LISBON
SCHOOL OF
ECONOMICS &
MANAGEMENT
UNIVERSIDADE DE LISBOA

Mergers, Acquisitions and Restructuring of Companies

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1. The importance of Mergers, Acquisitions and Restructuring of Companies

The importance of MARE

Advantages of the processes of Mergers, Acquisitions and Restructuring

Global Perspective

1) Earnings through Synergies and Scale Economies
2) Optimization of the cost structure
3) Sharing of technology and know-how among companies
4) Sharing of information

Increasing of competitivenes

Renewal of the business environment

1. ***Types of Mergers and Acquisitions***
2. ***Why a merger and acquisition process***
3. ***Global perspective about a Merger and Acquisition process - methodology***

    3.1. Steps of an acquisition process

    3.2. Steps of a sale process

2. Types of Merger and Acquisitions

Mergers

It is a strategy which follow two companies that agree to incorporate their operations in the same one.

Situations where the companies, independent from the point of view of the rights of the property, that come to belong to the same company.

Types of companies' combinations (mergers and acquisitions)

1. Horizontal
2. Vertical
3. Conglomerates
4. Concentrics

Types of Mergers and Acquisitions

1. **Horizontal**

They are mergers and acquisitions among companies that operate in the same activity sector or industry.

Two main perspectives about what the horizontal mergers and acquisitions are for.

- Theory of the maximization of the value
- Theory of the management

Types of Mergers and Acquisitions

1. **Horizontal**

Theory of the maximization of value

This theory is based in the:

- Increase of the efficiency in the production and distribution
- Increase of the market power
- Increase of the dealing capacity
- Reconfiguration, rationalization, improvement in the use of core competencies
- Scale economies

Theory of the management

- Management “not enough” of the target company

Types of Mergers and Acquisitions

1. Horizontal

Example of the horizontal merger:

Travelling agencies

Reasons for the merger

- Enlargement of the distribution channel -the branch network with national coverage

- Increase of the dealing capacity with suppliers (tour operators, hotels, etc)
- Racionalization of processes and more efficient use of the human resources
- Internacionalization

Types of Mergers and Acquisitions

2. Vertical

They are mergers and acquistions among companies that operate in **different phases of the value chain** of a product or service. It is found potentially in a supplier-customer relation.

When a company buy another company that is located upstream or downstream in the value chain.

The vertical integration has effects on the capital cost, operational cost, associated risks and effectiveness of the coordination.

Types of Mergers and Acquisitions

2. Vertical

Reasons for the existence of the vertical mergers

- Participation in stages of the value chain with higher value added
- Guaranteed access to other markets
- Technology economies
- Elimination or decrease of the cost of researching, publicity, communication, coordination of the production, billing and other transaction costs
- Improvement in inventory and production planning due to the more efficient information flows
- Decrease the cyclic or seasonal aspects and uncertainty at the search
- Decrease the duration of the market failures affecting to the company
- Higher proximity of the real customers

Types of Mergers and Acquisitions

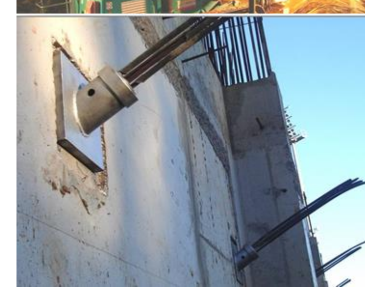
2. Vertical

Example of vertical merger

Firm Foundations and Geotechnical and metalworking company – vertical merger with upstream integration

Reasons for the merger

- Entry into a new market segment that shows synergies with current business
- Decrease the risk inherent to innactivity periods due to breakdowns in the material
- Cost economy in the components acquisitions
- Higher control of the valur chain



Types of Mergers and Acquisitions

3. Conglomerate

They are mergers and acquisitions among companies that operate in **markets without any relation**, making a diversification strategy.

