**MACMILLAN'S
MERGERS AND
ACQUISITIONS
YEARBOOK**

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K. D. George

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He appears regularly on the Channel 4 Business Programme and has twice won the Wincott Award for financial journalism.

Sir Godfray Le Quesne, QC, has just retired as Chairman of the Monopolies and Mergers Commission. He was Chairman of the Commission from December 1975 to December 1987. He is now practising at the Bar.

Professor D. P. Tweedie is the National Technical Partner at Peat Marwick McLintock. He also holds a Chair of Accounting at the International Centre for Research in Accounting at the University of Lancaster.

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A REVIEW OF 1987

K. D. George

This short review of takeover and merger activity in 1987 covers acquisitions, mergers, divestments and management buy-outs of companies operating in the United Kingdom. The information is that contained in the mergers and acquisition database of *Infocheck Ltd.*

1987 saw a continuation of the boom year of 1986. The year began rather inauspiciously, however, with BTR announcing in January that it had abandoned its £1 billion plus bid for the Pilkington Group. This came after a welter of adverse comment in the press following upon the mega-bids of 1986. By the end of the year, however, the number of acquisitions was well up on 1986, and the value of mergers and acquisitions although about 20 per cent lower in real terms than the previous year was still higher than in the peak years of 1968 and 1972. (See article by George.)

A summary of the successful transactions contained in the Infocheck database is given in Table 1. As can be expected few transactions come into the hundreds of millions of pounds category. Of those acquisitions and mergers whose values were disclosed only 6 per cent involved the take-over of assets of £100 million or more. More interestingly the table shows the continuing importance of divestments. These transactions have accounted for a substantial proportion of total activity in recent years. In Table 1 37 per cent of deal types were either

divestments, or, in a small minority of cases, management buy-outs. To what extent are these divestments the result of past merger failures? To what extent are they part of management's strategic planning? Whatever the answer to these questions so long as acquisitions and mergers remain at a high level so too can we expect the sale of subsidiaries to be an important part of the changing structure of industry.

A more detailed break-down by deal-type for those transactions involving a consideration of £25 million or over is shown in Table 2. For these larger transactions acquisitions account for 57 per cent of all deals, divestments and management buy-outs for 34 per cent, and mergers for the remainder.

The 66 largest deals involving companies operating in the UK are detailed in Table 3. As can be seen there were no billion-pound transactions in 1987, the largest being TSB's acquisition of the Hill Samuel Group. Twenty-one of the acquired companies had manufacturing as their main activity, the rest being spread across property investments, retailing, finance, and other services. In this group there were 16 divestments, the largest of them being the sale by Reed International of its paints and DIY division to William Holdings. There were five management buy-outs the largest involving the MFI Furniture Group.

The largest bids in 1987 were in fact ones that failed. Mention has already been made of BTR's failure to acquire Pilkington in a bid that was launched in 1986. Two other major bids that were launched in 1986 – Gulf Resources' bid for IC Gas and Tate and Lyle's bid for Berisford – were also abandoned early in 1987. In September 1987 both Benlox Holdings and the Mountleigh Group launched bids in the region of £2 billion for the Storehouse Group, but both failed in the wake of the October stock market crash. Towards the end of the year Barker and Dobson tried to swallow up the Dee Corporation in another £2 billion transaction but this too was to end in failure. These

TABLE 1
Transactions by Deal Type and Value, UK, 1987

Value of Consideration £ million	Deal Type	
	Acquisition and Merger	Divestment and Management Buy-Out
0 < .5	46	23
.5 < 1	41	12
1 < 2	57	42
2 < 5	89	40
5 < 10	53	30
10 < 25	49	37
25 < 50	32	19
50 < 100	16	7
100 & over	29	14
Value not disclosed	25	33
Total	437*	257†

* Includes 15 acquisitions pending.

† The total includes 23 management buy-outs.

TABLE 2
Transactions Exceeding £25 million

Value of Consideration £ million	Deal Type				
	Acquisition	Merger	Divestment	Management Buy-Out	Total
25 < 50	28	4	17	2	51
50 < 100	14	2	7	–	23
100 & over	25	4	9	5	43
Total	67	10	33	7	117

TABLE 3
Top 66 Deals 1987
(Value exceeding £50 million)

<i>Acquiror</i>	<i>Target</i>	<i>Deal Type</i>	<i>Value £m</i>
TSB Group	Hill Samuel Group	A	777
Argyll Group	Safeway Food Stores	A	681
British & Commonwealth Holdings	Mercantile House Holdings	A	550
Reed International	Octopus Publishing	A	534
Maxirace	MFI Furniture Group	MB	505
Compagnie du Midi	Equity & Law	A(H)	457
Sears	Freemans	A(HP)	429
FKI Electricals	Babcock International	M	415
St. Paul Companies	Minet Holdings	A(FP)	370
Equiticorp (NZ)	Guinness Peat Group	A(H)	356
Mountleigh Group	Stockley	A	355
Next	Combined English Stores	A	323
Williams Holdings	Reed International (Paints and DIY division)	D	285
Rank, Hovis, McDougal	Avana Group	A(H)	282
Mountleigh Group	Pension Fund Property Unit Trust	A	271
Willis Faber	Steward Wrightson Holdings	A	266
RTZ	MK Electric	A(HP)	263
Private Investors	Hays Group	MB	255
British Airways	British Caledonian	A(H)	250
Ferranti	International Signal & Control	M	249
Granada	Electronic Rentals Group	A(HP)	249
United Newspapers	Extel Group	A(H)	246
Woolworth Holdings	Super Drug Stores	A	235
Tesco	Hillards	A(H)	228
International Thompson Org.	Associated Book Publishers	A	209
Forcefern Ltd	Martin CTN Group	D	202
British Commonwealth Holdings	Abaco Investments	A(FP)	189
Hawley Group	British Car Auction Group	A	182
ASW Holdings	Allied Steel & Wire	MB	181
Whitbread	James Burrough	A	170
Scottish & Newcastle	Matthew Brown	A(H)	170
Hudson Place Investments	International Leisure Group	MB	150
APV Holdings	Baker Perkins	M	147
Ohbayashi	Financial Times HQ	D	143
Gilbert House Investments	Singer & Friedlander Holdings	D	143
Atlantic Computers	Comcap	M	138
Williams Holdings	Berger, Jensen & Nicholson	D	133
Brent Walker Group	Lonrho (Metropole Casino Division)	D	128
GEC	TI's Creda Domestic App. Division	D	126
City Quest	Wickes	MB	120
Bass	Horizon Travel	A	101
Mount Charlotte Investments	International Leisure Group	D	100
Amec	Brent Walker Group	D	100
Evered Holdings	London & Northern Group	A(H)	99
Belhaven Group	Garfunkels Restaurants	A	94
Rosehaugh	General Funds Investment Trust	A	90
Brent Walker Group	Trocadero Development	D	90
Colorol Group	Crown House	A	87
Avis Europe	CD Brammell	A	87
Morgan Crucible	Holt Lloyd International	A	83
Suter	Mitchell Cotts	A(H)	76
BET	Scott Greenham Group	A	75
Private Investors	R H Group	D	74
Godfrey Davis (Holdings)	Sunlight Services Group	M	70
Hepworth Ceramics	TI Glow Worm	D	64
Kennedy Brookes	Barclays Hotel Group	D	64
Control Securities	London & Edinburgh Trusts	D	62
Raine Industries	Aberdeen Construction Group	A	61
Brookmount	Trafalgar House	D	60
Aurora Group	Hampton Trust	A	60
Gilbert House Investments	Centrovincial Estates	A	59
Randsworth Trust	London & Provincial Shop Centres	A	59
Mecca Leisure Group	Astley's, Ladbroke Holidays	D	55
Inspectorate UK Holdings	United Leasing	A	53
Kennedy Smale	McLeod Russel	M	52
Granada Group	WSL Holdings	A	52

A = Friendly Acquisition

M = Merger

D = Divestment

MB = Management Buy-Out

A(H) = Hostile Acquisition

A(HP) = Hostile Acquisition, Pending

A(FP) = Friendly Acquisition, Pending.

and details of the other big fish that got away in 1987 are shown in Table 4.

Takeover and merger activity is big business for the advisors. Who were the leading advisors in 1987?

The information that is readily available is far from complete so the information contained in Tables 5 and 6 must be treated with caution. It is based not on income but simply on the number of times a company appeared as an advisor. Table 5 relates to advice given to acquiring firms only and to all such firms in 1987 whether they were successful or unsuccessful in their bids. Advisors to target companies are not included because there are too many gaps in the information. For financial, legal and broking services the table lists the ten leading

advisors out of a total number in each case of around eighty. For public relations advice over sixty firms in all were listed and Table 5 shows the leading six. Table 6 gives the same information for the leading advisors in the 66 largest deals whether the advice was given to the acquiring company or the target.

As would be expected in a year of intense merger activity there was a great deal of comment during the year on matters relating to merger policy and in particular on whether in the UK the cards are not stacked too heavily in favour of mergers. Calls for the introduction of a tougher policy with the onus of proof switched to the acquiring company to demonstrate benefit fell on deaf ears. The Secretary of State produced a White Paper 'DTI – the department for Enterprise' in January 1988 which leaves merger policy substantially unchanged. The Monopolies and Mergers Commission is to take less time in completing

TABLE 4
Major Unsuccessful Bids of 1987

<i>Bidder</i>	<i>Target</i>	<i>Value £m</i>
Benlox Holding	Storehouse	2007
Barker & Dobson	Dee Corporation	1984
Mountleigh Group	Storehouse	1800
Associated British Foods	S. W. Berisford	767
Gulf Resources	I C Gas	750
Williams Holdings	Norcros	540
Tate and Lyle	Berisford	478
Brierley (New Zealand)	Equity and Law	452
Ratners Group	Combined English Stores	294
TSB	Hogg Robinson Group	282
Tops Estates	Pension Fund Property Unit Trust	270
Banque Paribas	Pension Fund Property Unit Trust	270
Midsummer Leisure	Boddington Group	263
Legrand SA (France)	MK Electric	248
Thornton Pacific Investment Trust	TR Pacific Basin Invest. Trust	230
Blue Circle Industries	Birmid Qualcast	217
SAS	British Caledonian	110

TABLE 7
Transactions by Deal Type and Value: January–March 1988

<i>Value of Consideration £ million</i>	<i>Deal Type</i>	
	<i>Acquisition & Merger</i>	<i>Divestment & Management Buy-Out</i>
0 < .5	20	9
.5 < 1	16	6
1 < 2	17	9
2 < 5	25	18
5 < 10	18	13
10 < 25	9	9
25 < 50	—	6
50 < 100	6	3
100 & over	3	2
<i>Value not disclosed</i>	8	9
<i>Total</i>	122	84

TABLE 5
Leading Advisors to Acquiring Firms

	<i>Financial</i>	<i>Legal</i>	<i>Broker</i>	<i>P.R.</i>
1	S G Warburg	Slaughter & May	Cazenove	Streets Financial Strategy
(	Morgan Grenfell	Linklaters & Paines	Hoare Govett	Binns Cornwall
(	Lazard Brothers	Herbert Smith	Rowe & Pitman	Charles Barker City
(	Kleinwort Benson	Clifford Turner	Phillips & Drew	Dewe Rogerson
5	Hill Samuel	(Travers, Smith, Braithwaite	A Laing & Cruickshank	Broad St. Associates
6	Rothschild	(Nabarro Nathanson	De Zoete & Bevan	Valin Pollen
7	Hambros Bank	Freshfields	Capul-Cure Myers	
8	Baring Brothers	Clifford Chance	Panmure Gordon	
9	County Bank	Allen & Overy	L Messel	
10	Robert Fleming	Herbert Oppenheimer	Scrimgeour Vickers	

TABLE 6
Leading Advisors in Big Deals

	<i>Financial</i>	<i>Legal</i>	<i>Broker</i>	<i>P.R.</i>
1	S. G. Warburg	Slaughter & May	(Hoare Govett	Streets Financial Strategy
2	Morgan Grenfell	Linklaters & Paines	(Cazenove	Dewe Rogerson
3	Kleinwort Benson		de Zoete & Bevan	

merger references and the Office of Fair Trading is to be given wider powers in making deals with companies, but that's about all. In his article Christopher Fildes reviews the development of UK merger policy. Sir Godfray Le Quesne, recently retired as Chairman of the Monopolies and Mergers Commission, examines critically the decision by the Secretary of State to reduce the time taken over merger references.

Apart from the concern expressed over unscrupulous and illegal tactics in contested take-over battles the other main issue in 1987 was that of our accounting procedures and, once more, whether accounting for acquisitions and mergers is too lax, making it unduly easy for acquiring firms to divorce financial performance from underlying realities. The issues are taken up in Professor David Tweedie's article.

