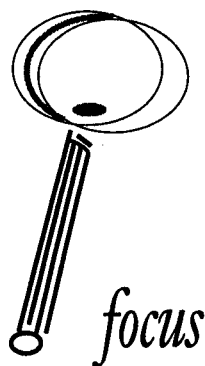


1

An Overview of Mergers and Acquisitions



Learning Objectives

By the end of this chapter you should be able to:

- List several different methods of business combination.
- State the difference between a hostile versus friendly acquisition.
- List the two Federal Government agencies responsible for regulating antitrust issues in acquisitions.
- Explain why growth alone is not sufficient reason to undertake an acquisition.
- List and briefly describe the two methods of accounting for an acquisition.
- List several problems that may arise after an acquisition is completed.

INTRODUCTION

Mergers and acquisitions have had an important impact on the business environment for over 100 years. They have often come in waves of activity that were motivated by different factors. From 1890 to 1905, more than 200 mergers of major importance occurred as many small companies in the same industries merged to form monopolistic entities. After 1905, merger activity was particularly heavy during the 1920s as small companies in similar industries continued to merge to gain market power. The volume of merger activity was also heavy after World War II as large companies completed friendly acquisitions of small privately held companies. Another large wave of mergers occurred in the 1960s and 1970s, motivated largely by the quest for risk reduction through diversification. It is during this period that large conglomerates such as ITT, Textron, Litton Industries, and LTV were formed.

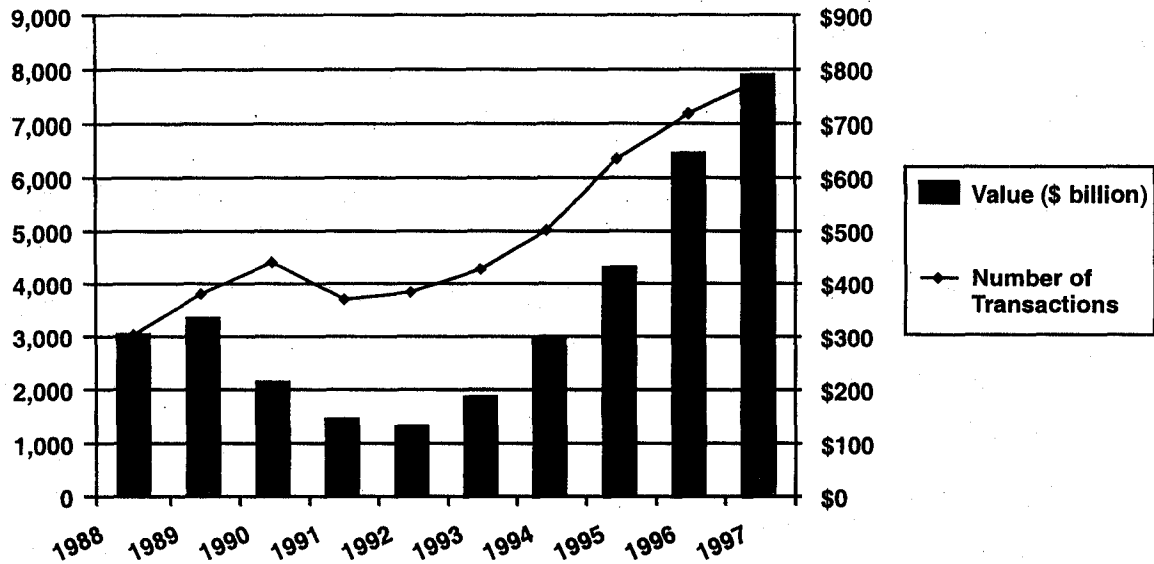
In the 1980s, another wave of mergers occurred as corporations or corporate raiders purchased large, inefficient, undervalued companies and restructured them to make them more efficient. During this wave of activity, many of the conglomerates formed during the 1960s and 1970s were broken up into smaller, more efficient companies. Many of these mergers were unfriendly transactions, opposed by the management of the company being acquired. The 1980s also continued to see companies diversifying, but typically for more strategic reasons. For example, R. J. Reynolds acquired Nabisco and Phillip Morris acquired General Foods and Kraft, providing these companies in declining industries entrees into new industries with growth potential. Unfriendly acquisitions became more difficult to consummate in the 1990s due to increased state takeover laws, more effective takeover defenses enacted by corporate managers, and a decline in the availability of junk bond financing.