Types of Conglomerate

- ❖ Financial control
- ❖ Enterprises, estrategics, or of management

Advantages

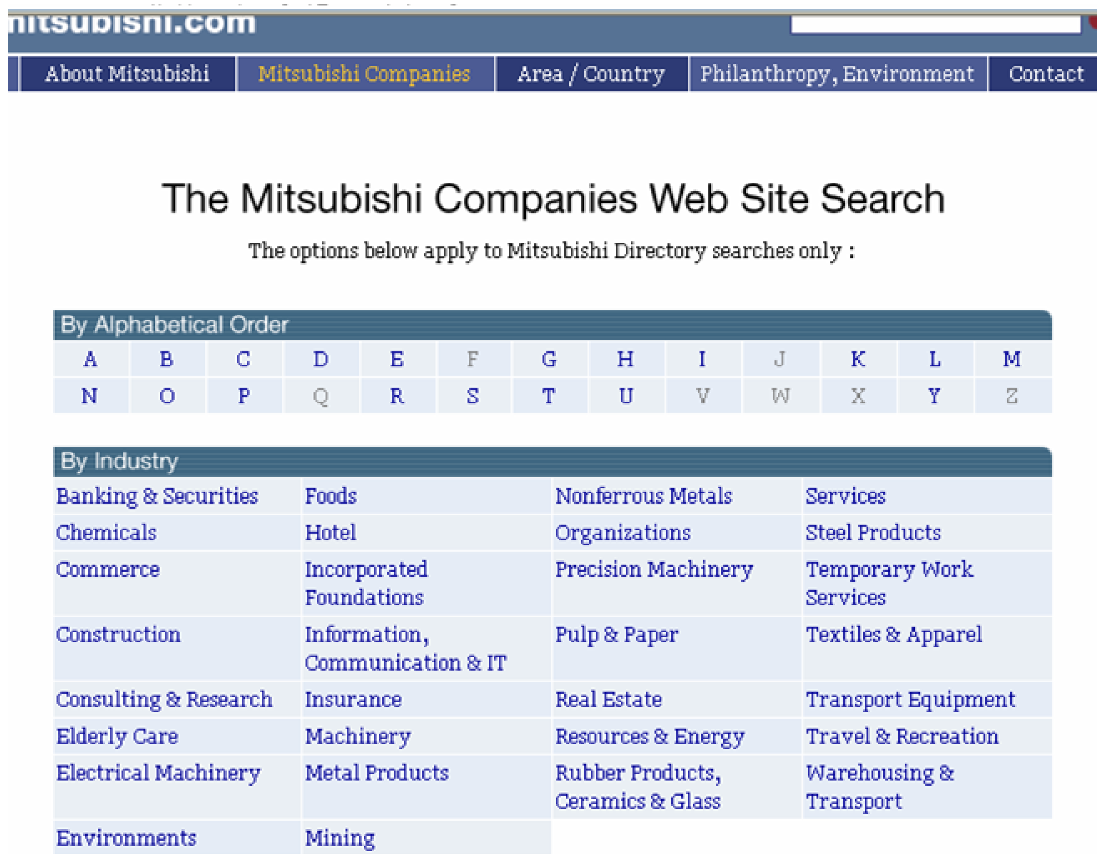
- ➢ Taking advantage of the business opportunities in different sectors of activity
- ➢ Flexibility and opportunity
- ➢ Security/ strength
- ➢ Risk management through the diversification of activities

Types of Mergers and Acquisitions

3. Conglomerate

Examples of conglomerate

- Mitsubishi
- Siemens
- General Electric
- …



Types of Mergers and Acquisitions

4. Concentrics

The concentrics mergers and acquisitions are carried out among companies that operate in **different markets,** they have as a goal the attainment of earnings coming from common situations.

In special, these situations are the markets, the processes and the technologies that both use.

The most typical example of these types of merger is the case of bank and insurance sector:

- The banks employees try to sell the services of the insurance companies and vice versa.

Exercise

Examples of different Types of Mergers and Acquisitions

Exercise

Presentation of the next points by the class **working groups:**

- Example of a vertical merger/acquisition
- Example of a horizontal merger/acquisition
- Example of a conglomerate merger/acquisition
- Example of a concentric merger/acquisition

Additionally, it should be done

Reasons for the realization of this type of operation

3. Why a merger and acquisition process

Reasons for the operations of business concentrations

Reasons for the mergers

- ❖ **Market power**

- ❖ **Decrease of the competitors**

The mergers can decrease the competitors in the market among the companies that make a merger and the rest companies of the industry making higher the earnings of the companies that made the merger and making a higher viability of practices “concerted action”.

