Mergers and takeovers

2017-18

Objectives of this class

- What is the *reason* of mergers and takeovers?
- What is the *difference* between mergers and takeovers?
- What is meant by *horizontal* and *vertical integration*?
- What are the *risks* and *rewards* of mergers and takeovers?
- What are the main problems when companies *grow rapidly*?

Reasons for mergers and takeovers

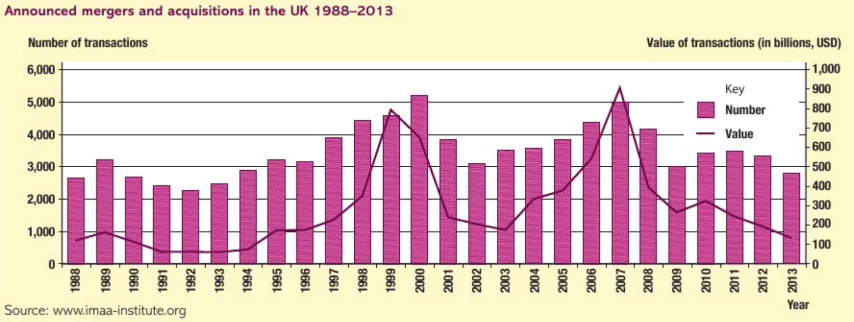
- *Mergers* and *takeovers*: take place when firms join together and operate as one organisation
- Why do *mergers* and *takeovers* occur?
  - exploit *synergies* (e.g., economies of scale, diversification, common management)
  - *expand* the business
  - may be cheaper than *internal growth*
  - use *excessive cash* instead of holding to it
  - *defensive reason*: get bigger to avoid takeover
  - as a response to *economic changes* (e.g., creation of euro)
  - entry into *foreign markets*
  - gain *economies of scale*
  - *asset stripping*
  - or simply because objective is *growth of business*

Distinction between mergers and takeovers

- *Merger*: two or more businesses join together and operate as one
  - *agreement* of all involved businesses
  - *name* of new business composed of names of involved businesses
  - Example: Holcim Ltd. + Lafarge SA = LafargeHolcim
- *Takeover*: one business buys another
  - *public limited company*: anyone can buy them
  - *predator* company
  - takeover of public limited company $\rightarrow$ rise in *share prices*
  - Example: Takeover of O_2 by *Three*

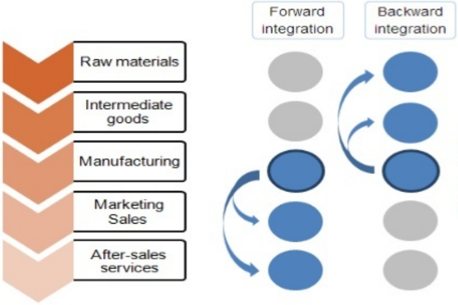
Distinction between mergers and takeovers

Number of transactions



Horizontal and vertical integration

- *Integration*: businesses join together to form one
  - *Horizontal integration*: when firms are in the same line of business
  - *Vertical integration*: when firms are in different stages of production
    - *Forward vertical integration*: joins business that is the *next* stage of production
    - *Backward vertical integration*: joins business that is in the *previous* stage of production



Financial risks and rewards

Corporate strategies (e.g., M & A) can also go wrong:

- Risks:
  - *Regulatory intervention*: Competition and Markets Authority (CMA) in the UK
  - *Resistance from employees*: job losses
  - *Integration costs*: expensive and time-consuming process
  - *Bidding wars*: if there is more than one potential buyer $\rightarrow$ price of acquisition $\uparrow$
- Rewards:
  - *Speedy growth*: growth can be achieved faster than through internal growth
  - *Higher remuneration for senior staff*: salaries of managers $\uparrow$
  - *Rewards to previous owners*:
  - *Increased profitability*:

Problems of rapid growth

- *Drain on resources*:
- *Coping with change*:
- *The alienation of customers*:
- *Loss of control*:
- *Shortages of resources*:

Key terms

- **Backward vertical integration**: joining with a business in the previous stage of production
- **Forward vertical integration**: joining with a business in the next stage of production
- **Horizontal integration**: the joining of businesses that are in exactly the same line of business
- **Integration**: the joining together of two businesses as a result of a merger or takeover
- **Merger**: occurs when two (or more) businesses join together and operate as one
- **Synergy**: the combining of two or more activities or businesses creating a better outcome than the sum of the individual parts
- **Takeover**: the process of one business buying another
- **Vertical integration**: the joining of two businesses at different stages of production

Key terms

Revision of chapter 11

- **Competitive pricing**: Pricing strategies based on the prices charged by rivals
- **Cost plus pricing**: Adding a percentage (the mark-up) to the costs of producing a product to get the price
- **Mark-up**: The percentage added to unit cost that makes a profit for a business when setting the price
- **Penetration pricing**: Setting a low price when lanching a new product in order to get established in the market
- **Predatory** or **destroyer pricing**: Setting a low price forcing rivals out of business
- **Pricing strategy**: The pricing policies or methods used by a business when deciding what to charge for its products

Key terms

Revision of chapter 11

- **Product life cycle**: Shows the different stages in the life of a product and the sales that can be expected at each stage
- **Psychological pricing**: Setting the price slightly below a round figure
- **Skimming** or **creaming**: Setting a high price initially and then lowering it later
- **Unit costs**: The same as average cost (total cost divided by output)

Key terms

Revision of chapter 12

- **Agent** or **broker**: An intermediary that brings together buyers and settlers
- **Breaking-bulk**: Dividing a large quantity of goods received from a supplier before selling them on in smaller quantities to customers
- **Direct selling**: Producers selling their products directly to consumers
- **Distribution**: The delivery of goods from the producer to the consumer
- **Distribution channel**: The route taken by a product from the producer to the customer

KEY TERMS

REVISION OF CHAPTER 12

- **E-commerce**: The use of electronic systems to sell goods and services
- **Intermediaries**: Links between the producer and the consumer
- **Retailer**: A business that buys goods from manufacturers and wholesalers, and sells them in small quantities to consumers
- **Wholesaler**: A business that buys goods from manufacturers and sells them in smaller quantities to retailers