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Gaining advantages with existing resources-the synergy way

Surya Narayan Singh
Research Scholar, Department of Commerce and Business Administration, Lalit Narayan Mithila University, Darbhanga, Bihar, India

Abstract
Synergy is an important concept for mangers because it will reinforce the need to work together in a cooperative manner. Further, organisational units tend to be more successful working together than working alone. Synergy arises when two actions performed jointly produce a greater result than they would if performed independently. There are different ways in which synergy can be obtained when a company expands its range of products and the markets it sells its products in, or when it diversified into new products and markets. It is useful to identify different categories of synergy. Synergy is gained by exploiting the strengths within the company and is closely associated with economies of scale. Although synergy might be acquired by developing the internal resource of a company, it is more commonly sought through mergers and acquisitions.

Keywords: economies of scale, organisational arithmetic, mergers and acquisitions, synergy, takeover bids

Introduction

Synergy is the advantage to a firm gained by having existing resources which are compatible with new products or markets that the company is developing, i.e. with product making entries. It can be described as the 2+2=5 effect, where a firm looks for combined results that reflect a better rate of return than would be achieved by the same resources used independently as separate operations. The combined performance, therefore, is greater than the sum of its parts. Concept of Synergy is that the whole is that the whole is greater than the sum of its parts. This is popularly expressed as '2+2=5'. Its application can be extended to industries in which the most efficient plant size should be determined. If the firm is broken into smaller units performing the same function, this would lead to a reduced aggregate output and/or increased costs.

Synergy represents dynamics that possess the following characteristics:

- The whole organization would be greater in capability than the sum of its individual parts.
- Individual parts may consist of people and/or units of organization.

Synergy is an important concept for mangers because it will reinforce the need to work together in a cooperative manner. Further, organisational units tend to be more successful working together than working alone. Synergy arises when two actions performed jointly produce a greater result than they would if performed independently. An example is building a restaurant with a motel. The restaurant will make the motel a more convenient place to stop and the motel contributes business to the restaurant. The total business is larger than it would be if the two units were located five miles apart. This often called the '2+2=5' effect. Synergy is applied to marketing for measuring overall effectiveness through the coordinated operation of the many elements comprising the marketing mix.

Negative Synergy

It may be pointed out that not all synergy is positive. The combined negative attitudes and bickering of dissatisfied group members can add up to greater trouble than any one of the members could have caused individually. Negative synergy in action is at times called a panic or a riot. Quantitatively when 2+2 equal 3, it is known as 'negative synergy'.

A large store achieved prominence by selling high quality distinctive men and women apparel. The new management attempted to capitalise on the firms reputation by adding a line of medium-priced clothing. The prestige of the store fell rapidly and the reduction in profits on the higher margin line more than offset the gain in medium-priced goods. The shift in strategy affected the morale of the long-service employees who had taken great pride in the distinctiveness of the stores products and customers. Sick companies suffer from negative synergy. There is an urgent need for use of technique of synergy to turn sick units into healthy ones.

Synergy as a Part of Management

Management consists of four major functions namely planning, organizing, directing and controlling. Besides other aspects organization change is an important constituent of the second function of management i.e. organizing. Chief sources of change include growth and decay, internal and external environments, new personnel, change agents and domino effect.

Growth can be achieved through mergers and acquisitions and reorganisation. Synergy effects are usually sought in a merger.

Synergy can, therefore, be defined as the fact that the total effect of two organisations coming together is greater than the sum of the effects taken independently. To illustrate, Firm X may be strong in finance and Firm Y may be strong in marketing. Both would gain form the synergetic effects of a merger. Use of synergy is a challenge for accomplishing organization change. This must be met. Challenge is to use synergy to harness its benefits to the advantage of the enterprise.

Synergistic Effect of Organization

The output of an organization may differ in quantity or quality from the sum of the inputs. In 'ordinary arithmetic', 2+2 would equal 4. However, in 'organizational arithmetic', two units of input plus two more units in input may give 3, 4, 9 or 14 units of output. In terms of organisational arithmetic, the position is as under:

Situation 1 if the output is three (3) units, it means an organization looses one (1) unit. It represents an unsuccessful organisation.

Situation 2 if the output is four (4), it represents break-even. Accordingly, there is no profit and no loss.

Situation 3 if the output is seven (7), or fourteen (14), it represents successful organizations because their output is greater than their costs or inputs. This would be an example of accelerated positive synergy.

The greater the synergy a firm can manage to achieve through its selection of products and markets, the more flexible will be its competitive position and the more cost-competitive it will be. This can then be used to advantage in the following ways:

1. Increasing market share through price reductions.
2. Making larger investments in research and development than competitors.
3. Increasing return on investment, thereby increasing the firm's capital base, if some of the extra profits are retained in the business.

