IN THIS NEWSLETTER

- Introduction
- Calendar of events
- Commentary: The Quiet Revolution: The Opening of Saudi Arabia Securities Market to the West, by Roy J. Girasa
- Commentary: Mergers and Acquisitions in the 21st Century, by Sofya Frantslikh

Introduction


In this edition of the newsletter, we detail some past and upcoming activities. We are particularly excited about the upcoming At the Center event, in which Charles W. Gasparino, author of “Blood on the Street,” will speak on the topic of "The Sensational Inside Story of How Wall Street Analysts Duped a Generation of Investors."

This newsletter also includes three commentaries by business practitioners, academics, and students. The first commentary is by Roy J. Girasa, a Professor of Law at the Lubin School of Business, Pace University. The second is by Nagi Sukkarieh, a Project Engineer at the Lockheed Martin Corporation. The third is by Sofya Frantslikh, an Honor’s student in Finance at Pace University. Enjoy!
Global Finance Letter: The Newsletter of the Center for Global Finance

Recent Events:

At the Center
Thursday, November 4th
Robert Rauch,
Managing Director and Director of Research in Gramercy Advisors LLC.  
Topic: "Hedge Funds: The Search for Alpha at the Efficient Frontier"

Tuesday, November 9th
Robert Isaak,
Lubin School of Business, Pace University

Presidential Debate
Wednesday, November 10th
Vincent Catalano, President, iViewResearch, LLC
Subodh Kumar, CIBC World Markets
Matt Morey, Center for Global Finance, Pace University
Topic: "Economic Challenges for the Elected President"

Global Finance Leadership Forum
Monday, December 6
Pete G. Peterson,
Chairman of The Blackstone Group.

Upcoming Events:

At the Center
Wednesday, February 16th
Charles W. Gasparino, DYS '85,
author of Blood on the Street
Topic: "The Sensational Inside Story of How Wall Street Analysts Duped a Generation of Investors"

Multipurpose Room,
1 Pace Plaza, Pace University New York Campus,
8:00 AM - 9:30 AM
Presented in association with the Lubin Alumni Association Board
Commentary: The Quiet Revolution: The Opening of Saudi Arabia Securities Market to the West

By Roy J. Girasa

Roy J. Girasa is Professor of Law at the Lubin School of Business, Pace University. This commentary represents the opinion of the author, and does not represent the opinion of the Center for Global Finance or Pace University.

Introduction
The events in the Middle East, particularly the war in Iraq, the events of September 11, 2001, and the escalating violence within Saudi Arabia itself that until recently has been relatively shielded from internal violence have brought to the forefront the existence of terrorism and the need to attack its roots and provide the mechanisms to prevent its growth and global spread. Saudi Arabia was thus placed at the crossroad of following its prior fundamentalist past or to engage and become a part of the modern global community. It appears that it has elected to become modernized in a Western style manner albeit retaining its religious traditions.

The Quiet Revolution within Saudi Arabia
The recitation of some basic statistical data may be useful in our discussion. Saudi Arabia possesses a population of some 21.7 million (2002 estimate) with a young population. Approximately 55% of its population is under the age of 24 years, the largest portion thereof being under the age of 14 years. It is the youthful segment of the population that poses the threat to the existing authority and to global society. It is estimated that some one-third of the young population will not have jobs in the forthcoming decade. A growing restless and unemployed fundamentalist population may turn to violence using the alleged corruption of Islamic values as the basis for the commission of terrorist activities. Thus, the need for reform is made abundantly clear.

Saudi Arabia is a country blessed with remarkable revenues due to its one basic commodity, that of oil. Its 2002 GDP is $181 billion. It dwarfs the GDP of other countries in the region. For example, the GDP for Syria is $24 billion and Kuwait is $37 billion. The closest rival in the region is the State of Israel with a GDP of $122 billion. The Kingdom’s per capita GDP is about $9,000. The crux of the problem for the Kingdom is how to expand its economy so as to provide employment for the current young population and the far greater number of young people who will enter the marketplace within the next decade.

