

Question Paper

Integrated Case Studies –II (MB381) : October 2007

Case Study (100 Marks)

- This section consists of questions with serial number 1 - 7.
- Answer all questions.
- Marks are indicated against each question.

Case Study

Read the case carefully and answer the following questions:

1. Analyze the various growth strategies adopted by P&G and Gillette before their merger.
(16 marks) < Answer >

2. “The developments in the consumer goods industry were forcing companies to go in for mergers and acquisitions. Moreover, the fact that companies had huge cash reserves during 2004 made growth through mergers and acquisitions a favorable choice for them”. In this context,
 - a. Explain the reasons for the wave of consolidations in the consumer goods industry that also led to P&G and Gillette merger.
 - b. Do you think the timing of the merger was right? Justify.(10 + 10 = 20 marks) < Answer >

3. “Mergers such as P&G-Gillette bring together companies that are complementary in their strengths, cultures, and vision to create the potential for superior sustainable growth.” Explain the underlying reasons for mergers and acquisitions in general and their applicability to this case in particular.
(14 marks) < Answer >

4. As per the P&G and Gillette merger deal, P&G would exchange 0.975 shares of P&G common stock for each share of Gillette. This invariably leads to dilution of control. Analyze how P&G could overcome the problem of dilution of control.
(7 marks) < Answer >

5. Assuming that there are no regulatory pressures, what could be the best strategy for P&G and Gillette to deal with product overlaps?
(11 marks) < Answer >

6. “The combination of two best-in-class consumer products companies, at a time when they are both operating from a position of strength, is a unique opportunity.” Discuss the post-merger benefits and challenges of the P&G and Gillette merger.
(9 + 8 = 17 marks) < Answer >

7. “P&G-Gillette deal created merger pressure for competitors in the industry. P&G would have at least some time in hand before its rivals caught up with it as most of its competitors were in bad health and needed to reformulate their strategies”. In this context, examine the effects of the P&G-Gillette merger on competitors.
(15 marks) < Answer >

THE PROCTER & GAMBLE (P&G)-GILLETTE MERGER

“This combination of two best-in-class consumer products companies, at a time when they are both operating from a position of strength, is a unique opportunity.”

[1]

– AG Lafley, Chief Executive Officer, P&G.

“This marks the realization of an historic next phase of great opportunity for Gillette and also for P&G. It brings together two companies that are complementary in their strengths, cultures, and vision to create the potential for superior sustainable growth.”

[2]

– James M. Kilts, Chief Executive Officer, Gillette Co. (Gillette).

“This merger is going to create the greatest consumer products company in the world. It's a dream deal.”

– Warren E. Buffett, Chairman and CEO, Berkshire Hathaway Inc.,

[3]

– **Gillette's largest shareholder.**
“Mergers that increase market share are generally productive because they increase market share and reduce competition. We don't think that the two companies combined will be any stronger, from a marketing point of view, than the two companies would have been if they were kept separate.”

[4]

- Al Ries, Consultant, Ries & Ries Consulting, Georgia.

P&G GETS THE RAZOR EDGE

With Cincinnati-based P&G announcing its investment deal to acquire Boston-based Gillette for \$57 billion, the stage was set for it to become the world's largest consumer products company with annual sales of \$60.7 billion. The new company would overtake Unilever, which had sales of \$48.25 billion in 2003. After its purchase of Gillette, P&G would have 21 billion-dollar brands with a market capitalization of \$200 billion.

In the past, Gillette had been considered as a company averse to mergers. Revlon Inc. (Revlon) had attempted a hostile takeover of Gillette in 1986 but was not successful. In 1999, P&G had approached it with a takeover proposal but Gillette had turned down the offer. Therefore, when Gillette's CEO, James M Kilts (Kilts), started merger talks in November 2004, saying that the timing was ripe for such a move, it came as a surprise to analysts. The price issue left the merger talks deadlocked for a month. But later, A G Lafley (Lafley), CEO of P&G, restarted the talks in January 2005.

Analysts said the merger was a brave move by Lafley who had led P&G during difficult times after he joined the company in 2000. Lafley changed the company's focus from household products to the fast growing health and beauty products. The company bought hair care firm Clairol from Bristol Myers Squibb in 2001 for \$4.9 billion and German hair care firm Wella AG (Wella) in 2003 for \$7 billion.

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At the same time, Gillette had also grown since Kilts joined the company in 2001. Rivals such as Energizer

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and Rayovac made attempts to diversify to compete with it (Refer Exhibit I for a note on Gillette's competitors). Commenting on the merger deal, Kilts said, “We believe we can bring these companies together and create a juggernaut”. He added that he was a great believer in scale and did not want to “get stuck with the

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leftovers” in a consolidating sector .

According to analysts, the merging companies had a lot of similarities – a corporate history more than a century old, billion-dollar brands, and pioneering consumer product marketing initiatives. They called it a unique case of acquisition by an innovative company to expand its product line by acquiring another innovative company. Analysts said both companies had faced similar problems of low sales and dwindling profits around the year 2000 and both had emerged winners after following similar approaches. Both the companies had focused on strong brands and cut down costs to ensure productivity gains. They described the merger as a “perfect marriage”. Some analysts also viewed the merger as a move to bring the consumer goods manufacturers on par with retailers, who had gathered considerable bargaining power.

However, analysts were concerned about P&G's handling of the risks accompanying the biggest merger it had planned to undertake in its 168-year-old history. This merger was 10 times bigger than P&G's largest purchase

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earlier . Therefore, analysts felt that the scale of the merger would make the integration a huge challenge. Further concerns were raised by analysts with relation to the integration of the workforce and the culture of the two companies, especially as there would be massive layoffs across countries. They also feared that P&G could face the risk of not being able to concentrate on its functioning due to the demands of the integration effort. They felt that the formulation of country specific strategies for the combined firm could take considerable time. Critics also pointed out that P&G already had some in-process integration of Wella that it had acquired in 2003 and this could also divert the management's attention and energies away from the current integration.

BACKGROUND NOTE

P&G

P&G was established in 1837 when candle maker William Procter and his brother-in-law, soap maker James Gamble merged their small businesses. They set up a shop in Cincinnati and nicknamed it “Porkopolis” because of its dependence on swine slaughterhouses. The shop made candles and soaps from leftover fats. By 1859, P&G had become one of the largest companies in Cincinnati, with sales of \$1 million. The company introduced Ivory, a floating soap, in 1879 and Crisco, the first all-vegetable shortening, in 1911.

In the 1940s and 1950s, P&G embarked on a series of acquisitions. It acquired Spic and Span (1945), Duncan Hines (1956), Chairman Paper Mills (1957), Clorox (1957; sold in 1968) and Folgers Coffee (1963). In 1973, P&G began manufacturing and selling its products in Japan through the acquisition of Nippon Sunhome

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Company .

In 1981, when John G. Smale (Smale) became the CEO, P&G's financial performance was under pressure. Manpower strength had crossed 100,000 due to P&G's acquisitions. P&G also faced intense competition from

companies such as Kimberley-Clark and Colgate. P&G stumbled in many categories, losing market share and profits. It had to withdraw its Rely tampons from the market after the product was linked to the deadly disease — Toxic Shock Syndrome. P&G responded by slowing down its research efforts. It also modified compensation plans for managers and plant workers to eliminate the obsession with short-term returns.

P&G moved into healthcare when it purchased Richardson-Vicks and G D Searle's non-prescription drugs division in 1985. In the same year, it announced several major organizational changes relating to category management, purchasing, manufacturing, engineering, and distribution. In 1988, the company formed a joint venture to manufacture products in China. P&G became the biggest cosmetics company in America when it acquired Noxell (1989) and Max Factor (1991).

