CHAPTER 1

MERGER ACQUISITION AND CORPORATE RESTRUCTURING

INTRODUCTION

During the last few decades, the global industrial landscape has been completely redrawn by the forces of globalisation, deregulation and unprecedented technological development. Companies have responded to the competitive pressures unleashed by these forces and they are today vying with each other in search of excellence and competitive edge, experimenting with various tools and ideas. The changing national and international environment is radically altering the way business is conducted. With the pace of change so great, corporate restructuring has assumed paramount importance.

As a result of globalisation, today the business firms are operating in highly competitive environment. In today's business world, profitable growth constitutes one of the prime objectives of the business organisations. It can be achieved in two different methods:

Internal

- Through the process of introducing as developing new products.
- By expanding as enlarging capacity of the existing products.

External

By acquisitions of exisiting business firms in the forms of mergers, acquisitions, amalgamations, takeovers, absorption consolidation, etc.

Both of the above methods have their own strengths and weaknesses. In the competitive world, the growth of the firm should be quick and sustainable. The internal growth usually involves a longer implementation period and also entails greater Uncertainties. The external growth expedites the pace of growth as the acquired firm already has the facilities as market acceptable products. Hence, a growing firm may be in constant search for indentifying potential firms which may be merged. The firm will opt for merger if it maximises the wealth of shareholders. M and A have become Universal practice in the corporate world for securing, survival growth, expansion and globalisation of the enterprises and achieving multitude of objectives. M and A have started taking place in India in the recent years.

Corporate restructuring is the partial dismantling or otherwise re-organising a company for the purpose of making it more efficient and therefore, more profitable. The process of corporate restructuring often occurs after buy-outs, corporate mergers and acquisitions, divesitures, demergers and bankruptcy.

In a rapidly changing world, companies are facing unprecedented turmoil in the global markets. Severe competition, rapid technological change, and rising stock market volatility have increased the burden on managers to deliver superior performance and value for their shareholders.

In response to these pressures, an increasing number of companies around the world are dramatically restructuring their assets, operations, and contractual relationships with shareholders, creditors, and other financial stakeholders. Corporate restructuring has facilitated thousands of organisations to re-establish their competitive advantage and respond more quickly and effectively to new opportunities and unexpected challenges. Corporate restructuring has had an equally profound impact on the many more thousands of suppliers, customers, and competitors that do business with restructured firms.

One of the most high-profile features of the business and investment worlds is corporate restructuring. In the case of mergers and acquisitions, the potential acquiring firm has to deal with the management and shareholders of the other firm. Corporate restructuring is carried out internally in the firm with the consent of its various stakeholders. Corporate restructuring has gained considerable importance due to the following reasons:

- Intense competition
- Globalisation
- Technological Change
- Initiation of Structural reforms in the industry due to LPG (shedding non-core activities)
- Foreign investment

It involves significant re-orientation, re-organisation or realignment of assets and liabilities of the organisation through conscious management action to improve future cash flow stream.

Meaning

Corporate restructuring is an episodic exercise, not related to investments in new plant and machinery which involves a significant change in one or more of the following:

- Pattern of ownership and control
- Composition of liability
- Asset mix of the firm

It is a comprehensive process by which a company can consolidate its business operations and strengthen its position for achieving the desired objectives:

- Staying
- Synergetic
- Competitive
- Successful

Restructuring is the act of partially dismantling and re-organising a company for the purpose of making it more efficient and therefore more profitable. It generally involves selling of portions of the company and making severe staff reductions. Restructuring is often done as part of a bankruptcy or of a takeover by another firm, particularly a leveraged buyout by a private equity firm.

The rationale behind corporate restructuring is to conduct business operations in more efficient, effective and competitive manner in order to increase the organisation's market value of share, brand power and synergies.

Characteristics

The selling of portions of the company, such as a division that is no longer profitable or which has distracted management from its core business, can greatly improve the company's balance sheet. Staff reductions are often accomplished partly through the selling or closing of unprofitable portions of the company and partly by consolidating or outsourcing parts of the company that perform redundant functions left over from old acquisitions that were never fully integrated into the parent organisation.

Other characteristics of restructuring can include:

- Changes in corporate management (usually with golden parachutes)
- Retention of corporate management
- Sale of underutilised assets
- Outsourcing of operations such as payroll and technical support to a more efficient third party
- Moving operations such as manufacturing to lower-cost locations

- Re-organisation of functions such as sales, marketing, and distribution
- Renegotiation of labour contracts to reduce overhead
- Refinancing of corporate debt to reduce interest payments
- Forfeiture of all or part, of the ownership share by pre-structuring stockholders.

Need and Rationale of Restructuring

The important rationale behind every corporate restructuring are:

- To flatten organisation so that it could encourage culture of initiatives and innovations
- To increase focus on core areas of work and to get closer to the customer.
- To reduce *cost*/reduce level of hierarchy/reduce communication delay.
- To reshape the organisation for the new era.
- To develop organisation on the guidelines of consultant/stake holder

We have been learning about the companies coming together to form another company and companies taking over the existing companies to expand their business. With recession taking toll of many Indian businesses and the feeling of insecurity surging over our businessmen, it is not surprising when we hear about the immense numbers of corporate restructurings taking place, especially in the last couple of years. Several companies have been taken over and several have undergone internal restructuring, whereas certain companies in the same field of business have found it beneficial to merge together into one company.

All our daily newspapers are filled with cases of mergers, acquisitions, spin-offs, tender offers & other forms of corporate restructuring. Thus, important issues both for business decision and public policy formulation have been raised. No firm is regarded safe from a takeover possibility. On the more positive side, Mergers & Acquisitions may be critical for the healthy expansion and growth of the firm. Successful entry into new product and geographical markets may require Mergers & Acquisitions at some stage in the firm's development.

Generally, most of the corporate growth occurs by internal expansion, when a firm's existing divisions grow through normal capital budgeting activities. Nevertheless, if the goals are easily achieved within the firm, it may mean that the goals are too small. Growth opportunities come in a variety of other forms and a great deal of energy and resources may be wasted if an entrepreneur does not wait long enough to identify the various dynamics which are already in place. The most remarkable examples of growth and often the largest increases in stock prices are a result of mergers and acquisitions. M&As offer tremendous opportunities for companies to grow and add value to shareholders' wealth. M&As is a strategy for growth and expansion. M&As increase value and efficiency and thereby, increase shareholder' value. M&As is a generic term used to represent many different types of corporate restructuring exercises.

Successful competition in the international markets may depend on capabilities obtained in a timely and efficient fashion through Mergers & Acquisition's. Many have argued that mergers increase value and efficiency and move resources to their highest and best uses, thereby increasing shareholder value. To opt for a merger or not is a complex affair, especially in terms of the technicalities involved.

In this context, it would be essential for us to understand what corporate restructuring and mergers and acquisitions are all about.

