

# Merger and acquisition joint ventures



Mergers and acquisitions (M&As) are becoming a strategy of choice for organizations attempting to maintain a competitive advantage. This paper reviews related literature to identify some underlying issues related to the success rate of M&As. It also discusses critical issues of joint ventures and also the problems and benefits of them. In addition, there has been an increased focus on the use of inter-firm relationships or strategic alliances in today's business. This paper also argues the factors which lead to successful strategic alliances. When firms are dealing with negative earnings and/or economic downturns, operational restructuring and consolidation are initiated as a rescue tool. Some firms recover, while the others fail to survive. Restructuring and consolidation are the next issues which discuss generally.

## **Introduction and Background**

### **Mergers and Acquisitions**

Acquisitions and mergers are a national as well as global trend. They occur everywhere in organizations, administrative units and businesses in all industries and of all sizes. Many people are at stake and a great deal of money as well (Balle, N. 2008). Mergers and acquisitions are becoming an increasingly popular strategic option for organizations (McEntire and Bentley, 1996). In fact, recent estimates indicate that the annual price tag of mergers and acquisitions consummated in the USA exceeds \$1 trillion (Stanwick, 2000).

Mergers are commonly characterized as the consolidation of two organizations into a single organization. Acquisitions, by contrast, are

commonly characterized as the purchase of one organization from another where the buyer or acquirer maintains control (Borys and Jemison, 1989).

Mergers and acquisitions (M&As) have been a very popular strategic maneuver for global businesses, attaining growth, diversification, or profitability (Fowler and Schmidt, 1988). In fact, the merger mania that started in the 1980s, continued throughout the 1990s and is still vigorous (Houghton et al., 2003).

M&As are nothing but extreme forms of organizational change, and change is often perceived by employees as threatening, due to their feeling of vulnerability and fear of losing security (Saunders and Thronhill, 2003).

Under these circumstances, they have become increasingly important in helping to redefine employment relationships (Anderson and Schalk, 1998; Cartwright and Cooper, 1993; Guest, 1998; Herriot and Pemberton, 1995, 1996; Hiltrop, 1995; McLean Parks and Kidder, 1994; Turnley et al., 2003).

## **Joint Ventures**

Joint ventures (JVs) occur when two or more legally separate bodies form a jointly owned entity in which they invest and engage in various decision making activities (Geringer, 1988; 1991). A joint venture may be termed International (IJV) where at least one of the parties (or parents) is based outside the country where the venture is taking place or if the joint venture is being administered on a wide level in more than one country (Geringer and Hebert, 1989).

JVs are now seen in terms of weaponry employed by companies within the context of their business networks to facilitate competition in relation to

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firms' core markets and technologies (Beamish and Banks, 1987; Harrigan, 1987; Buckley and Casson, 1996); they are thus of vital strategic importance for international business and their significance is growing.

It has been argued that various features of culture might affect the development of joint ventures. In their article Swierczek and Hirsch (1994) concluded that it is important that future partners understand the impact of differences in culture before they begin to joint venture. They added that JVs are often characterized by problems of misunderstanding and limited effectiveness because of the lack of compatibility of the cultures represented in the joint ventures.

Similarly Beamish and Inkpen (1995) found that MNEs could benefit equally well from local market knowledge which their partners could provide. They also stated that the life cycles of many manufacturing subsidiaries are short because the MNE is unable to understand the knowledge of local culture, economy and politics.

## **Strategic Alliances**

A strategic alliance is an agreement between two or more partners to share knowledge or resources which could be beneficial to all parties involved.

Strategic alliances can be as simple as two companies sharing their technological and/or marketing resources. In contrast, they can be highly complex, involving several companies, located in different countries. These firms may in turn be linked with other organizations in separate alliances.

The result is a maze of intertwined companies which may be competing with

each other in several product areas. (Niren M. Vyas, William L. Shelburn and Dennis C. Rogers 1999).

