The M&A Process Revisited – Identifying a Suitable Phase Model

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Abstract
Perhaps the most significant aspect of the Mergers and Acquisition (M&A)-phenomenon is their high failure rates which have been documented for many decades. They have attracted substantial interest from a variety of management disciplines. Poor M&A management during the process phases has been posited as a potential source of this disappointing performance. However, in academic literature one may often see slightly different definitions of the M&A process. In fact, there is no convention (in the sense of “common understanding”) which of the numerous M&A project phase models offered in the large corpus of academic work one should choose when analysing and measuring M&A performance. The author believes that this is a critical omission. The paper presented here represents an attempt to review different M&A phase models and identifies a 5-step M&A process as being the most suitable one. This analysis can thus help researchers and practitioners to build on these findings when trying to identify practical solutions to the vexing problem of M&A failure.

Key words
Mergers and acquisitions (M&A), M&A phases, M&A performance

Introduction
Possibly one of the most remarkable aspects of M&A as a phenomenon is its high propensity to fail. The high failure rates and rather disappointing financial returns on M&A transactions have been documented in detail for quite some time now. Using comparable methodologies, several M&A studies from the 1970s and the 1990s
reported failure rates of roughly 50 percent.\textsuperscript{1} Contemporary researchers have reported equally disappointing findings. Coffey, for instance, found that 70 to 80 percent of the M&A cases studied did not meet their projected operational synergies\textsuperscript{2} (Coffey and Garrow, 2003). In a meta-analysis of 128 M&A studies, researchers concluded that only 20 to 30 percent of the companies investigated created significant value above the annual cost of capital (Bruner, 2002). Other empirical studies completed most recently mainly in the field of finance conclude that M&A transactions show failure rates ranging between 44 and 50 percent.\textsuperscript{3} More recent studies investigating German listed companies have reached similar conclusions. Here, the failure rate for M&A projects amounts to around 50 percent.\textsuperscript{4} Risberg (1999), therefore, states “Mergers and acquisitions have fascinated many researchers and practitioners for decades, especially because many companies that acquire other companies often experience their acquisition as disappointing.”

In academic literature there are three main directions that discuss the determinants of M&A failure. The first is the literature emphasizing “strategic fit”, which focuses on the link between M&A outcome and the strategic patterns of the combining firms or, to be more precise, the extent to which a target firm’s business should be related to that of buyer (Capron, 1999; Elbanna and Child, 2007).

The second is the so-called “organisational fit” literature corpus, which aims to understand how the organisational and human resources aspects of an acquisition influences the subsequent performance of an M&A. This strand of academic literature has its roots in the human resource, organisational behaviour and strategic management disciplines

\begin{itemize}
  \item \textsuperscript{1} See Kitching (1974), p. 124-130 and Rostand (1994), p. 27
  \item \textsuperscript{2} Operational synergy is the disproportionate increase in productivity resulting from the combination of two or more operating units \((1 + 1 = 3)\)
  \item \textsuperscript{3} See Cartwright and Schoenberg (2006), p. 51-55
  \item \textsuperscript{4} See for one example Oleownik and Bussmann (2002), p. 244
\end{itemize}
(Schweiger et al., 1993; Cartwright and Cooper, 1993; Very and Schweiger, 2001).

However, despite this robust and on-going interest from researchers and practitioners, empirical analysis reveals that there has been little change in M&A failure rates over time. The reason for this could lie in the fact that in the aforementioned academic literature, the M&A process is seen as a process directed and driven by economic analysis and rational decision making. However, contemporary researchers are suggesting other explanations and look at the company`s M&A processes from other perspectives. Within the literature examining M&A, one such perspective is the process view and, thus, representing the third direction, the so-called “process literature”. It focuses on the important role that the choice of M&A process can play. The studies highlight that inappropriate decision-making, negotiation and integration processes can result to inferior M&A outcomes (Jemison and Sitkin, 1986; Haspeslagh and Jemison, 1991; Pablo, Sitkin and Jemison, 1996).

