

M and A performance improvement: A non-traditional view

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ABSTRACT

Mergers and acquisitions are important phenomena yet many fail (Vermeulen, 2008). Much research has been undertaken to identify reasons for failure with a view towards providing practitioners with suggestions and normative guidelines about how to avoid buying unattractive candidates (Arthur D. Little, Inc, n.d).

Acquisition performance could also be improved by increasing the number of attractive candidates that are acquired. Yet there is evidence to suggest that some opportunities are not exploited.

Myriad factors might result in the failure of a firm to pursue an attractive candidate after negotiations begin or a public announcement of the intent to acquire it is made. Some of these, like negative reactions of regulatory authorities or the financial community, may be difficult to anticipate or plan for. Other decisions to pursue seemingly attractive candidates, however, are reversed before public announcements of intent are made or negotiations begin as a result of the intervention of factors that may be subject to managerial control.

This paper suggests what some of these factors might be. And, it is the position of the paper that they deserve attention during acquisition planning since better management of them might lead to an increase in the number of truly attractive candidates that are acquired and in so doing improve acquisition performance.

Key Words: Mergers and Acquisitions, Decision Making

INTRODUCTION

Mergers and Acquisitions (M and A's) are an important and growing phenomenon. Yet, there seems to be a consensus that in the order of one-half to three-quarters of them fail (Porter, 1987, Ansoff, Portner and Radosevich, 1971, Kitching, 1967, Pablo, 1994, Vermeulen, 2008).

The two major traditions in Strategic Management provide significant insights into potential ways to improve M and A performance. For example, content scholars have focused on specific factors that correlate to success and failure (Ansoff, et. al, 1971) like the relatedness of the industry of the candidate to the acquirer (Rumelt, 1982, Sing and Montgomery, 1987, Lubatkin, 1983, 1987) or used broad constructs like degree of strategic and organizational fit that suggest a normative framework for understanding how attractive candidates are (or should be) to a specific acquirer (Haspeslaugh and Jemison, 1991, Chaterjee, 1986). The process school deals with, among other things, cognitive limitations that impede rational decision making about candidates (Duhaime and Schwenk, 1985) and how the acquisition process itself affects merger and acquisition outcomes (Jemison and Sitkin, 1986a, 1986b). Much focus has been placed on acquisition costs and the success of post-acquisition integration (Pablo, 1994, Graebner, 2004).

While beneficial for its explanatory value and the normative guidelines to practitioners it suggests, this paper calls to attention to two limitations in this diverse body of research:

- It is oriented towards avoiding failure;
- It does not address the complete acquisition process.

It is the position of this paper that acquisition performance might be improved not only by avoiding failure but by increasing the number of attractive acquisitions that are consummated. And, that considering factors that result in acquirers withdrawing from potentially attractive acquisitions before negotiations begin will provide important pieces to the incompletely researched mosaic of the acquisition process by covering a period in the process heretofore largely ignored.

The paper is in five parts. The first part consists of selected evidence of the importance of M and A's and the high failure rate. The second part summarizes the traditional view of M and A performance improvement adopted in most performance improvement literature. In Part Three, some of the limitations of the traditional view are discussed. Part Four advances an alternative view of performance improvement. Part Five consists of a brief discussion of the implications of this non-traditional view for future research.

THE IMPORTANCE OF ACQUISITIONS AS VALUE DESTROYERS

Acquisitions are increasing in value as they proliferate

The global value of Merger and Acquisition transactions reached a peak in excess of \$1.5 trillion in the second quarter of 2007. In spite of quarterly declines since then, their long term secular trend is positive (Dealogic, 2009). More companies, in more industries, in more countries, are engaging in mergers and acquisitions, for more reasons (Haspeslagh and Jemison, 1991, Melin, 1992).

M and A scholars have acknowledged the growth and spread of these phenomena. Haspeslagh and Jemison suggest that “(in the 1980s) ... acquisition activity in all countries with market economies has heightened ... and ... going into the nineties, the acquisition phenomenon appeared increasingly broad- based, fragmented and global” (Haspeslagh and Jemison, 1991, p 180). These characteristics of the M and A phenomenon still pertain.

While there are still industry and company loci to much M and A activity¹, they are becoming less important. Pablo states that acquisitions “have become a well institutionalised phenomenon.” (Pablo, 1991, p803); Melin (1992 p 111) refers to them as “a predominant feature of internationalisation during the last decade.”

Because of the proliferation of M and A’s across industry sectors, companies and geographic markets, it is reasonable to assume that M and A’s will continue to play an important role, subject to a plethora of environmental factors that may affect the level of activity year-on-year.

M and A Decisions Are Important to the Firm

M and A decisions are important to the firm. While some scholars view acquisitions as nothing more than another type of capital investment decision (Hitt, Hoskisson and Ireland, 1990), the view that they are highly important and somehow different from other decisions is held by others. Haspeslagh and Jemison further maintain that acquisition decisions are qualitatively different from other types of major capital expenditure decisions for reasons including the speed and secrecy they require, the lack of information on which they are based, and their inherent risk (Haspeslagh and Jemison, 1991). Other authors call attention to their discontinuous and fractionated nature, (Jemison and Sitkin, 1986a), the distinct ways in which alternatives are generated and analysed, the high organizational level at which they are made (Carter, 1971a), and their visibility and the intense personal commitment they engender (Pablo, 1994). Brown and O’Connor state that in light of the importance of such decisions “acquisitions are the principal interest of the chief executive and he has reserved the company’s efforts in this area for himself” (Brown and O’Connor, 1974 cited in Power, 1983 p 63). While there are differences in opinion about the extent to which M and A decisions are truly unique in terms of the descriptors used to characterize them in the literature, there appears to be a consensus that they are important.

¹ Historically, M and A’s occurred in “waves” that have been associated with specific industries or company groupings

Many M and A's Fail

While M and A decisions are important, they receive much attention in the popular press, and much research has been undertaken to provide insights into M and A decision making, the significant failure rate suggests that many M and A decisions are poorly made.

Directly measuring or inferring success and failure and linking them to performance is problematic. Scholars in different disciplines use varying perspectives, each with its own set of foci, criteria, assumptions and methodologies. For example, some measures rely on self reporting by managers, others, based on the use of the CAPM, consider shareholder value in relation to risk; others use various measures of profitability and growth. Still others use a combination of measures and approaches.

Differences in approaches, measurements, indicators, time frames, samples, methods and units of data analysis, all contribute to the significant variance in success/failure rates in the literature. While it is outside the scope of this paper to compare and contrast differences in such rates, the following are indicative of their overall level in the USA: 40 – 50% of M and A's are failures (W.T. Grimm and Co., 1985, 1988, Bagchi and Rao, 1992); 34% had lower sales than pre- acquisition, 46% had lower profits, and only 22% met all management's objectives (Ansoff, et al., 1971). According to Kitching (1967) 35% were failures. And, Vermeulen states that "most executives know that the majority of acquisitions will fail" (Vermeulen, 2008 p 23). Failure rates for European M and A's appear broadly in line with those of the USA. Citing Kitching's (1974) study of US-based companies' acquisitions in Europe, and Bleek, Isono and Ernst's study (1990) of cross-border acquisitions and acquisitions of UK-based companies on the Continent (1992), Angwin and Savill note that between 43% and 54% of M and A's are "considered failures or not worth repeating" (Angwin and Savill, 1997 p 427). Moreover, while no time-series of comparable data is available, there are indications that the failure rate has been substantial, at least in the USA, since the very first M and A wave at the turn of the 19th century.²

Given the importance of mergers and acquisitions and the high failure rates, a substantial body of knowledge has evolved addressing issues related to performance improvement. The traditional view of the way to improve acquisition performance emphasizes avoiding failure. In this paper a complementary view is taken which focuses on increasing the total number of successful acquisitions by not forgoing opportunities that are identified as potentially sound.

The Traditional View of Improving Performance Focuses on the Content of Strategy and the Process by which it is Made

The performance improvement literature, like the performance measurement literature, is multi-disciplinary, fragmented and characterized by a multiplicity of

² In 1935, Shaw Livermore (cited in McCarthy, 1963 pp 30-31) analysed 409 US-based "business combinations" which occurred in the 1888-1905 period and concluded that 43% were outright "failures," and 9% were "limping." Kusewitt cites a study undertaken in 1921 by Dewing in which the number of failures was high although specific rates are not available (Kusewitt, 1985).

paradigms and approaches. Much of this literature tends either to build upon or to reflect suggestions that are expressed or implied in the performance measurement literature. These are ordered below for convenience using the content- process dichotomy recognizing that this distinction, at an analytical level, may be a “trap,” or a “hindrance” (Pettigrew, 1992 p 6), “artificial” (Schendel, 1992 p 2) or “misleading” (Melin, 1992, p 101).

