WHY MERGER AND ACQUISITION (M&A) WAVES REOCCUR: THE VICIOUS CIRCLE FROM PRESSURE TO FAILURE

Christopher Kummer, Institute of Mergers, Acquisitions and Alliances, Webster University &
Ulrich Steger, International Institute for Management Development (IMD)

INTRODUCTION

Merger and acquisition (M&A) activity has just broken another record and another M&A wave appears to be over (Figure 1). This development contradicts the fact that most M&As are considered to be unsuccessful (Jensen & Ruback, 1983; Agrawal et al., 1992; Mitchell & Stafford, 2000; Ali-Yrkkö, 2002; Tichy, 2002). We are not surprised, however, at how difficult it seems to be to succeed in M&A transactions. Most studies stop at examining the success or failure rate of M&As and one or two obscure success factors. We are interested in the following question: Why do M&As continue to take place, not only on a small scale but also periodically with great magnitude (Gort, 1969; Bower, 2001; Brealey & Myers, 2002), particularly when M&As in the previous wave – and even the ones before that – may have failed (Borg et al., 1989; Moeller et al., 2003). In this paper we explore why companies, their management and shareholders are prepared to try over and over again, an aspect that M&A research has not explored to date.

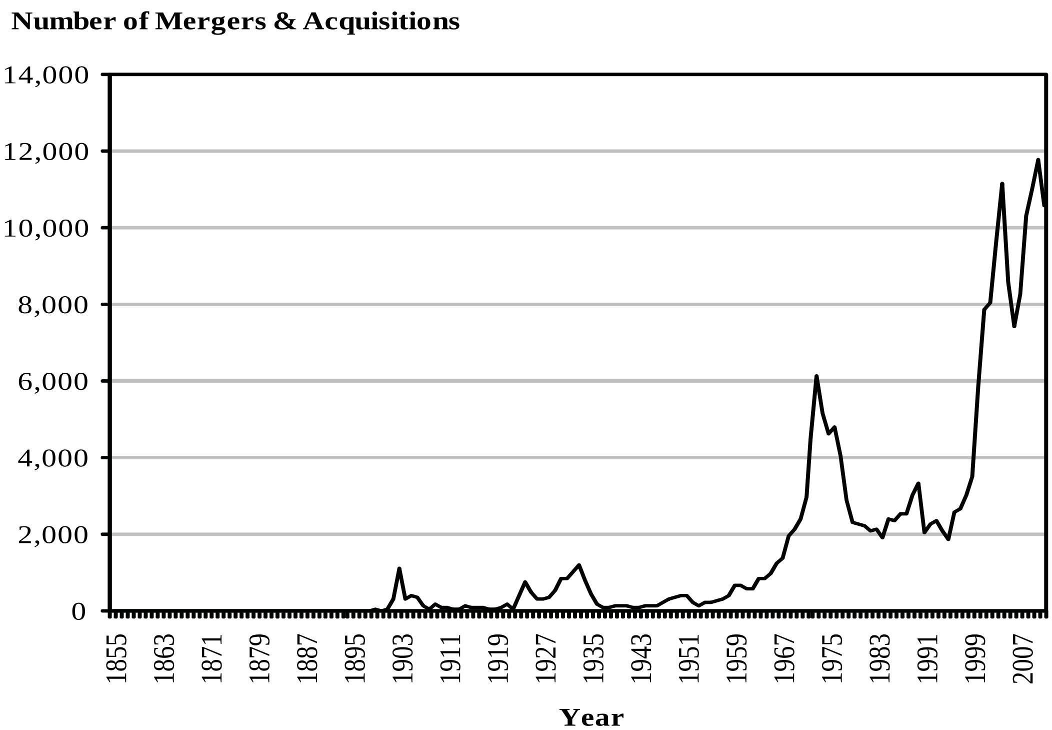

Figure 1: Merger and Acquisition Activity in the United States (1887-2007)[1]

We explain why M&A waves happen with such a magnitude despite their high rate of failure. Because there is a time lag before M&A failures are realized, the M&A wave can build up. But when failures are realized on a critical level, the M&A wave collapses quickly as we can see from the life cycle of M&A waves (see Figure 2).

1 Source: 1887-1889 (Conant 1901), 1890-1894 (Thorelli 1955) 1895-1953 (Nelson 1959), 1954-1963 (FTC 1971), 1964-2007 (Mergerstat 2008). Note that these data stem from different sources that are not consistent – for extensive comments on the data and its drawbacks see (Golbe & White 1988).

Periods with little M&A activity (near the natural rate) are used by the whole industry to develop new concepts and strategies that will later give rise to new M&A transactions.

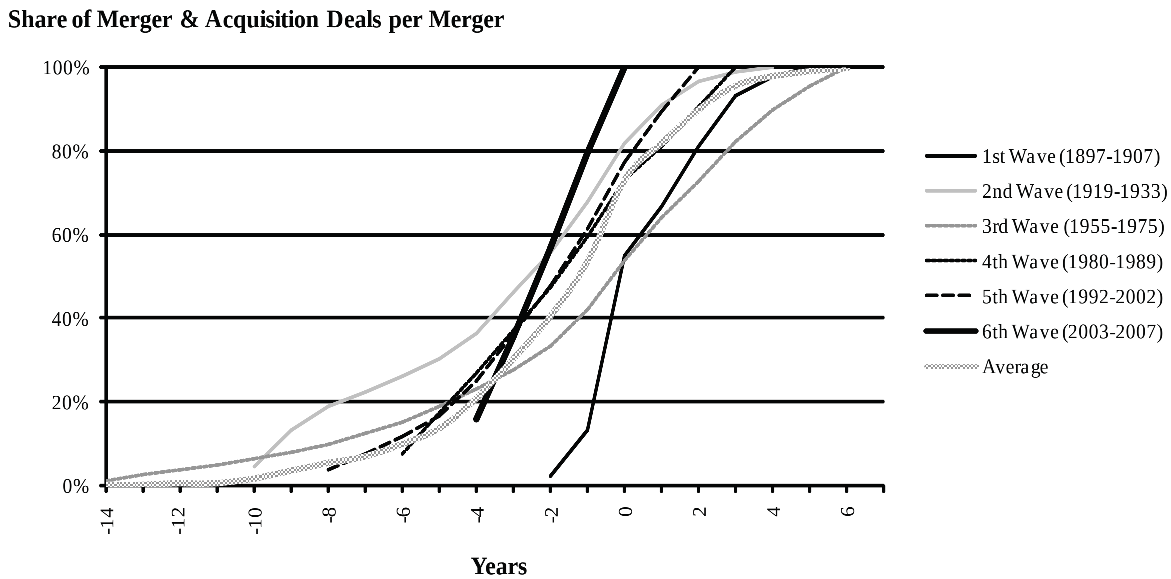

Figure 2: The Life Cycle of Merger and Acquisition Waves[2]

