The article surveys theories of merger motives and relates them to prescriptions for merger strategies. The theories of merger motives can be classified into seven groups. Those theories arguing with private information, managerial empire-building or process influences are better supported by evidence than those tracing mergers back to efficiency gains or monopoly power. The explanations of mergers in terms of raider activity or macroeconomic disturbances carry the least plausibility. Strategy authors have discussed mergers with respect to the choice of acquisition mode, entry mode, and integration mode. The prescriptions on all three topics are dominated by the efficiency theory of mergers. For this reason they are dangerous guides for participants in merger processes. On the other hand they provide an efficient language for communicating one's position. The research in merger motives should be redirected from the efficiency theory to explanations that build on decision processes, conflicting goals, and ambiguous private information.

Why do mergers occur? Why can we observe premiums and bidding contests as in the case of RJR Nabisco? Is it because 'the public markets are incapable of understanding the true value of corporate assets [or because] management was trying to steal the company from underneath the noses of its shareholders [or because] Wall Street, steeped in greed and ego, ran amok and overbid for the company' (Barlett, 1988: A1)? The wave of mergers and reverse mergers during recent years has drawn widespread attention, but most of the academic and public discussion has been devoted to the mergers' consequences. The motives behind these mergers have received only modest attention although they ultimately decide whether a merger is attempted or not.

This article gives a critical overview of merger explanations and relates them to prescriptions for merger strategies. The first main part discusses the explanations put forward for mergers and examines the evidence on the several theories. This is not done to refute or prove a single theory. Most observers agree that mergers are driven by a complex pattern of motives, and that no single approach can render a full account (e.g. Steiner, 1975; Ravenscraft and Scherer, 1987). But knowing that the world is complex cannot be the end of scientific endeavor. Therefore an attempt is made to order the merger theories according to their plausibility and consistency with the evidence. There are two possible ways of getting evidence on motives; direct investigation and indirect inference from merger outcomes. Direct investigation may produce unreliable results while inferences may be unwarranted. To offset these shortcomings both kinds of evidence are used here with some caution.

The second main part examines the literature dealing with prescriptions for merger strategies. This field can be divided into three major topics: the choice between related and unrelated acquisition, the choice between acquisition and internal development, and the choice between integration and autonomy of acquired units. This part of the article aims at identifying the underlying assumptions about the rationale behind a merger strategy. These assumptions
contrast sharply with the evidence on merger motives. The motive most merger prescriptions implicitly rely on is scarcely supported by evidence. The third and final part suggests some conclusions following from this discrepancy.

THEORIES OF MERGER MOTIVES

Merger motives have triggered far less theoretical efforts than merger consequences. But still the field has brought forth a total of seven different theories. At the most general level those theories that regard merger consequences as the moving cause behind mergers can be distinguished from those that do not. Gort’s (1969) disturbance theory and those approaches that view mergers as process outcomes belong in the second category. In the first category most theories focus on shareholders’ interests while one group focuses on managers’ interests and their deviations from shareholder value maximization. Finally, those theories dealing with shareholders’ gains can be distinguished according to the postulated source of merger gains. These are either net gains through synergies or private information or wealth transfers from a target’s shareholders or from customers. Further possible sources of wealth transfers are employees and the state. But wealth transfers from employees have not received much factual importance (Jensen, 1984). Wealth transfers through tax savings are prominent in many mergers but cannot explain more than a fraction of the premium usually paid (Kaplan, 1987). Figure 1 orders those theories included in the survey.

Efficiency theory

This theory views mergers as being planned and executed to achieve synergies. In general, three types of synergies can be distinguished.

1. Financial synergies result in lower costs of capital. One way to achieve this is by lowering the systematic risk of a company’s investment portfolio by investing in unrelated businesses. Another way is increasing the company’s size, which may give it access to cheaper capital. A third way is establishing an internal capital market. An internal market may operate on superior

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Figure 1. Theories of merger motives.

information and therefore allocate capital more efficiently.

2. Operational synergies can stem from combining operations of hitherto separate units (for example a joint sales force) or from knowledge transfers (Porter, 1985). Both kinds of operational synergies may lower the cost of the involved business units or may enable the company to offer unique products and services. These potential advantages have to be weighed against the cost of combining or transferring assets.

