

Financial Synergy in Mergers and Acquisitions in Saudi Arabia

Basmah Al Qudaiby (Basmah, A. Q.,)¹, Muhammad Rahatullah Khan (Rahatullah, M, K.,)²

¹University of Lausanne Switzerland

²Effat University, Jeddah Saudi Arabia

basma-t@hotmail.com, mkhan@effatuniversity.edu.sa (correspondence author)

Abstract: *Businesses today consider mergers and acquisitions a new strategy for their company's growth. Companies aim to grow through sales' increase, assets purchase, profits' accumulation and market share gains. The better way for achieving these targets is by getting into either a Merger or an Acquisition. As a matter of fact, growth through mergers and acquisitions has been a critical part of the success of many companies operating in the new economy. Mergers and Acquisitions are an important factor in building up market capitalization. Based on three detailed and in depth structured interviews with major Saudi Arabian banks it has been found that, Mergers motivated by economies of scale should be approached cautiously. Companies should also approach vertical mergers cautiously because it is often difficult to gain synergy through a vertical merger and firms should also seek out mergers which allow the firm to acquire specialized knowledge. It has also been found that the firms should look for mergers that increase market power and avoid unrelated or conglomerate mergers.*

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1. Introduction

1.1. Mergers & Acquisitions in the Business World

There is a major difference between mergers and acquisitions. Mergers occur between companies similar in size and the collaboration is "friendly" between both companies. However, Acquisitions occur between companies with different sizes and the partnership is usually forced and hostile.

Wheelen and Hunger (2009:255-256) define a merger as a transaction involving two or more corporations in which stock is exchanged but in which only one corporation survives. In other words, the two companies become one and the name for the corporation becomes composite and is derived from the two original names. Furthermore, an acquisition is the purchase of a company that is completely absorbed as an operating subsidiary or division of the acquiring corporation (Wheelen and Hunger 2009: 256). The authors also stated that hostile acquisitions are called takeovers.

1.2. Reasons for Mergers and Acquisitions

The main reason for firms entering into M&A is to grow, and companies grow to survive. Growth strategies expand the company's activities and add to its value since larger firm have more bargaining power than smaller ones. A firm sustaining growth will

always have more opportunities for advancement, promotions and more jobs to offer for people (Wheelen and Hunger 2009:256). In general, mergers and different types of acquisitions are performed in the hopes of realizing an economic gain. For such a business deal to take place, the two firms involved must be worth more together than each was apart.

Few of the prospective advantages of mergers and acquisitions include achieving economies of scale, combining complementary resources, garnering tax advantages, and eliminating inefficiencies. Other reasons for considering growth through acquisitions contain obtaining proprietary rights to products or services, increasing market power by purchasing competitors, shoring up weaknesses in key business areas, penetrating new geographic regions, or providing managers with new opportunities for career growth and advancement (Brown, 9-10).

Many firms choose M&A as a tool to expand into a new market or new area of expertise since it is quicker and cheaper than taking the risk alone. Furthermore, M&A happen when senior executives feel enthusiastic and excited about a deal that can take place, the idea of chasing and taking over another company is successful before other competitors do. Competition in a growing industry drives firms to acquire others. In fact, merging with other companies increases benefits for the entire corporation.

1.3. Problems with Mergers and Acquisitions:

Haberberg and Rieple (2001:614) indicated that 50% of acquisitions are unsuccessful; they increase market power but not necessarily profits.

Brown explains the reasons for the high failure rate of M & A as follows:

(a) Over-optimistic assessment of economies of scale. Economies of scale are usually achieved at certain sizes of the firms. However, expansion beyond the optimum will result in disproportionate cost disadvantages that lead to various diseconomies of scale.

(b) Inadequate preliminary investigation combined with an inability to implement the amalgamation efficiently. Resistance to change and the inability for the acquired company to manage change well is a main reason fail because employees and management of both companies always resist change.

(c) Insufficient appreciation of the personnel problems, which will arise, is due mainly to different organization cultures of both companies.

