## Mergers and Acquisitions

**The terms merger and acquisition refer to the combination through consolidation of two or more business entities to achieve synergies by - for instance - expanding operations, gaining market share, reducing costs, or enhancing profits. Therefore, the aim of such transactions is to create shareholder value: Only a few do, though.**

A merger occurs when two or more individual businesses combine to create a new enterprise. An acquisition, on the other hand, refers to a takeover of one business entity by another one. Whilst mergers are always friendly, acquisitions can also be hostile. - Since mergers are fewer and takeovers in the past by times been viewed with scepticism, the two terms have become blended, and jointly with corporate restructurings all of them are nowadays usually referred to as: merger and acquisition (M&A) transactions.

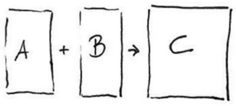
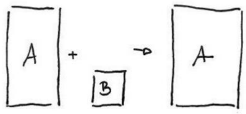
In the course of a merger the merged entity often assumes a new name, ownership structure, as well as management (of members of each firm). The stocks of both companies are surrendered and new ones issued under the name of the new business identity. Usually, no exchange of cash is involved. Instead, mergers dilute each company's individual power, whereby the shares of the new entity are distributed proportionately among existing shareholders of both companies. - Merging parties tend to be similar in terms of size or scale of operations, treating each other as sort of equals.

In an acquisition, on the other hand, the relatively weaker company is consumed, ceases to exist, with operations and staff absorbed by the acquiring firm. In some cases, however, the target may retain its original name and continues to be separately managed to preserve its brand, culture or (often research-related) operations. – In order to achieve operational and managerial control, the acquirer must at least get hold of the majority of the target company’s stock by either offering cash or shares or a combination of both. Whereby most acquisitions are mutually agreed upon. In contrast, though, in a hostile takeover attempt the acquirer aims to gain control over the target without its management to consent.

Most prevalent are deal structures where a buyer acquires all (or a certain percentage) of the shares in the target company. An alternative to this are asset deals, where the acquirer purchases specific tangible and intangible assets of a target (only). Typically, this would include operating assets of the business (such as working capital, equipment, production site, customer lists, patents, selected contracts). – Now, if shares are acquired, then the entire firm is acquired: This would include all of a target´s assets and liabilities (on- and off-balance sheet), along with it also the risk that unforeseen costs or liabilities emerge after closing of the transaction. If properly structured, though, then those risks are covered by warranties and indemnities as part of the share purchase agreement. - In the course of an asset deal, on the other hand, the scope of acquired liabilities is limited, in most cases entirely excluded.

M&A transactions expose shareholders of the acquirer and the target towards risks, both prior to closing a deal as well as such post-closing, during the integration phase. Pre-closing, the main risk is related to price fluctuations of the stock of the bidder and that of the target. Such share price volatilities may seriously affect the terms of a deal and reduce the likelihood of closing. Post-closing, the biggest risk – foremost for the bidder, though - is the target failing to perform up to expectations (risk of overpayment).

Despite promising shareholder value creation, the track record of M&A transactions is mixed, as most acquirers materially overestimate the synergies a merger will generate: In practice, the greatest errors appear on the revenue side, followed close by failures to account for disruptions and underestimating onetime costs. Besides, often too simplistic and overly optimistic assumptions are made about how long it will take to capture synergies, not least whether they are sustainable. – Now, in the run-up of M&A transactions involving publicly listed companies, in most cases the share price of the target company tends to move up whilst that of the acquirer tends to decline: Based on what has been mentioned above, many transactions eventually result in nothing else than a value transfer from the acquiring company to the shareholders of the seller.

| | MERGER | ACQUISITION |
|---|---|---|
| |  |  |
| RESULT | FORMATION OF NEW COMPANY | COMPLETE TAKEOVER OF TARGET COMPANY |
| DECISION | MUTUAL CONSENT | MUTUAL OR HOSTILE |
| COMPARATIVE STATURE | SIMILAR STATURE, SIZE & SCALE | ACQUIRER LARGER AND FINANCIALLY STRONGER |
| POWER | DILUTION BETWEEN INVOLVED COMPANIES | ACQUIRER EXERTS ABSOLUTE POWER OVER TARGET |
| SHARES | NEW SHARES | CASH OR ACQUIRER'S SHARES |

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