Mergers and Acquisitions

Center Forward Basics

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Overview

Mergers and acquisitions (M&A) are the combining of companies or assets through various types of financial transactions. They are important because they allow for businesses to grow or downsize in order to increase their competitive position or improve the overall structure of their business. They can also help struggling companies to expand new product lines or share a product line in a new market. Mergers and acquisitions can also benefit consumers by enabling firms to operate more effectively or to offer product or service bundles for discounted prices. But some mergers may change market dynamics in ways that can lead to less competition, higher prices, fewer or lower-quality goods or services, and less innovation. Transactions over a certain size (currently $94 million, but adjusted annually) are reviewed by either the Federal Trade Commission (FTC) or Antitrust Division of the Department of Justice (DOJ) to ensure they comply with U.S. Antitrust Laws. Transactions that involve the transfer of control of a radio license also require review and approval by the Federal Communications Commission (FCC). This basic will explore the process, government review, and impact of mergers and acquisitions.

Mergers and Acquisitions

A merger occurs when two firms combine into a single new entity. Mergers can be structured in a variety of ways based on the relationship between the two companies involved in the deal. Common examples of mergers are:

- Conglomerate: a merger between firms that are involved in unrelated business activities.
- Horizontal Merger: a merger occurring between companies in the same industry. The businesses typically operate in the same market space and are often competitors that offer the same goods or services.
- Market Extension Mergers: a merger between two companies that deal in the same products, but operate in separate markets. This helps companies have access to a larger market and to an expanded client base.
- Product Extension Mergers: a merger between two business organizations with products that are related to each other and operate in the same market. This allows the merging companies to combine products and gain access to a bigger set of consumers.
- Vertical Merger: a merger between companies that provide goods or services at different levels within an industry's supply chain for one specific finished product. Vertical mergers are typically pursued to increase synergies, gain more control of the supply chain process, and expand business. A vertical merger often results in reduced costs and increased productivity and efficiency.

An acquisition occurs when one company purchases a controlling interest in another company and becomes the new overall owner. Acquisitions often include consolidating another entity's stock, equity interests, assets, and liabilities under one new single entity.

Center Forward Basics

Center Forward brings together members of Congress, not-for profits, academic experts, trade associations, corporations and unions to find common ground. Our mission: to give centrist allies the information they need to craft common sense solutions, and provide those allies the support they need to turn those ideas into results.

In order to meet our challenges we need to put aside the partisan bickering that has gridlocked Washington and come together to find common sense solutions.

For more information, please visit www.center-forward.org

Mergers & Acquisitions of Private Companies

The ability for a business to be merged or acquired is especially important for private companies that are not publicly traded. For many of these businesses, the future promise of being acquired is what drives investors to provide it with the capital needed to grow, innovate, and hire more employees. This is especially true for newer start-ups or businesses in the growth phase of their lifecycle. However, it is also true for companies that are not a fit for the public markets. An example of such a transaction is Tate's Bakeshop, which was ultimately sold to Mondelez International.

Relatedly, as long-term investors in businesses (3-7 years on average), private equity (PE) firms and their funds are frequent participants in mergers and acquisitions. These funds often raise capital from pensions and other institutional investors to acquire and grow the value of businesses with the ultimate goal of eventually re-selling an improved business to another business or initiating an Initial Public Offering (IPO) of stock (e.g., Dunkin' Donuts). Additionally, PE and other private companies often participate in both mergers and acquisitions during strategic corporate divestitures as other private sector participants seek to strategically reduce assets or restructure.

Economic Impact

M&A transactions are often a complement to organic business growth. Growing a business through a merger or acquisition can offer various benefits, including:

- Access to markets that one company may not reach on its own or expansion of a company's reach from a local business to a regional or national one;
- Help for weakened or underperforming companies or business units. Mergers and acquisitions can help employees of a struggling business or business unit retain jobs that may be preserved in an acquisition versus employment losses due to bankruptcy;
- Diversification of the products, services, and long-term prospects of a business;
- The ability to obtain quality staff and additional skills, industry knowledge or sector expertise - for example, merging two businesses to solidify strong management or create more efficient production or distribution capabilities; and,
- An improved balanced sheet through savings from reduced overall costs and overhead expenditures. Businesses in the same sector or location can combine resources to reduce costs, eliminate redundant facilities or departments and increase overall profitability.

However, some argue that there can be downsides to certain mergers and acquisitions, including:

- Concerns regarding reduced competition associated with antitrust issues, extreme market consolidation and extreme market control. Such scenarios could result in higher prices for consumers, decrease the quality of products or services offered, and stifle innovation; and,
- Uncertainty and confusion among the employees and/or risk of employment reductions.