Choices for the Kingdom
The current leadership could continue its leadership of the Islamic world claiming the adherence of both moral authority and the physical location of Islam’s holiest sites. Its sponsorship of traditional educational values would emphasize the need for strict adherence to Koranic ideals and values. The difficulty lies in the direction that extremists have directed their energies in the maintenance and promulgation of such values. Almost all of the hijackers involved in the 9-11 incident were from Saudi Arabia. Osama Bin Laden’s family owned the leading construction firm within the Kingdom, thus enabling its famous offspring to conduct significant operations both within and without the Kingdom. The first Gulf War led to the stationing of U.S. and other Western military forces within the region. Such presence, including the U.S. support of Israel, the “Crusades” remark by the current President Bush, the invasion of Iraq, and other Western actions have created fears that Islam was under attack. So long as terrorism was not a part of the Saudi landscape, the need to bring extremist forces under control did not appear to merit immediate attention. The wave of explosions and killings in the past year within the country sent a clear message of the need to reform its society and create a safe haven for the restless youth. The possible overthrow of the current monarchical leadership and its possible replacement by an extremist group of leaders has led to the institution of major changes within the
Kingdom. The expansion of the securities market is a significant part of the proposed changes.

**Saudi Arabia's Modernization of its Securities Market**

The Exchange is presently very small with only 76 companies listed, all of which are companies within the Kingdom.¹ Its concentration (percentage of total capitalization) is dominated by Saudi Telecom (22%), SABIC (18%), and Saudi Electricity (15%). Thus, 68% of total capitalization is composed of five firms and 82% of the ten top firms. Its potential is enormous. The market value of its debt market (as of 2001) was $0 billion albeit its potential was $163 billion. Similarly, the market value of its equity market (2001) was $75 billion but its potential was $235 billion. If its potential is realized it would place its market within that of the largest global markets. Its equity market potential would exceed that of South Korea and be close to that of India. The Kingdom, for the reasons previously stated, has opted to expand its market to the West in an endeavor to make its economy more open to foreign involvement and be more transparent. The model its has chosen is that of the United States and the United Kingdom.

**Creation of the Saudi Arabian Capital Market**

Recently, this author was among a number of persons who were invited to deliver a series of lectures to governmental representatives from Saudi Arabia.² These officials constituted the upper echelon of the Capital Markets Authority, the equivalent of the Securities and Exchange Commission of the United States. The purpose of the lectures was to educate them with respect to

---

¹ Contrast Saudi Arabia’s listing of 76 companies with that of Israel with 649 listed companies, Egypt with 1,110 listed companies and Iran with 297 companies. Even the tiny Kingdom of Bahrain has 42 companies and the somewhat larger, albeit much poorer state of Jordan has 161 listed companies.

² The invitation was given by Gary Tidwell, Vice-President in charge of NASD International Education and Training Program for the National Association of Securities Dealers (NASD).

---

³ Capital Markets Regulations (hereinafter referred to as “Capital Markets Law” inasmuch as it is the statutory authority) Article Four (a).
transactions. The Authority resembles the U.S.’s Securities and Exchange Commission with its Board consisting of five members, each of whom is employed full time without outside conflicting employment, and who are professionally qualified. Persons engaged in the brokerage business are required to be licensed and be an agent for a licensed firm. The Saudi Exchange (TADAWUL) states that persons engaged in specified registrable activities must be appropriately licensed to do so. A registered person must have the experience and competence to perform the activities to be undertaken and be ready to demonstrate them to the Exchange when called upon to do so. Accordingly, the Exchange sets forth certain examination requirements which may be waived only upon a clear showing that the particular individual has demonstrated significant competence in the activity engaged in as, e.g., substantial experience (at least 4 years, reasonably up to date) or is a senior practitioner either within or without Saudi Arabia.

The statute has stringent measures against manipulation and insider trading. A person who violates the Regulations by intentionally acting or engaging in any act that creates a false or misleading impression concerning securities, prices, or value of any security becomes subject to civil and criminal penalties.

In the area of mergers and acquisitions, the Saudi Regulations appear to be much more protective of clients and customers than U.S. regulations. The clear emphasis is the assurance of fair and equal treatment of all shareholders in regard to takeovers. The Capital Markets Authority (Authority) is given the mandate to assure protection to both the Kingdom and especially to actual or potential shareholders. Confidentiality of information given to the Authority is assured.

Members, agents, employees, and the families of the Authority are forbidden from profiting from the information gained while acting in the performance of their duties. All purchases and sales of securities by these persons must be immediately reported to the Authority. Among the other protective measures for shareholders are the requirements:

- Identity of the true offeror must be made known at the outset and that the Board of the target company be satisfied the takeover offer can be implemented;
- The retention of secrecy of the possible takeover offer before the announcement is made to prevent insider trading;
- The necessity of a public announcement of the proposed acquisition when a number of possible scenarios arise including unusual movement of price, acquisition of 30% or more of the voting rights of a company;
- The requirement that the board of the offeree company seek independent advice on any offer and that the advice given be made known to the shareholders;
- The requirement that the offeror company not sell securities of the offeree company during the offer period (presumably to prevent a sudden drop in share price so as to enhance its position);
- The prohibition of purchase of shares in the offeree company, making a loan for purchase, and other related activity by a financial adviser or stockbroker or associate during the offer period;
- The prohibition of special arrangements with certain shareholders unless the arrangements are extended to all shareholders.

