University of Bath

PHD

Strategic trading in business units: a study of strategic aspects of restructuring, and the exchange, sale, disposal and acquisition of business units by firms in the United Kingdom

Davis, Michael Gary

Award date:
1986

Awarding institution:
University of Bath

Link to publication

Alternative formats
If you require this document in an alternative format, please contact:
openaccess@bath.ac.uk

Copyright of this thesis rests with the author. Access is subject to the above licence, if given. If no licence is specified above, original content in this thesis is licensed under the terms of the Creative Commons Attribution-NonCommercial-NoDerivs 4.0 International (CC BY-NC-ND 4.0) Licence (https://creativecommons.org/licenses/by-nc-nd/4.0/). Any third-party copyright material present remains the property of its respective owner(s) and is licensed under its existing terms.

Take down policy
If you consider content within Bath's Research Portal to be in breach of UK law, please contact: openaccess@bath.ac.uk with the details. Your claim will be investigated and, where appropriate, the item will be removed from public view as soon as possible.

Download date: 19. May. 2025

STRATEGIC TRADING IN BUSINESS UNITS: A STUDY OF STRATEGIC ASPECTS OF RESTRUCTURING, AND THE EXCHANGE, SALE, DISPOSAL AND ACQUISITION OF BUSINESS UNITS BY FIRMS IN THE UNITED KINGDOM

Appendix Volume

Submitted by Michael Gary Davis
for the degree of Ph. D.
of the University of Bath
1986

Attention is drawn to the fact that copyright of this thesis rests with its author. This copy of the thesis has been supplied on condition that anyone who consults it is understood to recognise that its copyrights rests with its author and that no quotation from the thesis and no information derived from it may be published without the prior written consent of the author.

RESTRICTIONS ON USE

Volume I of this thesis may be made available for consultation within the University Library and may be photocopied or lent to other libraries for the purposes of consultation.

The Appendix Volume of this thesis may not be consulted, photocopied or lent to other libraries without the permission of the author for five years from the date of acceptance of the thesis.

M. Gary Davis

CONTENTS OF THE APPENDIX VOLUME

PERSONAL INTERVIEWS: UNDISGUISED CASE STUDIES AND ANALYSIS A-1

APPENDIX A-1 CASE STUDY: MR. ORLANDO OLDHAM A-26

APPENDIX A-2 CASE STUDY: PROF. RAYMOND E. THOMAS A-36

APPENDIX A-3 CASE STUDY: MR. ROBERT W. HOLDER A-44

APPENDIX A-4 CASE STUDY: MR. ROBERT CARLTON-PORTER A-55

APPENDIX A-5 CASE STUDY: SIR KENNETH SELBY A-66

APPENDIX A-6 CASE STUDY: MR. TERRENCE J. ORGAN A-77

APPENDIX A-7 CASE STUDY: MR. MALCOLM A. ANSON A-87

APPENDIX A-8 UNDISGUISED SUMMARY OF RESPONSES TO PREPARED QUESTIONS A-96

APPENDIX VOLUME

PERSONAL INTERVIEWS: UNDISGUISED CASE STUDIES AND ANALYSIS

This Appendix Volume contains confidential material from the seven interviews discussed in Chapter Eleven of the thesis. Each interview, supplemented by some publicly available material, was written up as a separate case study. The real names of the people interviewed, their disguised names and the number of the respective appendix in which their interview is reported, are given in Exhibit A-1 below.

Exhibit A-1 Real and Disguised Names of People Interviewed

Appendix A-1	Mr. A. Alpha	Mr. Orlando Oldham
Appendix A-2	Prof. B. Beta	Prof. Raymond E. Thomas
Appendix A-3	Mr. G. Gamma	Mr. Robert W. Holder
Appendix A-4	Mr. D. Delta	Mr. Robert W. Carlton-Porter
Appendix A-5	Mr. T. Theta	Sir Kenneth Selby
Appendix A-6	Mr. K. Kappa	Mr. Terrence J. Organ
Appendix A-7	Mr. L. Lambda	Mr. Malcolm A. Anson

On the following pages is a detailed analysis of the interviews using the real names of those interviewed and the firms involved. It was written before Chapter Eleven, and although much of it is discussed in that chapter, it goes somewhat further because it was possible to be more specific. This volume also includes a summary of responses to the questions prepared for the interviews (Appendix A-8). This is substantially the same as Exhibit 11-3 in Chapter Eleven, but real names were used here. References follow each case.

Analysis of responses to prepared questions

Four of the executives interviewed had been involved in divestments recently. All of them had taken part in acquisitions. It was established that all seven were knowledgeable about issues concerning firms on both sides of these transactions.

One wonders whether divestors know how ahead of time they will use the proceeds of a divestment. Both Prof. Thomas and Mr. Organ said that their divestments were to allow them to do something else, although in the former case it was not known what it would be. It was also clear from the discussions on pressures to divest that all respondents could see advantages in divesting in specific circumstances, but these circumstances were as varied for these seven people as in the list in Appendix 4-2.

It was stated by four respondents that there was one business in their respective firm which was more essential than the others. In firms where relatedness or affinities among businesses is a criterion for making acquisitions or for eliminating businesses, the identification of the main businesses is an important starting point. At the same time, if there is some other criterion for making acquisitions, such as pursuit of some broader strategy like diversification or growth, then the identification of a main business is less important.

There was broad agreement that divestments take much longer than acquisitions. A very rough average from their statements is about

three years for divestments (less in a successful takeover battle), and a year or less for acquisitions.

Of the three people who answered the question about comparing values of businesses as opposed to evaluating them separately, two thought comparing was easier. It appears to depend on whether one is assessing them as independent units, or their impact on the firm as a whole. Comparison has a more practical purpose in the latter case.

Six of the seven respondents gave reasons for different people putting different values on a given business. They all said that it depends on the criteria used. They mentioned a variety of criteria, including financial (ROI and price/earnings ratio), relatedness to other businesses, relatedness to strategy, optimism, and other subjective requirements. The four categories of strategic investment decisions identified by Mr. Carlton-Porter show that it is possible for a firm to acknowledge that many criteria are possible, and to build this into their planning system.

A variety of responses were given to the question of the price received for a divestment compared to its value to the divesting firm. Perhaps the best was Mr. Anson's, that the selling price always seems too low, the price you pay seems too high. This reflects the subjectivity of value. Mr. Carlton-Porter's answer was also interesting in that it reflected the dual issues of economic value received and satisfying shareholders. This is the same as Prof. Thomas's point that a firm has difficulty selling a business for less than book value if its profits are low, because of shareholder or head

office resistance.

The answers to the question about when trading businesses might be feasible were not very useful, but it is notable that in answering a later question three of the six business executives said they had participated in at least one strategic trade or a similar transaction. This indicates that trading is a realistic strategic alternative.

17 items appear in the list of 'pressures to divest' subsidiaries. All of these have close parallels in to the list of divestment motives in Appendix 4-2, although a few are interesting variants. It may be significant that two of the seven respondents indicated divestment as an alternative to having to make employees redundant in the future. One question that arises is, who would acquire a business faced with this problem? One answer is clear because in one of these cases members of the organisation saw that it was able to adapt to market forces as an independent unit, and it was bought by its employees. It was also interesting that Mr. Organ said that Cadbury Schweppes were prepared to divest strategically related businesses if this was necessary to advance the firm as a whole. (This may be what they did when they divested the UK food and drink division in 1986.) This recognises that criteria in a strategy sometimes conflict, but when this happens, one has to dominate.

The discussions of pressures to acquire were not as lengthy, but the statement by Mr. Anson that Imperial Group had been prepared to make an acquisition if there was no reason not to sheds some light on the thinking processes of managers of conglomerates, where business

relatedness is not an important criterion. Rather than needing positive reasons like relatedness, they reject unacceptable options. This is quite a different approach.

In discussions of 'portfolios' of businesses in their firms, five executives indicated that they thought of their firms as portfolios. Mr. Carlton-Porter described it in terms of both cash redistribution (portfolio concept) and risk reduction (portfolio theory). Mr. Oldham saw it as a possible way to reduce risk (portfolio theory), but thought that it would be difficult to achieve. Two indicated that they tried to leave a lot of decision making discretion to managers of subsidiaries (which is necessary if financial portfolio theory is to work), but they still retained substantial control (indicating that financial portfolio theory probably did not apply in their situations). In Imperial Group, the portfolio concept seemed to be practiced, but not explicitly, while management tried to impose constraints on subsidiaries, even if they cooperated, as indicated by Mr. Anson's comment in his speech about Howard Johnson.

It was interesting to observe that acquisition and divestment planning was done by a very small group (two or three people) in three of the four cases noted. In the fourth case the group was also small, but its size was not specified, except to the extent that only about 12 people in the firm were even aware that a divestment was being planned.

At least five of the seven respondents had been involved in acquisitions and divestments simultaneously. Three of them had

actually been involved in strategic trades, one of them twice. This indicates that strategic trading may be applicable in a large number of cases if the appropriate conditions exist and managers are prepared to consider trading as an alternative.

Further analysis of the seven cases

Although the specific subject matter varied widely from one interview to another, many additional useful observations about strategic trading can be made when they are examined collectively. The following discussion examines these issues.

Control, leadership, and personal contact with subsidiaries

An important issue in this research is the question of control. Of particular importance is the question of whether parent firms exert a significant amount of control over subsidiaries, because 'having control' is not the same as 'being in control' of subsidiaries. If they do exert control, then one of the main assumptions of financial portfolio theory is violated, drastically reducing the applicability of that theory to the management of diversified firms (See chapter Four). Note, however, that this does not disqualify the 'portfolio concept'.

Direct control was clearly important to Mr. Anson, who said that when they went 'shopping' for an acquisition (leading eventually to Howard Johnson), one of the criteria was that they wanted one large acquisition, not six smaller ones, because one is easier to 'manage'

(control) than several. This was evident in some of their other acquisition criteria, and a statement he made in his 1981 speech also made it clear that Imperial Group had told Howard Johnson's management that there were going to be changes. However, control at the strategic level seemed to be lacking in the Imperial Group, as exemplified by the case of the St. Anne's board plant, where there was a wide variance between the recommendations of the subsidiary's managers and the best interests of the parent. Direct control also seemed to be weak in the case of Imperial Group's unsuccessful venture into the crisps business.

When Mr. Carlton-Porter said that one business was divested because it was too small to be interesting to them, he implied that control was important to English China Clays, because to him ownership required time commitments by central managements, which implies control.

Mr. Organ described Cadbury Schweppes as 'a nice company' that does not give a lot of direction to its subsidiaries, to encourage them to use their own initiative. He pointed out that his sometimes caused problems because sometimes the subsidiaries looked for direction and could not find it. On the other hand, he also gave examples of subsidiaries seeking to increase their own power by becoming administrative centres or by wanting to make acquisitions in their own right, and being thwarted by top management because it would have contradicted their strategy.

Sir Kenneth, who believed that a good measure of independence

benefitted subsidiaries, said that managers of diversified firms are not willing to let go of businesses they control. They are more interested in managing than in being shareholders. This confirms the view that portfolio theory is frustrated, because subsidiaries do not operate independently.

Mr. Holder said that the threat of divestment also had a positive impact on managers in USA. Mr. Oldham had also remarked on the negative connotation of divestment from the employees' point of view. Mr. Organ said that managers of a subsidiary would be 'demoralized' if they knew their business was about to be divested.

Mr. Organ commented on the significance of the kind of chairman a firm has, and used Cadbury Schweppes to illustrate the influence he can have on the success of a firm.

The 'feel' of a business. In several interviews, executives said that they gained essential information about their subsidiaries from the 'feelings' they got, particularly when visiting a plant, rather than from formal reports. This supports the contention that intuition and judgment are important factors in decisions. Mr. Oldham said that one's 'feel' for a business was important, and that one needed to 'understand' the business. Mr. Holder said that he puts great emphasis on his own interpretation of facts. He inspects plants by himself. He said that one needs to understand the peculiarities of each business, and that many things come to mind only at the plant.

Mr. Carlton-Porter felt that it was necessary for him to 'sniff

around' in the business for him to understand it sufficiently well to make an important investment decision. Clearly he believed that there was important information that could not be conveyed by other means. He said that 'gut feel' was an important part of decision making, and that one could no longer rely only on accountants' forecasts. Personal contact was important to him, but he also said he put a lot of faith in the ability of subsidiary managers to recommend where money should be spent.

Mr. Holder's desire to be involved in decisions limits his ability to control individual businesses, and therefore may restrict the size of firm he can manage. Geographical proximity makes management easier, but is not always possible. To illustrate the importance of his own involvement, he gave two examples where miscalculations by business unit managers led to serious difficulties (mechanical tolerances of bicycle transmissions, and aircraft production learning curve.) Because of his assessments, he avoided investment in the former, and was able to turn the latter business around.

The value of a business and multiple criteria

Mr. Anson explained that Imperial Group paid a large premium on the listed share price of Howard Johnson because the proliferation of state and federal government regulators involved made it necessary to avoid a hostile takeover. Putting a value on the avoidance of problems was also expressed by Prof. Thomas, and was suggested by Mr. Carlton-Porter as a reason for divesting.

Mr. Anson said that the buying price of a business always seems to be 'too much' and the selling price 'too little'. This reflects the value added or lost due to subjective influences, and includes a measure of criticism by interested people who were not part of the decision process, for example shareholders.

Mr. Anson also indicated that profit is a very important criterion related to value (and to the amount a firm will invest in a business), but that there are other important influences as well, such as employee and community relations. He viewed this as an unintended positive side-effect of the abortive attempt to turn around the St. Anne's board plant.

It appears that one prerequisite for making successful acquisitions is the ability to deal with several criteria simultaneously, especially when the criteria oppose each other. For example, when Mr. Oldham tried to convince the chairman of Hargreaves that a proposed American acquisition was too expensive, he was accused of being against foreign investment.

On value to shareholders, Mr. Oldham said that by and large shareholders had no interest in what a firm did to increase its value. He said that public relations, and attention from the news media, affect share prices, but not the actions of management directly.

Sir Kenneth Selby said that if you have a multidivisional company, and one division is having problems, negative press reports will result in the value of the whole company being dragged down.