Improving Performance by Improving the Content of Acquisition Strategy

Early work by strategy ‘content’ scholars tended to focus on identifying factors that appeared to influence the profitability of M and A’s. The goal of this research was to identify what distinguishes good from bad acquisitions. Ansoff and colleagues refer to such studies as the “correlates of success” stream (Ansoff, et al., 1971 p 39). Correlates are myriad; the following are indicative of the stream’s scope:

- Characteristics of the acquirer – for example, amount, nature, timing and performance of past acquisitions (Fowler and Schmidt, 1988, Kusewitt, 1985, Hayward, 1999);
- Characteristics of the candidate – for example, historical growth rate, market share, profitability, industry (Rappaport, 1979, Salter and Weinhold, 1979, Kitching, 1967, Kusewitt, 1985, Fowler and Schmidt, 1988, Rumelt, 1982);
- Aspects of the relationship of the parties in the dyad – for example, degree of industry relatedness or “type” of acquisition (such as horizontal integration, vertical integration, conglomerate), and relative size (Rumelt, 1982, Singh and Montgomery, 1987, Salter and Weinhold, 1979, Lubatkin, 1983, 1987, Kitching, 1967); and
- Nature of the deal – for example, timing, mode of payment (equity or cash), form (such as merger, tender offer) (Kusewitt, 1985, Rappaport, 1979, Datta, et al., 1992, Schmidt and Fowler, 1990).

Some of the correlates, particularly the degree of industry relatedness, have proved difficult to measure, and their relationships to financial indicators of performance remain elusive (Rumelt, 1982, Datta, Pinches and Naryanan, 1992). Work on them continues along traditional “correlates of success” lines. Various combinations of the correlates, however, can be used to help a firm set objectives for an M and A effort, or to highlight potential problem areas, or they can be translated into criteria for screening and ranking sectors or candidates. Otherwise put, they may constitute a large part of the content of strategy.

A more recent approach to developing acquisition strategy content, particularly for distinguishing the relative attractiveness of sectors and candidates that are under consideration for strategic reasons, emerged in the 1980s. It couples an advancement of correlates theory – using strategic fit as an umbrella dimension – with concepts from organization behaviour theory that can be used to assess organizational fit, another umbrella dimension.

A distinction is made in the literature between “value capturing” and “value creating” acquisitions (Pablo, Sitkin and Jemison, 1996, Haspeslagh and Jemison, 1991). The former, also referred to as financial acquisitions, are motivated by such factors as a desire to buy assets below market value, capitalize on a tax benefit, or otherwise exploit a non-recurring financial advantage. The latter, usually referred to in the strategic management discipline as “strategic” acquisitions, involve candidates that are related or

complementary in some sense and the acquisition of which is motivated by a desire to realize synergies. Synergies, in turn, rely primarily on the sharing or transfer of skills, knowledge and other resources between the candidate and the acquiring company (Haspeslagh and Jemison, 1991, Salter and Weinhold, 1978, 1979, Lubatkin, 1983, Chatterjee, 1986). The sum of the potential for such transfers constitutes the strategic fit between the candidate and the acquirer.

While much of the strategic management literature prior to the mid-1980s emphasized the importance of strategic fit and how to assess it, a recognition emerged that strategic fit was an insufficient predictor of outcomes (Jemison and Sitkin, 1986a, 1986b, Haspeslagh and Jemison, 1991, Lubatkin, 1983). Organizational theory scholars supplemented the strategic fit model by suggesting that for synergies to be realized, the organizations must mesh, and their people work well together after the merger or acquisition is completed (Soderberg and Vaara, 2003). Working together can be constrained by differences between the organizations in corporate cultures, administrative systems, management styles and other “human factors” (Porter, 1980, Jemison and Sitkin, 1986a, Lubatkin, 1983, Soderberg and Vaara, 2003, Buono and Bowditch, 1990, Larsson and Lubatkin, 2001). Such factors, in aggregate, constitute organizational fit. Chatterjee, Lubatkin, Schweiger and Weber seek to establish the benefits of this perspective by relating strategic fit and organizational fit to performance (Chatterjee, et al., 1992). While their criterion variables are very narrowly defined (organizational fit is equated to managements’ perceptions of cultural differences; good performance is equated to increases in shareholder wealth), their findings broadly support the assertion that benefits result from acquisitions having high levels of both.

In sum, in value creating or strategic acquisitions, strategic fit represents the potential for a candidate to contribute to the acquirer’s objectives, and to complement or augment its strategies, in part through synergy effects; organizational fit and softer issues like “people, cultures and politics” (Soderberg and Vaara, 2003 p 3) influence the extent to which synergies can be achieved in the post-acquisition period (Jemison and Sitkin, 1986a; Haspeslagh and Jemison, 1991).

The implications of the use of the strategic fit and organizational fit concepts for selecting candidates appear in Figure 1. Failure can be avoided by forgoing acquisitions in the lower left cell. These are unattractive candidates that lack both strategic and organizational fit. Success is more likely to be achieved by focusing on candidates in the upper right cells - those that are attractive as a result of their high degree of strategic and organization fit. The priority placed on candidates in the other cells would depend on the balance of risks and rewards the acquirer chooses.

Insert Figure 1 here

In conceptual literature and in some of the empirical literature, this tradition’s focus has been on improving the evaluation and selection of acquisition candidates (Pablo, 1991) and, overlapping with a corporate finance stream, arriving at appropriate valuation decisions (Salter and Weinhold, 1978, 1979, Rappaport, 1979). Two fundamental assumptions underlie most of this work. First, the acquisition decision making process is (or, in the case of normative literature, should be) logical and rational. Second, if the analytical tasks and the important decisions they support are based on the

use of the right approaches, tools and techniques, failure will be avoided and performance improved (Ansoff, et al., 1971). The rational, analytical approach and the general decision making context that the use of this model suggests have some support in the literature (Hitt and Tyler, 1991, Pablo, et al., 1996). The outputs of the analysis based solely on this model, however, are suspect to process scholars, who consider the rational approach to be simplistic and facile. Mintzberg and colleagues (1976), for example, find little evidence of the “rational analytic” model in their analysis of strategic decisions of all types and they suggest the possibility that much analysis is accomplished by lower level technocrats who provide it to higher level senior managers. The latter then use it as input for decisions but ultimately rely more on judgment and bargaining. And, Bourgeois and Eisenhardt consider such models “unrealistic” because they don’t take into account cognitive and other limitations on decision making (Bourgeois and Eisenhardt, 1988 p 818).

Improving Performance by Improving the M and A Strategy Process

A strategic management process tradition in the M and A domain began to emerge until the mid-1980s, following the publication of seminal articles by Jemison and Sitkin (1986a, 1986b). These authors make three key points that underpin much subsequent work in M and A research and provide a context for understanding better the traditional view of performance improvement:

- The rational choice model had achieved primacy (if not exclusivity) in prior M and A research by strategic management scholars;
- Process is a potentially important determinant of outcomes and should supplement the strategic and organizational fit concepts heretofore advanced by strategic management scholars; and
- Different kinds of process “impediments,” which come into play at different phases of the M and A process, are identifiable although some may be inherent to the process and not always subject to managerial control.

Much subsequent work was undertaken to build on Jemison and Sitkin’s thinking. This work is subdivided below into four overlapping streams:

- Behavioural impediments to rational acquisition planning: Behavioural decision theorists (BDT), drawing heavily on research from cognitive psychology, seek to identify and describe decision makers’ cognitive limitations, motivations and other psychological factors, that tend to bias or corrupt, in a systematic and predictable way, the analytical mode of decision making assumed in the rational acquisition planning model. Duhaime and Schwenk, for example, describe perceptual processes and heuristics that overly simplify acquisition decisions (Duhaime and Schwenk, 1985). These authors also hypothesize that simplification has a negative impact on outcomes. Haunschild, Davis-Blake and Fichman, drawing on Staw’s escalation of commitment theory (Staw, 1976, 1978, 1981) identify situational factors, such as public announcements of the intent to acquire, which result in an over-commitment to an acquisition candidate which, in turn, can lead to managerial error and failure. Hayward provides another example by relating hubris to the premia paid for candidates (Hayward, 1997, 1999)

The key assumptions underlying this stream are, first, that individual managers are subject to introducing biases into the decision making process under different conditions and that such biases negatively affect outcomes. Second, and often implicitly, if the linkages and causal relationships between people, situational factors and biases can be identified and understood, they can be managed and reduced (Pennings, 1985). Haunschild and colleagues (1994), for example, suggest that over-commitment can be avoided by assigning responsibilities for candidate evaluation and selection to different people in an organization.