The 1990s however, have been another time of heavy merger activity as corporations acquire other companies, typically in similar industries, for strategic reasons that consolidate resources and form larger, more powerful entities. For example, the 1998 merger of Daimler-Benz and Chrysler created a global automobile industry powerhouse with a broad array of product lines. The banking industry has seen many large mergers in the 1990s as local banks merge to better compete with super regional banks, and super regional banks merge to compete internationally. We are currently in the midst of this wave of mergers, making the careful evaluation of merger candidates as crucial as ever.

The number of acquisition transactions completed and the total dollar value of completed transactions for the past ten years are shown in Exhibit 1-1.

The thrust of this course, however, is not historical. Rather, its purpose is to delineate how and why a merger decision should be made. This course will focus on mergers and acquisitions in the context of publicly traded companies. The concepts and tools learned in this course can be modified and applied to companies whose stock is not publicly traded. These acquisitions of private companies account for the majority of transactions, but receive little publicity. Analysts of potential mergers recognize the need to perform the fundamental strategic and financial analysis presented in this course before a merger is completed, but they remain aware of the idiosyncrasies that each potential merger contains.

A merger is a pivotal event for the companies involved. Both parties hope to benefit from the greater efficiency and competitive strength found in the combined company. Strategies are altered and as a result product lines are broadened, strengthened, or refocused; management systems and personnel are changed; and levels and growth rates of profits are shifted. In many instances, however, one side or the other (or both) lose substantial sums of money. Merger costs, including the direct costs of attorneys, accountants, investment bankers, and consultants, are substantial even though they are not a large percentage of the value of the merger. There is also substantial cost in terms of time required by key employees to evaluate, complete, and implement the merger. More than half of all mergers and acquisitions fail or do not achieve the desired results. Most mergers fail because projected synergies do not materialize, often due to human obstacles. If a merger is not well

E**Exhibit 1-1****10 Years of Acquisition History**

Data obtained from *Mergers and Acquisitions* (1998).

received by the employees of the new entity, then its chances of success are greatly diminished. It is critical that the parties involved in a merger become skilled in managing change. Sometimes acquisitions fail for the acquiring company simply because it pays too much for the acquired company. Careful forecasting and valuation analysis is required to avoid this pitfall.

Because an entire company is acquired in a merger, determining the advisability of a potential merger requires a much broader analysis of the factors involved than most other areas of financial management. In addition to the usual tax, legal, cash flow, and cash outlay considerations, competitive positions and strategies are important. This course is designed to assist the analyst in identifying and analyzing many of the important financial and strategic factors important to analyzing an acquisition.

The remainder of this chapter will discuss several topics important to understanding the basic nature of and issues surrounding mergers and acquisitions. These include methods of business combinations, motives for mergers and acquisitions, antitrust considerations, accounting for mergers, and post-merger analysis. The chapter will conclude with an overview of the remainder of the course.

METHODS OF BUSINESS COMBINATION

There are several methods for achieving a business combination. It is useful to have an understanding of these different methods. Hereafter, the term acquisitions will be used to refer to any type of business combination.

Acquisition

An acquisition usually refers to the purchase of the assets of a company. However, in the remainder of this course, the term will be used in a much broader sense to indicate the purchase of shares, assets, or companies in the merger process. Thus, the narrow, distinct meaning of the term will not be used.

Merger

In a merger, two separate companies combine and only one of them survives. In other words, the merged (acquired) company goes out of existence, leaving its assets and liabilities to the acquiring company. Usually when two companies of significantly different sizes merge, the smaller company will merge into the larger one, leaving the larger company intact.

Consolidation

A consolidation is a combination of two or more companies in which an entirely new corporation is formed and all merging companies cease to exist. Shares of the new company are exchanged for shares of the merging ones. Two similarly sized companies usually consolidate rather than merge. Although the distinction between merger and consolidation is important, the terms are often used interchangeably, with either used to refer generally to a joining of the assets and liabilities of two companies.

