The Importance of Mergers and Acquisitions in Today's Economy

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Abstract. **Undoubtedly today we live in a time of significant economic change. Mergers and acquisitions have become common business tools, implemented by thousands of companies in world. Driven by a philosophy of shareholder value they not only form a new economic, social and cultural environment, but also enable strong companies grow faster than competitors and provide entrepreneurs rewards for their efforts, ensuring weaker companies are more quickly swallowed, or worse, made irrelevant through exclusion. The article answers the question why mergers and acquisitions (M&As) are important in today's economy. It presents the advantages of M&A deals and underlines their features. It also presents the correlation analysis on selected factors and results of research completed among Lithuanian companies. The article concludes that the number of M&A transactions most likely will increase.**

Keywords – **mergers and acquisitions, M&A, advantages, importance.**

I. Introduction

Having in mind, that the increase of inter-dependence of markets for various goods and services as well as increasing foreign competition, it is obvious, that today we live in a time of significant changes. That's why many companies are expanding their geographic reach and grow. Companies which choose to grow, normally try to take an additional market share, reach new customer base, create economic profits, provide returns for their stakeholders, etc., while companies which choose not to grow, are obviously doomed to failure due their loss of customers and market shares, destroyed shareholder and stakeholder values and so on.

Today growth in many cases occur through mergers and acquisitions (M&As): during the last few years there was over 30.000 M&A transactions, equivalent to the completion of one deal every 17 minutes (Faulkner, Campbell, 2003).

M&As have many potential benefits, which mainly focus on boosting profits and shareholder value through:

- the economies of scale produced by increasing market share;
- the expanded use of an existing distribution network by the acquisition of new product capabilities;
- the extension of a strong product capability into new markets;
- the diversification of product and market risks.

This way mergers and acquisitions become an essential tool for corporate development in today's global marketplace, which is characterized by consolidation, convergence, the competition for talent and technology, and the increasing importance of such intangible assets as knowledge, skills and customer relationships.

II. Definitons

According to Gaughan (2007), DePamphilis (2003), Scott (2003) a merger is a combination of two corporations in which only one corporation survives and the merged corporation goes out of existence. In a merger, the acquiring company assumes the assets and liabilities of the merged company. Moreover, although the buying firm may be a considerably different organization after the merger, it retains its original identity.

An acquisition occurs when one company takes a controlling ownership interest in another firm, a legal subsidiary of another firm, or selected assets of another firm such as a manufacturing facility (DePamphilis, 2003). In other words, an acquisition is the purchase of an asset such as a plant, a division, or even an entire company (Scott, 2003).

On the surface, the distinction in meaning of "merger" and "acquisition" may not really matter, since the net result is often the same: two companies (or more) that had separate ownership is now operating under the same roof, usually to obtain some strategic or financial objective. Yet the strategic, financial, tax, and even cultural impact of a deal may be very different, depending on the type of transaction (Sherman, Hart 2006).

III. Reasons behind decision to participate in M&A deals

First reason – growth. There are many reasons why companies decide to participate in M&A deals. The primary reason is the determination to grow. There are two growth options: internal or organic growth (e.g. hiring additional salespeople, developing new products, expanding geographically, which in fact is a very time and strength consuming option); and inorganic growth (e.g. acquisition of or merger with another firm, often done to gain access to a new product line, customer segment, or geography) or by external means (e.g. franchising, licensing, joint ventures, strategic alliances, and the appointment of overseas distributors, which are available to growing companies as an alternative to mergers and acquisitions as a growth engine).

In response to the good growth prospects, mergers and acquisitions, just like internal investments, are means for companies to increase their capital base, as concluded by Andrade, Stafford (2004).

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It is obvious that companies may grow within their own industry or they may expand outside their business category, which means diversification. An example of using M&A to facilitate growth is when a company wants to expand to another geographic region. It could be that the company's market is in one part of the country but it wants to expand into other regions. Alternatively, perhaps it is already a national company but seeks to tap the markets of other nations, such as a U.S. firm wanting to expand into Europe or contrary. In many instances, it may be quicker and less risky to expand geographically through acquisitions than through internal development. This may be particularly true of international expansion, where many characteristics are needed to be successful in a new geographic market. The company needs to know all of the nuances of the new market and to recruit new personnel and overcome many other hurdles such as language, culture and similar barriers. Internal expansion may be much slower and difficult.

