



**SWP 14/87 MANAGEMENT: THE VITAL INGREDIENT
IN THE RECIPE FOR ACQUISITION SUCCESS**

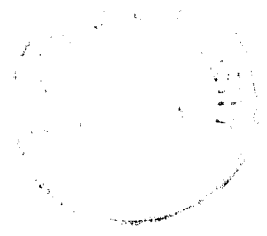
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ABSTRACT

Both management style and corporate culture are specific to the management team which make up a particular organisation, and are held to be a key determinant in its success. Yet while a mismatch in corporate cultures has been blamed for the failure of some acquisitions, the degree of managerial 'fit' has received little recognition as a determinant of acquisition success. This paper argues that the importance of Management within the acquisition process is understressed, and that to improve the probability of success the acquiring management team must demonstrate increased rigour in identifying and cultivating managerial compatibility.

In 1985 UK companies completed acquisitions worth £9 billion. In addition there were outstanding bids at the year end valued at a further £10 billion, giving a total commitment for the year greater than the UK defense budget.

In addition 1985 saw - Daimler Benz fight a long battle for control of Dornier.

- ITT planning to sell \$1.7 billion of assets worldwide.
- Volvo merging its machinery operations with Clark, and buying two pharmaceutical companies.
- Nestle offering \$58m for Life Savers of Australia.
- Beechams buying Zambiletti of Italy.

This level of activity has in turn led to concern about the status of anti-trust legislation with conflicting demands for complete deregulation at one extreme and at the other the conviction that all mergers above £16m should be held to public scrutiny with the onus on the acquiring firm to demonstrate that the ex-post corporation would benefit society. From the academic world, White (1981) argues that mergers have not led to a concentration of industrial strength as measured by value added, profits or employment, and therefore are not against public interests. In contrast, Pickering (1980) argues that the public benefits of acquisitions are so difficult to predict, or realise, that they should be more strongly regulated. Indeed many would

argue that Government intervention in the acquisition process over the past 20 years has a very dubious performance record: many thwarted companies being in a state of limbo, or worse, going out of business. In 1967 the Commission blocked the merger between UDS and Burtons leading to the slow decline of UDS until it was dismembered in 1982. Similarly in 1975 the shipping industry's attempt to pool the container resources of Furness Withy, Manchester Liners and Euro-canadian was blocked leaving the participants with limited financial success

From the commercial world, lavish adverts in the quality press are now a normal part of the acquisition process as suitors compete to woo shareholders. Advertising in the recent Guinness/Distillers/Argyle battle was estimated at £2m per week - a substantial bill to be paid by the shareholders. News and advertising footage increases in line with the passion generated and the premiums paid.

Passion itself appears an important element in the current "Merger-Mania" and is reflected in the terminology used. "Predators" and "Corporate Raiders" are countered with "Shark repellants" and "Poison pills". Beleaguered directors leap to safety with their "Golden Parachutes" or swoon into the embrace of a "White Knight" who rides to their rescue while the "Arbies" pick over the bones.

Gone is the security of size; gone is the safety of good performance and growth; loyal shareholders are made "offers they

can not refuse". And gone, apparently, is the dispassionate approach to the rational business decision. Inevitably the question therefore must be asked "Is it all worth it?"

Acquisition Performance

The findings of the European and US studies concerning the impact of mergers on corporate performance which relate entirely to publically-quoted companies may be summarised as follows:

1. Returns to the shareholders of acquiring firms are at best slight and tend to disappear rapidly, and, at worst, are significantly negative.
2. Returns to the shareholders of acquired firms are strongly positive.
3. Gains and losses of victims and predators became a zero-sum.
4. In certain cases a failed bid leads to improved stock market valuation.
5. Acquisitions were unlikely to reduce risk.