- ❖ **Change of the market structure**

The effect that produce a merger is, in some cases, that companies decide to set **higher prices** and, in this way, they do not need of doing so many turnover to achieve earnings.

Ex. Bus transportation of passengers in Portugal

- Decrease on the number of trips available
- Increase of the price of the tickets

Reasons for the mergers

❖ Operational eficciency

Many times the operations of business concentration are carried out in order not to increase the market power but to increase the production efficiency.

Mergers may seek to obtain increases in operating efficiency, ie, a profit maximization and minimization of costs of the companies involved.

The main causes of these increases of efficiency are:

- Scale economies
- Economies of scope
- Faster recovery effect experience curve

Reasons for the mergers

❖ Management efficiency

With the merger it is expectable that some needs are going to appear as can be human resources or other kind in relation with the companies management grows less proportionally comparing with the turnover and that these resources can, eventually, be sharing without increasing the costs.

❖ Financial earnings

Due to the possibility of the resultant company of the merger finances itself at an average lower cost than an individual company, this advantage will result in a financial earning.

In case there are a company with positive earnings and another with negative earnings, there will be a fiscal advantage.

Reasons for the mergers

❖ Acquisition of undervalued assets

Due to the fact that in specific situations the market value of some companies can be considered lower than its potential value which let the maximization of the company acquirer.

For example:
If the **seller was inefficient**:
economic value (*owner value*) **<** market value

If the specific **buyer had scale/synergies economies:**
economic value (*intrinsic value*) **>** market value

❖ Valuation more optimistic of the goal company

Mergers can happen when the buyer, having into account the uncertainty that exist, make a valuation more optimistic of the company than the seller.

Reasons for the operations of business concentrations

Acquisitions

It is a strategy which consist in the buying of a control participation of a company for another company with the intention of transforming the acquired company in a subsidiary company inside of its business portfolio.

The Takeover is a special kind of strategy in which the management of the target company was not heard/agreed with the proposition of company buying by the acquiring company (*).

(*) Note: There are several strategies of defense on the part of the target company

Reasons for the operations of business concentrations

Reasons for the Acquisitions

- **Cost of development of new products –** The acquisition of a company makes return more predictable, a fast entry into the market and a fast access to new capacities.

- **Overcoming barriers to entry –** The acquisition of a company already set will be able to provide a more efficient way of coming into the market as a competitor, a the same time, that provides to the acquirer company an immediate access into the market.

- **Learning and development of new competences –** With the acquisitions, the company can acquire new aspects that it did not have.

- **Dimension –** Increase of efficiency inherent to the scale economies and higher market power.

- **Manager clearly focused in acquisitions –** The managers of the target company concentrate exaggeratedly their attention in the acquisition process what can create a perspective of short term and a higher aversion to the risk.

