
MSL 686

Strategic Leadership

Belhaven University

Unit 8

- Merger and Acquisition Strategies and Implementation of Domestic and International Strategies

Introduction Unit 8

- In the latter half of the 20th century, acquisition became a prominent strategy used by major corporations to achieve growth and meet competitive challenges. Even smaller and more focused firms began employing acquisition strategies to grow and enter new markets. However, acquisition strategies are not without problems; a number of acquisitions fail. Unit 8 addresses how acquisitions can be used to produce value for the firm's stakeholders.

Introduction Unit 8, cont.

- The match or degree of fit between strategy and structure influences the firm's attempts to earn above-average returns. Thus, the ability to select an appropriate strategy and match it with the appropriate structure is an important characteristic of effective strategic leadership.

Unit 8 Topics

- Merger and acquisition strategies in firms competing in the global economy
- Seven problems that work against achieving success when using an acquisition strategy
- Attributes of effective acquisitions
- Restructuring strategy and outcomes
- Three versions of the multidivisional (M-form) structure

Unit 8 Topics, cont.

- Organizational structures used to implement three international strategies
- Strategic networks and how strategic center firms implement such networks at the business, corporate and international levels

Merger, Acquisition, Takeover Differences

- Merger
 - Two firms agree to integrate their operations on a relatively co-equal basis.
- Acquisition
 - One firm buys a controlling, or 100%, interest in another firm with the intent of making the acquired firm a subsidiary business within its portfolio.
- Takeover
 - An acquisition in which the target firm did not solicit the acquiring firm's bid for ownership.

Strategic Focus

- Acquisitions enable firms to gain greater market power. Acquisitions to meet a market power objective generally involve buying a supplier, a competitor, a distributor, or a business in a highly related industry.
- When a competitor in the same industry is acquired, a firm has engaged in a ***horizontal acquisition***. Horizontal acquisitions increase a firm's market power by exploiting cost-based and revenue-based synergies.

Strategic Focus, cont.

- A ***vertical acquisition*** has occurred when a firm acquires a supplier or distributor that is positioned either backward or forward in the firm's cost/activity/value chain.
- When a target firm in a highly related industry is acquired, the firm has made a ***related acquisition***.

Strategic Focus, cont.

- When barriers to entry are present, the firm's best choice may be to acquire a firm already having a presence in the industry or market. In fact, the higher the barriers to entry into an attractive market or industry, the more likely it is that firms interested in entering will follow acquisition strategies.
- Acquisitions between companies with headquarters in different countries are called ***cross-border acquisitions***.

Strategic Focus, cont.

Acquisitions represent a viable strategy for firms that wish to enter international markets because:

- This may be the fastest way to enter new markets.
- They provide more control over foreign operations than do strategic alliances with a foreign partner.

Strategic Focus, cont.

Cost of New Product Development and Increased Speed to Market

- Acquisitions also may represent an attractive alternative to developing new products internally due to the cost and time required to start a new venture and achieve a positive return.

Strategic Focus, cont.

Internal development of new products is often perceived by managers to be costly and of high risk. It may be in the firm's best interest to acquire an existing business because:

- The acquired firm has established sales volume and customer base, thus yielding predictable returns.
- The acquiring firm gains immediate market access.

Strategic Focus, cont.

- Acquisitions have gained in popularity as a related or horizontal diversification strategy (enabling rapid moves into related markets or to expand market power) and as an unrelated diversification strategy because of the changes in regulatory interpretation and enforcement of antitrust laws.
- Using acquisitions to diversify a firm is the quickest and often the easiest way to change its portfolio of businesses.

Strategic Focus, cont.

- Some acquisitions are made to gain capabilities that the firm does not possess—e.g., acquisitions used to acquire a special technological capability. Acquiring other firms with skills and capabilities that differ from its own helps the acquiring firm learn new knowledge and remain agile, but firms are better able to learn these capabilities if they share some similar properties with the firm's current capabilities.

Problems in Achieving Acquisition Success

- Difficulties integrating the two firms after the acquisition is completed
- Paying too much for the target (acquired) firm or inappropriately or inadequately evaluating the target
- The cost of financing the acquisition, related to large or extraordinary debt
- Overestimating the potential for gains from capabilities and/or synergy

Problems in Achieving Acquisition Success, cont.

- Excessive or too much diversification
- Management being preoccupied or overly focused on acquisitions
- The combined firm becoming too large
- Integration problems or difficulties that firms often encounter can take many forms. Among them are:
 - Melding disparate corporate cultures
 - Linking different financial and control systems

Problems in Achieving Acquisition Success, cont.