Leveraged Buyout (LBO)

A leveraged buyout (LBO) is a type of acquisition that occurs when a group of investors, sometimes led by the management of a company (management buyout or MBO), borrows funds to purchase the company. The assets and future earnings of the company are used to secure the financing required to purchase the company. Often employees are allowed to participate through an employee stock ownership plan (ESOP). ESOPs provide significant tax advantages and may improve employee productivity by giving employees an equity stake in the company.

Holding Company

A holding company is a company that owns sufficient voting stock to have a controlling interest in one or more companies called subsidiaries. Effective working control or substantial influence can be gained through ownership of as little as 5 percent to as much as 51 percent of the outstanding shares, depending on how widely the shares are distributed. A holding company that engages in the management of the subsidiaries is called a parent company.

Forming a holding company allows one company to acquire control of another with a much smaller investment than would otherwise be the case. In addition, a holding company may be used to avoid foreign or state corporation status for the subsidiaries. (A "foreign" corporation is defined here as a corporation that is incorporated in a state different from the state where it is doing business.) For example, assume that division A of company X operates in New York but company X is chartered in California. Under these circum-

stances, division A is considered a foreign corporation in New York. However, if division A is instead held as subsidiary A by company X and is chartered in New York State, then subsidiary A is considered a domestic corporation and is therefore likely to pay lower taxes and may receive other legal advantages in New York.

Divestitures

While divestitures do not represent a business combination, they are a means of facilitating the acquisition of part of a company. Sometimes divestitures are used by companies as a means to improve earnings and shareholder value, or as a means of raising capital. A divestiture involves the sale of a portion of a company. Two popular means of divestiture are spin-offs and equity carve-outs.

In a spin-off, a company distributes all of its shares in a subsidiary to the company's shareholders as a tax-free exchange. The reorganization of AT&T is an example of a spin-off. AT&T was reorganized into three separate publicly traded corporations, and a fourth business was sold. What remained was AT&T, comprised of long distance and wireless phone businesses, a credit card business, and two other companies that were formed and spun off to shareholders by giving them stock in the two companies. One of these companies, now Lucent Technologies, was an equipment producer and research company. It was spun-off to avoid conflicts with customers of other AT&T products. The other company was NCR, a computer company. This was spun-off to remove the effects of a poor-performing business from AT&T's results. An equity carve-out is similar to a spin-off. It occurs when a company sells some of its shares in a subsidiary to the public. This raises additional capital for the company.

Hostile versus Friendly Combinations

Acquisitions may be hostile or friendly. In a hostile acquisition, the acquiring, or bidder, company makes an offer to purchase the acquired or target company, but the management of the target company resists the offer. At that point, the bidder often tries to take control of the target through a tender offer, whereby the bidder offers to purchase a majority of the target's stock at a predetermined price, set sufficiently higher than the current market price to attract the shareholders' attention. Hostile acquisitions are typically more expensive for both parties since they involve more time and negotiations, fees to experts such as attorneys and investment bankers, and may result in a bidding war where multiple bidders enter the contest for control. The large number of hostile acquisitions in the 1980s led to the coining of the term "market for corporate control." This terminology reflects the view that acquisitions are really market-based contests whereby corporate managers bid to control corporate assets, with the highest bidder receiving control.

Even though hostile acquisitions receive much of the media attention surrounding acquisitions, the great majority of acquisitions are; friendly. In a friendly acquisition, the management of both companies come to an agreement over the terms of the acquisition. Many acquisitions that begin as hostile end up being completed on a friendly basis.

MOTIVES FOR ACQUISITIONS

The overriding motive for any acquisition should be to maximize shareholder value. There has been increasing emphasis on maximizing shareholder value and managers are under more and more pressure to do so. The threat of a hostile takeover places pressure on all corporate managers to manage their companies to maximize value, or risk being taken over and restructured by another management. Increasingly competitive global capital markets, active institutional investors, active and independent boards of directors, and better informed market participants have all led to an increased focus by shareholders on shareholder value, and have placed increased pressure on corporate managers to maximize shareholder value.