The prospects for 1988 are that an active market for corporate control will continue. The effect of the stock market crash of October 1987 seems to have been slight and business confidence

continues to be high. In the first three months of 1988 there were over 200 transactions in the Infocheck database, and the breakdown of these transactions by deal type and value is shown in Table 7. Early in the year BP was successful in acquiring Britoil in a deal worth around two and a half billion pounds. Two other successful large deals were divestments – one involving Hanson Trust's sale of Ross Young Holdings to United Biscuits for a consideration of around £330 million, the other the sale of RTZ Cement Ltd to Scancem of Scandinavia in a deal worth around £230 million. Divestments and management buy-outs continue at a high level, amounting to 40 percent of all deals over the first three months of the year.

The major failures so far in 1988 have been Barker & Dobson's unsuccessful £1.98 billion bid for the Dee Corporation and Blue Circle Industries' failure to gain control of Birmid Qualcast. There is little sign as yet however of any significant abatement in merger activity.

2

THE MONOPOLIES AND MERGERS COMMISSION AT WORK

Sir Godfray Le Quesne, QC

On 25 November, 1965, the Monopolies and Mergers Commission signed the first merger report. The merger proposed was between the British Motor Corporation and the Pressed Steel Company. The inquiry had lasted just over three months – from 20 August to 25 November. In addition to the evidence of the parties to the merger, written evidence was submitted by a handful of bodies and oral evidence given by one. The report extends to 19 pages.

The first merger inquiry over which I presided concerned the proposed merger between Eurocanadian Shipholdings, Furness Withy and Manchester Liners. It lasted from 28 November, 1975 to 6 July, 1976 – over seven months. In addition to the parties to the merger, 40 bodies submitted written evidence and oral evidence was given by 11. The report extends to 41 pages.

On 4 November, 1987 the Commission signed its report on the proposed merger between British Airways and British Caledonian. The inquiry had begun on 6 August, so had lasted just under three months. In addition to the parties to the merger, 71 bodies and 44 individuals submitted written evidence and 19 bodies gave oral evidence. The report extends to 89 pages (much larger pages than were used in 1965 and 1976).

These three snapshots illustrate clearly two developments. The first is that merger inquiries have been becoming more and more elaborate. As experience of these inquiries has grown, the scope of topics regarded as possibly relevant by the companies concerned and their advisers has grown also. At the outset of an inquiry there is a natural inclination to put forward material on any matter which may ultimately prove helpful to a party's case. This expansion of the topics considered has been accompanied by growing intensification of their treatment. Facts and circumstances are more exhaustively considered and presented in greater and greater detail. The Fair Trading Act, 1973, under which merger inquiries take place, is not an outstandingly straightforward statute, and as years go by its provisions are scrutinized and argued more and more minutely.

Such a development is bound to occur when similar issues have to be considered repeatedly in relation to different facts. All that is involved does not reveal itself at once on the first occasion. One line of argument leads to another, and different facts may suggest different approaches to the question. The intensity and ingenuity with which merger inquiries are pursued seems also to have been affected in recent years by the enormous sums of money at stake and the bitter contention with which some merger struggles have been conducted.

The volume of material submitted to the Commission to assist it in deciding whether a proposed merger may be expected to operate against the public interest has therefore increased. Meanwhile the Commission itself has not been immune from

the same influences. The scope of its investigations has grown and also the detail of its reports. When I first became a member, in 1974, the Commission had only recently appointed its first staff economists. Nowadays no merger inquiry is conducted without the participation of economists at every stage, and every report contains much material contributed by them. Large parts of a report consist of summaries of the evidence and the arguments of the parties, and expansion of these parts has been inevitable as the submissions of the parties have themselves expanded. In addition, recent reports contain much more detailed accounts of the relevant market and more extensively argued conclusions than reports of 20 years ago.

The second development concerns the length of the inquiries; and the relationship between this and the first development contains a surprise. Increasing elaboration might be expected to lead to increasing time. So, for some years, it did. Inquiries became longer as they became more complicated. For years the period allowed for completion of a merger inquiry was always six months, and the extension of three months for which the Fair Trading Act provides was sometimes required. Since 1986 there has been a conspicuous change. Some criticism was being expressed of the length of merger inquiries, and ministers of the Department of Trade and Industry asked the Commission to see if they could be shortened. The Commission's efforts have achieved notable success. In the course of 1987, and the first month of 1988, 8 merger inquiries were completed. With the exception of the Tate & Lyle/Berisford/Fernazzi case, which was a double inquiry of very unusual complexity, none of them took more than four months, and four of them only three. This reduction of time has not been the consequence of merger inquiries becoming any less complicated or elaborate. The scale of the inquiries is undiminished. It is tightening of procedure which has enabled the Commission, with the cooperation of the parties, to complete them more speedily. For merger inquiries the process has been salutary (though it has been carried out at some cost to the expedition of other parts of the Commission's work). Any body which is constantly repeating accustomed procedures may find it difficult to be constantly vigilant for opportunities of improving details or saving time. Such vigilance may need to be prompted by some stimulus from outside. The Commission deserves credit for what it has succeeded in doing since 1986, but its very success shows that previously it did not avoid this difficulty.

However, pressure for greater speed may continue to be exerted. If the Commission has managed so much, can it not manage more? Three months is a less serious period of delay than six months, but two months would be better still. The Commission, it may be said, has halved the average period of merger inquiries by tightening its procedure, so it should be

able by adapting its procedure to shorten the period still more. Such arguments have attraction for those in industry whose natural desire is to minimize the extent and the duration of any possible interference with the free course of business. (This feeling, in my experience, is not always shared by parties to a merger which has actually been referred. Their concern is often to persuade the Commission to allow them as much time as possible for presentation of their case.)

Such arguments cannot be ignored, nor should they be resented. The work of the Commission inevitably involves it in imposing burdens upon parties referred to it, but it always tries to minimize those burdens and to reduce as much as possible the inconvenience caused by its inquiries. This attitude is applicable to the duration of inquiries as much as to other aspects of procedure. If there is a serious desire in the commercial world for shorter inquiries, it is right for the Commission to consider that and, up to a certain point, to do what it can to meet the desire. The Commission exists for the business world, not the business world for the Commission.

To the question whether the Commission's procedure could be adapted so as to reduce the length of merger inquiries to two months, the answer must be that it could. The existing procedure was devised to meet the time of six months chosen by Parliament. If Parliament had chosen a time limit of two months, procedure would have been devised to meet that. It would not be impossible, therefore, to devise such procedure now; but there would be a price to be paid. The reduction of time which the Commission has already achieved has been made without loss of any of the essential features of the existing procedure. Manifestly, however, there must be a limit to what can be done in this way. It is impossible to expect that everything which can be done in six months can be done in two. There comes a point at which procedure can be tightened no further. It may still be possible to reduce the time needed for inquiries, but beyond that point it can only be done by cutting parts of the procedure out.

This gives the clue to the point up to which, as I have suggested, the Commission should be prepared to do what it can to meet a desire expressed by the commercial world for shorter inquiries. It is the point at which further shortening would mean such changes as would make the procedure inappropriate for the work which the Commission has to do. Speed is a desirable feature of a merger inquiry, but achievement of speed cannot ultimately be the controlling consideration. The controlling considerations must be the conduct of the inquiry in a way which attracts the confidence of all parties concerned by giving them fair treatment, and the production of a report which covers all relevant matters and gives the Secretary of State the information which he needs to carry out his functions. If other objectives were to be given priority over these, the consequences for the system of merger control would ultimately be very serious.

It is therefore useful to consider the principal characteristics of the Commission's task. The most important of these is that the Commission's report, if its conclusion is that the merger may be expected to operate against the public interest, gives the Secretary of State power to prohibit the merger. (In practice the consequences of such a conclusion go beyond this. There has only been one case in which the Secretary of State has ever allowed a merger to proceed in spite of a conclusion of the Commission that it might be expected to operate against the public interest.) In other words, the Commission's report may lead to company A being prohibited from buying the shares of company B and the shareholders of company B being prevented from selling their shares to company A. This purchase and sale, although lawful in all other respects, is prohibited, as a result

of the Commission's report, for the protection of the public interest.

This constitutes a significant interference with ordinary legal rights. I do not suggest that such interference should not be possible. On the contrary, there is obviously a very strong argument for the view that in this field private rights must in appropriate cases yield to the public interest. Parliament so decided in 1965, and since then no government has sought to change the position. Nevertheless, the interference is a serious matter. If it is to be widely acceptable, it must not be undertaken without very good reason clearly established. All parties who would be affected, or believe they would be affected, by the merger must be given the opportunity to state their views, and those views must be properly considered. The Commission must investigate all matters which it thinks may bear upon the significance of the merger for the public interest. The reasons for its conclusion must be clearly set out in the report.

This points to a second characteristic of the Commission's task – the scope of the inquiry which it conducts. One feature of the Fair Trading Act in particular widens that scope. The Commission has to decide whether the merger may be expected to operate against the public interest. The Act provides (by s.84) that in doing this 'the Commission shall take into account all matters which appear to them in the particular circumstances to be relevant' (and among other things shall have regard to the desirability of five matters particular set out).

In practice there are certain questions which figure prominently in practically every inquiry, the foremost being competition; but the language of s.84 means that there is no limit to the matters which may have to be considered in relation to the public interest. An example of an inquiry turning upon an unaccustomed issue is that into the proposed merger between Elders IXL and Allied Lyons in 1986. The principal question was that of the soundness of the very complicated financial arrangements which Elders proposed to make for the merger. Another issue which has had to be considered in the past is that of the effect upon a British company of transfer to foreign ownership; and there have even been cases which have turned largely upon personal considerations affecting individuals concerned in the bid.

When the proposed merger between Elders IXL and Allied Lyons was referred, the Secretary of State specified the financial issue which he thought to be important. It is very unusual, however, for him to do this. A reference is normally made without any statement by the Secretary of State of the reasons for making it or the issues which it may raise. These matters will have been discussed by the Director General of Fair Trading in his submission tendering advice to the Secretary of State, but it is necessary for the Commission at the outset of its inquiry to take a wide-ranging look at the companies and the market concerned, in order to identify possible issues affecting the public interest in the particular case. It may find itself as a result faced with an investigation of an unfamiliar problem, or of the significance of a familiar subject, such as competition, in highly specialized fields (e.g. the inquiry into the proposed merger between G.E.C. and Plessey in 1986).

In conducting its survey and considering the issues which emerge the Commission carries out its own investigation over the whole field, though members of its staff are sometimes supplemented by consultants. It also considers material put before it by the parties to the merger. This material, as I have said, has become increasingly voluminous and detailed. It has to be carefully analysed, and discussed at hearings with the parties submitting it. In addition submissions are always received from third parties who believe they will be affected by the merger or suggest some way in which it will affect the public

interest for good or ill. If the Commission considers that the position of either party to the merger may be prejudiced by material received from any source, it must put that material to the party and allow an opportunity for comment.

A third characteristic of the Commission's task is that it has no power itself to stop a merger. If it concludes that a merger may be expected not to operate against the public interest, there is no power at all to stop the merger. If it concludes that a merger may be expected to operate against the public interest, there is power to stop the merger, but this power is conferred by the Fair Trading Act on the Secretary of State, not on the Commission. Having reached its conclusion, the Commission has power only to recommend what action the Secretary of State should take (e.g. to stop the merger or to allow it subject to undertakings). The Commission's conclusion that the merger may be expected to operate against the public interest enables the Secretary of State to exercise his powers under the Act, but he is not obliged to do so, nor if he decides to do so is he obliged to exercise his powers in the manner recommended by the Commission. He decides at his discretion whether to accept the conclusion and the recommendations of the Commission.

I was often asked while I was at the Commission whether I found it irksome that the Secretary of State was free to follow or not a conclusion reached by the Commission at the cost of great labour. I always answered that, so far from finding this irksome, I considered it the correct constitutional position. It is right, in my opinion, that the ultimate decision, whether in a particular case the public interest should prevail over private rights, should be taken by a minister answerable to Parliament.

This position does, however, have an important consequence for the form of the Commission's report. The Secretary of State receives the report and nothing more. He does not receive any of the material submitted to the Commission. The report, which under the Act the Secretary of State is obliged to publish, contains all that the Commission wishes to say. The Commission always refuses to add to it either publicly or privately, by comment or answers to questions or in any other way. It is therefore essential that the report contain a summary of the evidence and the Commission's reasoning sufficient to show how the Commission came to its conclusion and recommendations and to enable the Secretary of State to decide whether he should follow and adopt them. This means that the preparation and writing of the report is bound to be a substantial undertaking. The fact, to which I have referred, that the Secretary of State has only once decided not to accept a conclusion of the Commission adverse to a merger may be some indication that the Commission's reports have been adequate to carry conviction to him. The Secretary of State is obliged by the Fair Trading Act to publish the Commission's reports, so it is also important that each report contain enough material to explain and support its conclusion. For this purpose too the reports seem to have been adequate. Some of the Commission's conclusions have naturally been criticized, but I have never heard any complain that a report did not contain enough material to explain the conclusion.

