Chapter 16 - Business Expansion

1 (2018)

3.			(i) An acquisition (takeover) is a form of ***inorganic growth*** (ii) In a merger, ***a new legal entity is created.*** (iii) In a strategic alliance, businesses share expertise, and the agreement is ***temporary***. (iv) Expansion can be financed by debt capital which ***does not include*** ordinary share capital. (vi) Economies of scale are defined as ***unit (average) cost*** decreasing as output increases.	10 3+2+2+2+1

2 (2015)

5			**Illustrate the difference between a *merger* and a *strategic alliance*.** A merger is a friendly or voluntary amalgamation of two or more businesses for their mutual benefit. A single new legal entity is formed. Example: Glanbia plc was formed in 1997 out of the merger of Avonmore Foods plc and Waterford Foods plc. A strategic alliance: When two or more independent firms agree to co-operate and share resources and expertise for the mutual benefit of all parties involved. The firms remain completely independent legally and each firm maintains its own separate trading identity. Example: Starbucks partnered with Barnes and Nobles bookstores in 1993 to provide in-house coffee shops, benefiting both retailers / Mazda and Toyota sharing technology resources etc.	10

6	**B**	(i)	**Benefits** • It is a voluntary agreement. • Each party remains a separate legal entity. • Skills and risks are shared so both parties gain. • Access to an established network of suppliers and distributors. • It is a quick low-cost way to expand into foreign markets. • The partners benefit from the sharing of business networks. • Increased resources. **Risks** • Corporate secrets/competitive advantages can be lost. • Alliances may not be equal. One side may contribute more than another. • 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.	15 At least 1 of each required
6	**B**	(ii)	**Mergers** Two business join together and create a new legal entity. Not only does the firm acquire new capacity, experience and skills quickly but it also acquires more consumer demand quickly (market share increases immediately). **Acquisitions** One business purchases a controlling stake (51% or more of voting shares) in another business and 'acquires' it. Acquisitions are often hostile and can go against the wishes of the existing owner. **Franchising** 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. **Licensing** **Exporting/finding a new market** **Diversification** **Organic Growth**	10

Question 6

(A)	Outline the internal **and** external sources of new product ideas for technology companies like Google.	2 internal sources@ 5 marks (2+3) 2 external sources@ 5 marks (2+3)	20
(B)	Evaluate **two** methods of business expansion.	2 methods @ 10 marks (2+3+3+2)	20
(C)	Discuss the short- term **and** long- term implications of business expansion using the following headings: *Organisation Structure;* *Product mix;* *Profitability;* *Employment*	4 @ 5 marks (4+1)	20

(A) Outline the internal and external sources of new product ideas for companies like Google.

Internal

- Brainstorming sessions. This involves people from different areas of the business coming together and creatively thinking up new ideas. Some of these ideas are rejected while some are giving further consideration. The diversity of the team assists in the creativity process.

- Sales personnel**.** Market research or feedback from sales representatives is a major source of product innovation and new product ideas.

- Ideas from employees through suggestion schemes or suggestion boxes. A good idea may be rewarded by a bonus. A good intrapreneurial culture exists within Google fostering innovation e.g. “Google’s "20 Percent Time" strategy gives engineers time and space to work on their own projects.

- The R&D department may discover a new product/or improve an existing product through research and development, for example Google spent in the region of 13% of its revenue ($3.7 billon in 2011) on research and development.

External

- Monitoring competitors and copying some of their product ideas, while being mindful of patent and copyright law e.g. Samsung and Apple.

- Import substitution where a product that is currently being imported is substituted by a home produced product of a similar quality or price.

- Use a Market Research company to identify gaps in the market and market trends. Companies can then exploit these gaps or niche markets.

- Customer Complaints/Feedback could result in changes in or further developments of existing products.

- Foreign travel or trade shows such as the Dublin Web Summit could inspire companies to make a new product for the domestic market.

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

A merger:

- A **friendly or 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.
- E.g. Irish Permanent and Trustee Savings Bank merged to form Permanent TSB. Avonmore Co-op and Waterford Foods merged to form Glanbia plc.
- 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'.
- Costs will be lower because of economies of scale and the sharing of costs and resources.

Evaluation: **Own judgement required**

A takeover:

- This occurs when one company **purchases 51% or more** of the shares in another company in either a hostile or friendly manner.
- 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.
- Eircom took over Meteor mobile phone company for €420 million. Google bought the popular online video site YouTube for $1.65 billion. Google has acquired Motorola Mobility, a mobile device manufacturing company, for $12.5 billion.

Evaluation: **Own judgement required**

A Strategic alliance:

- When two or more independent firms agree to co-operate and share resources and expertise with each other for the mutual benefit of all parties involved.
- The firms remain **completely independent legally** and each firm maintains its own separate trading identity.
- Google has worked with several corporations, in order to improve production and services. In January 2013, Google announced a partnership with Kia Motors and Hyundai. The partnership integrates Google Maps and Places into new car models to be released later in 2013.
- The firms benefit from the sharing of resources and talent that otherwise they wouldn't have access to. Either party can end the arrangement easily if they choose to do so.

