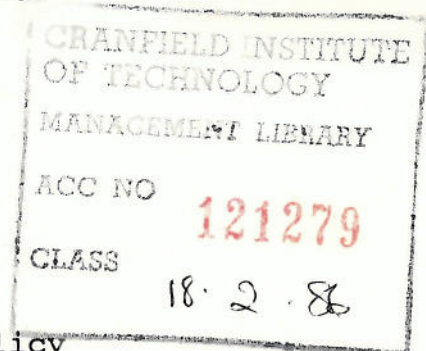


THE MANAGEMENT FACTOR
IN ACQUISITION PERFORMANCE



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ABSTRACT

This paper reviews the "state of the art" of both theoretical development and empirical investigation concerning Mergers and Acquisitions. It classifies existing knowledge within three main areas:

- . pre-acquisition procedures - typologies of selection and decision making processes;
- . valuation activity - the determination of price and methods of payment;
- . success criteria - what should be measured.

The review highlights the paucity of research as to the different effects of managerial behaviour and motivation upon acquisition outcomes, and therefore suggests a number of testable hypotheses in urgent need of investigation.

The purpose of this paper is firstly to review the "state of the art" of scholarship concerning Mergers and Acquisitions by classifying according to methodological dimensions, and secondly, to suggest a programme of research to investigate the potential importance of Management within the process, a subject of increasing emphasis within the corporate world.

In addressing the issue of financial benefits from Mergers and Acquisitions, overall research findings are consistent and suggest that if shareholders' wealth maximisation is the primary objective, the impact for acquiring companies shareholders is at best neutral (Meeks 1977; Franks, Broyles & Hecht 1977; Firth 1980). Despite this, contemporary statistics from the United Kingdom show a continuing and widespread use of acquisition as a key element of corporate strategy, the average value of each having increased by nine times over the last decade (Business Monitor, 1984).

This level of activity has in turn led to concern about the status of anti-trust legislation with conflicting demands for complete deregulation at one extreme to the statement at the other extreme that all mergers above £16m should be held to public scrutiny with the onus on the acquiring firm to demonstrate that the ex-post corporation would benefit society. White (1981) argues that mergers have not led to a concentration of industrial strength as measured by value added, profits or employment, and therefore are not against public interests. In contrast, Pickering (1980) argues that the Public benefits of acquisitions are so difficult to predict or realise that they should be more strongly regulated. This very controversy, coupled with current increased levels of acquisition activity, makes it apposite to review existing

knowledge which, broadly speaking, has focussed upon three main areas:

1. Pre-acquisition planning - typologies of acquisitions and the decision making processes.

2. Valuation activity - the determination of price, and methods of payment; an area essentially within the domain of Financial theorists and therefore outside the brief of this paper.

3. Acquisition Performance - which criteria are appropriate, and how should success be measured.

Beyond these three areas, an additional dimension is gaining momentum - the significance of management behaviour as an explanatory variable, a view personified by Bradley and Korn's (1982) study of failed acquisitions who state that "the most common causes of nonsuccess are overoptimism and a lack of adequate contingency planning, including a dearth of healthy skepticism in business projections and a failure to appraise personality incompatibilities between managements".

LITERATURE REVIEW

Pre-Acquisition Planning:

The categorisation of acquisitions starts at the planning stage - opportunistic approach, research approach, combination approach (Fray, Gaylin & Dawn, 1984), continues through the timing of the acquisition process - industry peaks and troughs (Beman 1973; Bradley & Korn 1981; Kumar 1977; Lynch 1971; McCarthy 1963; Salter & Weinhold 1979, 1982), and the method of payment - cash, stock or various combinations (Nielson 1972; Allen, Oliver & Schwallie 1981). However the most generally used classification method is to compare the industry relatedness of the acquirer and

the acquiree - the degree of "fit". Using this criterion, a summary of acquisition typology research is shown in Table 1.

