Why Do Mergers and Acquisitions Quite Often Fail?



DOI: 10.26573/2007.1.1.4
Volume 1, *Number* 1
January 2007, *pp*. 53-69

T. Mallikarjunappa, Panduranga Nayak
Department of Business Administration
Mangalore University
Mangalore, Karnataka, India
(tmmallik@yahoo.com), (pnayak62@yahoo.com)

Abstract: *Corporate mergers and acquisitions (M&As) have become popular across the globe during the last two decades thanks to globalization, liberalization, technological developments and intensely competitive business environment. The synergistic gains from M&As may result from more efficient management, economies of scale, more profitable use of assets, exploitation of market power, and the use of complementary resources. Interestingly, the results of many empirical studies show that M&As fail to create value for the shareholders of acquirers. In this backdrop, the paper discusses the causes for the failure of M&As by drawing the results of the extant research.*

Keywords: Mergers, Acquisitions, Synergistic gains and shareholders value

1. Introduction

The prime objective of a firm is to grow profitably. The growth can be achieved either through the process of introducing or developing new products or by expanding or enlarging the capacity of existing products. External growth can be achieved by acquisition of existing business firm (Ghosh and Das [22]). Mergers and Acquisitions (M&As) are quite important forms of external growth.

The last decade of 20th century has seen substantial increase in both number and volume of M&A activity. In fact, consolidation through M&As has become a major trend across the globe. This wave was driven by globalization, technological changes, and market deregulation and liberalization. Almost all industries are going through reorganization and consolidation. M&A activity has been predominant in sectors like steel, aluminum, cement, auto, banking and finance, computer software, pharmaceuticals, consumer durables, food products, agro-chemicals and textiles (Maheswari [37], Sirower [52]). Generally, M&As aim at achieving greater efficiency, diversification and market power. The synergistic gains by M&A activity may accrue from more efficient management, economies of scale and scope, improved production techniques, combination of complementary resources, redeployment of assets to more profitable uses, the exploitation of market power or any number of value enhancing mechanisms that fall under the general rubric of corporate synergy (Bradley, Desai and Kim [9], Kumar [31]). It is argued that M&As are indispensable strategic tools for expanding product portfolios, entering new markets, acquiring new technologies and building new generation organization with power and resources to compete on a global basis (Yadav and Kumar [59]). M&As may also be undertaken by managers of firm driven by non-value maximizing

motive of empire building or to enhance their prestige by managing a larger post acquisition entity (Malatesta [39], Roll [49]).

Though M&As basically aim at enhancing the shareholders value or wealth, the results of several empirical studies reveal that on average, M&As consistently benefit the target company shareholders but not the acquirer company shareholders. A majority of corporate mergers fail. Failure occurs on average, in every sense, acquiring firm stock prices likely to decrease when mergers are announced; many acquired companies sold off; and profitability of the acquired company is lower after the merger relative to comparable non-merged firms. Consulting firms have also estimated that from one half to two-thirds of M&As do not come up to the expectations of those transacting them, and many resulted in divestitures (Schweiger [50]). In this backdrop, the paper tries to analyse the reasons for the failure of M&As by drawing the results of the extant research.

The structure of the paper is as follows. Section 1 deals with introduction, the section 2 presents the theoretical background of M&As and section 3 focuses on the findings of some of the earlier studies on M&As. Causes of failure of M&As are presented in section 4 and conclusions of the study appear in section 5. References are given in section 6.

2. Theoretical background of Mergers and Acquisitions

M&As are taking place all over the world irrespective of the industry, and therefore, it is necessary to understand the basic concepts pertinent to this activity. The term merger involves coming together of two or more concerns resulting in continuation of one of the existing entities or forming of an entirely new entity. When one or more concerns merge with an existing concern, it is the case of absorption. The merger of Global Trust Bank Limited (GTB) with Oriental Bank of Commerce (OBC) is an example of absorption. After the merger, the identity of the GTB is lost. But the OBC retains its identity. Consolidation or amalgamation involves the fusion of two or more companies and forming of a new company. The merger of Bank of Punjab and Centurion Bank resulting in formation of Centurion Bank of Punjab; or merger of Indian Rayon Ltd, Indo Gulf Fertilizers Limited (IGFL) and Birla Global Finance Limited (BGFL) to form a new entity called Aditya Birla Nuvo is an example of amalgamation. Acquisition is an act of acquiring effective control by a company over the assets or management of another company without combining their businesses physically. Generally a company acquires effective control over the target company by acquiring majority shares of that company. However, effective control may be exercised with a less than majority shareholding, usually ranging between 10 per cent and 40 per cent because the remaining shareholders, scattered and ill organized, are not likely to challenge the control of the acquirer. When the acquisition is ‘forced’ or against the will of the target management, it is generally called takeover. Takeover generally takes the form of tender offer wherein the offer to buy the shares by the acquiring company will be made directly to the target shareholders with out the consent of the target management. Though, the terms ‘merger’, ‘amalgamation’, ‘consolidation’, ‘acquisition’ and ‘takeover’ have specific meanings, they are generally used interchangeably.

Mergers may be horizontal, vertical or conglomerate. Horizontal merger is a combination of two or more firms in similar type of production, distribution or area of business. Vertical merger is a combination of two or more firms involved in different stages of production or distribution. Conglomerate merger is a combination of firms engaged in unrelated lines of business activity. Further, they may be friendly or hostile. Generally, mergers are friendly whereas tender offer takeovers are hostile.

M&As aim at optimum utilization of all available resources, exploitation of unutilized and under utilized assets and resources including human resources, eliminating or limiting the competition, achieving synergies, achieving economies of scale, forming a strong human base, installing an integrated research platform, removing sickness, achieving savings in administrative costs, reducing tax burden and ultimately improving the profits.