- Organizational impediments to rational acquisition planning: Organizational behaviour scholars have considered a wide range of impediments to rational decision making. This diversity reflects, in part, the absence of a predominant paradigm in the parent discipline, or, as Astley and Van de Ven put it “theoretical pluralism” (Astley and Van de Ven, 1983 p 245). Part of this diverse body of literature builds upon the global critique of decision making by Cyert and March who describe how conflicting goals, limited search and standard operating procedures or organizational routines affect decision making (Cyert and March, 1963, Ansoff, 1965, Bourgeois and Eisenhardt, 1988). While Cyert and March’s work deals with operating decisions, Carter extends their framework to strategic decisions (Carter, 1971a, 1971b). He describes how biases develop as a result of one organizational unit or level filtering or withholding information that could have an impact on the conclusions drawn about a candidate’s attractiveness by another unit or level. Relating his findings to behavioural decision theories of over-commitment, Carter hypothesizes a phenomenon that he refers to as ‘post-decision uncertainty absorption’. He illustrates this phenomenon with an example of the manager who does not perceive, or process correctly, information that would make an acquisition candidate less attractive after the decision has been made to pursue the candidate even though an offer has not yet been made.

In addition to bias, Carter notes political behaviour, around which much research has coalesced. A number of other social impediments to effective decision making are examined in this stream. For example, Janis identifies the emergence of overly convergent options as a result of “group think” (Janis, 1985). And, Haunschild finds support for inter-organizational imitation in the M and A domain (Haunschild, 1993). Much of this stream is based on assumptions similar to those of the behavioural impediments stream but they relate to group rather than individual motivations, limitations and behaviours. For example, conflicting interests and goals across organizational units can result in political and other behaviours that have a dysfunctional impact on decision making (leading to failure in the case of acquisitions); and that it is possible that some of these can be identified and managed to improve decision outcomes.

- Strategic decision making: SDM is an eclectic field drawing from and, overlapping with the behavioural and organizational streams described above (Papadakis and Barwise, 1998). One large and recent stream of SDM research does seek to establish linkages between four main categories of variables: the type or content of a decision, the context in which it is made, the process or mode used to make it, and its outcomes. Strategic or value-creating acquisitions fall within the scope of SDM based on a generally agreed set of criteria for distinguishing these decisions from more operational ones. They are, for example, important in terms of the actions taken, resources committed, and precedents set (Mintzberg, et al., 1976, Eisenhardt and Zbaracki, 1992). Acquisition scholars have drawn from SDM to frame much of their research. Hitt and Tyler, for example, seek to reconcile the rational normative, strategic choice and external control models of decision making (Hitt and Tyler, 1991); Pablo and colleagues seek to ground acquisition decision making models more firmly in behavioural decision theory, from which much SDM draws, by suggesting the addition of a variable representing risk propensity in process models of candidate selection and post-acquisition integration decisions (Pablo, et al., 1996).

This stream includes among its major assumptions that good or appropriate processes can be distinguished from bad or inappropriate ones. Bad or inappropriate ones may result in poor outcomes. Poor outcomes can be avoided and, as a result, acquisition performance can be improved. Performance may, for example, be improved by selecting, in a non-political consultative process, an approach to integration that optimises trade-offs between the desire for control and autonomy of the two parties in light of the requirements of the acquirer to derive the synergies that justified the acquisition .

Content scholars consider strategic fit as setting an upper limit on the potential for a candidate to meet an acquirer's objectives; organizational fit is viewed as a constraint. Building on this framework, process theorists consider strategic fit and organizational fit as the content on which M and A decisions are based. The content determines the upper limit for success; the extent to which the limit is reached, however, is influenced by the decision making process (Pablo, et al, 1996); and, variables in various decision making models include the people, cultures and politics suggested by Soderberg and Vaara (2003) that are also relevant to organizational fit.

A number of other process-related prescriptions are advanced in the normative literature or implied in the empirical literature that do not neatly fit the paradigms as they are described above. They include suggestions about such factors as the nature and number of employees who should participate in the acquisition decision making process, and whether or not to use which type of external advisers (Angwin, 2001). There is also a growing body of literature that uses organizational learning theory to explain and predict various aspects of acquisition behaviour (Lindvall, 1991, Hayward, 1999, Vermeulen and Barkema, 2001, Bjorkman, Tienari and Vaara, 2003, Very and Schweiger, 2001). Various means of achieving harmonious integration have been identified so that the benefits of mergers and acquisitions are achieved (Larsson and Lubatkin, 2001). And, there is a stream that seeks to explain M and A motives using agency theory.

The Traditional View of Performance Improvement is Limiting

A multiplicity of diverse disciplines and streams contribute to predicting acquisition performance and understanding how it might be improved. For example, by formulating better and more explicit rationales for making acquisitions, incorporating measures of the potential for asset, skill and capability transfer into definitions of strategic fit (and the criteria that comprise it) and by analysing both strategic fit and organizational fit, poor choices can be minimized. Appropriate valuations can be determined by using models and tools to discount cash flows or support use of other valuation techniques (Hubbard, 1990) and analytical tasks. Optimal procedures for due diligence can be followed (Hubbard, Lofstrom and Tully, 1994, Angwin, 2001). The best payment methods, modes and timing can be selected. In addition to choices involving substantive aspects of content, psychological, organizational and other process impediments to rational decision making can be identified and, at least in part, dealt with to minimize biases and distortions in choices and to create a positive climate for implementation (Haspeslagh and Jemison, 1991). Finally, while not always subject to managerial control, a number of variables that, if managed properly would contribute to smooth post-acquisition integration has, at least, been identified (Soderberg and Vaara, 2003). And, there are suggestions and prescriptions, some of which have empirical support, for how issues related to “human capital” can be better managed to achieve integration goals (Larsson and Lubatkin, 2001, Brousseau, Larsson, MacPhail and Swaels, 2004).

Taken together, this literature³ is oriented towards improving performance by reducing failures associated with firms buying the wrong candidates, paying too much for them, or failing to realize the intended benefits by not recognizing them when justifying the acquisition internally before it occurs, or mishandling integration after it occurs. By eliminating failures, the ratio of successful acquisitions to total acquisitions will increase and performance will improve.

Simply reducing failures, however, is limiting. Haspeslagh and Jemison implicitly recognize this by suggesting that companies that are successful in their acquisitions are quite different from those that are not (Haspeslagh and Jemison, 1991). Rather than avoiding failure, the alternative view of performance improvement proposed in this paper focuses on increasing successes by not missing out on potential opportunities.

An Alternative View of Performance Improvement Complements the Traditional View

While the thrust of much of the literature on performance improvement emphasizes failure avoidance, arguably, improvement can also be realized by increasing the number of attractive candidates that are acquired. Attractive candidates may not be acquired for a variety of reasons. Many of these have received attention in the literature. For example,

³ Haspeslagh and Jemison's managerial work *Managing Acquisitions: Creating Value Through Corporate Renewal* (1991), is a notable exception

- The acquirer's management's opinion of a candidate may change as a result of the receipt of new information. During the due diligence effort, for example, pending litigation or the prospective loss of critical customers may become apparent (Puranam, Popwell and Singh, 2006). Management styles may be incompatible and irreconcilable (Brousseau, et al., 2004); or during negotiations an acquirer may learn that critical employees in the acquisition candidate will leave (Kusewitt, 1985), or some other event may occur or factor become known that will reduce the value of the candidate to the acquirer or increase its risks to an unacceptably high level (Carter, 1971a, Paine and Power, 1984).
- A candidate may not be for sale or an offer may be rejected (Puranam et al., 2006, Jemison and Sitkin, 1986a).
- A publicly traded candidate may engage in defensive activities including counter-bidding for the acquirer, issuing negative press releases, selling off one or more particularly attractive strategic business units (SBU's) or incorporating anti-takeover provisions ("poison pills") into its corporate charter (Jensen, 1984).
- A bid may be too low in an auction. Haspeslagh and Jemison suggest establishing a "maximum walk-away price" as part of the justification for an acquisition recognizing that it may be below the bid of a competitor who may be able to add more value to a candidate, or simply overvalue it (Haspeslagh and Jemison, 1991, p 50).
- Legal and regulatory obstacles, including anti-trust objections, may arise (Evenett, 2001, 6, Puranam et al., 2006).
- The general public or the capital markets may react negatively (Haspeslagh and Jemison, 1991, Puranam et al., 2006).

A candidate may be "put on hold." It may be attractive but not at the current price or under the existing legislative regime or until some other change takes place either internally in the candidate or externally in its environment. There are occasions, however, when companies evaluate a candidate, find it attractive but do not negotiate with, bid for or otherwise pursue it. Nor do they necessarily plan to pursue the candidate pending the outcome of a specific change in the environment or in the candidate itself. In the context of a discussion of organizational decision making, March and Olsen observe that "organizations often ... do nothing to implement a decision after having devoted much time, energy and enthusiasm to making it" (March and Olsen, 1976, p 10). More particularly, Haspeslagh and Jemison maintain that during the acquisition process "a commitment may stall, reverse or accelerate" (Haspeslagh and Jemison, 1991, p 51).