The concept of restructuring involves embracing new ways of running an organisation and abandoning old ones. It requires organisations to constantly reconsider their organisational design and structure, organisational systems and procedures, formal statements on organisational philosophy and may also include values, leader norms and reaction to critical incidences, criteria for rewarding, recruitment, selection, promotion and transfer. A company that has been restructured effectively will generally be leaner, more efficient, better organised, and better focused on its core business

Reconstruction is a scheme of compromise or arrangement entered into by a company with its members and creditor with a view to reconstituting its financial structure. It is a process by which the assets and liabilities of a company are revalued, the losses suffered by the company are written off by a deduction of the paid-up value of shares and or varying the rights attached to different classes of shares and compounding with the creditors. Reconstruction may be external or internal. Internal reconstruction is effected without the company being liquidated. External reconstruction on the other hand, is brought about by liquidating the company. In this case, the business of the company is transferred to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company. External Reconstruction is in fact covered under the category of amalgamation in the nature of merger.

Before going for merger considerable amount of brainstorming would be required by the managements to reach a conclusion. E.g. A *due diligence report* would clearly identify the status of the company in respect of the financial position along with the net worth and pending legal matters and details about various contingent liabilities. Decision has to be taken after having discussed the pros & cons of the proposed merger & the impact of the same on the business, administrative costs benefits, addition to shareholders' value, tax implications including stamp duty and last but not the least also on the employees of the Transferor or Transferee Company.

India's emergence as one of the fastest growing major economies of the world has been supported by the economic policy measures initiated particularly since the 1990s. After the tentativeness of the early years of reform, restructuring of companies started in a big way in the early 90's with the impact and fruits of LPG (Liberalisation, Privatisation and Globalisation), when the Indian economy unleashed immense opportunities for growth and leadership in both the new age businesses as well as real economy businesses. As Indian companies stood on the threshold of the next phase of growth, several of them found themselves required to make more decisive choices in respect of the portfolio of businesses in their fold. In the process, Indian companies – the public sector included -were increasingly called upon to pursue focused growth through mergers and acquisition on the one hand, and divestiture and demerger on the other.

Restructuring-Underlying Issues

Corporate restructuring, which includes many forms of business and financial activities as seen above, raises several questions like:

- *Are* they good or bad for the economic health of the nation?
- Do they divert the energies of managers from bonafide economic activity to financial manipulation?
- Do they use up financial resources which otherwise would be employed in real investment activities?
- Why has such heightened merger activity been a phenomenon in the last 20 years?

To answer these questions we need to look at the theory or theories explaining these restructuring activities. We will try to explain this gradually as we progress into the subsequent chapters.

We begin with explaining the major merger movements that have taken place in the United States since the 1890s.

Merger Waves

United States has witnessed five periods of merger activity, often referred to as merger waves, each wave having been dominated by a particular type of merger. These periods were characterised by high-level of cyclic activity, that is, high levels of mergers followed by periods of relatively fewer mergers. All the merger movements occurred when the economy experienced sustained high growth rates and coincided with particular developments in business environments, because firms are motivated to make large investment outlays only when the business prospects are favourable. When such favourable business prospects are joined with changes in competitive conditions directly motivating a new business strategy, M&A activity will be stimulated.

The First Wave -1897-1904

The mergers of the first wave consisted mainly of horizontal mergers, which resulted in a near monopolistic market structure. This merger period is known for its role in creating large monopolies. The first billion-dollar mega merger deal between U Steel and Carnegie Steel took place during this period. The resulting steel giant merged 785 separate firms. At one time, US Steel accounted for as much as 75 per cent of the steel-making capacity of the United States.

Some of today's industrial giants originated in the first merger wave. These include General Electric, Navistar International (formerly International Harvester; Du-Pont Inc., Standard Oil, Eastman Kodak and American Tobacco Inc. Some of these companies like American Tobacco (enjoyed 90 per cent market share) and Standard Oil (enjoyed 85 per cent market share) were truly dominant firms by the end of the first merger wave. During this wave, there were 300 major combinations covering many industrial areas and controlling 40 per cent of the nation's manufacturing capital. More than 3000 companies disappeared during this period as a result of mergers.

Another feature of this wave is the formation of trusts, where the investor invested funds in a firm and entrusted their stock certificates with directors who (ensured that they received the dividends for their trust certificates. These trusts were formed by dominant business leaders, such as JP Morgan of the House of Morgan and John D Rockefeller of Standard Oil and National City Bank, as a response to the poor performance of many of the nation's businesses as the) struggled with the weak economic climate. They used their voting powers to force multiple mergers in certain industries in an effort to reduce the level of competition allowing the surviving companies to enjoy certain economies of scale. Liberalisation of corporate laws was also one of the reasons behind the resounding success of this merger wave.

This merger movement accompanied major changes in economic infrastructure and production technologies. It followed the completion of transcontinental railroad system, the advent of electricity, and the increased use of coal. The completed rail system resulted in the development of a national economic market and thus, the merger activity represented to a certain extent the transformation of regional firms into national firms.

As firms expanded, they exploited economies of scale in production and distribution. In pursuit of economies of scale, an expansion process took place in many manufacturing industries in the US economy. The expansion of the scale of business also required greater managerial skills and lead to specialisation in management.

Financial factors led to the end of the first merger wave. First, the shipbuilding trust collapse in the early 1900s brought to light the dangers of fraudulent financing. Secondly, the stock market crash of 1904 followed by the banking panic of 1907 led to the closure of many banks and paved the way for the formation of the Federal Reserve System. The era of easy availability of finance, one of the basic ingredients of takeovers, ended resulting in the halting of the first wave. Further, the application of anti-trust legislations, which was earlier lenient, became very stringent. The Federal Government under President Theodore Roosevelt and subsequently, under President William Taft made a crackdown on large monopolies. For example, Standard Oil was broken into 30 companies such as Standard Oil of New Jersey (subsequently renamed Exxon), Standard Oil of New York (renamed Mobil), Standard Oil of California (renamed Chevron) and Standard Oil of Indiana (subsequently renamed Amoco).

TABLE 1.1

Year	1897	1898	1899	1900	1901	1902	1903	1904
Number of Mergers	69	303	1208	340	423	379	142	79

Source: // Mergers, Acquisitions and Corporate, Restructurings//, by Patrick A Gaughan.

The Second Wave -1916-1929

Like the first wave, the second merger movement also began with an upturn in business activity. Several industries were consolidated during the second merger wave. The result was an oligopolistic industry structure rather than monopolies. The consolidation pattern which was established in the first merger wave, continued in the second merger wave also. The combinations in this period occurred outside the previously consolidated heavy manufacturing industries. The most active were the banking and the public utilities industries. A large number of mergers occurred in industries like primary metals, petroleum products, food products, chemicals and transportation equipment.

A large portion of the mergers in the 1920s represented product-extension mergers like IBM and General Foods, market-extension mergers like in food retailing, departmental stores, and vertical mergers in the mining and metal industries.

The second merger period witnessed the formation of many prominent corporations that still operate today. These include General Motors, IBM, Union Carbide Corporation and John Deere.

