FACTORS INFLUENCING THE SUCCESS OF CORPORATE MERGER IN MALAYSIA: THE CASE OF ROTHMANS PALL MALL (MALAYSIA) LIMITED AND MALAYSIAN TOBACCO COMPANY LIMITED (MTC)

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ASIA e UNIVERSITY

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ABSTRACT

Rothmans of Pall Mall (Malaysia) Berhad was incorporated in the Federation of Malaya on 11 September 1961 with an authorised capital of RM20,000,000. The Company was the first Rothmans venture in Asia and became the first overseas tobacco company to offer 50% of its holdings to the Malaysian public. On 31 October 1985, the company announced proposals for a restructuring of its equity in line with the Malaysia's National Economic Policy (NEP). Revised in May 1986, the scheme increased the Bumiputera shareholding in the Company from 4% to 30% without departing from the equity partnership, whereby the company was 50% owned by Rothmans International plc and 50% by local investors.

Malaysian Tobacco Company Berhad (MTC) was incorporated in the Federation of Malaya on 28 September 1956 as Malayan Tobacco Company. It was converted into a public company in February 1962. The company's name was changed to Malaysian Tobacco Company Berhad on 17 March 1977. The company was formed to take over the business of Malayan Tobacco Distributors Ltd (MTDL), a subsidiary of British-American Tobacco Co Ltd. In 1979, MTC started a modernisation programme (completed in 1987) which has provided up-to-date manufacturing and processing facilities at both its Sungai Besi and Shah Alam factories.

Given this background, the scope of this research are between two synergic companies; Malaysian Tobacco Company Berhad (MTC) and Pall Malls (Malaysia) Limited as British American Tobacco (Malaysia) Limited – BAT. The study primarily employs a PIE Model that encompasses three merger phases, i.e. pre-merger planning (P), merger integration (I) and post-merger evaluation (E). As such, the study aims to shed light on the critical success factors in these three merger phases that will contribute to the overall success of the merger between the two companies.

Corporate mergers represent part of a corporate business strategy used by many firms to achieve various objectives. For example, mergers can be used to penetrate into new markets and new geographic regions, gain technical and or management expertise and knowledge, or allocate capital. In order to survive and grow, business organisations often utilise mergers and acquisitions strategically. Nonetheless, many corporations worldwide utilise mergers as one of the most frequently selected instruments for growth. Understanding the sources and or determinants of value creation or value loss is vital to comprehending the causes of success and failure of corporate mergers.

However repeated analyses by researchers, academicians, business gurus, management consultants and investment bankers have all reached the same conclusion: in the medium term, fewer than half of all mergers add value. The shareholders whose company is bought end up richer; the shareholders of the buyer seldom do. There is plenty of scope for failure. Indeed, the marvel is that any mergers create value at all. Initially, many destroy it. Mergers suddenly throw together two teams of managers who have inevitably spent their working lives competing with each other prior to the merger. Mergers also scare employees, who know that 'economies of scale' spell redundancy. They signal to competitors that customers, suppliers and good staff are up for grabs. They wreck carefully nurtured corporate cultures. Historically, mergers and acquisitions have consistently been considered the domain of economists and market strategists rather than the behavioral sciences. Within the terms of the rational economic model, the activity is conceptualized as exclusively an association of financial and strategic convenience, which will lead to rapid and substantially

increased profitability. Financial analysts frequently fail to recognize that the merger or acquisition is an important human as well as financial activity.

From the study conducted and from the findings obtained, it is made to understand that influencing the success of Corporate Merger in Malaysia. Other than that, the outcome from the study is both purpose or objective as well as obtaining of reliable and valid information about the target were the most significant dimension in the pre-merger planning and both are equally important. The most important critical success factor in the merger integration process was the establishment of a sense of unity between the two merging firms. In addition, the identification of effective merger integration practices as soon as the merger deal is confirmed was the most crucial dimension in the merger integration phase. Market share gains or losses was also identified as the highest-ranking factors in the post-merger evaluation process. To add, Value-Based Management (VBM) proved to have significant and popularity in evaluating performance gains in the corporate merger.

Towards the case study, the significance of the study is to understand corporate restructuring and the factors that influence the success as well as the corporate exercises.

APPROVAL

This is to certify that this thesis conforms to acceptable standards of scholarly presentation and is fully adequate, in quality and scope, for the fulfilment of the requirements for the degree of Doctor in Business Administration

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DECLARATION

I hereby declare that the thesis submitted in fulfilment of the Doctor in Business Administration (DBA) degree is my own work and that all contributions from any other persons or sources are properly and duly cited. I further declare that the material has not been submitted either in whole or in part, for a degree at this or any other university. In making this declaration, I understand and acknowledge any breaches in this declaration constitute academic misconduct, which may result in my expulsion from the programme and/or exclusion from the award of the degree.

