Management Dynamics

Volume 2 | Number 1 Article 5

April 2001

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Recommended Citation
Pathak, Kavita (2001) "Exploring Marketing Synergies In Mergers & Acquisitions," *Management Dynamics*: Vol. 2: No. 1, Article 5.
DOI: https://doi.org/10.57198/2583-4932.1264
Available at: https://managementdynamics.researchcommons.org/journal/vol2/iss1/5

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EXPLORING MARKETING SYNERGIES IN MERGERS & ACQUISITIONS

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Abstract

Ansoff established the economic basis of synergy- how it can be possible for different businesses to add up to more than the sum of their parts. The synergy equation is based in part on the economies of scale gained through common operations, for example it may be possible to lower costs across two businesses by increasing the capacity utilization of plant, using a common sales force, or combining the purchasing volumes. A less frequent, but much sought after effect occurs, when by combining resources the joint firm gains access to product-markets which neither could previously access with out major investments.

The future holds promises of further acceleration in the M & A activity. At the level of industry, as the barriers to doing business across borders are gradually getting eliminated the effect of industry concentration is going to percolate down from one market to another. Many Asian markets are fragmented in character with diffused and fluid competition. Global integration as stated earlier, will result in more consolidations and shakeout. Tackling monopoly creation and cornering of competition by mega mergers is an issue before each national government to handle. We on our part in India have responded with setting up of the competition commission.

At the level of firm, M & A's will go on making sense till such activity continues to result in incremental revenues (which will not be possible otherwise as stand alone operations). Synergy, and that too strong positive synergy generation should, however, be the guiding principle.

"Strategy is one thing that will keep you clean. When in doubt, just check whatever you want to do against strategy." - Sergio Zyman, Chief Marketing Officer, Coca Cola Company.

I Introduction :

Formulation of effective strategy in marketing needs some assumptions about the constants and variables, the controllables and non-controllables in the environment. Once formulated, an effective strategy leads to building up of critical mass and continued stream of cash flows to a company. The prescribed interval for the review of strategy may vary from 15 days to once a year, depending upon the industry.

Yet, how much chance would you give to strategy and strategic marketing in times when competition and market positions may do a turn around almost every day? The leader changes over night or shakes hand with sworn corporate enemies to become a monolith.

The fact is—thanks to the corporate enthusiasm (or paranoia?) towards Merger & Acquisition (M & A) activity, markets, players and competition are all changing too much and too soon. This has resulted in the loss of stability and critical mass for some businesses. World over the industry concentration is building up against small and medium players who are either being marginalized or eliminated altogether. As a result the divide between big and small & medium players is becoming almost unpluggable in most of the industries across the globe.

This, excessive reliance on M&A as a growth & expansion engine has had effects which are more bad than good in some cases. Yet companies are ear- marking budgets for this strategic activity. The expectations are rising with each passing day. M & A activity is required to perform miracles overnight, and that too under market conditions which, as follows are far from conducive for growth:

* Sluggish demand i.e. stagnant or sluggish markets.
* Excess capacity i.e. conditions of over supply and less cost effective production.
* Consumers becoming demanding to the point of being dictatorial
* Agile, active and at times anonymous competition

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* Multi-dimensional competition i.e technology, price, cost, brand, size, reach etc. all combined together.
* Ever shrinking product life cycle i.e. shorter return period for every new product developed
* Faster technology obsolescence rate i.e. incremental cost of technology development and shorter period to reap its benefit.

II The synergy Effect in Merger & Acquisition:

Synergistics benefits are those sources of value that allow the business units in a portfolio to achieve higher profitability levels than they would normally achieve as stand alone operations. Several types of synergy can be classified as follows:

1. *Sales synergy:* When common distributor, common sales administration or common warehousing, advertising, sales promotion, past reputation result in multiple returns for the same rupee spent.
2. *Operating synergy:* Higher utilization facilities and personnel spreading of overheads, advantage of common learning curves and large lot purchasing.
3. *Investment synergy:* This results from higher utilization of common facilities, plants, raw material inventory, transfer of R& D from one product to another, common machinery.
4. *Management synergy:* This results from efficiency of using a common resource pool.

It was Igor Ansoff in 1965, who identified four components of corporate strategy: product -market scope, growth vector, competitive advantage and synergy. He proposed for the first time the concept of synergy[1].

For the sake of simplification, one or more of the following marketing synergies may accrue to a firm merging or acquiring:

* Instant market development
* Instant access to a ready clientele
* Immediate cost economies
* Reduced development cycles and shared cost in R & D activity
* Infrastructure expansion in no time and least cost
* Sales force expansion
* Brand & product portfolio expansion & diversification
* Overnight market leadership
* Avoiding start up costs

In principle, all synergistic effects can be mapped on one of the three financial variables: increased volume of rupee revenue to the firm from combined sales, decreased operating cost & decreased investment requirements[2].

