Chapter 9: Acquisition and Restructuring Strategy

CHAPTER SUMMARY

This chapter focuses on mergers and acquisitions as popular strategies commonly used in tandem with diversification strategies. Reasons that mergers and acquisitions are selected during the strategic management process are examined, as are the problems associated with their failure and the keys for their success.

The chapter is closed with descriptions of three restructuring strategies and the outcomes resulting from their use.

CHAPTER OUTLINE

The Popularity of Merger and Acquisition Strategies
  Mergers, Acquisitions, and Takeovers: What Are the Differences?
Reasons for Acquisitions
  Increase Market Power
  Overcome Entry Barriers
  Reduce Costs and Risks Associated with New Product Development
  Increase Speed to Market
  Increase Diversification and Reshape the Firm’s Competitive Scope
  Learn and Develop New Capabilities
Problems in Achieving Acquisition Success
  Integration Difficulties and an Inability to Achieve Synergy
  Inadequate Evaluation of Target
  Large or Extraordinary Debt
  Too Much Diversification
  Managers Too Focused on Acquisitions
  Firms Become Too Large
Effective Acquisitions
Restructuring
  Downsizing
  Downscoping
  Leveraged Buyouts
  Outcomes from Restructuring
Summary

KNOWLEDGE OBJECTIVES

1. Explain the popularity of acquisition strategies.
2. Discuss reasons firms use an acquisition strategy to create value.
3. Describe seven problems that work against developing a competitive advantage using an acquisition strategy.
4. Name and describe attributes of effective acquisitions.
5. Define the restructuring strategy and distinguish among its common forms.
6. Explain the short- and long-term outcomes of the different types of restructuring strategies.
The Popularity of Merger and Acquisition Strategies - This section opens the topic of mergers and acquisitions by examining the popularity of employing these strategies to increase economic value through ownership and use of an acquired firm’s assets. The need to respond to market conditions and competitive realities influences the popularity of acquisition strategies today. Statistics about the use of these strategies, resulting success and failure rates, and the expectations for their future use are also included. (See slides 1-2.)

<table>
<thead>
<tr>
<th>Key Terms</th>
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<tr>
<td>Merger - strategy through which two firms agree to integrate their operations on a relatively co-equal basis.</td>
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<td>Acquisition - strategy through which one firm buys a controlling, 100 percent interest in another firm with the intent of making the acquired firm a subsidiary business within its portfolio.</td>
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<td>Takeover - special type of acquisition strategy wherein the target firm did not solicit the acquiring firm’s bid.</td>
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<td>Hostile Takeover - unfriendly takeover strategy that is unexpected and undesired by the target firm.</td>
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Additional Discussion Notes for Mergers, Acquisitions, and Takeovers - These notes include additional materials that cover the historical use of acquisition strategies.

Stats and Background
There were five waves of mergers and acquisitions in the 20th century, with the last two in the 1980s and 1990s. About 40–45% of the acquisitions in recent years were made across country borders. There were 55,000 acquisitions valued at $1.3 trillion in the 1980s, but acquisitions in the 1990s exceeded $11 trillion in value. The annual value of mergers and acquisitions peaked in 2000 at about $3.4 trillion and fell to about $1.75 trillion in 2001. Slightly more than 15,000 acquisitions were announced in 2001, compared to over 33,000 in 2000.

Although acquisitions have slowed, their number remains high. Firms make acquisitions to increase market power, reduce competitive threat, to enter a new market, to spread risk, or as a way to obtain options that allow shifts in core business. Studies show that shareholders of acquired firms often earn above-average returns from an acquisition, while shareholders of acquiring firms typically earn returns from the transaction that are close to zero.
### Reasons for Acquisitions

This section outlines several reasons that an acquisition strategy is used by firms even though it may not result in achievement of a competitive advantage.

<table>
<thead>
<tr>
<th>See Figure 9.1: Reasons for and Problems with Acquisitions (slide 5).</th>
<th>1. What are the major reasons that firms select an acquisition strategy?</th>
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<tr>
<td></td>
<td>a. Increase market power</td>
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<td>b. Overcome entry barriers</td>
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<td>c. Reduce costs and risks associated with new product development</td>
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<td>d. Increase speed to market</td>
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<td></td>
<td>e. Increase diversification and reshape the firm’s competitive scope</td>
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<td></td>
<td>f. Learn and develop new capabilities</td>
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### Increase Market Power

This section describes the primary reason that firms engage in acquisition strategies and three types of acquisitions used to increase market power and pursue a market leadership position. The importance of understanding the political and legal segments of the general environment to anticipate regulatory review and financial market scrutiny is also noted.

