Davis

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Growing a company by international acquisition

CURRICULUM TOPICS
- Inorganic growth
- Organic growth
- Acquisition
- International business

Introduction

Successful businesses know when and how to adapt and change. This involves growing some areas of activity and cutting back on less profitable areas. Companies can often benefit from acquiring businesses operating in overseas **markets**. For example in Europe, the USA or the Far East, the availability of new customers or cheaper costs of employing people may give **competitive advantage**.

This case study describes and analyses the growth of the Davis Service Group. The term Group describes companies that are joined together with a shared ownership.
The Davis Service Group provides textile maintenance services in the UK and Europe. This includes linen hire, workwear rental, dust control mat, laundry and washroom services.

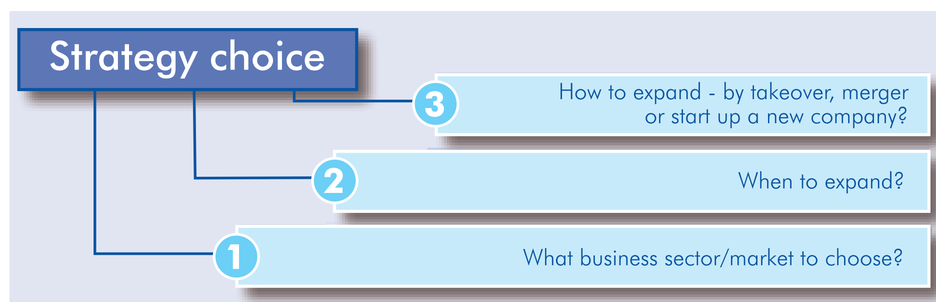
The Group operates across Europe from its London headquarters. It employs 17,000 people and has an annual turnover of more than £820 million. The Davis Service Group used to be a **conglomerate**. A conglomerate is a group consisting of businesses focused on different markets.

In 2001, the Davis Service Group consisted of three main operating companies each of which was the UK market leader in its own sector:
- Sunlight (textile maintenance) – hiring sheets to hotels, hospitals and private businesses. Sunlight was the original company from which the Group developed
- Elliott (building systems) – hiring modular buildings for temporary office space.
- HSS (tool hire) – operating through 450 outlets in the UK.

Although these companies were strong, they operated only in the UK which had become a **mature market**. This means that there are fewer opportunities for growth. Sunlight was the strongest performing part of the business with 45% of **revenues** at that time. Therefore, to improve **return on investment** to **shareholders**, the company chose to focus on the linen hire and textile maintenance part of the business and look for ways to grow it overseas.

Davis Service Group had a number of options to choose from to follow its **strategy** of overseas growth. A strategy is a plan that a company develops and implements.

Strategic choice involves deciding:
- *what* business sector or market to expand into
- *when* to expand
- *how* to expand – for example, whether to take over another company, set up a joint venture or set up a new company.



GLOSSARY

Markets: the range of means by which consumers can buy a particular product.

Competitive advantage: a strategic element that enables an organisation to compete more effectively than its rivals.

Conglomerate: a group of businesses joined in a single entity. Each of the businesses focuses on a different product or service area.

Mature market: a market in which the prospects of future growth are diminishing.

Revenues: the total value of sales.

Return on investment: the return on the funds invested in the business.

Shareholders: persons owning or holding a share or shares of stock.

Strategy: long-term business plan of an organisation.

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International expansion

Expanding into other countries can be a good way to grow a company. In particular, expanding into other areas of the **European Union** (EU) provides many opportunities for a UK business. The EU currently has 27 member countries. It is a huge potential market. Any business in the European Union has over 500 million customers on its doorstep.

Goods and services can flow freely in the single European market. This means it is much easier to do business in the EU. Trade within this area has risen by 30% since 1992. The development of fast transport links, for example, the Channel Tunnel, high-speed trains and cheaper air links, means people can travel to and across Europe more easily. The Internet and email enable companies to communicate instantly.

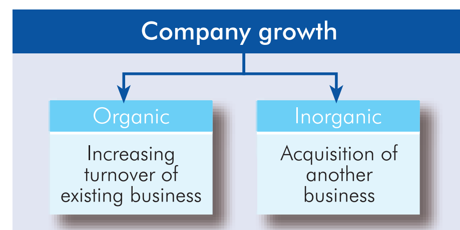
British firms locating factories and offices in the EU are able to benefit from a skilled labour force. Within Europe, most member countries use a common currency – the Euro. This makes it easy to trade within this market place.

When a business decides to expand overseas, there are a number of factors which may present barriers that it needs to consider.