Between 1926 and 1930, a total of 4,600 mergers took place, and between 1919 and 1930, 12,000 manufacturing, mining, public utility, and banking firm disappeared. The development of a nationwide rail transportation system combined, with the growth of motor vehicle transportation, continued to transform local markets into national markets. The proliferation of radios in homes as a major source of entertainment enhanced the competition among firms. Marketers took advantage of this new advertising medium to start national brand advertising. This led to the beginning of the era of mass merchandising.

Mergers in this wave were facilitated by the limited enforcement of antitrust laws and the federal government's encouragement for the formation of business co-operatives to enhance the nation's productivity as part of the war effect. The firms were urged to work together, rather than compete with each other during wartime. The government maintained these policies even after the war ended.

The second merger wave came to an end when the stock market crashed on October 29, 1929. The crash resulted in a dramatic drop in the business and an investment confidence. Business and consumer spending was curtailed, thereby worsening the Depression. After the crash, the number of corporate mergers declined dramatically.

Investment bankers played a key role in the first two phases of mergers. They exercised considerable influence among the business leaders. A small number of investment bankers controlled the majority of capital available for financing mergers and acquisitions. The investment banking industry was more concentrated in those years than it is today.

The 1940s

The Second World War and the early post-war years were accompanied by growth of the economy and an increase in merger activity. However, the merger movement was much smaller than the earlier ones.

Economists pointed out that government regulations and tax policies are the motivating factors behind mergers. During this period, larger firms acquired smaller privately-held companies for motives of tax relief. Due to the high estate taxes, transfer of businesses within families was very expensive and hence these businesses were sold to other firms. These mergers did not result in increased concentration because they involved smaller companies, which did not represent a significant portion of the total industry's assets.

As this period did not feature any major technological changes or dramatic developments in the nation's infrastructure, the merger movement was smaller compared to the earlier ones.

The Third Wave - 1965-1969

The merger activity reached its then historically highest level during this period. This was due to the booming economy of this period. This period is known as a conglomerate merger period, as small or medium-sized firms adopted a diversification strategy into business activities outside their traditional areas of interest. During this period, relatively smaller firms targeted larger firms for acquisition. Eighty per cent of the mergers that took place were conglomerate mergers that were more than just diversified in their product lines. For example, ITT acquired such diversified businesses like car rental firms, bakeries, consumer credit agencies, luxury hotels, airport, parking firms, construction firms, etc.

The conglomerate movement was due to the tougher antitrust enforcement. Armed with tougher laws, the federal government adopted a stronger antitrust stance, coming down heavily on both horizontal and vertical mergers. Firms with financial resources, which sought to expand, found that the only available alternative was to form conglomerates.

The rapid growth in management science accelerated the conglomerate movement. With the wide acceptance of management principles, graduates believed that they possessed the broad-based skills necessary to manage a wide variety of organisational structures. Hence such managers believed that they could manage the corporate organisation that spanned various industry categories. The belief that conglomerate mergers could be manageable became a reality.

TABLE 1.2

Year	1963	1964	1965	1966	1967	1968	1969	1970
Number of Mergers	1361	1950	2125	2377	2975	4462	6107	5152

Source: *"Mergers, Acquisitions and Corporate Restructurings", by Patrick A Gaughan.*

Around 6000 mergers took place in the US economy during this period and which led to the disappearance of around 25,000 firms. Because most of these mergers were conglomerates, they did not result in increased industrial concentration.

Investment bankers did not finance most of the mergers in this period. The booming stock market prices provided equity financing to many of the conglomerate takeovers. As the mergers financed through stock transactions were not taxable they had an advantage over cash transactions, which were subject to taxation.

Many of the acquisitions that took place during this period were followed by poor financial performance. Many of the mergers failed as managers of the diverse enterprises often had little knowledge of the specific industries that were under their control. For example, Revlon, a firm that has an established track record, (success in the cosmetic industry), saw its core cosmetic industry suffered when it diversified into unrelated areas such as healthcare.

The Fourth Wave - 1981-1989

Following the recession in 1974-1975, the US economy entered a long period (expansion during which the merger and acquisition trend went upward). Hostile mergers played a significant role in the fourth wave. Takeovers were considered healthy or hostile by the reaction of the target company's board of directors. If the board accepts the takeover, it is considered friendly, and if it opposes it, it is deemed to be hostile.

Although the number of hostile deals were not very high, the figure was significant in terms of value of mergers and acquisitions. The size and prominence of the merger and acquisition targets, distinguishes the fourth merger period from the other three waves. The fourth wave was a period of mega-mergers. Some of the largest firms in the world (Fortune 500 firms), became the target of acquirers.

TABLE 1.3

Year	1981	1982	1983	1984	1985	1986	1987	1988	1989
Number of Mergers	2395	2346	2533	2543	3001	3336	2032	2258	2366

Source: *"Mergers, Acquisitions and Corporate Restructurings", by Patrick A Gaughan.*

There was a great degree of concentration within the oil industry, as it experienced a high level of merger activity. The oil and gas industry accounted for 21.6 per cent of the total dollar value of mergers and acquisitions between 1981 and 1985. Another industry, which experienced high level of merger activity, is the drugs and medical equipment industry. Deregulation in some of the industries was the main reason behind the disproportionate number of mergers and acquisitions. For example, deregulation of the airline industry led to numerous, acquisitions and consolidations in this industry.

The fourth wave also witnessed the emergence of corporate raider. The raider's income came from the takeover attempts. The raiders earned handsome profits without taking control over the management of the target company. They attempted to takeover a target and later sell the target shares at a price higher than what was paid originally.

The fourth wave featured several other unique and interesting characteristics, which differentiate it from the other waves. Investment bankers played an aggressive role. M&A advisory services became a lucrative source of income for investment banks. The merger specialists at investment banks and law firms developed many techniques to facilitate and prevent takeovers.

Another important feature is the increased use of debt to finance acquisitions. The yield on junk bonds was significantly higher than that of investment grade bonds. Hence, the ready availability of finance helped even small firms to acquire large well-established firms. The phenomenon of leveraged buyout emerged. This merger wave also featured innovations in acquisition techniques and investment vehicles. The investment bank, Drexel Burnham Lambert pioneered the growth of the junk bond market.

The Fifth Wave - 1992-Till Date

The current merger activity can be described as the fifth wave. There was once again increased activity of mergers in 1992. Mega-mergers, as in the fourth wave, began to take place in the fifth wave also. The number of hostile deals was less than strategic mergers.

With the recovery of the economy in 1992, companies sought to expand and mergers were seen as a quick and efficient way to do so. Unlike the deals of 1980s,the transactions of the 90s emphasised on strategy with quick financial gains. Most of the deals were financed through the increased use of equity.

