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Proactive Merger and Acquisition and Firm Performance

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Abstract
Holistic growth is a common phenomenon that is guaranty when all others substances take the best chosen positions at the right time and place. This improves efficiency; effectiveness and profitability are among the key benefits sought from mergers and acquisitions (M&A). This study seeks for the proactive mergers and acquisition, and firm performance. The study is descriptive research using positive accounting theory as theoretical framework. This shows how financial reports are prepared upon which investors' decisions are based. The study discovers that merger and acquisition have a positive relationship with firm performance if it can be properly planned, implemented and evaluated. Specifically, organization should make efforts to attract and keep key employees of the merged organizations through performance contracts or allowance; suitable conflict settlement measures should be established as well as conscious effort should be made to derive the expected gains of the merger. This is because benefits from mergers and acquisitions are not automatic.
Keywords: Merger and Acquisition, Due diligence, Firm performance

1. Introduction

One of the most popular approaches of achieving desirable external growth in any entity is merger and acquisition strategy. Mergers and Acquisitions theoretically promise a lot of benefits like operating economy, economies of scale, management effectiveness, diversification of risk, synergy, merger defence to mention a few. Some scholars have grouped all these benefits as growth/ increase in the size and activities. The brain behind this strategy is to increase shareholders' wealth. Some researchers also assume that, to a large extent, corporate firms engage in Merger & Acquisition for growths which bring about increase in market power, expenses reduction, reduced earnings volatility, and scope and scale economies.

However, the extant studies in many countries in the subject matter have reported conflicting results. Whilst some literature has concluded that Merger & Acquisition have synergistic effect, others paradoxically have reported negative effect with others showing mixed or insignificant results. Olagunju and Obademi (2012) examined analysis of the impact of Merger and acquisitions on commercial banks performance in Nigeria using correlation coefficient and T-test discovered that there is positive relationship between pre- and post merger and acquisition, and firm performance. In the same vein, KPMG (2003) carried out research work executed in Australia revealed that the shareholder wealth was improved, more than it was as a result of mergers and acquisitions. In contrast, Oduro and Agyei (2013) searched on Merger and acquisition and performance: evidence from the Ghana Stock Exchange, using univariate analysis with T- testing and panel data methodology for the analysis showed that merger and acquisition has negative relationship with firm performance. It has been established that traditionally, about half of entire mergers and acquisitions have witnessed total failure (Schneider, 2003). In the light of these results, this paper examines on proactive merger and acquisition and firm performance.

This exploratory study examines the following questions: is there any identifiable link between proactive firm strategic planning and merger and acquisitions? What are the possible due diligent procedures in selection a merger and acquisition strategy? What is effect of a proactive merger and acquisition strategy on firm performance? The major objectives are namely: to identify the link between proactive corporate strategic planning and merger and acquisition strategy; to observe the due diligent procedure in selection a merger or acquisition; and an analysis of existing experience in the focus oriented merger & acquisitions. The intent of the paper is to expand frontier of knowledge about major impact of proactive merger and acquisition as related to firm performance.

2. MERGERS AND ACQUISITIONS

Many researchers have discovered that the terms "mergers" and "acquisitions" are frequently used interchangeably by authors even among the scholars, but in actuality, they are two differing types of meanings. Gaughan (2002) is of opinion that a merger as a combination of two companies in which only one company survives while the merged company goes out of existence. The paper also believes that there are three classes of mergers namely: the horizontal which occurs when two competitors combine; the vertical are combinations of corporations that have a buyer-seller relationship, while conglomerate mergers occur "when the companies are not competitors and do not have a buyer-seller relationship.

This is in line with Kazmi (2008) who believes that conglomerate merger exists with the combination of group of companies which are in different line of industries and not in the same risk class. Burki (2003) states

that acquisitions emerge when one firm purchases another and takes control of its entire assets, profits, and employees: these may be either friendly or hostile takeovers.

However, Rentsch and Schneider (1991) declare that the incidence of true mergers is rare, with various acquisitions disguised as mergers to avoid the appearance of dominance by a company. They justify by asserting that at the time of negotiation the purchasing company may create an impression of the combination being a cooperative partnership, designed to maximize the growth potential of the target, in order to make the deal attractive. However, "the larger firm may seek control over the smaller, but continue this facade until the deal is successfully closed, at which time they take more aggressive steps to impose rule over the target" (Rentsch & Schneider, 1991).