Furthermore, you are always bound to have one division that is having problems. The logical conclusion from this is that the shares of a multi-business firm will always be undervalued by the market! If this is true, then diversifying to minimise risk for a given rate of return might work in a private firm, but because of stock market influences on the cost of capital diversification would not be beneficial in a publicly traded firm. In other words, this tends to defeat portfolio theory if share price is the criterion, but not if book value is the criterion. Sir Kenneth wanted to put this into practice by spinning off 74% of each of six divisions of The Bath and Portland Group. He said that the shareholders would have benefitted more than from the takeover. Under Sir Kenneth's proposal, some managers of The Bath and Portland Group would have retained significant power in the six companies.

Sir Kenneth believed that Consolidated Gold Fields would probably sell off parts of The Bath and Portland Group to pay for the parts it wants to keep, and that those parts will end up costing nearly nothing.

Mr. Organ said it was necessary to invest in the Jeyes subsidiary in order to preserve its value even though (or because) it was being considered for divestment.

Estimating the value of a business. Mr. Oldham said that it was easier to compare the values of two businesses than to put a realistic money value on them. He emphasised the importance of one's 'feel' for the business. He also said that a given business would likely be

valued differently by two different firms.

Mr. Carlton-Porter said it was easier to compare the values of two businesses than to put a value on each separately, if the purpose was to assess the impact of each on the whole firm. He also pointed out that different people use different criteria. For example, English China Clays prefers return on investment, while the City uses the price/earnings ratio.

Prof. Thomas said that it is easier to put money values on two assets separately than to compare two.

On the price one received when divesting, Prof. Thomas said, 'you want to get the best', but if an asset has lost a lot of its value, you may be 'so glad to get ready cash' that it is 'better from your point of view than hanging on in the hope of a higher offer'. This is liquidity preference in practice. In a particular case mentioned by Prof. Thomas he said it was more valuable for the company involved to have £380,000 down than £60,000 per annum for N years. (Note that knowing these details implies the internal discount rate for the business.) Note that Sir Kenneth implied his preference for a high discount rate (internal rate of return) when he said that in the 1940's his company looked for investments with early cash flow. On estimating the value of a proposed acquisition, Prof. Thomas said it is a matter of 'finding out what was a realistic value'. A firm might pay quite a lot to obtain ... skills ... and ... commitment (of employees), he said.

Mr. Organ gave an example of divesting immediately to cut losses while accepting a book loss, as opposed to incurring further losses, similar to that described by Prof. Thomas.

Mr. Holder gave an example of estimating a bid: he and his managing director each made an estimate, and the actual offer was halfway between (and succeeded). In one case, strategic connection was most important, with property value as a cushion in case it failed. Wanted acquisitions that would lead to stock market listing. One needs to be experienced to evaluate a business. Prefers direct observation. Revalued assets on books are not trustworthy. Profit is important, especially beyond two years. When selling, wants to get more than the firm was worth to him. Different firms put different values on a given business.

'The Human Factor'. Mr. Oldham felt that a business is very much a living organism, and as such it was necessary to treat its members humanely. He called this 'the human factor', and felt that people would work more effectively for an organisation which treated them well. Thus he felt that divestments, or the threat of being divested, was a negative factor. He also felt that there had to be a cultural fit between the parent firm and the subsidiary.

Sir Kenneth's description of his firm's practice of helping inventive employees set up their own businesses and then buying back those that developed viable products reflects his perception of motivational factors, as well as his desire to acquire skills usable by his firm.

Portfolio concept

The portfolio concept was mentioned explicitly by Mr. Oldham, and implicitly (regarding planning corporate cash flows) by Sir Kenneth Selby. Mr. Carlton-Porter also saw an important corporate role as redistributor of cash among subsidiaries. The portfolio concept was also implied by Mr. Holder, who said it was possible for a firm to have too many good businesses.

Portfolio theory

Mr. Oldham thought that using portfolio theory to balance risks was attractive in principle, but would be difficult to carry out in practice.

Sir Kenneth felt that in a diversified firm there would always be at least one subsidiary that would be having problems, and that the performance of the others would counterbalance this in profit terms. This was satisfactory from the internal viewpoint of the firm, but as noted above, this did not eliminate problems with the stock market's evaluation of the firm's shares.

Mr. Carlton-Porter felt that it was beneficial to be in several businesses and in several countries at the same time, because it was unlikely that they would all go bad at the same time. This is sort of a portfolio approach with long time periods.

Affinity, relatedness and strategy

This section reviews points raised in discussions of the reasons for making acquisitions and divestments.

Mr. Anson said that in the last major acquisition in which he was involved, Imperial Group 'went shopping' for a suitable business. They were very open-minded about what to acquire. Rather than specifying criteria for an investment, he said they needed a 'positive reason for rejecting' a business, although relatedness was also a criterion. In their evaluation of the crisps business, it had seemed related to the cigarette using several criteria, but Mr. Anson said that it turned out to be different on at least two subtle but crucial characteristics. Mr. Anson insisted, however, that the differences between crisps and cigarettes should have been known ahead of time.

In contrast, it is interesting to note that when The Bath and Portland Group under Sir Kenneth Selby diversified from the lime business into feed and insecticides, using relatedness as a basis, there were also product differences that made them partially incompatible, although these differences were much more obvious to an outside observer than in the crisps/cigarette case. Nevertheless, The Bath and Portland Group was able to minimise the consequences of these differences and build a profitable business, until the business was abandoned because of adverse competitive forces.

Sir Kenneth's initial emphasis on diversification in the 1940's and 1950's was vertical and backward, developing stone cutting tools

and quarrying machinery, for example. But The Bath and Portland Group also diversified into products that were not related to the quarrying business but which applied some of the skills they had acquired there. This led quite far afield, to servicing Soviet submarine ports, for example.

It is clear from Prof. Thomas's description of Normalair-Garrett's approach to diversification that they pursued development of products that are technologically related to areas in which they have already been successful. They also acquired businesses that had suitable experience in areas they needed to fill out their inventory of skills, as it were, in order to develop and produce new products.

Mr. Holder felt that some businesses have 'affinities' for each other, implying that there are subjective aspects which go beyond 'rational' technological or market relatedness.

Mr. Carlton-Porter said that the china clay business is definitely his firm's core business. He also said that relatedness plays an important role in English China Clays, but he used the phrase 'related to strategy', indicating a broader approach to relatedness than the more obvious connections between products, markets and skills defined by Rumelt. This broader concept of relatedness can be seen to incorporate subjective aspects which might be excluded by a strictly 'rational' approach. He also made it clear that even related businesses had to satisfy the firm's financial criteria. The diagram in Exhibit A-2 below is the researcher's representation of when acquisitions or divestments might be seriously considered by English

China Clays.

Exhibit A-2 When acquisitions or divestments might be seriously considered by English China Clays

Is Potential R O I Above Target?		Affinity (Relatedness to Strategy): NO	Affinity (Relatedness to Strategy): YES
	YES	Divest or Do not buy	Keep or Acquire
	NO	Divest or Do not buy	Divest or Do not buy

In the case of IDF, English China Clays withdrew from the deal when the offering price dropped below the threshold of acceptable ROI. In other words, English China Clays believed they could earn more by keeping it than by investing the resources elsewhere. Thus the rate of return overrode relatedness as a strategic criterion. Note that this reflects implicit value/rate of return/cash flow criteria of the firm. It could also mean that the firm has put 'too high' a value on the asset, possibly because book value is higher than market value, although this was by no means indicated in the IDF case. This was very similar to Mr. Organ's description of the approach taken by Cadbury Schweppes. Note, for example, that Cadbury Schweppes invested in Jeyes to preserve its value, even though it was earmarked for divestment.

Mr. Carlton-Porter said that the company's diversification strategy was based on synergy, by which he seemed to mean relatedness, but he admitted that in some cases, notably leisure, that the connection was somewhat tenuous. It appears that qualitative factors are at work here, with the firm's skills in land and shipping being adapted by executives to a consumer business involving land and boating. To Mr. Carlton-Porter synergy also means filling in geographical gaps to make the firm's operations contiguous. In such cases, the acquired business would have to be integrated with existing operations in order to provide benefits attributable to synergy.

Mr. Carlton-Porter compared diversification to the branches of a tree, meaning that one acquisition can lead to another. This was also evident in some of the other interviews. This is a process that has to be carefully controlled, so it does not get out of hand and result in dilution of the firm's efforts. This control was exerted by Mr. Organ on at least two occasions. It was not as evident in the case of Imperial Group. As Mr. Carlton-Porter described it, diversification decisions in English China Clays are made more <u>in relation to his firm's strategy</u> than to any of its other businesses. (See Exhibit A-3.) This puts strategy external to and above the characteristics of the separate businesses, just as top management is hierarchically above the subsidiaries. In the language of Chapter Eight, we could say that any set of businesses that have an affinity for each other, over and above return on investment criteria, will have a higher value than those that do not.

Exhibit A-3 Relationship between strategy and value

STRATEGY
:
determines
:
AFFINITY CRITERIA
Including, for example:
Minimum acceptable ROI
Contribution to price/earnings
Technological relatedness
Market relatedness
Successful coexistence in the past
:
which determine
:
VALUE

While Mr. Holder said that there was 'absolutely no question' that some businesses are more essential to the firm than others, this did not necessarily imply that acquisitions had to be related to each other. The relatively low priority of business relatedness in his case is supported by his statement that he was not sure how this implicit ranking would affect divestments. If he had to divest one, the least related business might not be the one selected for divestment because other criteria could be more important. It was clear, however, that businesses had to be related to his strategy of building the firm to a listable size.

The destabilising effect of competition

Several comments were made which revealed some of the executives' views on competition. Mr. Anson, commenting on the desirability of acquiring a competitor, said that 'three competitors are better than four when you are negotiating with Mr. Tesco.' Mr. Organ compared Cadbury's competitive strength in Canada, where there are six major

firms of approximately equal size, and the competitive situation is unstable, to the United Kingdom, where there are three major competitors and competition is quite stable. He also noted that it was important for Cadbury's to increase control over their distribution channels in the United States to a greater extent than was necessary in the United Kingdom, where they could deal directly with retailers. Prof. Thomas had said that one firm he worked with dropped out of one business because 'It's no good being 1 1/2 percent of the market when there are a couple of guys each at 40.' Mr. Holder said that when he decided to compete directly with the thread companies he supplied, one of them exerted their strength by stopping buying his product (but eventually resumed because competitors' products were of lower quality). Sir Kenneth Selby also described the power of suppliers when he told how the chemical suppliers had squeezed them out of the farm chemicals business by raising prices. Mr. Carlton-Porter had commented that market dominance was an important criterion for English China Clays. (He also said he was aware of PIMS, but does not use it.)

In summary, this particular group of executives recognised that there were competitive advantages in being large (as measured by market share), in being one of a small number of major competitors (but not necessarily in collusion), and in having some control over sources of supply and distribution channels. All of this supports Porter's (1979) arguments.

'Forced Growth'

One other conclusion that can be drawn from these discussions is that firms which intend to make acquisitions appear to be more successful if they develop specific skills in making acquisitions. But as Mr. Organ said, preparation for acquisitions takes a long time, perhaps years, even if the specific business to be acquired is not known. Thus there is a need to include the development of acquisition skills and readiness in one's strategy. There also seems to be a particular difficulty in forcing growth upon an acquired subsidiary, thus the ability to grow appears to be a skill in itself. This may have been one of the reasons for the failure of the Imperial Group's crisps business. Normalair-Garrett acquired high levels of technological skills in order to facilitate growth and diversification, but this had to be supplemented by the parent firm's ability to integrate these skills. Mr. Oldham went further then this when he said that it is important that a firm understand the new business _before_ the acquisition is made, if the acquisition is to be a success.

Conclusions reached from the analysis of case studies

Collectively the seven interviews demonstrate the complexity of acquisition and divestment decisions, and the variety of issues that can be involved. The responses to prepared questions, despite some gaps, support many of the theoretical points discussed in Chapter Four. Briefly, some of these points are listed in Exhibit A-4.

Exhibit A-4 Theoretical points from evidence in case studies

- Divestments are made for strategic reasons, although the use of the proceeds of a divestment may not be specified in advance.

- In most firms one business is considered to be 'essential' to the character of the firm, and forms the basis for acquisitions depending on relatedness.

- Divestments take longer than acquisitions.

- When the impact on the firm as a whole is given precedence, comparing the value of two businesses is preferred to assigning values to them the value of two businesses is preferred to assigning values to them separately.

- Different values are attributed to business units because different criteria are used by different people or at different times.

- Executives would like the price they receive in a divestment to exceed its value to them, but it is not a requirement.

- Executives consider trading to be feasible, if conditions are right.

- The pressures to divest and acquire businesses were similar for this group of executives as for executives in other studies.

- The objectives of financial portfolio theory are difficult to achieve in a diversified firm (see also below)

- The objectives of the 'portfolio concept' are considered feasible.

- Three of the seven interviewees had participated in strategic trades, so strategic trading may not be as rare as one might have thought.

Much more was discussed in the interviews than is represented by the responses to the questionnaire. When this additional material was analysed, a number of tentative conclusions were reached, which are presented here in the form of rough hypotheses or concepts that can be tested by further research.

1. Top executives in multibusiness firms depend upon their 'feel' for a situation when they make decisions involving great complexity, including those involving multiple criteria and hidden criteria. Unable to know or evaluate all relevant facts, they paint a picture, filling in unknown details using intuition and judgment. The process is artistic and subjective rather than 'rational'.

2. As a consequence of dependence on this 'feel', the values top executives put on a business will vary from one executive to another, and probably will vary for the *same* executive over time, because of changing contextual or situational variables.

3. Many top executives are aware that 'feel' is an important part of their decision process, at least to the extent that they experience pressure to visit subsidiary businesses personally so they can expose themselves to sufficient stimuli to give them the 'feel' they need. This is part of 'knowing the business'.

4. Involvement in the decisions of subsidiaries can take many forms, ranging from influencing financial performance and risk taking to actual involvement in operating decisions.