I draw attention to one more characteristic of the Commission's task. Like virtually all tribunals in this country, it has a duty to act fairly – in accordance, as lawyers sometimes say, with the requirements of natural justice. The most important of these is the requirement that every party before the Commission must be given a fair opportunity to state its case to the Commission and to comment upon allegations made against it. This has an obvious effect upon the time needed for carrying out an inquiry. Adequate time must be allowed to the parties for the preparation of their submissions, and the Commission must be careful to ensure that all the arguments and all the evidence upon which

it may wish to rely in dealing with a party's case are put to the party with a fair opportunity for comment.

In making these requirements, the law does not require any more than the Commission would itself be disposed to do quite apart from legal control. In my experience, the Commission has always been anxious to treat parties with consideration and to ensure that nobody has cause to complain of any unfairness or discourtesy. Nevertheless, it is an important fact that the duty to act fairly is a legal duty, enforceable by the courts. Proceedings for judicial review have been taken against the Commission on a number of occasions, and have become more frequent in recent years. I confess to some pride in the Commission's record, for no allegation of unfairness made against the Commission has ever been upheld by the courts.

The increased frequency of these legal proceedings in recent years is not due to any relaxation of the Commission's standards. The most likely reason for it is that the enormous sums of money now at stake in some merger contests make it worthwhile for some parties to take proceedings though the prospects of success may be small – or even for the purpose of delaying for a time the final decision of the Secretary of State. However that may be, one consequence of greater readiness to resort to the courts must be even greater vigilance on the part of the Commission to avoid giving occasion for such resort. Even if the final outcome is favourable, litigation makes very heavy demands on the Commission's staff and resources.

I have shown that, in spite of the growing complication of merger inquiries, the Commission has made great efforts, and successful efforts, to reduce their length. It is right that these efforts should be continued. When suggestions are made from commercial or political quarters for shorter inquiries to reduce the burden of references, the Commission does not disregard them. It must meet these desires, to the extent that it can do so without falling short of the necessary standard of its work.

At the same time, the demands which those standards make must be recognised. The Commission's functions are functions which cannot be discharged with haste. They should be discharged with all reasonable and practicable speed, but what speed is reasonable and practicable must be judged with due regard to the nature of the task. It is surely clear from the characteristics to which I have drawn attention that the time required for the Commission's work is bound to be much greater than that within which an individual might reach a quick (not to say superficial) decision. There would be no profit to anybody in improving upon the Commission's time limits which made it impossible to conduct inquiries in a fair and proper way.

It is clear that such time limits would bring no benefit to the parties to a merger referred to the Commission. I have already observed that the desire for shorter inquiries is not always shared by parties to a merger actually referred. Once a reference has been made, the principal interest of each party is in having its case fully presented and carefully considered. This is not to say that parties to a reference are necessarily indifferent to the length of the inquiry. The bidding party, at least, often wants the earliest possible decision. What is certain, however, is that any party, faced with a choice between a longer inquiry with full opportunity to present its case and meet its opponent's arguments and a shorter inquiry with a less adequate opportunity, would unhesitatingly choose the longer. Time limits which might make it impossible to allow such full opportunities would bring no advantage to parties referred.

From the public point of view, it is desirable that the burdens imposed by merger control on industry and commerce should be no heavier than necessary, and therefore, that merger inquiries should not be unnecessarily prolonged. However,

the principal public interest must be that merger control be effective and acceptable. It cannot be effective unless it is based upon thorough investigation of the circumstances and full consideration of the advantages and disadvantages alleged in each case. It is unlikely to be acceptable unless it provides fair treatment of the parties and fair consideration of the arguments they wish to present. There would be no public advantage in any time limits which might make it impossible for the Commission to act effectively and fairly in carrying out its inquiries.

Merger control has now been practised in this country for

more than twenty years. After such a period a reassessment of procedure is appropriate. It was salutary for the Commission to be challenged to shorten merger inquiries, and by its response the Commission has achieved a significant saving of time. This very success may lead to the maintenance of pressure for still greater savings. It is important now to recognise that speed is not the only object nor the most important object of the procedure of control. Pressure for shorter inquiries must not be increased to a point at which it could threaten the effectiveness and the integrity of the Commission's work.

3

CURRENT DEVELOPMENTS IN TAKEOVER ACCOUNTING

D. P. Tweedie

INTRODUCTION

Until the October 1987 slide in Stock Exchange values takeover activity had been growing rapidly in conjunction with the bull market. In 1986 there had been 695 recorded acquisitions, almost 50 percent higher than in 1985 and the highest annual total since 1973. Industrial and commercial companies' expenditure on acquisitions and mergers within the UK reached £13.5 billion in 1986, almost double the 1985 total of £7 billion (British Business, 6 Feb. 1987). The 1986 figures include the two mega-takeovers which became effective in the spring of that year (Hanson/Imperial and Guinness/Distillers at around £2.5 billion each). Although there was some change in the post-Guinness climate (and particularly after the Stock Market fall) the high level of takeover activity continued in 1987.

There has, however, been criticism of some of the accounting practices adopted, or alleged to have been adopted, by certain predator companies. Defending companies have alleged that some predators have taken advantage of the accounting standards to make their financial performance look better. These concerns have been shared by, among others, Government ministers and officials and the CBI. Linked with this concern has been the criticism of the over-flexibility of the accounting rules concerned.

ACCOUNTING FOR BUSINESS COMBINATIONS

Merger v Acquisition Accounting

A business combination occurs when two companies are brought together into one accounting entity. The new entity carries on the activities of the previously separate, independent enterprises. Two forms of accounting are acceptable in dealing with business combinations, namely the merger method and the acquisition method. Before going any further it is probably important to note the differences between these two approaches.

Merger accounting is considered to be an appropriate method of accounting when the two sets of shareholders continue or are in a position to continue their shareholdings as before but on a combined basis. In such situations few, if any, assets leave the combined group, the takeover being effected by a share exchange. The changes made to the individual items in the accounts are minimal. In essence, the assets, liabilities and profits of companies whose shareholders will receive shares issued by the offeror company (the offeror) are simply added to those of the offeree. Assets of the offeree company (the offeree) do not have to be recorded at fair values and the offeree's entire profit in the year of the merger is brought into the consolidated

accounts, even if the combination takes place just before the offeror's year-end.

The consideration paid is recorded by reference to the nominal value of the offeror's shares issued; market value is ignored. Because market values are not applied goodwill does not arise in merger accounting – a major advantage which we shall discuss later.

In acquisition accounting one company is deemed to have bought the other. In these situations the acquired company's assets are stated at fair values and its results are brought into the group accounts only from the date of acquisition. Finally, in calculating the consideration offered, the shares given in exchange are valued at market value, i.e. inevitably a premium over nominal value arises (shown in a share premium account) and because the value of the consideration tends to be higher than the fair value of the net assets being purchased a surplus (goodwill) normally arises. This goodwill has then to be written off immediately against the group's reserves or amortized over its useful economic life against profit.

Merger accounting has obvious initial attractions when compared to acquisition accounting:

- (1) As assets do not have to be recorded at fair values depreciation will be lower;
- (2) As no goodwill is created there is obviously no obligation to write it off against profits or reserves;
- (3) Profits will show a higher absolute number for the year of combination than when acquisition accounting is adopted;
- (4) In general, pre-merger retained profits of the offeree remain available for future distribution if required. (On many occasions all retained profits can be distributed.)

The differences between merger and acquisition accounting can be illustrated as follows:

Example – Merger and Acquisition Accounting

1. Merger accounting rules

	A	B
Ordinary share capital	200	100
Retained profits	80	160
	<u>280</u>	<u>260</u>
Net assets	<u>280</u>	<u>260</u>

A offers 2 shares for 1 (200 shares) to shareholders of B and records the investment in B at the nominal value of shares issued.

	A
Ordinary share capital (200 + 200)	400
Retained profits	80
	<u>480</u>
Net assets	280
Investment in B	200
	<u>480</u>

Consolidation of A + B

under merger rules

	A	B	Adjustment	Consolidated
Ordinary share capital	400	100	(100)	400
Retained profits	80	160	(100)*	140
	<u>480</u>	<u>260</u>		<u>540</u>
Net assets	280	260		540
Investment in B	200	—	(200)	—
	<u>480</u>	<u>260</u>		<u>540</u>

* Effectively £100 of B's reserves are capitalized.

2. Acquisition accounting rules

- Assume
- A's shares are valued at £2, this would value B at £400
 - the value of B's assets at the time of the combination amounted to £310.

	A
Ordinary share capital (200 + 200)	400
Share premium	200
Retained profits	80
	<u>680</u>
Net assets	280
Investment in B	400
	<u>680</u>

Consolidation of A + B

	A	B	Adjustment	Consolidated
Ordinary share capital	400	100	(100)	400
Share premium	200	—		200
Retained profits	80	160	(160)	80
	<u>680</u>	<u>260</u>		<u>680</u>
Net assets	280	260	50	590
Goodwill	—	—	90	90
Investment in B	400	—	(400)	—
	<u>680</u>	<u>260</u>		<u>680</u>

Note the share premium, goodwill (400–310) and the revaluation of B's assets (to 310) – none of which appears under merger accounting rules. A further point to note is the reduction in the group's retained profits from £140 under the merger rules to £80 under the acquisition rules.

Goodwill

For companies using the acquisition method goodwill can create a major problem. SSAP 22 states that goodwill, which is the difference between the fair value of the consideration given and the aggregate of the fair value of the separable net assets acquired, should normally be eliminated from the accounts immediately on acquisition against reserves (the preferred option) or it may be eliminated by amortization over its useful economic life. A charge to the profit and loss account by way of amortization is unpopular because it results in a lower earnings per share (EPS) figure than would otherwise be reported. Given the importance analysts and management appear to attach to the EPS, which rather naively, is assumed to encapsulate all that is important about a company's performance, amortization is not a widely-used policy. It is often only used if a company's reserves are not sufficiently large to accommodate the immediate write-off of goodwill or if an overseas parent (usually North American) requires it.

The absence of appropriate reserves has, however, not appeared to be a major obstacle: some companies have used the revaluation reserve to write off goodwill, others have applied to the Courts for a reorganization of capital even though in good financial health and have sought Court approval for the cancellation of their share premium account to enable them to create a reserve against which they can write off goodwill. (The use of the share premium account is restricted in law, *inter alia*, to writing off expenses or discounts on the issue of shares or debentures or providing for premiums payable on redemption of debentures.) Others have simply written off goodwill to a 'goodwill write-off' reserve with an initial balance of nil. The result, of course, is a negative reserve which is then deducted in arriving at shareholders' equity. Despite some protests to the Department of Trade and Industry, the Department has found nothing illegal in the practice.

Other companies who opted for the amortization route have presented their auditors with problems in assessing whether the company's estimate of a lengthy economic life is indeed justifiable. Still others have tried to classify goodwill as something completely different (e.g. magazine titles, and then have argued that as the value of such titles does not diminish depreciation can be avoided).

SSAP 23 AND MERGER RELIEF**The legality of merger accounting**

Until the beginning of the 1980s there had long been a dispute in the United Kingdom as to whether merger accounting was legal. One argument stated that provided the contract for acquiring shares in the offeree specified only the number of the shares in the offeror which would be issued to purchase the offeree's shares and not the value of the offeror's shares there was no requirement to reflect the value of the shares in the books of the offeror. In other words, no share premium account needed to be set up since the shares having not been stated to be issued at premium were, accordingly, not being issued at premium. Others took the contrary view and maintained that the true value of the new shares was their market value and consequently it would be quite unrealistic to maintain they were not being issued for that value simply because the contract did not spell it out in words. In practice a number of groups adopted the merger accounting method on the basis of legal opinions of the kind outlined above. This state of affairs continued, a little uneasily, until March, 1980 when a tax case caused a furore by deciding that merger accounting was not permissible (*Shearer (Inspector of Taxes) v Bercain Limited*). It was decided

that where shares are issued in acquiring an asset the true value of the asset determines the value of the shares issued and the full amount must therefore be brought into the accounts of the issuing company whether by way of nominal value or share premium. Merger accounting could, therefore, not be adopted after that date and those who used the method in the past were then placed at the risk of having their past (and continuing) merger accounting treatment challenged. After initial reluctance to do more than merely nibble at merger accounting, the Government was finally persuaded by representations from the CBI and from the legal and accountancy professions that it should be permitted in its entirety. The Companies Act 1981 (now incorporated in the Companies Act 1985) legalized the situation for those combinations where merger accounting had already been used and enabled it to become an accepted part of accounting treatments thereafter. The law now enabled companies to take advantage of merger relief, which:

- (a) did not require the premium on the shares to be taken to a share premium account; and
- (b) enabled the premium to be omitted from the book value of the shares (or other consideration) acquired. The share premium, therefore, need not be accounted for at all by the issuing company: the transaction could be recorded at nominal value.

