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Abstract

A substantial body of accounting and finance literature has been devoted to the study of Mergers and Acquisitions (M&As) dominated by discussions relating to the gains and losses that accrue from transactions involving large public companies. This paper makes a unique contribution to the literature by investigating the M&A experience of microcap businesses. Transactions involving microcap M&A are substantially different to those involving large companies on a number of dimensions. This paper explores the determinants of microcap M&A success and pitfalls and problems from an integration perspective. Due to the paucity of research in the area an exploratory research design is employed, conducting interviews with five CEOs of companies that had each managed multiple transactions. We find microcap M&As are successful when measured against identified goals but generally take longer and cost more than expected. Further, culture and communication are key issues in determining success/failure. We also find the in-house management of integration aspects is problematic for these businesses and suggest this warrants further study.

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Introduction

Through the decades, Mergers and Acquisitions (M&As) have been a popular strategy for businesses seeking rapid growth. Accordingly M&As are one of the most studied areas in modern corporate finance. A merger can be defined as combining two firms into one, with the acquirer assuming assets and liabilities of the target firm while an acquisition refers to a takeover of a firm by purchase of that firm's common stock or asset (Brealey, Myers & Marcus 2003). It should be noted that the distinction between the two terms has blurred over time. A significant amount of literature has focused on those who benefit from M&As, the factors determining success or failure and, more recently, explanations of patterns in M&A activity over time. This is not surprising given the number and value of transactions and the impact on the lives and livelihoods of the people involved. In 2007 the year prior to the Global Financial Crisis, the value of M&A deals globally totalled over US$2 trillion (The Economist 2007).

Yet considerable differences still exist in the literature with respect to the definition and measurement of M&A success and failure. The majority of market-based studies indicate that shareholders of acquired firms generally make positive abnormal returns while acquirers' abnormal returns are either not statistically different from zero or negative (Cartwright & Schoenberg 2006). In contrast, accounting-based studies typically fail to find evidence of improved performance after integration.

The traditional view is that M&As are undertaken to reap economies of scale or scope or pursued by personal motives of management.

Such findings have led to an examination of the financial and strategic factors that contribute to success. While these motives may still hold true it is increasingly acknowledged that M&As can also be a strategic play for organisations in their effort to maintain a competitive advantage by acquiring innovative products and businesses (Cefis, Ghita & Sabidussi, 2009; Schraeder & Self 2003) or failure (Calipha, Tarba & Brock 2010). More recently, there appears to be a stronger focus on integration process variables as well as organisational and human factors (Cartwright & Schoenberg 2006). It is now commonly recognised that "all value creation takes place after the acquisition" (Haspeslagh & Jemison 1991, p129).

This paper reports the findings of a small exploratory study into the M&A activities of microcap Australian Companies and is the first study of its kind. Academic literature on M&As has focused on transactions involving large publicly listed companies such as Hewlett-Packard/Compaq, AOL/Netscape, Exxon/Mobil, NationsBank/BankAmerica, and British Petroleum/Amoco (for example, de Camara & Renjen 2004; Epstein 2004), while virtually ignoring unlisted and small companies. This paucity of research into small company M&A was recently noted by Patzelt, Schweizer and Knyphausen-Aufsesse (2007). Metz (2009) argues that small companies have strategic rather than financial value and transactions involving small companies have different dynamics to those involving large firms. Microcap companies have been ignored almost completely in the M&A literature, possibly because of difficulties in accessing data. Microcap businesses, though, have recently come into prominence. This is particularly evident in the area of biotechnology with larger companies absorbing smaller businesses identified as incubators of new product research and development as evidenced in the case provided by Patzalt et al. (2007). Accordingly this study aims to place an in-depth investigation of microcap organisations within the context of a wider understanding of M&As. The primary focus of the research is to examine the dynamics of microcap M&As and investigate the determinants of their success or failure. The study also attempts to explore the pitfalls and problems in microcap M&As from an

integration perspective.

The paper is divided into several sections. Section 2 provides a review of the relevant literature on M&A and Section 3 outlines the methodology employed in the study. Section 4 reports results and Section 5 provides a discussion of the research findings. Section 6 includes concluding comments and implications for future study.

Literature Review

Most of the literature on M&A can be broadly categorised into three broad streams: those studies which consider the benefits resulting from M&A transactions; the factors determining success or failure of M&A and, more recently, examinations of waves in M&A activity (Kummer & Steger 2008).

The existence of waves or cycles in M&A activity has been noted in the literature for many years (for example, Smiley 1981). M&A activity tends to increase in periods of economic expansion and buoyant stock prices as seen in the most recent wave of mostly horizontal mergers which peaked in 2000 (Bruner 2002). Several explanations have been proposed for the variation in the level of M&A activity over time. Kummer and Steger (2008) explain the causes of waves as due to lack of growth initiatives or organic growth options as well as pressure from investors demanding ever higher returns. Excessive capacity and the existence of a fragmented industry structure have also been identified as drivers for waves of M&A activity (Weston & Jawien 1999). M&As occur rapidly as industries regroup into fewer but larger companies in order to reduce costs and improve efficiency (Harford 2005). Deregulation, such as the removal of anticompetitive legislation, may initiate industry consolidation (Bower 2001).

