Analysis on Financial Issues in Mergers and Acquisitions and Countermeasures

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Abstract. Mergers and acquisitions are a strategic decision for enterprises to expand the scale of production and operation, seize market shares and achieve rapid growth, and financial issues in mergers and acquisitions run through them. The appearance of financial issues will endanger the interests of the merger and acquisition enterprises, and will even cause the failure in the entire merger and acquisition activities. This paper firstly introduces the meaning and causes of mergers and acquisitions; secondly, analyzes the common financial issues and their causes during the merger and acquisition course; and at last, puts forward the strategies for these financial issues.

1. Introduction
Under the context of global economic integration, mergers and acquisitions, as a kind of development strategy for expanding production and operation scale, reducing production costs, improving market shares and opening up new industries, are accepted by more and more enterprises. The enterprises hope to obtain competitive advantages and seize favorable positions in global economic market through effective mergers and acquisitions. Although our nation has made positive guidance on mergers and acquisitions, examples of failure in mergers and acquisitions can still be found everywhere. In all mergers and acquisitions, financial issues are closely related to the interests of merger and acquisition enterprises, and even determine the success of the whole merger and acquisition course. Therefore, this paper analyzes the financial issues that may appear in the merger and acquisition courses, and their causes, and puts forward effective countermeasures in the hope of providing reference for increasing the success rate of mergers and acquisitions.

2. Connotation of Mergers and Acquisitions and Their Driving Courses

2.1 Connotation of mergers and acquisitions
Mergers and acquisitions (M&A), generally refer to the behaviors of mergers and acquisitions between or among enterprises. Merger refers to the course of combining two or more independent enterprises into one enterprise through legal ways with the rights and obligations of the original companies undertaken by the new company. Acquisition refers to the transaction behavior of an enterprise of obtaining the control right over the other enterprise through purchasing the stocks or assets of such an enterprise in cash or by negotiable securities so as to be in the controlling status. The nature of mergers and acquisitions is the change in enterprise right subject. Under the context of market economy, the enterprises can complete the rational allocation and optimization of assets, improve competitiveness and strategic positions and achieve their own growth in value through the merger and acquisition behaviors.

2.2 Driving courses for mergers and acquisitions
The root cause for carrying out M&A behaviors by enterprise is to seek their own development and achieve value growth. Generally speaking, achieving development of the enterprises mainly depends on three ways, i.e., internal expansion, M&A and strategic alliance. Compared to other two ways, the
advantages of M&A are quickly accelerating development speed, breaking through the barriers to entry for target enterprises, and realizing mutual supports between enterprises in the market. From the theoretical level, most enterprises’ motivation of M&A is to realize the synergistic effect between enterprises, including the synergism in management, operation and finance so as to achieve the effect that the overall benefits of the company after M&A are larger than the sum of the benefits of two enterprises before M&A.

3. Financial Issues in Mergers and Acquisitions and Their Causes

3.1 Inaccurate valuation of target enterprises

Valuation of a target enterprise is the basic link of the whole course of a merger and acquisition. An accurate and effective valuation is favorable for determining the price for a M&A transaction, promoting the smooth proceeding of subsequent course, and providing solid guarantee for the stable development of the enterprises in the future. The key to making valuation of the target enterprise mainly lies in the acquirer’s systematic expectation of the time and amount of the future profits of the target enterprise. If the price of the target enterprise is fixed too high, the acquirer will pay the cash or negotiable securities more than the actual value, which may cause interruption in the subsequent course of M&A, or the problem of shortage of funds will arise because the enterprise after M&A cannot reach the prospective earnings, and even the overall sustainable operation of the enterprise will be affected.

There are mainly two reasons for deviation in valuation on target enterprises: firstly, the information of the target enterprise is incompletely mastered. The information distortion of financial statements of the target enterprise or the relevant personnel deliberate concealing of some financial information in M&A will trigger the problem of information asymmetry of all parties to the merger and acquisition. If the acquirer has difficulty in having a real understanding of the assets, liabilities and equity structure of the target enterprise, the valuation of the target enterprise will have deviation on this account. Secondly, the choice of the valuation method is unreasonable. In the actual valuation practice, cash flow method and net asset method are the common two valuation methods. However, the adoption of two methods has corresponding financial risks: the former one has relatively high requirements on the valuation ability of the professionals, and has relatively strong subjectivity; and the latter lacks the consideration of the future profitability of the enterprise and has randomness in accounting in the meantime.