[Insert Table 1 about here]

The genesis of this research route was the proposition by Ansoff & Weston (1962) that "the proper approach to merger is first an internal appraisal of the firm's objectives followed by an investigation of the kinds of mergers related to these objectives and finally, an evaluation of the synergism of management capabilities between the firm and its merger candidate". The work of Reed (1970 & 1972), Ansoff (1971), and Salter & Weinhold (1979) developed the first part of this proposition but with the exception of Birley's (1976) study, the management issues have, as yet, remained largely unexplored. In addition few new developments have emerged since the flurry of activity around the publication of the Federal Trade Commission classifications of acquisitions in 1978, which are now widely used by corporate practitioners.

Acquisition Performance:

The findings of the major studies concerning the impact of mergers on corporate performance which relate entirely to publically-quoted companies are summarised in Table 2 below, from which five general conclusions may be drawn:

1. Returns to the shareholders of acquiring firms are at best slight and tend to disappear rapidly, and, at worst, are significantly negative.
2. Returns to the shareholders of acquired firms are strongly positive.
3. Gains and losses of victims and predators became a zero-sum.

4. In certain cases a failed bid leads to improved stock market valuation.
5. Acquisitions were unlikely to reduce risk.

[Insert Table 2 about here]

Acquiring Companies:

The work of Firth (1976); Dodds & Quek (1985); Ellert (1976); Elgers and Clark (1980); and Michel, Shaked & Yobaccio (1983), all found evidence of increases in share value and abnormal returns to the acquiring firm in the period leading up to the announcement of the merger bid. Ellert (1976) found that although share values showed an overall appreciation of 8.5% over the 24 months pre-acquisition, share performance declined in the last seven months prior to the merger. Conversely, following the announcement a reduction of this initial gain was generally observed. Firth (1976 and 1980), and Barnes (1978 and 1984), identified a sharp decline immediately following the acquisition event while Michel, Shaked and Yobaccio (1983), and Dodds & Quek (1985), found a more gradual decline taking up to 55 months to eliminate the earlier gain.

Acquired Companies:

General agreement exists that the shareholders of the company to be acquired do considerably better out of the deal. Franks, Broyles & Hecht (1977) found gains of 20% to the victim's shareholders in the three month period before an acquisition was announced. This led them to consider the possibility of "insider trading" leading to speculation in the victim's shares. Their work was confined to the Brewing Industry but was confirmed by Wansley, Lane & Yang (1983) in a study of 200 acquisitions where they identified abnormal gains of 25% to the victims shareholders in the

40 days before the acquisition announcement. Using Cumulative Average Returns (CAR), Halpern (1973) identified positive abnormal gains of 30.4% and Malatesta (1982) showed gains of 22.2% within the last two months before the acquisition. All of these studies confirm that the shareholders of acquired firms earned abnormal gains from the merger.

Zero-sum:

However Firth's (1980) study of 434 UK acquisitions concluded that no aggregate advantage accrued since the gains accruing to the victim were cancelled by the losses of the attacker. By adding the gains to the victims shareholders to the apparent long-term losses to the shareholders of the acquiring firms Franks, Broyles & Hecht (1977) similarly confirmed the Mandelker (1974) hypothesis of Perfectly Competitive Acquisition Markets which proposes that competition among acquiring firms will cause the value of expected benefits from merging to be paid to the shareholders of the firm being acquired.

Bid failure:

Firth's (1980) study found that unsuccessful attackers outperformed the market in the twelve months following the failed bid, a result supported by Dodd & Ruback (1977) who found that following the rejection of a bid, the target's shares failed to fall back to their pre-offer level.

Risk:

Lubatkin & O'Neill (1985); Langetieg, Hangeu & Wichern (1980); and Mason & Goudzwaard (1976) examined whether acquisitions were used to reduce the risk associated with a particular firm by managers. Lubatkin & O'Neill (1985) conclude that while certain

types of acquisitions can reduce systematic (market related) risk they are not an effective means of reducing unsystematic (firm related) and total risk. Indeed Langetieg, Hangeu & Wichern (1980) found that acquisitions tend to be associated with increased levels of systematic, unsystematic and total risk for the merged firms. Mason and Goudzwaard (1976) concluded that Unit Trusts and portfolios of selected industry shares were a more effective way for shareholders to reduce their risk profile than the shares of conglomerate firms.