3. Managerial synergies are realized when the bidder’s managers possess superior planning and monitoring abilities that benefit the target’s performance. A sideline to this argument are the positive motivation effects ascribed to LBOs (Jensen and Murphy, 1988).

The idea of financial synergies has received sharp theoretical criticism. The main argument is that financial synergies of any kind cannot be achieved in an efficient capital market. Research has shown that indeed there is no evidence for a lower systematic risk or a superior internal capital market (Rumelt, 1986; Montgomery and Singh, 1984). Size advantages, however, seem to exist in the capital market (Scherer et al., 1975). Managerial and operational synergies, on the
other hand, have been criticized as evasive concepts that are often claimed for mergers but seldom realized (Kitching, 1967; Porter, 1987).

One important variation of the efficiency theory of mergers is Jensen’s management competition model (Jensen, 1986). This model resembles earlier arguments by, e.g. Alchian (1950) and Manne (1965). Jensen pictures takeovers as a disciplinary force in the capital market, which functions as a market for corporate control. Managers who invest in projects with negative net present value instead of paying the excess cash flow to their shareholders are threatened by competing management teams. The latter provide an external control that substitutes for the insufficient internal control by shareholders. Jensen acknowledges that one way for incumbent managers to waste excess cash is to engage in mergers themselves. In these cases he sees the debt accumulated in the deals as an effective controlling device against further deviations from shareholder value maximization. Jensen and his predecessors relax the efficiency argument. They do not argue that all mergers are undertaken to promote the efficiency of the corporate world, but that this is their aggregate effect.

Merger makers frequently cite synergy arguments to justify their actions (Friedman and Gibson, 1988; Maremont and Mitchell, 1988; Porter, 1987). The differing perception of close observers (Dobrzynski, 1988a, b; Rothman, 1988; Smith and Sandler, 1988) is the best indicator that direct evidence can produce unreliable results.

Indirect evidence on the efficiency theory comes from three different types of studies. Event studies as summarized by Weston and Chung (1983), Jensen (1984), Dennis and McConnell (1986), and Ravenscraft and Scherer (1987) show that the stock market in general values mergers positively. Almost all of the gains, though, are reaped by the targets’ shareholders while the bidders’ shareholders gain nothing on average. Moreover, Ravenscraft and Scherer show that over 21 years only two of the most active acquirers of the 1960s outperformed the S&P industrials index. Studies using company performance data paint an even bleaker picture. Porter (1987) found that more than half of the acquisitions by major U.S. companies failed. On the other hand, his study showed related acquisitions to turn out better than unrelated ones, where three in four failed. Montgomery and Wilson (1986) reported similar figures but no difference between the two types of diversification. Ravenscraft and Scherer (1987) estimated a divestiture rate of one in three, and found the most active acquirers in their sample to be less profitable than the U.S. industry average. A third group of studies has investigated synergy categories. In the initial study, Kitching (1967) concluded that it was financial, not operational, synergy that could be achieved through mergers. Twenty years later, Chatterjee (1986) obtained closely similar results. In a more specific study, Shelton (1988) analyzed how far relatedness categories explained value gains in mergers. She found the categories to be only partially significant.

There is further indirect evidence on Jensen’s management competition model. In two articles (1984, 1986) Jensen himself surveys the stock market evidence and concludes that it is largely supportive of his model. Further backing comes from Walkling and Long (1984), who report that variables associated with managerial welfare explain targets’ bid resistance better than variables associated with shareholder welfare. On the other hand, the performance results obtained by Ravenscraft and Scherer (1987) and Porter (1987) cast a doubt on the stock market results. Besides the divestiture rates mentioned above, Ravenscraft and Scherer found that acquired companies had an above-average profitability prior to a merger, and that acquiring companies were below-average performers.

In sum, the efficiency theory’s record is unfavorable. It appears to be consistent with stock market quotations but far less with companies’ actual performance. If one regards financial statements as more reliable than stock prices the efficiency theory has to be rejected. However, if one assumes the capital market to be efficient the theory can be held (except for the idea of financial synergies). But adherents to capital market efficiency have to explain where the missing link between the public information from financial statements and the public information incorporated in the stock price is.

