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Mergers and Acquisitions: Failures and causes, an evidence-based approach

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Abstract: **Merger and Acquisitions have been for long the most commonly used method of growth, diversification and many other corporate strategies. Along with that there has also been literary evidence that the M&A quite more than expected have been unsuccessful in attaining their primary goal or objectives and thus have been deemed as failures. This study tries to bring out firstly the actual failure rates as per evidence in research and then the reasons that have been cited as per various researches and put forth a comprehensive opinion in terms of both of these parameters to guide the future researches into solving these issues by highlighting its scale and also the crux of the actual problem that may have caused them.**

Keywords: **Mergers and Acquisitions, Business Performance, Failures in M&A, reasons for failure of M&A strategies.**

I. INTRODUCTION

Mergers and Acquisitions have been one of the if not the most sought after mode of expansion and growth that is used by companies worldwide. As the popularity of Mergers and Acquisitions have increased so have the amount of failures and the non-achievability of prospected targets. According to a study the growth in M&A activity stand in sharp contrast to their high rate of failure (Schweiger & Lippert, 2005). For example, when the declared objectives of the acquisition are taken into account, only 56% of M&A are successful (Cartwright & Schoenberg, 2006). An extensive body of literature has investigated financial and strategic variables as predictors of M&A performance without finding clear relationships (King, Dalton, Daily, & Covin, 2004). Although human resources (HR) have been frequently mentioned as a potential factor in M&A failures (e.g., DeNisi & Shin, 2004; Stahl, Mendenhall, & Weber, 2005; Weber & Drori, 2008; Weber), there is a dearth of theoretical and empirical studies of the relationships between M&A performance and acquirer's HR practices during the integration period following a merger. Yet, despite this robust academic interest, empirical data reveal that there has been little change in acquisition failure rates over the same time period.

II. FAILURE RATES OF M&A GLOBALLY

In his original work on European acquisitions, Kitching (1974) reported failure rates of 46–50%, based on managers' self-reports. More recently both Rostand (1994) and Schoenberg (in press) have reported equally poor failure rates of 44–45%, using comparable methodology. An examination of the returns to acquiring firm shareholders also reveals that acquisitions continue to produce negative average returns similar to those seen historically (Agrawal and Jaffe, 2000). Previous studies have also reported similar findings like, Hunt (1988) estimate the overall success rates of mergers vary from a pessimistic 23% in the US to a more optimistic 50% in the UK. Due to the sizeable rate of merger failures, the academic literature of the last decade has made a distinction between combination potential (expected synergies) and synergy realization; “while ostensibly presented as a strategy for wealth creation, many organizational marriages fail to realize the potential synergism anticipated by the marriage brokers” (Cartwright and Cooper, 1993, p328).

Haspeslagh and Jemison (1991) and Saxton and Dollinger (2004) pointed out that post-merger/acquisition integration, which forms part of the dynamics, is key for the success of the deal. Pablo (1994) 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 so easily achievable, as we consider the fact that we are talking about two separate independent entities coming together. Koetter (2005), Cartwright and Cooper (1995), Child et al. (2001), and Sally Riad (2007) 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 (2009) also maintain that the failure rate is higher than 60%, which were confirmed by Watkins and Copley (2004) earlier. KPMG also did a research on M & A and found out that 75% to 83% of M & A fail (KPMG, 2001), as cited in Nguyen and Kleiner (2003). 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 (Hunt et al., 1987; KPMG, 1997) 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 (Marks and Mirvis, 1982).

III. REASONS FOR FAILURE ACCORDING TO LITERATURE

Media (e.g; Benson 2004) and research results (e.g., Weston and Weaver 2001) report on high M&A failure rates. These results are inconclusive in finding a common rate of failure (figures of 50 percent or two thirds are common) and also use various calculation methods. But the message is clear; many M&As fail. Integration is often referred to as a cause for M&A failures resulting in employees anxiety, management turnover and cultural clashes (Slowinski, Rafii, Tao, Gollob, Sagal and Krishnamurthy 2002). Cascio and Young (2003) 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 their research work on “successful mergers and acquisitions: beyond the financial issues”, Wageman and Lafforet (2009) 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. In the 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.

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 Cartwright and Cooper (1992, 1993), Cooper and Finkelstein (2004), Schuler and Jackson (2001).

