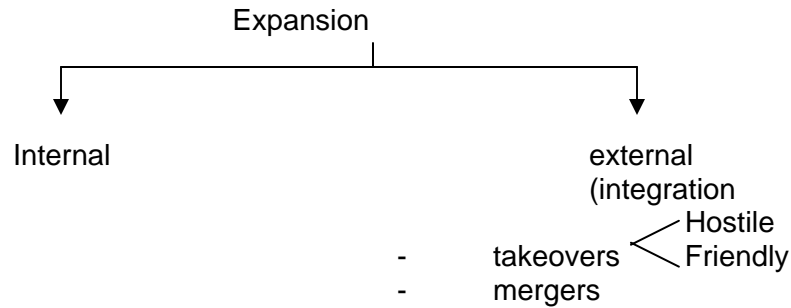


BUSINESS GROWTH



Types of integration:

1. Horizontal integration { Forward
2. Vertical integration } backward
3. Conglomerate integration
4. Lateral integration: { when two firms at the same stage of production but are diversified

type of a horizontal integration like soap and ice-cream i.e. having the same suppliers due to a single source of raw materials

Business growth means increasing the scale of operation, expanding production and increasing the sales and profits of any firm.

Business expansion is of two types

1. Internal Expansion
2. External Expansion

INTERNAL EXPANSION

It means expanding the business from within by using its own internal factors of production. It means increasing the number of employees, increasing the production of existing products or services, launching new products or services by finding new markets, opening new outlets or factories and increasing the quantity of goods sold.

This growth can be quite slow, however, it can avoid the problems of rapid expansion (excessive fast growth) which tends to lead to inadequate capital (overtrading) and managerial problems associated with bringing two businesses together that might have very different cultures attitudes and leaderships styles.

EXTERNAL EXPANSION (External integration)

External growth is achieved through integration i.e. from mergers and takeovers of firms from either the same or different industries. Integration leads to rapid expansion which might be essential in a competitive and expanding market. However, it often leads to financial, marketing, managerial and control problems. These are caused by the need for different managerial systems to deal with a bigger organization and due to conflicts between the two corporate cultures and business ethics.

TYPES OF INTEGRATION

A. Horizontal Integration

It occurs when two firms which are in exactly the same line of business and at the same stage of production process joined together.

ADVANTAGES

1. Common knowledge of the market in which they operate.
2. Reduced risk of failure.
3. Eliminates competition
4. Possible economies of scale
5. Greater power over suppliers
6. Similar skills of employees
7. Less managerial problems as compared to vertical or conglomerate mergers.
8. Scope for rationalizing production i.e. concentrating output on one site as opposed to two or more.

DISADVANTAGES

1. They lead to monopoly and higher prices.
2. If the production procedures are different into two companies, then technical and managerial problems might occur.
3. Previous relationships with suppliers or distributors of one firm might suffer.
4. Control problems might occur.
5. Financial problems related to longer size might occur.
6. Rationalising may bring bad publicity.

B. Vertical Integration

Vertical Integration can be forwards or backwards. Forward vertical integration is with a business in the same industry but at a next stage in the production process i.e. with a customer of the existing business e.g. a car manufacturer merging with a retailer (showroom). Vertical backward integration is with a business which is operating at a previous stage of a production process i.e. with a supplier of the firms e.g. leather garment manufacturer merging with an organization that manages cattle to get the leather. Or if retailer merges with a manufacturer.

ADVANTAGES – FORWARD INTEGRATION

1. Greater control over promotion and pricing of the products.
2. Eliminates the profit margin in expected by the firm in the next stage of the production process.
3. Greater confidence in production planning.
4. Gives a secure competition free outlet.

DISADVANTAGES:

1. Lack of experience in this sector of the industry.
2. Can be expensive to manage on its own as compared to dealing with a specialized competition.
3. Consumers may suspect uncompetitive activity and react negatively.

ADVANTAGES – BACKWARD INTEGRATION

1. Gives greater control over the quality, price and delivery times of the suppliers.
2. Eliminates the profit margin demanded by another supplier.
3. Encourage joint supply and development for improved quality of supplies.

DISADVANTAGES:

1. Lack of experience of managing a supplying company.
2. Supplying business may become complacent due to having a guaranteed customers.
3. Supplies might be more expensive as compared to another business with larger economies of scale.