- Building effective working relationships (especially when management styles differ)
- Problems related to differing status of acquired and acquiring firms' executives

Reasons for Acquisitions

- Increase market power
- Overcome entry barriers
- Reduce the cost of new product development and increase speed to market
- Lower risk compared to developing new products
- Increase diversification
- Avoid excessive competition
- Learn and develop new capabilities

Poor Performance of Acquisitions

- Integration difficulties
- Inadequate evaluation of target
- Large or extraordinary debt
- Inability to achieve synergy
- Too much diversification
- Managers overly focused on acquisitions
- Too large

Evaluation of Target Firm

- *Due diligence* is a process through which a firm evaluates a target firm for acquisition. In an effective due-diligence process hundreds of items are examined in areas as diverse as the financing for the intended transaction, differences in cultures between the acquiring and target firm, tax consequences of the transaction, and actions that would be necessary to successfully meld the two workforces.

Evaluation of Target Firm, cont.

- Due diligence is commonly performed by investment bankers, accountants, lawyers, and management consultants specializing in that activity, although firms actively pursuing acquisitions may form their own internal due-diligence team.

Evaluation of Target Firm, cont.

- Acquiring firms also face the challenge of correctly identifying and valuing any synergies that are expected to be realized from the acquisition. This is a significant problem because to justify the premium price paid for target firms, managers may overestimate both the benefits and value of synergy.

Evaluation of Target Firm, cont.

- Financial controls may be emphasized when managers feel that they do not have sufficient expertise or knowledge of the firm's various businesses. When this happens, top-level managers are not able to adequately evaluate the strategies and strategic actions taken by division or business unit managers.

Evaluation of Target Firm, cont.

- When they lack an understanding of business units' strategies and objectives, top-level managers tend to emphasize the financial outcomes of strategic actions rather than the appropriateness of the strategy itself.
- This forces division or business unit managers to become short-term performance-oriented.

Evaluation of Target Firm, cont.

- The problem is more serious when manager compensation is tied to short-term financial outcomes.
- Long-term, risky investments (such as R&D) may be reduced to boost short-term returns.
- In the final analysis, long-term performance deteriorates.

Evaluation of Target Firm, cont.

- Due diligence and negotiating with the target often include numerous meetings between representatives of the acquirer and target, as well as meetings with investment bankers, analysts, attorneys, and in some cases, regulatory agencies. As a result, top-level managers of acquiring firms often pay little attention to long-term, strategic matters because of time (and energy) constraints.

Evaluation of Target Firm, cont.

- Firms can reach economies of scale by growing. But after a certain size is achieved, size can become a disadvantage as firms reach a point where they suffer from what is called “**diseconomies of scale.**” This implies that problems related to excess growth may be similar to those that accompany over-diversification.

Evaluation of Target Firm, cont.

- Acquiring firms may not thoroughly analyze the target firm, failing to develop adequate knowledge of its true market value.
- Managers' overconfidence may cloud the judgment of acquiring firm managers.
- Shareholders (owners) of the target must be enticed to sell their stock, and this usually requires that acquiring firms pay a premium over the current stock price.

Evaluation of Target Firm, cont.

- In some instances, two or more firms may be interested in acquiring the same target firm. When this happens, a bidding war often ensues and extraordinarily high premiums may be required to purchase the target firm.
- To achieve a sustained competitive advantage through an acquisition, acquirers must realize private synergies and core competencies that cannot easily be imitated by competitors.

Evaluation of Target Firm, cont.

- **Private synergy** refers to the benefit from merging the acquiring and target firms that is due to the unique assets that are complementary between the two firms.
- Firms experience transaction costs when using acquisition strategies to create synergy. Direct costs include legal fees, charges from investment bankers, managerial time, loss of key managers and employees post-acquisition are indirect costs.

Effective Acquisitions

- When a firm's assets are complementary (highly related) with the acquired firm's assets and create synergy and, in turn, unique capabilities, core competencies, and strategic competitiveness
- When targets were selected and “groomed” through earlier working relationships (e.g., strategic alliances)

Effective Acquisitions, cont.

- When the acquisition is friendly, thereby reducing animosity and turnover of key employees
- When the acquiring firm has conducted due diligence
- When management is focused on research and development

Effective Acquisitions, cont.

