ADVANCES IN MERGERS AND ACQUISITIONS

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ADVANCES IN MERGERS AND
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ADVANCES IN MERGERS AND ACQUISITIONS

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> a marvel – a jargon-free business book based on serious research that offers genuine insights with clarity and sometimes even wit … It should be required reading not just for executives but for investors as well.

His latest bestselling book is *SUPERBOSSES: How Exceptional Leaders Master the Flow of Talent*, which was named one of Amazon's "Best Books" on business and leadership for 2016. LinkedIn Chairman Reid Hoffman calls it "a leadership guide for the Networked Age." He is a Fellow of the Academy of Management. He has had three books nominated for the Academy of Management's Terry Book Award, the most prestigious such honor in the field. He is a recognized thought leader on leadership, strategy, and corporate governance, and is listed on the "Thinkers 50," the most prestigious ranking of management thinkers in the world. He is well known for his keynote speeches and television appearances and is a regular columnist for the BBC.

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INTRODUCTION

Sydney Finkelstein and Cary L. Cooper

With this new volume of original and thought-provoking articles in the Advances series, we bring seven outstanding contributions together. As always, topics and authors are as diverse as can be. Despite the volume of past work on mergers and acquisitions (M&A), it is remarkable how the contributions assembled here add intriguing new insights, lines of inquiry, and practical relevance to what we know on this central topic of organizational life.

Timing is important in M&A, as it is in life! We know that merger waves occur, but we don't know much about how important it might be for an organization to pay attention to that timing. Enter Trang Thu Doan, Padma Rao Sahib, and Arjen van Witteloostuijn, who dig into completed and abandoned M&A deals to try to get at what's really going on. First, they conduct a textual analysis of the 150 largest abandoned M&A deals and find that competing bidders, regulatory concerns, and shareholder opposition from the acquirer are major roadblocks in the pre-merger process, and that these hurdles often occur jointly. Then they examine a sample of 2,802 announced M&A across four industry waves and find that M&A deals initiated earlier in a merger wave are more likely to be completed and are completed more speedily. So, yes, timing is important, and deal makers should be paying attention.

Patterns in M&A are not only relevant across firms but within firms as well. And that is what Natalia Vuori and Tomi Laamanen investigate in a set of in-depth case studies of geographic roll-up acquisition programs. In particular, Vuori and Laamanen break new ground by identifying four types of acquisition programs (cautious approach, political approach, investment-intensive approach, and hybrid approach), and an acquisition program has to be designed in a way that not only fits to the current environmental conditions in the host country, but also considers an acquirer's acquisition capabilities and resources.

Process concerns are also on the mind of Minh Thi Thu Vu and Salih Zeki Ozdemir, who set out to study whether firms rely on their own past experience or on what other influential firms have done in selecting their legal advisors for M&A transactions. They propose and find that firms with less experience in performing M&A deals place more emphasis on imitating others while firms with more experience with a particular legal advisor focus less on others' experience with this advisor.

The behavioral theory of the firm is one of the most central conceptualizations around for organizational scholars; yet, M&A have not always been evaluated in this context. Building on some of her empirical work in this area, Cyndi

Man Zhang turns her attention to M&A in her contribution to this Volume. She concludes that in fact, there are significant benefits from studying M&A decisions to enrich the overlooked coalition building and myopia mechanisms in the behavioral theory of the firm.

Philipp Geiler and Addis Gedefaw Birhanu are interested in the role of national corporate governance arrangements in acquisitions conducted in the European Union region. They put together an impressive sample of deals in 28 European countries between 2008 and 2015, and find that among the three types of corporate governance institutions, namely corporate ethics, accountability, and financial market development (efficiency), it is efficiency and a relatively higher level of corporate ethics within the target country in comparison to the acquirer country that are positively related to the value of acquisitions.

A major topic in both business and academia is business model innovation – changes to how a business is constructed to satisfy customers. The term "servitization" has been used to describe how a manufacturing firm redevelops its product offering to focus on the customer's *use* of products and thereby also adds services to the offering. The question is, what about M&A? What role do they play in such business model innovation, and how might that happen? Christina Öberg reviews the literature on these questions and identifies potentially important research gaps for scholars to focus on, something that many articles in the Advances series have done over the years and, hence, a key contribution to this Volume as well.

