Merger and Acquisition Performance Improvement: An Alternative View

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Merger and Acquisition Performance Improvement: A Non-traditional View

Abstract

About one-half of mergers and acquisitions fail (Ansoff, Brandenburg, Portner & Radosevich, 1971; Porter 1987).

The two major traditions in Strategic Management provide insights into ways to improve M and A performance. Content scholars examine factors that correlate to success and failure. (Rumelt 1982; Sing & Montgomery 1987). The process school considers decision makers' cognitive limitations that impede rational decision making about candidates (Duhaime & Schwenk 1985; Jemison & Sitkin 1986).

While beneficial, this diverse body of literature has two limitations: (1) It is oriented towards avoiding failure; (2) It does not address the complete acquisition decision-making process.

*This paper supplements the traditional views of performance improvement. Its position is that performance might be improved not only by avoiding failure but by increasing the number of attractive acquisitions that are consummated. It advances a model of factors that intervene in the decision making process to reverse decisions to pursue **attractive** candidates **before** negotiations.*

Results are derived from a field study of 27 decisions made by 24 firms. These are analysed using the multiple-case study method (Eisenhardt 1989; Yin 1994).

By identifying decision-reversing factor, it provides an important piece to the incompletely researched mosaic of the acquisition process by covering a phenomenon—withdrawals-- in a period in the process—pre-negotiations-- heretofore largely ignored.

Keywords: M and A planning/process, group decision-making, strategy implementation process

THE IMPORTANCE OF ACQUISITIONS AS VALUE DESTROYERS

The global value of M and A's totalled (US) $ 3.8 trillion in 2006 an increase of 37.9% over the value in 2005 (*Thompson Financial* 2006). Pablo (1994) notes that acquisitions have become a well-institutionalised phenomenon; and, Melin (1992: 111) refers to them as ‘a predominant feature of internationalisation’. Yet, there seems to be a consensus that in the order of one-third to one half of M and A’s fail.

Given the importance of mergers and acquisitions and the high failure rates, a substantial body of knowledge has evolved addressing issues related to performance improvement. The traditional view of the way to improve acquisition performance emphasizes avoiding failure. In this paper an alternative and supplementary view is taken which focuses on *increasing the total number of successful acquisitions by not forgoing opportunities that are identified as potentially sound*.

THE TRADITIONAL VIEW OF IMPROVING PERFORMANCE

The performance improvement literature is multi-disciplinary, fragmented and characterized by a multiplicity of paradigms and approaches.

Improvements to the Content of Strategy

Early work by strategy content scholars tended to focus on identifying factors that appeared to influence the profitability of M and A's. The goal of this research was to identify what distinguishes ‘good’ from ‘bad’ acquisitions or, as Ansoff and colleagues put it, the ‘correlates of success’ (Ansoff et al. 1971: 39). Correlates are myriad; the following are indicative of the stream’s scope:

- Characteristics of the acquirer – for example, amount, nature, timing and performance of past acquisitions (Fowler & Schmidt 1988; Hayward 1997; Kusewitt 1985);

- Characteristics of the candidate – for example, historical growth rate, market share, profitability, industry (Fowler & Schmidt 1988; Kitching 1967; Kusewitt 1985; Rappaport 1979; Rumelt 1982; Salter & Weinhold 1979);

- Aspects of the relationship of the parties in the dyad – for example, degree of industry relatedness or 'type' of acquisition (such as horizontal integration, vertical integration, conglomerate), and relative size (Kitching 1967; Lubatkin 1983, 1987; Rumelt 1982; Salter & Weinhold 1979; Singh & Montgomery 1987).

Some of the correlates, particularly the degree of industry relatedness, have proved difficult to measure (Rumelt 1982; Datta, Pinches & Narayanan 1992). None the less, various combinations of them can be used to help a firm set objectives for an M and A effort, highlight potential problem areas, or they can be translated into criteria for screening and ranking candidates. Otherwise put, they may constitute a part of acquisition performance improvement theory and the content of strategy.

A more recent approach to developing acquisition strategy content, particularly for distinguishing the relative attractiveness of candidates that emerged in the 1980s. It couples an advancement of correlates theory – using *strategic fit* as an umbrella dimension – with concepts from organization behaviour theory that can be used to assess *organizational fit*, another umbrella dimension.

