# 3.1.2 Business growth

*a) How businesses grow:*
  - *Organic growth*
  - *Forward and backward vertical integration*
  - *Horizontal integration*
  - *Conglomerate integration*

*b) Advantages and disadvantages of:*
  - *Organic growth*
  - *Vertical integration*
  - *Horizontal integration*
  - *Conglomerate integration*

*c) Constraints on business growth:*
  - *size of the market*
  - *access to finance*
  - *owner objectives*
  - *regulation*

- Organic/internal growth: grow within a firm by increasing the levels of the factors of production it uses
- Advantage of organic growth:
  - Low risk
  - Easiest growth to manage (more sustainable speed)
  - Can be financed through internal funds
- Disadvantages of internal growth (organic):
  - Hard to build market share if it is already a leader
  - Slower
  - May be more expensive
- External growth (inorganic): growth by buying out other firms, either by agreement (mergers) or taking them over (acquisition)
- Advantages of external growth:
  - Faster (economies of scale, increased market share)
  - Control of supplies
  - Acquire intangible assets (brands, trademarks, expertise)
  - Defend against a takeover threat
- Disadvantages of external growth:
  - Danger of firms getting too large e.g. diseconomies of scale and financial risks.
  - Risk of investigation by the Competition and Markets Authority
  - Clash of corporate cultures
  - Incompatibility of top management
- Three main ways a firm can grow externally:
  - Horizontal integration
  - Vertical integration
  - Conglomerate integration or ‘diversification’
- Horizontal integration: firms merge at the same stage of the same production process. They are likely to want to increase their range of products or to get into new markets
- Advantages of horizontal integration:
  - Economies of scale

  - Increased market share
  - Elimination of threatening competition
  - Remove risk of being bought out
  - Diversification/ economies of scope
  - Lower LRAC
- Disadvantages of horizontal integration:
  - Focus of risk on a narrow range of goods and services
  - Diseconomies of scale
  - The share price of the firm being bought might rise, meaning the buyout is very expensive
  - Some workers might lose their jobs if the roles in the new bigger firm are duplicated
  - Some workers might have to move or travel further
  - Some assets might be sold off which might be wasteful
- Vertical integration: firms merge at different stages of the production process. It can be back or forward vertical integration
- Backward vertical integration: One firms buys another that is closer to the raw material stage of production
- Advantages of backward vertical integration:
  - Guaranteed supply
  - Ring-fencing resources
  - The supplier's mark-up can become profit for the buying firm
- Disadvantages of backward vertical integration:
  - The firm might not need to buy all the supplies
  - The firm may lack specialist knowledge of production
  - The firm might find it hard to adapt to changes in consumer demand
- Forward vertical integration: buying another firm in the production process but close to the consumer
- Advantages of forward vertical integration:
  - Buying a retail outlet may guarantee customers see a firm's products at their best
  - The customer may not be distracted by other competition
- Disadvantages of forward vertical integration:
  - The firm on its own might not offer enough choice for the consumer
  - The firm might not have marketing and sales expertise
- Conglomerate integration or 'diversification'/ lateral integration: A firms buys another firm in a completely unrelated industry e.g. Virgin
- Advantage of conglomerate integration:
  - It spreads the risk- profitable areas can cross-subsidise loss-making areas
  - Different products do well at different parts of the business cycle
  - Brands can become better recognised
- Disadvantages of conglomerate integration:
  - Lack of expertise in new areas
  - Brands may become diluted
- Constraints on business growth:
  - Size of the market: some firms could increase output but would have to drop price considerably, or not even find a market at all

    - Access to finance: since 2008 it has become hard for SMEs to borrow because they are deemed too risky, and other forms of finance are limited.
    - Owner objectives: e.g. control. Some firms like to 'keep it in the family' by employing family members and avoiding taking on people from the outside which may make a firm easier to manage and workers may be more loyal. Some may want to protect the environment or have a strong Corporate Social Responsibility
    - Heavy government regulation: some firms are kept small because the government wants to prevent monopolies developing. Or, it can limit output e.g. environmental laws
- Alliances/ joint ventures: a business undertaken jointly by two or more parties which retain their distinct identities. Many advantages of a merger without losing separate legal identity.
- Reasons why small firms survive:
    - They act as a supplier to large firms
    - They take advantage of a low PED and high YED for niche products which command a high price
    - They can avoid diseconomies of scale nb
    - Many owners are not profit maximisers
    - They are often more innovative and flexible
    - They can benefit from online shopping