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MERGERS AND ACQUISTIONS

Dibyendu Nandy*
Pankaj Baag**

ABSTRACT

Motives for mergers are various, ranging from ones based on classic assumption of profit maximization to managers' self-interests and exogenous factors. It is assumed that mergers usually occur for a combination of reasons. Even so, it is worth pointing out that some factors have a greater impact on a certain type of mergers. Similarly, there are a number of reasons for frequent failure of mergers to create values for shareholders, especially, of acquiring firms. Companies who want to engage in a merger or acquisition should plan their steps carefully. First of all, they should try to find the best suitable target company. They should calculate the possible resulting synergies and risks. Furthermore, the acquiring company should calculate the highest possible premium to be paid. With the help of the different valuation methods, it should valuate the company worth. Finally, the acquirer should pay attention to the criteria mentioned in this paper and avoid the mentioned deadly sins as well as follow the suggested best practices.

Key words: Synergy, Valuation, Premium, Mergers, Acquisitions

Introduction

The statement-“one plus one is greater than two” represents the main theory behind mergers and acquisitions. Mergers and acquisitions (M&A) deal with buying, selling and merging of different companies. It represents a tool for companies to expand their operations either within the same business sector or to other business areas. The main goal of M&A is to create positive synergy effects out of business combinations, and to create through the business combination a greater value than they would have on their individual parts.

“An acquisition is where the acquirer subsumes the target company, thus becoming one legal entity.” On the other hand, a merger “extinguishes the identity of both participants, creating a new company.” Based on the empirical evidences from the available literature, this informatory article looks at the different forms and classification of M&A, the reasons behind, and for failures of M&A and the execution of M&A.

*Senior Faculty, ISB, Salt Lake, Kolkata e-mail : *dnandy_69@rediffmail.com*
** 3rd Year Fellow Programme Student, Indian Institute of Management Calcutta
e-mail: *baagpankaj@yahoo.co.in*

A merger is: "the combining of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock." A merger is more a mutual agreement on both sides, where companies about the same size decide to give up their individuality and to continue as one single company. An acquisition takes place "when one company purchases a majority interest in the acquired." This happens when one company takes over another and becomes the clear owner of the new company. The target company ceases to exist and the acquirer continues to trade its own shares. Acquisitions can be either friendly or unfriendly; it depends on the accordance of the target company. Even though the terms mergers and acquisitions mean slightly different things, they are often times used as synonyms. In reality mergers are seldom, often times acquisitions are just called mergers to avoid the negative connotations of being "bought of".

"The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies." M&A can add value to the company, hence higher returns on shareholder investments. Economies of scale can be achieved through M&A, thus costs are lowered which results in higher profits. M&A present huge investment opportunities, besides that the incentive for companies to merge or acquire is to gain competitive advantages over its competitors and to become more cost efficient. Companies hope that they can increase their market share and achieve more efficiency.

Often times M&A leads to increased market power and market share, resulting through the merger with a competitor. The merger in 1998 of Daimler Benz and Chrysler to form a 130 billion dollar company, DaimlerChrysler, which *Business Week* called "the first global car colossus," is a case in point. It was an attempt to consolidate a global market position in an industry where "there is plant capacity to build at least 15 million more vehicles each year than will be sold." One should also understand that in this the old market verities apply: As concentration increases, it's easier for remaining players to raise prices.

M&A also allow companies to cross-sell their products and enable manufactures to sell complementary products. In April 1998, Citicorp and Travelers group announced their merger and the first financial conglomerate in the U.S. was born in October 1998, as **Citigroup**. The purchase price was $82.8 billion. This is the first U.S. case when a commercial bank and insurance brokerage firm merged to expand their activities over a wide range of bank and non-bank activities. The merged group's total

assets became the largest among all U.S. banks. The strategy of Citigroup when it merged was to focus on the businesses of commercial banking, consumer banking, credit card, investment banking, security brokerage, asset management, life insurance and casualty insurance. The key for the success of this new conglomerate was how to materialize the benefit of cross-selling of banking, securities, and Insurance products to the same customer.

