Chapter 22

Identifying Business Ideas

Higher Level

Past Exam notes (For this chapter)

WHAT ARE THE REASONS FOR EXPANSION?

There are 3 reasons for a business to expand. These are

1. Defensive (they have to)
2. Aggressive (They want to)
3. Psychological (Its in their mind)

Past Exam Questions
2012 Q7 C

Defensive

A business may have to expand to ensure it survival. So they have to expand. Thiis is known as defensive and includes the following

1. Reduce costs

To help Generate economics of scale. These are the benefits that a business gets as it becomes larger and more efficient. It helps to reduce the average cost thus a more competitive price can be charged.

Economics of Scale – This when the unit price of a product reduces as you buy more of it.

2. Survive Economic shocks

bigger = stronger and business are able to survive upset in the business environment
E.g Recession, increase in interest rates and new legislation

3. Reduce risk

A firm may produce new products and/or enter new markets. This is to spread the risk (not have all eggs in one basket). This is known are diversification
E.g Toyota's product include trucks, cars, forklifts

4. Protect raw material suppliers

Business may take over their supplier of raw materials. This is do they can secure their source of raw materials. This is known as reverse integration. Fyffes purchase their own banana plantation

5. <u>Protect labour suppliers</u>

Larger firms can afford to recruit more qualified and experienced staff They do this by offering better pay, conditions and promotion prospects

6. <u>Eliminate competition</u>

Firms will often try to merge with or take over firms. They do this to eliminate the competition. This means they the business gets more of the market share

Aggressive

The business may want to expand because they want to. The following are some reason for Aggressive Expansion

1. <u>Increase profits</u>

As a firm grows it can make more use of it resources thus lowering costs and increasing profits. If it grows enough it can gain a dominant/monopoly position in the market. EU competition can also stop this

2. <u>Acquire new products</u>

If a rival business, make a new product it can be quicker to take over that business than spend time developing a new product. They may also expand to acquire new technologies
Unilver & Ben a Gerry's (Ice cream market

Psychological

1. <u>Empire building</u>

To try and create the largest business in their area, industry or Country. Maslow Hierarchy of needs – esteem needs. Example Donald Trump

2. <u>New challenges</u>

Many entrepreneurs need new projects/challenges. This may be developing new products or takeover. This helps them becoming bored and restless

WHAT ARE THE METHODS OF BUSINESS EXPANSION

A business that wants to grow can do it in two ways

1. Organic Growth – a Firm expands gradually using existing products or developing new ones
2. Inorganic growth – Means forming a strategy with or by engaging in mergers and acquisitions of another business

Organic

Past Exam Questions
2022 ABQ B

Through this option a firm can expand in the following ways

1. Increase domestic sales
2. Exporting
3. Licensing
4. Franchising

1. Increase Domestic Growth

This is low risk because 1. The product is already known, 2. There's now extra cost for R&D, 3. Skilled Staff. However, Ireland is a small country so growth many be limited and expansion may be slow

2. Exporting

Exporting means selling goods and service outside of Ireland (the money stays in Ireland). It can be very profitable and does not affect ownership. It can take years to generate profits (Training, Marketing Mix, Product methods). The risk is also greater – unknown markets

3. Licensing

This means allowing other firms to sell an invention/design in return for payment of a license fee or royalty. The firm selling the license (Licensor) it can be a fast low cost and low risk expansion, but loss of profits and control can be lost. For the firm getting the license it can be a low expansion method, but a license fee must be paid

- E.g Man utd

4. Franchising

Past Exam Questions
2013 Q6 B

This means renting (franchiser) of a complete business idea including name logo and products to someone else (Franchisee). It is growing in popularity in the retailing and service industry. E.g McDonalds, Munchies

Franchiser

It is a fast low-cost low risk expansion method. There is a loss of profits and control. There is loss of reputation of the whole business

Franchisees

Benefit from a proven business idea with an existing brand image and reputation. They also get training and advice from the franchiser. They bear the risk and financial burden of the new outlet with little control on how to manage it. Have to pay a royalty fee based on sales

Advantages of Franchises

Past Exam Questions
2018 Q5 A
2011 Q6 A

1. Low capital investment needed

It is a form of expansion which requires, low capital investment by the franchisor as the capital used to expand the business comes from franchisees. Very suitable/popular in the current economic climate as a form of expansion.

