

Resources for Teachers

LC Business

Unit 5 Business expansion

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Business expansion

Definition

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.



Reasons for business expansion



Defensive expansion

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

Defensive expansion helps a business to:

- ❑ **Reduce costs and gain economies of scale**, reduction in the average cost per unit as the business becomes larger and more efficient. As costs fall the business will be able to charge more competitive prices and hopefully increase sales and profit
- ❑ **Survive economic shocks**, because bigger businesses are more likely to survive if there are economic downturns, new legislation or rises in the interest rate
- ❑ **Diversify** by entering new markets or produce new products with the aim of spreading the risk
- ❑ **Eliminate the competition** where a businesses may try to merge, or takeover another business to eliminate competition.



Reasons for business expansion



Aggressive expansion

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

Aggressive expansion helps a business to:

- ❑ **Acquire new products** by taking over the firm that has developed it
- ❑ **Acquire new technology** by taking over the firm that has developed it
- ❑ **Safeguard supplies** if the business is very dependent on certain supplies, then it makes sense to take over the supplier to guarantee these supplies in the future
- ❑ **Make more efficient use of the resources**, for example, better use of staff, office or building space, machinery and advertising
- ❑ **Increase profits** by making more efficient use of resources, lower costs and generate higher profits.



Reasons for business expansion



Psychological expansion

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

Psychological expansion provides:

- ❑ **Esteem needs**, where a business is motivated to expand by the desire to be a success, and earn the admiration of others
- ❑ **Empire building** - they have the desire to be '**empire builders**' and increase the scope, power and influence of the business
- ❑ **Self-actualisation**, or the need for fulfilment, drives a business to continually build on their success.



How to expand a business

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



How to expand a business

Organic growth

Organic growth is expansion from within the business, using their **existing products** or by **developing new products**.

It involves **increasing sales** both at home and abroad.

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 - allowing others to buy the right to use its name.



How to expand a business

Inorganic growth

Inorganic growth is **external growth**, and it occurs when a **company grows by merger or acquisition** of another business. It is a way for a business to grow more quickly.

Inorganic growth involves:

- ❑ **Mergers** - when companies **voluntarily join together** into one new company
- ❑ **Takeover or acquisition** - when one business **takes control of another** by buying a majority of the share capital
- ❑ **Alliance or joint ventures** - when companies **work together** to achieve common business goal.



Expansion by franchising

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.



Franchise



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Expansion by franchising



Benefits of franchising

- ❑ **Low capital investment by the franchisor** - the capital used to expand the business comes from franchisees. The franchisor can expand with minimal risk as the franchisor does not need a lot of finance to expand the business
- ❑ **Expansion can be more rapid** - by using the franchisees' capital, the franchisor is able to establish a large number of outlets in a short period of time
- ❑ **The franchisee is an owner** - so will be more attentive than a manager, and by franchising the business, the franchisor places the expansion of the business in the hands of people who are the owners, and therefore are motivated to make it work and to succeed
- ❑ **Economies of scale** - as the franchise expands the franchisor will benefit from bulk buying supplies. This will reduce costs and increase profits.

Disadvantages of franchising

- ❑ **Damage to the reputation** - the franchisor is taking a risk of the franchisee not running the business properly. Poor quality output or staff could damage the reputation of the business
- ❑ **Loss of control** - the day to day management of the franchise is in the hands of the franchisee.



Expansion by merger

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.



Expansion by merger

Benefits of mergers

- ❑ **Diversification into new product areas** - by joining together firms can diversify into new areas as they have access to each other's products, ideas and marketing which reduces the risk to the firm
- ❑ **Economies of scale** - as the business becomes larger, they will benefit from purchasing economies which reduces their costs
- ❑ **The speed** of inorganic growth is usually a faster way to achieve higher revenues. The firm acquires new capacity, experience and skills quickly and also acquires more consumer demand, and an immediate increase in their market share.

Disadvantages of mergers

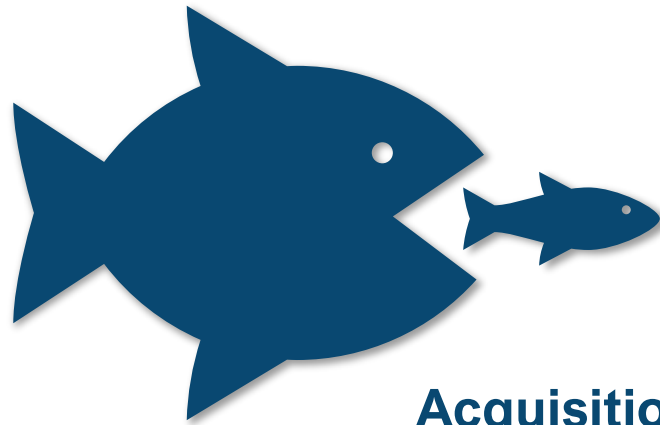
- ❑ **May lead to redundancies** - this can cause fear about job security and duplication of roles. Employee motivation may suffer.



