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MOTIVES FOR MERGERS AND ACQUISITIONS IN SMALL AND MEDIUM-SIZED ENTERPRISES

Assist. Prof. Dr. Nenad Vretenar[1]

Assist. Prof. Dr. Danijela Sokolic[2]

Full. Prof. Dr. Marija Kastelan Mrak[3]

[1] University of Rijeka, Faculty of Economics, **Croatia**
[2] University of Rijeka, Faculty of Economics, **Croatia**
[3] University of Rijeka, Faculty of Economics, **Croatia**

ABSTRACT

One of the most widely used means in achieving firms' growth and development are mergers and acquisitions (M&As). However, numerous empirical studies have questioned the success of M&As in increasing the firms' value for their owners. Even though varying in methodology, sample size and structure, monitored time and geographical spread, the majority of research indicate that many M&As fail in accomplishing described criteria, i.e. that they do not increase the firm's business success. This opens questions about the popularity of M&As since it is well known that there is a high rate of M&As failures in creating value. Organizational theory provides understanding three groups of motives for M&As: strategic (or market) motives, synergetic motives and managerial motives. The analyses of the motives show that the firm's goals for engaging in M&As could sometimes be reached even when financial analyses show failure. However, most attention, regarding M&A success, is focused on publicly listed firms, even though the majority of firms are small and medium-sized enterprises (SMEs). Due to their smaller degree of organizational complexity, limited reach to market and financial opportunities and higher resource dependency, it could be expected that their motives and goals in M&A processes are somewhat different than those of larger firms. In addressing these issues, we have tried to analyze the motives leading SMEs to engage in M&As. We conducted a questionnaire among SMEs in Croatia's Primorsko-goranska County which allowed us to determine the share of firms interested in future M&A involvement. For those that showed interest, we have then analyzed their motives. Although the achieved results are partially inconclusive and require further research, they allow us to the conclude that the motives for SME interest in future M&As are primarily strategic and that they mostly do not expect significant cost savings through organizational synergies.

Keywords: motives for M&As, small and medium-sized enterprises

INTRODUCTION

One of the reasons that there are so many empirical M&As studies probably lies in the puzzling nature of the motives pushing firms to engage into M&As even though there is a high failure rate in these processes. The popularity of M&As, as a means of achieving growth, is noticeable in the statistical data indicating about 80% of worlds FDI is made through M&As [1]. The same percentage (80%) is the most commonly cited estimation of M&A failure rate in achieving value creation for the firm's owners [2]. This data is seemingly illogical and leads to questioning the firms' reasons for engaging into M&As. Among the possible explanations for such a phenomenon, the following should be mentioned: 1) firms are unaware of high M&As' failure rate, 2) unsuccessful M&As are the result of managerial hubris [3], or 3) in some cases, firms engage in M&As even though they are expect probable value destruction.

The first explanation is not likely on major scale, since especially when bigger firms with professional management are concerned, basic awareness of possible risks is to be expected. The second explanation, the problem of managerial hubris, is applicable in situations when the manager of the acquiring firm mistakenly believes that he/she can estimate the true value of the target firm, better than the stock market, and thus ends up overpaying it. In line with the third explanation the motives for M&As could sometimes be others than pursuing value creation. Therefore, a better understanding of the motives for M&As could provide for a better understanding of M&As in general. Furthermore, if value creation is not the main goal and/or value destruction is viewed as a cost to be paid for achieving some other organizational goals, M&As can be considered as a successful by the decision makers even if financial data shows otherwise.

In terms of engaging into M&As, small and medium-sized enterprises (SME) are in a somewhat different situation than corporations. Namely, they are mainly not listed and therefore are not pressured by capital markets to perform. They are, however, under constant pressure to survive since the smaller scale of their business makes them more vulnerable to changes within the firm, and also to the changes in their business and economic environment. Consequently, this paper, aims to analyse the theoretical argumentation for undertaking M&As, and relate it to the results of the questionnaire conducted on the researched sample of SME in Croatia that have shown interest in entering M&As in the future.