'Strategic' acquisitions[1], involve candidates that are related or complementary in some sense and where the acquisition is motivated by a desire to realize synergies. Synergies, in turn, rely primarily on the sharing or transfer of skills, knowledge and other resources between the candidate and the acquiring company (Chatterjee 1986; Haspeslagh & Jemison 1991; Lubatkin 1983; Salter & Weinhold 1979). The sum of the potential for such transfers constitutes the *strategic fit* between the candidate and the acquirer.

[1] As opposed to 'value capturing' acquisitions like the purchase of low-cost assets

Organizational theory scholars supplemented the strategic fit model by suggesting that for synergies to be realized, the organizations must mesh, and their people work well together after the merger or acquisition is completed (Soderberg & Vaara 2003). Working together can be constrained by differences between the organizations in corporate cultures, administrative systems, management styles and other 'human factors' (Buono & Bowditch 1990; Larsson & Lubatkin 2001; Lubatkin 1983; Jemison & Sitkin 1986; Porter 1980; Soderberg & Vaara 2003).

In sum, in value creating or strategic acquisitions, *strategic fit* represents the *potential* for a candidate to contribute to the acquirer's objectives, and to complement or augment its strategies, in part through synergy effects; *organizational* fit and softer issues like 'people, cultures and politics' (Soderberg & Vaara 2003: 3) influence the extent to which synergies *can be achieved* (Jemison & Sitkin 1986; Haspeslagh & Jemison 1991) in the post-acquisition period.

The implications of the use of the strategic and organizational fit concepts for evaluating and selecting candidates appear in Figure 1. In brief, the matrix provides a tool for avoiding failure by forgoing acquisitions in the lower left cell; success is more likely to be achieved by focusing on candidates in the upper right cells.

"Take in Figure 1"

Where in the Process Failure Avoidance Theory Concentrates

Structure of a Seven-Phase Acquisition Process

In some conceptual and empirical literature, the acquisition process is deconstructed into phases, each of which consists of a collection of discrete activities and decisions, starting with the setting of objectives for an M and A effort and typically ending with completion of the deal or post-acquisition integration of the candidate into the acquiring firm. Numerous 'maps' of decision processes are presented in the literature (Haspeslagh & Jemison 1991; Salter & Weinhold 1979). While it is generally recognized that decisions do not necessarily (or even often) progress through phases in a linear sequence (Hickson, Butler, Cray, Mallory & Wilson 1986; Eisenhardt & Zbaracki 1992), such maps provide a useful framework through which to view the decision process (Risberg 2000).

One, to which Haspeslagh and Jemison (1991) refer as the traditional view of the process, appears in Figure 2.

"Take in Figure 2"

Avoiding Failure in the Phases Four and Five

In the model in Figure 2, Phases Three and Four constitute the period in which matrices such as that shown in Figure 1 are used and determinations are made about the attractiveness of candidates.

As noted, much literature that deals with the early phases in the process focuses on improving the search for and evaluation and selection of candidates (Pablo 1994) and, overlapping with a corporate finance stream, arriving at appropriate valuation decisions (Rappaport 1979; Salter & Weinhold 1979).

Avoiding Failure in Phases Six and Seven

There are a number of factors that may intervene in the M and A decision making process that result in a candidate that was evaluated in Phases Four and Five and found to be attractive becoming unattractive or unavailable on attractive terms. Some of these are well researched. They include, among others:

- Rejection of an offer that was too low (Jemison & Sitkin 1986);
- Legal and regulatory obstacles including anti-trust objections by the government (Evenett 2001);
- Negative reaction of the general public or capital markets (Powell, Puranam & Singh 2002);

- Incompatible and irreconcilable management styles (Brousseau, Larsson, MacPhail & Swaels 2004); or organizational chauvinism (Jemison & Sitkin 1986).

In addition, a substantial body of research focuses on how the negotiations undertaken in Phase Six may affect the post-acquisition integration that occurs in Phase Seven (Pablo 1994). Finally, there are suggestions and prescriptions, some of which have empirical support, for how issues related to 'human capital' can be better managed to achieve integration goals (Brousseau et al. 2004; Larsson & Lubatkin 2001; Soderberg & Vaara 2003).

