PART 1

Taxonomy of Mergers and Acquisitions and the Evolution of Managerial Thought

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Strategic Evolution of Mergers and Acquisitions

This chapter is intended to provide responses to several questions regarding the legal regulation of mergers and acquisitions; the form taken in specific operations; their meaning and role in managerial evolution; and, most crucially, the consequences of this type of operation.

External company growth forms part of a continuous development process, a response to evolutions in the environment intended to guarantee the survival of the business. This external growth is generated by merging with, or absorbing, other companies, and may be preceded by a takeover, in which the characteristics of the buyer company are modified to ensure that the new entity will be greater than the sum of its two constituent parts.

Horizontal external growth has only really taken off in the last two decades; previously, strategy was dominated by the conglomerate and vertical models. This shift justifies the logical evolution in managerial approaches. Over the next few decades, however, it is possible that vertical expansion may become more prevalent, or we may see a return to conglomerate strategy.

Scientific research into the finer details of company mergers and acquisitions has evolved and expanded in a similar manner, promoting the adaptation of these operations to an evolving environment and developing several different combination models.

1.1. Typology of mergers and acquisitions

The first author to discuss diversification was Chandler [CHA 62], followed by Wrigley [WRI 70] and Rumelt [RUM 74], who developed a distinction between related and unrelated diversification. These notions provided the basis for significant later work on the merger/acquisition phenomenon. However, the principle of "related and unrelated transactions" is difficult to define. The problem has been addressed by many authors, comparing the performance of various diversification activities, and by competition authorities, considering the risk of monopoly development and of concentration within sectors.

1.1.1. *Horizontal mergers and acquisitions*

1.1.1.1. *Definition of horizontal mergers and acquisitions*

Rumelt [RUM 74] was the first person to attempt to define related diversification, providing the starting point for many other studies. He aimed to connect strategic behaviors, notably relating to growth strategies, with company performance. Rumelt carried out a quantitative study highlighting four different growth strategies. The first strategy involves developing a single business, whilst the second includes diversification while maintaining a dominant activity. The third concerns diversification which remains linked to the original domain, and the fourth is unrelated diversification. For Rumelt, an acquisition is related to the existing activity if it respects at least one of the following four criteria:

– the purchaser and the target serve the same market;

– the purchaser and the target use similar distribution channels;

– the purchaser and the target use similar production technologies;

– the purchaser and the target carry out similar research and development (R&D) activities.

In a similar vein, Salter and Weinhold [SAL 79] speak of the ease of "transferability" of activities between the purchaser and the target. The authors consider that a transaction may be related if at least one function among research and development, production marketing or distribution is easily transferrable from the purchaser to the target or vice versa. Paturel [PAT 78] defines horizontal mergers/acquisitions as growth manifested by a strengthening of the existing production function within the company, obtained by acquiring an entity with a similar production function.

For Seth [SET 90a], external horizontal growth is the first main option for related diversification, through acquisitions involving the same product and/or the same

market. Thiétart [THI 93, p. 162] and Batsch [BAT 93, p. 116] speak of horizontal external growth in terms of specialization, concentration or centered growth. They refer to concepts of dominant activity, industrial units, and easily-dominated niches. Their approach also makes use of the notions of products and markets.

To provide a clear definition of horizontal mergers and acquisitions, we therefore need to focus on the key concepts of product markets. In their book *Le contrôle français des concentrations,* Cot and De la Laurence [COT 97] note that when defining a product or service market, competition authorities focus on a set of criteria used to characterize the interchangeability of the products involved. Markets are delimited using a set of criteria, within which it may be difficult to establish a hierarchy. The definition of a product market is thus broadly dependent on the definition of the products involved.

When the main resources used to make one product can easily be used to make another product, they can be said to be very similar. This similarity may influence demand when the price of a product changes. For example, if product price increases, demand may be transferred to a similar product. In this case, we speak of high substitutability. The definition of a product therefore depends on the notion of use of this product, its essential criterion, strongly linked to the service which it provides in response to consumer expectations.

A horizontal merger or acquisition is a total or partial, friendly or hostile acquisition of a company which immediately produces resources. These operations involve two companies with identical or very similar dominant activities, serving the same market, or selling similar products. The target market may or may not be situated in the same geographical zone as the buyer. An operation involving two companies working in different territories but selling the same product therefore meets the criteria for horizontal expansion.