The relief applied to *individual* companies not to groups and gave them the choice of showing the cost of a subsidiary at the nominal value of the shares issued *or* at the market value of the shares. Where the latter choice was made an 'other' reserve, commonly known as a 'merger' reserve, would be created rather than a share premium account. The profession's Accounting Standards Committee (ASC) was now free to determine the appropriate criteria for determining when a business combination could be accounted for using the merger method.

SSAP 23

The ASC duly produced a Statement of Standard Accounting Practice (SSAP 23 Accounting for Acquisition and Mergers) in April, 1985. It stated that a company had the option of accounting for a business combination as a merger if all of the following conditions were met:

- (a) the business combination resulted from an offer to the holders of all equity shares and holders of all voting shares which were not already held by the offeror; and
- (b) the offeror secured, as a result of the offer, a holding of:
 - (i) at least 90 percent of all equity shares (taking each class of equity separately); and
 - (ii) the shares carrying at least 90 percent of the votes of the offeree; and
- (c) immediately prior to the offer, the offeror did not hold:
 - (i) 20 percent or more of all equity shares of the offeree (taking each class of equity separately); or
 - (ii) shares carrying 20 percent or more of the votes of the offeree; and
- (d) not less than 90 percent of the fair value of the total consideration given for the equity share capital (including that given for shares already held) was in the form of equity share capital; not less than 90 percent of the fair value of the total consideration given for voting non-equity share capital (including that given for shares already held) was in the form of equity and/or voting non-equity share capital.

Companies which would otherwise have failed narrowly to meet the criteria for merger accounting and yet wished to use this method of accounting for a business combination have

simply constructed transactions to comply with the requirements of the standard. The techniques used include:

(a) *Vendor placings and vendor rights.* Since 90 percent of the consideration given for equity shares must be in the form of equity shares if merger accounting is to be used, a problem arises if the offeree's shareholders prefer cash rather than the offeror's shares. In such a situation the offeror simply exchanges shares with the target company and the shares issued are then placed in the market by a merchant bank on behalf of the target company shareholders who then receive cash. A variation of this technique is known as vendor rights. In such cases the shares issued are ultimately offered to the offeror's existing shareholders rather than simply placed in the market. Since a major condition of SSAP 23 is that in a merger no significant cash resources should leave the group (see criterion (d) above), rather than that the two groups of shareholders should continue as one, the techniques meet the requirements of the standard.

(b) *Preference share issues.* Another method of enabling the target shareholders to receive cash is to arrange that the target company issues preference shares to its equity shareholders before the takeover is agreed. These shares are then bought for cash by the acquiring company.

(c) *Bed and breakfast holdings.* Another obstacle to be overcome before merger accounting can be used is the condition that the offeror must not initially hold 20 percent of the offeree's shares. Where this condition has been violated it has been possible for companies to sell, on a temporary basis, sufficient shares in the target company to some understanding financial institution to reduce the offeror's stake below 20 percent before making the takeover offer and then to re-acquire these shares as part of the share-for-share offer for all the other shares.

Merger Relief

Initially, it was widely expected that merger relief would be used only in combination with merger accounting. That, however, has not turned out to be the case – companies using the acquisition method have increasingly taken advantage of the merger relief provisions of the Act. The criteria enabling companies to take advantage of statutory merger relief are drawn much wider than the requirements for merger accounting under SSAP 23. For merger relief to apply there are only two basic conditions to be met:

- (a) the issuing company must have acquired at least a 90 percent equity holding in another company; and
- (b) it must have done so in pursuance of an arrangement providing for the allotment of equity shares in the issuing company as a consideration for the deal.

The rules do not state what proportion of equity shares must be issued by the offeror. Merger relief, under Section 131 of the Companies Act 1985, is available where, under the arrangement, the acquiring company provides other consideration, for example a cash payment or the issue of loan stock in addition to an issue of its own shares. There is no restriction on the type of consideration which may be included in the transaction in addition to a share for share exchange. Consequently, only a very few shares need to be exchanged and merger relief may remain available (although the amount of the relief may be negligible in such cases).

The much wider availability of merger relief compared to merger accounting is illustrated by the following:

- (a) there is no 20 percent limit to the amount of any pre-offer holdings of equity shares;
- (b) there is no 10 percent overall cash limit;

- (c) the relief is available in the normal takeover situation where the offeror wishes to build up a significant holding in advance of making a formal offer.

In addition, by showing the investment at the nominal value of the shares issued, the distribution of pre-acquisition profits is facilitated. (The only restriction to onward distribution by the parent company of dividends received from a subsidiary would arise if the distribution by the subsidiary reduced the value of the parent company's investment below book value. Given the low value at which the investment is likely to be shown if nominal value is used this is unlikely to happen in practice.)

The effect of merger relief with acquisition accounting can be illustrated as follows (using the previous example):

2. Acquisition accounting with merger relief

Assume: A's shares are valued at £2, this would value B at £400.

Merger Relief is applicable.

	A
Ordinary share capital (200 + 200)	400
Retained profits	80
	<u>480</u>
Net assets	280
Investment in B (at nominal value)	200
	<u>480</u>

Consolidation of A + B

	A	B	Adjustment (1) (2) (3)	Consolidated
Share capital	400	100	(100)	400
Merger reserve	—	—	200 (90)	110
Retained profits	80	160	(160)	80
	<u>480</u>	<u>260</u>		<u>590</u>
Net assets	280	260	50	590
Goodwill	—	—	90 (90)	—
Investment in B	200	—	200 (400)	—
	<u>480</u>	<u>260</u>		<u>590</u>

While A can use the nominal value of the shares used to purchase B in its own accounts (s131 and s133 Companies Act 1985), SSAP 23 requires that the full value of the consideration is shown in the group accounts when acquisition accounting is adopted. Consequently, for consolidation purposes the investment would be valued at £400.

The creation of a merger reserve rather than a share premium account when adopting statutory merger relief assists in the writing off of goodwill (shown in the example). This elimination of goodwill coupled with other features of acquisition accounting has led some commentators to observe that the combination of acquisition accounting and merger relief is the best of both worlds.

The earlier example showing acquisition accounting could result in a similar consolidated balance sheet if the share premium account had been changed, by application to the Courts, (as explained above) to another reserve and goodwill then written off against the newly-created reserve. Otherwise, if instant write-off were adopted goodwill would have eliminated

the £80 of the retained profits, leaving a deficit of £10 to be made good by future profits.

As mentioned earlier, merger accounting enables a high absolute level of profit, i.e. the combined annual profit of the two companies can be shown in the year of acquisition. Acquisition accounting, however, coupled with merger relief can lead to a steeply rising trend of profits from the time of the combination although initial profits will be lower than under merger accounting. In situations where the requirements for merger accounting are met, management, since the use of merger accounting is optional, can choose the profit profile it requires. Companies which fail to meet SSAP 23's criteria for merger accounting but which nevertheless are entitled to take advantage of merger relief do not of course have the option and have to use acquisition accounting.

Reorganization Provisions

The rising trend of profits resulting from acquisition accounting can be assisted by the use on acquisition of provisions to cover:

- (i) liabilities of the acquired company which are deemed to exist at the date of acquisition though previously unrecorded;
- (ii) the costs of integrating and reorganizing the acquired company;
- (iii) reductions to fair value of the acquired company's assets; and
- (iv) estimates of future operating losses of the acquired company.

The effect of these reorganization and other provisions is that expenses or losses crystallizing in future years can be charged against the provision instead of against the revenue of future years. The only effect at the time of acquisition is to increase the amount of goodwill (since net assets acquired are reduced as a result of the provision). Goodwill, as we have seen above, can be written off to reserves and, consequently, the provision will not effect the level of profits shown. Frequently, it is suspected that over-prudent provisions are created which are then fed back into profits in future years when it has become manifestly evident that provisions were excessive. Such write-backs help to increase the trend of profit or to smooth out bad years in the future. Reductions in asset values have similar effects; for example, an excessive write-down of stock can lead to windfall profits in the future when the stock is sold.

While merger accounting avoids the problem of goodwill recognition, reorganization provisions would have to be written off to profit in the year of combination, which is usually done by showing these charges as extraordinary items.

THE FUTURE

Merger Accounting

In May 1987 the ASC announced that the Standards on goodwill and acquisitions and mergers would be reviewed as a matter of urgency. The DTI has also been concerned and around the same time wrote to certain interested parties such as the professional accountancy bodies and the CBI asking whether there was too much flexibility in SSAPs 22 and 23, whether the various options led to abuse and what action should be taken.

The ASC and the Government are looking at the rules overseas and perhaps from there a guide to the future may be seen.

Like SSAP 23, the International Accounting Standard (IAS 22) gives the option of using acquisition accounting. It allows merger accounting only if the shareholders of the

combining enterprises 'achieve a continuing mutual sharing in the risks and benefits attaching to the combined enterprise'. Further requirements are that the basis of the transaction is principally an exchange of voting equity shares and that, effectively, the whole of the net assets and operations of the combining enterprises are combined in one entity. Under such a system it would seem possible that arrangements such as vendor placings, vendor rights and the acquisition of preference shares would not be allowed.

In the USA, companies wishing to use merger accounting would have to meet a large number of criteria, the main ones being that:

- the combining enterprises should be autonomous, i.e. not subsidiaries or divisions of another enterprise;
- each of the combining enterprises is independent of other combining enterprises;
- equity shares should be issued and exchanged for at least 90 percent of the equity of the other company;
- only equity shares with identical rights to the majority of the acquiring company's existing equity can be issued in exchange; and
- the combination must be completed in accordance with a specific plan in less than one year.

If the list of conditions are all met then merger accounting must be used.

The Canadian Institute of Chartered Accountants has a far more subjective criterion for determining whether merger accounting can be used. Rather than a set list of conditions as in the USA, merger accounting is only allowed when 'two or more companies are joined together through an exchange of voting shares' and where 'none of the parties involved can be identified as an acquirer'.

For example 'A company which distributes cash or other assets (or incurs liabilities) to obtain the assets or voting shares of another company (or business) is clearly the acquirer. In situations where voting shares are issued or exchanged to effect the combination, the factors relating to control over the resultant combined company must be considered. One of the factors is the extent of holdings of voting shares in the combined company by the shareholders (as a group) of any of the combining companies. A company whose shareholders (as a group) hold more than 50 percent of the voting shares of the combined company will normally be identified as the acquirer' CICA Handbook Section 1580.

Where these conditions pertain merger accounting can be allowed since it is deemed that a pooling of interests has taken place 'in the sense that the shareholders combine their resources to carry on in combination the previous businesses'. In other words merger accounting should be used to account for what the CICA deems 'those rare business combinations in which it is not possible to identify one of the parties as the acquirer'.

Goodwill

As far as goodwill is concerned, the International Accounting Standard, like the United Kingdom's SSAP 22, allows an option of amortizing goodwill in the profit and loss account over its economic life or writing it off in total against reserves.

In North America such flexibility is not allowed. In both Canada and the United States goodwill arising on acquisition

has to be written off to profits over a period not exceeding 40 years.

UK Accounting

Undoubtedly change will come in the United Kingdom. The present method which will enable a company to make two identical acquisitions during a year and account for one as a merger and one as an acquisition with, as can be seen from the example, entirely different accounting results, is clearly neither acceptable nor understandable. Further guidance is certainly needed here.

Some commentators have argued that merger relief should only be allowed with merger accounting. This, however, is probably not a major issue – if companies were forced to use acquisition accounting and show the premiums on shares issued at market values in a share premium account rather than a 'merger' reserve, the Courts would, unless the law were changed, presumably still allow reorganizations of capital and enable companies to write off goodwill against the new reserve created by redesignating the share premium account.

There are, however, other more fundamental questions to be answered.

- (1) What is the nature of goodwill? Can we accept that goodwill is constantly being regenerated – while purchased goodwill may depreciate, new factors may result in the value of a company's goodwill remaining constant or even increasing. (In the same way as maintenance expenditure can preserve the value of a building.) In such cases does it make sense to account for goodwill as if it were declining in value? Why are we depreciating goodwill if no loss has occurred and the subsidiary could be sold with its goodwill intact? Since the law (i.e. the EC Fourth Directive) forces us to write down goodwill over a period should the law be changed? If such a philosophical change is too much for the EC to accept could a more pragmatic amendment enable goodwill to be amortized over its lifetime but charged to reserves to stop the present practice whereby some companies suffer a so-called reduction in profit by amortization through the income statement while others write off goodwill direct to reserves and leave the annual profit figure intact?
- (2) Should the assets of the offeree be revalued at a time of business combination no matter whether merger or acquisition accounting is used? Indeed, it could be argued that all parties to the combination should restate the carrying amounts of their assets and liabilities to fair value at the date of combination to enable readers to obtain a more realistic picture of the financial strength of the new group.
- (3) Should guidance be issued on the types of reorganization provisions which can be made and should disclosure of such provisions be increased?

