 'Market penetration' is in the top left quadrant, 'Product development' is in the top right, 'Market development' is in the bottom left, and 'Diversification' is in the bottom right. The diagram also includes arrows indicating increasing risk, with one arrow pointing right and labeled 'Increasing risk' for new products, and one arrow pointing down and labeled 'Increasing risk' for new markets.

[Generated by AI]

Market penetration

The market penetration strategy involves selling more of the same products and services to the same customers, or at least the same types of customers. The market penetration strategy is usually considered the least risky growth strategy as it rarely entails making large investments. In the case of a neighbourhood bakery, for example, market penetration might involve extending hours, changing pricing strategies, or using loyalty cards or other promotion strategies in an attempt to increase sales. However, these strategies may only produce a temporary increase in revenues.

Figure 2. Selling more of the same products to existing customers, for example by lowering prices through a sale, is considered a market penetration strategy.

Credit: JackalPan., Getty Images

In many cases, market penetration does not allow the organisation to grow and develop as fast as it would like. It may be that most potential customers cannot be persuaded to buy more. In the case of bread, for example, a customer purchasing to meet the needs of their family has a limited demand. Or it may be that there are many competitors in the market, so that increasing sales requires winning customers over from other businesses. Many organisations find themselves in circumstances where greater change and risk-taking are required in order to develop. This may involve one of the other three strategies in the Ansoff matrix.

Product development

Product development involves selling new products within the organisation's existing market, often to existing customers. In the example of the bakery, product development might involve selling cakes, sandwiches or beverages to complement the simple baked goods.

Product development usually involves some risk because it requires more investment in time and resources. The bakery will have to experiment with sandwich offerings or various cake recipes to see which ones are popular. Investment in storage and refrigeration equipment may be required. These efforts may distract the owner from the core business of making bread. Efforts to sell new products may fail if managers do not understand customers' needs and expectations.

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Figure 3. Selling new products in the same market is considered a product development strategy.

Credit: Luis Alvarez, Getty Images

Market development

Market development involves selling existing products to new customers. In the bakery example, this might involve opening a bakery in a new location and selling the same products in the new shop as the original shop.

Market development is considered riskier than a market penetration strategy. This is because the organisation may not understand the needs of the new customers, so its offerings might not be adapted to the new market.

There are several different types of market development strategies:

- Market development strategies often involve a new geographic market, such as moving to a new neighbourhood, a new town or even a new country.
- Market development can also involve selling the existing product to a new demographic group or target market. For example, Crocs were originally designed for use by boating enthusiasts before they were marketed to a wider range of people.
- Another example of market development is a company that begins selling directly to individual customers and families when the previous model was based on selling only to other businesses. Companies in the personal computer industry grew this way when individuals and families began to purchase computers that had initially been designed for office use.

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Figure 4. Selling existing products in a new market is classified as market development.

Credit: Michael H, Getty Images

Exam tip

How to apply the categories in the Ansoff matrix is not as obvious as it might seem. When asked to apply the Ansoff matrix in an exam context, it is therefore important to justify your choice of the classification of different strategies.

It is also helpful to draw the matrix and place the example from the case study in the matrix, as well as to explain it in a paragraph.

Finally, do not forget to consider the risks involved in each strategy as you analyse and evaluate the situation or make recommendations.

Diversification

Finally, diversification involves selling new products in a new market. In the bakery example, this would mean selling new types of baked goods in a new geographic market or to a new target market.

This is considered the riskiest growth strategy, as the business is involved in activities where it may have little knowledge. There is a chance of making costly mistakes.

If the new activity has some similarities with the existing business, it may be considered related diversification. For example, if the baker decides to open a chocolate shop in a new location there may be some similarities to their existing activity. Their expertise in terms of managing a small shop and satisfying customers will be useful in running the new business. If,

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on the other hand, they decide to sell furniture online, little of their existing expertise will be relevant. This is called unrelated diversification. Therefore, engaging in diversification that is unrelated to the original business is, in most cases, the riskiest growth strategy of all.

