

1.5 b) The difference between internal and external growth (AO2)



Organisations that pursue growth can choose from two broad methods: internal and/or external growth.

Internal growth (also known as **organic growth**) takes place when an organisation expands without the help of an external partner firm. Instead, it uses its own resources to do so, such as using retained profits to invest in production facilities in new locations. Large companies can also sell shares on a public stock exchange to raise finance for expansion, whilst new companies can raise share capital (to fund business growth) from an initial public offering (IPO) on the stock exchange.

Case Study 1 - The World's 11 largest IPOs

1. Saudi Aramco, Saudi Arabia, \$29.4 billion
2. Alibaba.com, China, \$25 billion
3. SoftBank, Japan, \$23.5 billion
4. Agricultural Bank of China, China, \$22.1 billion
5. Industrial & Commercial Bank of China (ICBC), China, \$21.9 billion
6. AIA, Hong Kong SAR, \$20.5 billion
7. General Motors, USA, \$20.1 billion
8. NTT DoCoMo, Japan, \$18.4 billion
9. VISA, USA, \$17.8 billion
10. ENEL SpA, Italy, \$17.4 billion
11. Facebook, USA, \$16.0 billion

Source: Adapted from **Statista**

Organic growth, or natural growth, comes about from increased sales revenues and higher profits, with retained profits being reinvested in the organisation. Using bank loans to finance expansion of the organisation is still considered as internal growth as the bank is a third party, rather than a partner organisation in the pursuit of growth.

Business organisations pursue internal growth for several reasons, including:

- To foster brand awareness and brand loyalty
- To increase market share
- To maintain its corporate culture
- To maintain ownership and control of the organization
- To avoid the comparatively high expenses and risks associated with external growth.

However, due to the relatively finite resources available for internal growth, it often takes far longer to materialise than with methods of external growth. In some cases, organic growth can even lead to diseconomies of scale caused by inefficiency and coordination problems of being too large.

By contrast, **external growth** (also known as **inorganic growth**) takes place when an organisation needs the support of a partner organisation for growth. For example, McDonald's uses franchisees who buy McDonald's restaurants and operate using the franchisee's brands and products. The franchisee pays for this, helping McDonald's to grow through partner businesses. **Mergers and acquisitions** are other examples.

Business organisations pursue external growth for several reasons, including:

- To grow at a faster pace
- To diversify their product portfolio
- To gain market share
- To gain customers in new and existing markets
- To reduce competition in the industry.

External growth is usually faster than internal growth, but also more expensive to execute (especially in the cases of mergers and acquisitions). Inorganic growth typically requires external sources of finance, and also involves a lot of bureaucracy. Gaining trust from partner companies can be another hurdle for achieving inorganic growth. It also carries significantly more risks, such as organisational culture clashes and **diseconomies of scale** due to the inefficiencies created by the larger organisation.

Case Study 3 - Samsung

Although Samsung is best known for its smartphones and other consumer electronics products (such as televisions and digital cameras), the South Korean conglomerate is also involved in advertising, construction, food processing, insurance, textiles, ship building, theme park management, and weapons manufacturing!

Founded in 1938, Samsung is the largest South Korean conglomerate. The company did not enter the consumer electronics industry until the late 1960s. According to *Forbes*, by the end of 2022, Samsung was the 4th largest global technology company as measured by brand value.

Business Management Toolkit (BMT)

Examine how knowledge of SWOT analysis can help managers to make more informed decisions about methods of internal and external growth.

You might find it useful to refer to **BMT 1 - SWOT analysis** prior to answering the above task.