2. More rapid expansion for the franchisor

Franchising permits a more rapid expansion. By using the franchisees' capital, the franchisor is able to establish a large number of outlets in a short period of time. Rapid expansion can be achieved without incurring the overheads and costs associated with opening company-owned restaurants.

3. Motivate people to run the franchisor

An owner will be more attentive than a manager. This is the central point which makes franchising so attractive. The franchisor can be assured that the person operating its restaurant will be "attending to business" as much as they would. By franchising the business, the franchisor places the expansion of their business in the hands of people who are motivated to make it work and are therefore more likely to succeed.

4. Economies of scale exist.

There is strength in numbers. The successful franchisor can command deals with various suppliers. Can control supplies to various franchisees. The cost savings can increase the franchisor's profits.

5. Grater profits generated

Because there is a smaller capital investment required the franchisor's profits are generated on a much lower capital investment even though the revenue from franchised restaurants may be less than that received from company-owned restaurants.

6. Less management required

A franchise system requires less management than a company owned chain of restaurants. Hiring, motivating and retaining competent staffing are all functions handled by the franchisee, not the franchisor.

Disadvantages

Past Exam Questions
2018 Q5 A

1. Control is lost over the day-to-day management of the franchise businesses.
2. The reputation of the whole business could be affected by the actions of one franchisee poor quality standards
3. A training programme for franchisees will be required. This will be expensive and time consuming.
4. Franchisees will have to be monitored on a regular basis.

6. Develop new product/Diversification

This may be used when a product is coming to the end of its life cycle. It is the increasing the range of products services that are offered by a business. Apple (iphone, ipads, iwatch). It's a popular method of expansion as there are very high. But it is also high cost and high risk as many new products fail. It can also take a long time to get from a development stage to a launching stage

Organic

> **Past Exam Questions**
> 2022 ABQ B
> 2015 Short Question 5
> 2013 Q6 B

1. Form a strategic alliance

This occurs when two or more firms agree to co-operate in the establishment of a project of business for mutual benefit. The remain separate legally identities but share skills and resources. It can be a fast and low risk method of expansion. Profits and control may be shared. Greater communication and shared decision making may slow down expansion. E.G Glanbia and French company Yoplait

Benefits

> **Past Exam Questions**
> 2019 Q6 B

1. It is a voluntary agreement.
2. Each party remains a separate legal entity.
3. Skills and risks are shared so both parties gain.
4. Access to an established network of suppliers and distributors.
5. It is a quick low-cost way to expand into foreign markets.
6. The partners benefit from the sharing of business networks.
7. Increased resources.

Risks

1. Corporate secrets/competitive advantages can be lost.
2. Alliances may not be equal. One side may contribute more than another.
3. Alliances are temporary so careful change. management is needed to ensure that full-time staff are not alienated as they will be relied on when the alliance is over.

2. Acquire/takeover

> **Past Exam Questions**
> 2020 Q5 A (i)
> Short Question 5
> 2013 Q6 B
> 2011 Q6 A (i)

This occurs when one firm buys at least **51% of voting shares** of another firm and gain majority control to acquire it. Takeovers are hostile if it takes place against the best wishes of management. The **acquiring company** absorbs the other company, which loses its identity after the acquisition and becomes part of the acquiring company. The cost of the takeover can be very expensive. Subsidiaries are companies where another company owns 50% or more of their shares
E.G Google bought youtube for 1.65 bn

Advantage of a Takeover

Past Exam Questions
2020 Q5 A (ii)
2011 Q6 A (ii)

1. Increased Sales/Acquire new products

A Takeover leads to the business acquiring new products and increasing their product portfolio. This can result in increased sales and profits.
For example Apple's takeover of Beats by Dr. Dre resulted in Apple now having Beats headphones as part of their product portfolio.

