

# **Mergers and Acquisitions: Their motives and pitfalls**

**Fuusiot ja yrityskaupat: Niiden motiivit ja ongelmakohtat**

Bachelor's thesis

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## ABSTRACT

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<b>Keywords:</b> Mergers, Acquisitions, Corporate Unifications, Motives, Synergies, Pitfalls, M&A	
<p>Firms do commit to mergers and acquisitions for a variety of reasons: However, realizing potential benefits will prove challenging in many cases, weakening the potential added value of the acquisition or merger.</p> <p>The aim of this bachelor's thesis is to study the motives of acquisitions and, frequently encountered problem related to them. Objective is to try to find dependencies and form a frame of reference between them. The work has been done entirely as a literature review.</p> <p>Motives behind M&amp;As can occur as diverse and complex entireties. Most firms seek to streamline their operations, increase their resources or market reach or seek for other benefits, often referred to as synergies.</p> <p>Most chains of events that eventually harm the added value in M&amp;As start at very early phases of the transactions. They usually occur in the form of misjudgments in planning processes their effects are usually fortified by several other factors throughout the long process.</p> <p>The complex and case-by-case nature of acquisitions makes it difficult to categorize them and hamper the general use and cross-utilization of the findings and customs between discrete cases</p>	

## TIIVISTELMÄ

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<p>Yrityksen tekevät yhdistymisiä ja muita yritysjärjestelyjä useista syistä. Potentiaalisten hyötyjen realisointi osoittautuu kuitenkin useissa tapauksissa haastavaksi, jolloin yrityskaupan tai yhdistymisen luoma potentiaalinen lisäarvo heikkenee.</p> <p>Tämän kandidaatintyön tavoitteena on tutkia yrityskauppojen motiiveja sekä niihin liittyviä ongelmakohtia, sekä yrittää määrittää tavanomaisuuksia ja yhtenevyyksiä edellä mainittujen välille. Työ on tehty täysin kirjallisuustutkimuksena.</p> <p>Yrityskauppojen motiivit voivat esiintyä moninaisina, laajoina kokonaisuuksina. Useimmiten yrityskaupoilla tavoitellaan yrityksen kasvua, kasvun tuomia mittakaavaetuja, toimintojen suoraviivaistamista tai molemminpuolisia kumulatiivisia etuja, synergioita.</p> <p>Useimmat yrityskauppojen lisäarvoa heikentävät tapahtumaketjut alkavat jo suunnitteluvaiheessa erilaisina virhearviointeina ja niiden vaikutukset usein vahvistuvat prosessin edetessä useista muista eri syistä.</p> <p>Yrityskauppojen monimutkainen ja tapauskohtainen luonto kuitenkin vaikeuttaa niiden kategorisointia ja niiden välisten tavanmukaisuuksien yleistä käyttöä ja ristikkäistä hyödyntämistä.</p>	

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# 1 INTRODUCTION

The purpose of this introductory chapter is to familiarize the reader to the background and the main questions and problems of the research. In addition to that, research motives and limitations are presented as well as research methods.

## 1.1 Background

In the present corporate world companies need to carry out complex and calculated strategic acts in order to gain a competitive advantage over their rivals and in order to react to new external changes. Mergers and acquisitions (M&A) have become increasingly popular strategic option for countless companies aiming for successful and long-lasting future trade. (Bösecke 2009, pp. 1-2)

Constant globalization, desire to expand current markets and swift technological development are only a few of the vast number of drivers that promote companies and organizations to seek co-operation from other companies in form of M&As. The main objective in M&As is to create some variety of value to the corporate ecosystem. The sought value might largely differ between transactions depending on the characteristics of the companies and their role in the process. (Hitt et al. 2009)

However, M&As are very complex, hard-to-optimize processes that might revolutionize a company's whole identity and structure. They demand and consume enormous amounts of effort and resources in order to be completed. Thus, committing to M&As possess large risks that might cause tremendous damage to the merging business from all points of view. They might face many sorts of unexpected events or difficulties that limit their capability to perform and create value as expected. (Fiorentino et al. 2015)

The aim of this study is to examine why a merger, or an acquisition is decided to carry out and what are the usual problems limiting their success on achieving their objectives.

## 1.2 Objective and limitations of the study

Objective of this study is to explore common themes about M&As' motives and their problems that cause M&As to lose value. Aim is to gather relevant information about them in an easily accessible compilation and additionally to try find some congruence between certain motives and risks. Main research question of the study is: What are the motives of Mergers and Acquisitions and which factors cause trouble achieving their objectives? Research question is presented and broken down to three more specific questions in Table 1 below.

**Table 1: Research questions**

<b>Main research question: What are the motives of Mergers and Acquisitions and which factors cause trouble achieving their objectives?</b>	
Sub questions	Objectives
Why are M&As decided to carry out?	To define key motives, objectives and their reasons.
What are the main reasons desired outcomes won't be achieved?	To research common difficulties regarding M&A processes.
Are there certain pitfalls that often appear alongside certain motives?	To find relations that repeat frequently between certain motives and risks.

First two questions will be mostly explored together. In the first main chapters of the thesis these topics will get answered thoroughly in a way that the most common types and methods of M&As will be inspected and presented with their usual characteristics concerning their motives, objectives and plausible frequent obstacles or pitfalls.

The third sub-question will be observed from slightly a different point of view. Target of the last question is to try connecting the two previous questions and to present tendencies that link some events together. Sought benefit of this question is that one could identify similar traits in forthcoming cases and handle them with proper attention.

Main motive of the thesis is to gather key information about corporate transactions in one paper in order to create a comprehensive picture about their common features. The study will accumulate reader's knowledge about corporate strategy and its transactions.

Object of the study is limited to mainly industrial or productive sectors of global business. Limitation excludes e.g. financial and educational sectors for the sake of keeping the study concise, explicit and appropriate for its context.

This study will be done exclusively as a literature review. The material used in the research is heavily focused on the scientific books and reports published by researchers and educational institutes. Structure of the research is mainly focused on the theoretical framework and deriving conclusions about it.