It has been suggested that some M&As may be initiated by management with the intention of fulfilling some private agenda such as empire building, or increasing personal remuneration, status, power and prestige. Jensen (1986) proposes that takeovers are one way managers spend free cash flows rather than making distributions to shareholders. Accordingly, a reduction in free cash flow may avoid hostile takeover and ensure management entrenchment. The general implication of these managerial motives is that many M&As provide little benefit and may even be value destroying.

The issue of whether M&As benefit companies and who personally gains has provoked a steady flow of research in finance and accounting. To investigate these issues two research approaches have been employed in practice; event studies using share market data and studies using accounting data. Most post-acquisition performance research has employed event studies, thus ignoring other potentially relevant dimensions of firm performance.

In general, studies using accounting data fail to find any evidence of M&As providing benefits such as improved profitability (King et al. 2004). Kitching (1974) argues that there are serious limitations using accounting data to measure or judge M&A success. For instance, the benefits of a merger or acquisition may take years to be fully reflected in earnings and are likely to be revealed at different times for different companies. Target company data is often lost or destroyed after the acquisition making performance appraisal problematic. Furthermore, figures may become distorted due to changes in accounting conventions, tax liabilities, and transfer prices (Devine 2002) while profitability ratios may be biased owing to revaluation of the target company's assets and the write-off of takeover-related goodwill. In light of this, it has been suggested that estimates of operating cash flows before interest and tax, rather than accounting profit, should be utilised.

Most studies using sharemarket data indicate that M&As at best do not add to shareholder value and, at worst destroy value. Adams and Neely (2000) found that a merger has no better than a 50-50 chance of creating value for the acquirer. A more recent global

survey by KPMG (Colin & Spitzer, 2001) reported that 70 percent of the combinations studied failed to add value. Shelton, Hall and Darling (2003) noted that two-thirds of the M&A transactions they considered destroyed shareholder value, primarily because of intended synergies not being realised. Other studies held a similar view that, while the target shareholders generally fare well, most acquisitions fail to create value for acquirers (Carr et al. 2005; Hazelkorn, Zenner & Shivdasani 2004; Mamdani & Noah 2004; Vester 2002;). Appelbaum et al. (2000) claimed that, in general, M&A adversely affect the economic performance of the new entity with estimates of their success ranging from 20-60 percent. Schraeder and Self (2003) report that only 56 percent of acquisitions can be considered successful when measured against their original objectives. In summary then, the success rate of acquisitions in meeting both firm and shareholder expectation is very low (Beard & Zuniga 2006).

The poor performance of M&A has provoked a steady stream of research for the past two decades that focuses on understanding the factors that lead to M&A success or failure. As Tarba and Brock (2010, p.2) note, there is a “need to continue to research in depth and in breadth the parameters that influence the overall M&A deal success”. Research has considered pre-acquisition issues leading to failure including paying the wrong price, the wrong method of payment, buying for the wrong reason, selecting the wrong partner or target, and buying at the wrong time (Schraeder & Self 2003). Over-optimism (Lynch and Lind, 2002), poor strategic rationale behind the deal (Schraeder & Self 2003), lack of knowledge of industry or target (Early 2004; Porrini 2004; Zollo & Singh 2004), and little or no experience of acquisitions (King et al. 2004; Nguyen & Kleiner 2003; Porrini 2004; Zollo & Singh 2004) are among the commonly cited causes of failure. Even though overcoming these factors might lead to M&A success a majority of studies conclude that post-acquisition factors such as post-acquisition planning (Adams & Neely 2000; Carr et al. 2005; Huang & Kleiner 2004; Lynch & Lind 2002; Mamdani & Noah 2004; Schraeder & Self 2003), poor management and leadership (Marks 1997; Nguyen & Kleiner 2003), and the need to gain the co-operation and commitment of employees (Arnold 2005), are critical in determining success. Rikard and Finkelstein (1999) also indicates the importance of non-quantifiable elements such as human reactions and organisational factors in determining success.

In light of the close association between people and success revealed by the research, an emergent and growing field of enquiry has been directed at understanding the cultural aspects of M&A and the behavioural response of the employees involved. For example, in a worldwide survey in 1998/99 by Watson Wyatt, retention of talent, communication and integration of cultures were rated as the three most critical activities in the integration plan (Devine 2002). Poor cultural fit or lack of cultural compatibility have become much-cited reasons for M&A failure (Beard & Zuniga 2006; Bijlsma-Frankema 2001; Cartwright & Schoenberg 2006; Huang & Kleiner 2004; Lynch & Lind 2002; Shelton et al. 2003; Teerikangas & Very 2006). Furthermore a by-product of many, if not most M&As, is that, target firm executives experience considerable stress causing an average of almost 70 percent to depart in the five years following completion (Schraeder & Self 2003).

