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Mergers and Acquisitions: Why do Big Mergers fail to Achieve their Purpose?

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It's referred to as the winner's curse. When two companies merge, the majority of the value for shareholders created is likely to go to the seller instead of the buyer. Matter of fact, on average, the buyer pays the seller the entire value created by a merger, in the form of a premium varying from 10% to 35% of the target company's preannouncement market value. The fact is well known, but the reasons for it are rather less. Our analysis of post - M&A convergence has shown the main source of the winner's curse: the typical acquiring firm substantively overestimates the synergies that a merger will produce. These synergies can result from economies of scale and scope, best practices, the sharing of capabilities and opportunities, and, in many cases, the combination's stimulating effect on the individual companies. However, even a minor error in estimating these values can cause an acquisition effort to falter.

Keywords: *merger & acquisition, post-merger failure, synergy, due diligence, cultural differences.*

INTRODUCTION

M&A happen for several reasons but they also fail for several reasons. Earlier, a lot of research was done by companies before the mergers on the benefits of the M&A but little to no research on the factors of failures. This is because there is no general model to understand the aspects of failures. Mergers and Acquisitions play a significant role in today's industrial sector. These terms may be used interchangeably but hold different legal meanings. Earlier mergers happened on friendly terms with a negotiated deal. But, with changing times the competition has become so severe that to become more prominent, companies are ready to wipe off the name of their competitors from the market. There are strategic mergers and acquisitions in which companies want to gain more foothold in the market as compared to their competitors and then there are the ones who acquire the company to be a market leader or to enter into a new market.

Every M&A process is initiated with a strategic perspective with its main objective to create value for the shareholders. "According to research, it is shown that almost 70-90% of all mergers fail after integration and 10% of all mergers and acquisitions are cancelled before the integration process due to a variety of reasons."[1] The major reason why any merger or acquisition fails is that often the companies make the mistake to overestimate the result post-integration, there is also some mismatch in expectations around the synergies of the companies and the value they create together. This is done at the cost of the shareholder's equity.

WHAT ARE MERGERS AND ACQUISITIONS?

Mergers and acquisitions play a significant role in the industrial sector of any economy.

"Some people run the race on their own without purpose. Running by an individual takes time. Collaborations and strategic alliances make the race-winning

- Peter Drucker."[2]

In recent times mergers and acquisitions are a well-established practice which is why more and more businesses are turning to mergers and acquisitions (M&A) as a strategic growth tool to help them grow at an accelerated pace, not only stay competitive but also increase their profitability, market share, and domination in the market.

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[1] Kenny G, 'Don't make this common M&A mistake' (*Harvard Business Review*, 17 March 2020) <https://hbr.org/2020/03/dont-make-this-common-ma-mistake> accessed 01 November 2022

[2] A Amaladas, 'Mergers And Acquisitions: A Review Of Episode, Failure And Success New Mantra' (2013) 9(19) European Scientific Journal

MERGER

A merger is described as the combining of two or more companies into a single company in which one entity survives and the other ceases to exist. Both the assets and the liabilities of the amalgamated company or companies are acquired by the survivor. Simply put, it involves combining two or more enterprises into one. In Indian law, the word "merger" is referred to as "amalgamation." Typically, it entails the merger of two comparable-sized and same-status businesses. Companies can merge under a variety of concepts, including horizontal mergers, vertical mergers, conglomerate mergers, and reverse mergers. Mergers are also referred to as inorganic growth, companies undergo corporate reconstruction to expand their businesses and boost revenue also increasing the value for the shareholder.[3]

ACQUISITION

In a broad sense, acquisition refers to acquiring the ownership of an asset. It is the acquisition of controlling interest in the share capital of another existing company by a single corporation. The Companies remain independent and separate; there is only a change in control of the companies. Even after the takeover, there is a change in the management of both businesses, but the companies keep their own legal identities. These are also referred to as inorganic growth processes. Mergers and Acquisitions are instruments of corporate recon structuring that provide growth and expansion in a short period. If nothing Mergers and Acquisitions are at least learning experiences. Each time a merger fails it provides the participants as well as the observers with some takeaways.

