“Assessing the determinants of mergers in financial holding companies: a multi-method examination”

| AUTHORS       | Li-Min Chuang  
|               | Chi-Ming Ho    
|               | Wen-Chia Tsai  
|               | Ching-Liang Hsiao |


| RELEASED ON   | Friday, 24 June 2011 |

| JOURNAL       | "Investment Management and Financial Innovations" |

| FOUNDER       | LLC “Consulting Publishing Company “Business Perspectives” |

| NUMBER OF REFERENCES | 0 |
| NUMBER OF FIGURES   | 0 |
| NUMBER OF TABLES    | 0 |

© The author(s) 2019. This publication is an open access article.
Assessing the determinants of mergers in financial holding companies: a multi-method examination

Abstract

The most significant events influencing Taiwan’s financial industry in the 21st century were definitely financial acts that were put in place. They offered incentives for banks to merge of their own accord in hope of decreasing competition, which had increased drastically because of the large number of banks. After the enactment of the Financial Holding Company Act, the financial system in Taiwan underwent shocks and changes. This research used in-depth interviews and analytical hierarchy process (AHP) to address the benefits, challenges and key success factors (KSFs) of mergers through interviews with the executive directors of financial holding companies (FHCs). This case study revealed three main structural dilemmas: the difficulties associated with integration, the benefits of integration, and key success factors. Different corporate cultures were major factors in fail of mergers, and the quality of integration also determined the postmerger achievements of firms. The acquirer must fully understand the acquired firms’ work, allow independence and respect the firm’s integrity. Also, during the merger process, select skills and technical knowledge should be used to obtain the optimum results. With regard to the challenges of integration, it should be noted that although organizational cultures matter much, reorganizing firm structures, management, value, and environments is also crucial after mergers. Of the benefits of integration, operation and market results are not as significant as financial outcomes. For a merger to succeed, sound financial outcomes must be accompanied by a sound operating structure. Regarding KSFs, it remains true that the external environment can be hard to predict. However, the appropriate management of internal resources is the key to growth.

Keywords: financial holding company, merger, key successful factor, determinants.

JEL Classification: E58, G21, G24.

Introduction

Research background. Mergers and acquisitions (M&As) are becoming an increasingly popular strategic option for organizations (McEntire and Bentley, 1996; Marks and Mirvis, 2001; Chew and Sharma, 2005; Wickramasinghe and Karunaratne, 2009). Taiwan has always been an export-oriented country, and therefore, the companies in Taiwan need to begin internationalizing at a faster pace to adapt to the harsher competitive environment, thus improving their competitiveness worldwide. After the Asian financial crisis, the currencies of the Asian countries depreciated, which made companies in Europe and the US look like low-priced, high-quality targets to Asian companies. At the same time, companies in Asia were willing to accept lower merger offers because they urgently needed capital and better performance, and a wave of mergers resulted. After the establishment of the Financial Institution Merger Act, the amount of mergers further increased in the banking industry in Taiwan. Many banks contemplated mergers to increase their competitiveness. Mergers created the advantage of increased resource capacity and addressed key success factors (KSFs) in the industry, thereby creating higher value added for the financial institutions in question. The banks evaluated their own resource capacity and chose whether to participate in mergers based on whether a merger would provide a necessary improvement in their competitiveness. However, postmerger firm performance was not always as good as expected, and this generated many problems associated with integration. Those integration problems were the inspiration for this research.

Purpose of the research. As Wickramasinghe and Karunaratne (2009) have suggested, there is a growing body of studies related to different aspects of M&As (Griffith, 2000; Conyon, Girna, Thompson and Wright, 2002; Appelbaum and Gandell, 2003; Gugler and Yurtoglu, 2004). However, most research tends to be framed in terms of the discipline from which it originates, whether it is economics, finance, organizational behavior, or strategic management (Papadakis, 2005).

An in-depth study of KSFs influencing the success of mergers by financial holding companies (FHCs) is important for both theoretical exploration and business practice. The main objectives of this research are: (1) construct an analytical typology of KSFs influencing the success of mergers by FHCs; (2) employ a rigorous research process using qualitative and quantitative methods in order to produce an in-depth study into the nature and discuss the relative importance of the KSFs influencing the success of mergers by FHCs; (3) based on the above-mentioned analytical framework establishing process and results, make suggestions for future researchers and recommend useful strategies for enterprises.
1. Literature review

M&As are some of the most important ways for companies to create value because they allow them access to new capabilities and markets. Mergers have also been touted as a way for firms to adjust to changes in their competitive environment. Scholars in the fields of economics and strategic management see acquisitions as a primary mechanism for firm survival and growth (Ravenscraft and Scherer, 1987; Bowman and Singh, 1993; Jensen, 1993; Mitchell, 1994; Rosenkopf and Nerkar, 2001; Karim and Mitchell, 2000; Capron and Guille, 2009). The behavioral research stream deals mainly with corporate culture (Burns and Rosen, 1997; Bijlsma-Frankema, 2001; Stahl and Voigt, 2004; Riad, 2007), corporate structure (Mizrui, 1985), and human resource policies (Kerr, 1995). Before exploring the FHCs in Taiwan, one should review the prior studies of the KSFs of mergers, other variables affecting merger success, and merger benefits.

