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IN THE LONG RUN, SOME MERGERS SPELL SUCCESS FOR JAPANESE BUSINESSES

FAYETTEVILLE, Ark. – Mergers and acquisitions grew rapidly around the world in the 1990s as companies tried to consolidate their position in an industry or diversify into a different area. The resulting losses led many business experts to believe that acquisition destroys value for the acquiring firm. But University of Arkansas researcher Tim Kruse found that acquisition for diversification can improve a firm’s performance in the long-term.

Kruse conducted his study of Japanese firms with Hun Park and Kwangwoo Park from the University of Illinois at Urbana-Champaign and Kazunori Suzuki of Chuo University in Tokyo. It is among the first to look at long-term performance following Japanese mergers. They presented their findings recently at the American Finance Association Annual Meeting in Washington, D.C.

Historically, listed Japanese companies have been reluctant to merge, preferring to use internal growth mechanisms like reinvesting earnings and setting up subsidiaries. However, since 1990 Japan has experienced a dramatic increase in the number of domestic mergers and acquisitions during the past decade – from 268 in 1990 to 1,190 in 2001.

“We looked at the results of mergers prior to 1992 to see if they could help to predict the success of the current wave of mergers,” Kruse explained. “We wanted to know if the mergers
led to the expected improvements in company performance. We found that there is a remarkable degree of consistency between the pre-merger and post-merger performance. Basically, if the firm did well before the merger, it did well after the merger.”

The researchers examined data for all mergers between manufacturing firms listed on the Tokyo Stock Exchange for a 23-year period, from 1969 to 1992. They identified 46 mergers of manufacturing firms and reviewed the performance of each company for the five years before and after the merger. The majority of the mergers, 54 percent, occurred between 1969 and 1976, when there was an international oil crisis and shrinking demand for Japanese goods; 33 percent were completed during 1977 to 1989, when the Japanese economy was expanding steadily; and 13 percent occurred between 1990 and 1992, when the market was at an all-time high.

“In the United States, the consensus view two years ago was that diversification destroys value, but this may need to be revisited,” said Kruse, assistant professor of finance in the Walton College of Business. “Our results indicate that the benefits of diversification mergers evolve over time.”

To examine the impact of diversification, the mergers were categorized as across different industries, among affiliated companies or among members of the same business group. They found that 28 percent of the mergers were diversified, with the target and acquiring companies in different industries, and 74 percent were affiliated mergers, where both target and acquiring firms have a common major shareholder. Mergers among companies that were members of the same business group represented 17 percent of the sample.

The analysis was limited to manufacturing companies because cash flow structure is very different in the non-manufacturing sectors. Using listed firms ensured that the stock had been widely traded and a large number of shares were listed over the sample period.

“To control for changes in performance resulting from industry-specific or general economic factors, we selected a control firm for every acquiring and target firm in the study,” Kruse explained. “They were matched according to size and industry code.”

The researchers found that the overall operating performance for mergers between affiliated companies or within business groups was positive, but not significant. These companies were generally unable to improve their post-merger performance.

“This may be caused by the pace of integration in Japan, which is very, very slow,” Kruse explained. “Operating efficiencies don’t kick in, so firm performance remains flat. For example,
in a famous case, Dai-Ichi Kangyo Bank maintained separate personnel departments for 20 years following its creation by a merger.”

However, when the merger was between firms operating in different industries, the researchers found significant performance improvements. This improved performance was concentrated among the firms with lower post-merger leverage, which is the degree to which a company is using borrowed money. Highly leveraged companies may have difficulty finding new lenders and have a greater risk of bankruptcy.

“Long-term operating performance was significantly greater following diversifying mergers,” said Kruse.

The researchers also evaluated the impact of the relative size of the target firm to the acquirer. They found that the larger the relative size of the target firm, the worse the post-merger performance.

“We suspect that our results capture the inefficiency of a so-called ‘merger of equals.’ Such a merger tends to blur the management responsibility between the acquirer and the target and sometimes results in a prolonged internal fight between the management and the employees of the two firms,” Kruse explained.

Superior post-merger performance of diversifying mergers could also be associated with “rescue mergers,” according to Kruse. In the two years prior to the merger, operating returns from target firms in diversifying mergers were significantly lower than those from non-diversifying mergers.

“Contrary to the notion that acquisitions of poorly performing firms are less likely to succeed, this indicates that rescue mergers involving distressed targets are unlikely to lead to inferior long-term performance,” he added.

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