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# APPLIED MERGERS & ACQUISITIONS WORKBOOK

ROBERT F. BRUNER

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ROBERT F. BRUNER



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# ***Introduction to the Workbook***

This *Workbook* aims to help you learn faster and more deeply from *Applied Mergers and Acquisitions* by Robert F. Bruner. Its mission is to promote self-instruction about M&A. Its chapters track exactly the content of the chapters in the main book. The problems and answers in this book carry the reader beyond the end-of-chapter questions on the CD-ROM, offering more exercise, stimulating further reflection, and exploring the topics in more depth. Specifically, each chapter in this book can help you:

- **Review** the main ideas in each chapter and a few focused problems and questions.
- **Survey** the ideas in a forthcoming class and chapter reading assignment.
- **Track** the quantitative analysis of M&A issues in a step-by-step fashion.
- **Exercise** spreadsheet models in hands-on fashion.
- **Test** your own grasp of tools and concepts.

Activities such as these are valuable in the effort to gain a solid mastery of M&A. The *Workbook* has four key features supporting the study of each chapter:

- 1. *Introduction to the chapter.*** Stated in a few sentences, the introduction conveys the main focus of the chapter.
- 2. *Key ideas.*** These are listed at the start of each review chapter in bullet-point fashion to summarize and express key learning points.
- 3. *Worked-through problems and questions.*** These are useful to illustrate key concepts and to test your grasp of lessons.
- 4. *References to Excel spreadsheet files.*** Found on the CD-ROM, these contain the actual models underlying the

worked-through problems. You can study these files for the structure of the models and the logic of the analysis.

Chapter 38 of the main book emphasizes the importance of active learning to support one's study. It is not enough simply to *read*: one must *do*. The spirit of this *Workbook* is to help you convert ideas into *best practice* in your daily work.

# ***PART ONE***

## ***Questions***

# ***CHAPTER 1***

## ***Introduction and Executive Summary***

**M&A (mergers and acquisitions) is one of the most important means by which companies respond to changing conditions. Many firms have no alternative but to merge, acquire, or be acquired.**

**Although M&A is often portrayed as a gamble that one cannot win, it is possible to succeed in M&A. However, competitive forces may limit the chances of success.**

- M&A is a world of contingencies. There are few universal absolute truths about M&A success. For the M&A professional, therefore, there will always be a market for diligent research, sound judgment, and artful execution.
- Success in M&A is driven by both the *structure* of the M&A opportunity one faces and the *conduct* by which one pursues it.
- Elements of *structure* of the M&A environment include:
  - ***Economics.*** This refers to quantitative drivers of the attractiveness of the opportunity: revenues, costs (both fixed and variable), risk, and required rates of return—these determine cash flow and the net present value of an M&A transaction. They also drive the financial stability and future growth of Newco. Best practitioners in M&A are rigorous analysts of the economics of an opportunity.
  - ***Strategy.*** Strategic strengths, weaknesses, opportunities, and threats are part of the structure



of the M&A environment. Many M&A transactions are motivated by a need to respond to the strategic environment. Careful strategic planning is crucial to success in M&A.

- **Organization.** Culture, leadership, talent, and organizational architecture of the merging firms have a major influence on the ability of Newco to achieve benefits of the deal. M&A practitioners must therefore lend careful thought to postmerger organizational structure.
- **Brand.** Large intangible influences in the setting of the M&A opportunity are the reputations of buyer and target. As a brand name affects the thinking of consumers, reputations can shape the expectations and behavior of participants in a merger. Best practitioners seek to create and preserve brand value, and to understand the sources of the counterparty's brand.
- **Law.** Laws and regulations limit the actions of buyer and target firms. M&A practitioners must manage legal risk exposure and to consider opportunities to shape legislation.
- **Ethics.** Ethical norms surround everything one does in M&A and are often discovered only after they are broken. Best practitioners in M&A consciously address the ethical dimension in deal development.
- *Conduct* is the behavior of managers in the pursuit of good M&A outcomes and appears in M&A in the form of creativity, interpersonal skills, and elements of personality. Behavior is important because it filters and interacts with the structural elements of a deal. Behavior affects M&A outcomes in areas such as the following:
  - **Search for partners.** Discovery of partners may rely on “networking,” which relies on social skills.