Additional positive outcomes of M&A are employee synergies, which come into existence through acquisition of know-how, company cultures and values. Patents are another benefit resulting from M&A. For example, despite the credit crunch, mergers and acquisitions in the global pharma sector do not appear to have slowed substantially, as of the third quarter 2008. Irving Levin Associates, US reports that M&A activity in the US health care sector, which includes pharma, increased slightly in the third quarter of 2008 to $89 billion from the second quarter, $86 billion. The fourth quarter of 2008 saw King Pharma acquire Alpharma for $1.6 billion, and Eli Lilly acquire Imclone for $6.5 billion. The major force that is driving this trend is the 'Loss of patent protection.' For example, King Pharma is expected to experience the loss of patent protection on a substantial number of drugs between 2010 and 2013. And, one way to avoid a drop-off in revenue in the coming years is to use their cash and strong balance sheets to acquire smaller/weaker rivals. Finally, the acquiring company can benefit from tax reductions due to the acquisition of loss makers. For example, in the 2006-2007 Kao Corporation's US$3.5 bn merger with Kanebo, Kao's benefit from tax breaks was worth some 100 bn yen because of its purchase of Kanebo. However, tax reductions are often times limited by law in most countries.

Types of mergers and acquisitions

Mergers can be characterized according to three main categories: horizontal mergers, vertical mergers and conglomerations. Additionally there are market-extension mergers and product-extension mergers.

A horizontal merger is a merger between "two companies that are in direct competition and share the same product lines and markets." This kind of merger can have either large effects on the market or little effects. It depends on the size of the merging companies. In case of two large companies merging, the market impact is huge. The new company resulting from this merger has an unfair market advantage over its competitors. This new company holds a too large market share, thus it is perceived as anticompetitive. Furthermore, the resulting effects of a large merger can

be even felt all over the market sector and occasionally throughout the whole economy. On the other hand, if very small companies unite, or horizontally merge, the outcomes of the merger are less visible. Compared to large horizontal mergers, these smaller horizontal mergers are very common. Actual examples of such mergers in the past include Chase Manhattan Bank, US with Chemical Bank; Boeing's merger with the McDonnell Douglas; and Exxon's merger with Mobil.

A vertical merger is a merger "in which a firm or company combines with a supplier or distributor." According to this, a vertical merger occurs when two firms, both working at different stages in the manufacturing of the same good, combine. The participating companies acquire parts of the supply chain and benefit from the resources. A vertical merger can be viewed as anticompetitive as it can frequently rob supply business from its competition. This form of merger can cause that competitors go out of business because it involves that manufacturers form a partnership with distributors. Therefore, it is hard for competing companies to contest with the newly merged company. Actual examples of such mergers are PepsiCo's mergers with Pizza Hut, Taco Bell and KFC. Pepsi supplies soft drinks to each of these fast-food outlets.

"A conglomeration is the merger of two companies that have no related products or markets. In short, they have no common business ties." Through a conglomeration a company expands its product range and enters at the same time into new business sectors. A conglomeration enlarges the brand portfolio of a company. But these kinds of mergers bear huge risks of failure, simply because of a lack of expertise in the new field of business. Real world examples include the merger between Walt Disney Company movies and the ABC radio and television; the merger between America Online-internet service provider and the Time Warner-communications.

A market-extension merger involves "the combination of two companies that sell the same products in different markets." Therefore this merger type allows expanding the customer base and market share. A product-extension merger is "between two companies that sell different, but somewhat related products, in a common market." This merger type enlarges the market share in combining the customer bases of both companies.

The importance of Valuation

Before acquiring another company, investors in a company have to decide whether the acquisition will be beneficial to them or not. Therefore, they must determine the worth of the target company. The target company and the acquirer will have different

ideas about the worth of the acquisition. Buyers generally tend to undervalue and sellers to overvalue their assets. The main different valuation methods used to determine the company worth are the comparative ratio method, the replacement cost method and the DCF method.

One of the important comparative ratios method used is the Price-Earnings Ratio (P/E Ratio). Here, the acquiring company makes an offer that is a multiple of the earnings of the target company. It looks at the P/E for all the stocks inside the same industry group which is a good guidance for what the target's P/E multiple should be. Another ratio used is the Enterprise-Value-to-Sales Ratio (EV/Sales). Here, the acquiring company makes an offer as a multiple of the revenues while keeping in mind the price-to-sales ratio of other companies in the industry.

