Chapter 9a: Corporate Strategy: Strategic Alliances and Mergers & Acquisitions

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Chapter Case 9:
Disney: Building Billion Dollar Franchises
Disney: Building Billion Dollar Franchises

- Disney: creates billion-dollar franchises
  - Frozen, Toy Story, Star Wars

- Why this is risky:
  - Many obtained through acquisition (e.g., Star Wars)
    - Only so many can be acquired.
  - This may reduce originality/increase boredom.
    - Recipe for success becomes predictable.
  - Half of Disney profits come from TV networks
    - This industry is being disrupted.
Disney is the world’s largest media company
- $50 billion in annual revenues
- Has grown through high-profile acquisitions
  - Pixar (2006), Marvel (2009), and Lucasfilm (2012)

How Pixar became an acquisition
- Originally produced graphic display systems, animated movies demonstrated systems capabilities
- Steve Jobs bought it for $5 million
- Rolled out one blockbuster after another
  - Toy Story, A Bug’s Life, Monsters, Inc.,
  - Finding Nemo, The Incredibles, and Cars
Disney: Building Billion Dollar Franchises

• Disney acquisitions
  – Pixar for $7.4 billion in 2006
  – Marvel for $4 billion in 2009
  – Lucasfilm for $4 billion in 2012

• Franchise model
  – Get a big movie hit, then derive spin-offs
    • TV shows, theme park rides, video games, toys, clothing

• Disney’s hit Frozen
  – Most successful animated movie ever
  – Grossed $1.5 billion since 2013
Given the build-borrow-buy framework (Exhibit 9.1), do you think Disney should pursue alternatives to acquisitions? Why or why not?
Why do you think Disney was so successful with the Pixar and Marvel acquisitions, while other media interactions such as Sony’s acquisition of Columbia Pictures or New Corp’s acquisition of MySpace were much less successful?
How Firms Achieve Growth
The Build-Borrow-or-Buy Framework

• Conceptual model

• Aids in determining whether firms should pursue:
  – Internal development (build)
  – Enter a contract /strategic alliance (borrow)
  – Acquire new resources, capabilities, and competencies (buy)
Guiding Corporate Strategy: The Build-Borrow-or-Buy Framework

Exhibit 9.1
The Main Issues in the Build-Borrow-or-Buy Framework

- **Relevancy**
  - How relevant are existing internal resources to solving the resource gap – do they pass the VRIO(N) test (chapter 4)?

- **Tradability**
  - How tradable are the targeted resources that may be available externally? -- e.g., biotech firm licenses to pharmaceutical company.

- **Closeness**
  - How close do you need to be to your external resource partner?

- **Integration**
  - How well can you integrate the targeted firm should you determine you need to acquire the resource partner?
Strategic Alliances
What are Strategic Alliances?

• A voluntary arrangement between firms

• Involves the sharing of:
  – Knowledge
  – Resources
  – Capabilities with the intent of developing:
    • Processes
    • Products
    • Services
Explosive growth in R&D alliances since the 1980s
How Do Strategic Alliances Assist Firms?

• They may complement a firm’s value chain.
• They may focus on similar value chain activities.
• They may enable:
  – Firms to achieve their goals faster
  – Lower cost
  – Fewer legal repercussions than M&As

• An alliance qualifies as strategic if:
  – It has the potential to affect a firm’s (sustainable) competitive advantage
Why Do Firms Enter Strategic Alliances?

• Strengthen competitive position
• Enter new markets
• Hedge against uncertainty
• Access critical complementary assets
• Learn new capabilities
Strengthen Competitive Position

• Strategic alliances can help:
  – Change industry structure to the firm’s favor
  – Influence industry standards

• Example: IBM & Apple
  – Entered a strategic alliance
  – Desired to strengthen their competitive position
    • In mobile computing and business productivity apps
  – Put competitive pressure on rivals such as Microsoft
IBM and Apple: From Big Brother to Alliance Partner

• IBM was a fierce competitor with Apple (1980s).
• Then Apple dominated
• 2014: Apple and IBM form a strategic partnership
  – Apple sold mostly to consumers, IBM to businesses.

  – IBM and Apple -- long-time rivals – have formed a strategic alliance to created simple-to-use business productivity apps and to sell iPhones and iPads to corporate clients. Discuss how each company might benefit through this alliance.
Enter New Markets

• Product markets
• Service markets
• Geographical markets
  – Governments such as Saudi Arabia or China may require that foreign firms have a local joint venture partner before doing business in their countries.
Hedge Against Uncertainty

- Real-options perspective:
  - Approach to strategic decision making
  - Breaks down a larger investment decision into a set of smaller decisions
  - Staged sequentially over time
  - Allows firms to obtain information in stages

Roche invests in Genentech in 1990 and buys it in 2009
Access Critical Complementary Assets

- Complementary assets such as:
  - Marketing
  - Manufacturing
  - After-sale service
  - From upstream innovation to downstream commercialization
Learn New Capabilities

• Firms are motivated by the desire to learn from their partners (e.g., GM & Toyota (NUMMI) – formed in 1984)

• Co-opetition
  – Cooperation by competitors to achieve a strategic objective

• Learning can take place at different rates.
  – The firm that learns more quickly is motivated to exit the alliance/reduce knowledge sharing.
  – Referred to as “learning races”
Governing Strategic Alliances

• **Non-Equity Alliances**
  – Partnerships based on contracts
  – Examples: supply agreements, distribution agreements, and licensing agreements
    • e.g., Genentech licensing an insulin drug to Eli Lilly

• **Equity Alliances**
  – One partner takes partial ownership in the other.