3. Literature Review

Lot of research has been undertaken in the area of M&As and on their impact on the shareholders of acquiring and acquired companies in the context of developed countries. There are two research approaches generally employed in addressing the question of impact of M&As on shareholders. One approach is to employ share price data to establish the distribution of gains and losses to shareholders. The other approach is to focus on the profitability of companies involved, using accounting data.

Security price studies are mostly based on event study methodologies that have focused on announcement period returns with an identification of the wealth gains or losses to the various groups of shareholders. A few studies have been undertaken to study the long-run impact of M&As on the shareholders. Findings of most of the studies undertaken to study the impact of M&A activity on shareholders wealth for both short-run and long-run have revealed that M&As fail to create value or wealth for the shareholders of acquiring companies. Findings of earlier studies about the impact of M&As on the shareholders are presented below.

3.1. Stock Price Studies: The results of some of the studies on stock prices are presented in this section.

Dodd [18] finds that stockholders of target firms earn large positive abnormal returns from the announcement of merger proposals i.e. approximately 13 % at the announcement of the offer and 33.96 % average over the duration of the merger proposal (10 days before and 10 days of the announcement). But the stock holders of bidder firms in both completed and cancelled merger proposals experience negative abnormal return of -7.22% and -5.50%, over the duration of the proposals. Firth [20] examines mergers and takeover activity in the UK, specifically, the impact of takeovers on shareholders returns and management benefits. The research shows that mergers and takeovers resulted in benefits to the acquired firms' shareholders and to the acquiring companies' managers but that losses were suffered by the acquiring companies' shareholders. The result of his study shows that takeovers being motivated more by managements' motive rather than the maximization of shareholders wealth.

Porter [44] based on an analysis of acquisitions made by 33 Fortune 500 firms, concludes that acquisitions have been unsuccessful as over half of them subsequently divested. An examination of acquisition of 96 acquisitions completed between 1974 and 1983, by Varaiya and Ferris [58] reveals that the winning bid premium did, on average, overstate the markets' estimate of the expected takeover gain. Further, cumulative average excess returns to the winning bidder, measured over the period from 20 days before to 100 days after the acquisition announcement, was significantly negative. For the 58 % of the acquisitions in which the bid premium overstated expected takeover gains, average excess return to the winning bidder was -14 per cent. In the cases in which the premium did not overstate expected gain, average excess return was a positive 13.4 %. Caves [11] finds that shareholders of target firms gain substantially and total gains to bidders and target together is thin. The excess return studies show their shareholders at best break even at the time of announcement and they have been doing worse recently. After the announcement they seem to suffer additional losses. The evidence on the ex-post profitability of merger is similar but a little more pessimistic; the average acquiring firm at best realized no net profit on its consolidated assets and may do substantially worse. Revenscraft and Scherer [48] conclude that, on average, acquiring firms have not been able to maintain the pre-merger levels of profitability of the targets.

Agrawal, Jaffe and Mandelker [2] show that the results obtained by Franks, Harris and Titman (1991) were time-specific (1975-84) and a function of the sample of acquisition examined. Agrawal, Jaffe and Mandelker [2] also report that acquisitions undertaken in the time period 1955 to 1987 are followed by significant negative returns over a five-year period after the outcome announcement date. Datta, Pinches and Narayana [16] based on the 75 observations for bidders and 79 for targets, find that bidders on average, gain nil or statistically insignificant gains from announcement of mergers while target firms' shareholders experience over 20 per cent increase in value. Loderer and Martin [33] control for size effects, changes in the risk-free rate and changes in systematic risk and find that, on average, acquiring firms do not under perform a control portfolio during the first 5 years following the acquisition. They simply earn their required rate of return, no more or no less. There was some negative performance for the first three years, especially during the second and third years after the acquisition but it is most prominent in the 1960s, it diminishes in the 1970s and disappears completely in 1980s.

Sullivan, Jensen and Hudson [56] find that bidding firm shareholders experience insignificant returns, and these returns are not affected by the medium of exchange. Sudarsanam, Holl and Salami [55] find that marriage between companies with a complementary fit in terms of liquidity slack and surplus investment opportunities is value creating for both groups of shareholders. However, when highly rated firms acquire less highly rated targets, the acquiring firm shareholders experience wealth losses whereas target shareholders experience wealth gains. This result is consistent with acquiring managers acting out of hubris.

Loughran and Vijh [34] in a study of 947 acquisitions during 1970-1989, find that five years following the acquisition, on average, firms that complete stock mergers earn significantly negative excess returns of -25 % whereas firms that complete cash tender offers earn significantly positive excess returns of 61.77%. Over the combined pre-acquisition and post-acquisition period, target shareholders who hold on the

acquirer stock received as payment in stock mergers do not earn significantly positive excess returns. Gregory [23] shows that the post-takeover performance of UK firms undertaking large domestic acquisition is unambiguously negative, on average, in the long-run.

Rau and Vermaelon [47] explain the acquirers' performance in terms of three variables- the type of acquisition i.e. merger or tender offer, the pre-bid valuation of the acquirer i.e. glamour or value acquirer, and method of payment. They find that acquirers in mergers under-perform in the three years after the acquisition while in tender offers earn a small but statistically significant positive abnormal return. However, the long-term under performance of acquiring firms in mergers is not uniform across firms. It is predominantly caused by the poor post acquisition performance of low book to market 'glamour' acquirers who perform much worse than other glamour stocks and earn significantly negative bias adjusted abnormal return of -17 % in mergers.

Weber and Camerer [58] undertake laboratory experiments and prove that failures to coordinate activity based on cultural conflict, contribute to the widespread failure of corporate merger. Further, the likelihood of cultural conflict and coordination failure is underestimated, which explains why firms enter into so many mergers that are doomed in the first place. Sudarsanam and Mahate [54] in their study of UK takeovers completed between 1983 and 1996 find acquirers experience buy and hold abnormal returns (BHARs) in the range of -1.4% at the time of the bid announcement and an average of -15% across the various benchmark models, over a three year post acquisition period and value acquirers outperform glamour acquirers. Limmack [32] opines that while Sudarsanam and Mahate [54] find that glamour stocks consistently under-perform value stocks in the long run following takeovers, they nevertheless find that, on average, value stocks also record significantly negative abnormal returns.