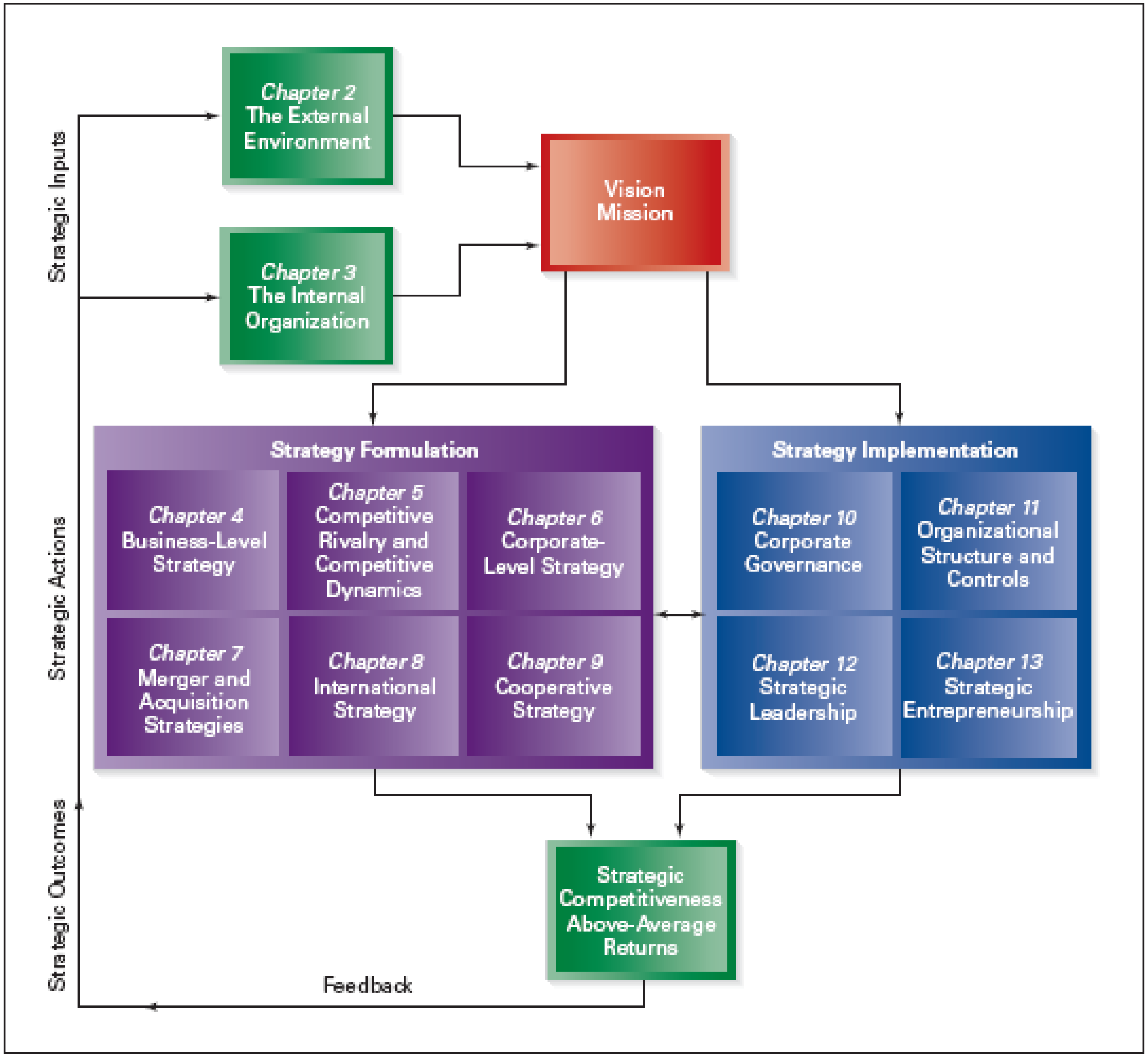
Reasons for the operations of business concentrations

