Economic Impact of Mergers and Acquisitions in Corporate World: An African context

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July 13, 2022

Abstract

Mergers and acquisitions have been pronounced and adopted with the profound need to combat the economic crisis and neutralize the detrimental effects of the COVID-19 pandemic. The uncertainty and risks involved in undertaking business operations have rapidly given rise to the strategic and systematic execution of cost-cutting measures and survival techniques. Mergers and acquisitions are one of the most effective strategies for the survival of a company through the creation of synergies and leveraging on economies of scale. The aim of the study was to establish the economic impacts of mergers and acquisitions in the corporate world. The study specifically sought to analyze and determine the extent to which mergers and acquisitions affect the selected variables constituting market share, shareholders’ wealth, portfolio diversification, employment, and economies of scale. The analysis apparently observed that mergers and acquisitions have no significant impact on shareholders’ wealth in the short run, as indicated by stock price movements, despite commanding an extensive customer base and market share, reduction of operation costs based on economies of scale, and mitigation of financial risks through portfolio diversification. The corporate employees always impede any kind of mergers and acquisitions due to the uncertainties and apprehensions associated with their engagements and organizational culture pitting them against the conventional narrative that change is inevitable.
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Abstract: Mergers and acquisitions have been pronounced and adopted with the profound need to combat the economic crisis and neutralize the detrimental effects of the COVID-19 pandemic. The uncertainty and risks involved in undertaking business operations have rapidly given rise to the strategic and systematic execution of cost-cutting measures and survival techniques. Mergers and acquisitions are one of the most effective strategies for the survival of a company through the creation of synergies and leveraging on economies of scale. The aim of the study was to establish the economic impacts of mergers and acquisitions in the corporate world. The study specifically sought to analyze and determine the extent to which mergers and acquisitions affect the selected variables constituting market share, shareholders’ wealth, portfolio diversification, employment, and economies of scale. The analysis apparently observed that mergers and acquisitions have no significant impact on shareholders’ wealth in the short run, as indicated by stock price movements, despite commanding an extensive customer base and market share, reduction of operation costs based on economies of scale, and mitigation of financial risks through portfolio diversification. The corporate employees always impede any kind of mergers and acquisitions due to the uncertainties and apprehensions associated with their engagements and organizational culture pitting them against the conventional narrative that change is inevitable.

Key Words: Mergers and acquisitions, Economic impact, Economies of Scale, Market share, Employment, Shareholder’s wealth

1 Background of the study

Numerous research papers have endeavored to evaluate and determine the operational costs and benefits of mergers and acquisitions. The conclusions drawn from the studies are so varied that it is quite uncertain to confidently come up with an independent, clear, and unequivocal agreement on this specific strategy (chu,
A merger is considered an amalgamation of two or more corporations with the sole purpose of operating as a single new company in the industry, while an acquisition is concerned with the arrangement where one corporation possesses complete control of all or part of the properties of another corporation directly or indirectly through the governing organization of the corporation. (Eric, 2015).

There are three main categories of mergers which include horizontal merger which is an amalgamation between competitors of similar geographical and merchandise marketplaces, vertical merger entails firms whose manufacturing products are compliments of each other and conglomerate which encompass firms that function in completely diverse product or geographic marketplaces (Mbuthia, Kiboi, & Omurwa, 2021). Muthukrishnan, (2021) established that corporate merger contribute to the increase in the value of the firm while acquisitions of corporates boost the brand and goodwill revaluation, henceforth leading to the growth in market share. That notwithstanding, most mergers and acquisitions collapse, and the intended objective is never realized due to the knowledge inadequacy of the directors and organizers who participate in the whole process (Daraban, 2020).

According to Eric (2015), shareholders’ wealth maximization has always been the main objective of every firm. Recent research studies on the realization of this objective have proposed a comprehensive approach towards increasing firm value and, consequently, the growth of share prices. The complexity, uncertainty and contingent risks associated with mergers and acquisitions demand creativity, keen attention, innovativeness, and professionalism on every step of the way in order to enable a successful corporate creation (Zhongming & Jingyun, 2022). Mergers and acquisitions present one of the most effective strategies for struggling firms and those that take advantage of economies of scale and synergies that result from such accomplishments. Firm performance and economic growth can be enhanced, and productivity can be increased. However, as an investment strategy to increase portfolio, mergers and acquisition, cannot dismissed without careful analysis and risk mitigation strategies, and the merger done on a systematic or piece meal method (Eric, 2015).