Deregulation and technological changes led to high level of merger activity in the fifth wave. Banking, Telecommunications, Entertainment, and Media industries were some of the leading consolidating industries. There was a dramatic growth in the banking sector in the 1990s as the banks grew larger than the central banks. Banks looked to take advantage of the economies of scale in this industry by expanding into new markets and found mergers and acquisitions to be the fastest way to do so.

There was a movement towards the oligopolistic market structure due to the volume of consolidating mega-mergers that occurred in many industries. As companies acquired or merged with other companies, the number of competitors declined. The resulting companies were large and only a few competitors commanded a relatively high market share. For example, in Beverages industry companies like Coco-Cola with 44.5 per cent market share, Pepsi with 31.4 per cent market share and Cadbury Schweppes with 14.4 per cent market share were the few major competitors.

TABLE 1.4

Year	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Number of Mergers	2074	1877	2574	2663	2997	3510	5848	7800	7809	9278	9566	7528

Source: *"Mergers, Acquisitions and Corporate Restructurings", by Patrick A Gaughan.*

The phenomenon of globalisation led to the breaking up of geographical barriers for entry into another country. The growth in the merger activity was no longer confined to US companies. US firms aggressively purchased foreign firms. Later, by 1995, foreign firms made major purchases of US firms. The fifth wave spread to Europe in the late 1990s.

Table 1.5 Major Mergers in the Telecom Sector

Acquirer	Vodafone	MCI World Com	Bell Atlantic	AT&T
Target	Cellular	Mannesman	Spirit	GTE
Acquirer	SBC	US West	Bell Atlantic	SBC
Target	Ameritech	Global Crossing	NYNEX	Pacific Telesis

The emergence of Internet and the intelligent application of information technology have resulted in a paradigm shift in the operations of firms. The impact of the wave is most visible in sectors such as telecommunications, entertainment and media, banking and financial services.

Table 1.6 Major Mergers in Media and Entertainment Sector

Acquirer	America On-Line (AOL)	Viacom	Walt Disney	AT&T
Target	Time Warner	CBS	Capital Cities	ABC Media One

Major M&A in the 1990s

Top 10 M&A deals worldwide by value (in mil. USD) from 1990 to 1999:

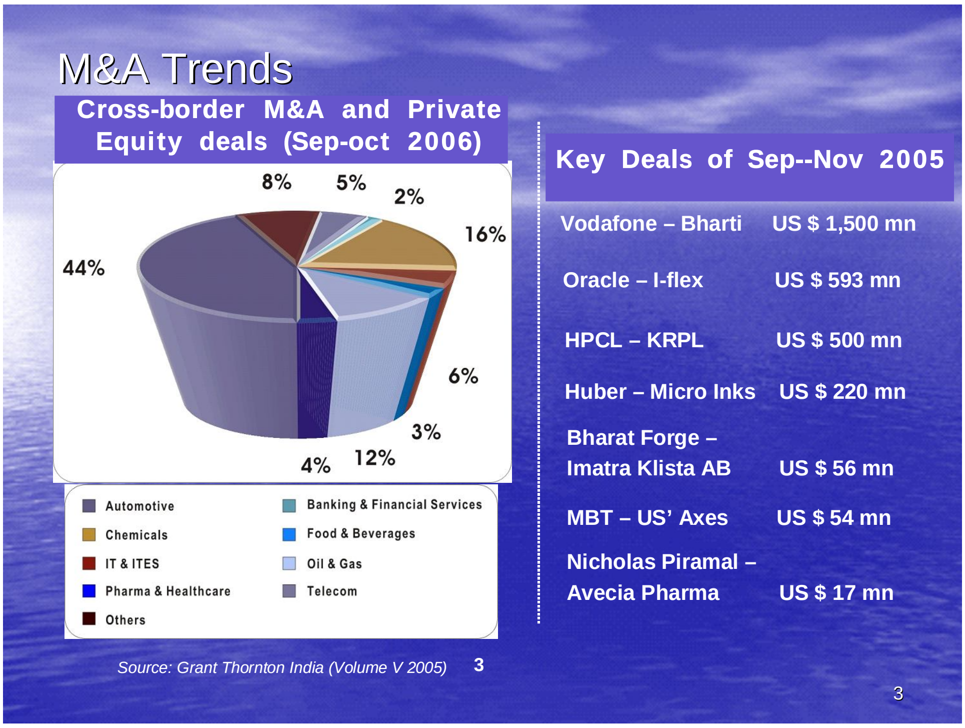
Rank	Year	Purchaser	Purchased	Transaction value (in mil. USD)
1	1999	Vodafone Air touch PLC	Mannesmann	1,83,000
2	1999	Pfizer	Warner-Lambert	90,000
3	1998	Exxon	Mobil	77,200
4	1999	Citicorp	Travelers Group	73,000
5	1999	SBC Communications	Ameritech Corporation	63,000
6	1999	Vodafone Group	Air Touch Communications	60,000
7	1998	Bell Atlantic	GTE	53,360
8	1998	BP	Amoco	53,000
9	1999	Qwest Communications	US WEST	48,000
10	1997	World com	MCI Communications	42,000

Major M&A from 2000 to present

Top 9 M&A deals worldwide by value (in mil. USD) since 2000:

Rank	Year	Purchaser	Purchased	Transaction value (in mil.USD)
1	2000	*Fusion*: America Online Inc. (AOL)	Time Warner	1,64,747
2	2000	Glaxo Wellcome Plc.	SmithKline Beecham Plc.	75,961
3	2004	Royal Dutch Petroleum Co.	Shell Transport & Trading Co	74,559
4	2006	AT&T Inc.	BellSouth Corporation	72,671
5	2001	Comcast Corporation	AT&T Broadband & Internet Svcs	72,041
6	2004	Sanofi-Synthelabo SA	Aventis SA	60,243

7	2000	*Spin-off*: Nortel Networks Corporation		59,974
8	2002	Pfizer Inc.	Pharmacia Corporation	59,5159
9	2004	JP Morgan Chase & Co	Bank One Corp	58,761
8	2008	Inbev Inc	Anheuser Busch companies Inc	52,000



MOTIVES BEHIND MERGERS

The primary objectives of Mergers & Acquisition are diversification, market expansion, improving competitive position, etc. Generally, two or more firms have to act for mergers. One of them is the buyer and the other is the seller. Both these firms have motives for combination. A different rationale can be assigned at both individual and collective levels which influence sellers and buyers to opt for Mergers and Acquisitions.