Monopoly theory

This explanation views mergers as being planned and executed to achieve market power. This
cannot only occur in horizontal acquisitions. Conglomerate acquisitions may allow a firm to embark on the following activities:

1. The firm can cross-subsidize products. Profits from the position in one market are used, for example, to sustain a fight for market share in another market. Philip Morris allegedly did this after acquiring Miller.

2. The firm can aim at simultaneously limiting competition in more than one market. One way to do so is tacit collusion with competitors it meets in more than one market. This theory of mutual forbearance was developed by Edwards (1955). A practical example is building a foothold in a competitor’s main market who in turn possesses such a foothold position in the firm’s main market (Porter, 1985). Other possible ways of limiting competition in more than one market are reciprocal dealing and combining business functions such as purchasing. The two latter phenomena are hard to evaluate since they can be synergistic as well as anti-competitive.

3. The firm can aim at deterring potential entrants from its markets. One possible way of achieving this is concentric acquisition by a market leader. Deterrence of potential competition is even harder to evaluate than the activities mentioned in the previous paragraph. The elusive character of potential competition seems to be the reason for its ever-changing fate in antitrust (Steiner, 1975).

These kinds of advantages have been referred to as collusive synergies (Chatterjee, 1986) or competitor interrelationships (Porter, 1985). These labels illustrate that from the firm’s point of view these advantages are as beneficial as the synergy types discussed above. But there is a clear difference at the level of the economy. Collusive synergies represent no efficiency gains but wealth transfers from the firm’s customers. The efficiency gains sometimes accruing to monopolistic competition do not occur in non-horizontal mergers (Scherer, 1980).

It is not too surprising to find no claims that a merger is made to achieve monopoly power. Even mergers that are widely perceived to follow this aim, like the merger wave around the turn of the century (Rhoades, 1983) can be ‘sold’ on efficiency grounds or by arguing that the relevant market is broader.

There is some indirect evidence on the monopoly consequences of mergers. Jensen (1984) summarizes a number of event studies that deal with the effects of merger announcements, FTC investigations, and merger cancellations on competitors’ stocks. Under the monopoly theory competitors’ stocks should rise upon an announcement and drop if the merger is challenged or cancelled. Since competitors’ stocks do not fall on the two latter events Jensen rejects the monopoly theory. Two other recent studies directly examine the role multimarket contacts play. Scott (1982) found that they were only associated with high profits if seller concentration was high, too. Contrary to that, Feinberg (1985) found a generally positive relationship, although it was much weaker on the industry level compared to the company level. Finally, the above-mentioned performance results from the studies by Ravenscraft and Scherer, and by Porter, apply here, too. They clearly contradict the picture of successful extortion of monopoly profits through non-horizontal mergers.

In sum, the monopoly theory’s record appears to be even weaker than that of the efficiency theory. The results on companies’ performance are mixed while the event studies are unfavorable. However, the results are not as devastating as Jensen (1984) and Ravenscraft and Scherer (1987) claim.

**Valuation theory**

This approach argues that mergers are planned and executed by managers who have better information about the target’s value than the stock market (Steiner, 1975; Holderness and Sheehan, 1985; Ravenscraft and Scherer, 1987). Bidders’ managers may have unique information about possible advantages to be derived from combining the target’s businesses with their own. Or they may have detected an undervalued company that only waits to be sold in pieces. Similarly, managers proposing an LBO may possess unique information about what they can do with a business once they are no longer under the influence of a corporate headquarters.

Like the financial synergy argument this hypothesis conflicts with that of an efficient
capital market. It has been argued that the two are not incompatible because the latter only requires that all publicly available information is incorporated in the stock price (Ravenscraft and Scherer, 1987). If the bidder possessed private information about the target's value (excluding synergies at the moment) he would reveal it in his bid. The stock price would climb to reflect the new information leaving the bidder in a winner's-curse situation. In this sense an efficient market does not preclude the existence of undervalued target firms, but only the possibility of capitalizing on revealed private information (Wensley, 1982).