Acquisitions are a means of creating shareholder value by exploiting synergies, increasing growth, replacing inefficient managers, gaining market power, and extracting benefits from financial and operational restructuring. However, for value to be created, the benefits of these motives must exceed the costs. These motives will be discussed in greater detail in Chapter 4, but let's discuss a common motive for many acquisitions, growth, in more detail here.

Growth through Acquisition

In one way or another, an acquisition causes a company to grow. At the very least, assets are increased. Sales are also likely to be higher, and profits may increase as well.

There are numerous reasons for a company to want to grow. Growth is often considered vital to the health of a company. A stagnating company may have difficulty attracting high-quality management. Furthermore, larger companies may pay higher salaries to top management than smaller companies. In some industries, size itself may bring competitive advantages. For example, marketing dominance may be strengthened through improved access to advertising. In addition, a large company may have significantly higher production or distribution efficiencies than a smaller one. Sometimes growth is a means of survival. For example, companies in the telecommunications industry have grown through acquisition in an effort to compete to control phone lines, cable systems, and content. The 1993 merger of Viacom, Blockbuster, and Paramount created a conglomeration of television and movie production, video distribution and publishing, and cable channels in an industry where many companies are merging to compete to become comprehensive media powerhouses. Firms in the defense industry have merged to survive in a declining market. Finally, tax laws may encourage merger growth.

Despite these reasons to grow, growth by itself does not necessarily benefit either the stockholders or the managers of a company. Growth is not something that must be achieved regardless of its price. Throughout this course, emphasis will be placed on an acquisition's impact on value. Careful comparisons between benefits and costs will be made. A good acquisition will be defined as one that can be expected to increase the stock price (other things being equal) of the acquiring company.

Furthermore, a merger is not always the best way to grow. A company can achieve internal expansion through investment in projects generated within the company itself. By doing so, efficiency may be improved, existing activities may be expanded, and new products may be introduced.

External expansion takes place through an acquisition. Because of the similarities between the acquisition and the capital budgeting process, the same approval and review forms, control procedures, and post-audit examinations commonly used for analyzing capital expenditures can be applied to an acquisition analysis as well. In addition, consideration should be given at the highest levels of the business to how the proposed acquisition fits in with the needs and strategic thrust of the company. With a good fit, even at a relatively high price, the company being considered may be viewed as a good investment. Without a good fit, the acquisition may not be a good deal at almost any price.

ANTITRUST CONSIDERATIONS

The antitrust division of the Department of Justice can bring suit to block an acquisition. Private individuals and companies may bring suit as well. Individual suits typically outnumber those initiated by the government. To be successful in its suit, the plaintiff (under the Clayton Act) must be able to show that a "substantial lessening of competition" might occur because of the acquisition. If an acquisition is challenged in this way, the costs in terms of executive time and legal expense will be very high. Thus, managers of the companies involved should carefully consider whether or not the acquisition is likely to be challenged.

Three statutes provide the framework for antitrust action. The Sherman Act of 1890 prohibited the restraint of trade (through combinations and collusion). Companies attempting to monopolize were deemed guilty of a misdemeanor. Despite its intent, the Sherman Act probably encouraged mergers and holding company operations because, under this act, companies could do as one company what they were forbidden to do as separate companies.

The Clayton Act of 1914 restricted practices that lessened competition. This was intended to clear up the ambiguity of the term monopolize in the Sherman Act. Stock acquisitions that lessened competition between competitors were specifically prohibited.

The Celler-Kefauver Amendment to the Clayton Act of 1950 introduced significant changes into the Clayton Act. Asset purchases, as well as stock purchases that lessened competition, were prohibited. The geographic scope of the definition of competition was narrowed and refined. The Federal Trade Commission was authorized to divest companies of assets or stock acquired in violation of the Clayton Act.