C. Conglomerate Integration or Diversifying mergers

This integration is between firms in completely different lines of business. A firm might fear a loss of market share due to greater competition. As a result it might try to explore different opportunities to minimize or diversify risks.

ADVANTAGES

1. Reduces risks of losses.
2. Reduced risk might take the business into a faster growing market.
3. Profit margins can be increased due to other businesses.
4. Market share can be increased because of the increased.

DISADVANTAGES

1. Risk of failure might increase due to the lack of experience in the new market.
2. Entry problems might occur.
3. If the business is new then its difficult to lower down the prices as compared to the established competitors.

REASONS FOR MERGERS

1. Growth in the economy and expectations of higher profits.
2. Active stock markets.
3. Greater competition in the service sector leads to many financial institution mergers.
4. Deregulation and liberalization of markets.
5. Increased and of globalization.
6. Improvements in the information and communication technology.
7. Economic problems in some countries made their firms cheaper for the developed country organization.
8. Quick and easy way to expand so companies can increase their market share in a short period of time.
9. Buying a business is sometimes cheaper than growing internally. Internal growth is costly and it takes time.

10. It is a profitable way to utilize available cash or other idle resources.
11. A businesses might buy another to consolidate its position in the market and to avoid takeover.
12. It's a way to enter the international market.
13. Economies of scale can be achieved. The effect of the reduced costs can be transferred to prices to increase the sales of the company. If the effects is not transferred still profits can be increased.
14. It is the way of asset stripping which is generally very profitable.

TAKEOVERS

Takeovers in plcs can occur because their shares are traded openly and anyone can buy them. One business can acquire another by buying 51% of the issued shares either from the stock exchange or strictly from the exciting shareholders. When a takeover is complete, the company that has been bought loses its identity and becomes a part of the buying company. Private limited companies however cannot be taken over unless the majority shareholders invite others to buy their shares. So this takeover is friendly and not hostile.

Takeovers of plcs often result in sudden increases in share prices due to the volume of buying by the predators and also speculation by the investors. If more than one firm is attempting to takeover a company, then this can result in a very sharp increase in the share prices as the two buyers bid up the prices.

REVERSE TAKEOVERS

Reverse takeovers usually occur when a small firm takes over a larger one. It's a friendly takeover as a smaller firm doesn't have enough funds to buy a larger firm against its will. The larger company may allow this takeover due to the smaller company's future potential to grow or due to the unprofitable conditions of the larger company at present.

DE-MERGERS

It is where a company sells of a significant part of its existing operations. A company might choose to break up due to the following reasons:

1. raise cash to invest into the remaining sections.
2. concentrate its efforts on a narrower range of activities.
3. avoid rising costs and inefficiency by being too large.
4. take advantage of the fact that the company has a higher share valuation when split into two components then it does when operating as one.

ASSET STRIPPING

Some takeovers result in asset – stripping. The asset – stripper aims to buy another company at a market price lower than the value of the firm's total assets. It then sells off the profitable parts of the business and closes down those which are unprofitable which activity has often been criticized since it leads to unemployment and uncertainty in those sections which are closed down.

BUSINESS GROWTH

Q.1. Define synergy. Explain it with respect to integration.
(5)

Ans. Synergy literally means that the “whole is greater than the sum of individual parts.” This in terms of integration means that when two businesses merge together their profitability, efficiency and effectiveness would increase to more than the combined profitability of the separate businesses. This can be because the economies of scale of the larger merged business is greater (e.g. purchasing) then could be gained by either of the business. This would lead to far lower costs and increase profitability. Also marketing and distribution costs can be saved by using the same sales outlets and sales teams. Finally if the businesses merged are similar then they could share their research and development ideas and technologies. This would result in higher efficiency.

Q.2. Explain the problems of rapid growth of businesses and suggest ways to deal with these problems.
(20)

Ans. Expansion is one of the major objectives of private businesses which means increasing in size in terms of number of employees, outlets, higher market share, etc. It is needed to remain dynamic and competitive against other companies. However too fast or rapid growth can lead to problems especially through external growth i.e. mergers or takeovers. The problems caused are financial, managerial, marketing and loss of control by original owners.

