The Risk of M&A and Clear-Cut Evidence in Three Failure Cases

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Abstract

The world is changing in which globalization is becoming the mainstream movement. All companies are heading towards globally expansion. To do so, they have employed various strategies. And merger and acquisition initiative is one of them. This paper is about to find out the driving force to engage in M&A deal and three cases of merger and acquisition will be examined to prove the risky trait of this option. In addition, the researcher will give some proposals to avoid unnecessary failure.

Key Words: Merger and acquisition, M&A, Daimler and Chrysler merger, Wal-Mart in Germany, Sprint and Nextel Company
1. Introduction

The terms of merger and acquisition which are normally known as M&A is the consolidation of two companies to form the new one with the wish of creating more value. In more detailed, merger is combination of two corporations in that one company disappears into the other one, and acquisition is the process by which the ownership of stock and asset of a corporation be transferred to the other one (Reed, et al, 2007). In the business world today, merger and acquisition initiative seems to be a favorable strategy of many businessmen. The evidence is the tremendous volume of M&A deals as well as the amount of investment in M&A activities have increased markedly in recent decades.

Figure 1: Global Merger and Acquisition Value (Source: Consultancy.uk)

![Global Merger and Acquisition Value](image)

It can be said that the participation in mergers and acquisitions is on the rise. The amount of investment in M&A is quite big and increased year to year. In 2015, the world spent $4,894 billion on M&A, and there was period in 2006 – 2007, the number peaked at around $4.5 trillion. Today this activity comes in all shapes and sizes. It takes places both inside the country (domestic M&A) and beyond the boundaries of the country (cross-border M&A). In addition, M&A are taking place in a wide range of industries, including mature manufacturing sectors, high-technology fields and service sectors such as banking, insurance, pharmaceuticals, etc.

2. Literature Review

2.1 The Driving Forces of Involving in M&A

The driving forces underlying the trend to cross-border M&A are complex and diverse by sectors. Each author with their own look in different angles of the matter has different
judgments of the motives of M&A. Briefly, the reasons that prompt executives to acquire, merge or force alliance with another organization can be summarized as follow:

- **To gain access to new markets**

  Enhancement market share is a prime motive for M&A. Growing market share was the single most important objective mentioned by 25 percent of respondents (Thompson et al, 2012). It is one of the fastest ways to penetrate a new market and remove the entry barrier of new markets. When the market is spread, the companies have ability to enhance profitability by their sales revenue increase.

- **To extend product lines**

  Merger and acquisition is the quicker and more potent approach for company to broaden product line (Marks and Mirvis, 2010). The company is able to develop new product categories through new available technic and know-how that acquire from partner. The existing product line of partner can also help company diversify its product categories and expand into additional market segments. This can offer companies benefits similar to those gained through geographic expansion: greater product differentiation. This diversification also helps firms reduce risk ratio (Mellen & Evans, 2010; Edwin and Miller, 2008)

- **To access new knowledge, resources and capacity**

  M&A is the fastest way to grow an organization and its capacity. Greely Holding Group, a big automaker of China quickly gained new technologies from the binding deal with Volvo in 2010. This acquiring helps companies save time and costs in improving technological capabilities. Additionally, M&A enable companies to eliminate redundant technology and gain new knowledge about customers, distributors and suppliers faster.

- **To increase operational efficiency**

  Facing stiff competition, enterprises choose to use acquisitions to operation efficiencies. Horizontal integration might also moderate the intensive competition (Bierman, 2010; Mellen and Evans, 2010; Marks and Mirvis, 2010)

  What is more, “two firms join together will be more valuable than the sum of the values of the two independent firms” (Bierman, 2010, p.291). There will be synergy value which is known when 1 and 1 are added, more than 2 is obtained. Two firms joined together may be worth more than they are worth separately. Specifically, when a company acquires another company, it is usually feasible to squeeze out cost savings in administrative activities, again by combing and downsizing such administrative activities as finance and accounting, information technology, human resources, and so on (Thompson, et al, 2012).

  In short, M&A is driven by various motivations. They are very attractive for all people who are running business, especially for those who want to get scale of economy in the fastest way.
3. Methodology

3.1 Research Questions

The potential benefit that M&A can bring to companies is really attractive and charming for enterprises. This may be the reason for a large number of M&A deals recently. This paper aims to find out whether or not the merger and acquisition is the best option to improve enterprise competitiveness and grow quickly in global business.

