BAE Systems

BAE Systems is Britain’s largest manufacturer, with sales of over £14 billion and some 88,000 staff based in over 100 countries world-wide. It is the largest defence company in Europe, and ranks seventh in the USA and fourth in the world. Its size and growth have been largely due to mergers and acquisitions since its very inception.

Today’s company began life as British Aerospace in 1977, a nationalised (Government owned) corporation formed from the merger of British Aircraft Corporation, Hawker Siddeley Aviation, Hawker Siddeley Dynamics and Scottish Aviation. The company was privatised (sold off) in 1981. The 1980s saw a string of acquisitions, most with little obvious logic: Royal Ordinance in 1987 (munitions), Rover Group in 1988 (cars) and Arlington Securities in 1989 (financial). By 1992 the strategy of unrelated diversification was discredited and the company was on the verge of collapse. The chairman was forced to resign and the company reappraised its strategies, being forced to sell-off Rover to BMW in 1993. Throughout the 1990s the company remained reliant upon a huge weapons contract with Saudi Arabia – a contract that would later prove controversial - but it also started increasingly turning its focus to Europe. This time rather than acquisition, it started forming alliances, doing deal with, among others, Dassault, Lagadere, Saab, Daimler Benz Aerospace and Siemans. The company also took part in the restructuring of Airbus and took a 20% stake.

However, its most important move was when it merged with GEC’s defence business in 1999, giving it a far greater presence in the USA, and greater vertical integration of its activities. From here on the strategy shifted. Mergers and acquisitions were still very important, but the focus for this activity shifted. Firstly the company focused very much on the defence business. It took a 33% stake in Eurofighter, a 37.5% stake in MBDA, the world’s leading missile systems builder, and a 20% stake in Saab AB, the aircraft manufacturer. In 2006 it sold its stake in Airbus, despite the success of the company.

Secondly, the focus shifted towards restructuring to give greater backward and forward vertical integration. In this way BAE could become one of the very few fully integrated suppliers of weapons for air, land and navel defence needs. It can supply the platform - for example, the ship or plane - and all the electronics, computers or missiles that go in it, which is where the real profit lies. This positions it so that it has fewer direct competitors and providing the sort of turn-key service Governments want. Where acquisitions were not possible, strategic partnerships were entered into.
Thirdly the focus shifted very much to the USA, the largest market for defence procurement in the world, and BAE started out on a strategy of buying its way into the US market. In 2000 it sealed its status as defence supplier to the Pentagon by purchasing two electronics businesses from Lockheed Martin in the USA. By 2007 it had made 16 acquisitions in the USA at which point it made a $4.1 billion for Armor Holdings – the manufacturer of the famous Humvee armoured vehicles. Armor is a prime contractor in the Pentagon (this means taking over-all responsibility for complete weapons systems), and its acquisition will seal BAE status in the US market. However, continuing accusations about bribes being paid to a Saudi prince to obtain the huge contract it survived on in the 1990s, nearly resulted in the acquisition being blocked. Even before the Armor acquisition, the USA accounted for almost 30% of sales, with joint contracts such as the huge F-35 Joint Strike Fighter project. The UK now accounts for only about 25% of sales, with contracts such as the Eurofighter, the Astute-class submarine and Nimrod marine-surveillance aircraft projects.

The final reason for BAE’s strategy was that of attempting to reduce market risk in what is a cyclical, high risk market by spreading its customer base across the world. There were also two reasons for wanting to move away from an over reliance on the British market. Firstly, British defence procurement is now more open to competition than any other Western country. Secondly, British defence contracts are normally fixed-price, unlike the USA where they are cost-plus with single figure mark-ups for the development of new products, and open competition, fixed-price for the production contracts. The British system has forced BAE to make some expensive write-offs in the past.

Up-to-date information on BAE Systems can be found on their web site: www.baesystems.com.

Questions
1. What do you think of BAE’s logic for using acquisitions, mergers and strategic partnerships?
2. What are the dangers of using mergers and acquisitions as such a central part of any strategy?