

RISKS OF MERGERS AND ACQUISITIONS PROCESSES

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Skitsko V. I., Huzenko O. Yu. Risks of Mergers and Acquisitions Processes

Despite structural changes both in the economies of individual countries and in the world at large, the size of the merger/acquisition market is not declining and is tending to grow further. However, uncertainty in the global environment increases the importance of proper analysis, assessment and risk management in merger/acquisition transactions. Using the relevant research and publications by various authors, we have built a general ranking of the significance of merger and acquisition risks according to phases of the indicated process, with comparison of individual risk ratings, based on the publications by authors from Central and Eastern Europe and other countries around the world. The ranking of risks and threats of mergers/acquisitions proposed in this work can be considered one of the most complete for today. Further research needs to focus on the analysis, evaluation, and modeling of merger/acquisition risks, which occupy the top of the ranking, presented by the article.

Keywords: risks, threats, mergers and acquisitions, rating.

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Скіцько В. І., Гузенко О. Ю. Ризики процесів злиття та поглинання
Незважаючи на структурні зрушення як в економіках окремих країн, так і у світі в цілому, обсяг ринку злиттів/поглинань не зменшується і має тенденцію до подальшого зростання. Однак невизначеність у глобальному середовищі зумовлює зростання важливості коректного аналізу, оцінювання та управління ризиками при укладанні угод злиття/поглинання. Використовуючи актуальні дослідження та публікації різних авторів, нами побудовано загальний рейтинг значущості ризиків у сфері злиттів та поглинань за фазами даного процесу, здійснено порівняння окремих рейтингів ризиків, побудованих на основі робіт авторів з Центральної та Східної Європи та інших країн світу. Запропонований рейтинг значущості ризиків та загроз сфери злиттів/поглинань можна вважати одним із найповніших наразі. У подальших дослідженнях потрібно зосередитися на аналізі, оцінюванні та моделюванні ризиків сфери злиттів/поглинань, які займають верхні місця побудованого в роботі рейтингу.

Ключові слова: ризики, загрози, поглинання та злиття, рейтинг.

Табл.: 4. **Бібл.:** 18.

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Скіцько В. И., Гузенко О. Ю. Риски процессов слияния и поглощения
Несмотря на структурные сдвиги как в экономиках отдельных стран, так и в мире в целом, объем рынка слияний/поглощений не уменьшается и имеет тенденцию к дальнейшему росту. Однако неопределенность в глобальной среде вызывает рост важности корректного анализа, оценки и управления рисками при совершении сделок слияния/поглощения. Используя актуальные исследования и публикации различных авторов, нами построен общий рейтинг значимости рисков в сфере слияний и поглощений по фазам данного процесса, проведено сравнение отдельных рейтингов рисков, построенных на основе работ авторов из Центральной и Восточной Европы и других стран мира. Предложенный в данной работе рейтинг значимости рисков и угроз сферы слияний/поглощений можно считать одним из самых полных на сегодня. В дальнейших исследованиях нужно сосредоточиться на анализе, оценке и моделировании рисков сферы слияний/поглощений, которые занимают верхние места построенного в работе рейтинга.

Ключевые слова: риски, угрозы, слияния и поглощения, рейтинг.

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The main goal of entrepreneurship is maximization of financial returns. Nowadays maintaining profit on the desired level and its increasing is possible through many ways, i. e. company expanding, customer base growth, etc. In the context of globalization, expansion could be held not only with the help of one company, but also in an even better way – through merger with some enterprise or its acquisition. The market for mergers and acquisitions (M&A – the common abbreviation, which will be used in the article) has been developing actively during the

last decade and this trend will continue [1; 2]. Whilst earlier mergers and acquisitions had been held in the context of confidence in the corporate and political landscape in a particular country or the whole world, the year of 2016 totally changed that. It showed that such conditions are not obligatory for M&A successful development. Despite of the very high level of uncertainty in the world, 2016 year became the second-best year by deals value since the financial crisis [2].

There are plenty of reasons why companies do choose M&A. Synergy effect can be a result of making M&A deals

for many companies, for which such results are unachievable in separate functioning. M&A deals help companies to get a monopoly position, achieve economies of scale (for example, production volumes increase may lead to a reduction of net cost per item), etc. Tax changes are also an important aspect in M&A. There is even special type of M&A called “tax inversion”, which means that the main reason of integration for a bigger company is escaping taxes [3].

Despite a host of advantages and opportunities, M&A deals also have some drawbacks. To be more specific, for such deals the problem of risk analysis, assessment and management is usually crucial. For example, nearly half of M&A deals failed [4] due to wrong risk assessment during making deals.

