What is the Value of M&A?
Podcast transcript

Jordan Ellison	Hi, this is Jordan Ellison from the Slaughter and May Competition Group. I am joined today by Professor Scott Moeller. Scott, among many other things, is the Director of M&A Research at the Business School at City University in London. Today I am going to ask Scott what is the point of M&A. I come at this question from a particular competition antitrust angle because I think the value of M&A is more relevant to antitrust assessment than it has ever been. Traditionally, as competition lawyers, our competition regulators look at the harms that M&A might do in terms of reducing competition in markets and we spend a lot less time thinking about the potential economic or other benefits of M&A and I think that has to change. There is an increasing assumption amongst regulators that ever smaller competition harms should result in deals being blocked and that only makes sense as a policy if you can assume that the M&A doesn't result in a great deal of benefit. I think increasingly there are regulators who are sceptical about whether M&A results in benefits. So today I want to start the process of educating myself and how we ought to think about the economic benefits of M&A because personally, and speaking for the competition law world, I think we spent a lot more time debating the harms of M&A and less time talking about the benefits. I want to explore some of that with Scott, who is very well placed I think to talk about this both from a practical perspective and from an academic perspective. So Scott, I know that you have had many different roles in M&A over your long and lustrous career: consultant, banker, academic. Perhaps you could give us a whistle stop tour of your career in M&A and how you got started and how you have ended up in the academic study.
Scott Moeller	Thank you Jordan. My background is one that does span both academia and, what we call in academia, the practitioner world. I have been involved with the business school for about 20 years. I came into that having done a number of guest lectures and some other things on the side whilst being at Deutsche Bank and working in M&A and in private equity, which I had done for about 6 years here in London. Prior to that I was with Morgan Stanley for 12 years in three different places. Before Morgan Stanley, I was with Booz Allen & Hamilton, the management consultancy, which is where I went immediately after attending business school to get my MBA. My research since coming to academia has been on the side of mergers and acquisitions. I found back in 2008 the M&A Research Centre at the university and we are the leading M&A research centre at any business school globally. I can say that without any doubt in my mind because to the best of my knowledge we are the only dedicated M&A research centre at any business

	school globally. But that also means that we do engage with a number of other business schools and professors and other academics in those business schools in research and we host again the only dedicated M&A academic conference that takes place annually, and which will be taking place next in the summer. So that is the background that I bring to this, Jordan. I am happy to speak about it from any of those perspectives. I will just say one more thing and that is that one of the reasons why we founded the M&A Research Centre was that there was a very large body of literature out there that may have helped me a lot as a practitioner if in fact I had known about it. But the fact of the matter is that there is almost nobody in the active practitioner world who does read those very weighty academic articles. Therefore we set up that business school research centre in order to be able to get some information from academia into practitioners. Indeed, thank you very much Jordan for giving me the opportunity to do that here today.
Jordan Ellison	Scott, we need this learning so I am really grateful that you are going to give us the benefit of some of that research. Maybe before we get into any empirical findings, it would be interesting just to, almost at a qualitative level, get your view of the main kind of objectives of M&A. What are the top three things that make a CEO say "I'm going to go out and buy this business rather than build my own." What really on a kind of gut level and a qualitative level do you think really drives business to do M&A?
Scott Moeller	Very good question. The first part of that answer is that before you get to an M&A deal other alternatives are typically assessed. That is, should we indeed grow organically, should we do it through a joint venture or strategic alliance, should we take a minority position in another company and thereby gain some benefits perhaps even as the largest shareholder but not as a controlling shareholder. So there are other alternatives to doing an M&A deal and any strategic assessment should have very carefully assessed those prior to coming to the decision of doing an M&A deal. Indeed M&A is not necessarily a bimodal decision: should I do an M&A deal or should I not do an M&A deal? But getting to your question about what are the most common objectives that a board would then look at in terms of trying to assess whether in fact an M&A deal should take place. I think they really fall into three different areas. One is synergies, the second is access and the third is size. Let me just briefly mention what I mean by each of those. The synergies people think about most often are expense synergies. That is the ability, once you put two companies together, to take out of the newly-combined organisation what would then end up being excess expenses. It maybe that you don't need two plants and you could close down one of the manufacturing plants. You certainly come into the deal having had two CEOs, two heads of IT, two heads of sales, two of anyone in the C-suite; you

probably don't need two of each. You have two payroll systems, you would be able to combine it into one. So there are a lot expense synergies that you can get rid of. The analysts, who are looking at a deal, will very often focus on that.