The Replacement Cost valuation method, acquisitions are based on the cost of replacing the target company while considering that the value of a company is simply the sum of all its equipment and staffing costs. So, the company which wishes to acquire the target firm offers price accounting to this value. But, if the target firm does not agree on the price offered, then the other firm can create a competitor firm with same costing. But, it should be mentioned here that, in case of the firms, where the main assets are not equipments and machinery, but people and their skills (service industry), this type of cost calculation is not possible. In the 1970s and early 1980s, the Securities and Exchange Commission required public corporations to estimate replacement values in their reports. This is no longer the case making this method less useful for U.S. firms but still is useful for international firms where the requirement continues. It has been often cited to explain the merger wave of 1970s and early 1980s. Replacement cost estimates are not highly reliable, often drawn by simplistic rules of thumb. Estimators themselves (operating managers) frequently dismiss the estimates.

One of the most important valuation tools is the Discounted Cash Flow (DCF) method. It determines a company's current value according to its estimated future cash flows. The forecasted free cash flows are equal to the net income + depreciation/amortization - capital expenditures - change in working capital. The forecasted free cash flows are discounted to a present value using the company's weighted average costs of capital (WACC). The DCF is not easy to calculate, but its still one of the best methods for the following reasons: It is not tied to historical accounting values. It is forward looking and focuses on cash flow, and not profits. It reflects non-cash charges and investment inflows and outflows and separates the

investment and financing effects into discrete variables. It recognizes the time value of money and allows private information or special insights to be incorporated explicitly as well as it allow expected operating strategy to be incorporated explicitly. It embodies the operating costs and benefits of intangible assets. In addition, virtually every number used in valuation is *measured with error*, either because of flawed methods to describe the past or because of uncertainty about the future.

Synergies I & II:

The creation of positive synergies is the most frequent reason for mergers and acquisitions. The reasons why companies pay premiums to acquire other companies are the synergy effects. A positive synergy is that the merger of two companies result in overall value increase, thus the acquiring company profits from the target company. These effects occur most of the time, because the acquired company is operating below its optimum. Shareholders benefit from these synergy effects when a company's post-merger share price increases by the value of the potential synergy. For example, on March 13, 2000, the Tribune, US acquired the Times Mirror in a $6.4 billion cash and stock deal. It purchased up to 28 million Times shares for cash at $95 per share. The remaining shares were to be exchanged for 2.5 shares of Tribune stock. The announcement of the merger caused Times stock to increase by 79% to $85.63. It is very clear that companies have to pay a premium despite the pre-merger valuation to acquire a company.

This premium represents the future prospects for the selling company and the post-merger synergy for the buying company. From this, it follows that the success of a merger is measured by the value increase of the buyer. A target company should only be_acquired if the expected outcomes result in positive synergy effects. Based on the positive market reaction, Times net gain was assumed to be $2.9 billion and that of the Tribune as $ 1.5 billion (Weston, 2001). Weston calculation was based on the future net present value (NPV) of an acquisition. If the resulting NPV is positive, the acquisition is worth paying a premium. In this calculation the NPV is calculated through the deduction of the premium paid from the expected synergies, using the DCF valuation method, NPV is assumed to be equal to Synergy less the Premium paid.

While we assume 'synergies I' for the acquiring companies, one has to understand that the owners of a target company are only willing to sell their company if they benefit more from selling than from keeping the company. This is 'synergies II.' In our example of the 'Tribune and Times', there are two aspects of the acquisition

which needs to be understood. They are the pre merger valuation of the individual firms and the post merger combined valuation. Weston (2001) in his study calculated the pre-merger value of Tribune to be $9.7 billion and that of Times to be $3.7 billion. However, the post merger valuation in fact was calculated twice, one with a pessimistic view and the other with an optimistic view. In the pessimistic view, the net combined value was calculated to $ 15.6 billion with a net loss of $0.6 billion to Tribune and a net gain of $2.8 billion to Times. While in the optimistic view, based on the positive market reaction, Times net gain was calculated to $2.9 billion and that of the Tribune as $ 1.5 billion.