In the light of above conflicting meanings of merger and acquisition, Kazmi (2008) asserts that merger and acquisition or take over are virtually the same phenomenon only that mergers refer to the combination of two companies of comparable size and take over occurs when a combination following which the management of one of the combining time will be dominant. Isenmila, Eragbhe and Ogiedu (2010), submit that the corporations involved in acquisition, may remain independent legal entities while the control of the companies would change. They observe that acquisition may either be stock acquisition or assets acquisition. Stock acquisition occurs when the acquirer procures all or substantially entire of the common stock of the prey firm for a specified price while the buyer replaces the acquired stock holders as the owner of the target firm. Asset acquisition occurs when the purchaser procures specific assets and some liabilities.

The implication is that both merger and acquisition involve the systematic way of seeking for external growth in order to increase firm size and activities which would eventually bring about firm performance and maximization of shareholders' wealth.

2.1 HISTORY OF MERGER

Five dominant merger eras characterize the history of mergers. These eras were recognized by cyclic movement, that is, high levels of mergers followed by eras of relatively fewer mergers (Gaughan, 2002). Mergers emerge in waves; "the first four waves commenced between 1897 – 1904; 1916 – 1929; 1965 – 1969; and 1984 – 1989 and started again in the early 1990's to begin the current fifth wave (Gaughan, 2002).

Dominant and Prominent Mergers and Acquisition eras:

1st Wave 1897 -1904 Horizontal Mergers
2nd Wave 1916 - 1929 Oligopolies and Consolidations
3rd Wave 1965 - 1969 Conglomerates
4th Wave 1984 - 1989 Mega-mergers and Hostile Takeovers
5th Wave 1992 - Present Consolidations

Brealey, Myers, and Allen (2006) notice each merger episode coincided with an era of buoyant stock prices, although there were substantial differences in the types of firms that combined even the ways they went about it. The period of first waves, the United States witnessed tremendous technological growth and resulted to a major industrial economy.

Gaughan (2002) reveals that the first takeover battle took place in 1868. The period was known for growth of the railroad industry and anti-railroad protests. Throughout this era, adequate restraints against unethical business practices were lacking as well as a lot of takeovers by today's standards were violent and unethical. For example, "one such take over involved an attempt to take control of the Erie Railroad" which "took a violent turn when the target corporation hired guards, equipped with firearms and cannons, to protect their headquarters" (Gaughan, 2002: 27). The reason for such disarray was "because bribery of judges and elected officials was common" as well as "legal remedies for violating corporate laws were relatively weak" (Gaughan, 2002: 27).

The first merger wave (1897-1904) transpired after the depression of 1883 (Gaughan, 2002). During this period a lot of horizontal mergers occurred in steel, oil, telephone, and the basic manufacturing industries (Weston & Weaver, 2001). Industries that accounted for two-thirds of this era's merger activity were "primary metals, food products, petroleum products, chemicals, transportation equipment, fabricated metal products, machinery, and bituminous coal" (Gaughan, 2002: 23). "Besides USX Corporation (formerly U.S. Steel), some of today's great industrial giants originated in the first merger wave" (Gaughan, 2002: 24).This first wave "produced 300 combinations covering many industrial areas" as well as "an excess of 3,000 companies disappeared during this period as a result of mergers"(Gaughan, 2002: 24).

The second merger wave (1916-1929) involved additional industry consolidations, oligopolies, as well as large-scale formations of conglomerates (Gaughan, 2002).Weston and Weaver (2001: 8) notice that the wave was "associated with the development of the radio, which made national advertising possible, and the automobile, which permitted more effective geographic sales and distribution organizations". Gaughan (2002: 29) observes that "just as in the first merger wave, the second merger period witnessed the formation of many prominent corporations that still operate today" such as "General Motors, IBM, John Deere, and the Union Carbide

Corporation".

The third merger wave (1965-1969) involved mainly in conglomerate mergers that invested and conducted a large proportion of their activities in multiple industries (Gaughan, 2002). It is evaluated that "80 percent of the mergers that took place in the 10-year period between 1965 and 1975 were conglomerate mergers" (Gaughan, 2002: 32). Weston & Weaver (2001: 8), these mergers "represented in part an adjustment to the slowdown in defense expenditures" as well as "at least one-half of the companies were aero-space or natural resource depleting companies (oil, forest)".