The alternative view of performance improvement advanced in this paper focuses on these apparently missed opportunities to acquire companies when they have been thoroughly evaluated and adjudged to be attractive by the acquirer... It implies that the causal factors for decision reversals and the "do-nothing" phenomenon may be manageable and that their impact on decisions with potentially positive outcomes can be reduced. It holds that if there were a reduction in their impact, fewer attractive opportunities would be missed and acquisition performance would be improved. This view assumes, for reasons described below, that the missed opportunities would, indeed, be attractive, that is, the acquisitions would predominantly consist of successes rather than failures; and, that missed opportunities are frequent enough to have a noticeable

impact on performance. Finally, it assumes that missed opportunities are sufficiently costly to warrant attention.

When are Candidates Attractive?

If thoroughly evaluated through Phase Four (see Figure 2 below) in a conventional acquisition process, and candidates are still found to be attractive, their acquisition is more likely to lead to success than the acquisition of candidates that are not similarly evaluated. This happens when candidates skip from the Search and Screening Phase (See Figure 2) by- passing the evaluative phases directly to negotiations; or the strategic and financial evaluations are truncated or undertaken haphazardly.

insert figure 2 here

Processes used in acquisition decision making have been conceptualised using different types of models for different purposes. Structural models are among the most common. These typically describe decision processes as being logical, rational and consisting of a series of distinct sequential stages or phases. (Mintzberg, et al., 1976, Eisenhardt and Zbaracki, 1992).

While a number of authors find logic in delineating phases, it is generally accepted that the strategic decision making processes for all types of decisions are highly complex (Mason and Mitroff, 1981, Mintzberg, et al., 1976), often involve shifting, rebranching (Eisenhardt and Zbaracki, 1992), (re) cycling and iteration (Mintzberg, et al., 1976, Thomas, 1984) and may even result in problem reformulation (Thomas, 1984). Phases and the tasks (or routines associated with them) are not necessarily temporally sequential (Mintzberg, et al., 1976, Thomas, 1984, Nutt, 1984, Hickson, Butler, Cray, Mallory and Wilson, 1986). And, the whole process may, in fact, be circular reflecting an interactive learning process (Quinn, 1980 cited in Gladstein and Quinn, 1985). As examples, detailed models used to map M and A decisions typically distinguish between candidate evaluation and choice, yet these sub-processes frequently occur simultaneously (Mintzberg, et al., 1976, Haspeslagh and Jemison, 1991). And, Mace and Montgomery point out how “evaluation goes on during negotiations and the problems of integration are profoundly affected by ... business discussions [during the Negotiation Phase]” (Mace and Montgomery, 1962).

Structural models that assume progressive movement through the phases on a time-line nonetheless, can be useful tools for understanding the kinds of analysis, inputs, outputs and decisions that make up the acquisition process even though sequential ordering may simplify processes-in-use. As Risberg states, “the point of identifying stages has been to distinguish events and activities of each stage to further the understanding of the acquisition process” (Risberg, 1999, p 34).

Haspeslagh and Jemison (1991 p 13) advance their concept of the “traditional model” of the acquisition process with seven phases (Figure 2).⁴ Although the authors don’t provide

⁴ The authors maintain that the adherents of the traditional process tend to focus on Phases Three (strategic and organizational fit) and Four (price). They suggest an alternative model which, they assert, helps managers focus on how value will be created. The two approaches need not be considered mutually exclusive. For example, how value can be created can be incorporated into analyses of fit. Extent of fit, in turn, can influence price.

details of the tasks or activities associated with each phase, the strategic and organizational fit between the acquirer and candidate would be logical to assess in Phase Three. In Phase Four, the supporting financial analyses and offering prices would be the primary outputs. Based on these, and assuming the candidate is sufficiently attractive as a result of them, the company proceeds to the Negotiation Phase. During this phase, due diligence is typically undertaken. Negotiations are followed by the preparation of legal agreements, the closing and payment. In a seventh and last phase, post-acquisition integration is undertaken.

The more detailed model(s) of SDM, advanced by Mintzberg and colleagues (1976) describes an Identification Phase, which occurs before Phase One of Haspeslagh and Jemison's traditional model. During this phase, the decision is made to pursue acquisitions and the objectives are set for the effort. Mintzberg and colleagues also include an explicit Authorization Routine. This routine involves having the decisions and recommendations of lower levels of management reviewed and endorsed by the highest approval authorities who are able to commit the corporation to a course of action, usually the CEO, board or owners (Mintzberg, et al., 1976).

Haspeslagh and Jemison maintain that the whole process must be understood to understand the parts. Below, the part of the process by which candidates are determined to be attractive is described as well as its implications for missed opportunities.

While opinions about the attractiveness of a candidate may be held by individual participants in the decision making process in the earliest phases of an acquisition effort, the development of a more formalized view of attractiveness typically follows the preparation of an explicit "acquisition dossier" (Haspeslagh and Jemison, 1991) by the organizational unit tasked with its compilation. Such dossiers are usually prepared after strategic and financial evaluations, which occur during Phases Three and Four, depicted in Figure 2. Many candidates are not subjected to the kinds of in-depth analysis associated with these phases before they are acquired. Thus, some unattractive ones are not winnowed out from the consideration set which, in the case of fully evaluated candidates is necessarily smaller and includes candidates that are more likely to be truly attractive. Yet there are indications that the more thoroughly candidates are evaluated and still found attractive, other things being equal, the more likely their acquisition will be successful and therefore lead to performance improvement.

Hickson and colleagues, in a sample of 124 of 150 strategic decisions (of all types including acquisitions), find that a decision had been made before detailed consideration was given to alternatives and outcomes in 40 cases. They refer to this phenomenon as "quasi decision making" (Hickson, et al., 1986, p 52). Mintzberg, Raisinghani and Theoret find "very little use of [such] an analytic approach" to decision making in the stage in the process (the "evaluation-choice routine") during which candidates in an acquisition search are evaluated and selected (Mintzberg, et al., 1976, p 258).⁵ With specific reference to acquisitions, Hubbard, Lofstrom and Tully cite as an example a lack of uniformity in due diligence check list characteristics such as length (six to 180 pages) and gaps in coverage and state that "no check list appeared to cover all areas in depth"

⁵ Their finding is difficult to interpret. They initially support this "revelation" by referring to a large number of cases in which evaluation and choice were undertaken concurrently rather than sequentially. They add, however, that they found little evidence to support the prevailing normative view of decision making which calls for the development of criteria for evaluating alternatives, weighting them and computing utility functions for alternatives – steps that are often equated with thorough analysis. (Mintzberg, et al., 1976).

(1994, p 40). Hespelagh and Jemison suggest that the extent to which a candidate is subjected to analysis is inversely related to the level in the hierarchy at which the acquisition is internally sponsored although they provide no data linking sponsorship level to success or failure (Hespelagh and Jemison, 1991). Souder and Chakrabarty find that the actual synergies realized and benefits derived from acquisitions are different than those identified during candidate analyses which motivate and justify the acquisitions (Souder and Chakrabarty, 1984 cited in Hespelagh and Jemison, 1991). Differences imply insufficient (or faulty) pre-acquisition evaluation. In sum, these authors all find evidence of various types that analyses of acquisitions may not be thorough.

While thorough analysis may not always be undertaken, a number of authors comment on its benefits, although their assertions appear to be based more on general observations than extensive data. Kitching (1967), in referring to the analysis required to systematically apply evaluation criteria, states that “successful companies do a thorough job”. He maintains that if the organization is “not evaluated [in detail] before the merger, the chance of failure increases markedly” (Kitching, 1967, p 96). Rappaport suggests that benefits accrue to acquirers in negotiations with owners if sound analysis of candidates is undertaken (Rappaport, 1979). Paine and Power suggest that if planning and analysis are not systematic, managers can rationalize any acquisition, and they warn of the dangers of substituting business analysis with simple rules and heuristics (Paine and Power, 1984). Furthermore, Power maintains that the quality of formal analysis is more important than the type, although he does not define either in detail (Power, 1983).

While a significant number of candidates may be acquired before they are thoroughly analysed, and there are assertions that thorough analysis improves chances for success, empirical support linking thoroughness of analysis to performance is limited. In the only known quantitative study that deals directly and explicitly with this linkage, Ansoff and colleagues find support for a positive relationship between the degree to which candidates are evaluated and post-acquisition success. These authors distinguish between acquisition “planners” and “non-planners.” The former engage in “when to” planning (for example, they formulate explicit objectives and criteria for evaluating candidates) and “how to” planning (for example, they establish procedures for conducting searches and accomplish thorough evaluations). Non-planners are less thorough, less systematic, and more ad hoc in their approaches (Ansoff, et al., 1971, pp 5-6, 26, 30-32). The performance of planners in their study’s sample exceeds that of non-planners on a variety of objective financial measures including sales growth, earnings growth and return on equity. The authors conclude that “a small number of alternatives thoroughly evaluated seemed to be the recipe for success.” They emphasize that thorough evaluation had the most consistent and strongest relationship to success of the process related variables they correlated to performance measures (Ansoff, et al., 1971, pp 13-16, 97). Authors in the process and related traditions also suggest that evaluations may not be thorough. BDT theorists suggest that the cognitive strain, stress and anxiety that often accompany the ambiguity and complexity associated with M and A decisions are reduced through the use of heuristics and other simplifying processes. As examples, Duhaime and Schwenk cite cases in which candidates were evaluated through reasoning by analogy, or in which the capabilities of an acquiring firm to solve potential problems in a candidate were overestimated (Duhaime and Schwenk, 1985).