The theory will be presented as follows: We explain why companies choose M&As and we look at possible reasons for failure, especially how they are (mis)interpreted. We then discuss why companies and managers are convinced and overly self-confident in trying M&A transactions again. The conclusion includes a summary of the vicious circle of M&As and examines whether unrealistic hope always leads to failure.

WHY COMPANIES AND MANAGERS CHOOSE M&AS

Plenty of rationales for M&As have been proposed thus far (Trautwein, 1990; Walter & Barney, 1990; Weston et al., 2001; Weston & Weaver, 2001; Brealey & Myers, 2002; Bruner, 2004). Most of these conventional lists lack a categorization of the strategic intentions which are often labelled as “rational” explanations for M&As (Steger, 1999; Bower, 2001), whereas “irrational” explanations focus on individuals, especially top managers who engage in ”empire building” and the like. Whichever explanation might be the most appropriate, the reasoning behind each M&A transaction seems mixed and caused by a variety of motivations simultaneously.

The quest for growth and pressure to grow

The primary motivation for M&A deals is the quest for growth. When internal growth initiatives do not materialize, or there are no other organic growth options, M&A transactions prove to be the only way to create growth.

External pressure can also force managers to initiate additional M&A transactions. Slywotzky and Wise (2002) found that the demand for double-digit growth from analysts and investors becomes hard to satisfy. For listed companies the external pressure for more growth can be so immense that it cannot be realized by organic growth through internal projects alone. In this situation, M&A transactions remain the only solution, even if they might have failed in the past.

2 Based on Steger & Kummer 2003b and Kummer, 2005

Being a consolidator

When the industry is in a period of consolidation, and as other competitors consolidate and challenge a company's market position, the fear of being left behind spreads. The "bandwagon effect describes companies engaging in M&As in order to survive (van Wegberg, 1994; Schenk, 1996; Fauli-Oller, 2000). Promoters of M&As come up with alleged opportunities and the motive to buy companies in order to prevent competitors from doing so is always difficult to evaluate.

Testimonials and success stories

Testimonial evidence about businesses at conferences and in the media tell us that some M&As have (supposedly) been a huge success. Often, the thinking goes that if other managers can make it work, I can do it too. But any given situation, and transaction factors, can be totally different, e.g. industry, life cycle of the company, firm-specific problems, timing of the deal and strategic intention. Stanovich (1998) has found that people, however, tend to accept testimonials, evidence that is of questionable validity. Also, when these success stories are examined in detail, it is often difficult to measure whether they really were successful. People tend to demand little follow-up evidence and do not look at the long-term success.

WHY M&A DEALS FAIL

Why do M&A transactions fail so often? The reasons are manifold; the proposed critical success factors for M&As are as numerous as the consultants, managers and academics in the field (Datta et al., 1991; Gadiesh et al., 2001; Cording et al., 2002). The fact that change is happening all the time, in addition to the interdependency of factors, can add complexity to the mix and cause significant problems. This is far from being well understood otherwise the success rate of M&As would have improved drastically as a result of defining these success factors. In addition, the reasons for M&A failures are not clear. We often see M&A deals that even neglect the few success factors of M&As that we do know. Therefore, we take quite a different approach to the reasons for failures. We see that the impediments of unrealistic expectations, (over)confidence, promoters and external advice, distrust and group dynamics all play vital roles.

Unrealistic expectations

The main reason for M&A failure is unrealistic expectations. First, making M&A deals work is a difficult task and many managers underestimate this fact. Second, the goals of M&A deals are often unrealistic.

Let us take a look at the task difficulty and the different phases of an M&A transaction from pre-M&A, M&A to post-M&A phase. The chronological order of the M&A transaction goes hand-in-hand with task complexity (see fig. 3). While the first steps are relatively easy, later ones become more complex. The search for potential targets is relatively easy and even the acquisition is as such (when one pays too much for the target company anyway), in comparison with the obstacles to be mastered during the actual integration phase. The search and acquisition phases are necessary steps, but are not sufficient to make the entire M&A transaction a success (Shelton, 1988; Datta, 1991; Datta & Puia, 1995). The inertia of organizations and people is underestimated. Resistance shows up and with resistance comes delay. Integration takes time and it is painstaking – this is where success can once again be spoiled. Although the speed of integration is often seen as one of the most critical success factors, the ease of integration is underestimated. It is often predicted that change will be faster and easier than what is realistic (Buehler et al., 1994; Kruger & Dunning, 1999). The profound changes needed for success are more difficult and take much longer than originally thought. The changes implemented during post-merger integration projects usually only scratch the surface. For years to come, the organization remains split in two separate groups – the former employees from company A and those from company B. These labels survive. Early on in the integration phase, the acquiring company and their management exercise more power, simply because their company is bigger in almost every respect – sales, employees, branches and costs. Suppliers will try to secure their piece of the pie and will court executives, like promoters, in the very beginning. Additionally, most concepts structure the integration process and its goals in short-, mid- and long-term time frames. Realizing short-term goals are the easy and quick wins. The low-hanging fruits are probably just 20% of all synergies and the rest are "strategic" synergies that have to be realized in the long run. Hence, some rewards of M&As are surely grasped. Of course, this procedure should create motivation for further endeavors but the ultimate success or failure of M&As come in the later stages of integration. As the integration progresses more difficult obstacles surface, synergies and the like become harder to realize. Unexpected compromises must be made with unions, employees and other stakeholders, diluting the original plan and its targets.

