THE EFFECTS OF MERGER ON COMPETITION: EVIDENCE FROM SMITHKLINE BEECHAM AND GLAXO WELLCOME

Mohammad Abu Sufian, Daffodil International University
S M Sohel Rana, Daffodil International University

ABSTRACT

The paper aims at clarifying the role of merger in influencing the competitive structure in the international market. Therefore, it reveals how merger as expansion strategy plays an important role to decrease and increase competition level in the market. It is indentified that merger leads to change in market share and power of a firm that may lead both negative and positive impact over the competition and related stakeholders. Price fixing, harm of consumer interest, production limitation, entry barriers, suppliers' restriction are some negative influences identified in this paper. In addition, developments of innovative products or services, price reduction, operational efficiency etc are some positive influences of merger identified in this paper. From the case study of merger between SmithKline Beecham and Glaxo Wellcome, it is identified that horizontal merger majorly influences the competitive structure of a market. It is identified that although this merger is responsible to emerge world's leading pharmaceutical company, at the same time, it increases competition that benefits customers in terms of low cost and high quality.

Keywords: Merger, Competition, Stakeholders, Company, Consumers and Market.

INTRODUCTION

In this dynamic and global business environment, each firm faces intense competition from other firms in the market. This intense competition among the firms creates significant difficulties for them to sustain profit and performance accordingly. In this scenario, corporations are seeking such ways through which they facilitate competition for other firms in the industry without affecting financial and operational performance. In order to remain competitive, companies are engaged to adopt some expansion strategies such as joint-venture, mergers, FDI and acquisition etc. (Duxbury et al., 2007). The above strategies enable firms to obtain several benefits such as economies of scale, cost cutting, operational efficiency, global presence etc. López & Vives (2018) state that mergers can have unilateral effects for investment in research and development (R&D) those are conceptually similar to the unilateral effects from mergers for price competition. Saraswathy (2016) found that in most of the merger intensive sectors, the disappearance rate was significant to influence market competition. On the other hand, for the surviving firms, the increase in market shares is not sustained in the long run as expected, which was mainly due to the absence of synergy creation during the post-merger period.

The strategic execution of large firms plays an important role to influence the competitive environment of a market or industry. This influence affects the functions of other companies in related industries. Thus, it is needed to analyze the effects of expansion strategies of a firm in terms of market competition. With the implementation of defined rules, policies and regulations under International Competition Law (ICL), the influence of expansion strategies over business activities are controlled in effective manner (Davison & Johnson, 2000). By this law, an expansion strategy should not influence the competitive structure of a market. ICL is implemented to measure and control the competition level that is influenced due to firms' expansion strategies. In this way, it plays crucial role in companies to motivate them for adopting competitive practices with ethical considerations. Under this law, each firm is obliged to get approval from the authorities of ICL, while executing any expansion strategy. By only getting approval from ICL, firms are able to proceed in their desire market through expansion strategies (Wood & Wrigley, 2007). A merger or any other strategy is not approved by this authority, if it either increases or decreases the market competition level at greater extent. There are mainly three type of mergers namely vertical, horizontal and conglomerate that are executed by the companies to expand their markets domestically or internationally. Each type of merger demonstrates different processes that reasonably influence market competitive structure differently. Although each expansion strategy plays an important role to influence the competition structure, merged companies have wider possibilities to impact ICL (Marsden, 2000). Due to this, regulatory authorities significantly focus over the merger process in analyzing the impact of ICL at greater extent. With the case study of GlaxoSmithKline, this paper evaluates the effects of merger on the competition level of market. Hence the prime objective of this paper is to explore the effects of merger on different stakeholders with special reference to SmithKline Beecham and Glaxo Wellcome.

