Managing the M&A process

Chapter 11

Beatrice Orlando

Introduction

- An acquisition occurs when one company buys another company or a business of another company.
- A merger occurs when a new company is formed and the acquirer and the target companies are dissolved.
- Mergers and acquisitions are different for taxes and purposes, but they can be similar for strategic purposes.
- There are several stages in M&A involving people and experts from within and outside the acquirer-target firms: target selection; valuation and negotiation; due diligence; integration and implementation; post-deal evaluation.
- Valuation, negotiation and post-merger integration activities in corporate acquisition depend on the underlying synergies in the transaction.

Valuation and negotiation: how much should you pay for a company?

- Valuation is an iterative process and it helps to define the price the acquirer should be willing to pay and the target should be willing to accept.
- The lower bound in valuation is determined by the standalone value of the target firm. Lower values are usually not accepted by the target firm.
- If the target firm is listed on a capital market, the current market capitalization of the firm is an indicator of the equity value. Equity plus debt minus cash balances gives the standalone enterprise value.

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- If there's no market price or it doesn't reflect the underlying value, other techniques are:
  - Intrinsic evaluation (NPV of future cash flows; balance sheet metrics; liquidation value of physical assets)
  - Relative evaluation (earning multiples; revenue multiples; other multiples)

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- The upper bound for the valuation of the target company is synergistic value: NPV of future cash flows of both the target + the acquirer, after considering effects of synergies minus the costs for their implementation.
- It is possible to use the premium over standalone value in similar prior transactions (deal multiples).
- More uncertain synergies can be discounted at a higher WACC, after breaking down synergies value, according to their type.

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- The integration cost also must be considered and separated into synergy dependent and synergy independent integration costs.

PMI: how much should you integrate both companies?

- The problem of PMI is an organizational design problem: a new common structure must be designed and implemented.
  - Complexity: function of the number of interrelated decisions.
  - Limited information.
  - Functioning while integrating.
  - Uncertainty and change.
  - Cultural differences.

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- In PMI integration decision depends on balancing the need for collaboration to extract synergies and the need for minimizing disruption to avoid negative impact on productivity.
- PMI decisions regarding the combined organizational structure is in terms of two sequential choices: grouping units and linking activities across groupings.

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- Grouping choices:
  - Autonomy when units operate separately, even if reporting to the same CEO;
  - Peer: units work together, with symmetric power;
  - Report: One unit reports to the other;
  - Absorption: one unit is absorbed by the other.

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- Linking choices:
  - Incentives;
  - Information channels;
  - Standardization of work procedures.

A framework for PMI planning

- Integration planning is based on the principle that in every acquisition, each pair of organizational units from the acquirer and the target could have a different optimal level of integration between them, based on the synergy operators that link them.

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- Clearly state potential synergies;
- Identify units which value chain is affected, in both acquirer and target firms;
- Create a matrix of synergies analysis