For mergers and acquisitions to be adopted and thrive, they require economic and political stability; legal protection; free markets with no restrictions on the movement of goods and capital; and a conducive enterprise environment. Madara, Mwaura, and Gichuhi (2021), note that one of the main objectives of mergers and acquisitions is to protect the going concerns of companies and seek assurance of growth opportunities and relevance in a highly competitive market. According to Arasa (2020), organizations usually adopt the strategic concept of mergers and acquisition in the modern world, necessitated by the dynamic technological advancements and availability of a conducive business environment depicting an almost Efficient Market Hypothesis (EFH) where information and blockchain technology have been enabled through economic
integration blocks and institutions as well as aiding transactions through cryptocurrency exchange protocol. It is on this point of view that this paper focuses, rooting out the economic impacts of such formations on corporates and the extent to which the need for mergers and acquisition has arrived.

2 Problem Statement

Mergers and acquisitions involve the systematic consolidation of institutions to create a single joint firm with the aim of realizing the dream of increasing and stabilizing shareholders’ value. Due diligence, efficient financial management, strategic fitness, and competitive intelligence incorporate the prerequisites of a successful organization. Failure to live up to such requirements may render the firm vulnerable to the missiles of competitive forces, resulting in uncertainty of going concern, closing down, diminished financial capability, devaluation of goodwill, loss of customers, and exposure to unnecessary litigation (Miriko & Muthoni, 2020). Firms resort to mergers and acquisitions objectively for the purposes that an individual firm could not attain and fulfill on its own, such as operating on economies of scale, saving and prolonging the going concern, finding competitive advantage, resolving agency conflicts, price leadership, extending corporate dominance, and much more importantly, maximizing the shareholders’ wealth of the firm (Arasa, 2020).

Divergently, Omweri and Wepukhulu, (2018) claims that mergers and acquisitions have in one way or another been unable to live up to the expectations of the value and synergy of the firms involved. From his survey of merger experiences, he found out that mergers do not add significant value to the merging corporations. They established that there is less likelihood of enhancement to firm performance and value creation through the well-known resulting forms of synergies after mergers and acquisitions.

In their study, Miriko and Muthoni (2020) noted that competitive advantage is the key strategy that a firm can adopt when entering into mergers and acquisitions since firms survive because customers are available, because they are directly and indirectly competing against other firms and appealing to their customers in their attempt to expand the customer base territory. This is further supported by Zhongming and Jingyun, (2022), who determined that the actual aim of some mergers and acquisitions is to boost revenue capacity and subsequently maximize shareholders’ wealth through a rise in stock values, hence attracting investors and expanding the capital base. Another aim is the change and diversification of businesses in a technique to minimize the risk of a single entity through the creation of a non-volatile portfolio that can withstand and survive any imminent threat of financial crisis.
However, Miriko & Muthoni (2020) cautioned firms against using illegal strategies to gain an undue advantage over the rest or changing the rules of the game to their advantage. Firms should be cognizant of the fact that the stakeholders are well informed and any slightest hint of foul play may render the firm irrelevant as investors may pull out for fear of a share price decline that may be occasioned by loss of customers and subsequent decrease in revenue, leading to the downfall and possible liquidation or acquisition of the firm. It is in the light of such a paradox that the researcher attempts to address the existing gap on the basis of a determination of the impact of such a corporate strategic action on the industry.

3 Methodology

Mergers and acquisitions are an instrumental resuscitation approach for struggling and surviving firms that are on the verge of being swayed into financial oblivion by the storms of economic instability, stiff competition, mismanagement of shareholders’ funds, and operational inefficiencies. The purpose of the study was to closely analyze the economic impacts of mergers and acquisitions on the corporate world. The study adopted a compiled data methodology where information was collected from available sources through a literature review with the aim of determining the extent to which the evaluated variables affected mergers and acquisitions in the corporate world.

