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Passage No. 88

Direction: Study the following information carefully and answer the question given below.

Paragraph 1: When you are the chief executive of a public company, the temptation to opt for a merger or acquisition is great indeed. Many such bosses may get a call every week or so from an investment banker eager to offer the kind of deal that is sure to boost profits. Plenty of those calls are proving fruitful. In the first three quarters of 2017, just over $2.5trn-worth of transactions were agreed globally, according to Dealogic, a data provider. The total was virtually unchanged from the same period in 2016, but the number in Europe, the Middle East and Africa was up by 21%.

Paragraph 2: It is easy to understand why an executive opts for a deal. Buying another business looks like decisive action, and is a lot easier than coming up with a new, bestselling product. Furthermore, being the acquirer is far more appealing than being the prey; better to be the butcher than the cattle. A takeover may keep activist hedge funds off the management's back for a while longer. And being in charge of a much bigger company is a more demanding task that will surely justify a larger salary for the executives in charge.

Paragraph 3: But these temptations, good and bad, should generally be resisted. S&P Global Market Intelligence, a research arm of the ratings agency, has updated a study on the impact of deals on the acquiring company's share price. The study looked at M&A deals done by listed companies in America's Russell 3000 index between January 2001 and August 2017; deals were only included if they cost more than 5% of the total enterprise value of the acquirer (5% of the equity value, for financial companies). The acquirers' shares underperformed the market and those of rival firms in the same industry.

Paragraph 4: That share-price performance was understandable, in the light of what tended to happen to the fundamentals of the acquiring company's business. The study finds that, relative to the company's peer group, net profit margins fall, as do the returns on capital and on equity; earnings per share grow less quickly; and both debt and interest expenses increase. As the deal is done, however, the executives always sound bullish. Costs will be cut, the companies will benefit from selling a wide range of products and so on; a whole range of "synergies" will be achieved. Instead, the combined companies tend to suffer from clashes of culture and teething problems as systems prove hard to integrate. The AOL-Time Warner merger of 2000 is perhaps the most famous example of a dysfunctional deal; at the time, it was one of the biggest mergers in corporate history. Not every deal is that bad. But instead of two plus two equaling the promised five, all too often they add up to three-and-a-half.

Questions:

1. What is the tone of the author in the passage?

A. Sarcastic B. Witty C. Explanatory D. Vindictive E. Positive

2. Which of the following statements, if true, could be warning signs ahead of a takeover?

I. The faster the company was growing before the acquisition, the worse it tends to perform afterwards.
II. All-share deals tend to perform less well than cash offers.
III. Large deals perform less well than small ones.

A. Only I B. Only III C. Only II and III D. All of the above
E. None of the above

3. What could be an appropriate title for the passage?

A. All that glitters is not gold
B. Make Hay while the sun shines
C. Rising populism and protectionism
D. When two plus two equals 5
E. Investment banks and the lure of M&As

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4. Which of the following statements can be inferred from the passage?

I. The acquirer firm's share underperforms its own historic performance 7 out of 10 times.
II. The newly combined company tends to have culture clashes and teething issues.
III. The acquiring company's fundamentals undergo a positive shift immediately after the acquisition.

A. Only II B. Only III C. Only I and II D. Only I and III
E. All of the above

5. As per the passage, why does it sound tempting to opt for a merger or acquisition?

I. This path is much simpler than coming up with a new product that would be a bestseller.
II. It is more appealing to be the one doing the acquisition rather than the one being acquired.
III. The bigger the company the more returns it guarantees in the long run

A. Only I B. Only I and II C. Only II and III D. All of the above E. Only III

Correct Answers:

1	2	3	4	5
C	E	A	D	B

Explanations:

1. The entire passage talks about how acquisitions may not be as great as they appear from a distance. The passage is replete with research.

Sarcastic and *witty* can be eliminated straight away.

Vindictive means spiteful/bitter and can be eliminated.

Explanatory is the best fit as the passage is not all that positive about acquisitions in general.

Hence, **option C** is correct.

2. None of the statements depict a sure shot warning sign of a potential merger failure.

Hence, **option E** is correct.

3. As per the passage, the main theme is that Mergers and acquisition have a charming glow about them but the reality is somewhat less lustrous on ground with many underperforming and suffering from weaker fundamentals. Other issues include culture clashes and general adjustment issues. Thus, the enthusiasm shown by the Investment Banks and even executives of the acquiring company is some what misplaced.

Options B and C are irrelevant.

Option D is opposite to what the passage conveys.

Option E gives the impression that the passage talks majorly from the perspective of Investment Banks while that is not the case here.

Option A is correct. It conveys the main point which is that what may appear to be very lucrative could be very different in reality.

Hence, **option A** is correct.

4. Refer to:

‘..The acquirers’ shares underperformed the market and those of rival firms in the same industry..’

This renders statement I incorrect.

‘..Instead, the combined companies tend to suffer from clashes of culture and teething problems as systems prove hard to integrate..’

Statement II is correct.

‘..That share-price performance was understandable, in the light of what tended to happen to the fundamentals of the acquiring company’s business. The study finds that, relative to the company’s peer group, net profit margins fall, as do the returns on capital and on equity; earnings per share grow less quickly; and both debt and interest expenses increase…’

Statement III is false.

Hence, **option D** is correct.

5. Refer to paragraph 3:

‘..It is easy to understand why an executive opts for a deal. Buying another business looks like decisive action, and is a lot easier than coming up with a new, bestselling product. Furthermore, being the acquirer is far more appealing than being the prey; better to be the butcher than the cattle. A takeover may keep activist hedge funds off the management’s back for a while longer. And being in charge of a much bigger company is a more demanding task that will surely justify a larger salary for the executives in charge…’

Only Statements I and II can be seen here.

Statement III is incorrect.

Hence, **option B** is correct.

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