CHAPTER 4

Mergers & Acquisitions – An Overview
Mergers & Acquisitions have created a significant impact on the business for more than 100 years. They were motivated by many factors. After the year 1905, Mergers were booming since small companies in similar type of industries merged in order to gain market power. The Mergers were heavy after the Second World War since large companies went through friendly Acquisitions of small privately held companies. However, sometimes Acquisitions fail since the acquiring company may pay too much to the acquired company. In order to avoid this, careful forecasting and value analysis is essential. Even, the best way to grow is not to undertake the merger activity. A company can expand internally by investing in projects generated within company itself. This may lead to improvement in the efficiency expansion of existing activities and introduction of new products.

Mergers and Acquisitions help the big and small companies which receive much attention. Most of the medium sized companies especially niche players use the Mergers and Acquisitions in order to help them to develop their capabilities. Clifford Chance, a leading law firm also emphasizes the intellectual assets that can be gained through Mergers. In January 2000 Clifford chance completed a merger with Punder, a German firm and Roger & wells an American firm.

Mergers & Acquisitions are strategic and legal transactions and also as profoundly human driven events. Any attempt to manage a merger as simply a legal and transactional event will be doomed to failure ----well housed strategies and logical organizational charts fall by the wayside if human being decides to subvert or sabotage the process.

A gap exists between M&A as to what the experts say and what the managers’ experience. Most M&A are a blend of planning and seat of the plant management with the business and integration strategy being adjusted in the crucible of experience. This is especially true when the external environment is moving at a faster pace than the integration itself. Integration approaches are constantly amended to take into account unpredictable events and unforeseen problems. Organizational charts are rewritten as
managers see new opportunities for internal and external synergies plan that are sound in theory prove difficult to execute in practice as managers and employees struggle to alter their behavior and work together. Managers in the middle of this experience use whatever tool process or behavior will get them through to the next stage of integration.

This integration of order and chaos as well as the planned and emergent is the hallmark of each and every M & A yet merger studies often hold up a very different mirror. All too often merger analysis takes place sometime after the dust has settled. The merger story is told with the benefit of hindsight. Whether they intend or not managers often give sanitized version of the merger or Acquisition. They may forget the daily insights that helped them make the merger work. In an effort to make sense of their experience they may imagine or invent an order and logic that was not there at that time.

GlaxoSmithKline, a global pharmaceuticals firm, provides an illustration of how in the short term at least a merger adds little to shareholder value. Before the merger announcement in February 2000, Glaxo Wellcome had a market capitalization of £66.2 Billion ($92.7 billion) and SmithKline Beecham had a value of £47.6 billion ($66.6 billion). Even though there were good reasons for the merger, almost £20 billion ($28 billion) was wiped off the market value of the new companies. One year later, the value of the new business was £113 billion ($158.2 billion), constituting merely the sum of the two original companies.

M&As will lead to financial valuation. They are notoriously difficult to manage. They disturb the performance of business and damage profits also distracting the management and eventually adds little or nothing to the book value of the new business.

Most of the time, the only people who can be confident of benefiting from the deal are the shareholders of the acquired business and a host of management consultants, lawyers and financial advisers.
The poor performance of M&As has provoked a steady stream of research for the past few decades. This concentrated initially on pre-Acquisition issues, such as weather failure could be attributed to inflated prices or poor strategy. Although these factors are important, the conclusion of the majority of studies was that post-Acquisition factors were a more critical determinant of success. More and more M&A studies reveal the importance of post-Acquisition leadership, an effective integration process, and the need to gain the co-operation and commitment of employees.

Many combining companies experience sharp dips in performance following a merger or Acquisition. For example, Sema, an IT services group, acquired LHS, an American telecom software provider for £3 billion ($4.2 billion) in July 2000. By November, management was forced to announce there had been a significant deterioration in LHS’s performance. Following the profits warning, Sema market value plunged by 41% to £1.7 billion ($2.4 billion), causing its exit from FTSE 100 index of leading UK listed companies.

