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INTENDED VS. ACHIEVED OBJECTIVES IN MERGERS AND ACQUISITIONS

ABSTRACT

This paper examines objectives of mergers and acquisitions and their realization rate in the post-merger integration in Slovenia. The results of this study suggest that acquiring companies were on average more successful than their counterparts in developed countries due to several specific factors such as the size and transition nature of the Slovene economy, a variety of unconsolidated industries after market liberalization in the early nineties and a limited number of possible transactions in the region. The study suggests further that executives, especially in transition economies, should see choosing the right partner in an adjacent industry and in the market space that is adjacent to their existing businesses as a better approach to pursue.

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1. INTRODUCTION

Acquisitions are commonly defined as the purchase of one company by another where the buyer maintains control. Mergers, by contrast, are commonly defined as the consolidation of two previously separate companies into a single organization. Global mergers and acquisitions (M&A) has reached $4.35 trillion (Thomson Financial, 2006) and is growing in the number and size of individual deals. While larger deals make the headlines, smaller and mid-market deals make up the breadth of the M&A activity. The current mergers and acquisitions activity is part of the fifth M&A movement and is expected to continue at a brisk pace in the future.

Intensified global competition, continual technological innovation and disruptive changes mean that companies are having to re-examine their traditional conduct (i.e., strategies,

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tactics and behavior) and their traditional structure (i.e., resources, positions and constraints) in order to gain a favorable outcome for their businesses (Bruner, 2004).

Most companies see M&A as an addition, not a substitution, in their quest for profitable growth (Feldman and Spratt, 1999). In fact, external growth is customarily built on a base of a strong and efficient operation expansion as a response to a changing business environment, which is characterized by increasing complexity, uncertainty and discontinuity (Chung et al., 2006; Patel, 2007).

Clearly, M&A are the growth strategy of choice (Early, 2004; Firstbook, 2007; Jackson, 2007), but they are no easy path to riches or career advancement (Bruner, 2004). For some, the impulse to buy other businesses is even a sign of weakness (Nolop, 2007). By and large, the track record of M&A is abysmal; most deals fail to accomplish major strategic objectives. The lackluster results may be due to several root causes – paying the wrong price, buying for the wrong reason, selecting the wrong partner or buying at the wrong time (Marks, 1997). Most deals face many challenges and success in M&A is by no means assured; in fact, no evidence indicates that they are more profitable than alternative investments. The unclear net effect of M&A is a matter of ongoing debate among academic researchers and, despite a number of studies, a need exists for continued research on this subject (Hassan et al., 2007).

This paper aims to develop a better understanding of the intended objectives in M&A activity in Slovenia and their actual realization level in the post-merger integration period. Discussion about M&A activity and its impact on companies in developed economies is commonplace. However, despite numerous papers written about M&A, the challenges facing acquiring companies in emerging economies in Central and Eastern Europe are given little attention. In an ever-increasing competitive environment, a strong focus on increasing the success rate in M&A to enable acquiring companies in Central and Eastern European countries to preserve sustainable development is required.

The paper is organized as follows. The next section summarizes the findings of recent research on the success rate of M&A. The third section addresses the motives for M&A activity, and it is followed by an explanation of the research methodology and sample. The final sections discuss the findings and conclusion.

2. CURRENT SUCCESS RATE IN M&A

The conventional wisdom has been that takeover targets are under-performers which attract capital market discipline. This perspective leads to the inefficiency hypothesis that M&A are motivated by a desire to correct and gain from target inefficiency. From the other perspective, acquiring companies can obtain a new set of valuable capabilities possessed by the acquired companies and do not need to develop them internally (Ahuja and Katila, 2001; Casal and Fontela, 2007).