In 1990, Ed Artzt, who had been heading P&G's international operations since the 1980s, replaced Smale as the CEO. Two years later, the company initiated an everyday low-pricing policy that reduced its reliance on coupons and trade promotions. The move helped in smoothening demand fluctuations and allowed P&G to cut prices on major brands. A year later, P&G initiated another restructuring program, cutting 13,000 jobs and closing 30 manufacturing plants. After years of trying to penetrate the orange juice market, P&G disposed of its Citrus Hill juice line and took a \$200 million charge in 1992.

In 1993-94, market research revealed that families loyal to P&G brands were paying \$725 more each year than families buying private label or store brands. P&G had been offering retail customers discounts from time to time, but it realized that it would have to offer these low prices every day if it wanted to remain a market leader. Sensing the need for a new operational strategy, P&G established eleven cross-functional teams to examine various work processes. Analysis revealed that P&G had the highest marketing overheads in the industry due to

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its complex product line. Five divisions with three sales layers each sold more than 2300 stock keeping units (SKUs), covering 34 product categories and 17 basic pricing brackets. Special deals meant that an average of 55 price changes worked through the system every day. To simplify this complex process, P&G reduced the number of pricing brackets from 17 to just 3 and the number of special prices from 55 to only 1 per day. It also reduced the number of SKUs by 25%. These changes, however, had only a short-term impact due to P&G's complex product line. Typically, P&G introduced a new brand for every significant technological innovation that occurred.

In 1994, P&G entered the European tissue and towel market with the acquisition of the German company, VP Schickedanz. A year later, John E. Pepper was appointed as CEO. During the year, P&G sold its Fisher Nut snack foods and Bain de Soleil skin care product units. In 1996, P&G agreed to buy baby wipes brands (Baby Fresh, wash-a-bye baby, and Kid fresh) from Kimberly-Clark. P&G also purchased the Eagle Snacks brand name from Anheuser-Busch. It pulled off a major coup when the FDA (Food and Drug Administration) approved the use of olestra, a fat substitute developed by P&G, for use in snacks and crackers. The company announced plans to use it in a fat-free version of Pringles potato chips. During the year, P&G decided to prune its Head & Shoulders product line, which had 31 varieties, and Crest, which had 52 versions. P&G also began to exercise strict control over its advertisement budget to reduce overall marketing costs to 20% (from 25%) of revenues by 2000. The company announced plans to pass on the cost savings to customers.

In 1997, P&G formed a global alliance with the German pharmaceutical company, Hoechst, to market P&G's new prescription bone health drug, Actonel, used in the treatment of osteoporosis. The company also signed a 10-year agreement with Regeneron Pharmaceuticals, to develop and commercialize pharmaceutical products. This agreement would combine Regeneron's strengths in molecular biology with P&G's development efforts and bring more products to the market in the long term. In April 1997, P&G decided to acquire Tambrands Inc., a company dealing in feminine protection products, for approximately \$1.85 billion. The acquisition was completed on July 21, 1997. In November, P&G announced that it would begin test marketing of Dryel, a new product that would enable consumers to take care of "dry clean only" clothes in the convenience of their homes. Toward the end of the year, P&G reached an agreement to sell its Duncan Hines baking mix trademark to Aurora Foods. As per the agreement, P&G would continue to accept orders from retailers on Aurora's behalf till March 1998. The people working in Duncan Hines would be re-deployed to other parts of P&G's food and beverages business.

In September 1998, P&G announced plans to redesign the company's management and operating structures. Under the 'Organization 2005 program,' as it came to be known, P&G announced that it would revamp work processes to improve efficiency and cut costs. P&G also explained that it would take several measures to provide a stimulating work environment to its employees.

In 2000, Lafley became the President and CEO. By 2002, as P&G celebrated its 165th anniversary, it had 12 billion-dollar brands in its portfolio. These brands represented more than half of the company's sales and earnings and included Pampers, Tide, Ariel, Always, Pantene, Charmin, Bounty, Iams, Crest, Folgers, Pringles, and Downy. By 2004, P&G manufactured and marketed over 300 branded products in more than 160 countries. It had sales revenues of \$51.4 billion and profits of \$6.48 billion (Refer Exhibit II). The company managed its business in five product segments: Fabric and Home Care, Baby and Family Care, Beauty Care, Health Care and Snacks and Beverages (Refer Exhibit III). The company re-aligned its businesses on July 1, 2004, to have three business segments (Refer Exhibit IV for new restructured segments). It was the #1 Fortune 500 Company in 2004 in the Household and Personal Furnishings segment.

GILLETTE

The Gillette Safety Razor Co. was set up in 1901 by King Gillette (Gillette) and William Nickerson (Nickerson). King Gillette was born in the central Wisconsin town of Fond du Lac and spent the first 30 years of his working life as a traveling salesman. Gillette like all other men at that time, used to shave with a heavy, wedge-shaped blade. He used to think how dangerous it could be to say shave in the lavatory of a moving train while traveling. The idea for a razor with a safe, inexpensive and disposable blade occurred to him one day when he was shaving. However, metallurgy experts said a small blade's edge could not be kept sharp. In 1901, William Nickerson, a Massachusetts Institute of Technology machinist, joined him and they took five years to build a machine that proved the experts wrong. They obtained a patent for a double-edged safety razor in 1904.

In 1905, the company established its London operations. During the 1920s, the company gained customers by rigorous marketing efforts. In 1939, the company started advertising during sporting events on radio. The next few years saw it undertake a spate of acquisitions. It acquired Toni company, which had personal grooming products in 1948. Two years later it took over another new business -- the Papermate Pen Company.

Gillette Safety Razor Co. was rechristened The Gillette Company (Gillette) in the 1950s. In 1953, it introduced Foamy shaving cream. During the 1960s-1970s, Gillette expanded its product range with the Right Guard deodorant, Cricket lighters, and Eraser Mate pens. A significant acquisition was that of Braun, which manufactured electric shavers and appliances, in 1967. In 1984, Gillette acquired the Oral-B tooth-care brand. Another significant development came in 1989 when Warren Buffett's Berkshire Hathaway acquired 11 percent of Gillette stock after the company defended four takeover attempts in the late 1980s - three from Revlon and one from Coniston Partners', a New York-based investment firm. Gillette acquired Duracell, the No. 1 battery maker, in 1996. It introduced the triple-blade Mach3 razor in 1998. Though the razor climbed quickly to the No. 1 position in the U.S., weak foreign sales hurt profits and Gillette had to cut jobs and close down factories. Michael Hawley (Hawley) became the CEO in 1999 and sold Gillette's hair-care business.

Within a year, Hawley was fired and COO, Edward deGraan, was named acting CEO. The company announced that it would cut 8 percent of its work force and 2,700 jobs. Kilts was hired as chairman and CEO in 2001. During the year, the company sold its stationery products business (Paper Mate, Parker, Waterman, and Liquid Paper brands). In 2003, it acquired a majority stake in Chinese battery maker Fujian Nanping Nanfu Battery Co. by buying China Battery International Ltd. Kilts was also successful in turning the company around. It had profits of \$ 2 billion on sales of \$9.25 billion for 2003 (Refer Exhibit V).

Gillette had five business segments - Blades and Razors, Duracell, Oral Care, Braun, and Personal Care (Refer Exhibit VI). It was the world leader in blades and razors, and alkaline batteries as well as in manual and power toothbrushes. The Blades and Razors segment was the primary business with sales of \$3.87 billion and profits of \$1.43 billion in 2003. Gillette had manufacturing operations at 32 facilities in 14 countries. Its products were sold in over 200 countries and territories.

THE CONSUMER GOODS INDUSTRY IN THE EARLY 2000s

The consumer goods industry grew rapidly from the 1950s through the 1990s, thanks to the launch of new products from frozen foods to disposable diapers. It was a period of growing population and increasing disposable incomes. Products were marketed based on the concept of mass marketing. However, in the early 2000s, slow sales growth, increasing costs of inputs, emergence of private labels, lower margins, difficult price negotiations, and increasing diversity of channels, choices, and consumer types posed new challenges for this \$ 2 trillion plus industry.

