MOTIVATORS BEHIND THE ACQUISITION PHENOMENON

by

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ABSTRACT

An acquisition is a corporate transaction in which a company purchases a target firm's ownership and assumes control of the target company. Acquirers typically rely on realizing synergies between multiple firms. Thus, corporations rationalize acquisitions as a way of externally sourcing resources to create growth. At face value, acquisitions are good business decisions for managers to undergo. They are designed to enhance shareholder wealth. However, acquisitions are expensive. Shareholders often pay billions of dollars in order to finance said deals, yet rarely realize the company's expected returns following the transaction. Therefore, the frequency of acquisitions undergone, often based on the potential profitability, disconnects from the recognized success rate of acquisitions, measured by changes in market value. The majority financially irresponsible acquisitions alludes to an irrational phenomenon. However, a company's internal persons; external, yet related persons; and the broader macroeconomic environment, all rationally motivate for corporate acquisitions.

Introduction and Research Question

Nearly every week, business papers and journals introduce developing acquisitions. A now regular occurrence, the acquisition phenomenon seems to grow exponentially. Shareholders pay billions of dollars to buy competitors, and thus these events are heavily cherished. Positive terms like synergies, economies of scale, horizontal and vertical integration, and diversification are often thrown out. Company executives are jubilant as they radiate optimism.

An article written by McKinsey and Company, a premier consulting firm, explains that there are five rationales for acquiring other companies: improving the target company's performance, consolidating to remove excess capacity from industry, accelerating the market's access to the target's products, obtaining skills or technologies faster or at lower costs than they can be built, or individually picking growing businesses and helping them develop.[1] Acquisitions seek to take advantage of synergies. These synergies can result from increases in revenue, decreases in costs, or taking advantage of financial benefits or process optimizations. Acquisitions have consistently occurred throughout our economic environment and will likely continue to occur in the future, as they can be profitable in theory.

Though an exciting time for businesses, acquisitions rarely end as planned. Managers are often over-confident and fail to correctly calculate the magnitude of these deals. Research indicates that roughly 50% of acquisitions are successful ones.[2] Additional sources cite more specific conclusions. For example, during the merger and acquisition boom of 1995 to 2001, shareholder

[1] Marc Goedhart, Tim Koller, and David Wessels. (2010, July). The five types of successful acquisitions. Retrieved from http://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-five-types-of-successful-acquisitions

[2] Forum, F. L. (2012, March 19). Why Half of All M&A Deals Fail, and What You Can Do About It. Retrieved from http://www.forbes.com/sites/forbesleadershipforum/2012/03/19/why-half-of-all-ma-deals-fail-and-what-you-can-do-about-it/#1b7bdb1b20ae

returns decreased by an average of 4.1% upon the announcement of their respective deals.[3] This means that acquisition announcements typically result in an initially decreased stock price of over 4.0% for the acquirer.[3] More so, this study concludes that initial reactions are persistent and indicative of future returns. The 302 companies sampled indicated an average 1-year return of -4.3%, meaning that most acquisition deals result in a short-term decrease in stock price as well as a long-term decrease in stock price.[3] Though studies differ slightly, these articles claim that there are many reasons for failure, particularly in regards to management capacity, culture, strategy, price, and costs.[3]

Regardless of the complexity, acquisitions are an integral part of modern business. 2015 was the largest year ever for acquisitions and set the record books with a market value of $4.3 trillion.[4] This phenomenon has transitioned into a growing trend, and thus investors should understand motivations and rationalizations going forward. Though multifaceted, this papers aims to answer the two related questions. First, since research overwhelmingly indicates that roughly half of all acquisitions are considered failures, why are acquisitions becoming more and more common? Are they being motivated by internal persons; external, yet related persons; or external factors brought on by the macroeconomic environment? Secondly, if this trend truly is destined for the future, what implications must follow?

[3] Sirower, M. L., & Sahni, S. (2006). Avoiding the "Synergy Trap": Practical Guidance on M&A Decisions for CEOs and Boards. Journal Of Applied Corporate Finance, 18(3), 83-95. doi:10.1111/j.1745-6622.2006.00101.x
[4] Goenka, H. (2016, January 08). Global M&A Activity In 2015 Worth $4.28 Trillion, Highest Ever. Retrieved from http://www.ibtimes.com/global-ma-activity-2015-worth-428-trillion-highest-ever-2256183

Literature Review

Acquisitions motivated by internal persons

Corporate executives are at the helm of business decisions. They create, introduce, and support deals from fruition to completion. Executives are typically financial stakeholders in their businesses and are naturally the individuals who advocate the most for developing deals. As such, executives have a crucial role in the process. More importantly, they have an incentive in the process.

