Hostile or friendly takeovers mergers economics essay

The process of mergers and acquisitions is gaining a significant importance in today's corporate world and is extensively used for reorganizing the business organizations. (Cartwright, Cooper, 1992). The phrase mergers and acquisitions refer to the characteristic features of Corporate strategy, corporate finance and management that deal with the purchasing, selling and combining of different companies that can support, fund, or give their hand to an upcoming company in a given industry and grow rapidly without having to create another firm(Gauhan, 2007).

There are many reasons why MNC'S go in for merging and acquisition, the most important among them are the rising market, political power, defensive reactions, economies of scope or synergies, reduction of transaction and information costs.(Gaughan, 2005)

The factors that generates a firm to go in for merger and acquisition are identified in the budding regulatory changes that happen internationally, regionally at national levels and in the fast pace of technological change which enhance the market opportunities of a business, technological interrelationship, communications and cross border reconstituting. The advantages of M&As are evaluated in terms of the ability to exploit the scale and scope of economies, gain the market control, economize the transaction costs, diversify risks, and to provide access to the existing know-how It is. (Cantwell, Santangelo, 2002)

A multinational enterprise (MNE) considering an entry into a foreign market by foreign direct investment (FDI) has to consider two strategic decisions regarding the organizational form of its foreign operation. First what is the level of control i. e. whether it will be a full ownership or a joint venture and, secondly, the mode of foreign entry i. e. setting up a new venture via Greenfield investment or merger and acquisition (Muller, 2007).

Let us analyze the circumstances which make M&A activity the optimal entry mode into a new international market in the forthcoming paragraphs.

In the period of global competition, firms realise that the effectual use of universal sourcing will contribute significantly to the performance of the market. With the materialization of new products and technologies, the firms began to experience a new developing cycle which is accompanied by the degree of competition in the market. Most of the development of the industries experience four processes and they are starting up, developing, maturing and the declining (Wang, 2009). With the invention of new products and technologies, the industries start experiencing a new developing cycle. In the initial stages of development due to less competition firms preferred greenfield investment as the optimal mode of entry in to the foreign market. As the industry started maturing the speed of the M&As which is one of the main factor started to be seen as the biggest advantage over the Greenfield investment or any other entry modes (Kang, 2001). One of the most fundamental motives for M&As is the speedy growth and the growth through M&As are a quicker process and it takes only few months than the other entry modes. An example of this kind is the German automobile company Daimler-Benz which realised that it needed a bigger occurrence in the U. S automobile market, therefore it did not waste its time by building new factories in United States which would have taken years, instead it acquired the number three U. S. automobile company, Chrysler, and merged the two operations to form Daimler-Chrysler(Barba Navaretti, 2006). Firms either expand within their own industry which is the internal growth or they expand outside their business category which is the external growth to increase the market share or the removal of a rival. When the firms grow internally, competitors respond quickly and take the market share and in due course of time the firm's advantages dissipate. The firms are left out with only solution of acquiring other companies that have possessions. For example Johnson and Johnson, rather than internally trying to be on the fore front of each of the major area of innovation decided to purchase those companies who had developed successful products. This strategy simply describes that instead of suppressing its competitors by its internal growth J&J stretched out for acquisition to increase its market power and this is referred to as inorganic development (Gaughan, 2007). Companies like Nestle use acquisition as a form of external growth to improve its organic growth(Morschett, Schramm-Klein, 2009)

Merging so as to create synergy is most often the cited validation for an acquirer to shell out a premium to the target firm. Synergy is created by redeploying a firm's assets. The acquiring firm may transfer a resource from the target firm to the acquiring firm and assets may be redeployed from the bidder to the target. Authors like Colombo, Conca, and Gnan (2007) found that a strong forecaster of acquisition performance was the extent to which the asset is redeployed from the target. For example, Renault acquired Nissan and therefore the leadership skills of CEO Ghosn were redeployed to the benefit Renault and firms like Ford and GM were unsuccessful in enticing Ghosn away from Renault (Hopkins. D, 2008)

Economic motivations are an important subcategory of M&A establishing the economies of scale thereby reducing the costs due to superfluous resources of two firms in the same or related industry. Thus acquiring a firm in the same or a related industry results in considerable overlap between the two firms and reduces costs. When Daimler-Benz acquired Chrysler it announced that the merger would lead to $1. 3 billion of cost savings in the first year mainly through collaboration (Morck, Yeung, 1992).

Diversification is another important strategy that motivates the firms going in for M&A. Diversification is growing outside a company’s current industry category. Firms either diversifies to extend their product, extend their market, or purely diversify. When a firm is specialized in a given technology or product base it tries to enter new market by entering in to different industries, different social group or different geographical location. An example of this type is G. E which was merely an electronic company through a pattern of acquisitions and diversification started operating in insurance, television stations, plastics, medical equipments and so on(Hitt. M, Ireland. D, 2009).

Often firms go in for merger and acquisitions to exploit a core competence and take an insubstantial skill, know-how, or information and purchase it by spreading its use to additional industries where it can create a competitive advantage. For example the company such as Honda by its internal combustion engines develops a core competence and tries to use it as a basis of competitive advantage in different businesses (Hopkins, 2008)

(Morosini, Shane, Singh, 1998) say that ‘ the larger the distance in culture of the countries in which merger partners are based the greater the potential benefit’

Cultural differences can also be a source of complimentary strength in the cross border M&As i. e. cultural differences between countries, like the nation’s strength allows working in groups for example collectivism in Japan versus the individualistic in the U. S, clearly shows that by the combination of two companies that are based out of different culture and country might result in a stronger combined company (Hennart, Young-Ryeol, 1993).

Companies in order to improve their product development and to improvise their research and development which is important for the future growth of many companies go in for M&A and cross border activities. During the 1990’s a widespread consolidation took place in the pharmaceutical industry and the motive for such a merger was to come up with new drugs and mounting costs of R&D, this explains the reason for the mega merger of Glaxo Wellcome and SmithKline Beecham merged in order to increase the R&D budgets.(Gaughan. P, 2007)

Changes in the technology results a firm to either buy or sell depending on its position with respect to technological changes and effects. For example, India’s third largest software exporter Wipro had a success history of 10 acquisitions. Most of the acquired companies were based out in Europe and dealt technology or R&D services. The Nerve Wire, AMS and Mpower helped Wipro gain skills in areas like financial securities, utility consulting and technologies respectively. (Paulson, Ed., Huber, 2007)

CONCLUSION

These were one among the few strategic factors that motivate a firm to opt for the Merger and Acquisition than going in for the other modes of entry. Despite the fact that by far the largest part of worldwide FDI takes the form of M&A while in some regions Greenfield investment is most prominent.