

3.0 Mergers and Acquisition

3.1 Bad Growth Strategy for Shareholders and Primary Stakeholders

Main Street Capitalism (MSC) management practices would ban all executive performance bonuses resulting from a corporate takeover deal, including 'change of control' golden parachute termination packages.

MSC's objective is to lessen the economic havoc foisted onto primary stakeholders by managers' capitalism high-risk "something stupid" takeover decisions. When asked why he kept so much cash on hand (\$40 billion) instead of investing it, Warren Buffet replied, "I would rather do nothing than "something stupid."

Mergers and acquisition affairs are known to spread economically transmitted diseases that reduce pre-merger shareholder value, eliminate well-paying, quality, jobs, dilute local government tax revenues and upsets social harmony.

An A.T. Kearney study of 115 global mergers in the mid 1990s showed that the total return to shareholders (relative to peer companies) was minus 58%! *BUSINESSWEEK*: October 19, 1995 The Case Against Mergers -- Even in the '90s, Most Still Fail to Deliver. *BUSINESSWEEK*: October 14, 2002 MERGERS Why Most Big Deals Don't Pay Off showed that 61% of buyers destroyed shareholder wealth. Since 2002, as reported herein, Managers' Capitalism Sagas #1, #2 and #3 on the next page, mergers are still as bad a growth strategy as ever for shareholders and primary stakeholders.

As shown in Insert 3-1, primary stakeholders are always the losers in a corporate merger. CEOs and key players are the only sure winners in a M&A affair.

Insert 3-1 Economic Aftermath of an M&A

Primary Stakeholders	Economic Aftermaths
Shareholders	At least 6 out of 10 times, the combined pre-merger shareholder value of the two companies will decrease after the merger.
Customers	Little new added value. Prices will not decrease. Service may not increase.
Employees	Well-paying jobs from common tasks will be eliminated. Companies will lose key skilled employees who don't like the new management culture.
Pensioners	Because of loss in market share value, a US employee's 401(K) contribution retirement plan may also lose value.
Suppliers	When a local Head Office moves away and jobs are lost, local suppliers will lose business.
Governments	Because of the loss of well-paying jobs' withholding tax remittances, the Total Tax Contribution will decrease.
M&A players: CEOs; executive teams of buyers and sellers; investment houses; banks; accountants; lawyers; merger consultants.	Each of key M&A player stands to earn multi-million dollar in bonuses and in professional service fees.

With no chance of personal financial gain, CEOs may grow the business with cost effective improvements to its value chain outputs and by making smarter, less high-priced, merger decisions. Smart corporate collaborative market initiatives may create greater financial wealth for shareholders and primary stakeholders than M&As.

The promise of the elimination of millions of dollars in redundancy labour and administration operating costs is a prime reason given for how a merger is to create financial shareholder value. However, the failure to achieve organizational cultural synergy between to the two merging organizations is quite often the main reason that mergers fail.

3.2 “Something Stupid”: Bank of America takeover of Merrill Lynch

Managers’ Capitalism Saga # 3: “Something Stupid”: Bank of America and Merrill Lynch.

Pre-merger share value: Bank of America’s stock spiralled downward 56% by January 24, 2009, following the Jan. 1 closing of its acquisition of Merrill Lynch into the mid single digits.

Loss of well-paying quality jobs: Bank of America Corp., battling the slowed economy, expects to eliminate about 35,000 positions over the next three years as it absorbs New York securities firm Merrill Lynch & Co. Ken Lewis must find a way to stem defections of top performers and key executives even as he slashes at jobs in a cost-cutting initiative that should save the big bank \$7 billion annually by 2012.

Pensioners’ income drastically cut: Ken Lewis slashed BoA’s annual dividend from \$2.56 cents to four cents to preserve cash.

Loss of government total tax contribution revenues from BofA: no corporate income tax will be paid in years while operating at a loss; annual losses will be applied to future year profits resulting in decrease in future corporate taxes paid; lay-off means less employer-paid payroll taxes and less employee income tax remittances; pensioners loss of annual dividend income means they will pay less taxes.

Flawed decision-making.

Before buying Merrill, Ken Lewis had spent close to \$110 billion to buy FleetBoston Financial Corp, credit card issuer MBNA Corp., LaSalle Bank Corp., the wealth-management business of U.S. Trust, and Countrywide Financial. How much of his financial performance bonus was he paid for these takeovers?

