

STRATEGIC MANAGEMENT: MANAGING MERGERS & ACQUISITIONS

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ABSTRACT

In this paper we have discussed what mergers and acquisitions are and how they are a part of any organizations strategic planning policy. Organizations 'merge' generally with similar organizations or 'acquire' weaker organizations, and the essence as to why they do so is that the value of two is greater than one. They basically merge with or acquire each other's strengths and try to overcome one another's weaknesses thus leading to increased market shares and profitability. We have discussed the various rationales for mergers and acquisitions like the strategic rationale, speculative rationale, management failure rationale etc, along with their types that include vertical integration, horizontal integration and conglomeration. We have also put light on how companies go strategically about mergers and acquisitions. The merger and acquisition life cycle aided by real examples (case studies) will offer a vivid understanding of these concepts to the reader.

KEY WORDS

Management, Strategies, Rationales, Mergers & Acquisitions

1. INTRODUCTION

Mergers and acquisitions that are usually referred to as M&As are an important part of corporate restructuring. The basic concept behind mergers and acquisitions is that two companies together are of more value than those two companies when they are separate entities. It is basically a consolidation of two companies. Therefore, the understanding of mergers and acquisitions is of great importance in today's world where newspapers almost every day tell stories of such taking place around the globe. Some business sectors where mergers and acquisitions take place are finance, pharmaceuticals, chemicals, oil, telecommunications, IT etc.

1.1 Merger

A merger is a strategy of joining two businesses. Basically a merger occurs when two companies join or merge to form one single company but with a new name.

'M&As represent a marriage.' [1]

This is because a merger often takes place between two companies that are equal in size and stature and with their cooperation, thus the term 'merger of equals'. This may not be true always or for all the companies that merge. Sometimes a merger is not a marriage between two equals. Hence:

'When two companies differ significantly in size, they usually merge.' [2]

1.2 Acquisition

'Acquisition refers to a situation where one firm acquires another and the latter ceases to exist'. [2]

Simply put in what happens in an acquisition is that one business buys another usually smaller business that might be absorbed within the parent organization or run as a subsidiary.

A company / organization that attempts to merge / acquire with some other company / organization is generally referred to as the acquiring firm. On the other hand the company / organization that is being acquired is known as the target company / organization.

2. MERGERS AND ACQUISITIONS AND STRATEGIC MANAGEMENT

Initially, that is in the past decades mergers and acquisitions were merely financial transactions aiming to control undervalued assets and the target was an industry or business very different from the acquirer's core business. Cash flows merely sufficient for debt repayment was the main goal. Mergers and acquisitions in recent times are very different.

'Today, the typical merger or acquisition is quite strategic and operational in nature.' [3]

This implies that today, managers are not just buying undervalued assets as discussed above but what they are buying are installed customer bases, better distribution channels, greater geographical boundaries, organizational competencies and a variety of new talent. All of these acquired factors in turn offer more strategic opportunities to organizations so that they can gain an edge over their competitors' products and services. Such organizations are successful in consolidating business units in an attempt to maximize revenues and share prices.

'Strategic Planning has long been emphasized by organizations as an important tool leading to business success.' [4]

Many studies conducted in this regard revealed that seldom did managers had any clear strategic rationale for M&As and the impact these deals will have on the company in the upcoming periods. As discussed above, companies have recently shifted their emphasis from cost saving to using M&As as a strategic driver for growth in corporations.

Mergers and acquisitions have several reasons to be justified. Organizations that undertake such deals can either gain from them or can be a complete failure. It is therefore very important to align any organizations strategic plans with their M&A plans. This can be done by an effective tool that is due diligence that implies the screening of all the potential merger and acquisition targets. Due diligence is explained later in our paper. [4]

3. THE IMPORTANCE OF MERGERS AND ACQUISITIONS

Mergers and acquisitions generally referred to as M&A are a very important means whereby companies respond to the ever-changing strategic environment.

‘Many firms have no alternative but to merge, acquire or be acquired’. [5]

Simply put when organizations have no chance of survival they give themselves a last chance by merging or by being acquired.

The basic goal of businesses in today’s world is to grow or death is destined for you. Companies that are successful that is those companies that are growing will snatch market share from their competitors, will generate high economic profits and provide reasonable returns to shareholders. On the other hand companies that experience stagnant growth lose both their customers and market share in addition to destroying shareholder value.

‘Mergers and acquisitions (M&A) play a critical role in both sides of this cycle.’ [6]

Mergers and acquisitions enable successful companies to grow faster than their competition by combining the strengths of the companies that have merged. On the other hand, they lead to total extinction of the weaker companies by having them acquired by other large and successful companies.