There are revenue synergies as well that you can get. That is, you may be able to sell more product because of the product you are selling from one side, in other words, you may be able to combine those.

There are financial synergies that take place as well. Those financial synergies being the fact that larger organisations tend to have a better credit rating -- all other factors being equal -- than small organisations and therefore you may be able to get the kind of financial synergies, for example, and it is not the only example I could give, of having a higher credit rating and therefore paying less interest on the debt.

You can also get tax synergies. It may be that there is an organisation that has a tax loss carry forward that would offset the taxable business that the other organisation combining in a merger acquisition would have.

So synergies are more than just the often stated expense synergies.

'Access' I think is almost as important and of course in any particular deal whether it is synergies, access or sizing, it could be one factor being more important than the other. But by 'access' what I mean is that there are deals that are done in order to access new geographic markets. A British company that wants to expand into France can try to do it the old-fashioned way from organic growth and build up from scratch or they can acquire someone that may look like a competitor. Of course you don't compete in the same market place but you are in the same point in the production chain.

Market expansion, is that you may want to add a product line that is not currently in your portfolio of products. You also can get this through things like innovation. I think there are some very academically-important studies that, for example, show that firms do seek innovation and do improve their innovation capabilities such as R&D and the ability to get patents. This is actually quite important these days. The access to innovation, IT and digital is one that is very important. When you do begin to have organisations talk about the fact that they don't have internal digital capabilities, one way to get that is through acquiring it. As this is just one of the most timely examples today.

And then the third area is size. Size does matter in the corporate world. I think we all know that. Being part of a large organisation does mean that you are more attractive to customers. You're more attractive to staff where many would prefer to be in a larger organisation where they can, say, count on a

	pension, or they think they can, at the end of their career. It matters to suppliers. This is of course important because this is the area that I think you mentioned first when we started off in terms of what regulators and lawyers very often will focus on because of course size and increased size does tend to be market share. But of course that also depends upon whether in fact it is a horizontal acquisition and you are getting greater market share. But certainly market share and increased market share is one of the effects of increasing size. I should mention one other point, Jordan, just on this topic. With all of these areas, by the way, there have been numerous studies done as you could probably imagine, but for both the size and the access factors these can very often be, and that is why I am mentioning this here at the end because it is a combination of those two, a strategic response to what the industry is doing or to what another competitor is doing. So when a competitor goes out and merges with another one of your competitors, that redefines what size is within the industry or at least within the competitive market place. A very valid strategic response on the part of the parties that are not combining would be to look for a combination that they would be able to do to keep up with their merging competitors. That is one of the reasons that you hear talk about merger waves because although one talks merger waves in general, actually the waves tend to be at the industry level and they typically get kicked off by one party within the industry redefining what size means within that industry and almost forcing the other players in that industry to go through a similar consolidation.
Jordan Ellison	That is fascinating, Scott. Thank you. That paradigm is really helpful in terms of synergies, access and size. If we just then think about those as the sorts of objectives that boards have when they embark on a merger how often does that succeed in creating value? If you take shareholder value at large to start with, you often see headlines in the press saying two thirds of M&A deals fail or whatever the factoid is. What is the latest and greatest academic research on whether or not M&A succeeds or fails in creating shareholder value?
Scott Moeller	Again, excellent question. I would say that there is more academic literature on whether M&A deals create shareholder value – going back to the 1980s and perhaps even earlier -- than on any other topic. My own feeling is that shareholder value is easy to calculate and one of the reasons why we focus on it is because it is very easy to determine, relatively speaking, to other things. But that isn't necessarily what is being looked at in the board. Boards of course have a responsibility, at least in certain countries, in order to be able to increase shareholder value as their principal concern but it is not the only concern. It is not an uncommon deal where a company may go out and buy