POST-MERGER ACQUISITION

PMI (post-merger integration) is also referred to as M&A (merger and acquisition) integration. Several companies are brought together in this process. The goal here is to maximise the available synergies. This is done to ensure that the deal meets its original value billing. To say the least, integration planning remains a daunting prospect. When you combine several entities

[3] *Ibid*

into one, you have to deal with a lot of organisational systems. This includes the assets, resources, people, and tasks of all the companies associated with the process. Then there are the technology and support systems to consider regarding. The period preceding an acquisition or merger encompasses complexities that are difficult to anticipate when the merger is planned.

There is an aphorism that makes a rather meaningful comparison. It is said that it is an enormous conundrum in the process of mergers and acquisitions. Both arms know how to work, but the problem is that they have never worked together before. To say that these procedures have more moving parts than one could count is an understatement. Entities should also keep in mind that matters can become significantly complicated. This is because a merger or acquisition demands companies - and their stakeholders - must come together and work without any difficulties all of a sudden.

FACTOR RESPONSIBLE FOR THE POST-MERGER INTEGRATION

More often than not mergers and acquisitions fail or underperform. While the transactions go through but it is a rare sight to see them reach their full potential. PMI Post Merger Integration also known as Post Acquisition Integration is the transition phase the companies have to go through once the process is executed. Combining two companies each with its own culture, process, and management systems in place is a difficult task on its own.

"According to research by BGC (Boston Consulting Firm), there are four fundamentals that should be achieved to attain a successful merger namely,

- To maintain momentum in the ongoing businesses.
- Maximize and accelerate synergies.
- Build the organization and align the cultures to derive the company forward.
- Use the combined capabilities to advance companies competitive position".

WHY DO BIG MERGERS FAIL?

"All companies considering acquisitions for faster growth should be aware that the majority of empirical studies have revealed that more than 80-90% of acquisitions are a complete failure[4]". But besides this, companies have been putting their businesses at risk in the hope of being part of successful acquisitions. It is perplexing that the disappointing data from most researchers somehow doesn't dissuade several corporations. The fear of a merger or acquisition failing has not dampened mergers and acquisitions around the world. Mergers and acquisitions are fraught with risk, and without a proper strategy, as well as the use of intuition and knowledge, they can be disastrous.

"Understanding why the majority of mergers and acquisitions fail can thus help those contemplating M&A avoid some of the pitfalls. These pitfalls can be learned by studying failed M&A transactions from all over the world, including India"[5]. Some famous examples of M&A failures in the world entail AOL-Time Warner, HP-Compaq, Quaker-Snapple, and eBay Skype, and an in-depth study of their reasons can certainly help the potential acquirer be on his guard. Mergers have failed for a plethora of reasons, including poor planning, inadequate research, and regulatory issues.

REASONS WHY MOST BIG MERGERS FAIL

As per several types of research, "it has been found that 80 to 90% of mergers fail due for some reason or another"[6]. Here are some of the common reasons why mergers fail to achieve their potential and turn out to be a losing hand instead.

Owner's Involvement - Generally big companies hire advisors exercising in Mergers and Acquisitions to look after their smooth progression. Although it facilitates the process owners often make the mistake of not getting involved in the process. The owner's involvement proves

[4] *Ibid*
[5] Kumar V & Sharma P, 'An insight into mergers and acquisitions: A growth perspective' [2019] Springer Singapore 183
[6] *Ibid*

very crucial for the success of any synergy. The owner's absence throughout the integration process is one of the most common reasons for the failure of any merger or acquisition.

Exaggerated Valuation and Overpayment - The personnel who favour M&A will often proclaim that it will help in reducing the costs and amplify profits to justify the premium that is to be paid for the acquisition. These proclamations will look good on paper but in reality, it is rare to see them bear any fruit. More often than not it tends to become dead weight instead.

Cultural Differences – The culture of a Corporate is basically how they treat their employees, customers, suppliers, and their other business partners. Some have a more liberal approach and some have strict rules and policies in place. This difference in cultures of the companies getting merged poses to be the basis for the dismantling of the M&A.

