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Looking into the 'black box'- unlocking the effect of integration on acquisition performance

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ABSTRACT

Extending research on the performance of Mergers and Acquisitions (M&As), this paper seeks to explain how the post-acquisition integration phase affects acquisition performance. Despite extensive research efforts, there remains a scant understanding of how acquisition implementation, particularly in the post-acquisition integration phase, impacts the performance of M&As. Based on an extensive study of eight acquisitions, in this paper, a grounded model detailing the mechanisms by which the post-acquisition integration phase affects acquisition performance is developed. The model posits that integration-related factors do not bear directly upon acquisition performance. Instead, their effect is mediated by functional organizations in both firms. When focusing into these functional mediating dynamics, we observe that integration-related processual, behavioral and cultural factors affect the identified functional mediators in different ways. Going forward, we echo calls for integrated perspectives to the study of M&A and M&A performance in particular.

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1. Introduction

Mergers and acquisitions (M&A) are a favored means of corporate growth and renewal in an increasingly competitive global arena (Faulkner, Teerikangas, & Joseph, 2012). Despite their managerial appeal, research observes that securing success in M&A transactions is a complex undertaking (Gomes, Angwin, Weber, & Tarba, 2013; Hitt et al., 2012; Larsson & Finkelstein, 1999). Studies on the performance of M&As consistently show that, contrary to expectations, M&As do not necessarily improve the financial performance of the buying firm (King, Dalton, Daily, & Covin, 2004; Papadakis & Thanos, 2010; Schoenberg, 2006; Zollo & Meier, 2008).

The downside of the majority of these studies is that they measure the financial performance of M&As mostly in a short timeframe ranging from a few days to a one-to-three year period around the M&A (see Meglio & Risberg, 2011; Thanos & Papadakis, 2012a for comprehensive reviews) where the integration process is still ongoing (Ranft & Lord, 2002). In contrast, the handful of studies taking a longer perspective (e.g., Laamanen & Keil, 2008; Quah & Young, 2005) suggest that the performance impact of M&As on buying firms would tend to be negative in the first post-deal years, moving at best toward the positive in the longer-term (Quah & Young, 2005). In other words, M&As would seem to be so complex to integrate operationally, organizationally and socio-culturally that it takes buying firms on average five to ten years, until they are possibly able to report positive performance figures. These findings point to the *inherent managerial complexity* in making M&As succeed.

Despite a wealth of interest in the study of acquisition performance (Zollo & Meier, 2008), the critical question of "how does the management of the post-acquisition integration process impact the performance of mergers and acquisitions" remains largely unanswered (Ahammad & Glaister, 2011; Gomes et al., 2013; Haleblian, Devers, McNamara, Carpenter, & Davison, 2009; King et al., 2004). In other words, there is scant understanding of the processual and managerial antecedents behind M&A performance (Ellis, Reus, & Lamont, 2009; Gomes, Weber, Brown, & Tarba, 2011; Zhang et al., 2015). In light of the fact that the post-acquisition integration phase is repeatedly mentioned as a key factor explaining M&A failures (Angwin & Urs, 2014; Duncan & Mtar, 2006; Heimeriks, Schijven, & Gates, 2012; Larsson & Finkelstein, 1999; Weber, Tarba, & Reichel, 2011), this can be considered a serious research gap (Angwin & Meadows, 2015). Haleblian et al. (2009) comprehensive review of 300 published papers in top-tier journals echoes

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this point: "We encourage research that explores the processes that foster effective integration" (p. 409). Other prominent M&A scholars have raised concerns as to the lack of appreciation of the factors impacting the performance and outcomes of M&A (Hoskisson & Hitt, 1993; Hitt, Harrison, Ireland, & Best, 1998; King et al., 2004). In their extensive meta-analytical study of research on M&A performance, King et al. (2004) identified no significant M&A performance antecedents, concluding that "additional, unknown variables may impact M&A performance", and subsequently calling for more theory-building research on M&As, using novel methods.

In this paper, an effort is made to address this theoretically and practically important gap. The research question guiding our work is: "How does the post-deal integration phase affect acquisition performance?" Our research approach deviates from the bulk of prior research on M&A performance, predominantly based on quantitative archival US data (Andonova, Rodriguez, & Sanchez, 2013) or surveys using perceptual top manager data (Meglio & Risberg, 2010). Our research approach aligns with the recommendations to explore the qualitative dynamics in M&A (Cartwright, Teerikangas, Rouzies, & Evered-Wilson, 2012; Meglio & Risberg, 2010) and M&A performance in particular (Meglio & Risberg, 2011) in order to "get inside the M&A phenomenon" (Haleblian et al., 2009, p. 492). In this paper, we report the findings of a large-scale interview-based study using grounded theory methods. Inductive approaches are particularly suited to the study of complex social processes unfolding over time (Eisenhardt, 1989; Glaser & Strauss, 1967), and thus can be considered adequate to appreciating the performance dynamics inherent in post-acquisition integration. Our focus was on acquisitions pursued using a growth-oriented business strategy and integrated adopting a symbiotic strategy (Haspeslagh & Jemison, 1991).