But this interpretation is too narrow. Wensley also notes that those who possess private information have to cope with its ambiguity. A prospective bidder envisages a number of future states of the world and his target's value in each state. He ends up with a set of states nobody else envisages because his situation is one of genuine uncertainty (Shackle, 1969, 1972). His problem then is to validate his expectations, which he ultimately does in his offer. The other market participants face a corresponding problem. Unless the bidder reveals an unequivocal strategy for the post-merger period they cannot incorporate his private information into the market price because they do not possess the necessary knowledge. The stock price rises, though not because of a new estimate of the company's income stream. The reason lies in the bid itself, weighed with the possibilities that enough shares are tendered and no competitive bidder emerges.

The difference between the valuation theory and other merger explanations is its recognition of the role which genuine uncertainty plays in strategic decisions such as mergers. Capital market participants cannot fully evaluate the information on which a bid is based. What is more fundamental, even the bidder cannot do so. The very nature of private information, its ambiguity, makes it impossible for him to reach confidence about the bid's basis.

The problem with assessing the valuation theory's validity is that it is not possible to derive any specific propositions about merger results. The owner of private information places a higher value on certain assets than does their current owner. He will offer a premium based on his private expectations and on his assessment of the market's reaction. It could be argued that bids based on private information will involve smaller premiums because they can be less easily matched. However, this is not true because private information is not one-dimensional (Wensley, 1982). Several bidders may have different pieces of private information on one target. Moreover, bid prices are influenced by considerations like 'how can we discourage competitive bids?' or 'how much can we get away with?'

There is widespread evidence that merger makers justify their actions in terms of the valuation theory. Ravenscraft and Scherer (1987: 9, fn 14) cite a wide array of according statements. Probably the most telling piece of information is how widespread the disbelief in stock market efficiency is. In the often-cited Harris poll in 1984, 60 percent of the executives thought their company was undervalued while 32 percent agreed with the stock market, and 2 percent felt overvalued (Business Week, 20 February 1984). These statements are clearly not sufficient to make the valuation theory the merger explanation of choice. Managers claim efficiency goals also, without producing too much evidence. But the concept of private information as a basis for mergers warrants further consideration, since it shows a way the problematic assumption of capital market efficiency can be avoided.

**Empire-building theory**

According to this theory, mergers are planned and executed by managers who thereby maximize their own utility instead of their shareholders' value. This approach has its roots in the original study on the separation of ownership and control in the corporation (Berle and Means, 1933). Its underlying idea was contained in the various managerial theories of the firm (Baumol, 1959; Marris, 1964; Williamson, 1964) and explicitly formulated by Mueller (1969). Recently, Rhoades (1983) and Black (1989) have developed related merger explanations.