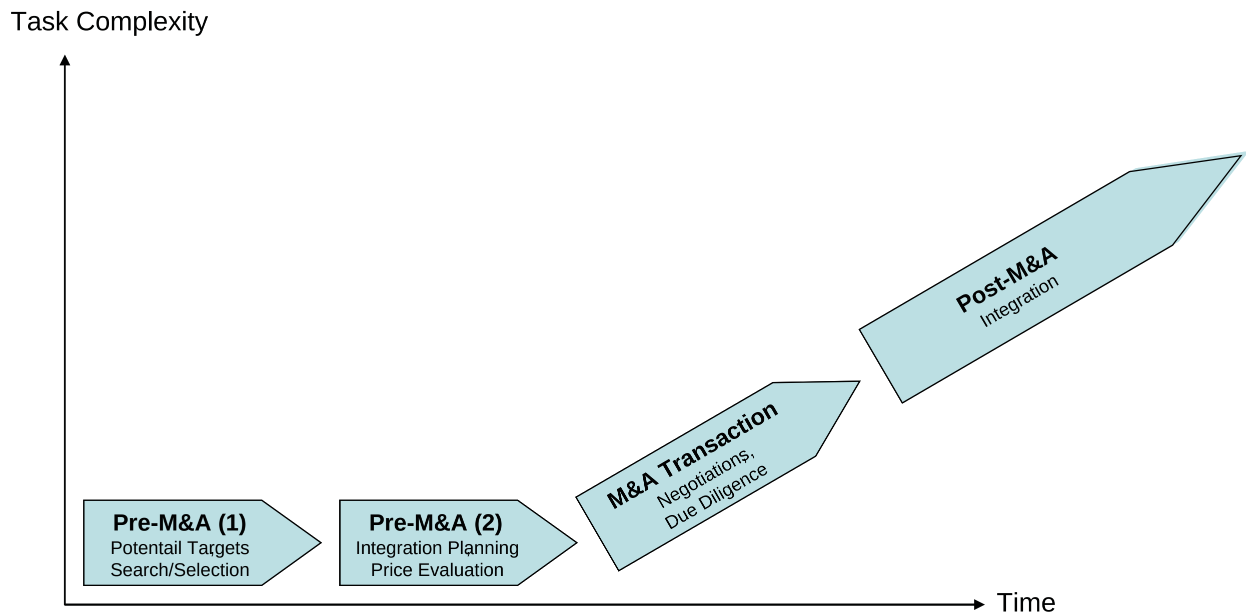

Figure 3: The Process and Task Complexity of Mergers and Acquisitions

Hopes in M&A deals can also exceed what is feasible. Alberts and Varaiya (1989) stated that, as a consequence, the amount spent for a target is too high or one of the merging partners is overvalued. Premiums paid can hardly ever be recaptured. Free cash flows are simply wrong and, therefore, when using net present values as the basis for company valuation the acquisition price is overrated. Synergies are also frequently overestimated – they look good on paper but are not realized as calculated. Erroneous evaluations can also be produced by the perspective buyer: the acquiring company judges the target with its own (and always different) perspective.

Managers also often believe that the M&A can be compensation for a floundering core business and a lack of vision. Instead of solving the real, and sometimes operational, problems or innovating the business, they turn to M&As (Hammer, 2004). As Steger (1999) pointed out, they hope that deals will solve other problems such as improving parts of the company, as well as its overall business., these options are presented as the company realizing its vision. It is often thought that M&As might also convert the company's image, especially when a new corporate name is chosen. M&As can be helpful in being a distraction from the real problems that the company experiences.

If the goals are unrealistic to start with, failure cannot be avoided. Resources devoted to these goals are almost always wasted. Not even a more capable management could realize them. The management just tries to make the impossible happen. Undoubtedly, M&A is a situation that is unfamiliar and exceptional causing distress for both managers and employees (Ivancevich et al., 1987). M&A is one of the most distasteful events in the life of today's manager (Steger, 2002). In addition to this situation, the unrealistic expectations cause further distress and deplete cognitive resources. The high emotional involvement of management and absorbed cognitive resources further increase the likelihood of failure. Unattainable goals should be abandoned. Lecei et al (1994) have found that if these goals are perceived as important, controllable and desirable managers will renew their efforts to achieve these unrealistic goals and undertake further attempts to achieve them. In general, managers are overly optimistic and predict outcomes for themselves that are too favourable (Weinstein, 1980; McKenna, 1993; Armor & Taylor, 1998). When these expectations prove to be wrong, managers remain motivated by using a variety of techniques to maintain their unrealistic beliefs and they will continue to try and succeed. This leads to further trials and the possibility of another failure. Of course, with more realistic goals they could succeed. Unfortunately, these more realistic goals rarely coincide with either their, or their company's, agenda of extraordinary growth. "Realistic" plans alone would probably be not enough to convince the board of directors and shareholders to pursue an M&A transaction. Deals have to be ambitious. But far too often the thin line between overambitious and unrealistic is crossed. With realistic parameters, the advantages of M&As are far smaller than the average premium paid. Hence, the failure remains too high for the premiums paid. Participants do not to walk away from deals during due diligence. Instead of abandoning the M&A transaction, the price to be paid is often raised in order to convince the target's shareholders and management of its viability. But then the goals have to be raised as well – they not only remain unrealistic but can also become even more unrealistic.

In brief, M&A efforts are often doomed to fail from the very beginning due to unrealistic expectations, especially concerning these issues: amount spent, speed, ease and other effects, as well as the rewards of change. These issues are pushed especially hard by the promoters of M&As who promise fast, easy, dramatic and successful change.

(Over)Confidence

Every entrepreneurial decision aiming for returns bears certain risks. This is also the case for M&A transactions. Bandura (1977) stated that confidence in the success of an M&A deal, and the achievement of its goals, are crucial ingredients for a potential success. If this was not the case, managers would hardly make the efforts necessary for M&A projects. Those who believe that they can succeed are more likely to make the effort. First, they have the opportunity to succeed because they try. Those who do not even make the effort cannot succeed but neither can they fail. Second, confident managers who try are more likely to succeed than are managers lacking confidence who also make the same attempt. The confident managers are also more likely to succeed because they will also work harder to overcome difficult obstacles.