3.2 Data

In this study, three cases of M&A will be analyzed to verify the hypothesis. They are the merger of Daimler and Chrysler in 1998, the acquisition of Wal-Mart in Germany in 1997 and the merger of Sprint and Nextel in 2005.

4. Results and Discussion

4.1 The First Case: Daimler and Chrysler Merger:

Daimler is a luxury automobile brand in Germany and Chrysler is an innovative US based company. In 1998, Daimler merged with Chrysler with the main purpose of entry into American market where the economy was booming and created the world's leading automotive corporation for the century of 21 (CNNmoney, 1998). Daimler also had desire in term of new technology and finance support from Daimler. However, the real operation did not follow their expectation, the market share fell from 16.2% in 1998 to just 13.5% in 2000 (Steger and Amann, 2008) and to 10.8% in 2011 (Cain, 2011). The operating profit of DaimlerChrysler Group also decreased 49% and even 90% for Chrysler group (DaimlerChrysler, 2000). The failure was due to diverse reasons and the main one is culture clash between two companies and the brand images were found in opposite promises. One is a German conservative, efficient and safe and the other is an American daring, diverse and creating company. They failed to meet each other in a mutual vision.

4.2 The Second Case: Wal-Mart’s Acquisition in Germany:

Wal-Mart is an American multinational retailer corporation which is at the top two of the best retail brand in the world (Brand-Finance, 2015). It entered Germany in 1997 by buying over 21 stores of Wertkauf with $1.04 billion and then 74 stores of Interspar by $560 million in the next year. With this acquisition, Wal-Mart hoped that it can do its aggressive global expansion to Europe. But very fast, its plan failed. In 2006, Germany Wal-Mart reported a loss of 1 billion dollars and decided to exit operation in this market after 10 years of attempting to achieve sustainable competitive advantage. Many researchers blamed this unsuccessful acquisition to the neglect of managers about culture of customers in German market (Lichtenstein, 2006; Kottolli, 2006; Schultz, 2006 and Clark, 2006). Wal-Mart tried to import American style into Germany and was be refused by German customers who were ridiculous with the faux cheerfulness and fake smile which have been style of American Wal-
Mart employees. So, they turn over it. In addition, Wal-Mart stores are designed for customers who are willing to spend lot of time on shopping, but in Germany, the shopping hours are shorter: Shops close by 5 PM on weekdays, and no shopping on Sundays. Thus, the customers do not have the habit of spending lots of time in a store, wandering around for the things they need. Another difference in culture is the management style. Wal-Mart assigned American as the top manager in German Wal-Mart, and these managers were alien in Germany market. They even did not understand German culture or language, and they disapproved advice, recommendation of ex manager of Wertkauf and Interspar.

4.3 The Third Case: Sprint and Nextel Company:

Sprint and Nextel are both American-based companies. In 2005 Sprint acquired Nextel by $35 billion to create the third largest wireless provider in US. However, soon after the merger, Sprint Nextel Corporation got loss in operating.

Figure 2: The Operating Income and Net Income of Sprint Nextel Corporation after Involving in M&A (in $Million) (Source of data: Sprint and Nextel Corporation’s Annual Report)

![Operating Income and Net Income](image)

In 2007, the second year after the merger, Sprint and Nextel Corporation suffered a huge loss of $29.590 billion, the stock price plunged more than 30% in compare with 2004. The revenue and the net income continuously declined dramatically in the following years. In October of 2012, Sprint Nextel Corporation announced to sell 70 percent of stake to Softbank for $20 billion and marked one of the worst M&A in the world (Faber, 2012). Similar to the cases of DaimlerChrysler and Wal-Mart, the main reason for the failure is the conflict of corporation culture amongst employees and managers in these two companies. The employee of Nextel wanted to be acting proposed quickly, but they felt shock with Sprint’s unresponsiveness, for Sprint people, they viewed Nextel as hasty and reckless. Consequently, it led to the dissatisfaction of employees in both companies and bad services (Haryanto, 2008).
To put it in a nutshell, M&A is a risky strategy. It can bring company’s brand to international market, and it also can pull company go to the hell. With various reasons, Daimler, Chrysler, Sprint, Nextel and Wal-Mart corporations went from giant corporations to the grave collapse. They wanted to combine the strength of two companies to achieve strategic and financial objectives but they did not consider carefully the weakness and conflict inside them. Thus, when they combined, these differences deteriorated their competitive strength and worsen their growth. They are the terrible failures in the history of M&A activities and are clear-cut examples of the snare of M&A initiatives. In the real world, two thirds of M&A deal fail on average (McKinsey, 2010), three-fourth of M&A deals fail to attain anticipated synergies (Marks and Mirvis, 2010; Bourgies, 2009).

