THE USE OF MERGERS TO INCREASE SHAREHOLDER VALUE IN FINANCIAL DECISIONS

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Breadth Component Abstract

Merger financing can be accomplished by a leveraged buy-out, a stock option plan in some instances, or a stock buy-out/transfer. The best way a company can finance a merger they want to pursue is truly up to their own needs and abilities. If they do not have a lot of money then one regime may suit them better than the other such as the leveraged buy-out. It is in this instance where the advantages and disadvantages of the different finance schemes come to light. Once financing for a merger can be procured, the decision as to what type of merger would benefit the company best should be decided. Vertical and horizontal mergers are two of the main mergers. Horizontal is the merging of rival companies, and this integration type has its advantages and disadvantages. Vertical is the merging of two companies within the supply-chain, and this integration type has its advantages and disadvantages. It should be of note that vertical integration can be up or down within the supply-chain. Ultimately the choice between vertical and horizontal should be whether the company wants to have a larger portion of the supply-chain or if the company wants to buy a rival.

Depth Component Abstract

Horizontal and vertical mergers are two of the biggest types of mergers available for a company. Each merger format has some benefits and drawbacks. Vertical merger will present a company with a wealth of tax benefits, cost benefits and a higher degree of profitability due to greater efficiency. Horizontal merger offers a chance at greater market share and a higher degree of market and price controls. Both types of mergers run into some problems with antitrust regulation. In vertical integration the antitrust guidelines mainly look to whether or not the buying of a supply-chain company will become a barrier to entry for other companies. The horizontal integration and antitrust procedures are a little more intense. The government utilizes antitrust guidelines and an index that is normally called the HHI to determine whether a horizontal merger violates antitrust laws, although the government and many economists will admit that horizontal mergers often benefit the public. Despite the overwhelming power of antitrust, other conditions will cause a vertical and horizontal integration to not occur as well. In vertical merger an issue of what type of property right is being transferred as well as the accounting costs outweighing the benefits are two items that can cause a company to have second thoughts about pursuing the combination. In horizontal merger a company will have doubts about the integration if the market is already too concentrated or the rival already has a large amount of the market share. The two merger types can be complicated and present the company with many pitfalls, but the benefits often outshine the numerous downsides.

Application Component Abstract

Vertical and horizontal integrations have benefits and negative ramifications, but all of this information would provide little knowledge without some actual examples to accompany it. First, a merger of any type usually succeeds more if the acquired company maintains some type of personal image through the keeping of managers and workers. Often companies will replace the management team at the target company, and this appears to be a mistake and one of the biggest elements that will determine merger success or failure. The vertical merger successes of Dell Computer and the music industry demonstrate how supplier control and promotional support can assist a company in the market. The vertical merger failure of the network television industry demonstrates how merger can stifle innovation. The horizontal successes of the beer industry and drug companies demonstrates how timing and cutting of costs as well as pursuit of opportunities will help a merger's bottom-line. The horizontal failure of the Chrysler and Daimler example shows how a lack of vision, planning, and cultural sensitivity will cause a loss in identity and a lack of cohesion between the two companies. A merger plan developed on these examples would be beneficial to an executive who is thinking a horizontal or vertical merger would be ideal for his shareholders.

Introduction to the Study

Background

International finance has changed throughout the more recent decades as the advent of globalization has firmly taken precedence over every avenue of worldwide economics. The introduction of globalization and an opening of foreign markets have introduced an increase of mergers that occur overseas between foreign companies as well as domestic companies. The fact that the Communist nations have fallen, OPEC has a diminished power, capital flows, new financial instruments and the spread of financial institutions, and the determinants of exchange rates all demonstrate how this new economy has created an environment of expansion for all corporations. (Solomon, 1999, p. 139) All of these criteria as well as many more have created a culture of increasingly larger and larger business models. One of the cheapest and quickest ways for a company to expand is through merger, acquisition, and integration. All three words are synonymous with a combining of entities or assets in the hope that the combination will create greater efficiency and market value for shareholders.