<table>
<thead>
<tr>
<th>See slide 6.</th>
<th>2. Describe some of the sources of market power.</th>
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<tbody>
<tr>
<td>See slide 7. See Additional Notes Below. See slide 8.</td>
<td>a. Size of the firm</td>
</tr>
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<td>See slide 9. See slide 10.</td>
<td>b. Resources and capabilities to compete in the market</td>
</tr>
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<td></td>
<td>c. Share of the market</td>
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<tr>
<td>3. Describe three types of acquisitions used to increase market power.</td>
<td>a. Horizontal Acquisitions</td>
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<tr>
<td></td>
<td>i. Acquisition of a company competing in the same industry</td>
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<td></td>
<td>ii. Increase market power by exploiting cost-based and revenue-based synergies</td>
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<td>iii. Character similarities between the firms lead to smoother integration and higher performance</td>
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<td>b. Vertical Acquisitions</td>
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<tr>
<td></td>
<td>i. Acquisition of a supplier or distributor of one or more products</td>
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<td></td>
<td>ii. Increase market power by controlling more of the value chain</td>
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<td></td>
<td>c. Related Acquisitions</td>
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<tr>
<td></td>
<td>i. Acquisition of a firm in a highly related industry</td>
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<td></td>
<td>ii. Increase market power by leveraging core competencies to gain a competitive advantage</td>
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Additional Discussion Notes for Reasons for Making Acquisitions - These notes include additional materials that discuss market power and illustrate the concept with an example of Office Depot. Then horizontal acquisition and vertical acquisition strategies are described, with examples that demonstrate the concept.

Market Power: The Staple-Office Depot Proposed Merger
- Rationalize the market, gaining strength to fend off discount national chains invading space (Wal-Mart, Target, and Kmart in office supplies and Best Buy and Circuit City in electronics)
- Merger would have given Staples-Office Depot a tremendous advantage over its closest rival, Office Max, even if it was forced to sell off 63 stores to Office Max
- Merger would help Staples-Office Depot to lower costs to better compete with larger rivals Wal-Mart, Kmart, etc.

Anecdotal Evidence
According to Office Depot’s own ads, file folders cost $1.95 in Orlando, Florida, where it competes with Staples and Office Max, and $4.17 in Leesburg, Florida, some 50 miles away, where it is the only office supply superstore (Source: FTC judgment). The Federal Trade Commission was concerned that the merge would allow the combined firm, which would have approximately 1,000 superstores, to control prices for the sale of office supplies in more than 40 markets throughout the United States.

For some people, office supplies are a subject that inspires much passion. The CEO of Office Depot told Reuters that he’s using bodyguards because of threats, apparently from his employees. A few of these employees, at least, seem to buy their executives’ argument that the merger will probably lead to price cuts because it will definitely lead to job cuts. Other believers include investors who have bid up the stock prices of both firms.

Punch Line
On March 10, 1997, The Federal Trade Commission rejected the proposed merger of Staples and Office Depot. The Commission feared the $4.9 billion merger would hurt competition in the growing market for office supplies. Staples and Office Depot are two of the three largest office supply superstores in the country.

Acquisitions
Regardless of size, Horizontal Acquisitions occur when the acquirer and acquired companies compete in the same industry. Examples include McDonald’s acquisition of Boston Market, Daimler-Benz’s acquisition of Chrysler, Coors’ acquisition of Bass Brewers, and Amgen’s acquisition of Immunex.

A Vertical Acquisition refers to a firm acquiring a supplier or distributor of one or more of its goods or services. This kind of acquisition leads to additional controls over parts of the value chain such as Walt Disney Company’s acquisition of Fox Family Worldwide.