It has been contended that the Justice Department grew more lenient in policing acquisitions for antitrust consideration during the Regan era of the 1980s. If this is the case, mergers may be subject to more scrutiny in this area in the future. Recent actions against Microsoft and Lockheed Martin show that the Justice Department is taking a more active role in policing antitrust cases. The Supreme Court has also broadened the authority of

E**Exhibit 1-2****The Top Ten Acquisition Transactions, by Purchase Price, Completed in 1997**

1. Bell Atlantic Corp. acquired NYNEX Corp. for \$21 billion.
2. SBC Communications Inc. merged with Pacific Telesis Group for \$17 billion.
3. Boeing Co. acquired McDonnell Douglas Corp. for \$13 billion.
4. CUC International Inc. merged with HFS Inc. for \$11 billion.
5. Dean Witter Discover & Co. acquired Morgan Stanley Group Inc. for \$11 billion.
6. Norfolk Southern Corp. and CSX Corp. acquired Conrail Inc. for \$10 billion.
7. Nations Bank Corp. acquired Boatmen's Bancshares for \$10 billion.
8. Raytheon Co. acquired Hughes Aircraft Co. for \$10 billion.
9. First Bank System Inc. acquired U.S. Bancorp for \$9 billion.
10. Travelers Group Inc. acquired Salomon Inc. for \$9 billion.

Data obtained from *Mergers and Acquisitions* (1998).

individual states to challenge acquisitions on antitrust grounds. Thus, a company that is considering an acquisition should hire legal counsel and become aware of any related antitrust considerations. A company may also address any pertinent questions directly to the Justice Department or to the Federal Trade Commission to obtain advice or opinions. After receiving a favorable response from the Justice Department or the Federal Trade Commission with respect to the proposed acquisition, the company may proceed with some degree of confidence.

However, many recent acquisitions involve companies growing and consolidating in their primary industries. In 1997, the banking, telecommunications, and defense industries have seen consolidation through acquisitions. This is illustrated by the top ten acquisition transactions, by purchase price, completed in 1997, shown in Exhibit 1-2.

ACCOUNTING METHODOLOGY: PURCHASE VERSUS POOLING OF INTERESTS

Two methods of accounting for acquisitions purchase and pooling of interests are generally acceptable under the regulations set by the Securities and Exchange Commission. These methods are governed by Accounting Principles Board Opinions 16 and 17. Financial statements that record the results of an acquisition must follow one of these two techniques. This is not to say that financial managers are entirely free to choose between purchase and pooling of interests accounting. Each method is permissible or not permissible under well-defined sets of circumstances. If management prefers one accounting method, it must ensure that the acquisition is structured to conform to the requirements established for that treatment. In general, these methods employ well-accepted accounting methods, but specific, cases may require substantial

analysis. Financial managers must be aware of the accounting requirements as merger negotiations near completion.

Under the purchase method, the acquired company is treated by the acquiring company as an investment, analogous to a capital budgeting expenditure. A totally new ownership is assumed. Asset values are reappraised in light of estimates of their current market values, and the balance sheet is restated to the new levels. As a result of these adjustments, goodwill often results. Goodwill is the amount by which the price paid for a company exceeds the company's estimated net worth at market value. Goodwill must be written off against future net income over a reasonable period not to exceed 40 years. Such deductions against income were not deductible for tax purposes until recently when they were made tax deductible to make the U.S. tax code comparable to the tax code in many other countries.

Under the pooling of interests method, the assets and liabilities of the two combining companies are simply added together. Since only the book values of the assets and liabilities are considered, no goodwill results. In 1970, several severe restrictions on a company's access to the pooling of interests method were established by the Accounting Principles Board. These restrictions included:

- Prior to the pooling, each company must have been autonomous for at least two years and must have been independent in the sense that less than 10 percent of its stock was held by any individual investor.
- There must be maintenance of the ownership position in the surviving company. No debt can be used in the exchange. There must be a stock for stock exchange for substantially all of the voting stock of the acquired company.
- There must be no planned future transaction that could reverse the stock nature of the exchange. For example, there must be no contingent payments. Acquisitions must be accomplished through a single transaction. There must be no significant sale of assets for two years after the pooling.

