Opening story: The merger of TPG Telecom with Vodafone Australia (VHA)

- On 18 August 2018 , the Australian third largest telecom company, TPG Telcom, and the Australian fourth largest Telecom company, Vodafone Australia, announced that they are going to merge two telecom companies into one new entity
- The proposed merged entity will become a much larger Australian third largest telecom company, only trailing after Telstra and Optus Telecom, and a major player in both mobile and Fixed line (NBN) markets.

The major players in the Australian telecom industry and their market share

	Telstra	Optus	Vodafone	TPG
Enterprise value (A$bn)	51	58.5	7.5	7.5
Mobile market share (%)	41	29	19	1
Fixed line market share (%) (NBN)	51	17	n/a	22

Why merge? - The strategic rationale

- The proposed merged group will be a stronger challenger to Telstra and Optus
- Highly complementary owned network infrastructure
- Complementary products and distribution channels
- Significant synergy potential: Merger is expected to achieve significant synergies due to cost reduction in duplicated activities, economy of scale, cross-selling, and network leverage.

The proposed merger was blocked by the ACCC

- The proposed TPG-Vodafone merger was blocked by Australian Competition & Consumer Commission (ACCC) on 9 May 2019
  - The ACCC considers that the proposed merger will reduce competition and contestability in the telecommunication industry
- TPG-VHA filed legal action over ACCC proposed merger decision on May 2019
  - The merger would combine their complementary assets and create an entity that can compete more aggressively in this highly competitive market than either VHA or TPG could on their own.. and will bring very real benefits to consumers.

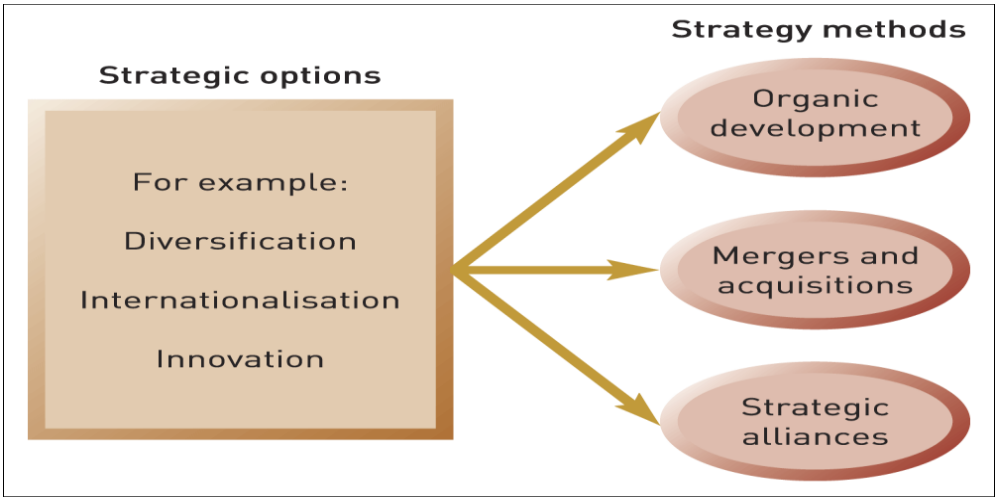
The Federal Court over-ruled the ACCC's decision on Feb 2020

- The proposed merger was given the green light after the Federal Court over-ruled the Australian Competition and Consumer Commission's decision to block the merger on 13 Feb 2020
- The proposed merger will proceed and completed by 31 August 2020

Learning Objectives

- After you have studied this module, you should be able to:
  - Understand the potential role of *organic development ('do it yourself').*
  - Identify key issues in the successful management of *mergers and acquisitions, and strategic alliances.*
  - Identify key issues in the successful management of *strategic alliances*
  - Determine the *appropriate choices* between organic development, mergers and acquisitions and strategic alliances, and compare *key success factors* in mergers, acquisitions and alliances.

Strategy methods



Organic (Internal) development

LO1

- ***Organic development*** is where a strategy is pursued by building on and developing an organisation's own capabilities. This is essentially the 'do it yourself' method.

Advantages of organic development

- *Knowledge and learning* can be enhanced.
  - e.g., Qantas set up its low-fare division: Jetstar
- *Spreading investment over time* – easier to finance.
  - e.g., Teltra to roll out its 5G network
- *No availability constraints* – no need to search for suitable partners or acquisition targets.
  - e.g., Tesla built its Gigafactory in Shanghai
- *Strategic independence* – less need to make compromises or accept strategic constraints.
- *Culture management* – allowing new activities to be created in the existing environment, thus reducing the risk of culture clash.