Ken Lewis, Bank of America’s CEO, has faced withering criticism for rushing to buy Merrill after less than two days of due diligence. At the time of the September Merrill Lynch offer to purchase, no one on Wall Street was blind to the severity of the mortgage problem. And it’s not as though economists haven’t predicted for months that the crisis would engulf other corners of the economy, vaporizing jobs and increasing defaults on corporate loans and credit cards.

“We just thought it was in the best interest of our company and our shareholders and the country to move forward,” said Ken Lewis concerning BofA’s rescue purchase of Merrill Lynch & Co. Inc. in September 2008. He was confident his Bank could swallow Merrill without asking taxpayers to help foot the bill.

Bank of America received \$25-billion in support from the government’s Troubled Asset Relief Program. By January 15, 2009, Washington forked over another \$20-billion in bailout money along with a promise that it will guarantee as much as \$118-billion in losses on the two companies’ most toxic assets. The federal government has injected \$45-billion into Bank of America, and holds a 6-per-cent stake, making it the largest single shareholder – and a key voice at the decision table. But not on its board.

The Bank of America bailout, part two, has investors asking whether Mr. Lewis properly understood the risks he was taking on with Merrill, or if the due diligence was flawed, or if he was simply too intent on expanding his empire. Investors have since learned that Mr. Lewis was considering abandoning the deal late in December because of the alarming pace at which Merrill was writing down the value of its assets.

The pressure has begun mounting on Lewis to explain how he could possibly have agreed to pay \$29-a-share -- some \$19.4 billion in stock for a nearly bankrupt Merrill Lynch. On February 20, 2009 BoA common share closed at \$3.79.

When asked when he thought the bank could extricate itself from the embrace of Washington, Mr. Lewis said: “I wish I knew,” adding that his preference would be “as soon as possible.” He then asserted that the company will generate “huge” profits when economic conditions normalize. “It’s almost directly related to how fast you think the economy will come back,” he said.

Wanted “Shot Gun” directors to protect stakeholders’ basic needs from managers’ capitalism antiques.

Michael Pascoe's, December 8, 2008 *Brisbane Times* **Mergers are for Suckers** expresses the public's frustration and rage against corporate mergers. Michael Pascoe's lament for M&A shareholders should have included woes for the financial and social losses suffered by all M&A primary stakeholders

Insert 3-4 Mergers are for suckers *Brisbane Times* Michael Pascoe | December 9, 2008

Most people think they are better-than-average drivers, which, by definition, most people can't be. Call it a mass delusion.

Takeovers and mergers are generally like that too - a source of delusion for the key players.

Various studies over the years have found most big corporate takeovers/mergers are failures as far as the acquiring shareholders are concerned - but that doesn't stop the moving and shaking boards, CEOs and fee-hungry advisers all proclaiming that their takeover is different.

But there is one player who never loses in a big takeover - the CEO of the taker or takee. The quickest and easiest way to receive a multimillion payout (without the slight opprobrium of being sacked for incompetence) is to be taken over. Next best is to do the takeover, which enables the CEO's remuneration consultant to argue for a pay rise on the basis of greater responsibility.

Then there are the great urgers of modern capitalism, the investment bankers and advisors whose very existence is fed by doing the deal, not the long-term outcome. Corporate Australia is littered with the skeletons of takeover mistakes that nonetheless made an army of urgers rich. And therein lies one of the under-examined aspects of M&A mania - the moral hazard whereby key players in the process make vast profits even if shareholders lose.

The urgers are another problem again. CEOs and chairman are constantly duchessed and propositioned by very personable investment bankers who profess to want nothing more than to find ways to add shareholder value. Or something like that.

And CEOs and chairmen are forever on the lookout for some bright "company making" deal i.e. they are willing buyers of the urgers' wares. Never mind that the urgers only real concern is to keep the fee flood flowing.

There was a time when it was thought a gentleman didn't do that sort of thing, that the long-term relationship and honour mattered more than the quick killing.

Now nothing can be taken for granted, including the moral hazard of urgers and CEOs being fabulously rewarded when shareholders are not. Maybe that's what they mean by "win-win".

3.3 Managers' Capitalism Saga #4: Microsoft's Dumb Luck.

A merger takeover is nothing more than a high-risk roll of the die. Microsoft's failure to buy Yahoo was more dumb luck than good management.

