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Corporate Merger between Volkswagen and Porsche

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Abstract: Volkswagen and Porsche are two firms that are well recognized and established in the automotive industry. Based in Germany, both companies were founded by Ferdinand Porsche in the 1930s and have remained in the Porsche and Piech families to date. There has been contention and rivalry, some fuelled by family differences between the two firms, in 2005, Porsche, the smaller of the two, began a takeover bud that included buying Volkswagen stock. This plan might have worked had Porsche fallen into financial constraint.

Volkswagen had to step in with a merger proposal which Porsche fought off fiercely but finally had to give in to because it would mean an infusion of much needed cash into the latter firms fried up coffers. The merger between the two companies, which hit a couple of snags, was finally ironed out in late 2009.

This assignment depicts the strategic merger between Porsche and Volkswagen and the factors that caused these two different car companies to come together. One of the main reasons why these companies merged because of Porsche's engineering expertise which was highly valued by other auto manufacturers in the industry.

Another reason was because was because Volkswagen had more fuel-efficient technologies and was one of the biggest auto manufactures in the industry. There were some doubts when the companies merged because of the Daimler and Chrysler merger, which was not successful because of both of the companies' different cultures. Porsche and Volkswagen proved sceptics wrong and is currently doing great financially and is in a stronger position because of Volkswagen. This continuation of this paper will dive into more in depth about the strategy of Porsche and its history.

I. INTRODUCTION

A corporate merger occurs when two firms come together to form a new company with one combined stock. Although a merger is typically thought of as an equal split in which side maintains 50% of the new company, that is not always the case. In some mergers, one of the original entities gets a larger percentage of ownership of the new company.

Merger are a great way for two or more companies with unique experience and expertise to come together and form one business that is more profitable than if the entities were on their own. There are several reasons why two companies might want to merge. Sometimes, it is out of convenience and other, other times, it is out of necessity. Regardless of the specifics, the goal of a merger is to take advantage of opportunities in the marketplace that benefit both businesses.

When a company merger happens, the two equal companies can convert their previous stocks into one new, combines company stock. First, they must decide that each company is worth, and then they split the ownership of the new company accordingly.

II. TYPES OF MERGERS

1) *Conglomerate:* A merger between two or more companies engaged in unrelated business activities is a Conglomerate. These firms can work in different industries or in different geographical regions.

There are 2 types of conglomerates-:

a) Pure conglomerate which involves companies that have nothing common in their respective business.
b) Mixed conglomerate which involves unrelated business too but are trying to gain product or market extensions through the merger.

2) *Market Extension:* This merger arises between companies that sell the same products but in different markets. The aim of these companies is to gain access to a bigger market and thus a bigger client base.
3) *Horizontal Merger:* When merger happens between companies operating in the same industry. These mergers are much common in industries that have fewer firms. Therefore, the goal is to create a larger business with greater market share and economies of scale since competition is higher among fewer companies.

4) *Vertical Merger:* When merger happens between two companies that produce parts or service for a product merger, the union is referred to as a vertical merger. It arises when two companies operating at different levels within the same industry's supply chain combine their operations. These mergers are prepared to increase synergies achieved through the cost reduction, which results from merging with one or more supply companies.

III. INTRODUCTION

Volkswagen and Porsche are well recognized and established firms in the automotive industry. Both the companies are registered in Germany and were founded by Ferdinand Porsche in the 1930s and have been in their families to date.

The anticipated Porsche and Volkswagen merger started in late summer of 2009. Porsche and Volkswagen have a long history between them which is way before the issue of merger began. The respective chairpersons of the two companies are the grandchildren of Ferdinand Piech who founded the companies. The Porsche and Piech families own 50% of Porsche Automobile SE stock.

Volkswagen is the biggest carmaker in whole of Europe having annual sales in the excess of US $151 billion and setting up to 6.7 million units a year. It owns 9 brands including the own VW brand and its portfolio comprises of the brands Audi, Bentley, Skoda, Lamborghini and more. Each of these brands operate independently in the market. On the other hand, Porsche has lower revenue of US $9.3 billion selling about 10000 units annually. Porsche AG is one of the most profitable manufacturers of the luxurious sports cars, Porsche.