Confidence can then make the critical difference between a make or break situation. Without confidence, the additional efforts to overcome these obstacles would not have been made. Despite the widespread belief that all obstacles can be overcome as long as one tries hard enough, this is not true. Belief or hope in the possibility of success seems to be another powerful ingredient in achieving success (Peterson 2000). Hope differs from confidence with respect to the locus of control – the latter depends upon the abilities of managers while the former depends upon some indeterminate circumstances and factors of supportive future situations. Armor and Taylor (1998) decalred that having optimism or positive expectations can also help. Managers who are optimistic usually have greater psychological well-being and other positive attributes which might relieve cognitive depletion. They are able to convince other people of the chances, benefits and success of the M&A transaction. Thus confidence, hope, belief, optimism and positive expectations can have positive effects on M&A success (Szulanski & Winter, 2002).

Peterson (2000) demonstrated that optimistic beliefs, however, that turn out to be wrong can be costly.

Confidence, hope and optimism are necessary to some degree and useful for M&A success but when managers strive for the impossible or the unlikely they are simply being overconfident. Some things are simply impossible to execute, especially when expectations are unrealistic and cannot be realized no matter how hard one tries. People may lack the necessary capabilities and resources, e.g. knowledge, management capacity or financial assets. Indicators that the task difficulties are beyond one's abilities are overlooked. The acquirer's management seems to know that with the resources available, they themselves cannot fulfil the tasks of an M&A transaction.

Take into account managerial overconfidence (Bradley & Korn 1982) when discussing the failures of M&A transactions. Overconfidence may lead to an illusion of control and hence to premature solutions with less thorough evaluation of acquisition candidates and little consideration of integration issues (Duhaime & Schwenk, 1985; Jemison & Sitkin, 1986b). Lys & Vincent (1995) use overconfidence as one explanation of the decrease in AT&T shareholders' wealth by between $3.9 billion and $6.5 billion caused by AT&T's acquisition of NCR Corporation in 1991. Hitt et al. (1998) see overconfidence as a stimulating force which can speed up the acquisition process and reduce the consideration given to integration issues – this causes managers to feel more in control of the situation as a result of their prior experience or expertise. Roll (1986) formulated the well known "hubris hypothesis" that managers overestimate their own ability and over evaluate target companies. Zajac and Bazerman (1991) has offered the existence of „competitive blind spots" as a partial explanation for high acquisition premiums. There is the risk of overbidding, especially in bidding contests, i.e. the winner's curse (Varaiya, 1988; Giliberto & Varaiya, 1989; Barnes, 1998; Goeree & Offerman, 2003).

As Fanto (2001) has found, CEO overconfidence is often seen as an important factor during bidding. If the CEO has been very successful thus far, who will dare to challenge him? Something called the "Jack Welch syndrome" was attributed to the Honeywell acquisition. Hayward & Hambrick (1997) have shown the effects of recent media praise for the CEO and the CEO's self-importance on M&As. Heaton (2002) identified that excessively optimistic managers and efficient capital markets are confronted with an under- and over-investment trade-off (Malmendier & Tate, 2003). On one hand, optimistic managers see their securities as undervalued by the markets, and therefore do not invest in positive net present value projects that must be financed externally. On the other hand, optimistic managers overvalue their own projects and might invest in negative net present value projects. Danbolt (2004) suggested "that any target company cross-border effect may be due to managerial overconfidence or managers of cross-border bidders pursuing the maximization of personal utility, rather than the maximization of shareholder wealth, to a greater extent than do domestic bidders". Even when diversifying into related fields of business, managers are overconfident in possessing the management skills needed in the new business, as Duhaine pointed out (1981). Böhmer & Netter (1997) found a weak support for the hypothesis that managers resist takeover bids because they are personally more optimistic about their firm's prospects under their control versus the company being in the hands of the bidder. Xia & Pan (2006) incorporated overconfidence in their game 'theoretical real options framework' to model the dynamics of takeovers.

The enormous difficulties of M&As tend not to become fully apparent until the integration phase, otherwise most people might restrain themselves from making the necessary efforts to do M&As. The successfully mastered first (and easy) phases of M&As foster the illusion that people are competent enough to succeed in the following phases as well, i.e. the initial success contributes to overconfidence.

In particular, incompetent people seem not to recognize their own inability (Kruger & Dunning, 1999). They are more prone to engage in projects and persist in efforts that are likely to fail. Thus, people who should be especially concerned about overconfidence do not seem to care and are likely to be overconfident. This could be another reason why there are a disproportionate number M&As failures – the overconfident managers try whereas the realistic ones do not.

Promoters and external advice

Managers rely heavily on “promoters” to initiate, structure and carry out the M&A transaction. Promoters for M&As are investment banks and top management consultancies. They have a vested interest in M&As and push companies into M&A deals in order to offer their services. Promoters convince managers that they can succeed. Managers expect to reduce the task difficulty by utilizing the promoters’ services. Promoters have a signalling effect to supervisory bodies that the M&A transaction makes sense and will work. They also provide the much needed additional capacity to manage the M&A integration phase that companies usually lack. Evidence however tells us that promoters are far from being omnipotent. They frequently fail to turn M&A transactions into successes.

Promoters can fulfil a useful function by fostering confidence, restoring hope and providing motivation – all of which are essential factors for success. There is nothing wrong with confidence, hope and belief. When these qualities are based on competencies, experience and a record of success they make future success more likely. But as Peterson (2000) exposed, success becomes less likely when the same qualities are unjustified and totally unwarranted. There is another factor – advice given by promoters is not always followed by managers. The ultimate responsibility lies with the management.