Acquiring Companies:

Strong evidence exists of increases in share value and abnormal returns to the acquiring firm in the period leading up to the announcement of the merger bid. However, following the announcement a reduction of this initial gain is generally observed, either as a sharp decline immediately following the acquisition event or as a more gradual decline which may take up

Acquired Companies:

In counterpoint, general agreement exists that the shareholders of the acquired company do considerably better out of the deal. Franks, Broyles & Hecht (1977) found gains of 20% to the victim's shareholders in the three month period before an acquisition was announced. This led them to consider the possibility of "insider trading" leading to speculation in the victim's shares. Their work was confined to the Brewing Industry but is confirmed by wider studies which identified abnormal gains of 22% - 30% to the victims shareholders in the 40 days before the acquisition announcement.

Zero-sum:

Firth's (1980) study of 434 UK acquisitions concluded that no aggregate advantage accrued since the gains accruing to the victim were cancelled by the losses of the attacker. By adding the gains to the victims shareholders to the apparent long-term losses to the shareholders of the acquirer, Firth confirmed the hypothesis of Perfectly Competitive Acquisition Markets. This proposes that competition among acquiring firms will cause the value of expected benefits from merging to be paid to the shareholders of the firm being acquired.

Bid failure:

Firth's study also found that unsuccessful attackers outperformed the market in the twelve months following the failed bid, a result supported by Dodd & Ruback (1977) who found that

subsequent to the rejection of a bid, the target's shares failed to fall back to their pre-offer level.

Risk:

Continuing the search for explanations as to the popularity of acquisitions as a strategic weapon, various studies examined whether acquisitions were used to reduce the risk associated with a particular firm by managers. These conclude that while certain types of acquisitions can reduce systematic (market related) risk, they are not an effective means of reducing unsystematic (firm related) and total risk. Indeed Langetieg, Hangeu & Wichern (1980) found that acquisitions tend to be associated with increased levels of systematic, unsystematic, and total risk for the merged firms.

What price failure?

Underpinned by these scholastic conclusions, it perhaps should come as no surprise that the last merger boom of the 1970's - the Conglomerate Wave - has resulted in considerable disillusionment. Divestment and a call for a "back to basics" approach appeared to gain strategic favour. Good examples are Mobil Oil pulling back from mineral extraction and the Imperial Group finally finding a buyer for their HoJo hotel chain.

Despite this these same companies are back on the acquisition trail undeterred by their highly visible mistakes. Is this the proverbial triumph of Hope over Experience or is

there something fundamentally different in the nature of these acquisitions which leads to an expectation of success?

Managerial Implications.

Kitching (1967) identified variables such as the relative size of the companies, the market share position of the acquiree, the retention of acquiree management, and the post-acquisition integration process and related these variables to success as defined by the management of the acquiring company. He suggested that management of the acquiring firm would increase the likelihood of success by "matching the availability of managers of change with the tasks of the newly merged enterprise", and by specifying at the outset the control system to be used and sticking to it. Salter and Weinhold (1979) similarly decided that successful acquisition outcomes were due to the "organisational structure and human resource skills of the acquirer, coupled with latent synergistic possibilities."

These statements imply that in unsuccessful acquisitions, either no synergistic benefits accrue to increase shareholders' wealth, or, that the acquiring companies lack the management ability to release the available benefits. The continuing popularity of acquisitions leads us to focus upon this latter belief. Despite its early promise little empirical research activity has extended Kitching's early work in linking these management features to acceptable measures of acquisition performance.

Industry 'fit'

Relatedness or degree of "fit" between acquirer and acquiree has been used in different stages of the research into acquisition performance. The degree of industry relatedness was thought to explain acquisition success until Cowling's recent study demonstrated that the relationships held true only in high profit industries and not in low profit industries, thus linking both industry performance and acquisition performance.

Management 'fit'

Kitching identified a "fit" between company characteristics (size, market share) in those acquisitions acknowledged as successful by the managers concerned. Norburn (1986) tested the characteristics of top managers within the UK's largest companies against the performance of those industries in which they were strategically competing. He found significant differences in management characteristics between industry sectors categorised as growth, turbulent and declining. This work extends the upper echelon theory of Hambrick and Mason (1985) which posits that top management characteristics will, partially, predict organisational success.