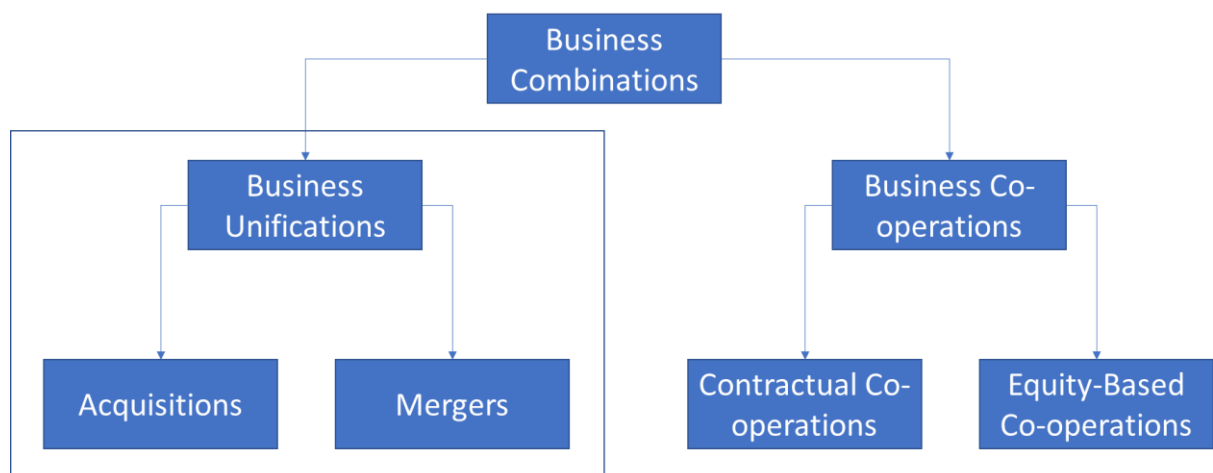
## 2 MERGERS AND ACQUISITIONS

This chapter will present the theoretical information about mergers and acquisitions and their different forms. The chapter will be focused on the most important terms and definitions in order to easily read and understand this research. First part of the chapter will define the core concepts of the thesis and discuss different forms of M&As while the second is focusing on motives and objectives of the transactions.

### 2.1 Definition

Mergers and Acquisitions as general terms are often used universally when speaking about any type of business combinations, which include a large number of different transactions, co-operations and alliances such as franchising, joint-ventures and R&D co-operations. (Bösecke 2009 pp. 7)

This study will focus only focus on genuine M&As (highlighted in the figure below) and leave other types aside. This choice is done on scoping purposes. The aim of this chapter is to clearly define the characteristics of each relevant types of mergers and acquisitions for this study.



**Figure 1: Combination types**

Mergers often are referred as transactions where two or more companies form a larger entity with a mutual decision and shared motivation. In a merger, merging companies usually create



a totally new unit which differs distinctively from the companies' previous form. In mergers authority of each participating company will somewhat remain and in many cases they form the executive group of the previous chairmen of merging companies. (Gallant 2019)

Acquisitions, or takeovers, are often transactions where a larger company acquires a smaller company or its property such as industrial plants or divisions by purchasing its assets or stocks. Acquisitions are often one-sided affairs in a way that the part takers do not share similar negotiation powers. In these transactions the acquiring company often will not face large changes concerning its chairpersons and management and the target company will lose its autonomy or possession of its certain assets. (Gallant 2019)

From another point of view mergers are transactions, where at least one participating company will lose their economic and legal autonomy in the process. While this might true in acquisitions, it is not mandatory in all cases, as it will be presented in later chapters. (Bösecke, 2009 pp. 6-7)

In short, the main distinctive characteristics between mergers and acquisitions are as follows: In mergers companies usually share the same interests and will continue rather equally in terms of authority after the unification. In acquisitions, often a more dominant company will acquire companies or their plants, divisions or other assets by purchasing their stocks or assets in a way that the target company will lose their autonomy and start acting as a sub-part of the acquiring firm. While in mergers one or more companies cease to exist, in acquisitions it is not necessarily the case.

Eventually, the difference and relevance between the terms might be quite trivial since the outcome of most M&As is practically the same: two or more previously separate companies or their divisions will start operating under the same name and ownership and start contributing to shared benefits and objectives. (Sherman & Hart 2005, p. 11)

## 2.2 Methods of M&As

Even though almost every M&A is a unique and highly complex transaction, they can grossly be grouped into a few groups (Figure 2) depending on the corporate relations, intentions and the way the unification is carried out.

Both mergers and acquisitions and their sub-types do share a lot of similarities and in some cases the terms are interchangeable. In this chapter the main traits of each M&A type will be presented in order to create some congruence for the later phases of the thesis.

Most common way to categorize acquisitions is to divide them into two main types by the method a transaction is executed. These two types are **stock acquisitions** and **asset acquisitions**.

In stock acquisitions the acquiring company purchases a major portion of the target company's stocks and thus becomes the major owner of the company in legal terms. When an acquisition is done by stock purchases, ownership of the whole legal corporate entity, including both company's assets and liabilities is transferred. After acquiring the target company's managements permission, purchasing organization usually commits to a share acquisition by placing an offer on the individual stocks in exchange to a higher price than their market value or by issuing and swapping new stocks of the company. (Balasubramaniam 2019; Ross et al. 2013 p. 887)

