Strategic Management

Undergraduate course in Management

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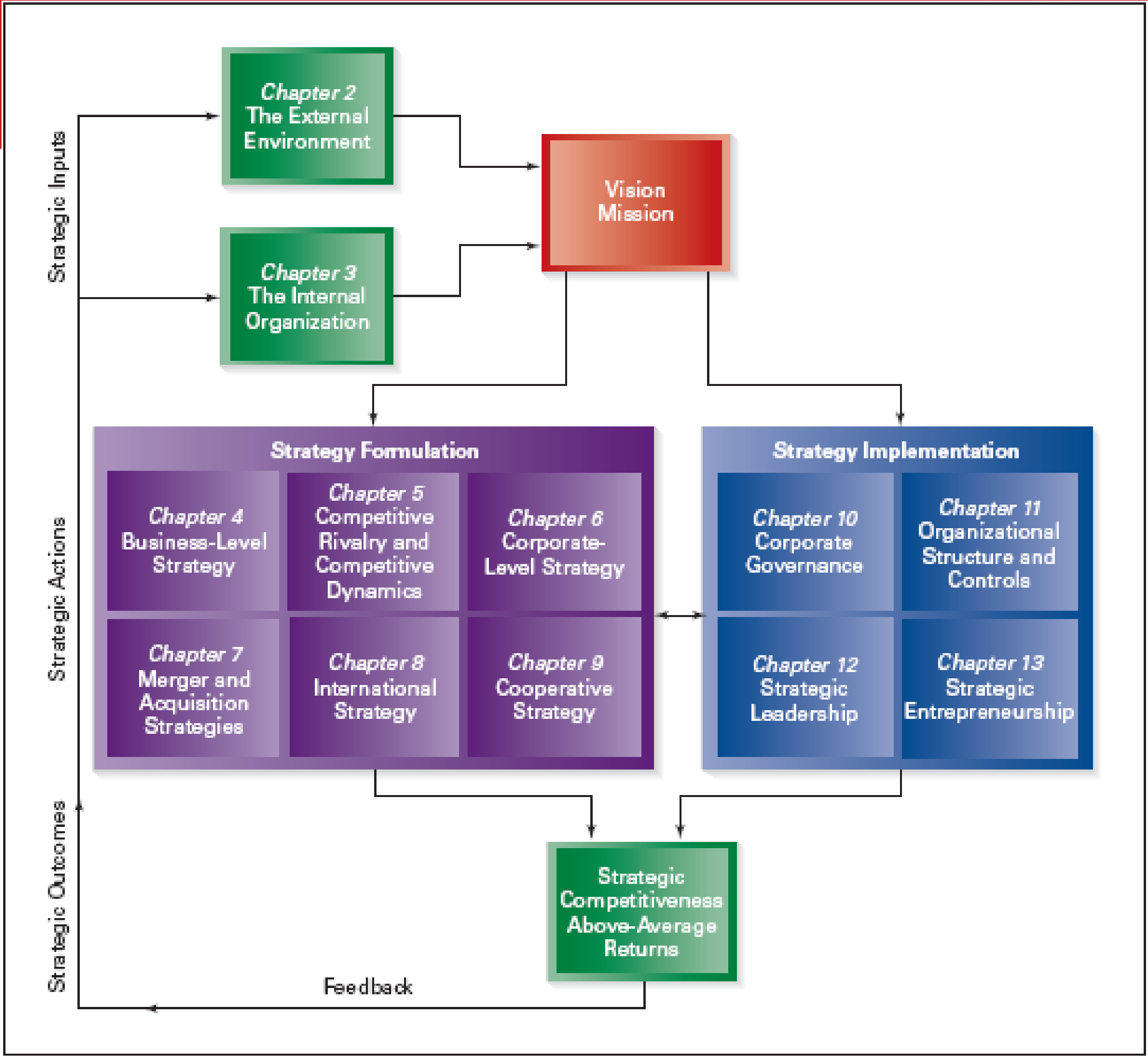
ISEG 100 1911-2011 ANOS

100 ANOS A PENSAR NO FUTURO

The Strategic Management Process



Six content areas

Popularity of acquisition strategies for firms competing in the global economy

Why firms use acquisition strategies

Seven problems working against developing a competitive advantage using an acquisition strategy

Attributes of effective acquisitions

Restructuring strategy vs. common forms

Short & long-term outcomes of different restructuring strategies

Introduction: Popularity of M&A Strategies

Instituto Superior de Economia e Gestão
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- Popular strategy among U.S. firms for many years
- Can be used because of uncertainty in the competitive landscape
  - Increase market power because of competitive threat
  - Spread risk due to uncertain environment
  - Shift core business into different markets (due to industry or regularity changes)
- Intent: increase firm's strategic competitiveness and value – the reality, however, is returns are close to zero

Merger

Two firms agree to integrate their operations on a relatively co-equal basis

Acquisition

One firm buys a controlling, 100 percent interest in another firm with the intent of making the acquired firm a subsidiary business within its portfolio.