Mergers and acquisitions

LO2

- ***Types of M&A***
  - ***A merger*** is the combination of two previously separate organisations in order to form a new company.
    - e.g., TPG and Vodafone to be merged in 2020
  - ***An acquisition*** involves one firm taking over the ownership ('equity') of another company through share purchase
    - E.g., Mengniu, a Chinese dairy producers, acquired Bellamy, an Australian baby formula milk powder assembler in 2019 for $1.5 bn
    - Sometimes acquisitions can be **hostile**, where target management refuses the acquirer's offer.

Motives for M&A (1/4)

- Three types of motives for M&A
  - Strategic
  - Financial
  - Managerial

Three motives of M&A: Strategic motives (2/4)

- Strategic motives involve improving the competitive advantage of the organisation and can be categorised in three ways:
  - *Extension – of scope in terms of geography, products or markets. (e.g., Facebook's acquisition of WhatApp)*
  - *Consolidation – increasing scale, efficiency and market power. (e.g., TPG and VHA)*
  - *Capabilities – enhancing technological know-how (or other competences)*

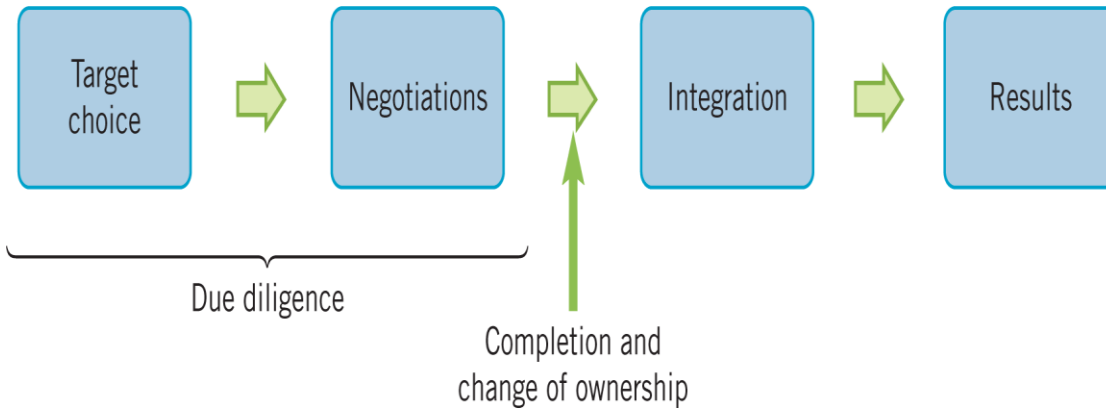
Financial motives for M&A (3/4)

- Financial motives concern the optimal use of financial resources.
- There are three main financial motives:
  - *Financial efficiency* – a company with a strong balance sheet (cash rich) may acquire/merge with a company with a weak balance sheet (high debt).
  - *Tax efficiency* – reducing the combined tax burden.
  - *Asset stripping or unbundling – selling off bits of the acquired company to maximise asset values.*

Managerial motives for M&A (4/4)

- M&A may serve managerial self-interest for two reasons:
  - *Personal ambition –* financial incentives tied to short-term growth or share-price targets; boosting personal reputations; giving friends and colleagues greater responsibility or better jobs.
  - *Bandwagon effects –* managers may be branded as conservative if they don't follow a M&A trend; shareholder pressure to merge or acquire; the company may itself become a takeover target.

The M&A Process



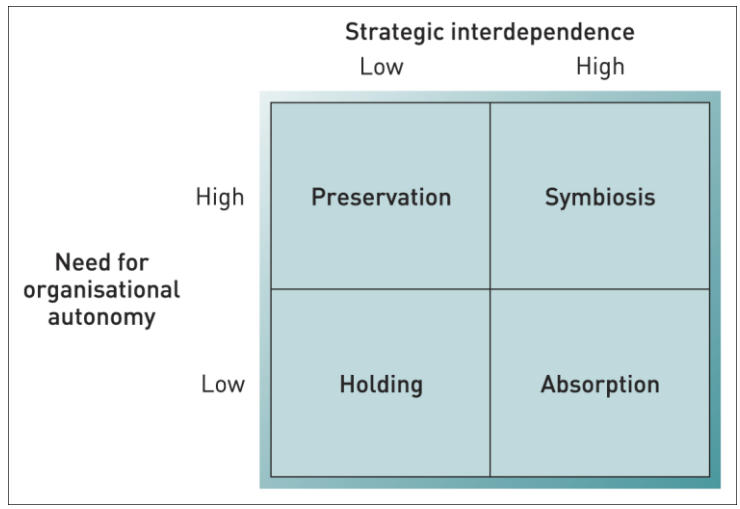
M&A processes

- Step 1: Target choice in M&A
  - Two main criteria apply:
    - *Strategic fit – does* the target firm strengthen or complement the acquiring firm's strategy? (N.B. It is easy to over-estimate this potential synergy).
    - *Organisational fit –* is there a match between the management practices, cultural practices and staff characteristics of the target and the acquiring firm?