1.1. Integrating problems of merger. As Galpin and Robinson (1997) have suggested, postmerger integration involves changes in management. On this subject, Youndt (1994) has more specifically advocated that the due date is the first time for reformulation.

1.1.1. Influence of mergers on employee behavior. Stabilizing the core human resources of the acquired company and eliminating mental pressure is the foremost task in human resource integration. The acquiring company should strive to support the personnel of the acquired company and make an effort to neutralize the conflicts that may result from the differences in the two firms’ organizational culture. Furthermore, the acquiring firm should establish a new organizational culture to improve the effects of integration. The executive managers at the acquired company may experience strong feelings of uncertainty and may even leave the acquired company as a result, causing brain drain.

1.1.2. Merger and communication. The acquiring firm should offer the employees information about human resources: Who is the new chief of the company? How will the management philosophy work in the future? The acquiring firm should also address employee worries about matters such as downsizing, compensation plans, individual career development and other issues that greatly affect employees.

1.1.3. Merger and organizational culture. Regardless of the stability and development level of the organization or the mindset of the employees involved in a merger, organizational culture can be essential. There are two kinds of effects of organizational culture: internal and external. Internally, organizational culture helps to establish the firm mission, helping the different branches of the organization unify in the face of challenges. Externally, organizational culture helps to define the unique climate of the firm that makes it different from other organizations.

1.1.4. Mergers and human resources management. Galpin suggests that whether human resources and company culture have been integrated is a key factor in the smooth execution of mergers. This research has revealed 11 factors that influence human resource management: employee retention, brain drain after mergers, communication after mergers, changes in human resource systems, personnel integration, mobilization and arrangement, mixed framing and personnel performance, recruitment and audits, education and training, performance evaluations, compensation and bonuses and overall welfare.

1.2. Benefits of mergers. Previous research suggests that many banks merge for the purpose of improving efficiency. For instance, the findings from Berger and Humphrey’s (1992) study of fifty-seven US banking megamergers from 1981 to 1989 support this conclusion (Al-Sharkas, Hassan and Lawrence, 2008). A number of studies have measured changes in the cost efficiency after mergers. Most of the studies show very little improvement in cost efficiency as a result of the mergers of the 1980s – improvements on the order of 5% of costs or less were typical (Berger and Humphrey, 1992; Rhoades, 1993; Al-Sharkas, Hassan and Lawrence, 2008). When the efficacy or efficiency of two companies after consolidation is far better than it is when they operated alone, this is what is called synergy in efficiency theory. Kitching (1967) has suggested that the types of synergy produced when companies merge are operating synergy, financial synergy and market synergy.

1.2.1. Operating synergy. The most recent analyses indicate that even fairly large banks are failing to fully capitalize on scale economics (Berger and Mester, 1997; Berger and Humphrey, 1997; Al-Sharkas, Hassan and Lawrence, 2008). Firms can achieve their optimum scale through mergers. After the merger process, increasing the quantity of a certain product or service provided reduces average cost because it allows efficient capital use and production activity, which in turn leads to greater competitiveness. Williamson (1981) suggests that parallel and upstream or downstream companies in the same industry can be integrated through mergers to
reduce expenditures related to marketing, checking, storage and delivery. Some studies from the 1980s and early 1990s indicate that mergers have improved profit efficiency and that this improvement can be linked to the increased diversification of risk and an improved tradeoff between risk and expected return (Akhavein, Berger and Humphrey, 1997; Berger, 1998; Al-Sharkas, Hassan and Lawrence, 2008). The FHCs with better management efficiency can also improve profits by acquiring financial institutions with worse management ability.

1.2.2. Financial synergy. Lewellen (1971) suggests that companies that have undergone mergers can achieve a lower borrowing rate than before the merger. Creditors may also be more willing to provide a higher volume of financing to firms that have undergone mergers. The results of studies using 1990s data are mixed but sometimes indicate greater cost efficiency gains (Berger and Humphrey, 1992; Roades, 1993; Al-Sharkas, Hassan and Lawrence, 2008). Mergers allow companies to take advantage of the diversification effect of systematic risk and reduce the influence of the transition on the business environment for FHCs. Companies can merge to diversify risk, for instance, in the financial industry, because different institutions experience different cash flows at different times, risk can be diversified through the effective adjustment of cash flows after a merger. Relaxed regulations can help consolidated companies or FHCs use the consolidated tax system to prevent the amount of loss carry over due to consolidation from decreasing.