1.1.1.2. *Concentration as defined by competition authorities*

The definition of horizontal mergers/acquisitions put forward by the European Commission involves two elements[1]: geographical markets and product markets, and an evaluation of mergers or acquisitions in terms of competition. Market assessment is designed to systematically identify competitive pressures with an immediate effect on the undertaking created by the concentration. The competitive aspect of a merger or acquisition is evaluated with reference to operations which increase a firm's power over the market, insofar as these operations may have a negative effect for consumers, such as a reduction in product quality, increased prices, or limitation of choice.

1 Council Regulation (EC) no. 139/2004 of January 20, 2004 on the control of concentrations between undertakings.

To evaluate the impact of concentration operations on a market, competition authorities assess their potential anti-competitive effects and factors which might limit these effects, for example buying power, entry barriers and the potential increase in efficiency cited by the parties involved. The European Commission then decides whether the concentration operation will significantly reduce existing competition by creating or by reinforcing an existing position of dominance.

The Commission uses the Herfindahl-Hirschmann Index (HHI) to measure the degree of concentration, calculating the sum of the squares of the market shares of each firm within the market in question. The index gives more weight to the market shares of larger firms. While it is best to include all companies in this calculation, the absence of information concerning very small companies is not necessarily problematic, given their weak influence on the HHI. Used as an absolute value and as a variance before and after the concentration operation, it is written as follows:

$$H = \sum_{i=1}^{n} s_i^2$$

where

– s_i is the market share of company i;

– n is the number of companies.

The absolute value of the HHI gives us a first idea of the competitive pressure to which the market will be subjected if concentration occurs within the sector. However, the variance in the HHI (the delta) gives us an indication of the change in the degree of concentration which might occur as a direct result of a merger or acquisition. HHI indices are generally categorized using three broad value ranges:

– HHI below 1,000: sector with low concentration, low risk;

– HHI between 1,000 and 2,000 (with a delta lower than 150): intermediate zone, may pose a risk in the presence of certain factors;

– HHI over 2,000 (with a delta over 150): high-risk zone.

Using the formula defined above, the HHI varies between 1/n and 1. If percentages are used as natural integers, for example 50 instead of 0.50, the value of the index can go up to 10,000 (a maximum value of $100^2 = 10{,}000$). In the US, any transaction which increases the HHI index of a sector by more than 100 points is subject to anti-trust laws.

The normalized HHI index may also be used. This index varies between 0 and 1, and is expressed as:

$$H = \frac{H - \frac{1}{n}}{1 - \frac{1}{n}}$$

where n is the number of companies in the market and H is the HHI index.

Within a market, products may be differentiated in order to identify those products which are the closest substitutes for other products. The higher the degree of substitutability between products made by companies involved in a concentration operation, the more likely it is that a significant price increase will occur. For example, a concentration operation involving two producers offering products which many clients cite as their first and second choices for a given purpose might well lead to a price increase.

The tendency of parties involved in a merger or acquisition to increase their prices is more likely to be limited if their competitors produce close substitutes. The risk that a concentration operation will significantly reduce effective competition, notably by creating or strengthening a position of dominance, is lower in cases where there is a high level of substitutability between products made by the concentrating parties and those made by rival producers. In cases where data is available, a degree of substitutability may be calculated based on customer preference studies, an analysis of buying structures, and an estimation of cross-price elasticity of demand for the products in question.

1.1.1.3. *Performance of horizontal mergers and acquisitions*

Following on from the popularity of conglomerate mergers and acquisitions in the 1970s, horizontal mergers and acquisitions became much more commonplace. This type of operation transforms the costs associated with competition into profits obtained through collaboration. The combination of companies involved in similar activities makes it possible to exploit synergies between linked activities. There are two types of synergy at work in horizontal mergers and acquisitions: revenue synergy and cost synergy. The former results from increased sales due to an increase in quality, thanks to the transfer of skills or greater market coverage. The latter relates to a reduction in costs, obtained by restructuring operating expenses and assets, alongside scale economies.

Capron [CAP 99] identified two schools of thought in relation to this question. Neo-classical economists and strategy experts maintain that horizontal mergers and acquisitions improve the competitive position of a company via the transfer of

specific skills or by developing synergy, for example by rationalizing assets. The "mainstream" school considers these operations as a way for companies to reinforce their positions within a market and to increase profits at the consumer's expense.

