Chapter- 4

Enterprise Growth Strategies

GROWTH AND DEVELOPMENT OF AN ENTERPRISE

- Growth is always essential for the existence of a business concern. A concern is bound to die if it does not try to expand its activities. The entrepreneur is an endless challenge seeker.
- The expansion of an enterprise may be in the form of diversification of activities or acquisition of ownership and control of other businesses.
- The expansion may be in the form of:
- Internal expansion
- External expansion

INTERNAL EXPANSION

- It is a slow and time-consuming process which is a result of a gradual increase in the activities of the enterprise. A firm may expand internally by:
- Expanding its present production capacity by increasing the number of machines.
- Replacing old machines with new technological machines.
- Entering new areas of production or marketing or both.
- Increasing the output of the enterprise.
- Internal expansion is generally financed through long term sources of finance and also through undistributed profits and reserves.
- The results of internal expansion are:
- Increase in business activities.
- Broadening the present capital structure.

EXTERNAL EXPANSION

- External expansion occurs when two or more business enterprises come together with the common objective of expanding their business. A firm may expand externally by:
- Franchising
- Mergers and acquisitions

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- External expansion is financed through long term sources of finance.
- The net results of external expansion are:
- Expansion of capital base as well as business activities.
- Elimination of unnecessary competition.
- The synergy effect is achieved.

FRANCHISING

- Franchising is an arrangement whereby the manufacturer or sole distributor of a trademarked product or service gives exclusive rights of local distribution to independent retailers in return for their payment of royalties and conformance to standardized operating procedures.
- The person offering the franchise is known as the franchisor.
- The franchisee is the person who purchases the franchise and is allowed to enter a new business with a better chance to succeed than if he or she were to start a new business from scratch.
- The franchise agreement is a legal document defining the mutual terms and conditions between a franchisor and a franchise.

INGREDIENTS OF A FRANCHISE AGREEMENT

- Contract explanation: The contract explanation is the part of the agreement that outlines the type of relationship a franchisee is entering into with the franchisor.
- Operation manual: The operations manual is the section of the agreement that details the guidelines that the franchisee must legally follow in operating the business as outlined by the franchisor.
- Proprietary statements: Proprietary statements outline how the franchise name is to be used, as well as the marketing and advertising procedures in place that the franchisee will be required to follow
- Ongoing site maintenance: It includes the types and timeframes regarding various maintenance items and upgrades that must be made to the franchisee's location.

TYPES OF FRANCHISING

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- Product franchise business opportunity: Manufacturers use the product franchise to govern how a retailer distributes its products.
- Manufacturing franchise opportunity: These types of franchises provide an organization with the right to manufacture a product and sell it to the public, using the franchisor's name and trademark.
- Business franchise opportunity venture: These ventures typically require that a business owner purchases and distributes the products for one specific company.
- Business format franchise opportunity: In this approach, a company provides a business owner with a proven method for operating a business using the name and trademark of the company.

ADVANTAGES OF FRANCHISING

- ADVANTAGES TO THE FRANCHISE
  - Product acceptance
  - Management expertise
  - Capital requirements
  - Knowledge of the market
  - Operating and structural control
- ADVANTAGES TO THE FRANCHISOR
  - Quick expansion
  - Cost advantages

DISADVANTAGES OF FRANCHISING

- DISADVANTAGES TO THE FRANCHISEE
  - Right and the only way of doing things.
  - Continuing cost implication
  - Risk of franchisor getting bought
  - Inability to provide service
- DISADVANTAGES TO THE FRANCHISOR
  - Difficulty in identifying quality franchisees

MERGERS

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- A merger is a combination of two companies into one larger company. In a merger, the acquiring company takes over the assets and liabilities of the merged company. All the combining companies and are dissolved and only the new entity continues to operate.
- Merger commonly takes place in two forms:
  - Amalgamation
  - Absorption

So, X+ Y= X, Y merged into company X (absorption)

X + Y= Z, Z is new company (amalgamation)

TYPES OF MERGER

- **CONGLOMERATE MERGERS:**
  - In this type of merger, the firms which are involved in totally unrelated businesses come together. This merger can be of two types:

i. Pure conglomerate merger: This merger involves firms with nothing in common.

ii. Mixed conglomerate merger: This involves firms that are looking for product extensions or market extensions.