The reality of many M&A is that they are often extremely difficult and stressful events for many people. Merger studies reveal that employees need emotional support and practical skills in managing changes in order to survive the upheaval. People can resist change by clinging to old behaviors and work practices. Even these are no longer appropriate. In rare cases, individuals may actively resist change by being openly critical and hostile. This may even result in organized resistance through a trade union or a similar professional body.

At worst, employees’ resistance leads to people leaving the new work business. Although, it is difficult to quantify the scale of the problem, it is clear that many companies lose valuable staff in the months after a merger or Acquisition. In some cases, people leave during the period between M&A announcements and its legal completion (often called closure) because they anticipate that they will lose their job or assume that the effects on their job and career will be adverse.
If M&As are so prone to failure, why do management teams still carry on making deals? And do business people use the same yardsticks to measure their transactions as academics and consultants?

When Manchester School of Management interviewed 146 CEOs of UK’s top 500 companies, the researchers found that the fundamental motive for acquiring was to maximize growth through improving profitability and market dominance. Against these objectives, over three-quarters of CEOs stated that they viewed their companies’ Acquisitions as successful. Some 66% said that this perceived success had influenced their decisions to undertake further Acquisitions.

The Conference Board discovered similar results when it asked 134 companies to judge their M&A success rate between 1990-2000.

In any proposed M&A the assumption must be that all the managers involved will identify closely with their own business and will be highly sensitive to any form of overt and covert criticism of its performance and track record. Mutual respect should be cornerstone of any deal. From there trust and openness can be built. As relationship develops, difficult issues can be debated fully, resulting in collective commitment to the overall M&A strategy.

In effect, those involved in the merger process must demonstrate the values and behaviors that they want in the new business. Ed Smith, responsible for global learning and education at PricewaterhouseCoopers, a professional services firm, says that the culture of the merged businesses will be strongly influenced by these early forms of collaboration. A clear message from successful M&A is that there must be a compelling strategic vision. Any merger or Acquisition required leadership, commitment and energy.
It is obvious that corporate culture is very important in any merger or Acquisition which depends on the collaboration for the success which they attempt doing in the new economy. Surprisingly, the evidence is that although firms involved in the merger process may acknowledge the importance of culture, they rarely perceive it as a potential deal breaker.

Even when human resources people are used to facilitate discussions of cultural issues all too often, senior managers are uncomfortable with the process and what it reveals. In one international retail company, the directors of organizational development had his offer to help turn down and culturally based disagreements soon emerged after the merger. It was only when three valued directors an several senior managers left the merged company in first three months that it was decided that some team-building sessions would be a good idea.

There is also a tendency for managers to assume that a single homogeneous culture exists throughout their organizations. In reality, many subcultures exist at the operating level and some of these may well become major barriers to a successful combination. It is important that representatives from different part of the company help identify potential areas of cultural conflicts during the due diligence phase.

Cross-border deals have the added complexity of involving different national as well as corporate cultures. These differences often become apparent during negotiations, even among companies from neighboring countries. For example, M. D. Foods, Denmark’s biggest dairy company, merged with Arla, one of Sweden’s largest dairy firms in 2000, cultural difference emerged immediately.

Firms involved in the cross-border Mergers would be wise to consider using consultancies specializing in inter-cultural businesses in order to get to the grips with cultural issues involved and develop managerial skills needed to deal with them.
The merger between firms Clifford Chance (UK), Plunder (Germany) and Roger & Wells (America) had to tackle the dramatic differences to the way partners were remunerated. Roger & Wells paid their partners on the principle commonly known among American lawyers, ‘Eat what you kill’ – profits are shared out among partners based on how much business they personally win for their firms.

Clifford Chance and Plunder followed the European approach of sharing profits among their partners according to seniority, known as ‘lockstep’. Their different approaches had the potential to jeopardize the merger’s goal of building a global law practice where expertise and market knowledge would be shared between offices around the world. After the intense discussions before the merger, three firms agreed a compromise in the shape of modified lockstep that enabled Roger & Wells’ highest paid partners to retain their earning system until sometime in 2002 when they would be on the same basis as other partners.