	something which doesn't necessarily, in the short term, increase shareholder value but does position the company in order to be able to, for example, achieve synergies in the longer term, achieve access in the longer term or increase size in the longer term. Sometimes things will get smaller before they get larger. There are M&A deals that are done in order to be able to get a particular team: a research team, a particularly insightful founder or leader of the organisation or team that that leader has put together. So it isn't necessarily always about shareholder value. The answer to your question, what does the literature show about whether M&A creates or destroys shareholder value, has changed over time and unfortunately the world seems still to hold on to a fair amount of the literature that was quite conclusive that M&A deals destroy shareholder value. This was in fact true back in the 80s and 90s with the research that was done on deals of that period. Post the turn of the millennium that seems to have changed and indeed studies started to appear in 2004 and 2005 to say 'something has changed here.' Prior to that time, it looked like anywhere between 60% and 80% - and a good rule of thumb was 70% - of deals destroyed shareholder value. That is, when you compared the companies that were combining with companies that didn't combine, 70% of them did worse than those that in fact didn't combine so therefore had not done an M&A deal. That pretty much shifted around the turn of the millennium to a 50/50 success rate and that has held very steady since that point. The academic literature is pretty consistent in the past 10 to 15 years in showing that shareholder value is about a 50/50 proposition when you just empirically look back at the deals that have been done and then do the proper analysis to try to isolate for that particular factor.
Jordan Ellison	Competition regulators will say that shareholder value could mask a whole bunch of different effects which could be good for consumers or bad for consumers. So if a deal results in less competition, higher prices, more market power, there may be a bunch of shareholder value there for the lucky shareholder in a monopolist but a bunch of harm to consumers and therefore a kind of antitrust bad deal. But the shareholder value might exist for reasons that are totally good for consumers. So if the combination allows you to get rid of a lot of variable costs or the combination unlocks an operational synergy or cleverer way of doing things, a cheaper way of doing things that could be good for shareholders and good for consumers. So it will be interesting to get your take on what the literature says on, where M&A does create value, what tend to be the levers that are creating that value.
Scott Moeller	One of the things that drives that is whether in fact the deal is what is called a horizontal deal versus a vertical deal versus a conglomerate deal. Just very quickly, although I think people should be very familiar with those terms, a horizontal deal would be buying a company that is in the same point in the production chain that you are. It wouldn't necessarily be a direct competitor as I said in my earlier example of buying a company in France

that does the same thing that you do in the UK. That wouldn't change the market share in either France or the UK except to the degree that over time perhaps that company would be better able to increase its market share organically than at that point in time. But the one thing that a horizontal deal does allow is management on both sides of the company to be able to understand what the other side is doing. And if I can again go back to my point about deal success in that things seem to change around the turn of the millennium, those of us who have been operating in the industry in trying to look back at what changed, said what really has happened during that period is that it's been more of a focus in the M&A industry, so to speak, on post-deal integration rather than just getting the deal done. And the analogy that I like to give is that it used to be that people defined deal success as to whether you got married. But a successful marriage is not getting to wedding night, a successful marriage is having many happy years of living together. That's the difference, that companies began to focus on integration and realising that the CEO, for example, couldn't walk away from the deal and start on the next deal until he made, or she made, sure that the deal that they had currently done was in fact being integrated properly. So horizontal is a lot easier to do if the two organisations are in the same point in the production chain.

A vertical deal, of course, is one where you buy a customer or where you buy a supplier. And again you tend to know the industry. In the relative scale of things, a vertical deal is not as good as a horizontal deal, although again, within industries you may understand them very well, you may even have employees who have worked in the other company at one point in time.

The conglomerate deals are the ones that tend to be least successful. The world does go through waves of conglomerate mergers and then ultimately they seem to fall apart from their own weight because that's where you have business areas that are not related at all.

Another thing is, is of course, companies that don't do ad hoc acquisitions or what are called opportunistic acquisitions and indeed even "me too" acquisitions that I was talking about earlier where you are trying to do something in response. But where they have what's called an acquisition programme and again there's a fair body of literature about the success of acquisition programmes. In fact, it was a number of consultancies a number of years of ago that started talking about the importance of acquisition programmes. That is, it isn't about any one particular acquisition, but that a series of acquisitions will be used to achieve what those long-term goals are. You are putting the pieces of the puzzle together to create a picture that perhaps the world doesn't know yet when you are doing each one of those acquisitions but they will because, ultimately, they will see the effect of what your strategy is. And there is literature that says that related acquisitions, and I'm not saying identical therefore, but related acquisitions in an acquisition programme can be much more successful.