Managers' Capitalism Saga #4: Microsoft 's Dumb Luck

Back on May 3, 2008, Microsoft Corp. CEO Steve Ballmer said he was disappointed that Yahoo Inc. refused a takeover bid that had gone as high as \$47.5 billion. Yahoo's founder and CEO Mr. Yang, rejected the unsolicited offer saying it substantially undervalued the company. Many a Yahoo shareholder said Mr. Yang was wrong.

Five months later, on October 10, Yahoo shares were at \$12.29 on the Nasdaq Stock Market. With a market value of \$17 billion, mark-to-market accounting would have required Microsoft to write that asset down by \$30 billion. Mr. Ballmer might well be the luckiest guy in the software industry said a market analyst.

Another recent dumb merger was UK's Rio Tinto PLC takeover of Canada's Alcan, Insert 3-2.

Insert 3-2 Another Bad Merger For Shareholders and Employees

Overpaying by the takeover company is often a very hard cash outflow for employees to swallow. Multinational mining giant **Rio Tinto PLC** struggling to cut 14,000 employees of its 2008 worldwide workforce to maximize cash generation. Most agree Rio Tinto overpaid with its \$38.1 billion all-cash for Canada's aluminum producer Alcan in 2007. Alcan operations are being asked to cut costs in light of brutal 2008 low worldwide prices for aluminum.

3.4 MSC Practices Face Legal Road Blocks

There are legal speed bumps on the road to implementing Main Street capitalism's M&A practices. It may be illegal in Canada or in the United States for a board of directors to refuse to accept a fair takeover bid because it would harm the economic and social well-being of Main Street stakeholders.

The 1986 Delaware Chancery Court **Revlon Ruling**, Insert 3-3, appears to compel U.S. board of directors to maximize only shareholder interests when a company takeover is in play.

Insert 3-3: The Revlon Ruling

A 1986 legal precedence, the Revlon Ruling, dictates if the sale of the company is forthcoming, the main goal the company's board of directors should have is to conduct the proceedings in a manner that would yield the most benefit for the company's shareholders. Essentially, assuming that a number of situations are fulfilled (there are two or more buyers, all bids are cash-based acquisitions and that all parties have the requisite financing), the board of directors should always be picking the highest bid.

December 19, 2008 The Supreme Court of Canada's, BCE Ruling (Insert 3-4) appears to put a greater onus on directors to balance the interests of a number of stakeholders when faced with a change of control or takeover offer. The ruling shifts Canadian law further away from the so-called Revlon rule in the United States.

Insert 3-4: BCE ruling expands directors' duties *Jacquie McNish Globe and Mail December 20, 2008*

The Supreme Court of Canada shifted the country's corporate law regime further away from U.S. laws in its written reasons yesterday for dismissing an investor lawsuit against the ill-fated **BCE Inc.** takeover.

In June, the court dismissed a claim by three classes of debenture holders that alleged BCE's board of directors failed to properly consider their interests when they approved a debt-heavy, \$35-billion takeover. Although the deal is dead, legal experts said the court's written judgment expands the duties of directors of public company's targeted in a takeover play.

Despite the bondholders weak legal hand, the court said directors are expected to treat all stakeholders "equitably and fairly" as part of their broader duty to act in the best interests of the corporation.

"In each case, the question is whether, in all the circumstances, the directors acted in the best interests of the corporation, having regard to all relevant considerations, including, but not confined to, the need to treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen," the decision said.

The ruling shifts Canadian law further away from the so-called Revlon rule in the United States which compels directors to maximize only shareholder interests when a company is in play.

Gary Girvan, a mergers and acquisition specialist with McCarthy Tétrault LLP said the decision puts a greater onus on directors to "balance the interests" of a number of stakeholders when a company is faced with a change of control or takeover offer.

The day has yet to come, if ever, when a board of directors will say "No" to a takeover bid because of job losses, local suppliers loss of business and less total tax contribution from the company being taken over. Only strong, 21st century, government regulations can say "No" to avoid M&A economic havoc.

3.5 Internal Organic Growth Strategy

Internal organic growth is the process of business expansion due to increased output, sales, or both, as opposed to mergers, acquisitions, or take-overs. It is not popular with many CEOs because it takes too long for executives to earn performance bonuses.

Growth achieved through a commitment to customer satisfaction, employee engagement, and core profitability—organic growth—is a smart long-term strategy for any company. Growth generated internally frequently results in better returns on investment, stock value improvements, lower employee turnover, and numerous other benefits. (The Road to Organic Growth' by Edward D Hess. © 2007, Tata McGraw-Hill Publishing Company Limited.)

Why not?