Research Paper
Impact Factor: 7.358
Peer Reviewed & Indexed Journal
www.ijmsrr.com

IJMSRR
E- ISSN - 2349-6746
ISSN -2349-6738

MERGERS AND ACQUISITIONS: A CONCEPTUAL REVIEW

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Abstract
From the last few decades, maximum studies focused to understand the importance of going into the deal of Mergers & Acquisitions (M&A). The current study examined the motivation to recognize either the assumed benefits of the deal of Mergers and Acquisitions have posted increase or not. The current study calculated whether the deal is beneficial or harmful for the organizations who want to enter into the deal of M&A. The study scrutinizes the issues by using the perspective of history, waves, motives and methods to determine Merger and acquisition value. The study focuses on the current Literature available on M&A from the recent past to portray unlike the methods used to gauge performance of M&A. Although field of M&A research is far too broad and more complex to be covered in a review paper, therefore, the study attempts to start covering some historical and background issues such as History, waves in M&A, Methods of measuring deals and M&A motives.

Keywords: Mergers and Acquisitions, Performance, Value.

Introduction

The main objective of every organization is to get maximum profit every year to increase the wealth of shareholders by giving them high dividends. Every organization adopts different techniques and tools to maximize its profit and can be able to survive in the fast growing market. There exists certain event for which every organization has to respond spontaneously in order to get maximum gains like entering into new markets, launching new products, increasing portfolio etc. The firms then require financial resources to achieve their objectives as quickly as possible to enjoy a certain monopoly in the market. These events and transactions create a huge amount of problems for those firms and organizations that lack or fail to arrange finance to meet the requirements of the growing market. The small or less profit oriented organizations left with no option except to quit from the market or else merged with or acquired by sound/good financial firms. Mergers and acquisitions are very easy and the only option for small or less profit making organizations to stay and survive in the emerging market. Mergers and acquisitions are a global business strategy that enables firms to enter into new potential markets or to a new business area.

Merger and acquisition are not the same terminologies but often it is used interchangeably. In acquisition one organization purchase a part or whole another organization. While in merger two or more than two organizations constitute one organization (Alao 2010). Merger is the legal activity in which two or more organizations combine and only one firm survive as a legal entity (Horne and John 2004). As per the definition of Georgios (2011) in a merger, two or more firms approach together and become a single firm while in acquisition big and financially sound firm purchase the small firm. Khan (2011) presented a definition of merger as two or more firms close together and form one or more firms. Durga, Rao and Kumar (2013) defined mergers and acquisitions as activities involving takeovers, corporate restructuring, or corporate control that changes in ownership structure of firms.The main objective of the firm behind entering into the deal of merger and acquisition is to

IJMSRR
E- ISSN - 2349-6746
ISSN -2349-6738

work with other companies that can be more beneficial as compared to work alone in a market. Due to merger and acquisition the return on equity and shareholders wealth increases and it decreases any related expenses (operating cost) for the firm as well (Georgios and Georgios 2011).

For survival in the fast efficient market, Maximization of shareholders wealth is the next important objective of merger and acquisition. The management of the firm is also in favor of merger and acquisition as their authorities will be increased and they can achieve both short term and long term objectives of the firm (Gattoufi et al, 2009).

Merger and acquisition is a very important tool for the expansion of business in different countries and the researchers from all over the world are taking interest to work in this field (Goyal and Joshi 2011). If we go into the history of Merger and Acquisition, M & A were started from the United States back in the eighteen century. In Europe, the M & A begins in nineteen century (Focarelli, Panetta and Salleo 2002). Maximum research on M & A has been done in the United States and Europe market. Comparatively little research work had been done on M & A in the developing countries like Pakistan, India, Malaysia and Bangladesh etc. For the last three decades, firms have been intensively used Mergers and Acquisition (M & A) as a strategic tool for corporate restructuring. Initially, this consolidation trend was limited to developed countries, especially the US and UK. However, afterwards developing countries started to follow the same pattern. The growth of the trend can be judged from the fact that in the US only the last decade of the twentieth century witnessed a threefold increase in the number of M&A whereas, a fivefold increase has been reported in terms of value (Coopland,2005).

The Different waves in M& A

The **first wave** started from 1897 and lasts until 1904. In the recorded period, M&A started grow in those firms and Organizations who want to get benefit from their manufacturing, as being a single seller in the market, like railroads, light & Power, etc. The discussed period appeared on screens as horizontal mergers and happened in the profound industries (Fatima and Shehzad, 2014). Maximum of the deals that were started in the first period of M&A proved to be unsuccessful as the deals failed to accomplish the set goals and objectives.