Kumar [31] in his study of effects of merger of Reliance Industries Limited and Reliance petroleum Limited (RIL-RPL) on shareholders wealth by following Market adjusted model and Market model for a window period of 40 days reveal that this merger is not positive in net present value activities for acquiring firms and merger programme was not consistent with the value maximizing behaviour of management. Based on a sample of both related and unrelated mergers completed in mid-nineties, Dash [15] examines the economic consequences of mergers on the shareholders of the acquiring firm. The event study methodology employed to assess the extent of value creation by mergers, indicates that on an average mergers lead to value destruction, irrespective of their pattern over a long period of time and the destruction is relatively greater in case of unrelated mergers. He draws a contradictory conclusion to the popular belief of merger as a means of corporate salvation and declares it as a myth.

Moeller, Schlingemann, and Stulz [40] analyzed a large sample of 12,023 acquisitions and their announcement returns over the period of 1980 to 2001. They found that the average dollar change in wealth of acquiring firm shareholders was negative around the time of announcement. After observing the overall returns, they examine the acquisition performance of smaller firms. They find that smaller firms do more profitable acquisitions while larger companies do deals that cause their shareholders to lose money. During their sample period small firms earned $9 billion

from acquisitions. Larger companies, on the other hand, caused their shareholders to lose $312 billion. They opine that managers of the large acquirer firm are acting to achieve their own personal motives rather than maximizing shareholders wealth. They also state that such managers may be afflicted with hubris that may cause them to do deals that are in their own interest as opposed to shareholders' interest. The managers of small firms may act in the interest of the shareholders wealth maximization and they may not be afflicted with the hubris. Abhyankar, Ho, and Zhao [1] find that acquiring firms do not significantly under perform in three years after merger since any evidence of first-or second-order stochastic dominance relation between acquirer and benchmark portfolios is observed. Using their large database of 12,023 acquisitions over the period of 1980 to 2001, Moeller, Schlingemann, and Stulz [41] analyzed the performance of acquiring firms through the two major merger waves that occurred during that time period. They find that over the period 1998 through 2001 shareholders in bidders lost $240 billion. They also find that even when the target shareholder benefits were taken into account, the net effects were still negative $134 billion. They opine that the target shareholders gain at acquiring firm shareholder's expense.

3.2. **Operating Performance Studies:** Studies based on analysis of accounting data have attempted to assess the economic impact of acquisitions by testing for changes in profitability of the combined firm. Most accounting studies, whether based on UK or US data, support the view that acquisitions are non-value maximizing to shareholders. Examples of such studies include those of Revenscraft and Scherer [48], Ali and Gupta [3], Pawaskar [43], Ghosh [21], and Fee and Thomas [19]. Findings of a few studies are presented below:

Ali and Gupta [3] examine the potential motives and effects of corporate takeovers that occurred in Malaysia during the period 1980 through 1993 and find that the acquirer firms have achieved larger size at the expense of reduced profit both for themselves and the acquired firms. Bidder firms in Malaysia in general, have lower profitability, higher risks and leverage vis-à-vis the control bidder firms. Ghosh [21] focuses on merging firms' operating performance following corporate acquisitions. Using firms matched on performance and size as a benchmark, he finds no evidence that operating performance improves following acquisitions. Findings of Dash [15] also extend no support to the influence of mergers on the operating profitability.

As against the findings of above mentioned operating performance studies, a few studies have presented that M&As will lead to increased post acquisition profits for the shareholders of merged companies. Healy Palepu and Ruback [25] and [26] examined the post-acquisition operating performance of merged firms using a sample of 50 largest mergers completed in the period 1979 to mid 1984 and their findings indicate that merged firms have significant improvements in operating cash flow returns after the merger, resulting from the increases in asset productivity relative to their industries. These improvements are particularly strong for transactions involving firms in overlapping businesses. The study by Rahman and Limmack [46] has tested for evidence of operating improvements in Malaysian acquisitions by examining operating performance for a sample of 94 quoted acquiring and 113 target Malaysian companies involved in acquisitions over the period January 1, 1988 to December 31, 1998. The analysis of the components of operating cash flow indicates that improvement in post-acquisition performance are

driven both by an increase in asset productivity and the higher levels of operating cash flow generated per unit of sales.

Thus, most of the studies carried out to study the impact of M&As on stock prices as well as on the operating profits in the period immediately following the mergers and also in the long–run, have shown that M&As have failed to create wealth for acquirer company shareholders and they have often failed miserably. Though the shareholders of the acquiring company do not gain from the M&A activity, it is argued that from the societal perspective, it is beneficial as the net effect of the activity, in general, is positive, and it is concluded that in general mergers create value. But this argument does not hold good from the point of the acquiring company shareholders perspective because they are the one who initiate the deal and it is a big disappointment for them. The net effects of M&As are irrelevant because it merely shows that the target shareholders gain at acquiring firm shareholder' expense.

4. Causes for Failure of Mergers and Acquisitions

The American Management Association examined 54 big mergers in the late 1980s and found that roughly one-half of them led to fall in productivity or profits or both (Chandra [13]). At least one in three employees will, during the course of their working life undergoes an acquisition or merger. Yet statistics show that roughly half of acquisitions are not successful. The recent Pan-European KPMG study held in the year 1997 found that contrary to their objectives, acquisitions systematically destroyed rather than created shareholder value. A Mckinsey study found that over a ten year period, only 23 per cent of acquisitions ended up recovering the cost incurred during the acquisition (Hubbard [27]). A Mercer Management Consulting Study shows that less than 50 per cent of acquirers outperform industry average and nearly 50 per cent of senior executives in acquired firms leave in the first year (Prayag [45]).