High-Cost Debt - To execute any merger a large sum of capital is required. It is the acquirer company that arranges the capital for the fulfillment of the premium that is to be paid to the company being acquired. To do so it becomes necessary for the acquiring company to immerse in large sums of debt putting them in a position of vulnerability. The risk taken by the acquirer company is dependent on the success or failure of the M&A.

Malafide Intentions - Executing an M&A while the stock prices are high will be very tempting to the acquirer company but this may also become a step forward to utter failure. Hasty decisions taken by executives in their ego boost can sometimes become the grounds for the collapse of an entity.

Shareholders and Employees' Interest Overlooked - Employees and Shareholders of a corporation are the pillars it stands on. During any take over it is inevitable that their focus is shifted to the conflicts that will arise and will affect their interest. This will lead to ambiguity in the mind of shareholders and a disruption in the lives of the employees restricting them to work at their full potential. Management must assure both the employees and the shareholders that the decisions being taken will be beneficial for them as well to avoid such aversions.

Lack of Common Vision - The greatest mistake an acquirer company can make is not taking into account the management that will go into the blending of the two entities after the convergence. PMI or PAI process requires a clear understanding of the targets that are to be achieved in the future and the plethora of problems that are associated with it. If not resolved swiftly it becomes another ground for the failure of the integration.

Poor Communication - To convince the customer base as to why the merger was done, how it will leave the company in a better position, and the improvements that will be seen in the services post the merger. The management of the acquirer and the acquiree company both have to work together to make the synergy between them a successful one. To work together despite coming from different work cultures it is pivotal for them to have good communication.

Weak Leadership - Only a great captain can steer his ship through the storms. An integration between two companies is nothing less than a storm, if steered through carefully will lead you to the treasure. The senior management is the face of any company their actions hold great credibility. The success of an M&A deeply depends on the interest the management takes in the process and the effort they put into reaching the goal.

Due Diligence - The key to success is in the finer details. M&A's are huge dealings, to think of the time and effort of so many people that are put into these transactions. One would expect the deal to be nothing less than perfection which results from good research and analysis but the primary reason for an M&A to fail is a gap in analysis. No matter how hard you try something or some consequence goes unchecked. Due diligence is of the essence in these transactions.

Irrational Exuberance: It's always about the money - The excitement that an M&A project is one of the leading causes of over-estimation and over-valuation which leads to unreasonable expectations for the growth prospects to a futile point.

Poor Integration Management - Poorly managed integration which is a result of unclear goals, ambitions, and a weak framework is a prominent basis for the failure of a big M&A. The result of a good merger can be measured through its management of assets, human capital, and the new entity working like a well-oiled machinery achieving all its goals and aligning with the interests of the stakeholder.

FAMOUS MERGER & REASON FOR FAILURE

1. The merger between AOL and Time Warner

"The merger between two media giants, America Online and Time Warner, seemed too good to be true. Both companies were the dominant players in the interactive service and entertainment business, respectively, so merging the two businesses seemed like an expected step of growth". This deal, which was valued at $166 billion, was supposed to be a synergy-filled marriage of content (Time Warner) and distribution (AOL). "The mega-merger of two giant media companies closed by giving AOL 55% ownership and Time Warner 45% of the company"[7].

Reason for Failure: However, this corporate disaster in the early twenty-first century was caused by inadequate due diligence in workplace culture, a lack of understanding of the media landscape, and an inability to see the future of the internet.

2. The merger between Pfizer and Allergan

"In 2015, the world witnessed the biggest pharmaceutical deal valued at $152 billion in 15 years between two leading pharma companies, US-based Pfizer and Irish pharmaceutical company Allergan". This deal would have provided Pfizer with the opportunity to relocate its headquarters to Ireland to reduce its tax bill. The purpose of this merger for Pfizer was to avoid huge corporate taxes in the US. So, they were looking for alternative structures that would allow the strategy of shifting their tax jurisdiction to a more favourable jurisdiction: one such favourable location for them was Ireland. This type of M&A transaction, which results in a change in tax jurisdiction, has been called "Corporate Inversion"[8].

