



Internal & External Growth

IB / A Level exam preparation notes

Organic development, mergers, integration, alliances, franchising and staying small.

What these notes cover

- organic growth and why it offers more control
- external growth through mergers, acquisitions, alliances and franchising
- horizontal, vertical and conglomerate integration
- stakeholder impacts, evaluation and why some firms stay small

Core idea: choose the growth route that improves market position without creating more finance and integration risk than the business can manage.

Revision map

Businesses can expand from within or by linking with other firms. Organic growth usually gives more control and cultural continuity; external growth usually gives more speed, scale and market access, but with higher finance and integration risk.

WHAT IS THE CHOICE?	WHEN IS INTERNAL GROWTH ATTRACTIVE?	WHEN IS EXTERNAL GROWTH ATTRACTIVE?
grow by developing existing operations, or expand by combining with / cooperating with another firm	when managers value control, gradual funding, culture continuity and lower integration risk	when speed matters, new capabilities are needed immediately, or entering a market alone would be difficult

Learning checklist

- define organic and external growth
- compare pace, control, risk and finance
- distinguish merger, acquisition and takeover
- explain joint ventures, alliances and franchising
- judge when staying small is a rational strategy

How size can be measured

- sales revenue
- output or customer numbers
- employees
- assets
- market share

High-value evaluation

- faster growth is not always better
- the finance method affects risk
- integration capability matters as much as ambition
- industry context changes the best answer

Golden exam chain

- define the method clearly
- show how it changes cost, speed or control
- apply a realistic example
- add a limitation, then conclude

Core judgement

There is no single best growth path. The strongest option is the one that fits the firm's objectives, funding capacity, management capability and need for speed.

1. Organic growth

Internal growth takes place when a business expands its own operations instead of combining with another firm. It is usually gradual, funded from retained earnings or new internal investment, and built on what the business already does well.

What organic growth looks like

- opening extra branches or outlets
- adding new features, products or product lines
- investing in machinery or technology to raise capacity
- expanding marketing to reach more customers
- hiring more staff to support higher output

Typical examples

- an app developer adds new tools to increase downloads
- a coffee chain opens outlets in nearby towns
- a bicycle manufacturer buys machinery to meet rising demand

Why firms choose it

- managers keep direct control over strategy
- culture and brand identity are easier to preserve
- finance can be raised gradually
- there is no need to integrate another workforce or system
- growth can be matched to demand step by step

Limits of organic growth

- it can be too slow to change market share quickly
- internal funds may be limited
- rivals may acquire technology or customers faster
- new markets may still be hard to enter alone
- the firm may miss short-lived opportunities

Exam judgement

Organic growth is often the safer route because it protects culture and control, but it only works well when the firm has enough time, finance and existing capability to scale from within.

2. External growth

External growth occurs when a firm expands by integrating with, buying, or formally cooperating with another organisation. It can deliver instant access to customers, brands, technology and distribution, but it raises integration and finance risk.

Method	What it means	Main strength	Main risk
Merger	Two firms agree to combine into one larger business.	Shared resources and possible synergies.	Culture clashes and difficult integration.
Acquisition	One firm buys another with the target's support.	Fast access to assets, brands and customers.	Expensive; may overpay or duplicate roles.
Takeover	Control is gained by buying a majority of shares without board support.	Rapid control of a target business.	Resistance from managers and staff.
Joint venture	Two firms create a jointly owned project or new company.	Risk sharing and access to local knowledge.	Conflict over control or profit-sharing.
Strategic alliance	Two firms cooperate on a project without fully merging.	Flexible access to skills or distribution.	Weaker commitment and possible knowledge leakage.
Franchising	Independent operators trade under an established brand and business model.	Fast expansion with less capital for the franchisor.	Quality control problems can damage the brand.

Fast comparison

External growth usually offers more speed than organic growth, but the price is higher coordination risk, higher financing pressure and a greater chance of culture conflict.

3. Mergers, acquisitions and takeovers

These three forms of external growth all change ownership, but they differ in consent and control. In exams, define them precisely before analysing their advantages or risks.

