# Fundamentals of mergers & acquisitions 2

*"Given the uncertainties in M&A as elsewhere, one must remember the ancient advice, caveat emptor (buyer beware)"*

(Bruner 2002, p. 65)

## 2.1 Introduction

This chapter is intended to provide an overview of key topics in the field of 'mergers and acquisitions'. It will first establish the terminological foundations in section 2.2. Section 2.3 will analyze past merger waves while section 2.4 will focus on exploring the typical steps of an M&A transaction and will provide further insights on important areas of M&A such as valuation and post-merger integration. Section 2.5 will explore the concept of M&A performance and will then proceed with a brief review of the methods commonly used in M&A performance research as well as a summary of previous event study-based findings.

## 2.2 Terminological basis of M&A

Very few economic phenomena attract as much interest in the research community as well as in the public eye as mergers & acquisitions. This is likely triggered by the fact that such transactions can be amongst the largest investments a company will ever make (See Betton et al. 2010, p. 6). While the term 'mergers & acquisitions' is today as ubiquitous in business literature as it is in the international business press it is difficult to identify a commonly accepted definition of the general term as well as of its indivudual components (See Lucks and Meckl 2015, p. 5), since in a very strict sense the term describes two distinct phenomena (See Straub 2007, p. 15).




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Despite this, the following subsections will set out to establish a clear definition of the term that will then serve as the terminological basis for the rest of this thesis. In addition to this, a classification of M&A transaction types will be provided in order to further explore the complexities of this extremely broad economic phenomenon.

### 2.2.1 Definition of the term M&A

Internationally, the term 'mergers and acquisitions' has grown to have a very broad meaning and generally refers to any activities that have to do with the buying or selling of corporations (See Lucks and Meckl 2002a, p. 23, 2015, p. 5; Straub 2007, p. 16). Many researchers have chosen a fairly comprehensive definition of the term and Copeland and Weston (1988) state that in its broad sense "the traditional subject of M&A's [sic] has been expanded to include takeovers and related issues of corporate restructuring, corporate control, and changes in the ownership structure of firms" (Copeland and Weston 1988, p. 676).

It is nevertheless important to note that while the terms 'merger' and 'acquisition' are often used interchangeably, there is a slight difference between the two. A 'merger' typically refers to a transaction in which two companies of normally relatively equal size are joining together and become one entity, usually via an exchange of shares. In a merger, all but one of the firms involved thus lose their legal and economic autonomy (See Boesecke 2009, p. 6; DePamphilis 2011, p. 13).[3] A special case of this can be a 'merger of equals' in which the transaction participants are approximately similar in size and valuation and it is therefore unclear if any one party is gaining control over the other (See DePamphilis 2011, p. 14; Lucks and Meckl 2015, p. 32). It has nevertheless been noted that true mergers of equals are in reality rare and that in most transactions one party dominates the other(s) (See Farschtschian 2012, p. 6). An 'acquisition' typically involves a buying firm which purchases either the assets or the shares of a target firm, commonly through a cash payment or by offering shares in the acquiring firm (See Sherman 2011, pp. 2–3). When compared to a merger, an acquisition conveys a clearer sense of which

3 Three types of mergers can be differentiated. In the case of a 'statutory merger', a company that was initially independent transfers its assets and liabilities to a partner company and thereby loses its economic and legal independence. A 'subsidiary merger' occurs if an acquirer maintains the identity of the target as a subsidiary. In a third case, at times referred to as 'statutory consolidation', two companies create a new legal entity and both firms transfer their assets into this entity. Both individual companies then cease to exist following the asset transfer (See Boesecke 2009, p. 6; DePamphilis 2011, pp. 13–14; Lucks and Meckl 2002a, p. 23; Megginson and Smart 2009, pp. 848–849).

company is in charge after the transaction (See Epstein 2004, pp. 174–175). While the acquired firm continues to exist as a legally owned subsidiary, it can remain economically independent or become partly or even fully integrated into its new parent company (See DePamphilis 2011, p. 15; Straub 2007, p. 15). In summary it can be said that in "a merger, two companies come together and create a new entity. In an acquisition, one company buys another one and manages it consistent with the acquirer's needs" (Schuler and Jackson 2001, p. 240). At first glance, this distinction might not seem important since in the end the outcome is similar – two (or more) firms with formerly separate owners begin to operate within the same entity. But the strategic, financial, tax as well as cultural implications of an M&A transaction can change dramatically depending on the type of the transaction (See Sherman 2011, p. 3). In particular, the cultural implications should not be underestimated. While the human resource side of an integration is already a challenging task in any acquisition, a merger can prove to be especially daunting if members of both organizations seek to take charge of the newly combined entity (See Epstein 2004, pp. 174–175). A 'merger of equals' that proved particularly troubled by HR integration issues was the Daimler-Benz and Chrysler merger in 1998 – one of the largest mergers in international business history (See Holtbrügge 2004, pp. 257–258; Shelton et al. 2003, p. 315).

The difference between a 'merger' and an 'acquisition' as outlined above is mostly of a legal nature. This is why the term 'mergers and acquisitions' will in the following be applied to summarize both activities and a differentiation will only be made if relevant differences arise in specific circumstances (See Boesecke 2009, p. 7; Lucks and Meckl 2002a, p. 24, 2015, p. 6). For the purpose of this thesis, the term will at the same time be regarded in a more narrow sense than what has been proposed by Copeland and Weston (1988) (See Copeland and Weston 1988, p. 676). In this thesis, only business combinations will be understood as M&A transactions (as summarized in Figure 2.1), so transactions through which a majority of control is transferred (See Laabs 2009, p. 16). This means that an acquirer obtains at least 50 percent of outstanding shares or private equity in a target firm (See Laabs 2009, p. 16). The resulting market has been described as a 'market for corporate control' through which the management of an acquiring firm can purchase the right to manage the productive resources of a target company (See Jensen and Ruback 1983, pp. 5–6). Lucks and Meckl (2015) identify three characteristics that constitute an M&A transaction. In their view such a project is made for strategic purposes, involves a capital investment and is followed by an integration of parts of a business. These characteristics differentiate M&A projects from strategic alliances which do not necessarily require an equity investment. A joint venture could nevertheless also

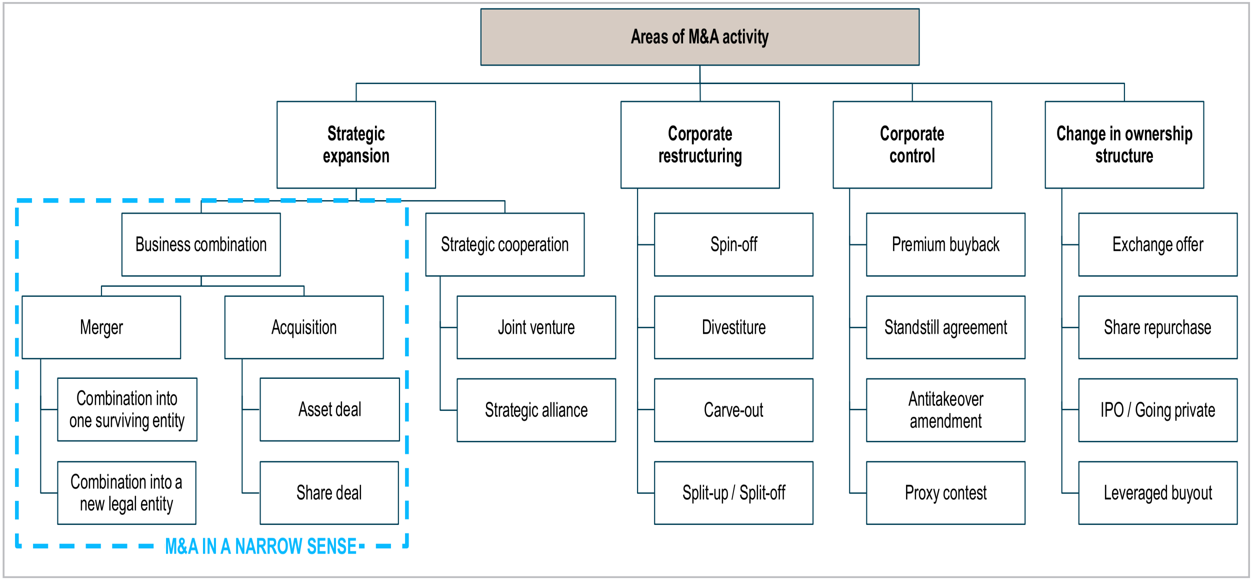


**Fig. 2.1** Areas of M&A activity in a broad sense

Source: Based on Wübben 2007, p. 6; in turn relying on Copeland and Weston 1988, p. 676 and Gaughan 1999, p. 7.

display these characteristics and might thus be regarded as an M&A project (See Lucks and Meckl 2015, pp. 6–7). Other forms of strategic expansion (e.g. cooperations) as well as M&A-related activities such as corporate restructurings or changes in ownership structure will hence explicitly be excluded from this definition and will not be discussed further in this thesis (See Wübben 2007, p. 6).

## 2.2.2 Categories of M&A

Despite this 'narrow' understanding of mergers & acquisitions (as depicted in Figure 2.1), the nature of transactions that are captured by an M&A definition that only includes deals involving a transfer of control still remains very diverse. It is therefore beneficial to introduce a more specific typology of M&A transactions, especially since some of these distinguishing transaction characteristics will become very relevant over the course of this thesis. For this reason, several criteria for categorizing M&A transactions will be described in the following section (See Figure 2.2), in addition to the distinction between 'mergers' and 'acquisitions' that was already discussed in the previous section.

| Criteria | Categories | | |
|---|---|---|---|
| Type of combination | Merger | Acquisition | |
| Strategic direction | Horizontal | Vertical | Conglomerate |
| Form of payment | Cash | Mixture | Stock |
| Acquirer attitude | Friendly | Hostile | |
| Target ownership | Public | Private | |
| Geographic focus | Domestic | Cross-border | |
| Acquisition structure | Asset deal | Share deal | |

**Fig. 2.2** Criteria for categorizing M&A transactions

Source: Based on Horzella 2010, p. 27; Jansen 2008, p. 99; Lorenz 2006, p. 9; Wübben 2007, p. 7.

One important categorization of M&A transactions is that of *horizontal*, *vertical* or *conglomerate deals*, a differentiation based on transactions' strategic direction along the value chain (See Lucks and Meckl 2015, pp. 29–30). A horizontal merger occurs when two competitors combine, often with the key benefit of an increase in market power for the newly joined entity (See Gaughan 2010, pp. 13–14).[4] Vertical M&A activity involves companies that are situated alongside different steps of an industry's value chain, so companies that have either current or potential buyer-seller relationships (See Brealey et al. 2011, p. 792). Benefits of these types of transactions can include an increased degree of product quality through improved control over suppliers and reduced input prices in a backward integrating transaction. Forward integrating transactions can provide an acquirer with increased control over the quality of output and distribution networks (See Megginson and Smart 2009, p. 855). A conglomerate merger is a transaction which does not fit in either of the other two categories, but involves two companies that are entirely unrelated (See Becketti 1986, p. 14). The rationale behind these types of transactions is usually to make earnings less volatile based on the principles of diversification, which can in turn result in financial synergies by reducing the cost of capital of a firm (See DePamphilis 2011, p. 6).[5] Even though such transactions were popular in the 1960s and 1970s, their numbers have declined considerably after the 1980s as focused companies have started to receive higher market valuations than their diversified counterparts (See Megginson and Smart 2009, p. 856; Servaes 1996, p. 1222).[6]

A further M&A classification that will become very relevant in section 4.3.4.1 of this thesis differentiates transactions by payment type. In order to pay for an acquisition, bidding firms in essence have the choice of offering either *cash*, *common shares* or a *mix of both cash and shares* (See Davidson III and Cheng 1997, p. 465). A considerable amount of research has analyzed the complex reasons why some acquirers chose to finance transactions with cash while others select stock financing. One finding of this literature has been that tax considerations can influence the choice between cash and stock payments (See Ayers et al. 2004, pp. 884–885). If target shareholders are paid in stock there is no immediate taxation applicable while cash payments must usually be taxed in the prevailing tax year (See Boone et al. 2014, p. 297; Brealey et al. 2011, p. 808). Another key finding of this literature has been that stock payments can be seen as a strong indication for information

4 For this reason horizontal mergers can draw considerable attention from regulatory bodies (See Becketti 1986, p. 13). For a more detailed discussion of market power as a driver behind merger activity, kindly refer to the discussion of the 'monopoly hypothesis' in section 4.2.2.1.1.

5 For a more detailed discussion of financial synergies as a driver behind merger activity, kindly refer to the discussion of the 'diversification hypothesis' in section 4.2.2.1.2.

6 This is driven by the fact that diversified firms frequently receive lower valuations on the capital market and that managers of diversified conglomerates hence fear to become subject to a 'conglomerate discount'. Kindly refer to Ammann et al. 2012, pp. 264–288 for a more detailed discussion of the reasons for and magnitude of this discount.

asymmetries between acquiring and target firms regarding their respective valuations (See Boateng and Bi 2014, p. 540; Eckbo et al. 1990a, p. 653; Faccio and Masulis 2005, p. 1346; Fishman 1989, p. 42; Hansen 1987, p. 76). It has, for example, been found that stock acquirers tend to be overvalued by the markets and that cash acquirers are frequently undervalued (See Chemmanur and Paeglis 2002, p. 5). At the same time, an acquirer might choose to pay for a transaction in stock if questions about the true value of the target persist and the bidder would like to share some of the risk of target mispricing with the target firm's shareholders (See Eckbo et al. 1990a, p. 653). Such perceived valuation uncertainties likely contribute to the fact that stock-financed deals regularly lead to negative capital market reactions (i.e. abnormal returns) for acquiring firms upon announcement (See for example Travlos 1987, p. 944).[7] These negative stock market reactions might have caused stock-financed deals to lose some of their relevance since the late 1990s. By 2013, more than 50 percent of transactions were cash-financed (up from approx. 25 percent in the late 1990s), 30 percent of transactions involved mixed payments (up from approx. 10 percent the in late 1990s) while the share of stock-financed deals has dropped to less than 20 percent in recent years (from over 60 percent in the late 1990s) (See Boone et al. 2014, p. 304).