Retailers like Wal-Mart and Sears Roebuck had gained size through expansion and consolidation. They had greater bargaining power with respect to pricing, delivery, and standardization conditions. Wal-Mart, the world's largest retailer, had expanded rapidly, adding 484 stores since 2000. By 2004, it had 3,013 stores across the U.S. It accounted for about 8% of total retail sales in America, and its increasing presence in the rest of the world had put it in a position of strength. Over the years, it had built up a reputation of passing on the costs to suppliers. Most retailers were following strategies like asking suppliers to customize products and delivery and keeping payments pending for around two months. Wal-Mart's growing dominance had even prompted competing retailers to merge. The \$11 billion combination of Kmart and Sears Roebuck to emerge as the third largest retailer in the US market was driven by the need to gain purchasing clout with suppliers. They had been negotiating for lower prices after their merger announcement in November 2004.

The main players who competed in the consumer goods industry were renowned names like P&G, Colgate-Palmolive, L'Oreal, Kimberly Clark, and Masco in the Household and Personal Products category. Other players in this category included Gillette, Revlon, Henkel, Reckitt-Benckiser and Bic. The Food Consumer products segment was dominated by Nestle, Unilever, Pepsico, Conagra Foods, and Sara Lee. Johnson & Johnson was a big player in the healthcare category. Most players had been gaining size with acquisitions. Competition had made promotional offers a norm in the industry and advertising and marketing costs had also increased due to stiff competition.

A key development in the industry was the successful emergence of private-label brands. Consumers were no longer willing to pay the high prices for goods just because for the brand name. Moreover, un-branded products provided fatter profit margins for retailers compared to renowned branded products. According to Mitchell Kates, Principal for Kurt Salmon Associates, a consulting firm, "Retailers could earn 5 percent to 10 percent

[11] more on private brands." In a research conducted by the firm, shoppers' willingness to buy branded goods

had dropped by 12 percentage points, from 84 percent in 1997 to 72 percent in 2003. By 2009, this was expected to decline further to 66%. Consumer goods companies needed to handle this pressure from private labels, most of which were produced by big retailers. In the past, retailers had purchased and distributed branded consumer goods but with the launch of their own private label products, they had also become competitors for manufacturers.

Increasing media fragmentation had occurred over the years across major markets, including the US. The average household had access to numerous television channels. Companies had to constantly come up with new advertising strategies with new technological developments like the Internet and mobile commerce to reach a larger number of customers. Retailers and suppliers had embraced information technology to efficiently manage their operations and improve financial performance. Wal-Mart had demanded that suppliers should fit their

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packaging with Radio Frequency Identification (RFID) chips to help track goods through the supply chain. As retailers continued to put pressure on manufacturers for lower prices and private labels mushroomed, product innovation had become extremely important. IBM Business Consulting Services had identified five trends that were re-molding the business environment for consumer goods companies (Refer Exhibit VII).

All these developments in the consumer goods industry were forcing companies to go in for mergers and acquisitions. Moreover, the fact that companies had huge cash reserves during 2004 made growth through mergers and acquisitions a favorable choice for them.

THE ACQUISITION

As per the P&G and Gillette merger deal, P&G would exchange 0.975 shares of P&G common stock for each share of Gillette. It represented an 18% premium to Gillette shareholders based on the closing share prices on January 27, 2005. However, the merger was subject to approval by the shareholders of both Gillette and P&G. The merger was expected to get regulatory clearance by 2005. P&G planned to buy back \$18-22 billion of its common stock immediately after the merger. The buy back process could take around 18 months to complete. This would make the deal structure a 60% stock and 40% cash deal, although on paper it was a pure stock-swap. According to marketing guru, Al Ries, "The extra 18% premium paid by P&G for Gillette's stock is going to

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make it 18% more difficult for the deal to pay dividends to stock holders." P&G would have to borrow funds to finance the planned repurchase of its stock. In light of this move, credit rating agencies put both companies under a review for a possible downgrade. S&P placed all ratings for P&G on Credit Watch with negative implications based on the likelihood that P&G's leverage would increase significantly due to the merger. As of September 30, 2004, P&G had debts of \$21.4 billion and Gillette of \$3.1 billion.

Analysts commented that P&G had to pay a premium price of \$57 billion for Gillette. They cited that the 2005 earnings for Gillette were estimated at \$1.90 a share, which meant that the deal valued Gillette at 19.3 times Gillette's earnings before interest, taxes, depreciation, and amortization (EBITDA) whereas P&G's own stock was trading close to 18 times earnings during January 2005. Pete Sorrentino, chief investment officer at Bartlett

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& Co. Cincinnati, said, "It certainly looks expensive." However, some other analysts felt that the price was justified due to Gillette's leadership position. P&G said cost savings would add up to at least \$14 billion, making the merger profitable in the third year.

Regulatory concerns raised by the merger could relate to product overlaps between both companies, to determine whether the combined firm would have the power to set prices. Analysts felt that the consumer goods industry was quite large and competitive. Ernest Gellhorn, law professor at George Mason University in Arlington, said,

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"The two giants share only a modest overlap in a few product lines." However, he added that regulators could ask the company to divest products due to overlaps in the toothbrushes and toothpaste categories although P&G would like to keep as many Gillette brands as it could (Refer Table I for product overlaps).

TABLE I

PRODUCT OVERLAPS

P&G	Gillette
Old Spice Deodorant	Right Guard Deodorant
Crest Toothbrushes	Oral-B Toothbrushes
Glide Dental Floss	Oral-B Hummingbird Flosser
Crest White strips	Oral-B Rembrandt

Source: compiled from various sources

Christo Lassiter (Lassiter), a law professor and antitrust specialist at the University of Cincinnati, predicted the deal would easily win regulatory approval as P&G and Gillette mostly sold different products to different customers. U.S. sales of toothpaste, toothbrushes, and deodorant, including its Crest, Secret and Old Spice brands, accounted for only about 2 percent of P&G's \$51 billion annual revenues. According to an analysis by the investment firm, Lehman Brothers, the same product lines including Rembrandt, Oral B, and Right Guard brought about 9 percent of Gillette's \$10 billion of annual revenues. Lassiter also said the there was a growing concern in the government that preventing American companies from growing bigger could make them

vulnerable to foreign competition. "What good does it do if you keep American companies small only to be sacrificed at the altar of bigger competitors,"^[16] he said. Objections were, however, expected to come from European Union antitrust regulators in Brussels, as the deal would give the merged company added strength in overseas markets. The Massachusetts Secretary of State, William F. Galvin, opened an enquiry on February 2, 2005, into Kilts's compensation as it had set off a heated debate about whether Gillette was put up for sale for sound business reasons, or whether Kilts was influenced by the prospect of a big gain.

The Synergies

Both the companies expected the merger to bring tremendous synergies. According to Lafley, "This combination of two best-in-class companies creates a stronger brand portfolio, opportunities for even more innovation, faster sales growth, and cost savings."^[17] Analysts felt that both scale and focus were important in this industry and P&G had attempted to gain both with this acquisition. In the words of Lafley, "P&G and Gillette can grow together at levels that neither could sustain on its own. The reason is that consumer products is, in the end, a scale business. The more scale a company can create, the more opportunities there are to grow margins and invest in brand innovation."^[18]

Both companies had products in segments like healthcare and personal care. While P&G's strength lay in women's personal care products with brands such as Olay, Always, Tampax, Cover Girl and Max Factor, Gillette's strength lay in the men's grooming category with the entire range of Gillette and Braun products. The companies also had a similar technological base in skin care and specifically in oral care with products like Crest and Oral-B. By acquiring Gillette, P&G would be adding the world's best shaving products to its portfolio. (Refer Table II).

