Mergers & Acquisitions

Mergers & Acquisitions (M&A) are common in the corporate world as companies aim to expand, enhance and grow their business to ultimately add shareholder value. Mergers differ slightly from acquisitions in that mergers happen when two firms agree to go forward as a single entity rather than remain independently owned and operated. In this case, shares belonging to either Company are surrendered and new shares are issued in its place. An acquisition occurs when one company takes over another clearly establishing itself as the new owner.

M&A activity has come to the forefront recently with Neal & Massy Holdings acquiring two small companies. This week GraceKennedy announced the merger of its Food & Trading Division and there is now speculation as to whether Bank of Nova Scotia (Jamaica) (BNSJ) is seeking to acquire Dehring, Bunting & Golding (DBG).

Why would well established, profitable companies seek to acquire other established and in some cases also successful companies? One of the main reasons is synergy. That is, the fact that the value and performance of the merged entity will be greater than what would have been produced by the individual companies. This is because by combining business activities, economies of scale are usually achieved thereby fostering greater efficiency. This greater efficiency is expected to enhance profit attributable to its shareholders.

For example, this was one of the reasons cited for the recent merger between Caribbean Communications Network (CCN) and The Nation Corporation. The integration of processes facilitated by the merged entity (One Caribbean Media (OCM)) and economies gained are expected to allow the merged entity to achieve far greater than what would have been possible individually. Also adding to its advantage is the increased asset base which would enable OCM to pursue relationships that would foster growth and bring better returns for shareholders.

Another reason for M&A activity is diversification. Companies that are excelling in its own industry may seek to enter another industry in order to broaden its horizons. In this instance, the acquiring company may seek a firm that has already penetrated that market. For example, the stockbrokerage industry in Trinidad was not too long ago made up of several private firms. However, as Banks sought to grow their Investment Banking Division and ultimately create ‘one stop shops’ one saw the acquisition of a couple brokerage firms by banking institutions. Thus, companies such as West Indies Stockbrokers and Reliance Stockbrokers Limited were eventually acquired by RBTT Financial Holdings and Republic Bank Limited respectively.

As mentioned earlier, there has also recently been speculation in Jamaica regarding the acquisition of DBG by BNSJ. This acquisition would give BNSJ enhanced presence in the securities market and allow them to build and grow its investment banking business. It would also allow them to gain market share already commanded by DBG.

Gain of market share therefore is another major benefit of M&A's as the market share of the other company is obtained without having to do much work to penetrate a new market. For example, CCN's merger with The Nation Corporation enabled both Companies to attain an already established market share in either Country. The merged entity, OCM therefore enjoys a market share that neither of the entities possessed before the merger. In this way, both Companies eliminated having to do the groundwork necessary to understand and grow in a different market as both entities previously enjoyed the distinction of being the dominant market leader in its respective territory.

Another example of this is Republic Bank's (RBL) acquisition of Banco Mercantile in the Dominican Republic in 2003. In keeping with RBL's bid to "Think Regionally", Republic entered this market in 2003 in order to expand its business in the Caribbean. In addition, Guardian Holdings Limited's acquisition bid in the UK was part of its geographical expansion strategy in order to minimize its Country risk as its operations in the Caribbean was exposed to disasters such as hurricanes.

Acquisitions can also be a strategy pursued to eliminate competition. In this approach, not only would the acquiring company eliminate the competition but it also gains a larger market share. For example, if CCN had gone into the Barbados market, it would have had to withstand competition from The National Corporation as well as other media houses. The merged entity therefore not only allowed each of them to gain market share, but also facilitated the elimination of competition from each other.

Another example is that of Caribbean Development Company's acquisition of the National Brewing Company. Everyone remembers the price wars engaged between Carib and Stag during the 1980's. Caribbean Development Company prudently bought out Heineken's majority shareholding in the National Brewing Company (producers of Stag), thereby controlling its pricing and eliminating competitive forces from that brewery. The shares of the National Brewing Company were subsequently de-listed.

Unfortunately there are also disadvantages that come with such activity. For instance, staff reductions are usually imminent. Because of this, there could be a short term drain on the acquiring company as separation packages are given to workers. While the acquiring Company enjoys the enhancement of its books through consolidation, there is sometimes a lag time before which the merged entity or newly acquired Company is able to produce enhanced results as it usually takes time for restructuring to bear fruit. For example, Sagicor Financial Corporation recently completed five acquisitions in 2005 which greatly added to its books. However, its recently released results did not mirror any significant growth in its earnings.

The benefit to shareholders however may vary depending on which side of the table they are on. In the instance of an acquisition, shareholders of the target Company usually stand to gain an immediate benefit as a premium is usually offered for their shares. For example, in the case of the BNSJ/DBG supposed acquisition, there is already the question of what kind of premium BNSJ may pay for the company if it is executed. Though shareholders of the acquiring company would see dilution of its earnings in the short term, the medium to long term horizon is usually what is expected to bring benefit to the shareholders of the acquiring firm.

Unfortunately, there are also instances in which acquisitions have not yet borne the fruit that was initially envisioned. Republic Bank's acquisition of Banco Mercantile of the Dominican Republic (now Republic Bank (DR)) in October 2003 has yet to mature into a profitable operation. In 2004, the Bank was affected by a volatile exchange rate and a general decline in the economy of the Dominican Republic. The combination of the above factors resulted in the Bank incurring a loss of $57.1 million for the fiscal year ended September 2004. In 2005 the Company made an operating loss of TT$80 million for the year. The Bank is however cautiously optimistic of the medium term prospects.

Guardian Holdings Limited's acquisitions in the UK were not able to positively contribute to earnings in 2005 as its Link and Zenith operations focused on profitability rather than defending market share. As a result, revenue was sacrificed to maintain acceptable underwriting margins. In this case, GHL found itself in a highly competitive market which has seen the withdrawal of other Companies due to the challenging environment.

From the latter two examples it is evident that while there were advantages to be gained, understanding of the market to be entered is vital for the success of a merger.

In conclusion, while Mergers & Acquisitions in fact can be a way to create a more competitive, cost-efficient company, some caution should be paid when entering into such transactions. While there are advantages to be gained, problems can occur depending on the market in which the acquisition is taking place. It is therefore necessary to explore all the forces in the market to be entered in order to fully comprehend possible risks and to be prepared for possible challenges in the market. All in all however, if prudently managed, M&A's can be a strategic way of creating value for shareholders.