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Motives for Telecom Mergers and Acquisitions

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ABSTRACT: The main objective of this work was to catalogue and bring to the fore, the various driving forces or motives that push leaders of Telecom companies to enter into mergers and acquisitions. The aim was to do a comprehensive review of literature on motives for mergers and acquisitions in the Telecommunications industry, to help researchers in this particular area, and also managers of Telecommunications companies, to understand better the dynamics of mergers and acquisitions worldwide. The work was purely a review of literature on motives for mergers and acquisitions. After a comprehensive review, the motives which stood out were Synergy, Growth, Improving market standing, creating wealth for shareholders, and Empire building for managers, in that order.

KEYWORDS: motives, telecommunications, merger, acquisition, synergy, growth.

1 BACKGROUND

Globally, mergers and acquisitions have taken a high lead in corporate strategy due to its perceived benefits. A merger is said to have occurred when two companies (usually corporations) combine to form a new company (http://www.wisegeek.com/what-is-a-merger.htm). It can be horizontal, vertical, or conglomerate.

Mergers and acquisitions in the Telecommunications Sector are mostly horizontal mergers simply because the entities involved operate in the same industry, that is the telecommunications industry, and also on the same product lines. Lately, vertical mergers are beginning to be popular, with Telecommunication vendors merging with Telecommunication operators, especially at the operational level. With acquisition, one company purchases another, generally by buying most of its stock. Ghana Telecom and Vodafone's deal for instance is purely an acquisition by Vodafone. The acquired company may become a subsidiary of the buyer. Over the last few years, a phenomenal growth has been witnessed in the number of mergers and acquisitions taking place in the telecommunications industry. The reasons behind this development include the following:

- Deregulation
- Introduction of sophisticated technologies (Wireless land phone services)
- Innovative products and services (Internet, broadband and cable services)

In countries like India, mergers and acquisitions have increased to a considerable level from the mid-1990s. In the United States, the mergers and acquisitions in the telecommunications sector are going on in a full-fledged manner.

Following are the important mergers and acquisitions that took place in the telecommunications sector as reported by EconomyWatch in 2010 (http://www.economywatch.com/mergers-acquisitions/international/telecom-sector.html):

- The takeover of Mobilink Telecom by Broadcom. This can also be described as a suitable example of product extension merger
- AT&T Inc. taking over BellSouth
- The acquisition of eScription Inc. by Nuance Communications Inc.
- The taking over of Hutchison Essar by the Vodafone Group. Now it has become Vodafone Essar Limited
- China Communications Services Corporation Ltd. taking over China International Telecommunication Construction Corporation

- The acquisition of Ameritech Corporation by SBC (Southwestern Bell Corporation) Communications
- The merger of GTE (General Telephone and Electronics) with Bell Atlantic
- The acquisition of US West by Qwest Communications
- The merger of MCI Communications Corporation with Worldcom

There are always driving forces behind the strong desire for mergers and acquisitions. These are often known as motives in merger and acquisition literature. Gaughan [1] established that the most often driving force mentioned is synergy realization. Others include new market access [2], Knowledge transfer ([3],[4],[5],[6],[7]), and Organizational learning ([8],[9],[7]).

Aside the above, it is also a known fact that mergers and acquisitions result in competitive advantage due to cost reductions and increased revenues. Following are other benefits provided by the mergers and acquisitions in the telecommunications industry:

- Building of infrastructure in a more convenient way
- Licensing options for mergers and acquisitions are often found to be easier
- Mergers and acquisitions offer extensive networking advantages
- Brand value
- Bigger client base
- Wide array of products and services

According to Ernst & Young's 2011 valuation paper[10] titled " Valuation drivers in the Telecommunications Industry", the following facts were gathered:

