

Defensive strategies by cadburys against craft marketing essay



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Discuss the types of defensive strategies available to target companies and in particular, describe the strategies used by Cadbury to, albeit unsuccessfully, defend the bid by Kraft.

With the development of economy and technology, competition among enterprises is becoming increasingly intense. Many companies decide to expand their companies' scale and business through mergers and acquisitions to achieve maximum profits. Takeover is a business behaviour that one company is purchased by another one. There are several types of takeover, including friendly takeovers, hostile takeovers, reverse takeovers and backflip takeovers. Even though some mergers and acquisitions can bring about synergy and more substantial profits, some takeovers are not welcome. Therefore, a large numbers of measures are taken by target companies to defend the hostile takeover. In this essay, I state different types of takeover defence and their characteristics. Furthermore, I introduce their practical application taking the merger of Kraft and Cadbury as an example.

Different types of defensive strategies

Defensive strategies can be classified into active measures and preventive measures. Active measures consist of greenmail, standstill agreement, white knight, and so on, while preventive measures are made up of poison pills, people pill and other defences. In particular, greenmail, poison pills, staggered board terms and supermajority rules are common used defensive strategies by incumbent managers.

Greenmail is purchasing enough shares of the target company to threaten its shareholders' interests and then forcing the target company to agree to buy the bidder's stock back at a premium as long as it does not want to be taken over. It has brought fabulous profits for investors. For example, in June 1979, Icahn Corporation in the United States bought 9.9% of the shares of the Saxon Industries Corporation at \$7.21 per share. And in February 1980, Saxon repurchased its own shares held by Icahn Corporation at the price of \$10.50 per share. Icahn also bought 10% of shares of Hammermill paper Corporation at 25 dollars per share in the late of 1979. After that, the latter bought back these shares held by Icahn at the price of 36 dollars per share. Icahn totally invested \$20,000,000 in the merger activities and made 900 million dollars profits after these stocks were repurchased. As the US tax law regulates that the income from greenmail should pay 50 percent of the tax. Moreover, disputes often lead to high legal costs, as a result, the use of this takeover defence are greatly restricted.

Stock price of the target company usually goes down after it pays greenmail to the firm which want to take over the company. For instance, in 1984, David Murdoch held 5% of Occidental Petroleum's stock and forced it to take measures to increase the value of its stock. Occidental Petroleum responded to the pressure by buying Murdoch's shares back at a substantial premium to the fair stock market price. It repurchased the 5 percent of stocks at a price of \$40.1 per share instead of the market price of \$28.75, that is, it enabled Murdoch to gain the extra 42 percent of profits to the market value and made the total profits up to 56 million dollars. After paying greenmail to Murdoch, the market price per share of Occidental Petroleum stock dropped

by \$0. 875, indicating the market value of the company declined over 80 million dollars. Since the stock price had decreased before the announcement of the repurchase, the actual losses were more than \$80 million.

A poison pill, which is also called a shareholder rights plan, is the most effective defence strategy. It was devised in the mid-1980s which forced the acquiring firm to negotiate the purchase price of the stock with the target firm's board of directors, rather than negotiate with shareholders directly. Even though there are different kinds of pills, they have one thing in common that they increase the cost of takeover as a transfer occurs from the bidder to shareholders.

Poison pills are forbidden in some countries such as the United Kingdom. In Europe, due to the complicated political environment and the uncommon explicit poison pills, many governments can prevent companies from buying other firms by taking a series of political actions, but some hostile takeovers may be successful.

There are five types of poison pills, including preferred stock plan, flipover rights plan, ownership flip-in plan, back-end rights plan and voting plan. Flipover rights plan is the most popular takeover defence in these five kinds of poison pills. Shareholders of the target firm have the right to buy stocks of the acquiring enterprise at a discounted price after the merger, which is equal to a stock dividend. In the event of the acquisition, the number of shares held by the bidder will decrease as well as stock prices. If Corporation A decide to merger with Corporation B and Corporation B have the option to

purchase A's shares at a discount, the acquisition cost is quite expensive for A so that it may choose to give up the acquisition of B ultimately.

An acquirer which has gained over fifty percent of a target firm's stocks may be unable to take over the company as some companies have regulations that who acquire at least two thirds supports from shareholders and sometimes 90% of shares have the right in charge of the company.

Staggered board of directors or classified board refers to that the board of directors is divided into different classes, and company's articles of association formulate that only a part of directors, commonly one third or one fourth, can be re-elected each year. The measure means that even if the acquirer has held enough shares of the target firm and gained control of the company, it can neither make a substantive restructuring of the board of directors nor immediately take over the board of directors. The staggered board of directors plays a significant role in delaying the process of hostile takeover. As the majority of directors in the board are original, they still hold the majority voting power and control the company. They can decide to broad investments and increase their shares to dilute the bidder's stock shares, or take other actions to achieve the purpose of anti acquisition. Staggered Boards is an effective takeover defence that has less impact on share prices.

