Mergers and Acquisitions - Overview

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 or reducing costs. 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 have by times been viewed with scepticism in the past, the terms have become blended. Jointly with corporate restructurings all of them are nowadays usually referred to as: mergers and acquisitions (M&A) transactions.

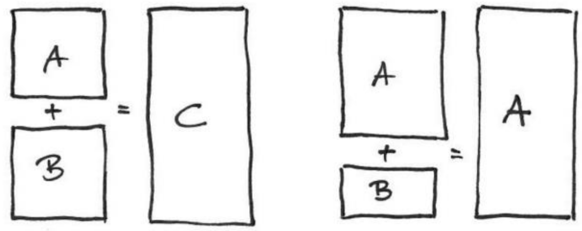
In the course of a merger the merged entity assumes a new name, ownership structure, as well as management (composed of members of each firm). The stocks of both companies are surrendered and new ones issued under the name of the new business identity. Usually, no exchange of cash is involved. Instead, 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. - Most acquisitions are mutually agreed upon. In contrast, though, in a hostile takeover attempt the acquirer aims to gain control over the target without management to consent.

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 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 post-closing. 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, especially in a stock-for-stock deal. 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 historical track record of M&A transactions is mixed, as acquirers tend to overestimate the synergies a transaction 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, and whether they are sustainable. – As a matter of fact, 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 the outlined above, therefore frequently transactions result in nothing else than a mere 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 & FINANCIALLY STRONGER
POWER	DILUTION BETWEEN INVOLVED COMPANIES	ACQUIRER EXERTS POWER OVER TARGET
COMPENSATION	SHARES IN NEWLY ESTABLISHED COMPANY	CASH OR ACQUIRER'S SHARES

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