Waves leading to the evolution of mergers and acquisitions along time

Business, Management

Mergers and Acquisitions have been and still are one of the trendiest topics around the world's economy. In the beginning of the year, the magazine Forbes classified it as one of the powerful ways to make money in 2018, aside with rates and taxes, cryptocurrencies and robo-advisors. For this, it is always a topic that asks for more and deeper research.

The economy and the industries itself have been changing and growing due to a fierce competition between corporations. Firms have always the intent of increasing its profits and a faster to solution to growing the company itself with inside projects is by merging or acquiring other firms. The latest option, Mergers and Acquisitions, is, therefore a virtuous instrument to grow externally. Not only allow firms to grow by eliminating competition, but it also allows firms to grow under the " 1+1= 3". More specifically, one of the most important benefits of Mergers and Acquisitions are the synergies that the two firms together will be able to generate. Such improvement allow firms to achieve higher profits that steam from cost savings, revenue enhancements, process involvements, financial engineering, and tax benefits or, as reported by Goold and Campbell (1998) shared know-how and tangible resources, pooled negotiation power and coordinated strategies, vertical integration, and combined business creation. As Murkherjee et al. (2004) show, the primary motivation for Mergers and Acquisitions is to achieve operating synergies. It is also important to mention their impact as a corporate governance mechanism. In fact, with the increased deregulation, privatizations firms are now less protected against hostile takeover so are the management teams that are now pressured by the market to present results: firms that are underperforming or that simply do not follow the wishes of the shareholders become targets. Mergers and Acquisitions should, therefore, increase firms' performance and consequently the wealth of the shareholders. For example, as Healy et al. (1992) show, the post-merger performance not only increase (increase in operational cash flows) but these increase it is also related with abnormal stock returns around the announcement date.

Example: Apple acquisitions such as Beatz and more recently shazamHowever, in the other hand, mergers and acquisitions might be motivated by greedy CEOs that cannot fall behind its competitors leading to less profitable deals.

The current literature concerning the impact of mergers and acquisition on firms' performance and shareholders wealth is divided. Therefore, this research aims to help to the discussion by trying to reach a significant conclusion about to which level do the acquisitions create wealth for target shareholders and improve the accounting performance. To investigate the effect of Mergers and Acquisitions on financial and operating performance of firms, the changes in various key measures of firm performance and efficiency are compared in the three years prior to and subsequent to the deal. To access the impact for shareholders, the shareholders wealth is measured with abnormal returns as a proxy.

It is expected that different circumstances lead to different results. Henceforth, following a general analysis, a narrower approach measures the different impacts under different scenarios such as: between Europe and

USA, across countries, industries, waves and finally the research also attempts to identify a difference between horizontal and vertical mergers.

In order to achieve a clear understanding of this research, it is first important to contextualize what are mergers and acquisitions and what reasons motivates them. For that reason, these section takes into tries to summarize some previous literature that had already explained the subject.

To start with a straight definition, Gersdorff and Bacon (2009) first describe that it is a phenomenon that " involve buying, selling and combining companies". The authors also explain that both acquiring and target firms aim to benefit from each other financially or operationally, within the same industry or across industries avoiding the need to creating another unit. From more specific perspectives, Depamphilis (2009) describe mergers and acquisitions both from a legal and an economic perspective. The first one defines a merger as a creation of a new legal entity that combines two or more companies. Within this subject firms can either merge under the name of the acquirer that, then, integrates all assets and liabilities of the target or, still continue as two legal entities but with a change in ownership, statutory merger or subsidiary mergers respectively. The author still mentions another possibility where firms merge into a completely new company, however, this case is not officially considered as a merger.

Regarding the economic relations of mergers and acquisitions, the differences between deals are a cause of firms operating in the same industry or not. More specifically, previous literature considers horizontal mergers deals between firms operating within the same industry and conglomerate mergers otherwise. Another type of mergers are vertical mergers and these cases describe deals between firms that belong to the same value chain, but operate at different stages of the production.

Since ever that mergers and acquisitions have been intensively studied and researches have found significant results. Taking into consideration the impact on shareholders wealth, while for target firms, previous literature mainly identifies significant positive abnormal returns, for the acquirer these results are neither so clear nor significant. More precisely, Agrawal and Jaffe (2000) find that acquiring firms have significant negative or slightly positive returns in the short term.

The lack of significant and strong positive abnormal returns raises the question: Why are mergers and acquisitions still such a popular tool for growing corporations? After all, the most important goal of a corporations is to increase its profits from which shareholders must benefit. In this line, also several researches have been made pointing several motives for mergers and acquisitions. First, Trautwein (1990) finds, under a strategic point of view, some different motives. Synergies, for example, is when firms join forces between them to reduce costs, financial synergies, to expand or develop other products, operational synergies or to better monitor the business, managerial synergies. The author also clarifies that some synergies are related with benefits from increasing market share and lastly, some also arise due to information asymmetries from the acquirer in comparison to the target under the premise that managers will take actions on behalf of their shareholders.