TABLE II
COMPANY COMPARISON

	P&G^a	Gillette
Sales	\$51.4 bn	\$10.3 bn ^b
Profits	\$6.5 bn	\$2.3 bn ^b
Dividends	\$2.5 bn	\$0.7 bn ^c
R&D Spending	\$1.8 bn	\$0.2 bn ^c
Leading Brands	Tide, Always, Pantene, Bounty, Crest, Ariel, Downy, Pampers, Pringles, Folgers, Wella, Olay, Head & Shoulders	Mach3, Gillette, Oral-B, Duracell, Braun
Employees	110,000	30,000

^a Year Ending 2004; ^b 2004 estimates; ^c 2003

Source: P&G

The acquisition would add about 20 percent to P&G's sales. This was significant in an industry where sales growth was difficult to achieve. Gillette and Colgate both had revenues of about \$10 billion. According to an interesting comparison, P&G's acquisition of Gillette would be similar to adding Colgate's sales to P&G's. Gillette had net income of \$1.39 billion in 2003, while P&G had \$6.48 billion. The combined company forecasted operating margins of around 25 percent by the end of 2015 in comparison to margins of 19.1 % in 2004.

Taking into account Gillette's growth potential, P&G increased its long-term sales-growth estimates to 5-7 percent a year, that is, approximately \$500 million each year. According to a research report from Citigroup analyst Wendy Nicholson, the Razors-and-Blades segment would contribute 7 percent to sales and about 12 percent to the operating profits of P&G after the merger. Sales of men's grooming products in the US totaled \$3.5 billion in 2004 and were expected to be \$8 billion by 2007. After the deal, health and beauty products would account for half of P&G's portfolio of products. Major gains could also come from bargaining with retailers on prices that would boost margins.

The companies expected cost savings of \$14-16 billion from combining back-room operations and the new growth opportunities. One of the areas of cost savings would be from eliminating jobs. Both companies would also benefit from adapting each other's technologies and joint Research and Development. The merger would also bring down the advertising and media costs due to greater bargaining power. According to the Advertising Age magazine, P&G had spent \$5.5 billion on advertising in 2004. Gillette had spent about \$600 million on marketing. The following could be the two major initiatives for innovation:

- Consumer Information: Procter & Gamble and Gillette's legacy of product innovation could be attributed to the fact that both the companies acknowledged the expressed and hidden needs of consumers. The combined company could influence retailers to share aggregated loyalty card information and use it as an important input for developing new products and services.
- Supply Chain Technologies: Both P&G and Gillette were considered leaders in the adoption of supply

chain technologies like RFID and Global Data Synchronization ^[19] (GDS). These technologies could be used to improve demand management by replacing historical forecasts with actual consumption signals. Since these companies were early adopters of RFID, much of their initial investment had already been made. But together they would have even more resources to strengthen their lead in a more cost effective way. RFID technology could help P&G in tracking stock-outs and could result in huge gains. Post-merger, P&G could also ask retailers to provide it with detailed supply chain information. George Colony, chief executive of Forrester Research Inc., said, "P&G was much farther in bringing electronic radio frequency tags on products to consumers and would likely bring Gillette up to speed. That will bring higher sales for ^[20] both companies and increase both top line and bottom line growth."

The two companies had a global scale with their products being marketed around the world. Also, both had placed a high priority on growth in developing markets. Gillette was more established in growing economies like India and Brazil. This would enable P&G to establish itself in these markets. P&G, on its part, would be able to provide wide distribution for Gillette products across the world especially in China and Japan where it had gained a strong foothold (Refer Table III for comparison of geographic sales of P&G and Gillette). Experts felt that P&G and Gillette could bring new products into the market more quickly, and learn from each other's strengths.

TABLE III
COMPARISON OF GEOGRAPHIC SALES OF P&G AND GILLETTE (%)

P&G (2003)		Gillette (2003)	
North America	50	North America	40
Western Europe	24	Western Europe	33
Northeast Asia	5	Asia Pacific	10
Developing Geographies	21	Africa/Middle East/Eastern Europe	10
		Latin America.	7

Source: www.forrester.com

Integration Issues

Kilts would be the vice chairman of P&G and would lead the integration for a year. The merger would result in around 6,000 job cuts equivalent to 4% of the two companies' combined workforce of 140,000. Most of these reductions would come from eliminating management overlaps and consolidation of business support functions. Although managing cultural issues is very important in mergers, especially cross-border ones, in this case, such problems were virtually absent given the geographic proximity of Cincinnati and Boston, the two firms' headquarters. However, P&G was considered a promote-from-within company and already had a lot of executive talent at the top. Absorbing Gillette's management to their satisfaction it was felt, could prove a problem. According to Deutsche Bank analyst, Bill Schmitz, "How P&G handles this massive cultural assimilation is likely the most important non-financial variable in ultimately marking this acquisition as a success or ^[21] failure."

According to Lafley, three potential categories that could help the combined company grow would be oral care, women's hair removal, and male grooming. P&G could use "technology transfer" ability (which refers to its drive to take technology from one brand and use it in another) for Gillette's products. Opportunities for product integration were also likely in the \$10 billion women's hair removal market that was growing at 8 percent a year. For example, it could apply some of its technology used in Olay skin-care to Gillette's women's razors. A major focus area could be the invention of new products. According to Steffen Lauster, a partner in the consumer products division of Booz Allen Hamilton, "P&G is very much structured around brands in which they can make a difference with innovation and technology. Gillette fits perfectly as it's a technology-based business in which ^[22]

they can add value." Also, P&G could promote Gillette brands together with compatible P&G products (Refer Table IV). Experts were of the opinion that the integration of their Enterprise Applications would not be that difficult as both P&G and Gillette had adopted SAP for their ERP deployments.

TABLE IV
POTENTIAL PRODUCTS FOR CO-PROMOTION

P&G	Gillette
Crest Spin Brush Electric Toothbrushes	Duracell Batteries
Noxzema Shave Creams and Gels	Mach3 Turbo razors
Folgers and Millstone coffee brands	Braun coffee makers
Crest toothpaste	Oral B toothbrushes

Source: compiled from various sources

OUTLOOK

Some analysts felt that the P&G-Gillette merger was a defensive move by P&G to check the growing power of retailers. "Retail had long been a struggle for power between vendors and retailers and lately retailers have had the upper hand," [23] said Robert Spector [24], a retail historian based in Seattle. He added, "Trying to raise prices and improve margins is very, very hard because of the Wal-Mart effect. This deal is about size versus size." [25] However, other analysts disagreed, saying it was an aggressive move for achieving growth rather than a balancing act. In the words of Jason Gere of A.G. Edwards', a brokerage firm, "While some view the deal as trying to shift the balance of power with Wal-Mart, we see it more about staying ahead of peers and enhancing Wal-Mart relationship." [26]

Some analysts felt the deal was the right move as it aimed at product diversification. According to them, the addition of Gillette's razor and Duracell batteries would further enhance P&G's strong and diversified brand portfolio. They pointed out that Gillette's brands had leadership positions and enjoyed a presence across various geographic locations.

Davis Dyer, a corporate historian and author of "Rising Tide," a history of Procter & Gamble, opined that acquiring Gillette would round out a personal care product range that tilted heavily toward women. He felt that acquiring Gillette was all the more important given the fact that P&G's recent acquisitions of hair care brands Clairol and Wella had reinforced that imbalance.

According to analysts, the P&G-Gillette deal created merger pressure for competitors in the industry. They also added that P&G would have at least some time in hand before its rivals caught up with it as most of its competitors were in bad health and needed to reformulate their strategies in light of this deal. So P&G could focus on integration without having to bother too much about competition.