Takeover attempts can moreover be classified by the attitude which the management of the target firm displays towards the acquiring firm. While uncontested bids are typically referred to as '*friendly*', resisted bids are called '*hostile*' transactions (See Megginson and Smart 2009, p. 859). In a friendly acquisition, the takeover is negotiated between the top managers of buying and selling firms (See Bruner 2002, p. 61). In a hostile situation, a bidder makes an offer directly to the target shareholders without seeking any negotiations with the firm's management. The target's shareholders then decide individually whether or not to tender their shares (See Schnitzer 1996, p. 37). The target management in turn usually actively seeks alternatives to the takeover bid from the unwanted buyer, which might in the end lead to a prevented bid or at least to a higher purchase price (See Rosenbaum and Pearl 2009, p. 77). As the M&A environment became increasingly hostile in the 1980s many U.S. corporations have since implemented an array of preventative as well as active antitakeover measures in order to be able to avoid – and in a worst case scenario fend off – hostile takeover attempts (See Gaughan 2010, p. 183).[8]

7 Fore a detailed explanation of the concept of abnormal returns, kindly refer to section 5.2.

8 Kindly refer to Gaughan 2010, pp. 183–241 for a very detailed description of common antitakeover measures. While hostile takeovers were a frequent phenomenon in the U.S. of the 1980s and accounted for 14 percent of merger activity, the markets became

Similarly, the ownership type of target firms can play a role in M&A transactions. If a bidder seeks to purchase a *publicly listed target*, the majority of shareholders must be convinced of the offer. In order to succeed in that respect, buying firms usually have to offer a considerable 'control premium' over and above the latest target firm share price (See DePamphilis 2011, p. 143; Sirower and Sahni 2006, p. 86). Such a control premium is essentially a way for target firm shareholders to obtain a share of the synergistic value (from restructurings, economies of scale, etc.) that will likely be realized by the acquirer post-acquisition (See Lucks and Meckl 2015, p. 165). In contrast, acquisitions of *private firms* regularly happen at a substantial 'private firm discount' when compared to purchases of similar public firms (See Koeplin et al. 2000, p. 95). This is thought to be due to the fact that private firm shares are less marketable (i.e. less liquid) and that the problem of information asymmetries between buyer and seller is more pronounced than in acquisitions of public targets (See DePamphilis 2011, pp. 38–39). Since private firms have lower disclosure requirements than public firms, only little or maybe even no reliable information might be available to acquirers of private firms before a transaction (See Martynova and Renneboog 2011, p. 213). Koeplin et al. (2000) were able to show that private companies in the U.S. were purchased at an average discount of 20-30 percent when comparing the transaction earnings multiples to similar public firm transactions. This discount grew even larger to 40-50 percent when U.S. firms acquired private companies overseas (See Koeplin et al. 2000, p. 95). The findings might also be an explanation for why acquisitions of private firms have been shown to lead to more positive stock market reactions than acquisitions of publicly listed firms (See Capron and Shen 2007, p. 892).

While most M&A activity used to be of *domestic* nature, meaning that acquiring and target firms are situated in the same country, the number of *cross-border* deals has risen dramatically over the last decades due to an ongoing liberalization of economies and the mega-trend of globalization (See Bruner 2004a, p. 99; Danbolt and Maciver 2012, p. 1028; Shimizu et al. 2004, p. 308). The differentiation between domestic and cross-border transactions can be very important because M&A activity across borders can add an additional set of complications before and after a deal. Before the acquisition, it can be much more difficult to establish a valuation for the target since a much larger set of assumptions is required (e.g. regarding

considerably less hostile in the 1990s as this number dropped to only 4 percent of transactions (See Andrade et al. 2001, p. 106). Apart from the increased number of firms with antitakeover defenses in place also newly introduced federal prenotification regulations as well as the soaring stock market valuations of the 1990s have likely contributed to this shift towards a more 'friendly' takeover climate (See DePamphilis 2011, p. 56).

interest and exchange rate developments) (See Lucks and Meckl 2015, pp. 388–390). Differences in the legal and regulatory environments between countries further add to the complexities of cross-border transactions (See Rossi and Volpin 2004, p. 278). After the transaction, additional frictions might arise due to cultural and geographic differences (See Erel et al. 2012, pp. 1045–1046).

Another transaction characteristic that can be used to differentiate M&A deals is the acquisition structure. As briefly mentioned in the previous section, an acquirer can choose to either take over the assets of a target firm through an *asset deal* or acquire all shares of the firm via a *share deal* (See Lucks and Meckl 2015, p. 165). A key difference between an asset purchase and a stock purchase is that in a stock purchase the acquisition price is paid directly to target shareholders, while in an asset purchase the selling firm receives the payment (See Brealey et al. 2011, p. 807; DePamphilis 2011, p. 435). The main benefits of an asset deal lie mostly with the acquiring firm (See Jansen 2008, p. 248). In this deal structure, the buyer can limit the acquisition to the exact parts of the target firm that are actually needed (See Lucks and Meckl 2015, p. 166). In addition to this, by only purchasing the assets rather than the shares of a target, an acquirer can try to avoid taking over a target's financial liabilities as well as other legal commitments (See Gaughan 2010, pp. 27–28). This might, however, not always be possible. If an acquirer buys a substantial amount of the corporate assets of a target firm prior court rulings have deemed such acquisitions 'de facto mergers'. In such cases, the buyer will likely be forced to also take over liabilities as well as key commitments of the selling firm (e.g. union contracts) (See Gaughan 2010, p. 28). A share deal can also come with benefits for both sides of the transaction. The acquirer in a share deal might have to invest a smaller amount of capital in order to purchase the targeted assets since only the net assets are being acquired (See Wübben 2007, p. 10). Share deals can also be less complex and costly due to the fact that contractual and documentation requirements of a single share deal can be less complicated than the ones for a transfer of a large number of individual assets (See DePamphilis 2011, pp. 438–439). At the same time, the acquirer in a share deal must take responsibility for all liabilities and legal claims of the purchased entity, which is why many sellers prefer this acquisition structure to an asset deal (See Jansen 2008, p. 248). The advantages and disadvantages of both transaction structures are nevertheless so complex that eventually only a detailed evaluation of each specific case can determine which structure is more beneficial (See Lucks and Meckl 2015, p. 168).[9]

9 For a more detailed overview of the advantages and disadvantages of asset versus share deals, kindly refer to DePamphilis 2011, pp. 436–437.

## 2.3 Waves of M&A activity

An enduring puzzle about M&A activity is why the number of deals increases and decreases so dramatically over time (See Rhodes-Kropf and Viswanathan 2004, p. 2685; Town 1992, pp. S83-S84). Despite the fact that the existence of so called 'merger waves' is generally undisputed in management literature, no universal consensus has so far been established as to why these surges of deal activity occur (See Harford 2005, p. 532).

Each merger wave of the last century was very unique and researchers have admitted that they still "don't really understand why merger activity is so volatile" (Brealey et al. 2011, p. 815). Some M&A scholars might be tempted to argue that there is only limited benefit in revisiting the history of merger waves if, apart from some loosely shared patterns, each wave is different and hence only of limited use in predicting the characteristics of the next wave (See DePamphilis 2011, pp. 29–31). But while the past might not be of much use in foreseeing the precise course of the next merger wave, there are a number of shared causes and effects behind each wave (See McCarthy 2013, p. 12). An awareness of the history of the field, as well as of the many past merger mistakes, might thus help M&A scholars and practitioners with predicting and avoiding future failures (See Gaughan 2010, p. 35). Bruner (2004) stated in that respect: "History is a tough instructor. Though its lessons are sometimes obscure, their ramifications can be severe. And, more often than not, they prove to be vital in charting a course for the future. This is why any serious student of M&A should reflect on the past century of activity" (Bruner 2004a, p. 69). Some researchers have even argued that understanding if takeovers create or destroy value necessitates a prior understanding of why and when merger waves occur in the first place (See Gregoriou and Renneboog 2007, p. 12; McCarthy 2013, p. 12). For these reasons, the drivers and characteristics of merger waves will be reviewed more closely in this section.

Factors that have been suspected to contribute to the development of merger waves are what can be described as economic, regulatory or technological industry 'shocks' (See Gaughan 2010, p. 36; Harford 2005, p. 559; Mitchell and Mulherin 1996, p. 219). The theory that economic disturbance triggers industry reorganization is also referred to as the 'neoclassical' explanation of merger waves (See Harford 2005, p. 532).[10] According to this theory, the magnitude and the duration of merger waves depends on how many industries and how strongly firms in these industries are actually impacted by the underlying shock (See DePamphilis 2011, p. 24). While the emergence of the internet can, for example, be seen as a broad shock that affected

10 One of the earliest proponents of this theory was Gort 1969, pp. 624–642.

firms in many industries, other shocks, such as an increased regulation of financial service firms, are more specific and hence thought to only trigger smaller and shorter merger waves (See DePamphilis 2011, p. 24). Additional factors that seem to play an important role in boosting merger activity are exceptional economic growth rates and the often coinciding increases in market liquidity (See Alexandridis et al. 2012, p. 664; Megginson and Smart 2009, p. 870). Harford (2005) found that major industry shocks can cause merger waves because they make a reallocation of assets necessary on a very large scale. He nevertheless also produced support for his hypothesis that sufficient capital liquidity in the form of lowered transaction financing constraints and high asset and stock market valuations must be present as well, in order for an industry shock to be able to set a merger wave in motion (See Harford 2005, p. 530). Shleifer and Vishny (2003), however, outlined several shortcomings of neoclassical theory when it comes to explaining merger waves. The theory is unable to explain merger waves that go beyond a certain industry, unless driven by major shocks that impact multiple industries. It also fails to explain the choice of payment type selected by acquiring firms (Shleifer and Vishny 2003, p. 296).

An alternative explanation for merger waves is more behavioral in nature (See Gugler et al. 2012, p. 1). This theory postulates that heightened merger activity is caused by incorrect stock market valuations (See Rhodes-Kropf and Viswanathan 2004, pp. 2686–2687; Shleifer and Vishny 2003, p. 296). Shleifer and Vishny (2003) saw indications that firms with inflated market values drive M&A activity by using their overvalued stock to finance acquisitions of relatively undervalued targets (See Shleifer and Vishny 2003, p. 309). Several researchers have since then found evidence in support of this hypothesis. Ang et al. (2006) showed that the likelihood of a firm to become a stock acquirer increases with its overvaluation and that overvaluation is in fact a motive behind stock acquisitions (See Ang and Cheng 2006, p. 215). Furthermore, Dong et al. (2006) found evidence that bidders are usually more highly valued than their target firms and that more highly valued bidders are more likely to use stock as their payment consideration (See Dong et al. 2006, p. 757). The causal relationship of these findings still remains disputed since it is still unclear if heightened M&A activity drives firm valuations or vice versa (See DePamphilis 2011, p. 24).

Even though both theories might have the ability to explain M&A waves to some extent, it has been argued that no single theory will ever be able to fully capture why and how merger waves are set in motion. Owen (2006) contends that the drivers behind merger waves “change fundamentally over time and, whilst some characteristics seem to be consistent, many others are not. In short, merger waves are simply the result of a combination of economic and legal conditions that make activity of this sort appealing to companies at certain times” (Owen 2006, p. 2).

This view becomes particularly plausible when the key characteristics of the six main merger waves of the last century are compared to each other:[11]

- *First wave (approx. 1890s-1904):* The first major M&A wave began in the United States at the end of the 19th century and was largely propelled by the requirement of firms to address the needs of a truly national economy (See Megginson and Smart 2009, p. 870). In addition, the 'Great Merger Wave' occurred at a time of radical economic, technical and legislative transformation and was characterized by horizontal mergers with the aim of consolidating industrial production (See Martynova and Renneboog 2008, p. 2149). It was a time when much of M&A activity had the purpose of creating monopolies in an industry in order to obtain as much market power as possible (See Bruner 2004a, pp. 72–73; Jansen 2008, p. 130). Standard Oil, owned by J.D. Rockefeller, for example, obtained a staggering 85 percent of market share while American Tobacco even managed to acquire a market share of 90 percent during this period (See McCarthy 2013, p. 13). The merger wave came to an abrupt end around 1904 due to fraudulent financing and a stock market crash (See DePamphilis 2011, p. 24; Gregoriou and Renneboog 2007, p. 2).
- *Second wave (approx. 1910s-1929):* The second major M&A wave occurred after World War I, fueled by favorable economic conditions, and was in principal very similar in nature to the first one. But while the first wave resulted in the creation of monopolies in many industries, the second wave led more to the formation of oligopolies (See Gaughan 2010, pp. 42–43; Mitchell and Mulherin 1996, p. 194). This was largely due to the fact that the antitrust regulatory environment had become more strict after 1904 and transactions had started to come under greater scrutiny by governments in order to avoid market abuses (See McCarthy 2013, p. 15). The stock market crash of 1929 triggered the end of this second surge in M&A activity and the ensuing Great Depression followed by World War II effectively prevented any further merger waves for several decades (See Jansen 2008, p. 63; Martynova and Renneboog 2008, pp. 2149–2150).

11 The start and end years of merger waves applied in this section are largely based on Martynova and Renneboog 2008, p. 2151. Other researchers have at times defined slightly different durations for each respective merger wave since establishing an exact timing can be difficult. For alternative definitions, kindly refer to DePamphilis 2011, pp. 24–27; Jansen 2008, p. 130. In line with Martynova and Renneboog (2008) no geographic distinction between takeover waves will be made – while the first two waves were mostly a U.S. phenomenon, the more recent waves were international in nature (See Martynova and Renneboog 2008, p. 2149).

- *Third wave (approx. 1950s-1973):* The third merger wave displayed very different characteristics from the first and the second wave. While being partly driven by a booming economy, it has become known as the 'conglomerate merger period'. A much more rigorous reinforcement of antitrust regulations limited the ability of firms to enter into as many horizontal combinations as in the first and second wave, which is why many firms turned to conglomerate and diversifying acquisitions (See Bruner 2004a, p. 74). During this time, it was not unusual for relatively small firms to aim for acquisitions of much larger corporations (See Gaughan 2010, p. 44; Servaes 1996, p. 1202; Shleifer and Vishny 2003, p. 296). By diversifying their businesses into new product markets, many acquirers intended to create value by lowering the volatility of their earnings and to thereby overcome imperfections in the external capital market (See Martynova and Renneboog 2008, p. 2150). This period marked the emergence of financial engineering techniques and companies that attempted to grow their earnings per share through M&A activity rather than by reinvesting their earnings into their own operations (See DePamphilis 2011, p. 25; McCarthy 2013, p. 17).
- *Fourth wave (1981-1989):* During the 1980s, a dramatic increase of 'hostile' takeovers became the defining characteristic of an M&A wave during which many acquirers where financiers and the typical method of payment was cash instead of stock (See Shleifer and Vishny 2003, pp. 295–296). The fourth M&A wave was fueled by the popularity of debt financed transactions which became widespread during this period, as leveraged buy-outs became a popular form of acquisition (See Owen 2006, p. 9).[12] The broader access to debt financing considerably lowered takeover hurdles, especially of large M&A targets (See Mitchell and Mulherin 1996, p. 215). This is partly why the era witnessed a sizeable rise in both average transaction values and as well as in the amount of 'megamergers', with the number of transactions over USD 100 million in value increasing 23-fold between 1974 and 1986 (See Gaughan 2010, p. 59). A notorious record in this respect was set in 1988 when the private equity firm Kohlberg Kravis Roberts & Co. acquired RJR Nabisco for USD 25.1 billion (See McCarthy 2013, p. 19). Aside from M&A activity by 'corporate raiders', the 1980s were also the first period of the century during which takeovers of U.S. firms by foreign corporations exceeded both the number and transaction volumes of American corporations in key overseas markets (See DePamphilis 2011, p. 26). This can

12 A leveraged buy-out (LBO) is "the acquisition of a company, division, business, or collection of assets ("target") using debt to finance a large portion of the purchase price" (Rosenbaum and Pearl 2009, p. 161). For a detailed discussion of the topic, kindly refer to Rosenbaum and Pearl 2009, pp. 161–192.

serve as an indication of an increasing internationalization of M&A activity (See Bruner 2004a, p. 74). Another distinguishing characteristic of this merger wave was that it was the first one which did not end in a market crash, but faded gradually as the bull market of the 1980s lost momentum (See Megginson and Smart 2009, p. 870).

