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The recession, the change in the national administration, the effect of Opinions 16 and 17 of the APB—all these have changed the merger climate drastically. This article explores the implications of those changes—and what they can mean to CPA MAS departments—

NEW DECADE, NEW LOOK IN CORPORATE MERGERS

by David F. Linowes
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IN KEEPING with the general cooling down of the economy, the advance of the conglomerates that seemed so invincible in the Sixties appears to have halted. The daring corporate raids that threatened so many companies in the recent past—including such giants as Sinclair Oil, Goodrich Rubber, Grumman Aircraft, and Armour Meat Packers—are no longer so bold, so successful, or so frequent.

There is more behind this than the business downturn, however. There has been a change in the national administration. Whereas the Johnson Adminstration looked with a rather condoning eye on the merger movement, the Nixon Administration has taken a very different attitude. The Justice Department through Assistant Attorney General Richard McLaren seemed at one time to have opened a broad-scale attack on acquisitions. Under President Johnson, a task force organized to study the entire merger question reported in June, 1968, that it did not feel the heavy merger activity of that time tended to create unreasonable concentrations of wealth or economic power and that, in its opinion, no new laws were required to deal with this trend toward acquisitions.

On the other hand, the Department of Justice, under the Nixon Administration, seems to have decided to interpret an existing law to hamper merger attempts; Mr. McLaren has chosen to interpret the Clayton Act by basing his actions on a corporation's intention to commit an act contrary to the public good. The act states that an acquisition is illegal if "the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly."

This is vague wording, and its very vagueness has made it possible

for Mr. McLaren to use considerable latitude in bringing antitrust actions.

Interestingly enough, the antimerger action taken recently by the Government does not mean that the Nixon Administration is antibusiness. On the contrary, the antimerger steps were sometimes initiated at the request of businessmen who resented the then merger entrepreneurs—such as Ling of Ling-Temco-Vought and Bluhdorn of Gulf & Western. The businessmen who resisted these aggressive overtures wanted to continue to run their businesses along traditional lines without disturbance to the status quo, and they put pressure on the Government's administrative agencies to help thwart some of the attacks.

So, both the business and Governmental climate have changed radically since the late Sixties. Yet many companies still are vitally interested in acquisitions. What do they do?

The trend that seems to be emerging is of vital interest to CPA firms and particularly to the MAS departments of those firms.

If anything in the present merger trend can be discerned, it is that much more thought and planning are being applied to acquisition programs. Acquisition executives have become far more respectful of the adage, "The buyer needs a hundred eyes, the seller not one." They are now more carefully than ever analyzing their own attributes and qualifications for acquisition and are exercising more prudence in readying their organizations before plunging ahead.

The major effort is being placed on evaluating management capability, rather than on financial statements, which in the past were the key factor in acquisition moves. No one familiar with business has to be told how the finding of hidden values in financial statements and the application of unique techniques of corporate finance led to many of the major success stories in the Sixties. It was often a matter of bookkeeping legerdemain—and, in some cases, even outright chicanery.

But now a combination of circumstances—not least the acceptance by the accounting profession of Opinions 16 and 17 of the Accounting Principles Board, which deal with mergers and business combinations—has placed the business of mergers in a state of reexamination. Because the general effect of the APB Opinions may reduce the reported earnings of some acquired companies, they will become less attractive as opportunities for acquisition gimmickry and financial entrepreneurship.

So the emphasis in future acquisitions will be on management capabilities, not financial statements. Sound management is the currently accepted catalyst for turning copper into gold, not financial machinations.

This sound management approach begins with self-analysis.

In self-analysis, companies are looking for the pluses within their own shop which give them a particular advantage in certain types of acquisitions.

These pluses are the unique attributes of an organization with special talents, rare experience, or superior people.

Here are some of them:

1. Ability to make fast decisions
2. Effective labor relations techniques
3. Know-how in setting up and supervising franchise or establishing chain store operations
4. Knowledge of transportation and public warehousing facilities
5. Familiarity with business customs in foreign countries
6. Experience in turning dormant real estate into profit opportunities
7. Resourcefulness to convert idle capacity into new profit centers
8. Capacity to operate in markets having severe price fluctuations
9. Capacity for quick responses to consumer wants
10. Familiarity with financing techniques and institutions.

There are many ways to approach a business organization's self-analysis. Outsiders can be helpful in giving an organization insights into its own strengths and weaknesses. Customer reactions, suppliers' opinions, bankers' evaluations may be helpful. Consultants that a business uses, such as lawyers, CPAs, engineers, are in a position to identify a company's strengths and weaknesses from their particular discipline's vantage point. Regardless of the approach or the mechanics, the self-analysis exercise has now become essential for laying a sound foundation for the steps in preparing an acquisition program.

The acquisition executive today is anticipating problems that may arise and is thinking through tentative solutions which he may apply on short notice. Here are some

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management actions which are now being thought through and worked on at the same time an acquisition program is getting under way:

1. Preparations are being made for increased demand on executive time and talent.
2. Controls that are comprehensive yet flexible are being readied.
3. Personnel who are to review the various functions of the acquired company are being selected and prepared.
4. The need for objectivity, intellectual independence, and integrity during each step of the acquisition is being emphasized.

The nature of the organization charged with the responsibility of an acquisition program is largely determined by the nature of the management hierarchy of the acquiring company.

All structures, however, are recognizing these three essential points:

1. An acquisition program is not a part-time job for an executive. A capable creative executive is being assigned to this function and is applying all his efforts to this work. If the man charged with the acquisition program is not the chief executive officer, he is an executive with authority to make decisions, and he has ready access to the chief executive officer at all times.
2. The procedures for processing acquisition candidates are being made flexible, fluid, and informal. The fact that time required to process papers through rigid procedures and long lines of authority may try the patience of an anxious seller and drive him into the arms of a competitor is now recognized.
3. The facility for strategic planning is being built into an acquisition structure.

There are so many facets to examine and weigh in a merger negotiation and so few people available to do this work that in the great majority of cases practically all planning had been on the tactical level. The immensely important strategical planning efforts got postponed to a later date. The later date came after the merger had been consummated, and then it was often too late.

The tactical aspects of a merger transaction include the price negotiations, products analysis, determination of asset values and liabilities to be assumed, terms of payment. These tactical facets all involve questions whose answers are signed, sealed, and delivered on the merger date or within a few months thereafter. Too frequently all attention during merger negotiations was directed to these tactical matters at the expense of strategical matters.

The strategical aspects of a merger involve the long-term relationships between the acquired company and the acquiring company—the management aspects, if you please. They include plans for realigning executive personnel and for consolidating production facilities, cutting back some of the divisions, entering new market areas, and consolidating the research and development laboratories of both companies, as well as plans for consolidating the sales and distribution organizations and instituting centralized or decentralized controls, all designed to carry the merged complex at least three years beyond the merger date.

The coming decade

In conclusion, I have presented in an abbreviated way what appears to be the new approach to mergers in the 1970's—this changed approach being brought on by rather adverse economic conditions and actions by Government regulatory bodies and even actions by the accounting profession.

The approach of the Seventies places its *major* thrust on management capability, not financial entrepreneurship. The management capability approach first identifies the acquiring company's own unique attributes; then organizes itself to handle problems that may arise later; and finally sets up a structure which provides for a full-time executive, flexible procedures, and strategic planning.

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