The common thread of the managerial theories of the firm is the maximization of managers' goals subject to constraints put upon them by the capital market. In Baumol's model managers maximize revenues subject to a minimum profit requirement. Marris' model overcomes this static perspective and instead postulates the financially sustainable growth rate of assets as the goal.
pursued by managers. Williamson introduced the concept of managers' expense preference, which he modeled as a compound variable containing factors such as company cars, excess staff or prestigious investments. Mueller built on Marris' work and developed a growth maximization model of mergers. Interestingly, Marris excluded mergers from his model because he regarded them as a financially unsustainable strategy. Mueller did not discuss Marris' concern but the general evidence on the amount of acquisitions by individual companies (Porter, 1987) stands against Marris' conjecture. An empire-building argument is not necessarily confined to the motive of growth maximization. This is shown by Rhoades' (1983) analysis of the merger wave of the 1960s. Rhoades juxtaposes the profit motive and the power motive as possible explanations of business behavior. Comparing the evidence on the merger waves around the turn of the century and in the 1960s he concludes that in the meantime the power motive has replaced the profit motive as the moving force behind large companies' conduct. Another recent development in this field is Black's (1989) overpayment hypothesis. Black postulates that managers overpay for targets because they are overly optimistic and because their interests diverge from those of their stockholders. In an efficient capital market the overpayment should result in an according drop in the bidder's stock price. Black argues that this does not occur because investors anticipate the overpayment (or other means of cash waste). With this interesting argument Black can reconcile the assumption of information efficiency with the theory of managerialism. Again, it is not too surprising to find no instances where managerial goals are cited to justify a merger. But the empire-building theory enjoys a popularity in the business press that seems to grow proportional with the size of a merger. In the case of Philip Morris' bid for Kraft, observers seemed to be divided between management's synergy explanation and a competing one that involved management's desire for growth and new fields of activity, fueled by excess cash (Dunkin, 1988; Friedman and Gibson, 1988; Rothman, 1988; Smith and Sandler, 1988). In the case of the LBO proposed by RJR Nabisco's management, the reactions were almost entirely in favor of an explanation in terms of managerial abuse (Bartlett, 1988; Dobrzynski, 1988a, b). There is only some related evidence from work concerned with merger consequences but it is mostly supportive. You et al. (1986) found that management share ownership and the number of inside directors were negatively associated with merger results. Amihud and Lev (1981) found management control to be associated with engagement in conglomerate mergers. Both results support the empire-building theory. Walsh (1988) reported that merging companies have a higher executive turnover than non-merging companies, which supports an explanation of mergers in terms of managers' quest for opportunities. Ravenscraft and Scherer (1987) concluded from the case studies accompanying their study that empire-building aspects play some role in merger decisions. Rhoades (1983) and Black (1989) each surveyed some of the evidence on merger consequences and found it to be consistent with their own empire-building arguments. In sum, the empire-building theory has to be given the most credit of the theories investigated up to this point. This is subject to two reservations. First, the evidence collected until today is relatively limited. Second, 'empire-building theory' is a common name for a variety of merger explanations, each with its own limited factual support. This is also true of the other six merger explanations, but the empire-building theory covers a much broader range than, for example, the monopoly theory. Process theory A fifth, only rudimentarily developed theory of merger motives has its background in the literature on the strategic decision process. This research field has produced a vast amount of models that describe strategic decisions not as comprehensively rational choices but as outcomes of processes governed by one or more of the following influences:

1. Practically all work on decision processes argues with Simon (1957) that individuals possess limited information processing capabilities. Therefore, the search for information and alternatives may be abridged, evaluations be incomplete, and cognitive simplifications be used.
2. Organizational routines play the central role in Allison's (1971) organizational process paradigm and in Cyert and March's (1963) behavioral theory of the firm. The multiplicity of participants and their limited rationality prevent a comprehensively rational solution of problems. The organization resorts to routines that have proven successful in the past. Old solutions for similar situations are tried on new problems. New solutions are only sought after the old ones have failed. Over time, the organization learns in the sense of developing a set of routines for different problems; it is adaptively rational.

3. Political power is the core category in Allison's (1971) political process paradigm and Pettigrew's (1977) analysis of strategy formulation. Strategic decisions are interpreted as the outcome of political games played between an organization's subunits and outsiders. Tactical considerations and mutual adjustments dominate the decision process.

Some recent work can be subsumed under the heading 'process theory'. Duhaime and Schwenk (1985) discuss the influence of individuals' limited information processing capabilities on acquisition and divestment decisions. Roll (1986) works out the implications of managerial over-optimism. In his hubris hypothesis managers' expectations are systematically erroneous with an upward bias since a stock's market price serves as a downside cut-off point. Overly good expectations lead to bids that would not be made by rational bidders. Jemison and Sitkin (1986) take an explicit acquisition process perspective and present a framework of four organizational process impediments to successful acquisition integration.

In a summary of earlier studies concerned with the acquisition process, Power (1983) reported mostly supportive evidence. The majority of studies concluded that the acquisition indeed was not a comprehensively rational decision. They found suppressed uncertainty, lack of planning, political influences, varying process participants, and no agreed-upon acquisition criteria. Song (1982) gathered evidence that supports the assertion that senior executives' background plays a role. As reported above, Walsh (1988) found executive turnover to rise after a merger, a fact that may indicate procedural conflicts. Finally, Duhaime and Schwenk (1985) and Jemison and Sitkin (1986) gathered illustrative material on how cognitive simplifications and other process factors can affect a merger.

In sum, the evidence on the process theory can best be described as ambiguous. The available evidence is largely supportive. At the same time, it is so scarce as to forbid any far-reaching inferences.