Regulatory Oversight

Since 1976, there has been a robust and detailed process required to approve significant mergers and acquisitions. The FTC and the DOJ enforce the nation's antitrust laws—complementing each other in enforcement and merger reviews by generally focusing on those industries and markets where they have each developed expertise. The agencies review over a thousand M&A filings each year and 95% of the filings have no underlying competitive issues. While there are some exemptions, current law largely requires any deals valued at $94 million or more to be reported to the agencies for review—allowing a preliminary review and optional extended review. Notably, the Clayton Act prohibits the transactions when the effect "may be substantially to lessen competition, or to tend to create a monopoly." To evaluate whether a transaction violates this standard, the agencies focus on whether the proposed transaction will significantly create or enhance market power or facilitate its exercise in a market. Often, antitrust concerns can arise with proposed horizontal mergers between direct competitors. The Hart-Scott-Rodino Act enables antitrust agencies to examine the likely effects of proposed transactions before they take place, and the agencies may take formal legal action to modify or to stop the merger. On occasion, the agencies have allowed some aspects of a deal to advance while eliminating other components that may present a competitive threat by way of a consent decree with the merging parties which requires either structural remedies (e.g., divestitures) or behavioral remedies (e.g., changes to the merging parties' conduct after the merger). Additionally, many states have antitrust laws under which they may also review a proposed transaction. In recent years, some states have increased such merger reviews.

For mergers in which a radio license or other authorization granted by the FCC will be transferred to a new owner, the FCC also must review and approve the transaction. In such cases, the FCC will launch a public comment proceeding in which any interested party can participate by filing formal or ex parte comments. The FCC's standard for approving mergers and acquisitions is different from the DOJ and FTC's antitrust standard. Rather, the FCC can only approve a transaction if it finds that it is in the "public interest." In M&A transactions in which the FCC is involved, the FCC typically coordinates its review closely with the DOJ or FTC.

The Coronavirus' Impact on Mergers and Acquisitions and Response

The coronavirus pandemic has already had a significant impact on mergers and acquisitions. M&A levels in the United States fell by more than 50% in the first quarter of 2020 to $253 billion compared to the first quarter of 2019. Thousands of businesses have been forced to cut back their operations, lay off or furlough millions of workers, and have had their supply chains disrupted. For many struggling companies a combination with a more financially secure business offers a valuable potential lifeline. This action could ensure that the company survives and employees retain their jobs, while continuing to receive a paycheck and other essential benefits.

There has been recent discussion regarding freezes or moratoriums on M&A activities, including Senator Warren's and Representative Ocasio-Cortez's recently proposed Pandemic Anti-Monopoly Act. Their proposal seeks to "impose a moratorium on risky mergers and acquisitions" until the FTC determines that small businesses and consumers are no longer under "severe financial distress." The sponsors argue that this will "stop large corporations from exploiting the pandemic to engage in harmful mergers and to strengthen the federal government's ability to respond effectively to future crises." Additionally, the sponsors argue that mergers and acquisitions could lead to job losses, price increases, and the exploitation of small businesses. Representative David Cicilline, Chairman of the House Antitrust Subcommittee, also supports a merger moratorium during the pandemic.

Opponents of the proposal believe their concerns are overstated or misplaced and that additional regulation is not required as the FTC and DOJ already have the robust ability to prevent anti-competitive transactions. Additionally, during past economic crises, mergers and acquisitions continued to go through the exact rigorous review process that is currently in place to evaluate the terms and protect consumers. Opponents argue businesses have and will be deeply impacted by the COVID-19 pandemic and it could be important that they have the option to either merge with another company or be acquired by a company at a time when they are experiencing a better financial standing— both to sustain the growing concern and the company's labor force. No formal Congressional action has yet occurred on Senator Warren and Representative Ocasio-Cortez's merger moratorium proposal.

Links to Other Resources

- Bloomberg – A Misguided Assault on Mergers
- Ernst & Young – Six ways private equity will help drive value in M&A
- Forbes – The Impact of the Coronavirus Crisis on Mergers and Acquisitions
- Department of Justice - Merger Enforcement
- Federal Trade Commission – Mergers

- Federal Communications Commission – Review of Significant Transactions
- The Hill – Democratic lawmakers push for merger freeze in next coronavirus relief package
- Investopedia – Mergers and Acquisitions – M&A
- Minority Business Development Agency – Benefits of a Merger or Acquisition
- Politico – House antitrust chairman proposes merger ban during pandemic
- Real Clark Markets – Elizabeth Warren and AOC Get Everything Wrong About M&A
- SIFMA – Global Capital Markets & Financial Institutions Primer
- SIFMA – Markets Matter: US Capital Markets are the Largest in the World