Unilever, P&G's arch rival, had been under fire from investors for missing earnings targets and had been forced to rethink its 2005-2010 strategy in light of low sales, changing consumer trends, and price wars. The struggling Anglo-Dutch firm was already under pressure to improve its performance. It could have to acquire other firms to keep pace with P&G. Unilever products included Calvin Klein fragrances, Birds Eye foods, Hellmann's mayonnaise, Lipton tea, and Dove soaps. The company announced on February 10, 2005, that although it had a 6 percent increase in revenues for the third quarter, its business was hurt by strong competition and weak demand. Sales of its Ben and Jerry's ice cream and Lipton tea had fallen. Unilever said it was well into a five-year plan that included focusing on a smaller number of global brands, selling businesses that did not earn enough and putting the savings into promoting the core brands. P&G's entry into the male grooming market posed a further challenge to Unilever. Its Persil and Omo brands were already fighting a price war with P&G's Ariel and Tide in the laundry sector.

Colgate-Palmolive (Colgate) announced on January 28, 2005, that its fourth-quarter earnings had fallen by 23 percent due to plant closures and increased marketing. Colgate's sales had the biggest gain in more than eight years but net income had declined to \$285.7 million for the quarter in 2004, from \$372.1 million in the same quarter in 2003. Colgate was cutting about 4,440 jobs and closing one third of its factories, reducing profit by 9 cents a share. Reuben Mark, the chief executive, planned to use savings from the revamping exercise to increase advertising and protect Colgate's lead over Crest, P&G's toothpaste brand. Colgate-Palmolive's toothpaste and Speed Stick deodorant would be battling with P&G's Crest toothpaste and Gillette's Right Guard deodorant. Shares of UK's Reckitt Benckiser and French pen and razor group Bic's had moved up after P&G's Gillette deal on speculation that Colgate-Palmolive could be interested in these companies. But the company announced it would not be engaging in any M&A activity for quite some time. Analysts said the company was too busy with restructuring to make any acquisition moves.

Henkel KGaA, the German maker of Persil detergent and Dial soap, could also be affected by P&G's purchase of Gillette. Henkel had bought Dial Corp. of the U.S. for \$3 billion in 2003 to reduce its dependence on domestic sales, where high unemployment was reducing consumer spending. The Paris-based L'Oreal SA, the world's largest make-up manufacturer, with 14.5 billion euros in sales in 2004 found that its shares had dropped 41 percent since P&G announced its Clairol purchase in May 21, 2001.

Analysts felt that Nestle SA based in Switzerland, had already reached a huge size and would not be thinking of expansion.

However, some analysts felt that competitors could find a silver lining in the P&G-Gillette merger. Glenn MacDonald, professor of economics and strategy at Washington University's Olin School of Business in St. Louis, said, "When industries consolidate, that typically leads to more profits. Further, no merger ever goes as quickly or as smoothly as predicted and so competitors can take advantage of the disorganization that happens during a merger." [27] He added that competitors could launch new products or strengthen their supply chain relationships during this time to gain an edge.

Analysts had long suggested that the sector was ripe for consolidation. Many felt that a P&G-Gillette combination could be a transformative deal for the industry because of Gillette's growth potential. They also

forecast that this deal could lead to further consolidation in the industry. Prudential Equity Group analyst, Constance Maneaty, said, “Brands with solid market shares should attract a lot of interest.” [28]

Brian Till, professor of marketing at St. Louis University, said, “History had proved that mergers often don't live up to expectations and smaller companies that are more focused deliver strong profits.” [29] Analysts argued that mergers simply undertaken to gain scale generally failed. However, others disagreed and observed that P&G had rejected acquisition deals earlier on the grounds that they were different kinds of businesses. They felt that P&G went in for acquisition only when it saw opportunities for growth and did not go through the exercise just for the sake of acquisition.

Although P&G believed that it could squeeze more value out of Gillette's brands, there was an opinion in some quarters that most of Gillette's products could be at the peak of their lifecycles. Moreover, the costs of product innovation were quite high for razors and some analysts feared that consumers might be getting fed up with the ever-increasing prices of razors. Gillette had admitted in the past that it feared competition from low-cost rivals, particularly at its Duracell electric-battery division. As for the argument of synergies, Bethany McLean of *Fortune Magazine* commented, “Personally, I think synergies are a lot like UFOs. Lots of people claim to have seen them, but few can actually prove they exist.” [30]

EXHIBIT I A NOTE ON GILLETTE'S COMPETITORS

All of Gillette's markets are highly competitive. Some of its competitors are larger and have greater resources. The Blades and Razors segment is highly competitive in terms of new technology, as well as product performance, price, marketing, advertising, and promotion. Gillette's major competitors worldwide in blades and razors include Energizer Holdings, Inc., with its Schick product line, and, in certain countries, its Wilkinson Sword product line, and Societe Bic S.A. The Duracell segment is highly competitive in terms of price, marketing, advertising, and promotion. Competition in the Oral Care segment is focused on product performance, price, and professional endorsement. Competition in the electric shaver and epilator product lines is based primarily on product performance, innovation, and price. The Personal Care segment is highly competitive in terms of price, product innovation, and market positioning, with frequent introductions of new brands and marketing concepts and with product life cycles typically shorter than in Gillette's other businesses.

Source: Gillette Annual Report 2003

EXHIBIT II P&G FINANCIAL STATEMENTS SUMMARY

Proctor & Gamble					
Year ended June 30,	2000	2001	2002	2003	2004
Particulars (in millions except per share data)					
Net Sales	\$39,951	\$39,244	\$40,238	\$43,377	\$51,407
Operating Income	5,954	4,736	6,678	7,853	9,827
Net Earnings	3,542	2,922	4,352	5,186	6,481
Net Earnings Margin	8.9%	7.4%	10.8%	12.0%	12.6%
Basic Net Earnings per Common Share	\$1.30	\$1.08	\$1.63	\$1.95	\$2.46
Diluted Net Earnings per Common Share	1.23	1.03	1.54	1.85	2.32
Dividends per Common Share	0.64	0.70	0.76	0.82	0.93
Research and Development Expense	1,899	1,769	1,601	1,665	1,802
Advertising Expense	3,793	3,612	3,773	4,373	5,504
Total Assets	34,366	34,387	40,776	3,706	57,048
Capital Expenditures	3,018	2,486	1,679	1,482	2,024
Long-Term Debt	9,012	9,792	11,201	11,475	12,554
Shareholders' Equity	12,287	12,010	13,706	6,186	17,278

Source: P&G Annual Report 2004

EXHIBIT III
P&G PRODUCT SEGMENTS AND REVENUES

Segments	Products	Important Brands	Revenues (2003-04) (In \$ billion)
Fabric & Home Care	Laundry detergents and bleaches, fabric conditioners, household cleaners, and dish washing detergents	Tide, Ariel, Downy, Lenor, Gain, Cascade, Ace Laundry, Cheer, Bold, Swiffer, Bounce, Dash, Dawn, Fairy Dish, Joy, Febreze, Ace Bleach, Era, Bonux, Dreft, Daz, Vizir, Salvo, Mr. Proper, Mr. Clean, Flash, Fairy Laundry, Viakal, Dryel, Alomatik, Ivory Dish, Maestro Limpio, Rindex.	13.9
Baby, Feminine, & Family Care	Diapers, facial tissue, toilet tissue, paper towels, baby wipes, feminine protection.	Pampers, Luvs, Dodot, Prima, Always, Whisper, Tampax, Lines Linidor, Evax, Ausonia, Orkid, Charmin, Bounty, Puffs, Tempo, Codi Feminine Care	10.7
Beauty Care	Facial cleaners and moisturizers, hand and body lotion, personal cleaning, color, cosmetics, skin care cosmetics, deodorants, shampoos, hair conditioners, hair spray.	Pantene, Olay, Head & Shoulders, Cover Girl, Clairol Herbal Essences, Max Factor Cosmetics, Hugo Boss, Secret, SK-II Skin Care, Zest, Safeguard, Rejoice, Vidal Sassoon, Clairol Nice 'n Easy, Old Spice Deodorant, Pert, Ivory Personal Care, Sure, Camay, Laura Biagiotti, SK-II Cosmetics, Old Spice Fragrance, Physique, Noxzema, Giorgio, Muse.	17.1
Health Care	Toothpastes, toothbrushes, mouthwashes, allergy remedy, stomach remedy, cold remedies, decongestant, sinus remedy, throat drops, pharmaceuticals.	Iams, Eukanuba, Crest, Asacol, Actonel, Vicks NyQuil, Metamucil, Vicks VapoRub, Fixodent, Scope, Pepto-Bismol, Didronel, Vicks/Wick, Macrobid, PUR, Vicks DayQuil, ThermaCare, Vicks 44, Kukident, Cacit, Vicks Sinex, Dantrium.	7.0
Snacks & Beverages		Folgers, Pringles, Sunny Delight, Millstone, Punica, Torengos.	3.5