- When integration quickly produces the desired synergy in the newly created firm, allowing the acquiring firm to keep valuable human resources in the acquired firm from leaving.
- Successful acquisitions generally are characterized by the following attributes and results:

Effective Acquisitions, cont.

- Target and acquirer having complementary assets and/or resources that result in a high probability of achieving synergy and gaining competitive advantage
- Making friendly acquisitions to facilitate integration speed and effectiveness and reducing any acquisition premium

Effective Acquisitions, cont.

- Effective due diligence - target selection and negotiation processes that result in the selection of targets having resources and assets that are complementary to the acquiring firm's core business, thus avoiding overpayment
- Maintaining financial slack to make acquisition financing less costly and easier to obtain

Effective Acquisitions, cont.

- Maintaining a low to moderate debt position, which lowers costs and avoids the trade-offs of high debt and lowers the risk of failure
- Possessing flexibility and skills to adapt to change to facilitate integration speed and achievement of synergy
- Continuing to invest in R&D and emphasizing innovation to maintain competitive advantage

Restructuring

- ***Restructuring*** refers to changes in the composition of a firm's set of businesses and/or financial structure.
- ***Downsizing*** represents a reduction in the number of employees, and sometimes in the number of operating units, but may or may not represent a change in the composition of the businesses in the firm's portfolio.

Restructuring, cont.

- ***Downscoping*** refers to the divestiture, spin-off, or other means of eliminating businesses that are unrelated to the firm's core business. In other words, downscoping refocuses the firm on its core businesses.
- Compared to downsizing, downscoping has a more positive effect on firm performance.

Restructuring, cont.

- Whereas downscoping often includes downsizing, the former is targeted so that the firm does not lose key employees from core businesses (because such losses can lead to the loss of core competencies).
- The firm is less diversified as a result of downscoping.
- Top-level managers can better understand the core and related businesses.

Restructuring, cont.

- A ***leveraged buyout (LBO)*** refers to a restructuring action where the management of the firm and/or an external party buys all of the assets of the business, largely financed with debt, takes the firm private.
- Often, LBOs are used for restructuring to correct for managerial mistakes or because managers are making decisions that primarily serve their personal interests, not shareholders interests.

Restructuring, cont.

- A firm is purchased by a few (new) owners using a significant amount of debt (in a highly leveraged transaction) and the firm's stock is no longer traded publicly.
- In general, the new owners restructure the private firm by selling a significant number of assets (businesses) both to downscope the firm and to reduce the level of debt (and significant debt costs) used to finance the acquisition.

Restructuring, cont.

- A primary intent of the new owners is to improve the firm's efficiency. This enables them to sell the firm (outright to another owner or by a public stock underwriting), thus capturing the value created through the restructuring. It is not uncommon for those buying a firm through an LBO to restructure the firm to the point that it can be sold at a profit within a five- to eight-year period.

Restructuring, cont.

- There are three types of leveraged buyouts: management buyouts (MBO), employee buyouts (EBO), and whole-firm buyouts where another firm takes the firm private (LBO). Research has shown that management buyouts can also lead to greater entrepreneurial activity and growth.

Restructuring, cont.

- Downsizing often does not lead to higher firm performance; in fact, downsizing contributed to lower returns for both US and Japanese firms. The stock markets evaluated downsizing negatively. Investors concluded that downsizing would have a negative effect on companies' ability to achieve strategic competitiveness in the long term. Investors seem to assume that downsizing occurs as a consequence of other problems in a firm.

Restructuring, cont.

- Downsizing tends to result in a loss of human capital in the long term. Losing employees with many years of experience with the firm represents a major loss of knowledge. Knowledge is vital to competitive success in the global economy. Thus, in general, research evidence and corporate experience suggest that downsizing may be of more tactical (or short-term) value than strategic (or long-term) value.

Restructuring, cont.

- Downscoping generally leads to more positive outcomes in both the short and the long term than does downsizing or engaging in a leveraged buyout. Downscoping's desirable long-term outcome of higher performance is a product of reduced debt costs and the emphasis on strategic controls derived from concentrating on the firm's core businesses. The refocused firm should be able to increase its ability to compete.

Restructuring, cont.

- Although whole-firm LBOs are a significant innovation in the financial restructuring of firms, there can be negative trade-offs.
- The resulting large debt increases the financial risk of the firm.
- The intent of the owners to increase the efficiency of the bought-out firm and then sell it within five to eight years can create a short-term and risk-averse managerial focus.

Restructuring, cont.