Other different paper concludes that the main reason for Mergers and Acquisitions is the ability of the manager to properly time market advances, followed agency motives. Nevertheless, both of the situations are also mostly combined in the evaluated deals which shows the possibility that both, value-creation or value destruction reasons, can coexist in the same deal.

Behavioural corporate finance, that explains the market mispricing and the consequent adjustments of corporate policies also has different explanation for Mergers and Acquisitions. Shleifer and Vishny (2003) show that overvalued firms are more prone to acquire other firms and use stock payments in order to benefit from their stock current mispricing. On the other hand, undervalued firms became targets. These results are directly related with the profitability of the deal because cash bids result in higher abnormal returns than stock bids.

Over more than one century of Mergers and Acquisitions, the volume and absolute value of the transactions has been changing. In fact, these changes have been heavily investigated and researches have identified the trend that mergers and acquisitions tend to accumulate in specific periods, named " Merger Waves", reaching extreme peaks. Golbe and White (1993) found that the annual time series data on mergers can be fitted by several continuous waves with significant explanatory power giving a solid ground for naming the trend of these deals.

Martynova and Renneboog (2008) did a review of the previous researches regarding the market for corporate control focusing on the cyclical wave pattern and its drivers. The authors cover five completed waves and a potential, at the date of the research, current wave that started in 2003 with the economic recovery after the downturn of the beginning of the century. Indeed, there was a 6th wave that ended with the subprime crisis of 2007 and more recently, in 2014, there was a change in the business environment. Managers started being less risk averse and showed renewed confidence. Hence, this environment led, throughout the first half of 2014, to an increase in the global value of mergers and acquisitions that reached 1. 75 trillion U. S. which represents an increase of 75% in comparison to the homologous period last year. All waves present unique characteristics and trends, however, there are two important similarities across all waves: their beginning and conclusion. Typically, the beginning of each wave coincides with a set of changes, that can be either economic (economic prosperity and technological innovation), political (world wars) or regulatory (deregulations regarding the market for corporate control). Lastly, all waves ended with the collapse of the stock market and consequent financial crisis.

The first wave started in the late 1980s and it was driven by a significant change in technology, economic expansion, innovation but also due to new legislation. This merger was ultimately characterized by horizontal deals that lead to the creation of many large corporations aiming to build their monopolies. At last, it ended around 1903 with the stock market crash and the beginning of the First World War. After the first world war, around the late 1910s, the United States beneficiated a lot by the wounded situation of Europe and its economies started to recover. Taking advantage, those firms that were left out of the monopolies of the first wave started merging in order to create economies of scale and be able to compete with previously created large corporations. This “ fight back” led to the second merger wave, know for the presence of no longer monopolies but oligopolies. Stigler (1950) justifies the lack of reaction from the established monopolies with absence of money and also due to political changes concerning antimonopoly law. Lastly, the merger wave ended, in 1929, with another stock market crash and the beginning of the great depression.

The third wave started only after the second world war, in the 1950s and it ended 20 years later with the oil crisis and consequent economic recession. These one differs from the previous two due to its diversification since firms with capital where mainly trying to stabilized their earnings per share while benefitting from growth opportunities in other markets.

Following, the forth wave started in 1981 which coincide with both a stock market recovery and political changes regarding anti-trust policies and deregulation. The big conglomerates had become inefficient and firms become a target for hostile takeovers or they were forced to divest. Both situations represent the core of this wave that ended in 1987, again, after the stock market crash.

Shortly after, in 1993, started the fifth wave. Driven by the same innovations, deregulations and economic booms that led the previous waves, this one also had as a trigger the increasing economic globalisation. The fifth wave was then marked by the amount of cross-border deals that were a mean to reach the global markets. Ultimately, the wave ended like the others, with the so-called “ Dot-com Bubble”.

At last, the sixth wave started in 2003, with friendly negotiations instead of the previously common hostile takeover, showing some modest signs of economic recovery. The beginning of the twenty-first century is marked by the appearance of new financial products such as mortgage-backed securities and collaterized Debt Obligations. The market was by then, drowned in liquidity but also in debt with no collateral. This situation led to lots of defaults and subsequently the collapse of the financial markets and consequent end of the wave with the financial crisis of 2008. Currently, as it was already mentioned, we might be living the seventh merger wave that started in 2014 as the markets started recovering from the crisis.