In the push for competitive superiority and rapid organizational growth billions of dollars are spent each year on M&A but only with mixed results. Empirical studies of many scholars suggest that more than half of them fail to produce results; at best they are break-even situations (Marks and Mirvis, 1992, 1998; KPMG 1999; Schraeder and Self, 2003). Nearly two-thirds of companies lose market share in the first quarter after a merger (Harding and Rouse, 2007). In the first four to eight months that follow the deal, productivity may be reduced by up to 50 percent (Huang and Kleiner, 2004). A major McKinsey & Company study found that 61 percent of acquisition programs were failures because the acquisition strategies did not earn a sufficient return (cost of capital) on the funds invested (Sirower, 1997). Between 55 and 77 percent of all M&A fail to deliver on the financial promise announced when the merger was initiated and some 40 percent of cross-border mergers among large companies end in what is termed total failure (Carleton and Lineberry, 2004).

An empirical study conducted in Slovenia by Bertoncelj and Kovač (2007) suggests that the average achievement level of stated objectives within the expected time period of Slovene companies is almost 70 percent, which is better than the performance of acquisitions of American acquiring companies, according to the findings of several empirical studies (Marks and Mirvis, 1998; Schreader and Self 2003). The average achievement level of 25 consummated transactions by Slovene companies in the period between 1997 and 2005 was measured and the response grade average was 3.56 on the scale from 1 (not successful at all) to 5 (fully successful).

A recent Deloitte Research-EIU M&A survey (2007) shows that only 49 percent of corporate acquirers in the U.S. said that over half their deals hit the mark on a timely basis. Given the amount of subjectivity involved, this is a surprisingly low self-rating. Therefore, the motivation for M&A activities, as well as the strategic value-creators that drive the deals in developed and developing economies, are of interest.

3. M&A MOTIVES

M&A activity is not a result of random behavior by executives, but rather motivated by deep forces of change at work in an economy (Bruner, 2004). Thus, to better understand the influence of change forces in the world economy, the aggregate activity over the last 100 years has to be observed. It can be briefly summarized in five periods of heightened activity that show wavelike behavior with worldwide appearance. The appearance of five M&A waves (first in the 1890s, second in the 1920s, third in the 1960s, fourth in the 1980s, and fifth in the 1990s and 2000s) remains one of the ten most important unresolved questions in financial economics (Brealey and Myers, 1996) and there is still a need for a general hypothesis to explain the M&A waves.

Weston and Weaver (2001) identify ten change forces in M&A: an accelerated pace of technological change, reduced costs of communication and transportation, internationalized markets, intensified competition, the emergence of new industries, deregulation, favorable financial environments, problems in individual economies and industries, and inequalities in income and wealth. These change forces have a strong impact and expand the opportunities and risks for companies. In response to an ever-changing environment, companies use a wide range of adjustments to create further dynamism in their activities with a focus on expansion and growth (mergers, tender offers, joint ventures, alliances, investments, franchising, supplier networks). Financial theory implies that M&A occur in the quest of positive synergistical effects, such as gaining fast access to new technologies and/or new markets, benefiting from economies of scale in research and/or production, tapping into sources of know-how located outside the boundaries of the firm and, finally, monopoly type advantages (Vos and Kelleher, 2001).

There is still no dominant hypothesis with realistic potential to scientifically rationalize a set of different, sometimes even offsetting motives in takeovers. Lubatkin (1983) and Vos and Kelleher (2001) segment M&A motives into seven theoretical areas: monopoly, efficiency, valuation, empire building, process, raider and disturbance.

Although a great deal of time and money can go into closing a deal, a merger or acquisition is not an end in itself, it is rather a process. A successful outcome to this process starts with the setting of M&A objectives and extends beyond the closing of the deal until the desired results have been achieved. Objectives such as enhancing revenues and profitability, adapting to disruptive changes, responding to continual technological innovation pressures, extending global reach and gaining access to new markets are generalizations that could apply to just about any merger or acquisition today.

What strategic rationale causes Slovene companies to merge with and acquire other companies? Due to the small size and transition nature of the Slovene economy, a variety of unconsolidated industries after market liberalization in the early nineties and a limited number of possible transactions in the region, it is argued that Slovene companies pursued the adjacent M&A strategy as the strategy of first choice, rather than the diversification strategy. It is argued further that Slovene acquiring companies should have been more successful in the last decade than their counterparts in developed economies, which have opted for more diversification as their growth strategy. Empirical evidence in the U.S. (Nolop, 2007) suggests that local extensions of current businesses into adjacent market space is a better approach to pursue by acquiring companies. In this respect we examined what the strategic motivations of Slovene companies were in the transition period when embarking on M&A activity, and their success rate after the completed post-merger integration process.