Executive compensation encompasses financial and non-financial awards that executives receive for the services they provide. Executive compensation often includes salaries, bonuses, benefits, perquisites, and stock options. Since executives are historically paid tremendously much more than their employee counterparts, executive compensation has rightfully become a hot-topic. Though debated, corporate structures must heavily incentivize their executives to propel their respective organizations. Many researchers have conducted studies on the topic, and most claim a strong correlation between incentives provided and actions performed.[5]

Research indicates that there is a strong correlation between executive compensation and corporate acquisition decisions.[5] These studies focus specifically on acquisition decisions because they are major, externally observable, long-term investments that corporations make. Because the quantity of compensation received is not necessarily comparable across different organizations, researchers group executives by the amount of equity-based compensation they receive based on their respective collective salary package.[5] Compared to low equity-based compensation managers, high equity-based managers pay significantly lower acquisition premiums and acquire targets with higher growth opportunities, meaning that managers make economically smarter

[5] Datta, S., Iskandar-Datta, M., & Raman, K. (2001). Executive Compensation and Corporate Acquisition Decisions. Journal Of Finance, 56(6), 2299-2336

business decisions when they have more of their own wealth at risk.[5] Furthermore, a correlation between compensation structure and long-term acquisition success exists.[6]

In the post-acquisition period, firms with low equity-based compensation structures for top executives significantly underperform, whereas firms with high equity-based compensation structures do not.[6] Firms that provide executives with larger equity-based compensation structures typically outperform those that do not in regards to corporate acquisitions. Though there are a multitude of extraneous factors, this yields an important conclusion: equity-based compensation structures incentivize top executives to make smarter, more methodical business decisions. These decisions translate into paying reduced premiums, which save shareholders money, and ultimately increase the probability of successful acquisitions.

Whereas a negative association exists between bid-premium and equity-based compensation for top executives, research indicates that there is a positive correlation between cash compensation and acquisition success.[6] Corporations pay their top executives when deals are finalized in the form of cash and cash equivalents. Executive compensation typically increases as firm size increases.[6] This potentially promotes acquisitions on the basis of bigger is better.

This study, which analyzed 646 merger and acquisition deals from 1994 to 1998, supports the claim that the magnitude of bid-premium paid and change in CEO cash compensation are associated.[6] An executive's self-interest in maximizing their cash compensation may result in the payment of a higher bid premium. Executives' pay structure incentivizes corporate executives to pay higher premiums, because doing so influences cash compensation received.[6] However, this study acknowledges that most corporate executives receive equity-based compensation because

[6] Association between Bid Premium for Corporate Acquisitions and Executive Compensation. (2006). Journal of Accounting, Auditing & Finance, 21(4), 373-397

when executives have equity-ownership in the company, they are more risk-adverse, and tend to better serve shareholders.[6] Though there is a positive association between the bid-premium paid and the change in CEO cash compensation, the positive association is significantly reduced if the CEO has at least two percent ownership in the firm.[6] Acquisitions can yield tremendous returns. However, the likelihood for positive returns quickly diminishes when acquirers pay higher premiums for their respective targets. The positive correlation between cash compensation to bid-premium paid and the negative correlation between equity compensation to bid-premium, alludes to the fact that equity-based compensation reduces the probability of over-paying, and thus increases the overall probability of a successful acquisition.

Many people believe that executives have larger-than-life egos. The word hubris is synonymous with executives' excessive pride or self-confidence. Research indicates that four indicators of CEO hubris are all highly associated with the size of premiums paid during the acquisition process.[7] These indicators include: the acquiring company's recent performance, recent media praise for the CEO, a measure of the CEO's self-interest, and a composite factor of the preceding three variables.[8] All four indicators lead to a decreased probability of a successful transaction. Executives' overconfidence, or hubris, creates substantial practical consequences for their respective company's during the acquisition process.[8] Aside from how executives receive compensation, research additionally indicates that acquisition behavior is significantly affected by corporate executives' compensation structure relative to that of their comparable peers.[8]

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[7] Hayward, M. A., & Hambrick, D. C. (1997). Explaining the Premiums Paid for Large Acquisitions: Evidence of CEO Hubris. Administrative Science Quarterly, 42(1), 103-127.

[8] Seo, J., Gamache, D. L., Devers, C. E., & Carpenter, M. A. (2015). The role of CEO relative standing in acquisition behavior and CEO pay. Strategic Management Journal, 36(12), 1877-1894. doi:10.1002/smj.2316

Executive confidence is rightfully justifiable granted corporate executives' unique opportunity in which they can potentially create or dissolve tremendous value for thousands, if not millions, of stakeholders. From beating Wall Street's expectations to leading the most employees, executives are fueled by competition. As such, they wish to be compensated accordingly. Employees typically view pay as reflective of their perceived worth.[8] When individuals believe that they are underpaid relative to peers, feelings of inequality arise, and employees respond with remedial actions designed to achieve perceived pay equality.[8]

Research supports this claim by concluding that CEO negative relative pay, negative to that of their peers, is positively associated with increased acquisition activity.[8] When executives believe they are underpaid, they tend to make riskier decisions. More so, executive compensation affects how deals are financed.[8] When companies undergo acquisitions, CEO negative relative pay standing will positively influence the use of stock as a payment method, as executives try to transfer some of the risks to their target firms.[8] Lastly, research concludes that acquisition activity is positively related to subsequent pay change and that acquisition activity partially mediates the relationship between CEO negative relative pay standing and subsequent pay change, meaning that acquisition developments provide reparations for what executives believe to be their un-just compensation.[8] These increases are funded predominantly by long-term, incentive-based compensation structures. Therefore, as firms continue to grow, executive compensation tends to better align with those of the shareholders.

Though there are a multitude of related variables, research reveals that executive compensation is heavily correlated to acquisition decisions.[5] More so, research shows a heavy correlation between an executives' compensation structure and the bid premium.[6] If executives are sufficiently underpaid, they encourage their respective companies to pay to purchase other

companies.[8] Many factors derive this occurrence, yet managers' hubris exacerbates the phenomena.[7] Internal persons, particularly top executives, are incentivized through their compensation structures to complete large deals and are thus largely responsible for the prevalence of acquisitions.