The fourth merger wave (1984 - 1989) was known as the period of the megamerger as well as hostile merger takeovers with innovative acquisition techniques even as investment vehicles (Gaughan, 2002). Weston and Weaver (2001) observe that in this wave, financial innovations even junk bonds made all firms vulnerable to a takeover bid; any company that was not performing up to its potential was subject to be taken over. It was revealed that the absolute number of hostile takeovers was not high with respect to the total number of take-overs, the relative percentage of hostile takeovers in the total value of takeovers was large (Gaughan, 2002).

"The 1980's became the period of the billion dollar mergers and acquisitions" (Gaughan, 2002: 47). During this period, "the number of $100 million transactions increased more than 23 times from 1974 to 1986" while the deregulation of some industries caused a disproportionate number of mergers and acquisitions to take place in some industries versus others (Gaughan, 2002: 47).

Gaughan (2002: 55), during the fifth merger wave (1992-present) mergers transformed to "a worldwide phenomenon, with a large volume of mergers taking place in Europe, and Asia" It is generally believed that merger activity is "more likely to be motivated by fundamental developments in the rapidly changing economy and reflect more traditional corporate goals of efficiency and competitiveness" (Pitofsky, 1998: 1). Merger deals "are pursued by the strategic reasoning that expansion can be more readily achieved through mergers versus through internal expansion" (Gaughan, 2002:51). However, mergers "failed to deliver on promised gains such as lower costs and greater synergies" (Gaughan, 2002:53).

The chronicle of these eras evidences that merger and acquisitions, which are well planned, have ability to increase both size of firm and activity as well as firm performance.

2.3 PROACTIVE STRATEGIC PLANNING AND MERGER AND ACQUISITION

This is a fact that firms seeking growth and expansion are facing with a choice between organic growth and external growth via mergers and acquisitions.

Gaughan (2002) asserts that organic growth may be a slow and uncertain process. Harari (1997) highlights several rationales specified by CEOs to defend a merger or acquisition. They include: to obtain economies of scale, synergies, increased products, rationalization of distribution channels and cost savings. Growth via mergers and acquisitions may be a much more rapid process, although it associates with it its own uncertainties. As a result of these uncertainties many companies which could have been strong and formidable as well as remained as market leaders were sunk in mire without trace, all because of merger and acquisition without strategic and proactive planning. Coulthard, Howell and Clarke (1996) see strategic planning an important tool leading to business success.

Harding and Rovit (2004) researched on the importance of aligning corporate strategy to planning for mergers and acquisitions were examined. They reviewed about 1,700 mergers and acquisitions as well as interviewed 250 Chief Executive Officers (CEOs). It was discovered that less than one in three CEOs questioned had a clear strategic reason for the M&A, or comprehended the contribution the decision would make to their organization's long-term financial future. It was also revealed that over half of those firms with a clear rationale underpinning their merger and acquisition activity came to a post-merger and acquisition conclusion that their rationale had been wrong.

Perry and Herd (2004) stress the critical role of strategic courses of action when carrying out Merger and acquisition exercise. Albizzatti and Sias (2004) declare that an acquisition needs to be more strategic rather than simply the use of excess cash. They coin out strategic reasons for merger and acquisitions as follows: acquire new products; extend their geographical reach; capabilities and skills; consolidate within a more mature industry; as well as convert the existing firm or create a new firm. In spite these above benefits Harari (1997) questions why a lot of merger and acquisitions fail woefully after CEOs extol their strategic rationales.

Balmer and Dinnie (1999) recognize a number of reasons for the failure of merger and acquisition. They revealed that there was an over-emphasis on legal and short term financial issues, at the neglect of the strategic mission of the corporation. The neglect includes a general lack of communication with key stakeholders and failure to clarify leadership issues during the merger and acquisition development.