Based on the study of eight acquisitions made by four Finnish multinationals and 166 one-to-one interviews with top and middle managers from both buying and target firms, in this paper, a grounded model of the mechanisms through which the post-acquisition integration phase comes to affect acquisition performance is developed. This is the main theoretical contribution of the paper. In so doing, the paper provides an important step toward opening the 'black box' of post-acquisition integration and its impact on acquisition performance. Importantly, we find that integration-related processual, behavioral and cultural factors do not bear directly upon acquisition performance. Instead, their effect is mediated by functional organizations, i.e. the sales, research, manufacturing, IT, finance and HR functions. This leads us to argue that positing an unequivocal causal link from one element in the post-acquisition phase to a particular acquisition performance metric needs to be treated with caution. Instead, echoing recent calls (Angwin & Vaara, 2005; Bauer & Matzler, 2014; Gomes et al., 2013), we call for integrated perspectives to M&A performance.

2. Literature review

2.1. The study of M&A performance

One of the most popular in the M&A literature concerns the success, i.e. performance, of M&As. Numerous papers have been published on this topic (Haleblian et al., 2009; Meglio & Risberg, 2011). Thanos and Papadakis (2012a) reviewed 13 US and European management journals 1980–2010, identifying 137 papers using M&A performance as their dependent variable. In another review covering the period 1970–2006 only in the top management and finance journals, Zollo and Meier (2008) identified 88 papers on M&A performance. Both reviews and several papers (e.g., Meglio & Risberg, 2011; Schoenberg, 2006; Very, 2011) argue that prior studies have adopted and emphasised the following approaches in measuring M&A performance.

Most of the studies have used short-term measures of M&A performance (i.e. 34% of the studies reviewed by Thanos and Papadakis, and 40% of the reviewed studies by Zollo and Meier). The method is based on the "event study methodology" which has its origins in the financial economics literature. With this method researchers assess M&A performance for a few days around deal announcement (Aybar & Ficici, 2009; Gubbi, Aulakh, Ray, Sarkar, & Chittoor, 2010; Markides & Oyon, 1998; McNamara, Haleblain, & Dykes, 2008). Although this is the most popular method in the literature, it has been subject to intense critique by prior scholars because it does not measure actual performance but investors' expectations concerning the outcomes of the deal (e.g., Zollo & Meier, 2008). The results of the studies using short-term financial measures of performance indicate that on average most the acquiring firms have negative returns (e.g., Papadakis & Thanos, 2010; Schoenberg, 2006).

The second largest group of studies has used accounting-based measures to assess the performance of M&As (i.e. 20% of the studies reviewed by Thanos and Papadakis, and 28% in Zollo and Meier's review). Prior studies using financial ratios including Return on Assets, Return on Investment, growth in sales and profits, etc., evaluate the financial condition of the acquiring or the target firm a few years after the deal and compare it with their financial condition a few years before the deal. Prior studies have used several different time periods. The majority of these studies assumes that two or three years suffice for the integration stage to be completed. Accordingly, it is considered that this is a proper time scale for measuring performance (Meglio & Risberg, 2011; Thanos & Papadakis, 2012b). Studies using accounting based-measures of performance have concluded that on average M&As do not improve the financial performance of the acquiring or the target firm (Tuch & O'Sullivan, 2007).

A third group of studies has used the event study methodology and has evaluated the long term financial performance of the acquiring firm for a few months after the deal (i.e. 13% of the studies reviewed by Thanos and Papadakis, and 19% in Zollo and Meier's review). Empirical studies indicate that on average 50% of the acquisitions fail to improve the long term financial performance of acquiring firms (Tuch & O'Sullivan, 2007). A fourth group of studies have relied on perceptions of key respondents such as managers, analysts, investment bankers, journalists, etc. to evaluate the performance of M&As against their initial objectives (i.e. 17.5% of the studies reviewed by Thanos and Papadakis, and 14% in Zollo and Meier's review). This method is gaining in popularity mainly because it can be used for both private and public firms. Also, it enables the evaluation of both financial and non-financial performance of M&As (Thanos & Papadakis, 2012a). Yet, the major limitation of this method for assessing M&A performance is that it is based on perceptions, instead of objective data. Results of studies employing the views of key respondents have reported failure rates for M&As in the range of 45–60% (see e.g., Papadakis & Thanos, 2010; Schoenberg, 2006).

The above four approaches capture the overwhelming majority of studies on M&A performance. Other less frequently used measures of M&A performance include divestiture rate (e.g., Porter, 1987), knowledge transfer (e.g., Ahammad, Tarba, Liu, & Glaister, 2016), innovation outcomes (e.g., Puranam, Singh, & Zollo, 2006), etc. Overall, these measures of M&A performance represent the minority of the studies and indicate high failure rates for the acquiring firms (see Thanos & Papadakis, 2012a; Zollo & Meier, 2008).

The conclusion drawn from the above reviewed literature is that on average M&As tend to fail to achieve their initial objectives. This conclusion is based though on studies which have evaluated the

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