Managerial Implications:

These studies referenced above use publically available financial data and assume a criterion that managers of both acquiring and acquired firms attempt solely to maximise the wealth of shareholders in their merger decisions. Yet, Boucher's (1980) study for the Federal Trade Commission, found that managers chose from a multiple set of criteria prior to the bid and listed twelve reasons ranging from increasing shareholder wealth, to increasing the power and prestige of the C.E.O.

Kitching (1967) identified variables such as the relative size of the companies, the market share position of the acquiree, the retention of acquiree management, and the post-acquisition integration process and related these variables to success as defined by the management of the acquiring company. He suggested that management of the acquiring firm would increase the likelihood of success by "matching the availability of managers of change with the tasks of the newly merged enterprise", and by specifying at the outset the control system to be used and sticking to it. Salter and Weinhold (1979) similarly decided that successful acquisition

outcomes were due to the "organisational structure and human resource skills of the acquirer, coupled with latent synergistic possibilities."

These statements imply that in unsuccessful acquisitions, either no synergistic benefits accrue to increase shareholders' wealth, or, that the acquiring companies lack the management ability to release the available benefits. The continuing popularity of acquisitions leads these authors to focus upon this latter belief. The impact of management style and behaviour on acquisition performance is similarly identified by Mace & Montgomery (1962); Sectoo (1977); Ansoff (1971); and Drucker (1977). Yet little empirical research activity has extended Kitching's (1967) early work in linking these management features to acceptable measures of acquisition performance leading us to propose certain hypotheses for future investigation.

THE MANAGEMENT FACTOR - FUTURE DIRECTIONS

Theoretical Direction:

Relatedness or degree of "fit" between acquirer and acquiree has been used in different stages of the research into acquisition performance.

The degree of industry relatedness was thought to explain acquisition success until the study of Cowling, Stoneman, and Cubbin (1979) demonstrated that the relationships held true only in high profit industries and not in low profit industries, thus linking both industry performance and acquisition performance. Kitching (1967) identified a "fit" between company characteristics (size, market share) in those acquisitions acknowledged as successful by the managers concerned.

Norburn (1986) tested the characteristics of top managers within the UK's largest companies against the performance of those industries in which they were strategically competing. He found significant differences in management characteristics between industry sectors categorised as growth, turbulent and declining. This work extends the upper-echelon theory of Hambrick and Mason (1985) which posits that top management characteristics will, partially, predict organisational success. The significance of management within performance outcomes is therefore appropriate for further investigation.

We therefore believe that the relatedness which actually existed in the earlier acquisition studies could be a relatedness of management characteristics and style which in turn leads to successful acquisition outcomes.

Conversely, the lack of relatedness or "fit" may become evident at various stages in the acquisition process. When Levinson (1970) looked at merger performance he contended "that some psychological reasons for merger not only constitute a major, if unrecognised, force toward merger but that they also constitute the basis for many, if not most, disappointment and failures". He concluded that these hidden psychological reasons for acquisitions led to a condescending attitude towards the victim which results in efforts to manipulate and control which in turn led to "(a) dissillusionment and the feeling of desertion on the part of the junior organisation and (b) disappointment, loss of personnel and declining profitability for the dominant organisation".

Similarly (Hayes 1981) suggested that expectations of the future relationship are created during the acquisition negotiations. When these expectations are not met ex-post facto, executives become disillusioned, morale falls, performance declines, and executives leave. This again is consistent with Cox's (1981) identification of the failure to link the negotiating team and the implementation team as a stumbling block to successful acquisition management.

Supporting the significance of managerial style and behaviour, Hayes' (1981) study of top executives who had sold their companies found that "extensive control or interference by the parent company was reported to be the prime reason for leaving by over two thirds of executives who left, following the acquisition." Further, Kitching (1967) and Cox (1981) suggested that many of the problems of style and expectations can be anticipated and the creation of false expectations can be eliminated by adequate planning of the management issues and implications of the acquisition.