Recognizing the Limitations of the Traditional View(s) of Performance Improvement

A multiplicity of diverse disciplines and streams contribute to predicting acquisition performance and understanding how it might be improved. For example, by incorporating measures of the potential for asset, skill and capability transfer into definitions of strategic fit (and the criteria that comprise it) and by analysing both strategic fit and organizational fit, poor choices can be minimized. Appropriate valuations can be determined by using state-of-the-art models to discount cash flows or support the use of other valuation techniques (Hubbard, Lofstrom & Tully 1994). Optimal procedures for due diligence can be followed (Angwin 2001). The best payment methods, modes and timing can be selected. In addition to choices involving substantive aspects of content, psychological, organizational and other process impediments to rational decision making can be identified and, at least in part, dealt with both to minimize biases and distortions in choices and to create a positive climate for post acquisition integration (Pablo1994; Haspeslagh & Jemison 1991). Taken together, this literature is oriented towards improving performance by reducing failures associated with firms buying the wrong candidates, paying too much for them, or failing to realize the intended benefits by mishandling integration. By eliminating failures, the ratio of successful acquisitions to total acquisitions will increase and performance will improve. Simply reducing failures, however, is limiting. Rather than avoiding failure, the alternative view of performance improvement proposed in this paper focuses on increasing successes by not missing out on potential opportunities.

METHODOLOGY

The overall purpose of this field study was to identify why firms withdraw from acquisitions they have evaluated and found attractive (after Phase Five) even before entering into negotiations with candidates (Phase Six) because, other things being equal, it is likely that their acquisition will contribute positively to M and A performance improvement.[2].

A search of the literature suggested three broad groupings or categories of variables that may result in decisions to stop pursuing candidates. The categories were defined broadly based on the literature, common sense and experience (Eisenhardt 1989):

- Strategy/objectives variables include factors related to the priority that is placed on acquisitions as a strategy, the objectives of an acquisition effort, the acceptability of a candidate's industry, location, 'type' or its other characteristics.

- Organization functional resources variables include staff that have the knowledge and skills that are required to assist with the consummation of the deal and in the post-acquisition integration or management of the acquired company.

- Financial variables include expectations that the price for a candidate will be too high or the inability of the acquirer to raise sufficient funds to consummate the acquisition.

Definitions of variables that constituted the categories at the outset of the study appear in Table 1.

Table 1: Initial Definitions of Variables in the Preliminary Explanatory Model

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[2] The acquisition of candidates that have not been fully evaluated is more likely to result in poor outcomes (Ansoff et al, 1976); poor outcomes may also result once negotiations begin and thee is an escalation of commitment to poor choices (Haunschield, Davis-Blake, Fichman, 1994)

Variable	Description/Rationale	Literature Source
Strategic Priority – Acquisition	Need which drove Search (e.g. ‘earnings gap’) no longer exists	Ansoff 1965 Haspeslagh and Jemison 1991
Strategic Priority – Candidate	Need for acquisitions constant but rationale for candidates with specific profiles changes	Pfeffer 1972 Haspeslagh and Jemison 1991
Saturation	Firm’s ability to absorb acquisitions becomes doubtful	Haspeslagh and Jemison 1991 Kitching 1967
Competitor bid for Candidate	Pre-emptive bid occurs or high bidding is anticipated	Kusewitt 1985 Haspeslagh and Jemison 1991
Alternative Candidate	A more attractive candidate becomes available	Haspeslagh and Jemison 1991
Funds	Unanticipated reduction in available finance	Salter and Weinhold 1979 Haspeslagh and Jemison 1991
Post Acquisition Manager	Unanticipated loss of or lack of availability of manager with appropriate skills/knowledge to add value to candidate	Kitching 1967 Paine and Power 1984
Saturation	‘Corporate indigestion’ and the potentially negative impacts of acquirers ‘biting off more than they can chew’	Kitching 1967 Haspeslagh and Jemison 1991
Approval Authority/Champion	The quality and availability of advocacy in at least two levels: the operating level at which the candidates are evaluated and recommended to senior management by a champion; and, secondly, the highest level at which they must be approved	Trautwein 1990 Haspeslagh and Jemison 1991

A multiple-case study methodology was used based on the principles advanced by Eisenhardt (1989) and Yin (1994). The sample population consisted of decisions made by 23 medium to large sized companies with sales between $300m and $20b. All were acquisitive yet had reversed decisions to pursue attractive candidates that they themselves had evaluated and found attractive. They participate in a wide range of industries including food and beverage, health care, professional services and energy among others. Individual decision cases were the units of analysis. Twenty-seven cases were chosen to fill theoretical categories, or extend or replicate them (Eisenhardt 1989). Twenty-four are reported on in this paper. Three were reversed after substantial negotiations had occurred and they were therefore excluded from the analysis.

