

Determinants of Successful Mergers and Acquisitions

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Abstract. This paper focuses on the risk control of mergers and acquisitions (M&A) and adopts a case analysis method to explore the relevant problems that may occur in the process of M&A. The goal is to find the key elements that need to be paid attention to within the progress and to put forward specific preventive measures and countermeasures for various elements. The aim is to provide a useful reference for other enterprises to implement M&A in the future. The paper is divided into three parts: the introduction, which outlines the background and significance of the study and determines the research content and methods; the second part, which segments the M&A process and identifies the key points within each stage; and the third part, which presents conclusions and recommendations on how to better leverage these key factors for better M&A outcomes. The success rate of M&A is not high, and this paper aims to help companies minimize the possibility of failure by focusing on risk control and key factors.

Keywords: Synergy realization, information asymmetry, cultural fit.

1. Introduction

When companies developed into certain stages, there are usually two ways for enterprises to realize growth strategy, one is through internal development; the other is through external expansion. In contrast, exogenous expansion can help enterprises achieve leapfrog development and strategic objectives more quickly, and M&A is an effective means and way to achieve exogenous expansion. Whether horizontal M&A or vertical M&A, the objective is to help enterprises achieve leapfrog development in a relatively short period and quickly grow bigger and stronger [1]. Due to the impact of the epidemic, the M&A market has gradually declined in the past three years (see Figure 1). By 2022, the total value of China's M&A transactions will fall to US\$485.8 billion, the lowest level since 2014, and a decrease of 20% from 2021 [2].

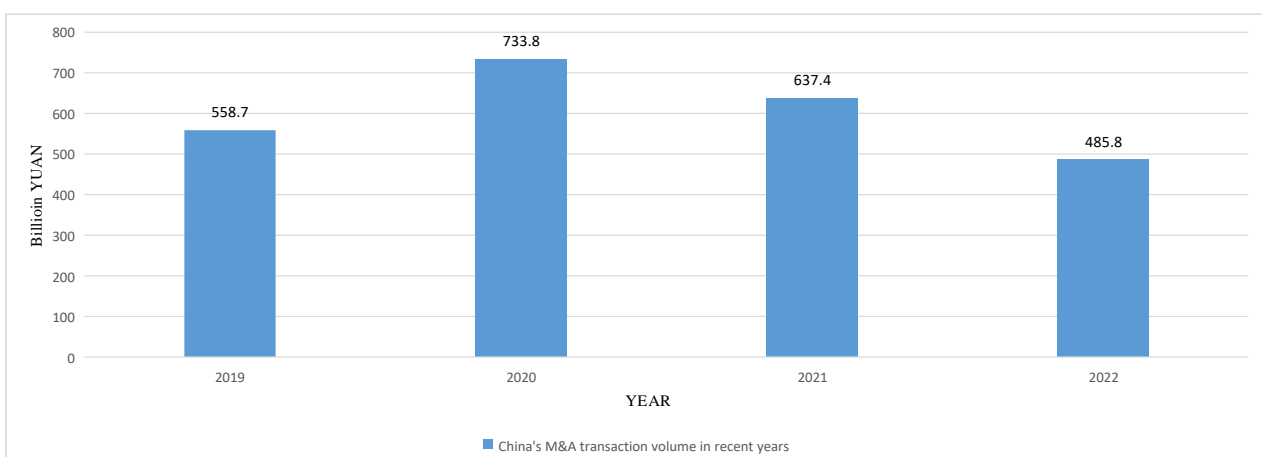


Fig 1. China's M&A transaction volume in recent years (Data from PwC)

According to the “Review of China’s M&A Market in 2022 and Prospect in 2023” by PwC, published on February 23, 2023, the total value of Chinese M&A deals in 2022 was \$485.8 billion, down 20% from 2021. Although the epidemic has brought a lot of impact on the market economy and caused a certain downturn, under the background of Chinese policies encouraging foreign investment in key industries and various regions actively promoting cross-border investment and

trade development plans, the M&A market will gradually increase in the long run [3]. With recovery, investor confidence will gradually recover, and market sentiment will also improve. According to the "Global Capital Confidence Barometer" recently released by Ernst & Young in 2021, 57% of the Chinese executives surveyed said they will actively seek M&A transactions in the next year, which is the highest level in the past ten years [4]. In conclusion, the market will face more intense competition in the future. However, whether the M&A activities are successful or not, risks still lie beneath. Hence, through the analysis and summary of various cases, this article aims to enable enterprises to correctly understand the key points in mergers and acquisitions so that they can maximize benefits and minimize risks in the process.

