The Goal of Further Growth is Increasingly the Driving Factor Behind Corporate Acquisitions

by
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The annual statistics published by the Federal Cartel Office continuously show new records in terms of the number of registered mergers and acquisitions. This development is not surprising. The alternative to acquiring a company is to build up one's own activities, be it in terms of products, markets, processes or regions. To this extent, the alternative is the same as the make or buy decision. New influences are the accelerating pace of technological change and the rapidly increasing internationalisation of products and markets. Both of these factors shorten the time period within which positions have to be occupied and secured.

1. Market Share is also Acquired

In many cases the most critical bottleneck is the problem of obtaining a sufficient number of qualified employees within an adequate time frame in order to realise necessary further development or to exploit new markets ahead of competitors. Growth considerations thus increasingly lead to the desire to acquire existing companies. Compared with internal growth, this alternative has the advantage that it provides the buyer with immediate use both of an existing infrastructure in terms of customers and suppliers as well as of an existing market share. These considerations are particularly important for companies offering branded products and for corporate entities in largely saturated markets, in the latter case because market share is obtained at the expense of other market participants rather than through overall market growth.

One repeatedly hears the argument that the acquisition of companies in Germany is much more difficult than in countries such as the USA and the UK. An important fact to take into account when reviewing this argument is the difference which exists in terms of the corporate landscape. 75 % of all German companies are sole proprietorships, 12 % are partnerships, 11 % are limited liability companies, 2 % have other legal forms and only 0.1 % are joint stock corporations. On the basis of taxable total sales, sole proprietorships and partnerships together generate 50 %, limited liability companies 25 %, other legal forms 5 % and joint stock corporations 20 % of this sum. These statistics underline the fact that most of the total sales obtained by corporate entities in Germany are derived from private companies.

This structure also manifests itself when comparing the relative sizes of the stock exchanges in Germany and other countries. Approximately 500 German companies are publicly quoted on the stock exchange. This compares with circa 2,500 in London. In Great Britain, the majority ownership of 200 publicy-quoted companies changed hands in 1988 alone. In contrast, changes of majority ownership in German publicly-quoted companies are still exceptional. There are also no obvious indications that this will alter in the foreseeable future. This state of affairs will remain unchanged until such time as substantially more companies become publicly-quoted. In addition, only some 6 % of total private savings in Germany are invested in shares and only 17 % of all German shares are owned by private households.

The most common cause of the sale of private companies is the imminent handover of the business from one generation to the next. In most of these companies the owners repeatedly address the question as to whether it is best to continue to run the company under family ownership or whether it would be better for the company's development if it were to become an integral part of a larger group. The owners of private companies are becoming increasingly rational when considering this issue.

The key factor in making the decision to retain or sell family companies is the desire to secure the long-term future of the company. At the same time, private owners take an increasingly critical view of what is the appropriate long-term investment structure for the family's wealth. This trend is unabated.

From the standpoint of a potential acquiror, this development is positive. The great majority of German companies have realised steady profit growth over the past years. As a result, the equity quota of many German companies has improved markedly in international comparison. Germany has also gained in terms of attractiveness with a view to 1993.

2. Germany is an Attractive Location

More and more American, Japanese and even Scandinavian companies value the fact that Germany is the most populous country in the European Community. With a GDP of over US $ 18,000 per head, Germany is both the wealthiest country within the Community and, with an annual export volume of US $ 300 billion, also the largest exporter of industrial products in the world. These statistics document the attractiveness of Germany as a location.

This attractiveness acquired a new dimension in November 1989: the opening of Eastern Europe and in particular of East Germany. This offers a potential which up until then nobody would have dared to consider realisable in the near future.

In spite of the manifold short-term problems, East Germany has a huge reservoir of well-trained labour, it enjoys a very strong economic position within the COMECON area and has the highest income per head in Eastern Europe.

3. Tradition of Intensive Trade Links to COMECON Countries

East Germany is easily the most attractive location for industrial investment within Eastern Europe. Its close ties with West Germany are an important additional factor. Some 60 % of the imports of the COMECON countries come from the European Community and 32 % from West Germany alone. Among the OECD-countries, Germany has the most intensive trade links with the COMECON area. It is the most important western trade partner. The traditionally close ties to both the West and the East emphasize the increasing locational attractiveness which Germany has to offer to international corporations.

The opening of Eastern Europe has prompted a sudden upsurge in the interest shown by Western companies in direct investments in the East. Up until now, these direct investments have been in the form of joint ventures. The local partner provides infrastructure and labour, the foreign partner technology, processes and management know-how. The Decree by East Germany's Ministerial Council dated January 25, 1990 provides general permission for joint ventures with foreign shareholdings of up to 49 %.

An alternative is to establish joint ventures in West Germany, as VW and IFA have done. In spite of the euphoric sentiment, however, one should not forget that, in general, joint ventures are one of the most difficult and demanding forms of industrial cooperation.

This is particularly the case at the interface between (still) different economic systems. At first, it is important that clarity is obtained concerning the operational income and costs of the Eastern entities. This is not only needed for the financial statements but also in order to permit correct operational calculations.

4. The Price of Companies

In general, the purchase prices for companies are based on their sustainable profit levels. The price earnings ratio in Germany has risen significantly in recent years. This is on the one hand the result of stock market valuations and on the other hand is caused by demand largely exceeding supply or, in other words, too much money chasing too few opportunities.

The emergence of numerous investment companies has made a substantial contribution to this trend. The salesmen selling shares in these investment companies collect money much faster than their colleagues can prudently invest it. Particular industries are also perceived as particularly attractive, so that their price earnings ratios are especially high.

Industries which are perceived as highly attractive include those engaged in waste management or security services as well as those engaged in markets which have, up until now, been dominated by price regulation or by limitations on the number of market participants via licensing, such as road haulage. In addition, industries in which national norms have acted as a barrier to entry such as telecommunications, food and beverages and financial services are also deemed to be particularly promising.

Prices are again high for companies offering market shares or brand names which would be much more costly to develop were the purchaser to try and establish these via internal growth. Small and medium-sized companies, however, are generally much more difficult to sell. They tend to have been dominated by the present owner. Overall, when compared with reconstruction values or international price earnings ratios, the prices for German companies are very reasonable.

5. The Instruments Used in Selling Companies

The systematic approach to selling companies is becoming increasingly established. The careful and logical presentation of the business structure and strengths of the company to be sold, the identification of its growth potential and the calculation and valuation of its sustainable profit level literally justify themselves in monetary terms.

As the next step, possible buyers have to be identified which, in terms of their existing structure, offer the greatest synergy potential, since the purpose of the exercise is to justify the sales price. The key contribution is nevertheless provided by the M & A adviser, who uses his experience to make the right proposals at the right time in the negotiation process.

The M & A adviser has the task of screening the interested parties, ensuring the progress of the negotiations, incorporating both the competitive situation and the conceptional goals of the potential buyer into the valuation process and finally influencing the representations and warranties made in the closing stage of the negotiations. The M & A adviser also often has to mediate between the various shareholders of the company offered for sale in order to determine the common denominator of the interests of his own client.

Handelsblatt on 18.04.1990

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