4 Literature review

Mergers and acquisitions are strategically adopted by firms to achieve specific objectives that can enhance the firm’s goal of productivity and decrease the cost of operations. The economic parameters that can propel corporates towards realizing optimal synergy are characterized by the profound need to deal with market share; portfolio diversification in order to minimize risk; taking advantage of economies of scale; employment; market expansion; and value creation (Mboroto, 2013).

Mbuthia, Kiboi, and Omurwa (2021) found that the performance of a firm after mergers and acquisitions is strongly associated with its asset base due to the fact that it increases the revenue of the firm through interest income and reduces the problem of planning, provision, and management of bad debts that would otherwise lead to liquidation of key assets had the firm not merged or acquired. They also determined that mergers and acquisitions enhanced financial performance and liquidity, but at the same time, the overall risk in the market increased consequently.
In this era where the corporate world is engulfed in a series of economic devastations brought about by the ongoing COVID-19 pandemic, cross-border conflicts, internal wars, and famine, Lee, Degtereva, and Zobov (2021) assert that there is a profound need to advance innovative techniques in our environmental and psychosocial structures in order to enable a conducive system of interactions and interrelation that will enable the flawless movement of human capital and facilitate the linkage between firms for the adoption of the merger and acquisition strategy to save struggling and surging firms before, during, or after the post-COVID-19 era.

4.1 Market share

In a competitive world where each and every firm is using all the means available at their disposal in order to obtain the maximum share of the revenues within the market for optimal financial performance, different strategies are invented and adopted with each firm targetting to seize the lion’s share of the customer base, which translates to higher sales volume. Market share is determined by revenues in a particular period divided by combined revenues from the whole market in a similar period and expressed as a percentage (Suryani, Hendrawan, Limanto, Wafda, & Auliyah, 2022).

According to Suryani, Hendrawan, Limanto, Wafda, and Auliyah (2022), market share is frequently perceived as the key performance indicator for the success of a firm. The impression of market share is not always mirrored in the financial performance of the firm. Nevertheless, numerous corporations consider it an imperative institutional objective. Market share is deemed as a determinant of price since firms with a higher share than the rest will always dictate the product value. Furthermore, they discovered that customer base fulfillment can forecast a firm's market share compared to its nearest challengers.

In his study, Chege (2016) found that mergers and acquisitions result in a considerable rise in market shares of the firms involved in the strategy. Corporations that evaded merging or acquisition posted a substantial increase in market share after mergers and acquisition agreements were reached and executed, despite the fact that they were not directly engaged in the mergers and acquisitions. He concluded that merger and acquisition results in not only an increase in market share but also market supremacy since the number of competing firms decreases, which makes the merged firms acquire price leadership status, a state that totally distabilises or shifts the market equilibrium.

4.2 Shareholders wealth

Needless to say, strategic corporate governance dictates that the major role that ought to be played by the company's directors is to maximize the shareholders' wealth. In one way or another, M&A contributes to
value creation of the firm through efficiency in performance, skills, and knowledge occasioned by a blend of professionals from different firms in what is often referred to as management synergy, expansion and growth, reduced competition, and a lessening of the tax burden (Ekambi, Oloko, & Senaji, 2021). Furthermore, they found that many firms enter into M&A agreements purposefully to develop a dominating player in the merchandise-marketplace zone of the tactical enterprise component, which may suppress competition by achieving a superior share of the market and mitigating corporate risk.

Conversely, Arasa (2020) determined that the M&A strategy has an insignificant effect on the share prices, as evidenced by past studies on firms listed on the Nairobi Securities Exchange (NSE), which had served to prove that stocks of most firms did not exhibit a substantial response to the announcement of M&A. Therefore, the impact of M&A on shareholders’ wealth in the short run may be less significant and the benefits, if any, not realized in that period. This is why some shareholders are usually hesitant and perhaps resistant to granting the go-ahead for such an agreement.