Following this development, focusing on the fact that horizontal operations may involve two companies with similar or complementary activities, Harrison *et al*. [HAR 91] studied post-acquisition synergies resulting from the presence of similar and complementary resources. They noted that the allocation of complementary resources results in better performance than that of similar resources. However, the presence of similar resources may also be a motivating factor for mergers [MON 87], resulting in financial synergies for the company through the use of similar strategies and higher performance [HAR 91].

In this respect, it is generally admitted that horizontal mergers/acquisitions result in significant scale economies, and that they create more value than other external growth strategies [HAR 91]. Capron *et al*. [CAP 01] studied the performance of horizontal operations, surveying 253 European and American companies, identifying five key elements for improving performance:

– managers could derive more benefit from skill transfers and by exploiting synergies in terms of revenue development;

– a rationalization of assets by acquisition does not necessarily lead to cost reduction. In fact, it is more efficient to sell off assets in the buying company than in the target company;

– excessive rationalization of the target's assets poses a risk of damaging the development capacities of the newly merged company in terms of innovation and markets. If the target company is forced to shoulder the full burden of rationalization measures, existing skills may be lost, and the development of new skills may be aborted. This results from the loss of the organizational margin required for innovation and the exploration of new markets;

– costs can be reduced by transferring skills, particularly toward the target company;

– skill transfers toward (and away from) the target reinforce the development capacities of the company created by the combination operation in terms of innovation and markets. In this way, acquisitions can represent an efficient means of capitalizing on skills.

Ramaswamy [RAM 97] carried out a study of the US banking sector, concluding that mergers between banks with similar strategies produce better results than mergers between banks with dissimilar approaches. In a different context, based on a study sample of 260 merger operations across all sectors, Maquieira *et al*. [MAQ 98]

observed that significant value is only created in horizontal mergers/acquisitions involving companies operating within the same market. Finally, we note that the multiplication of risky mergers and acquisitions can lead to the destruction of value, leading the company to divest assets in order to specialize and focus on niche products.

1.1.2. *Vertical mergers and acquisitions*

1.1.2.1. *Definition of vertical mergers and acquisitions*

Vertical acquisition strategies are used by companies wishing to master the whole of their economic chain, involving a company and its supplier or a client. This form of growth can concern any stage of the product creation processor and may result from the addition of activities complementary to the company's main activity. The company may take a step up the chain of production, producing something previously bought in from a supplier, or move down the supply chain, controlling the destination of its products. This strategy is suitable for specialized firms wishing to gain a stronger footing, and for firms which are subject to anti-trust laws. According to Seth [SET 90b], it also constitutes the second main option for related diversification.

Supplier acquisition is a form of upstream integration. It enables better control of the supply chain, with full control of efficiency, delivery times and quality. Client acquisition, on the other hand, is a form of downstream acquisition, allowing the company to guarantee that products will be distributed in line with its specific requirements. Full vertical integration combines both elements, with the buyer company at the center of a new organization, with full mastery of the whole production chain. Both forms of integration add value at each stage of production. They enable better distribution of fixed charges across the whole production chain. The profit margin taken by the supplier or client is cancelled, to the benefit of the buyer, and the company moves one step closer to the final consumer.

1.1.2.2. *Advantages and drawbacks of vertical mergers and acquisitions*

Using vertical integration, a company may cease to be dependent on a supplier or client. Among other things, the combination of two stages in the production process leads to:

– reduced storage costs;

– reduced transport costs;

– the potential for scale economies;

– vertical organization of the division of labor.

However, this strategic choice remains risky, hard to implement, and is rarely practical for companies. It creates high dependency on raw materials or on a major product and tends to reduce the level of specialization in a company, with an associated loss of certain advantages. By branching out into little-known areas, companies can pay a high price for attempting to obtain the elusive advantages offered by vertical integration. Combinations of this type are costly in terms of managing a new and unknown entity, and extremely risky, due to involvement in new markets and increased dependency on a single product.

One famous example of these issues can be found in the rise and fall of the *Post Journal* in the US, in which a vertical approach to external development proved to be fatal for the company. At the beginning of the last century, the *Post Journal* rose from nothing to become the biggest American newspaper, profiting from favorable economic conditions. With a circulation of several million copies, the paper was extremely profitable. The company decided to develop by adopting a full integration strategy in order to master the whole of the economic chain, from forestry management to paper production, printing and, finally, distribution. No link in the chain was omitted, and the whole process was internalized. This strategy initially yielded overwhelmingly positive results. After a time, however, the newspaper's message and ideas fell from public favor; furthermore, competition had increased, and sales fell dramatically. Every part of the chain of production was affected and the entire empire came crashing down in just a few years [THI 93].