**Raider theory**

This label can be applied to a sixth possible merger motive discussed especially in the business press. Its basic hypothesis is seldom stated overtly but is implied in the term 'raider'. Holderness and Sheehan (1985) interpret the term as meaning a person who causes wealth transfers from the stockholders of the companies he bids for. These wealth transfers include greenmail or excessive compensation after a successful takeover.

The first problem with the raider theory is that the wealth transfer hypothesis is illogic. In a successful bid the 'raider' pays other stockholders a premium to become the controlling stockholder of the company. Any extortion scheme would hurt him disproportionately, while partially bought-out stockholders might still enjoy a net gain from his activities. In the case of greenmail, wealth is transferred from the company and, ultimately, from the stockholders. However, the real question the latter have to ask is why their board made the payment. In terms of the board's fiduciary duty this can be justified only if a higher bid can be expected, or the company can improve its

perceived cultural differences (Sales and Mirvis, 1984) can influence an acquisition and the post-merger integration process.
stock price on its own, for example through restructuring (Jensen, 1984).

The second problem with the raider theory is the completely unfavorable evidence. In their study of 69 mergers initiated by some of the most prominent so-called raiders, Holderness and Sheehan (1985) found targets' shareholders' to gain in all cases. This replicates the general evidence on targets' shareholders' gains from mergers as summarized, e.g., by Jensen (1984): the average abnormal gains range from 8 percent in proxy contests to 30 percent in tender offers.

**Disturbance theory**

In Gort's (1969) theory merger waves are caused by economic disturbances. They cause changes in individual expectations and increase the general level of uncertainty. Thereby, they change the ordering of individual expectations. Previous non-owners of assets now place a higher value on these assets than their owners, and vice-versa. The result is a merger wave.

This theory is not considered further for three reasons. First, it does not discuss the institutional framework for mergers. But especially in a macro-level explanation this has to be included to explain, for example, why the oil crisis in 1973/74 did not trigger a merger wave like the one in the late 1960s that was not connected to any major economic disturbance. Second, most disturbances are of a sectoral nature. This should lead to a sectoral pattern of mergers. But this can be observed only in some cases; the food or oil industries are examples; the merger wave of the 1960s is a counterexample. Third, Gort's account of how disturbances affect individual expectations is not sufficient for his hypothesis that this overturns the ordering of expectations. However, Gort's theory is not hit by Wiggins' (1981) argument that it cannot explain premiums. This only depends on the difference in expectations and on competitive processes in the capital market.

**PRESCRIPTIONS FOR MERGER STRATEGIES**

This section turns the attention to strategy prescriptions relating to acquisitions. Figure 2 puts the three topics discussed here into the broader perspective of competitive strategy. The analysis in this section aims at identifying the merger motives that are either explicitly or implicitly assumed in the theories and practitioners' manuals in the three categories. Since the literature on the three topics is vast, the review is confined to major recent work in the field.

Competitive strategy can be separated into corporate- and business-level strategy. The former is concerned with a company's product-market scope and the interrelationships between business units. The latter is concerned with the competitive advantages of single-business units and with joint operations. The choice of a product-market scope can be further separated into the questions of which markets to serve and how to serve them. With respect to mergers this translates into the questions of which companies to acquire (acquisition mode) and when to acquire a business.
instead of building it internally (entry mode). The coordination of business units translates into a third question, namely whether and how to integrate acquired business units (integration mode).

**Acquisition mode**

One stream of work on the acquisition mode involves evaluation models that have been proposed for merger simulation. The models by Shay (1981), Silhan and Thomas (1986) and Kroll and Caples (1987) differ in complexity but have two things in common. They assume an efficient capital market and, following from that, regard synergies as the only justification for mergers. If these authors propose their models for merger evaluation this implies that they regard the efficiency theory as the valid explanation of mergers.

These models draw on the major stream of work concerning diversification that follows Rumelt's (1986) study of the relationship between diversification and performance. Rumelt found that some groups of related diversifiers outperformed the unrelated diversifiers. This finding was mostly upheld in later strategy studies, although industrial organization researchers, using different measures of diversification, largely found no relationship (Palepu, 1985). Recent research tends toward a consensus that relatedness is associated with superior performance (Montgomery and Singh, 1984; Kusewitt, 1985; Palepu, 1985; Shelton, 1988).