Members, agents, employees, and the families of the Authority are forbidden from profiting from the information gained while acting in the performance of their duties. All purchases and sales of securities by these persons must be immediately reported to the Authority. Among the other protective measures for shareholders are the requirements:

- Identity of the true offeror must be made known at the outset and that the Board of the target company be satisfied the takeover offer can be implemented;
- The retention of secrecy of the possible takeover offer before the announcement is made to prevent insider trading;
- The necessity of a public announcement of the proposed acquisition when a number of possible scenarios arise including unusual movement of price, acquisition of 30% or more of the voting rights of a company;
- The requirement that the board of the offeree company seek independent advice on any offer and that the advice given be made known to the shareholders;
- The requirement that the offeror company not sell securities of the offeree company during the offer period (presumably to prevent a sudden drop in share price so as to enhance its position);
- The prohibition of purchase of shares in the offeree company, making a loan for purchase, and other related activity by a financial adviser or stockbroker or associate during the offer period;
- The prohibition of special arrangements with certain shareholders unless the arrangements are extended to all shareholders.

Members, agents, employees, and the families of the Authority are forbidden from profiting from the information gained while acting in the performance of their duties. All purchases and sales of securities by these persons must be immediately reported to the Authority. Among the other protective measures for shareholders are the requirements:

- Identity of the true offeror must be made known at the outset and that the Board of the target company be satisfied the takeover offer can be implemented;
- The retention of secrecy of the possible takeover offer before the announcement is made to prevent insider trading;
- The necessity of a public announcement of the proposed acquisition when a number of possible scenarios arise including unusual movement of price, acquisition of 30% or more of the voting rights of a company;
- The requirement that the board of the offeree company seek independent advice on any offer and that the advice given be made known to the shareholders;
- The requirement that the offeror company not sell securities of the offeree company during the offer period (presumably to prevent a sudden drop in share price so as to enhance its position);
- The prohibition of purchase of shares in the offeree company, making a loan for purchase, and other related activity by a financial adviser or stockbroker or associate during the offer period;
- The prohibition of special arrangements with certain shareholders unless the arrangements are extended to all shareholders.

Members, agents, employees, and the families of the Authority are forbidden from profiting from the information gained while acting in the performance of their duties. All purchases and sales of securities by these persons must be immediately reported to the Authority. Among the other protective measures for shareholders are the requirements:

- Identity of the true offeror must be made known at the outset and that the Board of the target company be satisfied the takeover offer can be implemented;
- The retention of secrecy of the possible takeover offer before the announcement is made to prevent insider trading;
- The necessity of a public announcement of the proposed acquisition when a number of possible scenarios arise including unusual movement of price, acquisition of 30% or more of the voting rights of a company;
- The requirement that the board of the offeree company seek independent advice on any offer and that the advice given be made known to the shareholders;
- The requirement that the offeror company not sell securities of the offeree company during the offer period (presumably to prevent a sudden drop in share price so as to enhance its position);
- The prohibition of purchase of shares in the offeree company, making a loan for purchase, and other related activity by a financial adviser or stockbroker or associate during the offer period;
- The prohibition of special arrangements with certain shareholders unless the arrangements are extended to all shareholders.

Members, agents, employees, and the families of the Authority are forbidden from profiting from the information gained while acting in the performance of their duties. All purchases and sales of securities by these persons must be immediately reported to the Authority. Among the other protective measures for shareholders are the requirements:

- Identity of the true offeror must be made known at the outset and that the Board of the target company be satisfied the takeover offer can be implemented;
- The retention of secrecy of the possible takeover offer before the announcement is made to prevent insider trading;
- The necessity of a public announcement of the proposed acquisition when a number of possible scenarios arise including unusual movement of price, acquisition of 30% or more of the voting rights of a company;
- The requirement that the board of the offeree company seek independent advice on any offer and that the advice given be made known to the shareholders;
- The requirement that the offeror company not sell securities of the offeree company during the offer period (presumably to prevent a sudden drop in share price so as to enhance its position);
- The prohibition of purchase of shares in the offeree company, making a loan for purchase, and other related activity by a financial adviser or stockbroker or associate during the offer period;
- The prohibition of special arrangements with certain shareholders unless the arrangements are extended to all shareholders.
shareholders (the practice is generally permitted in Western markets whereby a company will buy out a shareholder at a premium price in an endeavor to ward off a possible takeover or to gain necessary shares to prevail in a takeover bid)\(^{18}\)

Information about companies in an offer must be made equally available to all shareholders as nearly as possible at the same time and in the same manner, together with any information concerning competing offers\(^{19}\).

