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MERGERS AND ACQUISITIONS FAILURE RATES AND PERSPECTIVES ON WHY THEY FAIL

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ABSTRACT: Mergers and acquisitions represent the ultimate in change for a business. Despite this, it is common knowledge that mergers and acquisitions do fail and they do not necessarily create shareholder value. The main aim of this piece of research work was to contribute to the general body of knowledge in the area of failure rates, and the perspectives on why mergers and acquisitions fail. The objective was to investigate from literature on the failure rates and perspectives on why M & As fail, present the various discussions and arguments on the subject matter, and then catalog them for researchers and students in this particular field. It was found that the integration stage of the whole merger and acquisition process was the most problematic area which contributes to merger and acquisition failure, and that the problem in the integration stage has to do with the human factor (the employees-coping with cultural differences, politics, lack of effective communication, etc). Another factor that occurred most after the human factor is poor strategies that are rolled out after the deal is sealed. Again, M & A failure rate is very high; averaging about 50%, regardless of the initial high hopes.

KEYWORDS: merger, acquisition, failure, perspectives, shareholder, value.

1 BACKGROUND

Merger and acquisition are sometimes used interchangeably, but there are significant differences which must be appreciated. Merger connotes the fusion, the union of two or more companies or entities into one through a *purchase acquisition* or a *pooling of interests*. It differs from a consolidation (the combining of separate companies, functional areas, or product lines, into a single one. In this particular case, a new entity is created). For a merger, no new entity is created. Purchase acquisition is an accounting method used in any merger in which the purchasing company treats the acquired as an investment, adding the acquired's assets to its own balance sheet, and recording any premium paid above market price as goodwill, to be charged against future earnings. Pooling of interests is also a method of accounting for a company merger, in which the balance sheets of the two companies are combined line by line without a tax impact (only allowed under certain circumstances-used when Merger involves stocks only). An acquisition (or a takeover) is simply acquiring control of a corporation, called a target, by stock purchase or exchange, either hostile or friendly.

In corporate law, a merger is the joining together of two corporations in which one corporation transfers all of its assets to the other, which continues to exist. In effect one corporation consumes the other, but the shareholders of the consumed company receive shares of the surviving corporation.

An acquisition, on the other hand, typically involves purchasing the assets and stock of the acquired company. The methods of merger and acquisition are varied and in practice the distinctions often blurred but the key difference between merger and acquisition lies in the position of the shareholder. Shareholders in merged companies typically exchange their shares for shares in the new company.

In an acquisition, however, the target company is usually acquired as a going business and its shares are transferred to the shareholders of the acquiring company for cash or debt, giving the acquiring company effective control over the assets and liabilities of the acquired company. Acquisition occurs either through buying substantially all the assets in a full takeover or buying part of the stock in a partial takeover.

A partial takeover involves a bidder buying a large enough stake to control or effectively participate in the resolutions of the board of directors (http://newsweaver.ie/altamimi/e_article001432224.cfm, retrieved 09/02/2012).

Researchers in the area of M & A have also come out with a lot of interesting definitions worth mentioning here. Sudarsanam [1] indicated that a merger occurs when corporations come together to combine and share their resources to achieve common objectives. The companies involved remain joint owners of the new entity. European Central Bank [2], Gaughan [3], and Jagersma [4] also defined merger as the combination of two or more companies in creation of a new entity or formation of a holding company. Pennings and Lee [5] also present it in this way:

> “Mergers are distinguished from acquisitions in that mergers are assumed to involve two firms with roughly the same size or equivalent resources. If one of the two firms is much smaller we are inclined to label their fusion an “acquisition”.”

This definition is in consonance with that of Haspeslagh and Jemison [6] and Soederberg and Vaara [7] who also talk about equal sized firms coming together with no one party clearly seen as the acquirer. The definitions of Butler, Ferris, and Napier [8] suggests that for a 50%-50% stake of both companies, it is a merger; and for anything different from the above, it is an acquisition regardless of the size of the companies involved. This is where Piekkari, Vaara, Tienari and Santti [9] also argue that “merger of equals” are rare, and that one party is most of the time in control. They continued to argue that the term “merger” is used for political reasons to avoid the notion of one firm or entity being in total control or dominance of the other.