Allocation of the top jobs in the new firm is often highly controversial and can be the main reason for the failure of M&A talks. For example, KLM and British Airways had the opportunity during year 2000 to create a larger airline in Europe and world’s fourth biggest. However, merger talks were called off after three months of negotiations because of dispute over who would run the merged business.

To avoid such fallouts, it is often decided simply to merge the two management teams and then allow natural shrinkage, as managers retire. This was the situation favored by Halifax and Leeds. David Jarett, former head of succession planning and organization development at Halifax and now retired, recalls that the new management team was accused of fudging the issue.

Mergers negotiation between Bank of Scotland and Halifax to create £30 billion ($42 billion) business were reportedly delayed by the issue of whether the headquarters should be in Edinburgh, Scotland or Halifax, England.
When it is decided to go ahead with M&A, a sale of purchase agreement is issued if the Acquisition is of a privately owned company. If the Acquisition involves public company, markets are informed through a letter of intent.

A decision to seek a merger must take into account strategic, financial, cultural and organizational and personal factors according to the relative weight of each factor is given. Objective analysis is critical – it can become difficult to walk away from the deal in which a lot of time and energy has been invested, especially if investors and analysts are hoping for something to happen.

The value placed on a company is now much more related to its intangible assets like its knowledge, skills, brands and customer relationships. The goal is to ensure that every client feels it has the knowledge of an international integration law firm working on its problems and not just the particular lawyer it is working with.

The company submits its proposal in the shape of Form co, a legacy department that requires companies to supply extensive and detailed information about their mode of operations, the structures of their current markets and potentially affected markets.

The European Commission considers these proposals and decides whether to launch a formal investigation. In all cases that do not include ‘serious doubt’, a clearance decision is taken within one month of the notification.

The Commission begins an in-depth investigation, lasting four months. Companies have until ninety days after the Commission launches its probe to offer solutions to potential competition problems.

The Commission puts in writing its assessment of a merger and its recommendations. If the authorities respond unfavorably to proposed merger, the managers involved are likely
to find themselves on a plane to Brussels. For example, when GE proposed a $43 billion merger with its rival Honeywell, the former’s CEO Jack Welch had to attend a number of lengthy meetings with Mario Monti, EU antitrust chief and his team of lawyers and advisers. Dr. Welch first tried to head off a formal investigation by personally pleading the merits of linkups. His attempt failed, leading to a series of tense meetings where the Commission argued that the combination of GE’s power in the market for aircraft jet engines and Honeywell’s strengths in avionics would give it a near-monopoly in the market for jet engines for large commercial and regional aircraft. Despite all these efforts and significant managerial attention, the deal was finally rejected.

**Motives for Mergers and Acquisitions**

During the nineteenth century industrial consolidation, growth companies increased market power and economies of scale through “horizontal integration” or buying out other companies producing the same service or product line. Then control was also expanded down towards suppliers of inputs and up towards the final consumer market through “vertical integration”. Government anti-trust or combined legislation was aimed at protecting a competitive environment from collusive business practices. As Government regulation cracked down on horizontal and vertical integration, restructuring took the form of diversified conglomerates spreading business risks throughout the economy, yet keeping control under the same financial umbrella.

These conglomerate Mergers are more financially motivated than product or market extension Mergers. Weston (1990) attests that conglomerate Mergers predominated in the 1960s almost half of which were “defensive diversification” in the USA defense and aerospace industries seeking participation in the broad spectrum of industries in order to diminish the impact of drastic reduction in the defense budget. The federal trade commission (FTC) classifies 75% of M&A between early 1950s and the late 1970s as conglomerates. The major driving forces for conglomerates style M&A are strategic considerations which includes to compensate for instabilities of mature industries with
wide fluctuations in demand and product mix, excess capacities related to slow sales growth and declining profit margins; entry of competitive firms and major long term decline in some markets.