The present state of accounting for business combinations is in some turmoil. Changes are undoubtedly coming although final agreement will not be achieved without a great deal of argument. The simple facts are first, that many companies like the rules the way they are and will not agree to change too readily, and second that the ASC has little power to push through radical proposals.

4

UK MERGER POLICY

Christopher Fildes

Merger policy in Great Britain got off to a bad start, turning out, when it was needed, not to be there at all. It has been limping behind events ever since, making, as now, the occasional spurt but never catching up.

It began, a generation ago, when Imperial Chemical Industries bid for Courtaulds – the largest takeover bid yet seen, bitterly contended, and in every sense a matter of public interest. A Member of Parliament in the Courtaulds camp asked the Government of the day to refer the bid to the Monopolies Commission. He was told that, as the law then stood, there was no power to make such a reference while the bid was in progress – though, of course, if it succeeded, and if it appeared to create a monopoly, the Commission could then be asked to have a look at it.

From this fatuous response derives the legislation which now governs mergers. They were made the Commission's business, and the words 'and Mergers' were implanted into its title. The City, under strong driving from the Bank of England, established its own code for takeovers and mergers, concerned not with the merits of mergers but with fair and open dealing. The Office of Fair Trading (OFT) followed, and brought with it a new layer of complication.

At the end of all this, we have a system which is elaborate but imprecise. The law defines its interest in mergers by two tests, the market share of the combined businesses, or the size of their capital – at figures to which inflation can be swift to give new meanings. It is a catch-all, and nothing could be wider than the test which the law requires a merger, once caught into the process of scrutiny, to pass – that is, whether it would tend to operate against the public interest.

The system is then left to be operated at the discretion of the minister of the day. He can intervene at every turn. He can and does set his own figures for size of capital, decreeing how big a merger must be before it concerns the system: *de minimis non curat minister*. He then hears from the Office of Fair Trading, which must recommend to him whether a merger should be referred to the Monopolies and Mergers Commission, but that advice does not bind him, either way. He can refer a merger which the OFT would have let go, or let go a merger which the OFT would have referred. In most cases this decision determines a merger's fate, because the Commission takes six or nine months to pronounce, which is longer than boards of directors like to leave themselves at risk. Offer documents have a standard clause allowing the bidder to back out if his bid is referred to the Commission. If a merger does go to the Commission, its conclusions need not, even then, bind the minister. He cannot ban a merger which the Commission would have permitted, but he can permit a merger which the Commission would have banned. It is and was bound to be a

system where policy is made by the length of the minister's thumb. Different ministers, different thumbs – and some ministers have been all thumbs.

By the early 1980s policy had degenerated into a confusion of ad hoc decisions and inconsistent precedents. Companies desperate to fight off a bid would seek to enlist their local MPs and their trade unions, and if they had the right ones, could often work up enough steam to generate a reference. The Commission, asked to rule on rival bids for the Royal Bank of Scotland, turned both down on grounds which included the need to preserve career opportunities for Scottish bankers. The minister, overruling the Office of Fair Trading, referred to the Commission an American bid for Sothebys, the auctioneers – which meant that the bid was dropped. It appeared that a firm of Parliamentary lobbyists, observing that Sothebys employed a number of royal friends and connections, had pulled strings at the Palace. A City poet received the decision sourly:

God bless the Queen and her relations.
And keep us in our proper stations.

Norman Tebbit, arriving at the Department of Trade and Industry, decided to clear out the jumble and replace it with a principle. The length of his thumb acquired the status of an Imperial measure. Merger policy, he decreed, was to be about competition and nothing else. This would be the test which the Office of Fair Trading would apply in scrutinizing mergers and deciding whether to recommend that they should be referred to the Commission, and this, of course, would be his own test. In effect he rewrote the law, and defined the public interest, by which the Commission has to judge mergers, in one precise sense. Tebbit's law had, and was intended to have, the prime merits of clarity and certainty; those who would be governed by it would know where they stood.

The lawgiver was unlucky in his moment. Such reforms come best in quiet times. This came at the beginning of a takeover boom which, on both sides of the Atlantic, was without precedent. We can now see it more clearly. It came with the worldwide deregulation of financial markets (Tebbit's Law being only one instance), with the flow of investment across frontiers, with the shift in finance away from lending and towards the issue of tradeable securities, and with the sustained bull market in equity shares. Paper gave the bidder his currency. The grouping of shares into institutional hands gave him easy access to his customers. A typical British company would have two-thirds or more of its shares owned by institutions, so that a short tour of fund managers would quickly establish what kind of offer they would accept.

In such conditions, the effect of Tebbit's Law was paradoxical. It meant that there was no outside limit on mergers, provided

that the bidder was moving into an area which was new to him. If a tar-boiler wanted to buy another tar-boiler, he risked having to run through the course of the OFT and the Commission. If, instead, he decided to buy a toffee-maker or a light railway or a bill-broker or some other business outside his experience, no-one would stop him. These conglomerate mergers flourished. The extreme example came at the top of the bull market, when a manufacturer of supermarket trolleys came under new management and took over the world's largest advertising agency, whilst another advertising agency was attempting to take over a high street bank.

The merger boom gave the markets a new vocabulary. A company would be said to be put into play, when a shareholding was put together, ready to be sold on to an eventual bidder. The man with the saleable shares was an arbitrageur. Sometimes the company could persuade him to go away, for a consideration, and this was called paying greenmail. Sometimes it took a poison pill, deliberately reconstructing itself so as to lose its attractions to a bidder. Its directors might do sweetheart deals, selling the best bits of the company on favourable terms to themselves. They might kit themselves out with golden parachutes – contracts which would compensate them richly for having to leave their jobs.

The grossest excesses were American. The US system of statutory regulation, so often praised as professional, could not for years detect that the leading arbitrageur was playing with marked cards, obtained by corrupt means. The City Takeover Panel, so often derided as amateurish, could at least check abuses committed by the defending side – by reference to its first principle, that shareholders great and small were entitled to equal treatment. That, though, was to open the door even wider for bidders.

Was the door too wide, was the Law too simple? Opinion began to swing the other way. The City found itself accused of taking a short-term view of industry – of being too ready to take a quick profit, and in the process to eat up the seedcorn of development. A test case was made of BTR's bid for Pilkington. Here, it seemed, was a company which believed in acquisition going for a company which believed in research. BTR wisely withdrew from the battlefield. Guinness lacked such wisdom. It charged ahead to win its battle for Distillers, by fair means or – innovative. It escaped reference to the Monopolies and Mergers Commission by coming to terms with the Office of Fair Trading, airily offering to discard a brand or two of Scotch.

The merger boom had become an embarrassment, and the government's responses showed as much. There was a drive on malpractices in the market. A blanket of financial regulation came down on the City. The Takeover Panel, which had indeed been gulled over Guinness, got a new chairman. So did the Monopolies and Mergers Commission. A controversial bid for Wedgwood was referred to the Commission, ostensibly on grounds of market share – but other objections had been raised, and the reference killed the bid. A review of merger policy was announced, to be conducted, economically enough, by the official who had conducted the last one.

His report went to a brisk new minister, Lord Young, who briskly proposed laws of his own. Tebbit's Law was to remain in force. Competition would still be the test. Beyond that, the public interest would only be invoked and defined in terms of protecting national security and defence capabilities, and then only in exceptional circumstances. (There is a residual power under the Industry Act, never tested, to block foreign takeovers of British industrial companies of strategic importance.) What Lord Young wanted was the Tebbit system, made more businesslike. Companies with mergers in mind would have the

option to approach the Office of Fair Trading and ask for clearance. If their plans were simple, they need do no more than fill in a simple form. Then, if they had heard no objection from the OFT within four weeks, they could consider themselves free to go ahead. There would be provision for bargaining giving unexpected authority to the principle established in an unofficial way by Guinness. The OFT would be prepared to negotiate terms for its blessing, and these would then be legally binding on the companies. All this will need to be watched with care. There is an obvious danger of inequity in a system which allows one party to a merger to make a deal with the OFT behind the scenes, while other parties with legitimate interests might know nothing about the dealing until it was over, and be denied the chance to make their case.

It seems odd to streamline the OFT's procedure while appearing to leave the Monopolies and Mergers Commission's alone, for of the two bodies, the Commission is by far the slower-paced. Such is its nature. The commissioners themselves are, all but the chairman, part-timers, with many other claims. Half a dozen of them will be formed into a panel to deal with a reference, and a regular item on the panel's agenda will be matching of diaries, to find a possible time and place for the next meeting. It would be sensible for the new chairman to ask his commissioners to take turns on a fire-brigade – a panel ready at short notice to deal urgently with an urgent case. He may well also ask for more resources, and a higher quality of back-up staff – for the highest Civil Service flyers do not, as a rule, fly and nest there.

The next reforms will come by courtesy of the European Commission. A directive on mergers is rumbling its way along the assembly-lines of Brussels. In its earlier design stages it looked legalistic. It could be expected, in the Bank of England's anxious judgement, to uproot the Takeover Code and Panel and replace them with a system operated through the Courts. The Code and Panel cannot, of course, supplant the law and are now more frequently tested in the Courts, which so far have tried to leave them as much scope as they reasonably can. To remove them, and replace them with the processes of the Courts, would produce a more cumbersome and less responsive system, and fit out Lord Young's streamlined machine with a jamming gearbox.

There remains the fundamental doubt over the definition of the public interest which Mr. Tebbit and Lord Young have now imposed. Should competition be the only test of mergers? If so, an immediate consequence is to give the conglomerate merger a clear run – to make it harder for companies to buy into businesses which they know something about, while freeing them to buy into businesses they know nothing about. Any creative draftsman of an offer document can demonstrate synergy between shoes and ships and sealing-wax, but making them into a coherent structure is another matter.

Experience suggests that governments cannot in practice maintain their indifference to mergers which involve the public interest in other ways. The existing law's special treatment of newspaper mergers is one instance. The treatment of bank mergers is another. These must pass the test of reciprocity. No foreign bank may do in Britain what a British bank would be unable to do in the foreign bank's home country. Only a fit and proper person, by the Bank of England's standards, may hold a sizeable shareholding in a bank. That is a power to protect the depositors from the consequences of a controlling or dominant shareholder who might harm them. Does not the same argument apply with equal force to life assurance companies, or fund management companies, or the managers of unit trusts? All of them have fiduciary relationships with

their customers, all can change hands without the customers' yea or nay. It can be argued that these are matters for the protection of investors and savers, rather than for merger policy – though mergers and takeovers of this kind have not so far set the watchdogs barking. For other kinds of merger, there are no watchdogs to bark. Reciprocity is a test for bankers but not for brewers. Raiders from overseas can move in on British companies and the British market, secure in the knowledge that their own home base is protected, and that no British company could expect to mount such a raid there. That is plainly a matter of public interest.

The Bank of England considers that there may be a public interest in the proposed financing of a merger, if it results in an unsound or over-extended business. There is no lack of financiers whose ingenious methods may run such risks. One

recent proposal involving a large public company set the Bank arguing, successfully, that there was a case to answer before the Monopolies Commission. Ministers now say that there will be no more such references. In another merger, also involving a large company, a would-be (or would-have been) rival bidder attempted to cast doubt on the identity of the successful bidder and of that bidder's sources of finance. If such doubts can legitimately be raised, there may well be a public interest in the impartial establishment of the facts.

It would be better to codify these and other tests of the public interest, in as definite and specific a form as can be. They would then stand behind competition, which is rightly the first test, but cannot be expected to be the only test. The alternative is to drift back into a succession of hard cases which make bad law. Better still to let Parliament, not ministers, make the law.

5

BRITISH ACQUISITIONS IN THE UNITED STATES

Steven J. Berger

1987 has seen a tremendous increase in the amount of money spent by United Kingdom companies on acquisitions in the United States, strengthening an already substantial flow of direct British investment in the US. A number of general economic and individual company developments which came together in 1987 have created an extraordinary environment for transatlantic takeover activity which may well carry into the next several years. US acquisitions also generally are the result of a clear emphasis by UK management on fulfilling a particular corporate strategic imperative, and the variety of these strategies has resulted in the acquisition by corporate Britain of a broad spectrum of American industry.

