Mergers and Acquisitions Performance Evaluation- A Literature Review

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Abstract

Mergers and Acquisitions (M&A) have received a lot of public attention during the past decade as several major M&A transactions have been affected. The Asia-Pacific region experienced significant growth in deal volume and value. The number of Asia-Pacific deals has increased from 2091 transactions in the year 2000 to 6,939 in 2011.The aggregate deal value jumped 103%, from $193.4 billion to $393 billion (M&A Report, 2011).However the studies show that mergers and acquisitions have not produced the anticipated benefits. The paper is an attempt to review the literature on the performance evaluation of mergers and acquisitions in last couple of years. It has also been seen that the neglect of HR function as a major cause of merger failure.

Introduction

Globalization, competition and a dynamic market has brought about a significant change in the world economy and the way businesses operate. Trillions of dollars have been spent in the acquisition of thousands of firms (Gupta and Gerchak, 2002). In order to stay competitive, many companies around the world have merged with each other with a motive to expand into new markets, incorporate new technologies and/or enhance revenue (Harpeslagh& Jemison, 1991). Mergers and acquisitions (M&A's) continue to play an important role in shaping business activities worldwide.They have become an important business strategy to help improve organizational performance. M&A are undertaken on the assumption that the combined company will have a greater value than the two companies alone (Mirvis and Marks 1992).

Meaning of Mergers and Acquisitions

Mergers occur when two organizations willingly agree to collaborate with each other by joining their available assets, liabilities, and cultural values on a relatively equal basis across different businesses and industries. In contrast, acquisitions occur when one organization buys and takes over the operations of another organization. (Horwitz et al. 2002)

The terms Mergers and Acquisitions are used interchangeably because the result is the same – one company takes control over another (Halperin& Bell, 1992), thus the firm's activity is sometimes referred to as Merger and Acquisition (M&A).

Mergers and Acquisitions - performance evaluation

Evidence regarding the outcome of mergers as success or failure comes to us from many different sources and perspectives. The success or failure of a merger or acquisition is usually evaluated based on accounting /financial parameters (e.g. Hoskisson et al., 1994) or the achievement of strategic objective (e.g. Clarke, 1987). Larsson and Finkelstein (1999) presented additional functional perspectives to assess the outcome of a merger. *Strategic management* measures success or failure in terms of achieving strategic objectives, *economics* mostly uses accounting based measures, *finance* uses stock market based measures, *organizational research* focuses on the post combination integration process and *human resource management* looks at psychological and other issues such as effective communication and career planning. Each of these perspectives represents the preferences of a dominant stakeholder.

Financial Performance

The main focus in the financial perspective is on the ultimate effect of a merger on the stockholders of the acquiring and target company, and on the market share, productivity, profits or price-cost margins. According to Paul (2001): "one common technique for examining the effects of a merger or acquisition employs the stock market's reaction to the event.

Jensen and Ruback (1983) who surveyed 13 studies of pre-1980 stock market data, found positive returns between 16 and 30 per cent. Andrade, Mitchell, and Stafford report (2001) found remarkably stable target firm returns of 23 to 25 per cent for completed mergers, spanning decades from 1973 to 1998. Bradley, Desai and Kim (1983) found that target firm stockholders realize significant positive abnormal returns upon the announcement of a takeover offer even if the takeover does not go through! The authors concluded that these gains are primarily due to stock market anticipation of a future successful acquisition

Rather than using abnormal stock market price movements around the time of an event as predictors of future actual performance, certain researchers have examined the market performance of merging companies over a long period of time (a few months to a few years). In many of the cases it is been seen that the intended benefits of acquisitions are often not realised over a period of time:- Moeller, Schlingemann, and Stulz (2004) analyzed the performance of acquiring companies through the two major merger waves that occurred during that time period. They found that over a period of 1998 to 2001 shareholders in bidders lost $240 billion. Dodd (1980) in his study found that the stockholders of target firms earned large positive abnormal returns from the announcement of merger proposals i.e. approximately 13 % at the announcement of the offer and 33.96 % over the duration of the merger proposal (10 days before and 10 days of the announcement). But the stock holders of bidder firms in both completed and cancelled merger proposals experienced negative abnormal return of -7.22% and -5.50%, over a period of time.

Research Studies done by Ravenscraft and Pascoe 1989, Healy *et al* 199.and Kaplan 1993 each have found a weak correlation between the stock markets and the profitability or the cash flows of the merged company in the long run.

Consistent with poor merger and acquisition performance, a study by McKinsey & Company found that only 23% of mergers and acquisitions succeeded. 60% of the mergers and acquisitions in the study failed and did not produce sufficient returns necessary to even finance the corporate combinations. Related studies indicated that up to 45% of these acquired companies eventually sold or became restructured stand-alone business entities (Hitt et al., 2001).

Mergers and Acquisitions Outcomes

The corporate leadership council M&A survey (2006) revealed that 12% of organisations report significant success in M&A, while 34% report no success in M&A transaction. Furthermore 77% of M&A do not achieve their original purpose. 50 to 80% of mergers and acquisitions never produce anticipated benefits

In a meta-analysis of 93 empirical studies of M&A performance, King, Dalton, Daily, and Covin (2004) concluded that stock values for both acquiring and target firms generally increase significantly on the day of the acquisition announcement. This suggests that shareholders expect long-term synergy gains from mergers. Despite anticipated gains at the time of the announcement, market returns to the acquiring firm after the acquisition, as well as accounting performance such as return-on-assets, return-on-equity, and return-on-sales, are generally a zero-sum gain. About half of all M&A's create value; the other half do not. Mergers, on average, fail to realize potential gains that are thought to exist at the time of the announcement.

