

Strategic justifications in the us wine industry



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Mergers refer to the aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid in, finance, or assist a growing company in a given industry. As outlined by Lawrence Gitman, it is the combination of two or more firms, in which the resulting firm maintains the identity of one of the firms usually the larger. The primary reason for a merger is to improve a company's financial and strategic position. (Gitman, 2009)

Determining whether the merger or the acquisition in the U. S. Wine Industry is offensive or defensive is dependent on each company's perspective.

International Beverage's quest for seeking an acquisition was considered a defensive action put forward by the company and it needed to lengthen its life within the organization. This company was known as a leading producer and marketer in the wine industry. This company being slow at achieving internal growth as their revenues grew at a mere 10% per year as a result of aggressive acquisition strategy. They needed to make an acquisition to prevent it from becoming a market failure as lack of any acquisition resulted in a no growth rate for the Company. This needed to be done to achieve growth internally and to refrain from going under. The wine industry has showed desirable preferences for change to higher end brand which placed International Beverage in a very dangerous position as customer would show a great deal of preference for the higher end brand wines.

International Beverage then had to take the initiative and move strategically in order to remain in the market as a key player, thus alleviating any adverse effects that would occur as a result of the new emerging preference in the future.

One of the other companies to be acquired was Starshine. One of the main compositions of companies that International Beverage acquires was the fact that they were all producers of low end quality wine. Starshine was one of them. They too were also facing the fact that they could eventually lose in the market shares as the market began leaning towards a higher end brand of wine and Starshine were offering mid range labels in the market.

Since Starshine produced only mid range brand wines, it would have been in their best interest to merge with the other company Bel Vino in order to secure a share in the market. This would have been their defensive action. The merger was crucial because had they not merged with Bel Vino, International Beverage could have acquired their company as they urgently needed some pull out, keeping in mind also that International Beverage also needed some fix for themselves to retain their market share. Starshine would then now be able to deal with their cost issues and competition from foreign producers. The merger between Starshine and International Beverage would be a defensive action with respect to the emerging market changes and also to avoid not having a say in the future business of the company.

Bel Vino was producers of high-end wine with a very strong brand. Despite this, they also had sluggish performance, there prevalent management conflicts, these were the internal problems the company was faced with; also their inability to form good distribution lines, have a bad management team and as a result, has unflattering performance levels (Luehrman & Kester, 2009).

The market change favoured Bel Vino prospects as it allowed them to have more clients to form a better distribution line which will then have positive effects on its revenues. Bel Vino did not need a merger neither an acquisition because it could have solved the aforementioned issues by itself.

Despite this fact, there was the option of solving these issues by taking advantage of the already established distribution lines and high earnings of both Starshine and International Beverage (Luehrman & Kester, 2009). Given these reasons, Bel Vino is the only one that would be taking offensive action in both instances with respect to merger and acquisition.

Question 2

What primary advantages did your company bring to the table?

An acquisition of or merger with Bel Vino would benefit both company as Bel Vino, is the company that offered classic vintages and strong brands (Luehrman & Kester, 2009). This would give them the comparative advantage over the other companies since these other companies, Starshine and International Beverage, deal mainly with lower end and mid range labels (Luehrman & Kester, 2009). From the fact that industry has overcome the wine glut the demand for wine has shifted to the higher end products which neither of Bel Vino's competitors possess (Luehrman & Kester, 2009). This was an advantage for Bel Vino since they were able to use this for their negotiations. This would be beneficial also for International Beverage and Starshine providing the opportunity to gain a market share and for their survival in the new market transformation.

Bel Vino also benefited from the low cost advantages with respect to the merger with Starshine given the fact of the apparent cost control issues. (Luehrman & Kester, 2009). Management in Bel Vino were able to utilize their finances as opposed to overspending on advertisement as Starshine did. All in all, Bel Vino brought several advantages to the table during this negotiation, all of which benefitted each of the companies of way or the other.

Question 3

Compare the market positions, financial performance, and future prospects of Bel Vino and Starshine. What are the most significant sources of synergies for the potential transactions?

Market position can be defined as the “ ranking of a brand, product, or firm, in terms of its sales volume relative to the sales volume of its competitors in the same market or industry” (Business Dictionary, 2009). In analyzing the three companies, it was found that from the years 2006-2010 Starshine continually had higher net sales to that of Bel Vino. In 2006 Starshine had 475 million compared to Bel Vino’s 359 million and International beverage’s 2980 million. In 2007 Starshine had 495 million compared to Bel Vino’s 360 million and 2999. 9 million. In 2008 Starshine had 525. 1 million compared to Bel Vino’s 366 million and 3019. 9 million. In 2009 Starshine had 557. 2 million compared to Bel Vino’s 382. 1 million and 6100. 4 million. In 2010 Starshine had 591. 5 million compared to Bel Vino’s 390. 1 million and 6141. 2 million. (Harvard Business School 2009) This shows that Starshine had a greater market presence than that of Bel Vino and that Bel Vino was finding

it difficult to generate sales especially in the international markets to compete with its rivals.

This was possibly due to its poor distribution lines. International Beverage could help Starshine and Bel Vino increase their market share both domestically and internationally and also help improve Bel Vino's distribution line.

Financial performance refers to the "measuring of a firm's policies and operations in monetary terms. These results are reflected in the firm's return on investment and return on assets" (Business Dictionary, 2009).