The former CEO of Porsche, Wendelin Wiedeking saw the merger between the two firms as way of making them into a single holding so that there would be created and economy of scale. He actually wanted to take complete control over VW but that seemed impossible as VW makes sales which is about 16 times the size of Porsche. In 2005, Porsche acquired a voting stake of 50.8% in VW and planned to increase these to 75% until the end of 2009 but what happened was exact opposite to it. VW took most control over Porsche and Porsche was forced to merge with VW. These problems were created by Porsche AG themselves as they were too ambitious and ignored the political relationship in order to take control over a giant like VW.

He reasoned that Porsche being a part of the VW group would benefit them because then they would not face the stiff penalties governing carbon emissions by automobiles that have been put in place in Europe since VW has automobiles that are considered fuel efficient and low-emissions. Despite of this Porsche's CEO had to resign at the end of 2009 leaving Porsche with a debt of $13 billion.

Therefore, Volkswagen saw this an opportunity to take control over Porsche and this battle went on for 3 and half years after which Volkswagen and Porsche merged as a sole group under the management of Volkswagen. VW purchased 41% of Porsche but Porsche still operates independently to some extent.

The merger between the Volkswagen and Porsche is a vertical merger because they both operate in related business and are competitors of each other. The merger between these two is considered as a friendly merger because the terms of merger have been negotiated by directors of the two firms until they have worked out an agreement which both parties find satisfactory.

"What VW plans to do is to take the brand names, along with other brands already under VW, and consolidate them into a holding company which Porsche terms as being an integrated leading company'.

The reasons behind the merger between the two companies were both financial and non-financial. One of the motives that lead firms to form merger is on a bid cost savings, this is to cut down on the cost of growth as compared to gearing internal growth.

For a firm it is more cost effective to take over a destabilized firm than trying to generate growth using the resources that are already at the firm's disposal. Acquisition means that the resources that were available to the acquired firm are now at the disposal of the firm conducting the acquisition.

The reason behind carrying out merger for non-financial issues is for its managerial rewards. A firm may aspire to expand its management and marketing capabilities while at the same time acquire new products to add to its brand.

For a firm like Volkswagen, there is also power play involved. Both Porsche and Volkswagen are having a power struggle for years. Porsche incurred a debt of $2 billion. The prestige of whoever was to get the last laugh has shaped the way the way the two firms are going about their merger with VW seemingly turning the tables on Porsche at the last moment.

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Then the question that why would stockholders be in favour of merger. They can be benefitted from a merger because it means that if the merger transaction is to be conducted in shares, then they will have the chance to acquire stock in the new company. In this merger, stockholders in VW firm will be presented with the opportunity to acquire Porsche shares and stock. they also get a chance to branch out into new and varied investment if the merger is performed in cash.

IV. ANALYSIS

A SWOT analysis of internal strengths, weakness and external opportunities and threats was made in order derive the benefits of merger. According to the analysis the significance of the size of Volkswagen AG stands out. As we discussed before it is the biggest car maker in Europe which is beneficial in regard to competition. One of the main goals of VW was to take the spot of Toyota as the biggest car manufacturer, and the merger with Porsche would made it helpful as it increases the size. VW AG is recognized worldwide that has production plans all over the world and sells in more than 150 countries. After the merger with Porsche international marketing could be increased. The size of VW Ag made it easier to take over Porsche, which in comparison is much smaller.

Volkswagen has nine car brands under its umbrella which means that VW AG is experienced in merging and taking over other car companies. Therefore, merging with well recognized car brands improves its image in the market. One of the weaknesses that were identified is the difference in cars that are produced. However, since VW owns Bugatti and Lamborghini, they should be experienced in the manufacturing of sports cars. It could be argued that the image of Porsche will slowly be damaged, since a mass producer takes over, and Porsche spent much more time and effort on the completion of a single car. This is rather harmful to VW, as Porsche clients would decrease brand loyalty.

A. Merits of Merger Between Volkswagen and Porsche

The benefits of the proposed merger include increase in sales revenue. VW's operating profit was expected to increase by 700 million euros a year. In the future the revenue can be raised in case the company diversifies.

After the merger new employment is barely needed as VW's can employ the already existing Porsche's employees. In the long run this merger will help VW to become the world's biggest car producer or manufacturer.