5. Managers of subsidiaries tend to look for this involvement, and expect it, and they will even respond to what they believe are intended influences, even if these are imagined ('the ghost at the party').

6. This involvement tends to defeat the applicability of financial portfolio theory for making diversification decisions because it creates a correlation in behaviour among the subsidiaries that is likely to increase the covariance of financial performance.

7. The deeper into a subsidiary that top management involvement penetrates, the more serious is the danger if they lack knowledge of the business. It would be better for them to give more independence to the subsidiaries, and for the subsidiary to accept this responsibility. However, it is risky to give the subsidiary too much responsibility if the parent is unable (through lack of knowledge) to judge whether the performance of the subsidiary is satisfactory.

8. Top management changes of the financial, cultural, or other criteria which subsidiaries are expected to follow will have an adverse effect on their performance in the short term, and if these changes are made frequently the adverse effect will be long-term.

9. Top management involvement will not necessarily defeat the (non-financial) portfolio concept, which is still consistent with qualitative evaluations by executives, partly because the definitions used in the concept are fuzzy and require a degree of subjectivity in their interpretation.

10. Firms that acquire businesses with the intention of using them as the basis for growth either through expansion of the business or as a contributor of skills to the larger organisation have to integrate those businesses into the firm and instill the skills and culture associated with growth into the organisation if it is to be successful.

11. An important concept evident here, and consistent with the view of strategy as a hierarchical structure, is the distinction between relatedness in terms of products, markets and skills, and relatedness of a given business to the corporate strategy of the firm. The strategy can change the firm in ways that are not readily apparent if one's view is limited to an assessment of business relatedness in the sense discussed by Rumelt.

Limitations of the present analysis

This aspect of the research could have been taken further in several directions, but for time and resource limitations. The researcher would have liked to have studied a much larger number of firms. The analysis might also have been enhanced if full scale cases had been prepared, with more information included about the firms involved. As the focus was on the decision makers, rather than the firms, this was not seen as a major handicap. It would have been useful to have been able to meet each of the people interviewed a second time to complete the questionnaire and expand on other topics.

APPENDIX A-1

CASE STUDY: MR. ORLANDO OLDHAM

Mr. Orlando Oldham, who holds an M.B.A. degree from the Harvard Business School, has been involved in a number of firms which have either been taken over or have acquired other firms. Notable among these is the former family battery business, Oldham International Limited, which was taken over by Carlton Industries Ltd. in January 1972. Because of the long time since the Oldham takeover, and because the events surrounding this event are covered in detail in Scott (1980), it is not discussed much here. Mr. Oldham was made deputy chief executive of Royal Worcester in March 1972. He was appointed chairman of Welwyn Electric (see Chapter Five), a subsidiary of Royal Worcester, in September 1972. He left that firm in 1973. Among other business activities, he was made a non-executive director of Hargreaves Group in 1975.

The Oldham takeover

Carlton Industries started buying shares in Oldham International in 1970, accumulating nearly 25% by March 1971. On 18 June 1970 Oldham's shares had been trading at 12½p. On 19 June Carlton made a cash offer of 16¼. (Scott 1980: 16) Oldhams attracted Chloride into the battle, which continued until, in December 1971, Carlton outbid

Chloride's most recent offer of 73p with a bid of 80p, almost five times their initial 1969 offer. Chloride withdrew and Oldham's recommended acceptance. Carlton got 90% acceptance by 5 January 1972. (Scott 1980: 26) Thus the transaction took nearly two years. (Carlton was taken over by Hawker Siddeley a few years later.)

Hargreaves Group

Mr. Oldham has served as a managing director in the Hargreaves Group, a firm involved in tanker transport, fuel oil distribution, coal handling, and other businesses. The company has made several acquisitions and divestments. For example, they sold a vehicle distribution business in the United kingdom, bought a transport business in the United States (a success), and bought a mine in Kentucky (U.S.A.) and a cement works in Saudi Arabia, both of which were unsuccessful.

Mr. Oldham said that he had opposed the acquisition of the mine, and when this happened he was told angrily by the chairman of Hargreaves, 'You are against foreign investment ' as if any foreign investment -- especially one in the United States -- was bound to succeed. Mr. Oldham said that subsequent to these failures the company's acquisition and divestment activities have been well run, largely due to the efforts of Dr. Michael Scott, who is in charge of the firm's planning group. (Hargreaves was itself the object of a takeover bid by Coalite, a fuel distributor, in 1986.)

Welwyn Electronics

Mr. Oldham also served as chief executive of Welwyn Electronics for two years. Commenting on the acquisition of Royal Worcester (including Welwyn) by Crystalate (see Chapter Five), he said that he would have been very unhappy if this had happened while he had been there, because this sort of takeover can be very demoralising for employees.

On Trading Businesses

Mr. Oldham said that if there was an opportunity to trade a business owned by his firm for one which he thought was worth more, then he would be willing to attempt it. As for the execution of a strategic trade, he said it could be done 'if you can handle it successfully', he said.

When he was asked if another firm owned a business that he wanted, and he did not have enough cash to buy it, would he consider offering one of his existing businesses in exchange for it? He said it sounds like a good idea. It would work in situations where there is a better 'fit' from the acquired business than the divested one. He felt that that it had 'real applications'. Considering it as an alternative would also help executives understand better what they were already doing -- it 'intellectualises the concept'. (See his comment below about 'gimmicks'.) He said that it sounded like a portfolio approach to managing subsidiaries. (I told him he was two steps ahead of me. He enjoyed this comment.)

When he was asked if the firm's shareholders would see an exchange of a subsidiary by the firm for one the firm valued more as an increase in the value of their shares, he said, 'Generally they take _no_ interest at all ' He cited the low takeover price of Royal Worcester as a good example. It is very difficult to get the shareholders interested, he said. It takes a lot of effort in public relations in order to stimulate media interest. This can increase the cost of your firm to the acquirer, which benefits your shareholders. He cited the case of his family's firm, in which he used publicity extensively to increase the price in a takeover bid:

> My father had fostered excellent relations with the press over many years and indeed our big brothers [competitors] were envious of the attention we received. The press liked us. If they could say something nice they did, and if things were not so good they gave us the benefit of the doubt. Here I would like to express my belief that establishing good relations with the press, public, employees is a very long term operation involving the building of trust and reputation. (Oldham lecture 1975: 3) (See also Scott 1980: 53-54)

He pointed out that it is important in any acquisition that you and your management understand the new business. As an example, he noted that at the time of the interview BTR was in the process of trying to take over Dunlop, which seemed sensible from BTR's point of view in that they were in the rubber business.

Mr. Oldham was asked if it was better to have money invested in a business (a going concern) than in cash and securities. He said it is: one generates wealth, the other is 'parasitic'. (At this point he

referred to comments made by his father in the late 1930's regarding fears about inflation and the need to keep investments productive, but unfortunately the details of these comments could not be recalled after the interview.)

When he was asked if it was easier to compare the values of two business units than to put a [realistic money] value on each of them separately, he said that it is easier to compare. He then referred to his recent assessment of a business. 'One's subjective impression would be quite useful. Your "feel" is very important here. Comparison is very important. Being impressed can mean a lot', he said.

He agreed fully with the statement that two different firms appraising a given business unit are likely to arrive at significantly different values for the unit. Mr. Oldham also said that a lot of evaluations of businesses that are taken over are 'wildly inaccurate' because of miscalculation of 'stocks' (inventories)

He disagreed strongly with the statement that the best measure of success of an acquisition or a divestment is whether the price of the acquiring firm's shares rises afterwards. 'The price of shares has very little to do with reality,' he said. 'It has more to do with psychology.' He agreed with the follow-up question, that many financial writers treat stock value as the only meaningful value. He felt they were quite wrong in doing so.

The 'portfolio concept' was described by the interviewer, but not

identified by name. He said he was well aware of the concept, noting that 'ICI think very much along portfolio lines.' He referred to it as a 'useful gimmick', adding 'and I don't mean to be rude'. He said he meant that it really was a useful tool, as a device 'to get people to think'. In five years there will probably be other devices to get managers thinking, he said.

Then financial portfolio theory was described as it would apply to a portfolio of businesses, again without using its name. He said it was 'a good thing to do.' It was important to have a good mix of businesses that would be up or down independently of each other. He said one could be in 'both swings and roundabouts' but moving forward all the time. However he did not seem to think that it was very realistic to be able to do this with much precision, but he said it would be 'nice if you can pull it off'.

He agreed that a firm that tries to maintain a balance along the lines of the portfolio approach must be prepared to acquire and divest business units at all times. 'It should be prepared to. It must be open minded.', he said. But he gave the impression that he felt that the phrase 'at all times' suggested too high a priority, and that there were other important things to be done. This suggests that he believes that a review of the portfolio should be an occasional, not a continuous, activity.

When he was asked whether sometimes a firm can have too many 'good' businesses, and therefore would have to divest some of them in order to advance the firm as a whole, he said 'Oh yes, very true.'

This was particularly true of Gould [an American firm with which he was familiar]. It would be better to divest a business that could not be given the optimum benefit of succeeding, in terms of cash needs and management skills, and so on.

He said he sees a subsidiary business 'very much as a living organism'. Referring to the high level of acquisition and divestment activity in recent years he said 'there is one snag about this wheeling and dealing', and that is 'the human factor'. For a business to be successful in the long term it is necessary to spend a lot of time 'building up the culture' of an organisation. That includes 'loyalty of your employees'. One potentially harmful aspect of acquisitions and divestments is having your employees 'in fear of being flogged off down the road'. He said that this 'could be a major problem'. It was also difficult when a business is taken over by managers the employees find unpleasant. He put it positively: 'people get personal satisfaction from working for or with people they find agreeable'. He said he could not think of much worse than 'the Goldsmith type of treatment.' (See Chapter Five)

A number of factors can influence the perceived value of a business unit. For example, when Carleton Industries acquired Oldham's, they divested Oldham's subsidiary in South Africa. Lord Rayne, the chairman of Carleton, was 'uneasy about racism', probably because of his being Jewish, Mr. Oldham said. Sir Michael Edwardes, then chairman of Chloride, a major battery manufacturer, was from Rhodesia and was perhaps less concerned about that aspect of the business, and Chloride bought it.

Mr. Oldham also noted that the organisation structure of the South African subsidiary was not very adaptable to change. The South African business's top manager dealt directly with operating management (for example sales, production, and so on) who, Mr. Oldham pointed out, were very good at their respective jobs. There was no middle level. This was compounded by the fact that he was close to retirement and there was no one ready to step in to take over. This arrangement worked under Oldham's ownership because of close personal relationships, but Mr. Oldham felt that any other owner would have difficulty with it. When Carleton, and subsequently Chloride, took over the subsidiary, the old chief executive left, and the new owners moved in their own people. This changed the working relationships and had a negative effect on profitability.

On subjectivity

> ... it is vital to stress to those studying business that they realise as early as possible that what is done, as in all other walks of life, is far more governed by subjective elements and emotions, even in a seemingly objective situation, that I at any rate would have thought at one time.
>
> In the case of Oldham's and many others I have studied reason prevailed up to a point. Calculations were made on a factual basis but when the battle hotted up then we rapidly found ourselves in the realm of the Territorial Imperative or Roman Europe being invaded by the Goths. (Oldham lecture 1975: 1)

Other Comments

The following other comments were made during the interview. While they may not relate directly to the research topic, it seemed inappropriate to leave them out of the dissertation.

Mr. Oldham compared business with sailing: you aim at a certain point, but there are many unknowns that interfere with your reaching it.

Mr. Oldham mentioned Sir Harold Nicholson, Chairman of Rothman's, and former chairman of BTR. Mr. Oldham referred to Sir Harold as an 'Anglo-Canadian', who had been successful in British business. Mr. Oldham said that he 'knows how to make money out of mature industries.' (This is one type of activity that would make strategic trading feasible.) A brief discussion ensued about the ability of some foreigners, notably Canadians (like Lord Beaverbrook, Lord Thomson and Sir Harold Nicholson), Australians (Rupert Murdoch and Robert Holmes a Court), and other immigrants (such as the Sieff family of Marks & Spencer and Sir Michael Edwardes) to succeed in U.K. businesses perhaps where British owners could not, or at least to a different extent. Mr. Oldham agreed with the researcher's view that these people were uninhibited or unconstrained by various cultural or social pressures. This allowed them to operate more freely (paraphrasing Mr. Oldham).

Mr. Oldham said that it would be interesting to compare Chloride with the American firm, Gould. (Both were involved in the battery

business, although Gould divested it to concentrate on higher technology electronics.) He had a friend from Harvard who became a Gould executive. He also said that some people blame Sir Michael Edwardes for the failure of Chloride to adapt -- even though the problems only became obvious after Sir Michael's departure from Chloride.

REFERENCES

Oldham, Orlando, 'Aspects of the takeover bid for Oldham Batteries', lecture to students at the University of Bath, 1975

Scott, J. V., 'The History and Takeover of Oldham International Limited', unpublished M.Sc. project report, University of Bath 1980

APPENDIX A-2

CASE STUDY: PROF. RAYMOND E. THOMAS

Prof. Raymond E. Thomas is Professor of Management at the University of Bath, and has been Head of the School of Management (of which he was a founder) and a Pro-Vice-Chancellor of the University. He is chairman of the Food and Beverage Economic Development Council ('Little Neddy') of the National Economic Development Office, and has been involved in the encouragement of the establishment of new businesses through The New Work Trust Ltd. in Bristol, and other organisations, and in maintaining existing ones directly through his own consulting activities, and indirectly in his association with South Western Industrial Research Limited (SWIRL), an agency established by the University of Bath. Prof. Thomas has, in his own words, 'been involved in an advisory and research capacity in several firms that have been undertaken acquisitions or been taken over.' Several organisations in which he was involved were discussed in this interview. They were the University of Bath, the New Work Trust Ltd., and Normalair-Garrett Ltd. (_Academic Who's Who_ 1975: 695; Coyne and Wright 1986: viii)

The New Work Trust, Bristol

The New Work Trust Ltd. has been involved solely in 'small firms

and their development'. It has made no divestments. Prof. Thomas described how the organisation expanded from one plant with one set of operations to five sites, involving three different types of activity. This has led to their 'acquiring premises and helping to support an operation into which we ultimately hope to spin off and divest one group of activities.' It also acquired assets which were involved in the discussion of value below.

