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THE IMPACT OF MERGER AND ACQUISITION IN CORPORATE MANAGEMENT AND FINANCIAL PERFORMANCE

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ABSTRACT

Over the last 35 years, more than one million mergers and acquisitions Merger and Acquisition ***(Herein referred as M&A)*** have occurred globally, yet the failure rate remains high, ranging between 70–90%. While M&As can be an effective strategy for companies to grow and expand, they can also present significant risks. As a result, it is crucial to critically assess their impact on corporate performance, highlighting both the positive and negative aspects to caution companies against pursuing M&As without careful consideration. This paper begins by discussing how fluctuations in employee turnover rates can adversely affect managerial performance following a merger. It then explores the potential changes in profitability, liquidity, and stock prices following an M&A announcement. Additionally, the paper examines the varying impacts on businesses, depending on the specific M&A strategies employed. The research primarily relies on secondary data from previous studies, further analyzing it in relation to LVMH's consolidated financial statements.

Keywords- Managerial effect; Financial Performance; M&A

1. INTRODUCTION

In an effort to maximize profits and achieve rapid growth, businesses frequently turn to mergers and acquisitions (M&A) as a key strategy. The first wave of M&A activity began in 1987, although the majority of these deals were not successfully completed until the 21st century. King (2019) defines mergers as the combination of two or more companies into a single entity, while acquisitions involve the purchase of more than 50% of another company's equity. When companies merge, they are often able to generate greater synergies than if they operated independently. From an operational perspective, Nelson (2018) suggests that M&As help businesses grow and enhance their profitability, primarily by reducing operating costs as production scales increase. Mergers also allow companies to explore new customer bases and enhance market power. Additionally, as equity returns and shareholder wealth increase, the firm's debt capacity grows, and it may benefit from tax advantages through higher leverage. Over the past 35 years, more than one million M&A transactions have occurred worldwide, though only 10,000 have been fully completed.

By 2020, only 10,000 mergers and acquisitions had been completed, marking the lowest point since 2014. Although M&A is a key strategy for business expansion, it can have a double-edged effect, amplifying the negative outcomes if synergies are not successfully realized. In the area of human resource management, Kantikoy (2020) discovered that the employment rate in post-merger companies could decrease by 10–20% following consolidation. As companies expand in size, financial and managerial challenges can become increasingly complex. Therefore, this study is crucial as it analyzes the effects of M&A through real-world cases to caution companies against focusing solely on the potential benefits. This paper will first explore the financial and managerial impacts of M&A, evaluating both the advantages and disadvantages from a critical standpoint. It will also examine how different M&A strategies influence the success or failure of these transactions. The study primarily uses secondary data to analyze LVHM's financial performance and management trends before and after mergers, conducting a comparative analysis to draw conclusions.

Managerial effect

Mergers and acquisitions have become a cost-effective strategy for acquiring top-tier talent, particularly when the labor market lacks sufficient resources. It is common for established firms to acquire emerging tech companies, as evidence suggests that technological M&A can enhance the acquiring company's innovative output once the deal is finalized. Between 1990 and 2011, approximately 4,000 high-tech startups were purchased by larger corporations in the United States, resulting in the transfer of around 350,000 startup employees to these firms.

However, a key rationale behind M&A is the potential for increased synergies through reduced operational costs. In pursuit of these benefits, companies often resort to cutting a significant number of lower-level employees to reduce payroll expenses. One major reason for the low success rate of M&A deals is the negative employee response, including high levels of turnover. According to Cartwright and Schoenberg (2006), 25% of senior managers leave the company before the M&A is completed. Additionally, Kim (2020) found that within the first year of acquisition, 33% of the acquired staff depart, with 12% of those being regular employees with similar qualifications and work experience. Over a three-year period, employee turnover rates are 15% higher compared to new hires. Moreover, around half of employees who do not feel aligned with the new company culture after the merger choose to leave.