Haspeslagh and Jemison (1991) conclude that “the whole process must be understood to understand the parts.” As a consequence, this third approach view puts more emphasis instead of analysing just the environment, motive and organisational or strategic fit between the acquirer and target, on the M&A process in itself, which have to be analyzed and considered, as this seems to be highly influential for a transaction`s value creation. It can be seen as a move from looking at the outcome to instead regarding the drivers of the outcome. Exemplarily, Jemison and Sitkin (1986) in their seminal analysis raised the question, “what a process perspective can contribute to the understanding of corporate acquisitions?”

The author shares this view which is why the paper under review has chosen to focus on the M&A process as well. It is the author`s

\[5\] See Jemison and Sitkin (1986), p. 110
opinion that a more successful M&A outcome inevitably goes via a successful and smooth process management. However, when turning to the extensive strand of academic literature analyzing the M&A process, it is noteworthy that there is - to the best of the author’s knowledge - a lack of convention in separating the different M&A project phases. The paper under review is an attempt in that respect. The objective of the paper under review is, thus, to review existing literature in this field and to identify a suitable M&A phase model with the ultimate aim of providing prescriptive advice to researchers and practitioners to build on these findings when trying to identify practical solutions to the vexing problem of M&A failure.

Methodology

In this descriptive analysis, the author searched for (peer)-reviewed journals in the areas M&A performance/success, M&A process and M&A phase models and identified a large number of papers published during 1989 to 2012. The author reviewed each of the papers in detail, analyzed the different phase models offered by different scholar and aimed at identifying a suitable one by combing the process phase perspective with main M&A success factors found in academic literature. The author also summarized the objectives and findings of each of the study fields. The reviewed papers cover a wide range of time segments, more than 20 years and include both Anglo-American and European authors.

M&A Project Phase Models in Academic Literature

In general, M&A transactions range from strategy development and systematic selection and screening of candidates, exploration, due diligence, transaction and integration preparation to integration itself as well as tracking of implementation measures. Therefore, M&A could be
divided into different distinct project phases. The business case is developed during strategy evaluation, candidate screening as well as selection and the determination of the business model. This preliminary explorative phase is followed by “deal-making” project phases which involve the due diligence, the financial/legal transaction, including price negotiations, setting of terms and conditions, contract development and antitrust clearance. Finally, the integration planning and implementation of an M&A project is where the organisational and cultural merger is conducted.

However, it is found in academic literature that the M&A process is described slightly differently by different researchers. To understand better what the various phases or stages of an M&A transaction might be, this paper reviewed prior research in this area and identified various approaches ranging from two to seven phases.

For example, Boland (1970) in an early study concluded that the M&A process should be divided into two phases: premerger and post-merger. Similarly, DiGeorgio (2002, 2003) classified the success of M&A into the so-called front-end success and integration success. The result of the front-end success is to select the right target for M&A which comprises many elements such as leadership, adequate time and resources and tools for M&A analysis, possessing and establishing learning mechanisms and understanding culture and organizational structure differences implied in the analysis. The successful outcome of the second stage is to achieve the objectives, which needs selecting the right leadership, structuring the integration team and detailed plan in terms of communication, integration and people issue.

Salus (1989) identified three process phases: premerger, merger and post-merger.6 Yet, according to Haspeslagh and Jemison (1991), the acquisition process is to contain four major phases: idea, acquisition

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justification, acquisition integration and results. During the idea phase, the potential acquisition is suggested and eventual partners are evaluated. Thereafter, the acquisition must be justified for the rest of the company before the actual decision to go on with the deal is made. When the deal is a fact, the integration starts with a special phase called the stage-setting phase. This phase involves a transition period before the integration actually starts. Likewise, Carpenter and Sanders (2007) divided the M&A process into four phases: idea, justification (including due diligence and deal negotiation), acquisition integration and results analysis.

Galpin and Herndon (2000) used the so-called Watson Wyatt Deal Flow Model consisting of five phases. It is worth mentioning here that this model takes into account the pre-acquisition analysis of strategic and organizational fit, the importance of which to the M&A process itself and M&A outcomes has been highlighted in academic literature as according to Jemison and Sitkin (1986).