Organizational behaviour scholars suggest other factors which bias decisions at the level of the decision making group or firm by truncating analysis. Alexander, for example, describes the “rapid convergence of options in number and range before the formal evaluation process” begins (Alexander, 1979, p 396 cited in Duhaime and Schwenk, 1985).

The influence of psychological and social factors on decisions is most commonly discussed in the M and A literature in the context of why unattractive candidates are acquired. The relationship of specific variables to the extent to which a candidate is subjected to scrutiny and analysis, and the success or failure of an acquisition in terms of performance outcomes are not often explicit. Nor have these kinds of relationships been empirically tested with quantitative data. Rather, the suggestion is made that biases emerge during various phases or stages in the acquisition process leading to faulty evaluations or the absence of thorough evaluations of candidates. The candidates are nevertheless acquired and the acquisitions result in failure.

SDM scholars have produced some findings, which broadly support but set limits on those of Ansoff and colleagues by taking into account various aspects of the context in which decisions are made. A number of studies have been undertaken, for example, which link “comprehensiveness,” a major characteristic of rational decision making, with performance. Fredrickson and Iquinto define comprehensiveness as the extent to which a decision is exhaustive and inclusive (Fredrickson and Iaquinto, 1989). Exhaustiveness and inclusiveness are examined by Fredrickson and Iquinto in a number of process phases including alternative generation and evaluation. The authors find a positive relationship between comprehensiveness and performance in stable environments; a negative relationship in unstable environments (Fredrickson and Iaquinto, 1989)⁶.

The relationship between thoroughness of evaluation and post-acquisition success has not been sufficiently supported empirically to draw definitive conclusions. Moreover, evidence for a consistent relationship is likely to be difficult to find given the array of factors, many previously discussed, which can moderate the relationship. This paper none-the-less adopts the assumption, consistent with the weight of evidence, that the acquisition of candidates found to be attractive after a thorough analysis is more likely to result in success than failure⁷ and that performance will improve if more attractive candidates are acquired. Otherwise put:

- Many candidates are acquired before they are systematically evaluated (through Phase Four);
- Many of these are thought to be attractive but fail;
- If candidates are systematically and thoroughly evaluated through Phase Four they are more likely to be objectively attractive and constitute real opportunities;
- To the extent that more of these real opportunities are exploited, other things being equal, acquisition performance will improve.

⁶ Bourgeois and Eisenhardt (1988) link rational decision making with high performance in “high velocity” environments leading Rajagopalan and colleagues (1993, 1998) to point out the need for an integrative framework for SDM that may be used to highlight inconsistencies and commonalities across studies.

⁷ This assumption is consistent with Duhaime and Schwenk’s interpretation of prior acquisition research and what they refer to as “conventional managerial wisdom.” That is, they imply that while biases may develop, thorough analysis increases the likelihood of success (Duhaime and Schwenk, 1985).

Below, some of the factors that may intervene in the decision process after candidates have been evaluated and have been adjudged to be attractive but before negotiations begin are explored.

What Factors Might Intervene in the Decision Making Process that Preclude Attractive Acquisitions?

Some of the factors that may make an acquisition become unattractive after an announcement is made or negotiations begin are referred to above. For example, there may be anti-trust objections or the price may be too high. Yet, there are a number of variables that have the potential to influence withdrawals from acquisitions about which the acquirer should have sufficient information at the end of Phase Four or which are subject to sufficient managerial control to preclude a precipitous withdrawal from an otherwise attractive acquisition.

A review of the literature suggests the following among many possible factors:

Strategic Priorities

A change in the priority a company places on acquisitions as a strategy is mentioned in Section 2.2 as a possible reason why M and A decisions might be reversed. Such a change may preclude the pursuit of an attractive candidate in at least three ways: first, acquisitions, in general, may become less important to the company; second, the acquisition of a specific candidate may no longer be the best means to achieve one or more of the acquiring firm's objectives. Finally, if other companies have recently been acquired, the firm may have reached a point of temporary saturation. Each of these is discussed below.

A Reduction in Priority Placed on Acquisitions

Minzberg and colleagues incorporate into their model(s) of complex strategic decisions an Identification Phase, which takes place at the start of the decision making process (Mintzberg, et. al., 1979). In this phase, problems or opportunities are identified which may serve as stimuli to evoke decision activity. Many of the conditions related to the overall M and A climate, the internal environment of the firm or prospective candidates that may serve as stimuli for acquisitions are discussed in the Section 2.2. A gap in future earnings or a change in share price, for example, may be anticipated or occur. Options for addressing the problem or exploiting the opportunity are considered. If an acquisition strategy is among the options, a search program may be launched. Given the inherently risky nature of the outcomes of acquisition search programs, other strategies to meet the requirement(s) are often pursued in parallel with acquisitions. When this occurs, three scenarios that could result in forgoing an attractive opportunity are possible:

- The factor(s), which drove the search (and alternative strategies), could change. For example, an anticipated shortfall in earnings (Christian, 1985) or so-called strategic portfolio performance gap (Ansoff, 1965) may not materialize;

- The underlying need to meet an objective may be constant but an alternative to acquisitions may meet the objective. For example, a cost reduction program may be sufficient to fill an earnings gap;
- The resources that were available at the outset of the strategy development effort when a decision to pursue acquisitions was made (Identification Phase) may no longer be available.

Under any of these scenarios, the priority the potential acquirer places on an acquisition strategy may decline.

Changes in critical resources to consummate the acquisition or subsequently manage it are described below under the Resources and Advocacy sub-headings for two reasons: first, they are likely to have a direct impact on individual acquisition decisions themselves independently of the overall priority a firm places on acquisitions; and, second, because they have received so much attention in the literature.

A Reduction in the Priority for Acquiring a Specific Candidate

The overall priority a company places on acquisitions might remain constant but the rationale for acquiring a company with a specific profile may change. This might happen if the strategic fit (or organizational fit) between acquirer and candidate changes over time. Academic theoreticians have added additional perspectives. For example, Pfeffer suggests that a set-defining rule operates and that (consideration) sets vary depending on whether companies pursue an “absorption” (vertical or horizontal integration) or “avoidance” (diversification) strategy (Pfeffer, 1972). According to Pfeffer, these strategies tend to be sequential. That is, once absorption benefits are achieved, firms tend to seek avoidance benefits. Since candidates who would provide absorption benefits are quite different from those who provide avoidance benefits, it is possible that an attractive candidate offering the former would not be pursued if the acquiring firm’s absorption benefits were met sufficiently after the candidate was evaluated and found attractive but the acquirer then sought avoidance benefits. Although Pfeffer’s sequencing may appear simplistic, it illustrates how priorities might change. Haspeslagh and Jemison, taking a somewhat less hypothetical approach to matching candidates to needs, refer to “strategic assemblers” who, in effect, make acquisitions, which are individual parts of a broader whole (Haspeslagh and Jemison, 1991). One candidate might have a strong distribution system, another brand, a state-of-the-art plant, or some other building block. The acquirer adds value by putting all of the parts or building blocks together. Alternatives to acquiring individual parts may be investigated and attempts made to secure them concurrently with a search. If implementation is successful, the acquisition of one or more parts may be obviated even though an attractive candidate who could provide the part is available. This would be the case, for example, if an acquiring firm sought a candidate with a particular product to fill out a product line but was able to develop a similar product using its own R and D resources. This factor differs from the Acquisitions- Priorities factor described above in that the former involves meeting a financial objective or target in a different, non-acquisitive way; this factor involves fulfilling a strategic need in a different, non-acquisitive way.

A Reduction in a Company’s Absorption Capacity

Haspeslagh and Jemison identify three phenomena that may stall an acquisition program. The first involves a dearth of candidates that are likely to be available in the targeted industry at reasonable prices; the second, consists of possible regulatory restrictions on a particular acquirer with a significant existing position in an industry owing to anti-trust considerations. The authors refer to the third phenomenon as “saturation” (Haspeslagh and Jemison, 1991, p 259). According to these authors, a point of saturation is reached when the internal resources an acquirer can devote to searching for, evaluating and implementing deals for candidates become over-stretched and the need for coordinating the operations of the companies already acquired and transitioning to integrated management becomes the acquirer’s most important goal (Haspeslagh and Jemison, 1991). Kitching refers to “corporate indigestion” and the potentially negative impacts of acquirers “biting off more than they can chew” (Kitching, 1967, p 98). He points to the need to have management capabilities in line with the magnitude of management tasks in the post-acquisition period and warns that “demands on the acquirer’s management time are [consistently] underestimated” (Kitching, 1967, p 100). Indeed, Kitching cites problems “digesting” acquired firms as a major reason for post-acquisition failure.