The University of Bath

The University of Bath itself was formed by amalgamating several 'related or independent' academic activities under one corporate organisation. This is an interesting subject by itself, but is not the focus of the present research. However, the University was involved in a divestment (its computer centre, which served several universities in the region) which is similar to divestments made by business organisations. The University has also made abandonment decisions.

Prof. Thomas said the divestment had allowed the University to do things they could not have done otherwise, because it released resources and relieved them of responsibilities, but they had nothing <u>specific</u> in mind when they divested it.

Negotiations were conducted by the chief administrative officer of the University and the University's computing director, who was actually head of the unit being divested, but he remained with the University after the divestment. The second person in charge of the

computer centre headed up the negotiations for the buyers.

Normalair-Garrett Ltd.

Prof. Thomas described Normalair-Garrett Ltd. as 'a joint subsidiary of Signal Corporation Inc. of California (now part of Allied-Signal Corp.) and Westland plc. (recently acquired by United Technologies Inc. and Fiat). The company has both acquired and divested activities. They have had what Prof. Thomas described as 'frustrated acquisitions'.

Prof. Thomas was co-director (with the managing director) of a project studying aspects of corporate planning at Normalair-Garrett, specifically '(a) the company's reorganisation and (b) the company's political forecasting.' The company wanted to get away from government contracts, lessening dependence on the Ministry of Defense, because of political and other uncertainties. The Government had implemented changes in policy on contracts. For example the formulae for payment of research expenditures depended on the type of product. High risk research was to be treated differently from products salable to other customers.

In looking at their 'forward position', Normalair-Garrett decided they wanted to switch their technology outside of their traditional aviation market. For example, by modifying the aircraft 'black box' (flight recorder) into an energy recorder for the electricity council.

They also explored other possibilities. For example, they made

pilotless aircraft for use as targets. This gave them skills in designing very light aircraft. They thought, 'why not have powered hang-gliding'? That is, they wanted to make microlight aircraft for commercial sale. To obtain the technology they bought a British microlight aircraft company, Westlake Engineering, and moved it to Yeovil. Westlake's product used a Volkswagen car engine Normalair Garrett set out to improve the product. They went into engine development and wanted to set the British standard for safety.

This led them into other acquisitions. As a deliberate policy, Normalair-Garrett sought to acquire either <u>people</u> or <u>companies</u> which would supply skills they needed to speed the adaptation process. For example, 'they actually bought a heat treatment company with a totally unrelated product and market simply to get the expertise and an advanced heat treatment system that they required in order to develop one of their new products. There is a very long lead time for development of high technology products, and acquiring skills in this way helps shorten it.

'Normalair-Garrett have had both acquisitions and divestments of activities. They have also had what I would call "frustrated acquisitions", in the sense that they have expanded their operations by bringing in Westlake Engineering and a heat treating company. They were prevented by the Office of Fair Trading and the Ministry of Defense from doing a tradeoff with the British Oxygen company, and they have disposed of part of their electronics operation in the Yeovil area. They have also had what are not strictly divestments but internal transfers that some activities have been passed over to other

companies which are within the Westland group.'

'They had been thinking about these new products <u>for many years</u>, and they had been thinking in terms of moving out of their traditional field. But some of their earlier attempts to do so had got them into areas of disbelief. They had developed some interesting products only to find that nobody would believe that they could do it. Their basic theorem was an interesting one. They said, "look, we're in aerospace. We keep people alive under low pressure and lack of oxygen. Surely undersea operations in the North Sea are a reversal of the pressure gradient -- hey presto -- let's make deep sea equipment." But nobody with any marine experience would believe that an aerospace company would be any good underneath the sea, even though Dowty had been extremely successful [in a similar transfer of technology] as an aircraft manufacturer in applying the principles of hydraulic support of undercarriage to keep up the roofs of mines. The whole of the Dowty mining operation is an astonishing example of transfer of thinking.'

Pressures to acquire and divest

Prof. Thomas said there were at least three kinds of pressures that managers felt to enter new businesses. One is 'a negative kind of pressure.' Executives ask themselves, 'is it safe to stay in what we're in? Is this a sinking area, a condemned cell'? The second is pressure to try something as an extension of what the firm is already doing, 'something we are capable of doing' based on existing skills. The third is what Prof. Thomas called 'the straight commercial one,

when you say "there's an area where clearly money can be made, where success can be achieved -- why aren't we doing it?"'

'In the kinds of organisations I have worked with, as opposed to retailing, it's the first and second ones [that predominate]. I think that sometimes in the kind of manufacturing companies I work with it's often "what else can I do with the technology?"'

Prof. Thomas described pressures felt to get out of a business: 'Normalair-Garrett had a feeling that they were losing out, that they were insignificant ... that it was pointless trying to stay in because they could make no mark on it, and if they looked at their main competitors, which were Fairey Hydraulics and Dowty, that their chances in those particular segments of the hydraulics market were low, and also they were so small in ordering the specialist equipment compared to them, that they always came bottom of the delivery of the specialist suppliers. They were always vulnerable. So it is a feeling that you just didn't have the clout to succeed. It's no good being 1 1/2 percent of the market when there are a couple of guys each at 40.'

Value

Asked how important it is to get something of significantly higher value than what you give up when you divest a business, Prof. Thomas said, 'Obviously when you divest yourself of a business you want to get the best, but I think that one should distinguish between the divestment of something which lost a lot of its value, where you are

so glad to get ready cash as a bargaining counter to do something new that that is much better from your point of view than hanging on in the hope of a higher offer.'

As an example, he said that the New Work Trust is purchasing the factory building they have rented since their formation. 'The company that owns the building is in serious trouble. It is a business where the product has changed. The firm needs the cash. We have offered to buy the part of their factory that we currently rent, and that will give them £380,000 of ready cash in exchange for a fixed asset. It is far more valuable to them to have £380,000 down than it is to have £60,000 per annum for N years ahead. Even though it is valued in their books at a very much higher figure.'

'They are sufficiently healthy now not to fear the [shareholder] repercussions that they did fear of writing off the difference in the book value in their accounts. Both they and the other people from whom we bought a factory -- who stood firm at £1,000,000 book value but eventually sold it for about £480,000 -- went through this process, but in each case it was a matter of finding out what was a realistic value.' Valuation is quite complicated. A firm might pay quite a lot to gain access to skills and to tie people down to a commitment to the firm.

When he was asked whether he found it easier to compare the values of two firms or to evaluate each separately, he said that he does not find it easier to compare the values of things which are unlike each other. It is easier to put money values on each separately. He

commented that he found the process of valuation to be extraordinary, and that in one case he was involved in they had four separate valuations made and all came out quite different.

Except in the case of the University's computer centre, all the organisations in which he was involved had a clear idea of where the proceeds of the divestment would be used.

REFERENCES

The Academic Who's Who, 2nd ed., Detroit: Gale Research Company 1975

Coyne, John and Mike Wright, Divestment and Strategic Change, Oxford: Philip Allan 1986

APPENDIX A-3

CASE STUDY: MR. ROBERT W. HOLDER

Mr. Robert W. Holder has been an active entrepreneur and manager, and is no stranger to turbulent changes. Exhibit 11-1 shows listings under his name in the Directory of Directors for 1977, 1980, 1984 and 1986. From these (taken at face value) it can be seen that he added at least 12 directorships and dropped at least 17 in the 10 year period.

Through acquisitions, Mr. Holder built up a company that was acquired by the Fairey group of aviation, marine and engineering companies, which appointed him its managing director. Under his management Fairey was extensively reorganized through a process of acquisitions and disposals of business units. For example, Fairey got out of the nuclear industry and sold several subsidiaries in foreign countries. One of the foreign businesses it kept, because of exit barriers, was a Belgian subsidiary that eventually was a key element in the firm's downfall. The intention had been to develop the acquisitions into major components of the overall firm.

Mr. Holder was chairman of the Fairey group of companies when it went into receivership after a hectic series of catastrophic events in 1977. (Times 21 July 1977: 20; 22 July 1977: 19; 23 July 1977: 17; 27

July 1977; 17 August 1977: 15; 20 August 1977: 15; 12 October 1977: 17; 112 May 1978: 26) This happened shortly after the firm after predicted 'another year of improved profits' (Times 2 December 1976: 24).

Acquisitions and divestments

Mr. Holder was asked to discuss acquisitions he had been involved in recently. Unfortunately this did not include Fairey, which could itself constitute as interesting research topic. He pointed out that he acts as a consultant (especially involving management buyouts) in addition to making acquisitions himself.

He said he had been involved in several acquisitions recently, including one the previous week. This was a manufacturer of a rock crusher employing a new design invented by a former employee of a major manufacturer of similar equipment. Mr. Holder saw the product as an improvement over other machines, and he thought he would recommend it for acquisition.

Sail cloth and narrow fabric

He was directly involved in the acquisition of a firm producing sail cloth and narrow fabric (webbing of the kind used in belts). He acquired the plant even though it employed old technology. He felt that he had two attractive alternatives: to update the technology or to sell the real estate, which was worth as much as the business would cost. But because the business had a strategic connection with his

Exhibit A-3-1 Directorships of Mr. Robert Holder

	1977	1978	1980	1984	1986
Fairey Co. Ltd. (chmn)	x				
Fairey Britten Norman Ltd.(chmn)	x				
Fairey Canada Ltd.(chmn)	x				
Fairey Engineering Ltd.(chmn)	x				
Fairey Industrial Products Ltd.(chmn)	x				
Fairey Marine Holdings Ltd.(chmn)	x				
Fairey S.A.	x				
Fairey Surveys Ltd. (chmn)	x				
Fairey Tress S.A.	x				
Intersint S.A.	x				
Gundry Bilmac Ltd. Canada	x	x	x		
Stone Platt Industries Ltd.	x	x	x		
Bridport-Gundry Ltd. (chmn)	x	x	x	x	x
Bridport Gundry Holdings Ltd. (chmn)	x	x	x	x	x
Crewkerne Textiles Ltd.(chmn)	x	x	x	x	x
E. Holder & Co Ltd.	x	x	x	x	x
James Pearsall & Son Ltd.(chmn)	x	x	x	x	x
Rex Bros. Motors Ltd.	x	x	x	x	x
Brownell Co Inc (chmn)			x	x	x
Globe Elastic Thread Co. Ltd. (dep ch)			x	x	x
John Williams of Cardiff p.l.c.				x	
West Monkton Technical Services Ltd.				x	
Aston & Nash Ltd.(chmn)				x	x
Council for Small Industries in Rural Areas				x	x
Longclose Ltd. (chmn)				x	x
NDN Aircraft Ltd.(NDN Aeroculture Ltd)				x	x
Lolift B-G Ltd. (chmn)					x
Mitel Delta Telecom Ltd. (chmn) rep of Ireland					x
Norman Aeroplane Co Ltd. (chmn)					x
Precis G6 Ltd.					x

Source: Directory of Directors for years indicated

existing businesses (involving vertical integration), he wanted to keep it as a going concern, and saw the property value as a 'cushion'. 'You have to look at it this way in case it goes bad, but that is not the main purpose for the acquisition', he said.

He said that he was able to make this acquisition because of his flexibility. Other firms wanted to acquire it. He and his managing director got together the day of the deadline for submitting bids, a

Friday. Each estimated the value, and Mr. Holder submitted a bid at the midpoint of these two estimates. The offer was accepted the following Monday, and the deal was completed that week.

He said the plant had one of the best names in the sail material business, but it was making the wrong products for current markets: heavy, ocean-going material. The markets which are growing are for lighter cloth for recreational boats and 'boards' (for windsurfing). It had 'ancient plant and equipment', and there were environmental problems. The manufacturing process was noisy, and it was close to a residential area. This limited its operations to one shift. To compete in the lightweight sail material business would require big investments in looms.

But the business also made 'narrow fabric' of the kind used in web belts, of the military type. He sold the cloth business to a maker of sail material, but kept the narrow fabric business, using the money from the sale to invest in the part of the plant he kept. The business now makes belt material for Levi Strauss and other fashion firms.

Netting for stowing and loading applications

He bought a company with a patented process for manufacturing netting for bulk loading and stowing. The business has customers worldwide. Because of his firm's flexibility he was able to submit a bid to acquire the business before the deadline, whereas large firms which might have been able to pay more could not move fast enough. He

said the business was worth even more to some large firms (like Johnson & Johnson and Bowater) than to him because they needed it for vertical integration (some forward, some backward). The high value of this business stemmed from the fact that there were few netting businesses of its stature, and building one up would be very difficult and costly. (One of the four major firms he mentioned has since started a competing manufacturer of these products.) When asked why he did not just sell it to one of them for a quick profit, he said that he needed the business for vertical integration as well.

Elastic thread

He also bought a specialised (elastic) thread business. At the time it was acquired the company was manufacturing only for other companies' brands. Mr. Holder decided that they should sell products in their own name, thereby competing directly with the big companies they supplied (including Tootal and Coates Paton). These firms were not happy about this and Coates Paton stopped buying from them at the time, but eventually resumed.

Personal involvement in decisions

Mr. Holder is involved in all the major decisions of his firm, but he said he never makes a decision that is against the wishes of his managing director. He inspects plants occasionally -- alone, not with a team of managers. He said he learns a lot from shippers (shipping clerks). His desire to be involved puts limits on his ability to control individual businesses. Direct communication as a technique of

control is difficult when you have foreign subsidiaries. 'If you go from the UK to inspect an operation in the U.S.A. they know you're coming', he said. This eliminates the element of surprise. 'And there is a tendency to stay too long. It is not as good for managing.'

He believes that geographical proximity is desirable when it is possible. He does not need a long time to assess problems in a business: two or three hours is sufficient, he said. He talks (alone) to various employees. He said that when he bought a business five miles away from his Leeds plant, there were vertical linkages, but it was also important for him to be able to drop in easily.

He has a subsidiary company in the state of Connecticut in the U.S.A. It had performance problems, so he telephoned the managing director and said 'improve in six months or I will sell the company.' Management improved the operation. They did not want to be divested.

