Ross School of Business at the University of Michigan

Independent Study Project Report

TERM : **Spring 1998**

COURSE : **OM 750**

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STUDENT : **Renee Robinson**

TITLE : **Mergers, Acquisitions, and Other Joint Arrangements**

Growth Model:

Mergers, Acquisitions, and Other Joint Arrangements

Renée Robinson, Global Entrepreneurial Leadership Fellow

Mergers, acquisitions and other joint arrangements provide methods for a company to grow into new products or new markets through external sources. External growth often appears to be the easiest solution to the question of how to grow. However, most acquisitions are considered failures. A recent McKinsey & Company study found that 61% of mergers studied failed to earn back its cost of capital. One reason for failure is a lack of adequate planning. Only 80% of companies involved in a major acquisition perform any pre-acquisition planning. This section will discuss the necessary consideration in exploring external growth.

Strategy

External growth should only be investigated after preparing a strategic plan for growth. It helps to write down the current state of your company in the overall industry. The following matrix can be used to simplify developing a growth strategy. List all of your present products and potential new products and their present markets and possible new markets. In each box write down your company's current market share. Also, in examining your product in that market, consider the potential for profitable growth in that market, i.e. how are the margins. This serious look should give you important information on targeting new markets, products, and services as well as discovering which product lines to sell or which markets to cease doing business. (Mergers & Acquisitions, Krallinger)

INDEPENDENT STUDY PROFESSOR COMMENTS

STUDENT NAME: Renee Robinson

The attached paper more than meets the requirements of the proposed independent study. The conceptual and empirical work is very solid.

The paper tackles the issue of how to successfully pursue a strategy of growth through a variety of joint venture and acquisition and merger activity. Ms. Robinson does a very good job of sorting out such key variables leverage, product portfolio mix and the soft cultural issues leading to success or failure.

The final section focus on the interesting area of compensation models in JVs.

In addition, Ms. Robinson particpated in a team project study that resulted in a frist rate written report and video presentation.

Noel Tichy

Present Markets			**New Markets**		
Present Products	Market 1	Market 2	Market 3	Market 4	Market 5
Existing Product 1	3 G				
Existing Product 2	2 G			1 G	
Existing Product 3		3 Y	1 R		
New Products					
New Product 1		1 G		1 Y	
New Product 2	1 G		1 R		
New Product 3					

Company's market share shows

1 = Minor market share
2 = Average market share
3 = High markets share

Future Growth of market niche

R = (red) for high
Y = (yellow) for medium
G = (green) for low profit margins

Acquisition Planning

Most acquisitions occur because the target company has something that the acquiring company needs such as; market share, technology, distribution, property, plant, and equipment, etc. The target companies are identified because the acquirer believes that synergies existed. Synergies are the justification for purchasing at a premium. Interestingly, most managers only have a vague idea of how 1+1=3. In Sirower's book, *The Synergy Trap*, he discusses the cornerstones to synergy; strategic vision, operating strategy, systems integration and power and culture.

Strategic vision is the foundation for all acquisitions. "Management's vision of the acquisition is shared with suppliers, customers, lenders, and employees as a framework for planning, discussions, decisions, and reactions to change. The vision must be clear to large constituent groups and adaptable to many unknown circumstances."" (Sirower) Visions are dangers if the words are not put into actions quickly. If the other cornerstones are not already in place, visions can act as early warning notices to your competitors, telling them which products and markets your company plans to focus on.

Operating strategy focuses on how to improve the value chain of the combined entity. Gains in market share and profit margins must be taken at the expense of competitors unless entering entirely new markets or with products for newly identified needs. In either case, competitor reactions should play an important role in how to operate. "The operating strategy must address how the new company will be more competitive along the entire value chain of the business." (Sirower)

Systems integration addresses how to implement the acquisition. It must support a detailed operating strategy. This involves detailing which operations will stand-alone and which will become integrated. Analysis of systems integration should be done in the process of valuation. If one of the synergy listed is economy of scale, it must be decided exactly how the cost savings will occur. System integration plans are time consuming because it involves careful analysis of areas of duplication and overlap in order to realize how everything will work together post merger. However, doing the legwork in advance will save you time and money. Most importantly, once your competition understands the direction you are heading, you will already be there.

Power and Culture is the "softest" of the cornerstones of synergy and the most difficult to define. Sirower moves away from the usual opinions that companies should have similar cultures. "The issue for acquirers is not whether the cultures are similar or different but whether the changes necessary to support the strategy will clash with either culture." Similar to systems integration, plans on how to handle conflicts and cooperation are necessary to align cultures. Carefully identified incentives and other reward systems for the new company will ensure that all parties are working towards a common goal.

The four cornerstones of synergy, strategic vision, operating strategy, systems integration and power and culture are all necessary to map out before making a bid on a company. Without looking at how the two companies will work together as one, it is impossible to assess a fair value. Not only will your company not be able to reap the benefits of the combination, you will tip off your competitors to the new direction you will be taking before you are ready.

Other Joint Arrangements

Mergers and acquisitions are sometimes viewed as the only ways to grow externally. There are many other ways to bring in outside expertise without having to purchase. Joint arrangements provide quick and trial solutions to how to expand into new products and new markets. Typically, these arrangements, such as joint ventures and partnering, are used in foreign markets to get around government restrictions. Alliances and partnering are becoming more popular domestically as companies are beginning to see the benefits of working together in alliances. Krallinger provides a list of examples of joint arrangements and how the compensation should work.

Type*	**Compensation**
Sales representation	Commission
Distribution	Commission or outright buy/sell
Franchise	Up-front payment plus royalty based on sales and possible agreement to buy materials and supplies from franchiser
License to manufacture and/or sell (may involve cross-license with each having rights to other's technology, products, etc.	Usually up-front payment plus royalty-type fees based on sales with annual minimums
Jointly own business and partnership	Both contribute funds and/or services, product technology, distribution, manufacturing management, etc.
Rental agreement for facilities or management or a tolling production arrangement	Fixed rent charge or straight fee for services rendered or products produced
Agree to fund project with rights to project results or products	Sharing of expenses, or equal or unequal contribution of funds

**May be granted exclusive or non-exclusive territories.*

When considering acquiring in order to grow, try to consider other methods besides acquisition. One solution may be to acquire top talent in the industry or market your company plans to expand into. Other arrangements can provide a quicker method to achieve your company's goal of growth.