Merger between SmithKline Beecham and Glaxo Wellcome

Glaxo Wellcome, a UK based pharmaceutical company, was engaged to produce pharmaceutical products for curing two main diseases namely asthma and HIV/Aids. It was the third-largest pharmaceutical company by revenues in 1991. Around 4 cent of market share of this industry was obtained by Glaxo Wellcome. On the other hand, SmithKline Beecham was also UK based company and engaged to produce medicines globally. In the year 2000, a merger between SmithKline Beecham and Glaxo Wellcome took place in the UK. This transaction renamed both companies in GlaxoSmithKline (EvaluatePharma, 2000). Glaxo Wellcome merged this company's operations by giving total value of $75.7 Billion. This merger proposal was reviewed by The European Commission and United States Federal Trade Commission (FTC) (Markham, 2002). It was declared that this merger would not influence competition level of this industry in negative manner. There were several objectives exist behind this merger. At the same time, there were several issues that greatly affected operations of this industry such as R&D pipelines and their cost, drug reimbursement, political pressure for reducing prices, expiration of patents etc. The objective was to either reduce or eliminate the above issues, while achieving and sustaining significant market share. Due to this merger, merged entity is enabled to achieve leading position in the global pharmaceutical company. A significant improvement is also noticed in the financial performance through this merger. This merger also laid significant innovation in the field of medicine production. It also enhanced its operational network in the global market, while satisfying the emerging needs of drugs. In above ways, it gained benefits for all stakeholders (Glader, 2006). A noticeable enhancement in competition level was also noticed due to this merger that motivated other global and national pharmaceutical companies for reducing operational cost, while maintaining quality in their products and services (EvaluatePharma, 2000).

LITERATURE REVIEW

Merger Types and Their Influence on Competition

The combination of two companies including their operations is termed as merger. It is because this activity of an organization is responsible to strengthen the operations at greater extent. This may enable a firm to influence the activities of other national and global organizations' functions (Bitzenis, 2005). Due to this, each merger activity is expected to induce two types of effects either competitive or anti-competitive. Each type of merger depicts different processes of a firm to make a combination with other one (Qing Hao & Howe, 2011). There are three types of mergers namely horizontal, vertical and conglomerate adopted by organizations and each influences competition level of market in different manner.

Conglomerate merger

The combination of two firms, which belong from totally different industries or businesses, is termed as conglomerate merger. Merger between the American Broadcasting Company and Walt Disney Company is one of the examples of this type of merger as both companies were engaged to perform completely different businesses. This type of merger does not influence the competitive structure of a market. In the comparison of other two mergers, it influences competition level in the least manner (Kumar, 2012). This merger is only performed by companies to enhance the business portfolio and to divert business risk for making it more competitive. The merger of two different businesses does not provide sufficient strength to influence market price and competitiveness in an industry (Al-Muharrami, 2009). It is because there is less possibility to influence competition structure of a market. At the same time, this merger is also unable to enhance a firm's market power and due to this it does not create entry barrier for other firms (Bitzenis, 2005). In this way, it does not possess significant influence over competition.

Vertical merger

A merger through which firms are able to reduce reliance and increase profitability by combining their operation with either supplier or distributor is termed as vertical merger. The merger between Time Warner Incorporated and Turner Corporation is one of the examples of this type of merger. The first company was engaged to perform cable operations and the other one produced TBS, CNN, and other programming. This type of merger plays a crucial role in increasing market power of a specific company (Andrews, 2008). The influence of this merger over the competition level is quit high from conglomerate and less from horizontal merger. Such integration allows an organization to perform in most effective manner in the comparison of other organizations that plays a crucial role to increase market power. It induces anti competitive activities in the form of decrease and increase in revenues and cost for rivals respectively. Through supplier or distribution firm, an organization is able to increase operational efficiency and to improve financial performance accordingly in this merger. The level of market power induced through vertical merger largely depends over the effectiveness of management skills and efficiency (Hitt & Ireland, 2008). It is because merger's influence over market competition is quite varied in nature.