A few years ago strategic alliances were perceived as an option reserved only for corporate giants. Today, however, for many companies, a go-it-alone strategy no longer seems to be a viable alternative. As a result of the maturation of several trends of the 1980s – intensified foreign competition, shortened product cycles, soaring capital investment costs, and the evergrowing demand for new technologies – alliances are becoming an attractive strategy for the future (Niren M. Vyas, William L. Shelburn and Dennis C. Rogers 1999).

## **Restructuring and Consolidation**

It is rare to find a single product company. Most have diversified their interests into related or unrelated areas. Some companies are known as restructuring companies, The latter acquire other companies essentially for the purpose of reorganizing or streamlining and selling them off subsequently to other owners at a profit. Restructuring companies also have the function of aiding the process of restructuring an industry (Proctor, T. 2001).

Operational restructuring involves making decisions about appropriate workforce size and skill requirements, plant capacity and location, functions consolidation, and possible shifts in production focus. More specifically, operational restructuring can be considered a program: that is planned and controlled by management, and materially changes either: the scope of a

business undertaken by an enterprise; or the manner in which the business is conducted (Lin and Lee and Gibbs, 2007).

Focusing is on operational restructurings for two primary reasons. First, such events often affect a company's business strategies, operations, organizational functions, and existing management structures. Second, operational restructurings entail controversial corporate accounting practices of restructuring charges (Lin and Lee and Gibbs, 2007).

Corporate consolidation is a topic of active debate among academics and practitioners alike. Academic researches emphasize the importance role corporate consolidation play in disciplining under-performing management and imposing operating efficiencies (Healy 1992; Jarrel et al., 1988), practitioners view it as a tool of market share expansion and an effective response to a plethora of competitive challenges (Read, 1999; Howell, 2002). In its most visible form, M & As, corporate consolidation is a sizable business run in Europe by established national players operating, increasingly, on a cross-border basis (Berg, 2002).

## **Merger and Acquisitions**

Several researchers have suggested that in most cases M&As fail to meet initial financial expectations (i. e. Bruner and Spekman, 1998; Haveman, 1992; Very and Schweiger, 2001; Zollo, 2003). Back in the 1980s, Lubatkin insisted that although M&As had been a very important and popular means for executing organizational strategies, less than 20 percent actually achieved its expected financial or strategic objectives. Almost a decade later, Cartwright and Cooper (1992) quoted nearly 40 per cent failure rates for

change efforts and a few years later, 1996, nearly 50 percent of M&As failure rate to achieve initial objectives. Along the same lines, Weber (1996) found that 35 per cent of those M&As that fail in their first three years of life are a result of poor employee relations. Over the years, several researchers have raised that percent again, advocating that more than two-thirds of M&As fail to create meaningful shareholder value (Ashkenas et al., 1998; Carr et al., 2004; Marks and Mirvis, 1998).

As for the main reasons for such failure rates, there is a dispute among researchers. Existing literature has identified among the main reasons for not fulfilling initial goals both hard and soft factors. Specifically, there are researchers suggesting that paying the wrong price, buying for the wrong reason, selecting the wrong partner, and buying at the wrong time are some of the most prominent ones (i. e. Armenakis, 1999; Haleblian, 1999).

However, others insist that underestimation of depth of the problems related to the human factor during a M or A condemns the project's success, and thus, more attention has to be given on employees' needs (i. e. Bijlsma-Frankema, 2001; De Cock and Rickards, 1996; Houghton et al., 2003; Lesowitz and Knauff, 2003; Seibert, 1995; Stahl et al., 2003).

### **Focus on value creation, not just integration**

Many companies organize their post-merger integration activities on a functional basis rather than a value-added basis. While many functional activities must be consolidated (such as bringing databases together and rationalizing policies, procedures and IT systems), not all integration activities yield equal benefits. Blindly and aggressively integrating various

functions and businesses without regard to a value-creating hierarchy can actually destroy value (Chanmugam, Shill, Mann, Ficery and Pursche, 2005).