The organizational behaviour and the human resources literature puts forward an interesting and new viewpoint on the above-mentioned issues involved. This strain of research emphasizes the importance of people in this process of synergy realization, indicating that a substantial number of merger failures can be traced to neglected human resource factors (Schuler and Jackson, 2001). Other than the increase in perception about the importance of human factors issues in merger synergy realization, there has been an unprecedented increase in the business press recently in executive literature and guideline proposals about how to successfully manage mergers and acquisitions. In spite of the soundness of these recommendations, the question of whether, and to what extent, they are based on scientific evidence is open to debate. This concern is important not only because factors driving M&A activity in the past appear to be intensifying but also because failure rates still appear to be substantial. We can think of the merger process by comparing it to the functioning of an electrical engine. It is well known from physics that part of the energy feeding the engine (expected synergy) is lost in friction and heat (employee resistance, for example), and that only a portion of the initial energy is actually transformed in motion (realized synergies). The relative number of the ratio of achieved synergies over expected synergies is what we comprehend as the efficiency of the whole merger process. The interesting research questions arising from this comparison are for example: to what extent can this efficiency ratio be managed by organizations; is this process

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endogenous or exogenous to the organizations involved; whether an effective communication and integration or transition process can help increasing the efficiency ratio? The answers to these questions are important not only for practitioners but also for researchers. Even though comprehensive and detailed answers to these questions would involve detailed inter-disciplinary studies that go beyond the scope of this paper we believe it is important to understand what empirical research is bringing on these issues. Thus, the inspiration and drive of this paper is to report, review and appraise the empirical and literary evidence that associates merger success with the employee issues. For the purpose of the study, we shall describe the above-mentioned efficiency ratio as a function of an overall human issues or employee resistance, which can be defined as the loss in efficiency due to change related frictions. Then we can approach the employee issues and resistance from a macro as well as a micro level dimension. However these two dimensions are somewhat interrelated, for expositional purposes we can group the first dimension as the collective factors and the second dimension as the individual factors

A. Comprehensive Representation of Mergers and Acquisition's causes of failures based on evidence in Literature:

The following is a comprehensive schedule of the most relevant and recent studies that have focused on the issue of failure of M&A and the reasons they have cited as per their study for the apparent causes why the M&A were not able to achieve the expected outcomes.

Table I: Representation of the most relevant previous studies and the causes mentioned for M&A Failures

Title of the Study	Authors	Year	Issues cited for Failure
Corporations as stepfamilies: A new metaphor for explaining the fate of merged and acquired companies	Allred, Boal, and Holstein	2005	Unplanned Integration
Corporate Acquisitions: A Process Perspective.	D. B. Jemison, S. B. Sitkin	1986	Improper Organizational fit
Managing acquisitions: Creating value through corporate renewal	P. C. Haspeslagh, D. B. Jemison	1987	Lack of Organizational fit
Changing pattern of acquisition behaviour in take- overs and the consequences for acquisition processes	Hunt, J. W	1990	Employee dynamics
Organizational fit and acquisition performance: Effects of post-acquisition integration.	DDatta, D. K.	1991	Difference in management styles
Cultural Impact in Cross-Border Acquisitions: A Critical Review of the Literature	Hoetzel B. R.	2005	Cultural Differences
Corporate identity and corporate communications: the antidote to merger madness	Balmer J. M. T. and Dinnie K.	1999.	Financial and Legal issues
Six rationales to guide merger success," Strategy and Leadership	Gadiesh O. and Ormiston C.	2002	Poor strategic planning
Planning for a successful merger or acquisition: Lessons from an Australian study,	Mc Donald J., Coulthard M., and De Lang P.	2005	Lack of strategic rationale
Escaping merger and acquisition madness	Lynch J.G., Lind B.	2002	Slow integration and cultural incompatibility
Mergers, Acquisitions, and other restructuring Activities	Depamphilis D. M.	2005	Financial Issues
Reasons for frequent failures in mergers and acquisitions. A comprehensive analysis	Straub T.	2007	Administrative problems

Mergers and the performance of the acquiring firm," Academy Of Management Review	Lubatkin M.	1983	Improper selection of target
Why do mergers fail? What can be done to improve their chances of success?	Salame R.	2006	Neglected HR issues
Why merger and Acquisition (M & A) waves Reoccur- The Vicious circle from pressure to failure	Steger U. and Kummer C.	2007	Unrealistic expectations

B. Conclusions and Implications

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 (1991) and Saxton and Dollinger (2004) 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 can be evidently seen as occurring most after the human factor are the poor strategies that are rolled out after the deal is closed. 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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