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Signature of Candidate: **Date**: 31 July 2022

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LIST OF ABBREVIATION

ASIA	Asset Sale and Investment Agreement
BAT	British American Tobacco plc
BAT(M)	British American Tobacco (Malaysia) Berhad
CID	Cigarette Importers and Distributors Sdn Bhd.
JPS	John Player Special Sdn Bhd
KLSE	Kuala Lumpur Stock Exchange
MTC	Malaysian Tobacco Company Berhad
MTCM	MTC Marketing Sdn Bhd
PWC	PricewaterhouseCoopers Consulting Sdn Bhd
RI	Rothmans International BV
RPM(M)	Rothmans of Pall Mall (Malaysia) Berhad
SPA	Sale and Purchase Agreement
TIM	Tobacco Importers and Manufacturers Sdn Bhd

CHAPTER 1

INTRODUCTION

1.1 Productive Corporate Combination

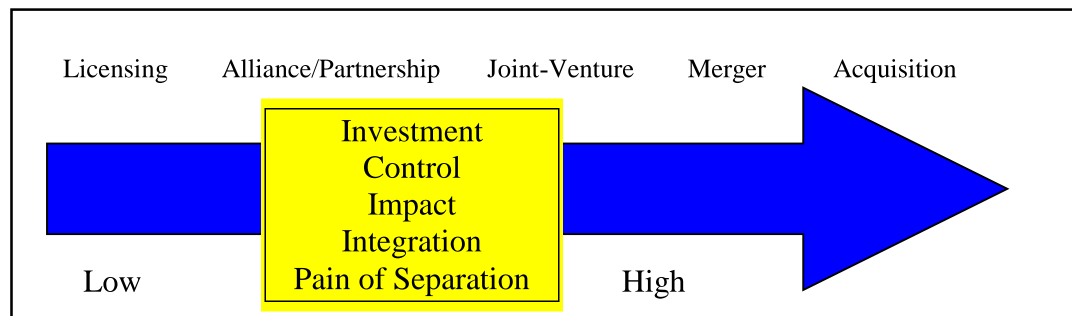
Productive corporate combination results when organisations join forces in a manner that genuinely enhances the capacity of the post combination organisation to achieve its desired strategic and financial objectives. To get one plus one to equal three, a combination must yield more than synergies based on economy of scale and elimination of redundancy. Although financial synergies can contribute significant savings, one-time gains do not leave the organization in a position to maintain a competitive edge in the long run. Neither does a focus on cost cutting tap the full potential of a combination. One study found that in 90 percent of all combinations, initiatives associated with generating revenue drove more value than any other action (Marks & Mires, 1998, p.5). Increasing revenue 1 percent has five times greater impact on the bottom line than decreasing operating expenses 1 percent. Yet managers in most combinations spend the bulk of their time searching for ways to reduce operating expenses.

Productive combinations, by contrast, build some capacity or asset that either was not present prior to the combination or was present and is now more fully utilised. This equates to using an acquisition or alliance to promote organisational change. According to Marks & Mirvis (1998, p.5), although many of the practices of executives and companies they have worked with fit under the umbrella of change management, they have found that lessons from generic change management texts do not neatly apply to the specific challenges set by combinations; nor do they consider the intellectual and emotional demands that senior executives encounter. Thus, managing change in a combination begins with asking why companies merge, acquire, or form

an alliance. This constructs the basis of what has to be planned and prepared for, and then what has to be done, to create value through a combination.

Organisations can link together in many forms of legal combinations, ranging from a relatively informal network to outright absorption of one entity by another. The forms of combination vary by the depth of commitment and level of investment between the organisations joining forces as shown in Figure 1.1.

Figure 1.1 : Types of strategic combination



Source: Marks & Mirvis (1998)

At the lower end of the continuum is the relatively simple relationship of organization 'A' licensing a product, service, or trademark to organization 'B'. Next, a strategic alliance is a cooperative effort by two or more entities in pursuit of their own strategic objectives. A joint venture goes further, by establishing a complete and separate formal organization with its own structure, governance, workforce, procedures, policies and culture while the predecessor companies still exist. At the far end of the continuum are mergers and acquisitions. A merger usually involves full combination of two previously separate organizations into a third (new) identity. An acquisition typically is the purchase of one organization for incorporation into the new parent firm. For the purpose of this study, where the combination between Rothmans of Pall Mall Malaysia (Berhad) and Malaysian Tobacco Company are concerned, the

terms 'Merger' and 'Acquisition' shall be taken to be synonymous, and they are therefore, interchangeable.