‘Mergers and acquisitions are a vital part of any healthy economy and importantly, the primary way that companies are able to provide returns to owners and investors.’ and also that ‘Merger and acquisitions are among the most powerful and versatile growth tools employed by companies of all sizes and in all industries.’ [6]

This also signifies the importance of mergers and acquisitions in that they are highly efficient growth tools employed by organizations of all sizes and virtually in all industries. This depicts as M&As being a global trend.

3.1 The Reasons behind Mergers and Acquisitions

Companies and businesses use mergers and acquisitions for many reasons. Some are mentioned below:

→ Mergers and acquisitions can pave ways for entering new markets, Adding new product lines and increasing the distribution reach—that is gaining a core competence to do more combinations.

→ Mergers and acquisitions are used to increase / enhance shareholder value. This is done by:

- Cost reductions that are achieved by combining departments, operations, and trimming the workforce—this cost reduction in turn leads to increased profitability.
- Increasing revenue by absorbing a major competitor and thereby increasing market share.
- Cross-selling of products / services.

- Tax savings that are achieved when a profitable company merges with or takes over a money-loser.
- Diversification that can stabilize earnings and boost investor confidence.

→Some mergers and acquisitions take place when management of any business recognizes the need to transform corporate identity. [6]

→Mergers and acquisitions are also used for risk spreading

→ Acquisitions are undertaken to achieve vertical and horizontal operational synergies where synergies signify that the whole is greater than the parts. [7]

→Some mergers and acquisitions take place for market dominance and reaching economies of scale. [8]

3.2 Screening of potential Merger and Acquisition targets

As complexity of mergers and acquisitions has increased, the scope and effectiveness of due diligence is now questionable. [9]

To overcome the danger of making a wrong decision, it should be well understood that the potential buyer of an organization needs to work out and act on a clear criteria when considering a potential merger or acquisition. [10]

Organizations considering a merger or acquisition should filter out their targets for the merger or acquisition to be a success. They should rely on several metrics to triangulate values, define and agree the criteria upfront, rapidly filter out irrelevant organizations, and should take a stealth approach to determining the size and performance of competitors.

Organizations should also plan for successful target engagement. To do so, they should clearly identify their targets and offer compelling value proposition to potential target candidates. [11]

3.3 Rationale behind Mergers and Acquisitions

There are many rationales that determine the nature of a proposed merger or acquisition. They are discussed as follows: [12]

→Strategic Rationale

To achieve a set of strategic objectives, the strategic rationale plays an important role. Mergers and acquisitions are usually not central to achieve strategic objectives, as usually there are other alternatives available. A merger to secure control of capacity in the chosen sector is an example.

→Speculative Rationale

This rationale takes place when the acquirer takes the acquired organization as a commodity. The organization only will acquire another if it feels that it is a potential target and that it could benefit from this acquisition. A major risk in this type of acquisition is that the acquirer can do anything with the other organization which is acquired. It could either split it up or sell it in parts. The speculative rationale is very much vulnerable to changes happening in the environment.

→**Management Failure Rationale**

Sometimes, mergers and acquisitions may be forced due to failure on the management's side. Strategies might be wrongfully aligned or market conditions may change significantly while implementing the timescale. The result may be that the initial strategy becomes misaligned.

.→**Political Rationale**

In today's world, the impact of political influences is becoming increasingly significant with respect to mergers and acquisitions. Mergers under this rationale usually take place on governmental levels.

→**Business Redefining Rationale**

Business redefinition is sometimes possible through mergers and acquisitions. This is an appropriate strategic rationale when an organization's mission and vision grow stale due to for example, a major technological change. When this is the case, the organization cannot immediately update its technology by internal investments so the organization seeks to acquire to redefine its business.

4. INTEGRATION AND CONGLOMERATION

Generally speaking, there are three types of mergers:

- Vertical Integration
- Horizontal Integration
- Conglomeration

They are discussed briefly as follows:

→**Vertical Integration**

This type of integration is characterized by forward and backward integration along the supply chain.

In its simplest form, it is the process of manufacturers merging with retailers or suppliers. This type of integration is an attempt to reduce risks related to supplies. Mergers and acquisitions are often used to achieve vertical integration. This integration merges manufacturers with suppliers or retailers. Vertical integration can both run backwards and forwards.

Integration which runs towards the customer base is known as forward integration where as the integration which runs towards the supplier base is known as backward integration.

Some advantages of vertical integration are briefly discussed below:

Combined processes

As the production processes of most organizations carry fixed price overheads, there is, theoretically, prospect of increased support function efficiency.

Quality management

A fully integrated production system provides better opportunities for a through quality management system which covers every aspect of production.

Reduced negotiation

The need for complex and competitive negotiations decreases due to the fact that suppliers are acquired.