According to the Columbia Encyclopedia, a merger is "in corporate business, [the] fusion of two or more corporations by the transfer of all property to a single corporation. The remaining corporation continues in existence, having absorbed the other(s)." ("Merger," 2007, p. 31585) The idea that a merger is the combination of two corporations is correct, but a merger is so much more than just this simple event. A merger can combine many different types of entities. A merger can combine just assets of another company or just the management of the other company. Mergers are usually fairly complicated in their approach and scope, and they cannot be explained with just one broad-based definition. Appreciation of the intricacies of mergers is needed in order to fully understand the vast undertaking associated with a merger of two companies.

Mergers, or integrations, are different with every group of companies that decide to combine. Because of the distinctions made with the companies, there are also distinctions to be made with different types of mergers. Two of the most common types of mergers are the vertical and horizontal mergers, and they encompass different aspects of combination as well as assets or management planning that defines what they accomplish. ("Merger," 2007, p. 31585) A company deciding to merge with another company will need to decide what type of merger to perform. The other consideration a company will need to ponder is what the most effective way to accomplish (finance) the integration.

Corporate decisions should have one goal in mind, and that is the increasing of shareholder wealth by increasing the value of the company. A merger should also have this goal in mind as well as an altruistic goal of whether or not the merger is beneficial for the public or will decrease competitiveness in the marketplace. ("A Beneficial Merger; XM-Sirius," 2007, p. A21) These types of obstacles must be overcome in order for an integration to be successful and fruitful for the company in the future as well as the transition period directly after the combining of entities.

This study will attempt to explore the advantages and disadvantages of different financing procedures, and to a certain extent how they correspond to mergers. The study will also demonstrate the advantages and disadvantages of the vertical and horizontal merger and give examples of the failures and successes, and conclude with an explanation as to why the failures or successes occurred. Finally a section on recommendations will be depicted that will break down the most logical process for deciding what type of merger and whether or not a merger should even be considered.

Research Objectives of the Study

The primary research objective of this study is to determine the most beneficial type of merger for a company when deciding to pursue a vertical or horizontal integration. This primary research objective will further be subdivided into three secondary research objectives:

1) To analyze the different methods associated with finances of a corporation, including stock buy-outs/transfers, leveraged buy-outs, and stock options. Also the first of the secondary objectives will concern the introduction of the vertical and horizontal merger theories. (Objective #1).
2) To critically examine the horizontal and vertical mergers and how they are perceived and utilized in a corporate setting. (Objective #2).
3) To propose structured criteria for deciding what type of merger should be pursued and how it should be procured through financing, and whether a merger should even be introduced due to a company's current financial and market position. (Objective #3).

The plan to accomplish the 3 research objectives thus outlined will involve making use of the Breadth, Depth, and Application components. The Breadth component will be used to conduct Objective #1, while the Depth component will be used to accomplish Objective #2, and lastly, the Application component will be used to demonstrate Objective #3.

Purpose and Significance of the Study

After the Enron debacle, the internet bubble, and the other numerous bankruptcies that have wiped out life savings, it is important to understand finances of corporations that attempt to become market leaders by integration and merging. International and domestic financial procedures need to be studied to see what activities a corporation is trying to accomplish. Investors and businesses need better education before they commit a drastic change such as merging with another entity.

The main goal of this study is to stress the careful consideration of shareholder value once a company is faced with the prospect of purchasing the assets of another company. Any type of purchase that is so large should be approached with caution and should be planned and discussed. Shareholders need to be the focus because as was seen in the corporate scandals of the late 1990s and early 2000s, the executives attempted to try and hide information from shareholders at the detriment of shareholder value. Education of both sides, shareholders and executives, will help with decision-making and when executives present a proposal and the shareholders vote on the proposal both sides will hopefully be informed as much as possible. By discussing the vertical and horizontal mergers and studying advantages, disadvantages, failures, successes, financing, and legal issues a shareholder can determine their own destiny with a company. This would be in direct contrast to the spin and cover-ups that shareholders were told during the dreaded Enron era of corporate finance…

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