Case Studies on

Mergers, Acquisitions & Alliances – Vol. I

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AN OVERVIEW

In today's competitive world, for any company, it is becoming harder to achieve leadership position and stay on top. Hence, companies tend to focus on inorganic (external) growth rather than organic growth when it decides to expand its existing operations quickly. There are several ways by which companies can combine their efforts. They can partner a project, mutually agree to join forces and merge, or one company can completely acquire another company, taking over all its operations, including its holdings and debt, and at times replacing management with their own representatives. Generally, there are three forms of inorganic growth – Mergers, Acquisitions and Alliances.

Mergers occur when two or more firms combine operations to set up a firm, with a new name. The major goal of a merger is to achieve management synergy by creating a stronger management team. An example of a major merger is the merging of JDS Fitel Inc and Uniphase Corp. in 1999 to form JDS Uniphase. Acquisitions, another form of inorganic growth, occur when one company purchases another company. Here, the acquiring company absorbs the other company, which loses its identity after the acquisition. The acquired company and its assets may be absorbed into an existing business unit or continues to function as an independent subsidiary within the parent company. Acquisitions usually occur when a larger firm purchases a smaller company. An example of a major acquisition is Manulife Financial Corporation's 2004 acquisition of John Hancock Financial Services Inc. The companies may also flourish by entering into Strategic Alliances, which are agreements between firms in which each company's resources are utilised to achieve a common set of objectives.

Mergers, acquisitions and alliances have been a part of the business world for centuries. In today's dynamic economic environment, through mergers and acquisitions, a company aims to corner a competitive advantage and ultimately increase shareholder value. The key principle behind buying a company is to improve shareholder value over and above that of the sum of the two companies in the long-term.

Mergers

In a merger, two firms of about the same size, agree to establish a single new entity with the goal of floating a company that is worth more than the sum of its parts. Both companies' stocks are surrendered and instead new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist post merger, and a new company christened, DaimlerChrysler, was created. A merger involves the mutual consent of two equal companies to combine and become one entity. Based on the relationship between the two companies, mergers are divided into the following types:

Horizontal merger – occurs between two companies that are in direct competition and share similar product lines and markets. For example, a beer company may choose to buy out a smaller competing brewery, enabling the smaller company to produce more beer and sell more to its brand-loyal customers.

Vertical merger – occurs between a customer and a company or a supplier and a company. A cone supplier merging with an ice cream maker is a good example. It occurs when two firms each working at different stages in the process of production of a same product decide to merge.

Market-extension merger – occurs between two companies that sell the same products in different markets.

Product-extension merger – occurs between two companies selling different but related products in the same market.

Conglomeration – occurs between two companies that represent different business areas.

Acquisitions

Although it seems to be synonymous with merger, it differs slightly. When one company purchases another company and clearly establishes itself as the new owner, the purchase is called an acquisition. Here, the purchased company ceases to exist and the buyer's stock continues to be traded.

An acquisition does not necessarily have to be a mutual decision of two companies. A larger company can initiate a hostile takeover of a smaller firm, which essentially amounts to buying the company in the face of resistance from the smaller company's management. Unlike in a merger, in an acquisition, the acquiring firm usually offers a cash price per share to the target firm's shareholders or the acquiring firm's shares to the shareholders of the target firm. Either way, the purchasing company essentially finances the purchase of the target company, buying it outright for its shareholders. Hence, whether a purchase is considered a merger or an acquisition depends on whether the purchase is friendly or hostile.

When a firm acquires another firm, there is a short-term effect on the stock price of both companies. In general, the acquiring company's stock plummets because of a number of reasons. First, the acquiring company must pay more than the target company currently is worth to conclude the deal. Beyond that, there are often a number of uncertainties involved with acquisitions. But, the target company's stock price will escalate because the acquiring company typically has to pay a premium for the acquisition.

Mergers and acquisitions create synergies and economies of scale, expanding operations and cutting costs. But, takeover company may encounter few problems at the time of acquisition:

- A turbulent integration process: problems associated with integrating different workplace culture
- Lost productivity because of management power struggles
- Additional debt or expenses that must be incurred to make the purchase
- Accounting issues that weaken the takeover company's financial position, including restructuring charges and goodwill.

Mergers can fall through for myriad reasons including a lack of foresight on the part of the management, the inability to overcome practical challenges and loss of revenue inflow due to neglect of day-to-day operations. To avoid any failure, acquiring companies employ various methods to weigh up their targets. Some of these methods are based on comparative ratios like the P/E and P/S ratios, replacement cost or discounted cash flow analysis.