In the final contribution in this Volume of Advances, Kamal Ghosh Ray takes on a classic issue in M&A – the hostile takeover. Relying on a detailed look at two well-known such instances in India, he develops a distinctive model to demonstrate that unsolicited hostile takeovers may not be a good mechanism for successful business combination.

In sum, we have in Volume 19 a collection of diverse articles from authors in different continents studying different aspects of M&A. Putting together a collection like this is always striking in that it once again highlights that there is a wide world of M&A deals, mechanisms, patterns, and solutions that are worthy of scholarly investigation.

CHAPTER 1

IS TIMING EVERYTHING? THE TIMING OF AN M&A ANNOUNCEMENT IN A MERGER WAVE

Trang Thu Doan, Padma Rao Sahib and Arjen van Witteloostuijn

ABSTRACT

The authors investigate the pre-merger process, defined as the period between the announcement and completion of an M&A (mergers and acquisitions) deal. Specifically, the authors examine if the timing of the announcement in a merger wave affects whether or not the M&A deal is completed, and how long this pre-merger process takes. The authors conduct a textual analysis of the 150 largest abandoned M&A deals in the sample. From this, the authors find that competing bidders, regulatory concerns, and shareholder opposition from the acquirer are major roadblocks in the pre-merger process, and that these hurdles often occur jointly. Subsequently, the authors examine a sample of 2,802 announced M&As across four industry waves and find that M&A deals initiated earlier in a merger wave are more likely to be completed and are completed more speedily.

Keywords: Mergers and acquisitions; acquisition completion; timing strategy; pre-merger process; first-mover advantage; merger waves

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INTRODUCTION

In recent decades, the study of mergers and acquisitions (M&As) has attracted much research interest across a variety of disciplines, particularly in Economics, Finance, and Management. In addition to the extensive research on determinants of M&As and M&A post-merger performance, studies have also started examining the merger *process* (e.g., Chakrabarti & Mitchell, 2016; Doan, Rao Sahib, & van Witteloostuijn, 2018; Gomes, Angwin, Weber, & Tarba, 2013; Junni, Sarala, Tarba, & Weber, 2015; Muehlfeld, Rao Sahib, & van Witteloostuijn, 2012; Sarala, Junni, Cooper, & Tarba, 2016). This chapter focuses on the pre-merger stage of the M&A process. Completing an M&A deal once you have publicly announced your intention to do so, and to do so within a reasonable time frame, is important to both firms and managers. There are financial costs such as termination fees, but also less visible reputational damages that follow from deal abandonment (Pickering, 1983). Also, an M&A transaction is generally perceived as part of growth and expansion strategies and is seen as "good" for the acquiring firm. So, there are clear firm-level incentives to complete the process. In addition to the usual economic motives for a merger (such as economies of scale, increasing profitability, and risk-spreading), managers also have individual motives to engage in M&A activities – for instance, taking on a managerial challenge and enhancing managerial prestige (Brouthers, van Hastenburg, & van den Ven, 1998). A successful and efficient pre-merger process could serve as a stepping-stone to achieving other longer-term goals for a manager.

This chapter contributes to a growing stream of literature on the determinants of the pre-merger process. Several factors have been shown to influence the probability of completing an announced merger – for instance, the geographic distance between both firms (Chakrabarti & Mitchell, 2016), distance in country law, regulation, and risk (Zhou, Xie, & Wang, 2016), capital market development and business group affiliation (Kim & Song, 2017), cultural and institutional differences between acquirers and targets (Ahammad & Glaister 2013; Ahammad, Tarba, Liu, Glaister, & Cooper, 2016), and experience with prior acquisitions (Muehlfeld et al., 2012). Related to this but in a broader context, Gomes et al. (2013) investigate how critical success factors affecting one phase of the M&A process may contribute to such factors in other phases.

