NICO Asset Managers

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INVESTOR'S GUIDE

A guide to the financial markets, investments and the economy
17 August 2018

Topic 278: Business Acquisitions

1. Introduction

Last week we introduced a new topic on business mergers where we looked at the reasons for merging and the types of business mergers. This week we will look at a related concept, business acquisitions, which is when one company takes a controlling interest in another. We will look at the types of acquisitions and some of its advantages.

2. Types of Business Acquisitions

i. Friendly Acquisitions

Friendly acquisitions occur when the target firm expresses its agreement to be acquired. In a friendly acquisition, management, shareholders and the board accept the acquisition. In most cases, the board approves a buyout offer from the acquiring firm and shareholders vote to pass the acquisition. Friendly acquisitions often work towards a mutual benefit for both the acquiring and target company. Both parties agree to the terms of the acquisition.

ii. Hostile Acquisitions

Hostile acquisitions occur when the target company does not want to be purchased. An acquisition is considered hostile if the target company's management and board reject the offer to be acquired but the acquiring company continues to pursue it. Hostile acquisitions can be accomplished in two ways:

- **Tender offer:** This is an offer to purchase some or all of the shares in a company at premium to the market price. This gives shareholders an incentive to sell their shares. The acquiring company can execute a tender offer directly to shareholders even without the board's consent.

- **Proxy fight:** This is when an acquiring company tries to pursue the target company's majority shareholders to replace its management with a new one which will approve the acquisition. The new management is typically more receptive to the proposed changes, making it easier to implement the acquisition.

3. Advantages of Acquisitions

- **Market Power**

An acquisition, especially of companies in the same industry, will quickly build market presence for a company, increasing market share while reducing the competition's stronghold. Where competition has been particularly challenging, growth through acquisition can reduce competitor capacity and level the playing field.

- **New Resources and Competencies**

Businesses may choose acquisition as a route for gaining resources and competencies currently not held. These can have multiple advantages, ranging from immediate increases in revenues to improving long term financial outlook. Diversity and expansion can also help a company to hedge against periods of economic or market volatility.

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