The recent trend has been towards related M&As. The shift towards divesture of non-core business too has lent support to M&As. Industries operating in the sector of telecommunication, broadcasting, utilities and pharmaceuticals have witnessed consolidation leading heavy M&As. Here the strategic forces aim at getting a bigger size of the market, enhancing product mix through R&D, to achieve economies of scale and synergy, strengthening ownership control and guarding against Acquisitions. By adopting these strategic considerations companies expected to focus on their core competencies through core consolidation and stay competitive.

**Mergers and Acquisitions in developed countries**

**USA:** Several major merger movements have occurred in the United States and each was determined to some extent by a certain type of merger. All the merger movements occur when the particular economy experiences certain developments in the overall environment surrounding the business.

The combination movements at the turn of the century comprises especially of horizontal Mergers which led to high concentration in many industrial units including the heavy manufacturing industries. The period was one of rapid economic expansion. The movement peaked in 1899 and almost ended in 1903, when severe economic recession set in. Mergers completed in the period 1887 through 1904 were estimated to involve 15 % of the total no. of plants and employees comprising manufacturers in 1900.

The advent of electricity and increased usage of coal, the complete rail system that led to the development of national economic market and thus leads to paving way for regional
firms becoming national firms. Large scale production was motive of combination. Three problems are pointed out in economies of scale rational.

(A) Although the scale economies can be more easily accomplished in combination of small firms than of large firms, Economies scale the merger activity was concentrated in large firms only. Markhan notes that all Mergers were based on large Mergers and did not include Mergers involving a capitalization of less than $1million.

(B) Lynch’s second point is that combination resulted in multi plant operation but scale economics are obtained when production is integrated by investment in larger replacement facilities. However economies of scale can exist not only in production but also in administration and marketing.

(C) Lynch observed that merger activity in the early period occurred in wide variety of Industries and technological advancements motivating horizontal Mergers cannot surface in a number of industries within a short time of span.

In study of 92 large Mergers by Moody, it is found that 78% controlled 50% of the market. According to Markhan, “Out of every five Mergers, ostensibly monopolistic in character that led to the monopolistic control”. Markhan found that Mergers formed during early merger movement did not have monopoly power of their principal objective and accordingly must be explained on other grounds.

In the beginning, the second wave of Mergers began with revolution in the business activities in the year 1922. Many combinations during this period started outside the consolidated heavy manufacturing industrial units. The most active amongst them were the public utilities and the banks. Around 60% of the Mergers occurred in the food processing and chemical and the mining sectors. The monopoly was not applicable in most cases and transformation of a near monopoly as oligopoly by merging for oligopoly
was more frequent. While oligopoly provided a motive for many Mergers it was limited to no more than a small fraction of Mergers. As for motivational factors of these Mergers both Markhan and stocking emphasized major developments in transportation, communication and merchandising. A new transportation system utilizing motor vehicles broke down small local markets by enabling sellers to extend their selling areas and make consumers more mobile. The rise of home radio facilitated product differentiation through national brand advertising.

By 1920s, mass distribution with low profit margin became a new method of merchandising. These developments caused an increase in scale of operation and hence encouraged Mergers. On the increase in Vertical Integration, Stocking noted that by 1920s, business had come to appreciate the advantages of integration. The advantages were related to technological economies of such shortening of manufacturing processes or to reliability of inputs supply and secured product outlets.

According to Stigler (1951) a large number of firms merged vertically to circumvent price controls and allocations during the war and post war period. Butters and Cary(1951)show that many owners were motivated to sell their firms because of high wartime and post-war income and estate taxes and the lower capital gains tax. Other sellers were motivated by such general business considerations of the firms and the buyer’s desire for a new product or production organization or for greater vertical integration.

**Mergers and Acquisitions and Corporate Performance**

An attempt has been made to summarize the important research literature on the M&A front in developed countries with respect to its impact on corporate performance.

