

The urge to merge

Mergers and acquisitions are increasing in the Middle East. What advantages might they offer the region's economy?



Due to economic globalization, companies often find it difficult to achieve growth and at the same time keep ahead of competition. Mergers and acquisitions have become increasingly common tools for firms wishing to enlarge operations and remain competitive. Merger & acquisition activity occurs when a firm decides to expand by buying up or becoming a part of other companies.

Although often used as though they were synonymous, the terms merger and

acquisition (or M&A) mean slightly different things. Mergers are generally differentiated from acquisitions partly by the way in which they are financed and

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partly by the relative size of the companies. Simply stated, a merger is

when you integrate your business with another and share control of the combined businesses with the other owner(s). An acquisition on the other hand is when a company buys another business and ends up controlling it.

Classifications of Mergers:

1-Horizontal mergers take place where the two merging companies produce similar products in the same industry.

2-Vertical mergers occur when two firms, each working at different stages in

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the production of the same good, combine.

3-Conglomerate mergers take place when the two firms operate in different industries.

A unique type of merger called a reverse merger is used as a way of going public without the expense and time required by an IPO. Opposite of a merger is a "demerger", "spin-off" or "spin-out". This occurs when one company splits into two, the 2nd often being separately listed stock company if the parent was a stock company.

The Reasons for Mergers & Acquisitions: Prime element for M&A is the belief that "synergies" exist between the two companies which will allow them to work more efficiently together. These synergies could be achieved by the firms' combined ability to exploit economies of scale, eliminate duplicate functions, share managerial & operational expertise, increased access to capital markets to raise capital, acquire new technologies and finally improve market reach and industry visibility.

Companies may pursue M&A as part of a deliberate strategy of diversification, allowing the company to exploit new markets and spread its risks. A company may seek an acquisition as it believes its target to be undervalued, and thus hunt a "bargain" to generate a high return for the parent company's shareholders.

Problems Faced with Mergers & Acquisitions:

The merger or acquisition process is extremely stressful for those involved: job losses, restructuring, and the imposition of a new corporate culture and identity can create uncertainty, anxiety and resentment among a company's employees.

Examples of problems companies may face with mergers range from poor strategic moves, such as overpayment, unforeseen events, such as technological obsolescence - resulting possibly from

poor due diligence. However, many analysts view clashing corporate as one of the most significant obstacles to post-merger integration. The lack of transparency of financial activities and the fragmented nature of debts and capital, especially for large financial institutions, prevent creditors, shareholders and regulators from imposing discipline.

According to research, a firm's productivity can drop by between 25 and 50% while undergoing such a large-scale change; demoralization of the workforce is a major reason for this. Globally, two-thirds of mergers end in failure – some because of staff hostility and others because of insufficient preparation and inability to integrate personnel and systems. Even more failures are due to irreconcilable differences in corporate cultures and management.

The success of a merger or an acquisition depends largely on the firms' ability & willingness to address the more human (intangible) issues – such as employee morale, receptiveness to change, cultural issues, etc. Making employees & customers feel a part of this process can ensure ownership of the decision and can help eliminate dissonance, uncertainties and insecurities.

According to management professor Martin Sikora, editor of Mergers & Acquisitions, "Companies merge and end up doing business on a larger scale, with increased economic power, but the important questions are whether or not they gained competitive advantage or increased market power, and that will be reflected in the stock price."

Making the Right Choice:

Successful mergers have a "defined plan and process" blending the operational with the cultural, with periodic reviews to ensure the process is working. Whether a certain acquisition is good can be measured by enterprise value or discounted cash flow. Likewise, what is a

good price earnings ratio for fuelling depends upon the time horizon chosen, and appetite for risk.

The ultimate objective of M&A activity is expansion or growth. Opportunities to grow by merger or acquisition may exist where the target business is undervalued, does not use its assets to maximum effect, would benefit from relocation, has poor management, and finally has complementary products or services which, when combined with it, will enhance the offering to customers.

M&A Deals in the GCC:

GCC companies played a significant role in global M&A activity, Khaleej Times reported. GCC-based companies have made more than US\$ 30bn worth of acquisitions so far this year (2006). Some of the notable deals are Bahrain-based investment group Arcapita acquisition of Northern Ireland's biggest electricity supplier, Viridian Group for US\$ 3.6bn, Istithmar's US\$ 1bn acquisition of a 2.7% share in Standard Chartered Bank and SABIC's acquisition of 100% of the shares of Huntsman Petrochemicals (UK) Limited for US\$ 700mn. The major deals backed by Gulf companies in the pipeline include £7 billion bid by a consortium led by Qatar's state-owned investment fund to acquire Thames Water which has been put up for sale by German owner, RWE.

Although it is obviously impossible to predict with certainty the outcome of a merger or acquisition before it takes place, thorough preparation can definitely help. Most importantly, any decision to carry out a merger or acquisition should consider not only the legal and financial implications, but also the human consequences – the effect of the deal upon the two companies' managers and employees. It is upon them, ultimately, that the fate of the newly – merged company will depend. ■

- Diana Dahdah, Amwal