Expansion by takeover or acquisition

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.

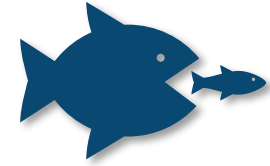
Takeovers are **often hostile** and can go against the wishes of the existing owner. Google has acquired more than 240 companies. In January 2021 they acquired Fitbit.



Acquisition or takeover



Expansion by takeover or acquisition



Benefits of takeovers

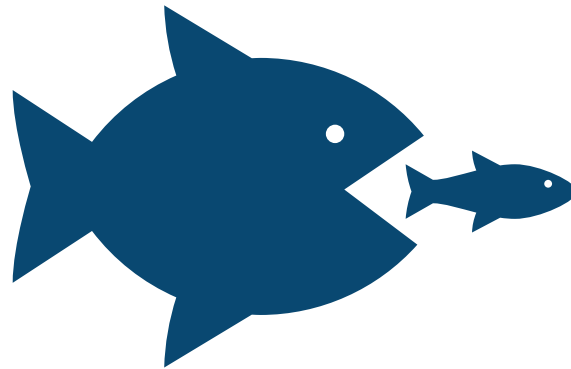
- ❑ **Diversification into new product areas** - by acquiring other firms, they can diversify into new product areas and increase their sales and profit e.g., Google bought Fitbit in 2021 diversifying into the smart watch industry
- ❑ **Economies of scale** - as the business becomes larger, they will benefit from purchasing economies which reduces their costs
- ❑ **Increase market share** - the business gains instant market share in an industry. Google gained the market share of Fitbit in the smart watch sector
- ❑ **Acquire expertise** - the business acquires the expertise of the staff from the company they have purchased. Google gained the expertise of Fitbit employees
- ❑ **The speed** of inorganic growth is usually a faster way to achieve higher revenues. The firm acquires new capacity, experience and skills quickly and also acquires more consumer demand, and an immediate increase in their market share.



Expansion by takeover or acquisition

Disadvantages of takeovers

- ❑ **Conflict** - different management culture and styles can be difficult to introduce. This can lead to poor industrial relations
- ❑ **May lead to redundancies** - this can cause fear about job security and duplication of roles.
- ❑ **Employee motivation** may suffer.



Expansion by strategic alliance

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.



Strategic alliance



Expansion by strategic alliance



Benefits

- ❑ **The firms can share costs**, skills and resources and they benefit from the sharing of resources and talent that otherwise they would not have access to
- ❑ **This reduces risks** and is a low cost way to expand, and skills and risks are shared
- ❑ Either party can **end the arrangement easily** if they choose to do so.

Disadvantages

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



Examples: MacDonal'd's and Coca Cola, and United Airlines and Starbucks. Starbucks will supply its coffee to United Airlines who in turn serve the coffee on board to passengers. The cup contains both Starbucks logo and United Airlines logo.



Implications of business expansion



Benefits

- ❑ **Profits** – successful expansion will lead to higher profits. This will be due to entering new markets and economies of scale
- ❑ **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. However, if a monopoly arises, they may raise prices.



Implications of business expansion



Potential downsides

- ❑ **Loss of ownership and control** – selling shares or bringing in new partners may reduce level of ownership and control
- ❑ **Increased finance needed** – expansion requires a lot of additional finance. Many mergers and takeovers are financed by debt. This will increase the gearing of a business
- ❑ **Lack of communication** – large organisations may need more complex organisational structures. Communication delays and misunderstandings may occur
- ❑ **Redundancies** – a rationalisation programme usually follows a merger. This may result in redundancies and industrial relations problems
- ❑ **No personal touch** – a bigger firm may lose its personal touch with consumers.



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**.

*Expand economy
Stimulate jobs
Raises living standards*



Importance of business expansion in Ireland

The domestic market



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.



Glanbia example

Glanbia has its headquarters in Kilkenny and is listed on the Irish and London stock exchanges. It was formed through a **merger** of Avonmore Foods and Waterford Foods and was renamed Glanbia in 1999. The food group employs more than 3,000 people, and has manufacturing and processing facilities in seven countries, with sales and technical support locations in fourteen countries.



Importance of business expansion in Ireland



Expansion into foreign markets

By entering foreign markets, Irish firms can expand their businesses further, and this in turn **benefits the Irish economy**.