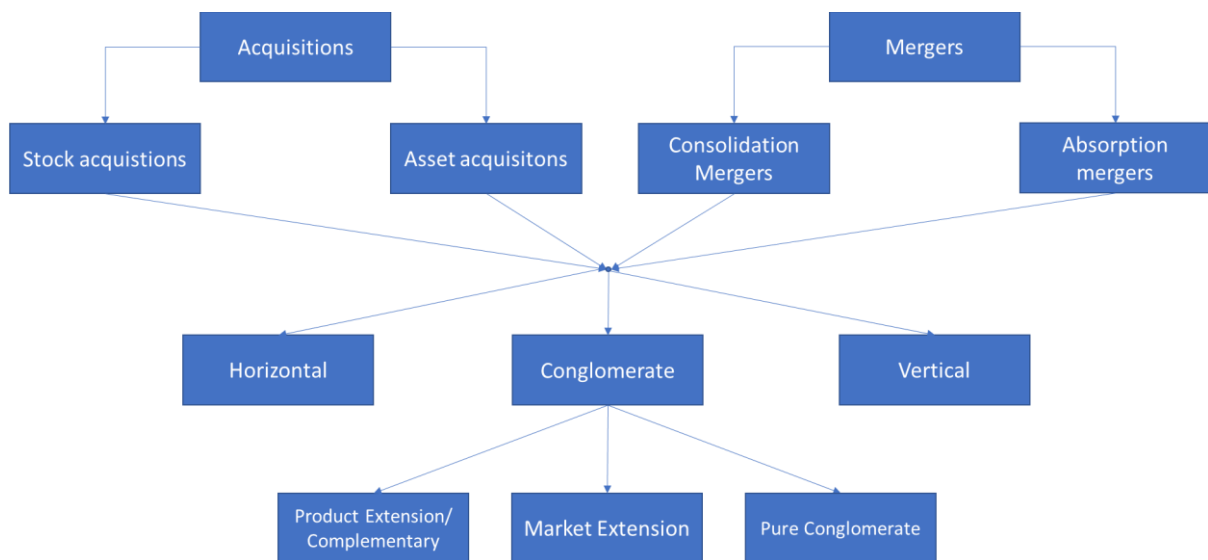
Asset acquisitions on the other hand are more diverse and somewhat more difficult explain in a way that would apply in all situations. In these cases, the acquiring company purchases, as the name suggests, assets from the target company. These might include e.g. industrial plants, machines or business divisions. Acquiring company can place a tailored offer on the precise assets they found useful and practical for their needs. In asset acquisitions, it is typical, that the previous owner of the target assets will maintain their autonomy outside the sold assets in question. (Ross et al. 2013, pp. 886-887)

Usually mergers are divided to two main methods of executing the transaction, **consolidation** and **absorption** mergers.

Absorption mergers refers to transactions where one or more companies are absorbed by another firm. The host company will acquire all the assets and liabilities of the absorbed firm and continue as its previous identity and as the same legal entity. Absorbed company ceases to exist as an autonomous business. (Ross et al. 2013, p. 886)

Absorption mergers share quite a few similarities with stock acquisitions. Different sources define concepts in different ways, and in some cases, terms are not even separated from each other. Ross et al. (2013, pp. 885-887) defines that absorption mergers are initiated by the smaller company, that is subject to be absorbed while acquisitions started by the acquiring direction.

Consolidation or equal merger is considered when two or more companies with similar resources create a new entity and the previous companies cease to exist. Consolidations are often carried out by acquiring shareholders' shares in exchange to financial securities issued by the newly forming company. Typically, in these cases the executive boards of the companies are combined in a way that the management of previous companies will have equal authority over the merged, new company. Forming a new entity by mixing different corporate cultures and strategies is very complex and might create significant challenges throughout the merging process. In consolidations, previous companies eliminate their previous legal existences and create a whole new corporation. Consolidation mergers are said to be the purest form of mergers, as the companies do combine their resources, processes and strategic objectives into a whole. (Bösecke 2009, pp. 6-8; Kenton 2019b; Ross et al. 2013, pp. 885-886)



**Figure 2: Typical M&A methods and types**

Both mergers and acquisitions are often executed with similar intentions in terms of gaining new opportunities. Another type of categorizing M&As aside of their transaction method is to divide them into groups by how their merging industries contribute to each other. These types often grossly grouped into horizontal, vertical and conglomerate M&As. (Ross et al. 2013, p. 887) On top of that, many M&As can be carried out on market extension purposes or in order to create complementary or extensive products or services to the previous portfolio (Copeland & Weston 1988, 678). These two are in many sources regarded to be sub-classes of conglomerate mergers, but they still can have both vertical and horizontal features of other traits that separate them from other groups.

In horizontal unifications, companies within the same industry become one. Horizontal M&As are typical in industries that experience considerable competition as the most typical reason behind these cases is to create competitive advantage via economies of scale by combining resources and processes. Horizontal mergers are often used to decrease competitive pressure in a market by creating one powerful force instead of two or more competitors. A typical example of horizontal activity is oil industry, which has a very narrow range of products while still having many large companies competing with each other. Oil industry has had numerous large M&As in the past creating few of the largest global companies by their result. (Grant 2019; Ross et al. 2013, pp. 886-887)

Vertical mergers refer to transactions where companies operating on different levels of certain value chains unite. Typical vertical integration could be a unification of an end-product manufacturer and its supplier or logistics partner. Objective behind a vertical expansion is to have more control over the whole value chain and to become a more independent company. Vertical mergers usually allow processes and supply chains to operate more efficiently and fluently while creating cost reductions by removing unnecessary intermediates that would otherwise require additional profit. (Bösecke 2009, p. 8; Copeland & Weston 1988, p. 678)

Conglomerate mergers signify unifications that happen between companies that are unrelated to each other. Whereas companies in vertical or horizontal mergers share the same value chain or compete with similar products on the same market, conglomerate mergers happen between companies that practice completely different businesses or operate on different markets and industries. (Bösecke 2009, p. 8; Ross et al. 2013, p. 877)

Copeland and Weston (1988, p. 678) classifies conglomerate mergers into three categories: market extension, product extension or complementing and pure conglomerate mergers.

Pure conglomerate mergers are transactions, where the merging companies do not previously interfere with one another and do not share the same industry. Pure conglomerate mergers might come in handy in occasions where a company decides to venture new business areas without previous skillset on the expertise. Holding companies might be considered a large utilizers of pure conglomerate mergers as they usually do not practice any industrial business on their own, while they can still possess a variety of different companies from various industries. (Copeland & Weston, 1988, pp. 678, 691-692)

