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# Mergers and Acquisitions as Vital Instruments of Corporate Strategy: Current and Historical Perspective

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## Abstract

In this paper our main focus is to provide insight into the history of M&A's for this purpose we have analysed the different waves of M&A. We have analysed these waves in context of available literature and fact and figures. During the study we realised that almost all of the waves of M&A's ended because of financial crises, although impact and severity of that crises may differ. We analysed the impact of current crises on M&A in global context and in order to establish how companies have and in post crises era i.e. after crises of 2007 onwards how the companies have changed their corporate strategies to accommodate M&A's. We have also analysed which factors fuelled M&A's in past and were these factors present in post crises era M&A activities. By first quarter of 2011 the many firms saw new growth opportunities in M&A activities seemed to rebound as large companies used M&A's as part of their corporate strategy but this was cut short by events like US debt ceiling, down grade of USA's credit ratings along with fears about Eurozone's financial health and their impact on future prospects of M&A's would they continue to prosper or would they be weighed down by these events.


**Keywords**: Merger and acquisition, Firm behavior, Financial crises, Corporate strategy.

**JEL Classification Codes**: D21, D22, G01, G34, G39.

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## 1. Introduction

Acquisition in run through is procurement of one company by other. In acquisition one company is called target company and it is the company mortal procured and the second company is called acquirer, this marks when all assets be in command of the target company is transferred to an acquiring company. In merger two or more than two companies with their consent shift the assets which are under their power over to a solo entity for the confinement of a new-fangled company. There is no consciences exist which can clarify the mergers and acquisitions and target and acquirer companies. In order to remove the ambiguity in this paper related to mergers and acquisitions and target and acquirer companies the intact pasture is dealt with as mergers and acquisition (Agrawal & Jaffe, 2000).

According to premise any firm manager's main role is to work for the wealth maximization of the shareholders by following favourable strategies and enduring via means of souk pro communal direct. In practice the wealth maximization concept of shareholders a bit failed as managers of many firms botched to maximize the wealth of shareholders. A gap comes between these two concepts which were filled out by recluses by means of mergers and acquisitions via replacing active management by new management. Company shareholders are inclined to review their existing and expected cash flows along with the profit later than the merger and acquisition underneath the new-fangled supervision. The cause of it is that predominantly market and shareholders enclose optimistic prospect. Managers in order to gain their private goals on the whole subjugated this actuality. The one evidence of this fact is the example of Merrill Lynch CEO; John Thain for his office decoration used up $1.20 million where as one of the first folks of USA's carry out similar mania by spending one hundred thousand (Amel et al., 2004). Denis and McConnell also reared this view by portentous pessimistic upshots of takeovers on NPV; it causes abating profits from projects. This pooled upshot starts minimizing a result shareholder's wealth via reducing cash flows and additional gains (Andrews, 1971).

In this cram we investigate the mergers and acquisition history and their progression and frequency rendezvous from preceding decade of 19th century to current. An additional facet of this cram is to verify the upshots of financial on regularity mergers and acquisitions and to identify their core reasons.

## 2. Main Part

To pull off organizational objectives organizations, organizations exploit the strategies of corporate mergers and acquisitions. Their strategies includes increment in the number of market shares, new-fangled markets stabbing, diversification, to capture the competitive advantage over their competitors and by expanding their organization in terms of size and resources so to control the market forces. From organization perspective this work out strategy is reasonably steep and time consuming. To expand and be in business for a long time organizations exploit mergers & acquisitions. As this is new practice for an organization the result of it is not always in the favour of new-fangled entity. Louise cram showed that not all mergers and acquisitions are successful in improving the new-fangled organization performance. Unsatisfaction arose out from the results subsequent the merger. According to Louis mergers and acquisitions are abortive due to meagre managing (Berger et al., 1971).