- These firms may fail to invest adequately in R&D or take other major actions designed to maintain or improve the company's core competence.
- *Downsizing* reduces labor costs, but the long-term results are a loss of human capital and lower performance.

Restructuring, cont.

- *Downscoping* reduces debt costs and emphasizes strategic controls, which result in higher performance.
- *Leveraged Buyouts* provide an emphasis on strategic controls but increases debt costs; the long-term outcome is an increase in performance, but also greater firm risk.

Strategy and Organizational Structure

- All organizations require some form of organizational structure to implement and manage their strategies.
- Firms frequently alter their structure as they grow in size and complexity.
- Three basic structure types
 - Simple structure
 - Functional structure
 - Multidivisional structure (M-form)

Strategy and Organizational Structure, cont.

- Because of limits to an individual CEO's ability to process complex strategic information, problems related to isolation of functional area managers, and increasing diversification, the structure of the firm must change again. In these instances, the multidivisional or M-form structure is most appropriate.

Strategy and Organizational Structure, cont.

- Different forms of the functional organizational structure are used to support implementation of the cost leadership, differentiation, and integrated cost leadership/differentiation strategies.

Strategy and Organizational Structure, cont.

- A ***simple structure*** is an organizational form in which the owner-manager makes all major decisions directly and monitors all activities, and the firm's staff is merely an extension of the manager's supervision authority.

Strategy and Organizational Structure, cont.

- The ***simple structure*** structure allows for functional specialization, facilitating active knowledge sharing within each functional area. Knowledge sharing usually supports career paths and professional development of functional specialists.

Strategy and Organizational Structure, cont.

- The ***functional structure*** consists of a chief executive officer and limited corporate staff with functional line managers in dominant functions: production, accounting, marketing, R&D, engineering, human resources.

Strategy and Organizational Structure, cont.

- The ***multidivisional (M-form) structure*** is composed of operating divisions where each division represents a separate business to which the top corporate officer delegates responsibility for day-to-day operations and business unit strategy to division managers.

Strategy and Organizational Structure, cont.

M-form can have three major benefits:

- Allows corporate officers to accurately monitor business unit performance, simplifying control problems.
- Facilitates comparisons between divisions, which improves the resource allocation.
- Stimulates managers of poorly performing divisions to look for ways to improve performance.

Strategy and Organizational Structure, cont.

- Different forms of the functional organizational structure are used to support implementation of the cost leadership, differentiation, and integrated cost leadership/differentiation strategies.

Strategy and Organizational Structure, cont.

- The differences in these forms are accounted for primarily by different uses of three important structural characteristics or dimensions—*specialization* (the type and number of jobs required to complete work), *centralization* (the degree to which decision-making authority is retained at higher managerial levels), and *formalization* (the degree to which formal rules and procedures govern work).

Strategy and Organizational Structure, cont.

- Firms using the cost leadership strategy want to sell large quantities of standardized products to an industry's or a segment's typical customer.

Strategy and Organizational Structure, cont.

The cost leadership form of the functional structure usually features:

- Simple reporting relationships
- Few layers in the decision-making and authority structure
- A centralized corporate staff
- A focus on process improvements through manufacturing rather than development of new products through emphasis on R&D

Strategy and Organizational Structure, cont.

- Firms offering products that are unique usually are using a differentiation strategy.
- A differentiation strategy requires:
 - ❑ The firm to sell nonstandardized products
 - ❑ Complex and flexible reporting relationships
 - ❑ Frequent use of cross-functional product development teams
 - ❑ A strong focus on marketing and product R&D rather than manufacturing and process

Strategy and Organizational Structure, cont.

- The integrated cost leadership/differentiation strategy is used frequently in the global economy, it is difficult to implement because of different primary and support activities
Low-cost strategies emphasize production and manufacturing process engineering and few product changes.
- Differentiation strategies require an emphasis on marketing and new product R&D.

Strategy and Organizational Structure, cont.

- The firm's level of diversification is a function of decisions about the number and type of businesses in which it will compete and management of the businesses. Increasing diversification eventually creates information processing, coordination, and control problems that the functional structure can't handle. This requires a shift from a functional structure to a complex multidivisional structure.

Strategy and Organizational Structure, cont.

The three variations of the multidivisional structure are the:

- Cooperative form
- Strategic Business Unit (SBU) form
- Competitive form

Strategy and Organizational Structure, cont.

- The cooperative form structure uses horizontal integration to bring about interdivisional cooperation. The divisions in the firm using the related-constrained diversification strategy commonly are formed around products, markets, or both.