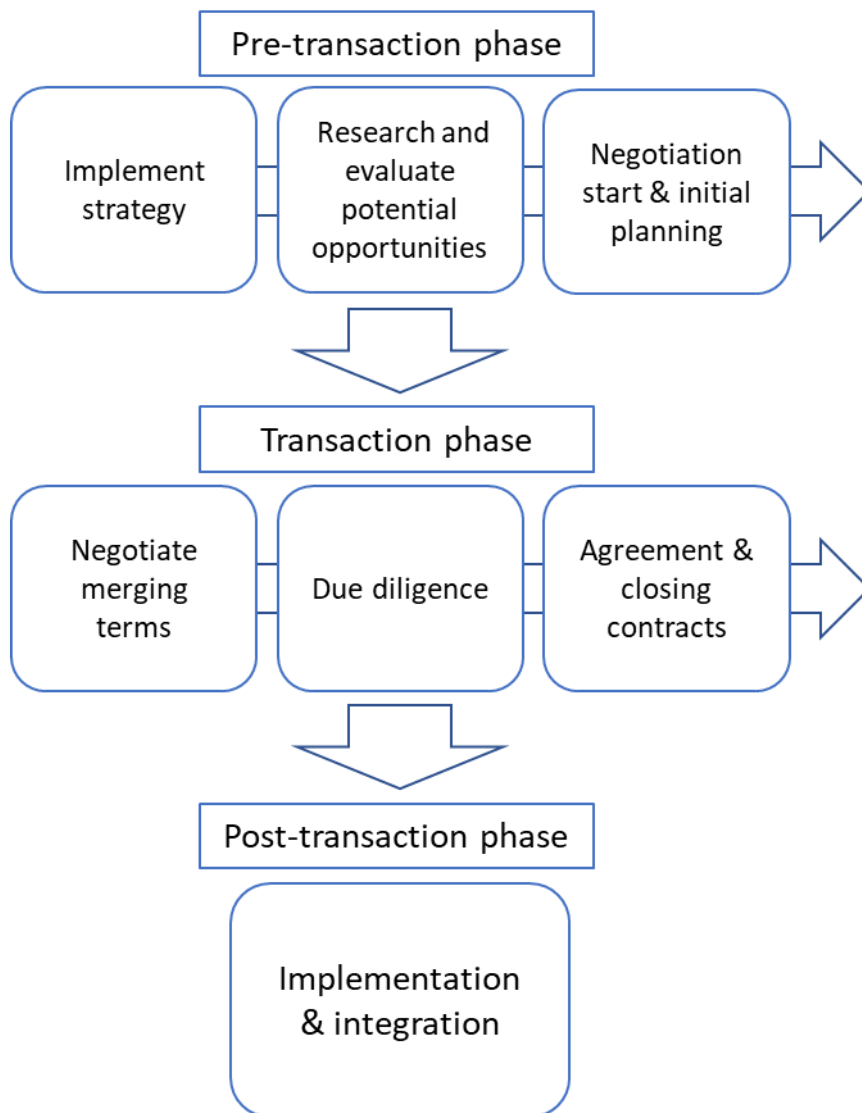
Market extension mergers usually involve companies that manufacture similar products that however do not compete on the same markets or geographic areas. Typically, this kind of transactions are used to grow company's overall turnover and thus grow the overall potential of company's business. Other important objective is to create larger global control on the markets which would allow the company to be more influential globally and have more negotiation power over its competitors. (Copeland & Weston, 1988, pp. 678, 691-692)

Product extension mergers refers to situations where companies unite on a purpose to broaden their product portfolio with new products that another company is already able to produce. Product extensions can be cost- and resource efficient alternatives to building new production lines from scratch. A usual example of a product extension merger could be any vertical merger that unite manufacturers that produce components related to each other. (Copeland & Weston, 1988, pp. 678, 691-692)

However, various market or product extension mergers do also have attributes similar to horizontal and vertical unifications. In some sources this allows them to be classified individually and not to be lower categories of conglomerate mergers.

### **2.3 Typical M&A process**

M&As are always complex and multidimensional, unique transactions. They are hard to model universally, but they still have similar processes and actions repeating in frequent order in many cases. Many researchers have developed their own models on M&A processes and only few of them are compatible or interchangeable. In this chapter some usual models are combined into a simplified timeline that would be helpful in order to demonstrate latter phases of this study. A simplified M&A process is presented in Figure 3.



**Figure 3: Typical M&A process**

M&As start from merging parties' or acquiring companies' perspective with implementing strategy and deciding what are the objectives of the upcoming transaction. Process continues with research for potential merging or acquiring candidates suitable for the strategy. In this phase, there might be several potential opportunities to evaluate and pick to most suitable candidates from. At this point, potential targets or merging partners are contacted and preliminary negotiations are initiated. Number of candidates has often diminished to only a few or the single, final partner company at this point. In some researches, process to this point is called pre-transaction phase. (Bösecke 2009, 12)

Transaction phase, of which sub-processes simplistically are of negotiations, due diligence and contract agreements, is arguably the most crucial part of M&A process. This phase includes all the complex parts that stand between starting the negotiations and the operation unification. At this point of the process, the number of candidates has diminished to only few or a single partner.

Due diligence is a very frequent term when exploring M&A materials, it refers to auditing and analyzing the target or merger partner company. In this large process the all the available information is being used to plan, evaluate, value and model the whole upcoming unification. Objective of this phase is to spot all the available synergies and other benefits the fusion will create and to define their upcoming profits or other sought values. In due diligence, there are often hundreds of little factors closely examined in order to get as accurate view as possible of the upcoming partner firm. Due diligence is often done by third party professionals, such as investment bankers, accountants, lawyers and management consultants. After thorough assessment and valuation, the firm should be able to offer suitable price for the assets or stocks they were researching. This starts the last process of transaction phase, creating and closing the contracts. (Bösecke 2009, 12-13; Straub 2007, 91)

Lastly, the post-transaction phase is implementing the merger or acquisition by integrating the operations by following the strategical plan created in earlier phases. After closing the transaction, companies must join the planned activities in the defined product or market areas together in order create the value and synergies the whole process was after. The complexity of this process is depending on the M&A method used, as for example, merger of equals requires total fusion in all departments and ownership change of a supply company will not affect operations excessively. (Bösecke 2009, 13)

As already said, M&As are unique and might differ from each other dramatically. This model is simplified version of other models and does not cover all cases. The total process might take anywhere between few weeks and years depending on the corporate differences, companies' scale and the scope of integration.



### 3 SYNERGIES AND UNIFICATION MOTIVES

In the previous chapters, terms of usual methods and companies' relations to each other are presented with some example motives, objectives and driving forces behind them. This chapter will create a more in-dept look to the topic.