This means that in reality mergers are on the low side compared with acquisitions; this is backed by United Nations Conference on Trade and Development (UNCTAD) 2000 report in which cross-border M & As from 1987 to 1999 revealed that only 3% of all the M & As were mergers [10], as cited in Buckley and Ghauri [11] and Teerikangas and Very [12]. The report continues to say that the number of “real” mergers is so low that, for practical purposes, M & As basically means acquisitions.

To those who are not privy to the agreement document, the following are some of the things that can influence their definition as to whether a particular agreement is a merger or an acquisition:

- **Name of resultant entity or company:** If the name of the resultant entity bears the name of the investor, it is easier for people to conclude that it is an acquisition. If it bears the name of the existing entity, then people will think of the agreement as a merger. Sometimes the resultant name may be a combination of the names of the two companies involved, and people will still consider it as a merger.
- **How the board and management are constituted:** People will easily go for a merger if the board and management of the resultant company are fairly constituted. People will easily go for an acquisition if the investor has more representation on the board and management. This is not always true especially when a merger allows for one party to be a management partner. From the above discussion, it can be clearly deduced without any ambiguity that a merger simply is made up of the fusion of two or more companies or entities into one, where none of the entities involved has complete dominance over the resultant entity, and also all the individual entities involved still maintain their identity as separate entities. The resultant name normally does not differ from the name of the existing company. The name can also be a combination of the two or more companies involved. Mergers and acquisitions represent the ultimate in change for a business. No other event is more difficult, challenging, or chaotic as a merger and acquisition. It is imperative that everyone involved in the process has a clear understanding of how the process works. Mergers and acquisitions have had an important impact on the business environment for over 100 years [13] (Gaugan, 1999). They have often come in waves of activity that were motivated by different factors. Mergers and acquisitions (M & As) continue to be a dominant growth strategy for companies worldwide. This is in part due to pressure from key stakeholders vigilant in their pursuit of increased shareholder value. International mergers and acquisitions also constitute the most frequently used means through which multinational corporations undertake foreign direct investment. According to Banal-Estanol and Seldeslachts [14], mergers and acquisitions are normally established to open up or expand a current organization or operation seeking or aiming for long-term profitability and an increase in market power, as cited in Chambers (2008).

Mergers and acquisitions are an on-going phenomenon; talks of possible mergers and acquisitions have become an important part of corporate organizational strategy despite knowledge of the high failure rates of about 50-80 % [15], and the fact that despite the popularity of most mergers and acquisitions, the strategic performance outcomes of most have been disappointing [16]. King [17] added his bit by saying that M & A have failed over the years to significantly add value to the acquiring firm, as cited in [18].

Companies normally would like to go for M & As than to resort to other cooperative approaches of Research and Development (R&D) network building, e.g., R&D joint ventures, because M&A provide an immediate conspicuous and controlling presence in the new, fast expanding market, rather than having to gradually build a new entity or negotiate with a partner about developing a cooperation ([19], [20]) as cited in [21].

The main aim of this piece of research work is to contribute to the general body of knowledge in the area of failure rates, and the perspectives on why M & As fail. The objective is to investigate from literature on the failure rates and perspectives on why M & As fail, present the various discussions and arguments on the subject matter, and then catalog them for researchers and students in this particular field. Industry players can also take a clue from it to inform them on the possible outcomes of M & As they want to embark on in the future.

It is common knowledge that most M & As do not yield the intended outcomes. What this works intends to do is to try to unravel the reasons why this occur from documented facts by authorities and researchers in this field.

2 Materials And Methods

This work is mainly a review of literature on first of all the failure rates of M & As, and then the perspectives on M & A failures.