In her study, Rono (2014) revealed that despite the conspicuous agreement by researchers on the insignificant impacts of M&A on stock prices in the short run in a deal that seems to be dilutive, there are always immense benefits and high probabilities that may accrue to shareholders in the long run due to improved performance, leveraging on the economies of scale, consolidating the customer base and relationships reinforced by an increased market share, and dominating the market because of reduced competition. She established that the returns on assets (ROA), returns on equity (ROE), and earnings per share (EPS) increased on the attribution of asset quality and synergy.

4.3 Portfolio diversification

Mergers & acquisitions avail an approach to revive struggling and collapsing companies in one way or another, as there is always an element of management synergy that advocates for investment in assets and securities with a positive Net Present Value (NPV), high return at the lowest risk and divest from assets and securities with negative NPV, low return and high risk. This assertion is evident as verified by Lee, (2021) that there is an indication demonstrating that divestments have a constructive effect on tackling the financial crisis and long-run performance recuperation, where firms substantially enhance their long-run operational performance compared to their counterparts that did not embrace any form of divesture.

The financial security portfolio in M&A focuses more on the capitalization of the business firms in the deal and achieving the optimal blend of bonds and equity, as well as investing those funds in a way that promotes sound working capital that encompasses an effective cash conversion cycle and generates sufficient income.
for the company (Njambi, 2018). He hypothesized that income diversification after M&A has a considerable impact on firm performance, which turned out to be true, and as a result, he argued that there is an optimal level of diversification that guarantees maximum returns upon which an increase in investments in the portfolio basket results in performance deterioration and decreases portfolio returns while tending to increase the risks associated with such an undertaking. Conglomerate mergers are usually compelled to enter into these kinds of agreements with the aim of diversifying the portfolio to mitigate the imminent risk and maximize returns.

4.4 Employment

As a matter of fact, M&A is one of the most effective solutions to agency problems and to an extent an umbrella that covers the practice of professionalism, prudence, integrity and roots the directors into the treasured virtues that lasts like honesty, responsibility, accountability, transparency, and fairness (KamranMalikov, MehmetDemirbag, AzimjonKuvandikov, & StuartManson, 2021). They concluded that in a M&A strategy, the question is not whether there will be restructuring and redundancy, rightsizing, and downsizing, but whether the layoffs will be efficient to promote performance. It was determined that larger board of directors’ size and enhanced independence promotes hiring of quality employees and redundancy of less productive employees result from M&A.

The resistance by employees to M&A is informed by these realities, though the aim is either to save the company or achieve synergies in operation, management, and financial performance. This action deprives the nation of disposable income and exhibits corporates as less considerate to the spirit of corporate social responsibility (Kyrlacopoulos, 2018). In addition, termination of the sales and marketing personnel leads to the disconnection of key customers from the company, thus being a recipe of customer discontent in the new team, an austerity measure that deprives the firm of its valuable customers (KamranMalikov, MehmetDemirbag, AzimjonKuvandikov, & StuartManson, 2021).

4.5 Economies of scale

Quw & Khumalo, 2(021) defines economies of scale as a considerable reduction of operating costs of a company as it increases in size and stability. From their analysis, they found out that firms achieve economies of scale by decreasing fixed costs due to the eradication of unnecessary sectors and processes through different strategies M&A being among the options. Economies of scale can be detected in improvement of performance that will bring about efficiency in operations, viability of decisions, effectiveness in service
delivery and product quality to sustain the increased customer share, take advantage of the reduced 
competition and grasp a larger market share (Mbuthia, Kiboi, & Omurwa, 2021). When performing daily 
operations, it is crucial for a business to maintain a balance between liquidity and profitability. Insolvency is 
a possibility if such a balance isn't kept. Maintaining a higher amount of current assets or working capital 
helps reduce risk (Chasha, Kavele, & Kamau, 2022). Mergers and acquisitions may play a key role in 
enhancing economies of scale when it comes to working capital management.