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.

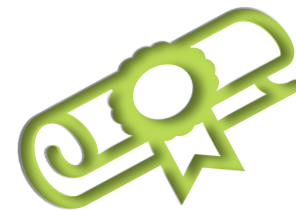
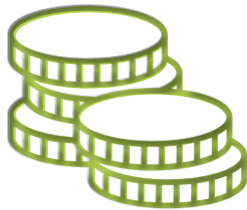


Finance for expansion

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.



Equity finance



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.

Benefits

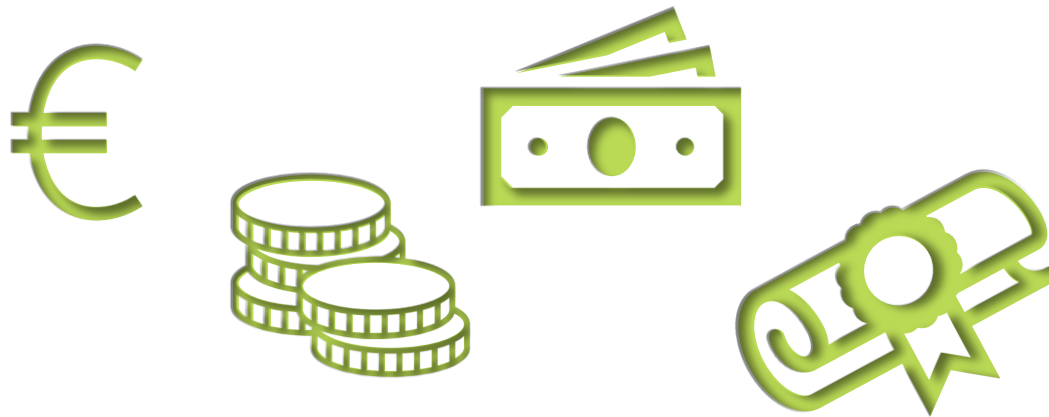
- ❑ **Cost** – equity capital is a **cheap source of finance**, it does not have to be paid back, and there are no interest repayments
- ❑ **Security** – the company **does not have to provide security** to raise finance. Security is usually a fixed asset
- ❑ **Gearing** – equity capital **does not increase a firms gearing**, and puts less pressure on the business
- ❑ **Risk** – equity finance is **low risk**. If the business makes no profits, then the shareholders receive no dividend.



Equity finance

Drawbacks

- ❑ **Control** – when **more shares** are sold, existing shareholders have a **loss of control**
- ❑ **Tax** – the payment of dividends is **not tax deductible**
- ❑ **Issuing shares** - is **expensive**, especially for companies listed on the **stock exchange**.



Debt finance

Debt capital is made up of:

Loans, mortgages, debentures and leasing or hire purchase.

Benefits

- ❑ **Control** – there is **no loss of control** in the business
- ❑ **Tax** – interest payments are **tax deductible**.



Drawbacks

- ❑ **Cost** – loan capital must be **repaid with interest**. Interest rates may be high
- ❑ **Gearing** – loans **increase the firm's gearing**, which is the debt to equity ratio
- ❑ **Security** – 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
- ❑ **Risk** – 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.



Comparison of types of finance

The table below **compares equity and debt finance** in terms of the amount of finance, the costs, risks and how it affects the control of the business.

Factor	Equity	Debt
Amount	Large amount of finance	Large amount of finance
Control	Control is diluted , more shares sold equals more shareholders	No loss of control , company assets are used as security
Costs	Cheap, finance belongs to the business , dividends made if profits increase	Expensive, loans come with interest to be paid
Risks	Low gearing This is lowly geared.	High gearing This is highly geared.



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.

EU competition law

Stops unfair practices

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.

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**.

Example: The Competition Authority blocked Eason's takeover of the book wholesaler Argosy.



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



Answer - 2021 Section 1

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 - 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)



Answer - 2020 Section 3 Q5a (ii)

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)



Answer - 2020 Section 3 Q5A (ii)

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.

Max Mark
15
3 x 5m (3+2)



Exam question - 2020 Section 3 Q5C

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



Answer - 2020 Section 3 Q5C

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.

**Max
Mark
20**

4 x 4m
(2 + 2)

Evaluation
(0,2,4)

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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- ✓ **Important definitions** highlighted in every section
- ✓ **Detailed revision notes** organised by topic
- ✓ **Original diagrams** aimed to clarify topics and promote understanding
- ✓ **Audio files** to make revision more flexible
- ✓ **Quizzes** provided at the end of each topic aimed at improving retention
- ✓ All available **exam questions** included by topic, helping to focus the study.

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