

Marketing & Economics

An integrated approach to making effective business
decisions in the world of global marketing

Sultan Kermally

Vernon Series in Business and Finance



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*This book is dedicated to my wife Laura and
my children Jenny, Susan, Pete and Zara and my
grandchildren Matthew, Anna and Eve.*

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for their support.*

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List of acronyms and other initials used

A.I.D.A.	Attention, Interest, desire, Action.
B2C	Business to Customers.
B2B	Business to Business.
B.R.I.C.S.	Brazil, Russia, India, China South Africa.
CPA	Customer Profitability Analysis.
CLV	Customer Lifetime Value.
CPV	Customer Perceived Value.
CRM	Customer Relationship Marketing. Customer Relationship Management.
DMU	Decision Making Unit.
EEC	European Economic Community.
EPA	Environmental Protection Agency.
EU	European Union.
EDI	Electronic Data Interchange.
EVCO	Economic Value of the Customer Organisation.
FMCG	Fast Moving Consumer Goods.
4Cs	Customer Value, Cost to Customer, Convenience, Communication.

GATT	General Agreement on Tariffs and Trade.
GVCs	Global Value Chains.
IMF	International Monetary Fund.
ITO	International Trade Organisation.
MGI	McKinsey Global Institute.
NAFTA	North American Free Trade Agreement.
PwC	Price Waterhouse Coopers.
S.T.E.E.P.	Sociological, Technological, Economic, Environmental, Political.
SWOT	Strength, Weaknesses, Opportunities and Threats.
TQM	Total Quality Management.
USA	United States of America.
WTO	World Trade Organisation.

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Chapter Six

Mergers, Acquisitions and Alliances

Nature of mergers, acquisitions and alliances

In economics, there are basically two types of competition, namely, **perfect competition** and an **imperfect competition**. Perfect competition is unattainable in reality because there are numerous imperfections in the market that create imperfect competition. These imperfections take different forms such as lack of knowledge of prices as far as consumers are concerned, transport costs, few suppliers in the market, various barriers to entry such as massive development costs, complexity of technology, various uses of digital media and platforms, ownership of resources, or trademarks, and so on.

Many firms in a competitive situation deploy various strategies to enlarge, penetrate or capture new markets. Some acquire sources of raw materials or distribution channels in order to consolidate their competitive position and survive in business whereas other acquire new businesses in order to diversify and spread risks.

A **merger** takes place when two companies combine to form a new company. An **acquisition** occurs when one company purchases another company to form a new company.

Marketing planning plays a key role where mergers and acquisitions involve branded products and services. Prior to planning any merger significant work has to be done in relation to examine the advantages of taking on brands from a merged organisation and

what research needs to be taken in preparing strong argument for mergers and acquisitions.

Merger takes place when one firm decides to merge with another firm in order to safeguard its supply or raw materials or to gain control of distribution channels or to dominate the market. There are three types of mergers. They are **horizontal mergers** in which firms in the same industry combine, **vertical mergers** and **conglomerate mergers**. An example of horizontal merger would be the coming together of Exxon and Mobil in 1998 or 2002 merger of Hewlett-Packard and Compaq Computer or Heinz and Kraft merger in 2015.

There are laws in existence in the USA and in Europe to restrict such mergers if they are likely to reduce competition. Mergers taking place in a moderately concentrated or highly concentrated industry are normally challenged. Concentration is concerned with control of market share.

The other type of mergers is known as vertical mergers in which two firms at different stages of the production process come together. The example of vertical merger would be the coming together of Merck, a pharmaceutical manufacturer and Medco, a pharmaceutical distributor in 1993.

When a manufacturing firm merges with a firm supplying raw material to that firm then backward integration and when a manufacturing firm merges with a firm which is its distributor of the products then this is known as forward integration. Vertical integration, according to some economists play key role in reducing costs. On the other hand, there are some economists who argue that mergers necessarily require coordination and such coordination increase administrative costs. Even for vertical mergers the government may restrict such mergers if they are deemed to restrict competition.

The third type is known as conglomerate mergers. In this case firms in unrelated businesses combine to form what is known as Conglomerate Corporation. Such mergers facilitate concentration of assets. Such concentration of assets does not necessarily bring about concentration of market power in individual industries. The

example of conglomerate merger would be Daimler Benz's acquisition in sectors such as the aerospace industry.

Mergers, competition and market dominance

Mergers are regulated in some countries, for example, in the USA, and Europe. In the USA, competition law is known as antitrust law. The Antitrust Division of the Department of Justice and the Federal Trade Commission focus on unreasonable monopolistic practices. These practices include agreements prohibiting free trading, price fixing by cartels, banning behaviour that lead to gaining dominant market position, and supervising the mergers and acquisitions of large corporations. In the early years in the US, a rule of reason was used to judge firms' actions. Unreasonable restraints of trade were considered illegal. The courts then adopted per se rule judging firms adopting monopolistic tactics as illegal. In the 1980s and through Regan and Bush administrations, the courts returned to using a rule of reason but based on a looser interpretation than before.