Mergers and acquisitions are well-thought-out as a measure by which firms can realize the benefits that can 
be attributed to economies of scale, removing unproductive administration, deal with an economic crisis, cut 
costs and mitigate competition as well. In his study, Quw and Khumalo, (2021) established that economies 
of scale and financial performance are relatively the considerable indicators for forecasting the effects of 
merger and acquisitions on overall performance after implementation of the amalgamation. However, the 
findings from the study did not depict a robust input of the success of economies of scale on the part played 
by M&A in relation to the financial performance after merger.

Therefore, firms should be emphatic on the need to enhance and sustain financial performance than relying 
on the scope of economies of scale. Horizontal mergers are usually pursed to basically expand the market 
share and realize the economies of scale (Mbuthia, Kiboi, & Omurwa, 2021). That notwithstanding, M&A 
have empirically failed to achieve the desired objective of enhanced performance and synergy boost through 
economies of scale (Quw & Khumalo, 2021). The elements contributing such tremendous outcome are 
denoted by decreased termination in auditing, accounting, human resources departments besides focusing 
on management proficiencies.

5 Conclusions

The world is more concerned about the ongoing economic crisis that has plunged firms into the storms of 
financial distress, prompting drastic measures directed towards resuscitating and maintaining operations by 
adopting certain strategies, with mergers and acquisitions conspicuously being the dominant, besides 
stabilizing the already volatile share prices. Mergers and acquisitions present the corporate world with an 
effective but less aggressive strategy to grapple with these economic predicaments and still enhance their 
going concern with a certain degree of assurance of long-term benefits. The impacts of mergers and 
acquisitions are highly determined by the causal desire and intention of the agreement. Studies indicate that 
most mergers and acquisitions are born out of necessity, and that's why the ideal motive of such a strategy
is often not realized in numerous mergers and acquisitions. However, several firms have merged, and others acquired, where the objective was fully achieved and the move was commendable, but such a positive outcome may not exclusively be attributed to the factor of mergers and acquisitions alone. Numerous other factors influenced the outcome of the intended aim.

In regard to the firm’s main objective of maximizing the shareholders’ wealth, mergers and acquisitions did not contribute to a significant stock price, especially in the short run. Shareholders' expectations on post-merger influence on their returns in earnings per share and dividends seemed an outrageous adventure that sent shockwaves down their spines as some firms even reported a decrease in value. Shareholders should be cognizant of such information and cases so that they should hold the perception that M&A is a long-term undertaking and not an overnight revenue generation venture. The correlation between shareholders’ wealth maximization and economies of scale is positive, portraying similar outcomes in the short run and long run. The struggle for dominance and control of market cannot be dismissed and M&A impacts on the market share cannot be underrated. The impacts can be both positive and negative in the sense that an increased market share taps into the benefits of sales growth brought about by large customer base and completion reduction or elimination, on the other side, lack of competition sways firms into complacency and propensity to assume product quality which can result in reduced sales and low or same customer base with little change respectively.

The risk factor is a substantial element that firms should be well conversant with and institute mitigation systems by engaging in proven risk reduction techniques such as portfolio diversification and handling it in such an undertaking. Preliminary assessments of the imminent risks, the extent of the effects of such risks, and the mitigation measures should encompass all players in the process and the approaches effectively applied not to avoid risk but to minimize it. M&A impact on portfolio diversification in the current corporate economic setup saw the need for firms to find alternative investment markets and creation on more portfolios in the attempt to diversify risk and sustain operations and keep on improving their securities until an optimal portfolio is achieved. Employing risk management and assurance professionals can go a long way in ensuring that M & A realize the dream of sustainable strategic corporate governance and guarantee the shareholders’ stock price stability.

Most studies have established that the probability of success of mergers and acquisitions is at or less than 30%. Christensen, Alton, Rising, & Waldeck, (2011), and the theoretical determination of the typical success indicators or failure warnings are yet to be empirically assessed and asserted. The integration of human resources, operations, logistics, and organizational culture may not normally be settled under key and lock principals. Only the few that register success are fortunate enough and cannot be a study case to find out
how mergers and acquisitions can succeed. For that matter, further studies need to be conducted on the determinants of merger success in the spectrum of pre-merger planning rather than emphasizing on post-merger impacts in order to determine the viability of the merger in advance before any loss is incurred.

Figure 1: Relationship between variables

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