STRATEGIC MANAGEMENT Notes Topic 31 – 40

Corporate Restructuring, Strategic Alliances, Joint Ventures and Mergers & Acquisitions

Stages of Corporate Restructuring

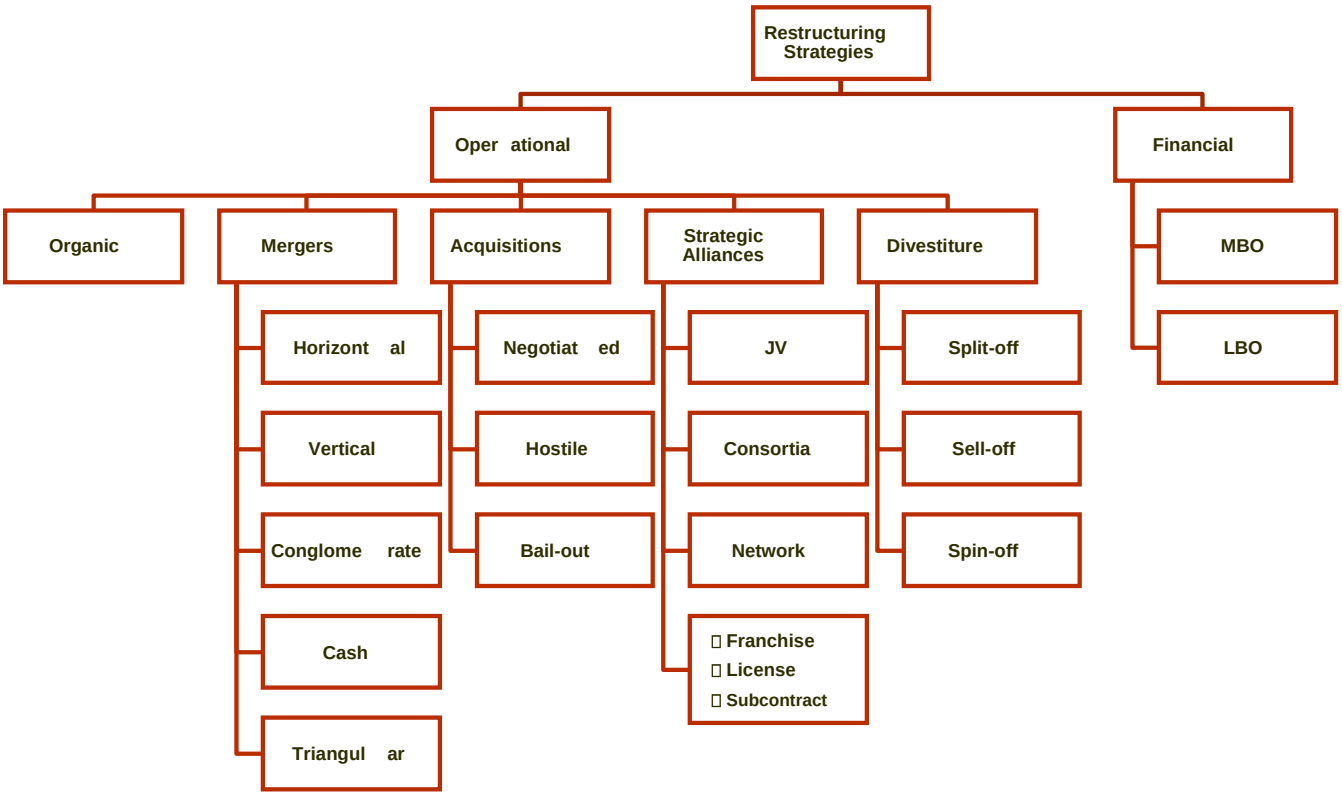
Restructuring is the corporate management term for the act of reorganizing the legal, ownership, operational, or other structures of a company for the purpose of making it more profitable, or better organized for its present needs.

1. The Evaluation and Assessment Stage: Where is the company now?
2. The Acute Needs Stage: Stop the bleeding
3. The Restructuring Stage: In depth fire-fighting
4. The Stabilization Stage: Starting to win
5. The Revitalization Stage: Business has stabilized

'Organic Growth' strategy

- Organic growth is the process of business expansion by increased output, customer base expansion, or new product development, as opposed to mergers and acquisitions, which is inorganic growth.
- Organic growth is growth that comes from a company's existing businesses, as opposed to growth that comes from buying new businesses.
- For example, by examining Ansoff's matrix, businesses can select from market penetration, market development, product development and diversification to grow their revenue organically.

