TOPIC FOUR

BUSINESS COMBINATIONS

A business combination occurs when two or more separate businesses are joined together through either common ownership or one firm taking control over the other. This working together can be achieved either through acquiring assets, liabilities, or a significant portion of the acquiree's voting stock (shares that allow a company to vote on key issues) or where two or more firms come together to form one big firm. Some examples of business combinations are: Airtel and Warid, DFCU and Crane Bank, Airtel Uganda and K2 Telecom, Ken freight and Spedag Uganda, etc.

Business combinations take place through mergers or takeovers (acquisitions).

(i) **Mergers** are agreed amalgamations between two firms to form a new identity or new entity.

(ii) **Takeovers** are ones where one firm seeks (acquirer) control over another. The acquiring company's management usually takes control of the taken-over firm sometimes leading to changes in management team of the acquired company. Takeovers can be 'friendly' or 'hostile'

4.1 Reasons for Business Combinations

(i) Need for Growth: Business combination can help an organization to expand its the market share, product lines and the geographical expansion quickly rather than organic growth or internal growth. The growth will help in Increasing Shareholder Value and will Improve the value of the overall business for shareholders (Deloitte, Mergers & Acquisitions: A strategic approach, 2024). A good example of such growth is Airtel combined with Warid such that it can grow. Deloitte merged with Haskins & Sells to form Deloitte Haskins & Sells in 1972 then with Touché Ross in 1989 to form Deloitte & Touché.

(ii) Need to create Synergy: Combining resources and expertise can lead to increased efficiency, cost savings, and improved profitability (PwC, Strategy& Deals: Mergers & Acquisitions, 2024). The merger of Coopers &Lybrand and Price Waterhouse in 1998. **Note**. Synergy refers to the interaction or cooperation of two or more organizations, substances, or other agents to produce a combined effect greater than the sum of their separate effects

(iii) To gain access to limited Resources: Since most valuable resources are scarce, some organizations go for combinations to get access to such important resources for example updated technology, talent pool, customer base, strategic location etc.

(iv) Diversification to spread risks: Reduce risk by entering new markets or industries (EY, Building a resilient business through M&A, 2024). This is possible when organizations dealing in different products come together such that it can offer a number of products to the market so that if one is affected by the business environment, the other can work for the organization (Picfare and Nytil)

(v) To Eliminate Wasteful Competition: Merging with competitors to increase market share. Sometimes organizations face wasteful or cut throat competition which needs to be dealt away with, this will drive those that are much negatively affected to go for combinations to reduce the competition. Businesses are forced to combine to eliminate intense competition to avoid over supply and collapse of prices. E.g. OPEC (Oil Producing and Export Countries).

(vi) To enable businesses, survive in hard times of the Business cycles. Business cycles refer to the ups and downs a business goes through in its entire life. It Consist of booms (peak prosperity) and depressions (low economic activity. Many organizations opt for business combinations to avoid closure**.** During a period of depression, economic activity drops to low levels thus business units think of combinations in an attempt to regulate supply and raise the level of prices**.**

(vii) Need to enjoy Economies of Scale. Organisations want to enjoy advantages of large-scale production. Since business combinations enable organisations to grow bigger, they run for business combinations such that they can grow big, produce on large scale production. The advantages of large-scale production lead, to lower unit costs e.g. raising finances or low costs of raw – materials (bulk purchase), R&D

(viii) Influence of tariffs. Tariffs are taxes that are charged by one country on the goods imported from another country. Also known as Mother of Trusts Used to protect infant industries in a country from foreign competition. This makes a number of firms come up in the infant industry encouraged by the protection which result into a lot of competition within the industry creating a desire to co- operate and hence combinations

(ix) To gain respect for big businesses. People generally admire and have more confidence in big businesses. Thus, business owners take pride in owning or being associated with large sized organizations**.** Try to bring several firms under one roof to become big. Companies like General Motors, Toyota, Toshiba, Ford, General Motors, MacDonald's, IBM, Coca –cola have worldwide respect because they are big.