According to Farley and Schwallie (1982), the M&A process has six phases: integration with the strategic plan, screening, evaluation of targets, understanding value and price, anticipating the post-acquisition phase and efficient implementation.

Finally, according to Kazemek and Grauman (1989), the M&A process consist of seven phases: assessment, joint planning, problem analysis, structure selection, securing approvals, final planning and, finally, implementation.

However, one could argue that discussing the M&A process in terms of different phases might be somewhat problematic, as it seems to be difficult to identify when each process phase ends and the next starts.

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7 See Galpin and Herndon (2000), p. 6
8 See Farley and Schwallie (1982), p. 32-40
9 See Kazemek and Grauman (1989), p. 82
since there is no clear-cut. There is another problem with pure phase thinking. (Process) phases do not have to correspond with time. Two events happening at the same time can consequently be referred to as completely different phases. Moreover, different parts of the organisation and different individuals can experience different process phases at the same time. One can also question whether phases really are sequential. Maybe some parts of the organisation experience a sequence of phases different from those described by academic literature. Despite these weaknesses, looking at the M&A project in phases is quite common in academic literature and widely accepted. As Risberg (1999) states, “the point of identifying stages has been to distinguish events and activities of each stage to further the understanding of the acquisition process.”\(^{10}\) For the purpose of this study the author, therefore, deems it reasonable and justifiable to examine an M&A phase model. Before attempting to identify a suitable phase model, the author deems it necessary and recommendable to first take a closer look at different potential M&A failures (successes) potentially active on different phases of an M&A transaction.

### Reasons for M&A Project Failure (Success)

As postulated above, successful M&A are neither an art nor a science, but a process. It is, thus, crucial to understand the M&A process itself when analysing the M&A outcome and result. Therefore, in order to attain thorough understanding about factors which could lead to the failure (success) of an M&A project, the following section is aimed at investigating two key areas: a.) causes to M&A failure and b.) critical factors for M&A success.

\(^{10}\) See Risberg (1999), p. 34
The use of appropriate criteria is apparently very important in assessing the performance of M&A. As Hopkins (1999) pointed out: “If failure is used in an extreme sense, such as the sale or liquidation of business, then the rate of failure is relatively low. If failure is the lack of attainment of management’s financial objectives, then the rate of failure is high.”\(^{11}\)

While it is clear that a transaction as complex as an M&A has many potential problems and pitfalls, in line with the shift towards a more process perspective oriented approach when measuring M&A performance in contemporary academic literature, as pointed out in the previous Chapter, several researchers identify M&A failure as being a failure of M&A process management. For instance, Haspeslagh and Jemison (1991) come to the conclusion that every step in the process is vital for the outcome of the acquisition. They conclude that key differences between acquisition success and failure lie in understanding and better managing the processes by which acquisition decisions are made and by which they are integrated.\(^{12}\) They also suggest that “although the strategic fit of an acquisition is the basis of the potential for value creation, it is managing the acquisition process well that underlies actual value creation.”\(^{13}\)

In short, according to these scholars all parts in the M&A process can be important for the outcome of the acquisition and may influence the performance and, therefore, researchers emphasize the extent to which the acquisition process itself may be related to the ability to make an M&A successful. Consequently, it seems to be worthwhile to shortly discuss the possible causes to M&A failure (success) which according to the assumptions made in this thesis have their roots in the M&A process.

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\(^{11}\) See Hopkins (1999), p. 220

\(^{12}\) See Haspeslagh and Jemison (1991), p. 3

\(^{13}\) See Haspeslagh and Jemison (1991), p. 164
Jemison and Sitkin (1986), for instance, identify the following reasons for M&A failure: a.) inadequate analysis of strategic fit, b.) failure of analyzing the organizational strategic fit, and c.) failure in analyzing and negotiating with a potential target.

Haransky (1999) attributes the failures to five dimensions: a.) insufficient assessment of target, b.) too much focus on the financial aspect of the transaction, c.) paid deal premiums too high to justify/pressure to make something happen, d.) M&A as part of an outdated strategic plan, and e.) no experience in integration of the entities.