At present, most of the existing research focuses on the consideration of M&A risk content. This paper sorts out the scholars' views and theories on M&A risks, focusing on the research and summarizing the key points that companies should pay attention to in the pre-M&A preparation, mid-term, and post-M&A integration stages, which theoretically enriches the research content. Mergers and acquisitions have been developed in Western countries for more than 100 years. Although mergers and acquisitions in China have experienced rapid development for more than 40 years, their success rate is relatively low [5]. A large factor is that enterprises have not fully implemented the risks in the process of mergers and acquisitions. manage. Therefore, finding the key points in the M&A process to control risks is an important guarantee for improving the success rate. This article analyzes and studies the key points in mergers and acquisitions, which have positive guiding significance for enterprise management and development.

2. Segmentation of M&A Process & Key Points in Each Stage

M&A is a complex systematic project. The generalized success of M&A is marked by the signing of an agreement. In this view, the success rate of mergers and acquisitions is extremely high. However, after the implementation of the merger and acquisition of some enterprises, in some cases, the operating performance of the host company and the acquired enterprise did not improve or even deteriorated, and the indicators reflecting the asset quality, such as the solvency, asset management ability, equity expansion ability, growth and the outstanding status of the main business, also deteriorated substantially. It can be seen that the integration process after the merger is equally important. Therefore, in the consideration of integrity, this article divides the M&A process into three stages, pre-M&A, M&A implementation, and later integration. The article synthesizes the research of scholars and identifies the four key points: M&A motivation and company capabilities, synergy, information asymmetry, and company culture.

Nowadays, mergers and acquisitions are powerful means of expansion in market competition. Increasingly, companies are making mergers and acquisitions for a variety of different reasons, however, one of the main ones is strategic acquisitions, which is the acquisition of disadvantaged competitors that can not only enhance their competitiveness but also reduce external threats [6]. However, it can be found from market cases that companies can easily take the financial risk to fall into a low-cost expansion trap due to the unclear motivation for M&A and an incomplete understanding of the company's capabilities. When some enterprises choose targets for mergers and acquisitions and find the opponents in a weak position which arise the motivation to acquire it at low prices, companies do not fully estimate their ability to transform such disadvantaged enterprises [7]. Thus, making wrong acquisition choices and falling into the trap of low-cost expansion, will undoubtedly bring huge risks to the development of the enterprise, and even eventually lead to losses due to the inability to continue operating the target company after the merger. Hence, M&A motivations and company capabilities are vital for the pre-M&A.

In the pre-M&A phase, here focuses on the period of M&A target selection, the company needs to clarify to have some measure of its capabilities, which include human resources, financial resources, market resources, technical resources, management resources, brand resources, and so on. These capabilities are not only related to whether the company can successfully carry out the M&A but also

to the issue of late integration and whether the acquired company can receive fixed resources to maintain long-term stable development to provide benefits for the company. Furthermore, The motivation for an acquisition is the most important element of all, as it determines the strategic objectives of the acquisition and the integration plan after the acquisition is completed. A company needs to be clear about the motivation for the acquisition before proceeding with it to make it as smooth and effective as possible. Once a company has completed the above pre-M&A preparations, synergies are a key factor in the subsequent M&A process [8]. Synergy is something companies must consider when acquiring because it not only plays an important role in the selection of the target company (it tends to choose a high synergy effect) but also is a part that must be considered since the acquisition premium is brought when pricing the target company [9]. Properly raising the price within the scope of the synergy effect can win the acquisition competition with a greater chance.