M&AS AS A MEANS OF ACHIEVING GROWTH

The classic approach that viewed the existence of firms and their attempts to grow primarily as a way of profit maximization proved insufficient so few branches of organizational theory offered explanations to these phenomena. Engaging firms can intend to achieve operational or financial synergies or accomplish market advantage. Strategic motives are driven by the presumption that the increase of market share will bring extra strength to the firm and will enable its greater influence on market prices. However, in achieving this, the firms will probably have to face the "merger paradox" i.e. the phenomenon that shows that horizontal mergers could prove to be non-beneficial for the merging parties in quantity-setting games unless the vast majority (more than 80%) of the industry is included in the merger [4].

As the oldest branch, technological theory emphasizes the importance of technology on firms' size. Stigler [5] mentions four sources of savings to be achieved with the firm's size increase. The first one is due to the overcapacity of some resources, especially in infrastructure, second is the ability to buy some of the resources at lower price due to their buying on larger scale, third source is in the better opportunities for process specialization, and the fourth, in statistical law of large numbers; both of these raise economies of scale. Chandler and Hikino [6] argue that the effect of the economies of scale is greater in capital-intensive production due to the higher level of technology, process reorganization and stronger use of energetic resources. Therefore, technological theory tends to see M&As as a means of achieving firm's growth, and as a means of achieving cost savings through the economies of scale and scope. Considering that SMEs mostly organize production on a small scale, it is to be expected that they may engage in M&As to reach MES, and together with it, competitiveness in the long run.

The resource dependency theory signifies that no firm is self-sustainable; it depends on its relations with customers, suppliers, competitors' strength, legislative jurisdiction and other [7][8]. Therefore, firms' growth and their engagement in M&As is not necessary connected to profitability but presents a deliberate attempt to diminish dependency on key resources and/or an attempt to take control in relations of interdependency. Although not new, resource dependency theory is important in explaining the possible motives for engaging in M&As that are not driven by the attempts to increase profitability or even sales, but achieving stability and survival. The influence of stability of environment is affecting firms' strategic choices and level of centralization of hierarchies [9]. This could especially be the case among smaller firms that constantly suffer from dependency of all explained forms.

Transaction cost economics (TCE) emphasizes the importance of business transactions costs that occur when using the market. Williamson [10][11], emphasizes the emergence of three key variables: bounded rationality, opportunism and asset specificity. For example, in ongoing debate regarding high cost of building and maintaining highways, it is noted that operation related to construction, maintenance, finance and consumption allocation need not to be performed by a single provider [12]. However, when business subjects make specialized investments to suit the needs of particular buyers, making it difficult to attract alternative buyers (should the need arise) lock-up situations will often arise [13]. Firms will then seek transaction realization solutions that will enable stronger mechanisms of control. This leads towards stronger contractual forms and/or towards internalization of transactions (building a hierarchy). Similar to usual TCE approach, Menard [14] explains that hierarchies occur in attempt to pool strategic resources or rights. In other words, internalization of activities therefore enables fully institutionalized control mechanisms achieved by establishing ownership rights [15].

SAMPLE AND DATA

The aim of this paper is to shed some light onto motives that attract SMEs' to M&As and relate these motives to the explained theoretical argumentations. In order to do so, an on-line questionnaire was conducted among Croatian firms in Primorsko-goranska County. The questionnaire was sent to all 3,630 firms with less than 250 employees, with publicly known e-mail address and that are not listed on stock exchange. Among 521 respondents, 448 have not had, and 73 had previous M&A engagement. Of the 448 firms without previous M&A experience, 158 (35%) answered that they are interested in engaging in M&As in the future. Big percentage of firms that stated interest in future M&A activity shows that the merging among firms as a means to achieve organizational goals is popular and desired, at least on consideration level, even among SMEs who are mostly neglected in M&A empirical studies. Among these 158 firms, 70 proceeded towards the section inquiring about the motives for their interest in M&As. The industry structure of firms who have completed the questionnaire is shown in Table 1.

Table 1 - Industry structure of the firms interested in engaging in M&A in future

	%		%
Production	12.7%	Tourism	5.6%
Trade	33.8%	Financial services	2.8%
Transport and logistics	2.8%	Other services	38.5%
Catering	2.8%	**Total**	**100% (70 firms)**

MOTIVES FOR M&As IN SAMPLE FIRMS

The questionnaire was conducted based on the Likert scale where every set of suggested motives was to be graded from 1 to 5, where 1 presented total disagreement and 5 total agreement.