Similarly, DiGeorgio (2002) cites M&A failure as a.) a result of inadequate due diligence, b.) lack of compelling strategic rationale, c.) overpayment for the target company, d.) conflict between corporate cultures, and e.) failure to quickly meld the two companies.

For Kale et al. (1998) it is mainly the following project tasks: a.) search for potential target, b.) determine the value as well as synergies from the deal, and c.) strategic activities.


In a similar approach, a rather recent study performed by Garbuio et al. (2010) attributes M&A failure to potential biases active on a four-process phase model, i.e. a.) pursuing a target, b.) preliminary due diligence, c.) the bidding phase, and d.) final due diligence.

Other scholars emphasize more on a two-dimensional M&A process, i.e. they try to identify success factors on the pre-acquisition or

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14 See Kale et al. (1998), p. 5
post-acquisition phase. Consequently, in terms of pre-acquisition success factors the body of literature suggest that companies with an overall strategy and experience of M&A are more successful than those that are less experienced or merely react to a M&A opportunity. One example of research in this respect is Very and Schweiger (2001), who found that poor management as well as planning in the pre-acquisition phase creates problems in the decision making process for the integration phase. According to them, the pre-acquisition planning should involve the post-acquisition integration style.

Meanwhile, Haspeslagh and Jemison (1991) specifically emphasize initial decision making (which is part of the pre-acquisition phase) and post-acquisition management. Similarly, Jennings (1985) takes the view by placing more importance in the planning stage, “Planning an acquisition strategy can help avoid a takeover marked by poorly matched partners and maximize the potential for success.” Likewise, according to Chapman (2004), the screening and pre-planning phases are critical success factors for M&A.

Researchers emphasizing the importance of the post-merger integration process in M&A performance (Graebner, 2004; Larsson and Lubatkin, 2001; Vaara, 2003; Haspeslagh and Jemison, 1991) began to flourish already in the 1980s. The complexity of the integration approaches used in M&A scenarios has led to the development of numerous contingency frameworks or typologies (Angwin, 2012; Haspeslagh and Jemison, 1991; Schweiger et al., 1993). Likewise, Schoenberg (2000) point out that effort toward integration during the post-merger integration period is somewhat critical to M&A performance. Moreover, Cartwright and Schoenberg (2006) discuss the

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16 See Jennings (1985), p. 37
increasing interest in post-merger integration among contemporary researchers. Similarly, topics such as post-acquisition resource transfer,\textsuperscript{19} post-acquisition performance\textsuperscript{20} and speed of M&A integration\textsuperscript{21} have been common in recent academic literature. Some researchers assert that successful companies always create a coordination team for the post-acquisition-integration phase.\textsuperscript{22} According to Schweiger et al. (1993), the earlier this team is created, the greater the possibility for pinpointing strategic fits between the combining organizations. They suggest that, where possible, the implementation team should even be created before the deal is concluded.\textsuperscript{23}

Others put emphasize on more granular aspects of the transaction phase. For instance, choosing the right partner is central to M&A success for some researchers (Hubbard, 2001; Hitt et al., 2001; Bruner, 2004). According to this literature, the ratio between potential deals and completed deals is very small, therefore, the efficiency of the acquisition search is crucial and can yield significant improvements in end-results.

For others, the proper analysis of a potential target and the due diligence is critical for the M&A outcome (Mirvis and Marks, 2001; Tetenbaum, 1999; Harding and Rouse, 2007). Moreover, McDonald et al. (2005) conclude that "due diligence was critical to success; its particular value was removing managerial ego and justifying the business case."\textsuperscript{24} Walsh (1989) and Depamphilis (2005), on the other hand, conclude that it is mainly the negotiations skills of an acquiring firm that is critical for the overall success of M&A.

