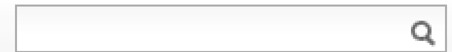
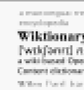


Mergers and acquisitions

From Wikipedia, the free encyclopedia

"Merger" redirects here. For other uses, see Merge (disambiguation). For other uses of "acquisition", see Acquisition (disambiguation).

The phrase **mergers and acquisitions** (abbreviated **M&A**) refers to the aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid, finance, or help a growing company in a given industry grow rapidly without having to create another business entity.



Look up ***merger*** in Wiktionary, the free dictionary.

Contents [hide]

1 Acquisition
1.1 Distinction between mergers and acquisitions
2 Business valuation
3 Financing M&A
3.1 Cash
3.2 Stock
4 Specialist M&A advisory firms
5 Motives behind M&A
6 Effects on management
7 The Great Merger Movement
7.1 Short-run factors
7.2 Long-run factors
7.3 Failure of M&A
7.4 Merger waves
8 Cross-border M&A
9 Major M&A in the 1990s
10 Major M&A in the 2000s
11 M&A in Popular Culture
12 See also
13 References
14 Further reading

Acquisition [edit]

Main article: Takeover

An **acquisition**, also known as a **takeover** or a **buyout**, is the buying of one company (the 'target') by another. Consolidation is when two companies combine together to form a new company altogether. An acquisition may be private or public, depending on whether the acquiree or merging company is or isn't listed in public markets. An acquisition may be friendly or hostile. Whether a purchase is perceived as a friendly or hostile depends on how it is communicated to and received by the target company's board of directors, employees and shareholders. It is quite normal though for M&A deal communications to take place in a so called 'confidentiality bubble' whereby information flows are restricted due to confidentiality agreements (Harwood, 2005). In the case of a friendly transaction, the companies cooperate in negotiations; in the case of a hostile deal, the takeover

target is unwilling to be bought or the target's board has no prior knowledge of the offer. Hostile acquisitions can, and often do, turn friendly at the end, as the acquiror secures the endorsement of the transaction from the board of the acquiree company. This usually requires an improvement in the terms of the offer. Acquisition usually refers to a purchase of a smaller firm by a larger one. Sometimes, however, a smaller firm will acquire management control of a larger or longer established company and keep its name for the combined entity. This is known as a **reverse takeover**. Another type of acquisition is reverse merger, a deal that enables a private company to get publicly listed in a short time period. A **reverse merger** occurs when a private company that has strong prospects and is eager to raise financing buys a publicly listed shell company, usually one with no business and limited assets. Achieving acquisition success has proven to be very difficult, while various studies have shown that 50% of acquisitions were unsuccessful.[*citation needed*] The acquisition process is very complex, with many dimensions influencing its outcome.[1] There is also a variety of structures used in securing control over the assets of a company, which have different tax and regulatory implications:

This section **does not cite any references or sources**.
Please help improve this article by adding citations to reliable sources.
Unsourced material may be challenged and removed. *(June 2008) Find sources:* "Mergers and acquisitions" – news · books · scholar · images

- The buyer buys the shares, and therefore control, of the target company being purchased. Ownership control of the company in turn conveys effective control over the assets of the company, but since the company is acquired intact as a going concern, this form of transaction carries with it all of the liabilities accrued by that business over its past and all of the risks that company faces in its commercial environment.
- The buyer buys the assets of the target company. The cash the target receives from the sell-off is paid back to its shareholders by dividend or through liquidation. This type of transaction leaves the target company as an empty shell, if the buyer buys out the entire assets. A buyer often structures the transaction as an asset purchase to "cherry-pick" the assets that it wants and leave out the assets and liabilities that it does not. This can be particularly important where foreseeable liabilities may include future, unquantified damage awards such as those that could arise from litigation over defective products, employee benefits or terminations, or environmental damage. A disadvantage of this structure is the tax that many jurisdictions, particularly outside the United States, impose on transfers of the individual assets, whereas stock transactions can frequently be structured as like-kind exchanges or other arrangements that are tax-free or tax-neutral, both to the buyer and to the seller's shareholders.

The terms "demerger", "spin-off" and "spin-out" are sometimes used to indicate a situation where one company splits into two, generating a second company separately listed on a stock exchange.