He emphasised that he likes to operate alone. He said he has no secretary. He depends heavily on his own <u>interpretation</u> of facts. He gets regular financial statements, but he said he learns a lot more by <u>seeing</u> the plants. The interviewer mentioned that Marks and Spencer executives often inspect stores in groups. He said he does not do it that way, preferring to do it alone. When the interviewer used an example of seeing a pile of things at one side of the plant he responded immediately with 'what the hell is that doing sitting there ' It was a very convincing representation of what he probably really <u>does</u> say in such situations.

The interviewer probed on the issue of subjective criteria -- the 'feel' he had for a business when he visited it. He commented on the importance of visiting the business to see what it looks like, to see how well it is kept up, to look at the workers and the plant in general, and at the condition and quantity of goods waiting to be shipped. Many things come to mind only at the plant, he said.

Valuation of businesses

Mr. Holder said that one needs to be experienced to be able to evaluate a business. One has to understand the business itself as well as financial statements, forecasts and projections. There is a great tendency for people to be too optimistic, he said, especially those starting new businesses. They tend to downplay delays in payment of receivables, design problems, manpower requirements, and so on. He also does not trust the accounts of firms with revalued assets. He made the point that one has a good idea of one's businesses' profits this year and next -- it's the year AFTER that he is most concerned with. (He said this twice: at the start of the interview, and near the end.)

He acted as an advisor to the Deal automatic bicycle transmission company, a new invention that won design awards. The project looked good on paper and the prototype seemed to work. Investors in the City put up between £250,000 and £300,000. But the product could not be manufactured because of its complex design. The designed tolerances of about 3% did not work properly in real life conditions, in which

pressures on pedals vary over a very wide range. He said he was not interested in investing in the business.

When estimating the value of a business, he prefers direct observation. He looks at forecasts and other documentation, but considers other factors to be more important. He looks around the plant and talks to employees. 'Many factories are poorly run, and better management can turn them around', he said.

As an example, he cited the Irish plant formerly owned by the Canadian electronics firm Mitel (since taken over by British Telecom). The plant was losing millions of pounds a year. He was asked by the government to come in to see if it could be saved. He said big expense cuts were made and the business was turned around. By eliminating superfluous activities losses were cut substantially on behalf of the new owners. He felt that many failing businesses are just badly managed and can be turned around if someone who understands the business goes to look at the plant.

Another example he used was of a firm 5 miles from his Leeds business. It was involved in the manufacture of aircraft with folding wings (to save on hangar costs) and aerial tankers. He said that the original people involved overestimated the learning curve (85% instead of perhaps 70%). This excessive optimism led to the firm's inability to meet projections.

When selling a business, he said he always <u>wants</u> to get <u>more</u> than the firm was worth to <u>him</u>. He is not a distress seller, he said. (To

him that means taking whatever is offered.)

He agreed that different firms would put different values on a given business, depending on how closely it is related to the rest of their firm.

He said that he is not always on the lookout for acquisitions, because there are other important things to be done. Certainly he is not constantly looking for investment opportunities. (He seemed to consider that to be a role for specialist business brokers -- but he said that by the time a business is in the hands of a broker the business is usually too expensive for him to get involved.) He said he prefers geographical expansion and new products as ways to grow, rather than making acquisitions. He sees acquisitions as just one alternative -- a fast way to get into a business. If it is cheaper than other alternatives, it is appropriate.

Strategic trading

To save time, the interviewer moved quickly to a discussion of strategic trading. It was explained briefly that it meant that firms acquire and divest businesses at or about the same time so the resources from one can pay for the other, and that the motives usually involve changing the direction of the firm, such as into or out of a particular technology, or to concentrate on what the business does best.

He did not see strategic trading as being particularly applicable

to him. (This even though it is very close to what he described about the reallocation of resources in the sailcloth business. This point was not drawn to his attention at the time because it would have broken the continuity of the discussion.)

He was asked about the appropriateness of divesting as a way of raising money for an acquisiton. He saw this as a possibility, but didn't see it as really necessary in his case. He goes to the City. He said he is able to get the required capital there, because he has good relations with the financial community -- but he says the City people would rather deal with listed companies. Thus, combining several businesses into one firm is desirable in itself because it improves access to financing. At the time of the interview his firm was too small for listing, but he wanted to make it bigger. Conglomerating can achieve this, he said. Mr. Holder finds a business that he wants to acquire, and then he arranges for the City to provide equity capital. Mr. Holder expects to accumulate businesses this way until the parent firm is big enough to be listed. Mr. Holder made it clear that one motive for adding going concerns to his firm in this way is to lead to eventual access to the stock market. To be listed a firm had to have regular annual earnings of £500,000, he said.

Mr. Holder said there is 'absolutely no question' that some businesses are more essential to his firm than others, and that they fall into a sort of declining order. But he is not sure how this would relate to divestment decisions. The least essential might not be the one selected for divestment. (In his conversation he was not a very divestment oriented person, although the activity of his c.v.

suggests that he is no stranger to it.) He does relate this implicit ranking to acquisitions, however, in that some are 'more sensible' than others. Usually business are tied into each other through the production process, he said.

He used the word 'affinity' in connection with buying businesses, suggesting that some of the ways businesses are associated with each other involve a great deal of subjective judgment by managers. The interviewer used the word 'synergy' in a question. Mr. Holder subsequently used it several times in the discussion.

REFERENCES

Directory of Directors, Windsor Court, East Grinstead, West Sussex: Thomas Skinner Directories 1977, 1978, 1980, 1984 and 1986

Times 'Fairey takes off, and should keep rising', by Ashley Druker, 2 December 1976: 24

Times 'Double dose of misfortune sends Fairey into a tailspin: board passing final dividend', by Ray Maughan, 21 July 1977: 20

Times 'Stock Exchange expected to hold inquiry into Fairey shares deals', by Ray Maughan, 22 July 1977: 19

Times 'SE will ask jobbers about Fairey deals', by Ray Maughan, 23 July 1977: 17

Times 'Fairey shareholders vote to raise borrowing ceiling to £5.6m despite slump in profits', by Ray Maughan, 27 July 1977

Times 'Fairey near deal on aviation assets', by Nicholas Kirst, 17 August 1977: 15

Times 'Fairey discusses sale of aviation business to Short', 20 August 1977: 15

Times 'Fairey forced to ask for receiver', 12 October 1977: 17

Times 'Nothing for Fairey holders', 12 May 1978: 26

APPENDIX A-4

CASE STUDY: MR. ROBERT CARLTON-PORTER

Mr. Robert Carlton-Porter is Finance Director of English China Clays, and a director of ten of that firm's subsidiaries. He is also a director of The Association of Corporate Treasurers. (Directory of Directors 1986: 255) His career prior to working for English China Clays has included working for a bank, a food company, and an industrial products firm.

English China Clays

The history of English China Clays begins with the discovery of very pure kaolinite deposits in Cornwall in 1746. Until 1830 these were largely controlled by Staffordshire potters, but economic conditions forced them to give way to Cornish entrepreneurs. In 1919 several of these merged to form the English China Clays Group. There was a major reorganisation in 1956 to create 'logical divisions' along business lines. (Wide World of ECC 1982; Guide to ECC)

English China Clays is the largest china clay producer in the world, with output from its Cornwall facilities alone of 3,000,000 tonnes in a world market of 15,000,000. The firm has large reserves and also has holdings in the United States and Australia. It has

grown internally and by acquisitions and joint ventures. English China Clays is one of the active acquirers and divestors identified in Chapter Seven.

Although clay production is by far the largest contributor to profit, the firm is also active in other businesses. The firm has five operating divisions, with profits before tax as shown in Exhibit A-4-1, and a sixth division consisting of 'group companies'.

Exhibit A-4-1 Operating Divisions of English China Clays

Division	1982 Profit before tax (£ millions)	1982 % of total	1983 Profit before tax (£ millions)	1983 % of total
Clays	26.3	60.5	26.3	56.6
Quarries	9.4	21.6	13.4	28.8
Construction	2.0	4.6	2.7	5.8
Leisure	2.0	4.6	0.3	0.6
Transport & Services	3.8	8.7	3.8	8.2

Source: English China Clays plc Divisional Profile (undated)

Clay: the 'core business'

There is no doubt at all in Mr. Carlton-Porter's mind that clay, which generates more than 51% of revenues, is their core business. Mr. Carlton-Porter saw no likelihood of this changing. The interviewer mentioned that some United States firms had gotten out of their original businesses, and wondered whether this could happen in the case of English China Clays. Mr. Carlton-Porter said this was highly unlikely, although he did say later that they would consider any divestment, but he believed that clays would remain their mainstay

unless there were drastic changes in the industry. He considered smaller business units or particular facilities or properties to be the most likely divestment candidates.

Mr. Carlton-Porter said that English China Clays is much more willing now to consider divestments, especially of non-core businesses, than it was in the past. For unrelated or inconsequential businesses which have ROI above their target (about 15% - 20%) the choice as he sees it is to keep them because of the income, or sell them and use the money elsewhere However, he also noted that some subsidiaries which are seemingly unrelated are actually needed by the firm. (He gave some examples but the interviewer was unable to remember them after the interview.) He foresees a lot more divestment activity in the future. 'We have a corporate strategy, but it is not inflexible,' he said. The firm is prepared to divest a business that does not fit their strategy, or which is not performing to standard. He also sees divestments as a source of cash, either to pay after the fact for an acquisition (presumably by repaying bridge financing) or before the fact, by generating a cash reserve for acquisitions or by reducing debt to save interest expense and allow further borrowing later to pay for as-yet-unspecified acquisitions.

He said that one important reason for making a divestment would be to avoid future liabilities, such as the need to lay off large numbers of employees or to avoid other future 'headaches'. He also said that he personally dislikes certain businesses for various reasons. For example, the trucking business, because owning a fleet of trucks means carrying a lot of overhead.

Mr. Carlton-Porter explained the rationale of the company's diversification. These were based on the principle of 'synergy', in the sense of relatedness of business activities. The firm is active in clays, quarries, transport, land, and leisure. 'So you ask, "how does leisure fit into this"', he said. The interviewer agreed that it seemed rather distantly related to the other businesses. Mr. Carlton-Porter said the relationship was through its connection with investments in land, but he did not seem fully convinced of this, giving the impression that he was not convinced that the leisure business fits well in their company, with the implication that it might be a candidate for divestment.

IDF International

In the early 1980's IDF International, which provided support services to oil exploration companies, was jointly owned by English China Clays and Trans-Canada Resources Ltd. (TCR) of Calgary, Alberta. English China Clays bought out TCR's interest. A firm called Diversified Energies (DE) said they were interested in 100% ownership. English China Clays decided that they would like to sell IDF, but if the deal fell through they were prepared to operate it themselves. A deal was worked out in 1984. English China Clays felt that the offer was attractive, but DE backed out. Mr. Carlton-Porter said that DE were playing a game, trying to knock the price down after English China Clays had prepared for its divestment. Rather than cut the price and raise controversial issues with shareholders, English China Clays decided to keep IDF, and the deal was called off. Mr.

Carlton-Porter admitted that the oil exploration support business is very variable, and said that the requirements of every customer and drilling hole are different, making the business rather risky. He gave the impression that he was not convinced that being in this business was a good thing for English China Clays, but said he supported the action taken.

Edwin H. Bradley Holdings Ltd.

Edwin H. Bradley Holdings Ltd. was a building materials and construction company acquired in December 1984. Asked why this business was acquired, Mr. Carlton-Porter said they 'looked at the map' and saw geographical gaps in areas served by their existing businesses which could be supplied by Bradley. Mr. Carlton-Porter described Bradley as a remarkably good fit with their existing operations.

Mr. Carlton-Porter emphasised the importance of continuity (or contiguity) of market areas. Having 'a blob here and a blob there' (geographically) is no good, he said. One can justify an acquisition by connecting two areas already served by the firm. After an acquisition, the firm can sell off parts which are not needed, he said. He said that a firm can use acquisition as basis for further product and market expansion and diversification, like branches of a tree.

When the interviewer asked how long the decision took, he said 6 weeks, from November 1 through 19 December. However, further probing

revealed that the decision actually took somewhat longer. Towards the end of 1983, English China Clays had heard rumours that Bradley was considering an issue on the unlisted stock market, and felt that their offer to acquire the firm would be an attractive alternative for Bradley's owners. (One of English China Clays' acquisition decision criteria was that the price should not exceed 12 times earnings.) English China Clays approached Bradleys around January 1984, but had been turned down.

In November 1984, under a new chairman, Bradleys contacted English China Clays and asked if they were still interested in buying the firm. English China Clays said they were. It was then that the six week deal took place.

Mr. Carlton-Porter said that English China Clays did everything possible to speed up the acquisition process. They wanted to do the deal as fast as possible because they thought that going slowly could jeopardise the whole deal, by giving Bradleys 'time to find reasons to back out.' For example, to save time he hired Coopers & Lybrand, Bradley's auditors, rather than a firm that was unfamiliar with Bradleys, to do a £30,000 evaluation of the business.

English China Clays had scheduled board meetings for 19 and 20 December 1984. Mr. Carlton-Porter stayed up all night to finalise the details of the Bradley acquisition. He said he went to the board having shaved and showered, but sleepless, with the final deal in his hand. It was approved by the board, much to his satisfaction.

Boat business in the United States

This business was divested in 1983. It had been part of a group of businesses acquired from Guinness. It was poorly run, 'typical of Guiness's businesses', he said. Having only 15 boats, it was also too small to be interesting to English China Clays -- it was of 'no consequence' to use Mr. Carlton-Porter's words. It was too much trouble to manage it. When it was divested, it was bought out by its management.

Quarry in Jersey

The following example is not of an acquisition or divestment, but it illustrates Mr. Carlton-Porter's decision process. Mr. Carlton-Porter mentioned a quarry the firm owns in Jersey. He said that the quarry manager wants to invest more in equipment, but 'the numbers' do not justify it. Mr. Carlton-Porter said that he would go over and look at it, 'sniff around', as he put it, and ask questions. He said that quarry managers do not like to put pen to paper, and that there may be a hidden message in the manager's request, which would justify the expenditure. He trusts the manager's judgment, but at the time of the interview he was against the requested investment. He said he is prepared to change his mind if direct observation indicates it is necessary.