Lastly, corporate executives have an incentive to acquire competitors in hopes of boosting their earnings. For most publicly traded companies, releasing earnings is a ritual. At the end of every quarter, as well as at the end of every fiscal year, public companies are required to release their financial statements. Though all financial statements are released, analysts are largely concerned about earnings. When a company beats analyst expectations, the company's stock price typically rises. If the company falls short, the price of their stock typically falls. Meeting Wall Street's expectations is a game in which short-term success is prioritized over creating a dominant long-term market position.

Earnings management, which is the use of accounting techniques and procedures to bolster financial metrics such as earnings per share, can be used to better position a company for short-term success. Earnings management is crucial to understand because it highlights another benefit of acquiring others: increasing financial valuations. Many companies trade based on metrics such as earnings per share or price to earnings, and acquisitions can largely affect these metrics. If an acquirer has a higher earnings per share than the target, then the transaction will increase an acquirer's earnings. This means that companies can undergo acquisitions to increase short-term metrics. Inorganic growth proposes a unique opportunity for companies. If companies face stagnant growth and fixed costs they can initiate acquisitions to better position themselves. By completing accretive acquisitions, companies can better position themselves for short-term growth. In many mature industries, organic growth is sluggish. Acquisitions are becoming

increasingly popular in these industries as a tool to increase earnings. However, research tends to attenuate said theory.[10]

In common value auctions, there is a phenomenon called the winner's curse. This phenomenon states that transactions curse winners in two ways. First, winning bids often exceed the value of the underlying assets purchased, thus the winner is worse off in absolute terms.[9] Acquisitions can be successful. However, acquirers often pay huge premiums to acquire targets, and thus their chances at deals being truly accretive quickly diminish. Second, the value of assets purchased is often less than the bidder anticipated, thus even if the bidder has a net gain, they will be worse off than anticipated.[9] Various factors derive this fault, one of which is earnings guidance provided by the target firm. Research indicates an association between the premium paid for a target firm and quarterly earnings guidance.[10] This means that the subjective nature of earnings guidance creates a distortion between intrinsic price, based on facts, and valuation, based on personal sentiment.

The winner's curse highlights a crucial aspect of acquisition development: managers should not use acquisitions as a means to increase short-term earnings because it is unlikely that the respective deal yields increased value for the acquirer. However, internal persons, both inside the target and the acquirer, rationally motivate for acquisitions. Top executives have the ability and incentive to create large deals, which is too often occurs.

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[9] RIZZI, J. (2014). Boards: Beware the 'winner's curse'. Directors & Boards, 38(3), 16-17.

[10] Koch, A. S., Lefanowicz, C. E., & Robinson, J. R. (2012). The effect of quarterly earnings guidance on share values in corporate acquisitions. Journal Of Corporate Finance, 18(5), 1269-1285. doi:10.1016/j.jcorpfin.2012.08.005

Acquisitions motivated by external persons

Merger and acquisition deals are a fundamental function of business in that they form the backbone of many other industries, including investment banks, accounting firms, consulting firms, and law firms. Many professional service companies have entire divisions established solely for aiding transaction deals. Various fees fuel these firms. These fees, though only a percentage of the deals they are attributable to, are instrumental to company health. In 2015, Goldman Sachs, the largest investment bank in terms of deal activity, collected $1.8 trillion from collecting advising fees.[11]

Fees related to acquisition announcements vary. The fee structure for investment banks provides an accurate representation of most professional service companies. Their fee structure has three simple parts. First, investment banks charge retainer and engagement fees. These costs are expensed monthly and are charged to keep the banks around.[12] Importantly, these fees are unsubstantial and banks typically do not profit from retainer and engagement fees.[12] Second, investment banks charge success fees.[12] These costs follow a progressive structure. The larger the deal, the more money banks earn. The progressive structure of these fees incentivizes banks to find the largest buyers, thus making the most money for their clients.[12] Lastly, banks charge break-up fees in which the potential seller is charged a fee if they back out of a deal.[12] Break-up fees mitigate the risk that banks have of deal failures. However, break-up fees are notably less than success fees, which prioritizes the completion of deals.[12] Any fee structure that ties a bank's commission to the acquisition price clearly serves the interests of the seller. Furthermore, research indicates that advisory fees received by investment banks representing either selling or buying companies were

[11] Lam, B. (2016, January 09). 2015: A Merger Bonanza. Retrieved from http://www.theatlantic.com/business/archive/2016/01/2015-mergers-acquisitions/423096/

[12] Nead, N. (2016, September 27). M&A Advisor Fees: Retainers, Successes & Ancillary Expenses. Retrieved from http://investmentbank.com/fees/

positively related to the acquisition premium.[13] This is especially troublesome for the acquirers, which are largely concerned with keeping the deal price low. Ultimately, the financial prosperity of these service companies depends not only on the success of deals, but based on the pure size and quantity of deals that come to fruition.

Though these professional service firms are instrumental, their fee-based compensation structures often lead clients to undertake acquisitions that are not wealth enhancing. In what will be one of the largest deals ever, AT&T Company offered $85 billion to acquire Time Warner.[14] The deal is far from complete, and thus other parties are expected to enter. Among them, analysts believe that Apple may potentially submit an offer.[14] Apple has ample cash, and analysts believe that the acquisition will allow Apple to take advantage of Time Warner's superior television content.[13] Apple traditionally advocates for organic growth.[14] Thus, the potential bid disconnects from Apple's traditional strategy. Though optimistic analysts believe Apple should submit a bid, doing so is likely to be disadvantageous for Apple for several reasons. Over the past few years, Time Warner's net profit margin has remained considerably lower than Apple's, which means that acquiring Time Warner will reduce Apple's margins. Additionally, Apple TV is insignificant in terms of overall company revenue. Spending $85 billion for an immaterial account is not justifiable. Regardless of whether Apple submits a bid, Goldman Sachs, the investment bank who is ironically not involved in the current deal, is pushing Apple to do so.[14] In doing so, Goldman Sachs likely aims to service and support the monumental deal on behalf of Apple.