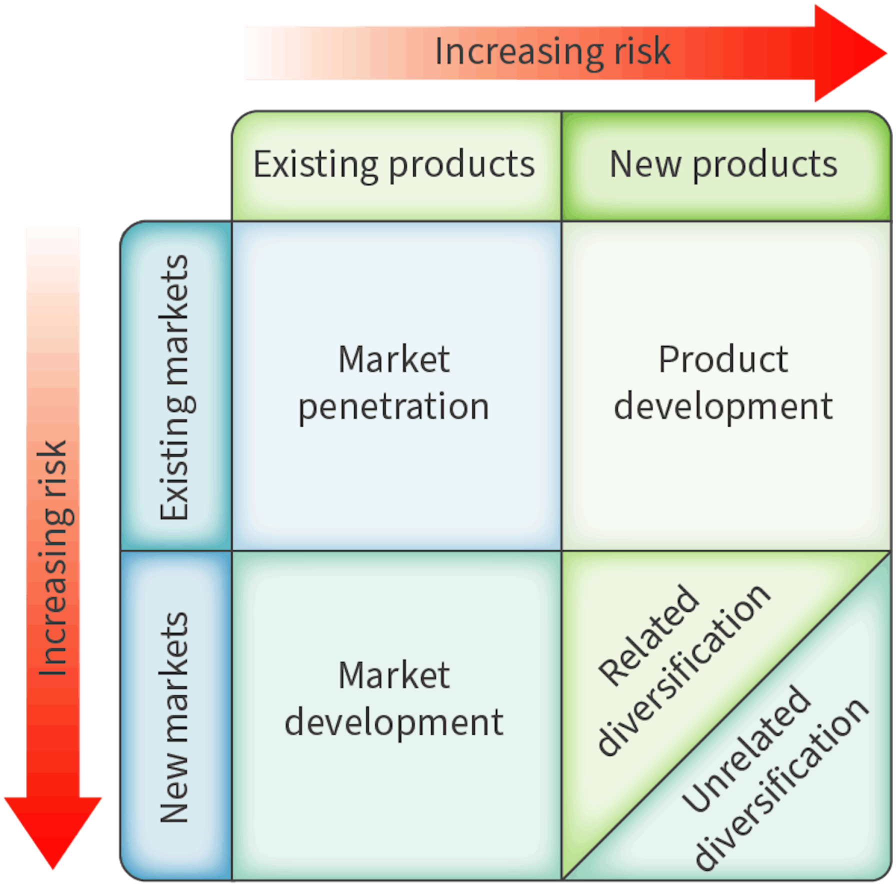

Figure 5. The Ansoff matrix showing the different diversification strategies.

More information for figure 5

The image is an Ansoff matrix, which is a 2x2 grid used to show different diversification strategies. The top axis represents products, with 'Existing products' on the left and 'New products' on the right. The side axis represents markets, with 'Existing markets' at the top and 'New markets' at the bottom. The matrix creates four quadrants: 1) 'Market penetration' in the top-left quadrant, indicating low risk based on existing products and markets; 2) 'Product development' in the top-right quadrant, focusing on new products in existing markets; 3) 'Market development' in the bottom-left quadrant, indicating the introduction of existing products into new markets; 4) The bottom-right quadrant is divided diagonally into 'Related diversification' and 'Unrelated diversification,' representing strategies with varying degrees of risk. An arrow indicating increasing risk runs diagonally across the matrix from 'Market penetration' to 'Unrelated diversification,' showing how risk increases both vertically and horizontally across the matrix.

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Activity

Learner profile: Knowledgeable
Approaches to learning: Thinking skills (critical thinking, transfer)

Read the following situations and identify how each activity would be positioned in the Ansoff matrix.

	Market penetration	Product development	Market development	Diversificatic
Zara is launching a new line of T-shirts to its current markets.				
Sony is launching a sale with a 5% reduction in price on the PS5.				
Tata Motors is selling its Nexo EV in a new market in South Africa.				
Danone is engaging in a joint venture with a dairy company in Mexico, to produce a new line of desserts.				

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3 section questions

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Question 1

Which is generally considered to be the riskiest strategy in the Ansoff matrix?

1. Diversification ✓
2. Market penetration
3. Product development
4. Market development

Explanation

Diversification is risky because the company is entering an unknown area of business, with both products and markets that are new.

Question 2

Which strategy involves selling more of the same product in the same market?

1. Market penetration ✓
2. Diversification
3. Product development
4. Market development

Explanation

The market penetration strategy is considered the least risky development strategy since it is selling the same products in the same market.

Question 3

Selling a new product in the same market is called:

Product development ✓

Accepted answers

Product development, Product development strategy

Also accepted

Student view

desarollo de productos, Desarollo de productos, Estrategia de desarrollo de productos, product devolpment

Explanation

Product development involves selling new products in the organisation's existing market, usually to existing customers.

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1. Introduction to business management / 1.5 Growth and evolution

Tool: Force field analysis (HL)

Tool: Force field analysis (HL) Tool: Force field analysis (HL)

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/tool-force-field-analysis-id-36540/print/) Assign

Kurt Lewin was a German academic who migrated to the United States in 1933. Much of Lewin's work focused on the dynamics of change.

In Section 1.1.6 (/study/app/business-hl/sid-351-cid-762729/book/tool-swotsteeple-analysis-id-36504/) you learned about how organisations must change in order to adapt to shifts in the external environment. But change can be difficult for individuals and entire organisations, generating fear and resistance, especially if communication is poor.