• **(Equity) Joint Ventures (JVs)**
  – A stand-alone organization created and jointly owned by two or more parent companies
### Key Characteristics of Different Alliance Types

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<tr>
<th>Alliance Type</th>
<th>Governance Mechanism</th>
<th>Frequency</th>
<th>Type of Knowledge Exchanged</th>
<th>Pros</th>
<th>Cons</th>
<th>Examples</th>
</tr>
</thead>
</table>
| Non-equity (supply, licensing, and distribution agreements) | Contract               | Most common     | Explicit                   | • Flexible  
• Fast  
• Easy to initiate and terminate                      | • Weak tie  
• Lack of trust and commitment                     | • Genentech–Lilly (exclusive) licensing agreement for Humulin  
• Microsoft–IBM (nonexclusive) licensing agreement for MS-DOS |
| Equity (purchase of an equity stake or corporate venture capital, CVC investment) | Equity investment      | Less common than non-equity alliances, but more common than joint ventures | Explicit; exchange of tacit knowledge possible | • Stronger tie  
• Trust and commitment can emerge  
• Window into new technology (option value) | • Less flexible  
• Slower  
• Can entail significant investments               | • Renault–Nissan alliance based on cross equity holdings, with Renault owning 44.4% in Nissan; and Nissan owning 15% in Renault  
• Roche’s equity investment in Genentech (prior to full integration) |
| Joint venture (JV)                                 | Creation of new entity by two or more parent firms | Least common | Both tacit and explicit knowledge exchanged | • Strongest tie  
• Trust and commitment likely to emerge  
• May be required by institutional setting | • Can entail long negotiations and significant investments  
• Long-term solution  
• JV managers have double reporting lines (2 bosses) | • Hulu, owned by NBC, Fox, and Disney-ABC  
• Dow Corning, owned by Dow Chemical and Corning |
Alliance Management Capability

The three phases of Alliance Management:
1. Partner selection and alliance formation
2. Alliance design and governance
3. Post-formation alliance management
How to Make Alliances Work

Exhibit 9.4
Mergers & Acquisitions
Mergers & Acquisitions

• Merger:
  – The joining of two independent companies
  – Forms a combined entity

• Acquisition:
  – Purchase of one company by another
  – Can be friendly or unfriendly.
  – Hostile takeover:
    • The target company does not wish to be acquired.
      – e.g., Vodafone’s acquisition of Germany-based Mannesmann
Value Destruction in M&A: The Worst Offenders

Shareholder value destroyed based on up to 3 years post-merger analysis compared to overall stock market
Mergers & Acquisitions

• Many M&As actually destroy shareholder value!

➢ When there is value, it often goes to the acquiree
  ❖ Acquirers tend to pay a premium

• Why are M&As still desired?
Why Do Firms Merge?

• Horizontal integration:
  – The process of merging with competitors
    – (e.g., Nation buys Ticketmaster in 2010)
  – Leads to industry consolidation

• Three main benefits:
  1. Reduction in competitive intensity
     • Changes underlying industry structure in favor of surviving firms
  2. Lower costs
     • Economies of scale
  3. Increased differentiation
     • Fills product gaps
### Sources of Value Creation and Costs in Horizontal Integration

<table>
<thead>
<tr>
<th>Corporate Strategy</th>
<th>Sources of Value Creation (V)</th>
<th>Sources of Costs (C)</th>
</tr>
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| Horizontal integration through M&A | • Reduction in competitive intensity  
• Lower costs  
• Increased differentiation | • Integration failure  
• Reduced flexibility  
• Increased potential for legal repercussions |

Exhibit 9.5
Food Fight: Kraft Hostile Takeover of Cadbury

• Kraft acquired Cadbury in UK
  ➢ Hostile takeover in 2012, $20 billion deal
  ➢ Cadbury has strong position in emerging economies
    ❖ Perfected distribution system in countries like India
  ➢ Kraft faces strong rivalries worldwide, including China

• The acquisition forces Hershey and other competitors to rethink their strategies
  ➢ Hershey 90% revenues from U.S. market
Food Fight: Kraft Hostile Takeover of Cadbury

- In 2015, Kraft merged with Heinz.
  - It is now the 5th largest food competitor in the world

- What are the advantages of the (hostile takeover) Cadbury acquisition on the new $37 billion Kraft Heinz merged firm?
Why Do Firms Acquire Other Firms?

• To access new markets and distribution channels
  – To overcome entry barriers (e.g., Kraft acquiring Cadbury)
• To access new capabilities or competencies
• To preempt rivals
  – Example: Facebook acquired:
    • Instagram (photo & video sharing)
    • WhatsApp (text messaging service)
    • Oculus (virtual reality headsets)
  – Example: Google acquired:
    • YouTube (video sharing)
    • Motorola (mobile technology)
    • Waze (interactive mobile maps)
Mergers & Acquisitions

• Desire to Overcome Competitive Disadvantage
  ➢ Adidas acquired Reebok in 2006
    ❖ Benefits from economies of scale and scope
    ❖ Compete more effectively with #1 Nike

• Superior Acquisition and Integration Capability

• Some firms have superior M&A abilities
  ➢ They identify, acquire, and integrate target companies
    ❖ Example: Cisco Systems
      • Sought complementary assets
      • Bought over 130 firms since 2001, including large firms: Linksys, Scientific Atlanta, & WebEx
Mergers & Acquisitions

• Principal–agent problems
  ➢ Managers have incentives to diversify through M&As to receive more prestige, power, and pay.
    ❖ Not for shareholder value appreciation, but rather to build a large empire; this is a principal—agent problem

• Managerial hubris
  ➢ Self-delusion
    ❖ Beliefs in their own capability despite evidence to the contrary
    ❖ Example: Quaker Oats purchase of Snapple at an unwarranted high price of $1.7 billion, which turned out to be $1.4 billion “down the drain.”