Organizational Restructuring and Realization of Synergy from Corporate Acquisitions
(Conceptual Paper)

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Abstract

Studies on post-acquisition or integration stage of acquisition process have revealed that increase in number of acquisitions results in diminishing contribution to the performance of a firm and increasing inefficiency of the system, which, at times, calls for organizational restructuring. Although disruptive in the short-run, organizational restructuring has been effective in realization of synergy benefits from acquisitions. The post-acquisition studies mostly assume strategic fit, the focus of pre-acquisition activities, to which contradictory evidence exists. Incorporating pre-acquisition or selection stage activities in post-acquisition activities may provide a better understanding of how corporation can realize synergy benefits from acquisitions.

Keywords: Corporate Acquisitions, Post-Acquisition, Synergy, Corporate Restructuring

1. Introduction

Organizational restructuring involves major changes in the organizational structure for enhancing the ‘efficiency and effectiveness’ of firms (Bowman & Singh, 1993). It involves reorientation of the business units to rearrange resources within a firm for better performance (Karim, 2006).

Acquisition refers to buying of a part of a company, like a segment, or the whole of a company. Firms engage in acquisitions for multiple reasons, which include obtaining specialized assets, overcoming barriers to entry, diversifying business, and attaining economies of scale and scope (Teece, 1986). Acquisitions help firms in value creation through attainment of ‘economies of scale and scope, market power and organizational learning’ (Iyer & Miller, 2008). However, it has been found that a number of acquisitions have failed to yield the desired results; the firms were not able to realize the anticipated synergy benefits from acquisitions (Datta, Pinches, & Narayanan, 1992; King, Dalton, Daily, & Covin, 2004).
Acquisitions process comprise of two stages, pre-acquisitions and post-acquisition stages. Both the stages have attracted lot of attention of researchers from such diverse fields as finance, organizational behavior, and strategy management. For the most part, pre-acquisition or selection stage of acquisitions, with focus on strategic fit, was under the lens of researchers. The researchers contend that realization of synergy benefits, innate in an acquisition, depends on the ‘strategic fit’ in terms of the compatibility of the resources of target firm with those of acquirer (Harrison, Hitt, Hoskisson, & Ireland, 1991; Kusewitt, 1985). Recently, however, researchers have shifted their focus to post-acquisition or integration phase, with focus on organizational fit. They argue that strategic fit of target firm creates synergy potential, which can be capitalized only if the acquired firm is properly integrated by the acquirer (Jemison & Sitkin, 1986; Haspeslagh & Jemison, 1991). According to Pablo (1994), an acquirer’s ability to extract benefits from a strategically fit acquisition depends on how and how much organizational fit it establishes. However, a firm’s efforts to reap synergy benefits may be stymied by a number of factors, such as inertia and resistance from acquired units (Weber & Camerer, 2003). In addition, studies have revealed that managers with access to organizational resources engage in value-destroying acquisitions, particularly during economic boom times (Wan & Yiu, 2009). Hence, post-acquisition or integration studies can be expected to provide better understanding of the potential of realizing synergy if they incorporate pre-acquisitions activities.

Researchers have mostly treated an individual acquisition as the unit of analysis, assuming that every acquisition is started with a ‘clean slate’ (Barkema & Schijven, 2008), when in reality, a single acquisition is a component of a set of acquisitions undertaken in pursuit of a corporate strategy (Kusewitt, 1985). Following this notion, this paper treats each acquisition as an element of the set of the sequence of acquisitions, encapsulated in a strategy, and aims at studying interrelationship among successive acquisitions. The objective of this study is to understand the role of organizational restructuring in tapping synergetic benefits borne by acquisitions.

The rest of the paper is organized as, section 2 presents review of related studies, section 3 discusses restructuring in context of three underlying studies conducted by Finkelstein & Halebian (2002), Karim (2006), and Barkema & Schijven (2008), and section 4 concludes the paper.

2. Literature Review

2.1 Rationale for acquisitions

Corporate acquisitions are risky ventures undertaken by firms in anticipation of value creation. Firms engage in acquisitions for multiple reasons:
1. Achieving economies of scale and scope through extension of the scale of operations (Iyer & Miller, 2008)

2. Gaining market power through vertical integration—backward integration by acquiring supplier and forward integration by acquiring distributors, and horizontal acquisitions by acquiring its competitors (Wan & Yiu, 2009).