(d) Dominance of subjective factors such as the status of the respective boards of directors.

Therefore, drafting careful plans before and after the merger is a necessity that shouldn't be overlooked. Some companies find the solution in hiring a change manager that will add value and better manage the transition of the "marriage between both companies". (Brown 16:17)

2. Literature Review:

This section discusses the literature on the subject matter.

2.1. Synergy in Mergers & Acquisitions:

Synergy, as defined in the business dictionary, is the state in which two or more agents, entities, factors, processes, substances, or systems work together in a particularly fruitful way that produces an effect greater than the sum of their individual effects. Synergy is the magic force that allows for enhanced cost efficiencies of the

new business. Synergy takes the form of revenue enhancement and cost savings (Mergers and acquisitions: Definition, n.d.).

Synergy is also expressed as an increase in the value of assets as a result of their combination. Expected synergy is the justification behind most business mergers. For example, the 2002 combination of Hewlett-Packard and Compaq was designed to reduce expenses and capitalize on combining Hewlett-Packard's reputation for quality with Compaq's impressive distribution system (Synergy Business Definition, n.d.).

Through research it has been noted that synergy is the concept that two businesses will generate more profits together than they could separately (Wheelen and Hunger 2009:262). Synergy is said to exist for a divisional corporation if the return on investment of each division is greater than what the return would be if each division were an independent business (Wheelen and Hunger 2009: 326).

Synergy can take several forms, according to Goold and Campbell (1998:131-143) synergy is demonstrated in six ways: benefiting from knowledge or skills, coordinated strategies, shared tangible resources, economies of scale, gaining bargaining power over suppliers and creating new products or services.

Mergers & Acquisitions result in the creation of synergies, the sharing of the manufacturing facilities, software systems and distribution processes. This type of synergy is referred to as operational synergy and is seen mostly in manufacturing industries. Another motive for forming an acquisition is gaining more financial strength by the purchase of a competitor, which increases market share. The aim of mergers and acquisitions is to achieve improvement for both companies and produce efficiency in most of the company's operations. (Haberberg and Rieple, 2001).

However, Brown (9-10) summarizes the sources of synergy that result from M & A under the following headlines:

1) Operating Economies which include:

(a) Economies of scale:

Horizontal mergers (acquisition of a company in a similar line of business) are often claimed to reduce costs and therefore increase profits due to economies of scale. These can occur in the production, marketing or finance divisions. Note that these gains are not expected automatically and diseconomies of scale may also be experienced. These benefits are sometimes also claimed for conglomerate mergers (acquisition of companies in unrelated areas of business) in financial and marketing costs.

(b) Economies of vertical integration:

Some acquisitions involve buying out other companies in the same production chain. For example, a manufacturer buys out a raw material supplier or a retailer. This can increase profits through eliminating the middleman in the supply chain.

(c) Complementary resources:

It is sometimes argued that by combining the strengths of two companies a synergistic result can be obtained. For example, combining a company specializing in research and development with a company strong in the marketing area could lead to gains. Combining the expertise of both firms will help in benefiting from knowledge and skills that one lacks.

(d) Elimination of inefficiency

If any of the two companies had been badly managed; its performance and hence its value can be improved by the elimination of inefficiencies through M&A. Improvements could be obtained in the areas of production, marketing and finance.

2) Market Power; Horizontal mergers may enable the firm to obtain a degree of monopoly power which could increase its profitability. Coordinated strategies between both companies will lead the entire organization in gaining competitive advantage.

Gaining bargaining power over suppliers is realized since the company is larger in size after the merge.

3) Financial Gains; Companies with large amounts of surplus cash may see the acquisition of other companies as the best application for these funds. Shared tangible resources such as sharing a bigger building, more office supplies, equipment, manufacturing facilities and research and design labs will also lead to a reduction in costs translated into better financial performance.

4) Others; such as surplus management talent meaning that companies with highly skilled managers can make use of their qualified personnel only if they have problems to solve. The acquisition of inefficient companies allows for maximum utilization of skilled managers. Incorporating efforts of both management teams will drive in the creation of innovative products or services.