The level of US corporate takeovers by UK companies in 1987 has been substantial; over \$30 billion was spent on over 260 US acquisitions an increase of 105 percent over 1986's previous record level of merger and acquisition activity (\$14.6 billion spent on approximately 210 transactions). This activity has been widespread across a number of industries and included more large transactions than ever before. There were more transactions with a value in excess of one billion dollars than in any prior year, and these included:

- British Petroleum's \$7.8 billion acquisition of the 45 percent of Standard Oil it did not already own, the largest amount ever spent on a US acquisition by a British company.
- Hanson Trust's \$1.7 billion acquisition of Kidde.
- Imperial Chemical Industries' \$1.7 billion acquisition of Stauffer Chemicals, which is a direct result of another UK company's US purchase, Unilever's \$3.1 billion 1986 acquisition of Chesebrough-Pond's.
- Blue Arrow's \$1.3 billion bid, originally hostile, for Manpower Inc., the largest US temporary agency.
- Grand Metropolitan's \$1.3 billion acquisition of the Heublen drinks business.
- Ladbroke's \$1.1 billion acquisition of the Hilton Hotels chain from Allegis Corporation.

In addition, a number of well-known players in the domestic UK merger market over the last several years turned, or returned, to the US in 1987, including:

- BTR's \$230 million bid for Stewart-Warner Corporation
- Hawley Group's \$715 million purchase of ADT
- FH Tomkins' \$112 million acquisition of Smith & Wesson
- Bass' \$475 million acquisition of the international network of Holiday Inns from the US Holiday Corporation.

1987 – A NEW ENVIRONMENT

The British have long been active acquirors of businesses in the US, so it is not particularly remarkable to see a strong flow of

investment coming westward across the Atlantic. As every chief executive and corporate development officer knows, the US is a very large and attractive economy, most people speak English, the country's customs and ethics are the least foreign of any, and the legal systems at least have a common basis. An important question remains, however; why particularly have we seen such a tremendous increase in recent activity?

A number of developments at both the individual firm and general economic level appear to have come together in 1987 to create an extraordinary environment for transatlantic acquisitions by British corporations. There are a number of general business and financial trends which developed over the last several years, in particular, which made 1987 a big year for US investment.

The most fundamental factor for British companies has been the longer term recovery of the domestic economy. Britain under Thatcher in the 1980s generally has been a good place for business; after several years of forcing business to restructure in order to become more competitive, corporate profitability and growth in Britain has rapidly been improving for the past several years. This in turn has created quite recently an environment where more and more firms have been able to turn their energies towards aggressive growth strategies, including acquisitions in order to achieve growth, having put their own domestic shops in order, and increasingly this has included international acquisitions.

The resurgence of corporate profitability has in turn helped to fuel a rampant bull stock market, at least up until October 1987. The bull market created a valuable acquisition currency, often for the first time, for the typically medium-sized (by US standards) firms which dominate various industrial and consumer segments of the UK economy. By year end it became clear, at least for certain companies, that the post-crash market was still willing to underwrite acquisition-related equity financings for transactions with industrial logic.

In a more subtle way, Thatcher's Britain has influenced the takeover game through the aggressive encouragement of the entrepreneur. Certainly by mid-1987 the UK stock market had come to believe so heavily in the 'rainmaking' powers of certain individuals that it was possible for acquisition-related equity financings to get underwritten beyond the scope of anything seen previously. The WPP Group's acquisition of the J. Walter Thomson advertising group is a tribute both to Martin Sorrell's dealmaking skills and to a top of the market phenomenon which allowed the necessarily immense rights issue to get underwritten.

At the level of the individual company, clearly the improved profitability of most businesses, the improved prospects for the British economy in general, lower UK domestic corporate tax rates and improved international competitiveness have all combined to make managements more comfortable about the

prospects for their home base of business and more aggressive about expansion. In addition, the leadership of a great many UK corporations has changed in the last several years so that there is, in many ways, a new class of chief executives and financial men running corporate Britain, a great many of whom are young, aggressive, firm believers in entrepreneurial growth strategies and keen to make their mark.

One of the most fundamental of forces at play in transatlantic acquisitions by corporate Britain continues to be the ongoing change in the structure of many industries which were previously fragmented and divided by geography. The globalization of products, markets and competition, whereby substantial national differences have been reduced or eliminated, has provided the rationale for a number of takeovers. Companies increasingly feel that they have outgrown their home market in the UK and are looking to expand into a bigger market, or in some cases are precluded from further expansion within the UK or the EEC for monopolistic reasons. In such circumstances, the US is often identified as a market with numerous structural similarities to that of the UK. In addition, many companies seek to acquire new technology that can be applied to existing markets, as evidenced by the high number of relatively low value electronics acquisitions, and seek to integrate vertically by securing sources of supply or outlets for their products.

US ACQUISITIONS – ANYTHING SPECIAL?

Making an acquisition in the US is considerably different from, and often more difficult than, making an acquisition at home. There are different stock exchange and other regulatory matters to consider, the legal risk of encountering significant litigation is much higher in the US, financing structures for transactions are considerably different, target company management's reactions to bid approaches are more difficult to read – the list goes on and on.

A British firm making an acquisition in the United States therefore is clearly seeking something special by making a US acquisition. In order to compensate for the increased risk (real or perceived) of making an overseas acquisition, UK management appears to have higher expectations with regard to return on investment for US acquisitions than for capital investments in their home businesses. These higher required returns are not always expressed as such, but often are evidenced by a general reluctance to 'stretch' on a particular deal.

Each US acquisition for a British company contains an element of, at least, one crucial strategic imperative which can be significantly different from those which are most important in a domestic UK situation. Several of these strategic imperatives have been highlighted in this year's rush of merger activity, and each has had implications for how the particular deal was analysed and the degree of enthusiasm with which it was pursued.

BUILDING FOR SCALE AND MARKET SHARE IN A GLOBAL INDUSTRY

One key strategic imperative is that of building for scale in what is perceived to be a globally competitive industry, of which Imperial Chemical Industries' \$1.7 billion acquisition of Stauffer Chemical from Unilever is a particularly good example. ICI acquired the Stauffer business in order to strengthen its position in the consolidating world market for agricultural chemicals. Stauffer's agrichemical business is one of the world's largest and is a good fit with ICI's existing agrichemical business

around the globe. After a very thorough analysis of the potential transaction, an analysis which included the opportunity costs of losing as well as winning, ICI was willing to pay the best price for a property which was heavily auctioned, even though they knew going in that they would want to dispose of several of Stauffer's large non-agraceuticals businesses (which they have subsequently completed).

Another example of an acquisition for reasons of control in the face of increasing global competition is British Petroleum's \$7.8 billion acquisition of the 45 percent publicly-held minority position in Standard Oil. After years of living with the minority outstanding, BP decided that it was important for control and strategic reasons to bring Standard Oil completely within the group.

ACQUIRING SCARCE RESOURCES

While traditionally the strategic imperative of acquiring a business due to its possession of scarce resources has been a consideration most relevant in the natural resource and energy fields, increasingly man-made resources such as branded products and market position are being viewed as worthy of significant scarcity value in an acquisition. In the recent rush to consolidate the global advertising agency industry, Saatchi and Saatchi, and others, have placed an historically unusual degree of value on intangible assets such as clientele, brand franchise and human resources. The consolidation under way in each of the world's major financial markets is in part an example of a similar recognition that certain businesses have been exceptionally successful at creating a consumer franchise for a particular name or image, that this franchise has transferable value, and that it can generate revenues and profits which could not be attained as easily or in as timely a manner by organic growth in a globally consolidating industry.

ACQUIRING A STRATEGIC FOOTHOLD

Another common strategy behind a US acquisition is a line of reasoning which goes as follows: 'I need to get into the US market somehow because in the long run the US will be critical to my growth prospects, but I don't know much about the market. Therefore I will try to find an attractive niche business to acquire with a significant emphasis on finding one which, no matter how hard I try, I cannot really get too wrong.' There are a surprising number of acquisitions made by foreign companies in the US where this no-downside foothold mentality dominates. This strategy again completely dominates the manner of acquisition investigation which is undertaken and the price paid. Management of the US business needs to be high quality and retained, the end user markets must be resilient, and the product must be well made and respected. While FH Tomkins undoubtedly has impressive plans to grow the business and profits of Smith & Wesson, the downside in an acquisition such as this must be limited and will allow the Tomkins management team to enter a US line of business with a good product and market share with limited risk to the overall strategy of the group.

ACQUIRING FOR OPPORTUNISTIC ADVANTAGE

The US domestic takeover market has increasingly in the 1980s become an arena for hostile and sometimes highly-levered takeover activity. These 'raiders' – both corporate and individual

– have typically sought to take advantage of what they perceive to be an imperfection in the stock market's pricing of a particular stock. The last several years have seen a meaningful increase in the number of British companies playing the US takeover market in an opportunistic manner. The most noted examples are Hanson Trust's 1986 acquisition of SCM and 1987 acquisition of Kidde. Again, the strategy behind the acquisition dictates the analysis preparation, and price thinking which ultimately goes into making a bid. All the legal, tax, regulatory and other ramifications of a bid made with the intent to break up the target and sell off all or most of the pieces must be considered in excruciating detail in these cases, and more typical corporate acquisition considerations regarding management and operating synergies are moot. Success will be determined by quickly making disposals at attractive prices rather than by gradually building a profitable business operation over time.

Opportunities also arise with regard to specific financing techniques which are not available to British corporations at home, particularly with regard to leveraged acquisitions. In 1987 John Crowther Group made two acquisitions in the US: LD Brinkman, the largest distributor of carpets and a natural extension of Crowther's UK businesses was acquired for \$58 million. Crowther also participated with Shearson Lehman Brothers in the \$93 million leveraged acquisition of The McCall Sewing Pattern Company. This business has strong fashion-related synergy with Crowther's apparel businesses, but negative net worth due to dividends taken by the former owner. A straightforward acquisition would have been impossible due to the goodwill involved, so a leveraged, off balance sheet investment was structured to make the acquisition. The

availability of debt and equity finance in the US for this sort of transaction occasionally provides unique opportunities for British companies to gain control of businesses which they might otherwise miss out on.

IMPLICATIONS FOR 1988 AND BEYOND

It is too early to tell (in late 1987) what the long term impact on the level of international merger activity will be in the wake of the October global equity market crash. We are already seeing pressure on deal pricing following the substantial share price decline, and the availability of acquisition finance, particularly highly-leveraged finance in the US and equity finance in the US and UK, is uncertain. In addition there is currently some concern about the strength of the US economy in 1988. All of this can be expected to act as some sort of a brake on transatlantic merger activity in the early part of 1988.

The longer term developments, however, continue to suggest that the strong level of British takeover interest in US corporations will continue. The British economy and UK corporate profitability are expected to continue to be strong in 1988, the pound/dollar relationship is expected to continue to be favourable to British acquirors, many major industries will continue to be consolidated on a global basis while the US will continue to be the breeding ground for new and internationally applicable technologies. The longer term economic development of Britain and the international competitive strategies of corporations in the UK lead one to conclude that the current invasion of the British is likely to remain strong over the next several years.

6

THE EXTENT, NATURE AND CAUSES OF MERGERS

K. D. George

Over the four-year period 1984–7 the UK experienced the largest merger wave in its post-war history, certainly in terms of the value of acquisitions if not in terms of their number. During this period several very large companies, many of them household names, were acquired, including Imperial Tobacco, Distillers, Coats Patons, British Home Stores and Debenhams. The first section of this article examines the extent and nature of mergers in recent years; the second section looks at the causes of mergers. (Although legally distinct the terms merger and takeover are used synonymously.)

THE EXTENT AND NATURE OF MERGER ACTIVITY

One of the most noticeable features of merger activity is that it occurs in waves, with periods of boom followed by periods

TABLE 1
Merger Activity within the United Kingdom, Industrial and Commercial Companies, 1968–78

	<i>Number acquired</i>	<i>Expenditure £m current prices</i>	<i>Expenditure £m 1987 prices</i>	<i>Expenditure as % of Gross Domestic Fixed Capital formation</i>
1967	763	822	8107	35
1968	946	1946	13 580	73
1969	846	1069	7549	37
1970	793	1123	8951	34
1971	884	911	6144	27
1972	1210	2532	13 409	67
1973	1205	1304	7982	27
1974	504	508	5296	9
1975	315	291	2423	4
1976	353	448	3118	6
1977	481	824	4472	8
1978	567	1140	5489	9
1979	534	1656	7025	12
1980	469	1475	5855	10
1981	452	1144	4024	8
1982	463	2206	6712	14
1983	447	2343	5636	15
1984	568	5474	11 069	28
1985	474	7090	11 614	29
1986	696	14 935	19 718	57
1987	1125	15 363	15 363	n.a.

Sources: Business Monitor MQ7; Economic Trends, Annual Supplement 1988 Edn.

Notes 1. Figures derived by using the FT Actuaries, Industrial (500 share) Index.

2. Provisional figures.

of relative calm. As Table 1 shows, the late 1960s and early 1970s was a period of intense merger activity both in terms of the number of acquisitions and expenditure on them. Over the seven years 1967–73 annual expenditure on mergers as a percentage of gross domestic fixed capital formation in the industrial and commercial sector averaged over 40 percent.