Types of Synergy

There are different ways in which synergy can be obtained when a company expands its range of products and the markets it sells its products in, or when it diversified into new products and markets. It is useful to identify different categories of synergy, as follows:

Sales Synergy- for products is obtained through use of common marketing facilities such as distribution channels, sales staff and administration, and warehousing. Supplying a range of complementary products increase the productivity of the sales force, Shared advertising, sale promotion and corporate image generate a much higher return than average per rupee spent.

Operating Synergy- arises from the better use of operational facilities and personnel, bulk purchasing, a greater spread of fixed costs (by producing more items with little or no increase in fixed costs, and so a reduction in unit costs) and the advantages of common learning curves whereby the experience gained by employees in making one product can be transferred to making new products. Thus, if two small firms merge and save fixed costs by moving into the same premises and sharing the same office staff, there will be some cost saving through operating synergy.

Investment Synergy- Can be achieved from the joint use of plant, common raw material stocks, transfer of research and development from one product to another i.e. from the wider use of a common investment in fixed assets, working capital or research.

Management Synergy – is the advantage to be gained where management skills concerning current operations are easily transferred to new operations because of the similarity of problems in the two industries. The converse is also true and there might be negative synergy at a top management level in situations where the problems inherent in new venture are unrelated to current operations and attempts to solve them in the familiar way lead to incorrect or even disastrous decision. Over-extending management capabilities is one reason for dis-economies of scale; however, in some circumstance, management synergy might be achievable.

Start-up and Operating Synergy

Synergy is gained by exploiting the strengths within the company and is closely associated with economies of scale. Although synergy might be acquired by developing the internal resource of a company, it is more commonly sought through mergers and acquisitions. However, the potential synergy is not always realized in mergers and acquisitions because of the difficulty of reconciling the different corporate cultures. When a company launches a new product, enters a new market or does both at the same time, there will be heavy initial costs- i.e. costs of starting up. There are the tangible costs of acquiring plant and machinery, working capital and skilled labour, together with the more intangible costs of early operating inefficiency (as the labour force acquires skills and learning) and management blunders due to inexperience. During this start-up time the firm will be at a disadvantage against well-established competitors in the field whose costs ought to be lower.

Clearly, a firm should look for product-market opportunities where the conditions of entry are not severe -i.e. start-up costs are lower and the start-up period is relatively short before the new area of business is well established. This is likely to occur where the company already has assets or experience which will minimize the start-up costs and reduce the start-up time i.e. where there is 'start-up synergy'. Corporate planners looking for new product and market opportunities should attempt to look for areas where both start-up synergy and operating synergy will be strong, or at second best, where one of the following apply:

- Start-up synergy is high, and so profits can be made fairly quickly, even though operating synergy is low.
- Operating synergy is high, and so the profits obtainable would justify the high initial costs of starting up.

Synergy is probably difficult to achieve in practice when one company takes over another. All too often, the expectation of synergy that help to justify a business combination fail to materialise. Certainly, making sure that synergy is achieve calls for good management. Synergy is probably more discussed in takeover bids than actually implemented.

Possible Opportunities for Synergy

Possible opportunities for synergy are presented hereunder:

Optimum Scale of Operation- At times, some asset or strength of company is not fully utilized. If an attractive additional niche can be found that needs this unused capacity, then synergy should arise.

Seasonal or Cyclical Stabilization -Synergy occurs when a company that faces large seasonal or cyclical fluctuations succeeds in finding a use for its resources that otherwise would be idle during the slack period. The resort industry may face seasonal peaks. One strategy to be followed could be to cater for training conference which may be held during off-peak period. Cyclical stabilization is much more difficult to achieve. The reason is that fluctuations are much more irregular and difficult to predict than seasonal fluctuations. One strategy to be used by industrial firms is to look for alternate sources for supply of services. An example in Pakistan is that of Karachi Shipyard which switched over form ship making to furniture for private and public sector and uniforms for educational institutions. Now this organisation is having plants to manufacture sugar. This established synergy between the know- how available and their utilization for jobs other than ship making when demand constraints for ships dominated the scene during recession of 1980's in the world.

Expansion-Through expansion, new uses of productive capability and new technology may look after the geographical expansion and new types of customers. Vertical integration may provide economies in marketing, purchasing and production scheduling.

Conclusion

We may conclude that where a firm looks for combined results that reflect a better rate of return than would be achieved by the same resource used independently and separate operations. Concept of synergy is that the whole is greater than the sum of its parts. It may be pointed out that not all synergy is positive. Negative synergy in action is at times called a panic or a riot. Synergy effects are usually sought in merger. Synergy may be of several types. It is gained by exploiting the strengths within the company and is closely associated with economies of scale. The potential synergy is not always realized. Hence, a close look on the matter is necessitated.

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