



The Urge to Merge* *

Give thought to the merger that pleases the stockholder,
Especially when he's a sizable block holder,
The welding, the melding, the wedding of firms
That after some haggling at last come to terms.

A restaurant chain buys a maker of bricks
And both are bought out by a steel mill, for kicks.
All three are absorbed by a firm pharmaceutical,
Made rich by a lotion for treating the cuticle.

Then these are all purchased along rather fair lines
By a combine of shoe stores, distillers, and airlines
Which further expands when it buys all the assets
Of a maker of dog food for bloodhounds and bassets.

This company now begins buying in earnest:
A smelter of ore that is splendidly furnaced,
A large stand of timber, some huge cattle ranches,
A seller of pizza with six hundred branches.

Then in rapid succession, with growing intent,
A maker of mouthwash, plus one of cement,
A radio network, a pipeline for gas,
The leading producer of pure isinglass

With mergers thus merging, conglomerates glooming,
The day isn't distant, it's rapidly coming,
When one needn't wonder which stock to invest in.
There'll only be one left, that's taken the rest in.

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ARE YOU MERGER-MINDED?

According to W. T. Grimm & Co., a management consulting firm, business mergers occurred at a rate of about 500 per year during the late 1950's. Despite a rising number of antitrust actions and unfavorable Supreme Court decisions, this rate has accelerated substantially in recent years. During the first six months of 1967, 1400 business mergers were recorded. And, in the first half of 1968, this rate rose to 1700.

Along with this dramatic increase has come a notable change in the composition of mergers. According to a Federal Trade Commission report, horizontal and vertical mergers declined from 41% of all mergers in 1948-1953 to 28% in 1960-1966. During the same time span, conglomerate mergers rose from 59% to 72%. More recently, conglomerate mergers comprised about 83% of all mergers.

Are You Considering a Merger?

Every available indicator points to a continuing increase in the merger rate. Are you considering a merger? What factors are you considering? What factors might you consider? What factors should you consider?

Fundamentally, there should be only one answer to the question of merging. Every agribusiness contemplating a merger must consider whether merging will result in optimum resource utilization. More simply, agribusiness must carefully evaluate every available investment alternative -- only one of which might be a merger.

Typically, there are many investment alternatives available to every firm. These may include:

- 1) expanding an existing market,
- 2) developing new products for the same market,
- 3) entering a completely new market with or without a new product,
- 4) vertically integrating product processes,
- 5) Etc.

Generally there exist only three avenues of attaining these alternatives: internal adjustment, acquisition, and merger. In short, the agribusiness should determine whether it would do better by growing internally or externally.

How About Internal Growth?

Internal growth allows the agribusiness to proceed with intent and thoroughly evaluate each stage of expansion before going to the next. The individual business, not the industry or market, sets the pace for growth.

Internal growth often requires investment in new plants and equipment, thereby ensuring the business of having the most modern technological base. This competitive advantage is not always achieved with acquisition or merger.

An often overlooked factor favoring internal growth is that the cost of developing a new product from within the business is deductible from income tax. The costs of adding products or markets through mergers and acquisitions often are not deductible.

The costs of internally developing a new product may be high, however. Several

indirect costs such as hiring and training new people to support an expanding marketing organization, advertising, and administration are associated with this expansion policy. Finally, one must realize that not all new products developed internally are successful when they appear in a highly competitive market.

External Growth

There are many reasons why agribusiness managers prefer external growth. These include:

- 1) the quickly acquired ability to integrate (and control) all processes from raw materials to finished products,
- 2) the ability to offset the detrimental effects of a seasonal product or a cyclical industry through diversification,
- 3) the accelerated entry of new product lines into a growing market,
- 4) the addition of a business's technical, managerial, and marketing ability,
- 5) the market muscle obtained from geographically dispersed plants and the resultant increase in product distribution.*

Under favorable conditions, all of the above advantages can also be achieved via internal growth. Agribusiness management would be well advised to carefully consider both avenues to growth before committing itself to action.

* John C. Narver. "Some Observations on the Impact of Antitrust Merger Policy on Marketing." Journal of Marketing, January 1969, Vol. 33, No. 1, pp. 24-31.