Summary of 'Restructuring Strategies'



Operational Restructuring

1. Organic Development: Internal development by building on and developing an organization's own capabilities.
2. Mergers: a combination of two or more distinct entities into one. The merging entities cease to be in existence and merge into a single entity.
    - Horizontal Merger – similar lines combine together.
    - Vertical Merger – merges with `upstream' and/or downstream partners.
    - Conglomerate Merger – unrelated business activities.
    - Concentric Merger – share some common expertise, or are closely related to the company's existing products and services.
    - Cash Merger – shareholders of one entity receive cash in place of shares in the merged entity.
    - Triangular Merger – it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer.
3. Acquisitions: It involves acquisition of controlling interest in a company by another company. It does not lead to dissolution of company whose shares are acquired.
    - Negotiated friendly
    - Open market/hostile
    - Bailout takeover
4. Strategic Alliances: where two or more organizations share resources and activities to pursue a set of agreed upon objectives, while remaining independent organizations.
    - Joint ventures are relatively formalized alliances
    - A consortium is a joint venture arrangement more focused on a particular venture or project.
    - Network arrangements are less formal arrangements without cross-ownership arrangements and formal contracts
    - Franchising involves the franchise holder undertaking specific activities such as manufacturing, distribution or selling, whilst the franchiser is responsible for the brand name and training.
    - Licensing is common in technology-based industries where the right to manufacture a patented product is granted for a fee.
    - Subcontracting is an arrangement wherein a company chooses to subcontract particular services or part of a process to be subcontracted (or 'outsourced') to private companies.
5. Divestiture: involves sale of a segment of a company for cash or securities.
    - Spin Off: Spinning off a division of company into a wholly owned subsidiary of the parent company.
    - Sell Off: Selling off assets of a company
    - Split Up: Splitting and selling a division of a company

Financial Restructuring

Formulating appropriate restructuring schemes involving a significant change in the financial/capital structure of a firm.

1. Management Buyouts (MBO) involves the sale of the existing firm to 'management'.
2. When debt forms a substantial part of the total financing, the buyout by outsiders is called Leveraged Buyout (LBO).

Motives for Mergers & Acquisitions

- Speed of entry
- Competitive situation
- Financial markets economics
- Capability considerations

- Exploitation of strategic capabilities
- Cost efficiency (Resource rationalization)
- Obtaining new capabilities
- Stakeholder Expectations

Divestiture strategy, Liquidation strategy & Bankruptcy

- Divestiture strategy: involves the sale of a part of a firm or a major component of a firm
    - When retrenchment fails to accomplish the desired turnaround
    - When a non integrated business activity achieves an unusually high market value
- Liquidation strategy: the firm typically is sold in parts, or as a whole, for its tangible asset value and not as a going concern.
- Bankruptcy: agreeing to a complete distribution of the firm's assets to creditors, most of whom receive a small fraction of the amount they are owed.

'Hubris Hypothesis' for takeovers

- The Hubris (or pride) Hypothesis implies that managers seek to acquire firms for their own personal motives and that the pure economic gains to the acquiring firm are not the primary motivation in the acquisition.
- The following should occur for those takeovers motivated by Hubris:
    - The stock price of the acquiring firm should fall after the market becomes aware of the takeover bid. This should occur because the takeover is not in the best interests of the acquiring firm's stockholders and does not represent an efficient allocation of their wealth.
    - The stock price of the target should increase with the bid for control. This should occur because the acquiring firm is not only going to pay a premium but also may pay a premium for excess of the value of the target.
    - The combined effect of the rising value of the target and the falling value of the acquiring firm should be negative. This takes into account the costs of completing the takeover process.

Synergy in Mergers and Acquisitions

- Synergy is the concept that the value and performance of two companies combined will be greater than the sum of the separate individual parts.
- If two companies can merge to create greater efficiency or scale, the result is what is sometimes referred to as a synergy merge.
- The expected synergy achieved through a merger can be attributed to various factors, such as increased revenues, combined talent and technology, or cost reduction.

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Reasons behind the failure of M&A

- Inaccurate Data and Valuation Mistakes.
- Insufficient Owner Involvement.
- Resource Limitations.
- Unexpected Economic Factors.
- Lack of Planning and Strategy.
- Lack of clarity in the post-merger integration process (key employees, processes, important projects, policies, etc.)
- Mismatch in the culture

Licensing and Franchising

- Franchising: It is an agreement between two parties where the franchisor permits the franchisee to use its brand name or business model for a fee in order to conduct the business as an independent branch of the franchisor.