The prohibition of the Board of the offeree company from engaging in a variety of activities to prevent or dissuade possible takeovers during the offer period or when it believes than an offer is imminent including: the issuance of authorized but unissued shares, the issuance or grant of options as to any unissued shares; the creation or issuance of securities carrying conversion rights, the sale or agreement to sell assets of a material amount, or to enter into any contracts except in the ordinary course of business. The purpose of this regulation is to prevent the common practice of companies wishing to prevent the offer or acceptance of a hostile offer such as “golden parachutes,” “poison pill,” “lock up agreements,” “greenmail,” “white squire” and “white knight,” “pac man” and other defensive tactics.\(^{20}\)

Thus, it can be seen that the Saudi regulations appear to be more protective of shareholders than U.S. and other Western securities laws and regulations. The rules and regulations are still in a state of flux and are being developed at the present time. It is clear that the Saudis are attempting to incorporate the best practices of Western securities while avoiding some of the impeding if not unlawful tactics practiced among the experienced operators in the U.S. and elsewhere.

**Conclusion**

Saudi Arabia is undergoing fundamental changes that seek to continue the modernization trend that began with the influx of significant oil revenues in the 1970s. The difficulty is that the onset of modernization comes at a significant price that places into conflict Western values and that promulgated in the Islamic faith. It is clear that the Middle East cannot remain outside the global modernization trend; yet the opening of the doors to Western thought, practices, and behavior is anathema to large segments of the followers of Muhammad. The problem is enhanced with the increasing youthfulness of the population that runs counter to the aging Western population. The current events in Iraq are symptomatic of the tensions that are enveloping the Middle East and other Islamic based societies. Saudi Arabia, in an endeavor to save the Kingdom from fundamentalist radicals, is opening the doors

\(^{18}\) Capital Markets Law Article 5(a)(4)(5) and Takeover Regulations Article 20.

\(^{19}\) Takeover Regulations Article 24.

\(^{20}\) “Poison pills” are securities issued by a potential target to make the firm less valuable in the eyes of the hostile bidder. They include “flip-over rights” which consist of rights offerings that allow the holder s to buy stock in the acquiring firm at a low price. “Flip-in” poison pills consist of allowing shareholders rights to acquire stock in the target company rather than in the acquiring company. “Golden parachutes” are special compensation agreements payable to upper management that come into play in the event of a hostile takeover. “White knight” is when a company is the target of an unwanted bid or the threat of a bid from a potential acquirer and it then seeks a more acceptable to buy some (“White Squire”) or controlling shares (“White Knight”). “Greenmail” is the payment of a premium above the current market price for the shares of particular shareholders. The Saudi Takeover Regulations 4b(9) provide:

At no time after the board of the offeree company has reason to believe that a bona fide offer might be imminent may any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits.
Global Finance Letter: The Newsletter of the Center for Global Finance

7 to the West by the creation of an Exchange that will permit foreign companies to offer securities on its capital market. Whether the opening will provide the jobs for the youth within the Saudi society and thus ward off revolutionary trends will await further developments. Clearly, the opening of the capital markets is a major development that may cause Saudi Arabia to be the center of the new and changing Islamic society.

Commentary: On-Line Payment Systems

By Nagi Sukkarieh

Nagi Sukkarieh is a Project Engineer at the Lockheed Martin Corporation, and a recent graduate of the MBA program at the Lubin School of Business, Pace University. This commentary represents the opinion of the author, and does not represent the opinion of the Center for Global Finance or Pace University.

In recent years, On-Line Payment Systems (OLPS) have undergone different generations, and developed into a more robust system of transactions. This came after a series of proprietary protocols and dedicated telecommunication, developed by the banking and credit card industries. The Internet, however, changed this ‘colonialism’ radically, and allowed heterogeneous computer systems to talk to each other and to provide a common and reusable set of processes (Goldfinger, 1999).

