

Knowledge organiser

LC Business

Unit 5 Business expansion

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Business expansion

Business expansion is when a business has achieved a level of success and reaches the point where they are **ready for further growth**. They begin to **seek out options** to increase sales and generate more profit. Expanding a business will involve **reaching out to new customers, strengthening their market position, and expanding into new markets**. They will need to **find ways to finance and grow the business**, which could be by **expansion from within**, or by **merger or acquisition** of other businesses.

Aggressive expansion

Aggressive expansion **reduces the dependence on other firms or supplies**. It **reduces risk** and improves efficiency by taking those businesses over.

- Acquire new products
- Acquire new technology
- Safeguard supplies
- Make more efficient use of the resources,
- Increase profits by making more efficient use of resources.

Defensive expansion

Defensive expansion is the need to expand to **ensure the continued survival** of the business.

- Reduce costs/ gain economies of scale
- Survive economic shocks
- Diversify
- Eliminate the competition

Psychological expansion

Psychological expansion is when businesses expand to **increase their power, influence and success**.

- Esteem needs/ earn the admiration
- Empire building increase the scope, power and influence
- Self-actualisation/ need for fulfilment.

Business can grow **organically**, which is from within or **inorganically** by acquiring or merging with other businesses.

Organic and inorganic

Organic growth involves:

- Increasing sales at home and abroad
- Exporting more goods
- Licensing their goods to be sold by other parties
- Offering new products or services
- Franchising the business.

Inorganic growth involves:

- Mergers - when companies voluntarily join together
- Takeover or acquisition - when one business takes control of another
- Alliance or joint ventures - when companies work together.

Types

Benefits of takeovers

- Diversification into new product areas
- Economies of scale
- Increase market share
- Acquire expertise
- The fast speed of inorganic growth

Disadvantages of takeovers

- Conflict - different management culture/ styles
- May lead to redundancies
- Employee motivation may suffer.

A takeover or acquisition refers to **one business taking control of another** by buying a majority of the share capital, e.g., 50.1% or more of voting shares. Takeovers are **often hostile** and can go against the wishes of the existing owner. Google has acquired more than 240 companies. In January 2021 they acquired Fitbit.

- Benefits and disadvantages
- ✓
 - ✓
 - ✗
 - ✗

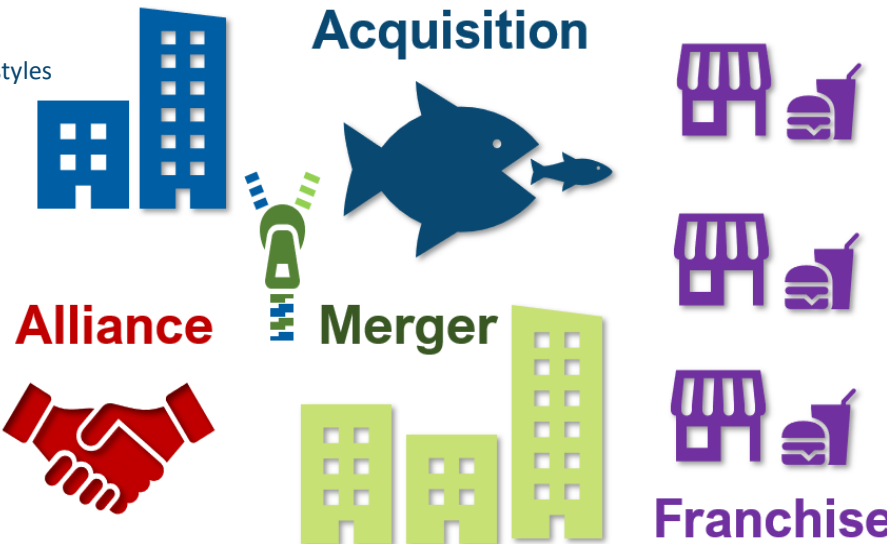
A **strategic alliance** is an **agreement between two or more companies** to achieve **common business goals** by sharing their strengths and resources. It is a **voluntary agreement**, and **each party remains a separate legal entity**. e.g., Google Cloud and Price Waterhouse Coopers (PWC) are in a strategic alliance to develop new work technologies.

Benefits of alliances

- The firms can share costs, skills and resources
- This **reduces risks** and is a low cost way to expand
- Either party can **end the arrangement easily** if they choose to do so.

Disadvantages of alliances

- Control is shared and could **lead to disagreements**
- Speed of expansion can be slow** shared decision making
- Profits must be shared**.



Expansion through franchising is a way to organically expand a business. A franchise is when an established business allows others to **buy the right to use its name**. The other business, known as a **franchisee**, must pay a fee and a percentage of sales. The franchisor wants to expand, and the franchisee wants to buy into an established name. **Examples:** McDonalds, Body Shop, Domino's Pizza, Subway, Starbucks etc.