Important differences distinguish these forms. Financial investment and risk increase along the continuum in Figure 1.1, but so does the control hold by the lead company. Concurrently, the impact on the target company or lesser partner grows, as do the requirements for integration. The pain of separation swells in moving from a partnership or joint venture to a merger or acquisition. If, for whatever reason, a combination does not live up to its expectations (or if the needs and desires of either party change), then the formal bonds of a merger or acquisition are much more difficult to undo than are the relatively tentative and loose arrangements of an alliance or joint venture.

In an alliance or joint venture, one does not own the other company, nor does one unilaterally control decision making. A merger, however, implies cooperation, but what may be announced as a merger is rarely perceived as being a combination of equals by the members of at least one of the partnering organisations. People from one side are likely to feel a sense of superiority and greater entitlement, while those from the other side may see themselves in a relatively weak position and fear a perceived threat to themselves and their way of doing things. Thus, these forms of strategic combination differ in psychological terms as well as legal and financial. A strategic alliance involves commitment and sharing of resources including money, technology, and people, but it is defined by temporary business relationships among autonomous partners. An acquisition is a more dramatic and substantial commitment, entailing complete union of the previously independent partners.

What Cartwright and Cooper call a “modern marriage” is the rarest form of organisational marriage. But it’s the type most likely to result in a productive

combination, with synergies between partners that create something that cannot be realised independently. The essence of this modern organisational marriage is shared learning: the partners are stronger and more successful together than if they continue to operate separately. Differences in organisational procedures or cultures are seen as potentially adding value to the partnership and are respected and built upon as their partnership unfolds.

Historically, executives have preferred acquisitions over alliances to be in clear control. Alliances involve forming relationships between individuals and organisations that retain substantial independence, in contrast to one side's dominance (at least in the legal domain) over another in an acquisition. Relative to acquisitions, alliances feature less-hierarchial structures, more collaborative cultures, and somewhat equitable distributions of power and authority among the alliance's principal participants. Alliances are frequently formed to produce a specific product or service rather than to affect the overall operations of an organisation; they are not company-focused. They frequently involve several different organisations that may, in other settings, actually compete against one another in a specific market. The members of alliances are primarily concerned with improving the quality of the product or service they provide, better serving their mutual customers, and finding ways in which together they can gain a greater share in their mutual market or broaden the scope or the market for which they sometimes compete.

Increasingly, alliances are favoured as new business realities make them more advantageous. It has been noted that in attractive new markets laws may preclude the possibility of a merger or acquisition. An unstable political situation, unpredictable currency exchange or unfamiliarity with the country's business environment could

acquire too risky or the most desirable partner may be open to alliance but not to acquisition.

1.2 Definitions of Abbreviations & Brief Description

Table 1.1 : Abbreviations & Brief Description

Abbreviation	Meaning	Brief Description
ASIA	Asset Sale and Investment Agreement	Agreement between acquirer and target company
BAT	British American Tobacco plc	Parent company of MTC
BAT(M)	British American Tobacco (Malaysia) Berhad	Proposed new company name arising from the merger between RPM(M) and MTC
CID	Cigarette Importers and Distributors Sdn Bhd.	Wholly owned subsidiary of RPM(M)
JPS	John Player Special Sdn Bhd	Wholly owned subsidiary of MTC
KLSE	Kuala Lumpur Stock Exchange	The Malaysian Stock Exchange
MTC	Malaysian Tobacco Company Berhad	The Target Company
MTCM	MTC Marketing Sdn Bhd	Wholly owned subsidiary of MTC
PWC	PricewaterhouseCoopers Consulting Sdn Bhd	Valuer of Target Firm
RI	Rothmans International BV	Parent company of RPM(M)
RPM(M)	Rothmans of Pall Mall (Malaysia) Berhad	The Lead or Acquiring Company
SPA	Sale and Purchase Agreement	Agreement between Target and Lead Companies
TIM	Tobacco Importers and Manufacturers Sdn Bhd	Wholly owned subsidiary of RPM(M)

