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Merging with another privately-owned company

A merger occurs when two companies agree to join together to merge their businesses in order to increase shareholder value. Mergers may involve companies of a similar size and can be friendly in comparison to acquisitions of a more hostile nature where, for example, a target company realizes that they have little option but to be bought by a rival acquiring company simply in order to survive financially.

The rationale behind a private company merger is ideally that the two companies combined will prove to be stronger and more valuable than two separate ones. This may be achieved through cost savings, improved market share or increased turnover leading to greater profitability which can either be reinvested in the company or distributed to shareholders by way of dividend.

A private company can be acquired either by buying its entire share capital, both issued and to be issued or purchasing such company's assets. In the former case the advantage of doing this is that all of the assets and business undertaking of the target company are acquired whereas in the latter only identified assets are purchased. However such asset sale may also require the need to obtain consents from third parties.

The process involved in a merger

In the first instance, once a target company has been identified and an initial approach made, confidential discussions will take place to negotiate 'heads of terms' or " letter of intent " for the proposed deal. These set out the main commercial terms of the merger usually on a non-binding nature and will typically include the proposed purchase price, timetable ,process, and the obligations on the parties, There may also be on a binding basis exclusivity clauses which may be set out in a exclusivity agreement giving the prospective buyer a specific period of time to complete the purchase to the exclusion of others and confidentiality clauses may be set out in a non disclosure agreement (an 'NDA' for short) which in the event of failure to proceed requires the potential buyer to return or destroy all information received from the seller and prohibits it from poaching employees or approaching the seller's clients.

Due diligence

When considering whether to pursue the merger it is important for each company to investigate the financial, legal and operational health of the other. Each will need to receive accounting records and balance sheets, a list of assets and liabilities, a list of actual and potential customers, details of employees and their benefits, any pending litigation or insurance claims, and the company's formation documents. The buyer ill also need to ascertain whether there are any pre-emption rights that shareholders may have to make prior to any share transfers, or whether there are any other restrictions.

Legal structure and personnel issues

Other issues that will require consideration post merger may include how the board of directors, executive officers and other managers will combine, and whether there will have to be any redundancies at this or other staff levels. It is essential that prospective employees who may be affected are identified early, not only because of the prospective liabilities but also if the buyer fails to comply with TUPE rules then it can attract substantial penalties. From a non legal perspective, thought should be given as to whether the cultures of the two companies will complement each other and whether the merger will achieve synergy, so that after merger the combined companies will improve performance and value.

Finance

During the planning process the cost of the merger will need to be assessed, and finance may need to be obtained either through shareholder contribution or bank debt. A realistic and evidence-based valuation and due diligence of the target company may require substantial preparation and negotiation.

Main documents

In a share sale this is evidenced by a share sale and purchase agreement to transfer the shares of the company from the seller to the buyer. In an asset purchase the asset sale (or business sale) agreement will transfer the assets and liabilities being purchased. It is usual in such documents to include various warranties given by the seller to the buyer (as modified by a disclosure letter qualifying such warranties) which are reinforced by an indemnity given by the seller to the buyer in the event of a breach. Unless excluded in the sale agreement it is also possible to be liable for pre-contact misrepresentation. it is vital therefore that expert advice is obtained at an early stage.

Post-merger integration

The process of combining two companies post-merger is called 'integration'. This is one of the most challenging areas to address during the planning process. The merger may lead to cultural clashes so it is very important to consider and address these before integration. If successfully executed, identified risks are dealt with and the subsequent change to the business, the people and the culture are all managed so as to achieve, or even exceed, the increased value expected by the merger. In order to achieve the best results this last stage requires careful planning and risk analysis. Practical steps include:

- starting the process of integration as soon as the merger has been announced;

- nominate key members of staff from each company to manage the integration, in such areas as human resources, office premises, legal, sales, manufacturing, IT, and finance;
- create a plan for internal communication; a blue print for employees from each company to follow showing them how they will integrate into the new business.

It is important to ensure that there is a clear picture defining what successful integration will look like, so that everyone knows the anticipated out turn when it is complete.

Many prospective mergers fall away during the planning process. This may be because what may have made theoretical sense at the outset ceases to make commercial sense. Expert advice at the outset can often find a way through difficult strategic decisions which is why it is advisable to seek the advice of an experienced merger lawyer at an early stage.

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