Kale et al. (2003) explore the effects of the financial advisors’ reputation in takeovers. They document that the absolute wealth gain, as well as the share of the total takeover wealth gain accruing to the bidding company, increases as the reputation of the bidder’s advisor increases relative to that of the target. They also find a positive relationship between the total wealth created and the bidder and target advisors’ reputation. The bidder advisor’s reputation is also positively related to the probability of bid success. There is considerable potential for conflict of interests regarding banks involved as M&A advisors (Allen et al., 2000; Castro & Fontrodona, 2002; The Economist, 2002b, 2002a). The bank’s trading arm would love to use insider information to make gains in merger arbitrage. Bank’s lending operations are interested in giving loans to finance a transaction. If there is the need for a capital increase to finance an acquisition, bankers will be happy to arrange it. Financial analysts judge the deals done. Fund managers decide in which companies to invest, or not.

Overconfidence can be found on both sides with managers and promoters. The self-assured candidates, and those with dominant personalities, are hired. Promoters more often recruit university graduates who are confident. There is no doubt that these recruits have received excellent grades but those provide little indication about their capabilities to make M&A strategies work. This recruitment bias might be true in a few cases and a self selection by applicants might already have taken place. The self-centered qualities one needs to be promoted in these firms do not necessarily contribute to the company’s success. Hence, promoters believe in their (own) success that is often based on false self-evaluation.

It is critical to examine the measurement of success or failure of the various participants. Promoters see fees and projects sold as their criteria for success. The important goal for consultants is that their integration services are needed and follow-up projects are sold. They might prefer complicated M&A projects where, in the end, blame cannot be clearly attributed. It is interesting to see that companies rarely switch their M&A advisors. Saunders and Srinivasan (2001) find that companies are paying higher merger fees to investment banks when they have had a prior relationship. But, they identify that there is no relationship between higher investment bank fees and acquisition performance. They do, however, see that firms are more likely to switch their advisors if their prior advisor has not been a top tier investment bank.

Distrust

At the grass root level, i.e. below top management, the attitudes and moods of the employees are often quite the opposite of (over)confidence – namely distrust. This might contribute to the failure because, as previously mentioned, an appropriate amount of confidence is a crucial ingredient for success. Why do so many employees feel a lack of confidence about M&A success? First of all, there is uncertainty about what will happen in the future. Is there the danger of losing their jobs? If not, how will their jobs and tasks be changed? How will the restructuring affect them personally? Will they have to move to another department, work with other colleagues, work for a different boss? Will the entity of the company that they work for be divested? These are uncertainties that can last quite some time. Second, companies are often restructured at least every two years. So, the M&A projects will produce "just another change program" that will not bring the desired outcome. Third, if people are fired the workload is not reduced which results in fewer people having to produce the same amount of work. Fourth, stakeholder management is performed poorly, if at all. In addition, employees are among the stakeholders who are often treated the worst of all. The manner in which, and at what point in time, employees are informed about the M&A transaction is another essential point (Schweiger & Denisi, 1991; Davy et al., 1988; Schweiger & Weber, 1989; Kay & Shelton, 2000; Risberg, 2001). Rumors spread rapidly, all over the company (Rosnow, 1987, 1988). Even months after the closing, integration plans are sometimes far from being settled; insecurity among the staff persists longer than necessary. The only stakeholders who are usually treated well are shareholders in an effort to prevent them from selling their shares and because their votes might be needed in general meetings, either to approve the M&As transaction or to re-elect corporate officers in the future.

The separation of ownership and management adds to the critical situation (Steger & Kummer, 2003a). Managers can pursue their own goals to some degree. Concerning growth however, M&A is a quick way to realize that goal, as Mueller (1969) pointed out. Conn (1980) however found no differences in the merger pricing policies by either owner-controlled or manager-controlled firms. But Datta et al. (2001) have stated that managers with high equity-based compensation pay lower acquisition premiums, acquire targets with higher growth opportunities and make acquisitions engendering larger increases in firm risk. Wright et al. (2001) show that risk-reducing strategies are subsequently emphasized as managers expand their stock ownership and that stock options have a consistently positive impact on firm risk taking and acquisition returns. This means that incentive systems, when properly designed, are working.

Group dynamics

An M&A transaction is a situation where a lot of people and teams are involved. There is a tendency to get carried away by group dynamics. Also, the decision for an M&A transaction is made by the board of directors and the management team, with all of the consequences that are inherent to group situations. First, the board has the ultimate responsibility but that is shared and unclear, at least when it comes to individual board members – everyone involved has a share of that responsibility. This is always the case when an M&As transaction becomes a success. Nevertheless, important projects do have an initiator, coach or implementer on the management board level. In the case of a failure, the responsible manager will have to leave. In the worst case scenario even the CEO has to give up his position. Second, as McFadzean explained (1999), groups make more extreme decisions, especially with big M&A deals where there are very difficult activities in which companies can engage in. The risks of such projects can lead to a company's bankruptcy. Third, blame is often put on those who carry out the post-merger integration and not on those who decided to initiate the transaction as such. Fourth, participants in M&A negotiations often become committed to the deal regardless of its logic or benefit to the company (Jemison & Sitkin, 1986b).

HOW M&A FAILURES ARE (MIS)INTERPRETED

Above of all, the failure of an M&A transaction has to be recognized as one. But the measurement of success and failure is far from being solved. Ex ante, many resources are devoted to the M&A process in identifying and evaluating potential candidates. Also during the integration phase a great deal of effort is usually made to make things work. But post-M&A, after the integration phase is complete, controlling is often neglected. Therefore, a learning curve is seldom experienced. For most M&A transactions the identification as a failure is very unlikely in the first place.

While managers often perceive their transactions as successful, outsiders think of them as being failures. Empirical evidence suggests that managers, at least publicly, always claim their transactions to be a success. Also, a difference between the manager's judgement and those of experts and studies is possible because on one hand the measurements for success or failure of M&A transactions are ambiguous. On the other hand, it takes quite some time, if ever, for the success or failure of a transaction to become apparent. There is a huge time gap between the closing of the deal and the "end" of the implementation. For example, some frequent acquirers like Cisco and General Electric have first been hailed as successful acquirers but, as of late, there has been much doubt about whether their transactions were actually successful. Certain thresholds have to be reached until a transaction is seen as a failure. These thresholds can differ from case to case, company to company or industry to industry. The thresholds are far from being fixed – they can vary during time and can also be raised. It is only a question of habituation. Even, when the managers and companies themselves see their transactions as failure, they usually do not interpret them as the result of their inability to succeed. If this were the case, they would stop trying.

