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Selection, valuation and performance assessment: Are these truly inter-linked within the M&A transactions?

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ABSTRACT

Merger and Acquisitions have been on the rise since the last three decades and as such have attracted considerable attention from the research community. Conclusions drawn by the existing studies indicate that such transactions do not result in a better performance, they erode acquiring firm's shareholders value, and also produce highly volatile market returns. A number of studies have analysed reasons for such inefficiencies and pointed out to several factors behind them. However, to the best of our knowledge, very little attention has been given to the business evaluation process as an influencing factor. Therefore, by providing a holistic view, the aim of this work is to investigate how the components involved in the business evaluation process influence the outcome of Merger and Acquisitions. Overall, the findings reveal that strictly controlled and inter-linked components relating to the business evaluation process have a significant impact on the outcome of the cross-border transactions. Further, the results also point out that if the selection and assessment of target firms is improved, the Merger and Acquisition results will be better.

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1. Introduction

Merger and Acquisitions (M&As) are of a wide significance for local as well as international businesses when one needs to address number of issues pertaining to the economies of scale, restructuring and expansions with the objective of improving performance. In addition to business, these transactions ensure an economic stability of a country either through foreign investments or a re-distribution of financial corporate assets and shareholder wealth, re-shape corporate strategies, transform organisational cultures and affect the livelihoods of employees (Bauer & Matzler, 2014; Marks & Mirvis, 1998, 2001).

Since the late 19th century, the worldwide trends of cross-border transactions have been witnessed in a number of forms across different industries and regions (Faulkner, Teerikangas, & Joseph, 2012). This has resulted in a number of recorded M&A's waves, characterised by periods of more intensive deal activity, regardless of economic crises (Cartwright & Schoenberg, 2006; Ghauri & Buckley, 1999; Haleblian, McNamara, Kolev, & Dykes, 2012).

With the entry of the emerging market players into the M&A's game since the early 21st century (Kale, Harbir, & Anand, 2009), it seems unlikely that the cross-border activity will decrease. As the history of many MNCs (or FTSE 100 companies) would confirm, cross-border M&As have been the basis to the growth strategy of many firms and have influenced both competitive and industry dynamics globally across different sectors (Gilson & Black, 1986; Hill & Jones, 2011; Lubatkin, 1987; Lynch, 2006). In addition, their importance in the last decade has increased significantly (UNCTAD, 2012).

According to Hill and Jones (2011) a business evaluation is seen as a process that determines the merit, worth and value of business activities. As such it is transdisciplinary in nature. Further, it also combines two processes together that are compiling and analysing. Chelimsky (1994) describes three broad purposes for a business evaluation. First, an accountability function that judges the impact of a program as well as its efficiency and effectiveness. Second, a development function that deals with the operation of a program by providing suggestions for an improvement. Third, a knowledge function that contributes to the generation of knowledge about social (or economic) phenomena (Jackson, 2001).

Following the literature, there are four basic steps involved in acquiring a company. First, a strategy is designed for undertaking an acquisition. Second, a choice of a target firm for the acquisition

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is appointed. Third, a decision on how to raise funds and to pay for an acquisition is made. Finally, the completion of the acquisition work is undertaken by following the objectives defined for the transaction during the initial stage (Kaplan & Weisbach, 1992).

The evaluation process includes both *ex ante* and *ex post* components with the latter almost always looking explicitly at future applications of past experience (Jackson, 2001). Because of that element, one can expect useful information derived from the evaluation process for decisions relating to a policy and program development, monitoring and assessment (Chelimsky, 1994).

Based on the above, the term business evaluation process logically includes three elements. These are, for example, as follow, (a) defining standards for the suitability of the transaction to both the parties as per their defined objectives, (b) assessing the worth of the business, and (c) measuring the performance on the basis of defined standards. Such process covers not only tangible but also intangible factors (Aybar & Ficici, 2009; Chase, Burns, & Claypoo, 1997; Epstein, 2005; Homburg and Bucerius, 2006; Mard, Hitchner, & Hyden, 2007).

Using a case study approach, this work aims to investigate how different components of the business evaluation process (i.e. the selection of a firm, the valuation of a firm and the performance assessment) influence each other to affect the outcome of a merger transaction. More specifically, using an empirical evidence through an in-depth case study of four M&As, this work intends (a) to look at the factors which contribute to the selection of a firm for M&As, (b) to examine how the merged and acquired firm is valued by a business, and (c) to investigate how M&As' performance can be assessed by integrating *pre* and *post* merger factors. This is achieved by combining the resource-based view (Barney, 1991, 2001; Beamish & Kachra, 2004; Peng, 2001; Penrose, 1959; Wernerfelt, 1984) with that of the transaction cost economics (Kogut & Zander, 1992, 1993; Kogut, 1988a; Williamson, 1981, 1991, 2005, 2010) as both approaches can help to identify factors that could form a basis for a business evaluation in order to assess the outcome of M&A transactions (Hennart, 1988, 2010; Kogut, 1988b).

