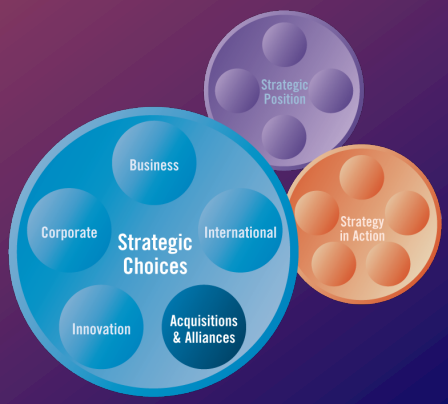
EXPLORING STRATEGY
10TH EDITION

Strategic Choices
10: Mergers, Acquisitions and Alliances



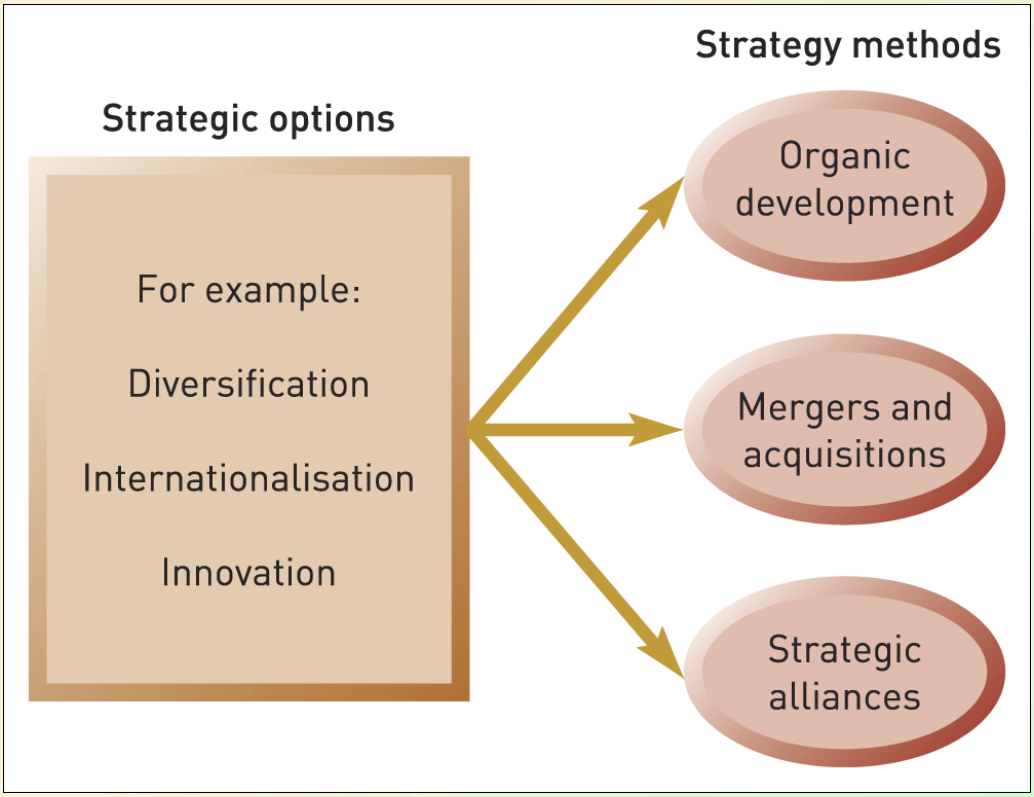
Johnson, Whittington, Scholes, Angwin and Regnér, *Exploring Strategy Powerpoints on the Web*, 10th edition ©Pearson Education Limited 2014

Learning outcomes

Identify

- key strategic motives for ***mergers and acquisitions*** and ***strategic alliances***.
- key issues in the successful management of ***mergers and acquisitions*** and ***strategic alliances***.
- the ***appropriate choices*** between ***organic development, mergers and acquisitions*** and ***strategic alliances***.
- ***key success factors*** of different growth options.