The force field diagram that Lewin developed can be used to study the factors that support or promote change (driving forces), and those that oppose or resist change (restraining forces). Each force is assigned a number, which is meant to indicate whether the force is relatively powerful (5) or weak (1). The framework for this is illustrated in **Figure 1**.

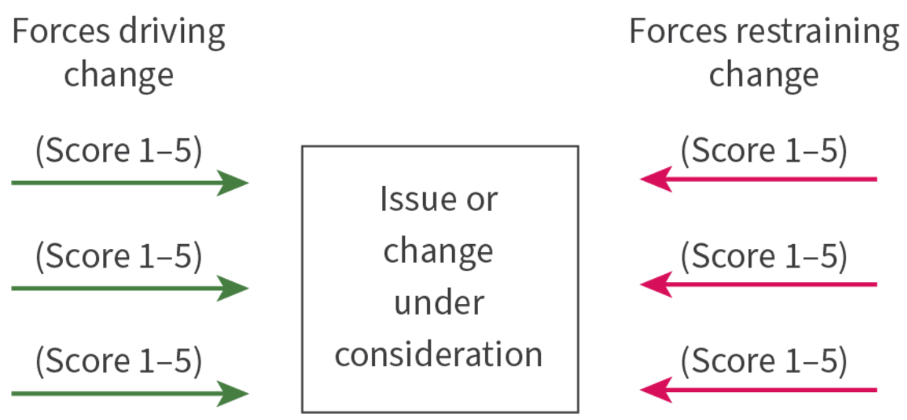

Figure 1. Force field analysis.

More information for figure 1

This diagram illustrates a force field analysis that shows forces driving and restraining change. To the left, there are arrows pointing towards a central box labeled "Issue or change under consideration," representing forces driving change. Each of these arrows is assigned a score ranging from 1 to 5, indicating their strength. On the right, there are arrows pointing away

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from the central box, representing forces restraining change, also scored from 1 to 5. The purpose of the diagram is to evaluate the factors that either support or oppose a particular change, with the scoring system used to assess the relative strength of each force.

[Generated by AI]

Once the diagram is complete, it is possible to identify which elements need to be modified in order to create change. Driving forces can be reinforced and restraining forces can be weakened. This will make it more likely that the desired change will occur.

For example, take a company that has invested in sophisticated new IT technology. Some employees may resist using the new equipment and insist that the old system works better. How can managers encourage employees to adopt the new technology? **Figure 2** shows how a force field analysis could be applied to this problem.

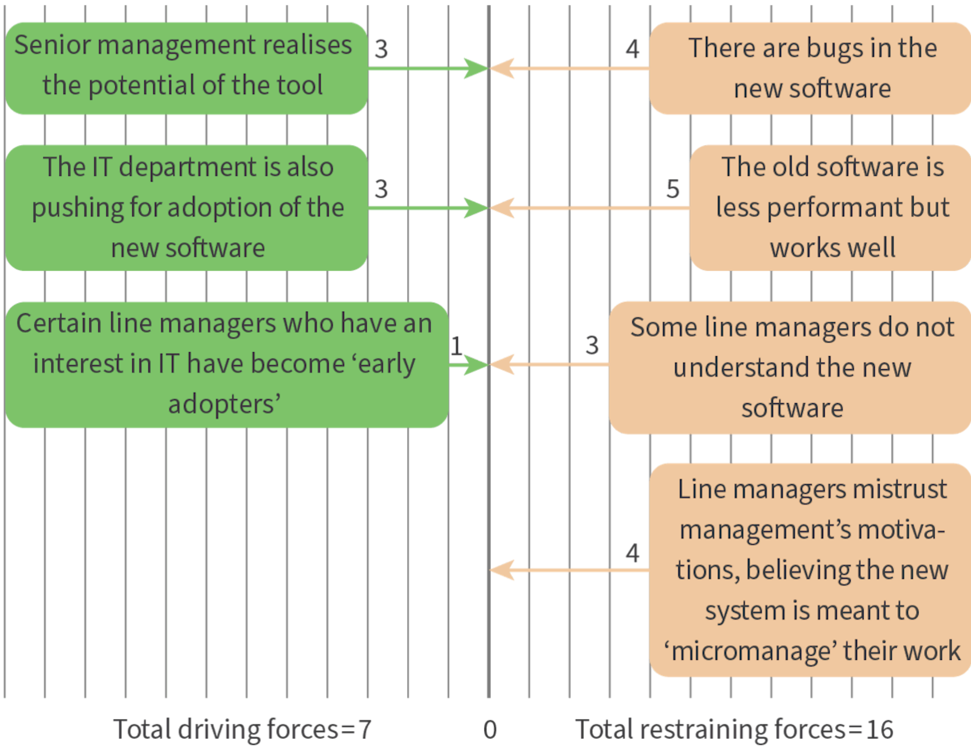

Figure 2. Application of force field analysis: driving and restraining factors for the introduction of new management software.