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These statistics highlight the risk that M&A poses to implicit psychological contracts and prior agreements, leading to reduced commitment and increased turnover. Another factor driving turnover is employees reevaluating their fit within the newly formed organization. Ensuring a stable turnover rate is crucial, as it directly affects business performance. The loss of high-tech talent, in particular, can erode a company's competitive edge and, in some cases, disrupt operations. Furthermore, a high turnover rate can demoralize remaining employees, damage the company's reputation, and make future hiring efforts more challenging.

Financial effect

1. Profitibality

Neoclassical economics posits that mergers and acquisitions (M&A) can lead to profit maximization by creating synergies. According to Gugler and Siebert (2007), successful M&As can enhance a company's profitability through economies of scale, reorganization of financial resources, post-acquisition adjustments, cost reductions, and knowledge spillover. Synergies arise from the integration of different businesses, altering their operational dynamics. Edi (2020) argues that sharing production factors—such as labor, capital, land, and enterprise—across merging firms helps achieve operational synergies and economies of scale. The effectiveness of these synergies depends on how similar and complementary the merging companies are, with cultural differences potentially offering opportunities for resource redeployment and added corporate value.

Profitability can be assessed through various metrics, including market share, revenue, and profit margins. For instance, LVMH, which began expanding through acquisitions in 1987, has grown into the world's largest luxury conglomerate. A notable recent acquisition was Tiffany & Co., purchased for approximately $16 billion in 2021. Despite LVMH's watch and jewelry segment initially representing only 8% of total group revenues, this segment's profitability doubled following the acquisition of Tiffany & Co., thanks to its strong market position in luxury jewelry. Between 2020 and 2021, revenue from the watches and jewelry division surged from €3,356 million to €8,964 million, and profits increased from €302 million to €1,679 million. The operating margin improved by 9.7%, indicating that the acquisition significantly enhanced LVMH's overall profitability. By 2021, the watch and jewelry division had risen to one of the top three most profitable segments within LVMH, illustrating how a successful M&A can substantially boost a company's profitability across various dimensions.

2. Liquidity

Mergers and acquisitions (M&A) lead to the creation of larger corporations with increased assets, profitability, and borrowing capacity. Consequently, these firms gain enhanced negotiating power with banks, enabling them to secure lower interest rates, extended repayment terms, and larger loan amounts. Typically, the consolidation of two companies results in an increase in their total assets. Additionally, as profitability rises, the extra profits are converted into liquid cash flows, which can be reinvested in daily operations. Analyzing these operational impacts reveals how M&A can significantly affect a company's financial structure and operational efficiency.

An analysis of the 50 largest American mergers and acquisitions from 1979 to 1984 shows that the asset productivity of acquired companies significantly improves after the deal is completed, particularly in terms of return on operating cash flow. Additionally, when a private equity firm replaces the management team post-acquisition, cash flow performance often strengthens. Positive net cash flow, a component of current assets, can be used in various ways, such as settling debts or paying dividends to shareholders. For instance, following its acquisition of Tiffany & Co., both LVMH's total assets and equity saw considerable increases.

Merged companies often seek tax advantages by reporting negative turnover. If a profitable company acquires a financially distressed one, the resulting merged entity might show a loss at year-end, thereby reducing its tax liability. Palepu (1990) describes leveraged buyouts (LBOs) as a strategy where investors borrow funds to acquire a target company.

LBOs can lower a corporation's tax obligations through two main mechanisms: forming an interest tax shield during the transaction and increasing amortization deductions due to the rise in tangible assets post-acquisition. According to Bruner (2004), the average leverage ratio of companies before acquisition was 23.7%, but post-acquisition ratios surged to nearly 70%.

Conversely, target companies may hide negative information or exaggerate their strengths due to asymmetric knowledge, which can jeopardize the success of M&As. Failure to investigate the source of the target company's debt can lead to overdue liabilities and potential bankruptcy. Van de Gucht and Moore (1998) examined 343 leveraged buyouts from 1980 to 1992 and found that after an average of 3.5 years, 27% of these companies experienced a decline in performance, 9% were sold to public companies, and 12% went bankrupt. The bankruptcy rate for LBOs was 27% in the 1980s but decreased to 17% from 1990 to 2006.