Another critical factor that has received increasing attention in the literature is the integration process. The opportunity for mergers to fail is greatest during the integration phase (Adams & Neely 2000; Carr et al. 2005; Huang & Kleiner 2004; Krell 2001; Mamdani & Noah 2004; Nguyen & Kleiner 2003; Zollo & Singh 2004). Poor integration often results from weak management, strategy or communication (Appelbaum et al. 2000; Dixon 2002; Huang & Kleiner 2004; Schraeder & Self 2003) which generates employee stress and resistance towards change, low morale, cultural differences, and lack of clear vision (Early 2004; Nguyen & Kleiner 2003; Schraeder & Self 2003; Teerikangas & Very 2006; Zollo & Singh 2004). The creation of a common mindset, linking people’s values with company

culture has been said to be one of the most important requirements for a successful merger (Appelbaum et al. 2000).

Additionally, matters such as the speed of integration (Angwin 2004; Lynch & Lind 2002; Roberts 1999; Vester 2002) and outsourcing various integration functions (Appelbaum et al. 2000; Early 2004; Linder 2005) have been noted as important in determining the success of M&As. The continuing ability to focus on sales and customers (Carr et al. 2005; Huang & Kleiner 2004), cost-based synergies versus revenue-based synergies (Early, 2004), and target company status, such as whether private or public (Hazelkorn et al. 2004), are also identified as important determinants.

According to Nguyen and Kleiner (2003), merger success correlates directly with the level and quality of the planning involved. In addition, Lynch and Lind (2002) claim that many transactions fail or suffer significant setback as a result of insufficient due diligence performed on the target at the pre-deal stage. Devine (2002) notes that the earlier and more thoroughly the program is mapped, the greater the odds of ultimate success. Further, Vester (2002) emphasises the importance of flexibility and innovation in dealing with the inevitable surprises that occur during integration.

Obviously, the success or failure of a merged entity depends on its ability to integrate effectively the two previously independent entities and to operate as a coherent corporation. Huang and Kleiner (2004) and Krell (2001) note that poor integration can destroy company value. Alternatively, Zollo and Singh (2004) identify that a high level of integration between two merged firms can significantly enhance performance. Schraeder and Self (2003) underscore four important contextual factors which impact on organisational integration. These are the integration of information systems of the constituent firms, cultural compatibility, communication, and people-related factors, such as shared goals, vision and stress. Of these factors cultural compatibility is perhaps the most frequently discussed in the literature.

Corporate culture encompasses the formal and informal decision-making processes that take place in the hierarchy and the manner in which people at different levels within the organisation interact with one another (Appelbaum et al. 2000; Teerikangas & Very 2006). How personnel are selected, trained, rewarded and moved through the organisation's hierarchy and the inevitable changes that ensue are also important features (Appelbaum et al. 2000). Culture also includes routine aspects such as expected work times, dress codes, rewards and recognitions, hiring and termination practices, titles, customer service orientation, employee loyalty, how information is communicated and how conflict is dealt with (Beard & Zuniga 2006; Schraeder & Self 2003). In essence, a company's culture is its personality commonly framed as, "the way we do things around here", which differentiates one organisation from another.

Organisational culture is regarded as important in determining an individual's commitment, satisfaction, productivity and longevity within the organisation as well as understanding the organisational climate (Teerikangas & Very 2006). Organisational culture is indeed holistic, soft, and difficult to change because it has an historical basis and is socially constructed.

When organisations merge they not only merge their buildings, plants and equipment, but also their individual structures, people, policies and cultures (Appelbaum et al. 2000). Carroll and Harrison (2002) assert that the cultural integration of two organisations depends on the compatibility of their respective cultures. Mergers are about compatibility which means finding agreement about whose organisational structures, values and policies will prevail and who will be the dominant partner (Arnold 2005). Studies have identified cultural difference as a critical factor in prolonging integration and causing synergy milestones to be missed which hinder the realisation of anticipated benefits from the transaction resulting in

poor corporate performance (Appelbaum et al. 2000; Beard & Zuniga 2006; Schraeder & Self 2003). Indeed, cultural compatibility is consistently rated as the greatest barrier to successful integration (Appelbaum et al. 2000; Huang & Kleiner, 2004; Lynch & Lind 2002; Schraeder & Self 2003).

Appelbaum, Roberts and Shapiro (2009) note the importance of management analysing its own cultural traits as a guide to selecting a combination partner and recognising and resolving cultural misunderstandings. Accordingly Schraeder and Self (2003) promote the importance of undertaking a cultural audit prior to acquisition to identify issues that should be managed during M&A and incorporated in the integration plan. Clemente and Greenspan (1999) believe that without a new set of cultural integration competencies, two diverse organisations are unlikely to discover the common ground to form the basis for a new culture from which synergistic solutions can emerge.