The Buyers Motives

The Motivation for Buyers are as Follows

- To increase the value of the firm's stock – that is, merger often leads to increase in stock price and/or Price Earning Ratio
- To increase the growth rate of the firm

- To make a good investment- a firm may make better use of funds by purchasing instead of ploughing the same funds into internal expansion
- To improve the stability of the firms' earnings and-sales. This is done by acquiring firm's whose earnings and sales complement the firm's peak and valleys
- To balance or fill out the product line
- To diversify the product line when the current products have reached their peak in the life cycle
- To reduce competition by purchasing a competitor
- To acquire a needful resource quickly. For ego High-quality technology or highly innovative management
- For Tax reasons- it may be desirable to purchase a firm with prior tax losses which will offset current or future earnings
- To increase efficiency and profitability, especially if there is synergy between the two companies

The Sellers' Motives

The motivation for sellers are as follows:

- To increase the value of the owners stock and investment in the firm
- To increase the firm's growth rate by receiving more resources from the acquiring company
- To acquire resources to stabilise operations and make them more efficient
- For Tax reasons- if the firm is owned by a family or an individual, a merger makes it easier to deal with estate tax problems
- To help diversify the owning family's holdings beyond the present firm
- To deal with top management problems such as Management Succession for an entrepreneur or dissension among the top managers

Advantages of Mergers & Acquisitions

The most common advantages of mergers and acquisitions are:

- Maintaining or accelerating profitable growth of a company
- Enhancing profitability through cost reduction resulting from:
  - Economies of scale
  - Operating Efficiency
  - Synergy

- Diversifying the risk of the company by way of acquiring the business of different income streams
- Reducing tax liability by way of setting off accumulated losses or unabsorbed depreciation of one company against the profits of another
- Enhancing the market power of the company

Merger Process

Mergers and acquisition activity should take place within the framework of long-range planning by business firms. The merger decisions involve the future of the firm. Hence, it is useful to understand the planning process involved in mergers. The planning processes can utilise formal procedures or develop through informal communications throughout the organisation. The strategies, plans, policies and procedures are developed in the process of mergers. The strategic planning in merger is behaviour and a way of thinking that requires diverse inputs from all segments of the organisation. For profitable and smooth flow of mergers, the entire process can be divided into three phases as explained below:

Formulation of the Vision

The acquiring company must formulate the future vision of merger moves in advance. The following vision should be, identified while planning for mergers and acquisitions.

- **Growth:** The vision for an organisation defines its purpose, where it is heading, and what it intends to do once it gets there. The vision includes a well-defined set of core values and beliefs that define a company's culture and purpose.
- **Competition:** The vision should identify the distinct set of competencies that will enable the organisation to deliver the unique value required to remain competitive as it moves forward. It should describe clearly the expectations for what the company will look like and how it will operate over time. Targets should be identified and evaluated in a manner consistent with the company's vision.

Pre-Merger Planning

A coherent pre-merger planning process should target companies with the desired capabilities, get the deal done, and lay the groundwork for a successful integration through rigorous planning and building of trust among the players.

Post-Merger Process

The post-merger process should be focused on cultural integration, retention of key people, and capturing well-defined sources of value as quickly and efficiently as possible.

Basic Steps in Strategic Planning in Mergers

Any merger and acquisition involves the following critical activities in strategic planning processes. Some of the essential elements in strategic planning processes of mergers and acquisitions are as listed below.

(1) Assessment of changes in the organisation environment

(2) Evaluation of company capacities and limitations

(3) Assessment of expectations of stakeholders

(4) Analysis of company, competitors, industry, domestic economy and international economies

(5) Formulation of the missions, goals and polices

(6) Development of sensitivity to critical external environmental changes

(7) Formulation of internal organisational performance measurements

(8) Formulation of long-range strategy programmes

(9) Formulation of mid-range programmes and short-run plans

(10) Organisation, funding and other methods to implement all of the proceeding elements

(11) Information flow and feedback system for continued repetition of all essential elements and for adjustment and changes at each stage

(12) Review and evaluation of all the processes

In each of these activities, staff and line personnel have important responsibilities in the strategic decision-making processes. The scope of mergers and acquisition sets the tone for the nature of mergers and acquisition activities and in turn affects the factors which have significant influence over these activities. This can be seen by observing the factors considered during the different stages of mergers and acquisition activities. Proper identification of different phases and related activities smoothen the process involved in mergers.

THE FIVE-STAGE (5-S) MODEL

Mergers and acquisitions are transactions of great significance not only to the companies themselves but also to many other constituencies such as workers, managers, competitor communities and economies. Hence, the mergers and acquisition process needs to be viewed as a multi-stage process with each stage giving rise to distinct problems and challenges to companies understating such transactions. To understand the nature and sources of these problems we need a good understanding of the external context in which mergers and acquisitions take place. This context is not purely economic but includes political, sociological and technological contexts as well. The context is also ever-changing. Thus, merger and acquisition could be regarded as a dynamic response to these changes.

The five-stage model conceptualises the merger and acquisition process as being driven by a variety of impulses, not all of them reducible to rational economic paradigms. Both economic and non-economic factors affect the merger and acquisition process. The five stages of merger and acquisition process under 5-S model can be divided as below.

(1) Corporate strategy development

(2) Organising for acquisitions

(3) Deal structuring and negotiation

(4) Post-acquisition integration

(5) Post acquisition audit and organisational learning

The brief explanation of the above stages of merger is given below:

Stage 1: Corporate Strategy Development

Corporate strategy is concerned with the ways of optimising the portfolios of businesses that a firm currently owns and with how this portfolio can' be changed to serve the interests of the corporation's stakeholders. Merger and acquisition can serve the objectives of both corporate and business strategies, despite their being the only one of several instruments. Effectiveness of merger and acquisition in achieving these objectives depends on the 'conceptual and empirical validity of the models upon which corporate strategy is based. Given' an inappropriate corporate strategy model, mergers and acquisitions is likely to fail to deliver sustainable competitive advantage. Corporate strategy analysis has evolved' in recent years through several paradigms- industry structure -driven strategy, competition among strategic group, competence or resource-based competition, etc.

Stage 2: Organising for Acquisitions

One of the major reasons for the observed failure of many acquisitions may be that firms lack the organisational resources and capabilities for making acquisitions. It is also likely that the acquisition decision-making processes within firms are far from the models of economic rationality that one may assume. Thus, a pre-condition for a successful acquisition is that the firm organises itself for effective acquisition making. An understanding of the acquisition decision process is important, since it has a bearing on the quality of the acquisition decision and its value creation logic.' At this stage the firm lays down the criteria for potential targets of acquisitions consistent with the strategic objectives and value creation logic of the firm's corporate strategy and business model.

Stage 3: Deal Structuring and Negotiation

This stage consists of:

- Valuing target companies
- Choice of advisers (investment banker, lawyers, accountants, etc) to the deal

- Obtaining and evaluating about the target from the target as well as from other sources
- Performing due diligence
- Determining the range of negotiation parameters
- Negotiating the positions of senior management of both firms in the post-merger dispensation
- Developing the appropriate bid and defence strategies and tactics within the parameters set by the relevant regulatory regime, etc.

Stage 4: Post-acquisition Integration

At this stage, the objective is to put in place a managed organisation that can deliver the strategic and value expectations that drove the merger in the first place. The integration process also has to be viewed as a project and the firm must have the necessary project management capabilities and programme with well-defined goals, teams, deadlines, performance benchmarks, etc. Such a methodical process can unearth problems and provide solutions so that integration achieves the strategic and value creation goals. One of the major problems in post-merger integration is the integration of the merging firm's information systems. This is particularly important in mergers that seek to leverage each company's information on customers, markets or processes with that of the other company.