- ***Due diligence.*** Success in due diligence is tied to the investigator's attitude and personal attributes such as stamina, care, and capacity for critical thinking.
- ***Negotiation and bidding.*** Psychology and self-discipline affect the outcomes of negotiation and bidding. Attitudes, appetites, and negotiation tactics have a large influence on deal prices and terms.
- ***Dealing with laws, regulations, and the justice system.*** Although laws and regulations may seem like constraints on actions, the M&A practitioner can strive to actually *shape* the structure of the M&A situation.
- ***Deal design.*** Deal design entails searching for trade-offs that will result in a win-win deal for both buyer and seller. Often, such a search requires flexibility and creativity from the deal negotiators.
- ***Postmerger integration.*** It takes managerial skill to successfully implement postmerger integration.
- ***Deal development process.*** Good *process* is one of the key drivers of good outcomes. Conscientiousness in developing a process mind-set lends discipline to thinking and increases the likelihood of a successful M&A outcome.
- The framework reminds us that successful *outcomes* have many dimensions. Best practitioners think in terms of the entire range of outcomes rather than narrowly in just one or two dimensions. One can benchmark the success of a deal against at least seven measures:
  1. ***Creation of market value.*** This is necessarily the first measure of success because of the obligation of managers and directors to serve the welfare of shareholders. But it is rarely sufficient by itself—to take an extreme example, value created unethically or illegally would be unacceptable.

**2. Financial stability.** Another measure of success is whether a deal strengthens the financial structure of the firm. Some deals have been so aggressively financed that they led to bankruptcy shortly after closing.

**3. Improved strategic position.** The deal should serve the mission and strategic objectives of the firm. Best practitioners look for a solid strategic rationale.

**4. Organizational strength.** The acquisition of talent, rejuvenation of a worn-out or defeatist culture, improvement of learning or technology transfer, and transformation of the organizational architecture of a firm are examples of ways in which a deal can strengthen the organization.

**5. Enhanced brand.** A successful deal may strengthen the esteem for the firm in the eyes of competitors, suppliers, customers, and employees.

**6. Observance of the letter and spirit of ethical norms and laws.** Success means more than avoiding criminal indictment: Best practitioners understand that it is important not only to do deals well, but also to do them *right*.

**7. Improved process.** Every transaction should sharpen a firm's leadership and business processes. This happens when one conducts a deal with a learning mind-set.

- The *practice* of M&A is continually changing. The chapter outlines several disruptive ideas that will affect the ongoing development of practice:
  - **A deal is a system.** Internal consistency is important; one must negotiate the pieces of the deal with a view toward the whole. There may be unanticipated side effects; practitioners must look out for these. There may be many attractive

structures, rather than a single best structure, that satisfy the objectives of all parties.

- ***Find and use optionality.*** Options are pervasive in M&A.
- ***Study market inefficiency.*** Where markets are integrated and efficient, decision makers can and should refer to market prices for signals about behavior. However, some markets may be inefficient—where this is true, the best practitioner modifies the tools and concepts to adapt to the market circumstances.
- ***Good governance pays.*** Good governance increases the chances of successful M&A outcomes, though the practices of good governance are still evolving.
- ***A deal is more than price.*** The practitioner faces a host of choices in designing a transaction, most of which have consequences for the buyer and target company shareholders. Deal design choices can create or destroy value.
- ***Behaviorism.*** M&A bidding processes, negotiations, and deal design can influence *and* be influenced by behavior.
- ***No silos.*** The M&A effort will be more successful the more integrated it is across deal design, strategy, and implementation.