We also contribute to a parallel stream of literature on the role of timing in M&A strategy. This literature has found that *when* a firm makes a strategic move in a merger wave can affect performance (Brauer & Wiersema, 2012; Carow, Heron, & Saxton, 2004; McNamara, Haleblian, & Dykes, 2008). For instance, theories on first-mover advantages suggest that "early birds" can cherry-pick a partner from a large pool of targets (Carow et al., 2004). This literature has focused on post-M&A performance, but we apply these arguments to the pre-merger process. We claim that early-stage acquirers are more likely to find targets that offer strategic fit and organizational rapport, and that this increases the probability that the deal will be accepted by both partners. Additionally, compared to later stages of a wave, competition at the beginning is likely to be less intense (Brauer & Wiersema, 2012; McNamara et al., 2008). This has two implications: first, the likelihood that competing bidders interfere during the process is lower; and second, if the target seeks a white knight bidder to contest the focal offer, the chance that the target can find one is likely to be lower than in a later stage, particularly *vis-à-vis* the time around the peak. Therefore, depending on the timing of the deal in the merger wave, firms might experience different hurdles, which influence the probability of completing the deal and the time needed to complete the pre-merger process.

To the best of our knowledge, this chapter is the first to examine the role of timing in the pre-merger process. We investigate the potential causes of announced M&A deals' abandonments, through a literature review and textual analysis of cases, and link these causes to arguments as to the role of strategic timing in the context of M&A waves. Our findings have implications for managers as they indicate that, even in the pre-merger process, the success of a strategy not only depends upon this strategy's substance and implementation, something that has been studied for many decades by now, but also on the timing of the strategy's launch.

THEORETICAL BACKGROUND

The Pre-merger Process

The pre-merger process is considered to be a strategic and complex phase, involving many interdependent tasks relating to finance and human resources, such as re-evaluating assets, choosing methods of payment, preparing for integration, etc. (Boone & Mulherin, 2007; Jemison & Sitkin, 1986; Meyer & Altenborg, 2008). In addition to internal issues, firms also need to deal with external issues such as regulatory concerns and public relations which might be changing (Arnold & Parker, 2007).

Considering the losses that accrue from terminating an M&A process, two main questions arise: (1) what are the hurdles that prevent firms from completing deals? and (2) how can firms overcome these hurdles? The majority of research on M&A completion has focused on investigating the second question. For example, research has shown that M&A completion is facilitated by payment in cash, better managerial understanding of cultural and institutional differences, and when acquirers have M&A experience. Yet, the current literature still remains unclear about *which* specific obstacles managers face in bringing an M&A deal to successful closure.

To better understand which roadblocks the involved parties may face during the pre-integration process, we conducted a textual analysis of the synopses of the largest 150 abandoned M&As between 2000 and 2010. Synopses are short textual summaries of the major events surrounding deals based on publicly available information. We collected data from the two most widely used databases in M&A research, namely Zephyr (a European database) and SDC (Securities Data Corporation's Worldwide Merger and Acquisition Database). We examined each synopsis in the sample and recorded the main hurdles that may lead to the abandonment of the transaction and/or to prolonged pre-integration processes. We then categorized these findings into different groups of reasons that are similar to each other. We present the major results from our analysis in Table 1, separating our findings based on the attitude of the deal – hostile versus friendly (hostile deals are initially opposed by the target). We conjecture that the hurdles that firms

Table 1. Number of Abandoned Deals by Reasons and Attitudes.

	Target Resistance	Competing Bidders	Regulatory Concerns	Acquirer Resistance	Total
Hostile	32 (94%)	19 (56%)	13 (38%)	2 (6%)	34
Friendly	52 (45%)	34 (29%)	17 (15%)	14 (12%)	116

experience in the pre-integration process in hostile deals might be different from those that emerge in friendly deals. Table 1 reports the number of abandoned M&A transactions by reasons cited and by attitude.