A key requirement of successful cultural integration is effective communication. Early and frequent communication of a realistic assessment of the facts (rather than being overly optimistic) not only with employees but also customers, partners, investors and the media is frequently associated with successful M&As (Appelbaum et al. 2000). The key challenge for communication is to resolve uncertainty quickly, particularly possible staffing changes, to significantly reduce employees' stress and maintain their effectiveness at work (Arnold 2005; Nguyen & Kleiner 2003; Schraeder & Self 2003). As time elapses without timely and appropriate communication employees settle back into the former culture which may delay the post-merger integration.

Companies often slow the pace of integration in the desire to respect the culture of the acquired firm. However, adopting a slow approach to integration may allow momentum and enthusiasm to dissipate (Arnold 2005). Natural inertia sets in (Lynch & Lind 2002) as management delays the inevitable "people decisions". However, Huang and Kleiner (2004) indicate that delayed integration causes greater uncertainty as everyone in both firms "knows what's coming". Moving and integrating quickly may then reduce the length of time for employees to experience uncertainty, as well as reduce the exponential effect of the rumour mill, thus enabling the creation of supporting organisational structures (Angwin 2004). Rapid integration also serves to reduce exposure to the uncertainties of the external environment, as well as to reduce the time available for competitors to respond to the new organisation, thereby increasing the competitive advantage of the new entity.

Homburg and Bucerius (2006) propose that the benefits of speedy integration depend on the magnitude of internal and external relatedness between firms. External relatedness concerns target markets and market positioning in terms of product quality and price. If target markets are highly related then there is a high potential for synergy realisation. If there is a low level of external relatedness with respect to market positioning then a speedy integration may reduce customer uncertainty and improve the chance of success of the M&A. Internal relatedness concerns factors such as management style, pre-merger performance and strategic orientation. Homburg and Bucerius (2006) argue that low internal relatedness can be detrimental for M&A success due to employee resistance and lower employee retention.

In addition to speed of integration, several studies have examined the effect of acquirers' prior experience on acquisition performance indicating that a lack of M&A experience may contribute to failure (Appelbaum, et al. 2000; Nguyen & Kleiner 2003). Early (2004) and Porrini (2004) argue that experienced acquirers can reapply lessons learnt from past acquisitions to facilitate processes for the identification of issues and facilitate integration of acquired firm resources. This contrasts with the lack of relationship between experience accumulation and acquisition performance observed by King et al. (2004) and Zollo and Singh (2004).

M&As require senior management to turn their attention away from their daily duties and focus on managing the integration, requiring substantial commitment and time. M&A therefore brings the challenge of running the business while simultaneously managing the transaction and subsequent integration (Appelbaum et al. 2000).This may be particularly challenging for small organisations with limited managerial resources. Many researchers emphasise the importance of ensuring a focus on business and customers throughout the M&A process. It has been observed that, shortly after an M&A many organisations experience lower sales as well as increased complaints about customer service (Huang & Kleiner 2004). Therefore, the challenge for managers is to maintain the standards of sales and service to meet customer expectations while ensuring successful and timely integration.

In small organisations with limited in-house resources it may be necessary to outsource various functions during an M&A. Schraeder and Self (2003) posit that involving credible outside consultants or resources can educate management on the plethora of issues involved with the integration process and avoid integration problems. Outsourcing finance and accounting, treasury, tax, and information technology processes may allow managers to avoid distraction during integration (Linder 2005). Contrary to this view, Bruner (2004) provides evidence that outsourcing integration does not significantly improve M&A success rates.

Another factor related to M&A success concerns the financial objectives of the transaction. Most firms focus on revenue-enhancement opportunities rather than cost-reduction, however, acquirers tend to do a better job of making estimates of cost-based synergies than they do of estimating revenue-based synergies (Early 2004). As costs are under the acquirer's control management can decide to spend or not to spend, thus it is easier to reduce costs than increase revenue. On the contrary, revenue synergies tend to be much more difficult to estimate because there is great reliance on how customers and competitors will react.

Finally, M&A success or otherwise has been studied in the context of company trading status. Hazelkorn et al. (2004) find that when the target is a publicly traded firm, acquirers experienced short-term returns of –2.3 percent around the acquisition and an industry-adjusted –4.4 percent for the following two years. In contrast, transactions in which the target was a private firm led to median short-term excess returns of 1.9 percent and median long-term excess returns of 4.2 percent. Two possible explanations were advanced for this pattern. First, acquisitions of public firms are typically more complex in nature and thus more prone to integration problems compared to private transactions. In the latter, acquirers do not tend to end up with the infrastructure and overheads of the target, thus facilitating post-merger integration. Second, acquisitions of public firms usually occur at a premium to an already-established share price. Indeed, private firms can sometimes be purchased without a considerable premium because no established public valuation benchmark is available.