Evaluating the performance of companies involved in Mergers and Acquisitions has become a subject matter of a great deal of research. Many attempts were made to throw
light on the motives behind the merger and Acquisition transactions and to determine their results by evaluating the cost benefits for both the companies and even the countries where they are located. The various reasons for Mergers and Acquisitions and the diversity of their results have given rise to a varied range of hypothesis, in which each part tries to explain a part of merger and Acquisition phenomenon. This hypothesis can be compiled into three major theories i.e. the internalization theory, technological competence theory and the transaction cost theory.

These three theories show the variety of reasons for M&As. Khemani (1991) states that there are varied reasons, motives as well as economic forces which can be taken together separately in isolation which influences the companies' decisions to engage in the merger and Acquisition activities. Over the past few years, the pressure from international competition, the innovations in finance, growth and expansion economically increased political and economic integration and the technological changes have contributed to the fast rate of growing merger and Acquisition activities. The Mergers and Acquisitions can also be motivated by commercial and economic considerations by broadening the extent of products that are related and also the geographical market, the diversification and the risks and benefits involved in vertical integration.

It can be well assumed that these motives have enhanced the profitability of the corporates as the long term objective. It can be assumed that even if this is not always the possibility, the main concern of corporate managers who make the Acquisition regardless of their motives is increasing profits at an alarming rate. However, there are so many factors that have an effect on this that it can become extremely difficult to make statistical measurements in isolation of the effect of merger and Acquisitions on profits. Free cash theory propounded by Jenson (1998) is an excellent example of immediate objective which in the long run can lead to more profitability. This theory has made an assumption that the managers and the shareholders of the corporates do not share the same objective. The conflict between these objectives may intensify when the corporates
are in a profitable position enough to generate free flow cash i.e. there is no reinvestment of the profits in the corporates. Under such conditions, the corporates may take the decisions to go in for Acquisitions to use the liquidities. This type of acquisitions are most often financed by issuing debentures and also by liquidating the cash. The managers are induced to take new measures to increase the efficiency of the operations of the corporates by the higher debt levels. Jenson says that the reorganization and restructuring which is made by takeovers leads to long term profits.

Several studies were made to measure the success of the early Mergers in terms of profitability and determine the reason for their success and failure. Livemore attributes success to astute business leadership and in particular to the rapid managerial and the technological improvements, new product developments and the entering into industries' new subdivisions and the promotion of brand names of quality as well as the exploitation of the research commercially. The causes for failure as given by Deving (1953) include lack of efforts to realize the economies of scale by modernizing inherited equipments, plants as well as the increase in overhead cost and the large size and inadequate talent to manage a large group of plants leads to lack of flexibility.

The studies conducted on the impact of Mergers and Acquisitions can be bifurcated as per the financial or industrial organization approach. One of the ways to measure the performance is by monitoring the prices of shares after the deal of Mergers and Acquisitions is struck. The financial approach that is most commonly employed examines the trends in the prices of shares of the corporates that are involved in Mergers and Acquisitions and compares them with a specific reference group of corporates. The performance of the corporates seemed to have improved when the shareholders' return tend to increase after the Mergers and Acquisitions. The results thus obtained especially in the United States and also in Canada showed that the corporate takeovers most probably have favourable effects for shareholders of the target
companies. The merger and Acquisition announcements are positively viewed by the stock market.

Further studies conducted evaluated the impact of Mergers and Acquisitions in respect to profitability before and after the merger and Acquisition. These organizations' studies do not consider share price studies instead the longer time horizons are taken into consideration. Most of the organizations do not show improvements in the profitability which is long term after the Acquisition. Some studies have concluded that compared to horizontal and vertical Mergers and Acquisitions, the conglomerate Mergers and Acquisitions provide more favourable results.

Many research studies that were conducted have investigated that the performance of unrelated conglomerate Mergers was not as good as the merging companies which have potential economies of scale. It is evident in terms of returns to the shareholders.