In both the cases, Times was a winner in terms of gains. The next question arises is why Tribune was interested in Times: Tribune was looking to built its base of print and broadcast media with a vision to become a leading media company. . It wanted to build a portfolio of media assets and then cross-sell advertising on its various assets, as advertisers will always pay more for increased exposure. We can assume this under 'synergies I.' Similarly, why did Times agreed to sell itself: Clearly, there was a gain because of their earlier recapitalization in 1999 coupled with a substantial premium in the offer price. Of course, this would have been possible without the merger over a long time but with greater uncertainty. We look at this from the 'synergies II' perspective. Therefore, it is now very clear that the potential buyers need to pay a premium to acquire the company. The equation below helps to determine if a deal makes sense and solves for the minimum required synergy by the acquiring firm: (Pre-Merger Value of Both Firms + Synergy)/ Post-Merger number of shares = Pre-Merger Stock Price. Putting the value of $(9.7+3.7) billion for the pre-merger values of both firms; 347 millions number of post-merger shares and a $53.90 pre-merger value of share, the synergy value comes to $5.3 billion which was shared between the Tribune and the Times.

Another good example of synergy II is the recent failure of Microsoft to acquire Yahoo. Yahoo knew its weaknesses, and knew that Microsoft will not achieve its goal of obtaining some sort of balance and scale in the search market with an acquisition of Yahoo! If we look at the share of search that Google has had over the past five years, it is an ever-increasing line, which we feel, will continue to grow until it has the entire English world. Neither Yahoo! nor Microsoft can do anything about it. The reasons are many. First, it is because Google does search better than any of its competitors and is the reason why we go to Google to search. Google also does a better job of monetizing search than Yahoo! and Microsoft, so they have better results

in the right rail and that is becoming increasingly important in areas like travel and financial services, where the organic results are being spammed up. Google is also investing heavily in social search and there is a good chance that they will get there on their own. In addition, if they do not, they are more likely to identify and purchase the startup that gets to it than Microsoft or Yahoo! are. There is another reason why Yahoo! disagreed, it knew many of its best services will languish under Microsoft's ownership and that users will leave. It is already happening under Yahoo!'s ownership to services like Flickr and Delicious, and MyBlogLog, which would be worse under Microsoft's ownership.

Criteria

It is more important that one also understand the following as a precaution while valuating- No valuation is “right” in any absolute sense. It is appropriate to use several scenarios about the future and even several valuation methods to limit the target's value. One should a*dapt to diversity that is i*t may be easier and more accurate to value the divisions or product lines of a target, than to value the whole company. We should recognize that different valuation methods might be appropriate for different components. Similarly, one should a*void analysis paralysis that is l*imit the value quickly. Then if the target still looks attractive try some sensitivity analysis. We should always remember that beyond the initial buy/no buy decision, the purpose of most valuation analysis is to support negotiators. Hence, knowing value boundaries and conducting sensitivity analysis enhances one's flexibility to respond to new ideas that may appear at the negotiating table.

Investors have to be very careful while valuating mergers; the failure rate of mergers is very high. The question is do mergers work. According to the KPMG, Mergers and Acquisitions: Global Research Report 1999, there are two aspects to this answer. First, the perception where 83% of the executives believed their deals had been a success but less than half had actually measured the result. Second, the reality is 17% had added value, 30% produced no discernible differences, 53% had actually destroyed value and 83% of mergers were unsuccessful in producing any benefit to shareholders.

Studies by IABC Research Foundation Report 2001, McKinsey & Co., A.T. Kearny (2001), Business Week, 1995 & 1997; Fortune, 1987 have also come up with other measures of failure like 1/3 will be sold within 5 years; 90% will fail to live up to financial expectations; 50% will destroy shareholder wealth; 60% will see their stock price fall behind peers' within 2 years; and 2/3 would earn more with bank fixed

deposits. Further, in a study for Business Week by American Customer Satisfaction Index, 2004 comes up with a different perception where they talk of dissatisfaction by the investors. They measured customers' perception of 28 big companies involved in mergers between 1997 and 2002 in terms of price, quality and ability to meet expectations. And, in 50% of the deals, consumers gave company lower marks in at least one of the three categories.