Consumer and Merchant Requirements

Since there is no personal interaction with brick and mortar personnel, the rules of business are somewhat altered to fit the new model.

Major Impact

When transferring funds using a credit card, consumers are mostly concerned with the ability to constrain others from illegally or unintentionally using their private information. It is, therefore, imperative for the OLPS to be able to first and foremost protect the personal information of its users. Therefore, consumers must be assured its security, reliability and anonymity.

Security: Since anyone with an Internet connection is able to effortlessly access other computers all over the world, a successful OLPS must implement more stringent security than the conventional payment systems. It must cover all aspects of a transaction, from identifying the customer, to protecting customer personal information, to authenticating the merchant and protecting from merchant’s system failures or fraud.

Reliability: The financial transaction software and servers of an OLPS must possess a highly dependable and robust Information Processing System. Customers must be able to trust in the accuracy and timely arrival of their bills and payments.

Anonymity: Given some of the dubious material available on the Internet, some consumers would rather use an undetectable OLPS. Meanwhile, and in order to prevent money laundering and tax evasion, the government needs to be provided with an audit trail that traces the passage of funds. Arguably, it is still comforting to depend on certain level of anonymity protection from the government. But consumers may get such protection while their personal identity is being leaked out.

Minor Impact

To support e-commerce, OLPS need to provide consumers and merchants with features that would promote or support their online shopping experience.

Consumer Effect: An OLPS would become less convenient if it required the consumer to go off-line in order to process the transaction. Not only does convenience have an impact on the ease of on-line

commerce, but it would also have an effect on impulse purchases.

Ease of use: Once shopping is completed, OLPS ought to use straightforward payment tendered for products/services. If a payment method requires actions such as first time setup and software download then the customer will be turned off.

Convertibility: An OLPS can become very important for merchants who depend on their business from overseas customers. This requires it to constantly adjust to the fluctuating currency exchange market.

P2P: Person-to-Person (P2P) - such as online auctions - is the act of allowing merchants to exchange goods/services through a provider. Monetary regulators need to look for methods to discourage tax evasion and draw merchants and consumers to pay their dues.

Price/Cost: The characteristics of the transaction help determine its cost (Peffers and Ma, 2003). Some features, such as ease of use and authenticity, encourage customers, while other characteristics, such as payment amount and margin size, could become prohibitive. The need for a micro-payment system is necessary.

Merchant Influence: The OLPS method that the merchant must select ought to be economical and convenient for both parties.

Scalability: An OLPS need to be able to grow quickly, by allowing continuous growth of throughput and reliability of transaction load. Further advances in computer science studies are providing a more reliable and balanced network architecture for delivering a solid Internet service, intended for the growing e-commerce.

Efficiency: Since OLPS connects buyers and sellers with financial institutions through different money transfer processes, merchants have to provide efficient ways to manager customer payments.

Accounting and Accountability: A well-established OLPS needs to be tightly coupled with A/R and A/P systems, support back-end payment-processing workflows and procedures, and provide detailed reporting capabilities.

Ease of Integration: Regardless of what web browser is used, the consumer should be able to adapt to his/her personal preferences. Even the billing solution should be able to integrate with a company's legacy systems and parsing engines to draw the information from existing databases and format the bill into a familiar HTML appearance.

Government Regulations
To guide and maintain a society free of outlaws, the government has to uphold a systematic way that does not impede the progress of Electronic Commerce Network (ECN), but yet control it. However, exploring OLPS regulations necessitates the awareness of some of the problems facing regulators.

Slow new technological adoption
In the 80s, consumers using ATM cards were still doubtful about exchanging their own monies electronically. Similarly, e-commerce users will be prudent about being the first to adopt any new technology. While there are social, legal, and regulatory and business hurdles to contend with, ECN suffers greatly from technological impediments. It is typical for new technologies to be slowly adopted, especially when they involve the exchange of money.

Limited Data
The statistics used to support laws is based on a multitude of assumptions and forward looking estimates that makes it hard to determine, with a great deal of certainty, the effectiveness of OLPS regulations. Even

---

worse, when data cited in defense of certain regulation contradicts other accurate data, it leads to potentially unfair and biased policy governing the OLPS world. Therefore, regulators have to carefully review their data and cautiously analyze the implied meaning of the information, to better understand the need and level of government regulations.