The main theoretical research works which cover the issues of managerial style and characteristics are summarised in Table 4 below in terms of their impact at various stages of the acquisition process.

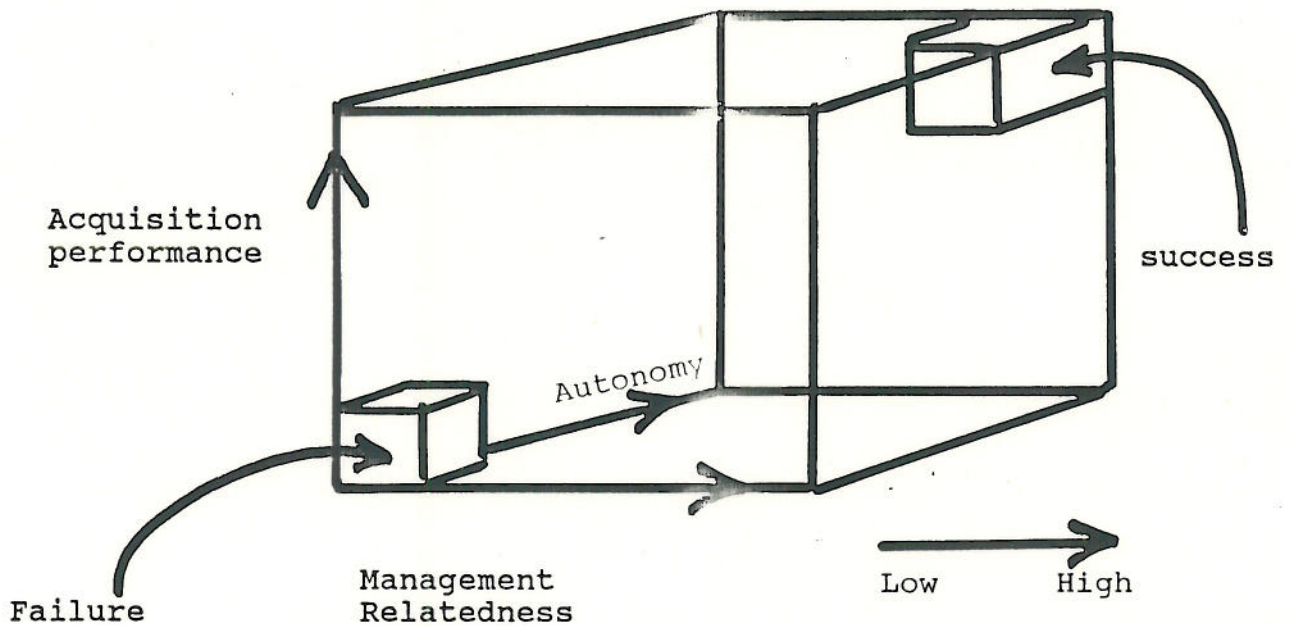
[Insert Table 3 about here]

However by contrast with the studies which identify management problems of acquisition, Hayes' (1981) study of top executives involved in acquisitions found that 75% of those "victims" who stayed with their company "enjoyed a satisfactory level of autonomy". Lack of autonomy was measured in terms of unsolicited

parent company directives and decisions, excessive operating control, excessive reporting requirements and corporate staff interference. It could thus be argued that acquired companies can be isolated from the impact of unrelated management style through the degree of autonomy they enjoy.

Therefore while we believe that a correlation exists between relatedness of management style and acquisition performance, acquisitions can be successful even in cases of unrelated management style where the acquiree had a high level of autonomy post acquisition. These relationships are shown graphically below.

Figure 1: The Management Factor Rubric



From this review, it would appear that although the significance of the managerial factor has been identified, insufficient empirical investigation has been conducted relative to the importance of ensuring acquisition success. We therefore suggest five hypotheses as fruitful avenues for field research.

Management Style Match: H 1

The degree of fit of Management style and approach between the acquirer and acquiree companies is directly correlated to the success of the acquisition.

Pre Planning: H 2

The success of the acquisition is determined by the amount of pre-acquisition "people planning" that took place.

