MEGADEAL - 1821 STYLE

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In Canadian history, Hudson's Bay Company has been of great importance. For two hundred years (1670-1870), by virtue of its Royal Charter, it effectively ruled British North America from Lake Superior to the Pacific, having title to much of the land and providing the facilities for the principle economic activity, the fur trade.

In the early 1800's, most business in Canada was carried on by partnerships. There was no right of incorporation in the British Empire, only a Royal Charter could provide limited liability and, perhaps more importantly, continuous life. The Hudson's Bay Company (technically "The Governor & Company of Adventurers of England trading into Hudson's Bay") was therefore an oddity, a venture formed in 1670 and over 100 years old, controlled from afar and with shares traded on an organized market (The Stock Exchange, London).

The Royal Charter in law provided Hudson's Bay Company ("HBC") with a monopoly of the fur trade. But, as so often in later years with foreign controlled enterprises in Canada, there was a great deal of discontent over HBC's activities. As the fur trade moved westward, less business was channelled through Montreal and some of its merchants joined with fur collectors to form a rival organization, the North West Company. Originally two related groups both used the name but in November 1804 they combined to form a partnership between a number of winterers (so called as they spent the winter in *the.* fur territories) - who did the trading with the Indian collectors and some Montreal merchants as their Agents who provided the capital (mainly stores for barter) and the marketing, particularly in London. The North West Company partnership agreement provided for termination in 1822.

Competition between HBC and the North Westers was fierce. As a result, costs rose, many areas were trapped out and selling prices in England fell. While available financial records are sparse, HBC apparently lost money every year from 1814 to 1820. By then, it had reached its loan limit of 75,000 with the Bank of England and had in addition, debts of £30,500 compared with capital of £103,139. Conversion of sterling amounts from 160 years ago into current dollars is unreliable but based on the current prices for sovereigns, the 1820 pound is about equivalent to $140. In our terms, HBC was losing about $1,700,000 a year on sales (in 1820) of only $9,700,000, current liabilities (all in England) were $14,800,000 compared with capital of $14,600,000. With assets in Canada and liabilities in London, the future was dependent on the support of the Bank of England.

While HBC was in difficulties, so was the North West Company. Even less financial data seems to be available for it but apparently substantially all profits were paid out each year (as in many

modern professional firms) to provide the winterers with income. Due to competitions, the return for their efforts was low and internal conflicts between the Agents and the winterers were increasing. While continuance of the partnership after 1822 was unlikely, a solution to HBC's financial hemorrhaging would not wait.

The solution, adopted after many discussions, would be applicable in the 1980's. While a combination of the businesses was necessary, the considerable enmity that existed between the organizations made a merger or acquisition impossible. Therefore a "coalition", effectively a joint venture of the organizations, was formed utilizing the name and charter of HBC with capital contributed by both and profits divided between all the participants. Like those relating to present day mergers, the negotiations for the combination of the business were conducted with considerable bluff and on the whole, the North West's agents were the better bluffers. In fact, in the end they were able to maintain that the North West Company had taken over HBC.

The joint venture, though using the name Hudson's Bay Company and HBC's Royal Charter, was functionally a partnership ("The Bay"). It was to have a life of 21 years (until 1842) and then terminate. The capital was to be controlled equally by HBC and the North West Company. The agreement between the organizations provided for the transfer of all assets as of June 1, 1821, including inventories (trade goods) receivables (both from the Indians and employees) trading posts, ships and Hudson's Bay House in London. Rules for valuing the assets were set out. Interestingly receivables from the Indians and the trading posts were not Co be considered in determining each group's capital contribution while staff receivables were valued at the lesser of the advance or a year's wages. The agreement also provided for a £5,000 transfer from the North West Company to HBC in satisfaction of all claims between them. After the completion of the various transfers and valuations, the two capital accounts were to be equalized by June 1, 1822 through a cash payment (with interest at 5% since June 1, 1821) by the party with the lower balance.

While The Bay's capital was to be contributed equally, control as shown by the members of the Board was to lie with HBC. The Governor of HBC and two members of its committee (Board of Directors) were to be joined by two representatives (initially its London Agents) from the North West Company. This Board met in London and was responsible for financial affairs and selection of the key employees. While capital was to be provided equally, The Bay's profit allocation reflected the importance of the field staff (the Winterers), as follows:

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HBC Shareholders	20%
North West Company Partners	20
Operating Executives (including winters)	40
Estate of Lard Selkirk (former Governor of HBC & founder of modern Winnipeg)	5
London Agents of North West Company (in exchange for termination of Agency)	5%
To be invested as a reserve fund of which on termination, half would go to HBC shareholders and half to North West Company partners	10
	100%

Profit for distribution was to be computed by valuing assets on June 1 of every year (HBC then had a September 30 year-end) after allowing 5% interest on the capital accounts. If losses accrued in any year, future profit distributions (other than those to HBC and the North West Company) were to be suspended until the losses had been recovered. The 40% of profit allocated to the operating executives in North America was divided into 85 units, two units were allocated to each of the 25 Chief Factors and one to each of the Chief Traders as their remuneration. The other 7 units were to provide half pay to retired officers. In other words, the key employees received 36.7% of the profits as their reward with the remaining 3.3% being used as a pension plan.