2.2. Financial Synergy

As defined by Knoll (2008:38) Financial synergies are performance advantages gained by controlling financial resources across businesses of firms. There exist four types of financial synergies, which are:

1) Reduction of corporate risk: Reduction of corporate risk is increasing the risk capacity of the overall firm, which means the ability of the firm to bear more risk. Meaning that by increasing the risk capacity the shareholders will invest more in the company and the firm will gain benefits such as coinsurance effects.

2) Establishment of internal capital market: Establishing internal capital gains means that the firm will decrease its financing costs and will increase financial flexibility which results in the company having higher liquidity and the ability to pay its creditors easily.

3) Tax advantages: Tax advantages by reducing the tax liabilities of the firm using the losses in one business to offset profits in the other business referred to as "profit accounting".

4) Financial economies of scale. Financial economies of scale reducing transaction cost in issuing debt and equity securities. (Knoll, 2008:38).

3. Methodology

There are several research methods available to the research including quantitative methods such as questionnaires with numeric responses and analysis of financial data. There are also qualitative research methods such as interviews and focus groups. For this project, the qualitative research method of interviews was selected because it is the most appropriate way to gather information about the interpretation of events of why some mergers produce synergy, while others do not and to understand the reasons why companies enter into mergers.

The planned interview method was to use a structured interview. In a structure interview, the researcher knows in advance what information is needed and asks a predetermined set of questions (Sekaran & Bougie 2009:188) In a structured interview the same questions are asked of all interviewees, which allows for better comparison of the response than unstructured interviews, where the interviewees are asked different questions. The structured interview process does allow the researcher to ask different follow up or probing questions based on the interviewee's response. This allows the interviewer to identify new factors and gain a deeper understanding of the topic (Sekaran & Bougie 2009:188).

The interviews were scheduled in advance and conducted face to face since the interviewees were located in different parts of Saudi Arabia.

The data was gathered by taking notes from the interviews, which were not recorded because that may have seemed too intrusive.

When conducting interviews it is important to conduct them in a manner that is free of bias or inaccuracies. Bias can be introduced by the interviewer, interviewee or the situation (Sekaran & Bougie 2009:190). Interviewers can introduce bias by distorting the information that they hear so it aligns with their expected responses to the question or through simple misunderstandings. To prevent this, the respondents' answers were summarized back to them before moving on to the next question. Interviewees can introduce bias if they do not like the interviewer or if they phrase the answers to be biased towards what they think the interviewer wants to hear (Sekaran & Bougie 2009:188). Since the interviewees were obtained through referrals, it is highly unlikely that they gave false responses. Also, the basic area of research was discussed with the interviewees, but no hypothesis was advanced to them, such that they would skew their answers to what they thought the interviewer wanted to hear.

3.1. Interview Results.

Three companies were interviewed. An interview was done with National Commercial Bank (NCB) of Saudi Arabia. NCB is an international bank headquartered in Saudi Arabia that is engaged in personal banking, business banking, private banking, and wealth management (NCB, 2011). Another interview was done with Samba Financial Group. Samba is also an international bank headquartered in Saudi Arabia that is engaged in personal and business banking (Samba, 2011). The third company that was interviewed was Savola Holding Company, which is headquartered in Jeddah Saudi Arabia and is engaged in the food industry. Through subsidiary companies, Savola is engaged in the manufacturing of vegetable oils, dairy products and food retailing operations both in Saudi Arabia and other international markets. Due to strict confidentiality of the companies interviewed, the names of the people will not be mentioned or their titles. This was the most important condition that in order to conduct these interviews.

Each of the three companies has been involved in significant mergers. NCB's most significant merger was when it acquired a Turkish bank, *Turkiye Finans Katilim Bank* in 2008. Samba's most significant merger was its acquisition of *Cairo Bank* in 1999. Savola's most significant acquisition was its acquisition of *Al-Marai* in 1991.

