Mergers and Acquisitions

Abstract

The report intends to reflect on the issues associated with the merger and acquisition. The major factors responsible for merger and acquisition have been pointed out in this report. In addition, the benefits of obtained through merger and acquisition activities have also been discussed in the report. It has been identified that acquiring economics of scale, elimination of the inefficiencies are some of the major advantages procured by the businesses through merger and acquisition.

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Introduction

Merger and acquisition are general terms used to refer to the consolidation of companies. A merger takes place between two companies to form a new company. An acquisition is the purchase or takeover of one company by another in which no new company is formed. Merger and acquisition both form part of corporate strategy, dealing with buying, selling, dividing and combining of different entities or companies, that can help an organisation to grow rapidly in the same sector or a new sector, without the need of a joint venture, subsidiary or a child entity (Ahlstrom and Bruton, 2009). This report provides details about the acquisition of Wimm-Bill-Dann by PepsiCo and benefits received from the same.

Reasons for merger and acquisition: Generally, companies carry out the process of merger and acquisition to create greater value for the company. Few strategic and financial motives for merger and acquisitions can include the following:

- Synergy
- Growth
- Tax advantages
- Increases liquidity of owners
- Gaining access to funds
- Cross selling
- Diversification
- Acquiring required and new managerial skills, assets and technology,

Analysis

The company that is popular for successful merger and acquisition is PepsiCo (Puttick and Esch, 2008). It is an American multinational food and beverage organisation. The headquarters of PepsiCo is in Purchase, New York, United States (DePamphilis, 2011). PepsiCo was formed in 1965, when it merged with Fritolays. Thereafter, PepsiCo has expanded from its only product

Pepsi to a wider range of food and beverages through various acquisitions and mergers. On the basis of net revenue, PepsiCo is the second largest food and beverage brand in the world. Within North America, based on the revenue, PepsiCo is considered the largest food and beverage business. February 2011 saw the company making its largest international acquisition, with the purchase of two-third stake in Wimm-Bill-Dann Foods, a Russian organisation that produces milk, yogurt, other dairy products and fruit juices. In October 2011, when PepsiCo acquired the remaining 23% stake of Wimm-Bill-Dann Foods, it became the largest food and beverage company in Russia (European Commission, 2005).

i) Economies of Scale: There are multiple benefits from mergers and acquisitions. It creates cost efficiency through economies of scale. At the same time, it can enhance the revenue through gain in market share, generate tax gains and reduce cost of capital. When a company acquires another firm, they benefit jointly, in terms of efficiency. Merger and acquisitions can create economies of scale and in turn, cost efficiency (Gray, 2009). When two firms merge or a firm acquires another, it leads to creation of a new and bigger company. The production is done on a larger scale (Madura, 2012). Therefore, the output produced increases and creates strong chances of reducing the cost of production per unit of output. Mergers and acquisitions more often result in economies of scale, thereby promoting cost efficiency (Dong, Hirschleifer, Richardson and Teoh, 2006). As the parent firm amalgamates with another firm, scale of operations increases as a whole. So, huge amount of production through acquisition always lowers cost of the company and betters their economies of scale. When PepsiCo acquired Wimm-Bill-Dann Foods, it added to the revenue of the company (Ayres and Nalebuff, 2003). The huge production of food and beverages brought down their cost of production and improved their economies of scale. It is the best example of economies of scale that took place from an acquisition (Weaver and Weston, 2008).

ii) Economies of vertical integration: This describes a style of growth and management control, whereby vertically integrated companies are united through a common owner. Here, each member of the supply chain produces a different product. The products sometimes combine to satisfy a need, which is common (Klenke, 2008). Vertical merger helps to reduce cost and increase efficiency. When one company acquires another, then the product line of the parent company gets enhanced (Madura, 2012). If the acquiring company have almost same type of product line, as the acquired one, then the former reduces cost in form of using same machinery, mode of transportation and labour among others (Ehrhardt and Brigham, 2010). Therefore, when PepsiCo acquired Wimm-Bill-Dann Foods, their product line diversified. PepsiCo started selling not only beverages, but also dairy products. Most importantly, it resulted in economies of vertical integration, as the acquiring company produced variants of food and sold them in new as well as existing markets by employing same machinery, technology, modes of transport and labour (Ayres and Nalebuff, 2003). Thus, these reduced costs incurred by PepsiCo after the acquisition and also, helped to augment revenue of the company (Weygandt, Kimmel and Kieso, 2009).