Since entering international markets is extremely difficult, acquisitions strategies are commonly used to overcome such barriers. The importance
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<table>
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<th>of entering and competing successfully in international markets is the fact that the five emerging markets of China, India, Brazil, Mexico, and Indonesia are among the 12 largest economies in the world, with a combined purchasing power that is one-half that of the G7 industrial nations of the United States, Japan, Britain, France, Germany, Canada, and Italy.</th>
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<tr>
<td><strong>Overcome Entry Barriers</strong> - This section discusses the use of acquisitions to gain immediate market access in industries with high barriers to market entry. The use of acquisitions to quickly enter international markets is described, along with the acquisition trends in several foreign regions. (See slides 11-12.)</td>
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<td><strong>Reduce Costs and Risks Associated with New Product Development</strong> - This section discusses the use of acquisitions to seek more predictable returns than might result from internal product development. The use of this strategy in high-technology industries and the risks of bidding wars and neglecting internal innovation are also noted. (See slides 13-14 and Additional Notes Below.)</td>
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<td><strong>Increase Speed to Market</strong> - This section highlights the use of acquisitions for rapid market entry critical to successful competition in the highly uncertain and complex global environment faced by firms today. (See slide 15 and Additional Notes Below.)</td>
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<tr>
<td><strong>Additional Discussion Notes for Reasons for Making Acquisitions</strong> - These notes include additional materials that discuss the cost of new product development and increased speed to market, providing two examples (activity in the pharmaceutical industry and an e-learning company) to illustrate the concepts. Additionally, the concept of synergy is demonstrated by an example of the HP-Compaq merger.</td>
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<tr>
<td><strong>Cost of New Product Development and Increased Speed to Market</strong> - Acquisition activity is extensive throughout the pharmaceutical industry, where firms use acquisitions to enter markets quickly to overcome product-development costs and to increase the predictability of returns on investments. Interestingly, Merck &amp; Co. tends not to acquire new drugs but to develop them internally, a strategy that has worked in the last 20 years. It became the world’s largest pharmaceutical firm. However, now Merck has experienced problems and it trails Pfizer and GlaxoSmithKline in the industry. Merck may be unable to return to its number one ranking unless it acquires a successful pharmaceutical firm.</td>
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<td></td>
<td>Acquisitions often represent the fastest means to enter international markets and help firms overcome the liabilities associated with such strategic moves.</td>
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<tr>
<td><strong>Cost of New Produce Development and Increased Speed to Market:</strong></td>
<td></td>
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</table>
### SkillSoft and SmartForce

SkillSoft and SmartForce created an e-learning outfit company. The global economic slowdown forced them to rationalize their operations and conclude that combining forces would lead to better product development, better client relations, and sustained competitive advantage.

### The Facts
- A global e-Learning leader
- Combined strength of two leaders: SkillSoft and SmartForce
- Content development team on four continents
- Over 4.5+ million registered online learners
- Content in 15 languages
- Over 18 years’ experience in learning
- 44 industry certifications offered
- Annual investment in R&D of $50+ million
- Around the world in 65 countries
- More than 2,500 enterprise-level customers
- Largest library of more than 300,000 learning objects

### Platform for Development
- Combination of SmartForce’s content with SkillPort, SkillSoft’s learning platform, to include support for SmartForce
- Integration of SkillSoft content with the MySmartForce learning platform
- Develop links to Books 24x7 Referenceware
- Engineer SmartForce’s e3 courses

### Results of Merger
- Gain competitive advantage
- Drive business transformation
- Launch products faster
- Improve customer loyalty
- Increase productivity
- Reduce costs
- Retain employees
- Ramp new hires faster
- Increase job satisfaction
- Eliminate knowledge gaps
- Educate extended enterprise
- Train globally, 24/7

### Synergy: The HP-Compaq Merger
- Extended broader product lines for combined firm and rationalize market standings.
- Melded the product-service model of the two firms, and brought scale vis-à-vis competitors like IBM, EDS, etc. as shown in these product categories:
    - HP market share: 11.4%
    - Compaq market share: 3.0% → Combined 14.4% → stronger position against market leader Sun Microsystems
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w/47.1% share
    ▪ HP market share: 30.3%
    ▪ Compaq market share: 4.0% → Combined 34.3% →
      stronger position against market leader Sun Microsystems
      w/23.5% share
  o PCs: U.S.-only (2001)
    ▪ HP market share: 9.4% (w/-21.3 growth rate)
    ▪ Compaq market share: 4.0% (w/-18.8 growth rate) →
      Combined 13.4% → stronger position against market leader
      DELL w/24% share (and 9.8% growth rate)
  o Laptops and Notebooks (2000)
    ▪ HP market share: 4.5% (w/129.2 growth rate)
    ▪ Compaq market share: 11.6% (w/10.4 growth rate) →
      Combined 16.1% → stronger position against market leader
      IBM w/13.3% share
    • Rationalized combined operations to squeeze cost structure
      (i.e., economies of scale argument)