Horizontal merger

A combination of two companies, which are engaged to sell the same product or service, can be defined as horizontal merger. In comparison of other two, this merger influences market competitive structure in most effective manner. Merger between SmithKline Beecham and Glaxo Wellcome is an example of this kind of merger. There are two types of effects such as unilateral effect and non-coordinated created by horizontal merger over competition. In unilateral effect, merged companies demonstrate significant power in market unilaterally and increase price of product or service (Lodorfos & Boateng, 2006). It harms consumers' interest as they tend to pay higher price for a product or service than earlier. In non-coordinated, merged firms exercise their market power to reduce and prevent the existing and new competitors respectively within an industry. This act of firms reduces the availability of sellers' options for the consumers that affects their bargaining power. In both effects of horizontal merger, interest of consumers is greatly affected. In addition, this merger enables a firm to influence price and quality standards at such extent that could exclude number of competitors within the specific industry (Dabbah, 2004). Therefore, this integration also allows a merged firm to prevent entry or emergence of new firms. Due to huge market power, horizontal merger also offers dominant place to a firm that induces cartel practices within an industry. Price fixing, control over suppliers and market share are some cartel practices that are conducted by merged firms easily (Delaney, 2003).

METHODOLOGY

The present study is qualitative in nature as it analyzes the effects of mergers on competition taking information from literatures on past studies. It basically takes the case of SmithKline Beecham and Glaxo Wellcome. It is based on the literature on the pros and cons of mergers in the competitive structure with special reference to SmithKline Beecham and Glaxo Wellcome. It critically analyzes the consequences of mergers between SmithKline Beecham and Glaxo Wellcome on the competitive structure in the market. At the same time, the present study's research design rests on the existing set of assumptions and concepts in literature related to mergers. While designing the study, the researchers took secondary data from the existing literature related to this study. Research papers from different sources were taken into consideration for providing an in depth knowledge on how mergers influence the competitive structure in the foreign market. Therefore, the study is based on secondary data on how merger as expansion strategy can play an important role to decrease and increase competition level in the market.

RESULTS AND DISCUSSION

The present study reveals how merger as expansion strategy plays an important role to decrease and increase competition level in the market. It is also indentified that merger leads to change in market share and power of a firm that may lead both negative and positive impact over the competition and related stakeholders. Price fixing, harm of consumer interest, production limitation, entry barriers, suppliers' restriction are some negative influence identified in this study. In addition, development of innovative products or services, price reduction, operational efficiency etc. is some positive influences of merger identified in this study. From the case study of merger between SmithKline Beecham and Glaxo Wellcome, it is identified that horizontal merger majorly influences the competitive structure of a market. In regard to this case, coordinated effects were produced by this merger within the pharmaceutical industry. This merged company is engaged to observe product and price launch of other competitors and to take decision accordingly. This act of merged firm influences competition level of the given industry. Through this, it launched products with low prices that discouraged other competitors. By this way, this merged company is engaged to obtain extensive market share in global pharmaceutical industry and to create entry barriers for the other organizations effectively (Chen & Lee, 2009). Apart from this, such integration of two major pharmaceutical companies also bought several forms of beliefs for customers. Due to this merger, both companies were able to integrate their R&D capabilities and to provide innovative medicines to the customers (Delaney, 2003). This caused a reduction in operational cost of both companies and enabled them to offer products in relatively low cost.

A horizontal merger also had an effect over the merged firms as well. In concern of this case, SmithKline Beecham merger with Glaxo Wellcome reduced the existence of one supplier from the pharmaceutical industry. This reduction in suppliers also tended to increase the demand for merged firms. This shift in demand benefited GlaxoSmithKline as it increased consumer base and market share of the merged company automatically. It will provide an effective floor to increase their prices, while reducing output level (Koenig & Bartosch, 2009). An increase and decrease in prices and suppliers have considerable impact on other firms in this industry. On the other hand, economic growth is not influenced negatively by all mergers. By increasing operational efficiency and promoting development, mergers enable the firms to produce positive outcomes for the market and economy both. For this reason, it is essential to facilitate effective control and flexibility on the merger processes. It would be effective to facilitate only effective mergers in terms of consumers and economy both (Junfeng, 2009). An effective control over mergers activities could also facilitate fair competition activities in the market that will be beneficial to the all stakeholders of a firm.