- *Fifth wave (1993-2001):* During the 1990s, the profile of M&A changed fundamentally again. Key drivers behind the M&A wave in this period were the rising impact of globalization in combination with an increasing worldwide focus on shareholder value as well as the growth of the internet and telecommunications industries (See Goergen and Renneboog 2004, p. 10; Jansen 2008, p. 65).[13] For the first time, the M&A activity of European firms was on the same level as that of their American counterparts (See Craninckx and Huyghebaert 2011, p. 10; Martynova and Renneboog 2011, p. 209). In addition, a substantial amount of M&A volume emerged in Asia and a considerable share of global M&A transactions happened across borders (See Gregoriou and Renneboog 2007, p. 4). Even companies that had traditionally had a domestic focus began to acquire abroad in order to be able to face the increasing competition of a globalizing marketplace (See Martynova and Renneboog 2008; McCarthy 2013, p. 22). The period also saw an increase in the use of stock-financed M&A transactions paired with the virtual disappearance of hostile takeovers and a shift towards friendly mergers of companies in the same industry (See Andrade et al. 2001, pp. 105–107; Megginson and Smart 2009, p. 870).[14] The fifth takeover wave broke every record in terms of transaction size, scale and value, but after the burst of the internet bubble in March 2000 M&A activity dropped sharply along with the U.S. economy and global markets (See Bruner 2004a, p. 75; McCarthy 2013, p. 21).
- *Sixth wave (2003-2008):* Similar to several previous merger waves, the sixth wave was set in motion by the market recovery that followed the downturn of March 2000 (See Martynova and Renneboog 2008, p. 2152). It became the first wave of the 21st century and at the same time the first truly global merger wave (See McCarthy 2013, p. 12). Key drivers were the privatization of major national companies (especially in China), cash-rich firms expanding into new markets

13 Gregoriou and Renneboog (2007) see globalization as the most important driver of the fifth merger wave followed by factors like technological innovation and a financial bull market (See Gregoriou and Renneboog 2007, p. 4). For a detailed summary of the key research findings on the characteristics and drivers of this merger wave, kindly refer to Jansen 2008, pp. 65–69.

14 While the shift towards friendly mergers is mostly true for the U.S. and U.K. merger activity, takeovers on the European continent become increasingly hostile towards the end of the 1990s (See Goergen and Renneboog 2004, p. 10).

| Characteristic | First wave (1890s-1904) | Second wave (1910s–1929) | Third wave (1950s-1973) | Fourth wave (1981-1989) | Fifth wave (1993-2001) | Sixth wave (2003-2008) |
|---|---|---|---|---|---|---|
| **Geographical scope** | U.S. | U.S. | U.S., U.K., Europe | U.S., U.K., Europe, Asia | U.S., U.K., Europe, Asia | U.S., U.K., Europe, Asia |
| **M&A outcome** | Formation of monopolies | Formation of oligopolies | Growth through diversification | Elimination of inefficiencies | Adjustment to globalization processes | Global expansion |
| **Key means of payment** | Cash | Equity | Equity | Debt financed/ Cash paid | Equity | Debt and cash financed/Cash paid |
| **Cross-border M&A activity** | N/A | N/A | N/A | Low | Medium | High |
| **Hostile takeover activity** | N/A | N/A | U.S. & U.K.: None<br>Europe: None<br>Asia: None | U.S. & U.K.: High<br>Europe: None<br>Asia: None | U.S. & U.K.: Low<br>Europe: High<br>Asia: None | U.S. & U.K.: Low<br>Europe: Low<br>Asia: Low |
| **Events coinciding with beginning of wave** | > Economic expansion<br>> Industrialization processes<br>> Introduction of new legislations on incorporations<br>> Development of trading on NYSE<br>> Radical changes in technology | > Economic recovery after the market crash and the First World War<br>> Increasing enforcement of antimonopoly laws | > Economic recovery after the Second World War<br>> Tightening of antitrust regime in 1950 | > Economic recovery after recession<br>> Changes in anti-trust policy<br>> Deregulation of fin. services sector & new financial instruments and markets (e.g. junk bonds)<br>> Technological progress in electronics | > Globalization processes<br>> Economic and financial markets boom<br>> Increasing focus on shareholder value<br>> Technological innovation in particular Internet and telecommunications<br>> Deregulation and privatization | > Economic recovery after the downturn in 2000–2001<br>> Lowering of primary interest rates by Federal Reserve System after September 11 |
| **Events coinciding with end of wave** | > Stock market crash<br>> Economic stagnation<br>> Beginning of First World War | > Stock market crash<br>> Beginning of Great Depression | > Stock market crash<br>> Oil crisis<br>> Economic slowdown | > Stock market slowdown | > Stock market crash after Internet bubble<br>> September 11 terrorist attack | > Stock market crash due to subprime crisis<br>> Global economic recession |

**Fig. 2.3** Summary of a century of merger waves

Source: Based on Martynova and Renneboog 2008, p. 2151 and own research.

as well as highly active private equity firms investing into sectors such as real estate and retail (See Gregoriou and Renneboog 2007, p. 5). A key contributing factor was the presence of extremely low interest rates introduced by the U.S. Federal Reserve in response to the events of September 11, which fueled a real estate bubble and also enabled the increased number of leveraged acquisitions by private equity firms (See Gaughan 2010, p. 71; Lucks and Meckl 2015, p. 399). The resulting low corporate loan rates also drove the number of cash financed mergers as well as the cash element in acquisitions to levels last witnessed in the 1980s (See Alexandridis et al. 2012, p. 664). Similar to many M&A waves before, the sixth wave ended in an economic crunch when the subprime crisis pushed the global economy into a recession in 2008.

The key characteristics of these six merger waves are again summarized in Figure 2.3.

## 2.4 Phases of an M&A transaction

If a process is defined as a logical and sequential succession of individual steps, it becomes clear that an M&A project can also fairly easily be translated into a process framework (See Meckl 2006, p. 408), a view that has been shared in literature (See Jemison and Sitkin 1986, p. 145; Wirtz 2003, pp. 94–118). Similar to the problems with establishing a unifying definition of the term 'mergers & acquisitions' mentioned earlier, researchers have so far also not been able to agree on a universally accepted process framework for M&A transactions. The range of process steps summarized in Figure 2.4 can serve as an indication of this so far unresolved issue.

| Gomez/Weber (1990) | Dabui (1998) | Jansen (2000) | Middelmann (2000) | Picot (2002) |
|---|---|---|---|---|
| > Fulfill prerequisites<br>> Select candidates<br>> Evaluate partners<br>> Execute transaction<br>> Execute acquisition | > Pre-merger phase<br>> Merger phase<br>> Post-merger phase | > Strategic analysis and concept phase<br>> Transaction phase<br>> Integration phase | > Industrial concept<br>> Acquisition management<br>> Post-merger integration | > Preparatory work, studies and analyses<br>> M&A planning<br>> Process planning |

**Fig. 2.4** Selected M&A process phase concepts

Source: Based on Hinne 2008, p. 51 in turn relying on Dabui 1998; Gomez and Weber 1990; Jansen 2000; Middelmann 2000; Picot 2002.[15]

15 For additional alternative concepts of M&A process phases refer to DePamphilis 2011, pp. 126–127; Müller-Stewens and Frankenberger 2004, p. 37; Pomp 2015, p. 12; Schertzinger

The diversity of the selected concepts depicted above might partly be due to the fact that an M&A process consists of a very large number of different activities (See Grill 2011, p. 22). Defining a general process framework is further complicated by the fact that every M&A transaction is unique, with some activities running early, late, in parallel or missing altogether (See Boesecke 2009, p. 11). A universally applicable M&A process concept must inherently simplify this complex phenomenon and force it into a unifying sequential workflow. Even though numerous different phase concepts of M&A processes have been developed in literature, many researchers tend to agree that an M&A transaction can fundamentally be divided into three key phases, namely a preparatory or conceptual phase, a transaction or execution phase as well as a subsequent integration phase (See Hinne 2008, p. 50; Lucks and Meckl 2015, p. 98; Meckl 2014, p. 54; Wirtz 2003, p. 107).

The following discussion of a standardized M&A process will be based on such a three-phased framework as developed by Meckl (2004) who separated the M&A process into preparatory, transaction and integration phases and isolated the related main activities as well as demands on the project organization which will be discussed in the following section (See also Figure 2.5). Particular attention will be paid to the transaction phase since this time period is the most relevant for the event study research methodology applied in this thesis.

### 2.4.1 Preparatory phase

The first stage of the M&A process is the *preparatory phase*. It begins with the development of the fundamental strategy to grow a corporation inorganically via M&A activity and is usually seen to end as soon as negotiations with specific targets are entered, an activity that typically commences after the signing of a Letter of Intent (LoI) (See Meckl and Riedel 2011, p. 380).[16] During the preparatory phase, the responsible team on the acquirer side is ordinarily kept rather 'lean', often with an informal structure that can include members of top management, experts from the internal business development department, managers of involved business units and, in some cases, external consultants (See Meckl 2004, pp. 457–458).

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2009, p. 11; Wegmann 2013, p. 58; Wirtz 2003, p. 107.

16 A Letter of Intent (LoI) usually comprises several major binding and non-binding terms that form a roadmap for the overall M&A transaction (See Sherman 2011, p. 49). For a more detailed explanation of the content as well as purpose of a LoI, kindly refer to DePamphilis 2011, pp. 164–166.

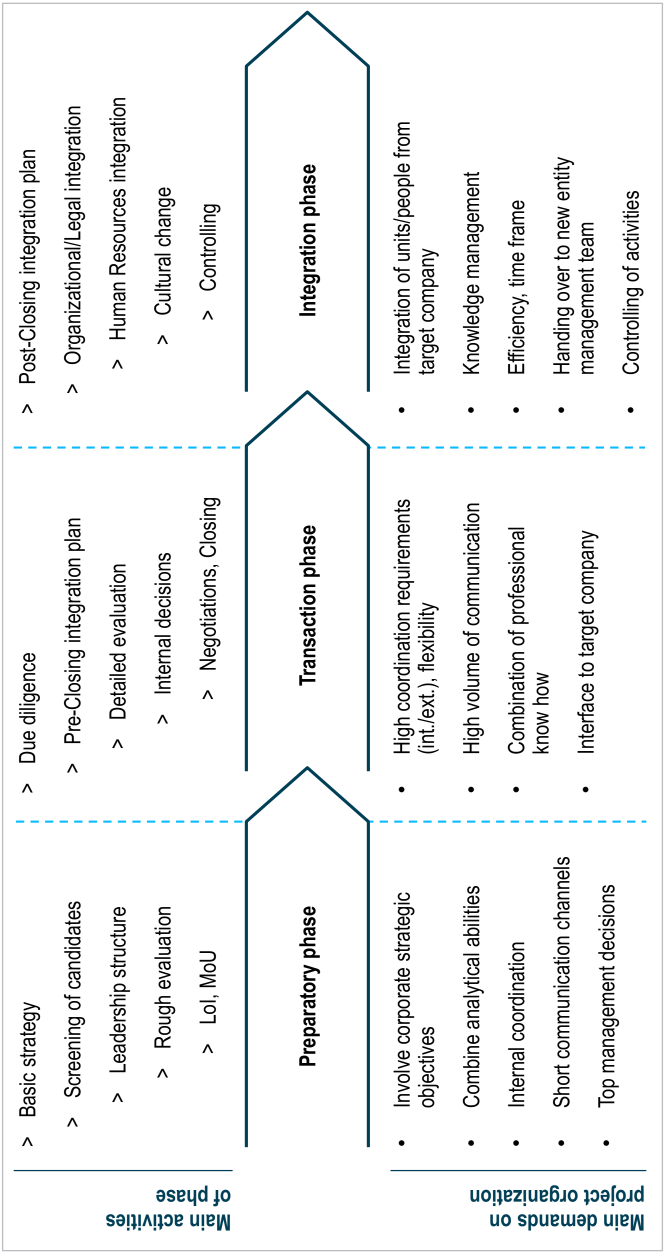


**Fig. 2.5** Three phases of an M&A process
Source: Meckl 2004, p. 457.

The most important element of this phase is the development of an *M&A strategy*.[17] During this process step a corporation has to evaluate if M&A, as one of several possible growth strategies, is a suitable option for attaining its overall corporate goals, particularly the increase of shareholder value (See Lucks and Meckl 2015, p. 113). Very concrete acquisition goals should be defined and it needs to be verified whether an M&A strategy is in fact the best strategic option to reach these goals (See Fischer and Meckl 2009, p. 38; Lucks and Meckl 2002a, p. 76, 2015, p. 113). M&A is often the best expansion option if building up internal competences would take too long, the target firm's acquisition price is not too high and the integration risks are seen as reasonable (See Wirtz 2003, p. 108).

Once the internal consensus has been reached that inorganic growth is the preferred growth strategy for a company, the firm usually begins with the implementation of the strategy by *screening* for potential M&A targets (See Lucks and Meckl 2015, p. 121). During this period, the acquirer attempts to gather preliminary information about all companies that might be relevant acquisition options – a delicate activity that necessitates highest levels of confidentiality (See Daniel and Metcalf 2001, pp. 111–112). The search is usually based on external and internal databases, information obtained from suppliers, customers as well as competitors and is frequently supported by external advisors such as strategy consultancies and investment banks (See Jansen 2008, p. 266). Once a 'long list' of potential targets has been established, these firms are commonly evaluated and ranked based on strategic, financial as well as cultural criteria such as synergy potential, ease of synergy realization (e.g. due to cultural fit), difficulty of knowledge transfer as well as the cost of the acquisition (See Lucks and Meckl 2002a, pp. 79–84, 2015, pp. 122–129; Weber et al. 2014, p. 19). The aim of such an initial selection process is to condense a 'long list' of acquisition targets into a 'short list' of the most suitable candidates before an even closer analysis begins (See Wirtz 2003, p. 109).

In a following stage, the acquiring firm needs to develop a *leadership structure* that comprises the targeted strategic (operational) and legal structure (See Lucks and Meckl 2015, pp. 155–159; Meckl 2004, p. 457). At this point of the transaction the key characteristics of the planned M&A deal are to be structured, a rough concept that can then serve as guidance for all following steps of the transaction process (See Lucks and Meckl 2002a, p. 97; Schäfer 2008, p. 250).[18] The initial leadership structure must subsequently be translated into a more detailed deal structure (See Lucks and Meckl 2015, pp. 175–176). Important components of such a deal struc-

17 Meckl (2008) refers to this activity as 'basic strategy' (See Meckl 2008, p. 267).

18 For an overview of seven different possible leadership structure models, kindly refer to Lucks and Meckl 2015, pp. 154–158.

ture are the decisions on whether to pursue a share or asset deal, the size of the intended ownership stake in the target firm as well as the planned legal structure of the acquisition (e.g. via a special purpose vehicle) (See Hinne 2008, p. 67). This deal structuring process is a complex and highly iterative process since any involved element (e.g. the payment type) can affect other elements of the transaction structure (e.g. the preferred tax strategy) (See DePamphilis 2010, pp. 178–179).

When a leadership structure has been established, a first *rough evaluation* of the target firm is commonly conducted, a process that is still limited to freely available public information (See Schertzinger 2009, p. 10). Despite this limitation, Weber et al. (2014) highlight that an acquirer should already perform a financial as well as a strategic evaluation of the value of the target firm at this point. This means that in addition to reviewing the stand-alone financial value of a target firm, an acquirer's strategic evaluation should already consider the synergistic value of the target to the acquirer in order to be able to establish a rough justifiable purchase price (See Weber et al. 2014, pp. 19–20).[19] Besides the positive synergies, also negative synergies (e.g. arising from integration costs) need to already be taken into consideration at this point (See Fischer and Meckl 2009, p. 38; Weber et al. 2014, pp. 19–20). But since the data available on the target is still sparse before an actual due diligence, the results of this rough evaluation should not be seen as a substitute for a more thorough firm valuation during the later transaction stage of the M&A process (See Hinne 2008, p. 67; Lucks and Meckl 2002a, p. 174).

Towards the end of the preparatory phase, a potential target firm is approached for preliminary discussions in order to evaluate its principle readiness to initiate more in-depth merger discussions. Should a target be willing to pursue more comprehensive talks, then both companies sign a *letter of intent (LoI)* and/or a *memorandum of understanding (MoU)* as a prerequisite before entering into the transaction phase.[20]

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19 For a more detailed discussion of the tools used to identify synergy potentials along eight different synergy types, kindly refer to Meckl and Riedel 2011, pp. 380–383.