- Year 2000 saw recorded the highest number of mergers and acquisitions globally in terms of volumes in US dollars and number of deals. This was followed by year 2006, and then 2005. Data was taken from 2000 to 2010.
- With the exception of 2001, local market deals exceeded cross-border deals from 2000 to 2010
- With answers from telecom operators, main strategic reasons for acquisitions were ranked with the highest reason to the lowest as indicated below:

➢ To enter new geographic markets

➢ To strengthen the core business

➢ To achieve economies of scale

➢ To eliminate or reduce competition

➢ To acquire new technology

➢ To enter new product markets

➢ To acquire liquid assets

➢ To take advantage of low valuations/distressed assets

- During the slowdown in 2007, predating the global financial crises, large European operators increased their exposure to emerging markets, with Africa outperforming developing Asia as a target market for footprint.

This clearly shows that Africa, as an emerging market has become the destination for most of these multinational Telecom companies, the reason being the motives discussed above. This is the more reason why attention must be paid to these acquisitions to help them succeed, so that Governments would not be disadvantaged, but benefit thoroughly from the deals in the short to long term. These motives or driving forces are expected to be achieved in the short, medium, and long term once the deal for the merger or acquisition is sealed.

The main objective of this work is to catalogue and bring to the fore, the various driving forces or motives that push leaders of Telecom companies to enter into mergers and acquisitions.

There are a number motives behind a particular merger and acquisition. In the Telecoms sector, these motives are usually overshadowed by the motives "To enter new geographic markets", "To strengthen the core business", and so on as was listed by Ernst & Young's 2011 valuation paper titled " Valuation drivers in the Telecommunications Industry". This work intends to explore from literature all the various motives behind mergers and acquisitions in the Telecoms industry, most of which may be silent, and yet are the main underlying motives.

2 MATERIALS AND METHODS

This work is basically a comprehensive review of literature on merger and acquisition motives. The various motives are discussed, and ranked in order of prevalence.

3 RESULTS AND DISCUSSIONS

Motive is simply “something that causes a person to act in a certain way, do a certain thing, etc; incentive. It is also the goal or object of a persons actions(http://dictionary.reference.com/browse/motive, retrieved 07/02/2012). Merger or acquisition motives therefore, means “the driving force/s that push managers and owners of companies to opt for merger or acquisition as a corporate strategy”. Motives may differ from one industry to another, one geographical area to another, one era to another, one market to another, etc. The dynamics may be different depending on the prevailing circumstances at the time. M & A literature talks extensively about merger and acquisition motives. This is confirmed by Kaushal [11], who pointed out that factors that affect mergers change with the changing legal, political, economic, and social environments. We look at some of the viewpoints of researchers over the years, and determine the most common ones that run through.

Harari [12] lists several reasons given by CEOs to justify a merger or acquisition. These include: to obtain synergies, economies of scale, cost savings, increased products and rationalisation of distribution channels, as cited in Mcdonald, Coulthard, and de Lang [13]. Albizzatti and Sias [14] identify that the reasoning for an acquisition needs to be more strategic than simply the use of excess cash. The strategic reasons they identify for acquisitions are:

(i) acquire new products, capabilities and skills;

(ii) extend their geographical reach;

(iii) consolidate within a more mature industry; and

(iv) transform the existing industry or create a new industry, as cited in Mcdonald Coulthard, and de Lang [13].

Other research findings also reveal M & As as growth strategies, as cited in Lynch and Lind [15]. Perry and Herd [16] underscore the critical role of strategic planning when using M & As to grow an organisation. They suggest that in the 1990s companies shifted the focus for undertaking M & As from a cost saving perspective to using M&As as a strategic vehicle for corporate growth, which the authors viewed as an inherently more difficult challenge, as cited in Mcdonald, Coulthard, and de Lang [13]. The 1990’s was the era of the Telecommunications wave, and growth was central in their motives to enter into M & As.

Selden and Colvin [17] even suggest that most common reason companies buy one another is to acquire customers.