  Examples of well-known franchise business models include McDonalds, Subway
- Licensing: It is an agreement between two parties where the Licensor, sells the Licensee the rights to use its intellectual property or manufacture the licensor's products in exchange for royalty payments.

  E.g. A merchandiser has a licensing agreement with Disney Corp. to use cartoon characters like Mickey Mouse, Donald Duck on bags, cups, bottles etc.

JV Life Cycle

Joint ventures typically go through life cycle phases.

1. Joint venture scoping and definition
2. Deal-making and due diligence
3. Venture execution and operational start-up
4. Governance and oversight, inclusive of contract or dispute resolution
5. Joint venture dissolution

JV Failures

There are many reasons why Joint Ventures fail and five of the most common reasons are:

- Lack of a proper Joint Venture Agreement. The importance of a proper JV Agreement cannot be emphasized enough. ...
- Lack of finance. ...
- Control issues. ...
- Compatibility. ...
- Unrealistic expectations.

JVs THAT FAILED

Joint Venture	Reason for break-up
Hero-BMW	Poor consumer response
Suzuki-TVS	Ownership issues
Yamaha-Escorts	Falling demand
Kinetic-Honda	Kinetic buys partner's stake
Kinetic-Hyosung	Steep pricing
LML-Piaggio	LML bought partner's stake

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JV Successes

Grant Thornton has set out the following guidelines for companies considering embarking on a joint venture.

- Agreement: Among the terms that should be clearly defined from the outset are the time span of the venture, performance norms, and governance processes. A joint venture board should be established and agreement

reached as to the scale of investment required from each party. Whether the parties will extract surplus cash or reinvest it into the business, along with a potential exit strategy, are other significant considerations.

- Alignment: Successful JVs are founded on shared objectives. The partners' risk/reward strategies must be aligned to ensure both derive value from the arrangement.
- Development: The strategic partnership, as well as the relationships between parties, are ongoing, rather than static, and need to be developed. Frequent communication is required to foster a feeling of belonging amongst employees on both sides.
- Flexibility: Parties should be aware of potential differences in business culture and decision-making processes and deal with any issues that arise in a flexible manner.

Joint Ventures that Succeeded

- Hindustan Aeronautics Ltd
- Vistara
- Tata Global Beverages
- BrahMos Aerospace
- Bharti-AXA General Insurance Co Ltd
- Mahindra-Renault Ltd
- AirAsia India
- Max Life Insurance Co Ltd

Strategic Tools

Benchmarking

- Also referred to as "best practice benchmarking" or "process benchmarking", this is used in organizations to compare and evaluate various aspects of their processes and performance metrics in relation to best practice companies' processes, usually within a peer group defined for the purposes of comparison. This then allows organizations to develop plans on how to make improvements or adapt specific best practices,
- Dimensions typically measured are quality, time and cost, comparing performance using a specific indicator (cost per unit of measure, productivity per unit of measure, cycle time of x per unit of measure or defects per unit of measure).
- Types of Benchmarking: ○ Historical benchmarking ○ Industry/sector benchmarking ○ Best-in-class benchmarking.