Distinction between mergers and acquisitions [edit]

*Although often used synonymously, the terms **merger** and **acquisition** mean slightly different things.*[2]

[This paragraph does not make a clear distinction between the legal Concept of a merger (with the resulting corporate mechanics - statutory merger or statutory consolidation, which have nothing to do with the resulting power grab as between the management of the target and the acquirer) and the business point of view of a "merger", which can be achieved independently of the corporate mechanics through various means such as "triangular merger", statutory merger, acquisition, etc.]

When one company takes over another and clearly establishes itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded.

In the pure sense of the term, a merger happens when two firms agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals". The firms are often of about the same size. Both companies' stocks are surrendered and new company stock is issued in its place. For example, in the 1999 merger of Glaxo Wellcome and SmithKline Beecham, both firms ceased to exist when they merged, and a new company, GlaxoSmithKline, was created.

In practice, however, actual mergers of equals don't happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it is technically an acquisition. Being bought out often carries negative connotations, therefore, by describing the deal euphemistically as a merger, deal makers and top managers try to make the takeover more palatable. An example of this would be the takeover of Chrysler by Daimler-Benz in 1999 which was widely referred to in the time.

A purchase deal will also be called a merger when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition.

Business valuation [edit]

The five most common ways to valuate a business are

- asset valuation,
- historical earnings valuation,
- future maintainable earnings valuation,
- relative valuation (comparable company & comparable transactions),
- discounted cash flow (DCF) valuation

Professionals who valuate businesses generally do not use just one of these methods but a *combination* of some of them, as well as possibly others that are not mentioned above, in order to obtain a more accurate value. The information in the balance sheet or income statement is obtained by one of three accounting measures: a Notice to Reader, a Review Engagement or an Audit.

Accurate business valuation is one of the most important aspects of M&A as valuations like these will have a major impact on the price that a business will be sold for. Most often this information is expressed in a Letter of Opinion of Value (LOV) when the business is being valuated for interest's sake. There are other, more detailed ways of expressing the value of a business. While these reports generally get more detailed and expensive as the size of a company increases, this is not always the case as there are many complicated industries which require more attention to detail, regardless of size.

Financing M&A [edit]

Mergers are generally differentiated from acquisitions partly by the way in which they are financed and partly by the relative size of the companies. Various methods of financing an M&A deal exist:

Cash [edit]

Payment by cash. Such transactions are usually termed acquisitions rather than mergers because the shareholders of the target company are removed from the picture and the target comes under the (indirect) control of the bidder's shareholders.

Stock [edit]

Payment in the acquiring company's stock, issued to the shareholders of the acquired company at a given ratio proportional to the valuation of the latter.

Specialist M&A advisory firms [edit]

Although at present the majority of M&A advice is provided by full-service investment banks, recent years have seen a rise in the prominence of specialist M&A advisers, who only provide M&A advice (and not financing). These companies are sometimes referred to as Transition companies, assisting businesses often referred to as "companies in transition." To perform these services in the US, an advisor must be a licensed broker dealer, and subject to SEC (FINRA) regulation. More information on M&A advisory firms is provided at corporate advisory.

Motives behind M&A [edit]

The dominant rationale used to explain M&A activity is that acquiring firms seek improved financial performance. The following motives are considered to improve financial performance:

- Economy of scale: This refers to the fact that the combined company can often reduce its fixed costs by removing duplicate departments or operations, lowering the costs of the company relative to the same revenue stream, thus increasing profit margins.
- Economy of scope: This refers to the efficiencies primarily associated with demand-side changes, such as increasing or decreasing the scope of marketing and distribution, of different types of products.
- Increased revenue or market share: This assumes that the buyer will be absorbing a major competitor and thus increase its market power (by capturing increased market share) to set prices.
- Cross-selling: For example, a bank buying a stock broker could then sell its banking products to the stock broker's customers, while the broker can sign up the bank's customers for brokerage accounts. Or, a manufacturer can acquire and sell complementary products.
- Synergy: For example, managerial economies such as the increased opportunity of managerial specialization. Another example are purchasing economies due to increased order size and associated bulk-buying discounts.
- Taxation: A profitable company can buy a loss maker to use the target's loss as their advantage by reducing their tax liability. In the United States and many other countries, rules are in place to limit the ability of profitable companies to "shop" for loss making companies, limiting the tax motive of an acquiring company. Tax minimization strategies include purchasing assets of a non-performing company and reducing current tax liability under the Tanner-White PLLC Troubled Asset Recovery Plan.
- Geographical or other diversification: This is designed to smooth the earnings results of a company, which over the long term smoothens the stock price of a company, giving conservative investors more confidence in investing in the company. However, this does not always deliver value to shareholders (see below).
- Resource transfer: resources are unevenly distributed across firms (Barney, 1991) and the interaction of target and acquiring firm resources can create value through either overcoming information asymmetry or by combining scarce resources.[3]
- Vertical integration: Vertical integration occurs when an upstream and downstream firm merge (or one acquires the other). There are several reasons for this to occur. One reason is to internalise an externality problem. A common example is of such an externality is double marginalization. Double marginalization occurs when both the upstream and downstream firms have monopoly power, each firm reduces output from the competitive level to the monopoly level, creating two deadweight losses. By merging the vertically integrated firm can collect one deadweight loss by setting the downstream firm's output to the competitive level. This increases profits and consumer surplus. A merger that creates a vertically integrated firm can be profitable.[4]
- Absorption of Similar Businesses under Single Management: Similar portfolio invested by two different Mutual funds (Ahsan Raza Khan, 2009) namely United Money Market Fund and United Growth & Income Fund, caused the management to absorb United Money Market Fund into

United Growth & Income Fund.</ref>

However, on average and across the most commonly studied variables, acquiring firms' financial performance does not positively change as a function of their acquisition activity.[5] Therefore, additional motives for merger and acquisition that may not add shareholder value include:

- Diversification: While this may hedge a company against a downturn in an individual industry it fails to deliver value, since it is possible for individual shareholders to achieve the same hedge by diversifying their portfolios at a much lower cost than those associated with a merger. (In his book *One Up on Wall Street*, Peter Lynch memorably termed this "diworseification".)
- Manager's hubris: manager's overconfidence about expected synergies from M&A which results in overpayment for the target company.
- Empire-building: Managers have larger companies to manage and hence more power.
- Manager's compensation: In the past, certain executive management teams had their payout based on the total amount of profit of the company, instead of the profit per share, which would give the team a perverse incentive to buy companies to increase the total profit while decreasing the profit per share (which hurts the owners of the company, the shareholders); although some empirical studies show that compensation is linked to profitability rather than mere profits of the company.

Effects on management [edit]

A study published in the July/August 2008 issue of the Journal of Business Strategy suggests that mergers and acquisitions destroy leadership continuity in target companies' top management teams for at least a decade following a deal. The study found that target companies lose 21 percent of their executives each year for at least 10 years following an acquisition – more than double the turnover experienced in non-merged firms.[6] If the businesses of the acquired and acquiring companies overlap, then such turnover is to be expected; in other words, there can only be one CEO, CFO, etcetera at a time.

The Great Merger Movement [edit]

The Great Merger Movement was a predominantly U.S. business phenomenon that happened from 1895 to 1905. During this time, small firms with little market share consolidated with similar firms to form large, powerful institutions that dominated their markets. It is estimated that more than 1,800 of these firms disappeared into consolidations, many of which acquired substantial shares of the markets in which they operated. The vehicle used were so-called trusts. In 1900 the value of firms acquired in mergers was 20% of GDP. In 1990 the value was only 3% and from 1998–2000 it was around 10–11% of GDP. Organizations that commanded the greatest share of the market in 1905 saw that command disintegrate by 1929 as smaller competitors joined forces with each other. However, there were companies that merged during this time such as DuPont, US Steel, and General Electric that have been able to keep their dominance in their respective sectors today due to growing technological advances of their products, patents, and brand recognition by their customers. The companies that merged were mass producers of homogeneous goods that could exploit the efficiencies of large volume production. However more often than not mergers were "quick mergers". These "quick mergers" involved mergers of companies with unrelated technology and different management. As a result, the efficiency gains associated with mergers were not present. The new and bigger company would actually face higher costs than competitors because of these technological and managerial differences. Thus, the mergers were not done to see large efficiency gains, they were in fact done because that was the trend at the time. Companies which had specific fine products, like fine writing paper, earned their profits on high margin rather than volume and took no part in Great Merger Movement.[*citation needed*]