The core objective and the driving force behind M&As is to create some sort of new value and open new opportunities to the companies concerned. M&As are driven by several trends and factors in every industry. Motives may heavily vary between cases and companies depending on their size, technological resources, business cost structure and their strategical goals. (Sherman & Hart 2005, p. 14-15)

Unifying operations, sharing resources and combining competencies between companies may allow companies to carry out projects they previously were not capable of, diminish unnecessary costs or create open routes to expand the market of products as well as give companies many other diverse mutual or bilateral benefits, synergies. (Sherman & Hart 2005, p. 14-15)

Synergy is a very often used term when describing the reasons behind M&As. Synergy as a concept is achieved when the combined value or performance of two or more entities is greater than their combined performance when functioning individually. In other words, synergy is created when two or more businesses are capable to create more revenue, eliminate redundant processes and costs or create greater profit for their stakeholders than they could do individually. (Barone 2019) That is to say, synergies are cumulative benefits regarding the whole integrating ecosystem, that might come in with several different forms.

Many say that synergies alone would be sufficient to describe the reasons behind almost every M&A. Referring Ross et al. (2013 p. 879), "*Is there a rational reason for mergers? Yes—in a word, synergy.*" Stopping the study there would however only scratch the paint. While many actual potential benefits could be considered synergies, would this kind of grouping lack the precision and depth that researchers look for. Certain synergies are often the mutual motives for every party in mergers, but not necessarily in acquisitions, where acquirer and seller

companies might have totally different way of approaching the situation (Sherman and Hart, 2005 pp. 16-18).

Regarded by several researches and professionals, almost all M&As are unique in the sense of motives and that the real objective of almost every M&A consists of numerous smaller parts forming a large, complex entirety rather than a single, unambiguous motive or objective.

### 3.1 Motives by their area of effect

Grouping the motives into subclasses is quite difficult as several motives might affect many different dimensions of corporate actions. In this thesis they are divided into three groups: economical, hard-to-trade and managerial motives.

#### 3.1.1 Economical motives

According to Ross et al. (2013, pp. 881-885), there are four kinds of sources of economical or financial synergy, that companies seek when committing to M&As. Those include **revenue enhancement, cost reduction, tax gains** and **reduced capital requirements** (Figure 4).

**Revenue enhancement** at its core means that merged companies could generate greater revenues than the companies separately, added together could. Ross et al. (2013 p. 881) names three usual reasons for that, strategic benefits, market or monopoly power and marketing gains. Strategic benefits, being a very broad diction, in this regard could include almost any possible improvements that could boost the previous revenue. A firm could for instance benefit from new technological know-how of the acquired firm which would allow them with new opportunities. Market power synergies happens when companies join with each other and are no longer competing with one another. As this eliminates some of the competition on the market, it releases external pressure off the merging companies. Having larger market share and thus larger control over the targeted markets, unified companies can have larger negotiation power over its competitors and gain competitive advantage. Market power synergies are somewhat proportional to the transactions' scale, which implies that when taken to larger proportions, they could controversially start resembling monopoly. With marketing gains they

imply that companies are often improving each other's competencies in all areas regarding marketing and trade. A merger could improve company's product mix that would allow other products or services to be more accessible for customers (i.e. complementary products). Also, M&As often do account for companies' external recognizability, what could increase demand and directly affect revenue. (Ross et al. 2013, pp. 881-885) In some cases M&As have also allowed companies to considerably strengthen their brands and get synergies through that (Dinner, Knowles, Mizik 2011).

**Cost reduction** is quite a self-evident benefit that many companies aim for in any operation. Ross et al. (2013 pp. 882-884) mention five ways to achieve cost reductions. Those are economies of scale, economies of vertical integration, technology transfer, complementary resources and elimination of inefficient management.

Economies of scale is a largely used term when describing M&As and other types of investments that expand some previous operation. Economies of scale are achieved, when average cost of production is lowered by increasing the production volume. This is often possible to a certain limit as larger material flows and production volumes can be operated with same fixed costs as lower volumes, meaning that cost per unit is lowered (Kenton 2019a).

Economies of vertical integration are the main motive of, as its name implies, vertical M&As. The main purpose of vertical integrations is to make communication between related activities more fluent and to remove unnecessary intermediaries from the process. As companies operating on different levels of a value chain unite, they often start operating under the same management allowing more straightforward passage of information. Other benefit regarding vertical synergies is that as discrete companies are no longer operating independently, they do not require individual profits on each step of the value chain, thus reducing costs. (Ross et al. 2013 pp. 882-884)

When a company acquires another firm of its assets in order to improve their technological capabilities rather than having to research and develop with their previous resources, that is considered seeking for benefits through technological transfer. (Ross et al. 2013, pp. 882-884)

In some cases, such as in the case of seasonal products, the combination of the two functions allows for an even distribution of resources. These cases function in some sense similarly to economies of scale, as even warehouse level or production volumes allow operations to use their capacity all time, saving in the fixed costs. This is called complementary resources. (Ross et al. 2013, pp. 882-884)

As the final cost reduction synergy, Ross et al. mentioned elimination of inefficient management. While mergers and acquisitions can be used as tools to optimize almost any process in any industry, they can also be executed in order to optimize the leadership and ownership structures of a company. In many cases, internal need for a change might be considered as the only option to improve company's actions. (Ross et al. 2013, pp. 882-884)