Merger activity was at a low level during the mid 1970s. There were signs of a resurgence in activity in 1978–9 and again in 1982 but the whole period from 1974 to 1983 was, by and large, one of relative calm. Over this ten-year period annual expenditure on acquisitions was, on average, less than 10 percent of gross domestic fixed capital formation.

In 1984, however, there was a big increase in expenditure and this expenditure, in real terms, peaked in 1986 at a level exceeding the previous peaks of 1968 and 1972. Although the number of mergers in 1986 was also up significantly on previous years the high level of expenditure in that year was due overwhelmingly to a handful of giant acquisitions, notably the Hanson Trust acquisition of the Imperial Group and Guinness' takeover of the Distillers Company.

The boom continued into 1987, and although real expenditure was about 20 percent down on the 1986 level the number of mergers shot up by about 60 percent, to attain the sort of levels that had been reached in the boom of the early 1970s. The contrast between 1986 and 1987 is illustrated by the fact that whereas in 1986 64 mergers accounted for 85 percent of expenditure, in 1987 it took around 200 mergers to account for the same proportion of expenditure. As in the late 1960s and early 1970s expenditure on mergers was high in comparison with expenditure on fixed capital formation, averaging nearly 40 percent over the three years 1984–6.

The information in Table 2 suggests that the intensity of merger activity is related to the state of both the financial markets and the product markets. The peak year of 1968 is followed by a fall in the stock market and to less buoyant product markets; the 1972 merger boom coincided with big gains in share prices and with a recovery in output from the 1970–71 recession; the low level of merger activity 1974–6 follows the fall in share prices 1973–4 and the slump in output 1974–5; the resurgence in merger activity 1977–9 is accompanied by steady gains of both share prices and output, a resurgence which is brought to an end by the recession of 1980–81. Finally the latest merger boom has coincided with several years of boom on the stock exchange and recovery from the 1980–81 recession.

The figures on mergers in Tables 1 and 2 include sales of subsidiaries between company groups. Over the period since 1969 the number of these transactions as a percentage of all acquisitions has varied from a low of 12.1 percent to a high of 36.5 percent. (Table 3). As a proportion of all takeovers the

TABLE 2
Expenditure on Mergers and Changes in Financial and Product Markets, 1967–87

	<i>Expenditure £m, 1987 prices</i>	<i>Industrial (500 share) index</i>	<i>Index of output of Production & Construction Industries</i>
		<i>% change on previous year</i>	<i>% change on previous year</i>
1967	8107	+ 6.8	+ 1.2
1968	13 580	+41.3	+ 6.3
1969	7549	– 1.1	+ 2.8
1970	8951	– 11.4	+ 0.1
1971	6144	+ 18.2	– 0.3
1972	13 409	+ 27.3	+ 2.0
1973	7982	– 13.4	+ 8.0
1974	5296	– 41.2	– 3.7
1975	2423	+ 24.9	– 5.4
1976	3118	+ 19.8	+ 2.5
1977	4472	+ 28.2	+ 4.2
1978	5489	+ 12.7	+ 3.6
1979	7025	+ 13.6	+ 3.4
1980	5855	+ 6.9	– 6.4
1981	4024	+ 12.8	– 4.6
1982	6712	+ 15.6	+ 1.9
1983	5636	+ 26.5	+ 3.7
1984	11 069	+ 19.0	+ 1.6
1985	11 614	+ 23.5	+ 4.1
1986	19 718	+ 24.1	+ 2.0
1987	15 363	+ 32.0	n.a.

Sources: Business Monitor MQ7; Economic Trends, Annual Supplement 1988 Edn.

TABLE 3
Sales of Subsidiaries between Companies

	<i>Number acquired</i>	<i>Number as % of all acquisitions</i>	<i>Expenditure £m 1987 prices</i>	<i>Average expenditure £m 1987 prices</i>
1969	102	12.1	704	6.9
1970	179	22.6	1004	5.6
1971	264	29.9	1116	4.2
1972	272	22.5	982	3.6
1973	254	21.1	1510	5.9
1974	137	27.2	514	3.8
1975	115	36.5	582	5.1
1976	111	31.4	694	6.3
1977	109	22.7	508	4.7
1978	126	22.2	785	6.2
1979	117	21.9	789	6.7
1980	101	21.5	835	8.3
1981	125	27.7	921	7.4
1982	164	35.4	2446	14.9
1983	142	31.8	1048	7.4
1984	170	29.9	2267	13.3
1985	134	28.3	1298	9.7
1986	159	22.8	3710	23.3
1987	219	19.5	3896	17.8

Sources: Business Monitor MQ7; Economic Trends, Annual Supplement 1988 Edn.

sale of subsidiaries tends to be highest during or immediately following periods of depression in financial and/or product markets such as 1970–71, 1975–6, and 1981–4.

An important feature of recent years has been the size of subsidiary sales. In real terms the average value of these sales

has been substantially greater in the 1980s than they were in the previous decade, with very large sales occurring in 1982, 1984, 1986 and 1987. In 1986 the average value of subsidiary sales (at 1987 prices) was £23.3 million compared to an average value of acquisitions of independent companies of £29.8 million. Provisional figures for 1987 show that the average value of subsidiary sales exceeded the average value of acquisitions of independent companies by some 40 percent.

The sale of subsidiaries is an inevitable product of merger booms as companies undo past mistakes and hive off acquisitions that have been unsuccessful. And the more diversified companies become, particularly in the medium-large size classes, the more likely it is that some asset disposals will prove necessary during the rationalization period following a merger; and the more likely also perhaps that takeover bids will be aimed initially at certain parts of a company rather than the company as a whole. Indeed in some recent cases (e.g. the Guinness takeover of Distillers) a bidder has been required by the Office of Fair Trading (OFT) to agree to the disposal of parts of the company it was seeking to acquire in order to avoid a reference to the Monopolies and Mergers Commission (MMC).

Another feature of 1986–7 was the strong upsurge in the acquisition of overseas companies. As a proportion of the total value of merger activity the figure for overseas acquisitions increased from 11.6 percent in 1985 to 18.3 percent in 1986 and to over 30 percent in 1987 (Table 4). Although not a record (overseas acquisitions were proportionately more important in 1980 and 1981) the total value of overseas acquisitions in 1987 was easily a record, well up on the previous year which itself was high in comparison with the average annual value of overseas acquisitions over previous years.

Mention has already been made of the importance of large mergers in explaining the peak level of expenditure in 1986. In more general terms the latest merger wave has been characterized by the increased vulnerability of very large companies. Over the period 1972–82 the pattern of death by merger amongst

TABLE 4
Expenditure on Acquisition of Foreign Companies by UK Companies

	<i>Number acquired</i>	<i>Expenditure: £m current prices</i>		<i>Expenditure: £m 1987 stock market prices</i>
		<i>Total</i>	<i>% of all merger expenditure</i>	
1969	43	29	2.6	206
1970	52	106	8.6	843
1971	62	73	7.7	492
1972	85	90	3.4	479
1973	88	179	12.1	1092
1974	53	121	19.2	1256
1975	18	41	12.4	344
1976	17	65	12.7	450
1977	18	143	14.8	775
1978	30	350	23.5	1684
1979	65	345	17.2	1462
1980	51	941	39.0	3734
1981	150	726	38.8	2555
1982	95	770	25.9	2344
1983	58	387	14.2	931
1984	74	816	13.0	1651
1985	64	932	11.6	1526
1986	89	3333	18.3	4401
1987	223	7048	31.5	7048

Sources: Business Monitor MQ7; Economic Trends, Annual Supplement 1988 Edn.

companies included in The Times 1000 list for 1972 was such that companies ranked in the top 200 in 1972 had approximately half the death rate of those with a lower ranking. For the period March 1982 to March 1986, however, the death rate for companies ranked 101–200 in 1982 turns out to be one of the highest and over three times higher than for the earlier period. In every case except one the predator was an even larger company.¹ In recent years therefore only the giants have enjoyed relative immunity from takeover.

Finally, what is the balance of merger activity between ‘horizontal’, ‘vertical’ and ‘diversification’? The classification cannot be unambiguous because many mergers contain elements of all three types of expansion. However, the OFT classification, based on merger proposals that fall within the scope of merger legislation shows that with the exception of 1985, when diversification mergers accounted for 54 percent by value of all qualifying mergers, horizontal mergers have continued to be the dominant type.

THE CAUSES OF MERGERS

Why do mergers occur at all, and why do they occur when they do? The two questions are related but the focus of attention here is on the former.

If there is one generalization that can safely be made about the causes of mergers it is that they are complex and managers undoubtedly enter into them for a variety of motives. Two seemingly obvious ways of ascertaining these motives, the direct method of questioning executives and the indirect one of deducing motives from effects are both fraught with danger. Executives may with the benefit of hindsight rationalize past decisions and fail to pinpoint the key influences in complex decisions. The method of deducing motives from effects is seriously flawed by the fact that mergers may fail to achieve their objectives. A firm may attempt, but fail, to increase its market power through acquisitions, another may end up with much increased market power as a result of acquisitions carried out for other reasons.

The vast majority of mergers are of course agreed and friendly and an important part of the explanation for them is frequently to be found in the motives of the acquired firm. For instance, a firm may have hit upon hard times and acquisition by a financially sound company may be the only way of keeping at least part of the capital and workforce intact. In other cases the owners of a company may search for a suitor in order to meet tax liabilities or simply to realize the benefits of past effort in building up a successful business. In this context of particular relevance is the concept introduced many years ago by Professor Austin Robinson of the firm of ‘pessimum size’, a size ‘which combines the technical disadvantage of smallness with the managerial disadvantage of being too large for individual control.’² In these circumstances acquisition by a larger company may be the only way – it will often be the safest way – of overcoming the financial and managerial obstacles to further expansion.

Although, then, the motives of acquired firms are important the survey that follows looks at the possible causes of mergers in the main through the eyes of acquiring companies.

Economies of scale

A frequently heard argument is that mergers result in the realization of scale economies. This may come about in a number of ways. First, there may be the possibility of benefiting

from product-specific economies as a result of increased specialization and longer production runs within plants. It may be argued that if there are big gains to be realized it should pay some firms to operate plants with these advantages, and these firms would gain market share at the expense of their less efficient competitors. However, if competitors produce overlapping product ranges the competitive process could well be prolonged and may indeed result in widespread price-cutting behaviour with all firms suffering lower profits and gaining little from increased specialization. By combining plants into a smaller number of firms mergers can result in the speedy rearrangement of production schedules and bring about benefits that could only be achieved, if at all, over a much longer period as a result of all out competition between existing firms.

Second, mergers may lead to plant-specific economies. For instance, an industry may be operating with chronic excess capacity, and if fixed costs are large, prices, although above short run average variable costs, may be well below unit total costs. Mergers would allow the speedy scrapping of the most inefficient plants and the concentration of production into a smaller number of the most efficient ones. Again, existing industry capacity may be no more than adequate to meet demand but individual plants may be of sub-optimal size; and even in an expanding market the incentive to build optimal sized units may be blunted because the optimal sized plant may be large in relation to annual increments in demand. Here too, the risks can be reduced and the willingness to build optimal sized units increased by the merger of competing companies. In principle, plant scale economies, where they are significant, should also be realizable as a result of sufficiently strong competition between independent firms. Once again, however, all-out competition may be prolonged, and managers may simply be unwilling to take the risks involved in building new plant in such a hostile environment.

Third, mergers may result in marketing economies as a result of such actions as the pooling of advertising campaigns, the sharing and rationalization of distribution channels, and the offer of a wider range of products to distributors.

That mergers may lead to scale-economy advantages is more easily argued than demonstrated. The evidence is far from being impressive. Very frequently the realization of scale economies is limited by customer demand for product differentiation; it may just as often fail to be exploited because of poor management. It was the author’s experience as a part-time member of the Monopolies and Mergers Commission that economies of scale arguments were badly argued. In part this may have reflected the firm’s own lack of conviction in the argument; in part it may have been due to the onus of proof being on the Commission to prove detriment rather than on the firm to prove benefit.

Complementarities

If one firm is strong in production but weak in marketing and financial control and another has the opposite characteristics a merger of the two should lead to substantial benefits. Similar motives may explain a vertical merger: a firm may acquire another because one supplies an important input for the other’s production process, or controls outlets for the other’s products.

Again it must be asked why these benefits cannot be realized by internal expansion and once more the answer may be found in part at least in market ‘imperfections’. If a firm wants access to research and development knowledge there may in practice be no alternative to acquiring a competitor, and in some industries, brewing is a good example, the limitation on the

number of sales outlets may make merger the only feasible means of forward integration.

Speed and safety factors

Even when internal growth is feasible merger is a quicker and often a safer way of growing. In some cases the emphasis on speed is simply a reflection of the importance of time in the estimates that a firm makes of the profitability of alternative courses of action. To take an extreme case, the time needed for internal expansion may be too long to save a firm from collapse. In the case of diversification there may be difficulties in moving into a new industry because of patent protection, the attachment of consumers to established brands, or because of the need to acquire new production and marketing skills. If a firm chooses to expand internally it has somehow to overcome these difficulties. The problems will often be solved more quickly by acquiring an existing firm with its own patents, brand names and appropriate management skills.