Anecdotal Evidence

Michael Capellas, chairperson and CEO of Compaq, said that his company’s merger with Hewlett-Packard could receive a financial boost as the combined company thins the ranks of its component suppliers and uses size to increase its competitiveness. With higher volumes on its side, the merged companies will trim the number of suppliers they use for components such as memory chips and monitors, creating a significant reduction in costs. Industry analysts have questioned whether the merge would help HP compete more successfully against Dell Computer Corp. and IBM. Becoming large enough to compete against IBM was a reason cited by HP executives, but the new company is still far from its goal. It will more likely succeed at giving HP the bulk to better dictate its own terms in working with suppliers and partners such as Microsoft Corp., Oracle Corp. and Intel Corp. Previously, if HP did not do what Microsoft wanted, Microsoft could go to Compaq. Strategic suppliers could leverage the two companies against each other. With the merger, they won’t be able to.

Source: Stacy Cowley. With deal closed, countdown to new HP begins. Merger plans are well organized, but some products and employees will become history, analysts say. IDG News Service, May 6, 2002. (http://www.computerworld.com/hardwaretopics/hardware/story/0,10801,70882,00.html)

Increase Diversification and Reshape the Firm’s Competitive Scope - This section discusses the use of acquisitions to quickly and easily change a firm’s portfolio of businesses, establish new lines of products in markets where the firm lacks experience, alter the scope of its activities, and create strategic flexibility. It emphasizes that acquisitions are often used in reaction to reduced profitability in a competitive environment of intense rivalry or to reduce overdependence on a single product/market. The increase in probable success that parallels the degree of an acquisition’s relatedness is also noted. (See slides 16-17.)
### Learn and Develop New Capabilities
- This section presents the use of acquisitions to gain capabilities that the firm does not possess, broaden their knowledge base, and reduce inertia. The value of acquiring related and complementary capabilities is also noted. (See slide 18.)

### Problems in Achieving Acquisition Success
- This section introduces a discussion of risks associated with acquisition strategies and provides some shocking numbers that highlight how frequently acquisitions fail.

#### Table: Reasons for and Problems with Acquisitions

<p>| | |</p>
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<tbody>
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<td>See Figure 9.1: Reasons for and Problems with Acquisitions (slide 19).</td>
<td>See Additional Notes Below.</td>
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</tbody>
</table>

4. What are some common reasons that acquisition strategies fail?
   - a. Integration difficulties and an inability to achieve synergy
   - b. Inadequate evaluation of target
   - c. Large or extraordinary debt
   - d. Too much diversification
   - e. Managers too focused on acquisitions
   - f. Firms become too large

#### Additional Discussion Notes for Problems with Acquisitions
- These notes include additional materials that discuss problems in achieving acquisition success and includes the HP-Compaq merger case to demonstrate implementation of a merger/acquisition.

### Problems in Achieving Acquisition Success
Research suggests that about 20% of all mergers and acquisitions (M&A) are successful, 60% produce disappointing results, and the last 20% are clear failures. Successful acquisitions demand a well-conceived strategy, avoiding paying too high a premium, and an effective integration process. As shown in Figure 8.1 in the text, several problems may prevent successful acquisitions. Integration is complex and involves a large number of activities. For instance, Intel acquired (DEC) Digital Equipment Corporation’s semiconductors division. Successful integration was crucial. On the day Intel began to merge the acquired division into its operations, hundreds of employees working in dozens of different countries needed to complete 6,000 deliverables.

### Merger & Acquisition Implementation: HP-Compaq Merger
Managing M&A implementation is challenging and often times beyond the scope of a firm’s core competence. Research and history show that M&A is not value creating, rather it generally results in value-destroying. So why do firms do it? And what separates the great integrators from the rest?