Thirty-nine informants split rough equally between M and A industry participants (bankers, consultants, lawyers) and employees of acquiring firms underwent 54 semi-structured interviews each of which lasted about an hour and a half. In some cases, interviews were supplemented with an analysis of memoranda, business plan s and other documents that were used to justify their acquisition.

Steps in the research process are consistent with those suggested by Eisenhardt (1989) and are self-explanatory. They appear in Figure 3.

“Take in Figure 3”

Trustworthiness and verifiability of findings (Creswell 1998; Guba & Lincoln 1994) were enhanced by triangulating data points, securing member checks of data, undertaking peer debriefings (Lincoln & Guba 1985), and incorporating negative case analysis as a research step (Yin 1994).

KEY FINDINGS

Decisions to pursue attractive candidates were reversed for a wide range of reasons, some strategic, some operational and some tactical. A sample of these appears below in Table 2. Those not appearing in the table are essentially replications.

Table 2: Reasons for Acquisition Decision Reversals

Case	**Apparent Reason for Strategic Disconnect**
Angloco	Poorly understood (or poorly communicated changes in) financial objectives and financial evaluation criteria at sponsoring level
Foodam	Lack of agreement about industry and geography within board
Foodco	Shortage of organizational functional resources (board time) leading to lowering in priority placed on all acquisitions (geography played a secondary role)
Transco	Board split about priority that should be placed on acquisitions in general compounded by geography of specific candidate(s)
Sasco	Division lost momentum/motivation when unable to achieve quick authorization from head office
Foodex	Lack of agreement between international division and board about priority that should be placed on acquisitions driven by questionable capability of likely post-acquisition manager
Pharmco	Acquirer evaluated candidate outside its home market and found it attractive. An

	alternative candidate in its home market became available
Indusco 1	Financial objectives, the driving force behind its acquisition strategy achieved without acquisition. Acquiring the candidate would have placed an extreme strain on MIS resources
Machineco	Strategic objective – diversification – was achieved organically
Adco	Company planned to generate funds required for acquisition from a divestiture. There were no buyers. Candidates that were in the consideration set all became less attractive due to an environmental change (burst in the Telecoms bubble)
Ensco	Priority on acquisitions in general was reduced when company shifted into a rationalization/cost reduction mode
Denco	Candidates were identified by SBU, but parent decided to sell SBU after a significant 'shock' in its environment making the industry sector unattractive
Zenco	Acquiring company became target and shifted its priorities to take-over defense

Cross-case analysis and pattern matching (Eisenhardt 1989; Yin 1994), suggest the model for factors that reverse decisions shown in Table 3.

Table 3: Empirical Model

Strategy/Objectives	Organizational Functional Resources	Other Financially Related
• Changes in, poorly defined, poorly understood, not agreed priorities regarding: Acquisitions (1) Industry (2) Geography (3) Type (4) Candidate, *and/or* (5) • Changes in or not agreed or poorly understood or financial objectives (6)	• Constraints on or lack of qualified, knowledgeable, skilled staff with appropriate power as: Approval authorities (7) Champions (8) Post-acquisition managers (9) Other key functions (10)	• Constraints on or lack of funds (11) • Price expectations (12)

As noted, variables and their definitions evolved as the study unfolded in line with the principles of the methodology (Eisenhardt 1989; Yin 1994). For example, the saturation variable was incorporated as a dimension into all of the organizational resources variables and dropped as a variable in its own right; and, the redefined variables were allocated to the three reconstituted categories.

Some of the variables had mediating effects and some interacted with others. For example, a shortage of funds was directly linked to a company forgoing a specific acquisition for which the funds were being raised. A lack of funds also resulted in the lowering a company placed on all acquisitions. In these and other cases more than half had greater than two variables that influenced a decision reversal.

In sum, a wide range of factors intervene in the acquisition process such that decisions to stop pursuit of candidates are made before negotiations begin even though the candidates have been strategically evaluated and financially evaluated (Phases Three and Four), found to be attractive, and whose acquisition could therefore have a positive impact on performance.