Some other authors also support this conception by tinted the actuality by showing the Mercer Management consultant's report that from 100% of merger and acquisition only half of the merger and acquisition was triumphant and 57% was the triumphant percentage of the earlier decade (Berger, 2003). It is stated that some conflict arises between the long term investors and shareholders in the form of capital gain as in case of merging organization shareholders attain short term gain and long term investors such as institutional investors get affected by the poor feat of the stocks (Bhagat et al., 1990), it is also stated that flattering gain is attained within 2 to 3 years of acquisition by approximately 35-45% of the acquiring firms. The standard deviation of these acquiring firms is calculated and it is about 10% of their mean returns (Bonge & Coleman, 1972).

Subsequent to mergers seventy percent of time the executives of mark firm quit from their offices within five years because of the organization recital trauma on them (Chatterjee, 1992; Datta et al., 1992). The biding facet of the acquiring firm was investigated in this article by evaluating the 500 U.K. intimidating take over's and results produced was that these take bids generated lofty financial returns them friendly takeover bids, or rescue packages (Datta et al., 1992). A hefty number of systematic corporate delve into was carried on to help businesses in attaining their foremost objectives and pre and post-merger performance. Organizations get benefit from these researches in term of proper growth (Denis & McConnell, 2003). Author has divergent opinion regard this fact; as according to author no lucid indulgent headed for performance of organisation depicts in empirical academic literature. Most often researchers not succeed to assist managers in taking mergers decisions (Dymski, 1999).

Financial economics and strategic management have been notorious as a basis of shareholder's wealth and these two different looms tag on diverse research directions. Unique hypothesis of market for corporate control verification was investigated in financial economic research. According to financial economic research competition crop up between diverse management teams in order to control corporate firms and they dissect acquisition activities as a challenge as argue by Fama and Jensen (1983). It is concluded that this dissect showed that capital market is the main force in the value creation in the course of mergers and acquisitions and competitiveness is considered to be in its features for example a fastidious market is exaggerated by authoritarian amendment (Denis & McConnell, 2003; Fama & Jensen,1983).

Factors under the heading of management come under strategic management approach. It was recommended that to gauge the post-acquisition performance, strategic management approach stab to make a distinction flanked by assorted diversification strategies (i.e. unrelated vs. related diversification), types of acquisitions (i.e. tender offer vs. merger) or types of payment in acquisitions (i.e. stock vs. cash). Those factors which lead the corporate acquisitions abortive are not elucidating by these two approaches. Mergers and acquisitions deeds vain performance decisive factors have been explained by investigating the rapport flanked by post-acquisition performance and post-acquisition amalgamation (Gaughan, 1999).

In contrast of the fact that main feature of thriving corporate acquisition is the post acquisition process, it was renowned that value creation of merger and acquisition conducts in the course of strategic features apprehended via synergies (Goold & Quinn, 1990) was not only one source but value also bent as of the practice itself, which pilot to expected synergistic features, the same as imitate in capital market expectations (Fama & Jensen,1983). Hence it is most vital to comprehend all the facts and figures ensuing in value creation via corporate mergers and acquisitions prior to decisively assess the value creation delve paradigm (Gaughan, 1999).

Acquisition advancement is embraced of three waves, first wave which is termed as merging for monopoly, second as oligopoly and third as conglomerate. Merging for monopoly (1987-1904) transpired subsequent to depression of 1883. It was spiky flanked by 1898 and 1902 and wrecked in 1904. General Electric, American Tobacco, Du Pont, Kodak and Standard Oil ensuing as of monopolies conceptions; considered to be present day colossal multinationals formed due to first wave of acquisition. As a result of antitrust law force for the period of second wave (1916-1929) of acquisition a huge amount of oligopolies and vertical integration bent and monopolies was in smaller amount in disparity to preceding wave (Goold & Quinn, 1990). The third wave (1965-1969) of acquisition created major fruitful changes, multinational companies not only grow in their sizes with a valuable and swift way but also boost the management efficiency, as a result miscellany was assist in companies operations and acquisitions (Goold & Quinn, 1993; Hamermesh & White, 1984).