Suggested motives were presented in following categories: cost synergies, increase of production/services capacities, improving market position and gaining market power, technology transfer, knowledge transfer, financial stability gains and access to raw materials and intermediate goods.

In theory, but also in common consideration, cost synergies tend to be recognized as one of most important motives for M&As. In horizontal mergers, possible cost synergies could be expected through economies of scale and scope in production or distribution, and it is expected that some financial synergies can occur in growth through diversification. However, as presented in Figure 1, the dominant answer was a neutral one.

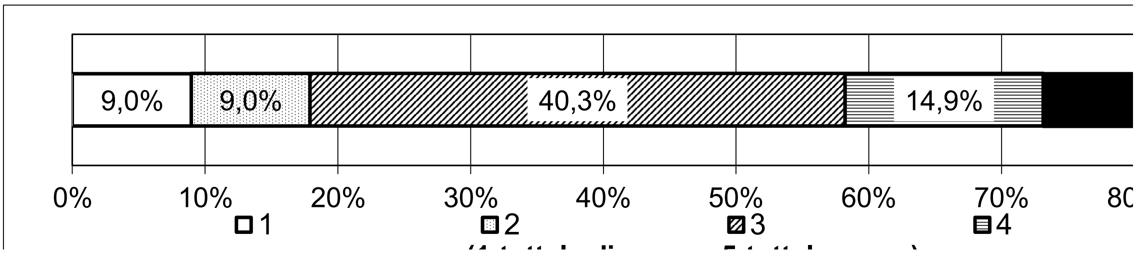

Figure 1 - Cost synergies

This could suggest that the respondents do not expect change in cost if they engage in M&A, or that, at this point, possible cost savings are hard to estimate. Positive answers (4 and 5) together had almost a 41 percent share, and negative ones (1 and 2) 18 percent, which leads to the conclusion that although answering this question was hard to most, among those who did not choose the neutral answer, cost synergies were among expected benefits of possible M&A engagement.

Unlike cost synergies, the motive regarding the improvement of market position and gains in market power (Figure 2) had only 5.6% of neutral answers. This presents the dominant motive among sample firms as 86 percent of the respondents chose a positive answer, 62 percent being 5-totally agree. Only 8.4 percent of the sample firms chose a negative answer when asked to grade this motive. This leads to a partial conclusion that, among the sample firms, when the two commonly considered M&As motives in Industrial organization are compared: synergies and strategic motives, the latter one is "far ahead".

Another strong motive for M&As, among sample firms, is the capacity increase (Figure 3). About 84 percent of questioned firms' representatives chose positive answers (4 and 5). This motive could be related to both previously mentioned sets of motives. Increase in capacities is hardly avoidable for SMEs aiming to get higher market share and more market power. The motive for capacity increase is also expected in firms that consider merger as a means of achieving cost synergies through economies of scale.

