

Chapter 3

The United States: The Case for Mergers

International Airlines, which has never recovered from the September 2001 stock market slump, is struggling to stay alive. An IA stock selling for \$28 one year ago now is priced at about \$14, and IA appears to be vulnerable to a hostile takeover. In fact, employees of IA have heard a rumor that Roland Crane, the infamous corporate raider and takeover artist, is preparing to stage a takeover of their once highly successful company. Crane is known as a cut-throat manipulator who treats his employees poorly and has little concern for the long-term growth and future of his companies. However, his wealth and power are so great that Crane usually gets whatever he goes after.

George Harris, the Chief Executive Officer (CEO) of IA, is determined to prevent the hostile takeover from succeeding. He is willing to use almost any tactics to achieve his goal. Harris has called an emergency meeting of the company's upper management to brainstorm a strategy to use in overpowering Crane's bid. The word on Wall Street is that Crane will make his move in the next ten days. Harris is leaning toward an Employee Stock Ownership Plan (ESOP), allowing IA employees to become employee-owners. IA could borrow money from a bank to establish an ESOP trust, which would buy shares of IA stock. Then the shares would be released to IA employees based on each employee's salary. By placing IA in an employee stock ownership plan, IA would change from a publicly owned to an employee-owned company, thus preventing takeovers. Now employees own about 10 percent of the stock, and with an ESOP, Harris thinks he could boost that to 55-60 percent. An ESOP would give employees an incentive because they would be working for themselves and taking a bigger role in running the company.

Patrick Fitzgerald, the Chief Operating Officer (COO) of IA, also has a proposal to present at the meeting, but it is quite radical. He wants to convince the company executives to attempt a last-minute merger with Worldwide Airlines, thus making Crane's takeover financially unfeasible. He knows, however, that he will face a great deal of resistance, especially from Paula Bergman, President of IA, and the senior executives. IA and WA went through an unsuccessful merger attempt last year, and there are hard feelings on both sides as a result. The merger failed because IA and WA executives couldn't agree on either the restructuring of the new organization or the company's long-term objectives. But Fitzgerald has reason to believe WA would be open to a deal, in light of its weak revenues.

Paula Bergman has rarely agreed with George Harris about anything, and now is no exception. Bergman has her own plan to present at the meeting. She and some other senior executives want to do a management buyout (MBO)* and buy IA themselves. Then IA would be a privately, not publicly, held corporation, which would protect it from any takeover attempts. Bergman knows their offer will have to be a fair one—and above the price of IA stock on the market—perhaps even \$20 a share, but she thinks it's worth

it. The only problem is how to raise the cash needed to buy the company. She is working on this and has already contacted several major banks that have tentatively agreed to provide financing at around 10 percent interest. Nothing has been settled, but she is hopeful that she'll have a viable solution by the time of the meeting. She heard that Harris will push for a merger with WA, which makes her angry. IA and WA have completely divergent long-term goals, company values, and business cultures. If they merge, she'll take early retirement. In Paula Bergman's eyes, the only way for IA to stay alive is to go the MBO route.

* MBO = Management Buyout: A company's management and/or other private investors buy out all the other shareholders almost entirely with borrowed funds.

Discussion

1. How should George Harris present his ESOP plan at the meeting?
2. Should Patrick Fitzgerald contact executives at WA about a merger?
3. How should Paula Bergman present her MBO plan at the meeting?
4. Should Patrick Fitzgerald meet with George Harris and Paula Bergman before the meeting to try to convince them of the advantages of a merger with WA?
5. What other options do the IA employees have?
6. Which option would you prefer if you were an employee of IA?

Case Study Report

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