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[7] *Ibid*

[8] Banerjee S, 'Why was the M&A deal between Pfizer and Allergan cancelled because of changes in the regulatory environments' (*iPleaders*, 29 June 2021) <https://blog.ipleaders.in/why-was-the-ma-deal-between-pfizer-and-allergan-cancelled-because-of-changes-in-regulatory-

Reason for Failure: However, Obama's government changed the tax laws to prevent "corporate inversions," which were attempts by American businesses to cut their tax obligations by moving profits abroad. These modifications eliminated the financial benefits Pfizer anticipated obtaining from purchasing Allergan, ultimately leading to the deal's termination.[9]

3. The merger between Microsoft and Nokia

When it came to the platform wars, Microsoft was late in the world of smartphones and swiftly lagged behind Apple and Android. Although a new Windows Phone with a new platform was released in November 2010. Steve Ballmer, the CEO of Microsoft, saw a chance in Nokia in 2013, a Finnish phone manufacturer that was losing market share to rivals. "The acquisition of Nokia by Microsoft was completed in 2014 for an estimated $7 billion".

Reason for Failure: However, The Nokia staff were unable to adapt to Microsoft's corporate culture following the merger. Because an American corporation and a Finnish company have different cultures, the merger presents additional integration issues. For ex.:

- "Individualism *v* Collectivism (Since both cultures are individualistic, a merger proved to become more difficult as each employee chooses to advance his interest instead of the company)
- Masculinity *v* Femininity (Americans are driven by competition and achievements while the Finns are driven by well-being, free time, and flexibility as a measure of success)
- Strong Uncertainty Avoidance *v* Weak Uncertainty Avoidance (Americans are more risk-takers than the Finnish)
- Leadership Turnover (the M & A happened during the end of the tenure of the previous MS CEO Steven Ballmer, thus, the newly formed Microsoft Mobile would operate with different management as soon as it started operations)
- Employee Turnover (Microsoft did not wait for the employees of Nokia to fully adjust to the company climate of the corporation)

environments/#:~:text=As%20Pfizer%20shareholders%20would%20control,agreement%20no%20longer%20made%20sense> accessed 01 November 2022

[9] *Ibid*

- Microsoft was unable to give a proper valuation of the assets it acquired from the merger. It overvalued the expected benefits it will get from the M & A of Nokia".

4. Merger between eBay and Skype

In 2005, eBay Inc. a global e-commerce site acquired Skype a European voice-over-internet protocol provider for $2.6 billion. "The purchase price was extremely high considering that Skype had only $7 million in revenues. Meg Whitman, eBay's CEO, justified the acquisition by arguing that Skype would improve the auction site by giving its users a better platform for communicating[10]". "With Skype, eBay gets a way to enter the voice communications business, integrate Skype with its auctions and payment systems, and deliver sales growth. Skype gets the resources to compete with rivals ranging from Google, Microsoft, and Yahoo to Verizon, Vonage, and SBC." The technology from Skype was ultimately rejected by eBay users as they didn't need this feature; emails still worked perfectly. Four years later, the majority of Skype was sold for a loss because this acquisition was deemed a failure. "It was calculated 17% of deals had added value to the combined company, and 30% produced no discernible difference. In other words, 83% of mergers/ acquisitions were unsuccessful in producing any business benefit as regards shareholder value."

Reason for Failure: Four factors can be identified to explain why the transaction did not go as expected and turned out to be one of the worst in the history of mergers and acquisitions. These four are listed below:

- The absence of synergy between the companies
- The attempt to draw customers' attention
- The difference in workplace culture and management style
- Overpricing of stocks, shares, and other assets

[10] Pines L, '4 cases when M&A strategy failed for the acquirer (EBAY, BAC)' (*Investopedia*, 13 July 2022) <https://www.investopedia.com/articles/insights/061816/4-cases-when-ma-strategy-failed-acquirer-ebay-bac.asp> accessed 01 November 2022

5. The acquisition between Tata Steel and Corus

"Tata Steel (part of the Tata Group based in India) acquired the Anglo-Dutch steel firm Corus after a four-month bidding war with Brazil's CSN (Companhia Siderurgica Nacional SA) for US$12.9 billion. The largest acquisition made by an Indian organization was this one. With a capacity to produce 25 million tonnes of steel annually, Tata's acquisition of Corus elevated it to the fifth-largest producer of steel worldwide". Tata Steel wanted to gain access to European markets as well as potentially generate synergies in manufacturing, purchasing, R&D, shipping, and back-office operations. But after the recession hit on Europe. The Tata strategy caused this heavy acquisition falls apart, and after that Tata Steel Europe could not manage to stable itself in the Europe market. "Till 2014-15 TSE witnessed a sharper 53% decline in operating profit"[11]. "They had to reduce the firm's steel capacity from 18 million tonnes per annum to 10 mtpa."