- Language differences can lead to confusion. However, English is the main global business language spoken by many people within the EU.
- Currency differences. Most countries within the EU use the Euro. The UK uses the British pound. The value of the pound can go up or down against the value of the Euro. This can make it difficult for a business to predict what its **costs** and revenues will be. If the pound has a lower value than the Euro, a UK business would pay more for **imported** materials but receive less for its **exported** finished products. This would mean less profit.
- Cultural differences. Ways of behaving and doing things vary between countries and even within countries. In business, some behaviours such as buying decisions may be the same. In other cases it is important to respect local differences, for example, how you greet someone new for the first time.
- Legal and administrative differences may vary across countries, for example safety standards for buildings. However, there are international standards that create common requirements.
- Skill levels may vary between countries. In setting up a business that needs particular skills, it makes sense to focus activities in countries where those skills exist.

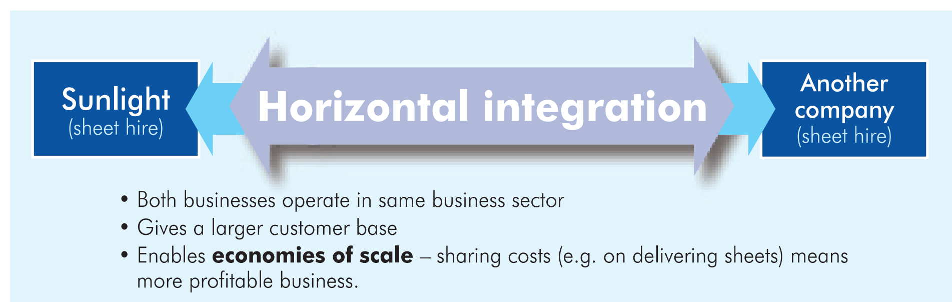
Inorganic growth

A business can develop by **organic growth** or **inorganic growth**. The term inorganic growth describes how a business grows by joining one or more companies together. This can be by:



- **Merger** - two firms join by agreement. Mergers make it possible to share the resources of the two organisations and focus on the best activities of each.
- **Takeover** - one company buys at least 51% of the shares of another company. This enables the company with the larger number of shares to have control over the other business and select which activities to keep.

Horizontal integration refers to a situation where two firms at the same stage of production join. If Sunlight joined another firm hiring sheets to hotels and hospitals in the UK, this would be an example of horizontal integration.



- Both businesses operate in same business sector
- Gives a larger customer base
- Enables **economies of scale** – sharing costs (e.g. on delivering sheets) means more profitable business.

GLOSSARY

European Union: 27 countries joined together by a Treaty allowing the free movement of goods, people and services in a single area and involving political and economic co-operation.

Costs: the price of carrying out an activity (can be in money, time or people).

Imported: goods or services purchased from other country.

Exported: goods or services sold abroad.

Organic growth: increasing sales and new customers for the existing business to improve profitability.

Inorganic growth: growth that expands the business from outside.

Merger: two businesses join through mutual agreement.

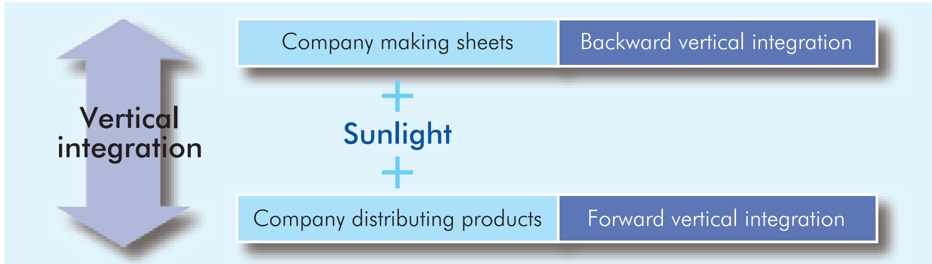
Takeover: one business acquires at least 51% of the shares in another company.

Horizontal integration: joining another business at the same stage of production.

Economies of scale: reductions in average costs that stem from operating on a large scale.

In contrast, **vertical integration** joins businesses at different stages of production. For example, Sunlight could join with a company that makes hotel sheets. This shows backward vertical integration where Sunlight benefits from controlling the supply of the sheets it uses. This ensures quality control and on-time delivery.

A business could also consider forward vertical integration. For example, it joins with a distribution company to economise on its transport costs. This could benefit Sunlight by showing its environmental responsibility.



The advantage of vertical integration is that it gives the business greater control over the **supply chain** of its product or service. The Sunlight business was partially vertically integrated by including the cleaning and delivery processes in its service.

Acquisition

In 2002, the Davis Service Group acquired Berendsen, a company operating in Denmark, Sweden, Norway, Austria, the Netherlands, Poland and Germany. Berendsen was an ideal acquisition because, like Sunlight, it was the market leader in providing textile services in its geographical area.

It was better for the Davis Service Group to take over Berendsen rather than set up a new rival company in Europe. Building on Berendsen's local experience and local market contacts, Davis Service Group could buy into established networks and customer relationships.