20 The terms 'letter of intent' and 'memorandum of understanding' are often used interchangeably in literature (See Lucks and Meckl 2015, p. 152). In real-life transactions MoUs regularly contain a greater level of detail in terms of financial, conceptual, legal and tax aspects of the planned transaction (See Berens et al. 1998, p. 54; Jansen 2008, pp. 274–275). Hohnhaus (2004) regards the MoU as advantageous due to its more binding nature compared to the LoI, while maintaining a brief form that remains easy to communicate on a management as well as board level (See Hohnhaus 2004, p. 63). Both documents are only intended as a moral and not as a legal obligation to pursue a transaction (See Vernimmen et al. 2005, p. 878). If the deal is not consummated, the LoI might yet still create legal liabilities for both buyer and seller if one of the two sides

### 2.4.2 Transaction phase

The *transaction phase* includes all aspects of deal execution ranging from the due diligence, the preparation of a preliminary post-merger integration plan, a valuation of the stand-alone and the integrated target business, internal decision making to the deal negotiations which, if successful, should eventually lead to a deal closing (See Meckl 2004, pp. 457–458). The negotiations during this stage of the transaction have a much more binding character than the talks during the preparatory phase and quantifying the actual value of the synergy potential becomes a key focus area (See Meckl and Riedel 2011, p. 380). In line with the new focus of this project phase, the team structure is frequently adjusted accordingly. A more formal multi-group organization has to be established that includes internal as well as external functional and business experts while still enabling a permanent horizontal and vertical flow of information throughout the project (See Meckl 2004, pp. 458–459). For a possible example of such a project management organization during the transaction phase, refer to Figure 2.6.

A central activity during the transaction phase is the so called *due diligence*. While no proper dictionary or legal definition of the term exists (See Howson 2003, p. 4), the basic purpose of this activity is to "assess the benefits and the liabilities of a proposed acquisition by inquiring into all relevant aspects of the past, present, and predictable future of the business to be purchased" (Lajoux and Elson 2000, p. 5).[21] One of the reasons behind the due diligence is the fact that M&A activity is inherently risky, which is to a great extent caused by the strong prevailing information asymmetries between buyers and sellers (See Howson 2003, p. 4). Part of the transaction risk is hence the direct result of a lack of access to crucial data about the target firm on the side of the acquirer, a problem that has recently only been further magnified by factors like increasing deal complexity and a larger number

is later accused of not entering the negotiations in 'good faith' (See DePamphilis 2010, p. 173).

21 The due diligence is deeply rooted in the common law principle of 'caveat emptor' (buyer beware) that is central to any acquisition process in the Anglo-Saxon world (See Howson 2003, p. 4; Reed et al. 2007, p. 381). Its application in the United States goes back to the U.S. Securities Act of 1933, which "required certain parties involved in a security offering to conduct an investigation into the company as a way to defend against accusations of inadequate disclosure to investors. Over time, the term has come into use in a number of other settings, including the investigation of potential mergers and acquisitions" (Gole and Hilger 2009, p. 8).

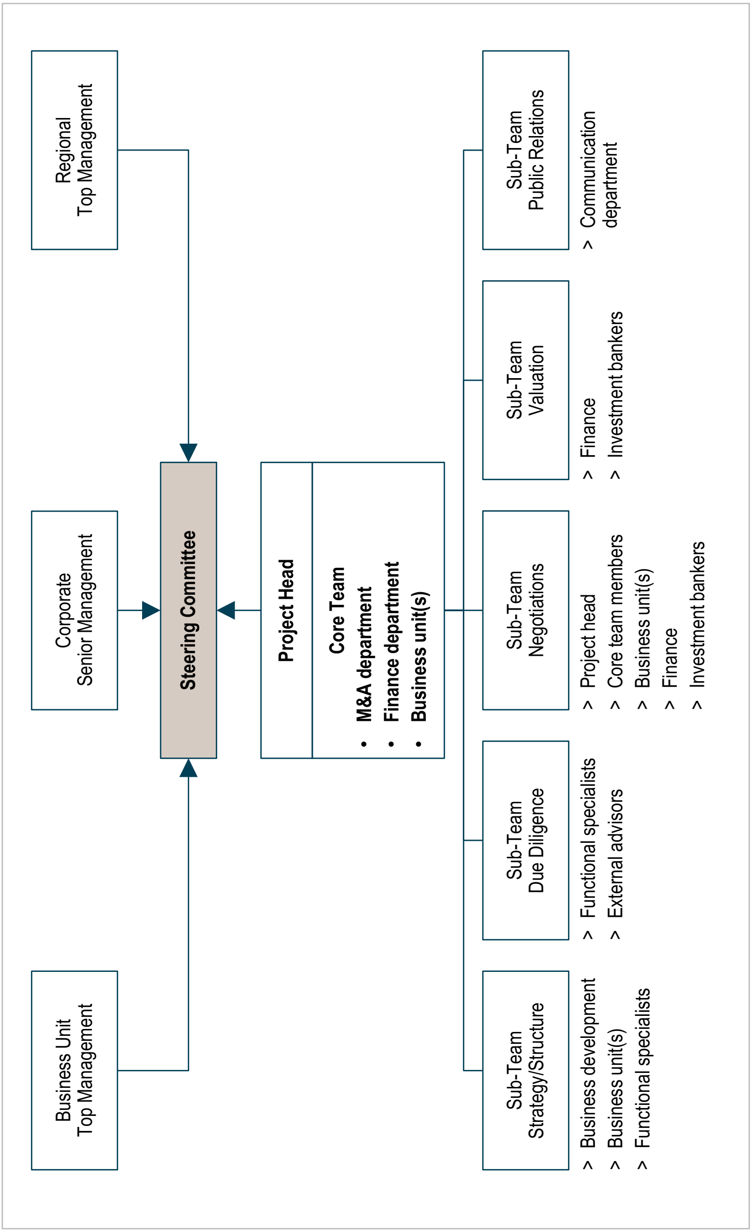


**Fig. 2.6** Schematic project management organization during the M&A transaction phase

Source: Meckl 2004, p. 458.

of cross-border acquisitions (See Perry and Herd 2004, p. 12).[22] During the due diligence process, a buyer has the opportunity to closely analyze the target in order to increase the level of comfort in key assumptions behind the transaction and to at least partly mitigate the risks of any detrimental surprises occurring in the wake of a transaction (See Berkman 2013, pp. 12–13; Gole and Hilger 2009, p. 8).[23] This in-depth analysis usually goes far beyond the pure operational, financial and legal elements of a transaction and frequently also touches on other key aspects of a target's business such as marketing, HR, corporate culture, IT and environmental standards (See also Figure 2.7).

The due diligence is by its very nature intrusive and requires a considerable amount of management attention from executives of both the target and the acquiring firms (See DePamphilis 2011, p. 176). For the buying firm's management, a key focus of the due diligence is the identification of potential 'deal breakers', which are aspects that, if uncovered, can be used to lower the purchase price or can even lead to the abortion of the entire M&A process (See Wirtz 2003, p. 186). An important success factor is to not only focus on the advantages and disadvantages of the target but to review the unique 'sources of value' of the combined entity, i.e. the targeted synergies (See DePamphilis 2010, p. 180; Weber et al. 2014, p. 21). The selling firm's management, on the other hand, has to closely balance the opposing requirements of maximizing its purchase price, revealing all fundamental risks to the potential buyer in order to avoid later litigation and demands for damages, while closely guarding confidential information and trade secrets as long as possible due to the risk that a transaction might still fall apart (See Wirtz 2003, p. 187).

Another key activity during the transaction phase is the development of a *pre-closing integration plan*. This activity relies to a considerable extent on the insights gained during the due diligence (See Fischer and Meckl 2009, p. 38). Beginning the integration planning process as early as possible has proven to be a crucial acquisition success factor and firms that only start preparing for the post-merger integration (PMI) after the merger announcement are undermining their chances of success from the very beginning (See Epstein 2004, p. 175). One reason for this is that decision makers on the acquiring side must already have a relatively firm idea about the benefits arising from the transaction as well as the costs of integration

22 An exploratory study by Angwin (2001) was able to show that national cultural differences affect the pre-acquisition phase and in particular the way in which acquirers assess their target firms during the due diligence phase (See Angwin 2001, p. 55). Others have stated that in non-Anglo-Saxon countries the due diligence is principally viewed as mistrust by the seller, which likely causes added complications (See Howson 2003, p. 18).

23 Even though the due diligence is usually associated with the acquiring firm, lenders and sellers also frequently perform due diligences (See DePamphilis 2011, pp. 176–179).

| Due diligence types | Key focus areas of analysis | Targeted key result |
|---|---|---|
| **Financial** | Financial statements, credit arrangements | Confirm accuracy of valuation |
| **Tax** | Tax records, existing tax liabilities or credits | Avoid tax liabilities and optimize tax structure |
| **Legal** | Corporate contracts, ongoing and potential litigation, compliance system | Validate existing contracts and avoid liabilities |
| **HR** | Org. structure, personnel qualification, employee benefits, labor matters | Assess potential HR risks and costs |
| **Operational** | Technology, property, plant and equipment, facilities, patents, real estate | Evaluate operational threats and synergies |
| **IT** | IT systems, network architecture, software licenses | Ensure feasibility of IT integration |
| **Marketing** | Competitive positioning, industry dynamics, commercial prospects | Formulate joint market strategy |
| **Cultural** | Corporate culture, level of employee commitment | Ensure cultural fit |
| **Environment** | Adherence to environmental regulations, pending environmental litigation | Avoid environmental liabilities |

**Fig. 2.7** Due diligence types

Source: Based on Gole and Hilger 2009, p. 9; Hinne 2008, p. 70; Howson 2003, pp. 8–9; Pomp 2015, p. 9; Wirtz 2003, p. 199.

before the deal is finalized in order to be able to know whether or not to acquire a firm and at which purchase price they will begin to overpay (See Weber et al. 2014, p. 20). Sirower and Sahni (2006) summarized this issue as follows: "A target cannot be credibly valued without considering the amount and timing of both benefits and related costs. It is also important to account for the incremental capital investment or costs that will be required to realize any synergies. The wrong time to consider severance outlays, additional capital investments, and related expenses is after a target company has been valued. These unanticipated costs will later translate into shareholder losses" (Sirower and Sahni 2006, p. 86). As part of an integration plan, the first concrete integration measures should thus be defined as to how the various business areas of a firm (e.g. purchasing, operations, sales) are to be integrated once the transaction has been finalized (See Hinne 2008, p. 70). The key goal of the measures included in this integration plan is to first quantify and later maximize the realization of all available synergy potentials, e.g. from measures like the consolidation of distribution systems or the harmonization of product characteristics (See Fischer and Meckl 2009, p. 39; Lucks and Meckl 2002a, pp. 111–112).

The subsequent *detailed evaluation* greatly depends on the findings of the due diligence as well as on the synergy estimates developed as part of the first rough implementation plan. This phase is very crucial as the buyer needs to establish as precisely as possible what maximum price can be paid to target firm shareholders before shareholder value is destroyed – a task that greatly relies on the exactness of all underlying information (See Hawranek 2004, p. 27). The maximum price is in essence set by the stand-alone value of the target firm plus the value of net synergies that are expected to arise from the transaction minus the cost of the transaction (See also Figure 2.8) (See Meckl and Riedel 2011, p. 378; Moeller and Brady 2014, p. 244).[24]

24 Net synergies are defined as the net present value of all realized synergies minus the costs of realizing the synergies during implementation (See Meckl and Riedel 2011, p. 378).

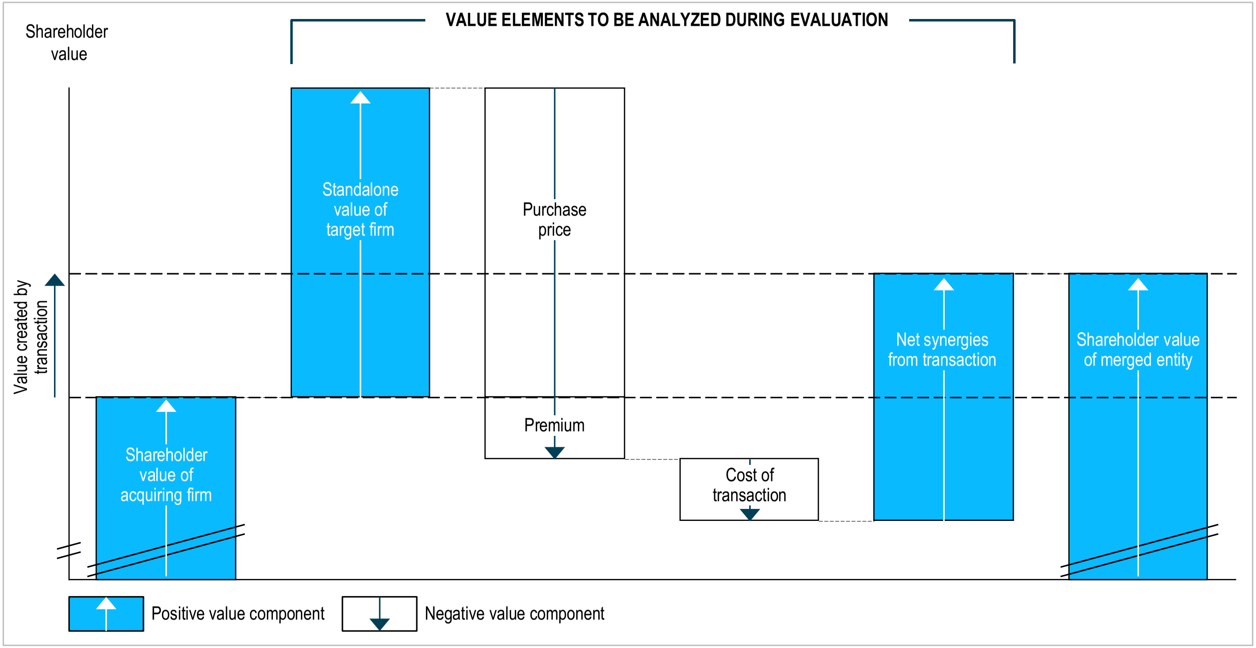


**Fig. 2.8** Essential shareholder value components in an M&A transaction from a buyer's perspective

Source: Based on Meckl and Riedel 2011, p. 378.

In transactions involving publicly listed targets, the stand-alone market price of both firms should theoretically already take into account the current operating performance of each firm and any future performance improvements that can be realized without the acquisition. Consequently, any planned synergistic improvements need to beat this already challenging 'base case' in order to create additional shareholder value (See Sirower and Sahni 2006, p. 86).[25] This translates into a crucial role for determining a suitable control premium, the part of the purchase price that is paid by the acquirer over and above the target's market value (See Moeller and Brady 2014, p. 245).[26] It "must be set high enough to induce the target shareholders to relinquish their control rights, but not so high as to make the acquisition economically undesirable" (Varaiya and Ferris 1987, p. 64). In order to strike this difficult balance, an acquiring firm must value the target firm, the cost of the transaction and the planned synergies as precisely as possible in order not to overpay. For this purpose, multiple valuation methods are usually employed, with the 'comparable companies analysis', 'precedent transaction analysis' and the 'discounted cash flow analysis' being the three most important and widely used methodologies (See Rosenbaum and Pearl 2009, p. 3).[27] It must be highlighted that even if no technical valuation errors are made in the application of these methods, different bidders are still likely to reach highly divergent valuation results. These variations can be caused by differences in the valuation assumptions (e.g. the assumed hurdle rate), the anticipated level of synergies, the respective tax situations or the perceptions of the future prospects of the target firm (See Varaiya and Ferris 1987, p. 65). At this point, the acquirer management must therefore be very cautious not to win a bid for a target by being the bidder that overestimated the value of the target the most and to thereby fall victim to the 'winner's curse' (See Giliberto and Varaiya 1989, pp. 74–75; Mukherji et al. 2013, pp. 43–44).