#### HP-Compaq Merger
- **Integration Difficulties:** Two very distinct cultures without a shared history. Compaq coming off a badly integrated merger with Digital.
- **Inadequate Evaluation of Target:** Did HP realize the erosion of Compaq’s market position in key product domains vis-à-vis
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<table>
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<th>competitors like Dell, Gateway, Sun Microsystems, etc.?</th>
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<tbody>
<tr>
<td><strong>Debt:</strong> No evidence of threat to date (may just ignore)</td>
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<tr>
<td><strong>Too Large of Firm:</strong> Does HP have any history absorbing a merger partner of this size?</td>
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<tr>
<td><strong>Managers Overly Focused on Acquisition(s):</strong> A proxy fight is not the best way to kick off a merger deal.</td>
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<td><strong>Too Much Diversification:</strong> Low margin product lines may need to be jettisoned?</td>
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<tr>
<td><strong>Inability to Achieve Synergy:</strong> Too early to tell, but melding the culture will go a long way towards achieving synergy</td>
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**Anecdotal Evidence**

“HP and Compaq claim to have dedicated some 1-million working hours to integration planning, which represents a thoroughness that is likely to pay off in the most well-organized transition plan in IT merger history,” according to Paul McGuckin, an analyst at Stamford, CN-based Gartner Inc.

**Ask**

Could that 1-million working hours be dedicated to better R&D, cost-saving measures, customer service, etc.?

**Ask**

If you were a strategic planner for IBM how would you react to the HP-Compaq merger?

**Ask**

What lessons did HP-Compaq learn from previous mergers, and why will this time be any different?

Source: Stacy Cowley. With deal closed, countdown to new HP begins. Merger plans are well organized, but some products and employees will become history, analysts say. IDG News Service, May 6, 2002. (http://www.computerworld.com/hardware/topics/hardware/story/0,10801,70882,00.html)

**Integration Difficulties and an Inability to Achieve Synergy** - This section describes integration as the single most important determinant of shareholder value creation in mergers and acquisitions—the primary phase to achieve potential synergies.

See slide 20.

<table>
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<tr>
<td>5. <strong>Describe the complexity and challenge in the successful integration of two businesses.</strong></td>
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<tr>
<td>6. <strong>Describe the concept of private synergy.</strong></td>
</tr>
<tr>
<td>a. Integration involves a large number of activities.</td>
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<td>b. Two disparate corporate cultures must be melded.</td>
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<td>c. Effective working relationships must be built.</td>
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<td>d. Different financial and control systems must be linked.</td>
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<td>e. The status of the acquired firms employees and executives must be determined.</td>
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<tr>
<td>f. Turnover of key personnel must be minimized to retain crucial knowledge.</td>
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<td>g. Acquired capabilities must be merged into internal processes and procedures.</td>
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<table>
<thead>
<tr>
<th>See slides 22-23.</th>
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<tbody>
<tr>
<td>a. Occurs when the combination and integration of acquiring and previously acquired firms’ assets yield capabilities and core competencies that could not be developed by combining and integrating the assets with any other company.</td>
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<td>b. Possible when the two firms’ assets are complementary in unique ways.</td>
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<td>c. Yields a competitive advantage that is difficult to understand or imitate.</td>
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<tr>
<td>7. Describe transaction costs and their impact on acquisition success.</td>
</tr>
<tr>
<td>a. Transaction costs are direct and indirect expenses incurred when firms use acquisition strategies to create synergy.</td>
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<tr>
<td>i. Direct costs include legal fees and charges from investment bankers who complete due diligence for the acquiring firm.</td>
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<td>ii. Indirect costs include managerial time to evaluate target firms and then to complete negotiations as well as the loss of key managers after an acquisition.</td>
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<td>iii. Additional costs include the actual time and resources used for integration processes.</td>
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<td>b. These costs must be added to the purchase price of an acquisition to adequately evaluate the potential value of an acquisition.</td>
</tr>
<tr>
<td>c. Firms tend to underestimate transaction costs, which has a negative impact on anticipated revenue projections and expected cost-based synergies.</td>
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</table>

Inadequate Evaluation of Target - This section describes the process of due diligence (through which a firm evaluates an acquisition target), the diverse items that are examined, who performs the due diligence process, and the value of the process. (See slides 24-25.)

Large or Extraordinary Debt - This section discusses the negative effects that high debt can have on a firm and junk bonds as a financing option used in risky acquisitions. (See slide 26 and Additional Notes Below.)

Additional Discussion Notes for Problems with Acquisitions - These notes include additional materials that discuss large or extraordinary debt and junk bonds as they impact the success of an acquisition strategy.