It is clear from the findings of the earlier scientific studies and reports of consultants that M&As fail quite often and consequently, failed to create value or wealth for shareholders of the acquirer company. A definite answer as to why mergers fail to generate value for acquiring shareholders cannot be provided because mergers fail for a host of reasons. Some of the important reasons for failures of mergers are discussed below:

4.1. Size Issues: A mismatch in the size between acquirer and target is one of the reasons found for poor acquisition performance. Many acquisitions fail either because of 'acquisition indigestion' through buying too big targets or by not giving the smaller acquisitions the time and attention it required (Hubbard [27]). Moreover, when the size of the acquirer is very large when compared to the target firm, the percentage gains to acquirer will be very low when compared to the higher percentage gains to target firms (Jensen and Ruback [29], Asquith, Bruner and Mullins [6], Sing and Montgomery [51], and Delong [17]). Moeller, Schlingemann and Stulz [40] analysed a large sample of 12,023 acquisitions and their announcement returns over the period of 1980 to 2001. They find that the smaller acquirer companies do more profitable acquisitions while larger acquirer companies do deals that cause their shareholders to lose acquisitions.

4.2. Diversification: Very few firms have the ability to successfully manage the diversified businesses. Lot of studies found that acquisitions into related industries consistently outperform acquisitions into unrelated (Lubatkin [35], Sing and Montgomery [51], Gregory [23], Hubbard [27], Sudarsanam [53], Dash [15]). Around 42% of the acquisitions that turned sour were conglomerate acquisitions in which the acquirer and acquired companies lacked familiarity with each others businesses (Chandra [13]). Unrelated diversification has been associated with lower financial performance, lower capital productivity and a higher degree of variance in performance for a variety of reasons including a lack of industry or geographic knowledge, a lack of focus as well as perceived inability to gain meaningful synergies. Unrelated acquisitions which may appear to be very promising may turn out to be a big disappointment in reality. For example, Datta et al. [16] find that the presence of multiple bidders and the conglomerate acquisitions have a negative impact on the wealth of the bidding shareholders.

4.3. Previous Acquisition Experience: While previous acquisition experience is not necessarily a requirement for future acquisition success, many unsuccessful acquirers usually have little previous acquisition experience. Previous experience will help the acquirers to learn from the previous acquisition mistakes and help them to make successful acquisitions in future. Those serial acquirers, who possess the in house skills necessary to promote acquisition success, as well as, trained and competent implementation team, are more likely to make successful acquisitions (Hubbard [27], Sudarsanam [53]).

4.4. Unwieldy and Inefficient: Conglomerate mergers proliferated in 1960s and 1970. Many conglomerates proved unwieldy and inefficient and were wound up in 1980s and 1990s. For example, Mobile sold its interest in Montgomery ward in 1988. The unmanageable conglomerates contributed to the rise of various types of divestitures in the 1980s and 1990s (Ogden, Jen and Connor [42]).

4.5. Poor Organization Fit: Organizational fit is described as "the match between administrative practices, cultural practices and personnel characteristics of the target and acquirer" (Jemison and Sitkin 28]). It influences the ease with which two organizations can be integrated during implementation. Machhi [36] states that organisation structure with similar management problem, cultural system and structure will facilitate the effectiveness of communication pattern and improve the company's capabilities to transfer knowledge and skills. Need for proper organization fit is stressed by Hubbard [27]. Mismatch of organization fit leads to failure of mergers.

4.6. Poor Strategic Fit: A Merger will yield the desired result only if there is strategic fit between the merging companies. But once this is assured, the gains will outweigh the losses (Maitra [38]). Mergers with strategic fit can improve profitability through reduction in overheads, effective utilization of facilities, the ability to raise funds at a lower cost, and deployment of surplus cash for expanding business with higher returns. But many a time lack of strategic fit between two merging companies, especially lack of synergies results in merger failure. Strategic fit can also include the business philosophies of the two entities (return on investment versus market share), the time frame for achieving these goals (short-term versus long term) and the way in which assets are utilized (high capital

investment or an asset stripping mentality). Sudarsanam, Holl and Salami [55] find that marriage between companies with a complementary fit in terms of liquidity slack and surplus investment opportunities is value creating for both groups of shareholders. The absence of strategic fit between the companies may destroy the value for shareholders of both the companies.

P&G –Gillette merger in consumer goods industry is a unique case of acquisition by an innovative company to expand its product line by acquiring another innovative company, was described by analysts as a perfect merger (Chaturvedi and Sinha [14]).

4.7. Striving for Bigness: Size is an important element for success in business. Therefore, there is a strong tendency among managers whose compensation is significantly influenced by size to build big empires (Chandra [13]). The concern with size may lead to acquisitions. Size maximizing firms may engage in activities which have negative net present value (Malatesta [39]). Therefore when evaluating an acquisition it is necessary to keep the attention focused on how it will create value for shareholders and not on how it will increase the size of the company. Firth [20] finds that the results of his study are consistent with the takeovers being motivated by maximization of management utility reasons, rather than by the maximization of shareholders wealth. Gregory [23] and Ali and Gupta [2] also support the managerial self-interest theory.

4.8. Paying Too Much (Over paying): In a competitive bidding situation, a company may tend to pay more. Often highest bidder is one who overestimates value out of ignorance. Though he emerges as the winner, he happens to be in a way the unfortunate winner. This is called winners curse hypothesis (Roll [49]; Chandra [13]). Abyankar, Ho, and Zhao [1] find that the benchmark portfolio of acquirer dominates the merger portfolio of acquirers that paid highest premiums to the target firms. He views that overpayment may be a possible reason for the long-run underformance of some acquiring firms. Moeller, Schlingemann and Stulz [40] find overall, the abnormal return associated with acquisition announcements for small firms exceeds the abnormal returns associated with acquisition announcements for large firms by 2.24 percent. They point out that the large firms offer larger acquisition premiums than small firms and enter into acquisitions with negative dollar synergies. Variaya and Ferris [57]'s empirical findings also subscribe to the overpayment hypothesis.