25 This assumption is based on the efficient market hypothesis. Kindly refer to section 5.4.1.1 for a more detailed discussion. Under the assumption that markets work efficiently, merging two publicly listed firms can only generate an economic gain if the two companies are more valuable combined than apart (See Brealey et al. 2011, p. 801).

26 The premium refers to the acquirer's bid price above the market price of the target's shares (See Díaz et al. 2009, p. 8).

27 Additional methods include balance sheet-based methods (e.g. book and liquidation value) as well as value creation methods (e.g. using economic value added and economic profit) (See Fernandez 2011, pp. 128–129). A detailed review of the various corporate valuation methodologies including the respective advantages and disadvantages of each method is beyond the scope of this thesis. For a more detailed discussion, kindly refer to Fernandez 2011, pp. 127–149; Gaughan 2010, pp. 541–564; Lucks and Meckl 2015, pp. 366–393; Rosenbaum and Pearl 2009, pp. 11–153.

In a next step, and based on all information gathered by now, the acquiring firm has to make the necessary *internal decision* to move forward with the acquisition process before engaging in the final negotiations with the target firm's management. The acquirer's leadership has to reevaluate to what extent the target meets the initially defined requirements of the M&A strategy and if an acquisition could create economic value based on all findings of the due diligence and the evaluation process (See Wirtz 2003, p. 255). This stage of the M&A process is a true test of the strength of the acquirer's corporate governance and specifically of whether a motivated and independent board of directors is in place that truly meets its fiduciary duty to protect shareholders' wealth by preventing value destroying transactions (See Gaughan 2010, p. 522).[28] In most real-world transactions this decision making process on a senior management and board level can nevertheless only be formally finalized after all contracts have been completed. This is also the reason why most M&A contracts include clauses that make the finalization of a transaction subject to the approval of the respective anti-trust authorities as well as the companies' own decision making bodies (See Hinne 2008, p. 72). In most cases, after the target and acquiring firms' boards of directors have approved the transaction, it still needs to be approved by the target (and sometimes also the acquiring firm's) shareholders (See DePamphilis 2010, p. 188).

As soon as the internal decision to proceed with a transaction has been made, the *negotiations* between the acquirer and the target firm reach a critical stage. Ideally, the negotiations will ultimately allow both parties to reach alignment on the many different positions related to the acquisition (See Lucks and Meckl 2015, p. 178). A core element at this point is reaching an agreement on the final purchasing price (See Figure 2.9). This price can differ fundamentally from the value of the target firm that was determined by the acquirer in the valuation phase since the purchase price is also influenced by factors like the strategic goals of both target and the acquirer as well as the strength of the negotiation position of each party (See Lucks and Meckl 2015, p. 387; Wirtz 2003, p. 256). Aktas et al. (2010), for example, found that even in one-on-one negotiations between target and acquirer an impeding threat

28 Gaughan (2004) suspects that part of why so many M&A transactions destroy shareholder value can be traced back to boards that are not diligent enough (See Gaughan 2004, p. 21). Grinstein and Hribar (2004) analyzed 327 large M&A deals between 1993-1999 and found that while bidder announcement returns were on average negative, this negative reaction was three times lower in transactions in which the acquiring CEO was also the head of the board of directors and therefore had the largest amount of corporate power (See Grinstein and Hribar 2004, p. 120). Kroll et al. (2008) found that vigilant boards with board members that are rich in relevant experience (e.g. prior acquisition experience) led to better acquisition outcomes (See Kroll et al. 2008, p. 378).

of another possible buyer can significantly increase the acquisition premium. At the same time, targets that are eager to sell (e.g. targets with high debt levels and targets that have initiated negotiations) usually receive lower takeover premiums (See Aktas et al. 2010, p. 242).

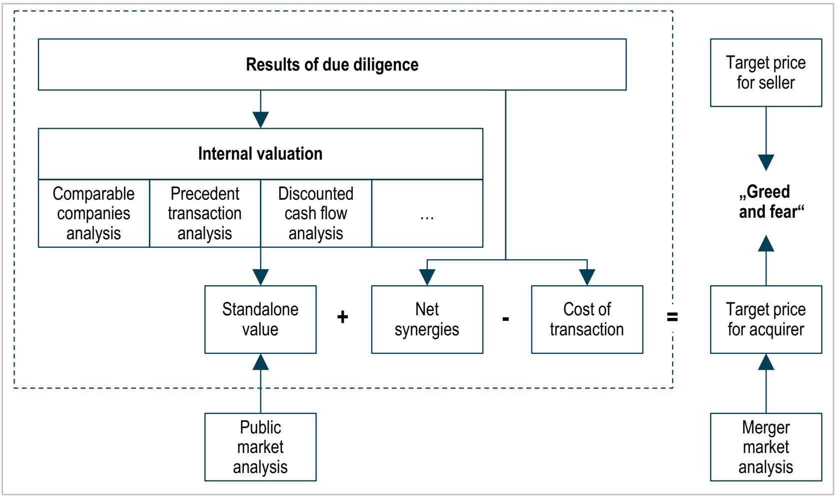


**Fig. 2.9** Schematic overview of the valuation and purchase price determination process

Source: Based on Jansen 2008, p. 283.

Another crucial element of this negotiation stage is finalizing the terms of the transaction which is usually achieved through a formal 'acquisition agreement', a closing document that includes the rights and obligations of all involved parties for the time before and after deal closing (See DePamphilis 2011, pp. 183–184).[29] Drafting this document is a complex and tedious process, especially in major deals involving public companies (See Gaughan 2010, p. 24). While some of the key parts of this contract are about setting the purchase price and the payment type to be used, other particularly important sections of the agreement focus on the risks

29 This document is also referred to as the 'definitive agreement of purchase and sale' (See DePamphilis 2011, p. 184). Contrary to the earlier nonbinding 'letter of intent' this agreement is a legally binding contract, subject to certain conditions (See Bruner 2004a, p. 768).

of a transaction which can be mitigated by ways of 'contractual protection' (See Moeller and Brady 2014, p. 283). Such protection can usually be achieved in several key areas of the agreement:

- Areas of great concern to both parties can be included in a 'representations and warranties' section, a segment of the acquisition agreement that aims to provide full disclosure of all information crucial to the M&A deal (See DePamphilis 2010, p. 189). An acquirer will usually demand a guarantee that a target only faces the lawsuits that were also revealed during the legal due diligence (See Lucks and Meckl 2015, p. 185). If any of the included guarantees are violated at the time of deal closing, the acquirer may be able to refrain from closing the deal or may be able to bring forward legal claims against the seller (See Crosier 2004, p. 74). Should the buyer incur a penalty for stepping away from a transaction also the resulting termination fee is defined in this section (See Gaughan 2010, p. 24).
- 'Covenants' regulate the actions of both parties which they either agree to take or agree to refrain from during the period between the signing of the agreement and deal closing (See DePamphilis 2010, p. 189). Such covenants are critical since after the signing, the ownership change for the target firm has not yet occurred while the acquirer already has to bear part of the risks arising from the ongoing target firm operations during that period. The acquirer thus needs to ensure that no actions are taken in that time that can significantly lower firm value (e.g. expensive works council agreements) (See Lucks and Meckl 2015, p. 185).
- 'Conditions to Closing' are a collection of items that must happen or must not happen in order for both parties to close the transaction (See Bruner 2004a, p. 769). These conditions normally include the payment of the purchase price but can also contain other elements, such as shareholder approval or a lack of court rulings prohibiting the transaction (See Lee and Swartz 2007, p. 9).
- The 'indemnity provisions' are normally some of the most contested items in the purchase agreement because the interests of both sides in the acquisition are highly conflicting. As part of these provisions, the buyer aims to be reimbursed after closing for any unfavorable transaction that might have occurred before closing, while the target shareholders would unsurprisingly prefer to obtain a release from any such liabilities as early as possible (See Sherman 2011, p. 198). An example for such a provision is that the buyer usually indemnifies the seller from any obligations arising from contracts that the buyer has taken on. The seller on the other hand will regularly indemnify the acquirer for any liabilities that were not properly disclosed during the transaction process (See Frankel 2005, p. 266). Such indemnification rights are normally limited in terms of time period during which claims can be made, in terms of caps on maximum claims

as well as in terms of losses that the buyer must sustain before any claims can be made (i.e. a deductible) (See Lucks and Meckl 2015, pp. 186–187; Rosenbaum and Pearl 2009, p. 275).

Once the merger agreement has been finalized and signed, the *deal closing* marks the end of the transaction phase. There is no standard structure or timeline to the closing process, but the closing of a transaction commonly occurs well after a final agreement between the involved parties has been signed (See Frankel 2005, p. 265).[30] This is usually because a multitude of formal preconditions need to be fulfilled (e.g. shareholder and/or governmental approvals) before a deal can actually close (See Gaughan 2010, p. 26; Reed et al. 2007, p. 614). At the day of deal closing the acquirer assumes all ownership rights from the target's shareholders (See Hawranek 2004, p. 28).

### 2.4.3 Integration phase

The integration phase (also referred to as post-merger integration or PMI phase) begins immediately after closing and is frequently seen to play a decisive role in the success of the entire acquisition project (See Hackmann 2011, p. 19; Jansen 2008, p. 318).[31] During this phase of the acquisition, time is of the essence (See Epstein 2004, p. 178; Lucks and Meckl 2002a, pp. 124–125). Acquirers that manage to gain momentum early in the integration have been shown to be more likely to produce successful acquisitions (See Bert et al. 2003, p. 43). Infusing a sense of urgency in both organizations is only healthy since any delay can cause the two separate organizations to drift without realizing any of the planned benefits of the acquisition and might even allow resistance to the deal to build up within organizations (See McGrath 2011, p. 187). The core focus of this phase clearly has to

30 If the time period between signing and closing is from the outset assumed to be long (e.g. due to many required regulatory approvals) acquirers will usually demand to include material adverse change (MAC) clauses in the acquisition agreement. These clauses decrease the acquirer's risk that the business deteriorates significantly during that period since they can be used to cancel the transaction in extreme cases (See Gaughan 2010, p. 24; Lucks and Meckl 2015, p. 188).

31 Haspeslagh and Jemison (1991) have defined post-merger integration as "an interactive and gradual process in which individuals from two organizations learn to work together and cooperate in the transfer of strategic capabilities" (Haspeslagh and Jemison 1991, p. 106). For overviews of various other definitions of the term PMI used in literature, kindly refer to Foley 2014, pp. 6–7; Gerds 2000, p. 14.

be on merging the acquiring firm and the newly purchased unit, a process that is in some ways comparable to a 'regular' restructuring process but also comes with unique peculiarities (See Meckl 2004, p. 459). To address these idiosyncrasies and to ensure a smooth integration process, the integration team structure is regularly adjusted again from the team structure that was in place during the transaction phase. While a dedicated integration manager – a 'merger champion' – often takes the main responsibility for the overall integration project, multiple task forces in a formal transitional structure should orchestrate the integration process (See Weber et al. 2014, p. 23). Meckl (2004) proposes to organize these task forces in a matrix structure, combining functional teams working on operational topics (e.g. procurement, R&D, etc.) with teams that drive more overarching integration areas (e.g. corporate culture, information technology, etc.). Such a structure enables a close interaction between managers across key integration areas (See Lucks and Meckl 2002a, pp. 121–123; Meckl 2004, pp. 459–460).

At the beginning of the integration, the various integration task forces need to draft a detailed *post-closing integration plan,* a key success factor in realizing the desired synergies (See Schäfer 2008, p. 38; Tetenbaum 1999, pp. 34–35). This plan can build on the less detailed pre-closing integration plan that was sketched out during the transaction phase. Since the acquiring firm has by now obtained access to a much more granular level of information (e.g. office and manufacturing locations, employee databases and other sources of information) a very detailed analysis of the status quo as well as a much more detailed planning of integration measures becomes possible (See Fischer and Meckl 2009, p. 39). The unobstructed access to all target firm information should be used to reassess if previously identified synergy potentials were correct and can in fact be implemented. If this is not the case, then adjustments to the integration plan might become necessary (See Hawranek 2004, p. 29). Measures that were previously defined in a slightly abstract and mostly top down approach now need to be broken down into very specific operational actions and tasks (See Hinne 2008, p. 79; Lucks and Meckl 2002a, p. 247). Each task should, in this respect, include a precise definition, person responsible, goal, timing, cost of execution as well as a deadline (See Lucks and Meckl 2002b, p. 498). Creating such a detailed master plan has been estimated to take between two to three months (See Kaltenbacher 2011, p. 34). But in reality, the development of the post-closing integration plan should be seen more as an iterative and continuous process than a 'one-time' task, since new synergy potentials might be uncovered over the course of the integration while other measures might not be implemented as planned (See Hawranek 2004, p. 29; Schäfer 2008, p. 39). In large PMI projects managing such an 'evolving' integration plan with a large number of interdependencies can be so complex, that the usage of a project management tool is recommendable (See Klein and Kahn 2003, p. 21).

In terms of actual operational integration, some of the areas that have to be driven forward as early as possible are the organizational and legal integration of the two entities. The *legal integration* is at its core a fairly procedural task that mainly involves the legal transfer of ownership titles (See Shrivastava 1986, p. 68). In many countries, this at first glance straight-forward process can have fairly wide-reaching consequences. The integration of local legal entities can, for example, have implications on aspects related to employment law, effects that need to be analyzed on a country-by-country basis.[32] Apart from the combination of all legal entities, other key facets of the legal integration process include the management of intellectual property, vendor and supplier agreements, customer contracts as well as the harmonization of all internal legal processes (e.g. contract management and contract authorization) (See PwC 2013, p. 5). Larsson and Finkelstein (1999) defined the *organizational integration* as "the degree of interaction and coordination between the two firms involved in a merger or acquisition" (Larsson and Finkelstein 1999, p. 6). This organizational integration must necessarily cover the processual as well as structural integration of the two organizations (See Hawranek 2004, p. 30; Schäfer 2008, p. 38). As part of the processual integration, all key business processes must be harmonized which usually includes customer relationship management, supply chain management, procurement, production, product life cycle management, R&D as well as management and support processes (See Lucks and Meckl 2015, p. 292). Regarding the structural integration, key organizational elements such as organizational structure, leadership concepts, job descriptions as well as job responsibilities need to be aligned or newly developed for the joint entity (See Hackmann 2011, p. 112). In terms of integrating the organizational structures of the two entities on a high level, four key options are available (See Figure 2.10). The choice between them should be made depending on the 'requirement for organizational autonomy' and

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32 As an example, section 613a of the German Civil Code protects the employees' rights in Germany if a company (or part of a company) changes ownership in a legal transaction. According to this regulation, a legal transfer of business in Germany does not result in the end of employment. On the contrary, the very employment relationship is transferred to the new company by law and the new owner assumes all rights and obligations. In addition to this, works councils might have a right of participation if the business succession results in any disadvantages for at least part of the employees (See Elert and Brooks 2014, pp. 80–81). Similar laws are in place in most European countries as well as in many other countries around the globe and their effects must hence be closely analyzed before the legal transfer of ownership is executed.

the 'requirement for strategic interdependence' of the two firms (See Jansen 2008, pp. 326–328; Lucks and Meckl 2015, p. 241; Wirtz 2003, pp. 284–287).

| | | | |
|---|---|---|---|
| Requirement for organizational autonomy | High | **Stand-alone positioning** (Preservation) | **Partial integration** (Symbiosis) |
| | Low | **Holding structure** | **Complete integration** (Absorption) |
| | | Low | High |
| | Requirement for strategic interdependence | | |

**Fig. 2.10** Possible approaches to organizational integration

Source: Based on Jansen 2008, p. 326; Lucks and Meckl 2015, p. 241; Wirtz 2003, p. 285 in turn relying on Foote and Suttie 1991, p. 122; Haspeslagh and Jemison 1992, p. 174.