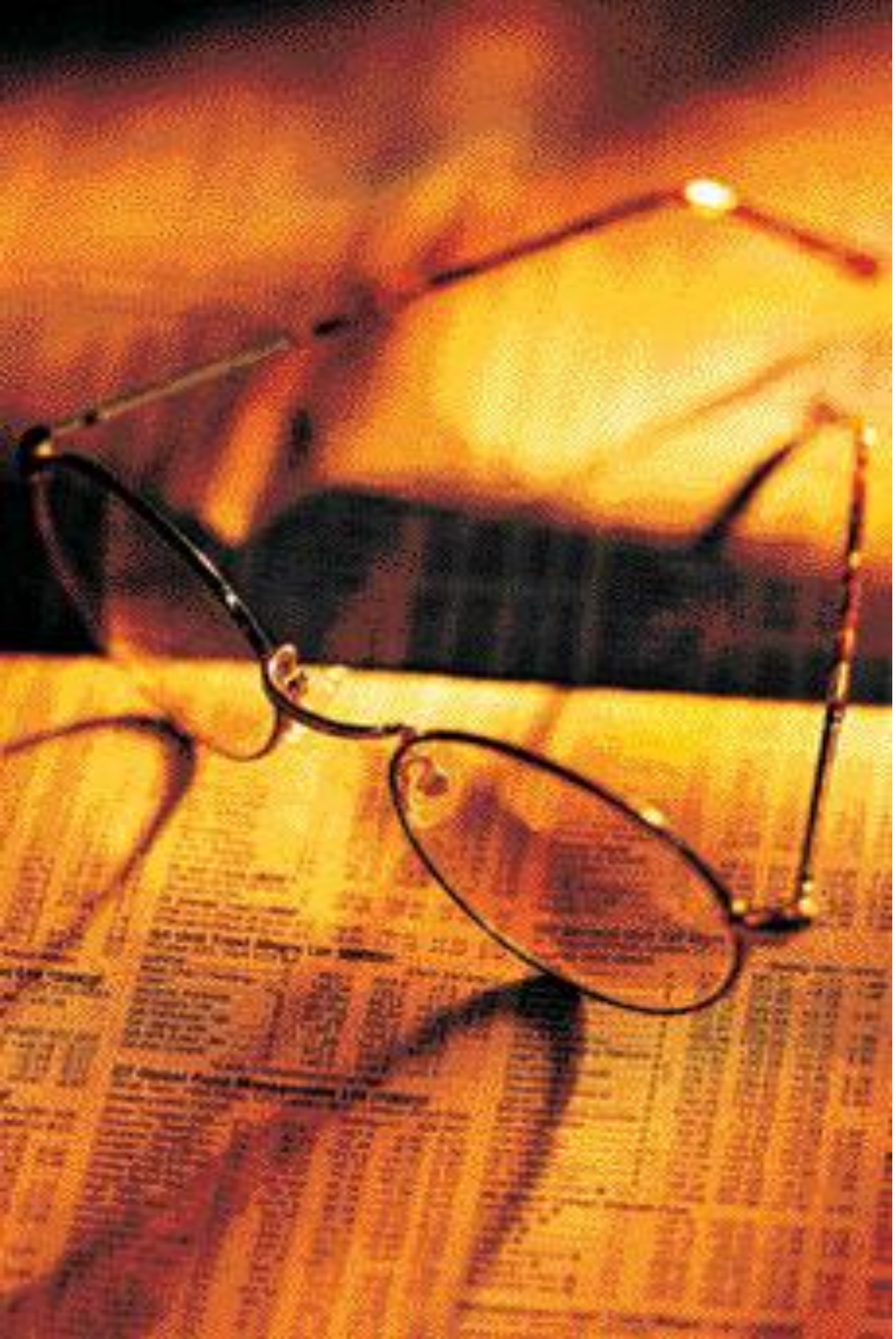
The importance of the process of merger, acquisition and restructuring in the modernization of the economy

The mergers and acquisitions, if they succeed in the implementation permit:

- Increase the earnings and the value of the companies involved
- A possible increase of the profitability and the market share
- Regeneration of the business environment
- Sharing of information
- Sharing of technology and, therefore, development of it
- Increase of competitiveness

The Strategic Management Process





4. Global perspective concerning a process of merger or acquisition - methodology

Making a purchase or sale operation

A significative part of the operations of purchase and sale of companies fail.