When the acquirer fails to achieve the synergies required to compensate the price, the M&A fail. More one pays for a company, the harder he will have to work to make it worthwhile for his shareholders (Banerjee [8]).When the price paid is too much, how well the deal may be executed, the deal may not create value (Koller [30]).

4.9. **Poor Cultural Fit**: The relationship between cultural fit and acquisition implementation is highly related. It is difficult to undergo a successful implementation without adequately addressing the issues of cultural fit. Cultural fit between an acquirer and a target is often one of the most neglected areas of analysis prior to the closing of a deal. However, cultural due diligence is every bit as important as careful financial analysis. Lack of cultural fit between the merging firms will amount to misunderstanding, confusion and conflict. Therefore, proper cultural due diligence is required for the success of M&As. Cultural due diligence

involve steps like determining the importance of culture and assessing the culture of both target and acquirer. It is useful to know the target management behaviour with respect to dimensions such as centralized versus decentralized decision making, speed in decision making, time horizon for decisions, level of team work, management of conflict, risk orientation and openness to change.

It is necessary to assess the cultural fit between the acquirer and target based on cultural profile. Potential sources of clash must be managed. It is necessary to identify the impact of cultural gap, and develop and execute strategies to use the information in the cultural profile to assess the impact that the differences have. This is followed by the strategies that need to be considered to manage such differences.

Cultural issues may create major problems if not addressed properly. If one organization is very paternal and feudalistic, and the other more open and transparent, culture can definitely become an issue when they come together (Prayag [45]). Merger of Daimler and Chrysler is an example for poor merger performance due to cultural differences. Weber and Camerer [58] undertake laboratory experiments and prove that failures to coordinate activity based on cultural conflict, contribute to the widespread failure of corporate merger. Further, they also opine that the likelihood of cultural conflict and coordination failure is underestimated, which explains why firms enter into so many mergers that are doomed in the first place. Hubbard [27] also highlights the significance of cultural fit for the success of mergers and acquisitions.

4.10. Poorly Managed Integration: Integration of the companies requires a high quality management. Integration is very often poorly managed with little planning and design. As a result implementation fails. The key variable for success is managing the company better after the acquisition than it was managed before (Prayag [45]). Even good deals fail if they are poorly managed after the merger. Zainulbhai [60] argues that in addition to retaining the best talent in the combined firm, a detailed plan has to be developed to ensure effective integration.

4.11. The Hubris Hypothesis or Behaviour: Roll [49] offers Hubris hypothesis or an explanation for an acquisition or takeover. He argues that the bidders' management overvalues the target because they overestimate their ability to create value once they take control of the target assets. The hubris hypothesis predicts that around takeover: a) the combined value of the target and bidding firms fall slightly, b) the value of the bidding firm should decrease; and c) the value of the target should increase. The empirical study of Roll supports the hubris hypothesis.

Sudarsanam, Holl and Salami [55] find that marriage between companies with a complementary fit in terms of liquidity slack and surplus investment opportunities is value creating for both groups of shareholders. However, when highly rated firms acquire less highly rated targets, the acquiring firm shareholders experience wealth losses whereas target shareholders experience wealth gains. This result is consistent with acquiring managers acting out of hubris. Findings of the Gregory [23], Zhang [61], and Moeller, Schlingemann and Stulz [40] are also supportive of hubris hypothesis.

4.12.Incomplete and Inadequate Due Diligence: Lack of due diligence is lack of detailed analysis of all important features like finance, management, capability, physical assets as well as intangible assets. Lack of incomplete and inadequate due

diligence quite often results in merger failure. ISPAT Steel as a corporate acquirer conducts M&A activities after elaborate due diligence (Machhi [36]).

4.13. Limited Focus: If merging companies have entirely different products, markets systems and cultures, the merger is doomed to failure (Maitra [38]). Added to that as core competencies are weakened and the focus gets blurred the effect on bourses can be dangerous. Purely financially motivated mergers such as tax driven mergers on the advice of accountant can be hit by adverse business consequences. Conglomerates that had built unfocused business portfolios were forced to sell non-core business that could not withstand competitive pressures. The Tatas for example, sold their soaps business to Hindustan Lever i.e. merger of Tata Oil Mill Company with Hindustan Lever Limited (Banerjee [7]).

4.14. Failure to Examine the Financial Position: Examination of the financial position of the target company is quite significant before the takeovers are concluded. Areas that require thorough examination are stocks, salability of finished products, value and quality of receivables, details and location of fixed assets, unsecured loans, claims under litigation, and loans from the promoters. A London Business School study in 1987 highlighted that an important influence on the ultimate success of the acquisition is a thorough audit of the target company before the takeover (Arnold [5]). When ITC took over the paper board making unit of BILT near Coimbatore, it arranged for comprehensive audit of financial affairs of the unit. Many a times the acquirer is mislead by window-dressed accounts of the target (Hariharan [24]).

4.15. Failure to Evaluate the Target Company' Condition in Detail: The risk of failure can be reduced by conducting detailed evaluation of the target company's business condition by the professionals in the line of business. Detailed examination of the manufacturing facilities, product design features, rejection rates, marketing net work, profile of key people and productivity of the employees is a pre-requisite for the success of the merger (Hariharan [24]). Decision to acquire the target company should not be influenced by the state of the art physical facilities which include, among other, a good head quarters building, guest house on a beach and plenty of land for expansion.

4.16. Failure to Take Immediate Control: Control of the new unit should be taken immediately after signing of the agreement. ITC did so when they took over the BILT unit even though the consideration was to be paid in 5 yearly installments. ABB puts new management in place on day one and reporting systems in place by three weeks (Hariharan [24]).