Takeover

Special type of acquisition strategy wherein the target firm did not solicit the acquiring firm's bid

Hostile takeover: Unfriendly takeover that is unexpected and undesired by the target firm

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Reasons for Acquisitions

1. Increased market power

- Sources of market power include: Size of the firm, unique resources and capabilities to compete in the market and share of the market
- Horizontal Acquisitions: Acquirer and acquired companies compete in the same industry (i.e., McDonald's acquisition of Boston Market)
- Vertical Acquisitions: Firm acquires a supplier or distributor of one or more of its goods or services; leads to additional controls over parts of the value chain (i.e., Walt Disney Company's acquisition of Fox Family Worldwide)
- Related Acquisitions: Firm acquires another company in a highly related industry

Reasons for Acquisitions

2. Overcoming entry barriers (Cross-border acquisition: headquarters in different country)

3. Cost of new product development and increased speed to market

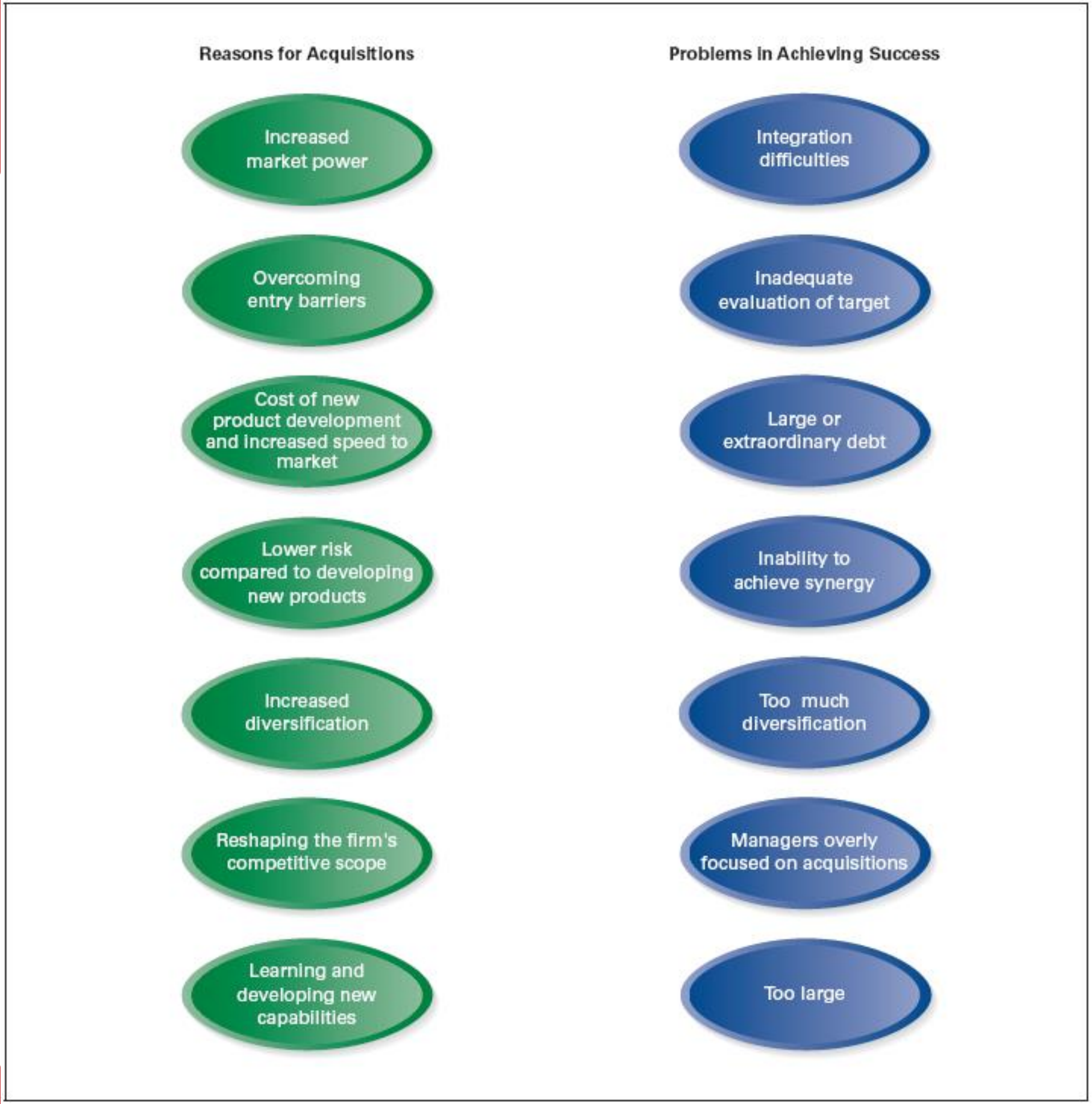
4. Lower risk compared to developing new products