As can be seen in Table 1, our textual analysis identifies, in order of importance, four main roadblocks: *Target resistance*, followed by *Competing bidders*, *Regulatory concerns*, and *Acquirer resistance*. Note here that by acquirer resistance, we mean that the shareholders of the acquiring company opposed the deal (although the management initiated the deal). Other reasons occurred infrequently (because deals may stall for multiple reasons, the cages do not add up to 100%). Considering deal attitude, two notable findings emerge from the textual analysis. First, the frequency with which each hurdle occurs in the pre-integration process follows nearly the same pattern in both sub-samples. However, hostile deals appear to "suffer" more from multiple reasons than friendly deals, and *Competing bidders* and *Regulatory concerns* occur in half of the sub-samples.

Table 1 shows that 84 deals (nearly 60% of our sample) experienced target resistance. Not only in hostile deals, but in a few friendly ones, strong target opposition is mentioned as the main roadblock. This finding is consistent with research on targets' roles in M&A transactions: targets are not passive, but can be active and sometimes contentious players (e.g., Graebner & Eisenhardt, 2004; Graebner, Eisenhardt, & Roundy, 2010). As mentioned explicitly by Graebner and Eisenhardt (2004, p. 375), "sellers are active participants whose interest in being acquired affects whether buyers succeed." Opposition from the target can come from the board, the shareholders, or both, due to several reasons such as low premiums or an unattractive method of payment. In general, a transaction financed by cash tends to be preferred by the target, compared with a share-financed deal, because of its transparency (Sudarsanam, 1995).

But there is more to deal-making than financial factors alone. According to prior literature, an important reason for firms to sell (or to reject an acquisition offer) are considerations regarding the two firms' combination potential and organizational rapport (Graebner & Eisendhardt, 2004). Findings from case studies of 12 ventures by Graebner and Eisendhardt (2004, p. 384) reveal that

> although price is important, selling leaders carefully weigh the match of the combination potential and organizational rapport between the two firms, factors that are more consistent with the long-term and multifaceted calculus of courtship, and, surprisingly, with the long-term interests of the buyer.

Indeed, 9 of the 12 selling firms studied in Graebner and Eisendhardt (2004) chose to partner with the firm that offered the best fit in terms of strategies, cultures, and human resources, rather than price alone. In most cases, acquiring firms that can create a feeling of trust and respect are also more preferred. However, even this is no guarantee for success as equality principles led to a failed merger as documented in the Telia Telenor case (Meyer & Altenborg, 2008).

Together with findings from our textual analysis, these results suggest that in addition to bid premiums and payment methods, considerations regarding strategic fit and organizational rapport play an important role in the M&A process.

The entry of competing bidders is another barrier to deal closure. This is referred to in one-third of the 150 abandoned deals. In many cases, the involvement of other bidders gives targets more options to choose from, which resulted in the target demanding a higher price (Graebner & Eisenhardt, 2004). Strategies such as white knight bids – that is, rival bids from other "friendly" companies, increase the number of competing bidders and reduce the chance of deal closure.

Also, M&As may be abandoned because of rejection by regulatory authorities. Thirty announcements out of 150 cases in our sample (19%) faced hurdles from competition authorities, due to concerns involving a post-merger increase in market concentration. The time taken by regulatory authorities to investigate an M&A deal may vary depending on the complexity of the deal and some may be scrutinized by more than one regulatory authority, depending on the markets affected by the integration.

Although, in general, acquirers want to achieve deal closure (as the deal are usually initiated by the acquirer), the acquirers withdrew the deal in 16 cases. The reasons referred to are somewhat similar to the reasons related to target resistance: the match between two firms is evaluated as unsatisfactory and/or bidding prices are assessed as being too high (here, of course, from the perspective of the acquirer).