	And then interestingly enough there is a learning effect. Practice does make perfect, as with most things in life, and the more deals you do the better it seems to be that you can get success from doing acquisitions. There is some research that we did a few years back that showed that firms that don't do any acquisitions at all during a period, perform over three per cent worse in terms of their share price performance than firms that just do one or two deals during that period. Interestingly enough, if you do three or four deals that's even better and we looked to the point where they did six or more, it was even better there. I'm not talking here about financial sponsors, Jordan. I'm talking about strategic deals. So I'm not talking about private equity firms buying firms because ultimately they intend to sell them. I'm talking the deals that are the 'marriage for life' deals where they are looking at integrating them into their current organisation. And that's where those studies looked at in terms of those strategic deals and excluded the financial sponsor deals. So there really is a greater success of horizontal deals and of course that's most deals that take place anyway. There's the fact that success comes from an acquisition programme when you link up different M&A deals. And then lastly, you do get that learning effect, more equals better, and practice does make perfect.
Jordan Ellison	That's fascinating because those three categories of horizontal, vertical and conglomerate are so central to the antitrust law world and the prism through which regulators look at deals as well. So it is interesting that some of your research is exploring those different channels. I guess I want to finish with the most topical question in our world at the moment, which is the impact of M&A on innovation. Traditionally, there's been a view that, particularly say in a vertical deal or a conglomerate deal, there is no loss of direct competition between the parties, they are not direct competitors, and often you are trying to plug together different parts of the supply chain or ecosystem, and that's going to unlock an ability to do something more efficiently or smarter than it was done before. And those deals were seen as pretty, on balance, good for innovation, good for new ideas and new products coming to market or just costs being cut. I think there is an increasing counterview in the competition law world that actually deals are on balance potentially bad for innovation, that, whether it is a vertical deal or a horizontal deal, things that reduce competitive tension, things that make the big guy bigger, take the wolf from the door and therefore the impetus to innovation gets less. And I know that this is an area where in our world we are at the level of counter assertions, but I know in your world there has been some actual research into this. So I would be interested to hear how far the research has gotten on the relationship between M&A activity in an industry or sector and levels of innovation or levels of R&D or that kind of thing. Just how far has that got as a study and what are the results in terms of any relationship there – positive or negative?

Scott Moeller	An excellent question, and I will just say one that you alerted me to. I have actually got an article sitting here in front of me which has in the abstract the final comment that says "we conclude that synergies obtained from combining innovation capabilities are important drivers of acquisitions." I can say, therefore, that there is a body of literature and some seminal studies that have looked at innovation in relation to mergers and acquisitions. They tend to look at R&D activity and the number of patents that are applied for and awarded. And basically, if I can just summarise it at a very high level, it finds that companies do seek innovative firms in order to be able to improve their own capability of being able to be more effective with their research and development expenses and as measured by the number of patents that have been awarded to them. So it seems to be pretty conclusive with that concluding sentence from that one particular study that was done, but there are other studies that have been confirming that as well. Indeed, at the business school, we are in the process of working on a study that's currently at the conference stage. That looks at one aspect of that, which is relating to ESG, and I think a very timely topic is one that relates to both sustainability and climate. That shows that when two firms combine and they have a different ESG rating, and here actually I am focusing on just the E side of that one, but it seems to be consistent with the S and the G from some other studies. But on the environmental side, in terms of their independent rating, post the deal taking place, the newly combined organisation tends to have an E rating, an environmental rating, that is closer to the higher of the two, than the lower. So, in other words, firms are seeking out other institutions to buy that have a better environmental performance rating in order to be able to improve their own. So I know that's just a very small part of where innovation is but certainly one that is very timely and very important with the climate conversation that's taking place now and the imperative for every company in order to be able to look at what it's carbon footprint is and how it is reacting in that particular manner. So, I hope that's helpful in being just one specific example, but also building on the other studies.
Jordan Ellison	That's really fascinating actually, and I think this is a debate that we will be returning to a lot and where practitioners are going to have to get a lot more familiar than we currently are with some of this research. As I reflect on the discussion we have just had, Scott, I think it's clear that from a competition regulator perspective, not all deals are good, there are bad anti-competitive deals a competition regulator should block. There are lots of benign deals which a competition regulator will have no problem with and there will be some deals which are maybe right on the cusp, and it is right that a regulator thinks about not just the costs or the downsides in a deal, but also the potential economic upsides of a deal, particularly if those flow through to consumers through something like better innovation.

	So I think what I take from this conversation is not sort of, and this is not what I'm doing and certainly not what you're doing as an academic, not some sort of grandiose claim that all M&As benefits the wider economy or that all M&A is value enhancing, but that as a competition community, when we are thinking about what deals get blocked, what deals get permitted, we at least ought to have a more empirical or research driven appreciation of the upsides of deals then we currently do. So I feel like am at the very bottom of a very big mountain in terms of learning about this but today you have at least helped me get into the foothills so it's been a really useful discussion, and I hope we can continue it further, but thank you very much for your time today.
Scott Moeller	And lovely to have talked about it with you. And yes, I do hope this discussion can continue in a much broader sense as well, because I think I would totally agree with you that M&A is a complex topic, and to try to look at it through only one lens doesn't do it justice.