Three strategy methods



Organic development

Where a strategy is pursued by ***building on and developing an organisation's own capabilities.*** This is essentially the 'do it yourself' method.

An example is Amazon's entry into the e-books market with the development of 'Kindle' – based on its own research and expertise.

Advantages of organic development

- ***Knowledge and learning*** can be enhanced.
- ***Spreading investment over time*** – easier to finance.
- ***No availability constraints*** – no need to search for suitable partners or acquisition targets.
- ***Strategic independence*** – less need to make compromises or accept strategic constraints.
- ***Culture management*** – new activities with less risk of a culture clash.

Corporate entrepreneurship

Refers to radical change in the organisation's business, driven principally by the organisation's own capabilities.

For example, ***Amazon's*** development of ***Kindle*** was a radical entrepreneurial step, taking it from retailing into the design of innovative electronic products.

Mergers and acquisitions

Mergers and acquisitions are concerned with the combination of two (or more) organisations.

•An ***acquisition*** is achieved by purchasing a majority of shares in a target company.

'Friendly' acquisitions are where the target's management recommend accepting the acquirer's deal.

'Hostile' acquisitions are where the target's management refuse the acquirer's offer.

•A ***merger*** is the combination of two previously separate organisations in order to form a new company.

Timing of mergers and acquisitions

- M&A activity has existed for over 100 years.
- It occurs in waves of high peaks and deep troughs.
- Cycles are affected by the state of the global economy, new regulations, finance availability, stock market performance, technological disturbances.
- Traditionally dominated by the US and Western European companies, but China and India are now very active acquirers.

Strategic motives for M&A

Strategic motives can be categorised in three ways:

- ***Extension*** – of the reach of a firm in terms of geography, products or markets.
- ***Consolidation*** – increasing scale, efficiency and market power.
- ***Capabilities*** – enhancing technological know-how (or other capabilities).

Financial motives for M&A

There are three main financial motives:

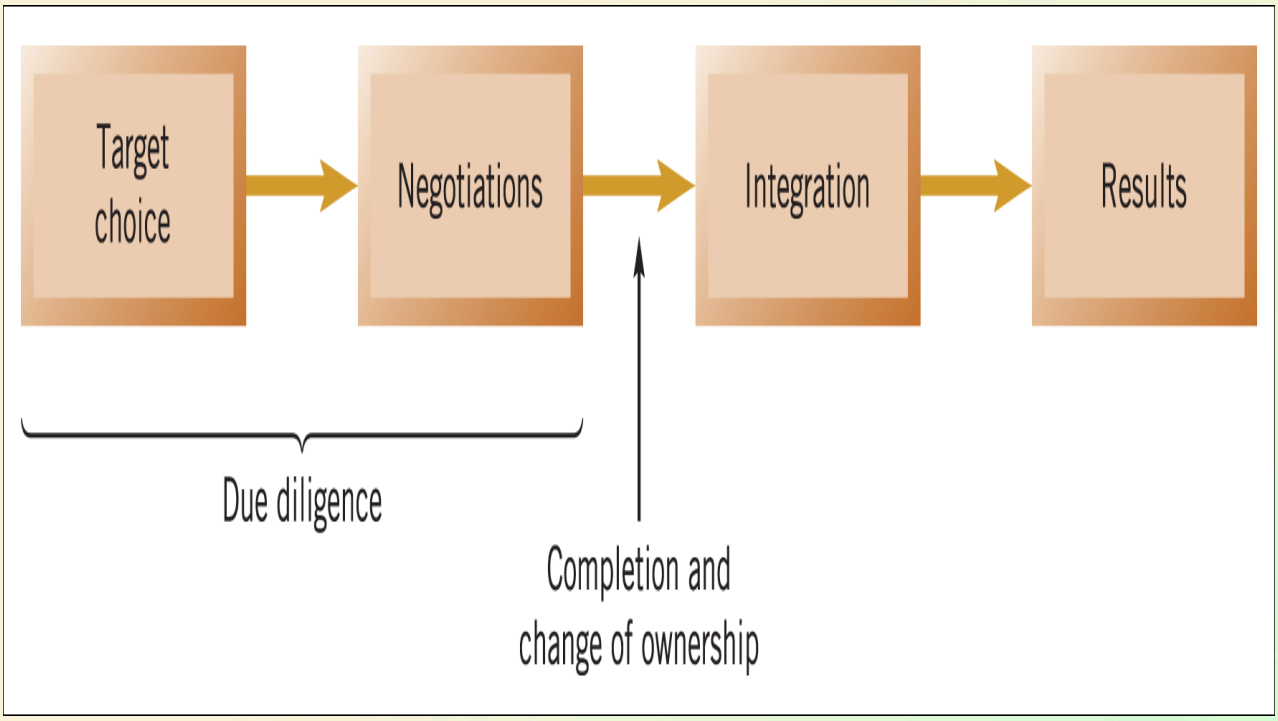
- ***Financial efficiency*** – a company with a strong balance sheet (cash rich) may acquire/merge with a company with a weak balance sheet (high debt).
- ***Tax efficiency*** – reducing the combined tax burden.
- ***Asset stripping or unbundling*** – selling off bits of the acquired company to maximise asset values.