This result is also reflected in the management literature (Salter and Weinhold, 1979; Drucker, 1981; Porter, 1985). Salter and Weinhold (1979) go back to Ansoff's product-market matrix reflecting different types of relatedness. They use this matrix to suggest certain paths to successful acquisitions. In a similar vein Drucker and Porter each suggest that acquisitions should be made around a common thread, and that potential contributions to the acquired business should play a role in the decision.

This stream of work on the acquisition mode resorts to the efficiency theory of mergers, too. This can be demonstrated by starting from Drucker's five rules for successful acquisition. In their review of the evidence on Drucker's rules Paine and Power (1984) identify two implicit assumptions he makes: he regards mergers as potentially successful and he regards managers as exerting a major influence on the success of a merger. The same two assumptions underlie other strategy prescriptions. If the analysis of the performance-diversification relation is to be meaningful it has to be assumed that managers influence merger success and that merger success plays a central role in their decisions. Whether this success is seen as stemming from internal efficiency gains or collusive practices remains an open question. However, two facts favor an interpretation exclusively in efficiency terms. First, there is no evaluation model for monopoly gains corresponding to the three synergy evaluation models mentioned above. Second, except for Porter (1980, 1985) no author proposes to look for collusive synergies as bases of competitive advantage. The focus is always on internal strengths in an adversarial environment.

**Entry mode**

Once a company has decided to enter a new market the central decision is between acquisition of an incumbent company and internal development of a business. Several authors have presented guidelines for this decision. Porter (1980) describes it as a function of the investment costs including those necessary to overcome the industry's barriers to entry, the expected costs of retaliation, and the expected cash flow. If a company wishes to develop a business internally it faces the industry's barriers to entry and the need to achieve a competitive advantage. If it decides to acquire an incumbent it has to determine its maximum purchase price and a way of achieving a competitive advantage. If it decides to acquire an incumbent it has to determine its maximum purchase price and a way of achieving a competitive advantage. In Porter's opinion only the ability to change the industry's structure can justify an entry, because otherwise no entry should yield an above-average return. Lorange, Kotlarchuk and Singh (1987) present a closely similar analysis.

Roberts and Berry (1985) also include some other entry options such as licensing or joint venture. They determine the suitability of an entry mode in terms of the market's familiarity and the technology's familiarity; thereby, they capture both supply and demand characteristics and the question of relatedness. In general, they recommend both acquisitions and internal development for more familiar new businesses. The main reason they cite is the greater corporate
involvement required by these entry modes. This increases the risk of failure in unfamiliar areas.

A special topic in this context is the choice of a target. When contemplating acquisitive entry into an industry a company usually will find more than one candidate. Several authors have made recommendations about which target should be selected. For example Kusewitt (1985) concluded from his study that targets should be above their industry's average in profitability and growth potential and should be about 5 percent of the acquirer's size. The latter recommendation is consistent with findings and recommendations by, among others, Kitching (1967).

The work on the mode of entry implicitly resorts to the efficiency theory, too. Porter treats the entry decision as a complex investment project involving barriers to entry, purchase price determinants, and the ongoing need to achieve a competitive advantage. In a related study Yip (1982) found evidence that only some variables associated with barriers to entry were significantly correlated with the choice of an entry mode. A variable indicating growth motivation, on the other hand, had the highest coefficient. Roberts and Berry (1985) treat the problem with a different focus but from the same point of view. For them the critical issue is not overcoming structural forces but allocating scarce management time and coping with uncertainty.

The literature on how to choose the right target has an even narrower perspective. Here, the point of view is that of an investment calculus. But the recommendations in part conflict with some of the findings on the subject. The acquirers in Ravenscraft and Scherer's (1987) sample bought above-average profitable companies, as advocated by Kusewitt, and in general fared poorly. This result and the one obtained by Yip indicate that it may prove fruitful to part with the efficiency theory of mergers in this area, too.