The net effect of synergy could be

* *Positive :* If all or one of the above three happen.
* *Neutral :* No change over the stand alone positions
* *Negative :* All or one of the above may happen in reverse direction

In effect, synergy is created and is positive only when the following equation holds true,

$$V(A + B) > V(A) + V(B)$$

Where:

Where:	V(A + B)	:	Value of the combined firm
	V(A)	:	Value of firm A
	V(B)	:	Value of firm B

Also, merger and acquisition effect along all of the above considerations should also be positive, failing which little synergistic benefit is deemed to have been generated.

III Types of Mergers & Acquisitions:-

Merger : At the level of concept, a merger takes place when two related or unrelated businesses combine their resources (financial and otherwise) to form a third (erstwhile non-existent) separate legal corporate entity.

The following types of mergers are commonly observed in the industry:

Horizontal Merger:-

Two firms operating and competing in the same kind of business activity. The motive is to generate economies of scale and market client. The number of firms in an industry is decreased by horizontal mergers and this may make it easier for the industry members to collude for monopoly profits. The governments closely scrutinize these for potential negative effect on competition.

Vertical Mergers:-

These may occur between firms in different stages of production operations. In the oil industry for example, distinctions are made between explorations and production, refining and marketing to the ultimate consumer. This results in technological economies, etc.

Conglomerate Mergers:-

It involves merger between firms engaged in unrelated types of businesses.

These could be:

* Product extension merger
* Geographical market extension merger
* Pure diversification based mergers[3].

Acquisitions: Some what predatory in nature, acquisition takes place when a current business partner in a joint venture or an outsider corners dominant stakes in a company for the purpose of management and control as well as market dominance. The acquired company, thereafter operates as a subsidary or a separate division of the acquirer (may or may not result in the creation of separate legal entity)

These acquisitions may be clubbed as follows:-

* Hostile take over by unrelated party
* Friendly takeover by unrelated party
* Hostile takeover by related party
* Friendly takeover by related party

IV) Global trends in Mergers & Acquisitions:-

The present corporate paranoia towards M & A's is just another movement in the series of many others that have taken place earlier.

1895-1904 merger Movement:-

Globally, this period consisted of mainly horizontal mergers which resulted in high concentration in many industries including heavy manufacturing industries.

1922-1929 Movement:

Product extension mergers - as mass distribution with low profit margins became a new method of merchandising the lead to in large scale of operation and hence mergers.

1940-1947 Movement:

A large number of firms merged vertically to circument price controls and allocations during the wartime.

1960 Movement:

Most acquirers in the period which were subsequently known as conglomerate were small or medium sized firms that adopted a diversification strategy into business activities outside their traditional area of interest. These were defensive mergers to avoid:

i) Sales and profit instability
ii) Adverse growth developments
iii) Adverse competitive shifts
iv) Technology obsolescence
v) Increased uncertainty associated with their industries[4].

1996 onwards:

The recent M & A movement which gathered pace around 1996-97 was at its peak in 1999 and the trend has since stabilized if not declined. World wide M & A activity has been rampant in the following sectors:-

1) Which have only recently been liberalized by some economies and promise good returns i.e. Banking in India
2) Which are technology intensive and where technology offers higher returns as well as faster obsolescence rate i.e. Information Technology, Communication and Entertainment
3) Which fall within the policy framework of WTO and expect a drastic change in the post 2005 scenario i.e. pharmaceutical.
4) Which are capital, technology or production intensive eg. Petroleum

Evidently, there is an urge to create instant synergies of finance, brands, reach, market share and technical & human resources. In addition to the above industries sectors like financial services, media, automobile and insurance are also active. The period of 1996-99 was known as the period of consolidations & shakeouts. Year 1998 alone witnessed mega merger to the tune of $395 billion (between giant like Exxon & Mobil, British Petroleum and Amoco for instance) In 1999, the legendary merger of Time warner - America Online and Glaxo Burrough's Wellcome - Smithkline Beecham rocked the corporate world. The value of completed and pending deals announced world wide in the first quarter of year 2000 exceeded $1 trillion[5].