More information for figure 2

The diagram is a force field analysis depicting the driving and restraining forces for adopting new management software. On the left side, three driving forces are listed in green boxes with arrows pointing to the center: 1) "Senior management realizes the potential of the tool" with a weight of 3, 2) "The IT department is also pushing for adoption of the new software" with a

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weight of 3, and 3) "Certain line managers who have an interest in IT have become 'early adopters'" with a weight of 1. The total driving forces are 7.

On the right side, four restraining forces are listed in orange boxes with arrows pointing to the center: 1) "There are bugs in the new software" with a weight of 4, 2) "The old software is less performant but works well" with a weight of 5, 3) "Some line managers do not understand the new software" with a weight of 3, and 4) "Line managers mistrust management's motivations, believing the new system is meant to 'micromanage' their work" with a weight of 4. The total restraining forces are 16.

[Generated by AI]

According to the weights given in the diagram, driving forces are 7 while the restraining forces are 16. After carrying out the analysis, managers can consider how to amplify the driving forces and lessen the weight of the restraining forces.

Activity

Your school is planning to expand by opening a new branch in another city. Use the force field analysis to evaluate the driving and restraining forces for this change. Identify some evidence that could be used to determine the weightings of the forces.

Exam tip

Every time you are applying a force field analysis, remember:

- to put weightings on the factors
- that the weightings should be justified
- that the driving and restraining factors are not a list of advantages and disadvantages, although there may be some overlap
- that the driving factors are conditions that help change and restraining factors are blocking or hindering change

Evaluation of the force field analysis

Some of the uses and limitations for the force field analysis are represented in **Table 1** below.

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Table 1. Uses and limitations of the force field analysis tool.

Uses	Limitations
Graphic representation of complex information; easy to understand	Requires weights for qualitative factors; weights may be unscientific/biased, they need evidence to be valid
Helps develop better understanding of stakeholders and other factors that may prevent positive change; management can plan how to reduce or eliminate restraining forces or amplify driving forces	Depicting stakeholders as restraining forces may cause conflict

1. Introduction to business management / 1.5 Growth and evolution

Terminology exercise

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/terminology-exercise-id-36541/print/) Assign

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Interactive 1. Growth and Business Expansion.

1. Introduction to business management / 1.5 Growth and evolution

Checklist

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/checklist-id-36542/print/) Assign

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What you should know

By the end of this subtopic, you should be able to:

- define the following terms: (AO1)
  - economies of scale
  - diseconomies of scale
  - internal growth
  - external growth
  - merger
  - acquisition
  - takeovers
  - joint venture
  - strategic alliance
  - franchising
- explain why businesses are interested in growing (AO2)
- discuss the impact of growth for companies and countries (AO3)
- explain different types of internal and external economies and diseconomies of scale (AO2)
- distinguish between internal and external growth (AO2)
- examine different types of external growth (AO3)
- explain why businesses decide to stay small or to grow (AO2)
- evaluate advantages and disadvantages of growing and/or staying small (AO3)
- describe generative business practices (AO1)
- apply an Ansoff Matrix in a given context (AO2)
- apply a Force Field analysis in a given context (AO2)

Reflection

Teacher instructions

The goal of this section is to encourage students to pause at the end of the subtopic and to reflect on their learning. Students can use the questions provided below to guide their reflection. The questions encourage students to look at the bigger picture and to consider how the subtopic's contents might have impacted the way they view the subject.

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The following table shows you how each prompt aligns to the DP *Business management guide*:

Prompt #	Syllabus alignment
1	**Learner profile:** Caring
2	**Concept:** Creativity
3	**Learner profile:** Risk-takers
4	**Concept:** Sustainability

Students can submit their reflections to you by clicking on 'Submit'. You will then see their answers in the 'Insights' part of the Kognity platform.

Reflection

In this subtopic you looked at businesses big and small. You looked at advantages and disadvantages of growing a business, and methods by which such growth can be achieved.

Take a moment to reflect on your learning so far. You can use the following questions to guide your reflection. If you click 'Submit', your answers will be shared with your teacher.

1. Does the expansion of a business necessarily stand in the way of caring or pro-social practices? Can a big business still be caring?
2. Do you agree with the idea that when a business grows big it stifles creativity?
3. Growing a business always involves a degree of risk. How much risk-taking can be justified when merging with or acquiring a business?
4. In your opinion, do large businesses have more or less potential to contribute to environmental sustainability?

⚠ Once you submit your response, you won't be able to edit it.

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Submit

Rate subtopic 1.5 Growth and evolution

Help us improve the content and user experience.

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