THEORETICAL IMPLICATIONS OF THE ALTERVATIVE VIEW OF PERFORMANCE IMPROVEMENT

This study makes three contributions to theory. First, it examines decision reversals instead of decisions instead of decisions that lead to acquisitions. Second, it contributes to an understanding of a phase in the acquisition process about which little has been written. Third, it provides an alternative lens through which to view M and A performance improvement. In the context of a discussion of organizational decision making, March and Olsen observe that ‘organizations often ... do nothing to implement a decision after having devoted much time, energy and enthusiasm to making it’ (March & Olsen 1976: 10). More particularly, Haspeslagh and Jemison (1991: 51) maintain that during the acquisition process ‘a commitment may stall, reverse or accelerate’.

The alternative view of performance improvement advanced in this paper focuses on apparently missed opportunities that result from the do-nothing, stalled or reversed outcomes described by March and Olsen (1976) and Haspeslagh and Jemison (1991).

While all of the variables in the model stalled or reversed outcomes, those in the Strategy/Objectives category were far more prevalent in the sample than those in other categories. Equally important, definitions of these variables evolved as the study unfolded. The initial definitions (Table 1) focused on *changes* in the strategic priorities of the acquiring firm that might actually make a specific candidate less attractive. The final definitions incorporated how strategies and objectives were defined, communicated and agreed at the outset of the search. Otherwise put, an inability to achieve consensus on strategy appeared to be more of an influence on outcomes than changes in the internal or external environment of the firm that might lead to a change in strategy and affect the attractiveness of a candidate.

By identifying the factors that influence decision reversals, this study provides a first step toward developing a theory of negative decision making in the acquisition domain. In doing so it, in part, responds to Hickson et al.'s concern that 'research [on strategic decisions] is based virtually exclusively on positive decisions' (1986: 35) yet these only yield a partial picture of organizational decision making.

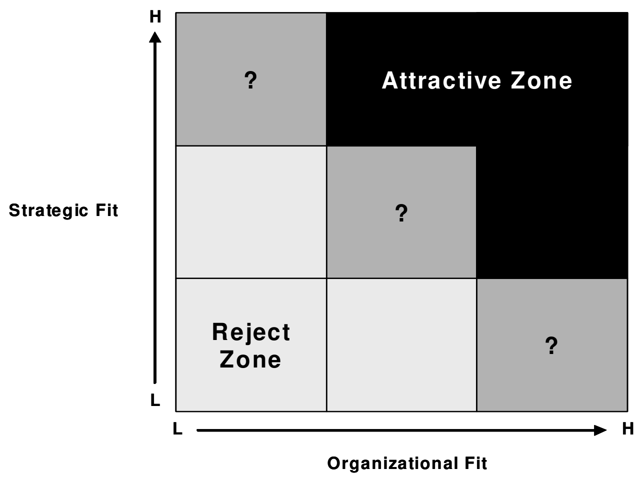
The M and A literature includes diverse streams that seek to explain why senior management may proceed with acquisitions at the expense of shareholder interests. These include hubris (Roll 1986), reasoning by analogy (Duhaime & Schwenk 1985) and ignoring new information to reduce dissonance about decisions already taken (Carter 1971). More complex theories have also been advanced, such as those dealing with the escalation of momentum (Jemison & Sitkin 1986) and commitment (Powell et al. 2002) and those drawing on agency relationships (Lane, Canella & Lubatkin 1998; Morck, Shleifer & Vishny 1990).

These streams seek to explicate why decisions are not reversed even when the candidates are unattractive. This research looked at the reasons why they don't proceed even when the candidates are attractive.

Second, the period on which this study focuses has largely neglected. According to Powell et al. (2002) 'very little attention has focused on the decision …to continue with or withdraw from the initial intent of acquiring a target firm' (2002: 1). By examining decision-reversing variables in what, in effect, constitutes the 'authorization' routine in Mintzberg, Raisinghani and Theoret's (1976) model of strategic decision making, it adds to the knowledge of this routine in the M and A domain. More specifically, it identifies reasons for the delays, interrupts and failures for which Mintzberg et al., found evidence in non-M and A related strategic decisions.