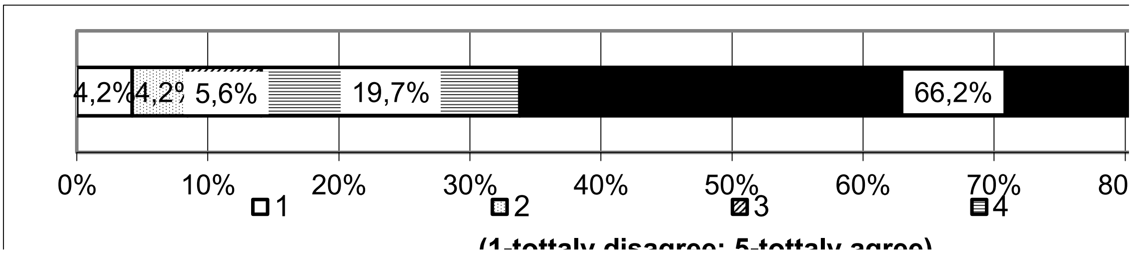

Figure 2 - Improving market position and gaining market power

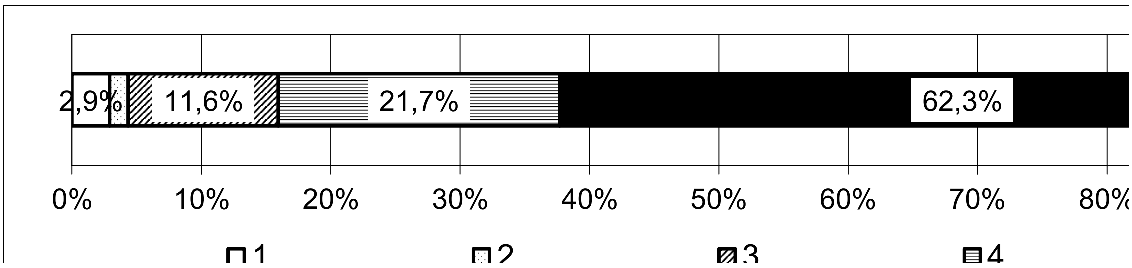

Figure 3 - Increase of production/services capacities

Taken the obvious similarities in answer distribution, it can be speculated that in the case of these sample firms, the motive guided by the increase of capacities is strongly related to market power aspirations.

Access to raw materials and intermediate goods (Figure 4) is the only set of motives with mostly negative answers. Negative answers were chosen by 48 percent of respondents; with most of them choosing 1 - totally disagree. Further, 21% of answers are neutral and less than one third are positive.

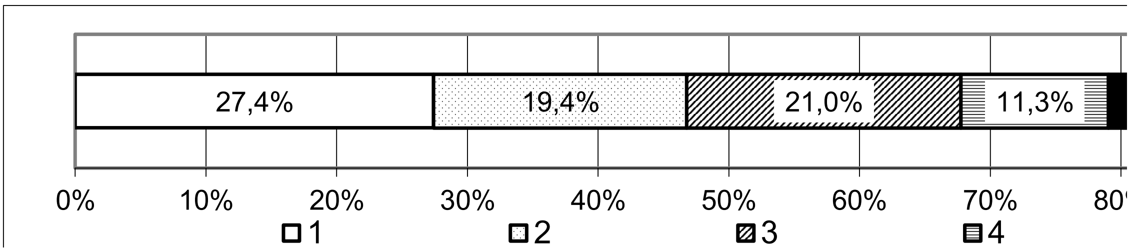

Figure 4 - Access to raw materials and intermediate goods

The small percentage of answers pointing towards vertical integration is not surprising and is in line with WIR statistics showing small share of evidenced vertical integrations in total number of M&As [1]. However, a relative lack of interest to secure input inflows shows that sample firms conduct their business on the markets where asset specificity is not strongly perceived.

Figure 5 shows a cluster of motives that we find potentially idiosyncratic for SMEs': knowledge transfer, technology transfer and increase of financial stability. Knowledge transfer was positively graded by 80 percent of respondents which could have been expected due to the firm's small size and thus limited resources. The closely related question about technology transfers is therefore expected to have similar answers. However, there was 65 percent of positive grades, which is relatively high, but still 15 percent less than in knowledge transfer.

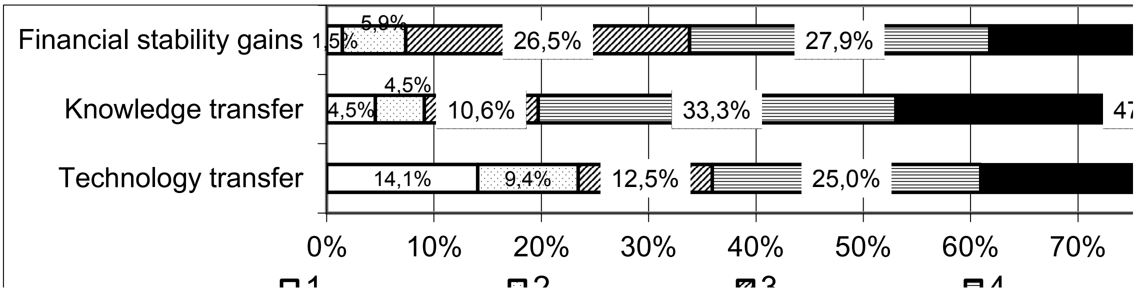

Figure 5 – Financial stability gains, knowledge transfers and technology transfers

At this point, this difference cannot be explained; but it can be speculated that it is the result of either a different comprehension of knowledge and technology among respondents, which is possibly related to the dominance of service industries in sample groups, or by the scepticism of some respondents that the M&A would result in technology transfer i.e. that there will be no technology transfer.