iii) Combining complementary resources: Theory of corporate control is very relevant here. When two firms merge, it creates greater power and provides more resources of the firm, than the competitors. It helps to surpass the performance of competitors (Nariño-Gil and Hartmann, 2006). During merger or acquisition of two companies, one company is acquired by another, which increases resources available to the company (Page-Beth, 2006). The acquired company must have an existing market base, customers and workers. In the same way, the acquiring company also have a market base, customer, suppliers and labourers (Hitt, Ireland and Hoskisson, 2010). Therefore, when mergers and acquisitions take place, the parent company gets hold of new as well as existing markets; and enters these markets in order to reach out to customers of the acquired firm (Sogorb-Mira, 2005). By following this way, the company expands and gains more recognition and market share. It has the chance to access new markets, customers and suppliers (Broadbent and Laughlin, 2013). The sales as well as revenue get inflated. In case of PepsiCo, after the acquisition of Wimm-Bill-Dann, it gained in the form of combined complimentary resources and increased revenue (DePamphilis, 2011). Wimm-Bill-Dann was one of the two largest Russian dairy goods company (Shah, 2007). It had a huge market in Russia. PepsiCo, therefore, got an opening in the Russian market as well. The resources of both PepsiCo and the company acquired by it increased the sales and revenue of the former (Kumar and Sharma, 2006). It helped PepsiCo to be more cost efficient, reach new markets, customers and enhance the already healthy sales rate.

iv) Elimination of inefficiencies: As per the theory of efficiency, mergers and acquisitions will occur only when they can create enough synergy and prove to be profitable and beneficial for both the parties (Garcı´a-Teruel and Martı´nez-Solano, 2007). It is expectations of gains that results in friendly merger, proposed and accepted by two companies, entities or parties. If it is not positive to both the parties, acquisition and merger can never take place. The inefficiencies of a non-performing company get reduced, after it is acquired by a more powerful company (Ayres and Nalebuff, 2003). The acquired company gets a boost in the form of efficient management from the team of the acquiring company (Weygandt, Kimmel and Kieso, 2009). Hence, whenever a company cannot perform well and the team of management becomes inefficient or leaves the company, acquisitions help to revive the same and bring the desired efficiency back. It always eliminates inabilities and renders a company more powerful (DePamphilis, 2011). In the case of PepsiCo, the company acquired Wimm-Bill-Dann, which was already popular in Russia. It was efficient enough to be so successful. Nonetheless, PepsiCo gained from the acquisition of this company, even though it only added to the efficiency that PepsiCo had, in terms of the business and team of management (Tomal, 2010).

v) Increased power in the market: Several literature states that the market power theory is a valid one for explaining mergers and acquisitions. Acquisition helps to increase the market base and power of the company (Klenke, 2008). It helps the parent company with the advantage of new markets, customer base, suppliers and production techniques of the acquired company (Steffan, 2008). All these have huge contribution in increasing power of the parent company. PepsiCo had gained more power in the market, after acquisition of Wimm-Bill-Dann (Ayres, and Nalebuff, 2003). It was the largest acquisition of PepsiCo and the most profitable one.

vi) Speed of growth: The theory of empire-building states that managers are explicitly motivated to increase growth of their revenue and assets (Weitzel and McCarthy, 2009). The speed of growth generally moves up, after a merger or acquisition. The company, that acquires the other, gets to sell a diversified line of products, more market openings, new customers, efficient suppliers and access to new technologies (Smith, 2002). These provide a much needed base for further growth of the company. PepsiCo gained further strength, following a number of mergers and acquisitions, along with the required momentum to grow faster. It provided the company with synergy in the market, where it faced competitors like, Coca-Cola. Thus, mergers and acquisitions contribute in many ways for increasing speed of growth of concerned companies.

vii) Financial Benefits: Theory of managerial discretion states that managers refuse to merge or acquire not because of over-confidence; but, due to being over burdened with debt (Armstrong, 2006). To get advantage of liquidity and less burden of debt, managers decide to merge with firms with more liquidity (Page-Beth, 2006). Hence, if the acquired company has low debt burden and high liquidity, it always benefits the parent company. Other benefits are mainly better product line of the company and lower cost of production. These are few points, which highlight the financial benefit from mergers and acquisitions (Ahlstrom and Bruton, 2009). PepsiCo, therefore, benefitted throughout by acquiring Wimm-Bill-Dann.

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