NCB has engaged in four mergers overall and three international mergers. In addition to its acquisition of the Turkish bank, it acquired *Estate Capital Holdings*, *The Capital Partnership Group Limited* and *NCB Capital*. The acquisition of the Turkish bank was considered the company's most successful acquisition because it allowed NCB to expand into a new international market with strong growth.

While NCB does not consider any of its acquisitions to be a failure, it has recognized losses through goodwill impairment, even in the Turkish bank acquisition, which it considers to be its most successful merger.

Savola has engaged in about 10 mergers including a few international mergers. It considers its acquisition of *Panda* (a supermarket chain) in 1998 to be its most successful because it allowed Savola to gain a major presence in the food retailing market and increases revenues significantly. Savola had a couple of mergers that it considered failures. One failed merger occurred when it acquired a real estate company in Jordan. This company was outside Savola's core business and outside its home country. Savola's learning from this failure was not to invest outside its core

business in a foreign country because there was no ability to create any value through this merger and it was investing in a country that it did not know as well as its home country. Another failed merger occurred when it acquired an edible oil company in Kazakhstan. This merger failed because even though the acquired company had good fundamentals, the value creation mechanisms were quite different between the two companies.

The strategic motivations for mergers were discussed with the companies and Samba provided the most detail in this area. One motivation is to increase lines of business. Another motivation is to move into a new geographic area. In many cases when expanding into a new country, it is easier to acquire an existing business than try to start a new one. Another motivation is to increase market share.

Particularly in a mature industry, a company can gain market share quickly through an acquisition, while it is usually a slow process to gain market share organically in an incremental manner.

All of the companies tried to achieve company growth and synergy in their mergers.

The criteria and selection process for mergers were also discussed with the companies. Savola worked with financial institutions to identify acquisition target companies. Savola looked for companies that were among the leaders in their respective markets. Savola believed that companies that were leaders generally had good processes and were well managed, so their operations would be good to acquire. After the failed merger with the real estate company, Savola looked to acquire companies related to its core food manufacturing and sales business. All companies obviously reviewed financial statements closely to assess the financial condition of the acquired firm. Samba noted that sometimes in the banking and financial industry, strong banks will acquire banks that are in a weak financial condition in a rescue operation, often due to political reasons. In reviewing candidates for a merger, Savola engages its operations and technical team to assess the target company's operation, processes and potential fit into the business group.

The companies use various metrics to evaluate the success of the merger. Savola evaluates the revenue growth of the sector where the acquisition occurred along with the market share and operating cost. The goals are to increase revenue, increase market share or reduce operating cost. Samba evaluated similar metrics of market share and operating cost.

Samba noted that it usually take until the second year after a merger to evaluate its success. In the first year, there are onetime costs associated with the integration costs of the merger. It usually takes until the second year to see reduced operations costs from activities such as closing and consolidating branches.

The different ways to obtain synergy in a merger were discussed with the companies. Savola looked to obtain synergy through economies of scale, as acquisitions would add to the company's shipment volume, which would allow the company to reduce freight and distribution costs. Samba also looked to obtain synergy through economies of scale and eliminating duplications of activities. When it acquired Cairo bank, which had previously acquired United Saudi Commercial Bank, Samba was able to cut costs in Saudi Arabia by reducing the number of bank branches and ATMs. NCB was able to gain financial synergies in its mergers by developing a more diversified and lower risk portfolio of investments.

3.2. Analysis and Discussion

The following discussions are based on the answers of the officials of Samba, Savola and NCB. All the officials were asked the same questions and their responses here are summarized and analysis carried out. The questions are placed in the appendix – 1.

The findings gathered from the interviews were well aligned with the information discussed in the literature reviewed.