Recognition that a saturation point has been reached, that is, that there is no slack, may result in management lowering the priority it places on acquisitions. This change, however, is assumed to differ from a more fundamental shift in overall strategic priorities in that the periods in which saturation occurs are typically of relatively short duration. Initial post acquisition integration or absorption might, for example, involve certain essential activities like establishing the reporting relationship for the CEO of the newly acquired company and installing people and monitoring and control systems into it while completing other steps required to fully integrate the candidate into the acquirer’s operations over a period of years. If a point of saturation is reached, the longer term strategic priority placed on acquisitions and the rationale for acquiring specific candidates may remain constant but an attractive candidate may not be pursued until the acquirer has the capacity to complete the deal and undertake the tasks required for initial absorption.

Resources

A wide range of physical resources, capabilities and skill sets are required to engage in successful acquisition programs, some of which have already been referred to. Having sufficient funding to complete the deal, for example, was suggested in the discussion of strategic priorities. Another factor, having a post-acquisition manager who can undertake the tasks necessary to ensure the candidate is initially absorbed into the acquiring organization, while not mentioned previously, has also received significant attention in the literature. Unanticipated changes in either factor could result in forgone opportunities.

A Reduction in Funds Available to Complete the Acquisition

High share prices tend to be accompanied by a greater level of M and A activity in the US than low share prices (Golbe and White, 1988). And, recent share price

increases, large cash balances and other factors that suggest the availability of funding tend to correlate with increased acquisition activity by individual companies. The role funds play as a constraint on M and A activity is likely to vary with the phase in the process. As indicated, acquirers typically eliminate from consideration in the Screening Phase (Phase Two) candidates that they cannot afford. This is done by setting an upper limit on their asset values, sales values, profit levels, share prices or some other financial measure that may be used to compute likely purchase prices. For example, in the absence of data other than a candidate's sales (for example, \$100 million), "rules of thumb" based on average industry returns (for example, 5% ROS) and average acquisition price to earnings ratios (for example, 10:1) might be used to arrive at a crude but sufficiently accurate valuation (for example, \$50 million) to eliminate companies for which sufficient funds are clearly not or won't become available. Funding might be drawn from retained earnings or elsewhere, for example, from cash flow from operations, the sale of an asset, the settlement of a claim, or an increase in the acquirer's share price. Funds might also be raised by borrowing or floating additional equity. But, numerous factors could either absorb available cash earmarked to finance an acquisition or interfere with the success of plans to raise funds before the negotiations begin. Haspeslagh and Jemison, for example, refer to the "interwoven" nature of divestitures and acquisitions (Haspeslagh and Jemison, 1991). An acquiring firm may plan to raise funds by selling one of its own companies and the divestiture may not be successful; it may want to acquire a company with multiple business units and have plans to on-sell one or more of them to a third-party who withdraws from talks. Salter and Weinhold (1979) specifically stress the need for acquirers to have a surplus of cash or borrowing capacity. A reduction of funding or the ability to raise funds, no matter how caused, if unanticipated and unplanned for, could preclude the acquisition of attractive candidates.

The Unavailability of a Planned Post-Acquisition Manager

The structuralist stream of strategy implementation literature suggests the importance of aligning formal organization structure with strategy (Drazin and Howard, 1984 cited in Nobel, 1999). If a lack of alignment increases risks of failure and alignment necessitates the availability of managers with specific and unique knowledge and skills to absorb an acquisition, it follows that if one or more managers with the requisite skills and knowledge becomes unavailable that risks will increase. More particularly, Mace and Montgomery identify, as a precondition for success in acquisitions undertaken in connection with diversification strategies, the availability of "competent manager(s) who can quickly adjust to doing business in a new field" (Mace and Montgomery, 1962 cited in Paine and Power, 1984). And, in examining the importance and role of capability transfer to achieve synergy, Haspeslagh and Jemison (1991) highlight how capabilities are embodied in people. Independently of acquisition "type" or motives, Kitching points to the necessity of the acquiring organization to appoint a key person to "ride herd" immediately after the acquisition to ensure that successful integration is begun (Kitching, 1967, p 96). The manager to whom the CEO of the acquired company will report or who will have significant responsibilities for integration may have specific post-acquisition experience, functional expertise in the area in which the realization of synergies has been targeted or general familiarity with the products and

markets of the candidate. In this case, the availability of the specific manager may be a precondition for success (Haspeslagh and Jemison, 1991). If such a manager (or managers) is perceived to be in a unique position to add value to the acquisition, his or her (or their) loss could result in a forgone opportunity.

Advocacy

There is a significant body of organizational behaviour and strategic management implementation literature on sponsorship, much of which deals with champions and championing. Nobel, in the context of a discussion of the influence of leadership and management styles on implementation, refers to a “change agent or champion who is typically a high level leader who paves the way for (strategy) adoption by shaping and guiding the ...process” (Nobel, 1999 p 122). Acquisition programs need internal advocates to ensure that M and A’s receive appropriate priority, that phases in the programs are implemented correctly and that a sufficient degree of consensus is achieved around specific opportunities for them to be pursued through completion. Haspeslagh and Jemison characterize the role of the champion in acquisitions as “selling-in the idea and overcoming hurdles” (Haspeslagh and Jemison, 1991, p 10). Trautwein considers selling mergers “one [of the two] most important tasks [in an acquisition effort]” (Trautwein, 1990, p 293). The individual champion can be critical to the advocacy process. Indeed, it has been suggested by a number of researchers that to reduce cognitive strain associated with the selection of candidates (or, more generally, alternatives in any strategic decision), decision-makers’ choices may be based more on an assessment of the sponsor than the facts he or she presents about the alternative (Mintzberg, et al., 1976, Carter, 1971a, Lyles and Mitroff, 1980). More specifically, Carter suggests that a sponsor’s qualifications, background and training influence the threshold levels used as standards by senior management for approving or rejecting the sponsor’s projects (Carter, 1971a).

Advocacy is important in at least two levels in the organization: the operating level at which the candidates are evaluated and recommended to senior management; and, secondly, the highest level at which they must be approved. Haspeslagh and Jemison (1991) suggest that, at the operating level, the champion role may overlap with the role of the post-acquisition manager. Alternatively, the champion may be the CEO of the acquirer or some other party at the corporate level who is actively involved in the search. Since ultimate approval for an acquisition frequently rests with the board, additional championing at board level may be required (Mintzberg, et. al., 1976, Haspeslagh and Jemison, 1991). While the role of boards is occasionally alluded to as one of “rubber stamping,” as noted, the importance of advocacy at this level is suggested by Haunschild and colleagues’ finding that companies which are tied to others through a director tend to imitate the acquisitive behaviour of the tied-to firm (Haunschild, et. al., 1994).

Since sponsors serve as enabling mechanisms for the successful execution of the search process and the securing of approvals at the highest corporate level, the loss of the day-to-day champion or most senior level advocate in a firm could result in a deal stalling or being forgone completely.

Competitive Context

At least two aspects of the competitive environment could result in the reversal of a decision to pursue an attractive candidate. The first involves a managerial reaction to direct external competition for the candidate. The second relates to internal competition between a candidate that has already been evaluated and found to be attractive and a new candidate.

A Competitive Bid for the Candidate Occurs or is Likely

A competitor may bid for a candidate thought to be attractive by another prospective acquirer and, as a consequence, the other acquirer drops out of the race. The premia paid for candidates when companies compete to acquire them are well documented in the literature. The escalation of [the] commitment [to acquire] is one of several psychological mechanisms that are used to explain the relationship of competition for a candidate to over-payment for it (Jemison and Sitkin, 1986 a, 1986 b, Haunschild, et al., 1994, Andrews, 1999, Puranam et al., 2006, kStaw, 1976, 1978, 1981). In describing this phenomenon, Duhaime and Schwenk warn against the “entrainment” effect that results from such an escalation (Duhaime and Schwenk, 1985); Andrews finds support for the relationship of price premia and the illusion that managers can control or fix problems in a candidate that are, in fact, beyond their capabilities (Andrews, 1999)⁸. The phenomenon of overpayment seems to be generally accepted, a range of explanations for it find empirical support, and a number of authors point to the dangers inherent in it. As noted in Chapter 1, to avoid it Haspeslagh and Jemison (1991) suggest that to avoid it companies establish a walk-away price to which they rigorously adhere. Kusewitt goes further by recommending “bidding competition...should be shunned” (Kusewitt, 1985). Given that overpaying is common and that competition seems to encourage it, it is possible that, in anticipation of the need to pay an inordinately high price, an acquiring firm, may forgo pursuit of a candidate if the firm faces significant competition for it. By withdrawing from a competitive situation prior to negotiating or bidding, an acquiring firm may either protect itself from overpaying for a candidate, or cope with concerns about being tainted as a “loser” if the candidate is acquired by another suitor. Finally it may avoid incurring costs associated with continuing pursuit of what it thinks is likely to be a losing proposition. In doing so, however, it may forgo a real opportunity about which it has insufficient information to justify its withdrawal.

