Volume Title: Mergers and Acquisitions

Volume Author/Editor: Alan J. Auerbach, ed.

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-03209-4

Volume URL: http://www.nber.org/books/auer87-1

Publication Date: 1987

Chapter Title: Introduction to "Mergers and Acquisitions"

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Chapter URL: http://www.nber.org/chapters/c5818

Chapter pages in book: (p. 1 - 4)

Introduction

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What causes mergers and acquisitions, and how do they affect the economy? The recent wave of merger and takeover activity in the United States has led many leaders of business and government to ask these and related questions. Some have concluded that there are questionable motives for mergers and takeovers and often undesirable results. This has led to government attempts to discourage corporate combinations through financial and tax restrictions and to increases in the frequency and sophistication of antitakeover amendments to corporate charters.

Because there are many classes of individuals affected by any particular change in corporate control, it is difficult to draw conclusions about the costs and benefits of mergers and acquisitions without comprehensive examination. In the case of a takeover attempt, for example, one must consider the impact on the shareholders, the creditors, the employees, the management, and the customers of each company involved, as well as on competing firms and, through changes in tax revenue or default risk, taxpayers in general. Not every group will be helped by a given merger, but a commonly accepted criterion is that the outcome is socially desirable if the benefits exceed the costs. The problem is that opinions vary about the magnitudes of these costs and benefits.

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A role of economic research is to provide information that can improve the accuracy of such cost-benefit calculations. Toward this end, the National Bureau of Economic Research initiated a project on mergers and acquisitions to encourage research by leading academics on a variety of specific topics. The five papers that follow report on ongoing research being done in connection with this project. Although the project has not reached its conclusion, these papers taken together provide a general perspective on the recent corporate boom in mergers and acquisitions that is far less alarming than a casual inspection of the financial press would suggest.

Robert A. Taggart, Jr., explores the recent increase in junk bond financing and dispels a number of concerns that have been associated with this financial innovation. He shows that junk bonds represent a relatively small fraction of total corporate borrowing and a tiny fraction of the assets (about one-half of 1 percent) of the savings and loans insured by the FSLIC. The majority of junk bonds have not been issued in connection with merger or acquisition activity, and only a small fraction of such activity has been financed by junk bonds. Perhaps most important, he shows that junk bonds adjusted for risk have thus far performed favorably relative to higher-grade bonds. Taggart provides evidence that, overall, the use of junk bonds in takeovers has not significantly harmed the value of preexisting corporate liabilities.

The paper by Devra L. Golbe and Lawrence J. White shows that the current merger wave is far less important in magnitude than two such waves that occurred earlier in this century. They find there has been no noticeable impact on industrial or overall corporate concentration as a result of recent mergers and acquisitions.

Thus, the first two papers suggest that there is less cause for concern about the impact of mergers and acquisitions than some have argued. The third paper, by Richard S. Ruback, shows that various charter provisions enacted to resist takeovers have, on average, been injurious to company stockholders. In fact, they have induced a significant decline in the value of the firms' shares.

The reduction of federal income taxes is an important potential motive for two corporations to combine. The Tax Reform Act of 1986 includes provisions to reduce the tax benefits available from such activity. The research by Alan J. Auerbach and David Reishus suggests, however, that tax benefits were not a significant factor in the great majority of large mergers and acquisitions that occurred in the decade ending in 1983. Moreover, such mergers were not associated with increases in corporate leverage, suggesting that the tax deductibility of interest incurred in such takeovers was not a key factor in the aggregate, either.

One increasingly common type of transaction which may be an exception to this rule, for which interest deductibility could have played a more important role, is the leveraged buyout. Less information is available about such transactions by their nature (the businesses are going private), but Andrei Shleifer and Robert W. Vishny suggest that, tax considerations aside, these have been generally beneficial transactions to those concerned, generating a 50 percent increase in the value of initial shareholdings. In many cases the company that went public again increased its value many times over.

The questions addressed in these five papers have yet to be conclusively answered, and there are many other important questions that have not been asked. At the very least, however, this research demonstrates the value of gathering relevant information before forming judgments about the appropriate policy responses to the recent increase in the number of corporate mergers and acquisitions.

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