2. Market Share

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

3. Acquire expertise and achieve synergies:

The business acquires the expertise of the staff from the company they have purchased. For example 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.

4. Diversification into new products

It is a defensive strategy as the merger may involve diversification into new product areas, which reduces the risk of the firm 'having all its eggs in the on basket'.

Disadvantages

Past Exam Questions
2020 Q5 A (ii)
2011 Q6 A (ii)

1. 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.
For example Apple paid $3 billion dollars to purchase Beats by Dre.

2. 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.

3. Lack of cooperation between the two companies

Different organisational cultures between the businesses can lead to conflict between competing management teams who are used to their own work practices and management styles and systems. This may cause a lack of co-operation within the new larger merged entity, leading to poor management decision making.

3. <u>Mergers</u>

<u>Past Exam Questions</u>
2015 Short Question 5
2013 Q6 B
2011 Q6 A (i)

It is a **friendly or voluntary amalgamation** of two or more businesses for their **mutual benefit**. It involve **mutual consent**. A **single new legal entity** is formed. The state competition Authority/EU commission may investigate proposed takeover and mergers to make sure a monopoly is not created
E.G AIB was formed from a merger of smaller banks, Glanbia plc was formed in out of the merger of Avonmore Foods plc and Waterford Foods plc

Acquisitions and mergers allow a business to spread the business risk by diversifying into new products. They can gain access to new products, markets, patents and brand names. IT can be expensive and require large amounts of long-term finance. Iindustrial relations problems may also arise

SOURCES OF FINANCE FOR BUSINESS EXPANSION

These include the following – 1. Grants, 2. Equity, 3. Debt finance (Loans & Debentures), 4. Sale and lease back

It important that if a business wants to expand that they know where the money is coming from

1. <u>Grants</u>

There is no loss of control or ownership with grants. No dividends, interest or repayments have to be made (if conditions are met). Main sources are form the Local Enterprise Office (Small Firms), Enterprise Ireland (Exporting Firms), IDA Ireland (Foreign firms in Ireland) and The European Union

2. <u>Equity</u>

This is finance that is provided by the owners of the business. It can be raised by - Retained Earnings – Profits put back into the business, Entrepreneur investing more of their money, Bringing a new partner into the business, or Issuing (Selling) Shares

3. <u>Debt Finance</u>

Before a company take out a long-term debt, they have to make sure that they can pay it back Plus the interest on the loan. Debentures are long term fixed interest loans secured on an asset (Premises). There is no loss or control in the business. Security is usually required, and repayments must be made of time even if a profit is not made. Largo foods (Makers of hunky dory and king crisps) Spent 62m taking over rival Tayto crisps. This was financed by a debenture

4. <u>Sale and lease back</u>

This is a contract to raise cash by selling a piece of property and then leasing it back form the buyer on a long-term basis. This also the company to keep trading while also raising cash. Celtic helicopter sold an aircraft to a Russian company for millions of euro and then leased it back of the Russian company

You can also venture capital (like the dragons Den) and a long-term loan (Source of Finance)

EQUITY VS DEBT FINANCE

Past Exam Questions
2020 Q5 C

Amount

Equity finance	Large amounts are available depending how attractive the Business is
Debt finance	Large amounts are available if the risk is low and security is Available

Cost

Equity finance	Is cheap as payment of dividends to ordinary shareholder are optional (But if not paid the share price will drop leading to unhappy shareholders)
Debt finance	Is expensive interest and principal must be paid on time. These can be high

Ownership/ 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
Evaluate	In my opinion I feel equity capital is best because the current owners' control is not weakened. They maintain full control when expanding.