Improved risk management

One of the benefits of this type of integration is that the risk associated with suppliers is reduced to quite some extent. In many ways, the acquirer gets the control of supply products and raw materials.

→Horizontal Integration

Horizontal integration is when one company acquires another company that is active in the same sector. This type of integration occurs when two companies that are engaged in essentially the same product or service merger to increase and uplift their combined market value. Examples include global oil producing companies and automobile distribution companies.

→ Conglomeration

Conglomeration refers to the acquisition of unrelated companies that continue production in unrelated sectors. This can be a useful approach in spreading business risks across a wide range of areas. As conglomerates grow and expand, the risks increase rather than decrease.

4.1 Timing of Integration

Other than different levels and forms of integrations, the time of these integrations play a very major role in the success of the merger or acquisition. This is related to the ongoing processes in the acquired company. The exploitation and exploration of processes require different types of integration therefore their timing of integration will also be different. [13]

“The longer the temporal lag between the closing and start of integration, the lower the acquisition performance.” [14]

Thus it is very important to take timing of integration into consideration while acquiring or merging with a company. If time is not taken into consideration, the merger or acquisition could result in a major failure.

Sometimes, it also seems to be more beneficial to initially leave the target company on the grounds on it was previously functioning and move towards any sort of integration at a later stage in the change process. [15]

Whatever the case maybe, the acquirer company should carefully analyze and assess the company to be acquired and study its process and then figure out the right time and right type of integration.

5. LIFE-CYCLE OF MERGERS AND ACQUISITIONS

A typical flow chart of mergers and acquisition is given below: [16]

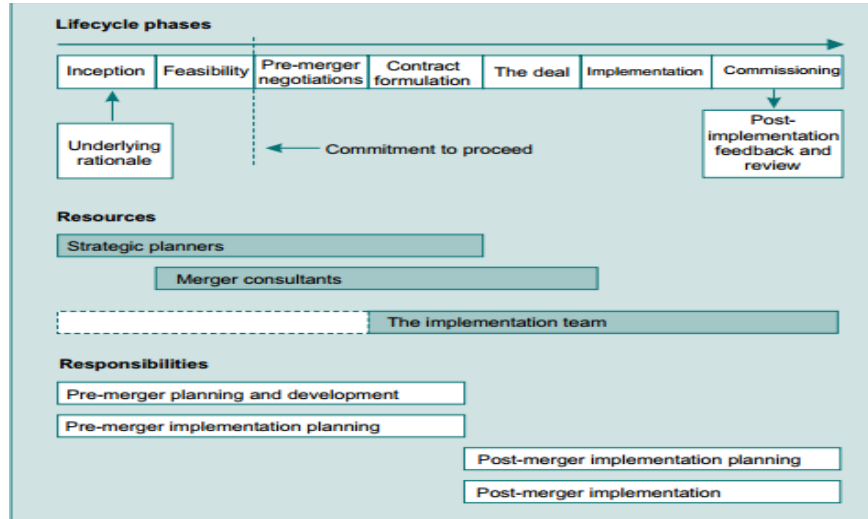


Figure1: M&A Flow chart

Almost all mergers and acquisitions begin with the inception phase. In this phase, the process is initiated by the senior managers of the organization. This step is usually followed by the feasibility stage where the financial and land logistics area is analyzed. The merger or acquisition may be taking place for the improvement of the financial position and market value. The feasibility phase includes a detailed analysis of the financial characteristics of the proposed merger while considering timescales, synergy generation and other variables.

During some point or towards the end of the feasibility phase, a proper decision is made on how to take things to the next level. At this point, the organization commits its self to the merger or acquisition and starts allocating the funds and resources as needed.

The next phase is known as the pre-merger phase and it starts immediately after the commitment to proceed. In this phase, the senior managers of both the organizations enter into negotiations to form a structure of the new combined organization. The services of external professional consultants are also needed in this phase. After the negotiations are made, The deal takes form of a merger. The contract sets out the rights, duties and obligations of both the organizations under the terms of the deal. As soon as the contract is in place, the implementation process begins. This process includes the mechanics of actually making the merger happen.

In real life, merger and acquisition life cycles can be considered in much more complex terms. In practice, it is necessary to subdivide each life cycle phase into manageable chunks to have sufficient control and response. Merger implementation managers usually establish detailed reviews and associated reporting procedures and formats for each phase. The procedures prove to be very helpful in keeping the entire merger focused and on track.

Figure 1 shows the various phases of the life cycle. Strategic planners dominate the early phases as they are responsible initiating the merger and for making the strategically correct decisions.