3 Results And Discussions

3.1 Failure rates of M & As

Haspeslagh and Jemison [6] and Saxton and Dollinger [22] pointed out that post-merger/acquisition integration, which forms part of the dynamics, is key for the success of the deal. Pablo [23] defined post- merger and acquisition integration as the implementation of changes in functional activities, organizational structures and cultures of the two organizations to expedite their consolidation into a functional whole. This is not to be achieved so easily, taking into consideration the coming together of two separate and different entities. Koetter [24], Cartwright and Cooper[25], Child et al. [26], and Sally Riad [27] made it clear that despite the high hopes of successes driven by the motives, research has shown that only 50% of mergers and acquisitions succeed(or 50% fail). Gerds and Schewe [28] also maintain that the failure rate is higher than 60%, which were confirmed by Chang, Curtis, and Jenk [29], and Watkins and Copley [30] earlier. KPMG also did a research on M & A and found out that 75% to 83% of M & A fail [31], as cited in Nguyen and Kleiner [32]. Research into companies involved in cross-border mergers and acquisitions, as in the case of global Telecommunications giants, points to failure rates of up to 70% with very few deals enhancing shareholder value (retrieved from www.communicaid.com on 17/11/2011). In Ghana, Ghana Telecom's experiences with Telkom Malaysia and Telenor of Norway in the past are all examples of failed mergers.

Research has been able to show that one of the key areas contributing to these failures is the employee factor in the dynamics. Many researchers ([33], [34] [35]) point out that about two-thirds (about 67%) of all mergers fail to achieve the desired results primarily because of the organizations' apathy to the employees' reactions and interests [36].

Cascio and Young [37] also revealed that Psychological responses of people are shown to have an impact on organizational performance and, they become more visible during situations of drastic change like Mergers and Acquisitions.

In a particular research work, when failure rates were analyzed in more detail, the overwhelming majority of senior personnel highlighted culture and communication to be the two areas that prove to be the most challenging. This according to the research was substantiated by a survey of Fortune 500 Chief Finance Officers where 45% attributed Merger and Acquisition failure to "unexpected post-deal people problems". It continued to say that issues ranging from corporate governance to employee satisfaction become complex when different cultures are involved (retrieved from www.communicaid.com on 17/11/2011).

In their research work on "successful mergers and acquisitions: beyond the financial issues", Wageman and Lafforet [38] also maintained that only the chief executive officer who can handle the finances and the people can do the whole job of leading a merger and create lasting value.

The uncertainties of Merger and Acquisition situations cause a series of psychological processes that result in manifest positive behaviors like commitment and loyalty, or negative behaviors like absenteeism, and sometimes, even acts of sabotage ([39], [40], [41], [42], [43], [44], [45], [46], [47], [48], [49], [50]).

Employees form a part of any organization's common factors. Farnham and Horton [51] defined organizations as social constructs created by groups in society to achieve specific purposes by means of planned and coordinated activities.

These involve human resources to act in association with other inanimate resources in order to achieve the aims of the organization. In as much as employees cannot achieve anything without the inanimate resources, the same applies for the reverse. This implies the importance of the employee in achieving good performance, especially in a post-acquisition era cannot be said to be over emphasized. Unfortunately, as has been established earlier, employees' interests in post-acquisition era are not given the needed attention.

Naharandi and Malekzadeh [52] pointed out that despite the popularity of mergers and acquisitions, the general consensus is that about 80% of M & A do not reach to their financial goals. Bruner [53] also confirmed that about 70-80% of M & A do not create significant value above the annual cost of capital.

A failed merger can be understood in two ways:

- Qualitatively, whatever the companies had in mind that caused them to merge in the first place doesn't work out that way in the end.
- Quantitatively, shareholders suffer because operating results deteriorate instead of improve (http://jurisonline.in/2008/11/failure-mergers/).

Despite the upsurge in international acquisition activity, the fact still remains that up to 83 percent of these transactions are unsuccessful ([54], [55], [56]). Thus, international acquisitions constitute an unexplained paradox: although academic research and business practice have shown that the majority of these transactions fail to achieve pre-acquisition objectives, acquisitions across borders continue to be very popular and remain the main vehicle through which Multinational Corporations (MNCs) undertake foreign direct investment ([57], [10]). In fact, some research studies suggests that with the right strategy and the right approach to post-merger integration, cross-border acquisitions can create value for the acquiring firm ([58], [59], [60], [61]). Thus, even though research suggests that most acquisitions fail, it may make sense in some cases.