1.1.3. *Conglomerate mergers and acquisitions*

1.1.3.1. *Definition of conglomerate mergers and acquisitions*

This form of development, also known as "unrelated diversification", is an umbrella term used to signify any external growth policy that cannot be characterized using the horizontal or vertical types. Conglomerate strategies may be adopted by firms with products that have reached maturity. They may also be implemented following a certain amount of horizontal or even vertical growth.

Conglomerate mergers/acquisitions involve firms producing goods which are in no way complementary or similar. The companies in question do not share missions, activities or markets. They are not competitors. External conglomerate growth includes technical, technological and market differentiation. It involves total diversification (i.e. a completely different product), characterized by a complete absence of common points between the buyer and the target. The entities produced by these operations are known as conglomerates.

Conglomerate combinations correspond to the notion of unrelated diversification, with no similarities between the four elements identified by Rumelt [RUM 74], as mentioned previously: market, distribution networks, production techniques, and R&D activities.

1.1.3.2. *Advantages and drawbacks of conglomerate mergers and acquisitions*

Williamson [WIL 70], Teece [TEE 80] and Hoskisson [HOS 87] have all shown that diversification creates value, as a diversified company is less subject to risk and less costly in terms of management than a specialized firm. Operations of this type provide a means of defense against the vagaries of the external market. For Paturel [PAT 78], conglomerate growth presents seven advantages:

– the strategy is necessary for company survival, as it reduces dependency on a single product;

– it allows companies to reach their growth and profit targets in situations where this would not be possible using traditional activities alone;

– it provides the means of responding to a specific demand: for example, companies involved in seasonal activities would benefit from branching out into another seasonal activity with opposite production and sales periods;

– it makes good use of any financial surplus;

– conglomerate growth is a risk diversification strategy: for example, the disappearance of a particular client group or the emergence of new competitors is less problematic;

– it facilitates the exploitation of the company's technological capacities, used to create different products;

– the strategy is rarely affected by anti-trust laws.

The limitations of this approach include a lack of coherency between the different strategic activities carried out by a company, which may lead to a conflict of interest between operational units. These units may also become difficult to control for directors who lack the necessary skills in one or more of the conglomerate's domains. Conglomerate growth can also raise organizational issues, is costly in terms of management resources, and involves a degree of risk inherent in taking on new activities. As we shall see later, many authors have responded to this point by recommending a return to restructuring strategies, with a greater focus on core activities.

1.2. Theory, diversification and divergence

Many mergers and acquisitions occur all over the world each year, carried out in the hope of increasing value [CHI 01, JOR 14], as a stimulus for rapid growth in competitive markets [BRU 16, FRE 14] and to create synergy [BRU 16]. However, the rate of failure following these combinations is high [BAR 03, CHI 01]. This upheaval resulting from diversification also contributes to the development of managerial thought, identifying means of supporting these changes and transformations toward a more complex, but clearer, state. In this respect, the definition of "relationality" between activities within the same firm laid the foundations for many studies of related and unrelated diversification. These studies formed the basis for the development of stock market classifications. However, the different components of each activity within different companies are not always easy to identify.

1.2.1. *Contributions pre-1980*

1.2.1.1. *Wrigley*

Wrigley [WRI 70] was the first to attempt a classification of diversification strategies. He measured the impact of these strategies on the structure and performance of companies, developing the notions of "specialization" and "relatedness".

The notion of specialization is used to reflect the degree to which a company's activities are focused within a single field or, conversely, spread across a variety of sectors. Specialization is measured in terms of the proportion of the company's total turnover which can be attributed to a single main product. If the ratio is higher than 95% ($R > 95\%$), the company is considered to be a "mono-product" company. "Dominant product" companies derive between 70% and 95% ($70\% < R < 95\%$) from this main product. A figure of under 70% ($R < 70\%$) reflects a "diversified" company.

The notion of relatedness is used to categorize diversified companies, with a specialization ratio of less than 70% ($R < 70\%$), by considering the nature of the connection between different strategic segments. Wrigley [WRI 70] considered that if the activities in question were linked in terms of production, marketing or technology, then the company's strategy was one of related diversification.