Methodology

A review of the relevant literature reveals that from an acquirers' perspective the success of M&As in general, and from an integration aspect in particular, is poor. Further, the literature notes several factors related to M&A success including management experience, cultural similarity and effective communication. We question whether these findings can be generalised to microcap M&A given that the extant literature focuses almost entirely on large public company transactions. There are two broad research questions to be addressed in this explanatory study. Firstly, what are the underlying determinants of microcap M&A success

or failure? Secondly, given the importance integration plays in the extant literature, what are the pitfalls and problems of microcap M&A from an integration perspective?

Our method is to study a small number of acquirers' recent experiences of M&As in detail rather than conduct a survey of a large number of organisations. This approach would elicit comprehensive responses enabling a more nuanced understanding of the issues involved to determine if any patterns replicate themselves by looking for common themes in the acquirer's experiences. The desire for depth and a pluralist perspective required that the number of companies to investigate be fairly small (Meyer 2001). The benefit of using such a small sample is the opportunity to gain a deeper insight into the full range of business, social, and personal issues (Saunders, Lewis & Thornhill 2007).Our focus on the acquiring firm, instead of the target, is influenced by Zollo and Singh (2004) who observed that learning processes and post-acquisition decisions are housed primarily with acquirers.

Given the paucity of research on the issue, an exploratory research approach is perceived to be appropriate in the conduct of this study. As we started with general research questions and broad models for investigation (Eisenhardt 1989) we employed this methodology rather than following a traditional grounded theory approach to theory building (see Glasser & Strauss 1967). Saunders et al. (2007) note that an exploratory study is an appropriate method of determining what is happening, to seek new insights, ask questions, and assess phenomena in a new light. The advantage of this approach is its flexibility and adaptability. The flexibility inherent in exploratory research means that our focus could became increasingly narrower as the study progressed arriving at specific conclusions based on generalisations. Following the recommendations of Yin (1994) and Eisenhardt (1989) we employ an exploratory case study methodology using pattern matching of the five interviews.

After a review of the literature on M&A integration and success or failure, a draft list of questions was prepared and forwarded to a highly experienced director of an M&A advisory group with over 12 years M&A experience to provide further comment and insight. The final list of semi-structured questions was then finalised and sent to five CEOs who were randomly selected current clients of the advisory group and who had consented to participate in the study (The list of questions is found in Appendix A). To ensure confidentiality we did not disclose the identity of the advisory group, CEOs or companies involved. The use of semi-structured interviews was employed to ensure greater depth and freer more open responses from interviewees. Also, interviews were carried out in such a way as to elicit open responses and volunteering of information that was not covered in the pre-designed interview protocol. Each of the five interviewees is the CEO of a Micro-Cap acquirer who had undertaken multiple M&A transactions during the period 2000-2007. Following the distribution of the interview questions, and allowing time for the CEOs to reflect on them, an interview was conducted with each CEO. These were facilitated by a single investigator, audio-recorded, transcribed and analysed.

Consistent with Saunders et al.'s (2007) suggestion for the need to use and triangulate multiple sources of data we accessed secondary data via media reports, company reports, and press releases. In most cases, the firms' websites proved helpful in compiling such an overview since they typically listed the firms' past acquisition history in press releases. Cross-checking of facts presented in the interviews with secondary data allowed triangulation across various data sources, hence data verification.

Despite the limited number of interviews the CEOs represented a significant body of experience in microcap M&As. Of the five companies involved in the interviews one had been involved in over ten acquisitions, another in a total of ten acquisitions, another more than six, and the other two companies in two acquisitions each. Each CEO had been present in their respective companies during all of the transactions. The five firms were involved in biotechnology, communications, digital media and entertainment and transport services. In

terms of size, we define the five firms as microcap firms with two firms generating annual revenue of between $30 and $50 million each, and the other three firms generating revenue of $100 - $120 million each. Firm revenue has been used as a proxy for market capitalisation as the firms considered were not publicly traded. Each of the companies in the study and their targets met the general definition of microcap being a company outside the ASX 300 (Peters 2011). A more precise description of microcap is given by Dimson and Marsh (2001) who define microcap equities as the smallest one percent by cumulative value of all equities. Each of the companies in our study meets this definition.

We asked CEOs to focus on their most recent transaction experience and encouraged them to provide open and multiple responses where appropriate. The target firms are all in the same industry as their acquirers and all operate in Australia.

Results

Motives for Merger/Acquisition

Many motives for M&As are proposed in the literature. Four of the respondents (CEOs A, C, D, and E) mentioned that the primary reason for the acquisition was to add complementary products and services. Two of these (CEOs C and E) also mentioned the desire to achieve financial and operating synergies. In addition, geographic expansion was mentioned twice by CEOs A and C, while another, CEO B, cited the acquisition of intellectual property for product development. These findings could be considered to be at odds with more recent studies such as that by Maybeck and Bains (2006) in the UK who reported that M&A transactions involving small firms were mainly motivated by a desire to improve shareholder returns rather than taking advantage of business opportunities or acquiring new technology.