\textsuperscript{19} See Ranft (2006), p. 56
\textsuperscript{20} See King et al. (2004), p. 187
\textsuperscript{21} See Angwin (2004), p. 418
\textsuperscript{22} See Inkpen et al. (2000), p. 50-71; Vasilaki and O'Regan (2008), p. 134
\textsuperscript{23} See Schweiger et al. (1993), p. 53
\textsuperscript{24} See McDonald et al. (2005), p. 1
To sum it up, all of these authors concur with each other in several causes for M&A failure such as M&A deals a.) lacking the right strategic rationale, b.) insufficient analysis or assessment of the target, c.) improper due diligence, d.) poor negotiation skills/overpayment as well as e.) insufficient management in the integration phase.

**Identifying a suitable M&A Phase Model**

As shown above, theoretical and empirical studies relating to the M&A process seldom reach consistent conclusions when trying to describe the different phases and/or its potential failures (successes). In addition, discussing the M&A process in terms of different phases might be somewhat problematic.

Despite these weaknesses and because it is beyond the scope of this paper to question why authors generally tend to focus on certain subareas of the M&A process over time, the author, based on the findings from the previous sections, deems it justifiable to divide the M&A process by aggregating separate process steps which have been identified as somewhat critical to M&A outcome. Consequently, the aggregated process phases are the following: a.) “lack of strategic rationale/lack of strategic fit”, b.) “insufficient assessment of target”, c.) “poor due diligence”, d.) “poor negotiation skills/paid premiums too high” and e.) “poor integration management” (see top line of Figure 1).

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25 and specifically why the post-merger phase seems to be gaining in popularity.
This Figure is an attempt to get a clearer picture on the issue by combining two perspectives which are a.) critical success factors as developed in previous sections above and b.) different phase models as introduced in the previous Chapter. This exercise should enable the author to identify a suitable phase model to choose.

Drawing from the above discussion and illustration, a phase model close to the Watson Wyatt Deal Flow Model is selected for illustration of the M&A process as presented in Figure 1 and, thus, this paper suggests to select a five-phase model as suggested by Galpin and Herndon (2000).26 Although there is no perfect match of M&A failures (successes) and respective M&A phase, the author deems it justifiable to use a five-phase model when it comes to explaining where M&A failure happens simply because the overlapping of both a.) potential M&A failure (success) and b.) process phase is greatest.

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26 For a similar approach, see Very and Schweiger (2001), p. 16
Looking at other alternative phase models, its limitations are rather obvious: A two-phase model would be too coarse while models with six or seven phases could prove too granulate for the intention of this paper. However, while using a model close to the one presented by Galpin and Herndon (2000), the author deems it necessary to use a slightly different terminology for the five phases. It is proposed to use the following naming convention of M&A phases: a.) strategy, b.) screening, c.) due diligence, d.) negotiation and e.) integration (see Figure 2). In the “strategy” phase the overall plan and rationale for the transaction is developed. In the “screening” phase the acquirer screens potential acquisition targets to select the one that will help fulfil the acquirer’s goals. “Due diligence” covers the operational, managerial and legal techniques and optimization, including activities like issuance of confidentiality or non-disclosure agreements, preparation of data room and performing the due diligence. The “negotiation” phase involves all decisions concerning the price and method of payment while “integration” is concerned with post-deal integration.

Figure 2: Five-Phase M&A Process Modell (Source: own illustration)

27 Picot (2002), p.16
Conclusions

As could be demonstrated, the large strand of academic literature offers inconsistent descriptions of the M&A process ranging from two to seven phases. In line with recent academic research suggesting that the M&A process perspective itself is the main driver of M&A performance, the aim of this paper was to review different M&A phase models in academic literature, find a common denominator and select the most suitable one. Despite some obvious weaknesses of looking at an M&A transaction in process phases, the author suggests a five-phase model consisting of a.) strategy, b.) screening, c.) due diligence, d.) negotiation and e.) integration. However, the problem of M&A failure and disappointing financial returns of M&A transactions have been examined only briefly. Further research is needed to better understand the main reasons of M&A failure on distinct transaction process phases. The author hopes that researchers will use the results to build on the findings of this paper and develop new theories or potentially modify existing views.

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