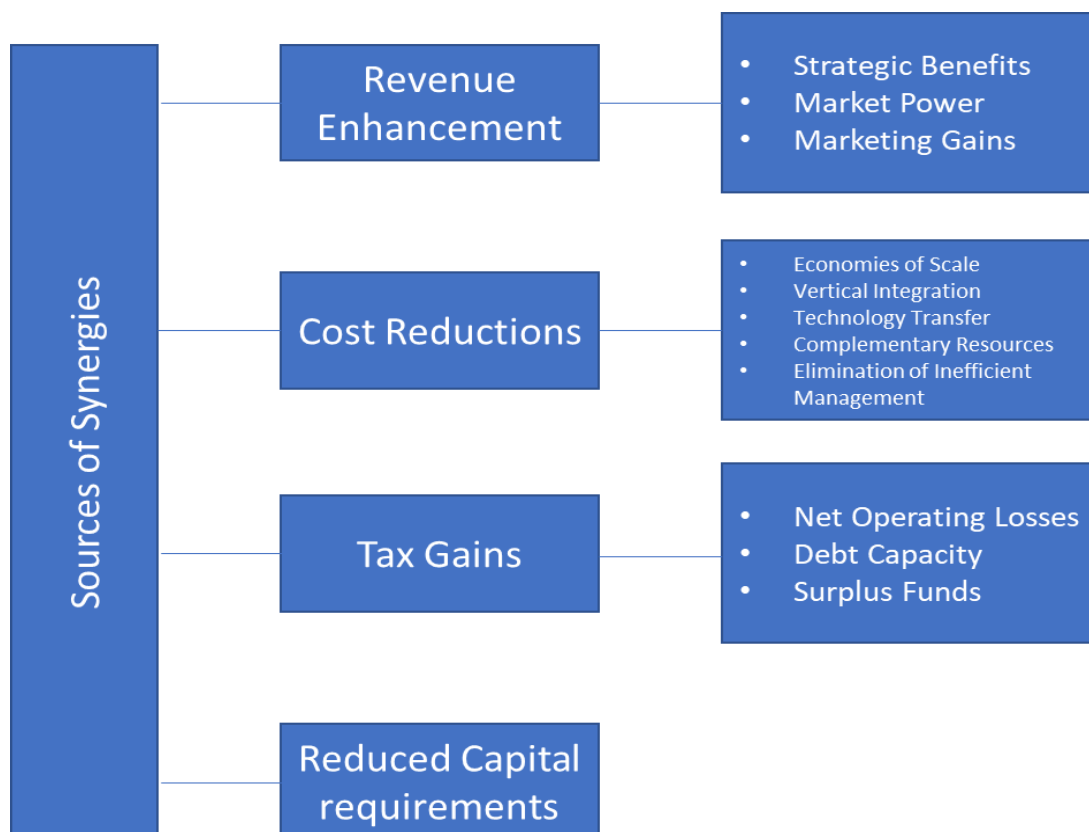
M&A synergies can also occur in the form of **tax gains**. These might come in as net operating losses, changes in dept capacity or management of surplus funds. Net operating losses refer to situations where two companies or divisions, a profitable and an unprofitable one merge and start acting as a unit. While the merge could have been vital for the non-profitable company in order to survive, the profitable company's revenue gets evened out resulting in lesser taxation. As the non-profitable company would not have paid any taxes due to their losses, the whole ecosystems combined tax payment decreases, creating a type of synergy. (Ross et al. 2013, p. 883)

Unifying companies do also unify their depts. Many companies do not have optimal level of dept, either having it too much to handle sustainably or too little to support investments and other operations, thus limiting potential capacity. If two companies as mentioned merge, they both benefit from the resource and dept share, creating synergies. Even if merging companies do have optimal dept levels, merging will result in larger shared dept pool while still being proportionally same sized as before. This is considered safer financially, thus resulting in better risk management. (Ross et al. 2013, pp. 883-884)

Other tax related synergy is management of surplus funds. If a company has free cash flow, meaning that it still has liquid funds after funding all projects and paying taxes, it is usually bound to paying dividends to its shareholders. If the available cash flow is abnormally large,

paying large amounts of dividends would be inefficient use of resources that would not aid the company for future success. In cases like this, it is quite common for large corporations to perform small acquisitions. Even if the motive of acquiring is only to spend resources, they are spent to grow the company rather than being inactive. (Ross et al. 2013, p. 884)

Fourth mentioned source of synergy are **reduced capital requirements**. Capital requirements designate a certain proportion of profit compared to company's assets (Chen 2019). Capital requirements must be achieved in order to keep shareholders and especially financing departments satisfied. Merging companies often find unnecessary duplicate facilities such as individual, similarly functioning headquarters, R&D facilities or industrial plants. As redundant facilities may be sold or rented, they reduce company's working or fixed capital, allowing for lowered capital requirements. Reduced capital requirements work in a similar fashion with economies of scale but dealing with corporate measures rather than industrial material flows. (Ross et al. 2013, p. 885)



**Figure 4: Economical sources of Synergy (Ross et al. 2013)**

### 3.1.2 Hard-to-trade motives

Hard-to-trade motives refer to gains that are not directly transmutable into profits, but they might have passive or long-term effects that might create competitive advantages over other companies. As their effects are difficult to measure in financial terms, their performance might be difficult to evaluate unambiguously. Even if these do not have direct effect on companies' business, these motives might be crucial for firms' inner development or their ability to enhance their products or operations. Motis (2007) names two kinds of examples of hard-to-trade motives: **Diffusion of know-how** and **merger of research and development** faculties.

**Diffusion of know-how** might refer to several types of synergy creation when merging operations. Know-how is often referred as the "soft" resources that support or upkeep companies' functions while being somewhat hidden to the public. They might appear, for example, as human capital, patents or trademarks, managerial skills or experience, organizational culture or technological capabilities. (Motis 2007)

**Research and Development (R&D)** is another common target in M&As. Sharing resources or complementary technologies allow for greater potential in R&D, allowing greater innovation in product and process development. R&D and general know-how often correlate in a way that skilled personnel do boost R&D which allows for better products, patents and other non-material benefits. According to Cassiman et al. (2005) R&D related factors are few of, if not the most frequent rationales behind unifications. It is also mentioned that gains in research and development are difficult to predict or to measure. This is because R&D progress is somewhat slow and each development process is unique, meaning that they are rarely comparable to others. Measuring R&D performance is difficult, because creating new innovations is hard to benchmark, as there seldomly previous data of comparable processes and events.

### 3.1.3 Managerial motives

Even if M&As should rationally seek efficiency, development and growth for the companies' shareholders' benefit, there are theories that some unifications are driven by personal interests of companies' management.

Sherman and Hart (2005, p. 18) name a couple of defensive managerial motives: **The desire to retire** with a lack of successors and **eliminating personal guarantees or obligations**. These are common motives for small companies with limited competitive powers. They are often partnered with the motive of not being able to compete independently and are often leading to the selling side of an acquisition. These are often used in order to save the company from difficulties.

There are also theories, that some acquisitions are driven by acquiring companies' managements self-interests. In some cases, managers tend to enhance their own welfare at the expense of their shareholders. These are often called the agency or managerialism motives (Kiymaz & Baker 2008). Types of agency motives are **empire building**, and a hypothesis called **Hubris theory**.

