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Holding Companies' Strategies and their Distinction from Large Organizations, Investment, Trust and Merger

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Abstract

The differences among various types of companies' associations including merger, consolidation, resource sharing, etc , and their difference from holdings, and similarities of holding companies and investment companies in terms of utilizing their own resources and acquisition of profit, have made these companies unknown and unfamiliar in Iran. In this study, attempt was made to review and differentiate holdings from investment companies, larger companies, trust, merger, and consolidation, and the existing differences among them in addition to introduce holding companies.

Keywords: holding, merger, trust, investment companies, holding challenges in Iran

Introduction

One of management strategies to maximize profits for trade institutions is combining business units. Capable organizations have functioned as *holdings* to enter global competition, to deal with instability in market environments, to grow, to gain more market share, to be involved in new and profitable activities, to create value, and to reduce cost so that they could be involved in global competition in addition to cope with problems (Dastmalchi et al. 2011). Effectiveness for holding companies in a variety of economic sectors is very important and most countries are known by names of their holdings and that is why the effectiveness of the activities in new global economy depends on the effectiveness for the strategies of holding companies. So, capable organizations tend to operate as holdings and utilize each other's capabilities thereby they could be involved in competition at higher levels and in global competition in addition to cope with the problems and difficulties. Most mangers found holdings' structure a miraculous formulation that removes any organizational problem such as complexity of economic relations, non-economic activities and barriers to growth (Gold et al. 2010). Holding companies of various dimensions were established in some European countries before and after World War II.

Then in 1960s and 1970s, the wave of establishment of such companies reached Asia and Africa. In 1988-1991, a more advanced form of such companies in large-scale was built in Algeria and Egypt that could have extensive effect on organizational structures, and their operational activities (Dastmalchi et al. 2011).

Theoretical basis and research background

In this section, first the implication for holdings and types of it, causes of their formation, and formation styles, and next advantages and disadvantages of holdings are discussed. Then differences between holdings and investment companies, large companies, merger strategy, consolidation, and trust are considered. Among conducted researches on holding companies, the

research conducted by Porter in 1987 in an article "from competitive advantage to organizational strategies" could be mentioned. Strategy in parent company level makes the company something more than total business components for it (Porter, 1987). Shafiei Nikabadi (2009) presented a brief description on types of holdings, structures, and managing styles in such companies, in an article "types, styles, and structures of holdings" (Shafiei Kinabadi, 2009). In 2006, Babaei Zakili in paper concerned with synergistic management in holdings, proposed a frame for audit of synergy management that is used for identification of ignored opportunities (Babaei Zakili & Hedayati, 2006). In a study dealing with theoretical and applied basics for takeovers and mergers, Jahankhani et al. (2006) tried to provide a summary of scientific and investigative researches. Scale of parent company and its effect on performance of subsidiary companies were indicated in researches by Chang & Singh (2000) and Hawavity (2003).

Implication of holding and its types

In the English language, *holding* is an equivalent of *parent* and *corporate* and in Persian language it could be considered equivalent to comprehensive companies or cooperatives, sometimes corporation, group, comprehensive company, parent and/or original, equivalent to central holding company, sometimes headquarter, original company, parent company, investment company, controlling company, holder company, owner company (Babaei, 2004). Several definitions could be mentioned for holdings:

A holding company is a company that has preferred stocks or major stocks of some other companies in a sense that has at least one representative member in board of directors of those companies, and it has vote, and thereby it could control and manage the companies, and gain benefits coming from variety of businesses (strategic process in holding organizations, 2007). Islamic Republic of Iran defines holding in Securities Market Act as a company that gets so many votes by investing in the investee company to gain profit that it could select board of directors and/or have influence on selecting board of directors to control company activities (Islamic Republic of Iran Securities Market Act, 1955).

According to classification of consulting group of Industrial Development and Renovation Organization of Iran, holdings may be structurally classified into the following classes:

Holding company consists of companies that operates in a certain and cohesive field. Automotive companies are tangible examples of holdings of this type.

Incoherent chain holdings in which there are some subsidiaries that operate in various fields and the main feature for holdings of this type is the presence of some subsidiaries together that create a value chain. In this case, National Industries Organization that operates in variety of production and trading fields could be an example.

In Iran, there are some companies operating in hybrid structures, and National Steel Industries Group of Iran could be mentioned as an example in this case (Shafiei Nikabadi, 2009).