4. RESEARCH METHODOLOGY

This section consists of the methods used in collecting data and related statistical analyses. Limitations of the study and the need for further research is presented. The study employs a standardized Likert-scale type survey. The survey items were originally prepared in Slovene and then translated into English by using the back-translation method. Slovenia was chosen for the reason that it is in transition from a planned economic system to a free market through liberalization, stabilization, restructuring, and privatization and is, therefore, a good representative of a transition economy. The case of Slovenia has some potential value to other transition economies, not only for Eastern European economies, but even for one as big as the Chinese economy.

To achieve the main research objective, the study attempts to seek answers to the following hypothesis:

H_1: The average achievement level of Slovene acquiring companies is better than that of their counterparts in developed economies due to more adjacent deals and less diversification.

Data Collection

Most of the data required to measure the importance of particular M&A objectives and their realization in the post-acquisition period are not available from archival sources. Therefore, the data were gathered through a mail survey of executives. The survey was prepared, tested and mailed to altogether thirty-five randomly selected companies in different sectors of industry in the target population of Slovene companies with more than 250 employees and revenues of more than 5 million euros (1 billion Slovene tolars at the time) that had consummated at least one deal in the period between 1997 and 2007. A total of fifteen companies were in manufacturing (pharmaceuticals, cosmetic products, food and condiment products, textile products, glass and glass products, fabricated metal products, wood processing, electric and IT components) and a total of eight companies were in services (fast moving consumer goods, wholesale of pharmaceuticals and cosmetic products, transport, handling and storage, market research and business consultancy). From those sent, twenty-three usable surveys were retrieved, meaning a response rate of 65.7 percent. Altogether twenty-one of the studied companies were founded before 1991 when Slovenia gained its independence and started the transition towards a market economy including the privatization of the socially owned companies and the development of the capital markets, which both generated the necessary conditions for M&As to take place. Though the sample is rather small due to the size of Slovene economy and limited number of acquiring companies, the companies are good representatives of different industry branches and offer space for some general conclusions concerning SMEs in Slovenia.

To obtain further information necessary to complete the study, it was decided to interview executives. Sampling was purposive; only those executives who had been included in the acquisition process from the very beginning and were aware of strategic factors that determined the transaction were interviewed. The meetings permitted a better appreciation of how acquiring companies manage M&A projects and improved the degree of understanding of the various questions posed in the research. During the interviews the content of the survey and the wording of the various items were discussed in order to ensure that they were understood and interpreted accurately.

The responses of the executives were recorded on a Likert scale which was scaled in the case of the examination of the intended M&A objectives as follows: 1 = no importance, 2 = slight importance, 3 = moderate importance, 4 = large importance and 5 = extreme importance. In the examination of the intended M&A objectives, respondents were asked to rate each of sixteen objectives based on their importance in the planning phase (pre-acquisition period).

Further, respondents were asked to rate same objectives based on their realization in the post-acquisition phase. In the case of the examination of the realization of the planned M&A objectives, the Likert scale was scaled as follows: 1 = no realization at all, 2 = slight realization, 3 = moderate realization, 4 = high realization and 5 = complete realization.

Limitations and Future Research

The results should be interpreted with caution due to the size of the sample and the measurement of the constructs. However, given that the constructs cannot be measured directly using archival data, reliance on a key informant is often necessary. Further studies are required in order to corroborate the results and to explore these relationships in other transition economies in the region. The results obtained could be affected by the cultural context and not be extrapolated to other contexts. A possible weakness of our approach was that executives could try to ex-post rationalize their actions by assigning better grades for the realization of individual objectives. Despite these limitations, the authors believe that the study helps to better understand which objectives are deal drivers in the eyes of Slovene executives and how they see their actual realization level after concluding the integration process.