Cornnell [62] pointed out that differences in approaches, measurements, indicators, time frames, samples, methods and units of data analysis, all contribute to the significant variance in success/failure rates in the literature. He enumerated a number of research findings pointing to different failure rates. These are stated as follows:

- USA: 40 – 50% of M and A's are failures ([63], [64]; [65]); 34% had lower sales than pre- acquisition, 46% had lower profits, and only 22% met all management's objectives [66]. According to Kitching [67], 35% were failures. Vermeulen [68] states that "most executives know that the majority of acquisitions will fail."
- Failure rates for European M and A's appear largely in line with those of the USA. Citing Kitching's study of US-based companies' acquisitions in Europe [69], and that of Bleek, Isono and Ernst [70] of cross-border acquisitions and acquisitions of UK-based companies on the continent, Angwin and Savill [71] noted that between 43% and 54% of M and A's were "considered failures or not worth repeating."

Bohlin, Daley, and Thomson [72] also placed success rate of M & As below 20%.

3.2 PERSPECTIVES ON REASONS FOR M & A FAILURE

Some commentators argue at length about the definition of success and the timescale, over which it should be measured, but the bottom line remains indisputable; far too few mergers and acquisitions deliver the desirable profitability, market share, and increased company momentum in a sustainable, long-term way. On the other hand, there are also some noteworthy success stories, such as ABB, Chemical/Manufacturer's Hanover, Bank of America/Schwab, and GE Capital.

So the question is posed: why do mergers and acquisitions work for some and not for others? In answering this question, this is what Bohlin, Daley, and Thomson [72] had to say:

> "The answers are of course complex. Mergers and acquisitions vary widely along a number of dimensions: company size and diversity; industry characteristics; overlap of products, markets, and customers; prior mergers-and-acquisitions experience of the parties; whether the takeover was hostile or friendly; relative performance strength of the acquired firm; and how much assimilation is desired or required".

There are a number of perspectives on the reasons why M & As fail. We look at it from researchers' point of view, and then find the most frequent causes.

- Hoetzel [73] found that mergers and acquisitions failures were related to national cultural differences and were more frequent in two phases: pre-acquisition and post-acquisition. Differences in organizational culture have a negative effect on acquisition performance ([74], [75], [76]), and national cultural differences too have negative effect on acquisition performance ([77], [78], [79]).
- Balmer and Dinnie [80] found that there was an over-emphasis on short term financial and legal issues, at the neglect of the strategic direction of the company. This neglect included failure to clarify leadership issues, and a general lack of communication with key stakeholders during the merger or acquisition process.
- Gadiesh and Ormiston [81] list five major causes of merger failure:
  - Poor strategic rationale.
  - Mismatch of cultures.
  - Difficulties in communicating and leading the organization.
  - Poor integration planning and execution.
  - Paying too much for the target company.

Of the above five causes of merger failure, Gadiesh and Ormiston [81] believe that *having a clear strategic rationale for the merger* is the most significant problem to overcome, as this rationale will guide both pre and post-merger behavior. They stress that this issue alone may result in the other four causes of merger failure taking place, as cited in Mcdonald, Coulthard, and de Lang [82].

- Lynch and Lind [83] also list other reasons for merger failure such as:
  - Slow post merger integration
  - Culture clashes and
  - Lack of appropriate risk management strategies.
- Steger and Kummer [84] looked at it from a different angle by enumerating the following as contributing to M & A failures:
  - **Unrealistic expectations**
  - **(Over) confidence**- confident managers who try are more likely to succeed than managers lacking confidence who also make the same attempt. The confident managers are more likely to succeed because they will also work harder to overcome difficult obstacles.
  - **Promoters and external advice**- Managers depend heavily on “promoters” to initiate structure and carry out the M&A transaction. Promoters for M & As are investment banks and top management consultancies. They have a vested interest in M & As and push companies into M&A deals in order to offer their services. Promoters convince managers that they can succeed, which may not be true in the end.
  - **Distrust**- Steger and Kummer [84] pointed out that at the grass root level, that is, below the top level management, the attitudes and moods of the employees are often quite the opposite of (over)confidence – namely distrust. They explained that this is so because some amount of confidence is very necessary ingredient for M & A success, and that the opposite is distrust. They further gave four reasons why employees feel a lack of confidence about M&A success. First, there is doubt about what will happen in the future. Is there the danger of losing their jobs? If not, how will their jobs and tasks be changed? How will the restructuring affect them personally? Will they have to move to another department, work with other colleagues, work for a different boss? Will the entity of the company that they work for be divested? These are uncertainties that can last quite some time. Second, companies are often reorganized at least every two years. So, the M&A projects will produce “just another change program” that will not bring the desired outcome. Third, if people are fired the workload is not reduced which results in fewer people having to produce the same amount of work. Fourth, stakeholder management is performed poorly, if at all. In addition, employees are among the stakeholders who are often treated the worst of all. The manner in which, and at what point in time, employees are informed about the M&A transaction is another essential point. Rumors spread rapidly, all over the company. Even months after the closing, integration plans are sometimes far from being settled; insecurity among the staff persists longer than necessary.
  - **Group Dynamics**- Steger and Kummer [84] explained that M & A responsibilities are shared, at least when it is a success. It is shared among the board members. On the other hand when there is a failure initiated by say, a major