As a result of these restrictions, the pooling of interests method is used much less today than it was prior to 1970. However, it does offer some advantages and corporate managers generally prefer to use this method. Since goodwill is not taken into account, none will be charged against future income. Therefore, reported earnings will be much higher, especially when substantial goodwill is involved. Since assets are stated at book rather than market value, asset levels will be lower under the pooling of interests method and profitability will appear to be higher when stated as a percentage of assets. Finally, assets may be acquired and recorded at depreciated book value. If they are sold years later at higher market prices, the profits on the sale will be added to net income, again enhancing profitability measures.

Because the goodwill write-off is now tax-deductible, the purchase method may actually increase after-tax cash flow. A study conducted by Hong, Kaplan, and Mandelker (1978) finds that the accounting choice of purchase or pooling of interests does not affect shareholders. At the time of the study, goodwill was not tax deductible. The Financial Accounting Standards Board

(FASB) has adopted a proposal that eliminates the pooling of interests method and requires the purchase method of accounting for acquisitions. This Statement of Accounting Standards (SFAS) will be effective January 1, 2001. As investors become more sophisticated and discounted cash flow valuations become more prevalent, the desire by managers to use pooling is declining. Many companies now comfortably explain away the accounting write-off of goodwill as irrelevant to corporate value, or believe it may actually improve value because of the tax write-off.

POSTMERGER ANALYSIS

Some problems must inevitably occur when two companies combine; however, these problems can be anticipated and minimized. Managers of the acquired company will feel some loss of autonomy since their decisions must now be meshed with the policies of the merged company. Once-simple procedures become complicated by a new control system. Furthermore, the acquired company's managers are often concerned about personal recognition, advancement, and job security in the new company. Historically, many managers of acquired companies have lost their jobs following an acquisition.

Problems in the acquiring company will emerge as well. Its strengths and weaknesses and the skills and potential of its personnel will not be immediately apparent in the combined company. In addition, the staff of the acquiring company may lack the expertise to understand completely the production processes of the acquired company and may therefore be unable to make appropriate decisions about them. Disciplines, procedures, and controls that have been well established over time may not work as well in the new environment. There may be a clash of corporate cultures. For example, Ted Turner had a substantially different management style than the managers of Time Warner, which led to conflicts after Turner sold his Turner Broadcasting Company to Time Warner and became a large shareholder in Time Warner.

Solutions to these problems cover too broad an area for satisfactory coverage in this brief introduction. Several suggestions can be given, and the issue will be taken up in greater detail in Chapter 8. Immediate arrangements should be made for orientation of the new staff, for discussing procedures with operational personnel, and for making shifts in assignments where necessary. Experts, who are responsible for preventing the imposition of inappropriate controls on the new division, and for educating top management about the characteristics of the unfamiliar company, can be added to the corporate staff. Furthermore, the increased opportunities for advancement in the larger, merged company can be communicated to lower-level employees. Finally, a special effort can be made to listen to what is happening during the initial period of difficulty.

OVERVIEW OF THIS COURSE

From an analytical point of view, this course will discuss the acquisition essentially as an investment decision. An initial outlay is invested to obtain expected future benefits. A good acquisition will generate greater benefits,

in present value terms, than its costs. The likely effect of a good acquisition will be to increase the stock value of the acquiring company. To properly conduct this type of acquisition analysis, some strategic concepts and many valuation tools are required. The remainder of this course will go through the strategic and financial analysis necessary to identify and evaluate acquisition candidates and assess the impact of acquisitions on company value.

