**6th Lesson**

1. **Mergers and Acquisitions (M&A)**

**3.1 Concept and distinction**

From a legal point of view, a merger is a legal consolidation of two companies into one entity, whereas an acquisition occurs when one company takes over another and completely establishes itself as the new owner (in which case the target company still exists as an independent legal entity controlled by the acquirer). Either structure can result in the economic and financial consolidation of the two entities. On other words, merger is a combination of two companies to form a new company, while an acquisition is the purchase of one company by another in which no new company is formed.

**3.2 Classification**

**Horizontal M&A**

Horizontal M&A happen when a company merges with or acquires another company that offers the same or similar product lines and services to the final consumers, which means that it is in the same industry and at the same stage of production. Companies, in this case, are usually direct competitors. For example, if a company producing cell phones merges with another company in the industry that produces cell phones, this would be termed as horizontal merger. The benefit of this kind of merger is that it eliminates competition, which helps the company to increase its market share, revenues and profits.

**Vertical M&A**

A vertical M&A is an operation between companies that produce different goods or offer different services for one common finished product. The companies operate at different levels in the supply chain of the same industry. In other words, same industry, different stage of production of products and usually one of the companies supplies goods to the other company. Usually the target company is an important supplier of its raw materials. For example, if a clothing store takes over a textile factory, this would be termed as vertical merger, since the industry is same, i.e. clothing, but the stage of production is different.

**Concentric M&A**

Concentric M&A take place between companies that serve the same customers in a particular industry, but they don’t offer the same products and services. Their products may be complements, product which go together, but technically not the same products. For example, if a company that produces DVDs mergers with a company that produces DVD players, this would be termed as concentric merger, since DVD players and DVDs are complements products, which are usually purchased together. These are usually undertaken to facilitate consumers, since it would be easier to sell these products together. Also, this would help the company diversify, hence higher profits. Selling one of the products will also encourage the sale of the other, hence more revenues for the company if it manages to increase the sale of one of its product. This would enable business to offer one-stop shopping, and therefore, convenience for consumers. The two companies in this case are associated in some way or the other. Usually they have the production process, business markets or the basic technology in common. It also includes extension of certain product lines. These kinds of mergers offer opportunities for businesses to venture into other areas of the industry reduce risk and provide access to resources and markets unavailable previously.

**Conglomerate M&A**

When two companies that operates in completely different industry, regardless of the stage of production, a merger/acquisition between both companies is known as conglomerate merger/acquisition. This is usually done to diversify into other industries, which helps reduce risks.

**3.3 Reasons and advantages of M&A**

There are [various reasons](http://www.mckinsey.com/insights/corporate_finance/the_five_types_of_successful_acquisitions) as to why a company might to decide to merge or acquire another company, although there has to be a strategic reasoning or logic behind the merger. All the successful mergers and acquisitions have a specific, well thought-out logic behind the strategic move. Mergers and acquisitions usually create value for the company in different ways, some of which are listed below:

**Improve the company’s performance**

This involves improving the performance of the target company, as well as the company itself. It is one of the most important reasons of value-creating strategies of M&A. The two companies’ combined would have a greater impact in the market as they are most likely to capture a greater market share by accessing a wider customer base and by the diversification of the products, services and long-term prospects of business. A target business may be able to offer products or services which can be sold through own distribution channels.

**Remove excess capacity**

As more and more companies enter the industries, the supply continues to increase more than demand, which brings the prices down. In order to correct this, companies merge with or acquire other companies in the industry, hence getting rid of excess capacity in the industry.

**Accelerate growth and reducing competition**

If a competitor company is taken over, its share of sales is also absorbed. As the result, the acquirer gets higher sales, revenues and consequently higher profits as consequence of competition reduction**.**

**Acquire skills and technology**

Companies often acquire or merge with other companies in hopes to acquire skills and/or technology of the target company. A merger/acquisition provides an opportunity for both companies to combine their technological progress and generate greater value from the sharing of knowledge and technology.