project, the initiator of that project would have to leave or is sacrificed. They also pointed out that groups make extreme decisions especially with big M&A deals where there are very difficult activities in which companies can engage in. The risks of such projects can lead to a company's bankruptcy. Also, blame is normally put on those involved in the integration process than those who initiated the M & A in the first place. Lastly, participants in the M & A negotiations become very much committed or dedicated to the deal regardless of its logic or benefit to the company.

- Haspeslagh and Jemison [6], and Pablo [23] link cultural differences and integration issues with merger problems.
- Depamphilis [85] pointed out that overpayment leads to expectations of higher profitability which is often not possible, and that excessive goodwill as a result of overpaying needs to be written off which reduces the profitability of the firm.
- Straud [86] said inefficiencies or administrative problems are a very common occurrence in a merger which often nullifies the advantages of the merger.
- Personal motives of executives- executives enter into mergers for the purpose of seeking glory and satisfying their "executive ego", leading to failure. They lose focus of the fact that they have to concern themselves with the strategic benefits of the merger.
- Selecting the target- Executives inability to select the target that suits the organization's strategic and financial motives and needs often lead to failure. Lubatkin [87] said that selecting a merger candidate may be more of an art than a science, as cited in Straud [86].
- According to Salame [88], and also from the site (http://jurisonline.in/2008/11/failure-mergers/), the following are some of the reasons which result in failed mergers:
  - Lack of Communication
  - Lack of Direct Involvement by Human Resources
  - Lack of Training
  - Loss of Key People and Talented Employees
  - Loss of Customers
  - Corporate Cultural Clash
  - Power Politics
  - Inadequate Planning

Salame [88] continued to reveal that while it is true that some of these failures can be largely attributed to financial and market factors, many studies are pointing to the neglect of human resources issues as the main reason for M&A failures. A 1997 PricewaterhouseCoopers global study concluded that lack of management and related organizational aspects contribute significantly to disappointing post-merger results [89], as cited in Salame [88].

4 CONCLUSIONS

The discussions so far on failure perspectives have pointed to the integration stage as one of the critical stages within the whole M & A process which can contribute immensely to M & A failure. This is in consonance with the works of Haspeslagh and Jemison [6] and Saxton and Dollinger [22] who pointed out that post-merger/acquisition integration is essential for the success of the deal. Again from the discussion, the most mentioned problem in the integration stage has to do with the human factor (the employees-coping with cultural differences, politics, lack of effective communication, etc). They contribute a lot to the success or failure of the deal. Equipment and processes can be changed without any problem, but human beings are difficult to change. In the bid or quest to roll out various strategies in the post- M & A era, to ensure good performance, the employee must be pivotal. Any attempt to sideline the employee in all these will spell doom for the new setup.

Another factor that occurred most after the human factor is poor strategies that are rolled out after the deal is sealed. Once management fails to get it right from scratch, it is bound to fail. One particular strategy may not work for different settings and environments, and so it is very important for management to take their time to study the terrain (especially during the time before the deal is sealed) to plan fitting strategies that can yield dividends at the end of the day. In most cases, there is so much pressure on management to roll out strategies immediately after the deal is sealed to announce their presence as an entity, and if prior proper planning is not done, it may lead to disaster.

Again, from the discussion, M & A failure rate is very high; averaging about 50%, regardless of the initial high hopes. Despite this high rate of failure, and for the fact that M & As do not necessarily create financial value for shareholders, they are still very popular, and is always almost the way to go for business transformation by top executives of business entities. This suggests that deliberately swallowing potential competitors, increasing points of presence, promoting special brands, running for undercover due to impending bankruptcy, etc may be among the other reasons why M & As are still popular.

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