Lesson 8. DEVELOPMENT MODALITIES. INTERNAL GROWTH VERSUS MERGERS AND ACQUISITIONS

Basic references:

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Lesson 8. DEVELOPMENT MODALITIES. INTERNAL GROWTH VERSUS MERGERS AND ACQUISITIONS

8.1. Modalities of development: internal growth versus external growth

8.2. External development

8.3. Reasons for proliferation of corporate operations (M&A)

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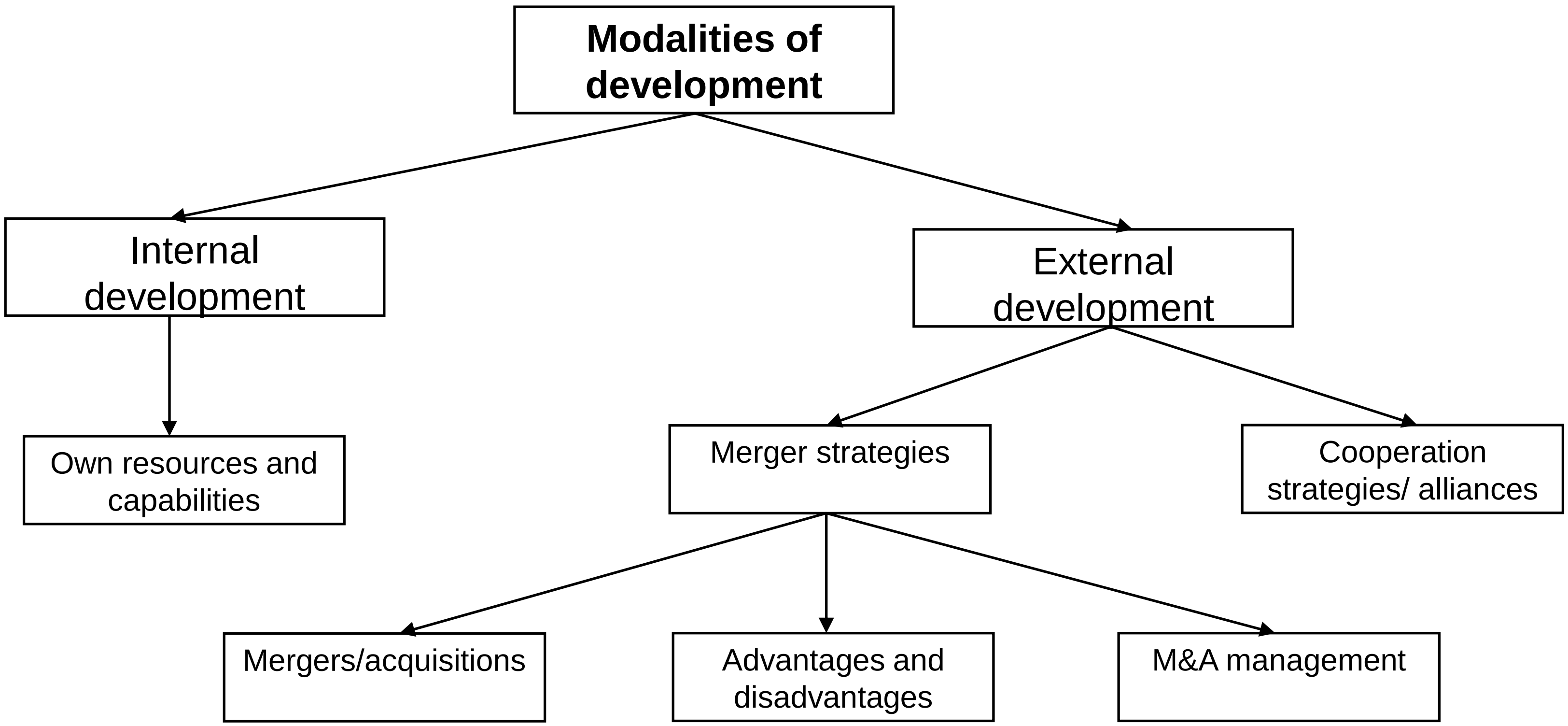
8.5. Management of mergers and acquisitions