M&A Success

Given that the firms studied were not listed, success or failure could not be measured in terms of shareholder return. CEOs A, C, D and E indicated they defined success in terms of improved financial performance through increased ROI and/or EBIT, NPV or attaining or exceeding some budgeted goals. Additional metrics which received one mention by each of CEOs A, B and C included increasing client numbers, removing outsourcing, raised company profile, acquiring new technology, and retaining key employees. It was noted by CEO B that success must be:

"*defined by the purpose of the acquisition*".

Interviewees were asked what they thought were the main factors that contribute to M&A success or failure. Consistent with the general M&A literature the most frequently noted response was cultural issues which were mentioned by CEOs A, C and D. Strategic fit (CEOs A and B), adequate planning (CEOs B and E) and understanding of the target business (CEOs A and E) were each mentioned twice. Other factors which were each cited once included getting target staff to change to their new circumstances (CEO A), a loss of momentum (CEO A), inadequate communication (CEO C), over optimism (CEO C) and, in the case of an acquisition involving a family business, a willingness of all of the family members to co-operate (CEO A).

In terms of their most recent M&A transaction CEOs B, C and D indicated that they had been successful when considered against initial purposes. CEO A reported their results were mixed while CEO E said it was too soon to judge. This appears to be a higher level of success than generally reported in studies involving public companies (Adams & Neely 2000;

Appelbaum et al. 2000; Carr et al. 2005; King et al. 2004; Mamdani & Noah 2004; Schraeder & Self 2003; Vester 2002). The rate of success appears consistent with other studies of private companies' M&As (for example, Hazelkorn et al. 2004). However, it should be noted that many private companies studied in the M&A literature are still large concerns and the companies investigated in this study are very small by comparison.

With regard to their experience of M&A transactions in general CEOs were asked whether the acquisitions met their financial performance expectations. CEOs A and E stated that half of the acquisitions they had been involved in were above expectations and half below. CEOs B and D stated that their expectations were met and CEO C stated that their acquisitions significantly outperformed expectations. In general therefore it can be inferred that the M&As undertaken were successful in meeting acquirer's financial expectations. As all of the CEOs interviewed had been involved in multiple transactions we cannot rule out that their past M&A experience contributed to this success.

Consistent with existing literature all five CEOs noted that cost reduction is more easily achieved than increased revenue. Two of them noted however that cost reduction is a short term proposition while revenue growth is harder and takes longer but is the ultimate goal of M&A.

Culture

As noted in Section 2 people and cultural issues are regularly cited as the main problems in the M&A integration process. With respect to the importance of culture CEO A mentioned the cultural fit of the vendors, and the ability to fully understand their point of view during the due diligence process as factors critical to success. CEO A also noted the importance of maintaining staff loyalty and morale, while CEO C mentioned maintaining the customer relationship. With respect to the management of the target or acquired company CEO E commented that:

> *"The unwillingness of management or the inability to get management to shift to a new paradigm, new operational processes, means that we couldn't move as quickly as we like."*

With respect to how the target's and acquirer's employees coped with organisational changes responses varied. CEOs A and B said they thought most employees didn't think it was a problem as, although some employees left, others saw the benefits of working in a larger organisation. CEOs C and D mentioned that the target company's employees did not typically welcome takeovers and often needed to be reassured as to their continuing employment and conditions. CEO E noted:

> *"what we found was that if we kept them (**target staff**) busy, then they had less time to worry about, to resist, or to be overly negative against it"*.

CEOs were asked if there was a divergence in cultures between the target and acquirer and how this was resolved. CEOs A, B, C and E answered that it was an issue in all the M&A transactions their companies had been involved in while CEO D noted that they were able to resolve it by having appointed a "cultural champion" to guide the cultural fit in all acquisitions. Consistent with the findings of Schraeder and Self (2003), none of the interviewees considered the cultural "fit" or analysed cultural traits with a cultural fit audit prior to the acquisition.

Communication

Consistent with the existing literature on M&A (for example, Appelbaum, et al., 2000), all five respondents acknowledged the importance of clear and frequent communication to reduce employee stress, integrate cultures and retain customers. As CEO B noted:

> *"Communication is a key factor, particularly in cases with different cultural backgrounds."*

CEO D identified communication as the single most important factor in the M&A process. CEO E said it was second only to having clear objectives, while CEO A said it was a key factor. CEO C noted that it is the type of communication that is important with face to face communication especially critical. This aspect has been noted in the literature (for example Dixon 2002).