4.17. Failure to Set the Pace for Integration. The important task in the merger is to integrate the target with acquiring company in every respect. All functions such as marketing, finance, production, design and personnel should be put in place. In addition to the prominent persons of acquiring company the key persons (people) from the acquired company should be retained and given sufficient prominent opportunities in the combined organization. Positive aspects of earlier culture should be preserved while discarding those not needed. Delay in integration leads to delay in product shipment, development and slow down in the company's road map. Arun Thygarajan, former MD and country manager, ABB India Ltd., opines that once the merger announcement is made, not only should things move in a flash but decisions

be seen as fair, correct and impartial (Prayag [45]). The speed of integration is extremely important because uncertainty and ambiguity for longer periods destabilizes the normal organizational life. It puts greater stress on employees and distracts them from the actual work. Thus earlier the chaos and confusion is sorted out, the better it is for the organizations economic health (Yadav and Kumar [59]). The disadvantage with a slow approach to integration is that it tends to dissipate momentum and enthusiasm. Moreover, delays can dilute the financial benefits of a deal.

4.18. Failure of Top Management to Follow Up: After signing the M&A agreement, the top management should be very active and should make things happen. Initial few months after the takeover determine the speed with which the process of tackling the problems can be achieved. It is very rarely that the bought out company is firing on all cylinders and making a lot of money. Top management follow-up is essential to go with a clear road map of actions to be taken and set the pace for implementing once the control is assumed (Hariharan [24]).

4.19. Incompatibility of Partners: Merger between two strong companies is safer when compared to merger between two weak companies. Frequently many strong companies actually seek small partners in order to gain control while weak companies look for stronger companies to bail them out. But experience shows that the weak link becomes a drag and causes friction between partners. A strong company taking over a sick company in the hope of rehabilitation may itself end up in liquidation (Chakravarty [12], Hariharan [24]).

4.20. Lack of Proper Communication: Lack of proper communication after the announcement of M&As will create lot of uncertainties. Apart from getting down to business quickly and constantly companies have to necessarily talk to employees. Regardless of how well executives communicate during a merger or an acquisition, uncertainty will never be completely eliminated. The objective of proper communication is to minimize as much uncertainty as possible, especially with regard to issues that directly impact people and organization. Failure to manage communication results in inaccurate perceptions, lost trust in management, morale and productivity problems, safety problems, poor customer service, and defection of key people and customers. It may lead to the loss of the support of key stakeholders at a time when that support is needed the most (Schweiger [50]).

4.21. Failure of Leadership Role: Some of the roles leadership should take seriously are modeling, quantifying strategic benefits and building a case for M&A activity and articulating and establishing high standard for value creation. Walking the talk also becomes very important during M&As (Prayag [45]).

4.22. Other Causes: Apart from the causes mentioned above there may be other reasons for failure of mergers which include: cash acquisitions resulting in the acquirer assuming too much debt (Business India [10]); mergers between two weak companies; ego clashes between the top managements of the companies to the M&As and subsequently lacking coordination especially in the case of mergers between equals; inadequate attention to people issues while the due diligence process is carried out; failure to retain the key people and best talent (Zainulbhai [60]); growth in strategic alliances as a cheaper and less risky route to a strategic goal than takeovers; loss of identity of merging companies after the merger; expecting results

too quickly after the takeover; and spending too much time on new activity neglecting the core activity.

A graphical representation of the reasons for failure of M&As is given in the pie diagram in the Appendix.

5. Conclusion

M&As have become very popular over the years especially during the last two decades owing to rapid changes that have taken place in the business environment. Business firms now have to face increased competition not only from firms within the country but also from international business giants thanks to globalization, liberalization, technological changes and other changes. Generally the objective of M&As is wealth maximization of shareholders by seeking gains in terms of synergy, economies of scale, better financial and marketing advantages, diversification and reduced earnings volatility, improved inventory management, increase in domestic market share and also to capture fast growing international markets abroad. But astonishingly, though the number and value of M&As are growing rapidly, the results of the studies on the impact of mergers on the performance from the acquirers' shareholders perspective have been highly disappointing. In this paper an attempt has been made to draw the results of some of the earlier studies while analyzing the causes of failure of majority of the mergers. While making the merger deals, it is necessary not only to look into the financial aspects of the deal but also to analyse the cultural and people issues of both the concerns for proper post-acquisition integration and for making the deal successful. But it is unfortunate that in many deals only financial and economic benefits are considered while neglecting the cultural and people issues.

Making the mergers work successfully is a complicated process which involves not only putting two organizations together but also involves integrating people of two organizations with different cultures, attitudes and mindsets. Meticulous pre-merger planning including conducting proper due diligence, effective communication during the integration, committed and competent leadership, and speed with which the integration plan is integrated, together will pave for the success of M&As. Findings of poor post-merger performance of the acquirers in some of the earlier studies may be attributed to methodological errors in the identification of long-run returns. These errors may arise either through the choice of inappropriate control models or through the introduction of some element of bias either in the chosen sample, the benchmark, or both. Potential areas of sample and benchmark control bias include survivorship and selection bias together with inappropriate tests of non-normal returns distributions. Therefore, there is also a need to develop appropriate methodologies to effectively measure the performance of the M&As and their effects on the shareholders.

6. References

1. Abhyankar, A., K.Y. Ho and H. Zhao, "Long-Run Post–Merger Stock Performance of UK Acquiring Firms: A Stochastic Dominance Perspective," Applied Financial Economics, 15(10), (2005), 679-690.
2. Agrawal, A., J.F. Jaffe and G.N. Mandelker, "The Post-Merger Performance of Acquiring Firms: A Re-Examination of an Anomaly," Journal of Finance, 47(4), 1992, 1605-1621.