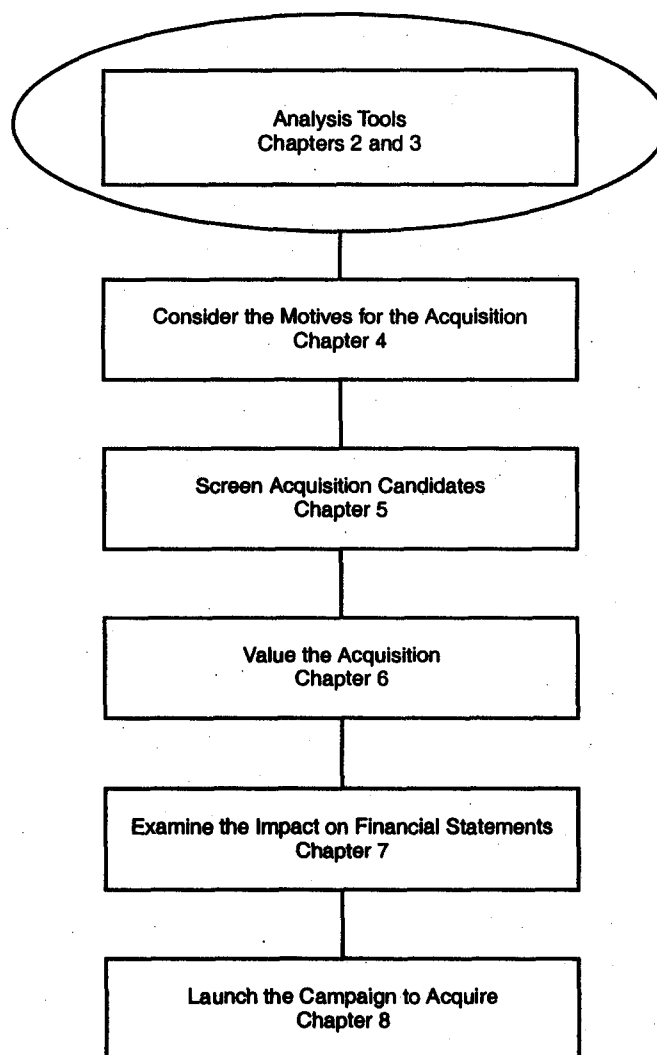
Acquisitions are financial decisions that should be consistent with the company's goal of shareholder wealth maximization. Sound and thorough financial analysis should be a part of any acquisition. Many acquisitions that fail, in the sense that they do not add value to the acquiring company, do so because they were motivated by wishful thinking rather than sound and thorough financial analysis. Chapter 2 will review methods for analyzing a company's financial statements. The basic financial statements will be reviewed and their limitations discussed. Key financial ratios will be computed and return on equity decomposition will be illustrated. Chapter 3 will review the basics of securities markets and valuation analysis. Stock price levels will be explained, and reasons for price changes will be given. The implications of competitive capital markets will be examined. Through this discussion, the financial analyst will be better able to view the acquisition process as a competition with other stock purchasers, all of whom are looking for good buys.

Acquisitions are also strategic decisions that should be consistent with the mission of the acquiring company and fit into its overall strategic plan. In Chapter 4, the reasons for an acquisition will be discussed and a review of strategic analysis will be provided. Acquisitions can be justified in terms of the competitive advantages they produce (for example, marketing positions may be strengthened or production costs reduced). Other motives, such as improved management, tax benefits, or defensive maneuvers to prevent takeover by other companies, will also be discussed.

The search for and screening of an acquisition candidate from among the thousands of potential companies is the topic of Chapter 5. Chapter 6 will present methods for valuing acquisition candidates and determining the maximum price to pay. The estimated future cash benefits will be valued using present value techniques.

Chapter 7 will describe the ways of measuring the impact of an acquisition on a company's financial statements. The impact of the acquisition on earnings per share and the price/earnings ratio of the acquiring company will be examined. Finally, Chapter 8 will cover the campaign to acquire. Once the maximum price to pay has been determined, strategies for making the acquisition bid and carrying out the campaign will be discussed. Postacquisition analysis will be discussed and tactics used for resisting an acquisition will be covered. Finally, international acquisitions and the acquisition of non-publicly traded companies will be discussed. A graphic summarizing the merger and acquisition process is shown in Exhibit 1-3.

Beginning in Chapter 2, a comprehensive example will be introduced that will carry forward through the remainder of the course. This integrative case example will be used to illustrate financial analysis, valuation, motives for acquisition, establishing the maximum price to pay for an acquisition

**Exhibit 1-3****The Merger and Acquisition Process**

candidate, examining the impact of an acquisition on the financial statements, and pursuing a campaign to acquire. The integrative case example will serve to tie the chapter material together, provide an example of how to apply concepts discussed in the chapters, and provide an example that will serve as practice and a guide for the Examination Case. Please note that most of the calculations and exhibits for this course were done on a computer spreadsheet. For presentation purposes, numbers are rounded. There will be slight differences in many totals, ratios, and values due to rounding.