So, why do mergers often fail? We can define “success” of a merger when it increases efficiency, profitability, thus, share prices of the firm, and ultimately, shareholder's wealth, and “failure” otherwise. It is reasonable to assume that a merger has an impact on efficiency and profitability of firms. On the other hand, it does not automatically lead us to conclude that the merged firm in fact becomes efficient and profitable. Here, the problem of asymmetric information between the acquiring and target firms comes in (Hviid and Prendergast, 1993). Target firms have an incentive to hide any characteristics that may lower the estimation of its value by bidding firms. These characteristics are usually not observable by the bidding firms prior to a merger. This may also imply the adverse selection problem. To put simply, target firms would accept a merger offer only if they think that the merger would increase their profits and, consequently, share prices, which we call the synergy II effect. This is often achieved at the expense of the acquiring firm's profits and share prices, making the merger failure for shareholders.

Mead (1969) suggests that capital market imperfection is another reason for failure to estimate the value of the target correctly since stock prices are one of important indicators. The effects can be both positive and negative as the market can both underestimate and overestimate a fair value of the target firm. Nevertheless, the effects are more likely to be negative, as managers tend to issue equity when the firm is overvalued than undervalued in the market (Andrade et al, 2001). Mallikarjunappa and Nayak (2007) argue that in a competitive bidding situation, bidders tend to overestimate the value of the target.

The argument may be further intensified by common use of the ascending price auction system where the one with the highest bid wins and pays his/her bid. Another factor that prevents the merged firm from fully exploiting theoretical efficiency gains may be failure to effectively integrate the merged firm due partly to incompatibility of acquiring and target firms (Mallikarjunappa and Nayak, 2007). The firms can differ in size, organizational form, strategies, cultures, management policy and so on. It is natural to conceive that the greater the degree of differences, the more difficult it gets to integrate into a single organization.

In addition, issues regarding size require careful attention. Neither too big target nor too small target is desirable as a partner. When the target is too big, the mergers might fail due to acquisition indigestion and when too small, by not giving enough time and attention required. When an acquiring firm is very large compared to a target firm, percentage gains to the acquiring firm will be relatively small compared to the target firm. Nevertheless, many large firms often seek small partners in order to gain control over them, but experience shows that a large and strong firm merging a sick firm in the hope of rehabilitation can result in liquidation (Hariharan, 2005).

Poor cultural fit may create major problems if not addressed properly in the pre-merger period. There are several factors that help to measure cultural fit such as management behaviour, decision-making processes, and the level of teamwork. It will lead to misunderstanding, confusion, and conflict, altering the level of risk aversion and openness. These characteristics of the partner(s) are probably more difficult to measure than such as the financial position. Hence, cultural mismatches may be found after a merger has been consummated (i.e. moral hazard). Achampong and Zemedkun (1995) argue that frequent failure of mergers is due to a principal-agent relationship between shareholders and managers in which, objectives of the two parties differ and often conflict. Managers may use mergers to gain control of a large corporation since it effectively means 'promotion' for them, receiving higher salaries and discretionary payouts resulted from an increase in the firm size, and improving the ailing financial conditions in order to reduce threat to their careers.

As a result, it is possible for managers to reject an otherwise lucrative merger proposal. Mergers motivated by managers' self-interests are, therefore, likely to fail from a point of view of shareholder. Their argument is consistent with the statistical findings where they observed a fall in insider ownership and an increase in retained earnings. These results imply that shareholders become less able to control management and management retains more earnings for discretionary spending at the expense of a fall in dividends. Therefore, investors should look for some simple criteria to find promising mergers: They are a reasonable purchase price, cash transactions and sensible appetite.

