AMALGAMATIO
N SCHEMES

Published @ 2017 Trieste Publishing Pty Ltd

ISBN 9780649013210

Amalgamation Schemes by Arthur E. Cutforth

Except for use in any review, the reproduction or utilisation of this work in whole or in part in any form by any electronic, mechanical or other means, now known or hereafter invented, including xerography, photocopying and recording, or in any information storage or retrieval system, is forbidden without the permission of the publisher, Trieste Publishing Pty Ltd, PO Box 1576 Collingwood, Victoria 3066 Australia.

All rights reserved.

Edited by Trieste Publishing Pty Ltd.
Cover @ 2017

This book is sold subject to the condition that it shall not, by way of trade or otherwise, be lent, re-sold, hired out, or otherwise circulated without the publisher's prior consent in any form or binding or cover other than that in which it is published and without a similar condition including this condition being imposed on the subsequent purchaser.

www.triestepublishing.com

ARTHUR E. CUTFORTH

AMALGAMATION SCHEMES

Trieste

AMALGAMATION SCHEMES.

BY

ARTHUR E. CUTFORTH, F.C.A.

(Of Deloitte, Plender, Griffiths & Co.)

Being a Reprint of a Paper read before the Chartered Accountant Students Society of London on 22nd October 1919.

LONDON:

GEE & CO. (PUBLISHERS) LTD., 34 MOORGATE STREET, E.C.2.

1920.

HF5686
C7C8

PREFACE.

THE following Paper was prepared for the purpose of being read before the Chartered Accountant Students Society of London. Suggestions were subsequently made to the writer that it might be of interest to others besides students of Accountancy—as, for example, to practising Accountants and to members of the financial and mercantile community who may become concerned with Amalgamations. Hence its appearance in book form.

January 1920. A. E. C.

37c

AMALGAMATION SCHEMES.

Preliminary remarks.

The old saying that "unity is strength" is as true of businesses as it is of nations. And while during the course of the war the Allies found that in complete co-operation lay the road to victory, so in the financial and industrial world business men have—especially during the last few years—become increasingly alive to the advantages to be obtained from a pooling of resources. In fact, we can hardly open our daily paper without reading of some merging of business interests—of undertakings which have been engaged in rivalry agreeing to co-operate in future instead of to compete.

Undeniably, there is much in competition that is healthy, but, undeniably also, competition may be wasteful. On the one hand, of course, the formation of trusts which are in a position to "corner" commodities or services and so force up the price of either against the consumer or the user is to be deprecated, yet, on the other hand, any form of co-operation which, by avoiding duplication of effort, will produce the same commodity or render the same service more economically cannot but be of benefit to the community as a whole, provided, of course, that the profit earned is not excessive.

In case any of you should at this stage be wondering whether you are to listen to-night to a paper on political economy, I hasten to set your minds at rest.

I only propose to deal with the question of amalgamations and other methods of merging interests in so far as we, as professional accountants, are concerned with them—and the way in which we are concerned with them is, of course, through our clients who own businesses or undertakings which can profitably be merged with others. Sometimes our clients ask us to outline possible schemes of amalgamation; sometimes they ask us to comment

529874

on schemes which have been put before them by the owners of other concerns or by third parties; and sometimes, where a scheme has already been agreed to, we are instructed to verify the figures or to make the calculations upon which the terms of the merger are based.

Before I proceed any further I ought to say that in many instances the businesses which are to be merged are already owned by limited companies, and as it is almost invariably the case that if a permanent amalgamation takes place it is effected through a company which will own or control the businesses in question, I am assuming to-night that we are dealing with limited companies throughout—both before and after the merger. I shall also assume, for the sake of simplicity, that we are considering mergers of two concerns only, and not more.

I now come to the forms of merger themselves.

Three forms of merger reviewed.

There are various ways in which mergers can take place: under some schemes the profits of the businesses are merged, but not the assets; under some schemes the merger is permanent, while in others it is temporary. I shall only deal to-night with three forms of merger, which three are, I think, the most usual.

The first is the entering into of a pooling agreement whereunder the future profits of the two businesses for a term of years are, in effect, first brought into a common fund and then divided out in certain proportions.

The second is an arrangement whereby one of the companies purchases the whole or a controlling interest in the share capital of the other company—or, alternatively, where a new limited company is formed to purchase the whole or a controlling interest in the share capitals of each of the existing companies.

The third is a scheme whereunder both businesses are placed under the direct ownership of one limited company. This would be effected either by a new company being formed to acquire the businesses of the existing companies or by one of the existing companies purchasing the other company's business. For the sake of brevity I shall refer to No. 1 as

"The Pooling Agreement," to No. 2 as "The Holding Company Scheme," and to No. 3 as "The Complete Amalgamation."