1.2.1.2. *Rumelt*

No study of diversification strategy would be complete without reference to Rumelt [RUM 74], whose work laid some of the foundations for later research in the field. Taking Wrigley's work [WRI 70] as a starting point, Rumelt addressed two

major issues: firstly, the construction of a system for categorizing diversification strategies, and secondly, performance evaluation for diversified companies with regard to the strategies used. He created a more sophisticated classification system than that put forward by Wrigley, using the following three criteria:

– Wrigley's [WRI 70] specialization criterion, used to distinguish between specialized and diversified firms;

– the related ratio criterion, showing the proportion of revenue that a company derives from its principal group of activities. These activities are considered to be related if they share a technological, commercial or industrial function;

– the vertical integration ratio, which is defined as the proportion of the company's revenues which come from the sale of products manufactured as part of activities within the production sequence of the main activity.

Rumelt refined the notion of relatedness, using four parameters to distinguish between related and unrelated diversification strategies: production techniques, target markets, distribution networks and research and development (R&D) technologies. He considered activities to be related if they presented similarities in one or more of these areas.

To determine the nature of connections between activities, Rumelt identified the different strategic segments of each company. Firstly, he checked for mutual independence by monitoring the implementation of one of three measures: a reduction or increase in production, the implementation of a new production process, or an alteration of the price or quality of products within an activity, which should not affect the offer of other activities. Secondly, Rumelt analyzed the complementarity of activities, taking account of the nature of internal resources and skills, which he grouped into two sets: related constrained, generic skills used for the new activity with a direct connection; and related linked, generic skills with only an indirect link, which is limited to resources derived from the application of generic company skills, and not from these skills themselves.

Finally, within the category of unrelated diversification, Rumelt built on criteria established by Lynch [LYN 71] to develop a distinction between "active" and "passive" conglomerate companies. Active conglomerates are companies which develop rapidly via a sustained program of unrelated acquisitions and an aggressive funding strategy. Passive conglomerates are those which, following an active phase, cease or slow their rate of acquisitions.

Moreover, Rumelt noted that vertically-integrated firms can be classified as dominant-product companies. His contribution is summarized in the following table:

Specialization ratio	Main categories	Sub-categories
R > 95%	Mono-product	
70% > R > 94%	Dominant product	*Nature of other activities:* – direct link to key skills within the company; – indirect link to key skills within the company; – no connection to main activity; – vertically integrated.
R < 70%	1. *Related diversification:* more than 70% of activities outside of the original activity are inter-related	*Relation between activities:* – direct link to key skills within the company; – indirect link to key skills within the company.
	2. *Unrelated diversification:* less than 70% of activities outside of the original activity are inter-related	– active conglomerates: significant financial leverage, aggressive purchasing program; – passive conglomerates.

Table 1.1. *Rumelt's classification of diversification strategies [RUM 74]*

Rumelt stresses the fact that differences in performance are due more to the way in which a company manages its diversification than to the adoption of any given strategy. His contribution is valuable in that it provides a methodology based on strategic analysis, focusing on the notion of a key activity, defined as the set of internal skills exploited in relation to a certain vision of key factors for success in the relevant industry. Rumelt defined different types of diversification in relation to internal, rather than sectorial, data. His essential contribution was in highlighting the connection between performance and the chosen approach to diversification.

1.2.1.3. *Salter and Weinhold*

Salter and Weinhold's [SAL 79] study aimed to define the connection between the activities of a target and those of a buyer, focusing on the internal resources of the two structures. They developed the notion of "strategic fit", the capacity of merged companies to benefit from the complementarity of their resources. The authors assessed strategic fit using three criteria:

– the buyer or target's ability to redeploy excess resources in order to develop the other partner's activity;

– the buyer's potential to use the resources of the target in order to develop their own activities;

– the possibility of resource-sharing between the two entities, creating new skills that could not have been developed autonomously.

Following on from this research, the two authors identified two categories of skills: firstly, general skills, linked to general company management, and secondly, functional skills, linked to research and development, marketing or production skills. From this typology, they then defined two types of diversification:

– related diversification: the commencement of a new activity which makes use of similar functional skills to those the buyer already has. Within this category, the authors noted a distinction between acquired companies involved in activities requiring additional skills on the part of the buyer, and acquired companies where no new skills are required;

– unrelated diversification: may involve the transfer of general managerial skills and the redeployment of surplus financial resources.