## CHAPTER 1—WORKBOOK QUESTIONS

**Explain why each of the following statements is false:**

1. *Success in M&A is determined solely by structural factors.*

2. *In the behavioral realm, success in postmerger integration is influenced more by the conduct and interpersonal skills of managers than by organizational structure.*
3. *Best practice in the legal area of M&A emphasizes only the avoidance of violating laws or regulations so that the pre- and postmerger firms involved in the M&A transaction are not exposed to any legal jeopardy.*
4. *Actions in M&A that are not clearly ethical or that even are unethical will not lead to outright failure as long as they do not violate the law.*
5. *Being able to negotiate and consummate a deal is the hallmark of success in M&A.*
6. *Planning everything with painstaking care ensures a successful outcome.*
7. *The best due diligence processes are those that simply verify facts.*
8. *In M&A, outcomes are more important than processes.*
9. *For every M&A deal, there is one “best” deal design.*
10. *Decision makers should always refer to market prices for signals about behavior.*

# ***CHAPTER 2***

## ***Ethics in M&A***

**Ethical dilemmas are pervasive in M&A.**

**Unethical business practices are unsustainable; they do not provide a strong foundation for long-term corporate or professional success.**

- Companies that are committed to ethical behavior build trust and add meaningful value to their brand. A strong corporate reputation attracts active buyers, intermediaries, advisers, repeat business, and price premiums that ultimately yield attractive profits and higher returns.
- Ethical business practices promote strong leadership and teamwork in organizations. Ethical behavior aligns a company's human capital around a set of shared values, which in turn enhance business processes and capabilities.
- A company committed to ethics will look above and beyond the law to set its standards for good business practices. The law is the lowest common denominator of social norms; it enforces punishment only for illegal behavior.
- Professionals who are guided by their consciences and commitment to ethical standards understand that personal pride and self-respect are invaluable, intangible assets.
- In most, if not all, cases, M&A professionals act as agents on behalf of a company's stockholders and/or stakeholders.



- The *stockholder theory*, advanced by Milton Friedman (1962), holds that a company must act in the best interests of its owners and strive to maximize shareholders' returns.
- Alternatively, Edward Freeman's *stakeholder theory* (1984) prescribes a broader view: management should act in the interests of all of its stakeholders, which include constituent groups such as customers, buyers, and employees.
- Moral philosophy offers at least three bases for assessing what is right versus wrong.
  - 1. Consequences.** The first perspective asks who will be affected, and how. This branch of philosophy argues that the "right actions" are those that produce the greatest good for the greatest number. Its best-known proponents include philosophers Jeremy Bentham (1748–1832) and John Stuart Mill (1806–1873).
  - 2. Duties or intentions.** The second perspective focuses on the matrix of duties surrounding the manager and the consistency of one's intentions to fulfill them. An action is deemed as moral if it is intended to benefit and respect others and it is done out of a sense of duty, not self-gain. Perhaps the best-known deontologist is Immanuel Kant (1724–1804).
  - 3. Virtues.** The third perspective asks how an action will affect one's virtue, either in one's own or in others' eyes. A simple test is to imagine how you would feel if the contemplated action were published on the front page of tomorrow's newspaper. Rather than following rules, people are best guided by considering what a paragon of virtue would do. The Greek philosopher Aristotle (384–322 b.c.) prescribed this view.
- Business leadership involves more than an understanding of ethics; it also entails the promotion

and practice of ethical behavior, active discussion, and reflection.

- Developing a high-performing culture that is also ethical can be achieved by adopting and enacting personal, corporate, and professional codes of ethics.

## **CHAPTER 2—WORKBOOK QUESTIONS**

### **Analysis of the 1984 Disney Case**

Imagine a conversation among three student philosophers: David, who is focused on duties; Ulyssa, focused on consequences; and Vera, a virtue-ethicist. They are debating the Disney Company's decision to pay greenmail. (For more information about this, see Chapter 2 of the main text.)

*1a. What do you think the three philosophers would say about Ron Miller and the 1984 greenmail situation?*

*1b. In your opinion, which philosopher could most successfully convince you as to whether paying greenmail was ethical and why? How might one philosopher's line of reasoning supersede the others?*

### **Applying Ethics to Real Business Situations**

#### ***Case #1***

Former majority owners of a manufacturing company, Power Electronics, have filed a lawsuit in federal district court against Systems Integration Corporation (SIC), to whom they recently sold Power Electronics. The plaintiffs claim that the buyer, SIC, ended up paying them about \$20 million less than the agreed-upon \$220 million for the company