Short-run factors [edit]

One of the major short run factors that sparked in The Great Merger Movement was the desire to keep prices high. That is, with many firms in a market, supply of the product remains high. During the panic of 1893, the demand declined. When demand for the good falls, as illustrated by the classic supply and demand model, prices are driven down. To avoid this decline in prices, firms found it profitable to collude and manipulate supply to counter any changes in demand for the good. This type of cooperation led to widespread horizontal integration amongst firms of the era. Focusing on mass production allowed firms to reduce unit costs to a much lower rate. These firms usually were capital-intensive and had high fixed costs. Because new machines were mostly financed through bonds, interest payments on bonds were high followed by the panic of 1893, yet no firm was willing to accept quantity reduction during that period.[*citation needed*]

Long-run factors [edit]

In the long run, due to the desire to keep costs low, it was advantageous for firms to merge and reduce their transportation costs thus producing and transporting from one location rather than various sites of different companies as in the past. This resulted in shipment directly to market from this one location. In addition, technological changes prior to the merger movement within companies increased the efficient size of plants with capital intensive assembly lines allowing for economies of scale. Thus improved technology and transportation were forerunners to the Great Merger Movement. In part due to competitors as mentioned above, and in part due to the government, however, many of these initially successful mergers were eventually dismantled. The U.S. government passed the Sherman Act in 1890, setting rules against price fixing and monopolies. Starting in the 1890s with such cases as *U.S. versus Addyston Pipe and Steel Co.*, the courts attacked large companies for strategizing with others or within their own companies to maximize profits. Price fixing with competitors created a greater incentive for companies to unite and merge under one name so that they were not competitors anymore and technically not price fixing.

Failure of M&A [edit]

A book by Prof. Dr. Thomas Straub (2007) "Reasons for frequent failure in Mergers and Acquisitions" develops a comprehensive research framework that bridges rival perspectives and promotes a modern understanding of factors underlying M&A performance. The first important step towards this objective is the development of a common frame of reference that spans conflicting theoretical assumptions from different perspectives. On this basis, a comprehensive framework is proposed with which to understand the origins of M&A performance better and address the problem of fragmentation by integrating the most important competing perspectives in respect of studies on M&A Furthermore according to the existing literature relevant determinants of firm performance are derived from each dimension of the model. For the dimension strategic management, the six strategic variables: market similarity, market complementarity, production operation similarity, production operation complementarity, market power, and purchasing power were identified having an important impact on M&A performance. For the dimension organizational behavior, the variables acquisition experience, relative size, and cultural differences were found to be important. Finally, relevant determinants of M&A performance from the financial field were acquisition premium, bidding process, and due diligence. Three different ways in order to best measure post M&A performance are recognized: Synergy realization, absolute performance and finally relative performance.

Merger waves [edit]

The economic history has been divided into *Merger Waves* based on the merger activities in the business world as:

Period	Name	Facet

1889–1904	First Wave	Horizontal mergers
1916–1929	Second Wave	Vertical mergers
1965–1989	Third Wave	Diversified conglomerate mergers
1992–1998	Fourth Wave	Congeneric mergers; Hostile takeovers; Corporate Raiding
2000 -	Fifth Wave	Cross-border mergers

[7]

Cross-border M&A

[edit]

In a study conducted in 2000 by Lehman Brothers, it was found that, on average, large M&A deals cause the domestic currency of the target corporation to appreciate by 1% relative to the acquirers.

The rise of globalization has exponentially increased the necessity for MAIC Trust accounts and securities clearing services for Like-Kind Exchanges for cross-border M&A. In 1997 alone, there were over 2333 cross-border transactions, worth a total of approximately $298 billion. Due to the complicated nature of cross-border M&A, the vast majority of cross-border actions have unsuccessful anies seek to expand their global footprint and become more agile at creating high-performing businesses and cultures across national boundaries.[8]

Even mergers of companies with headquarters in the same country are very much of this type and require MAIC custodial services (cross-border Mergers). After all, when Boeing acquires McDonnell Douglas, the two American companies must integrate operations in dozens of countries around the world. This is just as true for other supposedly "single country" mergers, such as the $29 billion dollar merger of Swiss drug makers Sandoz and Ciba-Geigy (now Novartis).