- **HORIZONTAL MERGERS:**
  - This merger occurs between companies in the same industry. It is generally between competitors, offering the same goods or services. For example, a merger between Tata Motors and Hyundai would be horizontal.
- **MARKET EXTENSION MERGERS:**
  - This type of merger takes place between companies that deal with the same products but in separate markets.
- **PRODUCT EXTENSION MERGERS:**
  - A product extension merger takes place between two business organizations that deal in products that are related to each other and operate in the same market.
- **VERTICAL MERGERS:**
  - A merger between two companies producing different goods or services for one specific finished product. A vertical merger occurs when two or more firms, operating at different levels within an industry's supply chain, merge operation.

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ACQUISITIONS

- A corporate action in which a company buys most, if not all, of the target company's ownership stakes to assume control of the target firm. Acquisitions are often made as part of a company's growth strategy whereby it is more beneficial to take over an existing firm's operations and niche compared to expanding on its own. Acquisitions are often paid in cash, the acquiring company's stock, or a combination of both. An acquisition, also known as a takeover, is the buying of one company (the target) by another.

TYPES OF ACQUISITION

- Friendly acquisition: Both the companies approve of the acquisition under friendly terms. There is no forceful acquisition and the entire process is cordial.
- Reverse acquisition: the private company takes over a public company.
- Backflip acquisition: A very rare case of acquisition in which the purchasing company becomes a subsidiary of the purchased company.
- Hostile acquisition: The whole transaction is carried out through force. The smaller company is either driven to such a condition that it has no option but to say yes to the acquisition to save its skin or the bigger company just buys off its entire share, thereby establishing majority and hence initiating the acquisition.

STEPS INVOLVED IN PROCESS OF MERGERS AND ACQUISITION

- Analysis of client’s requirements
- Generating ideas
- Valuing companies
- Identifying potential partners
- Drawing up documentation
- Due diligence
- Supporting management
- Conducting negotiations

REASONS FOR MERGERS AND ACQUISITIONS

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- **SYNERGY:** It implies a condition wherein 2+2 = 5 i.e. the combined value of the merging firm exceeds the individual value of the merged firms. Synergy can take different forms: operating synergy and financial synergy
- **ACQUIRING NEW TECHNOLOGY:** To remain competitive, companies need to constantly upgrade their technology and business applications. To upgrade technology, a company need not always acquire technology. By buying another company with unique technology, the buying company can maintain or develop a competitive edge.
- **IMPROVED PROFITABILITY:** Companies indulge in mergers and acquisitions if they feel that it would help increase their profitability.
- **ACQUIRING A COMPETENCY:** Companies also opt for M&A to acquire a competency or capability that they do not have and which the other firm does.
- **ENTRY INTO NEW MARKETS:** Mergers help companies to enter into new markets without facing stiff competition from existing companies. It helps in making the entry route easy.
- **ACCESS TO FUNDS:** If a company is facing with shortage of finance and it also does not have proper access to raise funds from the capital market, then it may decide to merge with another company that has surplus funds.
- **TAX BENEFITS:** Mergers are also adopted to reduce tax liabilities. By merging with a loss-making entity, a company with a high tax liability can set off the accumulated losses of the target against its profits gaining tax benefits.