## **Use culture as a value-creation tool**

The most successful acquirers of the future will see culture as a tool in three ways. First, they will look at cultural differences during the target identification and bidding phases, assess the potential impact of those differences, and incorporate their analysis into the valuation and bid. Second, they will try to avoid the pitfalls common during pre- and post-merger planning, and actively incorporate the elements of each company's culture that best support the desired combination. Finally, they will proactively use culture to create value through the use of high-visibility retention, promotion, termination and structural organizational design decisions (Chanmugam, Shill, Mann, Ficery and Pursche, 2005).

## **Joint Ventures**

### **Critical Issues for IJVs**

An IJV is defined as an equity sharing arrangement in which a foreign corporation and a local firm (either private or government owned) pool their resources, sharing risks and operational control to operate an independent business unit on a continuous basis for profit and/or to attain some strategic objective (Geringer and Hebert, 1991).

Broadly viewed, the IJV market entry mode represents two opposing trends. First, judged by the number of entries, it is becoming increasingly popular as a mode of market entry and expansion (Makino and Beamish, 1998; Vanhonacker and Pan, 1997). In recent years an increasing number of global



corporations have become involved in IJVs at home and overseas, covering many sectors, industries, and product groups (Griffith, Zeybek and O'Brien, 2001). The second issue relates to the fragile nature of IJVs, and it has been repeatedly argued that the failure rate or instability rate of IJVs is above thirty percent, and it is often markedly higher compared to other alternative forms of market entry and operation (Makino and Beamish, 1998). Gomes-Casseres (1989) offered two explanations for reasons of instability in any JV, arguing that the partners simply made a mistake; forming a JV when it may not have been the best thing to do, or they joined up with the wrong partner. Further, that their initial decision was right, but conditions changed so that the JV was no longer useful (Cullen, Johnson, and Sakano, 1995).

### **Problems with Joint Ventures**

Some of the main problems with Joint Ventures include: Significant differences in the major goals of the parties, Details of the joint venture contract, The foreign corporation's global integration and the local partner's national orientation, Differences between the partners concerning marketing, Desire for control, Transfer pricing conflicts, Conflict over decision making, managerial processes and style (Julian and O'Cass, 2003).

### **Benefits of Joint Ventures**

Joint ventures provide companies with the opportunity to obtain new capacity and expertise. They allow companies to enter into related businesses or new geographic markets or obtain new technological knowledge. Joint ventures have a relatively short life span (5-7 years) and therefore do not represent a long-term commitment. In the era of divestiture and consolidation, they offer a creative way for companies to exit from non-  
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core businesses (companies can gradually separate a business from the rest of the organization, and ultimately, sell it to the other parent company (appr. 80% of all joint ventures end in a sale by one partner to the other) (Trafford and Proctor 2006).

## **Succe of a Joint Venture**

success of a joint venture may be influenced by five important characteristics. These characteristics are illustrated as building blocks in a model which Trafford and Proctor(2006), have termed “ the ‘ COPED’ model”.

## **COPED Model (Trafford and Proctor, 2006)**

### **Communication**

Many business alliances fail to meet expectations because little attention is given to nurturing the close working relationships and interpersonal connections that unite the partnering organisations (Weitz and Jap, 1995). An awareness of communication processes is essential within alliances if maximum efforts are to be coordinated and directed towards the success of strategic alliances. Ineffective communication can reduce the effectiveness of a strategic alliance and thus lead to conflict between partners (Jain, 1987).

There is an assumption that organisations will function better if communication is open, if relationships are based on mutual understanding and trust, if relationships are co-operative rather than competitive, if people work together in teams, and if decisions are reached in a participative way. These conditions, however, are not observed in many organisational situations. Main barriers to communication concern are power differences;

gender differences; physical surroundings; language; and cultural diversity (Huczynski and Buchanan, 2001).

