# OnLine Case 11.2
# The ASDA – MFI Merger/Demerger

Asda - now owned by Wal-Mart - enjoys second position in the UK groceries market. Its large stores also sell a wide range of non-food products, including clothing and electrical goods.

Its real growth into one of the UK's largest food retail chains began in the mid-1960s when it first recognized the potential for out-of-town sites with large car parks. Asda remain strongest in the north of England; the head office is in Leeds. Asda's other main retailing activity in the 1980s, however, was carpets and furnishings, which it entered with acquisitions. Asda tried unsuccessfully to divest Allied Carpets in the mid-1980s, but then opted to support it by buying two-thirds of Waring & Gillow (furniture shops) and forming Allied Maples – again in 1989. Allied Maples was finally sold to Carpetland in 1993.

In 1985, with a welcome bid, Asda acquired MFI, the nationwide retailer of self-assembly furniture. This represented concentric diversification as, although the products were different, the customer base was seen as essentially the same. Synergy was expected between the food superstores and MFI rather than through the furniture links, as both were professional edge-of-town retailers in complementary businesses. Both were innovators and their management teams could learn from each other. There was an additional hidden motive. The Chairman of Asda, Sir Noel Stockdale, was approaching retirement and there was no natural successor. Derek Hunt of MFI was thought to be an ideal replacement. Hunt became Chief Executive of Asda–MFI in 1986, but retained his working base in the south of England where MFI headquarters had been.

The expected benefits and synergy did not accrue. In 1984 the return on net assets of Asda was 43% and of MFI 38%. In the three years that the companies were merged the relevant figures for the group dropped from 40% in 1985 to 27% in 1987.

In 1987 MFI was sold in a management buy-out to a consortium led by Derek Hunt, but Asda retained a 25% interest. Since the de-merger MFI has acquired its main supplier of furniture packs, Hygena, and this backward vertical integration quickly brought some tangible financial benefits. However, the improvement was temporary - in the recession at the end of the 1980s/early 1990s MFI traded at a loss. Interest costs arising out of the buy-back and a reputation for poor quality compounded their trading difficulties.

At Asda, John Hardman took over as chairman in 1987, but he resigned in 1991 when Asda also started losing money. The losses continued in 1992. The company was trading profitably but exceptional charges were leading to pre-tax losses. Asda had paid too much for 60 Gateway stores in 1989 and still owned 25% of the debt-ridden MFI. The MFI shares have since been sold, but the Gateway stores were valued in the balance sheet at just two-thirds of their acquisition price. Moreover Asda lacked an effective competitive identity and was perceived to be a less successful retailer than its main rivals, who were also proving more successful in obtaining the premium sites for new stores. Asda had centralized its distribution into a limited number of regional warehouses, but had been a follower rather than a leader in this key strategic development. In 1990 Asda formed a joint venture with George Davies (ex-Next) in an attempt to revive its non-food activities with a range of designer clothes.

The new chairman (Patrick Gillam) and 'youthful' chief executive (Archie Norman, then aged 37) embarked on a three-year programme which 'would not produce significant results in the immediate future'. Their aim was to turn back the clock and return to 'meeting the weekly shopping needs of ordinary working people and their families'. Asda saw itself positioned and differentiated as 'the store for ordinary working people who demand value'. The market was carefully segmented and prices made keener; Asda set out to be some 5–7% below Sainsbury and Tesco to drive higher volumes. Productivity has been improved and service quality stressed; supplier arrangements have been strengthened; and there is an increased emphasis on fresh foods and clothing, where Asda believes it has a relative strength. There are also regional variations in stocking policy. Norman perceived the increasing success of the discount-price food retailers to be a threat as Asda has retained a number of small stores in less affluent areas.

When Gillam and Norman took over, the *Financial Times* suggested that Asda's institutional investors 'would be persistently whispering thoughts of mortality into the ears of Asda's new emperors'. In the event Asda was successfully turned around.

The culture also changed. Asda now has a huge open-plan head office and managers are asked to wear Asda baseball caps at their desks if they do not want to be disturbed. In its attempt to strengthen its customer focus, Asda has increasingly pushed head office managers out into the stores. Internal communications have been fostered. Archie Norman became non-executive Chairman when he became a Conservative MP in 1997, but gave this up some time after the Wal-Mart acquisition. His previous deputy, Allan Leighton, took over for a period and consolidated Asda's strengthening position.

## Applying the acquisition tests to Asda-MFI

### The attractiveness of the kitchen furniture industry

In the case of kitchens supplied direct to individual customers (as opposed to sales to building contractors) the actual suppliers of kitchen furniture did not enjoy as strong a market profile as did MFI, and buyers individually had very little power. *En masse* they are influential. Any competitor wanting to enter the market on the MFI scale would require massive investment; substitute products were often units which were already assembled, such as those sold by Magnet Southern. Increases in disposable income might make these more attractive. There was intense rivalry for market share, however, as sales of kitchen furniture were flat in the 1980s.

On balance the industry was not unattractive, and MFI was a past 'winner'. Profits had grown 87% in real terms between 1980 and 1985.

### The cost of entry

MFI cost ASDA £570 million, which represented 5.5 times net assets and 14 times 1984 pre-tax profits. It was a 31% premium on the current market capitalization, and it measured MFI on a price-to-earnings ratio of 22 rather than the 18 that it had been before the bid. Debt and equity funding were both involved; and ASDA's gearing increased from little more than zero to 40%.

Both sets of shareholders were supportive, but with hindsight it seems a high price.

### Increased competitive advantage

There was no real benefit to be gained from common purchasing, no site sharing, and the two companies enjoyed different geographical concentrations. ASDA was northern and MFI national.

After the merger the companies were run autonomously with few activities shared. Prior to merging it had been argued that there would be intangible benefits from shared expertise. In the event, there was little cross-flow of managers, product innovation, marketing or operations skills. The cultures remained separate; and Derek Hunt, who became chief executive, worked from London despite ASDA's northern base.

While ASDA did compete with Sainsbury's, who at the time had a chain of Homebase DIY stores, this was not seen as a threat that MFI would address; and in any case MFI was very narrowly focused within the DIY sector.

While the industry was not unattractive the merger proved expensive for ASDA, and the potential synergy used to justify the merger to shareholders seemed not to be there in reality.

**Questions:** Do you agree with this final assessment of the Asda-MFI merger? Could this merger ever have been successful or was it always misguided strategically?

Why do you think that Asda's acquisition strategies typically failed whilst the acquisition of Asda itself (by Wal-Mart) has been an outstanding success?

**Project:** Since its demerger, has MFI also proved to be 'better-off'?

*ASDA* http://www.asda.com
*MFI* http://www.mfi.co.uk