Bohlin, Daley, and Thomson[18] pointed out seven motives for merger and acquisitions which were a result of Surveys of senior executives. They are:

- To create and exploit synergies (the primary motivation)
- To increase market share
- To protect markets by weakening or eliminating rivals
- To acquire products and/or technologies
- To strengthen the core business by expanding in areas of greatest competence
- To gain footholds in other countries or continents
- To achieve critical mass or competitive size

In commenting on these motives, they made it clear that most of these motives are not realized, and that the success rate was below 20 percent. More on failure perspectives are dealt with into more detail later on in this write up.

Neary [19] indicated that business organization literature has identified two major common reasons why mergers and acquisitions are sought after; they are *efficiency gain and strategic rationale.* Efficiency gain means the merger would at the end of the day produce benefits in the form of economies of scale and economies of scope. Economies of scale and scope are achieved because of the integration of the volumes and efficiences of both the entities put together. Strategic rationale is also derived from the point that mergers and acquisitions activity would lead to change in the structure of the combined entity which would have a positive impact on the profits of the firm. Inspite of these two broad motives, there are others worth mentioning to make the literature complete. Following are a few of them:

- **Synergy**

Synergy stems from the Greek word which simply means to co-operate or work together [20]. Synergies are the present value of the net additional cash flow that is generated by a combination of two companies that could not have been generated by either company on its own [21].

Synergy is particularly important because it is one of the main reasons for mergers to start with. Merger theoretically, revolves around it, and it simply means putting together the expertise and resources of the entities involved to perform better. It is believed that as individual entities, their effect will not be felt much, but when put together, the combined effect will be colossal [22].

Pearson [23] described synergy as 2 + 2 = 5. Shearman [24] interpreted this by implying the whole would be greater than the sum of its parts. There are four reasons why estimating synergies in a merger process is so important. First of all, assessing the value that would be created by synergies is so important, because mergers primarily is meant for value creation. Secondly, assessing how investors would react to the merger deal is another important consideration. Thirdly, because managers need to disclose these strategies and benefits of such deals to investors, perfect knowledge and estimation of them is very important. Lastly, valuing synergies is important for developing post-merger intergration strategies [20].

Synergy can be discussed in terms of *operational, financial,and managerial*. Peck and Temple [25] indicated that operational synergies refer to those classes of resources that lead to production and/or administrative efficiencies. Peng [26] also related operational synergy to common technology, marketing techniques like common brands and manufacturing facilities like logistics. Bakker and Helmink [22] explained further that operational synergy is a combination of economies of scale, which would reduce average costs as a result of more efficient use of resources and economies of scope, which would help an entity deliver more from the same amount of inputs. Financial synergy occurs when the cost of capital are lowered as a result of M & A impact on the newly formed entity[27].

Whiles cost of capital is reduced, there is an increase in borrowing power[28]. Financial synergies are possible between related and unrelated firms, unlike operational synergies that take place only between related firms[25]. Managerial synergy occurs when the management teams of the companies involved in the M & A come together, and strenghts and expertise are drawn from each other [29].

These synergies occur when competively relevant skills possessed by managers of previously independent entities can be successfully transferred to the merged entity[30]. Ficery, Herd, and Pursche [21] listed six most common mistakes that acquiring executives make and what can be done to improve the success of achieving synergistic benefits. This is captured in the table 1 below.