In India itself the following statistics is a definite pointer towards M & A mania:-

Table 1: Most active sectors in India for M&A

1999 Oct			1998		
Sector	No.of M/A	Amount*	Sector	No.of M/A	Amount*
Infotech	37	825	Cement	7	2,200
Power	5	3,046	Telecom	2	683
Media/Ad.	4	1,300	Power	1	619
Pharma	4	318	Metal	1	284
Cement	2	410	Pharma	4	153

** Rs. In crores*

Source: Business World 20 December 1999

Table 2:The Mega Deals of 1999-2000

	Value*
Tata Tea acquires Tetley	1,870
Lafarge buys Raymond cement	785
Cements Franchaise takes 50% stakes in zuari Cement	598
Lafarge buys Tata Steel's cement division	550
Times Bank merges with HDFC Bank	220
Satyam Infoways acquires India World	499

** Rs. In crores*

Source: Eco. Times 17 July 2000

The recent wave of M& A activity is centred around horizontal & conglomerate mergers and hostile takeovers.

The marginal impact of these M & As on industry concentration, the profitability of firms involved and on the consumer/ and investors is an issues to be reviewed and researched separately.

V) Guiding forces in M & A:

There could be a number of considerations guiding M & As. These may vary from accumulating financial muscle to adding hot selling brands, yet the two major propelling forces are as follows:-

Table 3: M & A Trends 2000-01

	Total acquisition		Mergers
	No.	Value*	No.
Feb 2000	107	6364	14
Mar 2000	136	6662	17
Apr 2000	92	6674	13
May 2000	107	3392	28
Jun 2000	125	3171	25
Jul 2000	91	1934	16
Aug 2000	103	3137	17
Sep 2000	89	1535	30
Oct 2000	84	2380	18
Nov 2000	101	1923	29
Dec 2000	85	2688	25
Jan 2001	93	5650	18
Feb 2001	94	1105	25

**Rs. In Crores*

Source: CMIE Monthly review March'01

i) Speed:-

Today the corporates have to make a conscious choice between merging & acquiring for growth and expansion; over growing organically with long gestation periods. The choice has apparently been made in favour of the high-speed alternative. "The plain fact is that acquiring is much faster than building. And speed-speed to market, speed to positioning speed to becoming a viable company - is absolutely essential in the new economy." [6]

It was this factor which guided Dr.Reddy's Labs acquisition of American Remedies Ltd. This acquisition gave Dr.Reddy's Lab three of the key element of success in Indian pharma market: complementary product portfolio, excellent field force of ARL in addition to the 10 key brands of ARL which account for 75% of ARL's sales. "Their product portfolio complemented ours and they have an excellent field force. While our products are primary (sole prescription). There's

are secondary (co-prescription). It meant good corporate fit"[7]. The effect: More marketing muscle in the least possible time.

Infact, in pharma industry today, if the big companies are gobbling up other corporations, it is not for their production capacity - capacity is available on lease but because they want their brands to build markets share, to support R & D effort to discover and launch new molecules as also to widen their product portfolio.

In yet another active sector i.e. Banking, M & A is fuelled by the prospect of generating overnight clientele, asset base, technology edge, etc. The bank mergers in the global arena are fueled by the need to acquire a size that would enable them to operate in a banking system that has increasingly become global in character. Industry observes feel that in the next few years there will be a lot of consolidation and the survivors would be technology savvy banks with a clear customer focus and low cost structure. Other banks would get either acquired or marginalized.[8]

Taking the case of 1999 acquisition of Times Bank by HDFC: This acquisition doubled HDFC's balance sheet size to over Rs.7,600 crore at one go and its ATM population increased from 57 to 97 and branches from 69 to 107. Besides Times Bank's trained manpower what HDFC got was 1,70,000 quality retail customers[9]. Mr.Aditya Puri, MD HDFC feels confident of achieving compounded annual growth rate of 30% to 40% now; and that's on the post acquisition balance sheet. Mr.Puri feels that "the era of traditional banking is once. The customer is the king and the bank has to tailor its products as per his requirments. You have to be anywhere, anytime - the distribution channel will also be decided by the customer". No wonder then, that competitor ICICI has followed suit with two Mergers & acquisition under its belt. UTI and Global Trust Bank merger has further strengthened the belief that the future of this industry, like many others lies in consolidations and shake outs.

ii) Size:

In the new age, MNC's with their extremely deep pockets and access to low cost funds in their home turf are bound to dictate and rule. Pushing the huge and pricey cross border deals is the almost universal belief that industry will inevitably become more concentrated as the worlds markets become more globalized. Companies believe that if they are going to be among winners, they will have to shore up economies of scale in manufacturing, branding and research & development. That's how they hope to scare away potential competitors and sew up new markets. From this perspective cross border merger are a do or die proposition.

