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Mergers—What Next

The great merger wave of the 90s continued in 1998. Again all records were broken. A new record for the value of all mergers. A new record for the largest merger. A new record for the largest cross-border merger.

As we enter 1999, there are the obvious issues affecting merger activity and some not so obvious. In the first category—and at least in the short run the most important—is the question whether the equity markets will continue their upward momentum creating the currency and the psychological underpinning for a high level of merger activity.

Just as a decline in the equity markets would curtail merger activity, so too would a resurgence of inflation. The increase in the cost of borrowing and the general uncertainty caused by inflation would have a curtailing effect in themselves and through their impact on the equity markets.

Antitrust enforcement has had relatively little impact on the current merger wave. However, both the FTC and the Antitrust Division of the Department of Justice have been increasingly more aggressive and less willing to deal with problems through partial divestitures and licensing. So too the EU competition authorities. If the mega-merger trend continues, antitrust will be a significant factor. If antitrust enforcement does little more than lengthen the time it takes to complete a merger, it will have a negative impact. The prospect of a lengthy period between announcement and completion of a merger is discouraging in several ways. It exacerbates the post-merger integration problems and it heightens the prospect of interference by an interloper.

Cross-border merger activity increased dramatically in 1998. We had several mega-mergers between Europe and the US and between European countries. The Asian financial crisis created opportunities for bargain-hunters and strategic buyers. Major US and European companies that have for many years sought partnerships in Asia, only to be rebuffed, suddenly found welcome. While the future volume of these transactions will depend in part on the Asian recovery, it appears that a cultural barrier has been lifted and that there is a prospect for greater cross-Asian-border activity than heretofore. The advent of the Euro may be a major stimulant to European cross-border mergers. If the Euro proves to be the strong currency it is expected to be, it may also encourage mergers between Europe and other areas.

The availability of pooling accounting has facilitated much of the recent merger activity, especially among banks and other financial institutions. The FASB and the other G4+1 members (which includes the UK and the IASC) on December 15, 1998 issued a discussion paper rejecting pooling and specifying purchase accounting for all mergers. While we are probably two to three years from the demise of pooling, it is fast approaching. In the meantime we can expect the SEC to continue its long-standing efforts to limit pooling accounting. In addition, the debate with respect to goodwill accounting has reached the point where we can expect action restricting amortization periods and requiring periodic reassessment of the value of goodwill.

Deflation has played a major role. In many industries growth is possible only through mergers. The decline in the price of oil underlies a number of 1998 mergers, including several mega-mergers. If commodity prices remain depressed, they will continue to stimulate mergers in the basic industries and among commodity traders and transporters. All industries that require continuing large capital investments experience similar pressures. There is a strong motivation to spread investments over a wider spectrum of projects and to increase margins by reducing employment.

Starting in the 80s and continuing in the 90s, companies have pursued a strategy of restructuring and focusing on core competencies. Much if not all of this restructuring has been accomplished and has been a great success in increasing productivity and competitiveness. However, there is a failure by many activist investors to recognize this and they are continuing the efforts started in the 80s to encourage hostile takeovers. These efforts, if successful, would in reality restrict rather than stimulate merger activity. This is particularly true with respect to the attack on the poison pill. The activists argue that the pill discourages hostile takeover bids. However, hostile bids are today but a tiny portion of merger activity. Even if in fact, which is highly doubtful, hostile bids were discouraged by the pill, the impact on overall merger activity would be negligible. The vast bulk of merger activity today is strategic negotiated mergers. Many of these mergers would not be considered if the pill were not available to provide protection against a hostile interloper.

Rapid technological innovation, deregulation, privatization and overcapacity will continue to drive mergers. In all probability these factors will transcend the others and result in significant merger activity even if the macroeconomic factors are less favorable. Given the multitude and diversity of factors affecting merger activity, it is not possible to predict the future level of activity. At this time it appears that the 1998 experience is likely to be repeated in 1999.

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