Finally, and most importantly, our textual analysis reveals that multiple obstacles can occur jointly during the pre-closure period. An example is the announced M&A transaction between the two UK banks Lloyds TSB Group and Abbey National. Lloyds TSB Group made a first bid on Abbey National in 2000, but their offer was rejected soon after. Then, in January 2001, Lloyds TSB launched their second bid for Abbey National, which was worth approximately GBP 19.8 million and valued Abbey National shares at GBP 13.10 per share. However, the board of the target still declared that the proposal was inadequate. Meanwhile, the UK competition commission announced that they had identified a number of issues that needed to be investigated before deal closure. The parties were supposed to be informed about the result of this investigation approximately two months later – that is, in June 2001. While the firms were waiting for the judgment from the authorities, Prudential plc announced interest in acquiring Abbey National in June 2001. Moreover, another company, National Australian Bank Ltd., also approached Abbey National with a takeover offer. Finally, on July 10, 2001, the bid was formally terminated because the UK Government and Trade and Industry secretary believed that the merger would be against public interest and reduce competition in the current market. This case demonstrates that a number of factors were involved in the abandonment of the announced M&A deal between Lloyds TSB and Abbey National – target opposition, competing firms, and regulatory authorities.

HYPOTHESES

We claim that the roles of the four main roadblocks, as identified in the above textual analysis, may well vary across different stages of M&A waves because of the advantages and disadvantages of moving early (or late). For example, in the case of the two UK banks, regulatory opposition was the first roadblock, followed by competing bidders. Therefore, the probability of an M&A being completed (and how long it takes) early in a wave may be different from an M&A that comes later.

In the first stage of the M&A wave, we expect a higher likelihood of deal closure and a quicker process because the hurdles are likely to be fewer and less pressing than in later stages. Due to first-mover advantages, firms that act early enjoy a variety of benefits. First, early movers can cherry-pick from a larger pool of targets (Carow et al., 2004; McNamara et al., 2008). Second, early movers are likely to possess superior information that allows them to identify and purchase targets at a discount price (Barney, 1988; Lieberman & Montgomery, 1988). Furthermore, the fact that there are not many bidding firms in the early stage of a wave (i.e., fewer *Competing bidders*) not only attributes to the low price that acquirers may gain, but also offers the additional advantage that competition between early acquirers and their rivals might not be overly harsh – another price-reducing mechanism. Hence, early movers can gain competitive advantages over their peers by acquiring more attractive targets against lower prices (Lieberman & Montgomery, 1988). All of this translates into lower *Target resistance* and *Acquirer resistance*, leading to a higher completion likelihood and a shorter deal process.

Similarly, we anticipate that the later acquirers act in a wave, the higher is the likelihood that they will face *Target resistance*, *Acquirer resistance*, and *Competing bidders*. As a deal gets closer to a merger wave peak, two scenarios may happen: (1) targets may reject the deal so that they can seek higher prices from the market as demand is high (Sudarsanam, 1995); (2) more competing bidders give targets more options to find white knight bidders to fend off the focal offer. Together, these imply that both the hurdle of *Competing bidders* and that of *Target resistance* increase along the wave, at least until the peak is passed.

After the peak, although the pressure on price may be reduced, the pool of targets also shrinks. Hence, it is more difficult for acquirers to find good matches, particularly in terms of organizational synergies and post-integration performance potential. In addition, evidence suggests that firms buying later in a wave pay more for targets (Fauli-Oller, 2000). As the pool of desirable targets is reduced along the wave, while demand is high, target prices are likely to increase (Carow et al., 2004; Graebner & Eisenhardt, 2004). These arguments jointly indicate that as firms move along a wave, not only is deal completion likelihood lower, but the pre-merger process is likely to be prolonged, since acquirers and targets may need more time to negotiate over bid premiums.

Lastly, in terms of *Regulatory concerns*, competition authorities evaluate if the M&A will reduce competition because of a dominant post-merger market position of the integrated firm. *Ceteris paribus*, as more firms engage in M&A

activities over a wave, market density will be reduced and market concentration will increase. Both changes in market structure trigger regulatory concerns for competition authorities, as standard logic in industrial organization economics, suggests that – if anything – lower market density and higher market concentration will affect competitive intensity negatively (Tirole, 1988; van Witteloostuijn & Boone, 2006). Moreover, an increasing number of announced M&As in a wave might slow down the process of regulatory investigation, given the limited capacity of competition authorities, thus increasing the length of the pre-merger process. All this leads to:

H1. The later an acquisition deal is announced in a merger wave, the lower is the likelihood that this deal will be completed.