Modalities of development
Internal development
External development
Own resources and capabilities
Merger strategies
Cooperation strategies/ alliances
Mergers/acquisitions
Advantages and disadvantages
M&A management

8.1. Modalities of development: internal growth versus external growth

- The company must decide the mode of development from different sets of strategic options, which can be combined and used simultaneously:

  - Internal or organic development
    - Implies the growth of the company (factories, employees, investments, etc.) based on its own resources and capabilities.
    - Requires real capacity to grow: financial, human, and technological resources.
  - Mergers and acquisitions
    - Implies growth of the company (factories, employees, investments, etc.) based on resources and capabilities of others.
  - Hybrid development or strategic alliances
    - Involves the growth of the company (factories, employees, investments, etc.) based on own and third-party resources and capabilities.

8.1. Modalities of development: internal growth versus external growth

Internal vs external growth:

Internal growth

- Individual intervention
- Slow and laborious process
- Requires less investment
- Less risk
- Reversible
- Greater cultural harmony

External growth

- Intervenes with other companies
- Fast
- Requires more investments
- Greater risk
- In some cases, it is irreversible
- Cultural conflicts

8.1. Modalities of development: internal growth versus external growth

Comparison of development modalities

	Control autonomy	**Growth Selectivity / flexibility**	**Growth speed**	**Cultural Harmony**	**Access to key resources**	**Adequacy to mature sectors**
Internal growth	+	+ / –	–	+	–	–
Mergers and acquisitions	+	– / –	+	–	+	+
Strategic alliances	–	+ / +	+	–	+	+

8.1. Modalities of development: internal growth versus external growth

External growth: mergers vs alliances

Mergers

- Market concentration
- Reduces competition
- Dependency relationship between companies
- Cultural shocks
- Social costs
- Irreversible

Alliances

- Market de-concentration
- Boosts competition
- Companies are independent
- Cultural shocks
- Opportunistic behaviour
- Reversible

8.2. External development

◆ A set of strategic options in which the resources and capacities necessary for growth are developed by acquiring another organisation, or creating a new one as a result of the integration of others that disappear.

- Options:
  - Merger: strategic option by which two or more companies dissolve and unite their assets to create a new company with a single strategy, a single organisation, and the same culture.
  - Acquisition: strategic option that involves the purchase of a company.
    - There is no acquisition without assuming control and direction of the company being purchased: income portfolio or speculative portfolio.
    - Part of the capital (less than 100%). The acquired company can be integrated (more or less quickly) or remain unintegrated in the organisation and culture of the buyer.
    - Absorption (100%): typically, the absorbed company is integrated into the organisation of the absorbent.

8.3. Reasons for proliferation of corporate operations (M&A)

- From industrial corporations to financial corporations
  - Theoretical reasons for mergers:
    - Synergies and economies of scale: not determined and limited
    - Improved efficiency and increased profitability: 80% failure rate
  - Real reasons for the mergers (hidden):
    - Tax advantages
    - Increased competitive position
    - Risk reduction
    - Increase in value for company
    - Prestige and remuneration for managers