Merger	Acquisition	Takeover
an agreed combination of two firms into one larger business; both sides usually approve	one business purchases another with the target board's agreement	control is gained without board support, usually by buying more than 50% of shares

Payment method	Typical implication
Cash purchase	Existing shareholders of the target are paid immediately, but the buyer may need heavy borrowing.
Share exchange	The buyer offers its own shares; this reduces cash pressure but dilutes ownership.
Mixed payment	Combines cash and shares to spread risk and improve deal appeal.

Why integration is hard

- systems, software and reporting methods may be incompatible
- leadership styles and culture may clash
- overlapping jobs can create redundancies
- advisory fees, restructuring costs and delays reduce the expected gains

Key line

A deal only creates value if the combined business generates real synergies after paying the costs of buying, restructuring and integrating the target.

4. Types of integration and motives

The purpose of external growth depends on the relationship between the firms involved. Different forms of integration create different benefits and different risks.

Type	What it means	Usual motive	Illustrative example	Main risk
Horizontal integration	combining with a business at the same stage and in the same industry	increase market share, reduce rivalry, spread fixed costs	two airlines combine to widen route coverage	competition concerns and overestimated synergies
Backward vertical integration	moving towards suppliers	secure inputs, improve coordination, control quality and cost	a smartphone producer buys a chip supplier	management distraction outside core strengths
Forward vertical integration	moving closer to the final customer	control distribution, retail presentation and customer data	a dairy producer acquires grocery outlets	channel conflict and retail complexity
Conglomerate integration	combining with a business in an unrelated industry	diversify risk and reduce dependence on one market	a pharmaceutical firm buys fitness centres	weak synergies and loss of strategic focus

Why the motives differ

- horizontal deals target rivalry and market power
- vertical deals target supply reliability and coordination
- conglomerate deals target diversification of risk

Evaluation

- horizontal growth may attract regulatory scrutiny
- vertical integration can improve control but increases management complexity
- conglomerates spread risk, but unrelated businesses may be harder to manage well

5. Stakeholder impacts and why deals fail

External growth affects more than the owners of the business. In strong exam answers, judge a merger or acquisition from the point of view of different stakeholders as well as the firm itself.

Stakeholder	Possible benefits	Possible risks
Investors	higher revenue, stronger market position and possible synergies can raise profits and share value	the buyer may overpay; debt and integration costs can reduce returns
Employees	a larger firm may create wider career paths or new jobs if it expands output	duplicated roles can lead to redundancies and lower morale
Suppliers	larger orders can increase sales volumes	the new firm may use stronger bargaining power to force lower prices or stricter terms
Customers	wider product range and better distribution may improve convenience	less competition can reduce choice or keep prices higher

Common reasons M&A underperforms

- managers overestimate cost savings or revenue synergies
- cultural resistance slows decision-making and execution
- IT systems and reporting structures do not combine smoothly
- large debt burdens create pressure before benefits appear
- the bigger organisation becomes bureaucratic and less responsive

Judgement

Rapid growth does not guarantee better performance. Success depends on whether post-deal integration is managed well enough for the predicted benefits to outweigh the costs and disruption.

6. Joint ventures and strategic alliances

Firms do not always need full ownership to grow. They can cooperate while remaining separate businesses, which often lowers cost and risk compared with a full acquisition.

Feature	Joint venture	Strategic alliance
Separate legal entity?	Yes - partners create a new jointly owned business.	No - firms cooperate while remaining fully separate.
Control	Shared ownership and shared management.	Control stays with each partner; cooperation is limited to the agreed project.
Best used when	a large project needs pooled capital, technology or local knowledge	firms want flexibility in research, production, marketing or distribution
Main advantage	clear long-term commitment and formal resource sharing	faster and more flexible than creating a new company
Main risk	disputes over strategy, profit-sharing or operational control	weaker commitment and possible leakage of know-how

Why they matter in foreign markets

- local partners understand regulation, supply chains and consumer behaviour
- risk is shared when the market is uncertain
- some countries require foreign firms to partner with domestic businesses

Illustrative examples

- a pharmaceutical firm and a biotech start-up create a vaccine venture
- a sportswear brand and a wearable-tech company collaborate on smart products
- a food producer partners locally before entering a new region

Exam line

These methods are strongest when a firm needs access to expertise or market knowledge but wants to avoid the cost and commitment of full ownership.