Findings and Discussion

Traditionally, executives link M&A to corporate strategy. In a traditional model, companies set strategic objectives on their own or with the help of outside consultants, and then identify and buy one or more targets to reach them. It is argued that acquiring companies should develop a more disciplined approach toward their M&A activity. In order to avoid costly mistakes, which are to some extent inevitable in this business, they should focus on areas that have greater potential for sustainable growth and profitability. In other words, they should objectively identify the right targets with such potentials for economies of scale and growth of market share in the existing and new markets.

As it is clearly visible in the following table, the leading motives of Slovene acquiring companies are related to their market objectives, such as growth in market share and access to new markets, both combined with an economies of scale objective. The other two leading motives that are high on the priority list are also closely related to market strategy of rapid growth, such as elimination of competitors as many industries in the post-transition economy were in the process of consolidation and access to distribution channels.

Table 1

Intended M&A objectives in decreasing order according to average grades

INTENDED OBJECTIVES	Averages	St.Dev.	Variance	Range	Min	Max
Growth in Market Share	4,78	0,422	0,178	2	4	5
Access to New Markets	4,39	0,783	0,613	3	3	5
Elimination of Competitor	3,57	0,945	0,893	5	1	5
Access to Distribution Channels	3,48	0,898	0,806	4	2	5
Reduction in Operating Expenses	3,22	0,600	0,360	3	2	4
Access to Suppliers	3,22	0,951	0,905	4	2	5
Enhanced Reputation	2,96	0,825	0,680	3	2	4
Access in New Products	2,87	0,869	0,755	3	2	4
Access to Talent	2,70	0,974	0,949	5	1	5
Access to Know-how	2,70	0,926	0,858	4	1	4
Reduction in Production Costs	2,70	0,703	0,494	3	2	4
Access to New Brands	2,57	0,590	0,348	3	2	4
Access to Production Capacity	2,48	1,039	1,079	5	1	5
Access to New Technologies	2,17	0,778	0,605	4	1	4
Reduction in Distribution Costs	2,13	0,869	0,755	4	1	4
Entry to New Industry	1,39	0,583	0,340	3	1	3

Source: Authors

Clearly, Slovene executives are seeking, or at least planning, revenue synergies ahead of cost synergies. Plenty of evidence suggests that platform acquisitions are often pursued, such as becoming a market leader and/or growing faster than the market. Cost savings as a strategic objective ranks relatively low, for example reduction in operating expenses ranks fifth, reduction in production costs ranks eleventh and reduction in distribution costs ranks fifteenth on the list of the sixteen most important intended M&A objectives in decreasing order according to average grades.

The study suggests that the intended M&A objectives of Slovene companies and their ranking are very similar to those of American acquiring companies (Feldman and Pratt 1999), which comes as no surprise. Almost all acquiring companies, at least in the planning phase up to closing, have similar market oriented objectives. The rationale lies in compelling growth strategy and the story holds together nicely when it is communicated to the internal and external public regardless of the environment of either a developed or emerging economy.

Despite the poor execution of business plans (i.e., of intended M&A objectives) in the post-merger integration, the average achievement level of Slovene acquirers is still better than that of their U.S. counterparts. Why is that so?

It is argued that this is due to the more open Slovene market since the liberalization in the early nineties and, therefore, increased competition among fragmented local and new foreign players. It was a logical move of domestic players to enhance their existing market presence through acquiring or merging with local competitors. In this way, they could have taken advantage of the tacit strengths and knowledge of their companies otherwise so often ignored by practitioners and deal facilitators (investment bankers). With nineteen out of twenty-three randomly selected and studied acquisitions in adjacent industry, Slovene acquirers have gone a long way toward making the post-merger integration work and eventually capitalize in the end. At least by a fraction more than their U.S. counterparts, which more often diversify and go into remote territories and eventually lose some shareholder value due to fewer appropriate and available (adjacent) targets in market economies than in transition economies (Bertoncelj and Kovač, 2007; Deloitte Touché Tohmatsu, 2007; Nolop, 2007).

The study finds that the most sought after objectives are not the most-achieved ones as can be seen in the following table of the achieved M&A objectives in decreasing order according to average grades by decreasing order (see Table 2).

Table 2.