8.4. Advantages and problems of M&A

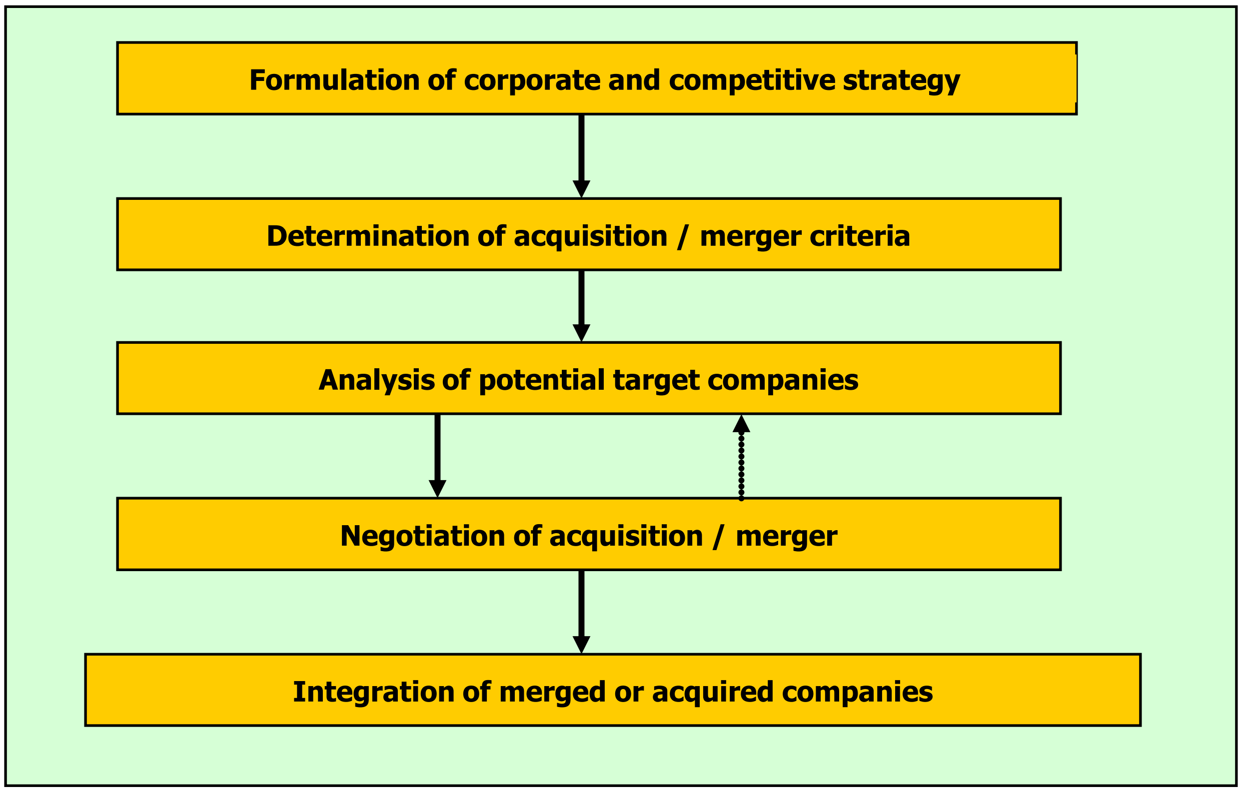
- **Advantages**
  - Time savings
    - Possibility of quick access/development of the capacities necessary for growth
  - Market saturation
    - Mature sectors
  - Improvements in competitive position
    - Acquisition of competitors
    - Acquisition of suppliers or customers
  - Economies of scale and scope to take advantage of potential synergies
  - Take advantage of market opportunities (undervalued companies or companies with great restructuring potential)

8.4. Advantages and problems of M&A

- **Disadvantages and limits**
  - Anti-monopoly and competition defense laws
  - Difficult reversibility
  - Unwanted purchases (purchase option indivisibility) / splits
  - Greater complexity of resulting business structure
  - Difficult integration process
    - Different cultures
    - Management styles
    - Organisational structures
    - Strategic business units (SBU)
    - Information systems
    - Employee resistance

8.5. Management of mergers and acquisitions

Development process for external growth options



8.5. Management of mergers and acquisitions

- Main economic and social consequences:
  - Legal principles of mergers
  - Non-neutrality: tax advantages for certain mergers
  - Interventionism: rigid control by the ministry
  - Discretion: authorities may determine the criteria for mergers
- Ethical and social problems of mergers:
  - Mergers reduce and eliminate competition in markets: concentration of supply
  - Ubiquitous problem of insider information
  - Conflicts of interest: partners-suppliers-customers
  - Effects on employment and environment

8.5. Management of mergers and acquisitions

- Main causes of failure (50-80% failure)
  - Formulation process
    - Excessive optimism in assessment of synergies
    - Little assessment of integration difficulties
    - Excessive purchase price (e.g., in the case of bid against takeover bid)
    - Turning merger/acquisition into an end rather than a means (non-rational reasons: ambiguity of expectations, escalation of commitment, fragmentation of tasks).
  - Failed start-up process