_Innocent Violators_
In the wild online world, it is very easy for an individual to purchase illegal material from a web-sight. This has invigorated lawmakers who are trying to uphold the law. But it has also deterred new entrepreneurs seeking new markets. There is an alarming increase in the number of violators that are being reported every month. However, not all violators are guilty. Research has shown that much of online entrepreneurs are only seeking to market a product or service on the Internet. They are not necessarily aware of the new privacy laws (Swindle, 1999).24

_Company and Industry Efforts to Protect Consumers_
If consumers remain concerned about security and privacy, then they will be deterred from using the Internet for shopping. Therefore, industry pioneers have embarked on a new standard that would help boost consumer confidence (the Platform for Privacy Preferences Project or P3P initiative). These company and industry efforts indicate an increased merchants’ concern to protect consumer privacy.

_Complications in Taxing the Internet Economy_
Lawmakers are unable to determine, with a great deal of certainty, the kind of commerce that they will need to tax. How would taxes be collected? Which state, counties or countries have the jurisdiction over the income generated by OLPS? All of this has to be settled, while merchants are still trying to reap their initial startup costs.

**Limited Government Intervention**
If the government regulates the Internet excessively, it associates a cost to its operation, which would run the risk of deterring interest in e-commerce by imposing the additional financial burden on both merchants and consumers. Unfortunately, lack of control could be a common breading ground for ad hoc communications and socially unacceptable behavior. Hence, without limited government intervention, the Internet might disturb the quality of lives.

_Government necessity to control e-cash_
Policymakers have expressed concern about the operation of e-cash because it is both electronic, and, more importantly, private firms are issuing it and not the government. Conceivably, if private issuers of electronic currency could create multiple currencies with different exchange values,25 they would also control the issuance of e-cash, and therefore, national economic indicators, such as inflation and prime lending rate. Moreover, they would force the public to substitute its monies with more costly means of payment for currency, causing loss of efficiency in the economy. Since it is in charge of achieving stability, safety and uniformity of its monetary policy, private issuance of e-cash is obviously a serious matter to the government (Schreft, 1997).26

**Determining legal jurisdiction over E-Commerce Transactions**
The borderless identity of the Internet challenges the traditional power of courts to assert its jurisdiction. It blurs away the ability of a court to decisively and fairly impose its statute. Governments around the world are looking for ways to settle on the definition of e-money.

**Banks and Other Lenders**

---


25 Analogous to each US state have its version of US dollar, or, more recently, each EC member having its own national currency.

A bank offers financial services to customers by moving their monies around in a manner that allows them to interchange products and services. The amount of money that banks can lend in the US is directly affected by the reserve requirement set by the Federal Reserve. This way if a bank defaults, it has limited liability to its consumers and limited protection from the US government. Therefore, the success of a bank lies in the confidence of its customers to save their monies and watch them grow. Evidently, the fact that banks are highly regulated by the government helps banks sustain their integrity and their consumer trust. When a bank offers an OLPS Bank (OLPSB) to exchange e-cash, it must work in a different model. An OLPSB needs no satellite locations, since it operates in cyberspace. OLPSB is convenient because a consumer can purchase online without the need to write a check or wire some money. To shift e-money, OLPSB can send checks through Federal Reserve or use a private clearinghouse.

There are other institutions which have created a payment system that is based solely on loaning money out. These OLPS Lending (OLPSL) institutions charge exuberant interest rates in order to sustain their operations. Nonetheless, the government has stepped in to offer some consumer protection. And while lending institutions enjoy such government protection, the collateral is not merely as close to that of deposit banks.

**Concluding Remarks**

The industry is moving in the direction of some degree of government protection that favors considering an OLPS as a bank. Such a move would not be the best to protect consumers who would otherwise be hesitant to utilize OLPS as a new mean for the new economy. But in the face of global challenges, forcing e-commerce and stressing the Internet, it is a sigh of relief to see that the government has stepped up to offer a limited protection to its citizen. Now the onus on the same government to look for ways to share such protection across the world and to offer better incentives that enables e-commerce globally.

**Commentary: Mergers and Acquisitions in the 21st Century**

**By Sofya Frantslikh**

Sofya Frantslikh is an Honor’s student in Finance at the Lubin School of Business, Pace University. This commentary represents the opinion of the author, and does not represent the opinion of the Center for Global Finance or Pace University.

In the world of growing globalization, major companies on both domestic and international markets struggle to achieve the optimum market share possible. Every day business people from top to lower management work to achieve a common goal – being the best at what you do, and getting there as fast as possible. As companies work hard to beat their competitors they assume various tactics. Some of their tactics may include competing in the market of their core competence, thus, insuring that they have the optimal knowledge and experience to have a fighting chance against their rivals in the same business; hostile takeovers; or the most popular way to achieve growth and dominance – mergers and acquisitions.