Benefits of franchising

- Low capital investment by the franchisor** - the capital comes from franchisees.
- Expansion can be more rapid** - by using the franchisees' capital, outlets can be established in a short period of time
- The franchisee is an owner** - so will be more attentive and motivated than a manager
- Economies of scale** - as the franchise expands the franchisor will benefit from bulk buying.

Disadvantages of franchising

- Damage to the reputation** - the franchisor is taking a risk to reputation
- Loss of control** - the day to day is in the hands of the franchisee.

A **merger** is a **voluntary amalgamation** or joining together of two or more firms for their **mutual benefit**, trading under a common name. A **single new legal entity** is formed once it is approved by shareholders and neither has control over the other e.g., Avonmore Co-op and Waterford Foods merged to form Glanbia plc.

Benefits of mergers

- Diversification into new product areas**
- Economies of scale**
- The speed of inorganic growth** is a faster way to achieve higher revenues.

Disadvantages of mergers

- May lead to redundancies** - this can cause fear about job security and duplication of roles.

Benefits of business expansion

- Profits** – successful expansion will lead to higher profits.
- Recruitment** – more jobs may be created
- Easier to negotiate loans** - banks will have greater confidence in an expanding firm to repay its loans
- Lower prices to consumers** – economies of scale may allow firms to offer more competitive prices.

Potential downsides of business expansion

- Loss of ownership and control** – by selling shares or bringing in new partners
- Increased finance needed**. If financed by debt, this will increase the gearing
- Lack of communication in large, complex organisational structures**. Delays and misunderstandings may occur
- Redundancies** and industrial relations problems
- No personal touch** – a bigger firm may lose touch with consumers.

Importance to Ireland

- Expand economy
- Stimulate jobs
- Raises living standards

The implications of expansion



Business expansion



Importance of business expansion in Ireland



Business expansion is important to the **Irish economy** as sustained growth **expands the overall size of the economy**. This will **stimulate jobs** and **lower unemployment** rates. This in turn **helps to reduce income inequality**, raise **living standards** and increase **tax revenues**.

Reasons to expand the domestic market:

- ❑ **Bigger businesses can survive economic shocks** and are often involved in exporting, and are therefore not totally reliant on domestic markets
- ❑ Bigger businesses contribute a lot of **tax revenue** to the Government
- ❑ Improvement in the **balance of trade** and the **balance of payments** as businesses export goods
- ❑ **Creates employment and** reduces unemployment levels
- ❑ **Increases tax revenue** and reduces tax expenditure.

Reasons to expand into foreign markets:

- ❑ **Irish firms repatriate** some or all of their profits back to Ireland – this increases the wealth of Ireland
- ❑ **New technologies and skills** are learned in foreign markets and can be used in Ireland
- ❑ **Increases the profile** of Irish businesses and will help attract business to Ireland
- ❑ **Economies of scale** can be fully realised by large scale expansion into foreign markets.

€ **Finance for expansion**

Finance for business expansion is usually **long term**. It can be made up of **debt or equity** finance.

There are **benefits and drawbacks** of both **sources of finance**, and a business will need to weigh them up before they decide on the best course of action for their business.

Factor	Equity finance	Debt finance
Type of capital	Equity capital is made up of: Retained earnings which are the profits kept by the business and share capital , which comes from selling shares to investors, who get part ownership in the business and dividends.	Debt capital is made up of: Loans, mortgages, debentures and leasing or hire purchase.
Tax	The payment of dividends is not tax deductible	Interest payments are tax deductible
Security	The company does not have to provide security to raise finance. Security is usually a fixed asset	To secure a loan the business has to provide collateral , which is usually a fixed asset, that a lender accepts as security for the loan. It can be sold off if the loan is not repaid
Control	Control is diluted , when more shares are sold, existing shareholders have a loss of control	There is no loss of control , company assets are used as security
Costs	Equity capital is a cheap source of finance because it belongs to the business , it does not have to be paid back, and there are no interest repayments	Expensive , loan capital must be repaid with interest . Interest rates may be high
	Issuing shares is expensive , especially for companies listed on the stock exchange .	
Gearing	Low gearing Equity capital does not increase a firms gearing , and puts less pressure on the business	High gearing Loans increase the firm's gearing , which is the debt to equity ratio
Risks	Equity finance is low risk . If the business makes no profits, then the shareholders receive no dividend.	Debt financing is high risk . If no profits are made the loan and interest must still be repaid . If a firm cannot make the repayments it can be liquidated.

Competition law



Competition laws **help restrict expansion**, by **regulating anti-competitive behaviour** by companies that would damage the interests of society.

Dominant companies **may fix prices**, agree with competitors to **reduce production to raise prices**, and **limit competition** in the market.

The Competition Authority

The **Competition Authority** is a **state agency** set up to **prevent deals between firms** which may prevent competition and cause **unfair business practices**.

It investigates mergers, takeovers and monopolies and any anti-competitive practices. The Competition Authority will be informed if a merger or acquisition will **control more than 50% of the Irish market**.