Major M&A in the 1990s

[edit]

Top 10 M&A deals worldwide by value (in mil. USD) from 1990 to 1999:

Rank	Year	Purchaser	Purchased	Transaction value (in mil. USD)
1	1999	Vodafone Airtouch PLC[9]	Mannesmann	183,000
2	1999	Pfizer[10]	Warner-Lambert	90,000
3	1998	Exxon[11][12]	Mobil	77,200
4	1998	Citicorp	Travelers Group	73,000
5	1999	SBC Communications	Ameritech Corporation	63,000
6	1999	Vodafone Group	AirTouch Communications	60,000
7	1998	Bell Atlantic[13]	GTE	53,360
8	1998	BP[14]	Amoco	53,000
9	1999	Qwest Communications	US WEST	48,000
10	1997	Worldcom	MCI Communications	42,000

Major M&A in the 2000s

[edit]

Top 10 M&A deals worldwide by value (in mil. USD) from 2000 to 2009:

Rank	Year	Purchaser	Purchased	Transaction value (in

				mil. USD)
1	2000	*Fusion*: America Online Inc. (AOL)[15][16]	Time Warner	164,747
2	2000	Glaxo Wellcome Plc.	SmithKline Beecham Plc.	75,961
3	2004	Royal Dutch Petroleum Co.	Shell Transport & Trading Co	74,559
4	2006	AT&T Inc.[17][18]	BellSouth Corporation	72,671
5	2001	Comcast Corporation	AT&T Broadband & Internet Svcs	72,041
6	2009	Pfizer Inc.	Wyeth	68,000
7	2000	*Spin-off*: Nortel Networks Corporation		59,974
8	2002	Pfizer Inc.	Pharmacia Corporation	59,515
9	2004	JP Morgan Chase & Co[19]	Bank One Corp	58,761
10	2008	Inbev Inc.	Anheuser-Busch Companies, Inc	52,000

M&A in Popular Culture [edit]

In the novel American Psycho the protagonist Patrick Bateman, played by Christian Bale in the film adaptation, works in mergers and acquisitions, which he occasionally refers to as 'murders and executions' to his unwitting victims.

See also [edit]

- Competition regulator
- Control premium
- Corporate advisory
- Data site
- Divestiture
- Factoring (finance)
- Fairness opinion
- International Financial Reporting Standards
- IPO
- List of bank mergers in United States
- Management control
- Management due diligence
- Mergers and acquisitions in United Kingdom law
- Merger control
- Merger integration
- Merger simulation
- Second request
- Shakeout
- Tulane Corporate Law Institute
- Venture capital
- Vermilion Partners Ltd
- Swap ratio

References [edit]

1. ^ "Mergers and acquisitions explained". Retrieved 2009-06-30.
2. ^ DePamphilis, D. Understanding Mergers, Acquisitions, and Other Corporate Restructuring Terminology
3. ^ King, D. R.; Slotegraaf, R.; Kesner, I. (2008). "Performance implications of firm resource interactions in the acquisition of R&D-intensive
8. ^ M&A Agility for Global Organizations
9. ^ "Mannesmann to accept bid - February 3, 2000". *CNN*. February 3, 2000.
10. ^ Pfizer and Warner-Lambert agree to $90 billion merger creating the world's fastest-growing major pharmaceutical company
11. ^ "Exxon, Mobil mate for $80B - December 1, 1998". *CNN*. December 1, 1998.