1.3 The Global Merger

The world's top four tobacco companies as at the beginning of 1999 were as follows:

i Phillip Morris

ii BAT place

iii R. J. Reynolds

iv Rothmans International BV

On January 11, 1999 the second and fourth largest international tobacco companies as above i.e., London based BAT place and the Netherlands based Rothmans International BV, announced a US$7.48 billion global merger. Regulatory approval from the European Commission was obtained on March 17, 1999, whilst the respective companies' shareholders gave their approval for the merger on April 8, 1999. The global merger was completed in London on June 7, 99 when BAT issued 604,336,627 Ordinary Shares and 241,734,651 Convertible Preference Shares in consideration for Rothmans International. Completion of the global merger meant that the ownership of Rothmans International had been transferred unconditionally from the owners, Camping Financier Richmond Ag and Rembrandt Group Limited, to BAT. BAT has thus become the sole shareholder in Rothmans International and Richemont and Rembrandt have become shareholders in BAT. Richemont and Rembrandt now own 35% of the fully diluted ordinary share capital of BAT. Rothmans International and its worldwide subsidiary companies henceforth became wholly owned subsidiaries of the BAT Group. The merger creates a new combined BAT with 16% share of the world cigarette market, making it the second largest global cigarette company after Philip Morris. The world's tobacco leader, Philip Morris which manufactures Marlboro and other brands, commands 17% of the world market. Together, BAT and Rothmans produced more than 900 billion cigarettes in 1997, production of which included brands like Kent, Lucky Strike, Dunhill, Benson and Hedges, Peter Stuyvesant, Rothmans and Parisienne. It was announced that the merged company will continue under the name BAT plc. Martin Broughton, who chairs the merged company said:

> "This merger represents a major step forward in the achievement of our vision to become the world's leading international tobacco company. There had been speculation that BAT was talking about a deal with R.J. Reynolds, ranked third in the international market, but this is the best alternative available to us. It gives us clear leadership in the emerging markets. The Reynolds deal wouldn't give us that."

It is obvious that the Chairman's vision is for the newly merged company to become a global leader in the industry.

1.4 The Local Merger

Following the successful global merger of the parent companies, the local subsidiaries RPM(M) and MTC on July 19, 1999 entered into a Sale & Purchase Agreement for MTC to be merged with RPM(M) for a purchase price of RM769,500,000 cash. The combined firms will together form a new BAT(M). RPM(M) has been the market leader of the Malaysian tobacco industry, with a market share of approximately 53% while MTC ranks third with around 17% market share. As at the time of writing, the objectives of the merger at the local level were not clear. Nonetheless, it appears that the acquisition of MTC by RPM(M) is a direct consequence of the global merger of their respective parent companies.

In order to capture merger benefits, merging firms must perform their merger process in a deliberate manner that converts the merger purpose into a realised one. It is important to acknowledge that the effective merger process must be synthesised and must simultaneously consider every factor affecting its outcome. Moreover, to maximise the merging firms' strategic gains, three general phases in the overall merger process, including the pre-merger planning phase, post-merger integration phase, and the post-merger evaluation phase, must be managed as integral to one another, rather than a separate phases or distinctive steps. In the context of the local merger viz.

Rothmans of Pall Mall (Malaysia) Berhad and MTC, this study will be based on these three merger phases.

1.5 The Lead Company: Rothmans of Pall Mall (Malaysia) Bhd

1.5.1 Background of the Company

The lead company was incorporated in the then Federation of Malaya on 11 September 1961 as Rothmans of Pall Mall (Malaya) Ltd with an authorised capital of RM20,000,000. It was converted into a public company on 12 October 1961 and subsequently listed on the Kuala Lumpur Stock Exchange's Main Board on 27 October 1961. Its name was changed to Rothmans of Pall Mall (Malaysia) Ltd on 1 September 1964 and later to Rothmans of Pall Mall (Malaysia) Berhad (RPM(M)) on 15 April 1966.

The Company was the first Rothmans venture in Asia and became the first overseas tobacco company to offer 50% of its holdings to the Malaysian public. Its operations commenced as a pilot plant in Singapore in May 1962 and in November of the same year in Malaysia. On 31 December 1981, a scheme was undertaken to separate the Rothmans Malaysia and Singapore operations. Rothmans sold its wholly-owned subsidiary, Rothmans of Pall Mall (Singapore) Pte Ltd to Rothmans Industries Ltd, also of Singapore. On 31 October 1985, the company announced proposals for a restructuring of its equity in line with the Malaysia's National Economic Policy (NEP). Revised in May 1986, the scheme increased the bumiputera shareholding in the Company from 4% to 30% without departing from the equity partnership, whereby the company was 50% owned by Rothmans International plc and 50% by local investors.

On 15 January 1987, the existing shares in the company were removed from the official list of the Exchange and 61,970,000 new shares arising from the restructuring