**3.4 Types**

#### **Acquisition types**

An acquisition can be performed in two ways:

* The acquirer buys the majority of the shares and so the majority of the share capital of the target company. The effective control of a company is reflected in the control of its share capital. As the company is acquired intact, this type of transaction includes all liabilities assumed by the company acquired in the past and all the risks.
* The acquirer purchases all net assets of the target company instead of their shares. The capital received by the company acquired is paid to its partners through an extraordinary distribution of dividend. This type of transaction leaves the company acquired as an empty shell if the purchaser buys all of its assets. The acquirer may structure the transaction to include the assets wanted and exclude the unwanted assets and liabilities.

**Merger types**

A merger is the concentration of two companies in one new company.

A merger can be performed in two ways:

* Merger by incorporation or absorption: The assets and liabilities of on company are transferred to another and the first one is extinguished;
* Merger concentration: The assets and liabilities of both companies are transferred for a third one and both original companies are extinguished.

Usually merger or acquisition are voluntary operations and the acquired company shareholders are offered an exchange of shares (stock swap) or a cash payment. The exchange of shares is usually used because it allows the shareholders of both companies to share the risks involved in the business.

The merger may be similar to an acquisition but results in a company with a new name (often a combination of the names of the original companies) and a new brand image; in some cases, it is called to the combination of companies a "merger" rather than acquisition purely for political or commercial reasons.

The opposite operation of the merger, where a company is divided into several is called demerger, spin-off or spin-out. One company divides its assets and create new companies. All companies are severally liable for the obligations.

**Case Studies**

1. **Distinguish merger and acquisition and refer some of the advantages of these operations.**

From a legal point of view, a merger is a legal consolidation of two companies into one entity, whereas an acquisition occurs when one company takes over another and completely establishes itself as the new owner (in which case the target company still exists as an independent legal entity controlled by the acquirer). Either structure can result in the economic and financial consolidation of the two entities. On other words, merger is a combination of two companies to form a new company, while an acquisition is the purchase of one company by another in which no new company is formed. The main advantages of the M&A are:

**Improve the company’s performance**

This involves improving the performance of the target company, as well as the company itself. It is one of the most important reasons of value-creating strategies of M&A. The two companies’ combined would have a greater impact in the market as they are most likely to capture a greater market share by accessing a wider customer base and by the diversification of the products, services and long-term prospects of business. A target business may be able to offer products or services which can be sold through own distribution channels.

**Remove excess capacity**

As more and more companies enter the industries, the supply continues to increase more than demand, which brings the prices down. In order to correct this, companies merge with or acquire other companies in the industry, hence getting rid of excess capacity in the industry.

**Accelerate growth and reducing competition**

If a competitor company is taken over, its share of sales is also absorbed. As the result, the acquirer gets higher sales, revenues and consequently higher profits as consequence of competition reduction**.**

**Acquire skills and technology**

Companies often acquire or merge with other companies in hopes to acquire skills and/or technology of the target company. A merger/acquisition provides an opportunity for both companies to combine their technological progress and generate greater value from the sharing of knowledge and technology.

1. **Identify and classify the following operations:**
2. **X company that produces ice tea acquired the majority shares of Y company that produces cans.**

The described operation is a conglomerate acquisition because the acquirer buys the majority of the shares and so the majority of the share capital of the target company and the two companies belong to different industries.

1. **B company that produces cheese and C company that produces milk being a C´s supplier decided to extinguish themselves and create BC company to produce only cheese.**

The described operation is a vertical concentration merger because the assets and liabilities of both companies are transferred for a third one and both original companies are extinguished. Two companies that are in the same industry but the stage of production is different and one company supplies goods to the other company. Usually the target company is an important supplier.

1. **D company that produces shoes absorbs all assets and liability of E company that produces shoes laces, and the last one is extinguished.**

The described operation is a concentric merger because the companies serve the same customers in a particular industry, but they don’t offer the same products and services. Their products may be complements, product which go together, but technically not the same products. And can be considered as a merger by incorporation or absorption because the assets and liabilities of E company are transferred to D and the first one is extinguished.

1. **F company that sells clothes acquired the majority shares of G company that also sells clothes.**

The described operation is a horizontal acquisition because the acquirer buys the majority of the shares and so the majority of the share capital of the target company and both offer the same or similar product lines and services to the final consumers, which means that it is in the same industry and at the same stage of production.