Mergers and acquisitions are the most frequently used methods of growth for companies in the twenty first century; they present a company with a potentially larger market share and open it up to a more diversified market. At times, a merger or an acquisition simply makes a company larger, expands its staff and production, and gives it more financial and other resources to be a stronger competitor on the market.

To define this topic more clearly, let me state that a corporate merger, as defined by the “Quick MBA” reference website, is the combination of the assets and liabilities of two firms to form a single business entity. In everyday language, the term "acquisition" tends to be used when a larger firm absorbs a smaller firm, and "merger" tends to be used when the combination is portrayed to
be between equals. In case of a merger between two firms that are approximately equal, there often is an exchange of stock in which one firm issues new shares to the shareholders of the other firm at a certain ratio. It has been customary that the firm whose shares continue to exist, even if that occurs under an alternate company name, is referred to as the acquiring firm and the firm whose shares are being replaced by the acquiring firm is usually called the target firm. A merger is considered to be successful, if it increases the acquiring firm's value.

An article which was recently published by the Federal Trade Commission (FTC) noted that the United States is heavily involved in the so called "merger wave." The number of mergers reported rose from "1,529 in 1991 to a record 3,702 in 1997 - a 142 percent jump." During this period, the FTC spent a great amount of time on distinguishing and at times preventing mergers which were potentially anticompetitive and directed at forming monopolies. This is a great example of the strong controls that the United States government has instituted, in order to prevent companies from forming monopolies, so that our financial markets will stay unpolluted and healthy competition can continue to thrive. It also shows that the topic of mergers is extremely controversial at times and involves a great number of legal aspects in order for any merger to become finalized.

Most mergers have actually been known to benefit both competition and consumers by allowing firms to operate more efficiently. However, it has to be noted that some mergers and acquisitions have the capacity to decrease competition. This is very dangerous for both us, the consumers, and the companies on the market, because declines in competition may cause higher prices, decreased availability of goods or services, products of lower quality, as well as declines in innovation. This is mainly due to some companies merging and creating a more concentrated market, with fewer suppliers, which leads to fewer options for the consumers, and thus gives some companies the advantage of raising prices since the consumers have no other choice of suppliers. This is even more crucial to realize in the case of companies which produce goods that have no or very few substitutes, and for which the demand is highly inelastic.

In a concentrated market, there are very few firms, by definition. The danger of a concentrated market is that in this case, it becomes easier for companies to stall competition by colluding. For example, some companies might agree on the prices they will charge their customers. Collusion can be of either of the two forms: by tacit agreement or by explicit agreement. As one may have guessed, tacit agreements are hidden and are kept a secret, while explicit ones are less subtle in their form. Obviously, corporations that want to become involved in collusion, use tacit agreements, which are harder to be uncovered by the law enforcement, since explicit agreements are prosecutable by law.

Usually, a merger can be construed as being anti competitive if it makes the market very saturated after the merger, as opposed to before the merger’s completion, and if the merger in addition makes it impossible or highly difficult for new firms to enter the market and present a challenge to the existing corporations. Companies who do this, want to keep other companies out of the market because the new entrants have the capacity to offer lower prices, forcing the existing firms to lower theirs as well, thus driving all of the prices in that market down.

Going deeper into the subject of mergers, it is important to present and distinguish between three kinds of mergers: horizontal mergers, vertical mergers, and potential competition or conglomerate mergers.

By definition, a horizontal merger is an acquisition of a competitor with an intention to increase the market concentration, and often also to increase the probability of collusions. A vivid example of this was Staples’ attempt to merge with Home Depot. This merger would have created a more condensed market for office and home supplies, because the number of stores
nationwide would have decreased, making it possible for Staples to set their own prices.

In retrospect, a vertical merger is said to take place when companies are in a so-called buyer-seller relationship. For example, when a company moves along its value chain and merges with its supplier, or distributor. As would be the case if a pencil making company would merge with the woodcutting company, or with the store that sells pencils. A vertical merger can impair competition by preventing other companies who use the same suppliers or distribution channels to operate normally. If companies A, B, and C both use supplier Y and no other effective supplier exists, and company A merges with supplier Y, this forces companies B and C out of business, because they have lost their connection with supplies Y. Company A has thus eliminated two of its competitors, companies B and C.