Second Wave

The second period of M&A started from 1916 and lasted until 1929. The core objective in this period was to enter businesses into the deal of mergers and acquisitions that want to enjoy oligopoly and not monopoly. The Hi-tech expansion as the progress of railroads and transportation took place in the said time period. This M&A wave were horizontal or conglomerate (Golubov & Petmezas, 2013). Firms and organizations that have entered into the deal of M&A were the key producers of Ore and mineral, food items, oil & fuel, transport and chemical etc. Banks played a serious role in assisting the deals of M&A. Banks like Investment banks granted loans to the investors on easy installments. The wave proved to be crumpled of the share market in 1929.

Third Wave

The third wave of merger happened in 1965 and ended in 1969. Most of the deals were conglomerated in nature. The deals of Mergers and acquisitions were mainly backed from the capital of owners and banks appeared to be off screen. The wave started to move towards the end as consolidation of unlike firms and organizations stated to post unsatisfying results in 1968 (Fatima and Shehzad, 2014).

IJMSRR
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ISSN -2349-6738

Fourth Wave

The fourth wave of mergers (1981-89) was exceptional in terms of noteworthy role of hostile mergers. Hostile mergers had turned out to be a tolerable type of business extension by the 1980s. The business invasion had achieved the rank, as highly beneficial speculative action. Furthermore! Organizations and speculative affiliations initiated to take over firms and treated it as mean of taking benefit from lofty profits in short span. Takeovers in the current wave were either believed to be friendly or hostile. It was mainly depended on the response of the board of directors of the target firm. If the board of directors endorsed the takeover, it was well thought-out to be a friendly one, and if the board of directors opposed the deal, the takeover was supposed to be a hostile. According to Golubov & Petmezas (2013), the merger that was initiated between the oil and gas, pharmaceutical, banking and airlines are basically recorded in the fourth wave.

Fifth wave

The wave started from 1992 and lasted until 2000. The wave gets its inspiration from the worldwide increased and boom in the share market and consequently happened deregulation. This wave took place in banks and telecom segments. The deals were backed by equity capital to a certain extent as compared to debt finance (Kouser & Saba, 2011).

Sixth Wave

The sixth merger wave (2003-2007) was described by merging in the metals, oil & gas, Utilities telecoms banking and Health care centers. This wave was fuelled by expanding globalization and support by the Government of specific nations like France, Italy, and Russia to make solid national and worldwide champions. Private equity buyers assumed an indispensable part, representing a quarter of the general takeover movement, empowered by the accessibility of credit that businesses were readied to give at low interest rate. Cash financed deals were significantly more pervasive over this period (Alexandridis, 2012).

Methods used in Mergers and acquisitions

The performance of Mergers and acquisitions are determined by different methods, therefore, the current study covers some of the techniques that are often used in existing literature.

Accounting Returns studies involve the analysis of the accounting performance of the joint entity measured in terms of Return on Assets or Return on Equity; two to three years post-acquisition. Accounting studies typically contrast results for the sample firms with control firms to discount any industry wide phenomenon (Krishnakumar & Sethi, 2012).

Furthermore, Ruback, and Palepu (1992) added to the expansion of accounting returns and in the methodology of gauging operating performance. The study illustrated that most preceding studies had analyzed the performance of stock prices and consequently capital appreciation could be due to market inefficiency and mispricing. In addition, the study used an operating cash flow, which has been adjusted against industry standard returns to judge performance for a period of five years post M&A. Healy, Palepu and Ruback, (1992) calculated the post-acquisition operating performance of fifty mergers between U.S. public firms.

Their study computed a return metric of cash flows classified as sales less CGS, and marketing and admin expenses, along with depreciation and goodwill expenses to give a return metric that is equivalent crosswise. By not including the cause of depreciation, interest exp, goodwill, and taxes,

IJMSRR
E- ISSN - 2349-6746
ISSN -2349-6738

methodology are unaltered for accounting of M&A or for financing the merger. The pre-acquisition accounting data for the target and acquirer firms preceding to merger was figured to attain pre-merger performance of the combined entity (Krishnakumar & Sethi, 2012).

Innovative performance
The innovative performance practice measures the impact of acquisitions on novelty or modernism as measured by the patenting frequency of the acquiring firm. Ahuja and Katila, (2001), figured innovation performance as a measure to point out success of technological acquisition. The study observes the effect of M&A on the succeeding novelty act of acquiring firms in the chemical sector. Their study has chosen a section of firms worldwide from chemical industry, free of their M&A, and outlined the acquisition performance of these firms.