The authors developed a set of criteria linking types of diversification and the benefits to be derived, presented in the table below.

	Related diversification	Unrelated diversification
Product/market analysis	Diversification into activities which are similar in terms of: – marketing/distribution; – production technology; – research and development.	Diversification into new activities, with key success factors unrelated to those of the buyer's activities.
Possibility of transferring resources	– Transfer of operational or functional expertise; – redeployment of surplus resources in terms of: - distribution systems; - production capacity; - research and development skills.	– Transfer of general management skills; – Redeployment of surplus financial resources.

Nature of potential benefits	Increase in internal efficiency via the exploitation of operational synergies, economies of scale, and the various advantages gained from increased size (more stable revenue).	More efficient cashflow management via an improved allocation of financial resources, reduction in capital costs and the possibility of inter-activity financial support.
Ease of establishing synergies	Difficulties linked to organizational problems when consolidating the two companies.	Potential to operate and exploit financial synergies.

Table 1.2. *Benefits of diversification [SAL 79]*

In terms of method, Salter and Weinhold [SAL 79] considered that external growth operations were more relevant than internal growth operations in studying the effectiveness of diversification strategies. Their reasoning was that external growth facilitates analysis of the impact of diversification strategies on the economic value of the company. They considered this growth to have an immediate effect on the combination of resources of the merged companies, as the stock market anticipates the gains to be made from the new combination of resources, reacting as soon as news of a merger is announced.

Whilst Salter and Weinhold [SAL 79] were able to combine the notion of company resources with the idea of relatedness and analyzed the connection between performance and the nature of resources combined in a merger operation, these relations were not used together in a single research project until the late 1980s.

1.2.2. *Contributions during the 1980s*

1.2.2.1. *The early '80s*

The merger/acquisition phenomenon has received considerable attention from academics and practitioners in recent years, notably in terms of the transaction-strategy relation, success factors, evaluation issues and post-transaction integration [GOM 13]. However, the notion of "relatedness" was already in use in the early 1980s, assessed on the basis of external criteria, such as sectoral classifications like SIC (Standard Industrial Classification) or classifications proposed by the FTC (Federal Trade Commission). Based on the nature of the activities, the SIC and FTC group acquisitions into four categories: horizontal, vertical, related diversification and conglomerate diversification. This classification was established using external data as a function of the products offered by companies within the market.

Authors such as Elgers and Clark [ELG 80] and Wanley *et al*. [WAN 83] studied value creation in mergers and acquisitions, linking their performance to the degree of diversification. They did this using the FTC database, which includes three categories: non-conglomerate growth (horizontal and vertical mergers), related diversification (product or market extension) and conglomerate growth (unrelated diversification). Other researchers, such as Choi and Philippatos [CHO 83], used the same database, focusing on non-conglomerate (horizontal and vertical) mergers and conglomerate mergers (diversification). They sub-divided the second category into two groups: companies which increased their debt capacity and companies with a debt capacity which remained stable.

In terms of strategy, Lubatkin [LUB 84] was one of the first to consider the connection between the degree of relatedness and the gains obtained through a merger. To study stock returns, he selected a sample of 1,031 merger operations in the US during the period of 1948–1975. He then drew on the FTC data, identifying four categories of merger: related diversification, corresponding to the extension of a product line; horizontal mergers and geographic diversification; conglomerate mergers; and vertical mergers. In terms of scale economies, market power and financial synergy, Lubatkin considered the evaluation of each type of merger, noting that the first two categories of merger created more value than the second two categories. He also questioned the link between the degree of relatedness and the performance of a merger. The author thought that it was difficult to anticipate the likely benefits of a merger based on the notion of relatedness alone. Furthermore, he highlighted the drawbacks of the FTC and SIC classifications, which only take account of the notion of products, ignoring internal data such as the nature of resources and skills.

1.2.2.2. *The late ’80s*

Following Rumelt’s definition [RUM 74], Singh and Montgomery [SIN 87] used two categories: related diversification and conglomerate diversification. To evaluate the degree of relatedness of a merger, the authors verified whether the companies involved in the merger exhibited similarities in terms of their distribution networks, products, production technologies and research capacities. Their contribution is significant in that it combined financial research (event studies) with research on strategy carried out during the late 1970s. Salter and Wienhold’s sample [SAL 79, SIN 87] studied 105 combination operations over the period of 1975–1979. Their results were similar to existing findings in terms of the benefits for buyer companies. However, they noted that the benefits for target companies were considerably higher in cases of related diversification than in conglomerate mergers.