In pharmaceutical industry mega merger are rocking the industry. "What really drives revenue in the drug business is R & D. When we look at merging with Glaxo for example, we were talking about synergies in R & D. By merging the two organisations we could probably save in the neighbourhood of $500 million - That's $500 million more a year that we could reinvest in the R & D itself and that's where merger's real benefit would be."[10]

The auto industry is also likely to shake out. New economies of scale beef up the big boys, which gobble up less efficient parochial players. The industry's top players are awash in cash and eager to buy; while the weakest are drowning in debt and glutted with factory capacity. The auto industry is producing 20 million more cars and trucks a year than it sells. Factors like over capacity high technology cost and cash rich big players are all pointing towards just six lead players remaining in the global automobile game namely —General Motors, Toyota Motors, Honda Motors, Volkswagen, Daimler Chryster, Ford Motors.[11]

In Petroleum sector significant advantages flow to the biggest petroleum companies globally. Exxon and British Petroleum were already outperforming most other major players before they merged with mobil and Amoco respectively. The merger provided them a bigger base for leveraging their exploration and operating skills. Indeed, the mega mergers have created a new category of players and this raises the bar for world class scale and scope advantages. In petroleum, as in pharmaceuticals, the effectiveness of a company depends on its pipelines and the megamajors have the broadest portfolios (and potentially) the lowest cost structures.

The mega majors have not only increased their size and improved their performance but they have also increased their clout. As in the case of global automobile market in petroleum too BP-Amoco, Exxon-Mobil and Shell will dominate the industry and no additional companies (even in combination) are likely to amass the financial power needed to make comparable plays in the global arenas.[12]

Two of the active M & A sectors in India are cement and fertilizer. In the recently derregulated fertilizer industry companies are exploring possible operating synergies through acquisitions. The rationale is best explained by Mr.Vellayan, Group Director Marketing, Murugappa Group which has been on an acquisition spree in Southern India's fertilizer market. "The demand for phosphatic fertilizer is expected to increase

to 5.5 million tonnes in the next five years from 4.3 million tonnes currently supply? The current production capacity is 5 million tonnes and nobody is brave enough to put up a green field plant in this industry. In such a scenario, acquisition an existing player is the best avenue for growth".[13]

On the other hand Indian Cement industry with total installed capacity of 109.16 MMTPA, 57 companies and 120 cement plants is a case in point for capacity in excess of demand. The depressed market conditions had pushed most companies to the wall. Yet MNC with their deep pockets foresee great long term and medium term growth prospects in Indian cement market. They are not averse to offering a tag higher than the market value of the acquisition. While the average price should range between $75 to $80 per tonne capacity as is accepted internationally. MNC suitors have paid up to $85 to $90 per tonne capacity for recent acquisitions.[14] For these MNC setting up greenfield project would not only be costly but is also dependent on the availability of lime stone. Hence acquisition we are going to see more of these in the coming years. Besides, Indian companies are not in a position to consolidate their market share any further given the high cost of funds available locally. Indian cement industry which has thus far been regional in character is now making way for global giants like Lafarge, Cement Franchaise, etc.

V) Conclusion:

The future holds promises of further acceleration in the M & A activity. At the level of industry, as the barriers to doing business across borders are gradually getting eliminated the effect of industry concentration is going to percolate down from one market to another. Many Asian markets are fragmented in character with diffused and fluid competition. Global integration as stated earlier, will result in more consolidations and shakeout. Tackling monopoly creation and cornering of competition by mega mergers is an issue before each national government to handle. We on our part in India have responded with setting up of the competition commission.

At the level of firm, M & A's will go on making sense till such activity continues to result in incremental revenues (which will not be possible otherwise as stand alone operations). Synergy, and that too strong positive synergy generation should, however, be the guiding principle.

When America online merged with Time Warner, great expectations were generated. "With all its copyrights Time Warner is in a marvellous position to take advantage of net and not be frightened by it. AOL's mindset, assets and expertise help them in that path" - Robert W.Pittman, Chief Operating Officer, AOL - Time Warners common. At the time of merging AOL - Time Warner, predicted 12% to 15% annual revenue increase and $1 billion in combined cost savings and net revenue in the first year (AOL's and Time Warner's stand alone revenue growth last year were 37% and 60% respectively) Now after one year it is expected that the new company will have revenue growth up just 11% and losses could top $5 billion towards merger right offs.[15]

At the level of investors and consumers this spate of M & A activity brings mixed news. KPMG November 2000 study quotes that 83% of the 700 largest corporate mergers from 1996 to 1998 failed to boost stock prices because of poor execution.[16]

On a concluding note, the big fish as the law of nature suggests will eventually swallow the small one; and if the two are of the same size then they may end up in marrying each other to live happily ever after. Yet it is common wisdom that marriages seldom have perfect fairy tale endings.

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