Stage 5: Post-acquisition Audit and Organisational Learning

The importance of organisational learning to the success of future acquisitions needs much greater recognition, given the high failure rate of acquisitions. Post- merger audit by internal auditors can be acquisition-specific as well as being part of an annual audit. Internal auditor has a significant role in ensuring organisational learning and its dissemination.

MERGERS AND ACQUISITIONS IN INDIA

During the licensing era, several companies had indulged in unrelated diversifications depending on the Time Warner availability of licenses. Takeover bids, mergers and amalgamations were not rare. The companies thrived in spite of their inefficiencies because the total industry capacity was restricted due to licensing. Over a period of time, the companies became conglomerates with a sub-optimal portfolio of assorted businesses.

Despite the unfavourable economic environment, the corporate sector has witnessed incidents of takeover bids from time to time. Since 1986 onwards, both friendly takeover bids on negotiated basis and hostile bids through hectic buying of equity shares of select companies from the market have been reported frequently. Instances of corporate raids by non-resident Indians as well as Indian industrial entrepreneurs on domestic corporate undertakings were many. For example, NRI's during 1988 made the following raids on corporate undertakings in India:

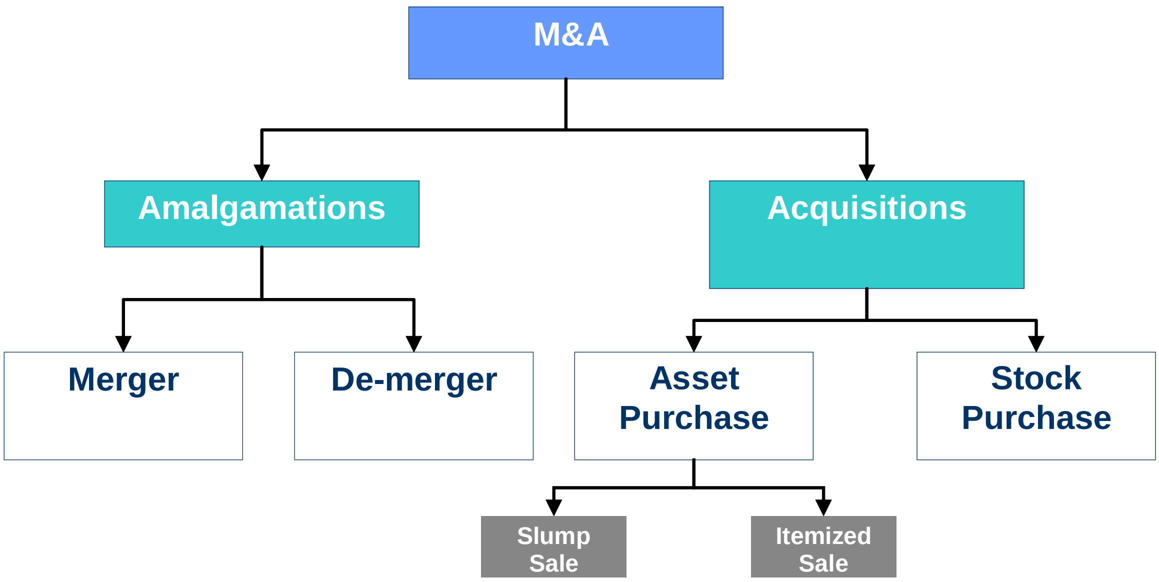
Swaraj Paul and Sethia groups attempted raids on Escorts Ltd. and DCM Ltd., but did not succeed. The Hindujas raided and took over Ashok Leyland and Ennore Foundries and secured strategic interests in IDL Chemicals and Astra IDL. The Chhabria Group acquired stake in Shaw Wallace, Dunlop India and Falcon Tyres.

Prominent industrial groups in the country have also been active in takeover bids. For example, the Goenka group from Kolkata successfully took over Ceat Tyres, Herdilla Chemicals, Polychem, etc. The Oberoi Group has taken over Pleasant Hotels of the Rane Group. Mahindra and Mahindra has taken over Allwyn Nissan; the Jindal Group has acquired Shalimar Paints. History was created by Tata Tea in September 1988, when it made a public offer to takeover Consolidated Coffee Ltd and acquired 50 per cent of the company's equity from resident shareholders in December 1989.

Four companies, namely Hindustan Computers, Hindustan Reprographics, Hindustan Telecommunications and Indian Computer Software Co., were merged to form HCL Ltd.

There has also been an active arrangement of takeover of sick undertakings by the Board for Industrial and Financial Reconstruction (BIFR). Some of the takeovers arranged by BIFR are, takeover of Hyderabad Allwyn Ltd by Voltas Ltd, Mahindra Nissan Allwyn Ltd by Mahindra and Mahindra, and Miami Pharma Ltd by Lakme.

MODES OF M & A IN INDIA



The major reasons for restructuring are:

- To induce higher earnings
- To leverage core competencies
- Divestiture and Networking
- To ensure clarity in vision, strategy and structure
- To provide proactive leadership
- Empowerment of employees
- Re-engineering Process

Induce Higher Earnings: The two basic goals of corporate restructuring may include higher earnings and the creation of corporate value. Creation of corporate value largely depends on the firm's ability to generate enough cash.

Leverage Core Competence: With the concept of organisational learning gaining momentum, companies are laying more emphasis in exploiting the rise on the learning curve. This can happen only when companies focus on their core competencies. This is seen as the best way to provide shareholders with increased profits.

Divestiture and Networking: Companies, while keeping in view their core competencies, should exit from peripherals. This can be realised through entering into joint ventures, strategic alliances and agreements.

Ensure Clarity in Vision, Strategy and Structure: Corporate restructuring should focus on vision, strategy and structure. Companies should be very clear about their goals and the heights that they plan to scale. A major emphasis should also be made on issues concerning time frame and the means that influence their success.

Provide Proactive Leadership: Management style greatly influences the restructuring process. All successful companies have clearly displayed leadership styles in which managers relate on a one-to-one basis with their employees.

Empowerment: Empowerment is a major constituent of any restructuring process. Delegation and decentralised decision-making provides companies with effective management information system.

Re-engineering Process: Success in a restructuring process is only possible through improving various processes and aligning resources of the company. Redesigning a business process should be the highest priority in a corporate restructuring exercise.

OTHER POSSIBLE PURPOSES FOR RESTRUCTURING ARE SHORT LISTED BELOW

(1) Procurement of supplies

(1) To safeguard the source of supplies of raw materials or intermediary product;

(2) To obtain economies of purchase in the form of discount, savings in transportation costs, overhead costs in buying department, etc;

(3) To share the benefits of suppliers economies by standardising the materials.