In Lithuania, growth is the most common reason cited as a motive for M&A transactions. For example, let's have a look at Societe Generale Consumer Finance acquisition of General Financing, a Lithuanian entity specialized in consumer credit activities (including the brand Kreditas123). Jean-Francois Gautier, Head of Specialized Financial Services of Societe Generale Consumer Finance declared: "The acquisition of General Financing allows us to set foot on the new fast-growing market while relying on the local knowledge of one of the leaders of consumer finance in Lithuania". "This acquisition is a timely coincidence of Societe Generale strategic entry to Lithuanian consumer finance market and of General Financing's goal to have a strong, established funding base necessary for further rapid expansion," commented Karolis Pocius, partner of GILD Bankers. "With the coming of Societe Generale Consumer Finance, UAB „General Financing" has completed its first stage of development and obtained one of the strongest possible partners to expand further its market share. Despite a controversial macroeconomic outlook the company is now set for rapid expansion", - commented the general manager of General Financing Raimondas Rapkevičius.

Second reason for M&As is synergy. Gaughan (2007) states that the term "synergy" is often associated with the physical sciences rather than with economics or finance. It refers to the type of reactions that occur when two substances or factors combine to produce a greater effect together than that which the sum of the two operating independently could account for. Simply stated, synergy refers to the phenomenon of 2 + 2 = 5. In mergers this translates into the ability of a corporate combination to be more profitable than the individual parts of the firms that were combined. The two main types of synergy are (DePamphilis 2003):

1. Operating synergy, which consists of both: economies of scale (or the spreading of fixed costs, such as depreciation of equipment and amortization of capitalized software; normal maintenance spending; obligations such as interest expense, lease payments, and union, customer, and vendor contracts; and taxes, of over increasing production levels); and economies of scope (which refers to using a specific set of skills or an asset currently employed in producing a specific product or service to produce related products or services).
2. Financial synergy, which refers to the impact of mergers and acquisitions on the cost of capital of the acquiring firm or the newly formed firm resulting from the merger or acquisition. Theoretically, the cost of capital could be reduced if the merged firms have uncorrelated cash flows, realize financial economies of scare, or result in a better matching of investment opportunities with internally generated funds.

Third reason is access to intangible assets. The emergence of the knowledge era since the 1980s has brought significant change in both global and local markets. Knowledge, as a core organizational resource and the basis for the development of organizational capabilities, is playing a key role in driving changes in companies. Today the value of knowledge-based, intangible resources has grown geometrically in companies. The intangible assets include (Saint-Onge, Chatzkel, 2009):

1. Human capital, which is the sum of all the capabilities of everyone who's currently working in company, i.e., the cumulative knowledge, experience, attributes, competencies, and mindsets of all employees, managers, and leaders. These individual capabilities of employees create value for the customers.
2. Customer capital, which consists of the strategies, structures, processes, and leadership that translate into a company's specific core competencies. These organizational capabilities leverage employees' individual capabilities to create value for customers. Structural capital also includes the organizational capacity and physical systems used to transmit and store intellectual material. Structural capital is composed in large part of:
   - company's organization (investment in systems, operational philosophy, and supplier and distribution channels),
   - innovation (capability to renew company along with the outcomes of innovation, which include the ability to anticipate market needs and lead the market in responding, the ability to bring new products to market rapidly, intellectual assets and intellectual property (which include copyrights, patents, trademarks, and trade secrets), company's brand and theory of your business. Although the best-known innovation capital is usually intellectual property, these are even more critical to company's well-being),
   - processes (comprises all the processes of the company that enable to create and deliver goods and services to both internal and external customers. These can be production, design, and product development processes; people development processes; communication processes; strategy-making processes, and knowledge development, capture, and leveraging processes).
3. Structural capital, which is the sum of all customer relationships, that can be defined by four parameters:
   - depth – penetration or share of customers' wallets,
   - breadth – coverage or share of the market,
   - sustainability – the durability of relationship with customers,
   - the profitability of company's relationships with all customers.

Furthermore, human capital interfaces with customer capital and structural capital to create knowledge value capital. These weightless assets now have a greater value in organizations than physical or financial assets have. This has been coupled with fundamental changes in legal, competitive, and global requirements. For example, one such quantum shift is the emergence of the European Union (EU), with its dismantling of boundaries and reduction of trade barriers. The emergence of the EU has also led to a shift in the regulatory environment in Europe, creating pressures to combine organizational strengths simply to be able to compete on a larger scale.

For example, Symantec's acquisition of Axent Technologies in 1999, that "acquisition" was also the catalyst for changing Symantec processes to support an enterprise business. Axent had systems in place for serving major corporate customers, and just as important, its senior executives had an understanding of the service and support needs of that market. As the former Axent executives assumed leadership roles at Symantec, they helped guide the company's investment in and deployment of new systems to undergird the new enterprise thrust" (Lawrence M. Fisher).