Strategy and Organizational Structure, cont.

- Although the SBU M-form appears similar to the Cooperative M-form, there are several differences.
- The SBU M-form includes an additional layer—the strategic business unit or SBU—between the corporate headquarters and product divisions.
- There may be integration and coordination between divisions in a specific SBU.

Strategy and Organizational Structure, cont.

- There is independence among and between SBUs.
- Headquarters manages approval of strategic planning of SBUs for the president.
- Individual SBUs may have budgets and staffs for within-SBU integrating mechanisms.
- Corporate headquarters staff serves as consultants to SBUs and divisions on product strategy (rather than having direct input).

Strategy and Organizational Structure, cont.

- The Competitive M-form differs from both the Cooperative and SBU M-forms:
- Establishing a smaller headquarters office, generally containing three functions:
 - 1. Legal affairs, which increases in importance when a firm acquires or divests units
 - 2. Auditing, which monitors divisional performance to ensure performance data are accurately reported
 - 3. Finance, which manages the firm's cash flow and allocates capital

Strategy and Organizational Structure, cont.

- Allowing independent divisions so financial performance can be monitored separately for each
- Setting up divisions that retain strategic control, but give up cash flow control
- Allowing competition between divisions for capital allocations

Strategy and Organizational Structure, cont.

- The ***multidomestic strategy*** in which strategic and operating decisions are decentralized to business units in each country to tailor products to each country.
- The structure used to implement the multidomestic strategy is the ***worldwide geographic area structure***, an organizational form in which national interests dominate and that facilitates managers' efforts to satisfy local or cultural differences.

Strategic Network

- A ***strategic network*** is a grouping of organizations that has been formed to create value by participating in an array of cooperative arrangements. It is often a loose federation of partners who participate in the network's operations on a flexible basis. A *strategic center firm* is the one around which the network's cooperative relationships revolve.

Strategic Network, cont.

- The strategic center firm—and other network partners—should note four critical aspects of the strategic center firm's functions:
 - ❑ Strategic Outsourcing
 - ❑ Development of Competencies
 - ❑ Technology Management
 - ❑ Race to Learn (or Managing Learning Processes)

Strategic Network, cont.

- *Strategic outsourcing* is one of the strategic center firm's key functions. In addition to outsourcing more than other members of the strategic network, the center firm also encourages member firms to go beyond contracting to solve problems and to initiate competitive actions that the network can pursue.

Strategic Network, cont.

- The *competence*-related role of the center firm is to build or develop the core competencies of other network member firms and encourage them to share these with other network partners.
- *Technology* aspects of the center firm's role include managing the development and sharing of technology-based ideas among network partners.

Strategic Network, cont.

- Emphasizing the *race to learn* implies that the strategic center firm must encourage positive rivalry among partner firms that strengthen each partner's (as well as the network's) value chain. The effectiveness of the center firm is related to how well it learns to manage learning processes among network partners.

Strategic Network, cont.

- Competing across national borders increases the complexity of the task of managing strategic networks that have been formed through international cooperative strategies and stifles the selection of a strategic center firm because great differences may exist among the regulatory environments of partners' home countries.

Strategic Network, cont.

- In response to this complexity:
 - Distributed strategic networks are formed
 - Multiple regional strategic centers are established

Unit 8 Recap

1. Explained the popularity of merger and acquisition strategies in firms competing in the global economy
2. Discussed reasons why firms use an acquisition strategy to achieve strategic competitiveness
3. Described seven problems that work against achieving success when using an acquisition strategy
4. Named and described the attributes of effective acquisitions

Unit 8 Recap, cont.

- 5. Defined the restructuring strategy and distinguish among its common forms
- 6. Explained the short- and long-term outcomes of the different types of restructuring strategies
- 7. Explained the use of the three versions of the multidivisional (M-form) structure to implement different diversification strategies

Unit 8 Recap, cont.

- 8. Discussed the organizational structures used to implement three international strategies
- 9. Defined strategic networks and discuss how strategic center firms implement such networks at the business, corporate and international levels

What's next?

- Complete reading assignments
- Complete writing assignments
- Answer discussion questions
- Complete unit quiz

References

Hitt, M., Ireland, R., & Hoskisson, R. (2017). *Strategic Management Competitiveness and Globalization 2015-2017*. Boston, MA: Cengage

Image References

Hitt, M., Ireland, R., & Hoskisson, R. (2017). *Strategic Management Competitiveness and Globalization 2015-2017*. Boston, MA: Cengage