Source: P&G Annual Report 2004

EXHIBIT IV
NEW RESTRUCTURED SEGMENTS

Business Unit	Detail
Global Beauty Care	Cosmetics, Deodorant, Feminine Care, Fine Fragrances, Hair Care, Hair Colorants, Personal Cleansing, Professional Hair Care, Skin Care
Global Household Care	Coffee, Commercial Products Group, Fabric Care, Home Care, Snacks
Global Health, Baby and Family Care	Baby Care, Family Care, Oral Care, Pet Health and Nutrition, Pharmaceuticals

Source: Compiled from various sources

EXHIBIT V
GILLETTE FINANCIAL STATEMENTS SUMMARY

GILLETTE					
Year ended December 31,	1999	2000	2001	2002	2003
Particulars (in millions except per share data)					
Net Sales	\$8,324	8,310	8,084	8,453	9,252
Operating Income	\$2,087	1,512	1,498	1,809	2,003
Net Income	\$1,260	392	910	1,216	1,385
Net Income per Common Share, assuming full dilution	\$1.14	.37	.86	1.15	1.35
Dividends Declared per Common Share	\$.59	.65	.65	.65	.65
Balance Sheet Data					
Net Property, Plant, and Equipment	\$3,467	3,550	3,548	3,565	3,642
Total Assets	\$10,162	10,213	9,946	9,863	9,955
Total Debt	\$4,729	4,476	4,317	3,657	3,312
Stockholders' Equity	\$3,060	1,924	2,137	2,260	2,224
Other Information					
Net Interest Expense	\$129	218	141	59	42
Depreciation and Amortization	\$464	535	509	500	578
Capital Expenditures	\$889	793	624	405	408
Employees	37,600	35,200	31,500	30,300	29,400

Source: Gillette Annual Report 2003

EXHIBIT VI
GILLETTE PRODUCT SEGMENTS AND REVENUES

Segments	Products	Important Brands	Revenues (2002-03) (In \$ billion)
Blades and Razors	Blades and Razors	M3Power, Mach 3 Turbo, Mach 3, Sensor SensorExcel, Atra, TracII, Sensor3, Custom Plus, Good News, Gillette for Women Venus, Sensor for Women, Sensor Excel for Women, Sensor3, Agility, Daisy, Venus Divine, Passion Pink Venus.	3.87
Personal Care	Skin care cosmetics	Gillette Series, Right Guard, Soft & Dri, Dry Idea, Gillette Complete Skin Care, Satin Care, PowerStripe.	0.86
Oral Care	Toothbrushes, Dental Floss, Mouthwashes, Tooth Whiteners	Oral-B toothbrushes, Exceed, Vision, Classic, Oral-B CrossAction Vitalizer toothbrush, Oral-B ProfessionalCare 7000 Series of power toothbrushes, Oral-B CrossAction Power toothbrush, Oral-B AdvancePower 400 power toothbrush, Oral-B Hummingbird Flosser.	1.33
Duracell	Batteries	Duracell CopperTop Batteries, Duracell Ultra alkaline Batteries, Duracell Prismatic Batteries, Duracell primary lithium, zinc air, and rechargeable nickelmetal hydride batteries, Duracell Hearing Aid Batteries, Duracell Flashlights.	2.02
Braun		Flex XP2, Braun Activator, Silk-Epil Soft Perfection, Thermoscan etc.	1.18

Source: Compiled from various sources.

EXHIBIT VII
CONSUMER GOODS INDUSTRY TRENDS FOR 2010

Shifts in demographics, attitudes, and behavior are leading to the emergence of micro-market segments.

- Empowered by new technology and regulation, consumers have more bargaining power.
- New branding and marketing capabilities are needed due to the consumer's easy access to information.
- Consumer product companies have to keep up with retailers' growing demands while ensuring that they continue to have a place on the retailer's shelf.
- Companies are focusing on strong collaboration with value chain partners to increase flexibility and cost efficiency.

Adapted from IBM Business Consulting Mega- trends for 2010, www.ibm.com

END OF QUESTION PAPER

Suggested Answers

Integrated Case Studies – II (MB381) : October 2007

Case Study

1. Growth for an organization can be organic and/or inorganic.

Inorganic growth: A growth in the operations of a business that arises from mergers or takeovers, rather than an increase in the companies own business activity.

Organic growth: Organic growth is the rate of business expansion through increasing output and sales. Its main focus is productivity enhancement and cost reduction.

Inorganic growth strategies followed by P&G

- In the 1940s and 1950s, P&G embarked on a series of acquisitions. It acquired Spic and Span (1945), Duncan Hines (1956), Chairman Paper Mills (1957), Clorox (1957; sold in 1968) and Folgers Coffee (1963). In 1973, P&G began manufacturing and selling its products in Japan through the acquisition of Nippon Sunhome Company.
- P&G moved into healthcare when it purchased Richardson-Vicks and G D Searle's non-prescription drugs division in 1985.
- In 1988, the company formed a joint venture to manufacture products in China. P&G became the biggest cosmetics company in America when it acquired Noxell (1989) and Max Factor (1991).
- In 1994, P&G entered the European tissue and towel market with the acquisition of the German company, VP Schickedanz.
- In 1997, P&G formed a global alliance with the German pharmaceutical company, Hoechst, to market P&G's new prescription bone health drug, Actonel, used in the treatment of osteoporosis. The company also signed a 10-year agreement with Regeneron Pharmaceuticals, to develop and commercialize pharmaceutical products.
- In April 1997, P&G decided to acquire Tambrands Inc., a company dealing in feminine protection products, for approximately \$1.85 billion. The acquisition was completed on July 21, 1997.

Organic growth strategies followed by P&G

- In 1981, when John G. Smale (Smale) became the CEO, P&G's financial performance was under pressure. Manpower strength had crossed 100,000 due to P&G's acquisitions. P&G also faced intense competition from companies such as Kimberley-Clark and Colgate. P&G stumbled in many categories, losing market share and profits. It had to withdraw its Rely tampons from the market after the product was linked to the deadly disease — Toxic Shock Syndrome. P&G responded by slowing down its research efforts. It also modified compensation plans for managers and plant workers to eliminate the obsession with short-term returns.
- In 1985, it announced several major organizational changes relating to category management, purchasing, manufacturing, engineering, and distribution.
- In 1990, Ed Artzt, who had been heading P&G's international operations since the 1980s, replaced Smale as the CEO. Two years later, the company initiated an everyday low-pricing policy that reduced its reliance on coupons and trade promotions. The move helped in smoothening demand fluctuations and allowed P&G to cut prices on major brands.
- P&G initiated another restructuring program, cutting 13,000 jobs and closing 30 manufacturing plants. After years of trying to penetrate the orange juice market, P&G disposed of its Citrus Hill juice line and took a \$200 million charge in 1992.
- P&G had been offering retail customers discounts from time to time, but it realized that it would have to offer these low prices every day if it wanted to remain a market leader. Sensing the need for a new operational strategy, P&G established eleven cross-functional teams to examine various work processes.
- P&G reduced the number of pricing brackets from 17 to just 3 and the number of special prices from 55 to only 1 per day. It also reduced the number of SKUs by 25%. These changes, however, had only a short-term impact due to P&G's complex product line.
- In 1996, P&G decided to prune its Head & Shoulders product line, which had 31 varieties, and Crest, which had 52 versions. P&G also began to exercise strict control over its advertisement budget to reduce overall marketing costs to 20% (from 25%) of revenues by 2000. The company announced plans to pass on the cost savings to customers.
- In September 1998, P&G announced plans to redesign the company's management and operating structures. Under the 'Organization 2005 program,' as it came to be known, P&G announced that it would revamp work processes to improve efficiency and cut costs. P&G also explained that it would

take several measures to provide a stimulating work environment to its employees.