Large or Extraordinary Debt

Junk Bonds are a financing option through which risky acquisitions are financed with money (debt) that provides a large potential return to
lenders (bondholders). Because junk bonds are unsecured obligations, interest rates for these high-risk debt instruments sometimes reached between 18-20% during the 1980s. Junk bonds are now used less frequently to finance acquisitions, yet some firms still take on significant debt to acquire companies. For example, Disney increased its total debt by $5.3 billion to $15 billion to acquire Fox Family Worldwide. This action caused Moody’s Investors Service to downgrade Disney’s debt condition. Disney is now a potential takeover target because of its poor performance. Analysts also question the amount of debt taken on by International Paper to finance several acquisitions. The firm built its debt to $15.5 billion, equal to approximately 50% of its capital and 400% of its annual cash flow.

In general, firms using related diversification strategies outperform those employing unrelated diversification strategies, yet conglomerates based on unrelated diversification strategy can also be successful. For example, Virgin Group, with interests ranging from cosmetics to trains, is successful, operating over 200 companies worldwide and employing over 25,000 people.

**Too Much Diversification** - This section discusses the eventual decline in performance that occurs when a firm becomes overdiversified and the pattern of acquisition-divestiture that is common for conglomerates. (See slide 27.)

**Managers Too Focused on Acquisitions** - This section highlights the substantial amount of time and energy required by managers to enhance firm value through acquisition strategies.

| See slide 28. | 8. What activities do managers undertake when executing an acquisition strategy? |
| See slide 29. | a. Searching for viable acquisition candidates |
| See Additional Notes Below. | b. Completing effective due-diligence processes |

9. How does overseeing the activities required for making acquisitions negatively affect firm performance?
   a. Managerial attention can be diverted from other matters necessary for long-term competitive success (such as identifying other activities, interacting with important external stakeholders, or fixing fundamental internal problems).
   b. A short-term perspective and greater risk aversion can result for target firm’s managers.
### Additional Discussion Notes for Problems with Acquisitions

These notes include additional materials that discuss managers that are overly focused on acquisitions and the impact it has on firm performance.

#### Managers Overly Focused on Acquisitions

Acquisition strategies with which managers become involved include (1) searching for acquisition candidates, (2) completing due-diligence, (3) negotiations, and (4) managing the post-acquisition integration. For example, Case Corporation acquired New Holland to create CNH Global with annual sales of almost $11 billion, resulting in the second highest market share in the agricultural and construction equipment industry. However, as markets were rapidly changing and customers were defecting, CNH’s annual revenues in 2000 declined by $2.5 billion. Clearly, executives should avoid focusing on an acquisition strategy at the expense of the firm’s long-term value creating ability.

### Firms Become Too Large

This section explains that, at some level, the additional costs and the need for bureaucratic controls to manage larger operations begin to exceed the benefits of the economies of scale and additional market power created by a firm’s size. The diminished flexibility and more rigid, standardized behavior of managers that results from formalized controls is also noted.

See slides 30-31.

#### Key Terms

- **Bureaucratic Controls**: formalized supervisory and behavioral rules and policies designed to ensure that decisions and actions across different units of a firm are consistent.

### Effective Acquisitions

This section describes proven patterns of actions and attributes known to improve the probability of acquisition success.

See Table 9.1: Attributes and Results of Successful Acquisitions (slide 32).

10. Describe the factors that impact acquisition success and how they create positive strategic results.
   - a. Complementary assets - create synergy.
   - b. Friendly acquisition - facilitates integration.
   - c. Effective due diligence - finds good fit for good value.
   - d. Financial slack - finances the purchase.
   - e. Low or moderate debt level - keeps debt costs down.
   - f. Emphasis on innovation - offsets the tendency to substitute acquisitions for innovation.
   - g. Flexibility and adaptability - contribute to faster and more effective integration and responsiveness to the need for change.
Restructuring - This section describes the restructuring strategy often used to redefine a firm’s set of businesses, to address environmental changes (opportunities or threats), or to correct a failed merger or acquisition implementation. Three restructuring strategies are then introduced.

<table>
<thead>
<tr>
<th>See slide 33.</th>
<th>Key Terms</th>
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<td></td>
<td>- Restructuring - strategy through which a firm changes its set of businesses or financial structure.</td>
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</table>

11. What are three restructuring strategies?

- Downsizing
- Downscoping
- Leveraged Buyouts

Additional Discussion Notes for Restructuring - These notes include additional materials that cover the concept of restructuring, outlining and discussing each of the three types.