## **Openness**

Trust is considered a prerequisite for alliance success (Byrne, 1993) and lack of trust is a major reason for alliance failures (Peng and Shenkar, 2002).

There is evidence to point to the fact that strategic alliances may be unstable and their success rate poor (Gant, 1995). Partner firms need to manage this risk adequately by understanding the conjoint roles of trust and control. The establishment of a new relationship between members of the organisation at all levels – a relationship based on trust – is an issue that is becoming increasingly important to organisations (Handy, 1995).

## **Planning**

Many “strategic alliances” lack “alliance strategies”. A coherent alliance strategy has four elements: (1) a business strategy to shape the logic and design of the alliance; (2) a dynamic view to guide the management and evolution of the alliance; (3) a portfolio approach to enable co-ordination among the alliance to enhance flexibility; and (4) an internal infrastructure that supports and strives to maximise the value of external collaboration (Gomes-Casseres, 2000). When managed well, the above elements can create tremendous value. At the wrong time and when managed poorly, they can be costly distractions (Gomes-Casseres, 2000).

According to Hill and Jones (2001), the strategic planning process can be broken down into five main steps: (1) mission and objectives; (2)

environmental scanning; (3) strategy formation; (4) strategy implementation; and (5) evaluation and control.

## **Ethos**

Ethos is the characteristic spirit or attitudes of a community, or people (Webster, 1992). It comes very much to the fore in strategic alliances when the co-operating firms continue to be independent organisations and a new situation appears in which an interaction is established between two firms with different organisational cultures.

This usually implies different leadership styles and different objectives, which may lead to lack of trust between the parties and to conflicts which may arise when the time comes to make decisions (Buono, 1991). Similarly, cultural conflicts are more common in joint ventures, where a closer contact between the partners is required, than in contractual alliances (Schultz, 1998).

## **Direction**

The public sector is under pressure to improve service delivery and cooperate more effectively (Cabinet Office, 2003). There is a growing demand for leaders able to carry out these tasks, and to see through fundamental processes of change. The appointment, monitoring, reward and accountability structures and processes all play some part in inhibiting and/or encouraging certain forms of leadership which give the correct direction.

## **Strategic Alliances**

Parkhe (1993) defined a strategic alliance as a: relatively enduring interfirm co-operative agreement, involving flows and linkages that use resources and/or governance structures from autonomous organizations, for the joint accomplishment of individual goals linked to the corporate mission of each sponsoring firm.

Following from this definition, it can be seen that an alliance must be a formal part of business strategy (Johnson, 1999), meaning that an agreement between two partners must be formalised into a contract, as opposed to a handshake deal or a verbal agreement. Second, alliances must be mutually beneficial; that is, they must result in a win-win situation.

Koza and Lewin (1998) argued that one of the many reasons that strategic alliances were formed was to seek out new knowledge by acquiring new technology and skills. In this type of alliance they argued that the partners would seek to reduce information asymmetry between the partners. This may involve the standardization of service delivery of production processes, joint strategic planning, sharing of databases and knowledge transfer through staff exchanges. A second and related motivation for forming an alliance was to explore for new market opportunities. This involved innovation, basic research, invention, risk taking, building new capabilities, entering new lines of business, and investments in the firms absorptive capacity.

## **Barriers to successful Strategic Alliances**

Barriers to successful strategic alliances must also be recognized. The three major barriers are: (1) Failure to understand and adapt to “new style” of management. The adaptation of a new style of management requires a change in corporate culture which must be initiated and nurtured from the top. (2) Failure to learn and understand the cultural differences. Not only do the cultural differences exist among international firms seeking alliances, but corporate cultures may be different among firms from the same country. Flexibility and learning are the greatest tools in overcoming this barrier. (3) Lack of iron-clad commitment to succeed. Individuals who negotiated or implemented the initial alliance agreement may change due to promotions, transfers, retirement, or terminations. Continuity of total commitment for the alliance is needed at all levels in the organization without which the alliance will fail to reach its full potential (Vyas, Shelburn and Rogers, 1995).