Achieved M&A objectives in decreasing order according to average grades

ACHIEVED OBJECTIVES	Averages	St.Dev.	Variance	Range	Min	Max
Growth in Market Share	4,13	0,920	0,846	5	1	5
Access to New Markets	4,04	0,825	0,680	3	3	5
Elimination of Competitor	3,91	0,996	0,992	5	1	5
Access to Distribution Channels	3,61	0,941	0,885	4	2	5
Access to New Brands	3,13	0,815	0,664	4	2	5
Access in New Products	2,70	1,020	1,040	4	1	4
Reduction in Operating Expenses	2,35	1,191	1,419	5	1	5
Reduction in Production Costs	2,35	0,832	0,692	4	1	4
Enhanced Reputation	2,17	0,778	0,605	3	1	3
Access to Production Capacity	2,13	0,694	0,482	3	1	3
Reduction in Distribution Costs	2,09	0,596	0,356	3	1	3
Access to New Technologies	2,04	0,475	0,225	3	1	3
Access to Suppliers	1,87	0,626	0,391	3	1	3
Access to Talent	1,74	0,810	0,656	4	1	4
Access to Know-how	1,35	0,573	0,328	3	1	3
Entry to New Industry	1,17	0,388	0,150	2	1	2

Source: Authors

The strategic objective of entering into a new industry was the lowest of all M&A objectives on the agenda of Slovene executives, thus giving diversification hardly any preference. Even those companies that made certain, although very limited attempts, of diversification into unrelated territory had not been successful, the responses in all cases were no realization at all or only slight realization.

The ranking of achieved M&A objectives is surprisingly similar to the ranking of previously set M&A objectives, but it comes as no surprise that the average achievement level is much lower than previously envisioned by executives of acquiring companies in the planning and executing phase. On only three counts – elimination of competitor, access to distribution channels and access to new brands - acquiring companies were better off than initially planned. Two out of three achieved strategic objectives - elimination of competitor and access to distribution channels - were closely linked to the consolidation process of specific industries; smaller competitors or competitors that had not yet adjusted to the market economy were eliminated with horizontal mergers or acquisitions in order to gain economy of scale, and with forward vertical mergers or acquisitions in retail segments better access to customers was gained.

The most important deal driver was intended growth in market share, which received the highest average grade of all M&A objectives and had the lowest standard deviation, showing very high level of unanimity among Slovene executives about their primary objective in M&A activity. Similarly ranked was access to new markets, due to the small size of the Slovene economy and wide-spread attempts of Slovene companies to re-enter markets of the former common market of Yugoslavia.

The strategy of entering adjacent territories as a logical extension of current operations, due to the similar cultural and language mix as well as historical ties (although nowadays Slovene companies boast more powerful technological, financial and marketing capabilities than their local counterparts), enables Slovene companies to benefit, at least short term, from these competitive advantages.

Given all these benefits, it is obvious why all the studied M&A were consummated either on the domestic market in adjacent industries or in adjacent industries of adjacent markets of the former Yugoslavia in the period from 1997 to 2007.

Keeping in mind these unique competitive advantages of Slovene companies, at least in the transition period, it comes as no surprise that executives clearly disfavor untested and unrelated industries and territories, so entry to a new industry as way of diversification received the lowest average grade of all M&A objectives with low standard deviation, showing a very high level of unanimity among Slovene executives about the low priority of any kind of diversification.

Statistically significant differences (<0.05) between the intended and achieved M&A objectives tested with a t-test and double-checked with the Wilcoxon rank test can be observed in the following pairs: growth in market share, reduction in operating expenses, access to suppliers, enhanced reputation, access to talent, access to know-how and access to new brands. All of them but access to new brands were under-achievers (see Table 3).

Table 3.