3.2.a Mergers to Expand to International Markets

One finding is that firms undertake some mergers to expand into new international markets. In doing so they are gaining the synergy of the acquired firm's knowledge of the market. In these cases, the acquiring firm saves the costs of starting up a business in the new country, gaining the necessary approvals, learning how to do business successfully in the market and building a brand in the country. This is especially true in the bank and finance industry, where the industry is closely regulated. It can be easier to acquire a company that already has all of the necessary regulatory approvals as opposed to trying to gain all of the necessary approvals to conduct business legally in the selected market. Also, build a brand is important in the banking industry, as consumers and commercial customers like to do business with a trusted firm in the market. In these mergers, synergy can be gained through the acquired firm's knowledge of the market and the acquiring firm's capital. The new infusion of capital can often allow the acquired firm to grow in the market. The NCB acquisition of the Turkish bank is a good example of this type of synergy.

Even when a firm acquires a company within their own market there is the chance to create synergies through knowledge gained and transferred. In many cases, the acquired firm has certain processes in some areas that are better than the acquiring firm, so selecting the best process allows the merged firm to improve its overall processes. Also, the acquiring company usually has some processes that are better than the acquired firm's processes in some areas, which allows the company to improve the newly acquired operations. As noted by Samba in their interview, the goal is to utilize the optimum processes from both companies to produce synergy from the merger.

3.2.b Mergers to Gain Economies of Scale

Firms also seek and gain synergies through economies of scale. Larger businesses can often gain economies in certain business activities including manufacturing, distribution and sales. One of the goals of Samba's mergers was to gain synergies through economies of scale. In their mergers, Savola hoped to gain economies of scale in shipping and distribution activities. Economies of scale can also be achieved in the banking industry since the cost of processing checks or issuing credit cards likely declines on a per unit basis with increasing volume, as the fixed cost associated with these activities can be spread over a larger volume. The result is reduced costs, which makes the merged firm more profitable and more competitive in the market.

3.2.c Eliminating Inefficiencies

Another way to achieve synergy is through elimination of inefficiencies. Inefficiencies can be eliminated by removing the duplication of resources. In horizontal mergers, it is common for the merged company to consolidate operations, close offices and reduce staff. Samba mentioned that reducing the number of bank branches, ATMs and staff was one of the ways that they drove cost efficiencies after acquiring Cairo Bank. Samba also provided the insight that there is a delay for these cost efficiencies to show up in financial performance, since it takes time to remove the duplication of resources involved and there are one-time costs associated with removing the duplication of resources. Thus, the success or failure of a merger should not be evaluated until at least two years after the merger.

3.2.d Gain More Market Power

Firms also try to achieve synergies through an increase in market power, by controlling a larger share of the market. Discussions by all respondents implied to increasing market share as one of the motivations to enter into a merger. Savola and Samba both mentioned increasing market share as a way to judge the success of a merger. Greater market power can improve profitability through a couple of mechanisms. One mechanism is greater monopoly pricing power in the market, which allows firms to increase prices due to reduced competition. This is one reason that major mergers have to be approved by government regulators who want to maintain a competitive market. A second mechanism is increased buyer power over suppliers. Since the merged firm represents a greater portion of an industry's business, suppliers to the industry want the merged firm's business more, which gives the merged firm better negotiating power over suppliers. This allows the merged firm to reduce its costs and increase its profits.

3.2.e Gain Growth

Growth is one of the main reasons that firms undertake mergers, as this was mentioned by all of the companies interviewed. Companies seek growth through mergers because it can allow this to gain market power, which generally leads to increased profits. Mergers are also a way to satisfy investors'/shareholders' expectations for growth. In many cases, it is difficult to grow a business in a mature market organically, so mergers are often the best way to achieve growth.

Samba provided a perspective on the use of acquisitions as a growth strategy. Samba believed that within the same industry organic growth was less expensive than growth through acquisition because a premium had to be paid for another company's operations in the same industry. Samba believed that when trying to expand to a different industry, growth through acquisition was less expensive than organic growth because the firm had no knowledge or expertise in the new industry. Samba used this philosophy when formulating their strategic growth plans. If the company simply wanted to expand within their current industry, the focus would be on organic growth initiatives, whereas if the company wanted to grow by expanding into new industries, the focus would be on acquisitions.

