

# [Analysis of kraft's takeover of cadbury](https://assignbuster.com/analysis-of-krafts-takeover-of-cadbury/)

### Overview Of Both Companies

Cadbury’s origins date back to almost two centuries when it was founded by John Cadbury who started the business by selling cocoa and tea in Birmingham, UK. Later he expanded by starting a line of beverages after a merger with Indian Schweppes changing the company name to Cadbury Schweppes (Chinn 1998). Successful product developments and launches have enabled Cadbury to boast of an extensive confectionary line consisting of Cocoa Essence, Easter Eggs, Milk Chocolate, Cadbury Fingers, Dairy Milk, BournevilleChocolate, Milk Tray, Flake Creme Egg, Crunchie, Picnic, Curly windy, Wispa boost, Twirl and Time Out (Cadbury 2010).

Kraft, on the other hand, is a US company about a century old, which started off as a door to door cheese business but expanded into other confectionary items through many takeovers previously such as Ritz Crackers, Nabisco (Oreos) and Phenix Cheese Corporation (Philadelphia Cheese) to achieve success (Smith 2009). It is second in terms of sales and popularity in the confectionary industry with annual revenues of $42 billion, operating in more than 150 countries (Kraft 2008).

### The Idea Of A Takeover

Due to recessionary times following fall in sales, many companies in the confectionary industry recognized the potential of merging with their competitors to become competitive and enjoy economies of scale (Mauboussin, 2010). Cadbury had continued to be a strong performer in the confectionary industry and shown steady performance and growth in light of the turbulent economic times. Much of Cadbury’s growth was due to its presence in emerging global markets. Kraft was attracted to Cadbury due its strong performance during the economic crisis. This led to Kraft’s proposal to Cadbury of a takeover.

The initial offering of $16. 3 billion or 740pence per share by Kraft to Cadbury was outright rejected as derisory and an attempt by Kraft to take over Cadbury for cheap. Cadbury has had strong brands whose icons are etched in the minds all over the world, an impressive category line and extensive worldwide consumer base. Successful financial overview and steady business model reinforced Cadbury’s belief that it should be an independent company. Kraft’s bid did not come remotely close to reflecting the company’s true worth.

Kraft proposed another bid shortly: This comprised of an offer of £10. 1 billion ($17 billion, same terms as the first bid in September-300 pence in cash and 0. 2589 Kraft shares per Cadbury shares. The closing price of 9th November reflected the bid valuation of Cadbury at 710 pence which was lower than the share price of 761p on that day.

Kraft’s share price: $26. 53; Exchange rate (as agreed): $1. 66 / GBP. Ratio: 0. 2589 Kraft shares per every Cadbury share (26. 53/1. 66 \* 0. 2589 = £ 4. 133 + 4. 13 = £ 7. 13). This was less than the price of Cadbury on that day and even the initial level of £ 7. 45.

Cadbury rejected the offer on the basis of undervalued Cadbury which was now of a lesser value. It was in fact even lower than the current Cadbury share price.

The Cadbury chairman said:“ Under your proposal, Cadbury would be absorbed into Kraft’s low growth, conglomerate business model, an unappealing prospect which contrasts sharply with our strategy to be a pure play confectionery company.”

The hype created by rumors of takeover figures led to exciting speculations . Media reported Ferrero to be considering a rival bid. Hershey’s confirmed its own interest for same purpose. There were not only speculations of a joint bid but also of Kohlberg Kravis Roberts & Co. joining the bidding race. All this favored Cadbury whose share price witnessed new highs. Hershey’s and Ferrero would struggle to bid alone and only their combined offer could beat Kraft’s offer.

On January 18, Kraft finally managed to take over one of the world’s second largest confectionery manufacturer in a hostile bid of an enormous 11. 5billion (US$19. 5billion). This deal will be remembered in history as one of the largest transnational deals, especially in the aftermath of credit crunch. After four months of continuous resistance, Cadbury shareholders agreed to Kraft’s offering of $19. 5 billion, (840 pence per share). This was agreed upon with the spirit of creating the world’s largest confectioner. This consisted of 500 pence in cash per share and the remaining amount paid to Cadbury shareholder in the form of Kraft shares. The shareholders had the power to decide the mix of amount they wanted in cash and shares.  According to estimations, the finals offer presented a multiple of 13 times Cadbury’s earnings in 2009 (after interest, taxes and debt were paid).

The high bid price overruled the threat of Hershey’s or Unilever offering a price for the same strategy, that is take over. The only rival left  was Nestle which too was reduced significantly when Cadbury’s Director signed the agreement that if Cadbury were to change its mind about the takeover, it would pay a handsome penalty for it, hence such a situation arising became highly unlikely. The Kraft management, led by Irene Rosenfeld also assured that Kraft had a great respect for Cadbury’s brands, employees and reputable history and therefore the employees of Cadbury would   do well in the new environment. Also, she verbally assured that under the new agreement the previous contractual rights of the employees would remain the same as before.

### Market Structure Of The Two Companies

Cadbury and Kraft are both multinational operations with activities in both developed and developing countries. Cadbury is however the market leader in UK and Ireland’s confectionary where consumers have a liking for British chocolate containing vegetable oil having a richer taste in milk and also sweeter as opposed to continental chocolate having cocoa fat content; hence Kraft has a low share in such markets.