Integration mode

The third topic is the choice of an integration mode as treated in the strategy literature. With the recent surge in merger activity this topic has received a lot of interest, although it can be traced back to Kitching (1967). He found the existence of a merger manager and the organizational relationship to be critical for a merger's success. In the recent literature prescriptions cover the whole range from preparatory measures (Shrallow, 1985) to the post-merger acculturation process (Malekzadeh and Nahavandi, 1987). For example Drucker (1981) recommends paying attention to organizational culture and management turnover and integrating a new business by switching a significant number of managers between the parent and the acquired unit. Yunker (1983) and Shrivastava (1986) give detailed accounts of integration issues. Shrivastava also postulates that the necessary degree of post-merger integration depends on the merger's objectives and on company features such as size ratio. Porter (1985) recommends aligning business units by a horizontal strategy aiming at synergies.

All the authors regard some degree of integration as inevitable. Indeed, if synergies other than lower costs of capital are a merger's rationale integration is mandatory. Mergers aiming at wealth transfers from customers or other shareholders do not require integration beyond reallocationing capital. Mergers undertaken to satisfy managers' interests do not require integration beyond exchanging some executives. So if the authors on post-merger integration recommend more than shifting capital or managers they implicitly rely on the efficiency theory of mergers.

In this respect they are even more specific than authors on the first two topics. Some of the most detailed accounts of possible synergy sources and obstacles have been developed in the context of integration (Yunker, 1983; Porter, 1985).

CONCLUSIONS

The survey of merger explanations suggests an ordering in three groups. The valuation, empire-building, and process theory of mergers have the highest degree of plausibility. The available evidence is favorable though severely limited. Next come the efficiency and the monopoly theories of mergers. In both cases there is more evidence, but it is mainly unfavorable. Finally, there are the raider and the disturbance theories. These theories are rather implausible, as well as unsupported by evidence.

This result contrasts with most of the previous surveys. Jensen (1984), Weston and Chung (1983), and Wiggins (1981) all supported the
efficiency theory against some of the competitors investigated here. Only Ravenscraft and Scherer (1987) favored an empire-building argument. This seeming contradiction is explained by the fact that only Ravenscraft and Scherer do not focus on event studies. The other authors’ support of the efficiency theory seems to root in their belief in capital market efficiency. This points at the core of the problems involved in merger explanations.

First, the current state of research in merger motives is unsatisfactory. The most promising explanations have hardly been developed while the most popular ones seem to have only very limited explanatory power. Research in this field should be redirected at explanations that build on decision processes, conflicting goals, and ambiguous private information.

Second, research should part with the assumption of capital market efficiency. As argued above, this assumption cannot be rejected on either empirical or theoretical grounds. On the other hand, the divergences between the findings from event studies and other sorts of evidence cast a severe doubt on the former. Therefore the search for evidence on mergers should turn from stock market studies toward studies of companies’ actual performance. Roll (1986) and Black (1989) have shown ways in which the assumption of an efficient capital market can be weakened. They have incorporated systematically irrational bidders into process and empire-building explanations. But there is a deeper problem involved: how can an observer call a bidder irrational if he does not possess the information the bid is based on? There is no common pool of expectations against which proposed mergers can be judged. Like any other strategic move, mergers must be based on private information to achieve sustainable advantages (Wensley, 1982). Much more work is needed to clarify how the concept of private information can be incorporated into explanations of business behavior (Shackle, 1969, 1972).

The efficiency theory of mergers dominates the field of corporate strategy as well as the research on merger motives. The prescriptions for merger strategies generally rely on efficiency arguments, although these have been shown to have only little validity. This leads one to ask what purposes such prescriptions can have.

First, the efficiency theory and merger prescriptions based on it are dangerous guides in mergers. Trying to understand the opposite party’s moves in a merger in terms of the efficiency theory is almost sure to lead to erroneous results. For example in the case described by Gaddis (1987) efficiency considerations would have led to a completely different way of integration. But such considerations were buried under divisional power struggles.

Second, the efficiency theory nevertheless provides an efficient language for ‘selling’ mergers. Mergers need marketing just like products, and effectively addressing the public or regulatory institutions in a merger may be critical to its success. Managing third-party perceptions and timing the merger process are two of the most important tasks for both sides in a merger. Studies of mergers suggest that managers know about this better than researchers (Gibson, 1988).

REFERENCES

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