The failure of M&A transactions is not seen as inevitable. If failed M&As had a prognostic value for the likelihood of future transactions' success, then companies and their management might take them at face value and would restrict their M&A transaction activity seeking some other, more promising way, e.g. organic growth initiatives. Bleeke and Ernst (1995) argued that strategic alliances are not the natural alternatives because they are not a guarantee for success either. Managers try again because they do not accept defeat easily. Although unrealistic expectations made the failure inevitable, they will find explanations and exculpations for the failure.

Internal attributions

In general, attributions for failure can be either internal or external ones, as Weiner explained. Both types help managers avoid facing facts once again. Interestingly, failure is often viewed as the result of external factors, while success is usually attributed to oneself and his own personal efforts and capabilities. Internal attributions for failures are rare but can be associated with issues such as a lack of preparation, planning or effort. If one had only been better prepared, made more elaborate plans, had only tried harder or devoted more resources the M&A transaction would have become a success. In addition, promoters of M&As have a vested interest in blaming the acquirer or the merging partners for causing the failure instead of calling their own services and performance into question. It is the classic example of blaming the victim (Ryan, 1976).

Managers might also conclude that this M&A deal was not so important after all. There is a cognitive dissonance between the desire for a successful M&A and the reality of an unsuccessful deal that is balanced by denying the wish and lowering the importance of unmet targets.

External attributions

External attributions are certainly the ones that managers prefer the most – they blame external factors which are the most unstable elements surrounding M&As. There are plenty of factors in today's business environment to choose from: a change in business indicators, economic outlook and situation, changing markets, reactions by competitors, choice of the wrong consultants and investment bankers or choice of the right ones who performed in an inferior manner. All of these reasons allow the acquirer to blame something that can be changed next time. The complex dynamics of M&As allow for various explanations. Managers often choose a reason that can be changed next time thus restoring hope for the next M&A deal and success in the future.

Another external attribution for failure is the immense task complexity. M&A transactions are perceived as being difficult to do. Rather than make this conclusion about M&As in general, or about the future, the acquirer or merging partner blame only task difficulty for the specific situation, as well as the strategy of the failed transaction.

The process was so difficult because the particular integration strategy, or other factors, were not up to it. By placing blame on that specific M&A transaction and its implementation, the chances for the next M&A attempt to become a success are restored. This is especially true when they acquire or merge with a better target or partner.

As previously mentioned, promoters of M&A might be inclined to blame the acquirer or merging partners for the failure. Managers can, however, shift the responsibility back to promoters (Byrne et al., 2002). If managers change promoters and use an enhanced – or totally different integration concept – for the next M&A deal, it can become a success. The range of concepts available is enormous and is constantly growing – they can at least be repeated under new guises. Ask any promoter and they will willingly come up with some sound new concept "tailored" to meet the needs and specifics of each M&A candidate. Thus, the unlucky acquirer can chose another concept to try next time. M&A promoters heartedly recommend changing concepts – that is what they are paid for and it brings them new business from new clients. The main selling point of these new concepts is that they make success almost calculable and automatic, they simulate the illusion of control. But the true make or break lies elsewhere, not in planning the integration and especially not in finding synergies that can be identified by almost everyone, at least on paper (Jemison & Sitkin, 1986a, 1986b). Often, these concepts are the kind of "one concept fits them all" which should make one sceptical immediately. Switching concepts and promoters is a preferable tactic psychologically because it relieves the acquirer, or merging partners, from any blame for the original failure except possibly that they displayed some naïveté in choosing obviously incompetent promoters and an inferior concept last time – they were simply tricked by the promoters' good shows at the "beauty contest". This solution also addresses task difficulty by allegedly reducing or eliminating some difficulties in future M&A processes.

Failures as near wins

Managers can interpret M&A failures as a near win. They are like gamblers who believe they will win next time and explain their losses away as near wins, only accepting wins as proper results, as Gilovich (1991) summarized. Managers might interpret a failed M&A transaction as a near success and only count successful deals as proper ones.

WHY COMPANIES ARE CONVINCED AND TRY AGAIN

So why should companies try M&As again, particularly after the first transaction was most likely far from being a success?

It's the same aims

The first reason for why companies try their luck again with M&A deals is that the outside pressure to grow still prevails. Even if the track record from past M&A transactions is at best mixed, it remains the only viable way for growth. The only thing managers can try and do is to handle some factors differently this time.

Companies are particularly likely to try an M&A transaction again if the first attempt is successful and has had the expected results. The anticipation of a positive outcome is almost the same the second time as they were for the first M&A attempt. Greater leeway is given to managers if some transactions are (thought to be) successful. Learning theory tells us that repeated failure, i.e. undelivered rewards, undermines the reinforcing power of these rewards and provides no compelling basis for retrying M&A projects. After all, the final positive consequences are rarely experienced. But when, once in a while, a successful M&A transaction happens this event acts as an intensifier and managers pursue an even more active and ambitious M&A strategy. In the rare case of a success, the origins of success most likely remain misunderstood.

As long as the motives behind M&As persist, companies will try again. The striving for profits, power, wealth and fame are so powerful and the glamour of M&A transactions is tremendously alluring. Managers are convinced that these goals are desirable and above all achievable. After all, they succeed to keep other activities, i.e. their business, under control. The M&A transaction and being in the press can become a thrill for managers. Doing the deal then becomes a success in itself. This positive illusion (Taylor & Brown, 1988) motivates future M&A projects and efforts. Some managers are involved only once in a lifetime in an M&A project. A new management (generation) will try again. M&A strategies seem to become more popular from one generation to the next. It is also a question of management styles. Additionally, promoters of M&As continuously lure clients with promising opportunities. Internal departments, like strategic planning and business development, come up with new ideas – M&A transactions often serve as a fast track to realize them. M&A strategies, however, often lack a risk-return-analysis although managers realize the high risk. How much can be gained by a successful M&A transaction? How likely is the initiative to succeed? How much can be lost? Even when the expected return or benefits from the transaction are realistic, the premium paid for targets is not risk adjusted. Realizing an M&A transaction is high risk and is even perceived to be so by managers because it could be the end of their careers. This risk can, however, be reduced a little by shared responsibility in the group situation. But when a real M&A strategy is pursued, the career of managers is at risk as well.