The 1990s witnessed the most intense period of mergers and acquisitions, particularly in the USA. The merger waves also impacted Europe as Europe in the mid-1990s experienced large number of cross-border deals within Europe

Transatlantic deals also started to take place in the late 1990s. Considering the present situation, mergers and acquisitions slowed down during the early period of 2000 and more specifically during the period of financial crisis in the early 2000. However, looking at 2014 and 2015 situations, there have been numerous mergers and acquisitions. Some experts have put forward the view that currently low inflation, deflation and low interest rates are pushing organisations to merge. In 2016 experts and business analysts are also predicting to see huge volumes of mergers and acquisitions.

European law and mergers

Under EU rules businesses are not allowed to merge if that would put them in a position to control the market. Larger companies that do a lot of business in the EU cannot merge without prior approval from the European Commission—even if they are based outside the EU (the merger regulation).

Firms proposing to merge have to get authorisation from the relevant government authority. If they go ahead without authorisation, they could be asked to de-merge if the authority find that such a move would lessen competition. Merger control is about predicting what the market will be like and making a judgement accordingly.

Under the EC law, a concentration exists when a “...*change of control on a lasting basis results from (a) the merger of two or more previously independent undertakings... (b) The acquisition...if direct or indirect control of the whole or parts of one or more other undertakings.*” (Art. 3(1), Regulation 139/2004, the **European Community Merger Regulation**).

The main objective of merger regulation is to stop merged firm abusing their dominant market position. In certain circumstances as in the case of a firm going out of business if it does not merge or where there is a good technical and economic progress argument, mergers are permitted. In some cases, mergers are approved under certain conditions such as they may be asked to sell part of the combined business or to license technology to another market player.

Some Examples of mergers examined by the European Commission. (58)

Pharmaceutical sector

Mergers of Sanofi/Syhelabo and Pfizer/Pharmacia were notified to the European Commission. “The European Commission concluded that both mergers could have an adverse impact on competition,

limiting the choice of certain drugs available to patients. In both cases, the parties proposed transferring some of their products to competitors, which the European Commission agreed would restore competition in the markets and so protect the interests of the patients...”

Consumer goods/food sector

Merger between Unilever and Bestfoods was intended to reduce competition in the markets for instant soups, pasta sauces, jams and other food products in almost all EU Member States. The parties proposed the sale of an estimated Euro 1 billion of their business to competitors and this allowed the European Commission to give conditional clearance to the merger.

French petroleum companies

The merger of TotalFina and Elf Acquitaine was considered to have led to being a leading supplier of liquid petroleum gas and the consequence of such dominance would lead to higher prices. Total-Fina/Elf Acquitaine proposed the sale of large proportion of their operations to competitors and the merger was given conditional clearance.

Globalisation has facilitated cross-border mergers and acquisitions. All such mergers and acquisition come under the scrutiny of relevant competition authorities.

Other examples of mergers and acquisitions:

- In 1992, the Hong Kong and Shanghai Banking Corporation (HSBC) took over Midland Bank Plc to create the second largest non-Japanese bank in the world and the largest in the UK.
- Guinness and Grand Metropolitan merged to create a drinks group called Diageo.
- The Italian phone company Stet bought 25% of Mobilkom, Austria, 49% of Telecom, Serbia and 60% of Retevision.

- Lufthansa formed Star Alliance with SAS, United Airlines, Air Canada and Thai Airways.
- Anglo-Dutch Publisher Reed Elsevier's \$8.8 billion stock swap over was agreed with German-Dutch rival Wolters Kluwer.
- British gas acquired 1 61% stake in India's Gujarat gas Co.
- Coopers and Lybrand merged with Price Waterhouse to form Pricewaterhouse Cooper (PwC).
- Worldcom's snatched MCI from the grasp of British telecommunications for \$37 billion.
- Daimler-Benz merged with Chrysler.
- British petroleum announced a \$30.3 billion takeover of Amoco of the USA.
- The Commission has approved the acquisition of sole control of Nyrstar of Belgium by Refigure of the Netherlands in 2015.
- Commission approves Etihad's acquisition of joint control over Alitalia in 2014.
- Commission approves the acquisition of Skype by Microsoft in 2011.
- Tata Steel purchased Corus in 2007.
- Microsoft acquired Skype.
- Dell acquired EMC in 2015.
- BT acquired EE, the UK's largest mobile group.
- There has been a merger of Facebook and WhatsApp.
- In 2015 the European Commission cleared the proposed acquisition of Aer Lingus by International Consolidated Airlines Group (IAG) under the EU Merger Regulation.