I will now describe, as briefly as I can, each of these forms of merger in turn, outlining in each case the means by which the merger is carried out, commenting on its advantages and disadvantages as compared with the other forms of merger, and dealing in particular with the points in which accountants are especially interested.

Pooling Agreement.

Firstly, then, we have to consider the Pooling Agreement.

As I have already mentioned, a Pooling Agreement is one which provides for the profits of the two companies for a future term of years being brought into a common fund and then redistributed in certain proportions. For instance, the two companies, which we will suppose have in the past been keen competitors, ascertain that their past profits (taking the average figures of a series of years) have been in the ratio of three to two. They may then sign an agreement under which for, say, the next five, ten, or twenty years, their annual profits shall first be added together and then be divided in the ratio of three to two—that is to say, the first company will take three-fifths and the second company two-fifths of the combined profits. The companies may, of course, agree upon the proportions in which their combined profits are in future to be shared without making any exact calculations as to what their past profits were; but it is in my experience usual for them first to agree upon the exact series of past years which are to form the basis for arriving at their respective proportions of the combined future profits and then to ascertain what were the exact profits earned in that series of years. The Pooling Agreement itself need not quote the proportions; it could merely state that the future combined profits were to be divided in the ratio which the average profits of Company A, for, say, the past six years, bore to the average profits of Company B for the same six years.

When once the Pooling Agreement has become effective, the companies can, to a considerable

extent, work their businesses in unison with each other instead of in competition. For instance, they would not bid against each other for raw material; one company would not spend money in pushing the sale of its products in districts where the other company already held a commanding position; one company would not refuse orders for sales merely because its own factory had reached its maximum output capacity, if part of the work could be carried out by the other company's factory. These are, I think, a few of the various directions in which the Pooling Agreement might be beneficial to both companies.

Of the three forms of merger which we are to consider, that by means of a Pooling Agreement is attended by the least expense and creates the least initial disturbance. Neither of the companies has to change its form or constitution in any way; the directors of each company merely pass a board minute authorising the agreement to be entered into. In fact, the shareholders may be unaware of the arrangement, except that where it can be done without any prejudice to the businesses the directors would certainly be well advised to inform the shareholders and obtain their formal assent, as the step taken is an all-important one.

As you will readily understand, the carrying out of the Pooling Agreement entails a considerable amount of skilled work on the part of accountants, both in regard to ascertaining what are the exact profits of each company for the series of past years which are to form the basis for fixing the proportions in which the future profits are to be pooled, and also in regard to arriving at the exact profits of each future year which each company has to bring into the pool. It is usual for each company to be represented by a firm of accountants who prepare the statements of its profits, which are then checked by the firm of accountants acting on behalf of the other company; and the two accountants then sign a joint letter or certificate which deals with the profits of both companies. Each company is, of course, interested in making its profits for the past, or basis, period appear as high as possible, as, the higher they are, the larger propor-

tion will that company receive of the pooled profits during the period over which the pooling arrangement extends. When, however, the profits of each year of the pool period have to be arrived at, each company is interested in making its profits appear as low as possible, for, the lower they are, the less is the sum which that company has to contribute to the pool. As you know, the term "profits" is a somewhat elastic one, and, in view of the contentious questions which may arise in interpreting it for the purpose of Pooling Agreements, it is usual for the agreement to define very clearly how the profits are to be arrived at. For instance, there would be expressly laid down the manner in which the charge for depreciation of fixed assets was to be calculated. Then, again, the basis on which stock-in-trade must be valued would be clearly defined, as this has a direct bearing upon the profits. Again, it is not unusual to place limits on the sums which each company can charge in respect of directors' fees and managing director's remuneration in arriving at the profits to be pooled—especially in cases where the directors may be large shareholders. You can quite appreciate the necessity for this, as if a company had a free hand it might pay away unduly large sums as fees to directors who, through their shareholdings, were really owners of the company, knowing that its contributions to the pool would thereby be lessened—in other words, the other company would, in effect, be made to bear a proportion of these abnormally high fees. Another class of expenditure which may be made the subject of a special provision in a Pooling Agreement is expenditure on advertising. As you know, it not infrequently happens that a portion of advertisement expenditure is held up as a temporary asset instead of being written off to Profit and Loss Account, if the expenditure can be shown to have been incurred for the benefit of trade in future years. If a company were unrestricted in this respect in a Pooling Agreement which covered a limited period only, it would obviously be to its advantage to spend largely on advertising during the period and to write off the whole of the expenditure to Profit and Loss Account each year before arriving at