Case Study Approach
A few but key researchers and practitioners have selected a case study approach wherein they have intended a small sample of acquisitions to figure out the factors that have guided to success or breakdown in a particular state of affairs. For example, Appelbaum and Roberts (2009), deliberated the role of cultural fit, direction and leadership in the triumph and failure of ten M&A situations.

Motives behind Mergers and Acquisitions
The current study elaborates some of the key and essential motives behind the deal of M&A.
Some of them are as follows:

Synergy Motive
The widespread goal of all mergers and acquisitions is to hunt synergy gains. Synergy is accomplished when the value of the combination of the two firms is superior to sum of the two stand-alone values (Jensen and Ruback 1983, Bradley 1988). This effect is often portrayed as 1+1=3. Synergy gains can be Operational or Financial. They may take the shape of Cost reduction and perfection in operational efficiency; revenue improvements due to optimization of distribution network e.g. cross selling, a boost in market power e.g. abolition of competitors or a range of financial advantages like tax efficiency and leverage (Seth, 1990a, 1990b). Cost reduction is a usual source of synergies and can be accomplished from economies of scale and scope; get rid of duplicate facilities or alternatives and increased bargaining power against dealer or supplier (Fatima and Shehzad, 2014). Revenue enhancement, another oftenly cited cause of synergy (Krishnakumar & Sethi 2012)..

Agency Motive
Under the agency motive, managers may get acquisitions against the attention of the shareholders. E.g. Amihud and Lev, (1981) depict that managers engage in conglomerate mergers in order to spread activities of the firm and smooth out earnings, thereby securing their jobs; though, this is against shareholders‟ interest as they can diversify at their own at a very little cost.

Firstly, executive’s payments are often connected to firm size, so that the managers have the first choice for growing the firm ever larger. As paying cash to shareholders lessens firm size and their discretion, managers tend to involve in negative NPV investments.

Secondly, it is simply more esteemed to head huge Organizations, CEOs in comparing to managers, who in fact believe in their abilities to build and craft value, are seeking more supremacy against shareholder interests. Thus prospects of lofty and towering remuneration and the kudos of running large firms push managers into making acquisitions even if the deal is unfavorable, harmful or unprofitable to the firm value.

Managerial Overconfidence (Hubris Hypothesis)

The merger wave was initially anticipated by Roll, 1986. The theory states that managers wrongly believe that they are quite better enough as compared to the rest of the management to control and supervise different firms. That is, they are arrogant and self-centered in their decision-making aptitude and conclude by paying more for target which turns the bidder firm to drop. Furthermore! It has been established that the hubris result is similar to the winner‟s curse that occur in frequent value auctions where bidders pay more for the auctioned item. Here, the bidder that has highest bid would yield highest positive valuation error (reflecting his boldness) and is successful in winning the target. At the end, shareholders of the bidding.

Efficiency gains

Farrell in 1990 and Shapiro in 2001 differentiated efficiencies as technical and synergy efficiency. They recorded technical efficiency as one that could be achieved by other ways than M&A. They concluded joint ventures, agreements, interior growth and licensing, as other ways of achieving efficiency than M&A. As per the study of instigators, technical efficiency communicates to the amendments that occur inside the combined manufacturing potential of the merging firms. In short, they can be increased by a redeployment of output across the merging entities or scale economies, provided the capital is portable. In long, they can be marked by starting investment on a mega scale. On the other side, synergy may be defined as efficiency attained through the close mixture of the merging firms and are intrinsically merger-oriented. Farrell and Shapiro (1990 and 2001).

Conclusion

Over the years several studies have been carried out to evaluate whether Mergers and Acquisitions have been value enhancing or destructive of organizations. The methods that have been used to analyze acquisition performance are varied. The objective of our study is to review the literature to study history of M&A, phases, Motives and different methods used for measuring performance; evaluate the benefits and shortcomings; investigate whether there have been new developments in the techniques used over the last few years. The study started reviewing the M&A literature with an aim to understand the relevant processes and synthesizing the research results for the benefit of managers and future researchers. The scope of the study thus was restricted to M&A history, phases, motives, and methods. To conclude, the current study shows that there are multiple methods of measuring acquisition performance, each with its merits and demerits. The selection of the method of measurement is crucial to the results drawn, hence should be selected with great care.

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IJMSRR
E- ISSN - 2349-6746
ISSN -2349-6738

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