An Alternative Candidate Becomes Available

There are numerous references in the literature to the need for and advantages of prospective acquirers to conduct broad-based and proactive searches to locate candidates (Haspeslagh and Jemison, 1991). And, it is possible that different candidates will be in different phases of an acquirer’s search process at any given point in time. In circumstances when an acquirer evaluates multiple candidates with parts of the search

⁸ Apart from the influence of cognitive and behavioural factors that result in mistakes, the research stream dealing with agency theory suggests that managers knowingly overpay for candidates but do so with a view to satisfying personal needs (at the expense of shareholders). Such explanations are not relevant here.

process and evaluations overlapping, the acquiring firm may find a new candidate that appears more attractive than one that has already been thoroughly evaluated but not yet approached. Alternatively, a highly attractive candidate that was not previously available at a reasonable price, and was therefore dropped from consideration, may become available under terms and conditions that would make it acceptable. Finally, acquiring companies may find candidates that are so attractive for reasons not originally envisaged and translated into search criteria that they adjust their strategies to formally accommodate them. In such cases, the original candidate that was evaluated and found to be attractive may not be pursued and an opportunity may be forgone.

In sum, candidates that are found attractive are not acquired. And, there may be a wide range of factors that intervene in the decision making process after candidates are evaluated but before negotiations begin which, if planned for and managed, could well improve acquisition performance.

To What Extent Might Managing Factors that Intervene in the Decision Making Process to Reverse Attractive Acquisitions Contribute to Performance Improvement?

The degree to which missed opportunities are significant in number and value is neither directly supported nor easily inferred from available data. There is, however, a body of anecdotal evidence suggesting that foregone opportunities may be both important in number and expensive in terms of out-of-pocket and opportunity costs.

Foregone Opportunities may be Significant in Volume

No known empirical studies quantify or compare directly the number of attractive acquisition opportunities that are foregone with those that actually do proceed to the negotiation phase and are ultimately consummated. Creswell (2001) claims that of 387 “buy outs” with values in excess of \$500m that she examined in 1999, 124 didn’t close but it is unclear when in the process and why they were forgone. Perhaps this knowledge deficit results from the inherent difficulties in defining and measuring things that don’t happen.⁹ Such difficulties are implied by Hickson and colleagues’ observations, citing the studies of March and Olsen (1976) and Mintzberg, et al. (1976) as examples, that “research [on SDM’s of all types] is based virtually exclusively on positive decisions” (Hickson, et al., 1986, p 35).

Haspeslagh and Jemison (1991) suggest another explanation. In comparing acquisition decisions with other significant project related capital expenditure decisions, they point out that top management rarely rejects the latter. They attribute the positive outcomes of non-acquisition related decisions (that is, their implementation) to the fact that project scopes and commitments can be shaped from very early on in the decision process and adapted to fit senior management requirements. Approvals are, in effect, built into the decisions. Hickson and colleagues similarly observed a scaling down of decisions to the point where they became “less serious” and progressed to conclusion with “less contentiousness” (Hickson, et al., 1986, p 257).

⁹ This may be true in other domains in which decision-making has been studied. Greenleaf and Lehman, for example, develop a typology of reasons for substantial delays in consumer decision-making. All of the decisions in their sample ultimately culminated in a purchase (Greenleaf and Lehman, 1995). The author was unable to identify any studies of why consumer decisions are actually reversed.

Acquisitions, however, are most often a kind of take-it-or-leave-it commitment (Agastya and Daripa, 2002) at a given price requiring a binary decision the content of which is difficult to modify (Hespelagh and Jemison, 1991, p 52). While acquisition decision reversals have not been studied extensively, two data sets imply few opportunities might be forgone as a result of them. These data, however, have significant limitations:

- Ansoff and colleagues find that one and a half candidates are “thoroughly” evaluated for each one acquired (Ansoff, et al., 1971, p 6).¹⁰ While this suggests a high rate of completions, their data have several limitations: First, during the 20-year period covered by the sample (1946-65), acquisitions were less prevalent than they are today. Second, their sample consisted of 271 publicly traded US-based companies that acquired other domestic companies for which Compustat data were available. Finally, and perhaps most importantly, in order to facilitate the financial analyses of the impact of the acquisition(s) on the acquirer(s), the companies studied had to have undergone significant periods during which no acquisitions were made before and after the periods in which performance outcomes were assessed. As a consequence of their sample requirements, almost half of their respondents had made only one acquisition during the 20-year period; two-thirds had only made two acquisitions. The average for all respondents was only one acquisition every seven years. While comparisons are difficult due to data comparability, Ansoff and colleagues’ findings appear to contrast significantly with those of Markell, who studied the acquisitive behaviour of 141 publicly traded US-based companies in the 1975-79 period. This researcher found that one-quarter of the sample had engaged in multiple mergers and acquisitions in a given year (Markell, 1984). And, while the author does not mean to suggest that US-based General Electric’s experience is representative, two of its divisions – Medical Systems and Aircraft Engines and Power Systems-- acquired 88 companies in the 1997- 2000 period in support of a strategic thrust to develop services (Welch, 2001).
- Using more recent data, Puranam, Powell and Singh (2006) find that of 11,556 M and A’s announced in the USA in 1999 and 2000, only 383 (3%) were withdrawn by January 2002. Moreover, decision reversals appear to be based on sound reasons which essentially result in a candidate becoming less attractive or simply not available, for example, as a result of poor due diligence findings, rejection of an offer, or unlikely regulatory approval. Their sample, based on Thomson Financial data, deals with publicly traded US companies only and does not cover the period between completion of a sufficiently thorough analysis of the candidate to justify a decision to proceed and the public announcement of intent (Puranam, et al., 2006). It, of course, also excludes the plethora of smaller acquisitions, which are not subject to public announcement.¹¹

¹⁰ The authors also find that for each company acquired, the acquiring firm had entered into detailed negotiations with another candidate who was not acquired. This suggests that negotiations often begin before candidates are thoroughly evaluated.

¹¹ Small acquisitions of non-publicly traded company’s account for the overwhelming majority of US acquisitions and have done for a significant period. Kitching, citing Federal Trade Commission data, notes that as far back as 1965 the acquisition of companies with assets or purchase prices of less than \$10 million accounted for almost 95% of all transactions (Kitching, 1967).

Other data suggest the possibility of forgone opportunities and imply they may be important. Only 8% of the strategic decisions studied by Hickson and colleagues were negative or suggested a reversal, that is, their purpose was “to preserve the status quo ... or [for example] not to make a take-over bid” (Hickson, et al., 1986, p 35). The authors believe, however, that executive biases toward reporting on positive decisions resulted in an under representation of negative decisions (or decision reversals) in their sample and they suggest that “negatives are a more important element among strategic decisions than has appeared to be so” (Hickson, et al., 1986, p 35). Mintzberg and colleagues refer to strategic decision “interrupts” in which a fully developed solution (to the decision problem) is rejected leading to a modification in strategy and development of another solution and they imply that interrupts are common (Mintzberg, et al., 1976). In an M and A context, this might be thought of in terms of the reversal of a decision to pursue an attractively evaluated candidate in favour of an alternative.

Finally, some studies which deal specifically with diversification and acquisition decisions use agency theory to explain situations in which attractive offers are rejected by candidates’ managements or acquirers’ managements either buy unattractive candidates or forego the acquisition of attractive ones (Achampong and Zemedkun, 1995, Lubatkin, 1983, Lane, Canella and Lubatkin, 1998). While the negative role of managements’ self-interest in influencing acquisition decisions is advanced as a theoretical explanation, the magnitude and number of opportunities that are foregone as a result are not quantified.

In sum, data which measure or otherwise allow an inference about the magnitude or frequency of foregone acquisition opportunities are not available. There is anecdotal evidence and there are suggestions, however, that it is possible that the number may be significant.

Forgone Opportunities Are Costly

Even if the number of forgone opportunities for a given firm were small, the costs of analysing candidates up to the point where conclusions are reached about their attractiveness can be high. Nutt (1998) states that “Enormous sums [are].....spent on decisions that [are] put to use only half the time.” Haspeslagh and Jemison (1991) assert that there is a requirement for substantial resources to successfully undertake an acquisition search. Identifying and evaluating acquisition candidates can take substantial managerial effort and involve significant out-of-pocket costs. In addition, there are opportunity costs associated with decision reversals. A number of authors, Haspeslagh and Jemison (1991) and Mattsson (2000) among them, point to the importance of time-based strategic action. Given the limited number of highly inherently attractive candidates in oligopolistic markets for example, “first mover” advantages (Mattsson, 2000) may be permanently lost.