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[13] Kosnik, R. D., & Shapiro, D. L. (1997). Agency conflicts between investment banks and corporate clients in merger and acquisition transactions: Causes and remedies. Academy Of Management Executive, 11(1), 7-20. doi:10.5465/AME.1997.9707100656

[14] Kosman, J. (2016, October 29). Goldman Sachs pushes Apple to make rival bid for Time Warner. Retrieved from http://nypost.com/2016/10/29/goldman-sachs-pushes-apple-to-make-rival-bid-for-time-warner/

The highly lucrative nature of the business and the high failure rate of new acquisitions have given rise to skepticism about the value of the intermediary and advisory role of investment banks. Skeptics claim that the fee structure of professional service firms inappropriately incentivize external parties.[13] The previous example highlights the conflict of interests that exist within professional service companies: external, yet related, parties are advocating for mergers and acquisitions. However, these conflicts are widely known.

Arthur Levitt, previous chairman of the Securities and Exchange Commission (SEC), acknowledged that "there is growing cynicism and suspicion among investments about the [merger and acquisition] industry and its practices."[13] Being the 25th and longest-serving chairman of the SEC, Levitt's logical sentiment resonates with many institutional investors. More importantly, his statement resonates with common shareholders. The number of lawsuits filed against investment banks has sharply risen.[13] This is largely due to the disconnect between fairness of opinions released and the true sentiment of shareholders. Investment banks formalize their advice in a fairness opinion, which is a written statement judging the terms of the deal from the perspective of the company's shareholders. Corporations and their shareholders are increasingly questioning the reliability of the recommendations and financial advice they receive from investment banks in acquisitions.[13]

However, it is important to note that banks serve a vital purpose. History shows that venturing into the acquisition world without the backing of an experienced investment bank is dangerous. The Trans Union Corporation lawsuit of 1985, though dated, presents a case in point: the company's shareholders sued its directors for accepting an undervalued bid without first consulting an investment bank.[13] Shareholders want investment banks, advisory firms, and other external parties involved in the process. However, though these businesses are wanted and needed,

their fiduciary duty should be to shareholders and investors. Shareholders want banks to serve their behalf.

Though today's banking culture promotes an atmosphere of sales, it is foolish to believe that external parties simply sell their deals to company management. Common sense argues that managers are the most knowledgeable parties regarding their respective organizations. A company's management is likely to thoroughly examine all potential offers. Paired with their extensive knowledge regarding the company, it is likely that managers make informed, rational decisions. Managers, as well as all parties involved, must adequately undergo an extensive due diligence process. According to Richard Harroch, who is a Managing Director and Global Head of M&A for Vantage Point Capital Partners, claims managers should consider twenty factors when evaluating deals.[15] Harroch notes that most companies evaluate everything from financial matters to strategic fit to marketing activities. In conclusion, the due diligence process is all-embracing, for sellers as well as buyers.

Since the pervasiveness of acquisitions directly affects professional service companies, it is unlikely that professional service firms do not advocate for acquisitions. Though external parties, particularly professional service firms, including investment banks, accounting firms, consulting firms, and law firms, are financially dependent on the prosperity of acquisition deals, they motivate and promote acquisitions.

[15] Harroch, R. (2015, February 22). 20 Key Due Diligence Activities In A Merger And Acquisition Transaction. Retrieved from https://www.forbes.com/sites/allbusiness/2014/12/19/20-key-due-diligence-activities-in-a-merger-and-acquisition-transaction/#32bd94e4bfc2

Acquisitions motivated by the broader macroeconomic environment

Macroeconomics is the field of economics that studies how the aggregate economy behaves. From interest rates, to inflation, to changes in the unemployment rate, macroeconomics affects nearly all aspects of business. As such, macroeconomics is arguably the broadest, yet strongest, motivator of acquisitions. Particularly, macroeconomic motivators include: low interest rates which create cheap financing and attractive valuations, the political landscape supporting declining government regulation, and the phenomenon of acquisition waves. Economists, including the Federal Reserve, can measure economic performance and are then able to implement various tools used to guide the market in their preferred direction. One of those tools is monetary policy.

Monetary policy is the economic policy established by the central bank. Monetary policy allows economists to alter the economy through three tools: interest rates, the money supply, and reserve requirements. Though the Federal Reserve historically prefers to not tinker with the economy, they instilled a policy known as quantitative easing following the Great Recession.[16] The theory behind quantitative easing is simple, increase the money supply and lower interest rates.[16] In doing so, the Federal Reserve discourages saving and encourages spending.[16] The Federal Reserve created and implemented this strategy to push our country out of a recession.[16] The success of the Federal Reserve's use of monetary policy is debatable. However, quantitative easing ultimately created an unprecedented economic condition.