The first option – especially suitable in the case of a relatively low requirement for strategic interdependence as well as for organizational autonomy between the acquirer and target firm – is a 'holding structure'. In this case, no organizational integration in the true sense of the word will be implemented, since both firms remain legally separate entities. Synergy potential will only be very carefully realized over a longer period of time in areas such as purchasing or sales (See Jansen 2008, p. 327). Benefits of integration are thus mostly limited to areas like management transfers as well as risk sharing (See Papathanassis 2004, p. 28). A strong need for organizational autonomy combined with a low requirement for strategic interdependence usually leads to a 'stand-alone' positioning of the acquired firm. This integration strategy is often selected if corporate strategies of acquiring firm and target are conflicting, independent brands should remain in place or if, for any other reason, benefits arise if the acquired firm remains independent (See Wirtz 2003, p. 285). This integration type is also often chosen if the acquisition constitutes a foray into a completely new business field for the acquirer (See Bauch 2004, p. 80). A 'partial integration' or 'symbiotic' organization is the most complex form of integration since it combines a requirement for strategic interdependence with organizational autonomy (See Papathanassis 2004, p. 29). This means that there is a need for selective integration while certain skills or resources must be maintained separately in both companies (See Bauch 2004, p. 80; Lucks and Meckl 2015, p. 241). The merger between Daimler-Benz and Chrysler has been named as an example for this integration type. While particularly the manufacturing-related side of the value chain offered significant potential for synergies, the brand names as well as marketing and distribution remained largely independent (See Müller-Stewens 2006, p. 794). The 'complete integration' (i.e. absorption) leads to a full consolidation of all activities of acquiring and acquired firm, a process that can be expected to take a considerable amount of time due to frequently arising integration issues (See Haspeslagh and Jemison 1992, p. 175; Wirtz 2003). Even more than in the other integration types, in this case the communication within the organization as well as with suppliers, customers and other stakeholders is crucial in order to ensure that all operations continue to run smoothly in parallel to the integration (See Jansen 2008, p. 328). The high-level integration type that is selected by the acquiring firm naturally strongly influences the later more detailed development of organizational structures and processes for the combined firm (See Hackmann 2011, p. 178).

An element of integration that is closely linked to the organizational integration is the *human resources integration*. The key pillars of this work stream are the allocation and hiring, the development and, if required, the outplacement of employees in the newly combined entity (See Lucks and Meckl 2015, p. 252). During the integration phase, the HR team will be highly preoccupied with the complicated and often political employee selection process that aims to allocate the best employees from both sides to existing and new positions in the organization as well as the many administrative issues that are related to such a large-scale employee transition process (e.g. revised employment contracts, expat assignments, etc.) (See Schuler and Jackson 2001, p. 247). In parallel, the HR integration team needs to finalize a detailed analysis of the current personnel levels in terms of quantity as well as quality and compare the status-quo with a target state for the merged firm that was developed during the transaction phase and likely further refined using more detailed information obtained after closing (See Lucks and Meckl 2015, pp. 251–252). Based on this gap analysis, the integration team is, on the one hand, likely to identify employee shortages in certain areas (e.g. due to new strategic requirements and/or lack of specific staff qualifications) (See Hinne 2008, p. 81), which will then have to be compensated by training existing personnel (if feasible) or by hiring new staff (See Hackmann 2011, pp. 136–137). On the other hand, M&A activity usually also ultimately results in the need to downsize the personnel base of the combined entity on a fairly large scale (See Aguilera and Dencker 2004, p. 1362; Kaltenbacher 2011, p. 58). This very difficult process must also be managed and responsible executives must balance the goal of swift synergy realization with the need for business continuity and a smooth overall integration process. In addition to this, many mergers face the issue of elevated employee turnover and that the best and brightest employees are the most likely to leave during this period of insecurity (See Cannella and Hambrick 1993, p. 137; Krug and Hegarty 1997, p. 673; Martin and McConnell 1991, p. 675; Walsh and Ellwood 1991, p. 215). It is thus an important task of HR and senior management to actively address this issue by continuously providing clear and consistent information on the transaction to employees (See Sherman 2011, p. 262). Many acquiring firms also chose to implement retention schemes for key employees at the target (and at times also the acquirer), in order to avoid an uncontrolled employee exodus.

A further crucial element of post-merger integration, seen by some as the heart of the integration, is the assimilation of corporate cultures (See Tetenbaum 1999, p. 26). The necessary *cultural change* might not have an impact that is immediately noticeable, but it has been found that, over time, a lack of cultural integration and the likely resulting cultural conflict can contribute to merger failure (See Bijlsma-Frankema 2001, p. 192; Cartwright and Cooper 1993, p. 59; Weber and Camerer 2003, p. 412).[33] Developing a set of commonly shared goals as part of an integrated corporate culture thus becomes crucial for the different units of an organization to be able to cooperate (See DePamphilis 2010, p. 230). However, "integrating two independent companies with divergent cultures into one cohesive organization is a daunting and delicate process" (Shelton et al. 2003, p. 315). Any successful cultural integration begins with a comprehensive cultural due diligence during the transaction phase and many acquisitions fail because no systematic and exhaustive assessment of cultural differences at that stage ever took place (See Cartwright and Cooper 1993, p. 68; Lodorfos and Boateng 2006, pp. 1411–1412; Schraeder and Self 2003, p. 520; Vrontis et al. 2012, pp. 291–292). Based on such an analysis, the acquiring firm should then be able to obtain a sense of the magnitude of cultural differences between the firms and of how difficult the planned cultural integration will likely become. Four different modes of acculturation have been identified in

33 So far the terms 'culture' and 'organizational culture' have been defined in many ways and each definition has a specific focus and level of analysis. For a more detailed discussion, kindly refer to Nahavandi and Malekzadeh 1988, pp. 79–80. Teerikangas and Very (2006) criticize this issue and highlight that as long as the term 'cultural differences' remains poorly defined and understood, the impact on M&A performance will stay difficult to grasp. As an example, they found that differences in organizational culture seem to have a much more pronounced impact on M&A performance than differences in national culture. They also highlight that cultural differences alone are likely not a sufficiently strong factor to explain M&A performance (See Teerikangas and Very 2006, pp. S45-S46).

literature (See Cartwright and Cooper 1993, pp. 65–66; Nahavandi and Malekzadeh 1988, pp. 82–83):[34]

- **Assimilation**: The employees of the acquired organization are willing to give up their current corporate culture and adapt to the acquirer's culture. This situation usually leads to a relatively smooth cultural integration process.
- **Integration**: The two cultures merge and form a new corporate culture, a process that requires adjustment from employees on both sides. Even though the process can potentially lead to a cultural collision it also offers considerable potential for improvement on both sides.
- **Separation**: Members of the acquired firm want to maintain their own culture and refuse to assimilate. This situation has the potential to lead to a collision of cultures unless a satisfactory level of cultural tolerance is established within the merged entity.
- **Deculturation**: The staff in the acquired firm is unsatisfied with the existing culture but is not attracted to the new owner's culture. This results in alienation of target staff and is highly problematic for the integration process.

The overall integration process should subsequently be managed according to what mode of cultural integration the acquiring firm expects.[35] But managing the cultural side of a PMI will always be a major challenge and no 'one-size-fits-all' approach will likely ever be developed. Several recommendations have, however, been made by researchers that might help acquiring managers during the difficult process. Such recommendations include the open sharing of information, the active involvement of individuals and groups in participatory decision making, the building of trust, instilling a sense of support in the organization as well as maintaining a degree of patience in the process (See Friedman et al. 2015, pp. 16–18; Schraeder and Self 2003, pp. 516–520).

In order to obtain an understanding of whether an implementation project is on track – and to be able to react quickly if this is not the case – any PMI should also include *controlling* activities (See Lucks and Meckl 2015, pp. 412–413).[36] In

34 The summarized modes of acculturation were initially developed by Nahavandi and Malekzadeh (1988) and later further adapted by Cartwright and Cooper (1993) (See Cartwright and Cooper 1993, pp. 65–66; Nahavandi and Malekzadeh 1988, pp. 82–83).

35 For a discussion of how the earlier defined organizational integration choices of preservation, absorption or symbiosis affect the cultural integration process, kindly refer to Teerikangas and Very 2006, pp. S37-S38.

36 Lucks and Meckl (2015) have identified three different work packages within the overall controlling process, namely a valuation controlling during the transaction phase, a

particular the progress of the organizational/legal integration, human resources integration and cultural change as outlined earlier should be continuously tracked. This can be achieved by monitoring the progress of all implementation activities compared to the timeline that was initially defined as part of the merger integration plan, with a particular focus on the achievement of key milestones (See Lucks and Meckl 2015, pp. 413–414). It is important to firmly anchor such a controlling system in the new organization to ensure that any delays in the implementation process are immediately addressed by teams as well as by individuals. This can be accomplished by linking the merger goals with individual goals on a team or employee level (e.g. via performance contracts, etc.) (See Studt 2009, p. 31). Should the continuous controlling of the implementation's progress reveal that key targets of the integration (in particular in terms of synergy realization) have not been achieved, then follow-up restructuring activities might become necessary which go beyond the initially planned organizational integration. The goal of such restructuring activities is to adjust integration activities in order to ensure a maximization of value creation based on the latest information available to the integration team (See Theuerkorn 2013, p. 95).

## 2.5 Performance of M&A transactions

A question that is central to M&A research in general and will be particularly crucial for this thesis is what constitutes a successful M&A transaction. In the context of M&A transactions, 'success' has been defined as the degree to which the initially set goals of an M&A transaction were reached within a certain timeframe (See Vogel 2002, p. 273). But corporations have a multitude of different stakeholders many of which have different – at times even conflicting – goals (See Eisenbarth 2013, p. 213; Kaup 2009, p. 34). Meglio and Risberg (2011) stated in this respect that "*M&A performance is an ambiguous construct. The ambiguity of the construct makes it essential that M&A scholars clearly define what it is that they label as M&A performance. This means clearly stating if M&A performance falls within the financial or the non-financial domain or both, over which dimension(s) the performance is measured, and through which indicator(s)*" (Meglio and Risberg 2011, p. 429). Also

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transaction success controlling at the end of the transaction as well as an operational project controlling that in essence spans all transaction phases (See Lucks and Meckl 2015, p. 406). Only the operational project controlling activity will be discussed at this point with a focus on the activities during the integration phase.

Halebian et al. (2009) have encouraged M&A scholars to be more precise in their definition of 'acquisition performance' since this will help to make study results more comparable and enable an integration of results across fields (See Haleblian et al. 2009, p. 493). For this reason, it is seen as crucial for this thesis to establish which stakeholder perspective is in focus in the analysis of M&A transaction success (section 2.5.1) and to then define what is considered as M&A success for this specific stakeholder group (section 2.5.2). Once clarity on these two dimensions has been established, section 2.5.3 will present an overview of the various research methods which have previously been employed for measuring M&A success and will evaluate the advantages and disadvantages of each method.

### 2.5.1 Perspectives on M&A performance

A corporation has many different stakeholders, most of which take their own unique standpoint when evaluating the success of an M&A transaction (See Martynova and Renneboog 2008, p. 2152; Schoenberg 2006, p. 368). In this respect, Beitel (2002) distinguished between four key stakeholder groups (See Figure 2.11), namely a firm's customers, its employees, society as a whole as well as a company's shareholders (See Beitel 2002, p. 32). While a firm's customers usually quantify the success of an acquisition by reviewing how a transaction has affected their available product/service spectrum, quality and prices, the employees involved in an acquisition are often primarily concerned with how their job prospects and remuneration were impacted by an acquisition (See Pauser 2007, p. 64). The general public will frequently measure the success of a transaction by reviewing aspects like its impact on securing existing company locations and the related jobs or if it contributed to a reduction of bankruptcy risks. Several of these views can stand in conflict with the perspective taken by a company's shareholders who measure success mostly in terms of the magnitude by which an acquisition has increased their shareholder wealth through the realization of revenue or cost synergies (See Beitel 2002, pp. 31–32; Wübben 2007, p. 13).

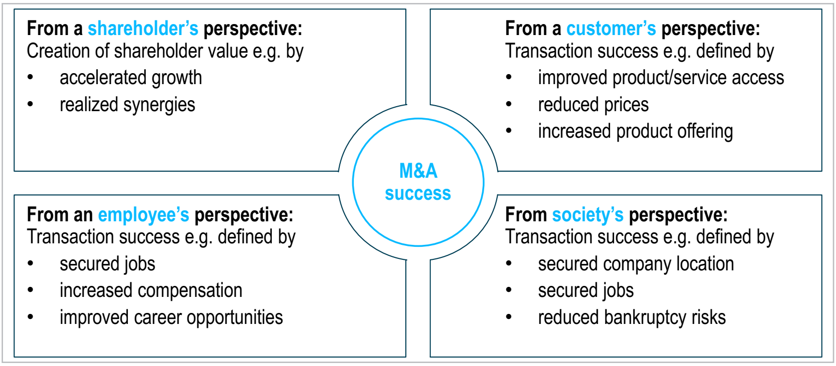


**Fig. 2.11** Potential perspectives for evaluating M&A success
Source: Based on Beitel 2002, p. 32; Wübben 2007, p. 13.

A majority of empirical studies on M&A success evaluates acquisition performance by taking the perspective of the involved shareholders and by measuring the shareholder wealth effects of acquisitions (See for example Cartwright et al. 2012, pp. 98–99; Cartwright and Schoenberg 2006, pp. S2-S3; Das and Kapil 2012, p. 288; Zollo and Meier 2008, p. 56). The key argument for applying this specific perspective is that while the relationships with most other firm stakeholders are defined contractually, shareholders play an especially prominent role by carrying the full entrepreneurial risks of operations and by being the stakeholder group that ultimately has the right to control the organization (See Eisenbarth 2013, p. 213; Jensen 1994, pp. 110–111; Kaup 2009, pp. 34–35). But Lucks and Meckl (2015) also see additional benefits arising from evaluating the success of an acquisition through its value creation impact, since

- the success can be analyzed relatively easily ex post by selecting an appropriate base unit of measurement (e.g. a firm's free cash flow or stock price),
- value generation is as an appropriate ex ante planning goal criterion for all process steps in an acquisition,
- the analysis of an acquisition's value impact makes most sense from an economic efficiency perspective,
- this particular view has come to dominate the research arena due to a generally increasing capital market orientation and a theory-guided discussion on optimal resource allocation (See Lucks and Meckl 2015, p. 16).

For this reason, this thesis will take a shareholder perspective when evaluating the success of M&A transactions and will thus focus exclusively on the shareholder wealth effects of acquisitions while disregarding potential other perspectives of evaluating M&A success.