3. Minimizing risks of developing new products, entering markets, and acquiring new capabilities. Acquisitions can help a firm in altering its resources and capabilities, particularly during hostile environmental conditions to avoid erosion of its profitability (Wan & Yiu, 2009).


5. Increasing longevity of business: Acquisitions provide firms with opportunities to reconfigure their business by expanding resource base, obtaining new resources, and acquiring new capabilities (Karim & Michelle, 2000)

2.2 Stages in acquisition process

Acquisition comprises of two major stages: 1) Pre-acquisition stage or selection stage, and 2) Post-acquisition or integration stage. For the most part, pre-acquisition stage has been the center of attention for researchers. At this stage, firms engage in identifying the opportunities that have strategic fit with their setup. The strategic fit is indispensable for the existence potential synergetic benefits in an acquisition (Barkema & Schijven, 2008). Finkestein & Haleblian (2002) posit that one of the major factors considered in initial analysis is ‘capability transfer’, which depends on resource sharing and functional skills, the factors subject to industry patterns. Higher the compatibility of these factors, better the strategic fit, and higher the potential of positive transfer effect. Transfer effect means the impact of an event on the outcome of its subsequent event.

Post-acquisition stage or the integration stage focuses on the ‘organizational fit’. Organizational fit is contingent on the compatibility of acquirer and target firms’ resources. Higher the compatibility better the prospects of successful integration, and higher the probability of the realization of synergy benefits Larson & Finkelstein (1999). It is affirmed that the strategic fit of target firm creates synergy potential, which can be unlocked only if the acquired firm is properly integrated (Jemison & Sitkin, 1986; Haspeslagh & Jemison, 1991). According to Pablo (1994), an acquirer can reap as much benefit from synergy embedded in a strategically fit acquisition as it establishes the organizational fit.
This study relates to the post-acquisition or integration phase of acquisition process, and focuses on the role of organizational restructuring in realization of synergy benefits from acquisitions. The study draws on the recent works of Finkelstein & Halebian (2002), Karim (2006), and Barkema & Schijven (2008).

Finkelstein & Halebian, (2002) applied the principle of ‘learning curve’ to Nelson & Winter (1982) theory of routinization and conducted functional analysis to develop a multilevel theory on transfer effect over successive acquisitions. The routinization theory states that repeated performing of an activity increases efficiency. Transfer effect is the impact of an event on the outcome of its subsequent events. A positive transfer effect exists when an event has a positive impact on the outcome of subsequent events and a negative transfer effect transmits negative effect to the outcome of subsequent events.

Finkelstein & Halebian studied 192 US-based companies that engaged in at least two acquisitions over a period of 20 years, spanning over 1970 to 1990. They studied relationship between performance and similarity of environmental conditions of acquirer and target, similarity of acquirer and target, and similarity first and second targets. They found that the similarity of the environments of acquirer and target firms had a positive transfer effect. The striking finding of this study was that the second acquisition, irrespective of whether it was similar or dissimilar to the first one, had a negative transfer effect and contributed less to firms’ performance. The finding was counterintuitive in case of similar targets. The authors opined that the negative outcome might be due to misapplication of the knowledge of first acquisition in the second acquisition and/or change in conditions from acquisition to acquisition, which makes an apparently similar second acquisition dissimilar.

To rule out the impact of extraneous factors on their findings, authors tested recency of acquisitions, impact of acquisition program, and period effect for their impact on performance. The recency of acquisitions was tested to assess the time-induced decay effect of previous event. The adoption of a program that involves multiple acquisitions is expected to be reflected in the price of a firm’s stock at the time of its announcement; subsequent acquisitions are not expected to add value to the stock. The period effect refers to impact of the order of acquisitions on firms’ performance. Initial acquisitions are expected to have a better fit with a firm than the subsequent acquisitions. The existence of any of these phenomena will lead to lower value addition from subsequent acquisitions. However, the empirical findings revealed that none of these factors was statistically significant in explaining performance of acquisitions, confirming the validity of the findings of the study.
Karim (2006) studied 250 US and non-US companies from the medical industry, over the period of 1978 to 1999. Her study focused on how companies reconfigure internally developed and acquired business units to reallocate their resources for better performance. Reconfiguration entails ‘the addition of units to, deletion of units from, and recombination of units within the organization.’ Karim identified four possible combinations of the internally developed and acquired units.