## **Importance of Knowledge in Strategic Alliances**

Inter-firm cooperative initiatives are one of the precious ways for firms to identify, transfer and internalize external knowledge. Kogut's review of literature addressing joint ventures found that one of the firms' main motivations for entering into collaborative agreements was to transfer organizational knowledge (Kogut, 1988).

Berg and Friedman, in a study of over 300 JVs at the 2-digit SIC level showed that in many cases, joint ventures did not in fact enhance the market power of the parent firm, but rather functioned as a means of knowledge acquisition (Berg and Friedman, 1981). Thus the issues of knowledge creation, knowledge transfer and learning have attracted researchers and

have been examined several times in academic research and management consulting applied studies.

## **Restructuring and Consolidation**

### **Why and how to Restructure an Ailing Business**

A number of typical situations that a firm with declining performance may encounter and could cause this firm to go through an operational restructuring are stated in this section.

#### **-Needs for operational restructuring**

The decision to restructure is driven by a number of considerations. At times, restructuring is in response to significant “ sea” changes in the business environment while in other cases it is done to address poor operating/stock performance. Both internal (e. g. financial distress) and external (e. g. recessions) economic and financial conditions can drive the decision to restructure. Additionally, votes of no confidence in management will likely lead to corporate restructuring (Lin and Lee and Gibbs, 2007).

#### **-Typical activities of operational restructuring and consolidation**

Restructuring and consolidation efforts can take on a couple of forms. Often times management takes steps to contain costs, but in at other times drastic changes such as a refocusing of business direction occurs. For a firm that incurs losses, cost control is often the first step to return to profitability. Slashing labor costs, production costs, selling and administrative expenses, R&D expenditures, and financing costs are common measures of corporate restructurings (Denis and Kruse, 2000). Downsizing and employee layoffs are

the restructuring actions that are typically taken to cope with poor operating performance, especially within contracting economies (Lin and Lee and Gibbs, 2007).

## **Other Issues**

Operational restructuring and consolidation has been considered as one important turnaround strategy for a firm in a bad situation, especially during an economic recession. Lin and Lee and Gibbs (2007), stated that delisting risk increases when firms undertake repetitive restructurings, massive workforce reduction, and large-scale asset downsizing. Moreover, firms with high levels of debt and failure to cut costs and/or narrowing its focus on core competencies are also more likely to delist.

## **Conclusion**

As more and more companies opt to supplement organic growth with mergers and acquisitions, the earlier stages of M&A transactions are becoming relatively mature, commoditized processes. According to Galpin and Herndon (2008), in order to build replicable M&A integration, M&A integration must be managed as an end-to-end business process. M&A integration is a competency set with specific skills that must be built throughout the organization. The organization's M&A integration process and capabilities must be in place before the "train leaves the station" – that is, before the deal gets done. The organization's M&A integration process must be continually improved by learning from previous mistakes and successes.

The researches indicate the existence of five helpful characteristics identified under the heading of Communication, Openness, Planning, Ethos and



Direction, which may be present in a successful partnership (joint) venture. The “ COPED” model, is for building more comprehensive and productive relationships between public sector organisations and private sector companies which lead them to a successful joint venture.

Strategic alliances are in the age of business without boundaries. A strategic objective aimed at expanding the competitive knowledge resource, and clearly there are special skills in bringing these arrangements to fruition. Professional managers recognize that in the age of business without boundaries it is essential that they provide learning opportunities and the necessary knowledge that will enable their employees to effectively and securely collaborate internally and externally. So there is a need for knowledge and learning regarding to strategicalliances (Dealtry, 2008).

Operational restructuring has been considered as one important turnaround strategy for a firm in a bad situation, especially during an economic recession. Moreover, firms with high levels of debt and failure to cut costs and/or narrowing its focus on core competencies are also more likely to delist. So considering and learning about restructuring and consolidation is another important issue to take account for managers.