Not a few studies that have shown the specific rationale for the failure of mergers and acquisitions. Gadiesh and Ormiston (2002) list five major reasons of merger failure which are: mismatch of cultures; poor strategic rationale; difficulties in communicating and leading the organization; paying too much for the Target Company as well as poor integration planning and execution. Gadiesh and Ormiston (2002) believe that strategic

rationale for the merger is the most vital obstacle needed to surmount, as this rationale will serve as guide for both pre and post merger behaviour. It was stressed that this issue alone may bring about the other causes of merger and acquisition failure occurring. According to Lynch and Lind (2002), other reasons for merger failure are: slow post merger integration, culture clashes as well as lack of appropriate risk management strategies.

Having established the essential role proactive strategic planning policy to merger and acquisition strategy it is essential to recognize and exploit an effective tool to ensure there is positive relationship between firms' proactive strategic plan and Merger and acquisition. This tool is popular known as the due diligence process.

2.4 DUE DILIGENCE: SCREENING OF POTENTIAL MERGER AND ACQUISITION TARGETS

Sinickas (2004) considers due diligence as '…where each party tries to learn all it can about the other party to eliminate misunderstanding and ensure the price is appropriate'. While, Angwin (2001) states that effective due diligence should be an all-inclusive analysis of the target firm's entire business, not just an analysis of their cash flow as well as financial stability. Perry and Herd (2004) point out that as the intricacy of mergers and acquisitions has amplified, the scope and effectiveness of due diligence are now key issues. This view is in line with Jensen (1982) who asserts that many acquisitions in the 1960s emerged from referrals through investment and commercial bankers, while in the 1970s a greater proactive screening process was put in place to identify suitable candidate. Jensen recommends that potential candidates have become well exposed to a lot of potential suitors and it can be difficult to decide if they are the most appropriate candidates available for merger and acquisitions.

In order to surmount the danger of entering a bidding war amongst suitors, Jensen (1982) asserts that it is important to analyze the business case by evaluating management and operational strengths and weaknesses. Therefore, Carey (2000) suggests that this examination should involve full financial information, candour about the firm's operating performance as well as problems, its corporate culture and an honest assessment of management competence. The study suggests that this can be accomplished by building relationships with target firms. Carey (2000) advises that a potential purchaser of a firm needs to set clear criteria when considering a future merger or acquisition.

3. Positive accounting theory is premised on the neo-classical economic theory. Fundamental to it is a belief in rational choice theory, that is material self-interest usually referred to as opportunity behavior as the basis for all economic activities. Therefore in positive accounting method self interest (opportunistic behavior) is the reason for the choice of accounting method and procedure as well as policy decision. Positive accounting theory is used as theoretical framework to examine the behavior of preparers of financial statements upon which investment decision is made. This theory consists of three hypotheses which are:

- the bonus plan hypothesis
- the debt covenant hypothesis
- the political cost hypothesis

The bonus plan hypothesis states that managers will use various accounting policies that are likely to shift reported earnings from future periods to the current period. This is to maximize managers' wealth as by reporting a high net income in as much their utility will be maximized through bonuses and incentives (Watts & Zimmerman, 1990).

The debt covenant hypothesis is one of positive accounting theories which disclose that the closer a firm is to compromising their debt covenants, the more likely management is to utilize accounting policies and principles that shift reported earnings from future periods to the current period. This is because higher net earnings will diminish the probability of technical default on the debts (Watts & Zimmerman, 1990).

The political cost hypothesis discloses that the higher the political costs to the firm, the more likely management are to apply accounting policies to defer reported earnings from current periods to future periods. This hypothesis introduces politics into the choice of accounting policies. Highly profitable firms come for media and consumer attention. This awareness can create an increase in taxes and other regulations (Watts & Zimmerman, 1990).

By implication, positive accounting theory reveals to every researcher brain behind figures used in preparation and presentation of financial statements which merger and acquisition decisions are based. Therefore, it would be wise to be proactive and looked beyond written figures and data.

4. Conclusion

This study has searched into proactive merger and acquisitions and firm performance. It has established that there is positive relationship between proactive merger and acquisition. The success factors as well as best practices offered in this study provides a glimpse into the enormous and intricate area of the processes influencing mergers and acquisitions.

The use of positive accounting theory complemented the study of mergers and acquisitions because it offered a new metaphor from which new understanding can take place. Knowledge about the successful implementation of mergers and acquisitions as relate to organization performance raises more arguments. This demands openness to new ideas and a striving for better understanding and a critical view of them.

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