4.2 Types of Business Combinations

(i) Horizontal/parallel/unit trade combination

This is a combination of firms at the same stage of production or the same plane of trade. Thus, it is a result of units in the same trade, or producing the same product joining together with a common end in view. E.g. Total and Caltex, Warid Telecom and Airtel Uganda, Nile Bank and Barclays Bank. It occurs for organizations which have been previously competitors due to being in the same industry & at the same stage of production or the same plane of trade. This is because of the need to monopolize the market, reduce competition, advantages of large-scale production, pooling resources together for research. However, this may lead to overproduction.

(ii) Vertical combination/sequence/process

This is the integration of firms at different but successive stages of production in the same industry. This can be forward or backward integration.

(a) Backward vertical integration is where a firm at a higher stage of production absorbs a firm at a lower stage of production. In other words, it's when a company combines with another that supplies the products or services needed for production.ie Kinyara Sugar Works Vs Sugarcane growers.

(b) Forward vertical integration is where a manufacturer combines with his retailers so that he can control the market.

It also refers to where a firm at a lower stage of production merges with a firm at a higher stage of production to control the market i.e. Sugarcane growers merging with sugar factories.

Advantages of vertical combinations

(i) Increased Control: The company gains greater control over the entire supply chain, from raw materials to finished goods. This allows them to ensure quality, optimize production flow, and potentially reduce reliance on external suppliers.

(ii) Cost Reductions: By eliminating the need for external suppliers or distributors, the company can potentially reduce overhead costs and negotiate better pricing on bulk purchases of raw materials.

(iii) Improved Efficiency: Vertical integration can streamline operations by eliminating handoffs between different companies. This can lead to faster production times, reduced inventory levels, and improved responsiveness to customer demands.

(iv) Enhanced Innovation: By controlling different stages of the production process, a company can foster closer collaboration between departments and potentially accelerate innovation in product design, manufacturing techniques, and distribution channels.

(v) Improved Quality Control: With greater control over the entire process, the company can ensure consistent quality standards throughout the supply chain, potentially leading to a more reliable and higher-quality final product.

(vi) Competitive Advantage: Vertical integration can give a company a competitive edge by allowing it to react faster to market changes, control pricing more effectively, and potentially differentiate itself from competitors with a more streamlined and efficient operation.

(iii) Lateral/Allied Combinations

These are combinations of firms that manufacture different kinds of products but these products are related. These can be convergent or divergent. I.e. Printing press unit vs. units dealing in machinery, papers and ink.

Lateral combination is divided into:

(a) Convergent Lateral integration

This is where various small firms join the bigger firms to supply raw materials. E.g. Printing Press unit combining with units engaged in manufacturing of paper, ink, typesetting equipment, printing chemicals, and machinery to get supply of raw materials.

(b) Divergent Lateral integration

This is where the big firm joins the smaller firms to supply them with raw materials i.e. the product of the firm becomes the raw material of many other firms. It happens where several products can be manufactured from the material produced by the firm. E.g. a steel mill that supplies steel to many allied firms for the manufacture of a variety of products like tubing, wire, nails, machinery, locomotives, etc. For example, Steel and Tube Uganda has established a mill that provides raw–materials for nails mesh, roofing, and others.

(iv) Diagonal/Service combination

This takes place when a unit that is producing essential auxiliary goods and services combines with the main line of production for example a school and a bookshop or a Transport company operating many buses combining with a mechanical workshop that repairs buses.

(v) Circular/mixed combination

Here the firms that integrate are producing different commodities. These sell their commodities under one central agency. E.g. combination of sugar and steel industries. Advantages of diversification accrue to such a combination/diversification of risk.

Other types of Business Combinations

(i) Federations: These are independent companies collaborate for a specific purpose but maintain separate ownership and control i.e. Uganda Wrestling Association (UWF), Federation of Motorsports Clubs of Uganda (FMU), Federation of Uganda Football Associations (FUFA), etc.

