FEAR OF MISSING OUT – THE HIDDEN VALUE OF INACTION IN MERGER AND ACQUISITION ACTIVITY

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dx.doi.org/10.18374/JIFE-24-3.4

ABSTRACT

Announcements of mergers and acquisitions (M&A), especially by well-known companies, are very often media attention grabbers. Despite the buzz generated, however, numerous studies have shown that most M&A activity results in value destruction for long term investors. Researchers have noted this loss of value but have been limited in their conclusions because they could not show that mergers were inferior value sources when compared to inaction (not merging/acquiring). This inaction could potentially be more value destructive than merger activity. Thus, this study investigates whether there is a penalty or benefit to inaction relative to M&A activity. The results of this study show an average non-merger (inaction) premium of 57% over expected market returns over five years. This study also finds that, on average, M&A activity is value destructive, and inactivity is value accretive. In general, it could be said that mergers are detrimental to value and inaction is preferred, but inaction bears its own risks.

***Keywords**: Mergers, acquisitions, value.*

1. INTRODUCTION

Announcements of M&A by well-known companies often make headlines and solicit images of greater and better things to come. Yet, at the same time, such announcements typically point to the possibility of the creation of monopolies and the ensuing antitrust law cases bringing into motion the Sherman Act of 1890, the Clayton Act of 1914, and the Federal Trade Commission Act of 1914, and question the possibilities of long-term synergies and value creation of the combination of the acquiring and the target companies.

Over the years, companies have purchased other companies to operate more efficiently, to control the supply-chain (vertical integration), or to expand their distribution networks, or to differentiate their products (horizontal integration). In some cases, mergers and acquisitions are fueled by the egos and/or agency issues of the individuals leading acquisition activity within a company. Companies also resort to organic and inorganic growth strategies in their quest to achieve their goals of growth and expansion (Rashid & Naeem, 2017).

On the one hand, organic growth strategies typically involve business expansion through new product development, enhanced productivity, increased output, cost reduction, new market penetration, and customer base expansion.

On the other hand, inorganic growth strategies typically include expanding existing business through mergers, acquisitions, divestitures, spin-offs and take-overs (Rashid & Naeem, 2017). Nevertheless, the question remains as to whether inaction, or not following through with a merger or acquisition results in a penalty or a benefit to both the acquiring and the target companies.

The extant literature is discussed in the next section. A description of the methodology used in this study is followed by a discussion of the results, limitations and conclusions and recommendations for future studies.