Shelton [SHE 88] made a particularly interesting contribution, developing a conceptually innovative methodology. Adopting Salter and Weinhold’s definitions

of the internal dimension of relatedness, he examined the connection between the nature of combined resources and performance in mergers. Shelton began by dividing companies into homogeneous strategic segments, considering the composite nature of company groupings. His results, obtained using a grid developed from Rumelt's definition [RUM 74], were projected onto a second grid borrowed from Salter and Weinhold [SAL 79].

The first grid, put forward in 1974, includes four factors: clientele, the nature of the products involved, the type of technology and the type of function occupied by the product. Shelton [SHE 88] considered activities as related if they presented similarities in three or more of these areas. He then considered the activities of the companies concerned by defining strategic segments instead of selecting companies as a whole. The second grid uses the definition of relatedness proposed in 1979 to establish the contribution made by each category in creating value. As we have seen, this definition proposed four different classes of combined resources: similar assets (identical products and clients), supplementary assets (similar products and different clients), complementary assets (different products and similar clients), and unrelated assets (different products and different clients).

Shelton studied the evolution of the stock market, considering the first public announcement of each merger. Irrespective of the drawbacks of a methodology based on the stock market, his work offers a broader and clearer view of the strategic approach to mergers and acquisitions. To assess the value created by mergers, Shelton considered the combination of the assets of the companies involved. His results are particularly striking, suggesting that most value is created by the combination of similar assets, followed by the combination of supplementary assets, then of complementary assets. The combination of unrelated assets, however, resulted in a loss of value.

1.2.3. *Management approaches and divergences*

1.2.3.1. *Management theory and diversification during the 1990s*

Researchers have studied the different diversification strategies implemented by companies with the aim of proposing suitable solutions for new and specific problems. Changes in the nature of merger and acquisition operations over time provided the stimulus for many new economic, financial and strategic studies. Goold and Luchs [GOO 93] developed a chronological presentation of this transition in 1993, aiming to explain the connection between the evolution of management theory and diversification strategies.