Table 1 :
Industry Premiums Across time (%)

	1992-94	1995-97	1998-00	2001-03	Mean
Energy	7	29	26	16	20
Healthcare	42	25	29	28	31
Industrials	33	29	35	31	32
Materials	19	36	37	27	30
Retail	24	25	32	29	27
Technology	35	23	33	28	30
Telecom	32	26	34	60	38
Utilities	12	24	30	27	23
Mean	**25**	**27**	**32**	**31**	**29**

Source : UBS Investment Bank, Factset, 2004

A reasonable purchase price : The premium to be paid should be reasonable, it should be around the industry mean, and as such should be around 30% above the market price. See Table 1. However, studies also have given contradictory results. UBS, 2004 have shown that premiums are not indicative of either short- or longer-term success. Successful deals demand a disciplined acquirer, yet premiums do not differentiate winners from losers. It did not find a statistically significant difference in premiums paid by short-term "winners" and "losers" or longer-term "winners" and "losers" and, in fact, longer-term "winners" actually averaged slightly higher premiums whereas BA&H, 2003 gives a different contra conclusion. The fact is premiums are influenced by too many factors to be a reliable indicator of success, including historical market values, strategic considerations, and estimated synergies. McKensey (2004) study concluded that mergers achieve cost synergies more often than revenue synergies25% of mergers failed to achieve 30% of stated revenue synergies while more than 60% of mergers realized close to 100% of stated cost synergies.

Cash transactions : Acquirers, who pay in cash, tend to be more careful when calculating their bids. Study by UBS, 2004 show that cash deals tend to outperform

stock deals. Longer-term cash deal outcomes were 56% more likely to be winners, and that short-term stock deal outcomes were less prevalent among the winners. Travlos, 1987 also corroborate the association between cash deals and success. Announcement returns are also positively related to the proportion of bank debt in a deal. One study of acquisitions from found that banks extend financing in 70% of the tender offers and finance the entire tender offer in half of these takeovers. The three-day announcement returns for cash tender offers, financed entirely by banks, average 4% and are statistically significant.

In comparison, cash tender offers financed partially by banks or those financed entirely by financial slack are associated with small and statistically insignificant announcement returns. Bharadwaj and Shivdasani, 2003, suggest that bank debt performs an important certification and monitoring role for acquirers in tender offers and are most important for both poorly performing acquirers and acquirers facing substantial informational asymmetries. While the use of stock may signal a belief by managers that their stock is fully valued, the use of cash and debt signals confidence in future cash flow and promotes increased discipline.

The cash cost of servicing debt creates an explicit hurdle, whereas equity introduces a hurdle rate that is merely an opportunity cost. However, acquirers with strong, long run stock performance are more likely to use their stock as an acquisition currency, while acquirers with weaker stock are more reluctant to use their stock, instead opting for cash. In addition, stock deals "hedge" the stock market values and execution risk. Cash transactions require acquirer shareholders to take the entire risk of realizing synergies, while stock transactions syndicate this risk across both shareholder bases. (Jullen et al, 2004). Thus, the decision between cash and stock financing directly affects the distribution of post M&A synergy benefits.

Sensible appetite : The target company should be well known. In this case, serial acquirers clearly outperformed onetime acquirers across longer-term time horizons. Successful serial acquirer's key success factors in their acquisition strategy are many. For example, UBS 2004 study found that the serial acquirer acquisition targets did

indeed tend to be more attractive. Their targets demonstrated slightly higher profitability and significantly higher valuations (Enterprise Value/Capital 2.3x versus 1.8x). Serial acquirers were twice as likely to make acquisitions of targets with revenue less than 25% of their own revenue, than one-time acquirers were, though in absolute terms, they were similar.

Fuller et al, 2002, found that 82% of all acquirers chose targets that had a relative size of less than 20%, that 76% used cash (hybrid deals are included in cash), and that 85% acquired private companies (includes sale of subsidiary). Ooghe et al, 2003 found that serial acquirers tend to buy targets with faster revenue growth. UBS 2004 study found that serial acquirers exhibited more conservative financial policies, providing increased financial strength to support business growth. It observed slightly higher liquidity in serial acquirers relative to other acquirers (16% cash to sales versus 10%). It found similar financial leverage but stronger credit quality (58% investment grade versus 21%). Serial acquirers maintained lower dividends and share repurchase program levels, likely due the availability of reinvestment opportunities (28% dividend payout ratios, 1.0% dividend yields, 0.9% share repurchase yields).