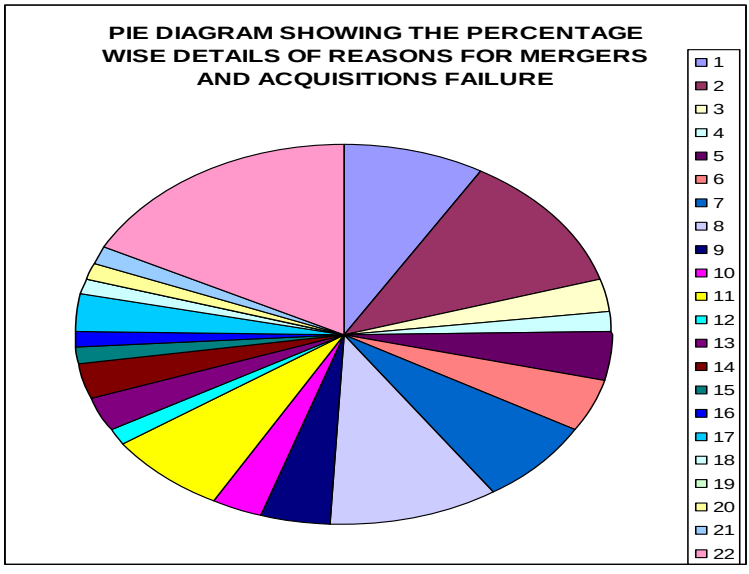
3. Ali, R. and G.S.Gupta, "Motivation and Outcome of Malaysian Takeovers: An International Perspective," Vikalpa, 24(3), 1999, 41-49.
4. Andre, P., M. Kooli and J.L. Her, "The long-Run Performance of Mergers and Acquisitions: Evidence from the Canadian Stock Market," Financial Management, 33(4), 2004, 27-43.
5. Arnold, G., The Handbook of Corporate Finance, A Business Comparison to Financial Markets Decisions and Techniques, 2005, Financial Times, Prentice Hall.
6. Asquith, P., R.F. Bruner and D.W. Mullins Jr., "The Gains to Bidding Firms from Merger," Journal of Financial Economics, 11(1-4), 1983, 121-139.
7. Banerjee, G., "Year of deals," Business World, 25(21), 2005a, 34-37.
8. Banerjee, G., "How Much Value is Created by M&A Deals in India?" Business World, 25 (21), 2005b, 40.
9. Bradley, M., D. Desai and E.H. Kim, Synergistic Gains from Corporate Acquisitions and their Division between the Shareholders of Target and Acquiring Firms. Journal of Financial Economics, 21(1), 1988, 3-40.
10. Business India, "Biggest deal?" Business India, 705, 2001, 162-163.
11. Caves, R.E., "Mergers, Takeovers, and Economic Efficiency: Foresight vs. Hindsight," International Journal of Industrial Organization, 7, 1989, 151-174.
12. Chakravarty, V., "How to Add Value to M&A," Business Today 7(5), 1998, 7-21.
13. Chandra, P., Financial Management: Theory and Practice, 2001, Fifth Edition, Tata McGraw-Hill Publishing Company Limited, New Delhi.
14. Chaturvedi, N.R. and P. Sinha, "The P&G-Gillette Merger," Effective Executive, 7(3), 2005, 14-19.
15. Dash, A., "Value Creation through Mergers: The Myth and Reality," The ICFAI Journal of Applied Finance, 10(10), 2004, 20-38.
16. Datta, D.K., G.E. Pinches and V.K. Narayana, "Factors Influencing Wealth Creation from Mergers and Acquisitions: A Meta-Analysis," Strategic Management Journal, 13(1), 1992, 67-83.
17. Delong, G.L., "Stockholder Gains from Focusing Versus Diversifying Bank Mergers", Journal of Financial Economics, 59(2), 2001, 221-252.
18. Dodd P., "Merger Proposals, Management Discretion and Stockholder Wealth," Journal of Financial Economics, 8(2), 1980, 105-137.
19. Fee, C.E. and S. Thomas, "Sources of Gains in Horizontal Merger: Evidence from Customer, Supplier and Rival Firms," Journal of Financial Economics, 74(3), 2004, 423-460.
20. Firth, M. "Takeovers, Shareholder Returns and the Theory of the Firm," Quarterly Journal of Economics, 44(2), 1990, 235-260.
21. Ghosh, A., "Does Operating Performance Really Improve Following Corporate Acquisition?" Journal of Corporate Finance, 7(2), 2001, 151-178.
22. Ghosh, A. and B. Das, "Merger and takeovers" The Management Accountant, 38(7), 2003, 543-545.
23. Gregory, A., "An Examination of the Long Run Performance of UK Acquiring Firms," Journal of Business and Accounting, 24 (7-8), 1997, 971-1002.
24. Hariharan, P.S., "Pitfalls in Mergers, Acquisitions and Takeovers (A-Z of Merger Failures)" The Management Accountant, 40(10), 2005, 763-766.