3.2 Unreasonable choice of ways of merger and acquisition financing

Compared to general financing, the financing behaviors of an enterprise for completing the merger and acquisition course are characterized by large amount, wide channels and many methods. The M&A enterprise shall prudently consider the influence of the financing way in the M&A course on the M&A enterprise in the future in the aspects of capital structure, company governance and operation mode. The capital source of the enterprise during the merger and acquisition course can be usually classified into internal financing and external financing, and the two ways of financing have their own advantages and disadvantages. The funds of internal financing are from the own funds or unused special funds of the enterprise, have the advantages of low risks, low costs and easy access, but may be likely to cause the situation of shortage in circulating funds of the enterprise. Moreover, based on the scale and development situation of the enterprises in China at present, most enterprises’ own funds of can hardly provide powerful guarantees for M&A and subsequent development after M&A; external financing is usually divided into three ways, debt financing, equity financing and mixed financing. The merger and acquisition enterprise completes merger and acquisition financing through raising funds from the economic subjects other than the enterprise. The choices of external financing are diversified, but because the capital market in China is relatively not mature enough, the relevant systems and specifications are not complete, and the restrictions on some financial ways are many, the
enterprises choosing the way of external financing are apt to trigger the financial issues in the financing course.

3.3 Relative single arrangement for payment means for mergers and acquisitions

The payment method in the merger and acquisition refers to the payment method adopted by the acquirer for obtaining the control right over the target enterprise. The main payment methods for merger and acquisition course at present are: cash payment, equity payment and leverage payment. Which payment method will be adopted by the enterprise to make payment mainly depends on the financial situation and capital structure of the acquirer, the intentions of the shareholders and management layer of the acquirer and the acquired party, and the enterprise tax arrangements. At the same time, the development degree of the capital market, and constraints of laws and regulations on payment for mergers and acquisitions are the factors affecting the choice of payment method. Different payment methods will bring different payment risks to the merger and acquisition enterprises, and these risks are particularly reflected in enabling the enterprises to bear too large fund pressure and capital operation risks in later period of M&A due to unreasonable payment structure and too big proportion of cash payment.

3.4 High financial risks in the integration period

The integration after M&A is a relatively complex course, and will often bring great challenges to the enterprise managers. Successful integration means the effectiveness of M&A strategy, enabling all parties to the M&A, and creating or adding enterprise value. Unsuccessful integration will make all previous efforts of the whole merger and acquisition course wasted, and the subsequent development of the enterprise cannot be guaranteed. In the period of integration of M&A, the enterprise manager shall mainly pay attention to cultural fusion, arrangement of organization structure and strategic decisions and other issues. Meanwhile, the financial issues in this period are also worth attention, including liquidity risk and financial operation risk. The former refers to the problems of too many enterprise liabilities or insufficient asset value in short term and decrease in adjustment ability of enterprise finance caused by unreasonable ways of financing and payment in merger and acquisition period; the latter refers to the financial problems of less optimistic realistic financial situation because the enterprise financial management personnel do not make the financial situation

4. Countermeasures for the Financial Issues in the Mergers and Acquisitions

4.1 Accurately valuating target enterprise

In the merger and acquisition course, the enterprise can start from the following two aspects to make comprehensive anticipation and evaluation on the target enterprise as soon as possible, and reasonably and accurately estimate the enterprise value.

1. Obtain complete financial information. In the merger and acquisition course, in order to reduce the possibility of estimation deviation in the value of the target enterprise due to the problem of information asymmetry, the merger and acquisition enterprise can appoint the relevant personnel in professional fields, including assets appraisal firm, agent, accounting firm, law firm, etc. to make thorough investigations on the asset ownership, authenticity and completeness of the statement data and actual operation capacity and give objective and fair evaluation. All enterprises shall also sign the relevant legal agreements, and make reasonable statement to all parties on the responsibilities in the merger and acquisition course and after M&A.