Inorganic growth strategies followed by Gillette

- Gillette acquired Toni company, which had personal grooming products in 1948. Two years later it took over another new business -- the Papermate Pen Company.
- A significant acquisition of Gillette was that of Braun, which manufactured electric shavers and appliances, in 1967.
- In 1984, Gillette acquired the Oral-B tooth-care brand.
- Another significant development came in 1989 when Warren Buffett's Berkshire Hathaway acquired 11 percent of Gillette stock after the company defended four takeover attempts in the late 1980s - three from Revlon and one from Coniston Partners', a New York-based investment firm.
- Gillette acquired Duracell, the No. 1 battery maker, in 1996. It introduced the triple-blade Mach3 razor in 1998.
- In 2003, it acquired a majority stake in Chinese battery maker Fujian Nanping Nanfu Battery Co. by buying China Battery International Ltd.

Organic growth strategies followed by Gillette:

- During the 1920s, the company gained customers by rigorous marketing efforts.
- In 1939, the company started advertising during sporting events on radio.
- Gillette Safety Razor Co. was rechristened The Gillette Company (Gillette) in the 1950s. In 1953, it introduced Foamy shaving cream.
- During the 1960s-1970s, Gillette expanded its product range with the Right Guard deodorant, Cricket lighters, and Eraser Mate pens.
- Gillette introduced the triple-blade Mach3 razor in 1998. Though the razor climbed quickly to the No. 1 position in the U.S., weak foreign sales hurt profits and Gillette had to cut jobs and close down factories.

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2. a. Reasons For Consolidation In The Consumer Goods Industry

- The consumer goods industry grew rapidly from the 1950s through the 1990s. It was a period of growing population and increasing disposable incomes. Products were marketed based on the concept of mass marketing.
- In the early 2000s, slow sales growth, increasing costs of inputs, emergence of private labels, lower margins, difficult price negotiations, and increasing diversity of channels, choices, and consumer types posed new challenges for this \$ 2 trillion plus industry.
- Retailers like Wal-Mart and Sears Roebuck had gained size through expansion and consolidation.
- Retailers had greater bargaining power with respect to pricing, delivery, and standardization conditions.
- Most retailers were following strategies like asking suppliers to customize products and delivery and keeping payments pending for around two months.
- Wal-Mart's growing dominance had even prompted competing retailers to merge.
- A key development in the industry was the successful emergence of private-label brands. Consumers were no longer willing to pay the high prices for goods just because for the brand name. Moreover, un-branded products provided fatter profit margins for retailers compared to renowned branded products.
- To have a competitive edge many big players had been gaining size with acquisitions
- Competition had made promotional offers a norm in the industry and advertising and marketing costs had also increased due to stiff competition.
- Wal-Mart had demanded that suppliers should fit their packaging with Radio Frequency Identification (RFID) chips to help track goods through the supply chain. As retailers continued to put pressure on manufacturers for lower prices and private labels mushroomed, product innovation had become extremely important.

b. Timing of the Merger

Analysts had long suggested that the sector was ripe for consolidation. Many felt that a P&G-Gillette combination could be a transformative deal for the industry because of Gillette's growth potential. The timing of the merger was right as many of its competitors like Unilever and Colgate-Palmolive were not in a position to cope up due to their own problems which are as follows:

- Unilever, which is an arch rival of P&G had been under fire from investors for missing earnings targets and had been forced to rethink its 2005-2010 strategy in light of low sales, changing

consumer trends, and price wars. The company announced on 2005, that although it had a 6 percent increase in revenues for the third quarter, its business was hurt by strong competition and weak demand. Sales of its Ben and Jerry's ice cream and Lipton tea had fallen.

- The struggling Anglo-Dutch firm was already under pressure to improve its performance. It would have to acquire other firms to keep pace with P&G.
- Colgate-Palmolive (Colgate) announced on January 2005, that its fourth-quarter earnings had fallen by 23 percent due to plant closures and increased marketing.
- Colgate's sales had the biggest gain in more than eight years but net income had declined to \$285.7 million for the quarter in 2004, from \$372.1 million in the same quarter in 2003. Colgate was cutting about 4,440 jobs and closing one third of its factories, reducing profit by 9 cents a share. The company announced it would not be engaging in any M&A activity for quite some time. The company was too busy with restructuring to make any acquisition moves.
- Nestle had already reached a huge size and would not be thinking of expansion.

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3. Motives behind M&A in general

- **Economies of scale:** This refers to the fact that the combined company can often reduce duplicate departments or operations, lowering the costs of the company relative to the same revenue stream, thus increasing profit.
- **Increased revenue/Increased Market Share:** This motive assumes that the company will be absorbing a major competitor and thus increase its power (by capturing increased market share) to set prices.
- **Cross selling:** Cross selling between the two companies can take place by sharing complementary technology platforms in skin care and particularly in oral care with the Crest and Oral-B franchises.
- **Synergy:** Better use of complementary resources.
- **Taxes:** A profitable company can buy a loss maker to use the target's tax write-offs. In the United States and many other countries, rules are in place to limit the ability of profitable companies to "shop" for loss making companies, limiting the tax motive of an acquiring company.
- **Geographical or other diversification:** This is designed to smooth the earnings results of a company, which over the long term smoothens the stock price of a company, giving conservative investors more confidence in investing in the company. However, this does not always deliver value to shareholders.
- **Resource transfer:** Resources are unevenly distributed across firms (Barney, 1991) and the interaction of target and acquiring firm resources can create value through either overcoming information asymmetry or by combining scarce resources.
- **Vertical integration:** Companies acquire part of a supply chain and benefit from the resources.
- **Increased Market share, which can increase Market power:** In an oligopoly market, increased market share generally allows companies to raise prices. Note that while this may be in the shareholders' interest, it often raises antitrust concerns, and may not be in the public interest.
- **Diversification:** If a firm launches a product that has no relation to its existing portfolio of the products there are lower chances of its success. Thus, in order to diversify, firms would prefer mergers and acquisitions route.
- **Empire building:** Managers have larger companies to manage and hence more power.

With respect to P&G and Gillette merger the motives for the merger include

- Both companies having corporate history more than a century old
- Billion-dollar brands
- Pioneering consumer product marketing initiatives.

Apart from these motives the merger took place because of other reasons such as global scale, cross selling synergy, resource transfer, diversification, etc.

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4. As per the P&G and Gillette merger deal, P&G would exchange 0.975 share for each share of Gillette

That is P&G gives => 0.975 for 1 single share of Gillette

This leads to the dilution of control for P&G as its shares get reduced which may inturn lead to dilution of ownership.

Therefore, P&G can handle this issue in only two ways.

- i. It can buy back some of its shares from the common stock of Gillette shareholders.
- ii. Prior to the merger, P&G could come up with a fresh issue for the purchase of new shares for its own

shareholders. But as the exchange of shares has happened after the merger, therefore, P&G can only buy back some of its shares in order to regain its control or ownership without any dilution.

According to the case study, P&G handled this problem through buyback of shares.

Although on the paper, it is reflected as a pure stock-swap, but the deal structure, constitutes 60% stock and 40% cash deal.