Information asymmetry is another major factor contributing to M&A failure and is widespread in all types of capital market transactions. Information asymmetry refers to the uncertain factors brought about by the serious asymmetry between the company's understanding of the acquirer and the target company's shareholders and management in the process of mergers and acquisitions. The merged company may hide its disadvantages from the acquirer for profit reasons. Hence, situations like the asset quality of the target company acquired by many enterprises are poor, and many unresolved liabilities may happen. The acquirer is unaware of the potential risks before the M&A, and the result is a foreshadowing of future restructuring failures. In the magazine's survey on the causes of M&A value destruction, respondents identified different stages of the M&A process as having different levels of impact on the risk of M&A failure, as shown in Figure 2.

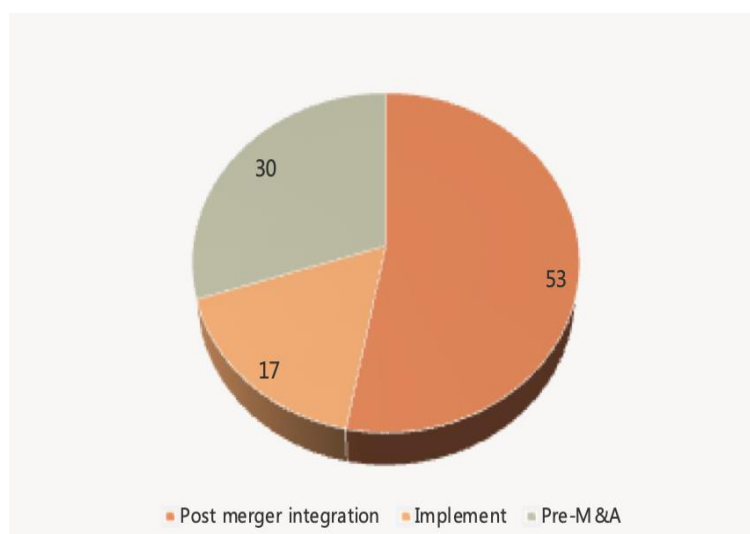


Fig 2, Risk ratios by stage (%)

However, in this later stage of the integration process, the article argues that the integration of the company culture is the most difficult to achieve [10]. Organizational cultures are collections of shared values, beliefs, and perceptions that result in behavioral norms [11]. In M&A restructuring, corporate culture integration is a key element in the success of a company's M&A strategy and long-term business performance. However, most cultures that have been formed over a long period are difficult to integrate in a short period. The result of poor integration is that there may be many conflicts in the way of thinking, business philosophy, team spirit, and working style of both parties, which eventually leads to reduced efficiency and lower earnings. Therefore, post-merger cultural integration can also be risky, so the cultures of the two companies must be well and quickly integrated [12].

The merger of Mercedes-Benz and Chrysler was announced on May 7, 1998, when Daimler-Benz in Germany and Chrysler in the United States officially merged under the new company name Daimler Chrysler Automobiles. Daimler-Benz holds 57% of the shares of the new company, while Chrysler holds 43%. After 2004, Chrysler's 13 brands fell apart, and in 2006 Chrysler's turnover fell

again, with a loss of US\$1,127 million. The company's turnover fell again in 2006, with a loss of US\$1,127 million. The reason for this is the difference in company culture. There were significant cultural differences between Daimler Benz in Germany and Chrysler in the USA, with the German company placing more emphasis on responsibility, efficiency, and professionalism, while the American company was more concerned with individualism and innovative thinking. The mutual lack of understanding between the employees of both companies due to this cultural difference eventually led to the failure of Daimler Benz's acquisition of Chrysler. At the same time, due to cultural differences, the management of the two companies had some differences and had different ideas about the future direction. This management disagreement was also one of the reasons for the failure of the merger.