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REASONS FOR FAILURE OF MERGERS AND ACQUISITIONS

- The unrealistic price paid for the target company
- Difficulties in cultural integration
- Overstated synergies
- Integration difficulties
- Poor business fit
- Inadequate due diligence
- High leverage
- Boardroom split

- Regulating issues
- Human resources issues

VALUE ADDITION

- Value addition means to add value to goods and services by modifying them in such a way that their utility is enhanced and a new product of greater value is created for the customers.
- The concept of value addition has two dimensions:
  - From a financial point of view: It represents the difference between the value of output and value of the input.
  - From a marketing point of view: It represents adding value that turns a commodity into a branded product.
- The value people place on goods and services is determined by two factors:
  - Quantitative value
  - Qualitative value

TYPES OF VALUE ADDITION

- **Quality added value**
- Quality added value is adding convenience, ease of use, or other desirable characteristics that customers value.
- For example, turning a commodity into a branded product or design enhancements like pull tabs for easy opening or sipper tops on beverage bottles.
- **Environmental added value**
- Environmental added value employs methods or systems that do not harm the environment or are less harmful than those commonly used.
- For example, using less electricity, using less fuel, and using recycled material for packaging.
- **Cause-related added value**
- Cause-related added value is a social marketing strategy where business contributes part of the revenue from a product or service to a cause.

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- For example, a business may donate a percentage of revenue from each transaction to a cause such as an educational facility for disadvantaged children or a wildlife sanctuary.
- **Cultural added value**
- Cultural added value is also a social marketing strategy that employs methods or systems of production involving cultural aspects or allows for the needs and sensitivities of cultural groups.
- For example, producing kosher food

VALUE CHAIN

- The concept of the value chain was developed by MICHAEL PORTER in his book competitive advantage in 1980.
- A value chain is the whole series of activities that create and build value at every step of production and distribution.
- Value chain analysis looks at every step of the business, from the acquisition of raw materials to the delivery of finished goods to the eventual end-users with one goal of that to deliver maximum value.
- Michael Porter suggested that all the activities which contribute to the value chain in an organization should be split into primary activities and support activities.

PRIMARY ACTIVITIES

- Inbound logistics: Goods being obtained from the organization's suppliers and to be used for producing the end product.
- Operations: Raw materials and goods are manufactured into the final product. Value is added to the product at this stage as it moves through the production line.
- Outbound logistics: Once the products have been manufactured, they are ready to be distributed to distribution centers, wholesalers, retailers, or customers. Distribution of finished goods is known as outbound logistics.
- Marketing and sales: Marketing must make sure that the product is targeted towards the correct customer group.
- Services: After the product/service has been sold, what support services do the organization offer customers?

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SUPPORT ACTIVITIES

- Procurement: Purchase department must source good quality raw materials at a competitive price.
- Technological development: Technology should be developed in such a way that costs are reduced; new products are developed through research.
- Human resource management: The organization should recruit, train, and develop the right people for achieving success.
- Firm's infrastructure: The Company's infrastructure related to every aspect of the business should work efficiently and contribute to an organization's success.

REQUIREMENTS FOR VALUE CHAIN MANAGEMENT

- **Coordination and collaboration:** To increase efficiency within an organization, coordination and collaboration are essential. Coordinate workgroups to ensure efforts are not duplicated. Utilize the theory that the whole is greater than the sum of its parts by collaborating with other groups and individuals to achieve a common goal.
- **Technology investment:** Technology plays a large role in manufacturing and distribution. With outdated technology, such as old computers or machinery, an organization's competitiveness is weakened due to a loss in productivity.
- **Organizational process:** In value chain management, every aspect of an organization's process is identified. Improvement in processes through better technology and greater procedural knowledge is important to the present and future success of a company.
- **Leadership:** Strong leaders are crucial to the success in value chain management. Good leaders earn the respect of their employees through sound management practices. Conflict management, motivation, and direction are traits that strong leaders display.
- **Employee resources:** A content and satisfied workforce are essential for proper management of value chain and a knowledgeable and active human resource department ensures just that by acting as a liaison forces between management and workers.

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- **Organizational culture and attitudes:** Organization that maintains a strong cultural identity with positive attitudes tends to attract and retain top employees which are essential for the effective value chain management.