Some of the reasons which they fail

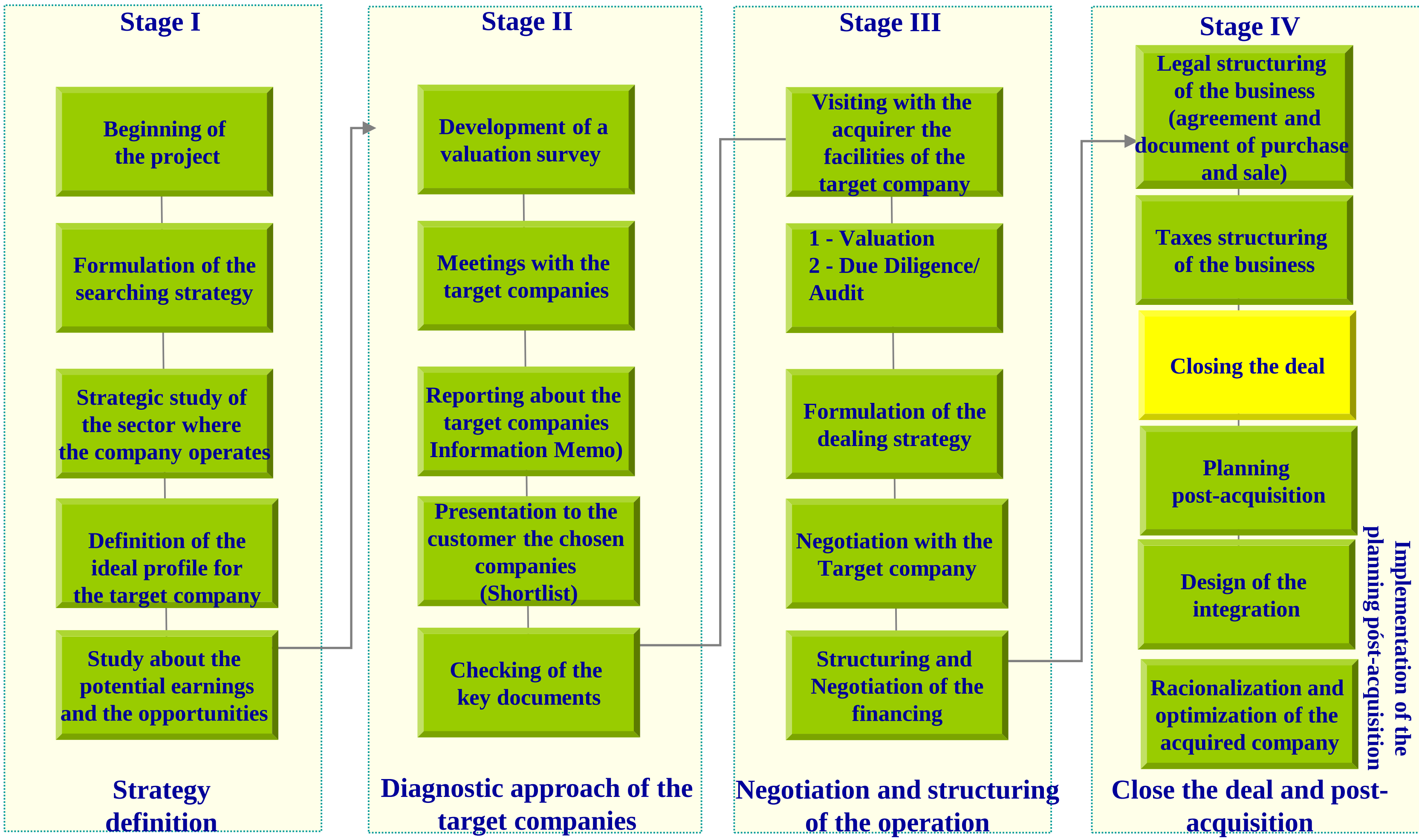
- Insufficient planning of the operation
- Lack of methodology of sustainable work
- Unexpected situations appear when the process is carrying it out
  - Accounting problems
  - Tax contingences
- No agreement for the price or purchase conditions
- Withdrawal of the counterparty
- Lack of specialized support

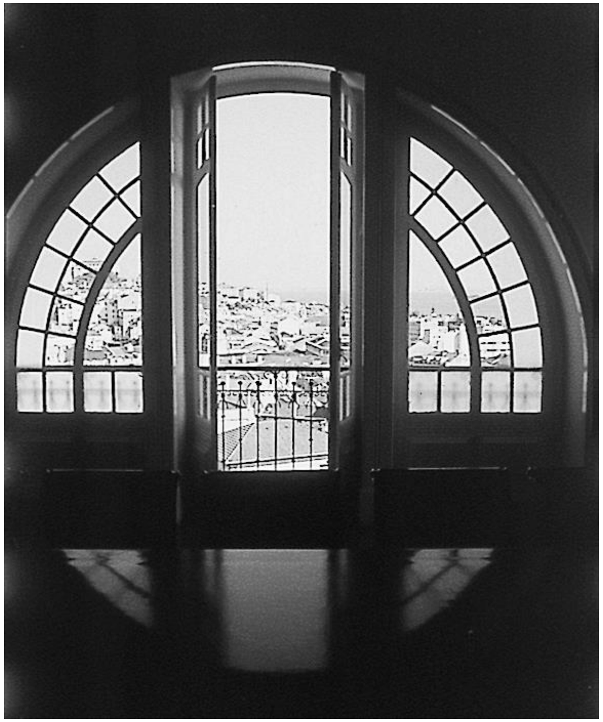
In order to **reduce the probability of unsuccess** in a purchase or sale operation should be followed a methodology of work that consists in several steps.