Which mergers are examined by European Commission?

"If the annual turnover of the combined businesses exceeds specified thresholds in terms of global and European sales, the

proposed merger must be notified to the European Commission, which must examine it. Below these thresholds, the national competition authorities in the EU Member States may review the merger. These rules apply to all mergers no matter where in the world the merging companies have their registered office, headquarters, activities or production facilities. This is so because even mergers between companies based outside the European Union may affect markets in the EU if the companies do business in the EU. The European Commission may also examine mergers which are referred to it from the national competition authorities of the EU Member States. This may take place on the basis of a request by the merging companies or based on a request by the national competition authority of an EU Member State. Under certain circumstances, the European Commission may also refer a case to the national competition authority of an EU Member State” (59).

Europe is following USA in relation to formation of mergers and acquisitions. Experts are predicting most of the mergers and acquisitions will be in the area of technology and media and telecommunications and pharmaceuticals.

Market conditions aside, legislation and tax are playing a key role. Jonathan Dunn says: "In general terms, the UK provides a highly stable legal, fiscal and political environment in which to do business. The UK also displays none of the protectionism that can be seen in other developed economies, in stark contrast with France, where both GE and Siemens encountered difficulties in their attempts to acquire Alstom in 2014." (60)

Mergers and acquisition in the service sector

The European banking sector has experienced a dramatic increase in the field of mergers and acquisitions A report issued by European Central Bank (2000), found that by the late 1990s the total number

of mergers and acquisitions within European banking had grown from 326 in 1995 to 497 in 1999. According to European Central bank 2004 Report, from 2000 to 2004, cross border mergers and acquisitions accounted for the all banking mergers and acquisitions in the Euro zone.

Banks have become very acquisitive. The pace of mergers and acquisitions in banking is accelerating not only in the USA but also in Europe and Asia. Recently Spain's Banco Santander Central Hispano acquired Abbey national in the UK. Banking mergers enable banks to expand their retail franchise and offer new products to reach new customers.

Mega mergers also take place within the country. In the USA, domestic mega-mergers include the merger between Bank of America with FleetBoston and J. P. Morgan Chase with Bank One.

Acquisitions

Acquisitions are takeover of one firm by another firm. Firm 'A' may negotiate with firm 'B' to take over its business. The buyer or the firm intends to take over buys the shares of the target company and by getting majority of the shares they gain control of that company. In some cases, acquisitions become hostile. A target firm will resist the takeover.

The Economist Intelligence Report on 'Making acquisitions work,' classify acquirers into (1) the carnivores (b) the dairy farmers (c) the vegetarians (d) the white hunters (e) the gentlemen shooters and (f) the cross-breeders.

The carnivores acquire businesses in order to add synergies to the main business. "*They have rigorous objectives and stick to them. They integrate, make changes and get rid of the bits (and the people) they do not want.*"

They cite corporations like Nestle, Unilever, Electrolux and General Electric as the examples of the carnivorous.

The dairy farmers also have clear objectives. *“They increase shareholder value by increasing the value of the company and milking it at the same time. They do not as a rule interfere in the running of their acquisitions, except for insistence on the proper financial disciplines. They do whatever is necessary to nurture the herd, selling off unsuitable parts from time to time and replacing them with healthier ones.”*

They cite Hanson, as an example as the dairy farmers.

The vegetarians have less clear objectives. *“Indeed, it is often difficult to detect a strategic or operational reason for their purchases, which tend to be opportunistic although they may be represented as part of repositioning or diversification exercise.”*

The examples of the vegetarian include Sony and Matsushita’s entry into Hollywood.

The white hunters are termed as professional acquirers and they do seem to lack industrial or commercial logic. *“The acquirers claim to force lazy management to make underused or undervalued assets work harder or get rid of them.”*

The examples cited include WPP takeover of JWT.

The gentleman shooters tend to make one big acquisition at a time. *“They are usually buying for good strategic reasons, and therefore wish to integrate their purchases. They have frequently researched the field and screened a number of possible candidates for acquisition”* (61).

The cross-breeders are a new kind of Eurocompany. These acquirers create trans-European alliances with no discernible national identity. The examples cited include Asea of Sweden and Brown Boveri of Switzerland in heavy electrical equipment; Reed (UK) and Elsevier (Netherlands) in publishing.

Acquisitions are often paid in cash, the acquiring company's stock or a combination of both. In some cases, acquisitions are financed by debt. This is known as leveraged buyouts and in practice,

the debt is often moved down onto the balance sheet of the acquired company.