Negotiations: H 3

In successful acquisitions a match in expectations exists in terms of personnel policy, remuneration, management style, and degree of autonomy between the management teams of the acquiring company and the acquired company.

Post Acquisition Style: H 4

Morale in the acquired company is directly correlated to post-acquisition performance.

Autonomy: H 5

Where a lack of "fit" in management style exists, the success of the acquisition is determined by the amount of post-acquisition autonomy which is granted to the acquired company.

CONCLUSIONS

Theoretical and empirical research in Strategic Management has developed from typologies of strategy through strategy formulation mechanisms and is now focussing on the managerial implementation issues of managing continuous change. In contrast, research on Mergers and Acquisitions has explored the structural issues of typology and performance and although several studies have commented on the importance of management style, existing knowledge is limited.

In seeking to develop a better insight into those aspects of research on Mergers which are in need of empirical development this paper, whilst recognising the difficulties of linking behavioural and performance issues, suggests directions for future research which would extend the 'static' models of mergers to include the changing aspects of organisational style and culture.

TABLE 1

Typology of Acquisitions

Related Acquisition

Unrelated Acquisition

Guth 1980

Guth 1980
Bettis & Hall 1982
Montgomery 1979
Rumelt 1974

Strategic

Investment

Guiniven 1985

Guiniven 1985

Related Complimentary

Related Supplementary

Pure Conglomerate/Conglomerate/
Selective Diversification

Pekar 1985
Salter & Weinhold 1979
Allen, Oliver &
Schwallie 1981

Pekar 1985
Salter & Weinhold
Allen Oliver &
Schwallie 1981

Baker, Miller & Ramsperger 1981
Poindexter 1970
Bradley & Korn 1982
Wansley, Lane & Yang 1983
Reed 1970
Pekar 1985
Salter & Weinhold 1979
Allen, Oliver & Schwallie 1981
Federal Trade Commission 1978

Vertical

Horizontal

Concentric Marketing

Concentric Technology

Herrman 1976
Stacey 1966
Baker, Miller
& Ramsperger
1981
Kitching 1967
Poindexter
1970
Reed 1970

Chakrabarti &
Burton 1983
Baker, Miller &
Ramsperger 1981
Kitching 1967
Poindexter 1970
Reed 1970
Herrman 1976

Baker, Miller &
Ramsperger 1981
Kitching 1967
Poindexter 1970
Reed 1970
Herrman 1976

Chakrabarti & Burton
1983
Baker, Miller &
Ramsperger 1981
Kitching 1967
Poindexter 1970
Reed 1970
Herrman 1976