We therefore believe that the relatedness which actually existed in the earlier acquisition studies could be a relatedness of management characteristics and style which in turn leads to successful acquisition outcomes.

Conversely, the lack of relatedness or "fit" may become evident at various stages in the acquisition process. When Levinson (1970) looked at merger performance he contended "that some psychological reasons for merger not only constitute a major, if unrecognised, force toward merger but that they also constitute the basis for many, if not most, disappointment and failures". He concluded that these hidden psychological reasons for acquisitions led to a condescending attitude towards the victim which results in efforts to manipulate and control which in turn led to "(a) disillusionment and the feeling of desertion on the part of the junior organisation and (b) disappointment, loss of personnel and declining profitability for the dominant organisation".

Similarly (Hayes 1981) suggested that expectations of the future relationship are created during the acquisition negotiations. When these expectations are not met ex-post facto, executives become disillusioned, morale falls, performance declines, and executives leave. The failure to link the negotiating team and the implementation team is also identified as a stumbling block to successful acquisition management.

Supporting the significance of managerial style and behaviour, Hayes' study of top executives who had sold their companies found that "extensive control or interference by the parent company was reported to be the prime reason for leaving by over two thirds of executives who left, following the acquisition." Further, Kitching (1967) and Cox (1981) suggested that many of the problems of style and expectations can be anticipated and the creation of false expectations can be eliminated by adequate planning of the management issues and implications of the acquisition.

The main theoretical research works which cover the issues of managerial style and characteristics are summarised in Table 1 below in terms of their impact at various stages of the acquisition process.

[Insert Table 1 about here]