Managerial motives for M&A

M&A may serve managerial self-interest for one of two reasons:

- ***Personal ambition*** – financial incentives tied to short-term growth or share price targets; boosting personal reputations; giving friends and colleagues greater responsibility or better jobs (and thus helping to cement their loyalty)
- ***Bandwagon effects*** – managers may be branded as conservative if they don't follow an M&A trend; shareholder pressure to merge or acquire; the company may itself become a takeover target.

The acquisition process



Target choice in M&A

Two main criteria apply:

- ***Strategic fit*** – does the target firm strengthen or complement the acquiring firm's strategy? (N.B. It is easy to over-estimate this potential synergy whereas negative synergies are often neglected.)
- ***Organisational fit*** – is there a match between the management practices, cultural practices and staff characteristics of the target firm and the acquiring firm?

Negotiation in M&A

Managements need to agree on both the price and the terms and conditions in M&A:

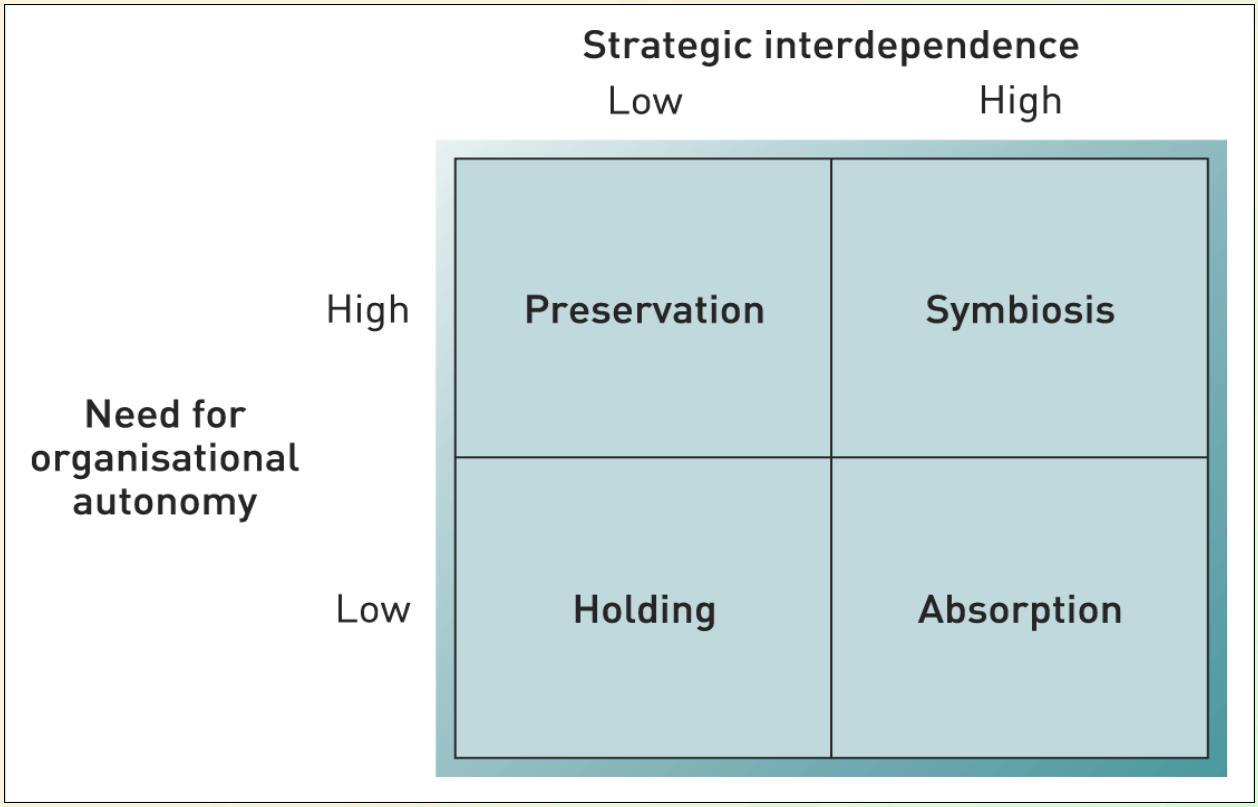
- Offer the target too little, and the bid will be unsuccessful.
- Pay too much and the acquisition is unlikely to make a profit net of the original acquisition price (*'the winner's curse'*).
- Acquirers do not simply pay the current market value of the target, but also pay a *'premium for control'*.

Integration in M&A (1)

Haspeslagh and Jemison emphasise two key criteria:

- ***Extent of strategic interdependence*** – the need for transfer or sharing of capabilities and/or resources
- ***Need for organisational autonomy*** – sometimes the distinctiveness of the acquired company can be an advantage, but sometimes it is problematic.

Acquisition integration matrix



Source: P. Haspeslagh and D. Jemison, *Managing Acquisitions*, Free Press, 1991.