To minimize cyclic risks and to expand companies like ITT (International Telephone and Telegraph Corporation, USA) and Textron get hold of copious distinct business. Conversely, at the end of 1960's poor performance was commence to face by most companies as seen by Textron shares which was chop down nearly 50% relative to 9% slump in Dow Jones Industrial average (Haspeslagh, 1982). Still in start of 1970's the other problem which was faced by companies was the drop down in profitable growth such as General Electric gain 40% increase in its sales as of 1965 to 1970 but in fact its profit slumped (Haspeslagh & Jemison, 1991). In 1970s a drop down was seen in mergers and acquisition activities. According to Andrews cram (1971) this drop down in mergers and acquisition activities commenced a novel notion of corporate strategy which firms can adopt and this strategy is accepted by majority of CEO's of the organizations as their inimitable and key chore (Humphrey et al., 2006).

Boston Consulting Group (1970) develops the concept of portfolio planning by taking guidelines from these revolutions (1970) in corporate finance. The portfolio planning notion of Boston Consulting Group laid down the common basis for managers to compare different businesses. This concept of portfolio planning got fame in corporate sectors. According to the result of one survey on portfolio planning among 500 Fortune companies 45% were employing this strategy (Itami, 1989). Conversely, as time passes problems get emerged in portfolio planning. More experienced corporate managers of a particular sector of industry commence facing snags in managing these new-fangled acquired businesses in vivacious and alien sectors (Hamermesh & White, 1984). Thus, a new-flanged merged or acquired firm have an effect on their performance. The solution against this problem was stated as in elucidation of mergers and acquisition the management was the imperative factor however mostly organizations pertained erroneous loom to a number of their businesses (Jemison & Sitkin, 1986).

Ion business world a novel wave of merger was seen in 1980's (fourth wave 1981-1989). During this time period a colossal number of merger activities were seen and total value of mergers were exceeded up to $ .13 trillion in US (Jensen, 1993). As a result of these merger activities service sector inclined and hefty support from a mammoth number of investors was seen; lenders and globalization assisted companies to support the buyout deals (Jensen, 1993). Academics like Sikora (1995), expressed this phenomenon as: "A highly skilled service infrastructure of investment bankers, lawyers, tax experts, due diligence probers, valuation mavens, and even environmental specialists developed to skipper buying and selling through the gritty M&A process. Shareholder value motivations leaped to the forefront, triggering both acquisitions and sell-offs" (Sikora, 1995, p. 50). Furthermore, the reasons of the fourth merger wave were recognized by some researchers. The major causes were capacity (see Jones & Critchfield, 2005), agency problems, market failure (Jordan, 2006), and tax and antitrust law changes (Judelson, 1969).

To sum up merger and acquisition activities during 1960s and 1980s, it can be stated that the major trends during 1960s were diversification and conglomeration and in 1980s the specialization and consolidations incident was obvious. Conversely, practical facts related to value creation be apt to state that a hefty number of 1960s mergers and acquisitions upturned consequently and unprofitable. Conglomerates which were created in 1960s and shattered in 1980s were the clear evidence of the failure of concept of "merger & acquisitions and value creation" that was not expected in 1960s (Kitching, 1967).

The current wave 1990-present, in contrast to 1960s decade of conglomerates and 1980s period of Leveraged Buyouts (LBO), the dominant deals of 90s were designed with a view to fit strategically among merging firms (Goold & Quinn, 1990). Moreover, the forces behind the merger and acquisitions activities were different than earlier periods and corporate sector seen some of mega-deals during that period. For instance in 1996, the top 100 deals of merger and acquisitions were worth more than $1 billion or approximately 53.5% of total transactions (Martynova et al., 2008).

The era of 90s was said to the decade of Consolidation; which means combination of operating and management resources between two companies as well as their stocks, assets and liabilities. Generally, the notion of consolidation means to reduce cost and achieve economies of scale from acquisitions (Martynova et al., 2008). Furthermore, in 1990s, stable economic environment, relax antitrust laws, stock market's favourable conditions and low cost of capital were the catalyst of merger and acquisition trends. However, still many firms failed to create shareholder value and according to study by Mercer Management[1] Consulting Inc. (1997) 48 percent of mergers failed to generate shareholder value in 90s comparative to 57 percent failure of 1980s (Berger, 2003). Nonetheless, the firms in 90s believed that larger pools of assets are essential either to survive or to grow but there are many explanations to the question that how to discover ways to create value for portfolio of firm's businesses (Hamermesh & White, 1984).