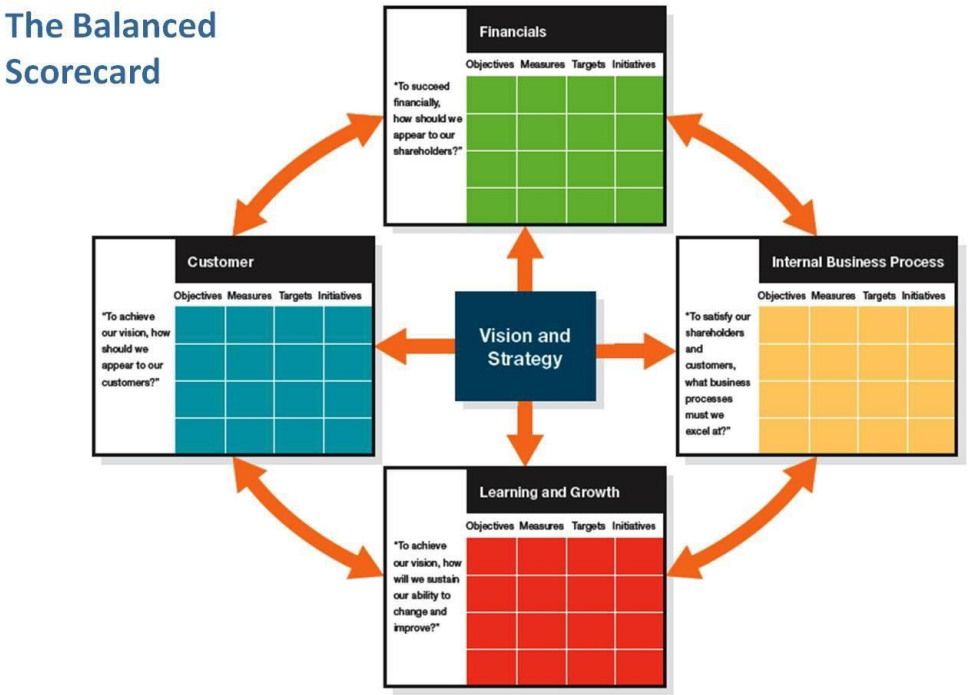
Restructuring & Reengineering

- Restructuring involves reducing the size of the firm in terms of number of employees, number of divisions or units, and number of hierarchical levels in the firm's organizational structure.
- Restructuring is usually followed by reconfiguring or redesigning work, closing plants, laying off employees and moving & reorganization operations.
  - Also called downsizing, rightsizing, or delayering.
- Reengineering is the FUNDAMENTAL rethinking and RADICAL redesign of business PROCESSES to achieve DRAMATIC improvements
- Reengineering involves a paradigm shift, reconfiguring or redesigning work, jobs, and processes for the purpose of improving cost, quality, service, and speed.
  - Also called process management, process innovation, or process redesign and optimization.

Reverse Engineering

- Reverse engineering refers to looking at the solution to figure out how it works. Basically, it is business analysis backward from the solution to understand the data, processes, and business rules.
- An example would be to reverse engineer a business plan to attain company vision.

The Balanced Scorecard



- The BALANCED SCORECARD is the tool for monitoring and measuring the strategic plan.
- It is a BALANCED (integrated and holistic) strategy map that addresses four key perspectives:
  - Financial Perspective: How well strategy and operations are contributing to improving the company's financial health and add value.
  - Customer Perspective: What value does the organization need to provide to its customers in order to achieve financial goals.
  - Processes Perspective: What internal processes are required to achieve financial goals and provide value to customers.
  - People Perspective: What skills and capabilities must the organization have to drive internal processes, provide value to customers & achieve financial goals.

Contemporary Issues

'Blue Ocean Strategy' and 'Red Ocean Strategy'

- Taking advantage of a strategic gap is an effective way of managing threats and opportunities.
- A strategic gap is an opportunity in the competitive environment that is not being fully exploited by competitors.
- W. Chan Kim and Renée Mauborgne have argued that if organizations simply concentrate on competing head to head with rivals, this will lead to competitive convergence where all 'players' find the environment tough and threatening. They describe this as a 'red ocean' strategy (red because of the bloodiness of the competition).
- They urge instead that managers attempt 'blue ocean' strategies, creating wide open spaces free from existing competition. 'Blue oceans' are strategic gaps in the market, opportunities that are not being fully exploited by

competitors (in substitute industries, in other strategic groups, in complementary products, in new market segments).

- E.g. creation by Australian wine producers of fun, easy-to-understand and easy-to-drink wines. A red ocean strategy would have been to compete against the established French producers with fancy labels, wine jargon and complex tastes.

Innovation as a strategy to achieve a Sustainable Competitive Advantage

- Michael Porter points out that sustainable competitive advantage occurs only when firms activities are different from those of their competitors, or when firms do the same activities differently (in terms of productivity, quality & speed) i.e. creating "preservable differentiation".

		SOURCES OF SUSTAINABLE COMPETITIVE ADVANTAGE	
		DIFFERENTIATION	**COST LEADERSHIP**
AREA OF FOCUS	**PRODUCT FOCUS**	**Best Product / Innovation**	**Process Economies / Innovation**
		Apple, Bang & Olufsen, Swiss Army	***Wal-Mart, Southwest Airlines, IKEA***
	CUSTOMER FOCUS	**Customer Intimacy / Responsiveness**	**Lock-in**
		Ritz Carlton, Singapore Airlines	***Microsoft, Google, Cisco, PEPSI***

BoP (Bottom of the Pyramid) Strategy

- "Bottom of the Pyramid" strategy is developing new models of doing business that deliberately target the poorest regions.
- In economics, the bottom of the pyramid is the 2.5 billion people who live on less than $2.50 per day.
- From multinational companies' perspective (MNC), there is a growing interest in the potential market of developing countries in the small upper-middle-class segments.