5. Increased diversification

6. Reshaping firm’s competitive advantage

7. Learning and developing new capabilities

Reasons for Acquisitions and Problems in Achieving Success



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Problems in Achieving Acquisition Success

1. Integration difficulties
2. Inadequate evaluation of target
3. Large or extraordinary debt
   - Junk bonds: financing option whereby risky acquisitions are financed with money (debt) that provides a large potential return to lenders (bondholders)
4. Inability to achieve synergy
   - Synergy: Value created by units exceeds value of units working independently (achieved when the two firms' assets are complementary in unique ways; yields a difficult-to-understand or imitate competitive advantage)
   - Private synergy: Occurs when the combination and integration of acquiring and acquired firms' assets yields capabilities and core competencies that could not be developed by combining and integrating the assets with any other company

Problems in Achieving Acquisition Success

5. Too much diversification

- Diversified firms must process more information of greater diversity
- Scope created by diversification may cause managers to rely too much on financial rather than strategic controls to evaluate performance of business units
- Acquisitions may become substitutes for innovation

6. Managers overly focused on acquisitions

- Necessary activities with an acquisition strategy: i) search for viable acquisition candidates; ii) complete effective due-diligence processes; and iii) prepare for negotiations
- Managing the integration process after the acquisition: i) diverts attention from matters necessary for long-term competitive success (i.e., identifying other activities, interacting with important external stakeholders, or fixing fundamental internal problems); and ii) a short-term perspective and greater risk aversion can result for target firm's managers

Problems in Achieving Acquisition Success

7. Too large

- Bureaucratic controls: formalized supervisory and behavioral rules and policies designed to ensure consistency of decisions and actions across different units of a firm – formalized controls decrease flexibility
- Additional costs may exceed the benefits of the economies of scale and additional market power
- Larger size may lead to more bureaucratic controls
- Formalized controls often lead to relatively rigid and standardized managerial behavior
- Firm may produce less innovation

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Effective Strategies

- Complementary assets or resources
- Friendly acquisitions facilitate integration of firms
- Effective due-diligence process (assessment of target firm by acquirer, such as books, culture, etc.)
- Financial slack
- Low debt position (high debt can…: i) increase the likelihood of bankruptcy; ii) lead to a downgrade in the firm’s credit rating; and iii) preclude needed investment in activities that contribute to the firm’s long-term success
- Innovation
- Flexibility and adaptability

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Restructuring

- **Definition: Firm changes set of businesses or financial structure**
- **Three restructuring strategies**

  1. Downsizing: reduction in number of firms' employees (and possibly number of operating units) that may or may not change the composition of businesses in the company's portfolio

  2. Downscoping: eliminating businesses unrelated to firms' core businesses through divesture, spin-off, or some other means

  3. Leveraged buyouts (LBOs):
    - One party buys all of a firm's assets in order to take the firm private (or no longer trade the firm's shares publicly)
    - Private equity firm: firm that facilitates or engages in taking a public firm private
    - Three types of LBOs: management buyouts, employee buyouts, and whole-firm buyouts
    - Why LBOs? i) protection against a capricious financial market; ii) allows owners to focus on developing innovations/bring them to market; and iii) a form of firm rebirth to facilitate entrepreneurial efforts

Restructuring

Restructuring Outcomes

- Short-term
  - Reduced costs: labor and debt
  - Emphasis on strategic controls
- Long-term
  - Loss of human capital
  - Performance: higher/lower
  - Higher risk

Restructuring and Outcomes