While the need for speed to also respond to unanticipated opportunities is acknowledged, proactive and broad searches are typically recommended in the normative literature. Such searches may extend over prolonged periods. Krallinger, for example, states that “typically, it will take a buyer one year to find a good business” (Krallinger, 1998 p 236). Ansoff and colleagues found that the period from the identification of a candidate to consummation of a deal varied from one month to five years and typically

lasted ten months (Ansoff et al., 1971, p 6). Cameron (1977) finds that in Europe the average time spent on identifying, evaluating and closing deals is 370 man-days.

It is generally recognized that such efforts require top management time. Ansoff and colleagues find that primary responsibility for searches in 44% of the firms they sampled rested with the Chairman or President. The authors note that, on average, 20 candidates were “worth considering” in each search. This implies some effort by senior management although, as indicated previously, the number of thoroughly evaluated companies in relation to the number acquired is small (Ansoff et al., 1971, p 34).

No known recent study has sought to quantify the value of time spent in the search and evaluation phases of the acquisition process but it is not unreasonable to assume that it is significant and costly¹².

Apart from management time, a search may involve the acquirer incurring a wide range of out-of-pocket expenses. For example, consultants and advisors may be used “upstream” in the process to assist a firm to develop acquisition objectives and to undertake the search. Further downstream, they may help evaluate candidates or undertake other tasks prior to negotiations such as legal, environmental and accounting due diligence. Fees can be substantial.

Two other kinds of costs are possible:

- Broken-deal fees: Anecdotal evidence from cases described in the popular business press illustrates the potential magnitude of these. For example, Martin Sikora, editor of Mergers and Acquisitions, describes Delta and Pine’s (Delta’s) rejection of an \$81 million broken-deal fee, which Monsanto offered to it after reversing a decision to merge with the company. Delta countered the offer with a suit against Monsanto for \$1 billion. Alleged damages result from Delta’s incurring costs and losing management time working toward the merger. In addition, Delta notes that its share price declined following its rejecting a one-time offer from a Monsanto competitor (Sikora, 2000).
- Effects on shareholder value: Costs to shareholders associated with withdrawals have been the subject of study but results are equivocal. Datta and colleagues undertook a meta-analysis of wealth creation based on share price movement following announcements and conclude that abortive acquisitions are cost neutral. Jensen and Ruback, however, conclude that bidders lose when they reverse decisions (Datta, et al., 1992, Jensen and Ruback, 1983).

In sum, apart from not realizing the benefits of an attractive opportunity, forgone opportunities can involve the acquirer incurring substantial costs.

The Need to Identify and Manage Factors that Contribute to Foregone Opportunities

In sum, there appears to be a consensus, supported by substantial empirical research,

¹² Ansoff et al., (1971) find that only 1 to 6 people staffed an organizational unit undertaking searches in the companies that had staff dedicated to this activity. This author doesn't find that surprising given the low level of M and A activity among the companies in their sample.

that mergers and acquisitions are important yet many fail. Much research has been undertaken by scholars from various disciplines to identify reasons for failure with a view towards providing practitioners with suggestions and normative guidelines about how to avoid failure and, in doing so, improve acquisition performance. Acquisition performance may also be improved by increasing the number of attractive candidates that are acquired. Yet there is some indirect evidence to suggest that some opportunities may not be exploited. More particularly, there may be occasions when candidates are found to be attractive after thorough analysis by the prospective acquirer, yet it does not pursue the candidate.

Myriad factors might result in a prospective acquirer reversing a decision to pursue a candidate once bids or public announcements are made or negotiations begin. Some of these, like reactions of regulatory authorities or the receipt of negative information about a candidate's operations not previously available, may be difficult to anticipate or plan for. Other decisions, however, are reversed before public announcements of intent are made or negotiations begin as a result of the intervention of factors which may be subject to managerial control. It is the position of this paper that these deserve attention since an understanding of them may help practitioners to formulate check-lists of factors to plan for to incorporate into their acquisition planning which would assist them to consummate a larger number of attractive deals.

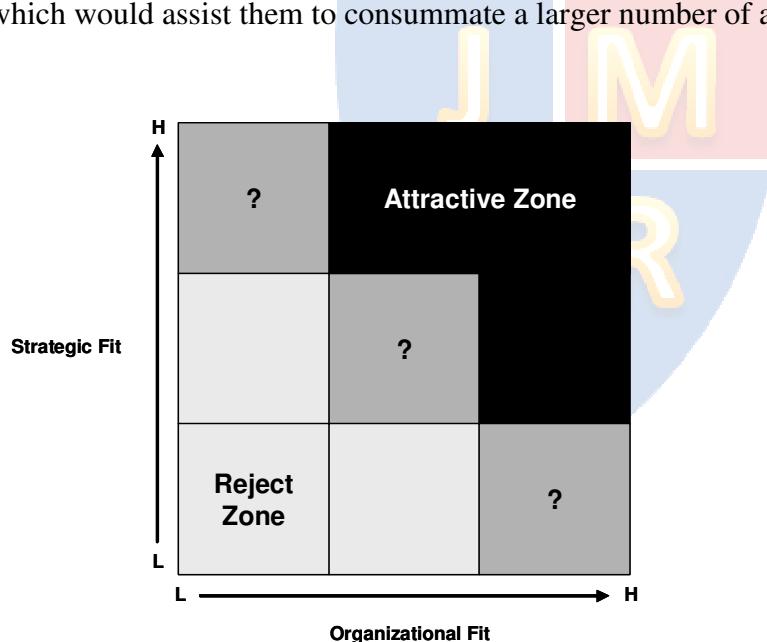
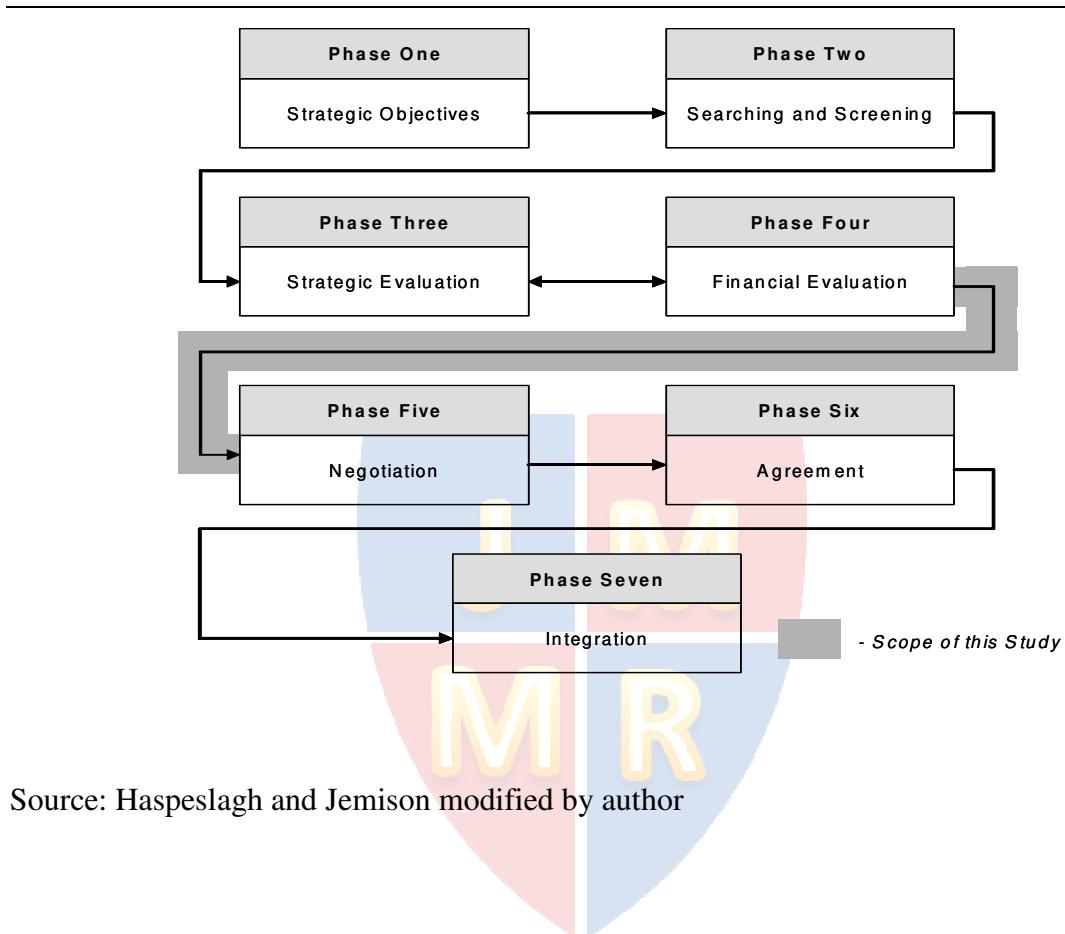


Figure 1: Strategic and Organizational Fit as a Means of Selecting Acquisition Candidates

Figure 2: Model of the Traditional View of the Acquisition Process



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