Different aspects of M&A deals considering risks are reflected in studies of such Ukrainian and foreign economists as I. Ivanenko [5], V. Makedon [6], Yu. Rybytska [7], E. Allenstrom [8], A. Conkle [9], K. Kocourek [10], H. Ridgeway [11], etc. Big advisory companies as Baker&McKenzie, Deloitte and PwC publish regular up-to-date researches where potential M&A risks are observed [1; 12; 13]. In these researches risks are thoroughly described, but there is a lack of well-grounded ratings with experts’ opinions taken into account. However, all these works could be a solid base for creating a generalized rating of M&A risks and associated threats. It gives an opportunity to combine and consider opinions of many experts in this sphere. Moreover, a variety of studies help to see the difference between foreign and Ukrainian scientists’ points of view.

The *main aim* of the article is examination and analysis of current studies made by Ukrainian and foreign scientists and experts in M&A risks area; creating a general rating of importance of M&A risks and associated threats based on the reviewed researches; comparison of separate ratings of M&A risks (and associated threats) based on different studies of scientists and experts.

We will form our general rating of risk importance in a precise way that will be described below.

Each of the investigated studies will be analyzed as a distinct opinion on such problem as M&A risk and associated threats ranking. For risk importance evaluation a rating scale from 1 to 5 points will be used, where 1 point is “very low level of particular M&A risk importance”, 2 points – “low level of particular M&A risk importance”, 3 points – “medium level of particular M&A risk importance”, 4 points – “high level of particular M&A risk importance”, 5 points – “very high level of particular M&A risk importance”. Each risk, which is mentioned in a particular research, will get the appropriate mark. It is based on the statistics provided in the study about a particular risk and described by the words that the author used to characterize this risk type.

The studies used in this research could be divided into two categories: 1) investigations with a statistically based approach to risk importance evaluation (for example, a poll among top managers and the provided statistics); 2) investigations where results are based on the authors’ opinion without statistical demonstration, and the risk is described mainly by special adjectives that reflect its importance. In each research [5–18] M&A risks and associated threats

were defined and then they got relevant points according to previously described rating scale (based on the authors’ rating or verbal description). If there were no rankings in some studies: no special adjectives (i.e. the most important, significant, high, the most likely, unlikely) and no quantitative characteristics, we presume that the mentioned risk has medium importance level equal to 3 points. As a result, we get M&A risks and associated threats list for each study [5–18] with relevant marks from 1 to 5.

Furthermore, all M&A risks and associated threats were divided into 4 groups according to the stages of M&A process where risks could occur: risks emerging at the phase of due diligence (*DD*), integration planning (*IP*), integration execution (*IE*) and those that could occur at all stages (*AP – all phases*). Then the points for each risk were summed up and we got the total mark, which reflected not only a number of mentions of a particular risk, but also – whether the authors consider it important or not. Higher points for a particular M&A risk mean its higher importance. Table 1 is a result of our examinations.

The analysis of some representative studies used in the rating of risks and associated threats is presented below (*Table 1*).

Among the analyzed researches there were some articles with only one risk mentioned as the most significant. For example, Ashley Armstrong [14] defined that for global mergers and acquisitions the most important danger is an increasing regulatory interference. In support of this point of view, the author provided the following statistics: nearly a third of deal-makers considered regulatory barriers the most challenging factor in recent deals whilst three-fourth of them blamed competition regulators for their failed deals [14]. Therefore the risk of government interference and its increasing regulation got 5 points – “very high level of M&A risk importance”.

Holly Ridgeway in her article [11] substantiated the fact that the biggest threat for M&A is a cyber-risk. Cyber-risk is the only risk that is mentioned in the article [11] and, according to the author, this risk is the most significant in M&A. That is why in our rating this risk receives 5 points – “very high level of M&A risk importance”.

Magazine CFO.com ranged risks and formed the list of TOP-15 most important M&A risks where the first 3 places are occupied by risks of deal overestimation, unsatisfied operational diligence, poor transparency of the deal strategy and its inadequate focus [15]. These risks got 5 points in our ranking. The authors of Magazine placed on the positions 4-6 the risks of wrong current valuations, culture assimilation challenges, fuzzy growth strategy and employee anxiety, morale, and/or engagement issues. In our rating those risks got 4 points. The risks of limited access to a target company, underestimation of time and resources needed for synergy and insufficient due diligence accuracy are even less significant (8–10 positions) [15]. Therefore, in our ranking, these risks got 3 points. The places 11–13 are taken by such risks as underestimation of integration work, lack of synergy in operational team priorities and operating capability of the target company management team [15]. They are considered as risks with low significance that is why in our rating