The distant goals or dreams of M&As probably cannot serve as such a powerful incentive for the acquirer's desire to try again and to take the trouble of yet another M&A. There can be more proximate rewards that are actually delivered during the M&A process early on, even if the new M&A transaction becomes another failure in the end. The first incentives during the M&A process can be the courting by the promoters of M&As, even before the company decides to actually pursue such a project. Investment bankers and consultants show significant interest in and pay attention to managers – they invest quite a lot of resources to acquire projects or to initiate transactions. There are interesting dinners, impressive slide shows and sumptuous beauty contests held for executives and company councils. Even minimal efforts to initiate an M&A, e.g. scheduling a meeting with promoters, can be rewarding.

The whole M&A process is so demanding (and unlikely to be ultimately either pleasurable or successful) that perhaps it is no surprise that people feel the most confident before they actually begin the process. Another reward is the mere decision to pursue an M&A project. The decision itself already leads to positive effects and is seen as a first step to success. It provides an initial feeling of control and efficacy, thus fueling further enthusiasm – after all, it is better to buy a company than to have the competitor do so. The decision is often mistaken for an act of control because there is a mistake in believing that everything can be controlled and planned – something which is actually feigned by promoters. Most people need and enjoy the feeling of certainty and being in control.

Another M&A incentive can be that if one looks for some target to be acquired, one will surely find a few, whether they are perfect fits or not. In any case, some fits can be found primarily due to the fact that they were hoped for. The early stages, i.e. search for targets, due diligence and the acquisition are relatively easy compared to the efforts required in the future during the actual integration. Thus, certain phases can be successfully completed and the expected rewards for them are delivered. During these first phases ample reinforcement is provided to the acquirer. The rewards, in addition to confidence that the failures of M&As will be avoided this time around, support the enthusiasm for yet another M&A project. If one has already made all the necessary efforts to get to this stage, why should they abandon the process even if tremendous difficulties and risks have been identified? The psychological costs of a "walk away" are high (Pickering, 1983; Holl & Pickering, 1988; Chatterjee et al., 2003). If a process has already been started, it is prone to be completed, even if the premium to be paid cannot be justified. However, stopping an acquisition process can be sold to the public as a strong reason not to overpay. When other competitors are paying high premiums, this action might especially restore the investors' confidence. There is widespread belief that they will have learned their lessons from the earlier attempt so that they will at least avoid the mistakes made previously (Leroy & Ramanantsoa, 1997; Haleblian & Finkelstein, 1999; Zollo & Leshchinkskii, 2000; Hayward, 2002). Managers might think that they have gained experience in mastering M&A transactions or suppose that they have learned from their mistakes in the past. But even when they have learned from past transactions, as well as having realized their mistakes, there are so many other ones to make – each M&A transaction is unique and similarities with other deals are few. Prendergast and Stole (1996) show that managers, in an effort to appear as fast learners, exaggerate their own information and become unwilling to change their decisions on the basis of new information.

New concepts and strategies

New concepts and strategies surface which can be realized with the help of M&As. But we should be aware that the run on fads and "herd behaviour", whereby people just copy what others do will not lead to abnormal value creation – that lies only in true uniqueness. Standard concepts are unlikely to solve the problem anyway, even if they do work in some cases.

Divert from other M&A deals

Managers might initiate new M&A transactions in order to divert attention from the failures of the last transaction. With this diversion technique they manage to shift the focus and attention of board members and investors to the new M&A transactions. Hence, the failures from the past are not identified. New transactions make the comparisons even more difficult and transparency is avoided.

Serial acquirers

Companies may want to solve problems or fill gaps where one M&A transaction is not sufficient. They therefore become serial or frequent acquirers and figure out an M&A process by trial and error. Not all of these transactions have to be failures or will be recognized as such. Companies might pursue active M&A strategies and buy companies frequently, despite the fact that these transactions are far from successful, because they did not have that insight in a timely fashion.

Overemphasizing the positive deals and aspects

Another aspect for new M&A deals is a tendency to forget, or to neglect the negative aspects and to overemphasize the positive ones. Moreover, there is a much better possibility of remembering the successful M&A or its positive points than to remember the negative transactions and their particulars. First, companies monitor progress and change more closely during the M&A transaction and stop such exhaustive measurements later on. Second, measuring results in the future might prove to be impossible after the integration. Third, the time frame for an M&A transaction is distinct – it is defined by the project plan with all its milestones whereas the time frame afterward is more diffuse. Fourth, cost cutting, profits, sales and such things are intentional but cost growth and losses are not. On one hand, the memory of desired targets is supported by attention, a well-defined time frame and intention. On the other hand, the memory of negative effects is diluted by a lack of intention, a diffuse time frame and a desire for it not to have happened.

Companies and executives think that promoters are experienced in M&A projects because they are specialists in these activities and can make the transactions a success. How can we explain the high failure rates when at least every large M&A transaction is carried out with the support of promoters and most of them still fail?

The Vicious Circle From Pressure to Failure

All of this amounts to a vicious circle from pressure to failure (shown in fig. 4). In brief, the circle goes as follows: Pressure to grow and overconfidence by executives and promoters lead to unrealistic expectations about the speed, ease, amount, and rewards of M&As. This prompts the company to commit to M&As and give it a(nother) try. Already the preoccupation with the possibility of, and the ultimate decision to do, a M&A transaction produces reinforcing feelings. In general, some successes are realized, especially early on in the integration process where goals are relatively easily met (the quick and easy wins). Unless there have been no mistakes made at this point, e.g. choice of the wrong target or the payment of a too high premium, etc., the integration phase is where the "make or brake" takes place and resistance shows up. Concepts are diluted by a series of necessary compromises and an adaptation to reality. As a result, some M&A projects turn out to be resounding failures.