With interest rates near zero, the Federal Reserve bolstered the equity capital markets. Investors, pessimistic in regards to rate hikes, moved their funds from fixed income investments

[16] R.A. . (2015, March 09). What is quantitative easing? Retrieved from http://www.economist.com/blogs/economist-explains/2015/03/economist-explains-5

into the stock market. In doing so, the equity market has seen record-high peaks.[16] Strong equity markets have a tremendous impact on the prevalence of acquisition deals, primary through matching buyers and sellers.

When capital markets are strong, sellers are more prone to look for buyers. Executives, who often have equity ownership in their companies, are susceptible to sell off their positions in return for strong yields. This is because prices are high. Equally important, strong equity markets incentivize buyers to look for targets to acquire. When a company purchases another company, there are two ways for financing: debt or equity.

First, acquirers can pay for deals with shares of equity, with either existing shares or by issuing new shares. When the overall equity market is vigorous, their equity shares are worth more, thus buyers pay less, relative to when their shares are worth less. Second, buyers can finance their acquisitions with debt. Credit holders typically charge an interest rate which moves parallel to the Federal Funds Rate or the London Interbank Offered Rate (LIBOR). Both are benchmark rates used by many of the world's leading banks. Since interest rates are historically-low, target acquirers are able to finance their deals at a rate near zero.[16] Low interest rates motivate both buyers and sellers to source and complete deals.

However, it is likely that interest rates will increase in the near future.[17] Recent comments made by Janet Yellen, the chair of the Board of Governors of the Federal Reserve, allude to increasing interest rates in upcoming months.[18] This incentivizes acquisitions in the short-term by

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[17]Granville, B. A. (2016, September 18). Why the Fed Is About to Raise Interest Rates. Retrieved from https://www.nytimes.com/interactive/2016/business/economy/fed-raise-interest-rates-explained.html?_r=0

[18]Josie Cox Business News. (2017, February 07). US dollar rises due to hints Federal Reserve will hike interest rates in March. Retrieved from http://www.independent.co.uk/news/business/news/us-dollar-rise-value-federal-reserve-hike-interst-rates-march-bank-a7566421.html

granting companies the opportunity to lock-in low interest rates for said deals. Analysts believe that corporations will continue to take advantage of these conditions in the forthcoming months.[19] Low interest rates motivate acquisitions by offering cheap financing, yet the immediate environment in which analysts believe that rates will increase in the near future further magnetizes that motivation.

Additionally, low interest rates promote acquisitions in regards to valuations. Valuation forms the backbone behind deals. Business must accurately calculate the underlying value behind companies. If the projected value is less than that of the market, acquirers are more inclined to purchase the respective target companies. An asset, or company, is worth the present value of what you expect to get from future cash flows. Analysts discount cash flows, and thus interest rates have an instrumental impact on valuation. With lower interest rates, companies forecast a lower cost of equity, or discount rate, and thus a higher valuation for companies. Therefore, low interest rates increase the attractiveness of valuations for both target companies and acquirers. Low interest rates motivate acquisitions by offering attractive valuations.

The political landscape, particularly the regulatory approval process, also affects the predominance and frequency of corporate business decisions. Understanding the approval process for merger and acquisition deals is instrumental in understanding any forthcoming acquisitions. Under the Hart-Scott-Rodino Act, the Federal Trade Commission and the Department of Justice are required to review proposed transactions that affect commerce in the United States. As a key provision in U.S. antitrust law, either agency can take legal action to block potential deals if it believes the deals would "substantially lessen competition."[19] Though exemptions exist, U.S.

[19] Chan, C. (2017, January). M&A Outlook for 2017. Retrieved March from http://www.dealogic.com/insights/ma-outlook-2017/

antitrust law requires companies to report any deal valued at more than $78.2 million for review.[20] This multistage review exists to determine whether the proposed deal raises antitrust issues.

Though the Federal Trade Commission claims, "the vast majority of deals reviewed by the Federal Trade Commission and the Department of Justice are allowed to proceed after the first, preliminary review," criticism subsists.[19] According to CNBC, deals are being rejected by regulators at a record rate.[21] 2016 was the biggest-ever in terms of the volume of collapsed deals.[22] Regulatory agencies withdrew more than half of a trillion dollars of previously announced tie-ups.[17] Anitrust issues is not the sole reason for the magnitude of dissolved deals. However, deal makers tend to view the Obama administration as tough on takeovers.[21] Going forward, regulatory barriers remain uncertain.

Uncertainty intensifies as the United States changes presidential administrations. During his campaign trail, Donald Trump promised to block AT&T's plan to buy Time Warner Cable, an $85 billion deal announced last October.[23] Trump cited that it is "a deal we will not approve in my administration because it's too much concentration of power in the hands of too few."[22] Nevertheless, as a political conservative, President Donald Trump is likely to decrease the government's regulation towards commerce. President Trump's congressionally-approved nominee for Attorney General agrees with this logic.