Integration in M&A (2)

Approaches to integration:

- ***Absorption*** – strong strategic interdependence and little need for organisational autonomy. Rapid adjustment of the acquired company's strategies, culture and systems.
- ***Preservation*** – little interdependence and a high need for autonomy. Old strategies, cultures and systems can be continued much as before.
- ***Symbiosis*** – strong strategic interdependence, but a high need for autonomy. Both the acquired firm and acquiring firm learn and adopt the best qualities from each other.
- ***Holding*** – a residual category – with little to gain by integration. The acquisition will be 'held' before being sold on, so the acquired unit is left largely alone.

M&A strategy over time

Mergers and acquisitions are rarely one-off events for an organisation:

- ***Serial acquirers*** – make multiple acquisitions (often in parallel). This enables them to build up M&A expertise. Examples include Cisco Systems and IBM.
- ***Divestment (or divesture)*** – the process of selling a business that no longer fits the corporate strategy. Unless the parent can provide a 'parenting advantage' the business should be sold off.

Strategic alliances

Where two or more organisations share resources and activities to pursue a strategy.

- ***Collective strategy*** is about how the whole network of alliances, of which an organisation is a member, competes against rival networks of alliances.
- ***Collaborative advantage*** is about managing alliances better than competitors.

Types of strategic alliance

In terms of ownership, there are two main kinds of strategic alliances:

- ***Equity alliances*** involve the creation of a new entity that is owned separately by the partners involved.
- ***Non-equity alliances*** are typically looser alliances, without the commitment implied by ownership.