Differences between holdings and investment companies

In nature, establishment of holdings and/or institutions that seek to create benefit by trading stocks are all equivalent to investment. A holding company is an investment company. The only difference is that Investment Company benefits from dividends and also rising stock prices by purchasing other companies' stocks without being involved in managing affairs for the companies whereas holdings participate in the affairs of the other companies and take charge of them by purchasing their stocks and/or loaning them (participants in roundtable of Tadbir magazine, 2004). For example, Sama (Iranian National Investment Company) seems to be a shareholder in most of the companies being involved in Tehran Stock Exchange but it does not have any member in board of

directors for any of them. Both are called investment companies while the first one is called an investment company and the second one is called a holding (participants in round table of Tadbir magazine, 2004).

Some experts state that the main difference between holding companies and the investment companies is that competition is the core of decision-making in investment companies and competitive advantage and market strategies are highly emphasized but the core and base of policy-making in holding companies is largely on parenting advantage (Gharabi, 2010).

Investment companies do not invest in companies with the intention of intervention in managing and they do not seek management, and basically they do not have long-term outlook for purchasing stock. Once they see their expected profit satisfied, they sell stocks of a company, and buy the other companies' shares or if they see a reduction in shares value in a short-term outlook, they will sell that share. The investment companies of this type seek to gain profit from stock price oscillation in market, and generally they should only invest in accepted stocks in Exchange (strategic process in holding organizations, 2007). In general, the difference between holding and investment companies could be summarized as given in Table 1.

Table 1. Comparison between holding and investment companies

Holding companies	Investment companies
Gain profit by synergy and profit of the associated subsidiaries	Gain profit by purchasing stocks and increasing stock prices
Seek to manage subsidiary company	Seek to purposes of being profitable
Create a full cycle for an activity and synergy	Collect a heterogeneous set of activities to being profitable
Manage acquired companies and make less effort to sell them	Lack of commitment to maintain stocks and sell stocks to make more profit
Hold stocks of other companies to manage them	Hold stocks of other companies only to supervise them
Parenting advantage is the core of decision-making	Competitive advantage and market strategies are cores of decision-making

Differences between holding and large organizations

Large organizations should have competition strategies to compete in the world. What they produce, and how they fight with competitors means they seek business. However, holding companies have two types of strategies: first, which company they hold that is highly similar to investment companies. Second, how they manage subsidiary companies. In fact, differences between the organizations and ordinary companies and holdings are that profits for holdings is mainly coming from subsidiary companies, and of course, holding could itself gain profit from trading stocks of the companies, so holding has not any direct customer and any certain competitor. Therefore, it should consider how to maximize and optimize profit for stockholders that affected by managements of subsidiary companies.

Philosophy of holding companies and their difference with large companies is that it tries to make performance, effectiveness and profit for subsidiary company better that any other parenting and better than individual operating. In this case, the holding company may state it is acceptable and legitimate (participants in roundtable of Tadbir Magazie, 2004). In other words, not only businesses under supervision of a parent company should have better performance than the time they are

independent but also they should operate better than businesses under supervision of other staff (competitor) (Johnson, G. and Scholes, 2002).

Challenge facing holding managers is that their decision-making affects not only companies covered but also the holding itself, so in addition to review and recognize staff of the organization, it should have a broader outlook and a full understanding of future for decision-making subsidiary companies so that it could make decisions and apply its own views. Therefore, holdings should control several companies (Gharabi, 2010). In general, differences between holding companies and investment companies could be summarized as given in Table 2:

Table 2. Comparison between holding companies and large companies

Holding companies	Large companies
Do not have any direct customer and any certain competitor	have direct customer and certain competitor
Have two types of strategies: which companies they hold how to manage the companies	Have competitive strategies
The main objective is managing subsidiary companies to make them effective and increase and optimize their profit	The main objective is business and producing better products and compete with competitors
Gain profit by subsidiary profit and trading stocks	Gain profit by production and services
Complex decision-making due to presence of subsidiary companies	Less complex decision-making and applying view

Differences of holding, merger and consolidation

One of the strategies at a company scale is the strategy of takeover and merger that is adopted to create vale and increase wealth for shareholders. The most important motive that encourages senior managers of the companies to do such transactions is to get synergy to increase wealth for shareholders, economies of scale and scope, to increase market share, to enhance effectiveness, to increase research and development capability, company growth, and risk reduction (Jasbi, 1985). Synergy may be defined as when two or more elements or factors have collaboration and interaction, it leads to an effect. If this effect is beyond total of the effects any element is able to make, so synergy phenomenon has happened (Smith, 2001). The first wave of takeover and merger of companies appeared in twentieth century between 1893-1904 (Weston, and Weaver, 2001). Merger is a combination of two or more company by direct acquisition of net assets of one or more companies by another company. If we are not so much precise, every business combination is a merger (Jasbi, 1985).