EU competition law

The **European Commissioner for Competition** investigates large mergers and takeovers. They aim to **ensure a level playing field** for businesses, **prevent unfair business** practices within the 'Single European Market', while guaranteeing **choice and fair pricing** for consumers.

Exam question - 2021 Section 1

1. **Column 1** is a list of business terms.
Column 2 is a list of possible explanations for these terms.
(One explanation does not refer to any of these terms.)

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

Match the two lists by placing the letter of the correct explanation under the relevant number below.

1	2	3	4	5

Exam question - 2020 Section 3 Q5A

Apple takeover of Beats Electronics

In 2014, Apple confirmed an acquisition/takeover of headphone maker and music streaming service Beats Electronics for a reported fee of \$3 billion dollars. As part of its business expansion, Apple conducted market research.



- (A) (i) Explain what is meant by a **takeover**.
(ii) Outline **two** advantages and **one** disadvantage of a takeover as a method of **business expansion**.

(20)

Question	Possible Responses	Max Mark
5	A (i) A takeover refers to one business purchasing a controlling stake (50.1% or more of voting shares) in another business and 'acquires' it. Takeovers (or acquisitions) are often hostile and can go against the wishes of the existing owner.	5 5m (3 + 2)

Question	Possible Responses	Max Mark										
1.	<table border="1"> <tr> <td>1</td> <td>2</td> <td>3</td> <td>4</td> <td>5</td> </tr> <tr> <td>D</td> <td>F</td> <td>A</td> <td>E</td> <td>B</td> </tr> </table>	1	2	3	4	5	D	F	A	E	B	3,2,2,2,1
1	2	3	4	5								
D	F	A	E	B								

Exam question - 2022 Section 1 Ord

9. Explain the difference between a **Takeover** and a **Merger**.

A Takeover is:

A Merger is:

9.	Explain the difference between a Takeover and a Merger.	15m
	A takeover or acquisition involves one company buying out at least 51% of another company's shares. It can be a friendly or hostile situation.	8 (4+4)
	A merger is two companies coming together and operating as one. This is done for the mutual benefit of both companies.	7 (4+3)

Possible Responses

Advantage:
Increased Sales/Acquire new products:
An acquisition leads to the business acquiring new products and increasing their product portfolio. This can result in increased sales and profits.
Apple's takeover of Beats by Dr. Dre resulted in Apple now having Beats headphones as part of their product portfolio.

Market Share:
One advantage of an acquisition is that the business gains instant market share in an industry.
Apple became a market leader in the headphones industry and music streaming industry after acquiring Beats by Dr.Dre.

Acquire expertise/achieve synergies:
The business acquires the expertise of the staff from the company they have purchased.
Apple gained the expertise of the staff at Beats by Dr.Dre. This helped Apple develop Apple wireless headphones and the Apple music streaming service.

Disadvantage:
High cost associated with an acquisition:
An acquisition involves one business buying 51% of the shares in another company. This is an expensive method of expansion. There are also vast legal fees.
e.g. Apple paid \$3 billion dollars to purchase Beats by Dre.

Industrial Relations issues/ Conflict
An acquisition can be hostile. This is when a large percentage of shareholders are against the takeover. This can lead to conflict.
If the acquisition leads to redundancies it can cause industrial relations problems.

Exam question - 2020 Section 3 Q5C

- (C) Evaluate **debt capital** versus **equity capital** as methods of financing expansion for a business. (20)

Control:

- Debt capital – long term loans used to finance the business will not impact on control of the business.
- Equity - The issue of shares may dilute control of the business.

I feel equity capital is best because the current owners' control is not weakened. They maintain full control when expanding.

Interest Repayments/Dividends

- Debt Capital – Fixed interest repayments must be made e.g. Debentures, Fixed Dividends. e.g. 8% Preference Shares
- Equity capital – there are no fixed repayments. There is no obligation to ordinary shareholders. However, if dividends are routinely small or not paid, this may adversely affect share price.

I believe that equity capital is the best option because there are no loan repayments, therefore new profits are not used to repay the debt and interest.

Risk

- Debt Capital – high risk – the business is highly geared. Fixed interest repayments on debt capital must be made regardless of profitability. Increased risk of bankruptcy – more creditors, who may seek to have business wound up and assets liquidated to pay debts.
- Equity – equity capital is low risk. The business is lowly geared. The business has no long-term debt and no interest repayments. Business less likely to become bankrupt, as fewer creditors.

I believe it is best to use equity capital because it is a low risk option whereas debt capital is high risk and could lead to the business being forced to close.

Collateral

- Debt Capital – security is required from a financial institution when seeking a long-term loan.
- Equity capital – no security is required when using reserves or ordinary share capital.

Evaluation required.

Tax Implications

- Debt Capital - Interest repayments are tax deductible.
- Equity Capital - Dividends to ordinary shareholders are not tax deductible.

Evaluation required.



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