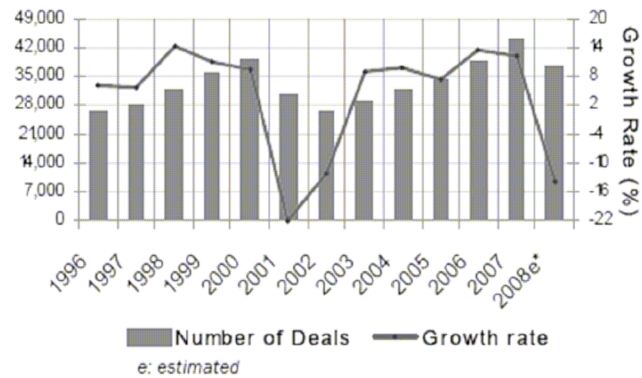
Firstly, as shown that diversification should be limited to companies which have synergy potential and without synergy a diversified business is nothing more than mutual fund (Martynova & Renneboog, 2008). However, in practice it has been found by studies that gaining synergy is not an easy task and most acquisitions and merger gains arise from either disposals of assets or from restructuring rather than synergistic benefits. It seems that synergy was a primary rationale for merger and acquisitions in the era but remains anomaly from value creation prospective (Dymski, 1999).

Secondly, the corporate strategy of the firms should focus on exploiting core competencies across different businesses. For instance, it was suggested that the corporate portfolio should be based on technological competencies instead of portfolio of businesses (Porter, 1987). Similarly, it was argued that invisible assets like reputation, brand names or customers list are the most valuable source for sustaining competitive advantage and could be used to create value by exploiting competitive opportunities (Prahalad & Bettis, 1986). Furthermore, other competencies such as technology or managerial expertise can also be used to enhance the performance of business portfolio (Prahalad & Hamel, 1989).

Thirdly, the best way to create value via successful diversification is to build a portfolio of businesses, which fits with the manager's logic and their management style (Shleifer & Vishny,

1) www.mercer.com

1994). If conglomerates diversification is based on business with similar strategic logic then it's possible to add value to business by adopting a common approach across all the business units. For instance it was exposed that sharing the skills or activities across organization can help corporate management to realize synergies (Hamermesh & White, 1984). When it comes to financial crises the main question here is whether or not it has any effect on frequencies of mergers or not.



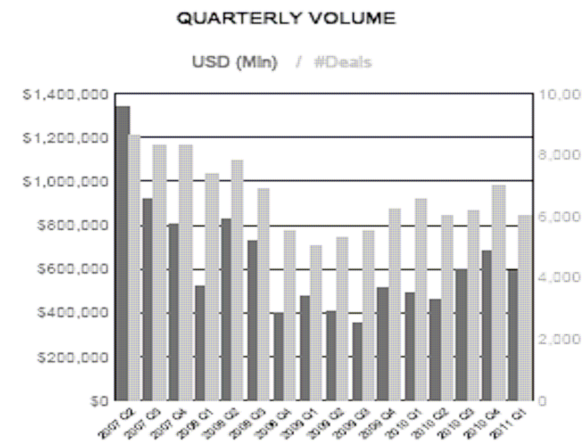

Source: Thomson Financial, Institute of Mergers, Acquisition and Alliances (IMAA)

<Figure 1> Historical view of M&A

The main reason for acceleration in frequency of the mergers was the deregulation by governments regarding financial institutions such as banks. Firms took full advantage of these deregulations along with economies of scale and technological advances (Shleifer & Vishny, 1997; Sikora, 1995). The second part of the above mentioned argument is also backed by (Lipin, 1997; Sikora, 1997; Singh & Zollo, 2000; Sirower, 1997).

According to estimates during 2007 M&A activity fell by almost 50 percent. The steep decline was mostly fuelled by fears of recession, Financing problems and the drop in activity results from several factors including lower value of completed deals, financing difficulties, and a general fear of the economic future. This was further enforced by past cycles as predictors such as 30 to 50 percent drop in stock markets in USA and around the world 2008, this crises shifted the focus of firm from profit maximization and capturing market share to just survival. Collapse of Lehman brothers, Bearstern etc. sent shock waves amongst the corporate world.