Stock Prices

The response of stock prices to mergers and acquisitions (M&A) reflects changes in company value, which are often linked to adjustments in debt structure. Stock price volatility can indicate various factors: cash flows, which provide insights into future expectations; information asymmetry, where managers might issue securities if the market price is perceived to be overvalued; and ownership changes, which can affect stock prices due to shifts in control.

The impact of an M&A announcement on stock prices can differ based on the type of consolidation. In stock-for-stock mergers, the share exchange ratio plays a crucial role in determining if one company will receive a premium (an additional acquisition fee) above its current share price. Typically, the stock price of the target company may rise, but the extent of this increase can vary depending on the specifics of the deal.

The impact of mergers and acquisitions (M&A) on stock prices can be constrained if the share price of the merger partner declines, which can erode the original premium. To mitigate this risk, merger agreements may include protective clauses. For example, if the share exchange occurs at a lower level than anticipated, the exchange ratio might be adjusted upward. However, such restrictions can potentially harm the interests of the merger partner and its shareholders.

In acquisition scenarios, the acquiring company usually pays a premium to secure the target company. This often results in a temporary drop in the acquiring company's stock price, while the target company's stock price tends to rise. This increase in the target company's share price is often due to the premium offered, which reflects the additional value the acquiring company is willing to pay. Pop's research (2006) found that the average premium paid in such transactions is around 40%, compared to an initial average premium of 27%. In the short term, the target company's share price typically rises because shareholders are attracted to the transaction only if the purchase price exceeds the company's current value. According to Tang and Xu (2016), abnormal returns for the target company's shares increase significantly in the days leading up to the announcement, with the growth rate averaging about 5.2% within 30 to 20 days prior and 4.8% within 20 days. Post-announcement, the growth rate can reach 10.5%, indicating that a substantial portion of the market response occurs before the announcement. Elad and Bongbee (2016) also noted that the market reacts quickly and effectively to M&A announcements, as evidenced by sudden changes in return rates.

However, there are risks associated with consolidation. Target company managers may withhold negative information to protect the company's reputation, which could lead to a more severe stock price drop when the truth eventually emerges. Such delayed disclosures can result in a significant decline in stock prices once the negative information becomes public.

2. CONCLUSION

This paper examines the impact of mergers and acquisitions (M&A) on both corporate management and financial performance, and explores how various M&A strategies can enhance these effects. From a managerial perspective, the focus is on how M&As influence employee turnover and company profitability. For instance, technology acquisitions can help firms hire specialists and boost innovation and productivity when senior talent is limited. However, M&As often lead to job redundancies, resulting in increased employee turnover as companies reduce payroll costs. Additionally, some employees may choose to leave the company voluntarily before the merger is completed. High turnover rates can negatively impact employee morale and damage the company's reputation, making future recruitment more challenging. On the financial front, successful M&As can generate synergies that positively affect profitability. For example, LVHM's acquisition of Tiffany illustrates how effective M&As can enhance financial performance. Horizontal and vertical integrations can lead to resource complementarity, allowing companies to scale production, expand market share, and boost profits. Furthermore, when a profitable company merges with a financially distressed one, the combined entity may initially report a loss, which can reduce its tax liability for the year. Additionally, the increased scale of operations following such mergers can contribute to improved financial outcomes. Increased profitability and cash flow flexibility following a merger or acquisition can enhance a company's debt capacity, as rising fixed assets contribute to this improvement. However, when a company engages in a leveraged buyout with a heavily indebted firm, there is a significant risk of debt default, which could potentially lead to bankruptcy. Additionally, the share price of the acquiring company typically declines due to the premium paid, while the target company's share price often increases. M&A transactions sometimes involve concealing negative information about the target company, and once such issues come to light, the share price of the acquiring firm can suffer substantial declines. This paper aims to provide companies with a critical perspective on M&A, assisting them in selecting the most advantageous M&A strategies. However, since the study relies largely on secondary data from previous research, there may be limitations regarding the timeliness of the information. Moreover, the impact of the current global economic situation, including ongoing epidemics, could influence the M&A landscape. Future research should focus on obtaining up-to-date primary data and analyzing the effects of M&As within the context of the current economic environment to provide more relevant insights for companies.

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