TABLE 2
Summary of Major Studies on Benefits of Mergers

Author	Date	No. of Companies studied	Measurement methods	Findings
Barnes	1978	39	Share price	Sharp drop in acquirers share price immediately post merger.
Barnes	1984	39 as above	Share price	Slight gains in acquirers shares followed by substantial decreases.
Choi & Philippatos	1980	81	Market	Merger portfolio appreciates by 8.7% due to operational and financial synergies.
Dodd & Ruback	1977	N/A	Share price	Following rejection of a bid the market price of the targets shares does not fall back to its pre-offer level.
Dodd	1980	151	Market and CARs	Victims shareholders earn returns of 13% in 20 day period around the merger. Mergers vetoed by victims management revalue thus shares 11% higher. All other failed bids return to normal.
Dodds & Quek	1985	N/A	Monthly CAR	Acquiring firm shows share price increases for 25 months after merger but by month 55 this had been replaced by significant decreases.
Elgers & Clark	1980	337	Market	Acquiring firms shares appreciate by some 10% in the 2 years pre-merger but post-merger benefits are either zero or negative. Benefits to acquired firms outweigh losses of acquirers.
Ellert	1976	772	Market	Acquiring firms shares appreciated by 8.5% over the 24 months prior to the merger but declined over the final 7 months.
Firth	1976	(UK)	Share price	Significant increases in acquirers share prices in the 3 month period pre merger announcement.
Firth	1980	(UK)	Share price	Acquirers share price dropped significantly post merger. Unsuccessful attackers outperformed the market for the next 12 months. Victims showed sharp gains whether merger consummated or not.
Franks, Broyles & Hecht	1977	(UK) Brewing Industry	CAR	Acquired company's shareholders show positive gains of 20% in the 4 months pre merger. Acquiring company's show slight gains which are not sustained.
Halpern	1973	77	Market and CAR's	Acquiring and acquired firms gain equally from the merger. Acquired companies show gains of 30% in 8 months pre announcement.
Kusewitt	1985	N/A	ROA and Market returns.	Identified 6 factors which correlated with acquisitions which outperformed the average for all acquisitions.
Langstiel	1978	149	Market	Acquired firms shares appreciated by 12.9% compared with only 2.15% for the acquiring firm.
Lev & Maudelker	1972	N/A	Share price	Slight positive benefits to acquiring company.
Malatesta	1982	N/A	CAR's	Acquired company showed gains of 22% within the last 2 months before the merger.
Mandilker	1974	241	Market	Acquired firms shares appreciated by 14% due to merger compared with only 1.9% for the acquiring firm. Overall ? gain
Mason and Goudzwaard	1976	22	Accounting	Portfolios of selected firms performed better than conglomerate firms.
Meeks	1977	233 (UK)	Return on Net Assets pre merger predictions.	Improved performance in the years of merger is then followed by a steady decline to pre-merger levels.
Melicker & Nielson	1978	116	Accounting	Acquiring firms are likely to offset any P/E gains by paying a premium for the lower P/E of the victims.
Melicker & Rush	1973	N/A	Share price	Slight positive benefits to the acquiring company.
Michel, Shaked & Yobaccio	1983	N/A	CAR's	Increasing CAR's for the acquiring firms up to 2 days pre announcement then steady decline.
Nielson	1972	N/A	EPS and R.O.I.	Cash acquisitions are associated with better performance than share acquisitions.
Newbould	1980	N/A	Mgt interviews	"Management appears to be the only consistent gainer from merger activity".
Schick & Jen	1974	24 in 3 industries	Annual Market Returns	Positive returns of 10% above levels predicted without the merger to acquiring firms
Wansley, Lane & Yang	1983	200	Daily CAR's	Victims shareholders gain 25% abnormal returns in the 40 days pre announcement but thereafter little or no change.
Weston & Mansingka	1971	63	Accounting	Acquiring firms performance is lifted to the industry average but no higher.

TABLE 3
Review of Management Characteristics and
Style issues raised in Acquisition Research

Timing	Issues	Reference
Pre Acquisition Planning	<p>Familiarity leads to lack of internal consultation.</p> <p>Failure to allocate responsibility for the acquisition to a key individual.</p> <p>Failure to anticipate people issues results in false expectations.</p>	<p>Power (1985)</p> <p>Mace & Montgomery (1962)</p> <p>Kitching (1967)</p> <p>Cox (1981)</p>
Negotiations	<p>Involvement of CEO decreases with number of acquisitions.</p> <p>Failure of integration team to be involved in negotiations.</p> <p>Expectations created which are not subsequently realised.</p>	<p>Power (1985)</p> <p>Cox (1981)</p> <p>Hayes (1981)</p>
Post acquisition Management*	<p>Lack of broad executive involvement may lead to the development of ineffective procedures for implementation & control.</p> <p>Morale problems result from:</p> <ul style="list-style-type: none"> - immediately firing or freezing out unwanted executives - Failing to agree on an appropriate organizational structure - Failing to divide responsibility for the integration process equally between the acquiring and acquired firms. - Condescending attitude to the victim <p>Degree of control exercised by the parent resulting in high top management turnover</p> <p>Changes in Management Team responsible for the acquisition</p>	<p>Mace & Montgomery (1962)</p> <p>Kitching (1967)</p> <p>Harvey (1969)</p> <p>Ansoff et al (1971)</p> <p>Levinson (1970)</p> <p>Hayes (1981)</p> <p>Kitching (1967)</p> <p>Levinson (1970)</p> <p>Kitching (1967)</p> <p>Mace & Montgomery (1962)</p>

* Partially adopted from Seetoo (1977)

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