Another example is acquisition of Fontes Vilnius by MPS Enterprises Ltd., which is an EU-based, private partnership corporation. Pasis Hartunen, the managing director of MPS for Baltic region, says that "the purpose of the transaction is to settle down in quickly developing Lithuanian and Baltic human resource consulting market. We will be looking for opportunities to provide new services to the current and prospective clients in Baltics and international markets". Alternatively, Regina Laimikienė, the managing partner of Fontes Vilnius, says that "now we will be able to learn from the long-lasting experience of the leading corporation and its broad spectrum of services, which was formed while working in international markets. This transaction will allow us to offer the greater value to the client, but also to provide with the exceptional human resources decisions. This way we can become a trustworthy partner not only in Lithuania, but also abroad."

So in today's knowledge economy intangible assets, which are seen as organization's most valuable assets, are also the most fragile and difficult to control since they depend on the goodwill and commitment of people (Coffey, Garrow, Holbeche, 2002).

Other reasons. Apart from growth, synergy and access to intangible assets motives, there are several other reasons that drive companies to engage in M&A, which are widely reported in the literature:

- Horizontal and vertical integration (Gaughan 2007). Horizontal integration refers to the increase in market share and market power that results from acquisitions and mergers of rivals. Vertical integration refers to the merger or acquisition of companies that have a buyer-seller relationship.
- Improved management (e.g., belief of better management of targert's resources), research and development (e.g. it critically important to the future growth of many companies, particularly pharmaceutical companies) and/or distribution (e.g., when there is no direct access to ultimate customers) (Gaughan 2007).
- Tax benefits (certain studies have concluded that acquisitions may be an effective means to secure tax benefits) (Ghosh, Jain 2000);
- Changes in markets, e.g. regulatory changes, reallocation of market power (Cassiman, Colombo 2006).
- Changes in technology and industry, e.g. emergence of new businesses and markets, new forms of communications and cross-border restructuring (Cassiman, Colombo 2006), reaction to deregulation, increased foreign competition, financial innovations, oil price shocks (Andrade, Stafford 2004).
- Cost reduction (Kreitl, Oberndorfer 2004).
- Extension of R&D capacities (Kreitl, Oberndorfer 2004).
- Obtaining a new customer base (Kreitl, Oberndorfer 2004).

Motives behind the seller decision to sell. While all the above mentioned motives fall under the buyer's perspective (and this is widely reported in the literature), we must not forget that any M&A transaction also includes the other side – the seller. Hence, Frankel (2007) and Hart with Sherman (2006) provide the motives for M&A from the two different perspectives. Since the buyer's perspective has been analyzed above, let's have a look at the seller's motives, which include the following points:

- Company doesn't have the resources to grow further;
- Because a company thinks it has maximized growth in its own market and does not think it can expand to new markets;
- It thinks it reached its historical peak of its valuation;
- Lack of viable replacement for the founder of the company, as the founder nears to retirement;
- Lack of access to capital (including the restrictions of borrowing capacity);
- If the company is owned by investors, they might want to cash out;
- New competitors emerge.

It is obvious that the choice to sell is one of the most dramatic – last and big decision that a company will ever make. It has an influence on everyone, associated with the company. At the same time, the decision to be a buyer today is a standard business tool, utilized by many, if not most, companies.

IV. CORRELATION REGRESSION ANALYSIS ON SELECTED FACTORS

In order to find out the number of M&A transactions dependence on some factors, I have decided to take into account the following variables:

- total value of M&A transactions;
- country's gross domestic product (GDP);
- country's inwards foreign direct investments (FDI);
- country's outwards foreign direct investments (FDI).

It must be pointed out that the above factors were chosen due to the available information. It would have been interesting, for example, to analyze whether the number of M&A transactions depends on overall number of companies operating in the country, or number of profitable companies in the appropriate country, but such information is not published for all the countries, hence, I have chosen the variables where the information is available.

So my initial hypothesis would be that the number of M&A deals depends on all the four factors: the total value of M&A transactions, country's GDP, country's inwards FDI and country's outwards FDI.

The data analyzed is for the year 2007, because not all official data is yet available for 2008. The selection of countries is based on the information provided by Thomson Reuters reports for 2008 (it includes the final figures for 2007). The data for analysis is shown in Table 1 below.