Paired samples test

Pairs	Intended vs. Achieved Objectives	Paired Differences					t	Sig. 2-tailed
		Mean	Std. Dev.	Std. Error Mean	95% Confidence Interval of the Difference			
					Upper	Lower		
Pair 1	Growth in Market Share	0,652	0,714	0,149	0,343	0,961	4,380	0,000
Pair 2	Access to New Markets	0,348	1,112	0,232	-0,133	0,829	1,500	0,148
Pair 3	Elimination of Competitor	-0,348	1,335	0,278	-0,925	0,230	-1,249	0,225
Pair 4	Access to Distribution Channels	-0,130	1,424	0,297	-0,746	0,485	-0,439	0,665
Pair 5	Reduction in Operating Exp.	0,870	1,392	0,290	0,268	1,471	2,997	0,007
Pair 6	Access to Suppliers	1,348	1,112	0,232	0,867	1,829	5,811	0,000
Pair 7	Enhanced Reputation	0,783	1,242	0,259	0,246	1,320	3,023	0,006
Pair 8	Access in New Products	0,174	1,267	0,264	-0,374	0,722	0,658	0,517
Pair 9	Access to Talent	0,957	1,147	0,239	0,460	1,453	3,998	0,001
Pair 10	Access to Know-how	1,348	1,112	0,232	0,867	1,829	5,811	0,000
Pair 11	Reduction in Production Costs	0,348	1,112	0,232	-0,133	0,829	1,500	0,148
Pair 12	Access to New Brands	-0,565	0,788	0,164	-0,906	-0,225	-3,441	0,002
Pair 13	Access to Production Capacity	0,348	1,369	0,285	-0,244	0,940	1,219	0,236
Pair 14	Access to New Technologies	0,130	0,869	0,181	-0,245	0,506	0,720	0,479
Pair 15	Reduction in Distribution Costs	0,043	1,065	0,222	-0,417	0,504	0,196	0,847
Pair 16	Entry to New Industry	0,217	0,518	0,108	-0,007	0,442	2,011	0,057

Source: Authors

5. CONCLUSIONS AND MANAGERIAL IMPLICATIONS

Every executive has a profound interest in creating value with M&A. Despite their popularity, about half of all deals actually achieve the desired strategic or financial objectives. Although many in-depth studies have been performed, only a few have offered non-ambiguous conclusions.

M&A should be carefully planned and nothing should be left to chance. What matters is the net sum of what they accomplish. Plenty of evidence, including the results of our study, suggest that a better approach for acquiring companies to pursue is what are called adjacencies to current existing business, especially those with high growth potential and without cycles and seasons.

Zook (2001) and Nolop (2007) suggest that adjacent M&As as well as other adjacent growth initiatives correlate with increased shareholder value. On the other hand, diversification into unrelated areas correlates with decreased shareholder value.

The study suggests that executives should see choosing the right partner in an adjacent industry and in a market space that is adjacent to their existing businesses as the most important factor for success in M&A. The more related the target company and the territory, the greater the chances of success; this may be expected as the transfer of knowledge and skills is essential in the integration period.

We are aware that there is a cluster of other variables influencing the aforementioned conclusions and reason that further longitudinal and international studies and in-depth analyses are needed. It would be interesting to compare them with our findings, which is a matter of future studies, preferably in more than one emerging economy of Central and Eastern Europe. However, our analysis does provide a framework for a promising investigation in that field.

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NAMIJENJENI ODNOSNO OSTVARENI CILJEVI U SPAJANJIMA I PREUZIMANJIMA

SAŽETAK

Članak istražuje ciljeve spajanja i preuzimanja te njihov stupanj ostvarivanja u okviru integracija, nakon spajanja, na području Slovenije. Prema rezultatima ovog istraživanja, preuzeta su poduzeća u prosjeku bila uspješnija od istih poduzeća u razvijenim zemljama. Pritom su prisutni određeni čimbenici - veličina zemlje, tranzicijska priroda slovenskog gospodarstva, raznolikost nekonsolidiranih industrija nakon liberalizacije tržišta u ranim Devedesetima te ograničeni broj mogućih transakcija unutar regije. Istraživanje također ukazuje na ulogu rukovoditelja, osobito u okviru gospodarstva u nastajanju, prilikom odabira pravog partnera u susjednoj industriji i na tržišnom prostoru koji je najbliži postojećem poslu.

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Ključne riječi*: Spajanja i preuzimanja, Susjedni poslovi, Ciljevi S&P, Gospodarstvo u nastajanju, Slovenija.*