**What are the reasons for expanding a business? Defensive vs. Aggressive**

**Defensive (Have to)**

* **Reduce costs** → economies of scale are benefits that arise in a business as it becomes larger and more efficient, equals more sales and more profits
* Increase ability to **survive** economic shocks
* **Reduce risks** through *diversification* (not having too many eggs in one basket)
* **Protect raw material supplies** → *reverse integration* means taking over your suppliers
* **Protect labour supplies** – increase ability to recruit better staff by offering more

**Aggressive (Want to)**

* **Increase profits** - may achieve dominant or monopoly position
* **Acquire new products** –may be cheaper to take over a firm than R&D new product
* ‘**Empire Building’** – may want to create the largest business in an area/industry/country
* **New challenges** – some get bored
* **Eliminate competition** through mergers or take-overs

**What are the methods of business expansion?**

1. **Organic Growth** → where a firm expands slowly/gradually through the use of its existing products or by developing new products (inside the business)
2. **Inorganic Growth** → involves forming strategic alliances with, or by engaging in mergers and acquisitions of, other businesses (outside the business)

**Organic Growth – strategy one: Use existing products**

* **Increasing sales domestically** – low risk, limited opportunities and may be slow
* **Exporting** – very profitable, doesn’t affect ownership or control, is expensive (must adapt marketing mix and strategy) and higher risk
* ***Licensing*** → allowing other firms to use or sell an invention or design in return for payment of licence fee or royalty. This is fast and low cost but involves some loss in profits and control
* ***Franchising*** → the renting (by a franchisor) of a complete business idea, including name, logo and products to someone (the franchisee), fast, low cost and low risk however potential profits and day-to-day control less and higher risk of damage to reputation
  + - * Adv: Little capital required
      * Adv: Economies of scales
      * Adv: Less supervision required
      * Disadv: Risk to Reputation
      * Disadv: Loss of Control

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| --- | --- | --- |
|  | **Franchisor** | **Franchisee** |
| Adv | Quick method of expansion | Buying an already success idea |
| Adv | Low cost expansion | Economies of Scale |
| Disadv | Lose Control | Not allowed to make own decisions |
| Disadv | Bad Reputation | Lose % of profits |

**Organic Growth – strategy two: Develop new products/diversification**

***Diversification*** → increasing the range of products/services offered, potentially high profits, high cost, high risk and can take a long time

**Inorganic Growth – strategy one: Form a strategic alliance**

**Strategic alliances/joint ventures** → when two or more firms agree to co-operate in the establishment of a project or business together. Firms remain separate but share skills – fast, lower risk, less costly (shared) however profits and control must also be shared

Eg: SMART car (Swatch and Mercedes) Swatch now makes watches and cars. Mercedes sells high quality luxury cars and a small fun affordable car.

Adv: Cost effective: costs are split, assets, equipment and skills are shared

New Markets: attract new customers

Disadv: Conflict:

Lose Customers:

**Inorganic Growth – strategy two: Mergers/Acquisitions**

* ***Acquisitions/take-overs*** → when one firm buys at least 51% of the voting shares of another firm and gains the majority control (can be ‘hostile’) – subsidiaries are the companies where another company owns 50% or more of their shares. May be blocked by EU competition policy - Ryanair were not allowed to buy shares in Aer Lingus.
* Eg: Facebook bought WhatsApp for £11.4bn in 2014.
  + - Adv: Economies of Scales
    - Adv: Increased Profits
    - Adv: Access to new ideas, products and markets
    - Disadv: Expensive
* ***Mergers*** → when the managers and shareholders of two companies of roughly equal size agree to voluntarily join together to form a single firm (may be blocked by EU competition policy)

Eg: Air France and KLM merged in 2004 and are now called Air France-KLM. Disney and 21st Century Fox are currently in process of merging (June 2018)

* + - Adv: Economies of Scale
    - Adv: Increased Profits
    - Adv: Synergy
    - Disadv: Conflict
    - Disadv: Reduces Morale

**Main Sources of Finance for Business Expansion:**

1. **Grants** → no loss of ownership, control, dividends, and repayments (unless conditions are broken).
2. **Equity** → finance provided by the owners

* *Retained earnings* → where profits are retained in the business to finance future developments (savings in a household)
* Entrepreneur investing their *own* money
* Bringing in a new *partner* (who will invest)
* Issuing (selling) *shares* (if PLC)

1. **Debt finance – Loans and *debentures*** → long term fixed interest loans secured on a valuable asset e.g. premises. No loss of ownership or control, and interest payments are tax-deductible. (however collateral must be offered)
2. **Sale and Leaseback** → a contract to raise cash by selling a piece of property while simultaneously leasing it back on a long-term basis

**Comparing and contrasting the use of equity and debt finance**

|  |  |  |
| --- | --- | --- |
|  | **Equity Finance** | **Debt Finance** |
| **Amount** | Potentially large | Potentially large |
| **Cost** | Cheap as dividend payments are optional | Expensive as interest and principle must be repaid |
| **Ownership/control** | Diluted | No loss |
| **Risk** | Low – if no profit made, only lose out – low geared | High – repayments must be made, if not then liquidated – highly geared |

**Implications of Expansion for a Business:**

* **Profitability** → short term profits may fall off but long term benefits from economies of scale
* **Organisational structure** → may need to change e.g. from functional to geographical
* **HRM** → usually means recruiting more staff or increased redundancies
* **Marketing** → becomes more complex as one than one marketing mix
* **Legal** → usually change from sole trader to PLC required legal changes
* **Finance** → may need to raise finance (the bigger the easier)
* **Ownership** → new partners = new ideas, can be good or bad

**Staying Small:**

+ Easier to **manage** and control (less work and responsibility)

+ Less **stress** – small but profitable

+ Staff **relations** and communications are easier

+ Stronger sense of team spirit, recognition and **motivation**

+ Better personal **service** = more loyal customers

+ Can remain **competitive** in niche market if they offer high quality flexible service

* **Costs** tend to be higher (can’t use mass production)
* **Profits** tend to be smaller
* Less **investment opportunities** (e.g. R&D, tech, recruitment)
* Small firms struggle more to **compete** against larger firms