Once it is decided go ahead with the merger, the role of the strategic planners lessens and the implementation teams and specialists become active. The external consultants are there to set up the contracts and the remaining aspects of the deal. The integration team comes into action as soon as the contracts are finalized and signed by both parties.

6. IMPORTANT TACTICS FOR MERGERS AND ACQUISITIONS

There are five overarching areas that all CEO's and strategists should address to ensure a successful M&A journey:

1. Internal capabilities:

The process of assessing and integrating of a target company should be carried by a business development team.

2. Strategic goals and alignment:

It is very important to evaluate a company's strategic and financial goals—determining if they can be achieved faster or more easily via organic growth or an acquisition.

3. Selection criteria:

Selection should be based on post-acquisition market share, cost reduction and synergy opportunities. Flexibility should be maintained as criteria in one industry may not apply to another.

4. Target selection:

The target selection process needs to be carried out quickly keeping in mind that it should be explicit and transparent. [17]

7. MERGERS AND ACQUISITIONS - SUCCESSES AND FAILURES

M&As can either be successful or complete failures. A study in which 180 cases were studied showed that two-thirds of mergers and acquisitions fail. Substandard outcomes were also considered as failures. [18]

According to an earlier research, inadequate planning, hurry to close the deal, not being able to foresee the future integration problems and projecting synergies that turn out to be illusionary are all causes of failure. [19]

A detailed merger plan over how the implementation of the merger or acquisition should be executed and implemented is extremely important. A successful merger plan will bear fruitful results. In the mergers that do succeed, experiences and preparation are said to be the key factors. A merger or acquisition has a higher chance of succeeding if the organization and its management has previously experienced and survived a merger.

8. CASE STUDIES

Discussed below are case studies on mergers and acquisitions:

→Mergers:

One of the biggest mergers of 2013 is of Microsoft Corporation with Nokia Handsets and Services Business. Microsoft purchased Nokia for \$ 7,200,000,000. [19] Microsoft is attempting to bail out one of the first makers of smart phones but at the same time, strategists say that it could also be the other way round in the long run. According to Nokia's CEO Steve Ballmer, Microsoft bought Nokia only in an attempt to strengthen its fight against Apple Inc. and Google Inc. so that it could be able to capture a portion of the lucrative mobile computing market.

It is now up to Microsoft whether they will work together with Nokia or whether they will completely rebuild Nokia from the ground up in its own image.

According to some strategy makers, Microsoft realized well in time that it would not be able to succeed without controlling the whole supply chain and at the same time, Nokia realized that it needed a stronger partner with good a goof financial portfolio to continue with its Lumia smart phones.

Microsoft hopes to complete the deal by early next year. This merger will result in the transferring of 32,000 Nokia employees to Microsoft which currently has a workforce of 99,000 employees. [20]

→Acquisitions:

Cisco Systems is a computer networking company which came into existence in 1984. It is a world leader in networking and has transformed how people connect, communicate and collaborate.

Mergers and acquisitions veteran Cisco Systems has acquired more than 149 companies over the past 15 years. Cisco's growth strategy is based on identifying and driving market transitions. Corporate Development focuses on acquisitions that help Cisco capture these market transitions. Cisco categorizes its acquisitions into three categories: market acceleration, market expansion and new market entry. The target companies offer different types of assets to Cisco which include talent, technology, mature products and solution what Cisco is actually looking for is the potential to reach billion dollar markets.

Cisco seeks acquisitions where there is not only a strong business case but also a shared business and technological vision, and where compatibility of core values and culture foster an environment for success. [21]

9. CONCLUSION

Mergers and acquisitions are being used as an important strategic tool for survival by many organizations in today's competitive business environment. The essence of mergers and acquisitions is that the value of two companies together is greater than one. Companies merge with or acquire other companies to make use of one another's strengths and these results in increased market shares and profitability that are vital for survival. Mergers and acquisitions enable companies to work as one and thus increase their total market value. In this paper, we have discussed what mergers and acquisitions really are, their causes and their importance. We have also described the ways to screen a potential target and the rationales behind mergers and

acquisitions. This paper also discusses the types of mergers i.e. vertically integrated, horizontally integrated and conglomeration. Next is the life-cycle of mergers and acquisitions. It begins with inception and ends at post-implementation. Towards the end, we have discussed successful cases studies of mergers and acquisitions for a better understanding of the paper.

Mergers and Acquisitions are becoming a means of survival and are not less than a competitive weapon among business firms in today's world. Our paper discusses the importance of these and contributes to the subject in that it discusses how business firms strategically and successfully merge and/or acquire for mutual benefit. Our paper further discusses the strategies that firms can adopt and reap benefits or merging and/or acquiring through business rationales, integration and conglomeration. We aim to provide a consolidated paper having the stages, rationales and types of mergers and acquisitions.

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