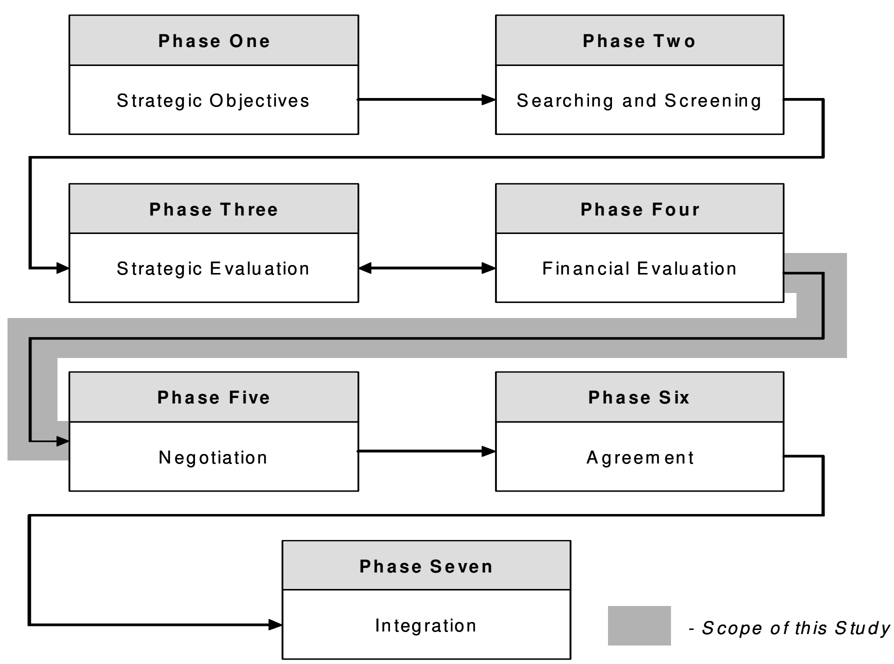
Finally, in simple arithmetic terms, if M and A failures are the numerator in a fraction and total M and A's the denominator, most research heretofore focuses on producing theory that may be used to reduce the numerator. This paper takes the position that performance may also be improved by increasing the denominator assuming candidates are evaluated sufficiently and found truly attractive. In doing so, it provides another piece to the complex mosaic of the M and A decision making process.

Figure 1: Strategic and Organizational Fit as a Means of Selecting Acquisition Candidates



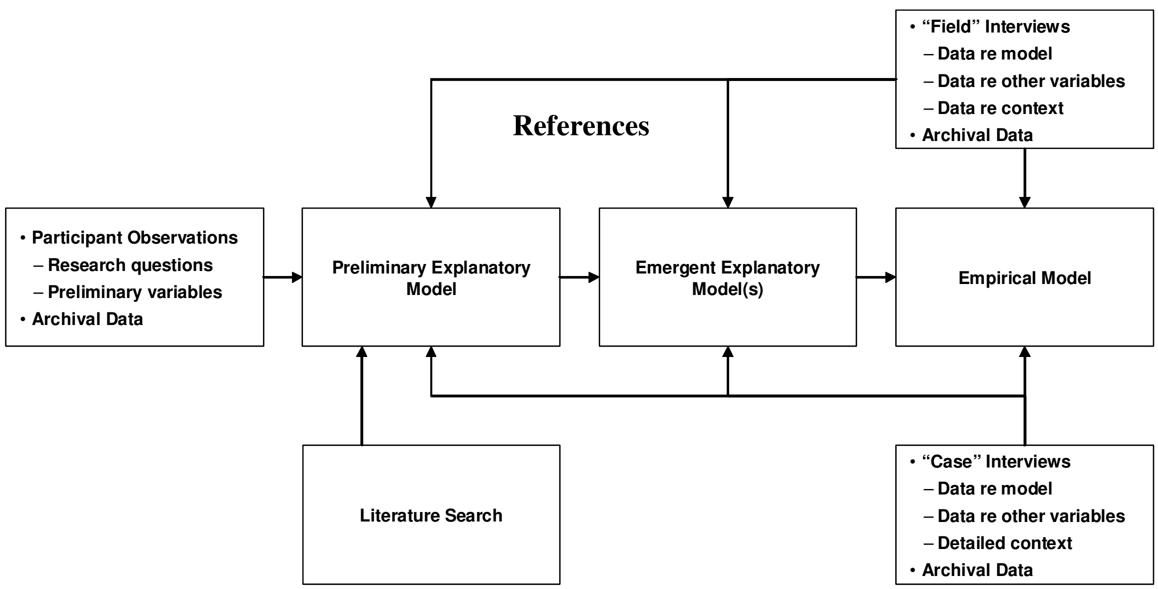
Source: Arthur D. Little, Inc.

Figure 2: Traditional View of the Acquisition Process



Source: Haspeslagh and Jemison, 1991 modified by author

Figure 3: Main Steps in the Research Process



Source: Author

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