M&A processes (2/3)

- Step 2: Negotiations in M&A
  - Getting the offer price correct is essential:
    - Offer the target too little, and the bid will be unsuccessful.
    - Pay too much and the acquisition is unlikely to make a profit net of the original acquisition price. *('the winner's curse').*
    - Acquirers do not simply pay the current market value of the target, but also pay a *'premium for control'.*
  - Financial and non-financial evaluation
    - *NPV, DCF, Internal return rate, payback period*
    - risk, uncertainty, shareholder structure, etc.

M&A processes (3/3): Step 3: Integration in M&A



Integration in M&A

- **Approaches to integration**:
  - *Absorption* – strong strategic interdependence and little need for organisational autonomy. Rapid adjustment of the acquired company's strategies, culture and systems.
    - e.g., Wesfarmers' acquisition of Coles
  - *Preservation* – little interdependence and a high need for autonomy. Old strategies, cultures and systems can be continued much as before.
    - e.g., China's Minmetal Corporation's acquisition of most assets of OZ Minerals

Approaches to integration (cont'd)

- *Symbiosis* – strong strategic interdependence, but a high need for autonomy. Both the acquired firm and acquiring firm learn and adopt the best qualities from each other.
  - e.g., BHP and Billiton
- *Holding* – a residual category – with little to gain by integration. The acquisition will be 'held' temporarily before being sold on, so the acquired unit is left largely alone.
  - TPG acquisition of Myer

Strategic alliances

LO3

- ***A strategic alliance*** is where two or more organisations share resources and activities to pursue a strategy.
  - M&A bring together companies through **complete changes** in ownership.
  - Strategic appliances involve collaboration with **only partial changes** in ownership or **no ownership** change at all as the parent companies remain distinct.

Types of strategic alliance (1/3)

- There are two main kinds of ownership in strategic alliances:
  - ***Equity alliances*** involve the creation of a new entity that is owned separately by the partners involved, such as JV (two partners) or consortium (more than two partners).
  - ***Non-equity alliances*** are typically looser alliances, without ownership and often based **on contracts** e.g. *franchising*, *licensing* or *subcontracting.*

Types of strategic alliance (2/3)

- Equity alliances

- The most common form of equity alliance is the ***joint venture***, where two organisations remain independent but set up a new organisation jointly owned by the parents.
- **A *consortium alliance*** involves several partners setting up a venture together.

Types of strategic alliance (3/3)

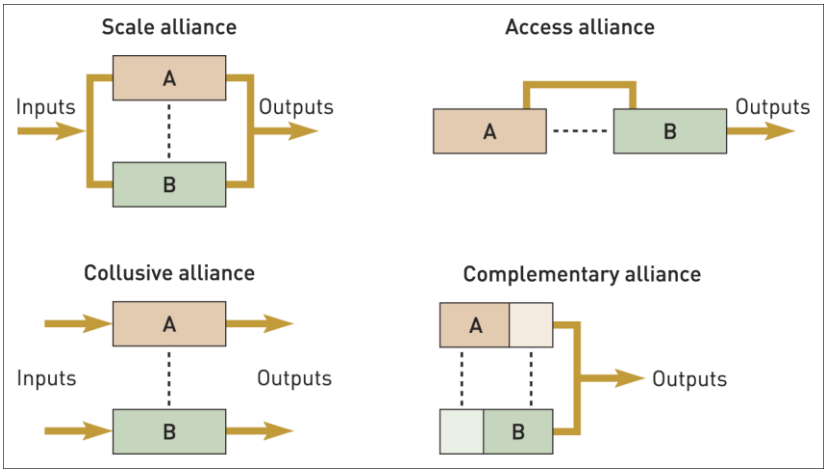
- Non-equity alliances

- Non-equity alliances are often based on contracts.
- Three common forms of non-equity alliance:
  - *Franchising.*
  - *Licensing.*
  - *Long-term subcontracting.*

Motives for alliances

- ***Scale alliances*** – lower costs, more bargaining power and sharing risks. (e.g., oil & gas industry)
- ***Access alliances*** – partners provide needed capabilities (e.g. distribution outlets or licenses to brands) (e.g., JVs in China)
- ***Complementary alliances –*** bringing together complementary strengths to offset the other partner's weaknesses. (e.g., JVs in China: technology and distribution)
- ***Collusive alliances –*** to increase market power. Usually kept secret to evade competition regulations.