7. Franchising

In a franchise system, the franchisor allows the franchisee to use an established brand and business model in return for fees and ongoing royalties. It is a popular route for rapid, low-capital expansion.

Aspect	Franchisor	Franchisee
Provides / receives	provides the brand, systems, training and operating rules	invests in the outlet and pays fees or royalties
Main benefit	expands quickly without funding every new outlet itself	uses a tested model and a recognised name
Main concern	weak quality control can damage the whole brand	less freedom over pricing, suppliers and product range

Why franchisors like it

- franchisees finance local expansion
- royalty income creates a continuing revenue stream
- owner-managers are often highly motivated to make their outlet succeed

Why franchisees buy in

- reduced uncertainty compared with starting from scratch
- training, marketing support and bulk purchasing can improve performance
- a strong brand can attract customers faster

What affects franchise cost

- expected sales and profit margins
- the size and exclusivity of the territory
- the extent of training and ongoing support

Key judgement

Franchising can be an excellent scale strategy for service and retail brands, but only if systems, training and monitoring are strong enough to keep standards consistent across outlets.

8. Why some firms prefer to stay small

Growth is often treated as a sign of success, but remaining small can be a deliberate strategic choice. In some industries, personal service, flexibility and independence matter more than becoming bigger.

Why staying small can be rational

- to avoid aggressive retaliation from dominant competitors
- to stay below the level that attracts heavy regulatory scrutiny
- to preserve simple management structures and quick decisions
- to keep control in the hands of the founder rather than outside investors
- to maintain close customer relationships and a strong shared culture

Typical examples

- a niche ride-sharing firm avoids direct price war with global rivals
- an organic farm rejects external investors to protect its mission
- a tailoring business keeps personalised service as its key advantage

What growth may damage

- the personal touch that differentiates the business
- employee belonging and direct feedback
- speed of decisions and owner autonomy

Evaluation

A small firm can be strategically strong when customers value craftsmanship, trust, mission or fast responses more than low prices from large-scale production.

9. Organic versus external growth

The best route depends on what the business needs most: time to develop capability, or instant access to markets, assets and knowledge. Many successful firms use both routes at different stages.

Criterion	Organic growth	External growth
Speed	slower; market share changes gradually	faster; assets, staff and customers can be gained immediately
Finance	often funded from retained earnings or planned investment	may require large cash payments, share issues or borrowing
Control	high control over culture and strategic direction	shared or disrupted control during integration
Culture risk	low because the business grows from within	high if values, systems or leadership styles differ
Market entry	harder in unfamiliar markets	easier if the target or partner already operates there
Access to skills / technology	must be built internally over time	can be acquired quickly through buying or partnering
Management complexity	rises gradually	can jump sharply after a deal
Best when	time, patience and internal capability exist	speed or capability acquisition is critical

Hybrid strategies

- open new branches organically while buying selected niche brands
- enter a foreign market through franchising or a joint venture first, then invest more later
- use acquisitions for speed but rely on internal growth to deepen capability afterwards

How to evaluate in essays

- start with the objective: speed, control, diversification or capability
- consider finance and integration capacity
- apply industry context and stakeholder effects
- finish with a conditional judgement, not a blanket rule

10. Exam technique, practice and recap

Command words

- define: give a precise meaning
- explain / analyse: show the chain of cause and effect
- evaluate: weigh both sides and end with a supported judgement

High-scoring structure

- define the growth method clearly
- explain how it changes cost, speed, risk or control
- apply a realistic business example
- add a limitation or opposite side
- conclude conditionally: 'this depends on...'

Common mistakes

- confusing a merger with an acquisition or takeover
- assuming external growth always succeeds because it is fast
- ignoring finance, culture and stakeholder effects
- writing generic evaluation with no industry context

Practice questions

- Explain two reasons why a firm may prefer organic growth.
- Analyse how vertical integration can improve performance.
- Evaluate whether franchising is the best route for an expanding service brand.
- Discuss whether some firms should deliberately remain small.

30-second recap

- Organic growth builds from within and usually gives more control.
- External growth is faster, but it increases finance and integration risk.
- Horizontal, vertical and conglomerate integration have different motives.
- Joint ventures, alliances and franchising are flexible alternatives to full ownership.
- The best answer is usually conditional: choose the route that fits the objective, industry and capability of management.