Table 1: Correcting Synergy Slip-ups

Slip-up	Correction	Example
Defining synergies too narrowly or too broadly	Post-close integration priorities should precisely match the value and type of synergies that drove the deal in the first place. When done correctly, pre-deal synergy estimates should determine the total valuation and premium	When Sony and Bertelsmann formed Sony BMG Music Entertainment, they mapped financial and overhead spending for 60-plus geographies and businesses to identify baseline elements such as payroll expenses (one company classified them as HR expenses, the other as finance). Only when the baseline was agreed to by both parties was it possible to implement the synergy targeting
Missing the window of opportunity	Successful acquirers tend to capture 70-75 percent of synergies in the first year after the deal. The synergy capture effort should be ‘‘front loaded’’ so that the emphasis is to go after the biggest synergies as soon as possible	When a major specialty chemicals company began to plan its acquisition of a large global rival, it focused ruthlessly on planning and achieving the major source of synergies – savings from procurement of direct materials. That singular focus led the client to exceed its publicly stated cost synergy target of $200 million by more than 40 percent – a quarter ahead of schedule
Incorrect or insufficient use of incentives	they should create meaningful rewards which are Incentive programs should be explicit and timely;directly tied to synergy goals	After Cadbury Schweppes purchased candy and gum maker Adams, the external rallying cry was ‘‘Beat Wrigley!’’ Internally, it was ‘‘Beat the Model!’’ Personal financial incentives were tied to the performance of each functional and regional teamagainst the integration model
Not having the right people involved in synergy capture	Just as companies must appropriately match people with the skills needed in a given position, so too must they get the right people doing the right things in relation to capturing synergies	Early in a large merger of wireless providers, core finance staff was tied up preparing the integration plans for their own department. The merger integration team saw that these people were needed to craft a synergy management process for the whole company. Key Finance staff were adjusted their roles accordingly
Mismatch between culture and systems	Achieving synergies requires some degree of‘‘measurement culture’’ where the idea of tracking a success and tying it to a financial metric is a way of life	A merger of Medicare Advantage providers was predicated on achieving scale economies and sharing operational best practices to fuel continued rapid growth. But without formal budgeting and KPI processes, the NewCo could not agree to how many cost synergies could be harvested without sacrificing growth. As a result, synergies were not captured, operational dis-synergies began to show up in the absence of clear integration action, and the NewCo quickly faced a major slowdown in growth – with big profitability problems
Using the wrong process	Companies must use a rigorous, holistic process to capture synergies. Such a process includes Detailed tracking mechanisms, linking synergy targets to ongoing budgets and financial plans, and a system to quickly determine if synergy capture is on schedule (and fix it if it is not)	When Rogers Communications was merging with Microcell, clear synergy guidelines were established before the integration teams kicked off

Source: *Ficery, Herd, and Pursche [21]*

- **Growth**

Growth is essential for the survival of any entity. This growth can be achieved through two major means; organic amd inorganic. Mergers and acquisitions are examples of means of achieving inorganic growth. Among other things, mergers come with consumer demand [31]. Mergers also come with them access to facilities, brands, trademarks, technology, and employees [32]. Cameron and Green [32] also noted that growth cannot be dissociated from risk as far as mergers and acquisitions are concerned, even though mergers and acquisitions are quite easier than organic growth.

- **Diversification and risk management**

Diversification in mergers and acquisitions is more pronounced in conglomerate mergers where the entity's eggs are put into different baskets instead of one in the area of goods and services it offers or trades in. Levy and Sarnat[33] pointed out that the probability of a financial failure of two individual corporations is more than that in case of a conglomerate merger of the two. Diversification normally leads to possession of the necessary management, technical and marketing expertise which leads to an increase in market share [23]. Each type of merger offers some kind of reduction in risk. Vertical integration reduces risk by controlling the production process. Horizontal mergers reduce competition and hence uncertainties. It is asserted that conglomerate mergers are normally done in the interest of managers since shareholders can diversify their portfolios themselves [34].

- **Empire Building**

Top Executives of large entities carry out mergers and acquisitions out of their personal egos of building an empire [11]. Managers in their bid to exercise and exert power and authority, engage in empire building [35]. Managers normally state diversification as the motive for engaging in mergers and acquisitions, while in reality are engaging themselves in ambitious empire building [36].