H2. The later an acquisition deal is announced in a merger wave, the longer the pre-merger process will take.

DATA AND METHODOLOGY

Data and Waves

We test our hypotheses in the context of industry merger waves between 1996 and 2002 (in the so-called fifth global merger wave). We followed the classification of merger waves as documented in McNamara et al. (2008), examining the four largest waves from their sample: *Semiconductors*, *Telephone communications*, *Real estate operators*, and *Information retrieval services*. Subsequently, we collected M&A data from Thomson SDC database with restrictions as to the industries and time ranges based on the selected waves (see Table 2). We required that (a) at least one partner is from the selected industries and (b) the transaction was announced in the period of the chosen waves. The final sample contains 2,802 announced M&A transactions worldwide, including 1,509 firms over four industry merger waves. The abandonment rate for the whole sample is 16.5%. The rate varies across the waves, with a minimum of 8.2% in the semiconductors' wave, and a maximum of 19.8% in the wave in the telephone communications industry. The median time to completion is approximately two months (65 days). Most of the deals are friendly, with only 6% of the sample (162 observations) involving hostile deals.

Table 2. Selected Mergers and Acquisitions Waves.

	Industries	Wave Date Range	SIC Code	Cases in Analysis	Completed Transactions
1	Semiconductors	1998–2001	3674	380	349
2	Telephone communications	1998–2002	4813	810	650
3	Real estate operators	1996–2000	6512	404	342
4	Information retrieval services	1997–2001	7375	1,208	999
	Total			2,802	2,340

Variables

Our first dependent variable, *Pre-merger process completion*, is a binary variable, which takes the value of 1 if the focal announced M&A deal is "completed" and 0 if "abandoned." Our second dependent variable, *Pre-merger process duration*, is measured as the number of days between the announcement and completion (or abandonment) dates of each deal. Our independent variable is *Deal position*, which captures the timing of each M&A announcement in a merger wave. Similar to McNamara et al. (2008), we calculated this variable by dividing the ordinal position of the focal deal announcement by the total number of announced M&A transactions in the overall wave. An example of how to calculate this variable is shown in Appendix.

We added a number of the transaction-level and firm-level control variables. At the transaction level, *Cash payment* is a dummy variable that takes a value of 1 if the payment method of the transaction is cash (as recorded in SDC). *Deal attitude* is a dummy variable coded as 1 if the focal transaction is a friendly deal (as recorded in SDC). *Deal size* is measured by the natural logarithm of M&A deal value (in million Euro). *Acquirer size* is measured by the natural logarithm of the total assets of the acquirer (in million Euro). *Ratio deal size to acquirer size* is calculated by dividing deal values by acquirers' total assets. At the firm level, *Industry relatedness* takes the value of 1 if the acquirer and the target operate in related industries (their US Standard Industrial Classification [SIC] codes at the four-digit level coincide). *Acquirer public status* and *Target public status* are dummy variables, coded as 1 if firms are publicly owned, as recorded in SDC. *Acquirer termination fee* is 1 if the acquirer has to pay a termination fee and *Target termination fee* is similarly defined. Industry dummies were also included.

Estimation Method

We estimated two separate models: a logistic regression model with *Pre-merger process completion* and a linear regression model with *Pre-merger process duration* as the dependent variables, respectively. Although the dependent variables are different in both models, the independent and control variables are identical. We estimate the model with clustered standard errors to account for within-firm correlation, as some firms undertook multiple acquisition attempts during the observation period.

RESULTS

Table 3 presents descriptive statistics and the correlation matrix for our set of variables. All variance inflation factors range between 1.01 and 2.38, which are well below the standard cut-off level of 10 (Kennedy, 2000). The descriptives show that our data are not very different from data used in other studies on M&As – most acquirers are publicly owned and 38% of the deals were paid in cash.

Tables 4 and 5 provide the results of our analysis on M&A deal closure and the pre-merger process length. Table 4 indicates a negative and significant effect