A potential competition or conglomerate merger is said to take place when one company merges or buys another company that is anticipated to enter a market and become a potential competitor to the acquiring company. It is said to be a so-called elimination technique of a company’s potential competitors. A conglomerate merger can be detrimental in two ways. First of all, this type of a merger deters healthy competition because it involves acquiring companies before they even enter the market. Second of all, it prevents the company that otherwise would have entered the market to make positive contributions to the market, such as promoting healthy competition or offering more diversified products to consumers. The reasoning behind this type of a merger is closely related to the first two types, namely to keep the prices higher, without the threat of new competitors coming in and forcing the prices down, and to keep fierce competitors out.

The United Nations’ “World Investment Report 2000” suggests that the recent increase in cross-border mergers and acquisitions is mainly due to increase in the globalization of markets.

If various statistical sources are combined it can be observed that domestic as well as worldwide mergers and acquisitions “have been growing at an average of 42% per year between 1980 and 1999, reaching $2.3 trillion dollars in value in 1999,” according to the World Investment Report as of the year 2000. “Such deals were worth about 0.3% of world gross domestic product in 1980, rising to 2% in 1990 and 8% in 1999. More than 24,000 [mergers and acquisitions] took place during the last 20 years.”

The rapid growth has been overwhelming to both corporations involved and consumers. The increase in mergers has definitely been noticeable over the last couple of decades. Due to a major growth spurt of technological advances, news about mergers and acquisitions arrive to consumers and companies faster and more efficiently, with the most recent information available for anyone who is interested in the topic. Thousands of emails and faxes arrive to their destinations with the speed of lightning to notify us of companies’ plans and new conquests. The ease of communication has undoubtedly been a major factor in increasing mergers and acquisitions.

Most mergers and acquisitions took place in developed countries, due to a larger number of strong corporations and well functioning economies in countries like United States and European countries like United Kingdom.

The World Investment Report makes the statement that there are three main forces that drive mergers and acquisitions, which incidentally coincide with my own previously made assumptions. These forces are rapid technological advances, new and more efficient ways of financing, and a more favorable regulatory setting.

Statistics also show that in 1999, the United States sustained a trend of being the most important target country in cross-border mergers and acquisitions, “with the EU accounting for four-fifths of the $233 billion dollars in assets that the US sold to foreigners.”
Global Finance Letter: The Newsletter of the Center for Global Finance

In addition, the World Investment Report presents that “70% of the value of cross-border mergers and acquisitions” in 1999 were made between competing firms in the same industry, or as noted previously, through horizontal mergers. Vertical mergers remained far below 10% throughout the 1990s, with the remaining mergers resulting from companies merging with other companies that operated in different markets from the acquiring corporation.

The survival of the fittest is usually determined by capital markets, which award companies that deliver promised benefits, and punish those who do not. If the success of the mergers becomes questionable, corporate raiders carry out their function, and eliminate unproductive management which fails to earn sufficient returns for the shareholders, and thus makes the stock value drop. This simple technique makes management work harder and more efficiently in order to ensure their own job stability and stockholders’ wealth.

The main economic argument for rejecting a merger is that mergers and acquisitions contribute to the risk of monopolies. Consumers then become exploited and resources become misallocated if these mergers create major entry barriers restricting competition, which can potentially lead to market failure and a decline in economic welfare.

The evidence is diverse as to whether mergers improve company’s performance. As times, companies make predictions for growth, increased efficiency, and greater profits. However, more often than not, those predictions prove to be over inflated, and this also leads to disappointments on the side of investors, shareholders and the management involved in the merger.

There are certain imperfections in the capital markets which contribute to imperfect information and at times even merger failures. The reasons for market imperfections include the fact that often corporate control does not work optimally, and that unsuccessful management is in place for a long time.

Technological advances have played a key role in the increasing number of mergers in the 21st century. The idea of electronic mail, wire transfers, easy and efficient credit checks, and other wireless marvels have made the tasks of millions businessmen much easier to handle. Because of these changes, mergers have become quicker and more efficient. Decisions and ideas get to their recipients at the blink of the eye, and senior management no longer relies on the post office to deliver important mail to their offices. Over the phone, or video conferencing have made the decision making process, as well as meeting arrangements easy and business smart. In the 21st century, business is done online, and over the phone, with blackberries and laptops, cell phones and digital mail; everything is fast and prompt.

The prediction of many experts and researchers is that as we go forward, we will see even more mergers and acquisitions, favorable market conditions permitting, then ever before.

Given that everything is legal and economically efficient, mergers will have even less obstacles to overcome, and only future will show whether that is a valuable contribution to our business and corporate infrastructure.