Consolidation is a combination of two or more companies that make a new economic unit that possesses assets of combined units. The difference between merger and consolidation is that no new economic unit is established in merger whereas a new one is established in consolidation (Saleh Ardestani, 1994). In merger, legal entity of buying company remains but Target Company as a business unit continues to operate and its legal entity cease to exist (Jasbi, 1985). Despite the initial and common objectives in establishing holding and combining institutions, there are some differences in the following areas between holding and merger:

Legal entities for subsidiaries: In merger, direct acquisition of net assets of one or more companies is considered and the existence of merged companies is ceased by absorption, and it loses its own legal entity, and the merged company is practically liquidated.

Organizational structure: Holding companies have some differences with merger companies in organizational structure. Merger companies often use divisional structure whereas holding companies uses decentralized structure (Mohgammadi, 2011).

One the most important issues discussed in the emergence of holdings is consolidated financial statements of constituent companies of holding company and financial reporting of the large economic unit. Consolidated financial statements are generally consisted of financial information associated with the original unit and all subsidiary units. It represents shareholders that investing in subsidiary companies has profit for them (Saleh Ardestani, 1994). Generally, differences between holding and merger summarized as given in Table 3.

Table 3. Comparison of holdings and merger

Holding	Merger
Subsidiary companies of holdings maintain their legal entities.	Merged companies lose their legal entities.
Subsidiary companies operate under holding management	Merged companies cease to exist by absorption.
Has decentralized organizational structure.	Has divisional organizational structure
Consolidating financial statements of constituent companies of holding and making consolidated financial statements is very difficult and complex.	Accounting of merger is easier than that of holding companies.

Difference between holdings and trust

Some mistakenly confuse holding with monopoly trust. Trust is established by consolidation of some companies that produce similar goods, and hold major share of the market. Trust is defined as a kind of agreement in which members lose their own legal entities and are completely subsidiary to the core; so in trust, members have no opportunity to exercise, and parent company will be the "decision-maker". Therefore, trust means guardian, and means that small companies assign their own governance to a large company, and the latter is guardian for small companies (Namazi, 2005).

The main function of trust is to control the affairs of member companies by controlling their shareholders' votes, appointing directors and applying central supervision on affairs of individual companies such that maximum profit for trust is achieved and finally this profit is shared among members. These large economic units in capitalist companies are very powerful, and they are always the cause of industrial, trading and military dominance on other countries. Competition in capitalist countries became monopoly and some antitrust laws were made to cope with trust (Namazi, 2005).

The main difference between holding and trust is that in trust, total shares of companies is assigned to parent company but in holding, part of shares of companies is acquired by a large company or organization. Trust dominance causes distortion of financial independence and future policies in market being affected; however, nature of holding is totally different from that of trust and in developed countries, large part of companies' management is in holdings hands to the extent that basis and foundation of world exchanges and capital markets of different countries is on operation and role-playing of holdings (Gharabi, 2010). In general, difference between holding and trust could be summarized as shown in Table 4.

Table 4. Comparison of holding and trust

Holding	Trust
Buys half of companies' shares.	It is a trustee for companies' shares and companies have the ownership of shares.
Part of companies' shares is acquired by the large company.	Total companies' shares assigned to parent company.
Role of holdings is so significant and effective that the countries are known by names of their holdings.	Investment companies need some antitrust laws to prevent trust.

Conclusion

In this paper, firstly a review of definitions and implications of holding and types of them were discussed. Then in order to separate holdings from other structures and combinations, we compared them with investment organizations, large organizations, and structures of merger and trust, and we mentioned their differences with holding.

A holding company is an investment company and the only difference is that it seeks to manage subsidiary companies not to make income by selling shares, and unlike large companies, they do not have any competitor and any certain customer, and subsidiaries of holdings like merged companies do not lose their legal entities, and they purchase companies' shares to manage them, and they are not trustees of other companies' shares, like trust. Philosophy of holding companies is strategically managing covered companies. If holding companies could run their own covered companies better that the time of being independent and also better than any other managing organization, in fact a value has been created, and this is the very competitive advantage in large companies.

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