Risk

Debt Capital	This is high risk as the business is highly geared. This is because the business has to pay Fixed interest repayments on debt capital 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.
Evaluate	In my opinion 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.

Interest Repayments and Dividends

Debt Capital	Fixed Interest repayments must be made e.g. Debentures, Fixed Dividends. For example 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 affect share price.
Evaluation	In my opinion 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.

Collateral

Debt Capital	For debt capital security is required from a financial institution when seeking a long-term loan. This will be sold to repay the debt if the company cant repaid it
Equity capital	Equity capital requires no security is when using reserves or ordinary share capital. This is because the money is already there or been raised to be reinvested into the business

Tax Implications

Debt Capital - Interest repayments are tax deductible.

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

IMPLICATIONS OF EXPANSION FOR A BUSINESS

The following are some of the implications for expanding a business

1. Profitability — short term profits may fall (Costs) but in the long term the company can benefit from economies of scale
2. Organizational Structure_ This may be changed. The bigger the company become the harder it is to manage
3. HRM — Recruiting more staff (Or redundancies – Merger or acquisition) HR manager may need to be employed
4. Marketing — Expanding business can offer larger range of products. They can also spend more on marketing and develop new products. Marketing also become complex as there are different marketing mixes
5. Legal — Business may change their legal structure (Sole trader to Limited company)
6. Finance — Need to raise finance to expand. Larger companies will find it easier to raise new finance

7. Ownership New owners/shareholders may come into the business this may make the original owners unhappy

Anita Roddick (Body shop) regrets selling shares on the stock market as the new shareholders were only interest in making a profit and not the ethical values of the business. This led to her resigning from the company

REASONS FOR STAYING SMALL

Not every business wants to grow and expand and many owners who want to keep their business small. Here are some of the advantages and disadvantage of staying small

Advantages of staying small	Disadvantage of staying small
1. Easier to manage and keep control	1. Cost tend to be higher
2. Less stress	2. Profits tend to be smaller
3. Staff relations and communications are easier	3. Less opportunity in investing for the business
4. There is a stronger sense of team spirit and motivation	4. Small firms have to struggle more
5. A better personal service	
6. Many businesses can remain competitive	

THE SHORT TERM AND LONG TERM IMPLICATIONS OF BUSINESS EXPANSION

1. Organisation structure

Past Exam Questions
2013 Q6 C

Short-term Implication

As the business expands a new structure may be required as more activities may need to be organised. The business needs a formal organisation structure such as a functional structure which clearly identifies the chain of command and span of control within the business.

Long-term Implication

This functional organisation structure may be replaced by a geographic structure to facilitate expansion into new geographic regions or a product structure to facilitate the increased range of products. As businesses grow they rely more on specialist support functions and personnel.

An IT Department and/or a HR Department may be introduced to assist line managers and thereby increase efficiency.

2. Product mix

Short-term Implication

As the business begins to expand the product mix and portfolio of products available for sale will increase to suit the wider range of market segments targeted by the business. Any products acquired during growth that do not fit the company's business model may be sold off. Wider product range makes the management of the marketing mix more difficult.

Long-term Implication

Mergers and acquisitions will allow the business to satisfy the various niche markets. This will result in further investment in R&D and product development in order to satisfy the wide range of market segments the business is selling into. Different marketing mixes may have to be put in place for the wider range of products.

3. Profitability

Short-term Implication

Short-term restructuring costs. Initially profits may fall as a result of the increased expenditure on assets such as machinery, buildings, IT and R&D, premises. Diseconomies of scale due to lack of proper management and duplication of work.

Long-term Implication

As the business consolidates its position during business growth and maturity, sales and revenues should increase leading to greater profitability. The business may develop economies of scale such as bulk buying, increased market power, automation and elimination of duplication leading to efficiencies and greater profitability. Greater profits will allow for higher dividends to shareholder encouraging further investment and the building up of reserves. Profits could also fall in the long term due to diseconomies of scale (poor management, lower employee motivation resulting from very big business). Disconnection between management and employees.

