Merger mania and global commodities

The business news in Richmond, Va., lately has been dominated by stories about takeovers of local companies. Several years ago, the area banks were making headlines. Industrial companies then followed.

The recent acquisition of Reynolds Metals by Alcoa was reported almost like a death in the family. Not only will many jobs be eliminated (or at least relocated) but the charitable largess provided by Reynolds will be lost to the community.

There have been other similar transactions: Exxon's bid for Mobil, British Petroleum's purchase of Amoco and subsequent acquisition of Atlantic Richfield, and Dow Chemical's proposed acquisition of Union Carbide are just the most notable examples.

These events reflect the trend by commodity providers to consume each other as they search for economies of scope and scale. Mergers of banks and financial institutions revolve around another commodity — money — and related financial instruments.

Isaac Newton maintained that every action had an equal and opposite reaction. Such was the case with the Alcoa-Reynolds deal, which was triggered as a defensive reaction to a competitor, Acan Aluminum, which sought to merge with two European competitors.

All sorts of issues affect such a monumental transaction.

First, there is a question of timing — or "the first-mover advantage." The company that is quick enough to select its targets first benefits because it can choose the best company in terms of acquisition price and fit. The first to sell can often do better by beating its competitors, which must sell later and at distressed prices.

The aforementioned transactions all involved mature companies in cyclical industries facing less than robust times. All suffered from price deflation and global overcapacity. Usually, the acquiring company was in an advantageous position due to better management, past reten
cence to invest in capacity (and contribute to further over_capacity) and an inclination to move fast.

These companies were also all affected by the Asian economic problems, which have since affected a business transformation in Asia.

The financial crisis in Japan gave rise to a huge transaction, the merger of three money-center banks: Bank of Japan, Dai-Ichi Kangyo Bank and Fuji Bank — probably just the first of many similar transactions. There is some thought that the 18 money-center banks will consolidate into a handful which will compete globally.

In South Korea, despite genuine concern that the government is backloading on its economic reform initiatives, the dismantling of Daewoo is evidence that serious economic reform is taking place. All business segments will be sold off except automotive, and General Motors has been offered an investment position that would give it management control.

All this activity is familiar to those of us in the transportation industry.

Consider the railroad mergers. Union Pacific moved quickly when Chicago and NorthWestern was subject to a hostile takeover, yet UP could not overcome Burlington Northern's first-mover initiative with Santa Fe, leaving UP with no choice but the Southern Pacific.

Sea-Land and Maersk are enjoying their third time as first movers. In 1990, they formed the first major vessel-sharing agreement of this decade. Later, they formed the first alliance. Although just about every line followed suit, many lines waited too long and wound up with incompatible partners. Most are still suffering from the poor decisions they made.

The steamship industry is clearly in the midst of major changes. For many foreign lines, the U.S. lines were obvious acquisition targets.

NOL, Maersk and Hamburg-Sud moved quickly to acquire, respectively, all of APL, most of Sea-Land and a large part of Crowley Maritime. Maersk was also a first-mover with its acquisition of Safmarine. Only a handful of significant acquisition opportunities present themselves during these times, and there is no consolidation price for lines unable to move on a more timely basis. The same is true of similar transactions in the Australia trade and other niche markets.

First-mover status is important as steamship lines realize that vertical integration is no longer necessary and they begin the task of divestiture of non-core assets. Two recent examples demonstrate this.

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