When the Davis Service Group took over Berendsen, Berendsen was not performing financially as well as it could. **Profitability** was below that achieved by Sunlight. The Davis Service Group already had proven management systems in providing textile services. Taking over Berendsen, rather than merging with it, gave Davis Service Group the control to put the best systems in place at Berendsen. It was able to:

- reduce **operating costs**, for example, closing down some locations where Berendsen had two outlets operating in the same area
- strengthen the management of the two companies
- save **fixed costs**, by cutting out the central headquarters of the company.

This put Berendsen in a stronger position to improve its sales and profits.

Horizontal integration made sense. Sunlight and Berendsen are specialist companies at the same stage of production. It was possible to pool the knowledge and expertise of the two companies so that both benefited.

The factors that might have been barriers to international growth were easy to overcome in this acquisition:

- Language: Berendsen's business operates across several European countries and uses English as a common language.
- Cultural differences: buying patterns and the culture in the areas where Berendsen operates are similar to the UK.
- Currency: the countries in which Berensden operates already used the Euro or had currencies linked to the Euro.

Financing the takeover was straightforward: there was a close **strategic fit** with what Sunlight already did well, which was easy for shareholders and banks to understand. £150 million was raised through selling more shares to existing shareholders. The remainder of the £425 million to purchase Berendsen came from new bank borrowings.

GLOSSARY

Vertical integration: where a company buys another company that supplies it with goods or that buys goods from it in order to control all the processes of production.

Supply chain: the chain of processes linking the manufacture of products with physical distribution to move goods quickly and efficiently to meet consumer needs.

Profitability: money which is earned in trade or business, after paying the costs of producing and selling goods and services.

Operating costs: the overall cost of running the business.

Fixed costs: costs that remain unchanged over time e.g. interest charges on loans, permanent staff salary, pension rights of retired employees, insurance premiums.

Strategic fit: matching the resources of a business to the changing business environment.

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GLOSSARY

Best practice: the development of performance standards based upon the most efficient practices within an organisation.

Decentralised: authority delegated by dividing the organisation into several units, each responsible for its own performance/decisions.

The Davis Service Group successfully delivered the promised returns to its shareholders over the period 2002-2005 and has seen its share price rise accordingly.

The next phase of growth involved some additional small takeovers of companies to strengthen the business position. The focus was on keeping the most efficient units in the growing company. These additional takeovers added a relatively small workload without the need for substantial investment.

Organic growth

Organic growth is when a company increases the turnover of the existing business. Much of the growth of Sunlight and Berendsen involves organic growth. These businesses are market leaders that have been able to learn a lot from each other and share good ideas and **best practice**.

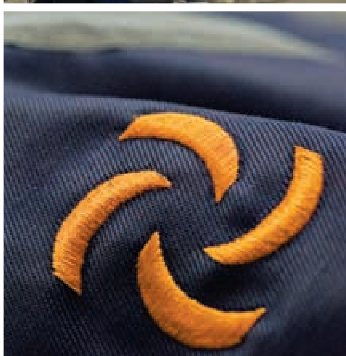
As part of the Group, these companies have increased their customers in existing locations, as well as in other areas of the rapidly developing EU market. Trade and living standards in the EU are growing fast. Large global companies are opening up new sites and they require textile services from Sunlight and Berendsen. Countries like Poland, which joined the EU in 2003, are experiencing growth in key sectors such as manufacturing so more uniforms are needed. New EU legislation also provides an opportunity for Davis Service Group. For example, the need for protective uniforms for industrial workers provides plenty of new contract work for textile services.

Organic growth - building on existing resources - is sometimes the only way to grow. For example, in many Eastern European countries that were part of the former Soviet Union, there are few companies suitable to take over. Most businesses in these countries had previously been government-owned. They had poor equipment and/or had no need to rent out textiles.

Conclusion

The Davis Service Group needed to grow. Of its original three divisions, the linen hire and textile maintenance services provided by Sunlight offered the greatest opportunities because of the strategic fit factors. The Group's other businesses were sold off to concentrate on the potential of the enlarged European textile maintenance business and to provide funds to invest further in this business.

The Davis Service Group is an international business. However, it believes in giving local people responsibility for managing the markets they know best. It has a **decentralised** approach. The small London Head Office has just 17 people working there. Local managers manage local companies using their expertise in their own markets.



Questions

1. Describe two major ways in which a company can grow. Give examples to illustrate the two ways of growing.

2. Businesses grow when they have the resources to expand and opportunities exist for growth. Explain how the acquisition of Berendsen provided such a good opportunity for the Davis Service Group.

3. What aspects of European Union markets have particularly encouraged:
   - horizontal growth of the Davis Service Group?
   - organic as opposed to inorganic growth?

4. If the company were to expand into new areas of the globe, where would you recommend and why? What factors might encourage or discourage this choice?

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