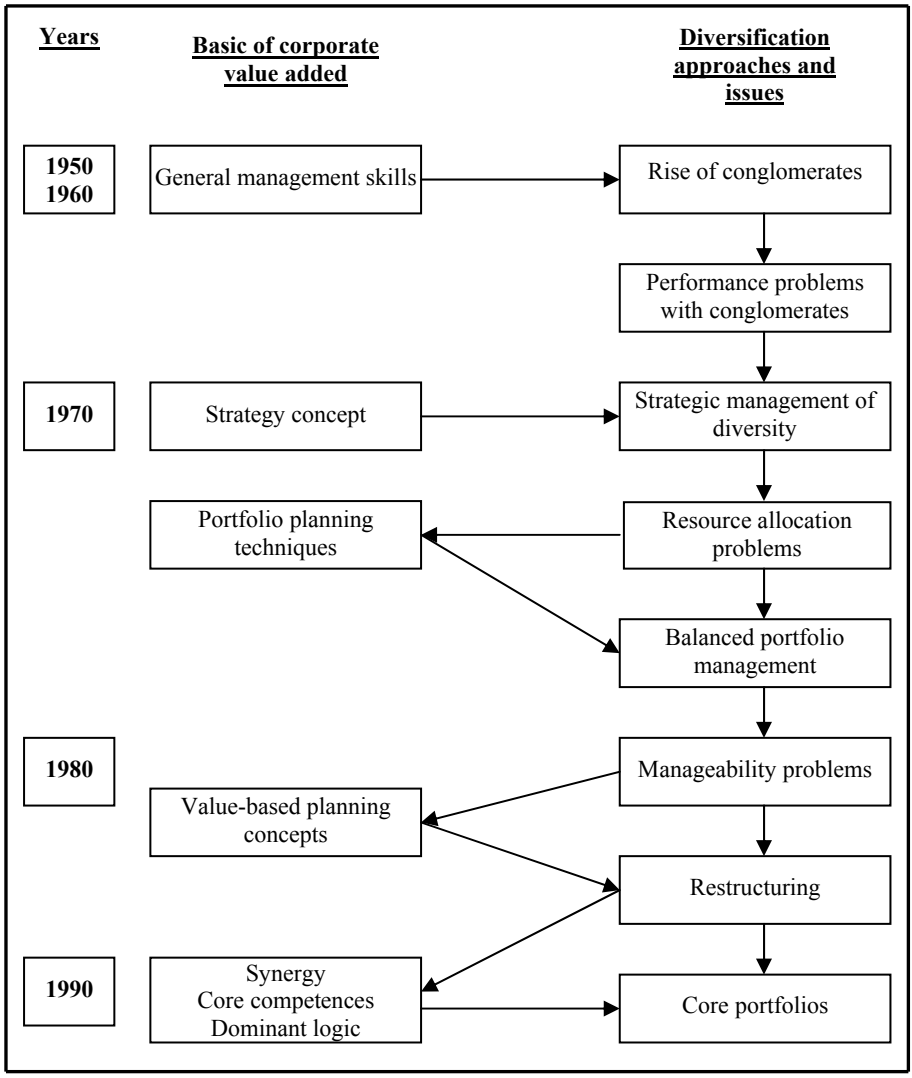

Table 1.3. *Evolution of thinking on corporate strategy and diversification [GOO 93]*

During the 1950s and 60s, company directors had a broad base of management skills, as competition was less developed and management systems were less sophisticated. These capacities were intended to permit efficient and concurrent management of several different sectors. This favored the emergence of conglomerates as the dominant style of external development.

A new current emerged in management theory during the 1970s in response to environmental developments and the gap left by the previous style of management. New strategy and portfolio management techniques were developed, and managers began to focus on strategic sectors of activity, allocating resources across these sectors.

Significant work was carried out on corporate strategy during the 1980s, responding to questions surrounding the disappointing results of mergers and acquisitions. Corporate restructuring offered one solution, shifting the focus onto core competences and the liquidation of less profitable activities. This technique was intended to maximize the value of companies lacking the capacity to manage diversification in an optimal manner.

Research during the 1990s aimed to combine strategic findings with financial results in order to provide satisfactory responses to the questions being asked. Several notions were put forward, including synergy, dominant logic, the identification of strategic sectors, conglomerates, concentrations and more.

1.2.3.2. *Divergences around mergers/acquisitions*

The topic of mergers and acquisitions has attracted considerable interest in both academic and corporate circles [JOR 13, VIE 15] due to the sums involved, the controversy surrounding the subject and the increasing intensity of operations. In spite of the high failure rates cited by researchers, external growth operations have continued to increase, modifying regional landscapes through restructuration and changing the profile of groups through resizing. In 2005, 80% of mergers and acquisitions were paid for in cash, thanks to a huge accumulation of liquidity. This figure remains incomprehensible, and an objective explanation is hard to find. Either company directors have simply ignored the studies being published on the subject, or researchers have made use of unsuitable data, giving them an erroneous vision of the reality of mergers and acquisitions. In any case, an agreement has yet to be reached on the subject. It is important to be aware of this issue; as objectivity is an asymptomatic approach, there can never be a purely objective response.

The real and expected results of mergers and acquisitions may also be seen to differ [JOR 13, JOR 14]. The heart of the problem lies in the fact that each actor defines success or failure based on their own ideological experience and psychological need. The two elements are not mutually independent: once a psychological need has been identified, all ideologies will tend toward this need. Knowledge is the appropriation of an object by a subject, and results from the combination of the two elements. Only through ignorance can the object be protected from the subject.

Any theory can be defended or criticized. A manager, increasing his or her salary, the power of their company or improving financial results through an acquisition, may consider the operation to have been an unmitigated success. A researcher might note a reduction in value, measured using the criteria selected for their study, and consider the same operation as a failure. KPMG assessed the failure rate for 1998 at 83%; nonetheless, in 2000, the total value of mergers and acquisitions on the international stage was in excess of $3,000,000,000,000. This discrepancy has naturally been interpreted in different ways.

The reasons for mergers and acquisitions are many and varied, even within the area of industrial and economic logic. They tend to be contagious and are self-sustaining, coming in uninterrupted waves, taking different pathways each time, adapting and responding to new economic needs.

These divergences result from the confrontation of heterogeneous ideas put forward from different perspectives. They act as a driving force in scientific thought and in life itself, pushing us inexorably forward. Differences in approach and interpretation should not be seen as a weakness but as a strength, pushing the boundaries of scientific research into mergers and acquisitions.