Case Study: Cadbury's defences against the bid of Kraft

Cadbury is an international company to produce, promote and distribute sweets and beverage products. It is the world's second largest confectionery company as well as the second largest chewing gum company. Kraft food is the second largest food company in the world, whose core products are <https://assignbuster.com/defensive-strategies-by-cadburys-against-craft-marketing-essay/>

coffee, candy, dairy products and beverages. It has over sixty thousand employees around the world and has launched business in 145 countries.

Even though the American blue-collar are enthusiastic about Kraft products, Kraft's sales performance was far less than expectation as its revenue declined by 6%. Due to the excessive reliance on low end market and the lack of new growth points, Kraft faced a crucial decision: one was introducing new products and promoting a new brand, the other was taking over the existing namely brands.

On 28 August 2009, Rosenfeld, the chairman of Kraft, proposed an offer to absorb Cadbury at a price which was 31% higher than the closing price at that day and amounted to nearly 10.2 billion pounds. Although Roger, the chairman of Cadbury realized that the development of the company size had suffered bottlenecks, he convinced that in the acquisition game, Cadbury would be able to reap the initiative opportunity. On 7 September, Cadbury formally stated that it rejected Kraft's acquisition, because the proposed acquisition greatly underestimated the value and development prospects of Cadbury. Because of the acquisition news, Cadbury's share price rose by 37% at that day, causing its total market value up to an unprecedented 106 billion pounds, which was more than Kraft's bid. On September 22nd, intolerable Cadbury asked the British M&A supervision institution to give a ruling to Kraft, forcing it to nail down before the 9 November. If it cannot submit a more reasonable offer, Kraft would not take acquisition activities within at least six months. Immediately, Rosenfeld said that Kraft did not have to take over Cadbury. This made a lot of Cadbury's shareholders begin to worry that Cadbury's share price would collapse if Kraft gave up the

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acquisition. Roger appeased shareholders and he believed that refusing the acquisition and remaining independence of Cadbury could bring about best interests to shareholders. Cadbury was confident of its independent strategy and development prospective in the future, while merging with Kraft, which had low growth, may have an obscure prospect. On October 21st, Cadbury released the third-quarter financial statement which indicated that the quarterly revenue rose by 7%. On that day, its stock price reached a record high, with a total market value as much as 11.08 billion pounds.

Shareholders of Cadbury took the opportunity to express that if Kraft's offer was 122 million pounds, they were able to discuss on the issue of acquisition. This price was 20 billion pounds higher than Kraft's original offer price. On 9 November, Kraft announced that it would launch a hostile bid for Cadbury in accordance with the previous offer.

In late November 2009, the US Hershey Corporation, the Italian Ferrero Corporation and Nestlé of Switzerland had expressed their willingness to bid. Therefore, Cadbury must not be so easily accept Kraft's offer. Because Kraft is not the only one which tended to take over Cadbury, while Cadbury is almost the only choice for Kraft. Roger Carr said that Cadbury preferred to merger with Hershey rather than Kraft, because this merger was expected to generate higher earnings per share. It was reported that the directors of Cadbury secretly contacted Hershey's directors to encourage it to act as a white knight and launch a tender offer in order to compete with Kraft. It is a takeover defence known as "white knight". When a company become the hostile takeover target, it may invite another company to make friendly acquisition proposal to defuse the pressure of hostile takeovers. The

company which is invited to help the target firm defend hostile takeovers is called “white knight”.

Success for the Cadbury takeover would bring about less synergy and make Nestle face antitrust scrutiny, while Hershey had no ability to bear acquisitions without Ferrero’s assistance. As a result, they gave up taking over Cadbury. Finally, Kraft’s merger of Cadbury was successful at the price of \$19.5 billion.

Conclusion

Takeover defences mentioned above are effective and commonly used measures to resist the hostile takeover of acquiring firms. Different strategies have different characteristics and applications. For instance, staggered board of directors has less influence with the company’s stock price than greenmail, while poison pills are forbidden in some countries.

The merger of Cadbury and Kraft is a well-known and significant M&A case in this century. Even if Cadbury had taken a series of actions to defend Kraft’s takeover and achieve some results initially, causing Kraft had to sell its pizza business at a super low price and issue new shares, eventually, Kraft gained the victory of the campaign. In my opinion, adopting efficient defensive strategies do not mean obtaining desired results. The surrounding economic environment and views of counterparty also play a vital role in merger and acquisition activities.