4.1. Stages of a process of acquisition

Methodology

Stages of an acquisition process





4.2. Stages of a sale process

Stages of a sale process

Fase I

- Beginning of the project
- Formulation of the searching strategy
- Strategic study of the sector where the company operate
- Definition of the ideal profile for the buyer companies
- Study about the potential earnings and the opportunities

Strategy definition

Fase II

- Analysis of the activity of the XPTO
- Analysis of the strategic positioning
- Vendor Due Dilligence
- Company's valuation
- Elaboration of the *Business Profile*
- Elaboration of the *Business Memorandum*

Elaboration of the supporting documentation

Fase III

- Meeting with the potential buyers
- Visit of the potencial Buyer to the facilities of the XPTO
- Formulation of the negotiation strategy
- Negotiation with the potencial buyers
- *Shortlist* of the most interesting offers

Negotiation and restructuring of the operation

Fase IV

- Legal structuring of business (agreement and document of purchase and sale)
- Taxes structuring of the business
- Due Dilligence / Audit
- Final negotiation of the reference terms of the business
- Closing the deal

Close the deal

Making a purchase or sale operation

Some of the stages shown at the previous diagrams may not happen exactly in that order, taking place situations in which can and must be developed in parallel or in another different sequence to the presentation.

Restructuring strategies

- Three restructuring strategies
  1. **Downsizing:** reduction in number of firms' employees (and possibly number of operating units) that may or may not change the composition of businesses in the company's portfolio.

  2. Down scoping: eliminating businesses unrelated to firms' core businesses through divesture, spin-off, or some other means.

  3. Leveraged buyouts (LBOs):
    - One party buys all of a firm's assets in order to take the firm private (or no longer trade the firm's shares publicly)
    - **Private equity firm:** firm that facilitates or engages in taking a public firm private
    - **LBOs:** management buyouts
    - Why LBOs?
      - i) protection against a capricious financial market;
      - ii) allows owners to focus on developing innovations/bring them to market; and
      - iii) a form of firm rebirth to facilitate entrepreneurial efforts

STRATEGIC ASSESSMENT

EIGHT KEY QUESTIONS FOR STRATEGIC ASSESSMENT

1. What is the strategic logic behind the acquisition? Why this company?

2. Is the target industry attractive? What are the key segments? What is the prognosis for industry evolution?

3. Is this an international acquisition? What are the key differences and performance implications?

4. Does an analysis of the target indicate it is healthy and viable?

5. How well does the company fit with ours? What are the expected benefits? What risks might occur?

6. How will the organization be integrated – how will it be organized?

7. Have alternative scenarios been considered? What is the best case/worst case scenario?

8. Is the valuation reasonable?

M&A STRATEGIES

Absorption

Need for strategic interdependence

Need for organizational autonomy		Low	High
	High	Preservation	Symbiosis
	Low	Holding	**Absorption**

Acquiring company completely absorbs the target company. If the target company is large, this can take time

Preservation

Need for strategic interdependence

Need for organizational autonomy	Low	High
High	**Preservation**	Symbiosis
Low	Holding	Absorption

The acquiring company makes very few changes to the target , and instead learned from it in preparation for future growth (e.g., many of Wal-Mart’s early international acquisitions)

Holding

Need for strategic interdependence

Need for organizational autonomy	Low	High
High	Preservation	Symbiosis
Low	**Holding**	Absorption

The acquiring company allows little autonomy - yet does not integrate the target into its businesses (e.g., Bank One’s acquisitions of local banks)

Symbiosis

Need for strategic interdependence

Need for organizational autonomy		Low	High
	High	Preservation	**Symbiosis**
	Low	Holding	Absorption

The acquiring company integrates the target in order to achieve synergies - but allows for autonomy, for example to retain and motivate employees. This is possibly the most difficult to implement (e.g., Cisco's acquisitions which cost the firm $1 million per employee on average)

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