(2) Revamping production facilities

(1) To achieve economies of scale by amalgamating production facilities through more intensive utilisation of plant and resources;

(2) To standardise product specifications, improvement of quality of product;

(3) Market and aiming at consumers satisfaction through strengthening after-sales services;

(4) To obtain improved production technology and know-how from the offered company;

(5) To reduce cost, improve quality and produce competitive products to retain and improve market share.

(3) Market expansion and strategy

(1) To eliminate competition and protect existing markets;

(2) To obtain a new market outlet in possession of the offeree;

(3) To obtain new products for diversification or substitution of existing products and to enhance the product range;

(4) Strengthening retail outlets and sale of the goods to rationalise distribution;

(5) To reduce advertising costs and improve public image of the offeree company;

(6) Strategic control of patents and copyrights.

(4) Financial strength

(1) To improve liquidity and have direct access to cash resource;

(2) To dispose of surplus and outdated assets for cash out of combined enterprise;

(3) To enhance gearing capacity, borrow on better strength and the greater assets backing;

(4) To avail tax benefits;

(5) To improve EPS (Earning Per Share).

(5) General gains

(1) To improve its own image and attract superior managerial talents to manage its affairs;

(2) To offer better satisfaction to consumers or users of the product.

(6) Own developmental plans

The purpose of restructuring is backed by the offer or company's own developmental plans.

A company thinks in terms of acquiring the other company only when it has arrived at its own development plan to expand its operation having examined its own internal strength where it might not have any problem of taxation, accounting, valuation, etc. But it might feel resource constraints with limitations of funds and lack of skill managerial personnel. It has to aim at suitable combination where it could have opportunities to supplement its funds by issuance of securities; secure additional financial facilities, eliminate competition and strengthen its market position.

(7) Strategic purpose

The Acquirer Company views the merger to achieve strategic objectives through alternative type of combinations which may be horizontal, vertical, product expansion, market extensional or other specified unrelated objectives depending upon the corporate strategies. Thus, various types of combinations distinct with each other in nature are adopted to pursue this objective like vertical or horizontal combination.

(8) Corporate friendliness

Although it is rare but it is true that business houses exhibit degrees of co-operative spirit despite competitiveness in providing rescues to each other from hostile takeovers and cultivate situations of collaborations, sharing goodwill of each other to achieve performance heights through business combinations, combining corporate aim at circular combinations by pursuing this objective.

(9) Desired level of integration

Mergers and acquisitions are pursued to obtain the desired level of integration between the two combining business houses. Such integration could be operational or financial. This gives birth to conglomerate combinations. The purpose and the requirements of the offeror company go a long way in selecting a suitable partner for merger or acquisition in business combinations.

GROWING NEED FOR CORPORATE RESTRUCTURING

Liberalisation in the' 90s and the recession in the economy have created new challenges for the Indian corporate sector. The policy of decontrol and liberalisation, together with globalisation of the economy, has exposed the corporate sector to rigorous domestic and global competition. Greater competition, freer imports, lack of economies of scale, over-creation of capacities, unwanted diversifications, funds constraints, and cost and time over-runs have become some of the new-found areas of concern. Therefore, restructuring of corporate India has now become a major theme. Companies are engaging in various efforts to consolidate themselves in areas of their core competence and divest those businesses where they do not' have any competitive advantage. Consequently, as an option, mergers and acquisitions are emerging as the key corporate activities. The changes in government regulations will make M&A an even more viable business strategy.

According to the Securities and Exchange Board of India (SEBI) working paper titled II "Impact of Takeover Code Regulations on Corporate Sector in India - A Critical' Appraisal", the major users of the acquisition mechanisms were Indian companies, which accounted for 85 per cent of the total takeovers.

Since SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations 1997 came into existence, 1,011 companies have been taken over for various purposes, which include consolidation, change in control in management and substantial acquisition. The most important objective of the acquisitions has been change in the management control. The number of open offers grew from two in 1994 to 98 in 2001-02. Bulk of M&A deals has been on cash basis.

Among the industries where the takeovers were more common, the Finance and Information Technology industries scored heavily on the number of companies acquired, but the amounts involved in these industries were small. On the basis of amounts spent, the electronic and electrical industry occupied the first position, followed by metals, cement and construction.

Since entry barriers are low in the new economy, the rate of creation of new companies is extremely high and so are the chances of M&As. Since most Internet start-ups are small, unilocational outfits, staffed by fewer people compared to brick and mortar behemoths, the actual process of integration is less burdensome and less painful. M&As enabled the widening of the portfolio of products and services, increase geographical coverage, and reduce the marketing costs and gestation period.

Very often, M&As have been found useful to consolidate the market position for instance, in the cement industry, the French firm, Lafarge bought the cement unit owned by Tisco, and Gujarat Ambuja acquired DLF Cement and half of Tata's share in ACC to capture the major share of the market between the two of them. It is easier to acquire companies than set up additional capacities.

The bidding war for licenses for the fourth cellular company to operate in each of India's 21 telecom zones shook up the country's fledgling cellular market. This forced some smaller groups to sell out because their pockets were not deep enough to bid for more licenses or to pump in funds to grow their business. The larger ones consolidated their market share through buyouts.

In case of global mergers of multinational companies, their Indian setups merge by default. Though the merger then is a part of global strategy rather than local market compulsions, it has effects on the Indian market too. Like it happened, when ANZ Grindlays Bank and Standard Chartered Bank merged (leading to large-scale business and manpower restructuring in their respective Indian outfits) or the HP-Compaq merger (which is expected to shake up the computer hardware market in India). However, the firm-level positive results from M&A deals, are yet to be strongly recognised. A recent KPMG(a leading CA firm) study found that only 30 per cent of cases of M&As in India created shareholders' value. In 39 per cent of such deals, there was near discernible difference, while in 31 per cent of cases, the shareholder value was diluted. The findings, though shocking to most, stems from imperfections, which exist in most economies and more distinctly in India.

The Indian banking sector, with too many loss-making units, could have possibly benefited from mergers, but M&As have failed to perform. The efficient operation of the takeover mechanism requires that vast quantities of information be widely available, which is not the case in India. Besides, there are huge transaction costs involved in takeovers, which hamper the efficiency of the mechanism. If information about a firm's operation is, or is perceived to be, asymmetric, it may pay rational managers even in rational markets to be narrow-minded. This would lead the short-term measures and to lower rates of investment than would otherwise be the case. The first to get hit, in this circumstance, is the shareholders' value.

The empirical findings are contrary to the expected results, mainly because increase of shareholders' value is not always the only motivator for M&As. Often mergers are initiated because companies face the threat of existence. The threat may be caused from the size or nature of a particular market or from demand from greater economies of scale, or when multinationals with access to relatively cheaper source of capital, seek to gain a market share through acquiring domestic firms.

In sectors where intangible asset advantages like brand names add to the cost of capital advantage, the pressure on domestic firms to be taken over is quite high. Hence, the number of M&As have increased drastically in lifestyle associate product markets like fast moving consumer goods, white goods and automobiles.