Restructuring

Restructuring is a strategy through which a firm changes its set of businesses or financial structure. Famous restructurings to correct for acquisition failures were (1) AT&T’s $7.4 billion purchase of NCR and subsequent spin-off of the company in a deal valued at $3.4 billion; (2) Novell’s purchase of WordPerfect for $1.4 billion and its sale to Corel for $124 million; and (3) Quaker Oats acquisition of Snapple Beverage Company for $1.7 billion, only to sell it three years later for $300 million.

Downsizing

Research shows that 85% of Fortune 1000 firms have used downsizing as a restructuring strategy. Moreover, Fortune 500 firms laid off more than one million employees, or 4% of their collective workforce, in 2001 and into the beginning of 2002. For example, to increase its operating profits by $9 billion over the next few years, Ford announced a major downsizing and restructuring plan in 2002. Ford will lay off 35,000 employees worldwide, closing five manufacturing plants and cutting production at the remaining plants by an average of 16%. Because four of the five plants scheduled for closure are in the United States and the fifth is in Canada, North American operations will be hit particularly hard. Ford executives felt forced to take this action because of poor financial performance and a loss of market share to competitors.

Downscoping

Downscoping refers to divestiture, spin-off, or some other means of eliminating businesses that are unrelated to a firm’s core businesses. For example, poor performance has forced AT&T into two restructurings in the last ten years. AT&T completed a divestiture by spinning off Lucent Technologies and NCR. When AT&T’s long distance business began to lose market share, CEO Michael Armstrong diversified by acquiring cable companies at a high a price. He then provided high-speed Internet access and local telephone service over the cable-television network, but
the poor performance in the core business continued. Thereafter a
downscoping restructuring was announced, but results in 2002 were not
erprising. Pro forma revenues were expected to decline almost 13%
compared to the previous year.

**Leveraged Buyouts**

A *leveraged buyout* (LBO) is a restructuring strategy whereby a party
buys all of a firm’s assets in order to take the firm private. Once the
transaction is completed, the company’s stock is no longer traded pub-
licly. Usually, significant amounts of debt are incurred to finance the
buyout. Hence the term “leveraged” buyout. Three types of LBOs exist:
management buyouts (MBOs); employee buyouts (EBOs); and whole-
firm buyouts, in which one company or partnership purchases an entire
company instead of a part of it. Research has shown that management
buyouts can also lead to greater entrepreneurial activity and growth.

**Downsizing** - This section describes downsizing as a proactive restructuring strategy, most often
used to improve profitability through cost reductions and more efficient operations.

See slide 35.

**Key Terms**

- **Downsizing** - strategy that involves a reduction in the number of
  a firm’s employees (and sometimes in the number of operating
  units) that may or may not change the composition of
  businesses in the company’s portfolio.

**Downscoping** - This section describes downscoping as a restructuring strategy used by firms to
strategically refocus their core businesses.

See slide 36.

**Key Terms**

- **Downscoping** - strategy of eliminating businesses that are
  unrelated to a firm’s core businesses through divestiture, spin-
  off, or some other means.

**Leveraged Buyouts** - This section describes leveraged buyouts as a restructuring strategy
commonly used to correct managerial mistakes or to serve managerial interests. High debt,
significant risks, related downscoping, and managerial incentives are also discussed as they relate
to LBOs.

See slide 37.

**Key Terms**

- **Leveraged Buyouts (LBOs)** - restructuring strategy whereby a
  party buys all of a firm’s assets in order to take the firm private
  (or no longer trade the firm’s shares publicly).
12. What are three categories of LBOs?
   a. Management buyouts
   b. Employee buyouts
   c. Whole-firm buyouts

13. Discuss the short-term and long-term outcomes of the three types of restructuring strategies.
   a. Refer to Figure 9.2 to compare each of the restructuring strategies.
   b. Short-term outcomes that vary by strategy include:
      i. Reduced labor costs
      ii. Reduced debt costs
      iii. Emphasis on strategic controls
      iv. High debt costs
   c. Long-term outcomes that vary by strategy include:
      i. Loss of human capital
      ii. Lower performance
      iii. Higher performance
      iv. Higher risk

Ethical Questions - Recognizing the need for firms to effectively interact with stakeholders during the strategic management process, all strategic management topics have an ethical dimension. A list of ethical questions appears after the Summary section of each chapter in the textbook. The topic of ethics is best covered throughout the course to emphasize its prevalence and importance. We recommend posing at least one of these questions during your class time to stimulate discussion of ethical issues relevant to the chapter material that you are covering (See slides 40-44).