25. Healy, P.M., K.G. Palepu and R.S. Ruback, "Does Corporate Performance Improve after Mergers?" Journal of Financial Economics, 31(2), 1992, 135-175.
26. Healy, P.M., K.G. Palepu and R.S. Ruback, "Which Takeovers are Profitable? Strategic or Financial?" Sloan Management Review, 38(4), 1997, 45-57.
27. Hubbard, N., "Acquisition: Strategy and Implementation," 1999, Palgrave MacMillan.
28. Jemison, D.B. and S.B. Sitkin, "Corporate Acquisitions: A Process Perspective" Academy of Management Review, 11(1), 1986, 145-163.
29. Jensen, M.C. and R.S. Ruback, "The Market for Corporate Control: The Scientific Evidence" Journal of Financial Economics 11(4), 1983, 5-50.
30. Koller, T., "Core Issue is Creating Values after M&As" Economic Times Daily {September 27), 2005, 7.
31. Kumar, R., "Effect of RPL-RIL Merger on Shareholder's Wealth and Corporate Performance" The ICFAI Journal of Applied Finance, 10(9), 2004, 13-35.
32. Limmack, R., "Discussion of Glamour Acquirers, Method of Payment and Post-Acquisition Performance: The UK Evidence" Journal of Business Finance and Accounting, 30(1-2), 2003, 343-350.
33. Loderer, C. and K. Martin., "Post-Acquisition Performance of Acquiring Firms," Financial Management, 21(3), 1992, 69-79.
34. Loughran, T. and A.M. Vijh., "Do Long-Term Shareholders Benefit from Corporate Acquisitions?" The Journal of Finance, 52(5), 1997, 1765-1790.
35. Lubatkin, M., "Mergers and Performance of the Acquiring Firm," Academy of Management Review 8(2), 1983, 218-255.
36. Machhi, H., "Merger and Acquisition," The Management Accountant, 40(10), 2005, 767-770.
37. Maheshwari, S.N., Financial Management: Principles and Practices, 2002, Sultan Chand and Sons, New Delhi.
38. Maitra, D., "Mega Money Mergers," Business Today, 5(23), 1996, 82-93.
39. Malatesta, P.H., "The Wealth Effect of Merger Activity and the Objective Functions of Merging Firms," Journal of Financial Economics, 11(1-4), 1983, 155-181.
40. Moeller, S.B., F.P. Schilingemann and R. Stulz., "Firm Size and the Gains from Acquisitions," Journal of Financial Economics, 73(1), 2004, 201-228.
41. Moeller, S.B., F.P. Schilingemann and R. Stulz., "Wealth Destruction on a Massive Scale? A Study of Acquiring-Firm Returns in the Recent Merger Wave," Journal of Finance, 60(2), 2005, 757-782.
42. Ogden, J.P., F.C. Jen and P.F.O. Connor, Advanced Corporate Finance: Policies and Strategies, 2003, First Indian Edition, Pearson Education Inc., India.
43. Pawaskar, V., "Effects of Mergers on Corporate Performance in India," Vikalpa, 26(1), 2001, 19-32.
44. Porter, M.E., "From Competitive Advantage to Corporate Strategy," Harvard Business Review, 65(3), 1987, 43-59.
45. Prayag, A., "M&Aking it Work," Praxis-Business Line's Journal on Management, 6(2), 2005, 34-41.
46. Rahman, A.R. and R.J. Limmack, "Corporate Acquisitions and the Operating Performance of Malaysian Companies," Journal of Business Finance and Accounting, 31(3-4), 2004, 359-400.

47. Rau, R.P. and T. Vermaelen, "Glamour, Value and The Post-Acquisition Performance of Acquiring Firms," Journal of Financial Economics, 49(2), 1998, 223-253.
48. Revenscraft, D.J and F.M. Scherer, "The Profitability of Mergers," International Journal of Industrial Organization, 7, 1989, 101-116.
49. Roll, R., "The Hubris Hypothesis of Corporate Takeovers," Journal of Business, 59(2), 1986, 197-216.
50. Schweiger, D.M., "M&A Integration: A Framework for Executives and Managers," Book Summary by Niranjan Swain, in The ICFAI Journal of Applied Finance, 9(2), 2003, 71-79.
51. Singh, H. and C.A. Montgomery, "Corporate Acquisition Strategies and Economic Performance" Strategic Management Journal, 8(4), 1987, 377-386.
52. Sirower, L.M., "The Synergy Trap: How Companies Lose the Acquisition Game," Book Review by Chiranjeevi, T., in The ICFAI Journal of Applied Finance, 6(3), 2000, 155-160.
53. Sudarsanam, S., Creating Value from Mergers and Acquisitions: The Challenges, An Integrated and International Perspective, 2004, First Indian Reprint, Pearson Education, New Delhi, India.
54. Sudarsanam, S. and A.A. Mahate, "Glamour Acquirers, Method of Payment and Post-Acquisition Performance: The UK Evidence," Journal of Business Finance and Accounting, 30(1-2), 2003, 299-341.
55. Sudarsanam, S., P. Holl and A. Salami, "Shareholder Wealth Gains in Mergers: Effect of Synergy and Ownership Structure," Journal of Business Finance and Accounting, 23(5-6), 1996, 673-698.
56. Sullivan, M.J., M.R.H. Jensen and C.D. Hudson, "The Role of Medium of Exchange in Merger Offers: Examination of Terminated Merger Proposals," Financial Management, 23(3), 1994, 51-62.
57. Varaiya, N.P. and K.R. Ferris, "Overpaying in Corporate Takeovers: The Winners Curse," Financial Analysts Journal, 43(3), 1987, 64-70.
58. Weber, R. and C.F. Camerer, "Cultural Conflict and Merger Failure: An Experimental Approach," Management Science, 49(4), 2003, 400-415.
59. Yadav, A.K. and B.R. Kumar, "Role of Organization Culture in Mergers and Acquisitions," SCMS Journal of Management, 2(3), 2005, 51-63.
60. Zainulbhai, A., "Tata-Corus Deal-The Wider Implication: A Debate," Economic Times Finance (October 31), 2006, 5.
61. Zhang, H., "US Evidence on Bank Takeover Motives: A Note," Journal of Business Finance and Accounting, 25(7-8), 1998, 1025-1032.

Appendix

Appendix: Graphical representation of the reasons for failure of M&As



1. Size issues
2. Diversification
3. Previous acquisition experience
4. Unwieldy and inefficient
5. Poor Organization fit
6. Poor Strategic fit
7. Striving for bigness
8. Paying too much (Over paying)
9. Poor Cultural fit
10. Poorly managed Integration
11. The Hubris hypothesis or behaviour
12. Incomplete and inadequate due diligence
13. Limited focus
14. Failure to examine the financial position
15. Failure to evaluate the target company' condition in detail
16. Failure to take immediate control
17. Failure to set the pace for integration
18. Failure of top management to follow up
19. Incompatibility of partners
20. Lack of proper communication
21. Failure of leadership role
22. Other Issues