Merger may be a safer as well as a faster way to expand. This is most evident in those industries where there is excess capacity or where there is a danger that excess capacity will emerge because of sluggish demand growth. In these circumstances competitive investment plans carry the danger that output from additional capacity will drive down prices and profitability. Acquisitions on the other hand leave industry capacity unchanged. The desire to stave off competitive investment plans is undoubtedly an important factor in explaining horizontal mergers.

Monopoly power

'Whenever merger is considered to be the most profitable way to expand there will surely be a tendency for merger to occur. Economic analysis that treats it only as a means of reducing competition, or establishing monopolistic dominance, is placing the wrong emphasis on one of the most significant characteristics of the firm in the modern economy.'³

There is certainly no need to quarrel with the statement that firms will resort to external expansion when this is the most profitable course open to them. In many instances this will be accompanied by efficiency gains and benefits to consumers. However, mergers will be especially profitable when they result in an increase in market power or when they eliminate a threatened increase in the intensity of competition following for example from competitive investment expenditures. Furthermore, once a position of dominance has been established mergers may be a means of protecting it. The fact that mergers are often the most profitable way to expand does not therefore undermine the importance of the monopoly motive.

There is, however, a wider aspect of the market power/competitiveness issue which is of particular importance during times of economic turbulence. For the competitive process to work at all there must be some degree of market power. The expectation of achieving market power and thus increased control over the economic environment is an inducement to invest. The possession of market power gives firms both the willingness and ability to invest: a willingness, because the firm can expect to be the main beneficiary of its investment expenditures; the ability, because of the greater availability of finance and the necessary elbow room from short-run competitive forces that enables the firm to develop long-term strategies. At the same time the threat of competition from actual or potential competitors and the danger that someone

else might 'get in first' is an important stimulus and a fundamental part of the competitive process.

Neither the extreme of perfect competition nor that of simple monopoly can be regarded as approaching the ideal, but somewhere in between there exists what businessmen would regard as an acceptable balance between safety (monopoly) and competition. This balance is not easily defined or indeed maintained. Existing large firms have an interest in arguing the case for more market power than can easily be justified, and this has to be guarded against by appropriate competition policy. From time to time, however, major changes occur that fundamentally alter the market environment and which upset the balance. These changes may be brought about by such factors as the widening of markets resulting from improvements in transport and communication or a reduction in trade barriers; prolonged recession; changes in competition policy or regulatory policy, and changes in technology and techniques of management. Factors such as these help explain upsurges in merger activity which may last several years and which may also be experienced more or less simultaneously in several countries. Over the post-war period, for instance, all the industrialized countries of the Western world have had to contend with more intensive competition from imports. During the 1950s and 1960s several countries experienced a strengthening of antitrust legislation. Technical and managerial changes have created a revolution in the distributive trades, and, recently, deregulation has created a more competitive environment in the UK financial sector. The entry of new competitors, the introduction of more efficient forms of organization and so on, upsets 'traditional' balances. When this happens firms will look to merger as one means of protecting their positions and restoring the balance. And once some firms resort to this course of action it is likely to trigger off defensive acquisitions by others.

A market for corporate control

The most influential argument advanced in recent years to explain, and to justify, merger activity is that mergers are a sign of an active market for corporate control which ensures that assets are managed efficiently. Competition between rival management teams for the right to manage assets ensures the survival of the fittest (i.e. those with the best profit performance). The inefficient use of assets, or inflated discretionary expenditures by management teams at the expense of shareholders, results in poor profit performance weak share prices and the exposure of the firm to a take-over bid. The threat of takeover may itself be sufficient to force management to improve its performance. If not, the firm is likely to be acquired by another whose management sees the opportunity for more efficient use of the assets, improved performance, and increased benefits to shareholders. A free market in corporate control thus provides the best guarantee of efficiency in the use of existing assets. Without takeovers there would be no effective constraint on the tendency of management teams to inflate discretionary expenditures such as head office costs, staff costs, and wasteful research and development expenditures at the expense of shareholders.

For the market to work in this way the stock market must be efficient, in the sense that companies are valued according to their expected future profit streams. Of two companies, therefore, the one with the higher earnings prospects will have the higher share price. In addition there have to be a sufficient number of predators whose motivation it is to maximize shareholder returns.

The proponents of the view that the stock market does work efficiently base their case on evidence of share price movements before and after takeover bids. Their interpretation of the evidence is that takeovers result in substantial gains to the shareholders of acquired firms and also result in gains, albeit on a much more modest scale, to the shareholders of acquiring firms.⁴

There can be little doubt that takeovers do frequently occur because a predator sees an opportunity for making more profitable use of the assets of another firm. However considerable doubt exists over whether the market works in quite the beneficent way claimed for it by the free marketeers. Consideration of these doubts helps cast some further light on the causes of merger activity.

As mentioned earlier, for the stock market to operate efficiently share prices must reflect the expected future earnings potential of firms. There is little evidence, however, that it does so systematically or continuously. At the very least there is a considerable element of short-run disequilibrium embodied in share values which has an important impact on both the pattern and extent of merger activity. Some companies will at a particular moment in time be undervalued relative to their long-run earnings potential, and thus be vulnerable to a takeover bid from companies whose shares are properly valued or overvalued. In the GKN/AE reference to the MMC for instance, AE argued that its low share price was due to low dividend payments resulting from the priority it had given to investment in rationalization, modernization and research and development. Hepworth's bid for Steetley came at a time of reorganisation and rationalization when Steetley's profits and share prices were depressed. In the event both bids were blocked by the MMC although AE was subsequently acquired by T & N.

Measures to improve long-term competitiveness may, it would seem, make a firm vulnerable to takeover. Against this it may be argued that if shareholders are fully informed of the measures being taken, and are convinced as to their effectiveness, a firm would not be exposed to a takeover bid on this account alone. Mistakes would it is true be made because of uncertainty surrounding future prospects, but if this were all that was involved there would be little reason for believing that interference with the market would improve matters. However there are a number of reasons for believing that this may be too sanguine an interpretation of reality.

Even if shareholders are typically well informed about the measures that are being taken to improve long-run competitiveness they may still attach greater weight to dividends in the short-run than to the prospect of higher dividends in the future. For this reason alone short-run disequilibrium in share values will result in a bias against the survival of firms whose shares are temporarily undervalued.

The different expectations that are held about the future performance of companies, as reflected in financial indicators, may give their own added impetus. By the very nature of things considerable uncertainty surrounds stock market valuations especially during stock market booms. In judging future prospects however the empire builders will adopt the most buoyant expectations. If their buoyancy is supported by the stock market their companies will be accorded high Price-Earnings Ratios which will place them in a strong position to acquire companies whose shares are rated less highly. So long as the growth maximizers retain the confidence of the market and maintain their high P/E ratios they will be able to continue their expansion by acquisition and at the same time improve their apparent financial performance. During a merger boom much of this external growth may occur without any underlying gains in efficiency.

Other factors may give further impetus to the short-run pursuit of profit. For instance, high P/E ratios may be supported by accounting procedures designed to inflate reported post-merger profitability. The main device is to record acquired assets at values less than the purchase price, thus raising the reported return on assets. When undervalued assets are subsequently sold a profit gain can be reported. A company may, for instance, make large provisions for writing off stocks, or to cover extraordinary reorganisation costs. The release of these reserves into the profit and loss account at a later date results in a boost to profits. Fully informed investors should see through what is happening but the fact that the average investor is less than fully knowledgeable gives opportunities for large profits to be made by knowledgeable insiders.

The fees and commissions (sometimes huge by any standards) paid to company promoters is also a factor to be considered. In 1986 and 1987 these fees and commissions added up to several hundreds of millions of pounds. There have been cases where massive payments have been made to individuals for specialist advice; there have been allegations of insider dealing and of the manipulation of share prices. A small number of knowledgeable insiders do clearly have more information than the average investor, and this coupled with the enormous rewards that accompany success means that there is at least a tendency for those who have most to gain (or lose) to be unscrupulous in their share dealings. In this sort of world it is not necessarily the case that mergers are based on any industrial logic or that the best managers win.

Finally what of the evidence of share price movements referred to earlier, which has been used to argue the case for the efficiency of the market? It is not in fact at all conclusive, because the evidence relates to a short period immediately before and after a merger occurs. When the evidence is examined over a longer period the picture becomes much less clear cut. Much of the evidence then suggests that the short-term gains are not sustained and that the share prices of acquiring firms decline relative to the values that would have been attained had the shares performed as well as those of non-merging companies.⁵ For the corporate control theory to be convincing we would also expect to find more direct evidence of substantial gains in the efficiency and profitability of merger intensive firms, but this again is not found.⁶ In addition the costs of takeovers have to be taken into account and subtracted from whatever benefit takeovers bring by way of the more efficient use of assets. These costs can be high in cash terms and also in the time taken up by management.

We have to conclude on the basis of the evidence that although many mergers undoubtedly occur because of the inefficient use of assets, the market for corporate control does not work as effectively as is claimed by its strongest proponents. Short-run disequilibrium in the stock market (i.e. the undervaluation of some firms relative to their long-run earnings potential and the overvaluation of others) leaves a great deal of scope for divergencies of expectations. These divergencies are likely to be particularly marked in times of economic upheaval such as when the stock market is booming. Speculation and empire-building motives unrelated to efficiency objectives may then play an important part in explaining merger activity.

SOME CONCLUDING COMMENTS

Invariably, after a period of intense merger activity there is a call for stricter controls. Certainly the events of 1986-7 show the need for measures to curb and punish insider dealing, for

stricter accounting procedures, and for companies to keep shareholders better informed of their activities.

Recent events, and particularly the debate surrounding the market for corporate control, have also called into question the need to rely so heavily on mergers as the way to discipline inefficient management teams. Is there another way of imposing this discipline – of monitoring performance, of dismissing inefficient management teams and of giving new managers the time to correct past weaknesses? The MMC has in a number of cases attached a great deal of weight to the quality of management under threat of takeover and to evidence of improvements that were being made in managerial efficiency.⁷ It would be far better if there was a mechanism within each company for monitoring performance and enforcing changes in management in good time.

Unfortunately in the UK an effective mechanism of this kind does not exist. It might be thought that the large institutional shareholders, who should be well informed, would be able to impose the right sort of discipline. However, traditionally, they have not used their powers to get involved in management in non-bid situations. Rather than interfere with management in an attempt to improve performance they will sell their shareholdings in a company that is performing badly thus increasing its vulnerability to a takeover bid. This reluctance to get involved is in part due to the fact that the institutions are also under pressure from the financial markets to produce sparkling short-run performance.

The way in which industry is financed in the UK and in particular the importance of the stock exchange is, then, an important part of the explanation of our high level of merger activity. Apart from the US other major industrial countries such as Japan, Germany and France rely less heavily on the

stock market and have closer and longer-term relationships between industry and finance.

If the market for corporate control does not always work in the interests of shareholders, not to mention consumers, there is an urgent need for an alternative, internal control mechanism for maintaining managerial efficiency. One possibility would be the introduction of German-type supervisory boards with powers to monitor performance, to hire managers, and to dismiss them when performance is less than satisfactory. This is not to deny that mergers or their threat play an important role in disciplining poor management, but the balance between internal and external control mechanisms has shifted too far in the direction of the latter and it is time to redress that balance.

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HOW TO USE THE BOOK AND READ THE FINANCIAL DATA

Announcement Date	The data at which the deal was publicly announced or agreement of previously undisclosed negotiations were announced.		<i>Share Price</i> Earnings per share
			<i>Market Value</i> Earnings
Deal Closed	Date at which the negotiations were successfully concluded or the offer gained adequate acceptance that it became unconditional.	Registration Number	The number allotted to a company at the date of its incorporation. Unique to the one company.
		Share Premium Multiple	Shows the multiple or discount of the Market Value to Net Assets. (Shareholders Funds).
EPS	Earnings Per Share		
Market Value	Corresponds to the Share Prices, and gives the total value of the company leading up to the deal. A direct multiple of the number of shares and the share price at any one time. (Public Quoted Deals Only).	Share Premium	<i>Market Value – Ord Cap, Reserves</i> Ord Cap, Reserves
		Share Prices	Indication of the fluctuation in the value of a company's individual shares leading up to the deal.
P.E. Ratio	Price Earning Ratio. signifies the relationship between a particular share price and the earnings per share, or it can alternatively be the relationship between Market Value and the company's earnings. (Net Profitability).	SIC	Standard Industrial Classification Codes are used to numerically classify and identify all company activities, enabling statistical sector analysis and industry comparison by activity.
		Termination Date	Date at which the negotiations came to an unsuccessful conclusion.