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5. In the case of any merger transaction, the new company will generally have product overlaps. The main decision pertains to whether the company wishes to drop the product or carry it further.

Companies generally derive synergies from elimination of product overlaps but this is not the case in this merger. Synergies in this merger will come more from other factors as most products happen to be complementary and enjoy strong brand equity. For example, both Right Guard and Old Spice are among the top three deodorants in terms of market shares.

Therefore, it is no surprise that P&G has indicated that it would retain all the brands if there were no regulatory pressures to do otherwise. In this scenario, the company should undertake a detailed assessment based on the current & potential revenues and market share of these overlapping brands. Based on this analysis, the company can differentiate the products based on parameters like region, function, technology, distribution channel, price, image, and customer perception and demographics.

In the case of the deodorants, P&G could consider leaving the Old Spice positioning untouched as it was renewed only recently and was selling well in the teen segment. However, it could try to re-position / renew Right Guard.

Alternatively, it could let the overlapping brands compete directly in the same markets to increase revenues by building on existing customer brand preferences.

This strategy could have the advantage of providing a shield in case of a sudden image problem or to balance the life cycle of each brand. In such a situation, P&G could substitute lost sales of one brand by gaining sales with the other.

With continuing multi brands, P&G would have the flexibility to react to newly emerging market trends by redirecting the market positioning of one brand while maintaining traditional customers with the other.

A multi brand strategy would also foster competition within P&G, resulting in better performance of both brands. In the overall analysis, the strategic handling of product overlaps is important because it would impact the ability of the new P&G to extract the planned value from the merger.

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6. SYNERGIES

- **Strong brands**

Both companies are built on leadership brands. The combined company will have the number global market position in categories representing about two-thirds of total sales. Combined, the companies will have annual sales of more than \$60 billion, eclipsing Unilever Plc as the world's largest consumer products company. Their portfolio will include Tide laundry detergent, Pampers diapers, Gillette razors and Duracell batteries. Both the companies had focused on strong brands and cut down costs to ensure productivity gains.

- **Heritage of Innovation**

Both companies have a strong heritage of innovation to delight consumers. In recent years, P&G and Gillette have accelerated their portfolio shift to faster-growing, higher margin, more asset efficient businesses providing greater value for their shareholders. Procter & Gamble and Gillette's legacy of product innovation could be attributed to the fact that both the companies acknowledged the expressed and hidden needs of consumers. The combined company could influence retailers to share aggregated loyalty card information and use it as an important input for developing new products and services

- **Global scale**

Both companies have global scale with their products being marketed around the world. Also, both companies have placed a high priority on growth in developing markets.

- **Expertise**

Both companies have complementary expertise in health and personal care. Historically, P&G has had strength in women's personal care with brands such as Olay, Always, Tampax, Cover Girl and Max Factor. Gillette has deep knowledge in the men's grooming category with the entire lineup of Gillette and Braun products.

- **Technology**

The companies also share complementary technology platforms in skin care and particularly in oral care with the Crest and Oral-B franchises. Both companies would also benefit from adapting each other's technologies and joint Research and Development. Supply Chain Technologies: Both P&G and Gillette were considered leaders in the adoption of supply chain technologies like RFID and Global Data Synchronization (GDS). These technologies could be used to improve demand management by replacing historical forecasts with actual consumption signals. Since these companies were early adopters of RFID, much of their initial investment had already been made. But together they would have even more resources to strengthen their lead in a more cost effective way. RFID technology could help P&G in tracking stock-outs and could result in huge gains. Post-merger, P&G could also ask retailers to provide it with detailed supply chain information.

- **Developing markets**

Both the companies had placed a high priority on growth in developing markets. Gillette was more established in growing economies like India and Brazil. This would enable P&G to establish itself in these markets. P&G, on its part, would be able to provide wide distribution for Gillette products across the world especially in China and Japan where it had gained a strong foothold.

- **Faster sales growth**

The acquisition would add about 20 percent to P&G's sales. This was significant in an industry where sales growth was difficult to achieve. Gillette had net income of \$1.39 billion in 2003, while P&G had \$6.48 billion. The combined company forecasted operating margins of around 25 percent by the end of 2015 in comparison to margins of 19.1 % in 2004. Sales of men's grooming products in the US totaled \$3.5 billion in 2004 and were expected to be \$8 billion by 2007. Major gains could also come from bargaining with retailers on prices that would boost margins.

- **Cost savings**

The companies expected cost savings of \$14-16 billion from combining back-room operations and the new growth opportunities. One of the areas of cost savings would be from eliminating jobs. The merger would also bring down the advertising and media costs due to greater bargaining power. According to the Advertising Age magazine, P&G had spent \$5.5 billion on advertising in 2004.

CHALLENGES:

The merger would result in **around 6,000 job cuts** equivalent to 4% of the two companies' combined workforce of 140,000. Most of these reductions would come from eliminating management overlaps and consolidation of business support functions.

Further concerns were raised by analysts with relation to the integration of the workforce and the culture of the two companies, especially as there would be massive layoffs across countries. They also feared that P&G could face the risk of not being able to **concentrate on its functioning due to the demands of the integration effort.**

They felt that the formulation of **country specific strategies** for the combined firm could take considerable time. Critics also pointed out that P&G already had some in-process integration of Wella that it had acquired in 2003 and **this could also divert the management's attention and energies away from the current integration.**

Although managing cultural issues is very important in mergers, especially cross-border ones, in this case, such problems were virtually absent **given the geographic proximity of Cincinnati and Boston, the two firms' headquarters.** However, P&G was considered a promote-from-within company and already had a lot of executive talent at the top. Absorbing Gillette's management to their satisfaction it was felt, could prove a problem.

The extra 18% premium paid by P&G for Gillette's stock is going to make it 18% more difficult for the deal to pay dividends to stock holders.

P&G would have to borrow funds to finance the planned repurchase of its stock.

Another challenge relates to product overlaps between both companies, to determine whether the combined firm would have the power to set prices.

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7. It was an aggressive move for achieving growth. The P&G-Gillette deal created merger pressure for competitors in the industry in the following ways:

- Some analysts felt the deal was the right move as it aimed at product diversification. According to them, the addition of Gillette's razor and Duracell batteries would further enhance P&G's strong and diversified brand portfolio.
- Gillette's brands had leadership positions created pressure among competitors.
- Their presence across various geographic locations posed challenge to competitors.
- The P&G-Gillette deal created merger pressure for competitors in the industry. P&G would have at least some time in hand before its rivals caught up with it as most of its competitors were in bad health and needed to reformulate their strategies in light of this deal. So P&G could focus on integration

without having to bother too much about competition.

- **P&G's entry into the male grooming market posed a challenge to Unilever.** Its Persil and Omo brands were already fighting a price war with P&G's Ariel and Tide in the laundry sector.
- Reuben Mark, the **chief executive of Colgate Palmolive**, planned to use savings from the revamping exercise to increase advertising and protect Colgate's lead over Crest, P&G's toothpaste brand. Colgate-Palmolive's toothpaste and Speed Stick deodorant would be battling with P&G's Crest toothpaste and Gillette's Right Guard deodorant.
- **Henkel** had bought Dial Corp. of the U.S. for \$3 billion in 2003 to reduce its dependence on domestic sales, where high unemployment was reducing consumer spending. Henkel KGaA, the German maker of Persil detergent and Dial soap, could also be affected by P&G's purchase of Gillette.
- The **Paris-based L'Oreal SA**, the world's largest make-up manufacturer, with 14.5 billion euros in sales in 2004 found that its shares had dropped 41 percent since P&G announced its Clairol purchase in May 21, 2001.

The above mentioned were some of the effects of P&G and Gillette merger on its competitors.

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- [11] Mike Hughlett, Becky Yerak, John Schmeltzer and Michael Oneal, "P&G, Gillette deal a matter of clout," www.chicagotribune.com, January 29, 2005.
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