Hence, when market compulsions and cost considerations drive M&A shareholders' value is likely to be maintained at the same level. It requires great management skills to amalgamate different operational cultures, re-orient manpower to common goals and streamline activities to core strengths to reap fruits of M&A deals.

Indian M&As in 2001-2002
Mergers & Acquisitions (M&As) have been a major source of corporate growth in India in the recent years. Nearly 40 per cent of foreign direct investments in India have been through M&As. According to the data compiled by the Centre for Monitoring Indian Economy (CMIE), there were 1,344 M&A deals in 2001-2002. However, in terms of absolute numbers, this involved Rs.35,360 crore in 2001-2002, compared to Rs.33,649 crore the previous year. The new factor in the fiscal *year* 2001-02 was disinvestment, which made up for over 10 per cent of the total amount. A pickup in the open offers and buybacks also spurred M&A activity. The number of open offers was the highest in the last three years with 98 open offers amounting to Rs.4,788 crore of which 30 were tram multinationals, Buy-back activities also spurred with 30 offers during the fiscal amounting to Rs.2,509 crore. The Central Government was able to secure Rs.3,881 crore through disinvestment Different stake in companies and hotel properties, thus accounting for over 10 per cent of the total M&A amount. The largest contributor towards the M&A activity was the communication industry followed by chemicals and the financial services sector. Consolidation initiatives by Bharti, BPL, and the Birla-AT& T combine saw M&A deals of over 7000 crore.

Source: The Economic Times, April 17, 2002.

M&As, which lead to higher market concentration do not effectively result in higher market power. Theorists of industrial organisation have not found a direct correlation between the two variables and have supported a case to case study which evaluate whether M&As generate greater economic efficiency or undue exclusive rights Most nations follow the US model where antitrust provisions are implied in generalities, leaving the courts free to interpret specific practices.

In India, the Monopolies and Restrictive Trade Practices (MRTP) Act defines dominance specifically (regardless of whether consumer interests were harmed or not) – to be not more than 25 per cent. The Act does not take into account antitrust practices of extra-territorial origin. With cross-border M&As getting increasingly popular, there could also be a conflict of laws of different countries.

The Competition Act, 2002, which has replaced the MRTP Act, 1969, defines dominant position as a position of strength, enabling a firm to operate independent of prevailing competitive forces, affecting competitors' and consumers' interests,

In such an atmosphere, where competition laws are still in a fluid state, M&As take effect on a level playing field and the protection of interests of producers and consumers alike will still take some time. Till then, it is unlikely to expect large-scale productivity increases or FDI inflows through M&As. However, companies are going in for strategic alliances, mergers, acquisitions or even hostile takeovers to gain market power.

Multiple Choice Questions

(1) Which of the following restructuring activities does not result in an expansion of a firm?

(a) Joint Ventures

(b) Mergers

(c) Divestitures

(d) Acquisitions

(e) None of the above.

(2) Which of the following activities is/are not associated with spin-off?

(a) Creation of a new legal entity

(b) Distribution of shares to a portion of existing shareholders in a subsidiary in exchange for parent company stock

(c) Distribution of shares on *pro rata* basis to existing shareholders of the parent company

(d) Separation of control

(e) All of the above

(3) Firm X plans to sell off a part of the firm via an equity offering to outsiders. Which of the following means shall be applied by the company for executing its plan?

(a) Equity Carve-out

(b) Spin-off

(c) Split-Up

(d) Divestiture

(e) Tender Offer.

(4) Changes in the company bylaws to make the acquisition of a company more difficult or more expensive are referred to as

(a) Takeover

(b) Anti-takeover Amendments

(c) Corporate Control

(d) Proxy Contests

(e) None of the above.

(5) Which of the following activities does not involve a change in the ownership structure?

(a) Share Repurchase

(b) Going Private

(c) Exchange Offers

(d) Leveraged Buyout

(e) Proxy Contest.

(6) Which of the following is referred to as “a going private transaction” initiated by incumbent management?

(a) Management Buyout

(b) Leveraged Cash out

(c) Management Buy-in

(d) Leveraged Recapitalisation

(e) None of the above.

(7) A transaction which forms one economic unit from two or more previous units is called

(a) Joint Venture

(b) Merger

(c) Corporate Control

(d) Divestiture

(e) None of the above.

(8) According to Prescott and Visscher, firm specific informational assets known organisation capital includes

(a) information used in assigning employees to tasks that they can best fulfill

(b) information used in matching employees for the formation of teams.

(c) information that each employee acquires about other employees and about the organisation itself.

(d) Both (a) and (c) above.

(e) All of the above.

(9) Investment opportunities can take the form of

(i) internal investment where there is expansion of existing projects or the addition of new projects internally.

(ii) external investment in the form of mergers.

(iii) restructuring.

(a) (i) only

(b) (ii) only

(c) (iii) only

(d) Both (i) & (ii) above

(e) All of the above.

Answer (1) c; (2) b; (3) a; (4) b; (5) e;

(6) a; (7) b; (8) e; (9) e;

Theory Questions

(1) Why do corporates go for restructuring exercises? Discuss the various forms of restructuring exercises that are being practiced by corporates across the globe.

(2) Mergers are not a new phenomenon, the history of mergers dates back to the 19th century. Narrate the history of merger movement.

(3) Explain meaning, characteristies and rationale of restracturing?

(4) Explain motives behind merger in details?

(5) Describe the process and steps in strategic Planning of Marga

(6) What are the visions should be identified while planning for M&A?

(7) State the critical activities in strategic planning processes?

(8) Discuss the "5-S" model in details?

(9) Explain "M&A" in India with examples?

(10) Discuss the purposes for restructuring?

Case Study

Read the case study carefully and answer the following question.

(1) What do you mean by internal development/internal growth? What decides for the company to go for internal growth strategies or external growth strategies (mergers and acquisitions)?

Internal development and mergers are mutually supportive activities. Growing companies adopt various forms of M&As and other restructuring practices depending on the existing opportunities and limitations. The characteristic and competitive structure of an industry will affect the strategies employed The factors and situations favouring M&As in part relate to industry characteristics. In an industry with excess capacity, horizontal mergers call be used to close down high-cost firms to decrease industry supply and to boost efficiency in the balance firms. In addition, a number of industries, earlier operating on small-scale operations, have been rolled up into bigger *units.* The larger units have been able to achieve economies of scale not achieved by smaller individual units.

A few more advantages of M&As or external growth may also be highlighted. An acquisition helps the acquirer to acquire a firm already in place with a historical track record. Some complexities are still possible, but can be eased off to some extent by appropriate due diligence. An acquisition usually involves paying a premium, but the cost of acquiring a company may be estimated in advance.

An acquisition may also represent acquiring a segment divested from another firm. The logic is that the segment can be managed in a better way when added to the activities of the buying firm. Another important motive for M&As is to increase the strength of the acquiring firm. For example, the exceptional growth of Cisco Systems was achieved by acquisition of companies with the technology and talent to expand capabilities.

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