MERGERS AND TAKEOVERS

Mergers, takeovers and joint ventures

In the modern business world, the ownership of companies often changes. This can happen in different ways:

- a merger: this is when two companies join together to form a new one (e.g. Exxon and Mobil, America Online and Time Warner).
- a takeover or **acquisition**: this is when one company buys another one (e.g. Vodafone and Mannesmann, Daimler-Benz and Chrysler). This can happen in two ways. Firstly, a company can offer to buy all the shareholders' shares at a certain price (higher than the market price) during a limited period of time. This is called a **takeover bid**. Secondly, a company can buy as many shares as possible on the stock market, hoping to gain a majority. This is called a **raid**.

Investment banks have **mergers and acquisitions (M&A)** departments that advise companies involved in mergers and takeovers.

Companies can also work together without a change of ownership. For example, when two or more companies decide to work together for a specific project or product, this is called a joint venture. An example is Sony Ericsson, which makes mobile phones.

"Well the merger is over, now the takeover starts."

Hostile or friendly?

There are two types of takeover bid. If a company's board of directors agrees to a takeover, it is a **friendly bid** (and if the shareholders agree to sell, it becomes a **friendly takeover**). If the company does not want to be taken over, it is a **hostile bid** (and if successful, a **hostile takeover**). Companies have various ways of defending themselves against a hostile bid. They can try to find a **white knight** – another company that they would prefer to be bought by. Or they can use the **poison pill** defence ('eat me and you'll die!') which involves issuing new shares at a big discount. This reduces the holding of the company attempting the takeover, and makes the takeover much more expensive.

Integration

Horizontal integration is when a company gets bigger by acquiring competitors in the same field of activity. **Vertical integration** is acquiring companies involved in other parts of the supply chain, usually to make cost savings. There are two possibilities: **backward integration** is acquiring suppliers of raw materials or components; **forward integration** is buying distributors or retail outlets. Companies can also buy businesses in completely different fields, which is known as **diversification**. This can be done to reduce the risk involved in operating in only one industry – but diversifying into completely different industries is a risk itself.

Complete the sentences. Look at A opposite to help you.

1 I want to work in the mergers and .... department of an investment bank in New York.
2 Beverage Partners Worldwide is a .... between the Coca-Cola and Nestlé companies, making ready-to-drink teas and coffees.
3 After their .... , Union Bank of Switzerland and Swiss Bank Corporation had combined assets of $600bn.
4 We started with a .... , buying all the stocks available on the stock exchange. That got us 15% of their stocks. Then we made a .... , offering 20% above the market price, and bought another 40% of the company.

Complete the sentences. Look at B opposite to help you.

1

Telecom Italia is looking for a .... to rescue it from a .... takeover by rival Olivetti.

2

Colonial has agreed to a .... takeover by Commonwealth Bank.

3

Mackenzie Financial Corp is planning a huge rights issue as a .... to fight off C. I. Fund Management's takeover offer.

Match the newspaper headlines (1–5) with the processes (a–e). Look at C opposite to help you.

1 **Shell Purchases 30 Gas Stations**

2 **Hotel Chain to Buy Furniture Manufacturer to Supply Its New Hotels**

3 **Electrical Retailer Dixons Bids for High Street Competitor Currys**

a horizontal integration
b vertical integration
c forward integration
d backward integration
e diversification

4

Coca-Cola Acquires Columbia Pictures for $700 Million

5

BP Now Controls the Entire Supply Chain, From the Oil Refinery to the Petrol Pump

LEVERAGED BUYOUTS

Conglomerates

A series of takeovers can result in a **parent company** controlling a number of **subsidiaries**: smaller companies that it owns. When the subsidiaries operate in many different business areas, the company is known as a **conglomerate**.

But large conglomerates can become inefficient. Top executives often leave after hostile takeovers, and too much diversification means the company is no longer concentrating on its **core business**: its central and most important activity. Takeovers do not always result in **synergy**: combined production or productivity that is greater than the sum of the separate parts. In fact, statistics show that most mergers and acquisitions reduce rather than increase a company's value.

An inefficient conglomerate whose profits are too low can have a low stock price, and its **market capitalization** – the total market price of all its ordinary shares – can fall below the value of its assets, including land, buildings and pension funds. If this happens, it becomes profitable for another company to buy the conglomerate and either split it up and sell it as individual companies, or close the companies and sell the assets. This practice, common in the USA but rare in Europe or Asia, is called **asset-stripping**. It shows that stock markets are not always efficient (see Unit 30), and that companies can sometimes be **undervalued** or **underpriced**: the price of their shares on the stock market can be too low. Some people argue that asset-stripping is a good way of using capital more efficiently; others argue that it is an unfortunate activity that destroys companies and jobs.

Raiders

If corporate raiders – individuals or companies that want to take over other companies – borrow money to do so, usually by issuing bonds, the takeover is called a **leveraged buyout** or LBO. Leveraged means largely financed by borrowed capital. After the takeover, the raider sells subsidiaries of the company in order to pay back the bondholders.

Bonds issued to pay for takeovers are usually called **junk bonds** because they are risky: it may not be possible to sell the subsidiaries at a profit. But, because of the risk, these bonds pay a high interest rate, so some investors are happy to buy them.

Sometimes a company's own managers want to buy the company, and re-organize it. This is a **management buyout** or MBO. If the buyout is financed by issuing preference shares and convertibles, this is called **mezzanine financing** as it is, in a sense, halfway between debt and equity. (See Unit 28 for another use of 'mezzanine financing'.)

Match the words in the box with the definitions below. Look at A and B opposite to help you.

asset-stripping	core business	leveraged	market capitalization
parent company	subsidiaries	synergy	

1 a company that owns or controls one or more other companies

2 the main activity of a company

3 buying a company in order to sell some of its assets

4 companies partly or wholly owned by another company

5 having a lot of borrowed money compared to one's own funds

6 the total value of a company on the stock exchange

7 two things working together that produce an effect greater than the sum of their individual effects

Match the two parts of the sentences. Look at A and B opposite to help you.

1 Large conglomerates formed by takeovers
2 If a conglomerate diversifies and doesn't concentrate on its core business,
3 An inefficient conglomerate's stock market value
4 If a company is worth less than its assets,
5 Raiders do not need to have very much money of their own if

a can be less than the sale value of all its assets.
b can become inefficient, especially if they are very diversified.
c they use leverage, and issue junk bonds.
d there might not be synergies among all its different activities.
e you can make a profit by buying it and selling the parts.

Put the sequence of events in the correct order. The first stage is a. Look at B opposite to help you.

a Corporate raiders calculate that a large company is undervalued.
b Investors buy the bonds because they pay a high interest rate.
c The new owners sell some of the company's subsidiaries.
d The new owners repay the bondholders.
e The raiders buy the company.
f The raiders issue bonds to raise capital to buy the company.

1	a	2		3		4		5		6	