This chapter provides an overall introduction to mergers and acquisitions, and outlines what to expect in the remainder of the course. The 1990s has brought another period of record levels of acquisitions. With increased pressure on companies to operate efficiently and maximize shareholder value, the necessity of careful planning and evaluation of acquisition op-

portunities is paramount. Acquisitions can take on a variety of forms, including mergers, consolidations, leveraged buyouts, and holding companies. These acquisitions may be hostile or friendly. Regardless of the nature of the acquisition, the underlying reason for the transaction should be to maximize shareholder value. This requires careful strategic and financial consideration of all potential acquisitions.

Two other elements that are important to acquisition decisions are anti-trust considerations and accounting methodology. The Justice Department and the Federal Trade Commission are agencies of the Federal Government that have jurisdiction over acquisitions. These agencies have the authority to challenge acquisitions that will lessen competition. The states have also been given increased power to challenge acquisitions. It is important to consider antitrust challenges to potential acquisitions and plan on how these challenges will be dealt with, prior to attempting an acquisition.

Acquisitions are accounted for as either purchases or pooling of interests. Corporate managers typically prefer pooling because it does not involve booking goodwill that is subsequently deducted from earnings. The Financial Accounting Standards Board is currently considering disallowing the pooling method and requiring use of the purchase method. Even though the purchase method does lower future accounting earnings, it may increase cash flows and value and should not be resisted. Therefore, the choice of accounting method should not impact shareholder value. This is supported by empirical studies.

As part of an acquisition program, a financial analysis of the acquiring and target companies should be completed. Tools for financial analysis will be reviewed in Chapter 2.



Review Questions

1. Which term is used to refer to any type of business combination? 1. (c)
 - (a) Holding company
 - (b) Merger
 - (c) Acquisition
 - (d) Consolidation

2. The pooling of interests method of accounting for acquisitions is often preferred by corporate managers over the purchase method by managers because it results in: 2. (d)
 - (a) higher shareholder value.
 - (b) lower taxes.
 - (c) a higher level of assets.
 - (d) higher future accounting earnings.

3. The two Federal Government agencies with authority to regulate acquisitions on antitrust grounds are the: 3. (a)
 - (a) Federal Trade Commission and Justice Department.
 - (b) Justice Department and Federal Bureau of Investigation.
 - (c) Federal Trade Commission and Department of the Treasury.
 - (d) Internal Revenue Service and Ways and Means Committee.

4. Acquisitions that lead to growth in assets and sales: 4. (b)
 - (a) always lead to increased shareholder value.
 - (b) may not lead to increased shareholder value.
 - (c) typically do not lead to increased shareholder value.
 - (d) cannot lead to increased shareholder value.

5. The high level of acquisition activity in the 1990s is associated with: 5. (d)
- (a) a relaxed stance by antitrust regulators.
 - (b) the high number of inefficient, undervalued companies.
 - (c) companies striving for diversification.
 - (d) strategic consolidation of companies in similar industries.

WHAT ABOUT YOUR COMPANY?

Each chapter will include a summary exercise comprised of a short series of open-ended questions, designed to get you to think about how the chapter material might relate to your company.

If you are considering growth through acquisition, consider the following questions:

1. Why is growth through acquisition a better option than internal expansion? Will the growth be profitable for the owners of the company?
2. Do we have the expertise to carry out an acquisition? If not, where will we turn for the necessary strategic, legal, and financial advice?
3. Do we have the people in our organization to plan and execute an acquisition? If not, where will we get them?
4. How will we screen for appropriate acquisition candidates?
5. If a friendly acquisition cannot be worked out, are we willing to undertake a hostile transaction?
6. How will we handle the problems of integrating the two companies to achieve the benefits of the acquisition?
7. How will we assess the success or failure of the acquisition after it is completed and implemented?