4. Employment

Short–term Implication

Initial expansion may result in rationalisation as the business attempts to remove wasteful duplication of roles. This can lead to compulsory redundancies. The uncertainty/fear about the future can demotivate staff and management and cause industrial relations problems (different pay and reward systems). Work relationships could be stressful, due to uncertainty. More training required for staff.

Long-term Implication

As the business consolidates its position during business growth and maturity its HR department may be able to engage in a recruitment drive for new employees as part of its manpower planning. The business may be able to motivate workers through higher wages and better working conditions. Staff training and development opportunities could open up promotion possibilities for staff improving staff morale and industrial relations. Bigger businesses could attract highly qualified personnel. Employees may become alienated and demotivated in a very large business, leading to inefficiencies.

Chapter 22

Business Expansion

Higher Level

Past Exam Questions (For this chapter)

SHORT QUESTIONS

2018 – Question 3

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

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

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

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

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

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

2015 – Question 5

Illustrate the difference between a merger and a strategic alliance.

LONG QUESTIONS

2023 – Question 8

Netflix on Sky

Netflix and Sky, the two entertainment giants will continue their successful subscription package.

(B) (i) Contrast a strategic alliance and a merger as methods of business expansion.

(ii) Evaluate one benefit and one challenge for a business of forming a strategic alliance. (20)

2023 – Question 8 Deferred

Read the information supplied and answer the questions which follow.

Gym+Coffee to add four new outlets as expansion continues

The Cork based Gym+Coffee clothing retail business is enjoying significant growth in 2022 on the back of new store openings. The athleisure brand, which provides a range of activewear, cur rently operates 13 outlets and is aiming to open a further four in 2023.

Adapted from irishexaminer.ie

(A) (i) Distinguish between organic growth and inorganic growth in a business.

(ii) Discuss the reasons, other than increasing profit, for expansion of a business. (25)

(C) Contrast Debt Capital and Equity Capital as sources of finance for business expansion. (15)

2022 – ABQ

(B) Evaluate the two methods of expansion used by Mike's Pizza. (20)

2020 – Question 5

Read the information supplied and answer the questions which follow.

Apple takeover of Beats Electronics

In 2014, Apple confirmed an acquisition/takeover of headphone maker and music streaming serv ice 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)

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

2019 – Question 6

(B) (i) Outline the benefits and risks of a strategic alliance as a method of business expansion.

(ii) Explain one other method of business expansion. (25)

2018 – Question 5

Read the information supplied and answer the question which follows.

Supermac's is an Irish fast food franchise which was set up in Ballinasloe 40 years ago by Pat McDonagh. In May 2017 Supermac's took home the award for "Franchise of the Year" at the Irish Franchise Awards. Source: www.hospitalityireland.com

(A) Outline the advantages and disadvantages for a business in the fast food sector of choosing franchising as a method of business expansion. (20)

2013 – Question 6

(B) 'For a business to survive it needs to grow and expand.' Evaluate two methods of business expansion. (20)

(C) Discuss the short-term and long-term implications of business expansion using the following headings: Organisation Structure; Product mix; Profitability; Employment. (20)

2012 – Question 7

Read the information supplied below and answer the question which follows.

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

(C) Discuss the possible reasons for business expansion and growth at SuperToys Ltd. (20)

2011 – Question 6

Read the information supplied and answer the questions which follow.

Kilronan Ltd produces a range of chilled food products. Made from natural ingredients, the firm's award winning products have become household names. It is now one of the leading brands in Ireland and supplies all the major supermarket chains. Kilronan Ltd is considering either a 'merger' or a 'takeover' as a method of expansion within the Irish market. It is also considering how it will finance growth.

(A) (i) Illustrate the difference between a merger and a takeover as methods of business expansion.

(ii) Discuss the benefits and risks of a merger as a method of expansion for Kilronan Ltd. (25)

2010 – Question 6

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

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

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