Reason for Failure: However, things did not turn out as planned, and a severe recession hit the European market. The deal was a mistake for several internal and external factors. Now, let's analyse a few of them:

- **Bad Economy:** The operations of Tata Steel in Europe had remained unchanged since the takeover. Steel manufacture in the UK plummeted in July 2011, following which it was stagnant for seven months. Additionally, demand for automobiles, capital goods, consumer durables, and other regionally dependent businesses declined. The company's fiscal performance reflected all of these.
- **The Shadow of the Chinese Market:** Cheaper Chinese steel overflowed the European market, distorting market dynamics and placing pressure on UK steel producers. "China now provides 48% of the world's steel consumption thanks to the huge growth of its steel sector. The European Union made only 12% of the total."[12]

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[11] *Ibid*

[12] Pandathil R & Kadam K, 'Tata Steel's failure with Corus and Tata Motors' success with JLR: A tale of 2 buyouts in 9 charts-business news' (*Firstpost*, 1 April 2016) <https://www.firstpost.com/business/a-tale-of-2-acquisitions-in-9-charts-tata-steels-failure-with-corus-and-tata-motors-success-with-jlr-2704788.html> accessed 01 November 2022

- **High Energy Cost:** Compared to other nearby nations, the UK's high energy costs have hurt energy-intensive industries like steel mills. Compared to a low of 6.7 pence per hour per kilowatt-hour in 2010, these businesses had to pay roughly 9.55 ppm in 2015. Since 2010, energy costs for heavy manufacturing sectors have significantly grown due to UK environmental legislation and the green tax.
- **Paying Too Much for the Acquisition:** "Tata acquired Corus for 608 pence per share in cash, which was 34% more than the company's initial 455 pence offer"[13]. The settlement was $12 billion, of which $6 billion was owed. Simply said, the transaction was far too profitable at the time, and Tata's management complied with the spirit of competition and paid more than they'd preferred, which is why the acquisition was overvalued.
- **Failing to Create Expected Value:** The created value in this deal was lower than the value that was anticipated. Within two years, Corus Steel's profitability began to fall. "The share price started to decline to 20% after a month since its introduction"[14]. This suggested that the shareholders thought the acquisition would decrease rather than increase the company's values.

6. The acquisition between Quacker Oats and Snapple

An American Conglomerate company Quacker Oats used to be a grocery store legend, which was established in 1901 with a wide range of breakfast cereals and energy drinks. "In 1994 QO acquired Snapple for about $1.7 billion which deals in iced tea and fruit drinks/juices in the hope that it will acknowledge considerable synergies". They had previously had success acquiring the Gatorade firm, which gave them hope that Snapple would enter the market quickly and profitably as well. The initial plan for Snapple's launch was to increase the synergy (cooperative energy) between Snapple and Gatorade. After the acquisition they acknowledged gains from Snapple, Quaker Oats ultimately emerged as the third-leading beverage manufacturer and distributor in the US, but this position only lasted a brief time.

[13] *Ibid*

[14] *Ibid 19*

"They quickly had a $75 million loss in 1995 as a result of a 5% reduction in revenue. After just 27 months they sold Snapple to Triarc for $300 million"[15].

Reason for Failure: Before and during the acquisition of Snapple, Quicker Oats committed several blunders. That is:

Overpaying: Quicker Oats allegedly paid at least $1 billion more than Snapple was worth which cause them a heavy loss in revenue.

Lack of Management Plan: Additionally, Quaker Oats did not adequately prepare for an upcoming competition. Soon after Quaker and Snapple merged, two of Snapple's main rivals, Pepsi and Coca-Cola, ramped up their rivalry with Snapple by launching new products of their own. Sales further declined as a result of this.