## 2.5.2 Definition of M&A performance

Even if the performance of an M&A transaction is measured purely based on its impact on the wealth of the involved shareholders, considerably different definitions of M&A success remain conceivable (See Vogel 2002, p. 273). Firstly, it is possible to evaluate the performance of a transaction from the perspective of acquiring as well as target shareholders or to analyze the combined wealth effects (See Martynova and Renneboog 2008, p. 2152). Also, an evaluation of the short-term or longer-term value impact of an acquisition can lead to drastically different definitions and understandings of M&A performance (See Vogel 2002, p. 273). Haleblian et al. (2009), for example, stated as a key finding of their meta-analysis of prior M&A research that "whereas many studies reviewed examined abnormal returns over short (2- to 4-day) windows around announcement, others examined long-term abnormal returns or accounting measures that stretched from 36 to 60 months. Therefore, time might potentially exhibit a contributing influence on research findings, which results in the equivocal nature of many of the areas we reviewed" (Haleblian et al. 2009, p. 492). It thus seems imperative to establish an even more precise understanding of what 'M&A performance' means by further specifying the precise *dimension of success* in focus as well as the *timeframe* and *performance benchmark* used in an analysis of M&A performance (See Pauser 2007, p. 65).

### 2.5.2.1 Dimension of success

The 'dimension of success' refers to the number as well as the content of the factors that are used to evaluate the success of an M&A transaction. Literature broadly differentiates between one-dimensional analyses of M&A success and multi-dimensional approaches of determining transaction performance (See Gerpott 1993, p. 190; Wübben 2007, p. 12). The former measures the success of a transaction based on only a single factor, e.g. through the shareholder value of a firm. Such a one-dimensional performance analysis will be used for the purpose of this thesis. It is usually viewed as sufficient for studies in which a shareholder perspective to M&A success is taken, since this stakeholder group is thought to measure success almost exclusively by an M&A deal's shareholder wealth impact (See Beitel 2002, p. 33; Rappaport 1986, pp. 138–140). More specifically, and in line with previous studies, this thesis will focus on the wealth impact of acquisitions on the shareholders of the acquiring firm (See Cording et al. 2010, p. 14). This has been common practice in many similar studies due to the fact that target shareholders almost always increase their shareholder wealth in the form of acquisition premiums, while acquiring shareholders seem to at best break even or even lose value (See Bruner 2002, p. 56; Cartwright and Schoenberg 2006, pp. S1; Haleblian et al. 2009, p. 470; Meglio and Risberg 2011, p. 424). The most interesting question in capital market-based M&A performance research is therefore if the shareholder wealth effects of M&A on the acquiring firm's shareholders are positive or not. It has at times been argued that wealth effects on target and bidding shareholders have to be analyzed in combination, in order to understand the true 'macroeconomic' impact of M&A. Datta et al. (1992) have discredited this argument and have voiced the opinion that "without an economic rationale for the bidder's behavior, macroeconomic claims about the economic benefits of mergers and acquisitions suffer from inadequate reasoning" (Datta et al. 1992, p. 80).

M&A scholars have cautioned that a comprehensive analytical review of M&A success might require the examination of multiple success criteria, for example, alongside financial as well as non-financial dimensions (e.g. market strategic and social) (See Eisenbarth 2013, p. 216; Lubatkin and Shrieves 1986, p. 499; Meglio and Risberg 2011, p. 426; Pauser 2007, p. 65; Vogel 2002, p. 275). Non-financial success dimensions, however, frequently face the challenge of a precise ex post quantification and capturing the initial strategic goals of an acquisition can be prone to inaccuracies. This likely contributes to the fact that studies on M&A success can come to widely differing conclusions (See Lucks and Meckl 2015, pp. 15–16). Also, the precise meaning of 'multidimensionality' remains a controversial issue in M&A performance research since it is disputed whether multiple indicators of measurement have to come from multiple domains (e.g. market, accounting and social areas) or if an analysis of multiple dimensions within the same domain (e.g. sales and profit development within accounting) can already be considered to be multidimensional M&A performance research (See Meglio and Risberg 2011, p. 421).

#### 2.5.2.2 Timeframe

Further crucial aspects to consider when determining M&A success are the time of measurement as well as the time period that is to be analyzed. In terms of time of measurement, an 'ex ante' analysis, usually involving a capital market perspective, can be discerned from an 'ex-post' analysis, which reviews transaction success based on developments between the acquisition announcement and a later point in time (See Vogel 2002, p. 275). Depending on whether an ex ante or ex post approach is chosen, the timeframe of analysis will likely differ considerably. An ex-ante analysis of capital market reactions to an acquisition regularly implicitly assumes that markets are efficient and can almost instantaneously capture the full impact of an acquisition on shareholder value (See Das and Kapil 2012, p. 288; Schoenberg 2006, p. 368).[37] This is why an analysis period of only a few days to a couple of weeks is usually viewed as satisfactory (See Eisenbarth 2013, p. 217; Gerpott 1993, p. 232). This thesis will pursue an ex ante performance examination in the form of an event study analysis and will assess the shareholder wealth effects of transactions in an event window of up to 20 days before and after an acquisition announcement.[38] Alternative ex-post analyses on the other hand – particularly if focused on stakeholders like customers or employees – require a much longer analysis period, usually between 2 to 5 years, since the impact of an acquisition integration needs time to fully unfold first in order to also be reflected in the respective analysis metrics (See Eisenbarth 2013, p. 217; Gerpott 1993, pp. 231–234; Meglio and Risberg 2011, p. 424; Pauser 2007, pp. 65–66; Schoenberg 2006, p. 368; Vogel 2002, p. 275).

#### 2.5.2.3 Performance benchmark

The results of an M&A performance analysis are only truly meaningful if compared against a relevant benchmark and researchers have four distinct performance benchmark options at their disposal: initial M&A goals, intertemporal comparisons, company benchmarking as well as a comparison with alternative investment opportunities (See Gerpott 1993, p. 190; Vogel 2002, p. 276; Wübben 2007, p. 12):

- **Initial M&A goals**: The actual results of an acquisition can be compared with the initially targeted goals. Such analyses can be based on internally set goals or on the goals communicated externally at the time of the acquisition (See Vogel 2002, p. 276).
- **Intertemporal comparisons**: With this option, the performance metrics under analysis are reviewed over a certain time period or compared at certain times before and after an acquisition. Even though this type of performance benchmarking can be used in both financial statement- as well as capital market-based analyses, it comes with the innate disadvantage that company specific as well as systematic trends (e.g. changes in the legal environment or the state of the economy) are usually impossible to discern from the impact of an acquisition (See Eisenbarth 2013, p. 218; Gerpott 1993, pp. 236–237; Pauser 2007, p. 66; Vogel 2002, p. 276).

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37 For a more detailed discussion of this efficient market hypothesis, kindly refer to section 5.4.1.1.

38 Kindly refer to section 5 for a more detailed description of the chosen event study approach.

- **Company benchmarking**: The performance of an acquisition can also be measured by comparing performance metrics of companies involved in a transaction against the metrics of firms that were not engaged in any M&A deals. In the case of capital market-based performance analyses – such as the event study method employed in this thesis – an acquiring firm's share price performance is benchmarked against a comparable portfolio of non-acquiring firms or a stock market index.[39] Even though this benchmarking approach to M&A performance measurement is widely used in literature, a problem that should be noted is that if prevailing group specific differences are not accounted for from the beginning, false interpretations of acquisition success can occur (See Eisenbarth 2013, p. 218; Vogel 2002, p. 276). Furthermore, during periods or in industries in which M&A is pervasive, it can prove to be difficult to identify reasonably similar control groups of non-acquiring firms (See Das and Kapil 2012, p. 286).
- **Alternative investment opportunities**: Since any corporate acquisition can technically also be seen as a simple capital investment, performance of an M&A transaction could also be compared to a firm's alternative investment opportunities such as an expansion into a new market or even plain stock market investments. In practice, this benchmarking approach is nevertheless challenging to implement since it causes considerable information acquisition costs which is why, while sensible, this option is only rarely chosen by researchers (See Bauer 2012, p. 138; Eisenbarth 2013; Gerpott 1993, pp. 239–240; Vogel 2002, p. 276).

In summary, for the purpose of this thesis, 'M&A performance' will therefore be measured through a single financial dimension of the acquirer's shareholder value. This means that an M&A transaction will be described as a 'success' if it had a positive impact on the acquiring shareholders' wealth. In line with similar previous studies, shareholder value will be measured through the market capitalization of a firm, which has been stated to be a clear and objective operationalization of M&A transaction performance (See Kaup 2009, p. 35). The capital market-based research methodology used for this purpose constitutes an ex ante analysis of acquisition success and involves an analysis time period of only a few days around the acquisition announcement. A stock market index will be used as benchmark for measuring how a firm's shareholder value has performed. The various other criteria for differentiating the success of M&A are again summarized in Figure 2.12, with the choices made for this thesis highlighted in blue.

39 Kindly refer to section 5.2.2 for a more detailed discussion of the benchmark index choices available in event study analyses.

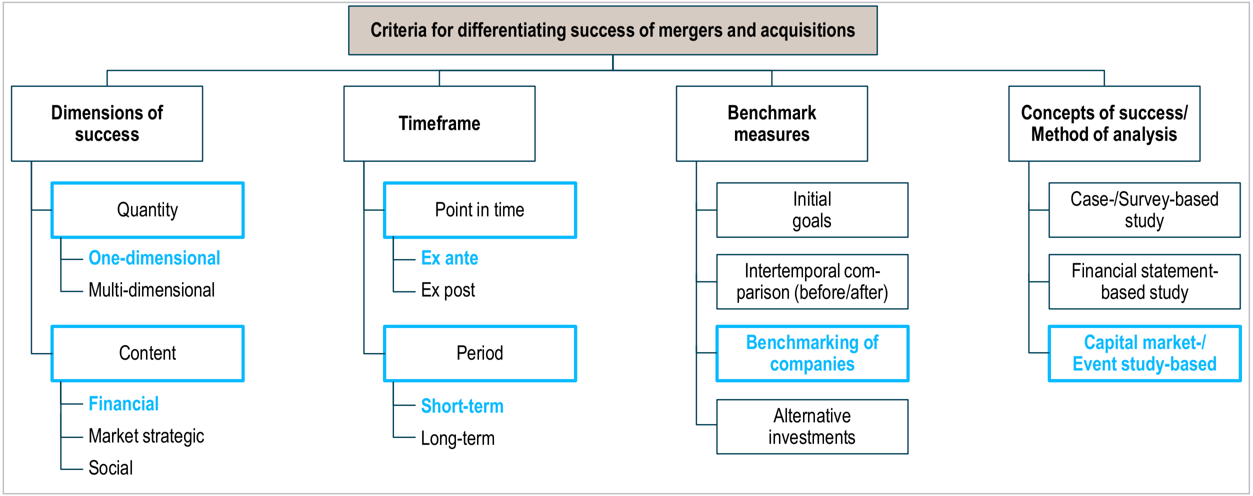


**Fig. 2.12** Criteria for differentiating M&A success

Source: Based on Eisenbarth 2013, p. 220; Gerpott 1993, p. 190; Vogel 2002, p. 274; Wübben 2007, p. 12.

### 2.5.3 Methods for M&A performance research

As indicated in Figure 2.12, M&A scholars also have multiple research methods at their disposal that can be used to measure acquisition performance. These nevertheless vary in their suitability depending on the choices that have been made in terms of dimension of success, timeframe and benchmark measure which is why the research method used in M&A success studies is usually indirectly a result of these earlier decisions. The following section will briefly review all three research methods and outline their distinct benefits and disadvantages.[40]

#### 2.5.3.1 Case- and survey-based research

To make post-acquisition performance measurable, many researchers have chosen to engage in studies that analyze the changes of financial metrics after a transaction (See Cartwright et al. 2012, p. 98). And "although such methods have provided scholars with valuable insights into the antecedents and consequences of acquisitions, they limit scholars' abilities to get "inside" the phenomenon" (Haleblian et al. 2009, p. 492). Despite the extensive efforts of M&A researchers worldwide, isolating a set of factors that can reliably predict acquisition performance continues to be difficult, even though "statistical tests of post-acquisition performance variability strongly suggest that moderating effects are [in fact] present. Researchers simply may not be looking at the 'right' set of variables as predictors of post-acquisition performance" (King et al. 2004, p. 197).

For these reasons, several M&A scholars have called for an increased usage of primary methods of data collection such as observations and interviews to further explore the drivers behind acquisition performance (See Haleblian et al. 2009, p. 492; Meglio and Risberg 2010, p. 88). The primary research methods used in case- and survey-based studies have the unique ability to provide a much deeper understanding of real life organizations than quantitative research methods (See Eisenhardt and Graebner 2007, p. 26; Zheng et al. 2014, p. 4).

Survey-based research in an M&A context usually involves requesting executives who were directly involved in a transaction to provide their assessment of the success of an acquisition (See Cording et al. 2002, p. 36; Wübben 2007, p. 138). This is typically done by asking executives of the acquiring firm to evaluate the extent to which their initial financial as well as non-financial acquisition goals were met post-acquisition (See Papadakis and Thanos 2010, p. 862). Measuring M&A

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40 Bruner (2002) has, in essence, found a similar classification of M&A performance research but has divided studies into four categories of event studies, accounting studies, surveys of executives and clinical studies (i.e. case studies) (See Bruner 2002, pp. 49–50).

performance through a survey comes with multiple unique advantages. Firstly, survey-based research benefits greatly from the fact that the involved managers have a very intimate knowledge of the acquisition as a whole as well as of the drivers of success or failure specifically, which gives scholars access to unique insights that cannot be obtained from any M&A databases or press reports (See Bruner 2002, p. 51). Besides, it allows M&A scholars to perform research on transactions for which information would otherwise not be publicly accessible (See Roediger 2010, p. 116). In addition to this, survey-based research also enables M&A scholars to develop a very fine-grained understanding of what drives M&A success and failure from within a company since the method allows for a multidimensional approach of measuring M&A success (See Cording et al. 2002, p. 36). The method nevertheless also has disadvantages. An obvious concern is that any survey suffers from the subjectivity of respondents, an issue that can fluctuate in magnitude over time or with the amount of direct responsibility a respondent had for initiating a transaction (See Schoenberg 2006, p. 362; Vogel 2002, p. 289). A further issue is that any type of survey is prone to so called 'self-reporting bias' (See Kling and Weitzel 2011, p. 358). Such self-reporting bias occurs due to the fact that survey participants "tend to under-report behaviors deemed inappropriate by researchers or other observers, and they tend to over-report behaviors viewed as appropriate" (Donaldson and Grant-Vallone 2002, p. 246). In an M&A context, this means that managers involved in non-successful deals might not participate in surveys and that such deals might thus be underrepresented (See Wübben 2007, p. 14). But even managers that do participate might either only vaguely recall the details of a deal or might tend to provide an overly positive image of acquisition performance (See Bruner 2002, p. 51; Schoenberg 2006, p. 368).

Case study-based M&A performance research comes with many of the same advantages and disadvantages of survey-based research since this research method ordinarily also involves primary data collection through interviews with individuals that have been directly involved in a transaction. In addition to primary information from survey respondents, a case study usually also relies on supplementary secondary sources of information (e.g. press reports). This process, referred to as data triangulation, is intended to ensure the quality of research output and should enable the generalization of findings from few case studies to a larger population (See Reddy 2015, p. 12).[41] It may also enable researchers to obtain an even more fine-grained picture of an M&A transaction when compared to survey data. Potential

41 'Data triangulation' refers to the common practice in social sciences to combine multiple research methods in order to improve the accuracy of findings, by gathering data on the same phenomenon from various sources (See Jick 1979, p. 602).

issues that can arise are related to the very small sample size of usually only a few M&A transactions or the possibility that researchers' own bias might flaw the case study results (See Cording et al. 2002, p. 36).