**Empire building** refers to situations where managers' objective is to enlarge the organization they are leading. Reasons behind empire building purposes can be as negligible as personal will to show off or that their salary to directly related to the size of the company they manage. (Motis 2007)

**Hubris theory** as a merger driver is presented in situations that managers are overconfident in their capabilities and believe that merging or acquiring would produce synergies, thus being beneficial in traditional terms. (Kiymaz & Baker 2008; Motis 2007)

### 3.2 Motives by different transaction roles

While many researches and views on the topic do categorize motives based on their core objectives or areas of effect, they often lack the source behind each objective, those being different company roles in M&As, such are acquirers, sellers and merging companies.

Sherman and Hart (2005 pp. 16-18) has taken a slightly different point of view into the subject and divided and grouped them into three groups: Characteristic for merging parties, for acquiring companies and for selling companies (Table 2).

From that perspective, merging parties and acquiring companies share often quite similar motives that revolve around gaining synergies on different operations. While these two groups are somewhat similar, acquirer motives do however focus slightly more on expansion purposes. Motivation for selling companies, however, varies dramatically from the two other groups. Selling companies might consider that they are unable to compete in the market, and they need a helping hand in the form of acquisition. Selling companies might also see M&As as a method to transfer the control or responsibility to others. Other reasons selling companies might want to consider are cost savings through synergies and achieving greater potential by having larger resources.

In short, mergers tend to happen in a pursuit to create mutual synergies over the whole ecosystem and they are usually meant to boost efficiency or performance rather than just expanding the scale of business.

Acquisitions, on the other hand, are often bi-polar in a way that common motives for its participants are quite discrete. Acquirer's motives are often active and rather offensive while selling companies seek more passive or defensive actions in M&As.



**Table 2: M&A motives (Sherman and Hart, 2005, p. 17)**

Merger	
<ul style="list-style-type: none"> <li>• Restructure the industry value chain</li> <li>• Respond to competitive cost pressures through economies of scale and scope</li> <li>• Improve process engineering, technology and innovation</li> <li>• Increase the scale of production in existing product lines</li> <li>• Find additional uses for existing management talent</li> <li>• Redeploy excess capital in more profitable uses</li> <li>• Obtain tax benefits</li> </ul>	
Acquisition	
Acquirer	Seller
<ul style="list-style-type: none"> <li>• Revenue enhancement</li> <li>• Cost reduction</li> <li>• Vertical and/or horizontal operational synergies</li> <li>• Growth pressures from investors</li> <li>• Underutilized resources</li> <li>• Increase market share and reduce price competition</li> <li>• A need to gain foothold in new geographic market</li> <li>• A desire to diversify into new product lines and services</li> </ul>	<ul style="list-style-type: none"> <li>• Ownership nearing retirement or ready for an exit</li> <li>• Inability to compete as an independent concern</li> <li>• The need to obtain cost savings through economies of scale</li> <li>• Access to greater resources</li> </ul>

## 4 PITFALLS IN UNIFICATIONS

While mergers and acquisitions can create considerable gains in several areas of business, they can prove too difficult to carry out fluently and might start becoming a burden for the companies. In some cases, wanted synergies are never achieved and the fusion will not succeed in its objectives. As M&As are usually highly complex, very long-term processes, problems might start appearing at multiple forms and times.

Success of M&As can be a difficult task to evaluate and their sought benefits might appear several years after the unification. Because M&As are complex and multidimensional endeavors, it is also common that they cause changes in other, unplanned areas and actions. It is common, that even if some objectives are achieved and value is created, some other factors do suffer from the unification. (Fiorentino & Garzella 2015)

M&As are often very expensive processes and covering their losses and costs by created synergies might take very long to occur. According to Gugler et al. (2003), 43 percent of all mergers and acquisitions were not creating benefits 5 years after the mergers.

In this chapter, common obstacles and sources of value loss are grouped by each typical phase of M&As. Pitfalls under the same heading might not be related to each other in other ways than the given step of a process, but they might occur in similar manners creating similar problems.

In a similar fashion with motives, sources of value loss rarely occur alone. Many obstacles can be derived to earlier processes of the M&A. Some problems are just symptoms of a larger reason to the knot. Complexity and unique nature of the processes, their objectives and their alleged disorders are making unambiguous and accurate analysis quite challenging. (Straub 2007, pp. 63-64)

#### 4.1 Pre-transaction problems

Friedman et al (2015) name one main problem that might ruin the whole transaction: partner selection. Selecting wrong kind of target or partner company often diminishes its potential synergies because of two reasons: problems related to **strategic fit** and **organizational fit**.

**Strategic fit** refers to situations, where all parties share same strategic goals in the merger. In some cases, misfits might occur, when two companies trying to achieve different objectives, or in other words, having different motives, try unifying their operations. Problems related to strategic fit are rare but occur by communicational issues. (Friedman et al. 2015)

Most examples cover companies that do not share the same industry or other similarities. That meaning, that pure conglomerate unifications do possess a higher risk to strategic misfits. Issues with strategic fit are also often present in acquisitions that present one-sided motives.

**Organizational fit** refers to various organizational features such as administrative and cultural factors. It might be defined as the match between administrative practices, cultural practices, and personnel characteristics of the target and parent firms. (Friedman et al. 2015)

Problems with organizational fit can be characteristic to M&As of which companies try to expand their network into new areas that have new, foreign cultures or habits. Issues with organizational fit usually cause trouble in the integration phase, as personnel and management need additional time and effort to adapt.

Other perspective on pre-transaction pitfalls includes frequent cases referring to purely managerial motives. Motis (2007) states, that some M&As happen because of managements pursuit in enlarge the company with no other synergic benefits in sight. Acquisitions belonging to that group do very rarely add other value than grow the company or its shareholders, thus not being beneficial in traditional terms. In some sense, M&As run by managerial or personal motives do not seek traditional gains, which implies that judging their success in traditional terms from an external point of view might be irrelevant.

Straub (2009, p. 72) mentions, that relative size of merging companies is often a crucial factor in M&As success. Vast synergic potential often needs a substantial critical mass behind it, meaning that the result is in many cases related to the pure scale of merging parties. This might render the potential of merger of scalar extremities smaller than desirable.