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[20] Federal Trade Commission. (2016, September 08). Merger Review, How Mergers are Reviewed. Retrieved from https://www.ftc.gov/news-events/media-resources/mergers-and-competition/merger-review

[21] Marino, J. (2016, July 22). REJECTED! More mergers are getting blocked this year than ever before. Retrieved from http://www.cnbc.com/2016/07/21/ma-is-being-rejected-by-regulators-at-a-record-rate.html

[22] Mattioli, D. (2017, January 03). After Slower Year, Deal Prospects Set to Brighten -- WSJ. Retrieved from https://www.morningstar.com/news/dow-jones/TDJNDN_20170103694/after-slower-year-deal-prospects-set-to-brighten-wsj.html

[23] Pressman, A. (2016, November 09). What AT&T Could Do If Trump Blocks Its Time Warner Merger. Retrieved from http://fortune.com/2016/11/09/att-trump-blocks-time-warner/

The Attorney General is the head of the United States Department of Justice. As such, the Attorney General is monumental in regards to the regulatory environment of acquisitions. As of February 9, 2017, Alabama Senator Jeff Sessions succeeded Loretta Lynch as the 84th Attorney General of the United States.[24] Sessions is considered one of the most conservative members of the US Senate. As such, analysts view Sessions' nomination and confirmation as a market positive for acquisition activity. Terry Haines, a macroeconomic research analyst for Evercore, an independent investment bank advisory firm, states, "Sessions as attorney general will shift immediately from the current mostly 'red light' Obama antitrust and competition policy and move towards one that would be friendlier to M&A activity."[25]

An expected decline in corporate taxes and increasing corporate confidence additionally motivates acquisitions. There were $3.7 trillion of takeovers announced globally in 2016.[21] While this represents a decline from 2015's record year, dealmakers believe that the Trump administration and a republican-led Congress will broadly ease regulation and boost financial markets, which has already begun taking course.[21] Peter Weinberg, co-founder of Perella Winberg Partners which advised the AT&T-Time Warner deal, claims, "I haven't seen a set of factors that's more bullish for M&A activity in some time."[21]

Like most aspects of business, the political environment plays its course. Proposed deals must obtain approval from federal agencies, which will likely become more accommodating under the Trump administration, Attorney General Jeff Sessions, and a republican-led Congress. Though obtaining regulatory approval is a high-hurdle for many transactions, as it has prevented many

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[24] Lichtblau, E., & Flegenheimer, M. (2017, February 08). Jeff Sessions Confirmed as Attorney General, Capping Bitter Battle. Retrieved from https://www.nytimes.com/2017/02/08/us/politics/jeff-sessions-attorney-general-confirmation.html

[25] Shen, L. (2016, November 18). Here's What Analysts Think of Trump's Pick for Attorney General. Retrieved from http://fortune.com/2016/11/18/donald-trump-attorney-general-analysts/

acquisitions from occurring, the conservative administration, which often tends to be more relaxed in regards to regulation, motivates businesses to pursue and complete acquisitions. However, our bipartisan system creates waves where certain parties are in control only to be replaced by a separate party in the future. Similarly, acquisitions tend to occur in waves.

There have been six waves of rapid acquisition activity within the past few centuries. The first waved occurred from 1897 to 1904 and reflected the industrial revolution.[26] The sixth waved occurred from 2003 to 2007 and was largely due to the availability of abundant liquidity.[27] Acquisition waves result from a changing external environment. These changes vary and differ, but are mostly attributable to related changes in technology.[27] Acquisition waves are historically massive and have a tendency to significantly change the market structure. Now, some analysts believe that we are in the middle of the seventh wave.[28] For businesses, this insinuates that the acquisition phenomenon is simply a trend. Regardless of whether we are in the heart of an acquisition wave, these deals are becoming more and more popular.[29] A trend in which a multitude of macroeconomic factors all work together to create a unique environment in which acquisitions are extrinsically supported.

Altogether, the macroeconomic environment creates a nature in which buyers are looking for sellers and sellers are looking for buyers, which has intensified the prevalence of acquisitions. Though a rate hike is likely in the foreseeable future, changes are unlikely to significantly alter the

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[26] Kleinert, J., & Klodt, H. (2002). Causes and Consequences of Merger Waves. Kiel Institute of World Economics. Retrieved from https://www.ifw-members.ifw-kiel.de/publications/causes-and-consequences-of-merger-waves/kap1092.pdf.

[27] Alexandridis, G., Mavrovitis, C. F., & Travlos, N. G. (2012). How have M&As changed? Evidence from the sixth merger wave. The European Journal of Finance, 18(8), 663-688. doi:10.1080/1351847x.2011.628401

[28] Cordeiro, M. (2014, September). The seventh M&A wave Retrieved from http://camaya.com.br/wp-content/uploads/2016/06/The-seventh-MA-wave.pdf

[29] Jardine, N. (2015). M&A Activity To Continue So Long As Good Times Roll. Fund Action, 39.

acquisition phenomenon from its course. Whether the macroeconomic environment changes in the near future or not, changes collect negative market sentiment. Investors too often focus on this possibility of declining equity markets. The macroeconomic environment is positioned to continue supporting the prevalence of acquisitions, and thus oscillations are unlikely to influence the level of acquisition activity.[28]

Discussion

Worth noting, the preceding conclusions have two serious limitations. The primary limitation is that there are other reasons for acquisitions regardless of whether they enhance shareholder wealth. The first reason for acquiring another company is to increase market power.[30] Achieving greater market power is the primary reason for acquisitions.[30] Market power exists when a firm can sell its goods or services above competitive levels or when the costs of its primary or support activities are lower than those of its competitors. Market power is usually derived from the size of the firm, the quality of the resources it uses to compete, and the percentage share of the market in which it operates.[31] Therefore, most acquisitions that are designed to achieve greater market power entail buying a competitor, a supplier, or distributor in a related industry. This creates core competencies which can develop into competitive advantages.[30] Both horizontal acquisitions and vertical acquisitions can lead to increases in market power. Horizontal acquisitions increase a

[30] Hüschelrath, K., & Müller, K. (2015). Market Power, Efficiencies, and Entry Evidence from an Airline Merger. Managerial & Decision Economics, 36(4), 239-255. doi:10.1002/mde.2664