In short the reasons for failure can be summarised as follows. First of all, there is the overestimation of positive effects, the acquiring company has too high expectations and pays an excessive premium. Another reasons is the lack of management prudence, managers take too high risks and expose their companies to these market risks. The incapability to overcome practical challenges is another reason for failure followed by the loss of revenue momentum. Furthermore, mergers can fail due to intercultural differences, when different firm cultures collide or through an overextension of the company.

Of course, the question remains, do mergers really fail so often? The results are contradictory. Studies by Andrade et al (2001) investigate in gains from a merger to acquirers, targets and combined firms in the announcement-period. Based on statistical results where we find statistically significant values for the 'combined' row during the

period of 1973-98 except for the 1970s, they conclude that “mergers seem to create value for shareholders overall, but the announcement-period gains from mergers accrue entirely to the target firm shareholders.” Hence, it may not be accurate to claim that mergers generally fail to create shareholders' wealth. Whereas surveys by KPMG, IABC Research Foundation, McKinsey & Co., A.T. Kearny, Business Week, Fortune, American Customer Satisfaction Index and UBS give a complete different picture. Nevertheless, having evidence based on short-run is not sufficient to evaluate overall effects of a merger. Even so, carrying out a similar analysis for abnormal returns in the long run is much more complicated. The majority of research suggests that mergers do not create long-run gains but there are also some studies suggesting otherwise. Andrade et al claim, however, that no one has provided a convincing way to study this issue. In fact, this area is still open to further investigation today.

One final question that still remains to be answered is when do these mergers fail? According to Harvard Business School (Adolph et al, 2006), most mergers (2/3%) fail at the execution stage. BA&H, 2001, and 2003, in their study also confirm this. DaimlerChrysler, for example, neglected early on to establish a proper set of guiding principles based on the merger's strategic intent, and then continued to misfire by failing to align leadership and integrate the cultures of the two organizations. These execution-related failures can be avoided. To do so, one needs to establish a program integration team early in the process that can respond to the execution risks inherent in all transactions. The Harvard study says that execution related failures could be avoided in paying attention to the “nine deadly sins”. These nine deadly sins can cause the failure of a merger. These sins (risks) are: No guiding principles, no ground rules, not sweating the details, poor stakeholder outreach, overly conservative targets, integration plan not explicitly in the financials, cultural disconnect, keeping information too close, and allowing the wrong changes to the plan.

At the same time, BA&H , 2003 comes up with the ten best practices based on the biggest “spread” between high and low success companies, which are in descending order of criticality: 1) Appoint strong executive to clearly lead the integration process. 2) Compress change duration by taking bold strokes early. 3) Provide for real incentives to reach targets. 4) Set out credible milestones and maintain pressure for progress. 5) Move quickly with regard to personnel changes 6) Build a robust plan

detailing integration activities. 7) Emphasize the transfer of critical capabilities to capture value. 8) Ensure senior management involvement in integration activities. 9) Adopt best practices in key functions from either company or external source. 10) Get task forces (with people from both companies) interacting as soon as possible.

Conclusion

Motives for mergers are various, ranging from ones based on classic assumption of profit maximization to managers' self-interests and exogenous factors. It is assumed that mergers usually occur for a combination of reasons. Even so, it is worth pointing out that some factors have a greater impact on a certain type of mergers. For instance, the diversification motive may account more for conglomerate mergers than the motive to increase market share within the industry, which is more important for horizontal mergers. Similarly, there are a number of reasons for frequent failure of mergers to create values for shareholders, especially, of acquiring firms. Of those, the problem of adverse selection seems to be neglected by decision-makers frequently. Factors leading to overvaluation of target firms seem to make it even more difficult for combined firms to run business profitably.

Companies who want to engage in a merger or acquisition should plan their steps carefully. First of all, they should try to find the best suitable target company. They should calculate the possible resulting synergies and risks. Furthermore, the acquiring company should calculate the highest possible premium to be paid. With the help of the different valuation methods, it should valuate the company worth. Finally, the acquirer should pay attention to the criteria mentioned in this note and avoid the nine deadly sins. At the same time, should ensure that the ten best practices based on the biggest "spread" between high and low success companies, are in descending order of criticality are followed.

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