All M&A Is Local
by Robert F. Bruner

Here we go again. The recent announcements of megamergers signal a return to our favorite business sport: handicapping potential buyers and targets. But approaching this like most bettors at the track is fruitless. In the high-stakes game of ever shifting competitive landscapes, only a clear view of the underlying drivers of mergers and acquisitions can yield intelligent guesses about who’ll buy, who’ll be sold, and the timing of either. Scholars have studied the drivers for years and by now have produced some insights that can help the handicapper.

One popular explanation, fed by findings that M&A waves coincide with stock market booms, is that M&A happens for behavioral reasons such as ego or irrationality. This view has led some scholars to hypothesize that M&A activity is an outgrowth of the wider market mania. Others infer that executives could be rationally exploiting irrational investors: inflated share values create an attractive currency with which to get big. A third hypothesis is that executives know how difficult it is to create value through M&A but continue to do deals out of sheer hubris. All of these arguments fit into a broader wave of studies confirming behavioral influences on investment decisions. These studies are probably on to something, but to believe that hubris or irrationality tells the whole story about M&A activity doesn’t help the handicapper or the decision maker think about what might be just around the corner.

We can gain more traction by viewing M&A as an instrument of corporate transformation, a response by executives to a turbulent environment. This view does not disregard the behavioral influences on M&A activity that other researchers have exposed, but it points to other drivers as well and, overall, presents a more complex picture. For instance, buoyant stock markets tend to coincide with episodes of industrial change; thus, turbulent conditions rather than the stock market might prompt M&A activity. And instead of simply blaming high-profile failures on hubris and leaving it at that, those who consider the forces of turbulence ask how the firms would have performed absent the merger. DaimlerChrysler and AOL/Time
Warner are certainly the poster children of the hubris view, but does anyone really believe that Chrysler’s or AOL’s shareholders and employees would be better off today had those companies walked away from negotiations with their partners? When they announced their deals, both firms faced the onset of “perfect storms” in their industries. An understanding of such turbulence gives a richer outlook on any merger.

The turbulence view has long been explored by researchers and practitioners. In 1942, Joseph Schumpeter described the business economy as characterized by ceaseless and self-generated change arising from turbulence in the firm’s environment. He argued that canny entrepreneurs and managers seize the opportunity created by this turbulence to make a profit—M&A is one way to do that. More recently, Bruce Wasserstein, the dean of M&A advisers, cited five forces that drive the merger process: regulatory and political reform, technological change, fluctuations in financial markets, the role of leadership, and the tension between scale and focus.

Various scholars offer evidence consistent with the view that strategic turbulence is the real driver of M&A activity. Consider these examples:

• In their study of the 1980s merger wave, Mark Mitchell and Harold Mulherin found that industries with the greatest amount of takeover activity were those that experienced fundamental economic shocks like deregulation, technological innovation, demographic shifts, and input price shocks. They pointed to M&A activity in banking and broadcasting driven by deregulation, textiles by liberalized trade policy, energy by petroleum price changes, and food processing by a demographic shift and low population growth.

• Naomi Lamoreaux studied the M&A wave of 1894 to 1904, when more than 1,800 firms disappeared into the formation of 93 “trusts.” She found that most M&A activity occurred within industries characterized by capital-intensive, mass-production manufacturing processes in which new firms introduced new and devastating technology. The M&A of this period removed older and less efficient players from these industries.

• Similarly, Boyan Jovanovic and Peter Rousseau studied the waves of 1890 to 1930 and 1971 to 2001 and concluded that the former was significantly associated with the diffusion of electricity and the internal combustion engine and the latter with the rise of information technology.

• Michael Jensen has argued that restructuring in the 1980s was stimulated by innovation in organizational design, such as the retailing model introduced by Wal-Mart and wholesale clubs. He has also pointed to the creation of new markets and trading systems (such as in high-yield debt) that stimulated the wave of hostile takeovers and leveraged buyouts.

The turbulence view of M&A activity has at least five implications for business practitioners.

1. All M&A is local. Tip O’Neil, former Speaker of the House, helped newcomers to Washington understand the behavior of politicians with the phrase, “All politics is local.” By this he meant that the mind-set of the successful politician begins with his or her constituency, not with supposed mood swings at the national level. Thus it is with understanding M&A. Pay attention to economic turbulence, the form it takes, how and which firms it affects, and who exploits it.

2. The sources of turbulence reveal more than the results. Observers tend to focus on M&A deals, rather than their drivers. The turbulence view encourages us to look upstream to the profound forces at work in a particular industrial market. Almost certainly, the drivers will vary from one industry to the next.

3. Flexibility is key. The forces behind M&A activity are most devastating when least expected. Just when you have the dance steps memorized, the music changes. Cultivate the ability to envision several scenarios and hedge accordingly rather than bet the ranch on your favorite view of the future.

4. Change leaders are likely to be those with the most at stake, either because of threat or opportunity. NationsBank changed the rules of M&A in interstate banking, led in no small part by a fear of being surrounded by larger players first in North Carolina, then the Southeast, and, finally, nationally. Change

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leaders are often created by circumstance rather than choice. As Hugh McColl, CEO of NationsBank, told me in a case interview, “Our goal was to survive, to have control over our own destiny, and to be prosperous.”

5. Targets are likely to be those that have lost the strategic initiative in the face of change. Strong players deal better with turbulence than weak players. Keep an eye on the relative financial and operational health, competitive position, and organizational strength of firms in the industry.

Our understanding of what drives waves of M&A continues to evolve. The behavioral view offers provocative insights and certainly makes interesting reading in newspapers. The thoughtful practitioner, however, should follow the turbulence to learn more. Perhaps the most important insight of the turbulence view is that broad-brush speculation about M&A activity around the globe doesn’t have much practical content. The best insights about the drivers of M&A are to be found industry by industry. It is through focusing on industry-level M&A activity that we can make more meaningful assessments of the larger movements.

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