[31] Haleblian, J., Devers, C. E., McNamara, G., Carpenter, M. A., & Davison, R. B. (2009). Taking Stock of What We Know About Mergers and Acquisitions:A Review and Research Agenda. Journal Of Management, 35(3), 469-502.

firm's market power by exploiting cost-based and revenue-based synergies.[32]Vertical acquisitions lead to increased market power by controlling additional parts of the value chain.[33]

Additionally, firms acquire companies to overcome entry barriers. Barriers to entry are factors associated with a market that increase the expense and difficulty new firms encounter when trying to enter said market. For example, cross-border acquisitions, those made between companies with headquarters in different countries, reduces the difficulty of entering a foreign market.[34] This minimizes risk. Another outcome of acquisitions is that transactions reduce risk since they can be estimated more easily and accurately than the internal product development process.[35] This is one reason why many companies in the pharmaceutical and biotechnology industries often undergo acquisitions. However, firms typically find it easier to develop and introduce new products in markets they are currently serving because of the experience and the insights resulting from it. Thus, it is relatively uncommon for a firm to develop new products internally to as a means to diversify.[36] Diversification allows for a changing businesses environment.

Lastly, acquisitions allow a firm to reshape its competitive scope and learn and develop new capabilities. The intensity of competitive rivalry is an industry characteristic that affects a firm's financial prosperity. To mitigate this rivalry, businesses often diversify their products to reduce their dependency on other markets. For example, Campbell Soup's intends to increase its position

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[32] Burghardt, D., & Helm, M. (2015). Firm growth in the course of mergers and acquisitions. Small Business Economics, 44(4), 889-904. doi:10.1007/s11187-014-9624-y

[33] Chou, C. (2014). Strategic Delegation and Vertical Integration. Managerial & Decision Economics, 35(8), 580-586. doi:10.1002/mde.2675

[34] Francis, B. B., Hasan, I., Sun, X., & Waisman, M. (2014). Can firms learn by observing? Evidence from cross-border M&As. Journal Of Corporate Finance, 25202-215. doi:10.1016/j.jcorpfin.2013.11.018

[35] Ahuja, G., & Katila, R. (2001). TECHNOLOGICAL ACQUISITIONS AND THE INNOVATION PERFORMANCE OF ACQUIRING FIRMS: A LONGITUDINAL STUDY. Strategic Management Journal, 22(3), 197.

[36] Hitt, M. A., Ireland, R. D., Harrison, J. S., & HOSKISSON, R. E. (1991). EFFECTS OF ACQUISITIONS ON R&D INPUTS AND OUTPUTS. Academy Of Management Journal, 34(3), 693-706. doi:10.2307/256412

in organic foods because in doing so the firm will reduce its dependence on slower growth segments such as soups.[37] Successful businesses must adapt to changing environments and acquisitions allow firms to constantly reshape their competitive scope, which allows the firm to gain access to capabilities they lack. Though profitable in theory, research proves that firms can broaden their knowledge base and increase the potential of their capabilities when they undergo acquisitions.[38] Altogether, mangers can fairly rationalize acquisitions as they can increase market power, decrease entry barriers, increase speed to market, reduce cost of product development, increase company diversification and thus reduce risk, and reshape a firm's competitive scope through learning and developing new capabilities.

The second limitation is that acquisitions fail for reasons not specified. The first problem in achieving success is general difficulty in integrating the companies involved. Some analysts believe that the integration process is the strongest determinant of acquisition success.[39] Thus, management should not underestimate the value of integration. In 2015, Nokia was in advanced talks to acquire Alcatel-Lucent. If completed, the transaction would create the second largest mobile equipment manufacturer in the world. However, in spite of the overall positive reaction to the proposed transaction, concerns of the integration process eventually caused the deal to fall through.[40]

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[37] Campbell's. (2015, January 29). Campbell Announces Plans for a Reorganization of Its Business Operations and Appoints the Presidents of Its Three New Business Divisions. Retrieved March 25, 2017, from https://www.campbellsoupcompany.com/newsroom/press-releases/campbell-announces-plans-for-a-reorganization-of-its-business-operations-and-appoints-the-presidents-of-its-three-new-business-divisions/

[38] Hajro, A. (2015). Cultural influences and the mediating role of socio-cultural integration processes on the performance of cross-border mergers and acquisitions. International Journal Of Human Resource Management, 26(2), 192-215. doi:10.1080/09585192.2014.922354

[39] Trichterborn, A., Zu Knyphausen-Aufseß, D., & Schweizer, L. (2016). How to improve acquisition performance: The role of a dedicated M&A function, M&A learning process, and M&A capability. Strategic Management Journal, 37(4), 763-773. doi:10.1002/smj.2364

[40] Hua, T. (2015, April 15). Nokia's Ambitions Could Crack Under Integration Pressure. Retrieved from https://www.wsj.com/articles/nokias-ambitions-could-crack-under-integration-pressure-1429110642

Likewise, inadequate evaluation of the target during the due diligence process is another fault. This can be accomplished internally, or externally through the use of advisory firms. A third problem is extraordinary debt. Simply, firms using an acquisition strategy want to verify that the transaction does not create a debt load that overpowers their ability to remain solvent and vibrant. Costs for deals are high. As such, the due diligence process must include all relevant synergies, including negative ones. Inability to achieve synergies is another problem that many businesses have.

