Making Alliances & Acquisitions Work

Chapter 11
Objectives

Define alliances and acquisitions
Understand influences of institutions and resources
Describe how alliances are formed and dissolved
Explain why firms make acquisitions and the problems surrounding them
Alliances and Acquisitions

Kind of like dating, different levels

- **Strategic Alliances** – voluntary agreements between firms involving exchange, sharing or co-developing products, technologies or services
  - Dating

- **Merger** – combination of operations and management into a single firm
  - P.C. term for an acquisition
  - Only 3% of M&As

- **Acquisition** – the transfer of the control of operations and management from one firm (target) to another (acquirer), the former becoming a unit of the other
  - What’s mine is hers and what’s hers is hers
    - Kidding… But it makes the point!
Acquisitions, not mergers…

Source: organizationsculture.blogspot.com
Drivers of Alliances and Acquisitions
Drivers

**Institution-based View**
- Anti-trust and entry mode restrictions
- Way around “outsider” status, buy local firm

**Resource-based View**
- Accessing VRIO resources and ideas

**Acquisitions or Alliances**
→ Choice of entry mode
Modes of Entry

Choice of Entry Modes

Non-equity Modes
- Exports
  - Direct Exports
  - Indirect Exports
- Contractual Agreements
  - Licensing or franchising
  - Turnkey, R&D, Marketing

Equity Modes (FDI)
- Joint Ventures
  - 50/50 JVs
  - Minority/Majority JVs
- Wholly Owned Subsidiaries
  - Greenfield Project
  - Acquisition

Based on contracts, no shared ownership
Commitment through contract

Based on shared ownership and financial interest
Commitment through investment
Alliances

Voluntary agreements of cooperation between firms

**Contractual alliance:** Association between firms that is based on a contract

- Does not involve the sharing of ownership
- Co-marketing, research and development (R&D) contracts, turnkey projects, strategic suppliers, strategic distributors, and licensing/franchising
Equity Alliances/Joint Ventures

Equity based alliance – based on shared ownership

- **Strategic investment** – one firm investing in another
- **Cross Shareholding** – each partner holds stock in the other
  - Remember as kids…

May run into formal constraints…
Formal Institutions

Antitrust Concerns

- Acquisitions and mergers raise regulatory flags
  - Contractual alliances are looser, reducing concern
  - Careful not to appear as collusion

- Entry mode requirements
  - Bans or restrictions on *wholly owned subsidiaries*
    - i.e. foreign ownership limited to 49%
  - Joint ventures (often) avoid these problems
    - Trend of allowing more wholly owned subsidiaries
    - Many governments still restrictive

https://www.reuters.com/article/us-baker-hughes-m-a-ge-idUSKBN1932B1
Alliance Types

Left-Hand Side
- Contractual alliance
- Low commitment
- Specified in contracts
- “coffee” or maybe lunch?

Right-Hand Side
- Ownership Investment
- More commitment
- More difficult to manage
- Buying a dog together?
- House?
- Marriage?
Non-equity entry: Contractual Agreements

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<thead>
<tr>
<th></th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td>Licensing/ Franchising</td>
<td>• Low development cost</td>
<td>• Limited control over tech</td>
</tr>
<tr>
<td></td>
<td>• Limited capital at risk</td>
<td>• May create competitors</td>
</tr>
<tr>
<td>Research and Development</td>
<td>• Tap into knowledge in other locations</td>
<td>• Difficult to negotiate and enforce contracts</td>
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<tr>
<td></td>
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<td>• May nurture competitors</td>
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## Alliances: Advantages and Disadvantages

<table>
<thead>
<tr>
<th>Must create value</th>
<th>Can reduce value</th>
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<tbody>
<tr>
<td>Reduce costs, risks, and uncertainties</td>
<td>Choosing wrong partners</td>
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<tr>
<td>Access complementary assets and learning opportunities</td>
<td>Potential partner opportunism</td>
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<tr>
<td>Possibility to use alliances as “real options”</td>
<td>Risk of helping nurture competitors, learning race – partners aim to learn the other firms “tricks” as fast as possible</td>
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Acquisitions and Mergers

**Acquisition**: Transfer of the control of operations and management from one firm to another
  - The former becomes a unit of the latter

**Merger**: Combination of operations and management of two firms to establish a new legal entity
11.2 The Variety of Cross-Border Mergers and Acquisitions

- **Cross-border M&As**
  - **Mergers** (3% of all M&As)
  - **Acquisitions** (97% of all M&As)

- **Consolidation** (equal mergers)
- **Statutory merger** (only one firm survives)
- **Acquisition of a foreign affiliate**
- **Acquisition of a local firm**
- **Acquisition of a private local firm**
- **Privatization (acquisition of a public enterprise)**