Alliances

Generally, strategic alliances are arrangement or cooperation or partnership between two or more equal companies. They join together for a set period of time to achieve mutual goals through collaboration. In a strategic alliance, resources, capabilities, and core competences are combined or shared to pursue mutual interests.

Strategic alliances enable businesses to gain competitive advantage through access to a partner's resources, including markets, technology, capital and human resources. Many fast-growth technology companies draw on strategic alliances to benefit from more-established channels of distribution, marketing, or brand reputation of bigger, better-known players. However, traditional businesses tend to enter alliances for geographic expansion, cost reduction, manufacturing, and other supply-chain synergies. Nearly two-thirds of fast-growing companies are involved in strategic alliances.

Strategic alliances can be categorized into different types – contractual arrangements (such as license agreements, marketing agreements, and development agreements), minority equity investments, joint ventures that are operated as separate legal entities (such as corporations, limited liability companies, or partnerships), joint marketing & promotion, joint selling or distribution, technology licenses, R&D contracts, design collaborations, production arrangements, business expansion abroad, outsourcing, etc.

The simplest form of strategic alliance is a contractual arrangement. Examples of contractual strategic alliances are license agreements, marketing, promotion, and distribution agreements, development agreements, and service agreements. The most intricate form of strategic alliance is a joint venture. A joint venture involves creating a separate legal entity through which the business of the alliance is conducted.

These inorganic growth strategies are illustrated in depth through the case studies in the book covering 24 companies spanning across 18 different industries. The following table lists the cases in the book and relates them to the conceptual framework, giving the primary issues each case is designed to highlight.

Sl. No.	Cases	Industry
1	Acquire and Ascend – The eBookers way	Travel
2	Ahold's Merger and Acquisition Strategy: Cees Van Der Hoeven's approach	Retail Services
3	Alcoa: The US Aluminum Giant's Growth Strategies	Metals and mining
4	Amgen's Growth Strategies	Biotechnology
5	AngloGold's Growth Strategies	Precious metals m
6	Barclays PLC: Growth Strategies	Financial Services
7	Carlson Wagonlit Travel: The Growth Strategies	Travel agencies ar services
8	Cendant: The US Travel Conglomerate's Growth Strategies	Travel
9	Finmeccanica:The Italian Helicopter Manufacturers' Growth Strategies	Aerospace and de
10	Growth Strategies of Rexam Plc.	Packaging and Co Manufacturing
11	Growth Strategies of Telefonica	Telecommunicatio
12	Heineken in Russia: The Growth Strategies	Brewers
13	Hypobank and Vereinsbank Merger: Troubles Outweigh the Synergies	Banking and Finan Services
14	ICICI into Universal Banking	Banking and Finan Services
15	InterActiveCorp: Growing Strong	On-line Retailing a Services
16	KB Home: The Homebuilder's Growth Strategies	Residential Constr
17	Lakshmi Niwas Mittal – Spearheading Consolidation in the Global Steel Industry	Steel
18	Nicholas Piramal India Ltd: Mergers and Acquisitions	Pharmaceuticals

There are twelve cases in the book that illustrate 'Acquisitions' strategy, providing insights into issues like how companies have grown through mergers and acquisitions. While *The Royal Bank of Scotland's Growth Strategies* delves into how The RBS (Royal Bank of Scotland) reaped benefits primarily through acquisitions to become the fifth largest bank in the world in June 2004, *InterActiveCorp: Growing Strong* highlights how Interactivecorp. became one of the most prospective on-line companies in the world by acquiring some highly profitable on-line services like Expedia.com, Ticketmaster.com and Lendingtree.com, among others.

The case, *Hypobank and Vereinsbank Merger: Troubles Outweigh the Synergies*, helps in understanding the concept of 'Mergers' and how the merger got into trouble.

Another case, *Carlson Wagonlit Travel: The Growth Strategies*, outlines how Carlson Wagonlit's aggressive global growth strategies, based on acquisitions and joint ventures has turned it into the second largest travel agency in the world.

Readers would also find eight case studies dealing with 'Mergers and Acquisitions'. In *Pfizer: Mergers and Acquisitions*, to maintain its competitive position as the biggest pharmaceutical company in the world, Pfizer, which had always adopted a strategy of 'organic' growth, abruptly changed its policy and turned to the path of 'inorganic' growth. The concept is also illustrated through *Nicholas Piramal India Ltd: Mergers and Acquisitions*.