

Merger and Acquisition Theories

Economists have promoted several competing theories of M&As. Among them are empire-building (Baumol, 1967; Mueller, 1969), furthering anti-competitive activities, such as monopoly power (Roll, 1986; Mueller, 1993), management-entrenchment (Shleifer and Vishny, 1989), and an overestimation of a manager's ability to improve the performance of a target he or she perceives to be underperforming (Roll, 1986). The theory most relevant to this study is that inefficient plants and firms are taken over and efficient firms survive (Manne, 1965; Mead, 1968; Jensen, 1988).

Theories of M&As are not mutually exclusive. A firm could, for example, seek to gain market power and at the same time be building an empire and believe that it can more efficiently manage the business of a firm or plant it has targeted as a potential acquisition.

The two leading M&A efficiency theories are the disciplinary and synergistic merger motives:

- Disciplinary mergers theory suggests that M&As discipline target firms' managers who pursue objectives other than profit maximization. Managers who do not maximize profits presumably would focus attention on goals other than profitability. Since this difference in focus can come at the expense of operating efficiency, a firm's performance may suffer. Poor performance does not go unnoticed, however. Opportunistic buyers may observe the poor performance accompanied by good assets and discipline the poorly performing plant by acquiring it. Thus, the disciplinary theory suggests that acquiring firms merge with poorly performing targets and improve their performance as new management realizes the full potential of a target's assets.
- Synergistic mergers theory holds that firm managers achieve efficiency gains by combining an efficient target with their business and then improving the target's performance. Buyers recognize specific complementarities between their business and that of the target. Thus, even though the target is already performing well, it should perform even better when it is combined with its complementary counterpart, the buyer firm. The synergistic theory implies that target firms (or plants) perform well both before and after mergers.

Empirical research evaluating the efficiency of M&As has generated mixed results. Connor and Geithman (1988) remind us that many economic studies have shown that returns to acquiring firms are zero or negative. Finance-study reviews (Jensen and Ruback, 1983; Smith, 1986) and industrial-organization studies (Mueller and Burkhard, 1999; Bhuyan, 2002) found little evidence of efficiency gains from M&As. However, Lichtenberg and Siegel (1992a), who used a balanced panel of large continuous U.S. manufacturing plants from the U.S. Census Bureau's Longitudinal Research Database, found that ownership changes are negatively related to plants' pre-acquisition labor productivity and that acquired plants had significantly improved labor productivity after mergers. They concluded that ownership change is motivated by lapses in productive efficiency.

McGuckin and Nguyen (1995), on the other hand, found that ownership change is positively related to initial labor productivity and labor productivity growth for small plants but not for large ones. They concluded that buyer firms acquire poorly performing large targets because they are good assets that appeared to be worth fixing and make smaller acquisitions for synergistic reasons.

The two studies dealing only with manufacturing (Lichtenberg and Siegel, 1992a; and McGuckin and Nguyen, 1995) are important in assessing the efficiencies gained from M&As in manufacturing. However, they either used data for the entire U.S. manufacturing sector (Lichtenberg and Siegel, 1992a) or for a broadly defined industry, such as the entire U.S. food and beverage industry (McGuckin and Nguyen, 1995). Thus, their results may not hold for the more narrowly defined four-digit Standard Industrial Classification (SIC) industries, such as meatpacking, examined in this report.

This report differs from previous research in several ways. First, it generalizes McGuckin and Nguyen's (1995) study by considering two merger periods—1977-82 and 1982-1987. Second, it looks at much more narrowly defined industries. Third, several factors that were not considered in previous studies are shown here to affect acquisition choice and productivity growth. Finally and more technically, ownership change is treated as endogenous, making the final result more statistically valid.