Even though applying survey- or case study-based research methods has many merits, neither method is well suited for the research purpose of this thesis. Firstly, this thesis aims to produce generalizable findings on how EMNCs from a diverse set of emerging markets perform when acquiring firms in the developed world. This will require the analysis of a large sample of acquisitions across various countries, which is not feasible with case study research. While a survey would allow for larger acquisition sample sizes, the method has proven to be problematic in emerging market settings. The reliability of respondents from emerging economies is thought to be more limited due to general language problems and possible issues of local executives with understanding survey terms and concepts common in Western corporations (See Hoskisson et al. 2000, p. 258). Moreover, prior studies involving emerging market firms have struggled with very low survey response rates, despite efforts from researchers to contact potential participants directly (See Barnard 2010, p. 170).

#### 2.5.3.2 Financial statement-based research

A separate M&A literature stream has relied on financial statement-based metrics in order to gain a more profound understanding of M&A performance. In these types of studies, accounting metrics such as the return on equity, return on sales or return on assets are used, usually over a multi-year period, to measure improvements in financial performance (See Cording et al. 2002, p. 36). The key goal of these studies is to test if the financial situation of companies engaged in M&A has improved after an acquisition when compared to a control group, involving either before-and-after comparisons or firms that are similar in size and industry but did not engage in M&A (See Bertrand and Betschinger 2012, p. 419; Bruner 2002, p. 50; Kumar 2009, p. 148; Papadakis and Thanos 2010, p. 861; Settnik 2006, p. 218).

Thanos and Papadakis (2012) identified three central reasons why management scholars choose accounting-based measures for their M&A performance research (See Thanos and Papadakis 2012, pp. 112–113):

1. **Measures of actual performance**: By looking at performance metrics that are derived from financial statements researchers can measure the actual 'ex post' performance of a merged entity, while capital market-based methods rely on investors' expectations of the future.
2. **Multidimensional analyses**: Researchers can analyze a diverse set of financial ratios measuring aspects of financial profitability as well as operational efficiency

and effectiveness, which can provide a more comprehensive picture of M&A performance than other methods.

3. **Synergy evaluation**: As synergies are assumed to be a key motive for M&A, a core question of M&A research is if synergies have actually been realized after deal closing. Accounting metrics can provide a direct indication of this since synergies should become visible in long-term accounting performance improvements (See Hitt et al. 1998, p. 93; Kumar and Bansal 2008, p. 1532).

But the approach also comes with inherent limitations. One problem stems from the fact that acquired firms commonly cease to exist after an M&A transaction. This can make measuring the impact of an acquisition through financial statement-based metrics challenging, especially if the target was much larger than the acquirer (See Kumar 2009, p. 148). Also, the fact that accounting-based research is focused on past performance changes and is hence not forward looking can be seen as a disadvantage (See Cording et al. 2002, p. 36). Likewise, the availability of accounting-data can become a problem for smaller firms that are not publicly listed or traded in more unsophisticated markets, particularly outside of the United States and Europe (See Roediger 2010, pp. 113–114). It has also generally been questioned, whether accounting figures can capture the true value generation of an acquisition since performance metrics derived from financial statements are usually not adjusted for changes in operational volatility or for other financial risks such as bankruptcy risk (See Cording et al. 2002, p. 36; Pauser 2007, p. 70; Picken 2003, p. 59).

Especially relevant for this thesis, however, is the issue that accounting-based studies are only as reliable as the financial statements they are based on, which can become particularly problematic in studies of both listed and unlisted firms from emerging markets (See Akben-Selcuk and Altiok-Yilmaz 2011, p. 2; Chen et al. 2001, p. 2; Hoskisson et al. 2000, pp. 258–259; Zhou 2007, p. 586). The difficulties that frequently arise in cross-national studies and studies on cross-border M&A due to international differences in accounting standards also make an accounting-based approach of measuring M&A performance challenging to use in an analysis of EMNCs' cross-border acquisitions (See Bruner 2002, p. 51; Thanos and Papadakis 2012, pp. 113–114). For these reasons, the financial statement-based research method is also not compatible with the research goals of this thesis.

#### 2.5.3.3 Event study-based research

The most commonly used tool for measuring M&A performance is the capital market-based event study method (See for example Cartwright et al. 2012, pp. 98–99; Cartwright and Schoenberg 2006, pp. S2-S3; Das and Kapil 2012, p. 288; Zollo and Meier 2008, p. 56). Such studies assess whether a specific event, in this case an acquisition announcement, has created abnormal stock returns, meaning if observed stock returns around the announcement were higher than what could have otherwise been expected based on a particular stock return model (See Fama et al. 1969; Lubatkin and Shrieves 1986, p. 499). The event study method has been selected as the research method for this thesis for multiple reasons, some of which have made it the most accepted empirical method for measuring M&A performance in the research community (See Settnik 2006, p. 205).[42]

One of its key benefits is that it is based on stock price data which has been considered to be "the only direct measure of stockholder value" (Lubatkin and Shrieves 1986, p. 499). Event studies are also widely regarded as relatively objective methods for measuring acquisition performance, since they are neither based on potentially subjective data from survey- or case-study participants nor on possibly inconsistent or even manipulated accounting data (See Pauser 2007, p. 71). Instead, event studies use the capital market's unbiased and rational expectations of how an acquisition will impact a firm's future cash flows to evaluate the success of an M&A transaction (See Cording et al. 2002, p. 36; Datta 1991, p. 68; Haleblian et al. 2009, p. 493; Schoenberg 2006, p. 362). The method assumes information efficient markets and hence market valuations that reflect the current and future economic situation of a firm sufficiently well at any point in time (See Vogel 2002, p. 282). Stock prices have even been stated to have the ability to 'see through' any attempts to manipulate reported accounting metrics (See Lubatkin and Shrieves 1986, p. 499).[43] In contrast to accounting-based studies, event studies are forward looking 'ex ante' analyses of M&A performance (See Bruner 2002, p. 51; Settnik 2006, p. 205). They also have certain characteristics that have attracted criticism. These are mostly related to the key assumptions underlying the method (i.e. market efficiency, unanticipated events and no interfering events) as well as potential difficulties of implementing the method properly in actual M&A research applications (e.g. due to illiquid trading or event-date uncertainty). The key issues will be addressed in more detail in section 5.4 while more general points of criticism will also be presented in section 5.6.

Even though several points of criticism might exist, the event study method is the research methodology that is best suited for the context of this thesis. An event study makes it possible to analyze the M&A performance of large samples of several hundred emerging market acquirers which, in turn, should make the

42 For more insights on potential issues as well as the advantages and disadvantages of the method, kindly refer to sections 5.4 and 5.6.

43 For a more detailed discussion of the efficient market hypothesis underlying event study research, kindly refer to section 5.4.1.1.

resulting findings highly generalizable. At the same time, the data required for such a large-scale analysis, covering acquirers and targets from multiple emerging economies around the globe, is relatively accessible through M&A databases and other publicly available sources (See Wübben 2007, p. 132). Even more importantly, the event study method comes with the unique advantage that the acquisition performance of firms from various countries engaged in acquisitions across borders becomes comparable without having to adjust for possible issues such as differences in international accounting standards.[44] While it might thus not be the perfect research method for measuring M&A performance, it is the method that is most suited for answering the research questions posed by this thesis.

The strengths and weaknesses of all three M&A performance research methods are again summarized in Figure 2.13.

| | Case- and survey-based studies | Financial statement-based studies | Capital market-based event studies |
|---|---|---|---|
| **STRENGTHS** | > Intimate familiarity of involved managers with specific acquisitions<br>> Can yield insights that might not be known publicly<br>> Well suited for 'explorative' research of moderators of M&A success | > Credibility of findings due to audited financial accounts as basis of research<br>> Relative ease of data availability<br>> Lower risk of selection bias since firms under analysis do not have to be publicly listed | > Direct and comparable measure of value created for investors<br>> Ease of data availability due to focus on publicly listed firms<br>> Objective and forward looking measure of value creation implicitly based on cash flows |
| **WEAKNESSES** | > Recollection of historical events might be 'hazy' or even biased<br>> Difficulty of access to involved firms and/or low response rates of involved managers in particular in an emerging market environment | > Possibility of non-comparability of data due to differences in accounting principles over time as well as across countries<br>> Backward looking nature of financial reports<br>> Possibility of inadaquate disclosure of companies | > Requires significant assumptions (e.g. efficiency of stock markets)<br>> Vulnerable to confounding events which could skew results<br>> Lack of insights on long-term effects of M&A activity |

**Fig. 2.13** Comparison of possible research approaches on M&A performance

Source: Based on Bruner 2002, p. 51; Cording et al. 2002, p. 36.

44 Also multi-country event studies can impose certain methodological problems, for example, due to the fact that stock markets differ in size and liquidity. For a more detailed discussion of potential issues of multi-country event studies and related mitigation measures, kindly refer to Campbell et al. 2010, p. 3078.

### 2.5.4 Summary of prior findings of event study-based research on M&A performance

The question whether or not M&A activity is on average successful or unsuccessful has proven to be an incredibly complex and difficult one to answer – despite decades of M&A research (See Bruner 2002, pp. 64–65). Summarizing the results of the mountains of research that have so far been published on the performance of M&A acquisitions is therefore beyond the scope of this thesis, but other literature reviews across several streams of M&A research have indicated consistently high failure rates of M&A transactions (See Cartwright and Schoenberg 2006, pp. S1-S2).

Due to the fact that this thesis will employ a capital market-based approach to M&A performance research and will quantify M&A performance through its wealth effects on acquiring shareholders, a brief literature review will be focused on previous findings of studies that have applied the same research method.[45] And even within this more specific area of M&A research, the number of previously published studies remains so enormous – each study with a slightly different focus in geography, industry or time period – that it is reasonable to use previously published meta-analytic syntheses of this vast body of research to gain a more thorough understanding of how M&A impacts acquiring shareholders' wealth.

#### 2.5.4.1 General findings on M&A performance

An early meta-analysis of M&A performance research was published in 1992 by Datta et al., who reviewed the M&A wealth effects that had been identified in 41 previously published empirical studies, all of which were based on different data sources, sampling criteria and time periods (See Datta et al. 1992, p. 73). Datta et al. (1992) found that while bidding shareholders experienced a slightly positive wealth effect of +0.39 percent in a time period of 10 days before and 10 days after the transaction, they actually lost -0.54 percent in shareholder value in the week following the acquisition announcement (See Datta et al. 1992, pp. 75–77). They thus concluded that the "synthesis of *ex ante* event studies presented in this paper provides robust evidence that, on average, shareholders of bidding or acquiring firms do not realize significant returns from mergers and acquisitions" (Datta et al. 1992, p. 80).

Bruner (2002) also reviewed the findings of prior studies on M&A performance using market-based returns to shareholders. He studied 44 papers published be-

45 For a meta-analysis of findings from other research streams, i.e. including research applying accounting-based or case-study based research, kindly refer to Bruner 2002, pp. 48–68.

tween 1977 and 2001 and discovered that their findings indicated an almost even distribution of shareholder wealth returns. Approximately one third of studies (13 studies) concluded that M&A had a negative impact on acquiring shareholders' wealth, one third (14 studies) found that no change in shareholder wealth had occurred for acquirers and one third (17 studies) concluded that M&A activity had increased acquiring shareholders' wealth (See Bruner 2002, pp. 53–55). Bruner thus concluded that "in the aggregate, abnormal (or market-adjusted) returns to buyer shareholders from M&A activity are essentially zero" (Bruner 2002, p. 56).

In 2004, King et al. performed one of the most comprehensive meta-analyses of prior M&A studies to date (See Homberg et al. 2009, p. 82). They reviewed the findings of 93 previous M&A performance studies published between 1921 to September 2002, analyzing a combined sample of up to 29,050 acquisitions (See King et al. 2004, pp. 188–189). Their extensive analysis reconfirmed that while acquiring shareholders earned very small, but significantly positive, abnormal returns on the day of acquisition announcement, these returns were either insignificant or negative for all subsequent event windows after the acquisition (See King et al. 2004, p. 195). They thus also concluded that "on average and across the most commonly studied variables, acquiring firms' performance does not positively change as a function of their acquisition activity, and is negatively affected to a modest extent" (King et al. 2004, p. 187).

#### 2.5.4.2 Specific findings on cross-border M&A performance

While acquisitions used to occur to a large extent within the borders of a country, an increasing level of globalization has contributed to a surge in cross-border M&A activity (See Shimizu et al. 2004, p. 307).[46] Such cross-border acquisitions (CBAs) are an important and versatile tool that can be used by corporations for multiple strategic purposes. By engaging in an acquisition across national borders a company might, for example, be able to further grow its business into a new market. As such, a transaction might allow it to leverage its existing set of capabilities in a better way, e.g. via an extended distribution network (See Hitt and Pisano 2003, p. 134; Shimizu et al. 2004, p. 309). A transaction across borders could also be motivated by obtaining entirely new capabilities that cannot be easily replicated by the acquiring company and that are currently not available in its respective home country, such as rare and proprietary technologies (See Anand and Delios 2002, p. 121).

46 The term 'globalization' applies when a company's activities are managed on a global scale and not just in a few selected countries, therefore involving global integration and coordination of efforts (See Singal and Jain 2012, p. 444).

Academic research on the capital market reactions of cross-border mergers and acquisitions has indicated that their wealth effects might be different from the wealth effects of domestic acquisitions (See Shimizu et al. 2004, p. 336). Several early studies have revealed that shareholder wealth was created in the case of U.S. firms acquiring non-U.S. targets (See Markides and Oyon 1998, p. 129; Morck and Yeung 1992, pp. 48–49). Also, non-American acquirers have been shown in several studies to display positive and significant abnormal returns of up to two percent when buying targets in the United States (See Cakici et al. 1996, p. 326; Eun et al. 1996, p. 1581; Kang 1993, pp. 354–355). More recent studies have also produced contradicting results, showing that returns to acquirers in cross-border acquisitions might also be insignificantly different from zero or even negative (See Aw and Chatterjee 2004, p. 341; Moeller et al. 2005, p. 758; Uddin and Boateng 2009, p. 442). It must therefore be stated that, similar to the more general research on acquirers' shareholder wealth, evidence on the wealth effects of cross-border transactions for the bidding firm's shareholders also remains inconclusive (See Rani et al. 2014, p. 90).

## 2.6 Summary

The past section constituted a detailed exploration of the phenomenon of mergers & acquisitions along several dimensions and was intended to lay the theoretical groundwork for the rest of this thesis. An important element of this past section was the establishment of a clear definition of several key terms, such as the term 'M&A' itself, but also the review of various categories of M&A activity that have found relevance in M&A research. The section also studied the six major waves of M&A activity that have occurred over the last century, primarily in order to demonstrate that no universal driver of M&A activity exists but that the key motives behind M&A activity have always changed – and will likely continue to change – over time. Also the various phases of M&A activity were discussed in an attempt to demonstrate the multitude of complicated activities across the various stages before, during and after a transaction that all have to be executed as flawlessly as possible in order to guarantee acquisition success.

The most important element of the past section was the detailed exploration of the concept of 'M&A performance'. This included the clear definition that 'M&A performance', for the purpose of this thesis, will be focused on M&As' wealth effects on acquiring shareholders, a perspective that has been common in prior M&A research. After a review of several methods for M&A performance research, meta-analyses of capital market-based studies of M&A performance were presented. In summary, this research has indicated that acquiring shareholders apparently do not benefit significantly from acquisitions. The M&A performance literature presented up until now has, however, been fixated on the developed world, with a strong concentration of interest on acquirer and target firms from the U.S. and the U.K. (See Cartwright and Schoenberg 2006, pp. S1-S2). The next chapter will demonstrate why it has become of utmost importance for researchers to broaden this focus and to begin including more firms from emerging markets in their research on the causes and effects of M&A performance.

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