1.2.3. Market synergy. When a merger has been completed, the acquiring company can take advantage of the existing marketing channels, resources, equipment and techniques of the acquired company. This can allow firms to rapidly enter a new market or new geographic region, integrate upstream and downstream companies and reduce business risk through new business opportunities and more diverse income sources. Mergers can help improve the apparent goodwill of a company and help them to acquire greater consumer trust. Mergers can increase organizational and management flexibility in the financial environment. Merged banks can provide their customers with various financial commodities, satisfying the needs of clients all at once.

2. Research design

2.1. Research framework. The foundation of the KSFs influencing the success of mergers by FHCs model developed in the present study is mainly based on Ravenscraft and Scherer (1987), Mitchell (1994), Berger and Humphrey (1992), Bowman and Singh (1993), Jensen (1993), Roades (1993), Karim and Mitchell (2000), Rosenkopf and Nerkar (2001), Al-Sharkas, Hassan and Lawrence (2008), Capron and Guille (2009). The preliminary KSFs model was established through a study of in-depth literature interviews with experts, assessors and subjects, together with focus group techniques (FGT) to compile the views and opinions on the dimensions and measurement indicators for the KSFs of mergers by FHCs. Based on the literature review and the work of relevant scholars, in this study, the benefits, challenges and KSFs associated with mergers were determined and the relative weights of each dimension and system using the analytic hierarchy process (AHP) were calculated. The research framework for this study is shown in Figure 1.
2.2. Selection of research subjects. The main focus of this research was the FHCs in Taiwan. Because the operation coverage of FHCs was broad, this research involved structural interviews with mid- and executive-level directors of FHCs as well as a questionnaire. The research is built on the literature review and secondary data observation as a means of understanding the problem and then focused on information gathering, interviews and questionnaires. The research subjects were acquiring companies, and the aims were to better understand the merger process and to further analyze and discuss the benefits of mergers, integrating questions and internal organization integration during mergers.

3. Analysis result

3.1. Case interview and analysis. 3.1.1. Interview outline. Content analysis. This research isolated three important factors related to mergers: the problems with integration, the benefits of mergers and the KSFs. Regarding the problems of integration, the main dimensions of the research were as follows: the influence of mergers on employee behavior, mergers and communication, mergers and organizational culture, and mergers and human resource management. The subjects were asked which one of the above was most significant and why. Regarding the benefits of integration, the main dimensions of the research were operating synergy, financial synergy and market synergy, and the subjects were asked which was most significant and why. With respect to the KSFs, this research considered organizational capacity, organizational culture and synergy created by mergers, and again, the subjects were asked which one of the above was most significant and why.

The companies in question typically used mergers to acquire external resources, to increase their size rapidly and to become more competitive. The motives for mergers and to what degree complementary characteristics were a focus of companies contemplating mergers were investigated.

3.1.2. Interview of analysis results. This research analyzed the problems with mergers by FSCs in Taiwan by considering the associated problems, benefits and KSFs. The results obtained through the interviews and questionnaires are presented separately to clarify the relationship between them.

With regard to the challenges of mergers, it emerged that the cultural environments of the merging firms was not initially an important factor. The future of a company should be announced publicly at the outset to let its employees know why the merger is occurring and what changes will be occurring in the future. This will influence the values and behaviors of the employees. If this does not occur, the behaviors of employees may change in undesirable ways, and further problems with communication may arise. It is true that each profession has its own characteristics, and both the mainstream culture and subcultures should be respected. Because the core culture is unchangeable, the integration of organizational cultures should be the aim of the firm from the beginning. The problem of brain drain was also significant in these cases. The departure of employees might be active or passive and might not necessarily take place because of a merger. The corresponding question becomes how to make the choices, changes and arrangements that will help the firm to retain the personnel appropriate for the job and eliminate redundant employees automatically.

With respect to the benefits of mergers, it is clear that operating synergy can develop through reorganization and adaptation. Regardless of ROE or EPS, the most important benefit was increased profits in these cases. Success in the market requires the exchange of value with others, and this occurred through resource sharing, increases in current accounts, improved product penetration and increased scope. In the end, these results also created financial synergy.

Regarding KSFs, it emerged that IT management teams needed to achieve total integration. The existence of relationships between different areas of operations and organizational flexibility may also create operating synergy. As a result, system integrity influences operating efficiency by decreasing risk and the cost of capital, reducing total resource costs and creating better business efficiency. The control mechanism governing the organizational chain of command must be totally clear for the production efficacy of the organization to improve. Therefore, when rebuilding an organization, it is important to evaluate the internal and external aspects of the organization and to determine whether the productivity and efficacy will improve as a result of the proposed changes.