## **4.2 Transaction problems**

One of the key factors in M&As is to value the upcoming transaction and its effects, benefits and aftermath. Valuating the process enables transaction parties to discuss about the merging terms and more importantly, find the suitable tradeoff that both acquirer and seller or the merging parties agree on. (Bösecke 2009, 12-13)

Problems in transaction phase are very often related to misjudgments in due diligence, creating unrealistic expectations for the synergies or other benefits. Fiorentino & Garzella (2015) state that “the mirage of synergy” is one the most crucial reasons for failures in M&As. Mirage in this sense refers to misleading illusion of non-existing potential synergy.

In order to M&As to be economically profitable, their created value must exceed the acquisitions price and created costs of unification. Economically, M&As’ failures may show, for example, as lowered shareholder value, low or negative return on equity or declining stock price (Friedman et al. 2015).

Mirage of synergies or other misunderstandings might lure companies to invest unnecessary large resource amounts or to offer excessive price for stocks in hope for great benefits. In other words, misconception might lead into too high a price tag, rendering economical profitability impossible or unnecessarily challenging. In these cases, the bar often is raised too high to start with. Internally set targets are impossible to obtain or investments are too expensive to get paid back. In events where potential synergies and benefits have been exaggerated, objectives might be impossible to completed even if the process would be performed perfectly.

In addition to the mirage theory, according to Christofferson et al. (2004), most of the value created in acquisitions goes to the selling party’s shareholders at the buyers’ expense, thus the

some of the added value might leave the ecosystem immediately after it is created. This might be referred as “The winner’s curse”. This is also explained by similar actions: an average acquirer tends to overestimate the synergies a merger will yield which will usually lead to overpaying the deal.

All in all, committing to M&As and performing the demanding and expensive unification might be considered a slight dilemma. Their real value and causes are very difficult to predict and only those M&As that seem the most favorable are performed. This implies, that some options that were bypassed in early phases might have been viable but misjudged.

### **4.3 Post-transaction problems**

Post-transaction pitfalls refer to problems when integrating the organizations. As aforementioned, organizational misfits may cause unnecessary value losses in M&As. When two organizations are binding together, their management, personnel and organizational structures need to adapt to changing conditions, which is often very time and resource consuming. Frequently, the clash of culture and learned customs might create a large obstacle between the strategical plan and the desired outcomes of it. (Friedman et al. 2015)

Organizational dissimilarities are present in almost every M&A. They tend to get highlighted in cases, where the companies in question are coming from different cultures or are separated by long geographical distance. This means, that M&As that aim to expand market share to new areas do often encounter difficulties when integrating operations, which might derive into loss of synergies. (Fiorentino & Garzella 2015)

Fiorentino & Garzella (2015) define that most common post-transaction problems are related to faulty integration processes, human behavioral factors or companies’ structural factors. They all are frequently related to misjudgments in planning phases, resulting in unwanted efforts to repair their causes, resulting in value losses. What is also pointed out, that changing conditions often effect the human behavior and performance. Uncertainty caused by M&As may expose both managers and operative personnel to unwanted reactions that would harm their actions.

Drivers that expose companies to faulty, inefficient integration, are often traceable to incompetent, unexperienced management and their choices. For example, the whole hubris theory, sourcing from managers' false self-beliefs is based on the failure due to managements overconfidence. (Motis 2007)

In overall, reasons causing M&As to have difficult time achieving their goals are almost always due to multiple factors most of which lead to others or fortify the effects of some obstacles. Even if most problems in M&A value creation are sums of vast numbers of smaller factors, almost all pitfalls in M&As can be tracked to the process origins and most of them are created by either unpredictable adaptation problems, false motives or overestimation of synergies.

## 5 SUMMARY AND CONCLUSIONS

The aim of this study was to define common motives and pitfalls and to find correlations between certain traits. In this concluding chapter, original research questions are presented with brief, composed answers.

### *1. Why are M&As decided to carry out?*

M&As can be carried out due to several different reasons. M&As can be reactions to competitive pressure or actions to fulfil strategic goals. The largest driving force behind most M&As is to create some value to the corporate ecosystem. These values can be highly diverse, and they can affect various business areas.

Most M&As seek enhancements in overall business scale, efficiency improvements on different operations or other benefits. M&A motives are often rationalized by market share and control, cost savings, technological development or new opportunities in product development or in R&D. Some M&As are, however, decided to execute mainly on management's own will with little to no actual rational benefit.

In many cases, a single motive for the transaction is unable to be tracked since the unifications do cause changes to many operations and business areas. In almost all cases, the real rationale behind M&As is a complex entirety of numerous smaller details, all of which added together would create a positive effect on the participating companies.

In almost all M&As, companies do consider several options before deciding which target or merging partner they decide to co-operate with. The process is carefully forecasted and projected before the actual integration starts. If the predicted outcome of the transaction seems to be economically profitable or strategically suitable, the unification is decided to carry out.

2. *What are the main reasons desired outcomes won't be achieved?*

M&As might have almost as many different reasons to why certain objectives are not achieved as there are different cases and motives in them. Desired outcomes are always projected before the transaction is carried out and integration may begin. Forecasting the complete effects that a corporate unification may have has proven to be excessively difficult and many M&As are carried out with incorrect predictions on how the process will end up. Main reasons for that are the unique and complex nature of each unification.

Misjudgments while evaluating and forecasting the upcoming transaction may create false information that might raise the transaction's price, investments bound to the project or create impossible objectives to the transaction.

Chains of events that lead to failed objectives or unprofitable results often consist of various factors. Most of the obstacles occur as clash of corporate cultures and its derivatives which have been unpredictable when planning and evaluating the process.

In many cases, these chains of events do have flaws to multiple phases of the whole procedure. However, it is clear that most of the flawed factors in the late phases could be avoided by better risk planning and risk management in earlier phases.

3. *Are there certain pitfalls that often appear alongside certain motives?*

There is plenty of theories, that some frequent risks or reasons for value losses do repeat themselves in several M&As which share similar traits. Most of them are related to cultural or industrial differences that need additional adaptations for managers and personnel throughout the M&A processes.

However, most M&As are too complex, multidimensional, independent and unique events that creating unambiguous proof of tendencies that would function universally, would require much larger research and vast, quantity-based data analysis of large number of different M&As. This



type of study is insufficient to demonstrate any widely applicable or universal evidence regarding those tendencies.

Even if this research question was not provided with useful results, it is relevant to include because it may help to understand the problem better. Creating a data-analysis research might prove to be an excellent topic for further study regarding M&As.

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