firms". *Organization Science* **19** (2): 327–340. doi:10.1287/orsc.1070.0313.
4. ^ Maddigan, Ruth; Zaima, Janis (1985). "The Profitability of Vertical Integration". *Managerial and Decision Economics* **6** (3): 178–179. doi:10.1002/mde.4090060310.
5. ^ King, D. R.; Dalton, D. R.; Daily, C. M.; Covin, J. G. (2004). "Meta-analyses of Post-acquisition Performance: Indications of Unidentified Moderators". *Strategic Management Journal* **25** (2): 187–200. doi:10.1002/smj.371.
6. ^ Mergers and Acquisitions Lead to Long-Term Management Turmoil Newswise, Retrieved on July 14, 2008.
7. ^ Reference Needed
12. ^ Finance: Exxon-Mobil Merger Could Poison The Well
13. ^ Fool.com: Bell Atlantic and GTE Agree to Merge (Feature) July 28, 1998
14. ^ http://www.eia.doe.gov/emeu/finance/fdi/ad2000
15. ^ Online NewsHour: AOL/Time Warner Merger
16. ^ "AOL and Time Warner to merge - January 10, 2000". *CNN*. January 10, 2000.
17. ^ "AT&T To Buy BellSouth For $67 Billion". *CBS News*. March 5, 2006.
18. ^ AT&T- News Room
19. ^ "J.P. Morgan to buy Bank One for $58 billion". *CNNMoney.com*. 2004-01-15.

Further reading

[edit]

- DePamphilis, Donald (2008). *Mergers, Acquisitions, and Other Restructuring Activities*. New York: Elsevier, Academic Press. pp. 740. ISBN 978-0-12-374012-0.
- Cartwright, Susan; Schoenberg, Richard (2006). "Thirty Years of Mergers and Acquisitions Research: Recent Advances and Future Opportunities". *British Journal of Management* **17** (S1): S1–S5. doi:10.1111/j.1467-8551.2006.00475.x.
- Harwood, I. A. (2006). "Confidentiality constraints within mergers and acquisitions: gaining insights through a 'bubble' metaphor". *British Journal of Management* **17** (4): 347–359. doi:10.1111/j.1467-8551.2005.00440.x.
- Rosenbaum, Joshua; Joshua Pearl (2009). *Investment Banking: Valuation, Leveraged Buyouts, and Mergers & Acquisitions*. Hoboken, NJ: John Wiley & Sons. ISBN 0-470-44220-4.
- Straub, Thomas (2007). *Reasons for frequent failure in Mergers and Acquisitions: A comprehensive analysis*. Wiesbaden: Deutscher Universitätsverlag. ISBN 978-3-8350-0844-1.
- Scott, Andy (2008). *China Briefing: Mergers and Acquisitions in China* (2nd ed.).

v • d • e	**Corporate finance and investment banking**	
Capital structure		Senior secured debt · Senior debt · Second lien debt · Subordinated debt · Mezzanine debt · Convertible debt · Exchangeable debt · Preferred equity · Warrant · Shareholder loan · Common equity · Pari passu
Transactions (terms / conditions)	**Equity offerings**	Initial public offering (IPO) · Secondary Market Offering (SEO) · Follow-on offering · Rights issue · Private placement · Spin off · Spin out · Equity carve-out · Greenshoe (Reverse) · Book building · Bookrunner · Underwriter
	Mergers and acquisitions	Takeover · Reverse takeover · Tender offer · Proxy fight · Poison pill · Staggered Board · Squeeze out · Tag-along right · Drag-along right · Pre-emption right · Control premium · Due diligence · Divestment · Sell side · Buy side · Demerger · Super-majority · Pitch book
	Leverage	Leveraged buyout · Leveraged recap · Financial sponsor · Private equity · Bond offering · High-yield debt · DIP financing · Project finance

Valuation	Financial modeling · Free cash flow · Business valuation · Fairness opinion · Stock valuation · APV · DCF · Net present value (NPV) · Cost of capital (Weighted average) · Comparable company analysis · Accretion/dilution analysis · Enterprise value · Tax shield · Minority interest · Associate company · EVA · MVA · Terminal value · Real options analysis
List of investment banks · List of finance topics	

Categories: Political economy | Corporate finance | Mergers and acquisitions

This page was last modified on 30 September 2010 at 21:09.

Text is available under the Creative Commons Attribution-ShareAlike License; additional terms may apply. See Terms of Use for details.
Wikipedia® is a registered trademark of the Wikimedia Foundation, Inc., a non-profit organization.

Contact us

Privacy policy About Wikipedia Disclaimers