The reasons why mergers and acquisitions take place are as follows:

- To create synergy. It is often expressed as $2+2=5$. That is, as the equation shows, the combination of two firms will yield a more valuable entity than the value of the sum of the two firms if they were to stay independent: $\text{Value (A + B)} > \text{Value (A) + Value (B)}$.
- To increase market share.
- Achieve economies of scale. Economies can be achieved in streamlining management or in purchasing and so on.
- To diversify business.
- To acquire new technology or knowledge.
- Empire-building.
- Reducing tax exposure. In some countries the firms pay less tax if they use cash to acquire assets than if it has cash in hand.

Mergers and acquisitions were mainly being talked and written about with reference to deals in the USA and Europe. But now countries like India is also involved in mergers and acquisitions.

The following is an extract from The Hindu Business Line:

“India is emerging a vibrant player in the world of mergers and acquisitions (M&A). Not long ago, Mr Lakshmi Mittal acquired Arcelor, and had Tata Steel's bid for the Corus group of the UK gone through, it would have made the company the world's fifth largest producer. Tata Group companies and many in the information technology, pharmaceutical and banking sectors have made a host of other acquisitions. Could anybody have imagined such a showing by Indian entrepreneurs even a few years ago?” (62)

In 2015 most of mergers and acquisitions have been in pharmaceutical, healthcare and cable industries.

Strategic alliances

Apart from merger and acquisitions, firms also now get together to form alliances for a variety of reasons. Some experts say that strategic alliances are no longer a strategic option but a necessity in many markets and industries.

A strategic alliance comes into existence whenever two or more independent firms collaborate in the development, manufacture or sale of products or services. Strategic alliances take many forms; they include licensing agreements, marketing agreements, development agreements, minority equity investments, as well as joint ventures that are operated as separate legal entities. Joint ventures are normally created if parties involved want to form long-term relationships or an alliance will require significant investment in resources.

Why form strategic alliances?

- To penetrate new markets.
- To achieve faster penetration of markets.
- Reduce costs.
- Acquire new technology or knowledge-base.
- Gain design collaboration.
- Enhance competitiveness in global and domestic markets.
- Create new business.
- Achieve economies of scale.
- Sharing risks.
- Reduce cycle time.
- Improve quality.
- Complementing core competencies.

Some examples of strategic alliance:

- In 2006 Microsoft Corp. and Nortel formed an alliance based on a shared vision for unified communications.

- Dell Computer Corporation formed an alliance with Sun Microsystems Inc.
- In 1997 Compaq Computer Corp formed an alliance with Intel Corp. to develop 100-megabit equipment. Compaq and Intel shared marketing and technical resources in order to achieve project objectives.
- In 1990, Hitachi and Hewlett-Packard (competitors) made an alliance to jointly develop and manufacture an advanced model of HP's Precision architecture RISC chip.
- Some airlines have come together to form an alliance to combine flight operations and dividing the markets.
- Food Science Australia formed an alliance with Singapore-based F & N Foods Pty Ltd to develop new products and processes.
- Alliance between Apple and IBM.
- Starbucks and books retailer Barnes and Noble.
- Fiat and Chrysler.

Alliances: Marketing perspective

'Place' is one of the key components of marketing mix. A firm has to consider very carefully what distribution method to use to reach its customers. Distributors in turn have to be careful in relation to the firm they are dealing with. They would want product delivered on time and in good condition and quality. Above all they are in business to make profit so they have considered what incentives they are being offered.

The trends these days to form network and alliances in order to reach consumers effectively. Various channels come together to form a network. These can be a vertical marketing integration where channel members function independently or relationship is based on contract. Horizontal channel integration occurs when one firm in a channel integrates with another channel at the same stage of distribution.

In order to enter markets swiftly **marketing alliances** are formed. Forming an alliance with another firm already established in a desired market region is faster and less costly than internal expansion or merger with another firm.

Global markets are becoming increasingly complex and competitive. Relatively few companies are now sufficiently large and have enough resources and skills to enter a completely new market through internal growth and using only their own resources.

According to Kotler and Keller (2006) (63), many strategic alliances take the form of marketing alliances. When one company licenses another company to produce its product or a service company markets its service with another service company it is known as product/service alliances.

When one firm promotes another firm's product or service, for example McDonalds promoting Disney films, then it is known as **promotional alliances**.

When one company offers logistical services for another company's product then it is known as **logistics alliances**. Finally, when firms collaborate on pricing offering mutual price discounts (airline firm and a hotel or car rental firm) then this is known as **pricing collaborations**.

Mergers need to be positioned properly to customers, employees and strategic partners. In addition, post-merger situation requires very thoughtful strategic marketing planning. Chief marketing officer has to play a key role in post-merger situations.

Mergers, acquisitions and alliances are important happenings for marketers. They involve dealing with customers in terms of achieving customer satisfaction, brand loyalty, customisation and personalisation, marketing strategy, value systems of organisations involved, relationship marketing, Public Relations, marketing communications and employment and redeployment of marketing resources.

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