### Forms of unit recombination and expectations

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<tr>
<th>Internally developed units dissolves into</th>
<th>Acquired unit dissolves into</th>
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<td>LOW likelihood (Consolidation)</td>
<td>HIGH likelihood (Buying resources)</td>
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<tr>
<td>VERY LOW likelihood (Replacing internal routines with targets)</td>
<td>HIGH likelihood (Molding acquisition)</td>
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Source: Strategic Management Journal, vol. 27, p. 806

She found that firms reconfigure acquired units sooner, and in majority of cases (61% of the observations) reconfigured them by combining them. Acquired-acquired integration was followed by reconfiguration of acquired units with internally developed units, which made 21% of the observations. The reconfiguration of acquired units with internally developed units synchronizes them with the established internal routines and resources to reap the broader benefits of acquisitions. The benefits originate from quashing the unwanted parts, transforming the acquired units' resources into ingredients for the value creation. One of the noteworthy findings of the study was reconfiguration of a sizable number of internally developed units (15% of the observations) into acquired units. Such a combination translates into overriding the set norms and routines of the internally developed units with alien norms and routines of the acquired unit. The rationale of such a reconfiguration lies in a firm’s intention to either maintain the independence of the acquired unit, and accommodate it within its broader organizational framework, including routines, or replace poorly performing, internally developed units' routines. Above all, an acquired unit may host resources that a firm would like to disseminate within the organization.

Barkema & Schijven (2008) adopted a long-term approach to study realization of synergy benefits from acquisitions. The study built on behavioral theory used its search and organizational learning themes. The behavioral theory says that search for solution is prompted by a problem confronted or foreseen. In strategy context,
search may be set off by zeal to locate productive opportunities. However, search process is subject to bounded rationality, which contends that a firm has ‘limited information, attention, and processing ability’ (Greve, 2003, p.12), as such managements’ ability to handle multiple events effectively is restrained. Managers are forced by strained resources and time to settle with satisficing instead of finding the optimal mix. They consider fewer alternatives and end up with acquisitions having suboptimal organizational fit.

Organizational learning follows search. As the number of searches increases, the search process becomes more routinized and refined facilitating automatic decision-making and implementation, precluding the need for cognitive efforts (Nelson & Winter, 1982). Barkema & Schijven (2008) deduced that organizational learning lessens reliance on bounded rationality, and allows managers to focus on fewer, but effective alternatives.

The study used 25 Dutch multinationals’ series of acquisitions and restructuring to monitor the realization of synergy benefits from acquisitions over time. It focused on how increase in the number of acquisitions influences the performance of a firm and relates to the probability of restructuring. An inverted U-shaped relationship was observed between the number of acquisitions and the performance of a firm. The curve depicted an early attainment of optimal point with a protruded declining phase, i.e., acquisitions add to the performance at initial stages and start hurting performance as they grow in number.

Barkema & Schijven explain the decline in performance of a firm with increase in the number of acquisitions in the context of ‘bounded rationality approach’. Scarcity of managers’ resources and time tempts them to settle with options having suboptimal fit with their organization. As the number of such acquisitions increases, a firm starts to suffer from inefficiencies mainly due to difficulty in coordinating the business units. At this point, management is forced to look for a distant search and consider organizational restructuring as a viable solution for achieving the desired goals from acquisitions. In other words, the probability of restructuring increases with increase in the number of acquisitions, and is accelerated by higher frequency of acquisitions. The study also found that experience in acquisitions and restructuring has positive relationship with a firm’s capability to extract synergy benefits effectively from acquisitions.

3. Discussion

Corporate acquisitions have attracted lot of attention from researchers. Initially, they focused on pre-acquisitions or selection phase, which entails identifying targets with strategic fit. Lately, their focus has shifted to post-acquisition or integration phase with organizational fit as focus. However, researchers have studies two phases of acquisitions
separately. Pre-acquisition studies assumed existence of organizational fit while post-acquisitions studies assumed existence of strategic fit. In addition, most of the research has studied a single acquisition as the unit of analysis, when an individual acquisition is a component of the corporate strategy comprising of a series of acquisition (Kusewitt, 1985; Barkema & Schijven, 2008).

Firms have carried out acquisitions to expand the scope of their operations and to identify the optimal opportunities for value creation. However, the outcomes of acquisitions have been mixed. The mixed outcome of acquisitions has enticed researchers to explore the factors that facilitate as well as inhibit the realization of synergy benefits.

