CA BUSINESS SCHOOL
POSTGRADUATE DIPLOMA IN BUSINESS & FINANCE

SEMESTER 3: Financial Strategy

Mergers & Acquisitions

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Introduction

Arguably, “Mergers & Acquisitions” might be the most popular topic in finance over the last decade around the globe. Even though Mergers & Acquisitions (M&A) used interchangeably, they are quite two different independent concepts in nature.

Concept of merger : 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". Most of the times, the entities involved in merger are in the same size. Shares of old companies' are surrendered and the shares of new company is issued in its place.

Concept of acquisition : One company takes over another company and completely establishes itself as the new owner. From a legal perspective, in an acquisition, the target company still exists as an independent legal entity, which is controlled by the acquirer.

More on M & A

It is an acquisition we basically consider in financial accounting as business combinations. Hence, you will understand that one entity should not necessarily acquire 100% share capital of other entity.

Acquisition has become popular since it involves less complexities as opposed to merger. It also preserves the identities of individual entities in the business world. Sometimes, acquisition also termed as takeover.

- Reverse takeover : small entity acquires a large scale company and continue business in the name of large company.
- Reverse merger : private company buys publicly traded company with the aim of becoming public limited company.
- Demerger : a particular company split into two companies in which neither company necessarily wants to be public company. This also called as spin-out and spin-off.

More on M & A (Contd.)

Following types of mergers are popular within business world;

- Horizontal integration : entities represent merger are in the same line of business.

- Vertical integration : one entity merge with another entity represents(operated in) different phase of the supply chain.

- Conglomerate : two or more entities merge together represent totally different line of businesses.

Synergy : NPV (MV) of the combined entity is greater than total of NPVs (MVs) of individual entities.

NPV [AB] > NPV [A] + NPV [B] / 2 + 2 = 5

Energy : reverse of synergy.

Top 10 M&A deals worldwide by value (in USD Mil.) from 2000 to 2010

Rank	Year	Purchaser	Purchased	Transaction value (in USD)
1	2000	AOL Inc. (America Online)	Time Warner	164,747,000,000
2	2000	Glaxo Wellcome Plc.	SmithKline Beecham Plc.	75,961,000,000
3	2004	Royal Dutch Petroleum Company	"Shell" Transport & Trading Co.	74,559,000,000
4	2006	AT&T Inc.	BellSouth Corporation	72,671,000,000
5	2001	Comcast Corporation	AT&T Broadband	72,041,000,000
6	2009	Pfizer Inc.	Wyeth	68,000,000,000
7	2000	Nortel Networks Corporation (Spin-Off)		59,974,000,000
8	2002	Pfizer Inc.	Pharmacia Corporation	59,515,000,000
9	2004	JPMorgan Chase & Co.	Bank One Corporation	58,761,000,000
10	2008	InBev Inc.	Anheuser-Busch Companies, Inc.	52,000,000,000
Source :	Web	Accessed on 14th June 2013		

Reasons for Mergers & Acquisitions

Fundamental expectation of every mergers/acquisitions is to form higher value of combination edge over value of respective entities separately.

Amidst many reasons for M & A, following are popular;

- ❑ Synergy benefit
- ❑ Enhance market share – existing
- ❑ Enter into new market
- ❑ Reduce competency (horizontal integration)
- ❑ Economies of scale | cost reduction | profit maximization
- ❑ Enhance efficiency
- ❑ Enhance investment opportunities
- ❑ Benefit over corporate tax
- ❑ Maximum utilization of capacity/assets
- ❑ Combining effect of skills/capabilities

Process of M & A

The detail procedure of M & A depend on the circumstance and specially the types of arrangement. The set procedure should be able to deliver ultimate objective of M & A without too many obstacles.

Effective communication is must for the successful M & A. following are the essentials in M & A;

- Determined the target/objective clearly
- Formal discussion and frequent communication
- In depth analysis of available data/information (financial)
- In depth analysis of other qualitative factors such as culture
- Determined the transactions values
- Determined the methods of financing
- Effect the transaction
- Continuous monitoring
- Evaluate post-merger results
- Make necessary amendments

Financing the Acquisitions

Financing the M & A is also a crucial element in overall chain of activities. The intended mode of finance essentially influence the decision of target company’s key management.

Widely applicable two modes of financing mechanisms are CASH and exchange of SHARES.

- Cash

This mostly suitable in small scale M & A since purchase consideration will not be material amount. Once the transaction being entered into with cash, acquirer might completely bought the target company immediately after the transaction. This method even persuades target company towards M & A.

- Exchange of Shares

In most circumstances, M & A transactions effect through exchange of shares in bidding company. This provides an opportunity to target’s to participate for the future earnings of bidder.

Post-Merger/Acquisition Acts

Both parties must all the time work towards enhance the value of merged entity and finally to make M & A is successful as expected. More responsibilities lies with bidder while key management of bidding company has to perform main role.

Effective tips to make it successful;

- Evaluate actual results as against expectation and take prompt actions accordingly.
- Determined the corporate objective(s) along with vision/mission.
- Formulate an aggressive strategic plan of achieving corporate goals.
- Seek all the avenues of minimizing costs along with enhancing efficiency such as merging valuable assets.
- Proper actions over staff including labors. Effective HR plan.
- Seek best possible mix of capital structure.
- WACC to be re-evaluated and determined.
- Minimize social and cultural effects.
- Diversification of combined risks.
- Get maximum benefit over economies of scale.

Why Most Mergers & Acquisitions Fail?

As same in most phenomena, M & A will not be successful as expected due to many reasons. Some of them are as follows;

- Lack of social and cultural fit
- Lack of fit in management styles
- Too much complication in setting goals/vision/mission
- Inability to meet obligations
- Lack of enthusiastic
- Lack of (immediate) finance to carry out the business
- Pressure created through reverse synergy
- Over/under pricing – creates frustration
- Lack of expertise in new industries
- Improper matching between scares resources
- Inability to meet the targets (financial and non-financials)
- Emergent issues such as LT

Management Buyouts

In simple term; when key management team of the existing entity purchase such an business/entity, it deemed to be treated as management buyout.

- ❑An entity need cash for upcoming major events
- ❑An entity need focus on core activities only
- ❑An entity need dispose loss making business units
- ❑Some key management personal feel isolated in decision making

Since buying party already aware on business and its key diversities, there might no need of following usual procedure such as conducting due diligence.

Since key management well aware about other areas of businesses in an entity, owners are expect certification from management nit being enter into such areas of businesses.

Management buyout can financed through debt/private placement of shares and/or seller financing.

Exercise

1. Is mergers and acquisition same?
2. Is mergers or acquisitions more popular?
3. What creates need for M & A?
4. How you can finance prospective M & A?
5. How you can win over M & A?
6. Why most M & A fail?
7. What is MBO?
8. What are the other exit strategies than MBO?