3.2.f Reducing Risks

Firms can gain synergies by reducing their overall risk through diversification and reducing their cost of capital. Generally, this is a weak form of synergy and prone to failures because it often entails firms moving into businesses outside of their core competencies. The businesses are then run without the knowledge of how to run a business successfully in that market. This leads to operational losses or subpar performance in the industry, which negates any synergistic gains from reducing the company's overall risk. This was experienced by Savola, who acquired a real estate company, which was outside its core business of the food market. Consequently, the acquired real estate business produced subpar performance and losses, which negated any gains from reducing risk.

Thus, the merger was considered to be a failure because it reduced the overall value of the firm. Because of the difficulties of creating financial synergies through diversification, there are few conglomerate mergers and few conglomerate companies.

The companies interviewed look for synergies when considering mergers and tried to estimate the potential synergistic gains that could be attained in a proposed merger. The potential synergies gained depend on the industry and the characteristics of the company acquired. In the failed mergers, the firm overestimated the amount of synergy that could be gained through the merger. Savola overestimated the synergy that could be gained through the acquisition of a real estate company because the only synergy that could be gained was reduced risk and a reduced cost of capital, which was exceeded by losses resulting from Savola's lack of knowledge and experience in this non-core business. In the other failed merger, there were likely synergistic gains that could have been achieved, but Savola was unable to merge the acquired company's operating model with its existing operating models. Thus, in order to realize potential synergistic gains that are available in a merger, firms need to be able to merge operating models.

Different company or national cultures can interfere with the ability to merge company operations successfully. However, with the companies interviewed, this was not a major issue. Therefore, these companies have done a good job managing and overcoming cultural differences in their mergers.

4. Conclusions and Recommendations

Firms engage in mergers for various reasons, but a goal in any merger is to create synergy. If synergy is created, the value of the merged firm will exceed the combined value if the two firms before the merger. There are several different mechanisms that can be used to create synergy in a merger, which are the motivation for using acquisitions as a growth strategy and selecting target firms to acquire. However, it is often difficult to actually achieve synergies in mergers for various reasons, because of this firm value can decrease through mergers rather than synergy being created.

The research showed that Saudi firms engage in mergers for different reasons to try to grow and create synergies. One of the reasons that Saudi firms engage in mergers is firm growth in the domestic market. This can create synergy through more market power. A firm can use its added market power to increase its prices, since it has greater monopoly pricing power in the market. A firm can also use its increased market power to gain more power over suppliers to obtain lower cost inputs. In addition, a firm can use its market power to attract and retain more talented employees than its smaller competitors. Synergy through increased market power happens almost

automatically through the increased size of the firm and the decreased competition. Thus, it is one of the most attractive value creation mechanisms in a potential merger. The Saudi firms researched were able to gain synergy through increased market power when they engaged in mergers that allowed them to acquire competitor firms in the same market.

Another reason that firms engage in merger is to acquire knowledge or market expertise from another firm. This can be combined with the acquiring firm's resources to create synergies. In the Saudi firms researched, this mechanism was the primary motivation for acquiring firms in different international markets. The firms in the different international market had knowledge of that market such that it was preferable to acquire an existing business already operating in the international market as opposed to starting one from scratch. This entry strategy into the international market avoids the start-up costs associated with starting a new business in a country. It also allows the acquiring firm to use the target firms business permits, brand name supplier network and distribution system in the market, which can all be key enablers to success.

Mergers can also create synergy through economies of scale. In a horizontal or related merger, there are often economies of scale created. Economies of scale often occur when a firm can spread the fixed costs of their operation across a greater volume of output. These economies of scale can occur throughout the firms' value chain and sales chain. For example, through mergers a firm can often spread the cost of their sales force over a greater volume of sales. The companies researched in Saudi Arabia sought economies of scale in their mergers. Firms looked to reduce their operating costs through economies of scale in mergers.

Firms also look to achieve synergy through economies of scope. Economies of scope can occur when the cost of joint production of two goods or services by a multi-product firm is less than the cost of producing these goods or services by two single-product firms.

This implies that there is a shared resource or resources that can be utilized by both product lines.