Integration

While all firms in the study had used the same Corporate Advisory firm to identify targets he researchers were interested in finding out the extent of outsourcing integration activities as this would have a direct bearing on the success or otherwise of the transaction. The use of outsourcing in integration activities was limited in all cases. CEO D (the largest company) stated that the company had all the required expertise in-house so they did not need to outsource any functions. In his opinion:

> *"What can be done internally should be done internally and if you need more staff resources then you have to hire rather than outsource".*

CEOs A and C stated that they did not outsource as they feared losing control over the process. CEO E stated they outsourced HR as they did not have a full time HR person and noted that:

> *"With many or most small companies there is not enough money to hire someone to bed the M&A down".*

CEOs, A, C and E said integrations had generally taken longer than expected. On the basis of their experiences CEOs B and C reported they thought that it takes two years on average to complete the whole integration process while CEOs A, D and E estimated 12 months on average. CEO C felt that he should have reduced timelines and pushed the integration more quickly. Apart from the largest company which stated that they had set and largely met their timelines, the other companies did not adopt strict timelines or rigid schedules. CEO C noted that, as their existing staff were already in place and working in the business, it did not matter if integration took longer than first thought as "you're paying them anyway".

CEOs A, C and E said they underestimated the effort required to integrate the acquisitions while CEOs A and B said integration was significantly more difficult than expected. Reasons attributed to this difficulty included systems integration problems, an inability to integrate and report operations, and generally poor planning for the integration.

CEOs A, B, C and E said the acquisition process definitely affected their ability to remain focused on their businesses. CEO C noted that because the typical transaction is a large investment:

> *"It has to dominate your thinking for that first period of time, so a lot of your day to day stuff has got to be able to be delegated …"*

CEO D said that the acquisition did not impact on his company's operations as they had a number of senior executives to ensure the core business was unaffected.

Prior M&A experience and hindsight

The M&A literature in general concludes that acquirer's prior acquisition experience may enhance acquisition performance. Our CEOs agreed with this proposition with CEOs A, C, D and Egiving an emphatic yes to this question. CEO D mentioned that despite this there are always surprises and CEO A noted that he felt that experience enables faster integration and completion in successive transactions. CEO C stated that:

> *"experience is very important in this area, because, when dealing with a small company, there's a lot of relationship capital in there, so to speak, and a lot of emotional stuff in there so if you don't read that correctly, you're liable to do a fast integration and find that you've lost 50 percent of your customers in trying to be too quick."*

The CEOs were asked to reflect on their most recent transaction experience and comment on what they would have done differently. CEO A noted that they would have spent more time on teamwork building between existing and new staff. CEOs C and E reiterated that they would have aimed for better communication with all stakeholders. Additional responses included the appointment of a champion to be responsible for the management of the integration (CEO B), the appointment of a Chief Operating Officer (COO) to continue operating the business as normal during the integration phase (CEO A), and commitment of more resources to integration (CEO B).

When asked to reflect on the major lessons they have learnt from all their experiences in M&A, CEOs B and D mentioned the importance of having staff skilled in various aspects of M&A. Other responses included keeping a tight timeframe and control of costs (CEO A), being more aggressive in planning synergy (CEO A), and organising to integrate systems and processes quickly (CEO B). With respect to communication and cultural issues CEO C commented that they had learnt that they are buying goodwill and the loyalty of a customer base. They offered this advice to companies proposing to engage in future M&As:

> *"Be clear with expectations … engage in communication regularly at all management levels, reassure suppliers that you will continue purchasing"*.

CEO E noted they have learnt to pay more attention to the management of the acquired business to ensure smooth integration and spend more time on alleviating HR issues.

Discussion

The results of the interviews indicate significant commonality between the very small unlisted companies' experiences of M&A examined here and several of the findings of studies involving large publicly listed company M&A transactions.

With respect to issues concerning cultural incompatibility, the responses here were consistent with the findings of existing studies in the M&A literature, in noting cultural incompatibility as a significant barrier to successful integration (Appelbaum et al. 2000; Clemente & Greenspan 1999; Huang & Kleiner 2004; Lynch & Lind 2002; Schraeder & Self, 2003). Additionally, the importance of clear and frequent communication to reduce employee stress, integrate cultures and retain customers was consistent with the existing literature on M&A (for example, Appelbaum et al. 2000). Indeed, one could reasonably expect cultural compatibility and good communication may be even more important for small companies than larger ones. Small companies often rely on a handful of clients and key staff for their success. Furthermore, an ageing labour-force in most western countries has meant talent retention is increasingly important.

Past research has noted the difficulty experienced by senior management in remaining focused throughout the M&A process (Huang & Kleiner 2004); a challenge highlighted by

most of our companies. However most did not outsource any integration functions firstly due to a fear of losing control over the M&A process and secondly due to limited financial resources. Consistent with the literature on larger public company M&A (Roberts 1999; Vester 2002;) our CEOs supported the notion that integration should be pushed quickly. In short, companies wanted faster integration but felt hamstrung in their ability to do so.

