The motivation behind corporate acquisitions and mergers finance essay

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Research that considers the motivation for corporate acquisitions takes essentially two forms. There are studies that concentrate on providing a theoretical analysis based on economic and behavioral theories and those which subject the theories to empirical tests.

Friedrich Trautwein (1990) provides a critical review of the predominant theories of merger motives and merger prescriptions. the theories of merger can be categorized into seven groups : efficiency theory, monopoly theory, valuation theory, empire-building theory, process theory, raider theory and disturbance theory.

7 Motivations for M&A:

â€£ Monopoly Theory: Gaining market power.

â€£ Efficiency Theory: Operating synergies, financial synergies and

Management synergies.

â€£ Valuation Theory: Bidder managers have better information about the

target's financial performance than the stock market.

â€£ Empire Building Theory: Planned and executed by managers who

Maximize their own utility instead of their shareholders value.

â€£ Process Theory: Mangers have only limited information and base

Decisions on imperfect information.

â€£ Raider Theory: Managers creating wealth transfers from the stockholders

of the companies they bid for.

â€£ Disturbance Theory: Merger waves are caused by economic disturbances.

Why Are There So Many Mergers and Acquisitions?

The most important motivation engaging in an M&A is to assure the existence or the continuity of the firm's activity. If all the major competitors become bigger through the M&A transactions, then a firm may take on in an acquisition to ensure competitive parity. Profits left for a firm after investing

in all current positive net present value opportunities is the firm's free cash flow.

The free cash flow can amount to billions of dollars. For example, Microsoft is reported to have had a free cash flow of $45 billion in 2004! Dominant firms in mature businesses often find themselves in such situations. For firms with free cash flow the obvious decision should be to invest the money in M&A activity because such transactions may at least generate competitive parity.

Today many businesses recognize the uncompromising demand to seek merger and acquisition transaction, to seek growth and profits.

In the strategy literature acquisitions are explained by two main classes of theories: first is the " value-maximizing theories" and secondly is the " managerial theories" (Seth1990a).

Merger and acquisition literature suggests that managers do have various motives for mergers (Trautwein, 1990). Managers may have personal goals and ambition that differ from the strategy and the need of the firm.

At times the manager's – shareholder conflict arise during the mergers and acquisition transactions.

These motivations originate from the ambition to get rich and securing their position hence reducing the risk of the firm's bankruptcy.

Managers may be motivated to engage in M&As even when such operations do not benefit the entity because acquisition is the fastest and the easiest way to expand the scope of their control.

In the context of M&A activity, this means that managers may engage in an M&A even when there is zero economic value for bidding firms. The argument made by managers here is that they can perform better than the managers of the target firm.

Examining the phenomenon of mergers and acquisitions what is the driving force behind it?

Mergers and acquisitions is reaching record braking levels, The 1980s and 1990s were characterized by a rash of mergers and acquisitions (M&A) with both domestic and foreign partners.

The wave of mergers during recent years has drawn widespread attention because The fact that some firms create positive economic value in M&A activity spurred some firms to pursue such transactions.

In the 1990s we saw a number of mega-mergers between multinationals-for example, DaimlerChrysler and Exxon-Mobil- CitiCorp and Travelers Group, MCI and WorldCom, Hewlett-Packard and Compaq which changed the entire competitive environment of their respective global markets. These high-profile corporate mergers become an great example for any corporation considering a potential acquisition.

The 1990s also saw the rise of privatization of enterprise in many emerging markets, creating growth opportunities to gain access to previously closed markets of enormous potential.

Looking into the mergers and acquisition literature, merger motives do not play a significant role; M&A give out more merger consequences than theoretical effort (Trautwein, 1990).

In fact, taking into consideration the work of Allen et al (2002) that was based in Trautwein (1990) findings and assumptions, most observers agree that mergers are motivated by a complex pattern of motives and that no single motive or method can provide a full explanation (e. g. Steiner, 1975; Ravenscraft and Scherer, 1987).

Such motives include increasing profitability, the pursuit of market power, and marketing economies of scale, cost reductions and creation of barriers to entry.

What is the true motivation for cross-border mergers and acquisitions?

The eloquent answer is the traditional one: building shareholder value!

Corporations frequently seek growth in search of new markets, resources, productive advantages, profit, investment opportunities and elements of competition through the acquisition of other companies.

Corporations undertake mergers and acquisitions transaction for a variety of reasons.

The drivers are strategic responses by firms to defend and enhance their global Competitiveness by:

â-� Gaining access to strategic proprietary assets

â-� Gaining market power and dominance

â-� Achieving synergies in local/global operations and across different industries

â-� becoming larger, and then reaping the benefits of size in competition and negotiation

â-� Diversifying and spreading their risks wider

â-� Exploiting financial opportunities they may possess and others desire

We can summarize that the Motives behind mergers and acquisition activity by listing

Some motives:

– To create a number of new business opportunities (Healy et al. 1990, 23) and entry new

Markets (Black, Carnes and Jandik 2001, 5)

– To reduce earnings volatility (Healy et al. 1990, 23; Black, Carnes and Jandik 2001, 5)

– Technical Efficiency (Chaaban, Réquillart and Trévisiol 2005) and economies of scale

– “ employment risk” i. e., risk of losing job, professional Reputation, etc. Managersâ€Ÿ personal wealth is linked more to firm size and risk ofBankruptcy than to firm performance (Amihud and Lev 1981). The merger offers anopportunity to improve oneâ€Ÿs social identity as well (Terry, Callan and Sartori 1996)

– Value maximization (Halpern 1983, 314) is specially a shareholderâ€Ÿs goal (Bethel and

Liebeskind 1993, 29)

– Use of control position (Halpern 1983, 314)

– Synergy (Halpern 1983, 314; Chatterjee 1992)

– Monopoly (Halpern 1983, 314)

– Corporate restructuring is needed industry wide (Hatfield, Porter Liebeskind, Opler

1996; Markides 2006; Chatterjee 1992)

– cost reduction (Dranove and Shanley 1994)

-managerial vs. shareholder interests (Taffler, Holl 2006; Holl and Kyriazis 1997; Mahoney and Mahoney 1991; Mahoney and Mahoney 2006; Firth 1991). Motives for takeovers tend to reflect managerial rather than shareholder interests in abandoned

mergers (Taffler and Holl 1991). Amit, Livnat and Zarowin (1989) have investigated owner-manager conflict of interest.

– Reputation enhancement (Dranove and Shanley 1994): local systems do not appear to have lower cost but do appear to enjoy reputation benefits

– Innovation performance (Ahuja and Katila 2001)

– Resource redeployment (Capron, Dussauge and Mitchell 1998)

– Power, achievement, sensation seeking and prestige (Lausberg and Stahl 2006)