This profit sharing proved successful, while in 1821 there were losses amounting to £196 a unit. In 1822, the profit was £203 a unit and by 1827, after the final merger, the unit profit was £550 (equivalent to over $150,000 a year today for a Chief Factor). A very fair return for the officers. As the Northwesters provide 32 of the 53 profit sharing, thus receiving 53.5%, of the profits, and provided 50% of the capital there was same basis for their claim to have taken over HBC. However, with the final combination in 1824 only one Northwester (and a London Agent at that) became a Director of HBC.

By 1824, after three years of operations, The Bay had successfully combined the two feuding operations and was making profits. However the Bay's major profit came from the Northern Department (the area from Hudson's Bay to the Pacific North from the U.S. frontier). With their own ships, this was best served from London rather than Montreal and so the North West Company Agents ran into financial difficulty. HBC still had a large overdraft and expansion of the trade indicated the need for more capital. A complete merger seemed desirable which would allow raising money, provide liquidity to the North West Company Agents and to the Selkirk Estate and simplify the organization.

The plan adopted, facilitated by an increase in the market price of the stock from £100 in July 1821 (just after the formation of The Bay) to £160 in July 1824 involved five steps. These were:

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1. Increase authorized capital to £400,000
2. A 1 for 1 rights issue HBC to raise £103,169
3. A 3% stock dividend on the new share issue
4. Issue of £175,000 of stock to acquire the capital and profit interests of the North West Company and its London agents
5. Issue of £13,140 of stock to acquire the profit interest of the Selkirk Estate.

On completion, The Bay and HBC were effectively legally one with the operating executives retaining their 40% profit interest and the balance going to the stockholders, the former HBC holders retaining a 52.7% interest (after subscribed additional cash) the North West Company partners and agents had 44.0% and Lord Selkirk's heirs the balance. The stock market effect was gratifying. The elimination of the overdraft and the increased profit interest (60% vs 20%) allowed an increase in the dividend from 4% to 10% on the increased capital. The stock priced followed rising to 260% by May 1825. In effect, the merger had increased the market value of the enterprise nine times from £103,000 in 1821 to £1,034,000 in 1825 (of which £103,000 had been provided by the stockholders). An excellent deal for the investors and the executives.

But what about the organization as a whole. A major problem in nearly every large merger is the combination of two corporate cultures. Apart from the obvious difficulties arising from staff terminations, there is the stress created by attempting to mesh separate organizational structures. In a merger, two groups - each with its own unique culture of tradition, objectives and standards - are thrown together. In such cases, as when any two culturally diverse groups are joined "we-they" attitudes often arise. Fortunately, the then Governor (CEO) of the HBC "resisted attempts by the Agents to -victimize some of the Hudson's Bay men who had shown most spirit during the struggle, he achieved the initial exclusion of the more principled Northwesters and the winterers who had rebelled against the Agents (during the North West Company internal conflicts) were fully acknowledged in the new concern". The spirit of co-operation was shown by selecting 15 of the 25 Chief Factors and 17 of the 28 Chief Traders from Northwesters. Another influence of the North West Company on The Bay were annual management meetings of the Chief Factors of each of the two regional departments to determine policy promotions and so on. Such annual meetings at Fort William had long been North West Company procedure.

The key figure in the successful merger was George Simpson who in 1820 had gone into the Athabasca area from London as the local HBC chief. In 1821 The Bay appointed him Governor (CEO) of the Northern Department. The major problems he successfully dealt with arose from the extravagance of the Northwesters (high salaries, support of women and children at the trading posts and generous credit to the Indians), the stolidity of the Hudson's Bayites and the excess of staff.

In assessing the successes of the merger, stakeholders other than the investors and employees should be considered, the Government, the Indians and the Environment were all affected by the deal. The British Government was pleased with the combination and in 1821 granted The Bay a Licence for Exclusive Trade, confirming HBC's Royal Charter rights. However, this license had certain obligations including, among others, acceptance of the Red River colony (fiercely opposed by the Northwesters) and a virtual prohibition of the use of alcohol as a trade good. The Indians as suppliers to a monopoly buyer suffered. Credit was cut off, prices reduced and many effectively put out of work by the policy of recuperation (cutting off purchase from an area to allow the animals especially Beaver to replenish themselves) applied to restore the environmental damage done by the Fur wars between the North West Company and HBC.

Looking at the transactions of 1821-24 from a distance of 160 years, the problems and the solutions seem contemporary. In fact, the gain to the investors is of the same order as found in many takeover bids and rather better than that achieved by nest acquirers today.

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