Diversification creates yet another roadblock in realizing synergies. Managers want to diversify their businesses as a means of mitigating their personal risk. However, increasing diversification leads to future problems. Additional amounts of diversification often cause managers to rely on financial rather than strategic controls to evaluate performance. Using financial controls causes managers to focus on short term goals. Focusing on short-term profits can negatively affect a firm's ability to remain financially prosperous.[41] Since a considerable amount of time and energy is required, managers can lose focus of managing their organization by being overly focused on the transaction at hand.[42] Lastly, organizations can become too large. The complexities of larger firms often lead managers to implement more bureaucratic controls, which decreases flexibility and innovation.[43] Though managers hedge their risk through diversification, shareholders want companies to focus on their competitive advantages. Investors can diversify

[41] DAVID, P., O'BRIEN, J. P., YOSHIKAWA, T., & DELIOS, A. (2010). DO SHAREHOLDERS OR STAKEHOLDERS APPROPRIATE THE RENTS FROM CORPORATE DIVERSIFICATION? THE INFLUENCE OF OWNERSHIP STRUCTURE. Academy Of Management Journal, 53(3), 636-654. doi:10.5465/AMJ.2010.51469005

[42] Perrott, B. E. (2015). Building the sustainable organization: an integrated approach. Journal Of Business Strategy, 36(1), 41-51. doi:10.1108/JBS-06-2013-0047

[43] Kauppila, O. (2014). So, What Am I Supposed to Do? A Multilevel Examination of Role Clarity. Journal Of Management Studies, 51(5), 737-763. doi:10.1111/joms.12042

more easily, since they are not forced to spend time and resources creating core competencies in additional industries, as do businesses.

Ultimately, research suggests that as little as 20% of mergers and acquisitions are successful, approximately 60% produce disappointing results, and the remaining 20% are clear failures.[44] Though a multitude of factors cause acquisitions to fail, primary problems include integration difficulties, inadequate evaluation of target, large or extraordinary debt, inability to achieve synergy, too much diversification, managers overly focused on acquisitions, or that a combined company is simply too large.

Implications

This paper began with a statement, claiming that the roughly half of all acquisitions are considered failures. Then, this paper outlined two important questions. The first question was why are acquisitions becoming more and more common? An in-depth analysis answered this question by claiming that internal persons, external persons, and the broader macroeconomic environment all motivate for these large transactions. The second question proposed was if this trend truly is destined for the future, what implications must follow?

Intuitively, the high failure rate of acquisitions paired with several motivators, warn investors and shareholders. Said findings should conclude that acquisitions are fiscally irresponsible. However, it is naïve to believe that acquisitions should not occur. Acquisitions create tremendous value for some shareholders and are rightfully a common strategic-decision in the marketplace. However, the primary implication is that investors should be pessimistic in regard to massive deals

[44] Hitt, M. A., Ireland, R. D., & Hoskisson, R. E. (2017). Strategic management: Competitiveness & globalization: Concepts. Boston, MA: Cengage Learning

as they are unlikely to yield the expected returns. Based on personal experience, investors view large transactions as fundamental business decisions necessary in obtaining competitive advantages. A cautious outlook will allow investors to make well informed investment decisions.

Additionally, it is naïve to conclude that acquisitions are fiscally irresponsible without additional studies. Does firm size affect the prosperity for shareholders after acquisition announcement? Most importantly, does the added value of the positive transactions outweigh the lost value of the negative transactions and are shareholders better off selling their ownership after acquisition announcement? The entire venture capital industry is built around the premise that few winners can outweigh many negatives. The following questions are necessary in order to reach an applicable solution, thus further research is needed. However, without answers to the following questions, typical shareholders should realize the potential for risk, and should adequately evaluate possible synergies with as much information as they have possible.

Conclusion

Acquisitions are becoming more and more common in today's business environment. Interestingly, the majority of acquisitions yield decreased shareholder value. Nonetheless, they continue to occur. Though the acquisition phenomenon is financially irresponsible in regards to increasing shareholder wealth, three variables rationally motivate for them.

Internal persons rationally motivate acquisitions. Research indicates that there is a strong correlation between executive compensation and acquisition pervasiveness. Managers are more likely to motivate for acquisitions when they receive higher compensation for doing so. This translates to future success in that firms with high-equity based compensation significantly outperform those without. More so, research shows that executive compensation comes in many

forms and facets, and when executives have a personal financial incentive to acquirer a competitor, they are more likely to do so. This is true regardless of how executives receive compensation, either by cash or equity. Managers are confident that they can source successful acquisitions. This is important because going forward, the high probability of unsuccessful acquisitions is irrelevant if managers are exceedingly confident in their abilities. Though earnings management does not lead to long-term success, managers can rationally motivate for acquisitions as a means of increasing short-term performance.

Additionally, external persons rationally motivate acquisitions. Investment banks, accounting firms, consulting firms, and law firms advocate for these deals. These external parties follow compensation structures which incentivizes a large sales price, which in turn hurts the acquiring company. Though this hurts the shareholders for acquiring companies, it is rational in that these external parties represent the agents they serve.

Lastly, the broader macroeconomic environment rationally motivate acquisitions. The Federal Reserve's quantitative easing policy created an environment characterized by low interest rates. This policy has led to increases in spending, but our quantitative easing environment has also created an atmosphere in which massive deals are simple to finance. This promotes acquisitions for buyers as well as sellers. Regardless, internal parties, external parties, and the macroeconomic environment all motivate for acquisitions.

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