Making the Choice

The choice of internal growth versus external merger is dependent on numerous conditions. These include:

- 1) the firm's desire for speed in growth,
- 2) its ability to absorb errors and development costs,
- 3) the current obsolescence rate (the adverse effects of rapidly advancing technology),
- 4) the firm's ability to accurately assess merger candidates,
- 5) opportunity costs.

Merging with an active and profitable business may require sacrifices such as diminished control, unequal stock transfers, loss of directorship representation, etc. A portion of this sacrifice may be attributed to insurance against risk of merging with a less viable business or against having an internally developed new product fail in the market. However, merging with a well-managed business in a growing and diversified market does not, in itself, assure success.

The fatality rate among mergers is high. Between 1960 and 1965, 36% of all business mergers consummated during that period failed. Generally speaking, firms involved in successful mergers chose a partner that produced a product that could be distributed through existing channels. A dairy products processor, for example, would merge with a specialty food firm and thereby utilize more fully existing distribution channels.

Some mergers were consummated in an attempt to smooth out the fluctuations of a cyclical business or fulfill unused plant capacity. Tax loss carryovers also contributed

to mergers. This, however, can prove to be a false incentive. Agribusiness managers would be well advised to study the tax laws carefully before taking action. Many agribusinesses have discovered, too late, that with the passage of time tax reductions reappear as burdens.

Planning for a Merger

The success of any merger will lie in planning and investigation. A business which is contemplating a merger should have a merger committee. It should consider all the factors noted earlier to decide if a merger will really achieve optimum resource utilization. If this decision is affirmative, the committee's next task is to assemble a list of potential merger candidates. From this list, the committee (in consultation with the business's ownership representatives and chief executive officer) should begin to eliminate the less desirable candidates. This process might employ a simple checklist of questions about:

- 1) managerial quality,
- 2) condition of plant equipment and accounting procedures,
- 3) compatibility of marketing scheme,
- 4) concentration of ownership,
- 5) labor union contracts,
- 6) tax status
- 7) Etc.

When this information is obtained and studied, the most promising candidates are selected and the appropriate contact or approach is decided on.

The Merger Negotiations

Several concepts should be kept in mind when negotiating with a prospective partner. First of all, make sure negotiations are conducted with only top management personnel. When proposals are brought forth, make them reasonable; compromise will not evolve if the candidate is confronted with an unrealistic proposal. Before beginning detailed discussions, be sure you are thoroughly familiar with the candidate's business structure. The depth into which this familiarization should go cannot be overemphasized. Make sure the premises on which the merger is proposed are based on fact.

Some of the major negotiable items which should be considered include:

- 1) earnings statements should be standardized and placed on a comparable basis between firms,
- 2) hidden costs in the area of inflated salaries and fringe benefits must be uncovered,
- 3) research and development efforts are often subject to personal biases,
- 4) the age of accounts receivable may depict hidden difficulties over credit policies,
- 5) the compatibility of the candidate's marketing strategy, and
- 6) the composition of present sales.

Other items of interest may include adequacy of plant facilities, growth potential, and labor availability.

If the candidate seems overly receptive, beware. Beware, also of the firm that is attracted to a merger because it is the fashionable thing to do, or of the firm that seems anxious to conclude a deal swiftly.

What About Earnings?

Evaluating a potential merger candidate is not and never will be a very exact science. As a result, many firms pass over items of importance and dwell heavily on the most price-related item -- earnings or dividend-paying capacity. All too often, negotiating firms concentrate so heavily on each of their earnings records that they overlook the potential dividend capacity of their two businesses if combined.

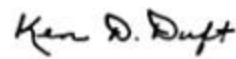
Past dividend histories of negotiating firms, of course, are important. However much greater emphasis should be given to their likely future. Net assets need to be analyzed to determine if they are adequate to support the potential earnings record.

In the final analysis, the true value of a merger candidate lies in its ability to fit well into the operational structure of the merger-proposing firm. When such compatibility exists, the resulting merger is apt to be successful. Without it, the merger is destined to add to the fatality rate.

Summary

If an agribusiness decides to merge -- and this decision is becoming more common each year -- careful planning and organization of goals is necessary. The merger committee must be as familiar with its own firm's objectives as it is with the merger candidate's qualifications. The committee should observe and investigate present business operations in the light of possible future courses of action.

A multitude of factors, conditions, and items must be considered before a merger is consummated. In short, all concerned persons must be merger minded.



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