2. Reasonably optimize valuation method. The M&A enterprise shall choose appropriate valuation model according to the relevant information obtained in the early period of M&A, and optimize the valuation way of the target enterprise based on the present valuation system. In different M&A cases, because the external environment of the target enterprise and its development characteristics are different, the M&A enterprise shall still make specific analysis according to the specific situations to
avoid deviation in valuation caused by improper use of valuation method or careless evaluation process although the enterprise valuation and pricing theory at present is relatively mature.

4.2 Reasonably optimizing the financing ways of mergers and acquisitions

The M&A enterprise can reduce financing risks under the premise of guaranteeing the smooth preceding of M&A through reasonably choosing the financing way in the enterprise M&A course with three kinds of specific practices as follows:

1. Financing way shall be reasonably arranged according to the own characteristics of the enterprise, including the structure of assets and liabilities, consideration valuation, expected future operation situation and other factors to guard against enterprise reputation reduction, blocked turnover of current assets, and even bankruptcy and other risks caused by liability pressure in days to come.

2. M&A enterprise can choose the method of matching with many kinds of financing way to expand financing channels and diversifying financing risks.

3. Properly choose mixed financing instruments for financing. For example, convertible securities combine the advantages of bonds and stocks. This kind of financing form can cut down the enterprise tax burden and reduce financing costs at the same time of maintaining its credit rating. Although the mixed financing form can bring higher returns to the enterprise, but at the time of choosing the financing mode, attention shall be paid to its current immaturity to make careful choice.

4.3 Flexibly choosing payment methods for mergers and acquisitions

Flexible choice of the payment way of M&A can reduce the enterprise financial pressure to a great extent, and propel the smooth proceeding of M&A. The specific countermeasures are as follows:

1. The choice of payment way shall be based on the asset liquidity and financing capacity of the acquirer and consideration shall be given to the preference of company shareholders and the management layer, share price level and capital structure of the target company. A reasonable and effective payment way shall enable the enterprise to have good capital structure and operation capacity after M&A.

2. Reasonable arrangement of payment time can also reduce the pressure of the payment course brought to the enterprise. Before choosing the payment method, the enterprise shall carefully analyze the term structure of assets and liabilities to achieve the maximum matching degree. For example, the enterprise can adopt the means of payment by installment, make planning and negotiation of payment time according to the fund level to reduce the pressure of paying large amount at one time in short time brought to the enterprise, and to avoid the risk of concealing liability by the relevant personnel caused by performance pressure.

3. Choose mixed payment method and reduce cash payment ratio to reduce liquidity risk according to the specific situations. Comprehensive choice of several payment instruments is good for diversifying payment risks of the enterprise and overcoming the defects of single payment method. At the same time, if the management layer of the target enterprise has no special requirement, the enterprise shall reduce the cash payment ratio as much as possible to avoid too large financial pressure.

4.4 Enhancing risk prevention consciousness of enterprises

In the later period of M&A, the enterprise shall enhance management on all links of merged and acquired enterprise, and strengthen risk prevention consciousness during the M&A integration period to guarantee that the enterprise runs smoothly and steadily. It requires the enterprise financial management and risk control personnel to constantly enhance understanding of the enterprise’s financial situation and financial risk consciousness, reasonable arrangement of structure of assets and liabilities, prediction of future profit status and avoidance of financial risk. In the meantime, it requires the enterprises to make reasonable estimate and judgment on the expected development situation after M&A, estimate the financial standing and guarantee the stability of future cash flow.
through financial data in the M&A course. Only when the smooth proceeding of the whole process is guaranteed, the whole M&A strategy can bring maximum benefits to the enterprise.

5. Conclusion

Successful mergers and acquisitions will bring huge economic benefits to the enterprises and develop the potentials for future development. Finding, evaluating and solving the financial issues appearing in the merger and acquisition courses will help mergers and acquisitions. To sum up, if enterprises are able to accurately estimate the value of target enterprises, reasonably optimize the ways of merger and acquisition financing, flexibly choose payment means for mergers and acquisitions, and enhance enterprise risk prevention consciousness, the enterprises will complete the merger and acquisition activities more smoothly and steadily and have better development.

References