Expectances prior to conducting this survey were that possible gains in financial stability would be, if not dominant, at least among the strongest motives for M&As among SMEs. One of the reasons for this is the fragile financial stability typical for small businesses. But even more, in the perspective of constant cash flow problems in the Croatian economy, potential financial stability was expected to be highly appreciated and anticipated. However, the research showed that, although there were 66 percent of positive grades (4 and 5), financial stability seems to be in the midrange of M&As motives. High share of neutral answers could mean that the respondents were doubtful about reaching financial through M&As, but it is an assumption that also needs further research.

T-TEST RESULTS

Series of t-tests were conducted with the attempt to establish possible differences between groups of firms within the sample. Firstly, the *micro* firms having 5 or less employees were isolated because it was expected that they might be showing differences in motives than other firms in the sample. However, the t-test showed no statistically significant difference among these groups. The isolation of production firms also showed no statistically significant differences, but showed some high, although insignificant, positive difference in motives considering access to raw materials and intermediate products with t-value of 1.492. Production firms are expected to be more dependent of asset specificity so this result is expected. Surprisingly, noticeable although also insignificant t-test values were negative considering cost synergies and knowledge transfer with values t = -1.09 and t = -1.03 respectively. Isolation of trade firms showed opposite directions with statistically insignificant, but strong, t-test value for expected cost synergies (t = 1.643) and negative differences for capacity increase (t = -1.316) and technology transfer (t = -1.4465). Expected cost synergies, but not expected capacity increase for trade firms, shows that they are hoping for a consolidation of market power rather than expansion. The only statistically significant t-test value among groups is for technology transfer for those firms that have placed themselves among *other services*. T-test value for that motive and for that group is 2.064. Insignificant, but also noticeable is the positive result for the increasing of capacity motive (t = 1.5459). Unfortunately, *other services* is a rough group with unknown attributes and it is unknown if there is an industry pattern connecting these firms. Insufficient layering of service industry firms is an overlook that shall be addressed in further research.

CONCLUSIONS

The popularity of M&As as a means of achieving growth, or other organizational goals, is well known and much discussed. This fact is clearly portrayed in this research as 35 percent of respondents without previous M&A engagement claimed interest in doing so in the future. Probably, most of these firms will never undergo M&A, but their interest should not be downplayed. When considering the motives for M&As, it appears that market driven motives are much stronger emphasized than the quest for organizational synergies. A vast majority of respondents claimed increase of market power and increase of capacities as their major reason for interest in future M&As, while cost synergies were among the less noticed ones. Lack of interest in achieving cost synergies can partially be explained by the fact that they are very hard to estimate, especially in terms of firms that are not yet in the process of merging but are merely interested in it.

The least expressed motive is the access to raw materials and intermediate goods. One could argue, and partially be right, that the developed global market diminished the need to secure inputs. The moderate interest in financial stability gains is much more surprising considering that: small firm’s funding opportunities are surely tighter and the cash flow problem is among the biggest worries of Croatian firms in general. Somewhat bigger, but still moderate interest has been shown for technology and knowledge transfers that were expected to be among the motives mostly considered among SMEs.

The strongly emphasized motive: improving market position and gaining market share is understandable but potentially dangerous for firms who might eventually engage into M&As to reach it. In fact, whether it is dangerous or not, depends on the reasons of firms’ desire for higher market share. If their main aim is to lessen the firm’s interdependency by raising market share, it could be achieved, especially for small firms as those in the sample. But if they are driven by the desire to increase profitability by gaining market power, their effort might be futile, and even counterproductive. This could especially be the case with SMEs as the merger paradox occurs unless the vast majority of industry is included. Actually, if market share aspirations were the dominant motive for M&As in larger scale (beyond this limited research), it could be considered among the main reasons for high M&A failure rate.

High interest in M&As shown among respondents presents a potential for their future M&A engagement. However, the main question is: at what price would they be willing to do it? The price here implies not only the sum of money needed to make a deal, but also the *price* that the current owner of the target firm is willing to pay in terms of losing at least a part of sovereignty in decision making and control, and in shifting the balance of power in general. Among all interested, only those firms willing to pay this price could actually be considered as potential subjects in future M&A deals.

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