- **Improved Market Standing**

Mergers and acquisitions are normally done to achieve market dominance in a particular sector or industry. Mergers are often seen to be successful if they are able to reduce considerably or remove potential threat of competition. A key source of supply can be protected from a competitor through mergers [23]. Mergers are also used to protect dominant positions [36], but research has also shown that market control through mergers do not necessarily lead to an increase in profitability [37].

Other motives which are on the lighter side are:

- **Increased managerial compensation and reward**

There is a high tendency among managers, especially limited liability companies,where there is a clear distinction of ownership and control, to enter into mergers and acquisitions for the lure of higher remuneration and more rewards. This normally happens in organizations where rewards are tied to employee performance. Such motives are destructive in nature, and result in failed mergers.

- **Managerial Hubris**

Managerial hubris is the unrealistic belief held by managers in bidding firms that they can manage the assets of a target firm more efficiently than the target firm's current management. Managerial hubris is one reason why a manager may choose to invest in a merger that on average generates no profits. While synergies lead to a positive correlation between target and acquirer gains, hubris is likely to result in a negative correlation [38].

- **Free cash flow theory**

A measure of financial performance calculated as operating cash flow minus capital expenditures. Free cash flow (FCF) represents the cash that a company is able to generate after laying out the money required to maintain or expand its asset base. Free cash flow is important because it allows a company to pursue opportunities that enhance shareholder value.

Without cash, it's tough to develop new products, make acquisitions, pay dividends and reduce debt. FCF is calculated as:

EBIT (1-Tax Rate) + Depreciation & Amortization - Change in Net Working Capital - Capital Expenditure

It can also be calculated by taking operating cash flow and subtracting capital expenditures. Jensen [39] pointed out that often managers tend to use sufficient free cash flow available to them to enter into mergers and acquisitions since they perceive mergers and acquisitions as more beneficial and profitable than other forms of investments. Wubben [40] also noted that the distribution of cash flows as dividends would lead to reduced resources at the disposal of managers and also loss of power.

4 CONCLUSION AND RECOMMENDATION

From the above discussions, it is clear that Synergy, Growth, Improving market standing, creating wealth for shareholders, and Empire building for managers stand out. Table 2 below adapted from Trautwein [2] and Cox [41] but cited in Nga and Kamolrat [42] shows the summary of merger and acquisition motives and the corresponding matching merger theories that underpin them.

Table 2: Merger and acquisition motives(adapted from Trautwein[2] and Cox [41])

1. M & A as rational choice	1.1. M & As benefits bidder's shareholders	1.1.1. Net gains through synergy	Efficiency Theory	M & A is planned and executed to achieve synergies of three types: financial, operational, and managerial
		1.1.2. Wealth Transfer from Customers	Monopoly Theory	M & A is planned and executed to achieve MARKET POWER. Horizontal and conglomerate M & A may allow firms to cross- subsidize products, simultaneously limit competition in more than one market, and deter potential entrants from the markets, all of which result in higher market power.
		1.1.3. Wealth transfers from target's shareholders	Raider Theory	A raider is a person who causes wealth transfer from the stakeholders of the companies he bids for in the form of greenmail or excessive compensation after a successful takeover.
		1.1.4. Net gains through private information	Valuation Theory/ Investment Theory	M & A is executed and planned by managers who have better information about the target's value than the stock market
	1.2. M & A benefits managers		Empire Building Theory/ Agency Theory	M & A is planned and executed by managers who thereby maximize their own utility instead of shareholder's value
2. M & A a process outcome			Process Theory	M & A decisions are outcomes of processes governed by one or more of the following influences: organizational routines, political games played between an organization's sub units and outsiders, and individual's limited information processing capabilities
3. M & A a macroeconomic phenomenon			Disturbance Theory	M & A waves are caused by economic disturbances: economic disturbances cause changes in individual expectations and increase the general level of uncertainty, thereby changing the ordering of individual expectation. Previous non-owners of assets now place a higher value on these assets than their owners and vice-versa. The result is an M & A wave.

Source: *Nga and Kamolrat [42]*

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