5. Conclusions and Recommendations

5.1 Conclusion

Merger and acquisition are not the best option to improve enterprise competitiveness in global business context. The failures of Daimler, Chrysler, Sprint, Nextel and Wal-Mart corporations are pieces of evidence to prove this. Accepted that merger and acquisition are the approach for entrepreneur to take advantage the strengths of partners, but they need to take into account partner’s weaknesses too. The weakness can worsen the situation of both two companies. Hence, any company should not get married with company that has similar weaknesses.

Even though M&A hold potential risk, in certain cases, it still is one of choices for enterprises. M&A initiative can partly help entrepreneurs achieve business purpose when it is used smartly. The wise usage can reduce the risk ratio and avoid stupid failures.

5.2 Proposals to Prevent M&A Failure

The nature of an entrepreneur is the ability to take risk and laugh at the face of potential failure. Hence, even though M&A is a risky strategy, many businessmen still favour it. The significant way here is to find the way to avoid the failure of M&A. Additionally, M&A failure is avoidable since it has certain reasons and mostly are from internal factors. Entrepreneurs have to follow the formers and learn from the failure in the history to get away from this headache matter of bankruptcy. It can be done by a good preparation and proper execution.

5.2.1 Preparation before Doing M&A

To have good preparation, both two players need form the corporate strategy policy group who will set the clear target of M&A deal, outline and analyze the internal and external elements such as the mission and visions of two companies, core competencies, core asset, culture, business environment, customers, suppliers, competitors and alliances. Companies base on this analysis to cognize whether or not they can achieve profitable growth from M&A.
deals and to choose partners to gauge with. The M&A should target only industries and companies that can both exploit strength and shore up weaknesses of each other.

“Planning makes a difference”, Marks and Mirvis (2010) stated. The proper preparation prevents a poor performance, and the more effort a company spent on preparing, the more it is able to adapt the headache issues and solve problems when they carry on the deal. The bankers, lawyer, and consultants must help executives to carefully build a plan including which company to ally with, how much they should spend, how to structure the transaction and where to position the new lines of products or services in the marketplaces.

5.2.2 M&A Execution and Post Combination

After get ready with a well-planned integration scheme, organization, people and culture are all ready for the M&A deal, two partners will go for the real action. This step also needs to be proceeded properly to keep away the collapse.

The most common challenge for M&A deals is the conflicting management style and conflicting culture value. Thus, the attempt for adjustment in term of culture is very important to take in to account. The participants can create the third culture - corporation culture and leadership style that force all employees to follow. This must get agreement of both two companies.

Most M&A deals fail to get synergy in the first years after M&A (McKinsey, 2010). Therefore in the case of getting the difficulties after the M&A, companies’ leaders need to carefully give tactics to recover the balance and do not be anxious to lead company sink more into the mud.

In short, for both acquirer and acquired company, M&A is a stressful experience, but when they choose this approach, they need to make their best effort to hold onto it. Scholars and economists have attempted to build a road map for M&A transactions. Hopefully that M&A players can follow this map smartly to avoid foolish failure.

5.2.3 Using Alternative Option

M&A is not the best choice to build competitive advantage as it is really risky. Therefore, the alternative options are recommended to avoid the horrible failure.

In business battle, there are various strategies, tactics or initiatives that entrepreneurs can employ to beat competitors and thrive. However, there are still situations that entrepreneur must use M&A approach to run their business. For instance, when the company is struggling to survive and they cannot continue to run, they need a larger strategic partner to buy them out. What businessmen need to do is to consider carefully to have the best option. Based on certain situation with specific condition and ability, the leaders could choose M&A initiative or other strategy such as marketing strategy, branding, innovation, customization, and so on.

If company chooses alliance strategy by involving in M&A with another company, it should bear in mind that do not get married with a partner that also has the same problems or
weaknesses. Since they would not support each other, instead they may bring the deal into the trouble and increase the risk for themselves.

Reference


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