Finkelstein & Halebian (2002) studied dyadic relationship between successive acquisitions, up to two, to ascertain the effectiveness of acquisition in terms of transfer effect. They studied relationship between performance and similarity of environmental conditions of the acquirer and the target, similarity of acquirer and target, and similarity of first and second targets. They found that similarity in environment of acquirer and target resulted in positive transfer effect. The revealing finding of the study was negative transfer effect from first to second targets, irrespective of whether they were similar or dissimilar in nature.

Karim (2006) studied reconfiguration of business units based on their origin. Origin related to whether the units were internally developed or acquired from outside, and reconfiguration related to reallocation of resources of units within an organization for better performance. She found that mostly acquired units were integrated with one another followed by integration of acquired units into internally developed units. In addition, a sizable number of cases involved integration of internally developed units with acquired units. In former case, continuity of existing norms and routines is ensured, while in latter case existing norms and values are overridden by those of the acquired units. It can be implied that acquisitions are undertaken not only to expand scope of operations but also to revive the existing underperforming, less efficient systems.

Barkema & Schijven (2008) studied acquisition over longer periods. They observed an inverted U-shaped relationship between the number of acquisitions and the performance of the acquirer. The curve had a longer downward sloping region than the upward sloping one. Using the bounded rationality theory, they suggest that over time the performance of acquisitions declines due to the selection of suboptimal targets. The firms tend to look beyond local search to find solutions to the inefficiencies piled up by lack of coordination among business units. They resort to distant search and opt for organizational restructuring to realign the system. Restructuring is
disruptive in nature and results in lower performance in the short-run. However, in the long run, restructuring has been found to be effective in extracting the synergy benefits from acquired units. Hence, restructuring should be undertaken only when its benefits are greater than the costs of inefficiency.

The above-mentioned studies, along with other post-acquisition studies conducted so far, assume existence of strategic fit, the most important ingredient of synergy benefits. Here, it is pertinent to ask whether assumption of strategic fit of logical and valid. A reflection on pre-acquisition studies, however, negates the validity of this assumption. A number of studies have confirmed that manager tend to squander organizational resources, under certain conditions, for the satisfaction of their hubris, at the cost of shareholders value. For example, Wan & Yiu (2009) studied availability of organizational slack and environmental conditions (‘environmental munificence’) for their impact on the performance of acquisitions. They found that during periods of environmental munificence, managers with access to organizational slack, particularly abnormal slack, tend to indulge in empires building for self-aggrandizement. Out of hubris, they also tend to bid up prices of acquisitions unreasonably, leading to winners curse. Many of the acquisitions carried out under these conditions have been value-destroyers and were reversed at later stages. As a result, it is hard to conceive that post-acquisition studies, sitting on the assumption of strategic fit, can be helpful in understanding the dynamics of synergy realization from acquisitions. It is explicit that an acquisition involving a perfect organizational fit may fail to benefit an acquirer if its value has been sapped considerably at the pre-acquisition phase; for example by acquiring target at unreasonably higher bid price.

4. Conclusion

Strategic fit of an acquisition is indispensable for the existence of synergy. Post-acquisitions studies, assuming strategic fit, however, have found that as the number of acquisitions in a strategic series of acquisitions increases, the performance of the acquirer declines. The decline in performance is attributed to misapplication of previous knowledge about acquisitions and/or ignoring changes in environment from acquisition to acquisition. The selection of incompatible targets culminates into lack of coordination among business units within the organization. At this stage, a firm is forced to undertake drastic measures, such as disruptive organizational restructuring. Organizational restructuring, however, has been effective in realizing the hitherto lost synergy benefits of acquisitions in the long run.

Assumption of strategic fit in post-acquisition studies seems unrealistic in the face of profound evidence that managers have indulged in a number of value-destroying acquisition activities. Hence, the reliability of post-
acquisition studies shall enhance if pre-acquisition activities are thoroughly investigated and incorporated in the studies. An acquisition with organizational fit cannot be expected to add value to a firm if its value has been compromised on during pre-acquisition phase. To conclude, combining pre- and post-acquisition activities in acquisition studies shall be helpful in enhancing the understanding of the performance dynamics of subsequent acquisitions and the need for disruptive but beneficial organizational restructuring.
References