3.2. Empirical of analysis results. The subjects of this research were 27 mid- and executive-level managers from FHCs. The results of the AHP analysis of the questionnaires are shown in Figure 2. After compiling experts’ opinions and undertaking AHP analysis, the research’s hierarchical structure was established to contain two levels: integrating problem, benefit and KSFs as system dimensions at the first level; main dimensions at the second level (10 dimensions). In order to verify whether the analytical hierarchy process method was congruous with the assumptions, the consistence ratio (C.R.) was used according to the suggestion by Saaty (1980). The result, $C.R. \leq 0.1$, indicates that the consistency is at an acceptable level.
In Figure 2, the most crucial problems related to integration, those with the highest relative weight, are mergers and organizational culture (0.299) and mergers and communication (0.272). The most crucial benefit, the one with the highest relative weight, is operating synergy (0.503), followed by financial synergy (0.270). The most crucial KSFs are organizational capacity (0.417) and organizational culture (0.339).

Figure 3 reflects the most crucial KSFs – again, those with the highest relative weight. Not only organizational capacity (0.417) and organizational culture (0.339) are crucial in these mergers, but synergy from mergers (0.245) is also essential. The most crucial secondary dimension of organizational capacity during these mergers are business performance (0.139), followed by overall efficiency (0.073). In turn, the most crucial secondary dimension of organizational culture is the centripetal force of the organization (0.108), followed by success in attracting talent (0.066).

According to the results of the empirical analysis, the following conclusions can be made.

The interviewees in this study were executive directors, and those who received questionnaires were middle- and executive-level managers. Both considered mergers and organizational culture to be the most crucial to the problem of integration. The executive directors considered financial synergy to be the most important benefit of mergers, whereas mid- and executive-level managers suggested that operating synergy was the most crucial benefit. Most of the executive directors believed that organizational culture was the most important KSF, whereas the mid- and executive-level managers indicated that organizational capacity was the most significant KSF.

The results of the analysis above indicate that the subjects held consistent opinions regarding most aspects of each dimension but that those at different levels of management also held different opinions on certain topics.
Conclusions
The aim of this research was to research the problems, benefits and KSFs associated with mergers by FHCs in Taiwan. The importance of each subitem within the main dimensions was determined via a questionnaire survey and further analyzed using AHP. The importance of the various dimensions was as follows.

The evaluation model for FHCs in Taiwan was based on research by prior scholars. After continuous testing and modifications, a model was developed that included three dimensions: the challenges, benefits and KSFs associated with mergers. The study also considered the integration of managerial behaviors and value creation during the merger process from multiple viewpoints.

In the case study, the AHP was used to evaluate the results. These findings, along with the qualitative results of the interviews, the literature review and the Delphi method analysis, indicated that “mergers and organizational culture” was the most significant subdimension of the main dimension (the question aspect). In his interview, director A commented, “Because the companies with similar organizational culture had a greater success rate in mergers, I believe that the organizational culture could best represent the prospect and philosophy of a company. Once the business philosophies were close, the members within the organizations would have a relatively higher business performance.” Director B made similar comments: “The members in the companies with similar organizational cultures would have similar thoughts and actions after the merger. On the one hand, the company could soothe their employees emotionally. On the other hand, this could increase the identification of employees toward the company and let them work collectively on the business goal.” Director C suggested that the culture might influence the overall image of the company through value and that this was a process influenced by the formation of policy that was easily produced from practice and action and that even changed with the distinction of ideology out of confidence crisis.

According to the empirical results of this research, the three main systematic dimensions of mergers in the financial industry are the problems of integration, the benefits of integration, and the KSFs. Although the quality of integration determined the organizational performance after consolidation, many companies typically failed after mergers because they were unable to successfully integrate two heterogeneous cultures.

To avoid such problems, acquiring companies should respect the independence of the acquired companies. Furthermore, during the transitional period after a merger, the acquiring company should select the best approach to consolidating the companies’ technical skills and other knowledge. The firm should also work to achieve the greatest synergy possible between the two firms in terms of organizational culture. To solve the problems associated with integration, the organizational culture must absolutely be addressed, although restructuring and reorganization of the management, redefining the roles of employees, and refining values and work patterns were also relatively important to successful integration in the cases studied. Regarding the benefits of integration, this research has indicated that operating and market synergy are less significant than financial synergy in determining the future of a company. However, the accommodation of flows and the establishment of operating synergy in connection with market synergy are certainly important to firm success after a merger. With respect to the KSFs, one can conclude that because the external environment is always changing, the KSFs are difficult for firms to properly understand. Under such conditions, the analysis of internal resources and capacity may be more appropriate as the foundation for company positioning and growth.

References