CONCLUSION

All over the world companies get merged for higher profitability and their sustainability in the competitive market. Sometimes companies are not allowed to mergers as they might result in higher prices and anticompetitive practices. However, mergers might bring forth substantial benefits for the stakeholders if they are done in a proper way. The merger of SmithKline Beecham with Glaxo Wellcome evidenced that different stakeholders get benefits when two companies wok together with the end in view of serving the consumers better. Based on the discussion of this paper, it can be concluded that merger as expansion strategy of organizations plays an important role in influencing competitive structure of a market in most effective manner. Horizontal merger process has wide chance to incur anti-competitive behavior within an industry. Although GlaxoSmithKline merger is created world's leading pharmaceutical organization, at the same time, it also provided innovative products to consumers that heal diseases in more effective manner. This merger also introduces huge R&D capabilities that also tends other pharmaceutical firms to increase quality and decrease costs. This merger proposed significant benefits for consumers.

REFERENCES

Al-Muharrami, S. (2009). The competition and market structure in the Saudi Arabia banking. *Journal of Economic Studies*, *36*(5), 446-460.

Andrews, M.L. (2008). Assessment and implications of consumer reactions to service mergers.

Saraswathy, B. (2016). *Impact of mergers on competition in the Indian manufacturing: An assessment*.

Bitzenis, A.P. (2005). Company oriented investment interest and cross-border transactions under globalization: Geographical proximity still matters, *European Business Review, 17*(6), 547-565.

Chen, H.H., & Lee, P.Y. (2009). The driving drivers of dynamic competitive capabilities: a new perspective on competition, *European Business Review, 21*(1), 78-91.

Dabbah, M.M. (2004). *EC and UK competition law: commentary, cases and materials*. Cambridge university press.

Davison, L., & Johnson, D. (2000). A review of the revised EC Merger Control Regulation: A case of the curate's egg. *European Business Review*, *12*(2), 76-83.

Delaney, E.L. (2003). GlaxoSmithKline Pharmaceuticals research and development: document delivery in a global corporate environment. *Interlending & Document Supply*, *31*(1), 15-20.

Duxbury, D., Moizer, P., & Azmimi Wan-Mohamed, W. (2007). Effects of the PricewaterhouseCoopers merger on the UK audit services market. *Managerial Auditing Journal*, *22*(2), 121-138.

EvaluatePharma (2000). *Glaxo wellcome and Smithkline beecham merger update: us regulatory clearance obtained*. Retrieved, March 25, 2013 from http://www.evaluatepharma.com/Universal/View.aspx?type=Story&id=6450

Glader, M. (2006). *Innovation markets and competition analysis: EU competition law and US antitrust law*. Edward Elgar Publishing.

Qing Hao, G., & Howe, J.S. (2011). Does merger structure matter?. *Managerial Finance*, *37*(12), 1112-1136.

Hitt, M., & Ireland, R. (2008). Competing for advantage. *Cengage Learning*.

Junfeng, L. (2009). Foreign-invested companies: more risky facing up to China's anti-monopoly law?. *International Journal of Law and Management*, *51*(3), 179-186.

Koenig, C., & Bartosch, A. (2009). *EC competition and telecommunications law*. Kluwer Law International BV.

Kumar, B.R. (2012). *Mega Mergers and Acquisitions*. Palgrave Macmillan.

Lodorfos, G., & Boateng, A. (2006). The role of culture in the merger and acquisition process: Evidence from the European chemical industry. *Management decision*, *44*(10), 1405-1421.

López, Á.L., & Vives, X. (2019). Overlapping ownership, R&D spillovers, and antitrust policy. *Journal of Political Economy*, *127*(5).

Markham, J.W. (2002). A Financial History of the United States: Volume III. ME Sharpe. *Inc. New York, USA*.

Marsden, C.T. (2000). Not so special? Merging media pluralism with competition and industrial policy. *Info*, *2*(1), 9-15.

Wood, S., & Wrigley, N. (2007). Market power and regulation: The last great US department store consolidation?. *International Journal of Retail & Distribution Management*, *35*(1), 20-37.