## Motive for Acquisitions

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<tr>
<th>Motive</th>
<th>Institution-based issues</th>
<th>Resource-based issues</th>
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<tbody>
<tr>
<td>Synergistic</td>
<td>Respond to formal institutional constraints</td>
<td>- Access Comp. resources</td>
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<tr>
<td></td>
<td>- Market power and scale</td>
<td>- Managers over confident</td>
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<tr>
<td>Hubristic (exaggerated pride,</td>
<td>Herd behavior – follow norms and fads</td>
<td></td>
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<tr>
<td>overconfidence)</td>
<td></td>
<td></td>
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<tr>
<td>Managerial (desire for power,</td>
<td>Self-interested actions such as empire building</td>
<td>Uses valuable resources</td>
</tr>
<tr>
<td>prestige, and money)</td>
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**Add Value**

**Reduce Value**
Performance

Up to 70% of acquisitions fail
Distraction causes vulnerability

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<th>Problems for all M&amp;As</th>
<th>Cross Border M&amp;As</th>
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<tbody>
<tr>
<td>Pre-acquisition:</td>
<td>-Managers over-estimate their ability to create value</td>
<td>-Lack of familiarity with foreign cultures, institutions</td>
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<tr>
<td>Overpayment for targets</td>
<td>-Inadequate pre-acquisition screening</td>
<td>-Nationalistic concerns against foreign takeovers</td>
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<tr>
<td></td>
<td>-Poor strategic fit</td>
<td></td>
</tr>
<tr>
<td>Post-acquisition:</td>
<td>-Poor organizational fit</td>
<td>-Clashes of organizational cultures and national cultures</td>
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<tr>
<td>failure in integration</td>
<td>-Failure to address stakeholder concerns</td>
<td>-Nationalistic concerns against foreign takeovers</td>
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Institutions, Alliances, and Acquisitions

Formal institutions

• Antitrust concerns - Antitrust authorities favor alliances more than acquisitions
• Entry requirements - Certain governments limit the formation of acquisition with foreign firms and favor acquisition within domestic markets

Informal institutions

• Normative pillar - Firms copy other reputable organizations to establish legitimacy
• Cognitive pillar - Internalized, taken-for-granted values that guide alliances and acquisitions
Organization

Difficult to organize mergers and acquisitions

- 70% fail (that’s worse than marriage!)
- **Relational capabilities** – ability to successfully manage inter-firm relationships are rare

Firms involved must have different skills that increase firm value

- **Strategic fit** – matching of complementary capabilities
- **Organizational fit** – similarity in cultures, systems, and structures
Forming and Dissolving Alliances
Forming Alliances: Stage One

Firm decides if growth can be achieved through market transactions, acquisitions, or alliances

- Firm has to confront competitive challenges independently to grow by pure market transactions
- Drawbacks of acquisitions make alliances a better option
Forming Alliances: Stages Two and Three

Stage two - Firm decides whether to take a contract or an equity approach

- Equity relationships allow firms to:
  - Learn tacit capabilities
  - Control certain joint activities

Stage three - Based on the choices made in stage two

- Firms specify a specific format that is either equity based or contractual
Exhibit 11.5

Alliance Formation

Dissolution

Initiation → Reconciliation

Going Public → Mediation by third parties?

Uncoupling → Last minute salvage

Aftermath → Go alone

Search for new partners

First mover advantage, typically held by initiator
Dissolution of Alliances

Like marriage, typically not “out of the blue”
- Initiator – party that begins dissolution
- Partner – other party to dissolution

Phase 1 – dissatisfaction
- Quiet, internal pressure

Phase 2 – Going public
- First mover advantage – win public sympathy
  - Tell your friends first why you were right in argument...

Phase 3 – Uncoupling
- Can be smooth phase out or ugly court battle

Phase 4 – aftermath
- Move on and find other partners.
## Concerns

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<th>Role</th>
<th>Concern</th>
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<tbody>
<tr>
<td>Investors</td>
<td>Will synergy benefits be downscaled?</td>
<td>Optimistic view of return on investment?</td>
<td>Will efficiency &amp; short-term revenues fall?</td>
</tr>
<tr>
<td>Top management</td>
<td>Synergies difficult to attain</td>
<td>Internal conflicts: fractious management groups, key staff leave</td>
<td>Unrealistic euphoria</td>
</tr>
<tr>
<td>Middle management</td>
<td>Concern over job security</td>
<td>Expect to do M&amp;A + day jobs at the same time</td>
<td>Overwhelmed by scale and scope</td>
</tr>
<tr>
<td>Front-line employees</td>
<td>What should I tell my customers?</td>
<td>When do lay-offs begin?</td>
<td>Who is setting my priorities and objectives?</td>
</tr>
<tr>
<td>Customers</td>
<td>So what?</td>
<td>Service quality dips, relationship suffers</td>
<td>No one is listening to me. Do I still matter?</td>
</tr>
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*Source: Peng 2e*
Debate: Acquisitions Versus Alliances

**Acquisitions**
- One-off deals
- Incorporate both the good and bad parts of the acquired firm

**Alliances**
- Cost less
- Allow for learning opportunities from working together
Implications for Action

Understand rules governing alliances and acquisitions
  - Formal institutions – requirement of JVs etc.
  - Informal institutions – cultural differences

When managing alliances, pay attention to soft relationship aspects

When managing acquisitions – do not over pay

Consider strategic fit and organizational fit