TABLE 1. ANALYZED DATA

Country	No of deals Y	Total M&A value (billions US$) X1	GDP (billions US$) X2	FDI inward (billions US$) X3	FDI outward (billions US$) X4
1. USA	10574	1345.30	13751.40	2093.05	2791.27
2. Canada	2286	197.65	1329.89	520.74	520.74
3. Brazil	715	45.96	1313.36	328.46	129.84
4. UK	3330	387.13	2772.02	1347.69	1705.10
5. Switzerland	432	35.64	424.37	278.16	603.62
6. Germany	1897	148.40	3317.37	629.71	1235.99
7. Australia	2389	136.46	820.97	312.28	277.92
8. China	2587	75.39	3205.51	327.09	95.80
9. Hong Kong	1024	45.70	207.17	1184.47	1026.59
10. Japan	2697	136.43	4384.26	132.85	542.61
Total:	27931.0	2554.04	31526.31	7154.48	8929.47
Mean:	2793.1	255.40	3152.63	715.45	892.95

After completing all the calculations, it occurred that in the analyzed case the relationship exists between number of M&A deals and:

- total M&A value (13.4977943 > 2.306004133);
- GDP (9.78835152 > 2.306004133);
- FDI (inwards) (3.38253459 > 2.306004133).

There is no stochastic relationship between number of M&A deals and FDI (outwards) (2.22602655 < 2.306004133).

Now another step of the analysis is to choose the linear function that describes the sum of statistical points at its best – that means that simple linear regression analysis develops an equation to express the linear effect of the independent variable on the dependent variable, and thus, it is assumed that the relationship between these two variables is indeed linear in nature. After completion of all the calculations, it appeared that the following equations can be used in planning and forecasting:

$Y = 972{,}83 + 7.13 \cdot X1$ (total M&A value)

$Y = 592{,}30 + 0{,}70 \cdot X2$ (country's GDP)

V. QUALITATIVE ANALYSIS COMPLETED AMONG LITHUANIAN COMPANIES

The purpose of this research was to find out the general attitude towards M&A transactions, to figure out the main trends and to forecast whether M&A transactions in Lithuania have any development possibilities in the nearest future.

The questionnaire was sent out to 100 small and medium enterprises in Lithuania. The response/completion/return rate (or ratio of number of people who answered the survey divided by the number of people in the sample) was 71%, because 71 companies completed questionnaire.

The completed qualitative analysis in mergers and acquisitions in Lithuania revealed that even most of the respondents agree on the benefits of M&A transactions (i.e. when asked whether, according to their opinion, M&As are effective ways of expanding the business, 93% agreed with this; in addition, 97% said they would prefer to grow this way), nevertheless, today they are not planning to buy/sell the business (86% of respondents). The paradox is that the majority (51%) says they would not consider buying the business, if the proposal was received. There was no clear tendency on considerations of selling the business if the proposal was received (43% said they would consider and 34% said they wouldn‘t).

According to respondents, the most common motives to buy the business are: growth (56%), access to intangible assets (24%) and other (20%); alternatively, the most common motives to sell the business were ranked as follows: getting the investment back (25%), maximized growth (24%), decision to go out of the business (23%), lack of capital (13%) and other (15%).

Finally, it was concluded, that the number of M&A transactions in Lithuania should increase (according to 92% of respondents).

IV. CONCLUSIONS

To sum up, the following conclusions can be made:

1. Mergers and acquisitions are understood as a general global trend associated with a global corporate restructuring across industries. They are the vital part of any healthy economy and the primary way that companies are able to provide returns to owners and investors.

2. From the buyer point of view, strategic motives to undertake M&A deals are primary related to decision quickly grow (as opposed to slow growth through their own resources) and to get the access to intangible assets, namely, human capital, structural capital and customer capital. Other additional motives include the achievement of synergies, adjustment to changes, undervalued assets, mismanagement problems, tax savings and so on. From the seller point of view, the strategic motives to sell the business include the decision to turn equity into cash, growth maximization, and peak in valuation, owner's retirement, lack of access to capital.

3. The correlation regression analysis of the number of M&A deals dependence on the selected four factors – total value of M&A transactions, country's GDP, inwards FDI and outwards FDI – has revealed that the stochastic relationship exists between number of M&A deals and total M&A value; GDP; inwards FDI. The further – simple linear regression analysis – allowed to conclude that the equations $Y = 972{,}83 + 7.13 \cdot X1$, whereas $X1$ = M&A value and $Y = 592{,}30 + 0{,}70 \cdot X2$, whereas $X2$ = GDP can be used in planning and forecasting.

4. The completed qualitative analysis in mergers and acquisitions in Lithuania revealed that even most of the respondents agree on the benefits of M&A transactions; nevertheless, today they are not planning to buy/sell the business. The paradox is that the majority says they would not consider buying the business, if the proposal was received. There was no clear tendency on considerations of selling the business if the proposal was received.

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