Also, Cadbury’s strong standing in the Indian (Schweppes) and North American Markets was cleverly identified by Kraft who wanted to tap it and exploit under its own name now to add to its success story.

### Advantages Of The Takeover For Kraft.

It was the biggest cross-border acquisition this year. Such a deal clearly pushed Kraft as number 1 dealer in confectionary. A merger allowed Kraft to gain a footing in the fast growing chewing gum category.

Kraft management believes that the combination of the two companies is both a strategic as well as complimentary fit, boasting a portfolio of over 40 confectionary brands each having the ability to yield annual sales of over $100 million.

A combination of Kraft products like Toblerone, Oreos and Ritz crackers with Trident gum and Dairy Milk chocolates from Cadbury would result in $625 million annual pretax cost savings on annual company costs of research and development, advertising, branding and procurement. There would also be a significant level of revenue synergy ($50 billion annually) that would subsequently result in higher earnings per share. After the takeover, Kraft would have a greater ability to compete with the giant Nestle on confectionary grounds by increasing its market share in Britain and enjoying the benefits of Cadbury’s strong geographical networking in Asia.

Kraft’s growth prospects would brighten through access to new brands particularly in the confectionary department along with new distribution channels for the existing products which are outside US. These constitute about one third of the market in developing countries such as Africa, China and India.

### Advantages Of The Takeover For Cadbury

Cadbury would profit from Kraft’s extensive distribution network around the globe. Cadbury had been vulnerable to a takeover ever since it demerged its US soft drinks business. This high takeover bid was an attractive opportunity to do away with such a fear. A combined Kraft and Cadbury would significantly expand the global reach of both businesses and create synergies worth in the region of $625m. Since a stand-alone Cadbury “ had limited opportunities for value creation,” agreement to the contract for takeover seemed like a wise decision.

### Disadvantages Of The Takeover

Along with the obvious benefits come the many challenges and ethical issues. These are primarily high debt issues and employee layoffs.  The high debt position of Kraft has further worsened with the takeover as funds were borrowed to pay the Cadbury shareholders a higher yield. Kraft also sold off its frozen Pizza line in order to make the takeover happen.

The unions are worried that the jobs of hundreds would be at stake (estimated 9000plus) as Kraft would try to reduce costs to operate efficiently and pay back its debts. The company has also not given any formal assurance that it would protect 4500 UK jobs. Also it is a known fact that when a company needs to cut costs, jobs and job conditions suffer.

The British Government also opposes takeovers of British companies by foreign giants as it nearly always leads to job losses. This takeover too was met with resistance including Gordon Brown’s advice and insistence against its happening but the shareholders overruled it and still went ahead with the deal. According to a Union head, “ This is a very sad day for U. K. manufacturing. A successful, iconic, independent U. K. brand will now be owned by a giant company with massive debt.”

In the face of such a scenario, even if employees are laid off it will not affect those who are rich and/ or are major shareholders in the company.  For example, if the chairman, Roger Carr gets axed, he would still walk away with $30 million! This proves that it is the low level managers and employees who feel the vulnerability of such an action. According to David Bailey, professor at Coventry University Business School; “ Serious questions need to be asked about Kraft’s intentions… Kraft already has a track record of cutting production and moving production abroad… There’s no guarantee that they’ll keep production in the UK in the long run.”

When employees of both companies were interviewed to ask about their view points, most expressed fear and uncertainty. They were resistant to the idea of such a large company where their positions and titles might be reduced or lost due to the massive structure. They are also despondent of their lack of involvement in this decision. According to one employee, “ nobody really knows what is going to happen, but it is definitely not going to be pleasant.”

A disadvantage for Kraft’s shareholders of the takeover is that they now mentally feel less financially strong as assets were being sold and the entire pizza production plant worth $3. 7 billion was sold to raise money for the takeover.

### The Market Theories Being Practiced

The Market theory witnessed in such a situation is a combination of globalization practiced over countries and between countries of the two companies having their origins in US and UK. The practice generated by Kraft, in this case, was that of a hostile takeover, where the big company used its aggressive stance on growth to acquire a smaller company. This is a very certain way to achieve company growth. In the event of a significant bid for shares, the shareholders are likely accept the offer but the board of directors more likely to resist. This is exactly what happened with this takeover too, however due to low bid price initially, the shareholders were not inclined towards the idea until the bid became impossible to resist.

Some Kraft shareholders too were also strongly against this idea, especially Warren Buffett who felt that Kraft was overpaying Cadbury when there was no need for Cadbury’s products in Kraft’s portfolio for long term growth. He expressed his desire of wishing to stop the takeover if he could.

### Conclusion

Objectively speaking, when takeovers of such a  nature occurs; Two large companies come under one brand name, with the larger one burdened with high debt, the risk of business coming down due to conflicts in operation strategies in the near future are highly likely to occur. These are not realized when the benefits of the takeover are being discussed and third parties involved in its happenings are proactive as they too are making money. These parties are usually the deal makers, lawyers and other advisers who earn their commissions irrespective of whether the deal is eventually a success or a failure.

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