Evaluation: **Own judgement required**

A Franchise:

- This is a business arrangement whereby the franchisor (the existing business with the proven business model) grants a contractual licence/permission to the franchisee (person setting up the business) to use its name, logo and business idea in return for a fee or a percentage of profits or sales.
- The franchisor can expand his business without having to invest further capital or take additional risks as these are passed onto the franchisee in the contractual arrangement.
- Some franchises in Ireland include, The Zip Yard, Gloria Jean's Coffees, McDonalds and GEMS.

- It is a cost effective form of expansion for the franchisor. It can be risky for a franchisor as if standards are not maintained by the franchisee the image of the franchisor could be affected.

  Evaluation: **Own judgement required**

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

Organisation structure:

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.

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.

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 etc.
- 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.

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.

(B) Within the product element of the marketing mix, evaluate "product design" and "product packaging".

"Product design"
Function: This is linked into the main clauses of the Sale of Goods and Supply of Services Act 1980 which puts a legislative onus on producers to manufacture goods that are of merchantable quality and fit for the purpose intended. The product must do what it is expected to e.g. a lawnmower should operate as expected and cut grass properly.
<u>*Evaluation*</u>
The value of this approach is that the specific needs of the consumer will be met in line with the marketing concept. This will lead to repeat purchasing, consumer loyalty and ultimately increased sales and profits for the business.

Form: The product must be aesthetically appealing in terms of shape, size, colour, style, image etc. e.g. (iPad).
The product must be practical and comply with safety standards; however it must also be appealing. For example car marketing campaigns emphasise efficiency, reliability and aesthetic appeal in their adverts.

<u>*Evaluation*</u>
Individuals are fashion conscious with unique tastes and preferences. If these needs can be satisfied by businesses then increased sales and profits will ensue.
"Product Packaging"
Product packaging serves many functions:
<u>Protection</u>: Packaging safeguards the product during transit, storage and handling. It also keeps the product fresh, preserving quality until it is used.
<u>Information:</u> The packaging contains information on contents, ingredients, best before date, health warnings etc.
<u>Differentiation/</u>source of competitive advantage: Many products are instantly recognisable because of the shape or design of the packaging, some of which are patented and legally protected e.g. Coca-Cola bottle.
<u>Promotion:</u> Packaging helps market the product because it can draw attention through brands and logos, shape and colour.
<u>Customer/user friendly</u>: Microwave porridge, popcorn, soup, beans etc. make food consumption more convenient and increase sales.

<u>*Evaluation*</u>
(Size and Quantity) Packaging can control the size and quantity of a product. Portion control helps control inventory, create product consistency and can help regulate prices.

(Marketing) Packaging is the front line of marketing. Through design and marketing communications, packages can help sell a product and differentiate it from similar products. The packaging can also help promote product branding.

(Security) Product security can be provided through packaging. Packing can make items tamper-resistant, can help reduce theft and can help prevent harm from dangerous products.

(20 marks)

(C) Reasons for Expansion

Small 'one person' sole trader type enterprises are attracted to growth because they may:

- Wish to test out and succeed with new product ideas or approaches. Strive for the personal satisfaction of watching the enterprise grow.
- Desire to provide career and economic opportunities to their children, staff and colleagues.
- See no point in buying particular items but would rather produce them in-house using advanced technology, so that product reliability will be increased and costs reduced.

Larger more established businesses are equally attracted to growth because it:

- Creates economies of scale. The general cost of running a larger business enterprise rather than a smaller one may be reduced because the business functions of the enterprise can be rationalised, cutting down expenses.
- Increases the security of the enterprise. Being a big player with a large market share will obviously strengthen the enterprise in the market place. The larger business is also able to weather the storms of recession if the need arises.
- Expansion increases the financial strength of the enterprise through sheer size. A large business enterprise commands prestige, influence and power, for example with banks, other smaller businesses and government departments.
- Allows for growth through diversification into varying product ranges. In this way the enterprise reduces its risk exposure and since it does not depend on any one product type in particular it has a higher chance of survival.

- Synergy. Where business enterprises merge together, synergy is the theory that the sum of the potential of the two amalgamated businesses is higher than the sum of the two enterprises if they remained separate from each other. It allows for the closure of inefficient plant and the sale of assets that may not be required by the large new efficient business.
- Helps to acquire certain patents, processes, expertise or technologies that enhance the overall profitability of the business in the short and long term.
- Protects vital raw material sources. An expanding enterprise may find it attractive to completely control a source of raw materials on which the future of the business depends.
- In the cases of the rapid growth of agricultural co-operatives that have become public limited companies (PLCs), such as Kerry Foods, Avonmore Foods, Waterford Foods and Golden Vale, the main reasons for so doing were that going public allowed for very large amounts of finance to be raised quickly through the issue of shares to the public. The stock exchange quotation afforded regular and widespread publicity in the media to the advantage of the enterprise. It allowed the founders, investors and employees to sell off some of their shares.