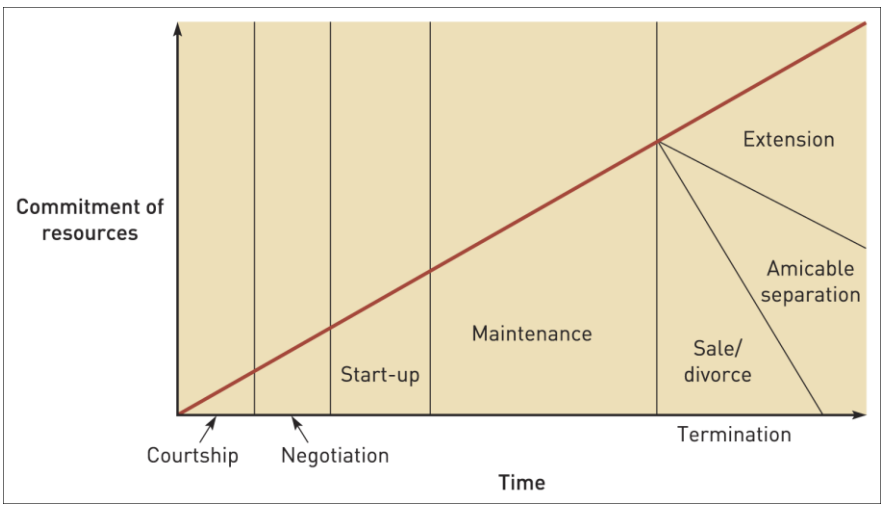
Strategic alliance motives (cont'd)



Strategic alliance processes

- Two themes are vital to success in alliances:
  - ***Co-evolution*** – the need for flexibility and change as the environment, competition and strategies of the partners evolve.
  - ***Trust*** – partners need to behave in a trustworthy fashion throughout the alliance.

Alliance evolution



Comparing acquisitions, alliances and organic development – the buy, ally or DIY matrix

LO4

	Buy	Ally	DIY
High urgency	Fast	Fast	Slow
High uncertainty	Failures potentially saleable	Share losses and retain buy option	Failures likely unsaleable
Soft capabilities important	Culture and valuation problems	Culture and control problems	Cultural consistency
Highly modular capabilities	Problem of buying whole company	Ally just with relevant partner unit	Develop in new venture unit

Comparing acquisitions, alliances and organic development (1/2)

- Four key factors in choosing the method of strategy development :
  - ***Urgency*** – internal development may be too slow, alliances can accelerate the process but acquisitions are quickest.
  - ***Uncertainty*** – an alliance means risks are shared and thus a failure does not mean the full cost is lost.
    - Where there is high uncertainty in terms of market and tech involved, alliance could be the best option.

Comparing acquisitions, alliances and organic development (2/2)

- ***Type of capabilities (to be sough-after)***
  - Acquisitions work best with 'hard' resources (e.g. production units) rather than 'soft' resources (e.g. people).
  - Culture clash is the big issue.
- ***Modularity of capabilities***
  - If the needed capabilities can be clearly separated from the rest of the organisation, an alliance may be best.

Key success factors

	M&A	Alliances
Similar	Strategic fit Organisational fit Valuation	Strategic fit Organisational fit Valuation
Different	Hostile option Integration Divesture	Courtship Co-evolution Termination

Module summary (1/2)

- There are three broad *methods for pursuing strategy*: mergers and acquisitions, strategic alliances and organic development.
- *Organic development* can be either continuous or radical. Radical organic development is termed corporate entrepreneurship.
- *Acquisitions* can be hostile or friendly. Motives for mergers and acquisitions can be strategic, financial or managerial.

Module Summary (2/2)

- *The acquisition process* includes target choice, valuation and integration.
- *Strategic alliances* can be equity or non-equity. Key motives for strategic alliances include scale, access, complementarity and collusion.
- *The strategic alliance process* relies on co-evolution and trust.
- The *choice* between acquisition, alliance and organic methods is influenced by four key factors: urgency, uncertainty, type of capabilities and modularity of capabilities.

Next Week

- Read Chapter 12 Evaluating strategies
- Working on the Tasks 4 & 6 of Assignment 2: Strategy evaluation and measurement