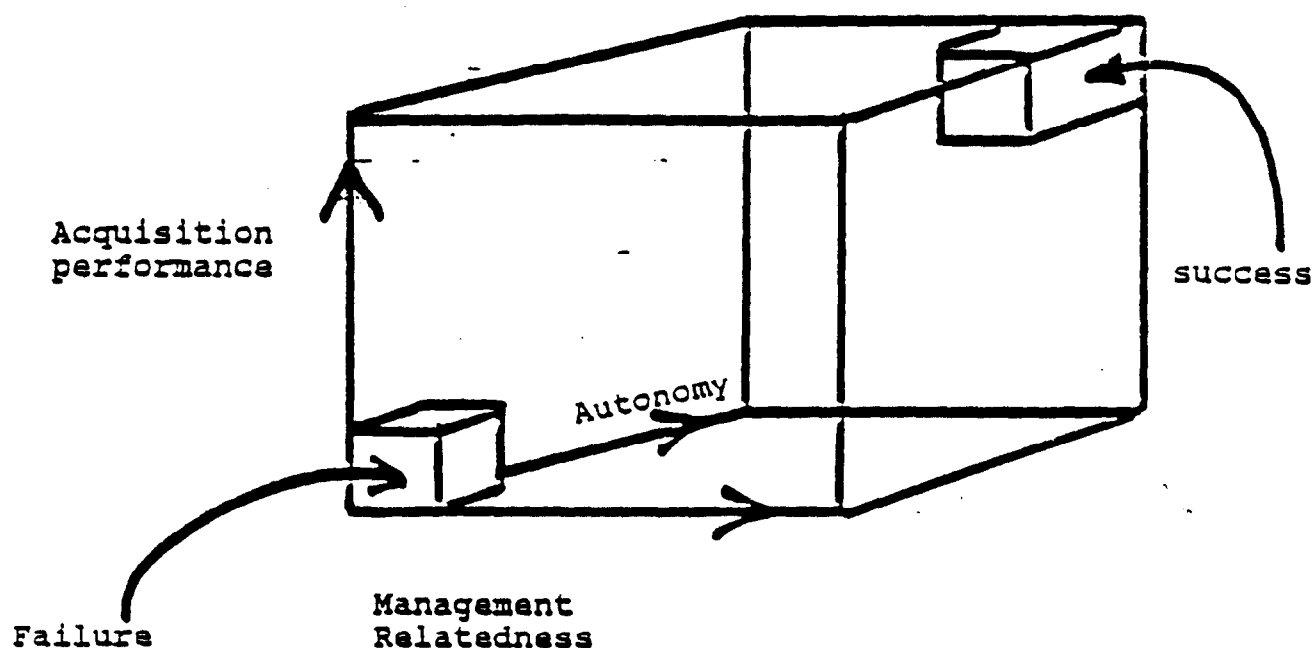
'Fit' v. Autonomy

By contrast with the studies which identify management problems of acquisition, Hayes' study of top executives involved in acquisitions found that 75% of those "victims" who stayed with their company "enjoyed a satisfactory level of autonomy". Lack of autonomy was measured in terms of unsolicited parent company directives and decisions, excessive operating control, excessive reporting requirements and corporate staff interference. It could thus be argued that acquired companies can be isolated from

the impact of unrelated management style through the degree of autonomy they enjoy.

Therefore while we believe that a correlation exists between relatedness of management style and acquisition performance, acquisitions can be successful even in cases of unrelated management style where the acquiree had a high level of autonomy post acquisition. These relationships are shown graphically below.

Figure 1: The Management Factor Rubric



From this review, it would appear that although the significance of the managerial factor has been identified, insufficient empirical investigation has been conducted relative to the importance of ensuring acquisition success.

Implications

There is no guarantee that the management style and culture at Volkswagen and SEAT will be the same; or those of Habitat/Mothercare and British Home Stores; or Olivetti and Acorn, Monsanto and Continental Pharma; or Volvo and Clark. Yet the fact that they already operate successfully in the victims industry must surely increase the commonalities in style, expectation, reward structure, attitudes and jargon.

We believe that those commonalities will also exist between acquirers and victims which do not share a common industry but it will require far greater rigour by the acquiring management team to identify and cultivate the meshing of management style which is the key to successful acquisition. This is consistent then with earlier research which demonstrated that industry relatedness alone was not sufficient to determine merger success.

Research confirmation of these hypotheses would not only have an impact on companies approach to acquisition as a competitive strategy but also on European anti-trust legislation. For if industry relatedness increases the probability of a 'fit' in Management style and culture, the various governments anti-trust bodies are busy preventing the mergers which are most likely to succeed.

TABLE 1

**Review of Management Characteristics and
Style issues raised in Acquisition Research**

Timing	Issues	Reference
Pre Acquisition Planning	Familiarity leads to lack of internal consultation.	Power (1985)
	Failure to allocate responsibility for the acquisition to a key individual.	Mace & Montgomery (1962)
	Failure to anticipate people issues results in false expectations.	Kitching (1967) Cox (1981)
Negotiations	Involvement of CEO decreases with number of acquisitions.	Power (1985)
	Failure of integration team to be involved in negotiations.	Cox (1981)
	Expectations created which are not subsequently realised.	Hayes (1981)
Post acquisition Management*	Lack of broad executive involvement may lead to the development of ineffective procedures for implementation & control.	Mace & Montgomery (1962) Kitching (1967)
	Morale problems result from:	Harvey (1969) Ansoff et al(1971)
	- immediately firing or freezing out unwanted executives	Levinson (1970)
	- Failing to agree on an appropriate organizational structure	
	- Failing to divide responsibility for the integration process equally between the acquiring and acquired firms.	
	- Condescending attitude to the victim	
	Degree of control exercised by the parent resulting in high top management turnover	Hayes (1981) Kitching (1967) Levinson (1970)
	Changes in Management	Kitching (1967)

Team responsible for
the acquisition

Mace & Montgomery
(1962)

* Partially adopted from Seetoo (1977)

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