Other issues

Asked whether it is easier to compare values of businesses or to evaluate businesses separately, he said it is 'very much the former', in that the overall effect of the acquisition on the firm is the important issue. Even supposedly independent subsidiaries have an impact on corporate overheads, he said. He said it is important to take into account the contribution of subsidiaries to corporate overhead.

Mr Carlton-Porter sees strategic investment decisions as falling into four classes:

1) To maintain (extend the life of) the business, for example by obtaining more mineral resources.
2) Investments (such as new plants in new areas) to increase the value of output.
3) Financial reasons.
4) The investment seems to be the right thing to do (not necessarily with strong financial reasons to support it).

As an example of the fourth type of investment he cited the decision a few years ago to have clay depots in Europe. Management felt that it was necessary to make the investment to assure continental customers that supplies would be continuous. This paid off in being able to maintain continuous supplies during UK dock strikes. Investments in slurry operations in Europe were another example of a capital investment with the intention of keeping

customers satisfied. Mr. Carlton-Porter emphasised the importance of doing this even when the financial advantages are not obvious.

Mr. Carlton-Porter sees an important corporate role as the redistributor of cash among subsidiaries, but he also puts a lot of faith in subsidiary managers' abilities to recommend where money should be spent.

He stressed the importance of being prepared to take advantage of opportunities when they arise, as well as the importance of being able to cushion against turbulence.

When he was asked if they had ever considered exchanging one business for another, he said they had actually done it twice that he knew of, albeit on a small scale. In one such case they had traded one mineral deposit for another owned by a competitor ('a corner off theirs in exchange for a corner off ours'). This made it more efficient for both firms, because the acquired resources were contiguous with existing quarries. A second case involved trading a 'non-mainstream business' of English China Clays for a quarry (with a cash side payment).

He said that there is no question that his decisions go well beyond financial projections. Most important is a relationship to 'strategy'. When the interviewer referred to the intuitive aspects of decision making, he used the phrase 'gut feel' to describe it. He said that the days of accountants forecasts or projections being relied on were gone.

In a brief discussion of the portfolio approach, Mr. Carlton-Porter said that it was good to be in several businesses and in several countries simultaneously. It is unlikely that all will go bad at the same time, and if they did then being in one or a few businesses would not have helped!

Market dominance is an important criterion to him and to English China Clays. When he was asked if he was familiar with PIMS, as it appeared as if his firm was employing its principles, he said no, and that he was not familiar with PIMS. He did mention a moment later that some of his staff were pro-PIMS, but he was not very interested in using such things as guides for decision making.

Mr. Carlton-Porter said that he has a couple of people who do work planning acquisitions and divestments, but they are not dedicated exclusively to that task.

He emphasised the importance of different financial criteria to different groups. The City likes price/earnings ratio, internally they prefer ROI. This means that both these criteria have to be satisfied, among others.

REFERENCES

Directory of Directors, Windsor Court, East Grinstead, West Sussex: Thomas Skinner Directories 1986

English China Clays plc Divisional Profile, English China Clays (undated)

A Guide to English China Clays, English China Clays (undated)

The Wide World of ECC, English China Clays 1982

APPENDIX A-5

CASE STUDY: SIR KENNETH SELBY

Until 1982, Sir Kenneth Selby was Chairman of The Bath and Portland Group plc. After wartime service with the RAF, he joined what was then a small firm called The Bath and Portland Stone Firms Ltd. His previous experience had been largely in financial work with local authorities, although his family had operated chalk and marl pits in Sussex. In 1955 he became General Manager, and was made Chairman in 1969. He has been actively involved in numerous outside cultural, educational, and other organisations that serve the public. (Certified Accountant 1978; Directory of Directors 1986)

The Bath and Portland Group plc

The Bath and Portland Group plc was, until 1985 'an industrial holding company with over twenty trading subsidiaries, prominent still in quarrying and masonry, general building, civil engineering, property development, lime for farming, animal feed supplements, fertilisers, instrumentation, engineering and security storage. The companies are grouped in six divisions, each of which is chaired by a Group Board Director. Operations are conducted throughout the United Kingdom and in several countries overseas.' (Annual Report 1982)

Sir Kenneth outlined his role in building the firm to its present size and form. Recognising the need to diversify, he said that he initially sought businesses that would provide a fast return. This provided money they needed to reinvest in other businesses. The firm changed its approach in the 1950's, putting more emphasis on long-term businesses.

The Bath and Portland Group diversified for extensively under Sir Kenneth's leadership. He used quarrying machinery as an example. The firm had observed that German-made equipment was better suited to heavier work than British equipment, so they decided to manufacture their own heavy quarrying machinery, and established a business for that purpose.

Another case was a company they created which made a stone cutting device by fusing diamonds and metal powder. This was a substitute for less efficient stone cutters which used diamonds set in metal. They traded this business in the 1950's for a company that manufactured machines. Conceptually this was a strategic trade with a cash side payment. In practice it was a purchase and divestment. This procedure was followed in order to remove minority shareholders, thereby simplifying the ownership situation.

The Bath and Portland Group's diversification policy was based on various kinds of relatedness. For example, many new businesses were related technically to the construction business (as a user of stone), and the crushed stone business (because of its requirement for quarrying skills).

This approach to diversification led in several directions away from quarrying. For example, the firm established a business to manufacture control instruments based on the measurement of pressure, because they had developed skills in this area from quarrying. These instruments had applications such as balancing fuel, water and bilge tanks in naval ships. The firm was invited to manufacture devices for Soviet-made floating docks used at various worldwide locations for servicing Soviet submarines. The firm even sent maintenance volunteers to Sevastopol and South Yemen. (Sir Kenneth observed that there were never any Russian submarines in port when they were there.) The firm also did some work connected with British nuclear submarines.

In another example, Sir Kenneth said they had studied their agricultural lime business. It had several drawbacks. Farmers cannot put lime on their fields in the winter because the soil is too wet and not in the growing season because plants are in the way. Thus, sales and deliveries take place only during about three months of the year. The firm looked for ways to use the same sales force, lorries, and so on, and they moved into fertilizer, animal feed, and later into insecticides. As a result, the lime business amounted to only 20% of sales. They bought chemicals from ICI and Fisons. Eventually the suppliers (in collusion) raised prices, forcing margins down to about 5%. Sir Kenneth knew that his firm could no longer compete so they got out of this business.

The firm had tried to increase the effectiveness of capital investment by using facilities for more than one product. There were

certain constraints, such as not using feed production equipment for insecticides. As a marketing technique they implemented a mobile soil testing service, developed mobile testing units, and employed pretty girls to operate them. Farmers liked both aspects. Farmers did not trust the old way of sending samples to a lab, because they felt that there was too great a chance of mixups and that they would get the wrong results back. This way they got results quickly and they trusted them.

The Government had been subsidising lime sales to improve soil, which encouraged overselling. Sir Kenneth was involved in a Government-sponsored study of this problem. He realised that Government controls would come soon, and that subsidies would be removed, so his company gradually reduced its emphasis on the business. Companies with less foresight (or foreknowledge) got stuck with equipment.

Control

Sir Kenneth discussed his views on control of subsidiaries. The interviewer noted that part of the theory behind conglomerates was that management should let the units run freely and allow the principle of portfolio theory to even out the risk/return relationship. But if headquarters interferes in any way (even implicitly) this advantage can be lost. He said he agreed strongly with this view, adding that most managers are not willing to let go of businesses they control. They are more interested in managing than in being shareholders.

Sir Kenneth also believes in the concept of letting employees with a bright idea prove it on their own, rather than on company time. To carry out this policy, The Bath and Portland Group helped to set them up as independent businesses. This encouraged the individual's motivation and eliminated control problems that were likely to arise if the development work took place within the firm. On several occasions Bath and Portland bought them back, to gain control over the inventions. This benefitted the inventors as well: 'most inventors only have one good idea,' he said. He noted that there were other firms, including Siemens, which now follow a similar policy on inventions.

Marples Ridgway Construction

Marples Ridgway Construction was acquired by The Bath and Portland Group in the late 1960's. It was sold to a South African company in 1983, but only after several years thinking about it. The transaction included the transfer of a large block of shares of The Bath and Portland Group, for tax reasons. (This unintentionally made the company vulnerable to a successful takeover bid two years later.) Those involved in the Marples Ridgway transaction attempted to keep it a close secret. 12 people or so on each side knew about the planned divestment until information was leaked.

The Bath and Portland Group had agreed to what amounted to a phased takeover of Marples Ridgway by a South African company. The idea was that the company would finish certain projects before

ownership was transferred, because several of these were in Islamic countries whose governments would not approve of South African companies. But future projects were foreseen in Peru and other countries where Marples Ridgway had no particular expertise, but the South Africans did. This arrangement was only known to a few top people in each (parent) firm, but the plans leaked down to lower levels on the South African side. This led to control problems, because many employees then felt that they were working for two bosses. The parent firms decided to get rid of the idea of a partnership and hand over the whole company to the South Africans at once, with The Bath and Portland Group retaining responsibility for completion of some projects.

Divestments

Sir Kenneth said that divestments take a lot longer 'from the first glimmer' to completion, than acquisitions do. He said that acquisitions are usually quite fast. He liked to pay cash for acquisitions, with a partial holdback to ensure satisfactory completion.

Sir Kenneth was very outspoken about the performance of top management in The Bath and Portland Group after he left the chairmanship. They could not fight the takeover attempts which were mounted by C. H. Beazer and Consolidated Gold Fields. They actually invited Beazer to look at one of their subsidiaries. When they did so, Beazer realised that they could get the whole company. Sir Kenneth said that he had been told this later by Mr. Beazer himself.

Consolidated Gold Fields was the eventual victor in 1985.

Valuation of firms

Sir Kenneth said that he believes Consolidated Gold Fields will probably sell off several parts of The Bath and Portland Group and that the proceeds will virtually pay for the quarry and stone business. He agreed that there may be many firms in a similar position to that of The Bath and Portland Group, with undervalued assets, whose parts could be sold for more than the whole firm.

Decision making and Sir Kenneth's personal values

Sir Kenneth said it was important to be able to make decisions quickly. He described himself as being more 'numerate' (literate with numbers) than a lot of people, and he said this gave him an edge in making deals. He could calculate and make decisions faster, and this was often very profitable. (He talked about this for about five minutes, and clearly felt that it was a significant factor in his own success.)

Non-financial issues related to the firm were also important to Sir Kenneth. He spoke proudly of two items in particular: (1) Bath and Portland's connection with Sir Christopher Wren, whose handwritten order for the stone used in St. Paul's Cathedral is in their offices, and (2) the architectural competition the company sponsored, which involved designing a building for an 'impossible' location, such as in Regent's Park, to test the imagination of architects. He said he

doubted whether the new owners of the company will continue this competition, and was disappointed at this prospect.

He also showed concern for the firm's employees in Bath, as well as for the well-being of the city itself. For example, he expects the new owner of The Bath and Portland Group to close the computer facilities of the company in Bath and to use their present staff to do the work. This will lead to redundancies in Bath. He said that job protection should be a criterion in cases considered by the Monopolies and Mergers Commission when the victim is still viable. He believes in 'a humane approach' to giving notice of redundancy to employees, for example one should tell them that if they find another job 'we'll pay you up to June 30 regardless.' This is preferable to saying 'people are only guaranteed employment up to 30 June'. The latter approach encourages unproductive hanging on and procrastination and may cost more as well.

He also expressed his view regarding the employment of managers of family businesses which have been taken over. He said it is best to get the family out: pay them off. Keep them as advisors if necessary but remove them from operations. Otherwise, problems are likely to arise from continuation of past practices such as taking time off when they want to, personal relationships with lower level workers, and so on.

He said that when he took over a company, he reserved the right to talk to any employee privately. He also made it clear that any employee could contact him, but he always told them that while he

encouraged them to talk to him, he reserved the right to tell the managers responsible what had been said. The purpose of this was to improve the company's operations.

There was a discussion of the immobility of certain labour groups, particularly in underdeveloped areas, for example in Scotland. Referring to coal miners (who had been in the news because of the Coal Board's intention to close several mines), Sir Kenneth said that some people were suited only to mining, and could not be expected to work in electronics plants, or whatever. Professor Thomas, who had joined the meeting, was not sure that this was the case. Sir Kenneth said that those who were more flexible or were not interested in mining had already left or were trying to find other employment. The 'fathers' were trying to make sure the 'sons' did something else, because they foresaw the decline of mining. Professor Thomas generally agreed with that, and saw himself as an example, perhaps, having come from a working class family in Wales. The interviewer, trying to get a word in edgewise between two old friends, cited the similarity to the Maritime Provinces in Canada and to some extent his own extended family.

Hidden value -- and portfolio theory

Sir Kenneth said he knew that the six separate parts of The Bath and Portland Group had been worth a lot more than the stock market had valued the whole company. If you have a multi-divisional company and one division is having trouble, the stock market will undervalue the whole company, he said, because the problem will be emphasised by the

press reports, while the good parts will receive less attention. And furthermore, he said that if you have a multidivisional company you are bound to always have at last one division that is having problems!

Asked whether he ever considered splitting up the firm and spinning off some of the six parts as separate companies, he said that was exactly what he had wanted to do. He would have kept 26% of each to maintain control, and distribute the rest to Bath and Portland's shareholders. That way the six managing directors would be chairmen, and they would be responsible to their own boards and shareholders. Each would be a listed company. Yet the 26% holding would have given Sir Kenneth's group a position of strength, and the managing directors could go to them for advice. Sir Kenneth said that if this had been done, the value to the shareholders would have increased by a substantial proportion, amounting to millions of pounds. This idea had been vetoed by 'the banker' who took over from Sir Kenneth as chairman, who had said it would be done 'over my dead body'. Later, the same man admitted to Sir Kenneth that the idea was ahead of its time and should have been done, but by then it was too late.

Sir Kenneth thought that spinoffs might also be a good prescription for firms that did not seem to be sure what to do with their money, because the shareholders could then realise the value of the companies.