3. Strategies for Improving the Success Rate of M&A

3.1 M&A Motivation & Company Capabilities

Companies may focus more on the value of the target company's resources when acquiring a company but ignore the long-term nature and complexity of the integration process. The motivation for acquiring a company is simply to pursue superficial and simple scale expansion, without considering whether the business direction and corporate functions of the two parties can be coordinated. This is why it is important to think holistically and long-term when considering the motivation for an M&A. According to Brouter's theory (1998), the motivations for M&A can be divided into three categories, namely economic, personal, and strategic motivations. Weston et al. (1998) classify the existing literature on M&A motivations into four categories: strategic-driven M&A, management ineffective-driven M&A, management interest-driven M&A, and stock market ineffective-driven M&A. Considering the research findings of global scholars, this article classifies M&A motives into the following three elements to provide reference advice and value to companies in determining their motivation for M&A: strategic motives, financial motives, and self-awareness. Strategic motives involve maintaining and developing a competitive advantage through mergers and acquisitions, while financial motives mainly focus on tax avoidance and the expectation effect, which can create a speculative opportunity for the company. Self-awareness involves understanding the company's own capabilities and resources to ensure the successful acquisition and development of the acquired target. It is suggested to use value chain analysis and internal environment analysis methods to gain a better understanding of the company's internal workings. By providing this classification, the article offers valuable guidance to companies looking to determine their motivation for M&A and achieve success in the process.

3.2 Synergy

Synergies are a critical factor in mergers and acquisitions and are typically classified into operational, financial, and management categories. In determining the value of an acquisition, synergies play a significant role and are difficult to identify. Mu Panke, an academic researcher, identified three mechanisms for realizing corporate synergies, including increased synergy, complementary synergy, and alternative synergy [13]. Increased synergy involves the integration of two companies to expand their industrial scale and achieve a 1+1>2 effect. Complementary synergy, which can be vertical or horizontal, is achieved when companies in the same industry or related business segments acquire each other to leverage strengths such as technology or customer resources. Finally, alternative synergy refers to the replacement of weaker resources with superior resources, resulting in optimal resource allocation. Mark Sirower's formula for M&A value highlights the importance of synergies, which largely determine the choice of a target company and the value of the acquisition.

3.3 Information Asymmetry

The complexity of M&A as an integrated system with multiple factors of production and relationships poses a great challenge to M&A parties in identifying truth and falsehood in a short period of time. To address this, companies need to collect a large amount of information on the target company's industrial environment, financial situation, top leadership, production and operation, management level, organizational structure, corporate culture, market chain value chain, etc. [14]. Additionally, secondary assessments and the signing of additional terms in the acquisition contract can be used to improve information disparity. By conducting a secondary assessment and adding additional terms to the contract, both parties can ensure the comprehensiveness of the information and ensure public disclosure of relevant materials and information.

3.4 Cultural Fit

Mergers and acquisitions can fail due to cultural conflicts and coordination failures [15]. To address these issues, the article recommends several approaches for post-merger corporate culture integration. Firstly, M&A parties should focus on corporate culture marketing prior to the M&A process to increase mutual trust, honesty, and willingness to integrate with each other. Secondly, companies can build a specialized corporate culture integration body with dedicated personnel who have experience in cultural management to build bridges and establish a system to implement the new philosophy after the integration and restructuring [16]. Thirdly, establishing smooth corporate culture communication channels can promote deeper cultural integration and improve post-merger cohesion and efficiency [17]. Companies should fully understand and respect the cultural traditions and emotional factors of all employees, while emphasizing equality and mutual respect among members, and increase the frequency and depth of communication by building formal as well as informal channels of communication. These approaches can help companies successfully integrate corporate cultures after a merger or acquisition.

4. Conclusion

Based on the analysis of the M&A process and the key determinants of success, it is evident that successful M&A requires careful planning, due diligence, and effective execution. Companies need to focus on achieving synergies and cultural fit, while also paying close attention to financial performance, strategic fit, managerial expertise, communication and coordination, human resources management, regulatory compliance, risk management, innovation, negotiation skills, and valuation accuracy. Furthermore, post-merger integration is critical for realizing the full potential of the acquisition. Therefore, companies must prioritize risk management, adopt appropriate preventive measures, and implement countermeasures to mitigate potential risks and challenges. In conclusion, this study provides valuable insights for companies planning to undertake M&A. By focusing on the key determinants of success, companies can minimize the possibility of failure and realize the full potential of the acquisition. By prioritizing risk management, adopting appropriate preventive measures, and implementing countermeasures to mitigate potential risks and challenges, companies can ensure successful outcomes in the M&A process.

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