(ii) Pools: These are similar to federations, but with a stronger central governing body that coordinates activities.

(iii) Cartels: These are arrangements or agreements between competitors to control prices, production, or markets, which are often illegal due to antitrust concerns (Department of Justice Antitrust Division, Antitrust Laws, 2024).

(iv) Partial Consolidations: Acquire a portion of another company's assets or equity, but not full control (Corporate Finance Institute, Partial Acquisition, 2024).

4.3 Advantages of Business Combinations

(i) Diversification of business: Since business combination can bring together organizations producing different products or just related products, it makes a business produce arrange of products which helps in the spreading of the risk in the business hence survival in periods when some products are not working well and others are profitable

(ii) Reduce /prevent unnecessary competition: Some businesses compete to the extent of selling products below the unit cost which makes them unprofitable. Business combination helps to reduce such terrible competition hence making the business more profitable

(iii) Advantages of large-scale production: Economies of scale refers to advantages that a business enjoys due to large scale production. As organizations combine, they are able to produce on large scale which helps the business to incurs relatively lower cost of production per unit. This lower cost of production can emanate from being able to bargain as a large producer and many others

(iv) Control of the market: This comes from the reduction in the number of competitors in the market. This gives control or power to the few or one remaining in the market as a result of combination. This also makes the

organization enjoy the advantages of being a monopoly in the market. The control can be on the prices, bargaining power and others

(v) **Increased efficiency and develop managerial abilities:** Since one of the reasons for business combinations is to share the scarce valuable resources, it makes the firm which had no access to such resources become more efficient than before and those who had no better management can learn from the efficient management of the other firm

(vi) **Stability during recessions:** A recession refers to a prolonged downturn of economic activities. During this period, almost all the macro-economic factors are unfavorable for the business. So, business combination can help firms suffering the recession to survive when they come together as one business.

(vii) **Production of quality products:** This is possible due to better management and the limited quality resources gained from business combination. This can also be as a result of one firm being able to control the quality of raw materials got from the other firm which it combined with. An example is when sugar factories combine with the out growers and they are given seeds, fertilizers, pesticides and many others to ensure the quality of sugarcanes to be used in sugar production

(viii) **Increased share value:** Business combinations allow businesses to grow externally which enables the organization at hand to also grow the share value of its owners. This can come from the increased customer base, efficiency and increased profitability.

(ix) **Increased public confidence:** Usually, big firms are more trusted and respected compared to the small ones. Since business combinations allow firms to grow, they will be more respected by stakeholders like government, financial institutions, employees, suppliers and many others.

4.4 Disadvantages of Business combinations

(i) **Concentration of economic power in few hands:** Economic power refers to a firm, individual or state having access to wealth, valuable natural resources, monopoly powers or superior technology. This makes such organization having a lot of control and authority in the country hence negative control

(ii) **Small firms may be driven out of the market:** Since those firms that combine grow and expand, they can easily out compete the small ones due. This makes most small companies to close hence loss of revenue by the country and loss of advantages of competition

(iii) **Encourages monopoly and its disadvantages:** Production of poor-quality products & overcharging of customers. Since business combinations reduce

the number of players in the market, competitions and its good side is not enjoyed in the country.

(iv) Its along and costly process i.e. expensive: The process of business combination is very expensive since it involves a lot of steps and requires a lot of expertise who require to be paid. There are also Integration challenges and costs associated with merging cultures, systems, and processes.

(v) The process can fail, not all the time the combination is successful: In case it fails, a lot of money is lost and a lot of confusion.

(vi) Employee uncertainty: employees become unproductive at the time when things are not yet clear because they do not know whether they will lose their jobs or not. It also results into unemployment

REFERENCE MATERIALS

Gomes-Casseres, B. (2015). *Remix strategy: The three laws of business combinations*. Harvard Business Press.