Poor Integration Process: Using the links it had already created with grocery retailers, Quaker Oats attempted to alter the Snapple sales strategy to move more Snapple products. Quaker Oats' decision, however, proved to be a costly strategic blunder because a sizeable amount of Snapple sales originated from convenience stores and fuel stations.

7. The merger between Amazon and Whole Foods

"In 2017, Amazon acquired Whole Foods for $13.7 billion". The acquisition of Whole Foods by Amazon seems to be a like Wall Street dream coming to life. But when Whole Foods' customer-driven ethos met Amazon's data-driven efficiency, the shelves started to empty.[16] Instead of operating like other grocery chains, Amazon-Go is set up such that customers use an app, also known as Amazon Go, to instantly add the items they intend to purchase to a virtual shopping cart. This allows them to leave the store without having to wait in a checkout queue. "Deal will provide over 460 grocery stores to Amazon with an average of eight million customer visit

[15] O'Brien B, 'big lessons from famous global business mergers' (*Trade Ready*, 9 May 2016) <https://www.tradeready.ca/2016/trade-takeaways/3-big-lessons-famous-global-business-mergers/#:~:text=However%2C%20a%20significant%20portion%20of,sales%20decreased%20as%20a%20result> accessed 01 November 2022

[16] *Ibid*

weekly which will be a potential user of Amazon Fresh and of Amazon prime which is generating around $ 6.4 billion revenue from prime membership subscription only."

A year later this deal become falls apart as at Whole Foods, it seems difficult to find such positivity. Over Amazon's adjustments, reports of employees grieving openly at work have started to circulate. Worker punishment and sometimes termination is done using scorecards that track compliance with a new inventory system. Subsequently, a few Whole Foods staff members started exploring labour unions. Even customers, whom Amazon considers to be its most important stakeholders, have expressed frustration with understocked locations.

Reason for Failure: Relationship issues between Whole Foods and Amazon were quite foreseeable. The two businesses may have realised the potential in leveraging one another's advantages, but they did not first consider whether their cultures were compatible. Due to their cultural differences, this deal became troublesome for their employees and customers.

"They now stand on a fault line where tensions often erupt in mergers. This fault line is what we call tightness versus looseness"[17]. In contrast to Whole Foods' more conventional and quaint beliefs, Amazon's culture is heavily centred on efficiency and achieving little advantages through technology.

CONCLUSION

There are numerous reasons for a merged entity to fail, but only a few for it to succeed. Failures, on the other hand, are not stepping stones to success in mergers and acquisitions. If new software fails by even 0.1%, the software fails. Similarly, if a merger fails by 1%, it is considered a complete failure. Not all mergers and acquisitions end on a high note. Corporate history is filled with instances and illustrations of how some big-ticket mergers and acquisitions failed miserably. By a Harvard Business Review article, the failure rate of M&As is around 70-80%. Even the most reasonable estimates place M&A failures at around 50%. Specifically, nearly half

[17] Gelfand M et al., 'One reason mergers fail: The two cultures aren't compatible' (*Harvard Business Review*, 17 October 2021) <https://hbr.org/2018/10/one-reason-mergers-fail-the-two-cultures-arent-compatible?registration=success> accessed 01 November 2022

of corporate takeovers, buyouts, acquisitions, and mergers fail to live up to the promise and deliver the value that was anticipated. According to a recent study, 75% of Indian companies that pursue outbound deals fail to gain value during the first years following completion, and 59% of M&A transactions destroy value.[18]

Assume that a company did everything correctly, including the homework, cultural mapping, valuation, and even integration. But that doesn't mean it's time to unwind and relax. One must actively monitor progress and realign their strategies. It is critical to understand that mergers do not work on their own and must be worked on. When Kingfisher Airlines acquired low-cost carrier Air Deccan a few years ago, it was assumed that the two would make a positive return on investment. Even after the merger, when Air Deccan was rebranded as Kingfisher Red, the parent airline continued to lose traffic, and the merger eventually failed. To summarise, an M&A is similar to marriage in that both partners must work hard to ensure that the relationship remains stable. After all, divorce is not always the best option.

[18] *Ibid*