Mergers, acquisitions, and strategic alliances are supposed to create new and stronger organizations, but literature shows that such combinations often fall far short of expectations. Every merger, acquisition, or strategic alliance promises to create value from some kind of synergy, yet statistics show that the benefits that look so good on paper often do not materialize (Rosalind and Kirstie 2004).The question that now triggers what causes such failures as mergers aren't really successful nor do they realise value or synergy,?

The next section highlights on the reasons for failure in mergers and acquisitions. It highlights the neglect of HR issues which causes a merger failure.

Reasons of Merger failures

Bellinger and Hillman (2000) provided an excellent summary of reasons for merger and acquisition failures: M&A failure has been attributed to many reasons: imitation of other M&A strategies without proper understanding (Haunschild, 1993), lack of integration (Haspeslagh& Jemison, 1991; Nahavandi& Malekzadeh,1988), managerial hubris (Haunschild,1993), inadequate estimation of target, lack of commitment, lack of leadership or strategic guidance after the negotiations of M&As, and a reduction in slack resources (Haspeslagh& Jemison, 1991).

Allred et al. (2005) found in his studies that impact of mergers and acquisitions is also due to the unequal sizes of mergers. If the companies merged or acquired are of different sizes, there would be power imbalance especially if the acquired is of a smaller size. The larger acquiring company does not bother to accommodate the issues of the acquired company, thereby not focusing on the integration areas. This could be the reason for merger failure.

Gadiesh and Ormiston (2002) discuss five possible reasons for the failure of a merger – poor strategic rationale, overpayment for the acquisition, inadequate integration planning and execution, a void in executive leadership and cultural mismatch.

According to the merger statistics, there were more than 7,700 deals in 1998 involving US companies valued at $1.2 trillion. Worldwide transactions totalled more than $ 2.4 trillion in nearly 23,000 deals. Of those, 96 per cent were friendly, 85 per cent were to gain competitive advantage and 88 per cent were companies in similar busness.Most of the companies reported that their mergers were successful but their end results weren't successful as they could have been.The author listed down a multitude of factors which contribute to merger failures. It was found that the success depended ultimately on the effective use of people. (Ruth 2000).

Using questionnaire & interviews from British case studies, Haspeaslagh and Jeminson (2004) in their research across twenty companies have drawn together the HR issues elements from entire spectrum of merger literature. They argue that acquisition managers choose to focus on quantifiable financial issues and ignore the messy human dimension. As a result, manager over simplify key issues and fail to develop creative HR solutions.

Giles (2000) also reported that one of the main reasons for failure of a merger or acquisition is based on **human resources neglect**. Companies which have failed to recognize the importance of human resources in their organizations and their role in the success of integration have failed to reach success.This is particularly critical in the area of mergers and acquisitions. Human Issues in mergers and acquisitions which have been the most sensitive issue have been often ignored).In a study done by Hunt(2003) it was found that the in one third of the companies the management had failed to recognize the role of HR post mergers which was the primary cause of the merger failure.

A lot of studies have discussed the involvement of HR in mergers and acquisitions, which becomes a critical factor that influences the success of mergers and acquisitions (Daniel & Metcalf, 2001; Jeris et al., 2002).Lack of direct involvement of HR during the strategic decision making, pre-merger and to a great extent during-merger phase is one of the main reasons for a merger going sour. In a research done by (Giles, 2000; Liberatore, 2000) they found that that only 35% of senior HR executives were involved in M&A activities that were been carried out in 60 different companies

A study done by Dixon and Nelson (2005) found that the HR professionals were not been included in the mergers and acquisitions team. The team only comprised of employees from the finance, IT and other disciplines. Organisations while deciding to merge or acquire look into the financial and legal fronts, but they somehow fail to look into the human resources of the organizations.

Gaughan (2005) stated: "*Human resource departments in today's organizations are practical and strategic. As such, they can add significant value for companies through development, managing personnel conflict, reinforcing the new HR system and corporate culture, and providing leadership and communication to reduce turnover*

Cartwright and Cooper (2000) acknowledged that the leading roles of modern human resources functions are to be actively engaged in the organization and perform as a business partner and advisor on business-related issues.

Conclusion

A lot of existing literature has studied the impact of mergers and acquisitions due to the post-merger and post-acquisition integration issue, and neglect of HR function in mergers and acquisition. Charman (1999) and Greengard (1999) in their research reported that 80% of combinations failed at the implementation stage as a result of the following factors: an inadequate road map, senior HR professionals brought in too late and senior HR professionals lacking both business and global experience.

Thus, if the HR is involved at the pre-merger discussion and at the strategic planning phase, the HR can identify the areas of divergence of both the companies which could help in a successful merger. It is thus imperative to involve HRfrom the day one so to identify the right target and issues which could be addressed at the earliest. Indeed, human resource development performance often becomes a critical factor that influences the success in mergers and acquisitions.

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