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A Merger of Equals?

By **ROBERT F. BRUNER**

The spectacle of Kirk Kerkorian's lawsuit against DaimlerChrysler offers something for everyone: aggrieved celebrity, high stakes, nativism vs. globalization, Germans vs. Americans, and bitterness over a difficult merger. Financial theater doesn't get much better than this.

But lost in the brimming schadenfreude is the deeper issue of what words mean. Is the phrase, "merger of equals" (MOE), a genuine business model, or is it a takeover cloaked in the high-toned language of amity? The answers shape this lawsuit as a lesson in speaking plainly.

In theory the MOE combines two firms that carry equal clout. Since it is not clear who is buying whom, one side does not pay a premium for the other. The board of directors and senior management of Newco become an equal blend of the two predecessor firms. The shareholders of the predecessors share equally in the prospective synergies. Most importantly, the MOE addresses a problem of organizational integration: it avoids the language of takeover and the consequent tone of victor and vanquished. So, if the MOE model is so good, then why isn't it ubiquitous?

- Most mergers of equals aren't. In reality most MOEs stray from the ideal. First, one side typically pays a premium to the other, less than non-MOEs, but still a premium. Second, the two firms often aren't equals in an economic sense. A casual review of 110 MOEs reveals that about half of the deals show material disparities in size, market position, and/or financial health. Third, the governance and control features of these deals reveal inequalities. For instance, DaimlerChrysler was headquartered in Germany with a German governance structure and, owing to German labor laws, a disproportionate number of Daimler directors.
- Equality in management and governance is temporary. Market turbulence, political infighting, and/or executive poaching intervene to upset the order of things with disastrous results for CEOs or their successors. Four mega-MOEs of 1998 are illustrative. David Coulter (Bank of America) lasted six months, a tenure cut short by the Russian debt default. John Reed (Citigroup) resigned after 22 months rumored to be a victim of corporate infighting. Mathis Cabiallavetta (UBS A.G.) lasted four months, felled by the LTCM debacle. Mr. Eaton (DaimlerChrysler) was gone in 23 months, shortly before the global auto industry free-fell into recession.
- Economic clout is decisive. In responding to turbulence, markets and directors

mete blunt justice: The side that eventually assumes outright control tends to be the side that generates the most economic value for shareholders. Those who have the gold rule. The classic case in point is the merger of AOL and Time Warner: structured as an MOE, many observers believed that AOL was actually the acquirer. But as the Internet bubble exhaled, AOL slumped against its old economy partner. Within 24 months, Steve Case, Robert Pittman and other senior AOL'ers had left. Soon after, "AOL" was dropped from the new firm's moniker. The MOE merely defers judgment about who will rule, creating a real option in favor of the target and at the expense of the buyer, a rational deal for the buyer if it is confident it has the clout to win. Fundamentally, then, the MOE is a bet by each side on its economic clout.

- Target shareholders pay. The division of returns to buyer and target shareholders is a distinguishing feature of MOEs. **A study by Julie Wulf and another by David Becher and Terry Campbell find that target shareholders fare worse and buyers fare better than their non-MOE peers. Ms. Wulf found a strong inverse relationship between the returns to target shareholders and the presence of typical MOE features. She argued that target managers trade premium to gain power.** In his lawsuit, Mr. Kerkorian argues that the discount reflects the exploitation of credulous target investors. Or it might amount to the present value of implicit side payments to the managers of the target firm. Finally, it might reflect the cost of delay in resolving the inevitable question of control. However you interpret it, target shareholders foot the bill.

Shareholders and directors should view MOEs critically. Who is really buying whom in this deal? Which side has the most economic clout? For target shareholders, does the price approach the value to be realized in an auction? Who will rule? And ultimately, why should investors care about equality of interests? The MOE is no easy path to equality and ill-serves more important aims, such as efficiency, transparency and integrity. Like "managed earnings" and "momentum growth," "merger of equals" fails to say things plainly.

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