By doing so, this study hopes to enrich our current understanding with regards to the relationship between the business evaluation process and the M&A's performance. More specifically, it aspires to show how the evaluation process could be effectively undertaken to ensure the right firm is selected for the acquisition at the realistic price. This is very important because a well planned and executed evaluation process, from the beginning, will certainly lead to a valid and long-lasting outcome (Bertrand & Betschinger, 2012; Colman & Lunnan, 2011; Weber, Rachman-Moore, & Tarba, 2012) providing an important source of external growth and corporate development (Bauer & Matzler, 2014). In addition, this could also assist in shaping the performance of M&A transactions by taking adequate steps during the implementation of the evaluation process where different components are considered for M&A success (Barkema & Schijven, 2008; Bower, 2001). This is also important since it appears, that amongst many managers, there seem to be an implicit understanding that the success of M&As strongly relies only on post merger issues (Bauer & Matzler, 2014).

In line with the above, the work is structured as follows. In Section 2, we provide a theoretical underpinning of this study. In Section 3 we discuss the methodological aspects behind the choice of the in-depth case study approach and its analysis. In Section 4, we discuss the findings of this work linked to the research objectives. In the final section, we conclude by providing some implications for management and also by acknowledging possible limitations of this study.

2. Research background

Over the years, a number of management scholars have pin pointed the lack of knowledge and theoretical insights with regards to the explanation of M&As (Cartwright, Teerikangas, Rouzies, & Wilson-Evered., 2012; Ghoshal, 2005; Hennart, 2010; King, Dalton, Daily, & Covin, 2004; Meglio & Risberg, 2011; Stahl & Voigt, 2008; Suddaby, Hardy, & Huy, 2011). For example, Greenwood, Hinings, & Brown (1994) agree that M&A research is more focused on specific "themes" than theory development. Schweiger and Goulet (2001) argue for the need of a comprehensive theory on M&A. Trautwein (1990) points that research on M&A should move away from efficiency theories towards more process related theories. Schweiger and Goulet (2001) and Von Krogh, Sinatra, and Singh (1994) call for a deeper consideration of M&As by integration a more dynamic approach to the understanding of M&As.

In addition, the subject of M&As has also remained under increasing criticism with regards to the performance of M&A and its measurement (King et al., 2004; Meglio & Risberg, 2011; Very, 2011; Zollo & Meier, 2008) as well as the antecedents of M&A performance (Bauer & Matzler, 2014; Haleblian, Devers, McNamara, Carpenter, & Davison, 2009; Sarkar, Echambadi, Cavusgil, & Aulakh, 2001; Vaara, Junni, Sarala, Ehrnrooth, & Koveshnikov, 2013). Overall, the criticism seem to relate to the fact that the M&A study poses several difficulties because not only one but two (if not more) organisations are under consideration (Parkhe, 1993). Further, the success of M&As depends upon a number of factors ranging from finance to human resource management (Bauer & Matzler, 2014; Epstein, 2005; Homburg & Bucerius, 2006). These factors tend to cover various industry, country or even corporate context-related contingencies (Faulkner et al., 2012). All this points out to many challenges relating to the understanding of different underlying motives influencing all components of the business evaluation process.

Therefore, by combining the resource-based view (Barney, 1991, 2001; Beamish & Kachra, 2004; Peng, 2001; Penrose, 1959; Wernerfelt, 1984) with that of the transaction cost economics (Kogut & Zander, 1992, 1993; Kogut, 1988a; Williamson, 1975, 1981, 1991, 2005) this work aims to enrich our current understanding of such motives.

In our view, these two theoretical approaches are relevant in explaining the motivations affecting the elements of a merger transaction since one approach focuses on firms' resources, which allow them to exploit opportunities and sustain competitive advantage (Beamish & Kachra, 2004; Penrose, 1959; Wernerfelt, 1984), and the second approach is derived from the theory of transaction costs as developed by Williamson (1975, 1985, 2010). Together, the combination of these two approaches can certainly give us good insights into the factors that form an integral part of the understanding of the cross-border activity.

2.1. The selection of a target firm

Since the selection of a target firm forms the foundation of the M&A transaction (Datta, 2002; Branch & Yang, 2006) the motives behind such selection have been previously researched by a number of scholars. For example, Haspeslagh and Jemison (1991) and Irfan (2012) pointed out that a significant overpayment for the target firm as well as a long and costly integration process contribute to an inadequate selection of a firm. Others identified factors such as economic efficiency (Jensen, 1993), managerial self-interest (Marris, 1964; Mueller, 1969, 1989), corporate control (Jensen & Ruback, 1983; Manne, 1965), the structure of the board of directors (Erkens, Hung, & Matos, 2009), the extent of a pattern of shareholding (Bai, Li, Tao, & Wang, 2000; Liu, Shu, & Sinclair,

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