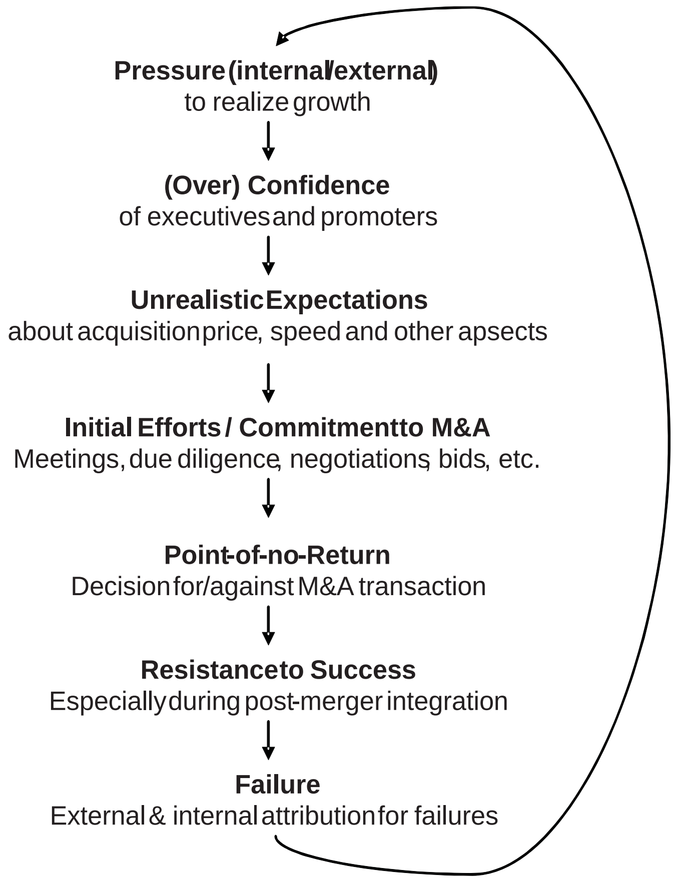

Figure 4. The Vicious Circle of Mergers and Acquisitions

When most of the M&A projects turn out to be failures, why do companies and executives give them another try? First, they have to realize that their M&A projects are failures to begin with. The projects therefore have to overcome significant thresholds to be recognized as failures. Second, it takes time to realize that their M&A strategy is unsuccessful. In the meantime, other M&A deals might have taken place there as well. Third, some M&A transactions may turn out to be successes and act as intensifiers. Fourth, a change of management takes place. Fifth, even when they do realize their failures, there is plenty of room left for internal and external attribution. While an M&A transaction might have been successful in the very beginning because they could at least acquire the desired target failure ultimately occurs, the company might be, and executives might feel, worse off than before. They will then try to degrade defeat by explaining the failure away using various attributions. These attributions distract from the unrealistic goals that were the reason for the failure in the first place – they can even allow commitment for further M&A transactions. These attributions lead to the conclusion that after all the next M&A transaction will be a success. Sixth, failed M&As actually add to the pressure to grow profitability causing the circle to start all over again.

Can the Vicious Circle be Broken?

How can managers and companies break the vicious circle? They should take a reality test concerning their expectations and not be carried away by the dynamics of the M&A situation (Bradley & Korn, 1979; Marks & Mirvis, 2001). They should also create transparency – internally and externally – by communicating expectations and influencing factors. Board members and managers have to strive for a true checks-and-balances relationship. An M&A deal should not be seen as a cure-all. A failed M&A transaction is not a catastrophe hence the success or failure of each transaction should be measured. M&A transactions should also be analyzed ex-post in order to initiate a learning effect. One should also be aware of the different attribution modes to explain the failure. Managers should create internal and external transparency of M&A transactions, in order to establish a learning curve. Failures could, and should, contribute to the knowledge base of acquirers.

We do not want to sound too pessimistic. M&As certainly are a good way, and a sound tool, to realize strategies in certain contexts when they are carried out properly and thoughtfully, in line with a corporate strategy. In general, the desire that M&As are viable solutions is not a false hope; the key is the way in which they are approached. The good news is that on average, M&A transactions do not do much harm unless one is directly affected by its outcome. On the one hand, reality testing is essential. But on the other hand, the function of dreams and visions – desirable if they are realistic expectations – are necessary human drives, especially for innovators and business leaders. Is there not always a chance of success, however remote? Although it is true that eventual strategy realization and problem solving may require multiple M&A attempts to succeed, that fact does not imply that multiple attempts guarantee success. Statistics alone are no reason for persistence. If the actual chances of success on a given attempt are 25%, it does not follow that four attempts will ensure success or that the probability of succeeding on the fourth attempt (following three failures) is greater than 25%. That is unless people have learned from the previous attempts. The false hopes syndrome is still a matter of likelihood, not of certainties. The tremendous value of success may more than offset the long odds against succeeding. But what is typically neglected in the calculation is the cost of another effort, e.g. distraction of the organization, management capacity and potential loss of customers.

The costs of M&A transactions, even successful ones, are steep. When these costs are added to the calculations, it is difficult to argue the merits of launching one for the umpteenth attempt. When the costs and benefits of unsuccessful M&As are added there is an immense downturn potential, arguing for another attempt is all the more difficult. There is the unsolved question about whether the downside potential is much greater than the upside potential. When we include the likelihood of success and failure, which is about 0.25 and 0.75, respectively, the sum becomes even more extreme. We could assume the upside potential to be 1’000 and the downside potential to be 500 (costs for investment banks, restructuring, benefits not realized, more bureaucracy, etc.). But the upside potential has to be shared with the target’s shareholders in the form of a premium, let us say 50% is passed on, than the eventual upside potential is only 500. So, the likely result is 0.25 * 500 – 0.75 * 500. Hence, the upside potential has to be more than six times the downturn potential to justify the risk of M&As. Even when the likelihood of success and failure could be influenced by experience – change it to 0.5 and 0.5 – the upside potential still has to be four times higher. This figure does not include any M&A attempts that are not realized and where money is spent on search and due diligence without an actual closing of the deal. Therefore, the overestimation of the upside potential is one of the most dangerous parts in the M&As.

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