The waves of mergers are usually ended by major regulatory changes or by a financial crisis, recent drop in M&A activities support this notion, see Figures 1 and 2. This also enforces the notion that mergers and acquisitions are strongly influenced by overall economic conditions (Smith & Hershman, 1997). Firms use mergers as tool to counter the negative effects of economic crises. Companies search for potential buy out deals in order to enhance their chances of survival as this increases their capital bias, the result is merger or acquisition of that company or firm (Sudarsanam & Mahate, 2006). During the crises the credit crises the financial markets were subjected to great uncertainty and as result of this uncertainty the credit spreads spiked. This caused the cheap funding sources to dry up and major equity indices dropped by almost ¼.




<Figure 2> Trends in M&A Activity Market

Following financial crises it is important notice that there seems to slight change in corporate strategy. One of the major changes in corporate strategy regarding M&A's is the enormous cash reserves held by large firms. This has greatly strengthened the balance sheets of firms. The cash held by the firms has risen from $410bn to $1.1trn in terms of percentage pre-crises percentage was 5.9% and post crises, this has almost doubled to 10.7% at the same time one considerable change is the leverage ratio which has dropped from 3.0x to 2.0x.[2)]

These huge cash balances were accumulated by firms during the crises by cutting down the spending on R&D, dividend payments and new acquisitions. As corporate strategy these firms concentrated on repayment of debt and improving their liquidity position. Now things are getting back to normal, these firms now have to spend these huge cash balances on new wave of mergers because firms are facing many critical issues such as decline in growth rates around the world and very few organic growth opportunities. One of the main reasons for this is the fact that many of the leading economies such as European economies and U.S. economies are not yet fully recovered from the shock of 2007. Many economies in Europe are facing debt crises and slowdown of growth rate. At the same time long term EPS growth rate of large cap has come down from 13.2% to 11.2%. These conditions are ideal for mergers and acquisitions as firms are looking for top and bottom line growth by expanding their geographical and product range not to mention diversification. In current scenario M&A are their best option. This can be proved by following stats which show 22% increase in M&A activities in 2010, when compare to crises years of 2007, 2008, and 2009. see Tables 1 and 2 for details.

2) The new face of M&A how a trillion dollars will change the strategic landscape by Corporate Finance Advisory & Mergers and Acquisitions J.P. Morgan

<Table 1> M&A by Industry 2008

| Industry | Number of deals | Value (in mil.$) | Average value |
|---|---|---|---|
| Financial | 101 | 12,275 | 122 |
| Healthcare | 19 | 9,952 | 524 |
| Telecommunications | 24 | 7,786 | 324 |
| High Technology | 85 | 6,142 | 72 |
| Real Estate | 40 | 6,069 | 152 |
| Energy and Power | 42 | 5,149 | 123 |
| Industrials | 95 | 4,737 | 50 |
| Materials | 45 | 2,131 | 47 |
| Media and Entertainment | 35 | 1,184 | 34 |
| Consumer Staples | 25 | 512 | 20 |
| Retail | 18 | 383 | 21 |
| Consumer Products & Services | 36 | 318 | 9 |

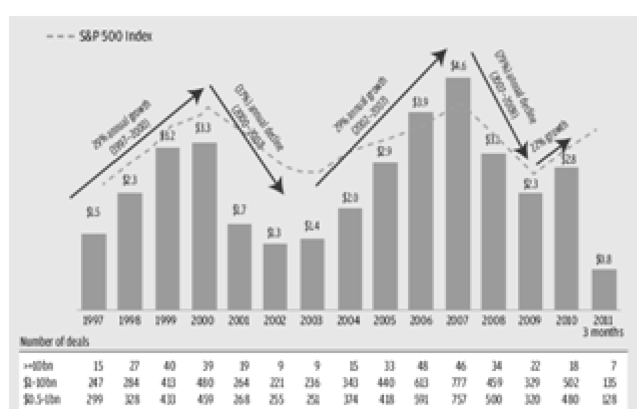
*Source: Thomson Financial, IMAA*

<Table 2> Summary of the S&P 500 (ex. Financials)