Mergers of firms in unrelated or slightly related businesses can create synergy and shareholder value through cross-marketing and promotion of products. The financial companies researched acquired firms with other types of financial products that could then be cross-marketed to an existing customer base.

Firms can also try to create synergy through vertical mergers where company acquires one of its upstream suppliers or downstream distributors or customers. In a vertical merger, value is only created if some improvement in efficiency is created. This is often difficult to do and does not inherently increase market power or gain economies of scale. In the research conducted, the firm researched in the food industry was able to create synergy in a vertical merger with a food manufacturer acquiring a grocery store chain. This merger gave the food manufacturer greater insight into the end market for its products and better control over the distribution of its products.

Some firms can try to gain synergy through a conglomerate merger with an unrelated company. Synergies can be gained through a lower cost of capital or through greater income stability. For example, a company with a low cost of capital can acquire another firm that was unable to pursue certain opportunities and projects because its cost of capital was too high, resulting in a negative NPV. With a lower cost of capital the acquired firm can then pursue the additional opportunities. As was illustrated in the companies researched, trying to gain synergies in an unrelated merger is inherently difficult.

Since conglomerate mergers do not result in any type of operational changes, they must rely solely of financial synergies to increase the overall wealth of the firm. The value gained through financial synergies, due to a lower cost of capital, is often offset by a decrease in performance in the acquired business, as the acquiring firm does not have experience and knowledge in the acquired business.

There are several conclusions that can be derived from this research. Since many mergers fail to produce synergies or firms overestimate the synergies, it is important that companies approach acquisitions cautiously and do not overpay for acquired firms. Firms can overestimate the potential synergies of the merger and not accurately assess issues such as product line overlap and cannibalization. They can also overestimate the cash flows associated with the target firm, which leads to overvaluing the target firm. Any potential synergy that is being considered to justify a premium purchase price for a potential acquisition should be challenged using a "devil's advocate approach".

Firms should avoid unrelated mergers or conglomerate mergers. The only way to create synergy through these types of mergers is through financial synergies, which can be difficult to obtain. Often any financial synergy gained is outweighed by a decrease in performance of the acquired firm. This often occurs because the acquiring firm lacks knowledge and experience in the new type of business acquired. Thus, firms that do engage in conglomerate mergers of previously successful firms should leave the acquired firm "as is" and not try to change its management, strategies or products/services.

Firms should look for mergers that increase market power. This type of merger is the type of merger that creates synergy most automatically. A larger firm created through a merger can benefit from greater monopoly pricing power (due to reduced competition) and greater power over suppliers in the industry. A larger firm can also benefit from being able to attract and retain more talented management and employees within the industry, which can provide the firm with an additional competitive advantage.

Firms should also seek out mergers which allow the firm to acquire specialized knowledge. This is often the motivation behind mergers in technology-based industries. The company can take the technology and knowledge acquired through the merger and use it to advance its own product line, creating synergy. This is also a good strategy to use when entering a new international market. An existing firm in the market has knowledge of the local market, the supply base, the distributors and the government regulations. Acquiring a firm like this can provide synergy and save the acquiring firm from climbing the learning curve on all of these issues in a new international market.

Mergers motivated by economies of scale should be approached cautiously. The acquiring firm needs to carefully understand the cost drivers within its business and make sure that they will actually decline. In many industries, the cost curve become flat or even increases with increasing volume. Increased market power can create economies of scale, so firms should look for mergers that increase market power as opposed to those that simply provide an opportunity for economies of scale.

In mergers based on economies of scales, companies need to execute consolidation plans effectively in order to consolidate resources and eliminate duplication of resources to gain cost efficiency synergies.

Companies should also approach vertical mergers cautiously because it is often difficult to gain synergy through a vertical merger. An acquiring firm needs to specifically identify areas where it is facing problems or areas where it is unable to pursue attractive opportunities and understand how the vertical merger could address

those areas. In some cases, the vertical merger can address these areas and synergy can be created. However, in many cases the vertical merger does not adequately address the issues and no synergy is created.

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