3.1.2 Business Growth

Organic/Internal Growth (Tortoise)

- A business can grow organically by purchasing capital, hiring workers, increasing worker hours
- Internal growth is the increase in output and sales using internal resources

Advantages

- Management has better knowledge of business
- Firm can respond quickly and dynamically to market changes
- No restructuring needed
- Less risky than inorganic/external growth

Disadvantages

- A slower method of growth

- May decrease competitiveness

- May not take on new ideas or people

- May specialise on dated ideas, stuck in the past situation

- A good and suprising example is Walmart. Walmart opened one store in 1950 and continued to open stores and increase sales by cutting prices. All without mergers/takeovers.

Inorganic/External Growth (Hare)

- Firms can grow by buying other firms
- External growth involves the expansion of a firm by mergers and takeovers
- If the firm agrees to being bought it is a merger
- If the firm is taken over by the buyer it is an aquisition (usually buy buying the majority of shares)
- There are financial risks as buyer may have to take on debt to buy firm which may not even work out

- There is also risk of being investigated by Competition and Markets Authority, who don't like monopolies and like to promote competition (booooooring)

3 Types of External Growth

- The three types are horizontal integration, vertical integration and conglomerate integration

Horizontal integration

- When firms merge at the same stage of production process (e.g. two supermarkets or car manufacturers)
- This can help with increased product range and market expansion (e.g. firm could enter markets in asia)
- An example is the Fiat Chrysler and Groupe PSA (Peugot owners) agreed to merge in 2019
- Advantages are: Increased Econs of Scale, Increased market share, reduced competition, mergers reduce risk of being bought out by a rival company, increased revenue
- Disadvantages are: Risk is focused on narrow range of g+s (e.g. cars), disecons of scale may occur, buyout could become very expensive due to speculation raising share price, potential job loss, assets may be sold (duplicated capital) which is a waste, workers may have to move or travel

Vertical integration

- When firms in different stages or production processes merge (e.g. a chocolate company and a sugar company)
- This can either be backwards or forwards
- backwards is towards the commodity producers
- forwards is towards the retailers and customers
- Starbucks is a good example as it owns retail outlets, bean farms, warehousing and distribution etc
- Advantages of backwards vertical integration are: control over raw materials ensures quality and supply, preventing competitors from gaining resources, eliminating supplier profit margins and turning them into profit
- Disadvantages of backwards vertical integration are: the firm may not need all the supplies, firm may not have specialist knowledge of production (disecon of scale may occur), firm may find it hard to adapt to changes in consumer demand
- Advantages of forwards vertical integration are: buying a retail outlet may allow firm to assure quality of product that is sold to consumers, market research is more effective, consumer may be less distracted by competitor products
- Disadvantages of backwards vertical integration are: the firm may not have wide enough product range for customers, firm may not have marketing and sales expertise,

risk of larger losses

Conglomerate intergration (diversification)

- When firm buys another firm in completely unrelated business
- Example is Honeywell. Honeywell owns aerospace, building technology, materials technology and safety products
- Advantages are: It spreads risk, different products do well at different points on business cycle, brands gain more recognition
- Disadvantages are: potential lack of expertise, brands may become diluted, differences in culture resulting in lower productivity

Constraints on business growth

- Government regulation (monopoly comissions)
- Capacity constraints (insufficient capital, finance, skilled labour)
- Market constraints (demand in the market may not be sufficient for large growth)
- Existing market competition (may take a portion of demand, too risky to grow)
- Vision constraints (owner's ambitions may be limited e.g. nepotistic practices, this can potentially lead to greater internal trust and productivity though)
- State of the economy (recession limits demand, no point in expansion)