This paucity of resources in small companies compared with large businesses, particularly with respect to M&A transactions, has received minor attention in the literature (see for example Frankel 2007). This may in part explain the respondent's belief that integration generally takes longer than expected and that most CEOs interviewed in the study felt additional resources would be useful to facilitate the process. The importance of proper planning, adequate resourcing and time for small companies to successfully engage in M&As is highlighted. We have some indication here that microcap M&A acquirers systematically underestimate the cost and time of their M&As. This is interesting particularly given that each of the CEOs and their companies had been involved in numerous transactions.

Most of the CEOs in this study noted that the transactions they have been involved in were successful. This is at odds with results generally reported by studies involving larger, publicly listed companies. It is interesting to note several studies involving private company M&A have found initial returns for acquirers stocks following the announcement of an acquisition of private firms are statistically significantly positive and higher than those of acquisitions involving public firms (for example Draper & Puadyal 2006; Capron & Shen 2007; Cooney, Moeller & Stegemoller 2009). Several explanations have been offered for this including uncertainty with respect to the valuation of the target company. As stated earlier, the acquirers in our study made several acquisitions of small private firms in the same industry as themselves. It seems plausible that the lack of information relating to small private firms creates difficulty in accurately evaluating their assets. This generates value creating opportunities while the market for corporate control for public targets serves as an information processing and asset valuation mechanism for all potential bidders (Capron & Shen 2007).

One notable finding is that the main reason for most of the acquisitions was the desire to obtain complementary product and services rather than short term financial gain. Small companies engaging in M&As are typically growth firms attempting to achieve critical mass; theirs is a long term strategic play. Despite the fact that companies were engaging in M&As primarily to obtain complementary products and services, CEOs gauged the success of their M&As on the basis of financial performance.

Concluding Remarks and Limitations

This paper examines the M&A experiences of microcap companies, an area largely ignored in the literature. There were two overarching research issues which drove this exploratory investigation. Firstly, we wanted to identify the factors that were associated with microcap M&A success or failure. Secondly, we wanted to identify the pitfalls and problems in microcap M&A, notably from an integration perspective. Results were contextualised with the existing literature involving large typically listed company M&A.

A limitation to this study, common to all similar exploratory studies was the small number of firms involved and industries represented. To some degree the fact that the respondents and organisations had undertaken multiple transactions mitigates this limitation. It also must be acknowledged that all of the companies involved in this study were the clients of one advisory firm. However, despite these limitations this study is unique in its examination of the experiences of M&A involving microcap companies whose dynamics and resources are very different to large publicly listed firms. The challenge for future research is

to ascertain whether the results obtained here can be generalised across other samples of companies and continue to build on our knowledge of smaller (microcap) company M&A.

One interesting observation that comes out of this study is the high rate of transaction success noted by CEOs. This is seemingly at odds with the CEOs' statements that integration generally took longer and cost more than first anticipated. The CEOs interviewed expressed an overall desire to better resource their integration efforts including the hiring of key personnel.

All but one of the CEOs interviewed indicated that M&A transactions distract them from the day to day management of the business. This may seem slightly contradictory in light of their expressed desire not to outsource integration aspects of these transactions, often from fear of losing control. An implication of this is that further study could be undertaken to see if outsourcing microcap M&A post integration functions does result in faster and better integration outcomes and whether this is a cost effective strategy. Positive findings may overcome the reluctance of management and improve organisational performance.

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Appendix A: Micro Cap M&A: An Exploratory Study Interview Questions

Question 1 What was the relative size (in percent terms) of the target/s compared to you/the acquirer?
Question 2 What were the main reasons for the acquisition/s?
Question 3 How does your company define and measure the success of M&As?
Question 4 What are the main factors that contribute to the success or failure of an M&A?
Question 5 Has the merger/acquisition been successful from your/your company's perspective?
Question 6 Have the acquisitions met your financial performance expectations?
Question 7 Based on your experience, are synergies more easily achieved by cost reduction or revenue enhancement?
Question 8 People and cultural issues are regularly cited as the main problems in the M&A integration process. Did these issues apply to the M&As your company was involved in? In general what were the issues?
Question 9 How did the target's and acquirers employees cope with organisational changes?
Question 10 Cultural incompatibility is receiving increasing attention as the culprit of M&A integration failure. Was there a divergence in cultures between the target and acquirer and how has this been resolved?
Question 11 How important do you feel that communication is with mergers and acquisitions involving small companies such as the ones you have been involved with?
Question 12 Did you outsource parts of the integration process by bringing in outside expertise? Why or why not?
Question 13 Was the last target company acquired fully integrated or left as a stand-alone entity?
Question 14 From your experience how long does the whole integration process take? Were timelines established and were they attained?
Question 15 Was the integration more or less difficult than expected or in-line with expectations?
Question 16 Did you find the acquisition process adversely affects your ability to remain focused on your business?
Question 17 Do you think that prior experience in M&As helps? In what ways does it help?
Question 18 In hindsight what, if any, changes would you have implemented during the integration phase?
Question 19 What are the major lessons that you have learned from your experiences?