As the formula for return on assets is $\text{Net Income} / \text{Total Assets}$, the Return on assets for Starshine through the years 2006 to 2010 are; in 2006: $11.1 / 498.3 = 2.23\%$; in 2007: $8.6 / 503.9 = 1.71\%$; in 2008: $17.4 / 507.5 = 3.43\%$; in 2009: $28.3 / 531.5 = 5.32\%$; in 2010: $36.9 / 556.9 = 6.63\%$.

In comparison, the returns on Assets for Bel Vino throughout the years are in 2006: $4.2 / 425.9 = 0.99\%$, in 2007: $18.8 / 406.8 = 4.62\%$, in 2008: $27.7 / 389.4 = 7.11\%$, in 2009: $33.2 / 403.6 = 8.23\%$, in 2010: $36.1 / 409.1 = 8.82\%$. This shows that Bel Vino had a higher return on assets than Starshine.

Our return on assets are as follows; in 2006: $162.2 / 1227.2 = 13.22\%$; in 2007: $109.9 / 1461.5 = 7.52\%$; in 2008: $97.5 / 1544.5 = 6.31\%$; in 2009: $423.7 / 2232.7 = 18.98\%$; in 2010: $446.6 / 2770.2 = 16.12\%$. This again shows that our company, International Beverage company is a larger better run company.

In relation to the future prospects of these companies, Bel Vino had to focus on the protection of their brands, increase in distribution lines and increase in sales volumes. Pertaining to Starshine, they need to cut costs and break into the high end market.

Question 4

What was the rationale behind the choice of target for the opening bid and our overall bidding strategy?

As we were in a better position than both companies, we were faced with the decision of it to stay as we were and run the risk of both companies merging or if to acquire one of the companies. We decided that we were not under any pressure and we were going to keep our bidding low as we felt it was in the other companies' best interest to merge with us. We started by making a bid for Starshine as we felt that with their greater presence in the markets would help us to gain an even stronger market share. We thus made an opening bid of \$45 per share to Starshine. This bid was rejected. As a result our share price dropped by \$0.50 to \$64.70 while starshine's rose by \$2.26 to \$56.64. We decided to start the bidding at such a low price so during negotiations; the ceiling price would not get too high. We realised that Starshine offered Bel Vino 1.05 new Starshine shares for each existing Bel Vino Share. So we decided to give Bel Vino something to think about by offering \$39 per share. This was lower than their share price at the current time which was \$45.96. We were not prepared to buy out any of these companies while incurring huge debts. This was another reason why our bids were kept so low. Bel Vino didn't see our bid as attractive despite the fact that we could improve their distribution line internationally considerably. So

they rejected our bid. We thus decided it was not worth it to acquire any of the two companies as they lacked the vision to see that they could only benefit by merging with us. In the end Starshine accepted Bel Vino's offer and the companies merged.

Question 5.

If you were not successful at completing a transaction, why do you believe this was the case? Do you think it represents the best outcome for your shareholders? Would you do anything differently if given another chance to negotiate?

According to the confidential information our team was provided with, both Bel Vino and Starshine were potential prospects for a merger. Our main prospect was Bel Vino since they sold high end products and our company would have received more value from this merger. We also noted that a merger with Bel Vino would have added worth to our company. Therefore in the long term, shareholder value will also be increased. In order to increase shareholder's value, it is imperative that a company implements strategic planning. This can be done by increasing cost base while maintaining revenue and by increasing revenue share and by reducing cost (Ezine Article, 2010). A merger between Bel Vino and Starshine would have reduced cost of goods sold by roughly \$3 million to \$ 5 million. In addition, their Research and Development cost would decrease by a significant amount, roughly, one million on an annual basis. Bel Vino showed strategic planning and they recognized the goal of the company and because of their financial operations which were done effectively and efficiently, they were able to develop their working capital. There was a possibility of mergers between Bel Vino and Starshine, which actually came to fruition.

Before any negotiation is made by any organization and for it to be successful it is critical for them to look over key issues that will affect their organization in the long run. In other words preparedness is one of the main key to successes in any business organization. In addition, a good strategy is also important for a healthy and long term existence of that company.

Our team definitely lacked in the area of preparation was resulted in International Beverage not being able to merge with any of the two prospective companies. Our team members were definitely not ready to negotiate because we did not conduct enough background work in terms of focusing on our operating assumptions which included domestic and international revenues. In addition, due to the lack of understanding the game and time, we were not capable of making enough offers to the other two wine companies

These factors needed to be decided upon before we ventured into the negotiation process. We also need to focus more on our balance sheet and make comparisons between Bel Vino's and Starshine's balance sheets.

Despite our unpreparedness, we were able to make bids by offers to both Bel Vino and Starshine at prices, \$48. 81 and \$58. 57 respectively. Both companies rejected our offers. We assumed that they believed that their companies were worth more than what we were offering them. At the end of the simulation, Starshine and Bel Vino merged.

In conclusion, the wine simulation was a learning experience for our team and we realized the importance of conducting our homework before venturing into negotiations. It is important to learn about your counterparts

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in detail, as opposed to looking on the surface. Details such as financials are crucial in getting into mergers. If given the opportunity to negotiate again, we will definitely make serious preparations for the negotiations.