REFERENCES

Annual Report of The Bath and Portland Group plc 1982

Certified Accountant October 1978: 308

Directory of Directors, Windsor Court, East Grinstead, West Sussex: Thomas Skinner Directories 1986

APPENDIX A-6

CASE STUDY: MR. TERRENCE J. ORGAN

At the time of the interview, Mr. Organ's responsibilities had just changed from 'Managing Director - U.K. Region' to 'Managing Director - International Confectionery' for Cadbury Schweppes plc. Positions he held, as listed in the Directory of Directors for 1984 and 1986 are given in Exhibit A-6-1. He had been employed by Fry's when it merged with Cadbury's.

Exhibit A-6-1 Positions held by Mr. Terrence J. Organ

	In 1984	In 1986
Cadbury Schweppes plc (Managing Director - UK Region)	x	
Cadbury Ltd. (Vice chairman)	x	x
Cadbury Typhoo Ltd. (Vice chairman)	x	
Jeyes Group Ltd. (Vice chairman)	x	
J. S. Fry & Sons Ltd. (Director)	x	x
The Kenco Coffee Company Ltd. (Vice chairman)	x	
Schweppes Ltd. (Vice chairman)	x	
Cadbury Schweppes plc (Managing Director - International Confectionery)		x
Cadbury Ireland Ltd. (Director)		x
Cadbury Schweppes Inc. (USA)		x
Cadbury Schweppes Overseas Ltd.		x
Cadbury Schweppes Export Ltd. (Chairman)		x
Cadbury Schweppes (South Africa) Ltd. (Director)		x

Source: Directory of Directors 1984 and 1986

Cadbury Schweppes plc

Cadbury Schweppes plc was formed through a merger in the 1960's. Since that time the firm has made numerous acquisitions and divestments, some of which are discussed below. By 1985, Cadbury Schweppes was active in several businesses, including confectionery, coffee, tea, carbonated soft drinks, juices, foods, and health and hygiene products, and managed operations around the world.

Control relationship with an acquired company

The interviewer asked Mr. Organ to discuss situations that described the relationships between the head office ('group') and subsidiary businesses ('divisions').

Communication with a new acquisition

Referring to a company (Mr. Organ asked that it not be named) acquired recently by Cadbury Schweppes, Mr. Organ said that at the beginning there were some problems involving communication with the head office. He described Cadbury Schweppes as 'a nice company' that does not give a lot of direction to its subsidiary managers. As a result, the managers of the newly acquired business were not sure to what extent they were supposed to continue to promote their old products, and how much emphasis to put on Cadbury's. They told Mr. Organ that they were getting 'a variety of signals' from London. Mr. Organ had told them that he was the only person from whom they were to receive direction.

This particular company had maintained a steady market share of about 6% in the years prior to its acquisition by Cadbury's. Mr. Organ said that Cadbury's wanted steady, even if slow, expansion, say from 6% to 7%, and Cadbury's wanted them to set specific intermediate goals. The acquired company had wanted to make acquisitions on its own, but this was vetoed by Mr. Organ because he did not want a 'patchwork of businesses all over the place.'

Australia

Mr. Organ said that some of the managers in the Australian subsidiary would like Australia to be the base for operations in the South Pacific and Far East. ('Slightly anti-British, you know', he said.) They once recommended acquisition of a company with several subsidiaries, all but one entirely unrelated to Cadbury's businesses. Mr. Organ said there was no way they would get into a situation like that. Relatedness is an important criterion for Cadbury Schweppes. He also emphasised that Cadbury Schweppes is not in the business of buying and selling companies, and that it is mainly interested in building up what it already has.

Planning depends on the competitive context

Mr. Organ described some of the differences between competing in different situations. In some countries, their businesses are quite stable and managers have a fairly straight forward job of preparing their plans. Some situations are more complicated for various

reasons. As an example, he compared the confectionery businesses in the United Kingdom with that in Canada.

In Canada there are six major competitors, none of which dominates the market. A situation 'always' arising is that at least one of these firms has a problem with some product or other and does a lot of promotion, which creates an imbalance in the market, to which the others have to respond. In the U.K. there are only three big firms which dominate the industry. The British situation is usually fairly stable, with fewer problems of this nature.

Power of customers

Mr. Organ also compared the power of customers in the United Kingdom with those in the United States.

In the United Kingdom, supermarket chains are extremely powerful. In Southern England, two firms have about 50% of grocery sales. They put pressure on suppliers like Cadbury's to reduce prices, with the implied or stated alternative that they will not carry Cadbury products. However, Cadbury's also has power, because of its high standing with consumers. Shoppers expect 'good' stores to carry Cadbury products, so the store's image, and to some extent their volume of business, would suffer if they did not carry them. He said that small stalls and shops are still numerous enough that most people who cannot get Cadbury products in a supermarket can (and do) get them in one of these shops. However, some consumers will accept substitutes rather than incur the inconvenience of shopping elsewhere,

so Cadbury's would prefer to sell through supermarkets.

In the United States supermarkets are also powerful, but there is a very important part played by the distribution (wholesale) sector. (This is also the case in Canada, he said.) The main benefit Cadbury's expected to gain from their 1978 acquisition of the confectionery firm, Peter Paul in the United States was access to their distribution channels. He said that if Cadbury's make more acquisitions in the U.S.A. it will probably be to strengthen distribution.

Rationale for acquisitions

Mr. Organ described how the firm's approach to acquisitions has changed dramatically in recent years. Today, acquisitions must be strategically related to the firm's needs, or in the Chairman, Sir Adrian Cadbury's words, 'All the acquisitions which the company has made in the last two years were directly in line with its strategic priorities. Our aim is to build these businesses up ....' (_Annual Report_ 1982: 7) This was not always the case.

Sir Adrian was quite young when Schweppes merged with Cadbury's. At that time it was decided that the Chairman of Schweppes should be chairman of the merged company. Shortly after his appointment he was offered the Governor Generalship of Australia. The company decided his vice-chairman could take over for the four years he would be away.

Mr. Organ said that when this happened, Sir Adrian's comment to

the Cadbury people was something like, 'don't worry, in a few years we'll be back in the driver's seat'.

The firm's leadership problems were compounded, however, when the new chairman died in his office a few months later, and the board asked a non-executive director, a politician, to be chairman. He ran the company in a 'political' way, in the sense of very short-term thinking, 'to win the voters', as Mr. Organ put it. Under his leadership the firm made a lot of ill-considered (unplanned) acquisitions. These cost the company a great deal at the time, and some of them a lot more later because many were divested at a loss. Among those acquired were a chocolate company in Spain, and the Jeyes hygenic products firm.

When Sir Adrian became chairman the firm stopped acquiring, and in 1974 under his guidance it took 'a very hard look at itself' strategically, Mr. Organ said. There was no question but that the chocolate/confectionery and the drinks businesses were considered essential to the character of the firm, and they decided to divest unneeded businesses as soon as possible.

Mr. Organ said he was sent to one possible divestment candidate to look at the situation, and his advice to Sir Adrian and other top managers was to get rid of it as soon as possible. 'But we'll lose a lot of money,' he was told by one executive. 'We'll lose a lot more if we keep it', he replied.

There was a period of several years in the 1970's during which

there was a series of divestments followed by a period with no acquisitions or divestments. In this period Sir Adrian brought the remaining divisions under control, focussing mostly on the two main businesses, confectionery and drinks.

Mr. Organ said that during this period they would have liked to have divested a couple of strategically unrelated businesses, but the amounts offered were too low relative to the earnings of the units, so they kept them.

It is interesting to note that in the company's 1983 annual report, Sir Adrian Cadbury said that [divestment and closure] 'decisions are only taken when it is clear that additional investment or a new management approach cannot put them on a sound footing .... The positive side ... is that the resources thus freed are available to reinforce the continuing businesses, making them more competitive and so more secure.' (Annual Report 1983: 7)

Mr. Organ said that they would normally not divest a business that had a close strategic relationship to the firm unless they could not proceed with some strategically important aspect of the parent firm without doing so.

Divestments are very slow, he said, while acquisitions can be made very quickly. But even with acquisitions there is a long preparation time, perhaps years, although the specific business to be acquired may not be known.

Cadbury Schweppes started making strategic acquisitions beginning about 1978. He said that the turnaround of Cadbury Schweppes illustrated the significance of the kind of chairman a firm has. It appeared to the interviewer that Cadbury Schweppes seemed to have a clear understanding about what businesses they are in -- although they had several marginally related or unrelated offshoots.

At the time of the interview in early 1985, Cadbury Schweppes owned mostly confectionery and beverage related businesses in many countries. One large exception seemed to stand out. The interviewer asked Mr. Organ what the Jeyes business had to do with candy and drinks. He said he was not so sure himself, but he went on to explain why they had recently ADDED to Jeyes through acquisitions, and why they SOLD their shares in Jeyes Ireland because it did not fit with the rest of the business. The reasons were strategic, he said. As it was, Jeyes was not seen to be viable in the long term. Cadbury Schweppes felt that by adding to it in appropriate ways it would be made much stronger. He said that they were essentially keeping their options open by making it more viable in the long term. At the time of the interview, the researcher noted that it appeared that they were preparing Jeyes to be divested some time in the not-to-distant future, say two or three years hence. Mr. Organ said that he could not say so in public because it would probably demoralize Jeyes management.

Subsequent events

The Jeyes Division was divested in three management buyouts at the end of 1985. (_Times_ 17 December 1985: 17; _Times_ 7 March 1986: 20)

Perhaps more significantly, Cadbury Schweppes also divested its Beverages & Foods Division in 1986 to its managers for £82.5 million. This division sold coffee, tea, jam and dried milk including Kenco, Typhoo, Chivers, Hartley, and Marvel brands. The company said that '... the operation no longer fits in with its worldwide confectionery and soft drinks business ....' (Times 14 January 1986: 17)

In 1986 the firm had been criticised by the press, largely because of losses in the United States market. One particularly severe comment said:

> The debilitating effect of ill-conceived attempts to diversify are clearly demonstrated at Cadbury Schweppes where the company has been weakened to such an extent that the trading profit fell by £28.8 million, excluding exchange rate fluctuations .... (Times 7 March 1986: 19)

However, even the author of that piece had to admit that 'Future strategy in all markets world-wide will concentrate on the areas where Cadbury is strong -- confectionery and soft drinks.' (Times 7 March 1986: 19) From Mr. Organ's comments this seems to have been their strategy for some time, and evidence of this is the agreement on a joint venture between Cadbury Schweppes and The Coca-Cola Company in the U.K. (Times 7 March 1986: 20), and the firm's attempts to acquire the Canada Dry and Sunkist soft drinks division of the American firm, R.J. Reynolds Nabisco (Times 17 May 1986: 21) just after three British breweries formed a joint venture to produce Canada Dry products, Britvic juices, and R. White's lemonade, and possibly Pepsi-Cola, which had formerly been produced in the U.K. by Schweppes (Times 12 February 1986: 17). These events illustrate the rate of

change in the soft drinks industry.

REFERENCES

Annual Report, Cadbury Schweppes plc 1982

Annual Report, Cadbury Schweppes plc 1983
Directory of Directors, Windsor Court, East Grinstead, West Sussex: Thomas Skinner Directories 1984 and 1986

Times, 'Cadbury to sell Jeyes offshoots for £19 million', by Teresa Poole, 17 December 1985: 17

Times, 'Cadbury to sell UK division for £82m', by Cliff Feltham, 14 January 1986

Times, 'Britvic and Canada Dry plan £65 million merger', by Teresa Poole, 12 February 1986: 17

Times, Cadbury Schweppes', 7 March 1986: 19

Times, Cadbury Schweppes advertisement, 7 March 1986: 20

Times, 'Cadbury in US drinks bid', by Derek Harris, 17 May 1986: 21

APPENDIX A-7

CASE STUDY: MR. MALCOLM A. ANSON

Mr. Malcolm A. Anson joined Imperial Tobacco Co. (of Great Britain and Ireland) Ltd. in 1948. He was made a director of the company in 1968, Deputy Chairman of Imperial Group plc in 1979 and Chairman in 1980. At the time of the interview, he was chairman of the Wessex Water Authority, having left Imperial Group in 1981. (_Who's Who_ 1984; _Directory of Directors_ 1986)

Mr. Anson summarised the history of the tobacco business from around 1902, when a British consortium of tobacco companies under the leadership of the Wills family formed Imperial Tobacco to repel an attempt by the American Tobacco Company (under James Buchanan Duke) to penetrate the British market. The defense was successful, and Imperial Tobacco agreed to confine itself to the United Kingdom, American Tobacco to the United States, and a new company called the British American Tobacco Company Ltd. (now called BAT) traded in the rest of the world. Imperial Tobacco retained 30% of BAT until the 1970's. (Anson speech 1981: 1-2)

The St. Anne's Board Plant

As part of Imperial's vertical integration strategy, adopted in

the 1950's, and being a heavy user of cardboard for cigarette packages, Imperial Group felt they should consider buying a plant and making board for themselves. They bought the St. Anne's board plant near Bristol. The plant encountered extremely strong competition from Scandanavian European Free Trade Area (EFTA) countries, and it became uneconomic. Imperial asked the St. Anne's management to consider alternatives. Their recommendation was to invest in equipment that would make the plant competitive, according to their (St. Anne's management's) forecasts.

Imperial's board of directors accepted the recommendation and made heavy investments in the plant. However, it did not perform as predicted, and eventually the plant was closed. This was shortly after the United Kingdom joined the European Economic Community, and Mr. Anson said that the EEC was unfairly blamed for the closure, because the problem had started long before. Mr. Anson said it was unreasonable to have believed that the plant could compete when the raw materials and electricity had to be brought to the plant from great distances or generated from coal, when EFTA competitors had forests and hydroelectric power adjacent to their plants. There were no potential buyers for the plant, and there was no way it could be made competitive, so it was closed.

He said that as it turned out it was good to have been able to say that they had tried to save it -- even though he said the board of Imperial Group 'was poorly served' by the management of St. Anne's who had, in his opinion, exaggerated figures to justify the investment and keep the plant going.