Business expansion, whether internal or external is expensive. Therefore rapid expansion can be very financially draining on a business i.e. on its financial resources. Rapid expansion would require fixed additional capital such as bigger factories, machinery etc. It would also require large working capital. Also takeovers are partially expensive because buying more than 51% of the issued shares of a company would require a lot of each. A business in order to get the required finance may take large long – term bank loans. Such borrowing may cause it to become highly geared over after the merger and large sums of interest payment may have cause a big problem. On solution to this financial problems would be through use of internal sources of finance such as retained profits, so long – term borrowing could be avoided. Then finance could be raised through share issue but it could mean loss of control. In case of a takeover, offer shares in the new business rather making a cash offer to the shareholders of the target business. But this could only be in case of a friendly takeover.

Another major problem caused by rapid growth is managerial problems. Rapid expansion means larger operations, more employees and more divisions. The present managers may not be able to cope with problems of controlling a larger business with a larger organizational structure and greater number of hierarchy levels. Also when two businesses integrate, there may be duplication of certain division and departments. Due to this a lack of co-ordination may occur between departments and the management may find it difficult to control the expanding business effectively. In addition to it, the original owner of a business or that of a business or that of the larger business (in case of integration) may find it difficult to adapt to being a traditional manager. In case of integrating businesses, both organizations may have different corporate cultures. E.g. one may be following an autocratic culture where employees do not give their feedback and do not participate in making decision. The culture of the other might be democate

where employees take an active part in the business decision. Thus there may be clash of culture and employees may find it difficult to settle and adjust. Management would have to make employees adapt to the integration too. Strategy to deal with such a problem might be to build new management structures and systems according to the requirements of the expanding business. Also a policy of delegation and empowerment would reduce pressure on staff and they could concentrate on strategic issues instead of difficulties of running a day-to-day business. A company expanding its divisions could benefit from decentralization. This would enable national divisions to use a degree of autonomy and would motivate managers along with giving them a clear focus. Since a lot of burden falls upon the original owner, he would have to decide the most important areas of management in which he has to personally remain involved while he should relax control over others e.g. the original owner should concentrate more on to the extent the company needs to remain diversified, which operations he should close down and which he needs to continue. These are the more strategic decisions. Others such as daily purchasing and daily rent & tightening should be left to lower management.

Then several marketing problems are also faced. First and foremost is that rapid growth leads to sudden increase in the products. This would require new marketing strategies which have to be quickly developed in order to maintain competitiveness. The original marketing strategy would no longer remain appropriate for a larger organization with a wider range of products. E.g. a marketing strategy for a product portfolio of four products would fail to effectively manage a portfolio of eight products that has formed because of the expansion. Also in the expansion results to growth from national to international markets, it would be unsuccessful if market strategies are not suitably adapted. It may be that prices may have to be changed for the products to sell in the international market, also changes may need to be appropriately made to package designs in accordance to the culture of different countries. At times even brand names have to be changed. For all these things, extensive market research should be immediately undertaken. The results would show what should be done such as adopting focused marketing strategies for each specific product or each country operated in the expanding business especially if its through takeover, would have to completely change its advertisements as the taken over business has lost its identity. Thus any shops and markets of that business would have to be redesigned and all its marketing strategies altered.

Finally rapid growth may result in loss of control by original owners. It is most likely to occur if a sole trader takes on partners or if a private limited company converts to a public one. In both these cases, there is an increase in the numbers of owners due to which control is divided between the raw owners / shareholders especially in the latter case where several new owners introduce capital into the business. This is an unavailable consequence of changing legal structure to gain additional capital. It also occurs within public limited companies when a large issue of shares occurs due to which owned to is diluted.

Business growth, due to bring an important objective, is one faced by managers at least once during their business era. Managers must therefore evaluate whether growth is desirable objective for achieving the aim of maximizing returns to investors. The cost of growth, especially external growth (integration) can easily outweigh the hoped for benefits. Also expanding the company too swiftly can overstretch both management and financial resources. If this problems becomes too serious, then rapid retrenchment (cutting back) of activities may

become necessary and this could lead to negative publicity and negative reaction from stakeholders. The pace of growth, the form that it should take and how the consequences of expansion are dealt with are some of the most vital issues for any manager to be concerned with.

Mega Lecture