Before the merger too Volkswagen and Porsche have worked together to build a similar SUV, the VW Touareg and the Porsche Cayenne in the same plant. The sales of these two SUVs were very successful. After the merger more cars like this could be built, and knowledge form both companies, VW and Porsche can be applied to produce such cars. Producing two cars, one from VW and one from Porsche will give the customers a greater choice.

Here is another main advantage of the merger between Porsche AG and Volkswagen AG is that both companies are German, making the communication very easy. This allowed a smooth start up and lesser conflict among the employees. The fact that they will have the same language and cultural background there will be fewer barriers to make the merger unsuccessful, thus making everyone happier to work together. Porsche's brand name is of a great significance to Volkswagen's future performance in terms of sales. The customers of Porsche will stay loyal to the brand as long as Porsche firm keeps its independence because in the past, Porsche has become a widely recognized automaker. Therefore, consumers can keep their brand loyalty to Porsche by purchasing its cars under the same brand name. Also, Volkswagen could diversify its business by producing more sports cars together with Porsche since VW's cars stand more for fuel-efficiency and low CO_2 emission.

B. Demerits of Merger

Along with great merits there are certain demerits. These are mostly related are its costs. During this process both the companies had acquired lot of debts particularly Porsche which racked up 12 billion when it was buying VW stock. At the time of merger Porsche had been losing billions due to costs associated with combing with VW. In the second half of 2009, the net income dropped by 83%. Secondly, there is tension created by putting the competing brands of Audi, Bentley, Porsche, Bugatti and Lamborghini under the same corporate umbrella. Finally, there is also the issue of management to consider. Porsche was the world's most profitable, small carmaker when the process began, and its initial steps to acquire VW shares were motivated by that company's weakness. After the merger the new company formed is larger and more debt ridden and VW's leadership will be taking over the Porsche rather than the other way round. In essence, a larger, weaker company has absorbed a smaller, stronger one, and while Porsche seemed to have a strategy of turning VW into a more cost-efficient and profitable company, VW is merging with Porsche only because it can or must.

Certainly, the 2008 recession exasperated the cost involved as it made harder for the Porsche to access to cheap capital. It racked up more debt acquiring VW stock than it would have year or two earlier. In this sense, Porsche chooses a poor time to embark on an aggressive, financial manoeuvre and VW who performed their own reverse take-over later on, did so in the same environment.

In 2008 car sales faced reduction globally due to 2008 recession, and this should have impacted the sales of both the companies equally making it a moot point. Porsche must have suffered more in the recession because they only sell luxury products, a category of goods that is very elastic in relation to income levels. VW on the other hand has a wider variety of products, including more affordable cars, which might help to keep them afloat as sales of their many luxury brands fall off.

V. FINDINGS

According to the research and documents it suggests that Volkswagen has mainly benefited in regards to their sales. In the future the sales will definitely rise as the two companies merge even tighter. There would be another widely known brand and company under VW AG's management allows for greater awareness of their company and brand. It is really beneficial as it could help of finishing the goal of becoming the world's biggest car producer and therefore taking Toyota's place. Furthermore, the large size of the company will allow VW to enter into other markets like in the US and operate there as a multinational company. The increased size of Volkswagen Ag suggests that it can benefit form economies of scale. The Porsche AG and Volkswagen having worked together in the past on two similar SUVs suggests for greater and better teamwork to build more efficient cars.

VI. CONCLUSION

The merger between Volkswagen and Porsch was an effective way to rescue Porsche, as they had debts up to 13$ billion. Volkswagen was benefitted in terms of sales, sales revenue, market share and market growth due to the merger. Thus, this merger was a stepping stone in the way of becoming the world's biggest car producer leaving Toyota behind. Porsche was a well-known brand and by adding it Volkswagen clearly raises awareness of the company itself. Volkswagen benefitted with the promotion created through this merger with such a luxurious car brand.

In the end it will be beneficial to both the firms since being powerhouses on their own, their combined name will be an even more marketable brand. Once fully merged, each car brand can operate independently on some basis. Overall, a main benefit is that they have been merging with a German company who has their headquarters in the same country. This creates ease for communication is much easier and cost and time saving.

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