The crisps business

When Imperial Group were looking for other investments in the 1960's, they tried to find businesses that would use skills they already had. These related to cigarettes and included, but were not limited to:

- processing of consumable agricultural products (of which tobacco is one)
- packaging skills, particularly to preserve freshness
- high volume production consumer products
- advertising directly to consumers (to gain measure of independence from retailers)
- distribution through channels similar to tobacco products.

One of the products they considered as a result of this kind of analysis was potato crisps. Potatoes were agricultural, and they were sold in small packages designed to preserve freshness. This led to their acquisition of a crisps business, but it did not work out. Mr. Anson blamed two main factors, which he said should have been foreseen:

(1) Tobacco is a raw material that is fairly hard to produce and get, and is dutiable (specially taxed). Potatoes are easy to grow and obtain and are not taxed.

(2) Moisture is beneficial to cigarettes, up to a point, protecting freshness. Packaging keeps the moisture in. Moisture is destructive to crisps. Packaging keeps the moisture out.

When Mr. Anson was asked how the significance of those particular

weaknesses could have been foreseen, in that all the other skills seemed to favour quite strongly the transferability of skills, and it was not likely that these weaknesses could have been foreseen as being critical, he said no, these problems should have been foreseen.

[It seems that similar decisions, with apparently similar poor results in many cases, were made by others and also seemed perfectly logical at the time. Examples are Philip Morris (with Miller Brewing and 7up), Rothman's of Pall Mall Canada (attempting to expand Carling brewing in the United States), Heublein (Hamm's brewery). The fact that most of these involve beer companies relates to the fact that the researcher recently completed some research on the United States brewing industry.]

Other acquisitions and divestments

Imperial group made a large number of acquisitions in the 1970's. By the end of that decade, about 20% of the firm was in brewing and 20% in food, the balance being mostly tobacco products. Some of them did not work out. For example, Imperial Group divested a tinned food business (Smedley's) because it was too small.

Diversification by acquisition in the 1970's

In the 1970's Imperial decided that they wanted to diversify because of downward pressures in the British tobacco market. Imperial acquired a large brewery, Courage, and numerous food businesses, which were brought under the umbrella of Imperial Foods. As owners of

Courage, they participated in the pub swaps in 1970, 1971 and 1977. (See Chapter Five.) In the mid-1970's they sold their shares in BAT, giving Imperial Group about US$630,000,000 to reinvest. The prognosis for British industry was not good, so they looked at other countries, deciding that the USA was 'the place to go', and they 'went shopping' there for a suitable investment. Mr. Anson said that they went through the entire list of industries looking for opportunities. Industries were only eliminated when there was a 'positive reason' for doing so, such as industries that were 'dominated by certain groups'. He also said that they wanted to invest as much of the cash as possible in a single businesses, not in 'six small businesses'. This was because six businesses would take six times as much top management time, he said.

Note that according to an article in the Financial Times in 1979, as cited by Slatter, Imperial Group's diversification criteria at this time were as follows:

- long-term growth prospects
- avoidance of commodity sectors characterised by low margins and high cyclicality
- avoidance of small fragmented sectors
- exclusion of capital-intensive industries
- degree of sector competitiveness
- a sector with a relatively simple distribution process
- sectors consistent with the 'imperial' image, not highly unionized and with little likelihood of government intervention. (Slatter 1984: 238)

Citing the same article, Slatter says that after initially defining 52 possible sectors, a second screening reduced this to 16. Within these sectors, the following acquisition criteria were

reportedly used:

- size of company -- large single firm with national coverage
- existence of a high level of management competence
- key management willing to stay
- good and consistent earnings track record
- strongly branded goods or services
- company to have strength in adding value
- a corporate philosophy consistent with that of Imperial Group (meaning a high level of corporate and individual integrity)
- profit record. (Slatter 1984: 238)

It is interesting to compare these lists with the five criteria in the order listed by Mr. Anson to a group of financial analysis in 1981:

1. A record of earnings growth and a prospect of future growth
2. Appropriate size to absorb all our money in one lump
3. Good management
4. Market strength and good repute
5. Something that we could understand.
   We were not looking for a turn-round situation.
   (Anson speech 1981: 5)

In that speech he also referred to '[The management's] eagerness to run the company our way and to share in our ambitions'. (Anson speech 1981: 7)

These seem to differ slightly from those cited by Slatter. Mr. Anson's comments in the interview shed light on some of these points.

The Howard Johnson acquisition

Imperial Group offered and paid $28 a share for Howard Johnson. At that time, its market price had been around $15. Some of Mr. Anson's critics said the offer was too high. At that time the pound was at about $2.25. Mr. Anson said that their feasibility calculations had been based on an exchange rate of about $2. One of their reasons for the $28 offer was to avoid theirs becoming a hostile takeover. There was one large shareholder who had to be convinced. (He may have used the word 'bribed'.) Imperial had been advised that if their bid had been contested, there could well have been serious legal obstacles, especially in California, Illinois, and Pennsylvania, on the grounds that brewers were not supposed to own hotels. In his 1981 speech, Mr. Anson said they had to clear 40 separate state liquor licensing authorities.

Mr. Anson made some interesting comments on the relativity of value in his 1981 speech:

> The Howard Johnson Company emerged as easily the best candidate. We were told that it was not for sale, but 'not for sale' is a relative term. It usually depends on price, and you can seldom get what you really want at a price which your friends will say it is sensible to pay. Our friends did not all think that we were paying a sensible price. But the right price is the one that meets the essential needs of both parties. It cannot be assessed totally in terms of PE ratios or balance sheet assets .... What matters is what you think you can do with the company after you've bought it.

Mr. Anson said 'yes' when he was asked if pursuit of profit was always foremost (this is related to the maximisation issue in the economic theory of the firm). But he later said that he was glad, in retrospect, that Imperial had put more money into the St. Anne's board plant before closing it because it showed the public, the government, and the employees that Imperial Group was interested in trying to keep people working if possible. (Even though this was not why they had put more money in in the first place!)

Mr. Anson emphasised the importance of 'knowing' a business before acquiring.

On buying out a competitor, Mr. Anson said that three competitors are preferable to four when negotiating with 'Mr. Tesco' (i.e., the big supermarket chains) because it lessens his bargaining power.

When he was asked how long a business had to decline before one decided it was time to get out, he said 'you have to know that the decline is not because of the business cycle.'

Regarding the question about getting more for a business than it is worth to you, he said, 'you pay "too much" when you buy a business, and you don't get "enough" when you sell a business.' This parallels the reference to 'your friends' in his 1981 speech.

He said he sees the purpose of divestment as being mainly appropriate to getting out of a bad situation.

REFERENCES

'Address by M. A. Anson, Chairman of Imperial Group Ltd., to Government Research Corporation Conference, Washington, D.C., 4.5.81'

Directory of Directors, Windsor Court, East Grinstead, West Sussex: Thomas Skinner Directories 1986

Slatter, Stuart, Corporate Recovery, Harmondsworth: Penguin 1984

Who's Who New York: St. Martin's Press 1984

APPENDIX A-8

UNDISGUISED SUMMARY OF RESPONSES TO PREPARED QUESTIONS

GENERAL:

Identify one or two recent divestments.

Mr. Oldham: Oldham International (Taken over in 1971). A vehicle distribution business owned by Hargreaves.

Prof. Thomas: University Computer Centre, and some abandonment decisions

Mr. Carlton-Porter: Boat Business in the U.S.A.

Mr. Organ: Jeyes Ireland.

Did divesting allow them to do something they could not have done otherwise?

Prof. Thomas: Yes.

Mr. Organ: Yes, to restore the firm to profitability and ensure its survival and growth.

Are some businesses more essential to his firm's identity?

Mr. Holder: Yes, there is no question about it.

Mr. Carlton-Porter: Yes, clay.

Mr. Organ: Yes, chocolate/confectionery and drinks.

Mr. Anson: Formerly tobacco, but less clear after diversification.

Appendix A-8 (Continued) Summary of Responses to Prepared Questions

TIMING (steps in the decision process):

Timing of acquisition process (from first thought to transfer of ownership).

Prof. Thomas: In the case of Normalair-Garrett's new products, the process sometimes took several years. They needed elements to fill their skill requirements.

Mr. Holder: Fast (note that he was an acquisition-oriented person).

Mr. Carlton-Porter: About a year, in the case of Bradley.

Sir Kenneth Selby: Usually 'quite fast'.

Timing of divestment process (from first thought to transfer of ownership).

Sir Kenneth Selby: Several years (in the case of Marples Ridgway).

Sir Kenneth Selby: Divestments take longer than acquisitions.

Mr. Organ: Several years, in the Jeyes case.

Mr. Organ: Divestments are very slow, acquisitions can be made quickly.

Appendix A-8 (Continued) Summary of Responses to Prepared Questions

VALUATION:

Which is a better method: A firm comparing two businesses relatively, or evaluating each separately in terms of a money value? (From the responses, it appears that the question was asked meaning 'which is easier?')

Mr. Oldham: It is easier to compare.

Prof. Thomas: It is easier to estimate separate values.

Mr. Carlton-Porter: Very much easier to compare, to assess the overall effect on the firm.

Why do two firms evaluating the same business arrive at different values?

Mr. Oldham: He agreed that they do (reasons not noted).

Prof. Thomas: The process is very complicated. Different people see different values in different attributes.

Mr. Holder: Optimism, the 'feel' of the business and relatedness to the rest of the firm affect its value.

Mr. Carlton-Porter: Relatedness to the firm's STRATEGY determines its value to his firm. Also other criteria may differ between two evaluators, such as ROI and price/earnings ratio.

Sir Kenneth Selby: People have different criteria (for example his own as opposed to the value attributed by the stock market).

Mr. Organ: Different criteria, for example whether the business is strategically related vs. an ROI-based valuation.

Appendix A-8 (Continued) Summary of Responses to Prepared Questions

Must the proceeds of a divestment exceed the value of the business to the divesting firm?

Prof. Thomas: One wants them to be, but liquidity may be important to the firm, overriding other issues.

Mr. Holder: One wants it to.

Mr. Carlton-Porter: The price they get has to exceed their own ROI-based value, and not raise controversy with shareholders.

Prof. Thomas: It is more of a problem when (1) the price is below book value and (2) the firm as a whole is having financial problems, making a book loss harder to accept.

Mr. Anson: The selling price always seems too low. The buying price always seems too high.

When might it be feasible for two firms to trade businesses with each other?

Mr. Oldham: Better 'fit' from the acquired business.

Mr. Holder: He said it is not particularly applicable to him (but it is close to his actual behaviour).

Appendix A-8 (Continued) Summary of Responses to Prepared Questions

PRESSURES: What pressures has he felt to acquire or to divest businesses?

Pressures to divest

Mr. Oldham: To advance the firm as a whole.

Mr. Oldham: If a business could not be given the optimum benefit of succeeding.

Mr. Holder: Possibly to raise money for an acquisition.

Prof. Thomas: Cost of having to dismiss employees later.

Prof. Thomas: The business was an insignificant competitor.

Prof. Thomas: The business had no influence on its suppliers.

Mr. Carlton-Porter: If it does not fit their strategy. To dispose of unwanted parts of the firm.

Mr. Carlton-Porter: If it is too small, of no consequence.

Mr. Carlton-Porter: Needed as a source of cash.

Mr. Carlton-Porter: To avoid future liabilities, such as layoffs.

Mr. Carlton-Porter: To reduce overheads.

Mr. Carlton-Porter: Not meeting financial targets or badly managed.

Mr. Organ: The business unrelated to corporate strategy.

Mr. Organ: He would be prepared to divest a business that IS strategically related if NECESSARY to proceed with some strategically important aspect of the parent.

Mr. Organ: To correct previous errors.

Mr. Anson: The business was too small.

Mr. Anson: To get out of a bad situation.

Appendix A-8 (Continued) Summary of Responses to Prepared Questions

Pressures to acquire:

Mr. Oldham: to advance the firm as a whole.

Mr. Anson: If resources are available and there is no reason not to make the acquisition.

Mr. Carlton-Porter listed four categories of strategic investment decisions:

(1) To extend the life of the firm (e.g.: new resources)

(2) Investments (such as new plants in new areas)

(3) Financial reasons

(4) It seems to be the right thing to do (highly qualitative).

Is a 'portfolio' approach used by his firm? (Leave it ambiguous between 'portfolio theory' and 'concept'. Can a firm have 'too many' good businesses?

Mr. Oldham: A portfolio approach is desirable 'if you can pull it off'.

Mr. Carlton-Porter: The firm redistributes cash among its subsidiaries and to cover overheads.

Mr. Carlton-Porter: Diversification lessens overall risk.

Sir Kenneth Selby: He liked to leave substantial control with managers of subsidiaries, to encourage initiative.

Mr. Organ: Theirs is a 'nice company'. They do not like to give a lot of direction to their subsidiaries.

Mr. Anson: Implicitly (as observed by the interviewer) they may have been using the portfolio concept, but it did not seem to be explicit.

Appendix A-8 (Continued) Summary of Responses to Prepared Questions

PEOPLE:

How many people were involved in particular acquisition and divestment decisions? What are reasons for limiting the size of the group? (secrecy, etc.)

Mr. Holder: Mainly made by himself and his managing director.

Mr. Carlton-Porter: Besides himself, part of the workload of two people.

Sir Kenneth Selby: Only 12 people knew about the Marples Ridgway divestment.

Interaction between acquisition and divestment decisions: (No responses)

Was he ever involved in an acquisition and a divestment at the same time?

Mr. Holder, Mr. Carlton-Porter, Mr. Organ, Mr. Anson and Prof. Thomas all were, but in the latter's case different organisations were involved. It is not clear whether the other two respondents were.)

Appendix A-8 (Concluded) Summary of Responses to Prepared Questions

Has he ever been involved in a strategic trade?

Mr. Holder: One combination that was very similar to a strategic trade.

Mr. Carlton-Porter: One involving two quarries, another involving trading a quarry for a 'non-mainstream' business.

Sir Kenneth Selby: One in the 1950's, a stone cutting business for a machinery business.

Were any other people involved simultaneously in acquisitions and divestments? (No responses)