| Corporate Balance Sheets | 2001 | Current |
|---|---|---|
| Cash/Total Assets | 5.9% | 10.7% |
| Cash/FV | 4.1% | 10.0% |
| Cash ($bn) | $410 | $1,058 |
| Average Cash Balance ($bn) | $1.0 | $2.6 |
| Debt/EBITDA | 3.0x | 2.0x |
| Coverage Ratio | 6.8x | 10.9x |
| Long-term Growth[1] | 13.2% | 11.2% |
| Price/Earnings[2] | 24.4x | 15.9x |
| Firm Value/EBITDA[2] | 10.0x | 8.1x |

Source : Fact Set, Bloomberg, J.P. Morgan
Note : Figures calculated using aggregate for S&P 500 excluding Financials
[1] Median IBED long-term EPS growth estimate.
[2] Valuation metrics calculated on an LTM basis on S&P 500 constituents in each respective year.

Before end of second quarter of 2011 there were fair chances that M&A activities would rebound from the effects of financial crises in 2007-09. At the same time we should not ignore the debt crisis unravelling in many developed economies like Greece and Ireland. The 500 billion euros ($717 billion) package approved by E.U. has to some extent calmed crises varied investors to some extent. At the same time Spain and Portugal are also taking measure to safe guard their economies. The price this package is austerity measure, which will result in cuts in consumer spending and further forcing firms to merge with one another, see Figure 3. These mergers would be welcomed by investors as they would increase the chances of survival of merging firms. Thus investors felt somewhat secure and as result their confidence grew day by day.




Source : DEALOGIC (M&A Manager) as of 3/31/2011
Note : Rank eligible deals with value greater than $10mm. S&P 500 Index represents average index value over each respective period.

<Figure 3> Global Announced M&A Volume ($bn)

With fears growing that the debt crisis could spread to Italy or Spain, the euro zone's third- and fourth-largest economies, Spanish 10-year government bond yields rose to 6.36 per cent, their highest since the introduction of the euro. The Italian equivalent also rose above 6.0 per cent. Due to uncertainty in the cooperate world many large firms are using M&A's as part of investment strategy. The main reason for this shift is the opportunity presented by weakening of many small and medium sized firms by financial crises and lowering of consumer spending around the world. This would most probably result in many oligopolies in major sectors of developed economies around the world. The only question is that will governments allow these oligopolies to be established and continue? Well in current scenarios governments will not bother as in post crises era the major concerns of most governments is to provide some sort of job security to general public and somehow continue to support and stabilise the growth rate of economies. In the difficult time there is safety in numbers.

Current events can hit M&A activities as in recent times especially after the downgrade of US debt rating, investors became more vary of the financial markets and as S&P and Moods have already warned every one that France could follow in the footsteps of USA. This scenario has proved to investors that volatility and uncertainty experienced by them in late 2007 is not over yet. At the same time the risk of these investments will increase with increase in volatility so the investors would ask for higher returns, but in volatile times such as current scenario these returns might not measure up to the investor's expectations. At the same time many governments might overlook creation of oligopolies via these mergers.

The massive deficits accumulated by US government ad financial health of Eurozone countries is worrying investors. This worry is translated in to ever rising prices of crude oil and record high prices of gold. So if you analyse the above stat in these context than it can safely be assumed that rebound of M&A's will have to wait for some time. Even if M&A's mange to stage a comeback, it will not be strong as suggested by the above stats.

## 3. Conclusion

To conclude, it is safe to say that M&A activities have flourished during boom time or times of economic prosperity. The main reason for this over the time has been the availability of cheap credit. The M&A activities have emerged in form of waves and each waves had its own characteristics, which were different from others. But one thing common between all the waves is the fact that all of them ended with advent of crises of some sort. In current post crises era up until first quarter of 2011 the M&A activities seemed to rebound as large companies used M&A's as part of their corporate strategy but this was cut short by events like US debt ceiling, down grade of USA's credit ratings along with fears about Eurozone's financial health.

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