Equity alliances

- The most common form of equity alliance is the ***joint venture***, where two organisations remain independent but set up a new organisation jointly owned by the parents. (An example is Virgin Mobile India – set up by Tata Tele and Virgin Service Group.)
- ***A consortium alliance*** involves several partners setting up a venture together. (An example is Sematech research consortium set up by IBM, HP, Toshiba and Samsung.)

Non-equity alliances

Non-equity alliances are often based on contracts. Such alliances are also common in both the private and the public and not-for-profit sectors.

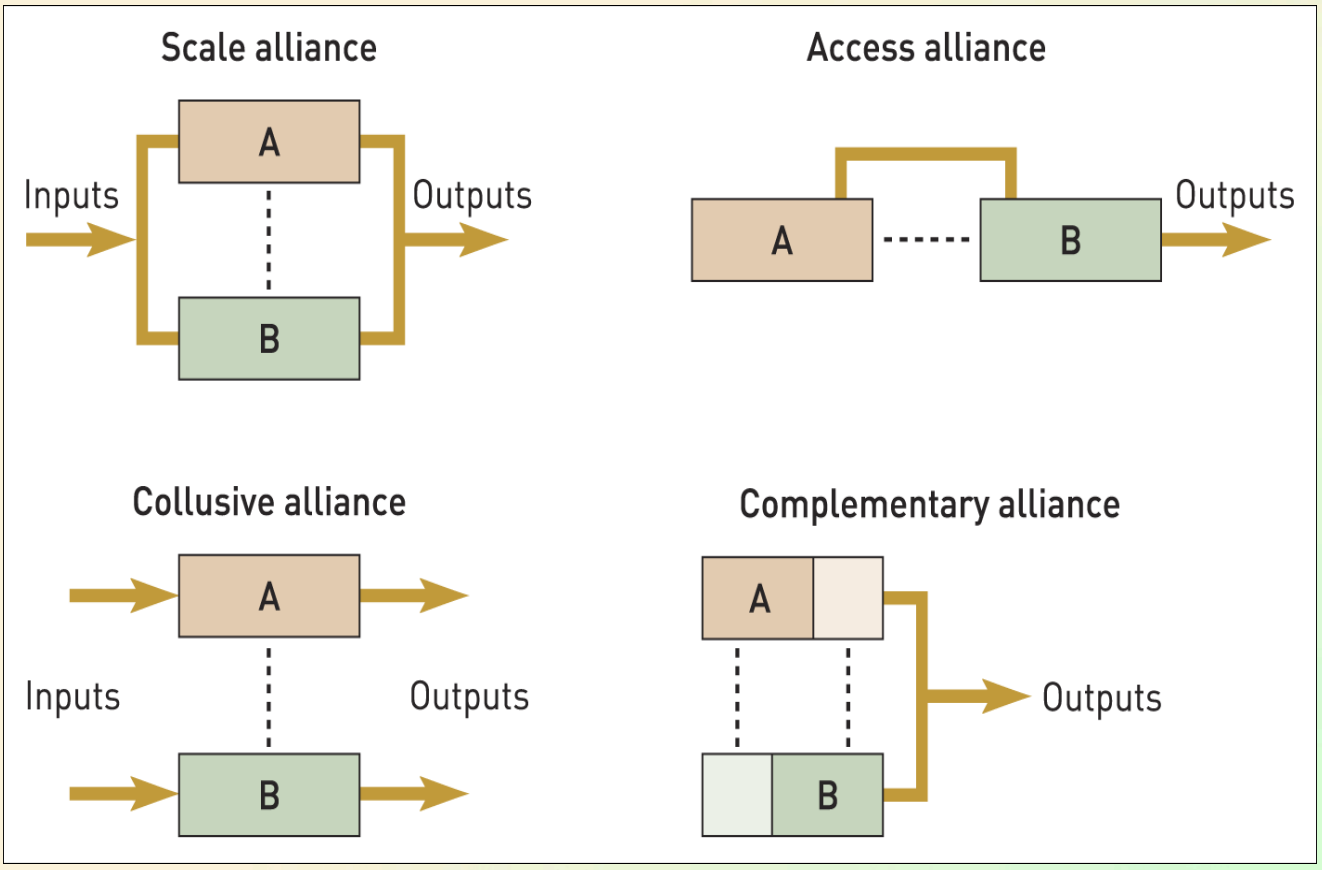
Three common forms of non-equity alliance:

- ***Franchising*** (Kall-Kwik printing or Subway)
- ***Licensing*** (common in beer brewing)
- ***Long-term subcontracting*** (common in supplying parts for automobile manufacture).

Motives for alliances

- ***Scale alliances*** – lower costs, more bargaining power and sharing risks
- ***Access alliances*** – partners provide needed capabilities (e.g. distribution outlets or licenses to brands)
- ***Complementary alliances*** – bringing together complementary strengths to offset the other partner's weaknesses
- ***Collusive alliances*** – to increase market power. Might be kept secret to evade competition regulations.

Strategic alliance motives



Strategic alliance processes

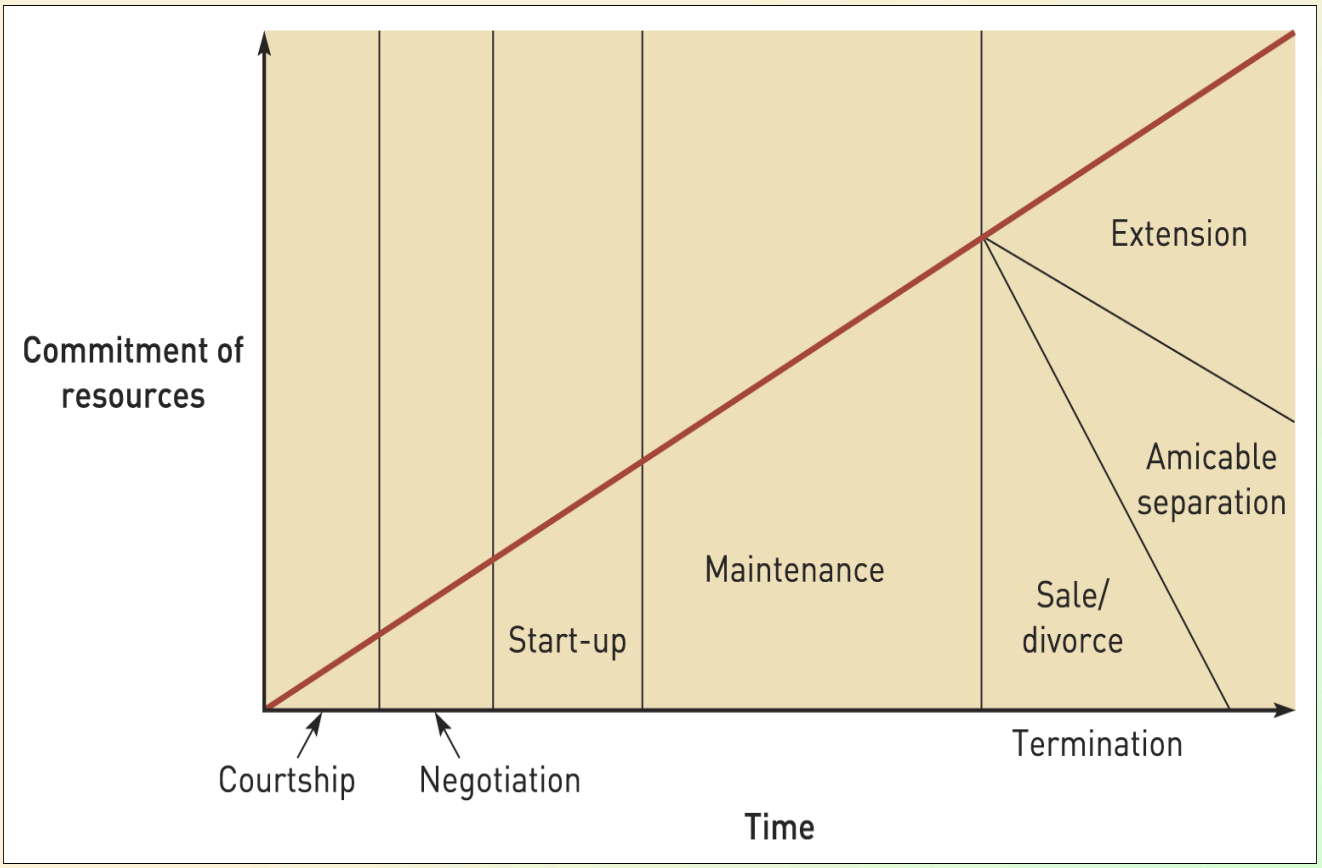
Two themes are vital to success in alliances:

- ***Co-evolution*** – the need for flexibility and change as the environment, competition and strategies of the partners evolve
- ***Trust*** – partners need to behave in a trustworthy fashion throughout the alliance.

Alliance evolution (1)

- ***Courtship*** – finding the right partner
- ***Negotiation*** – agreeing roles, ownership, profit share and responsibilities
- ***Start-up*** – committing resources, establishing systems, making adjustments
- ***Maintenance*** – ongoing investment and operations. Evolving with change
- ***Termination*** – finding an exit strategy (sometimes friendly but sometimes bitter).

Alliance evolution (2)



Source: Adapted from E. Murray and J. Mahon, 'Strategic alliances: gateway to the New Europe', *Long Range Planning*, vol. 26 (1993), p. 109.

Comparing acquisitions, alliances and organic development (1)

	Buy	Ally	DIY
High urgency	Fast	Fast	Slow
High uncertainty	Failures potentially saleable	Share losses and retain buy option	Failures likely unsaleable
Soft capabilities important	Culture and valuation problems	Culture and control problems	Cultural consistency
Highly modular capabilities	Avoid buying whole company	Ally just with relevant partner unit	Develop in new venture unit

Comparing acquisitions, alliances and organic development (2)

Key factors in choosing the method of strategy development:

- ***Urgency*** – organic development is slowest, alliances accelerate the process but acquisitions are quickest.
- ***Uncertainty*** – an alliance means risks and costs are shared and thus a failure means these costs are shared.
- ***Type of capabilities*** – acquisitions work best with 'hard' resources (e.g. production units) rather than 'soft' resources (e.g. people). Culture clash is the big issue.
- ***Modularity of capabilities*** – if the needed capabilities can be clearly separated from the rest of the organisation an alliance may be best.

Key success factors

Key elements in managing M&A and alliances:

- ***Strategic fit***
- ***Organisational fit***
- ***Correct valuation***
- ***Integration***
- ***Co-evolution***
- ***Appropriate exit strategies***

Summary (1)

- There are three broad methods for pursuing a growth strategy: ***mergers and acquisitions***, ***strategic alliances*** and ***organic development***.
- Organic development can be either continuous or radical. Radical organic development is termed ***corporate entrepreneurship***.
- Acquisitions can be ***hostile*** or ***friendly***. Motives for mergers and acquisitions can be ***strategic***, ***financial*** or ***managerial***.
- The acquisition process includes ***target choice***, ***valuation*** and ***integration***.

Summary (2)

- Strategic alliances can be ***equity*** or ***non-equity***. Motives for strategic alliances include ***scale***, ***access***, ***complementarity*** and ***collusion***.
- The strategic alliance process relies on ***co-evolution*** and ***trust***.
- The choice between acquisition, alliance and organic methods is influenced by four key factors: ***urgency***, ***uncertainty***, ***type of capabilities*** and ***modularity of capabilities***.