Table 1

M&A risks and associated threats ranking by M&A stages

M&A phases	M&A risks	Verdiev D. [16]	Ivanenko I. [5]	Makedon V. [6]	Rybytska Yu. [7]	Allenstrom E. [8]	Alloca S. [15]	Armstrong A. [14]	Conkle A. [9]	PwC [13]	Provititi Inc. [18]	Kocourek K. [10]	Pelland D. [17]	Deloitte [12]	Ridgeway H. [11]	Total point*
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
AP	Risks associated with ineffective management	2		4	4	3				3	3					19
AP	Risks caused by abnormal or unclear duties, ineffective communication	3		3		3										9
AP	Lack of accounting experience in integrations	2					3				3					8
AP	Risks associated with corruption					3						4				7
AP	Drawbacks and inconsistencies in control procedures of both enterprises	2					1					3				6
AP	Cyber-risk														5	5
DD	Incorrect deal valuation				4		5			3	3		5	3		23
DD	Ineffective due diligence						5					4		2		11
DD	Costs underestimation				4		3							3		10
DD	Profits overestimation						4									4
DD	Significant differences between the company strategy and the deal strategy	3	3													6
IP	Risks associated with an insufficiently planned strategy			4	4	3	5			3	3			2		24
IP	Risks associated with incorrect estimation and an incomplete list of basic opportunities	2			5		3		3							13
IP	M&A strategy doesn't consider legislative changes	3			3	3								3		12
IP	Risks associated with synergy evaporation (efforts needed for processes/systems consolidation are bigger than expected)			4			2			3				3		12
IP	Underestimated capital needs					3	4							3		10
IP	M&A strategy doesn't consider market changes, switch in customers preferences	3	3			3										9
IP	M&A strategy doesn't consider advantages and disadvantages of vertical/horizontal expansion	3									3					6
IP	Lack of effective management of stock market and investors' expectations	2														2
IP	Risks connected with lack of managerial participation in filters creation	2														2

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
IP	Risks associated with emphasis on separate deals without portfolios of opportunities consideration	1														1
IE	Significant cultural differences	3	3	3	3		4		3	3			4	4		30
IE	Problems with informational systems integration	4	3		3	3	1		3		3					20
IE	Employee anxiety, morale, and/or engagement issues					3	3				4		4	2		16
IE	Unexpected market changes	3			3	3				3				3		15
IE	Regulatory interference; unknown violation of the antitrust law	2			3			5				4				14
IE	Risks associated with taxation	5			3	3						3				14
IE	Customers attrition				3	3					4			3		13
IE	Incompatibility and complexity of structures within the company (managerial, legal and organizational)	3	3						3							9
IE	Financial position deterioration (of one of the companies)				3						4					7
IE	Incompatibility of financial/legal structures of two companies	1	3						3							7
IE	Operational risk: exceeding the company's optimum size				3	3										6
IE	Ineffective intellectual property management	3				3										6
IE	Different standards of financial statements	2							3							5
IE	For M&A of companies from different countries: risks connected with employees relocation												4			4
IE	Ineffective management of obligations and litigations	4														4
IE	Duplicated contracts with suppliers	4														4
IE	Limited experience, which may lead to inability to identify and enforce legislative and regulatory requirements	1								3						4
IE	Old products portfolio					3										3
IE	Weakening of products quality control					3										3
IE	Reputation risks											3				3
IE	Risks connected with debt, capital and liquidity management	2														2
IE	Undefined debts and/or financial consequences of their non-fulfillment	1														1

Note: * – Total points were calculated as sum $\sum_{i=1}^n m_i$, where m_i – risk importance mark, according to the study i, n – number of researches.

Source: compiled by the authors based on [5–18].

those risks got 2 points. The risks connected with costs for IT infrastructure change, IT infrastructure capabilities and those connected with contradictory planning and execution were placed on the lowest places in the CFO.com ranking [15], so they got 1 point in our ranking.

Deloitte experts in the article [12] proposed to rank risks according to the survey among CEOs and CFOs. In accordance with the answers concerning the most crucial factor for M&A transactions, the most often-cited risk is a post-deal integration failure (indicated by more than 35% of managers) [12], but it includes many types of risks, so it would not be included into our research as a separate risk. From 10% to 20% of top-managers mentioned the regulatory and legal environment, economic uncertainty, inaccurate initial valuation [12]. In our rating we assume that these risks achieve 3 points. While answering the question of which risk is the most significant during the integration, more than 40 % of officers voted for critical cultural differences. That is why, this risk got 4 points in our ranking. At the same time synergy capture and consumer retention got next places (with approximately 20% of one of the groups' votes) [12]. In our rating risks caused by the probable appearance of these threats got 3 points.

Having analyzed a few studies of Ukrainian scientists and experts about different aspects of M&A risks and associated threats, we can summarize that the majority of them defined the most important risks in the same way as their foreign colleagues. When defining success factors, V. Makedon in his study [6] referred to KPMG investigation and named 2 groups (that could be also considered as risks): "hard" and "soft". Among the risks in the hard group there is a risk of wrong merger synergy estimation, which can lead to insufficient organizational and financial effect from a deal. At the same time, "soft" group includes risks connected with management team selection, poorly organized communications and cultural differences. The author provides statistics that shows: more than 65 % of the interviewed companies consider management team selection and integration planning as the most important factors. Less significant but still driving factors are cultural differences minimization (more than 45% of companies consider this factor as important) and effective communication when adjusting the merged company (more than 40 % of the companies voted for this risk) [6]. Since in this study management choice and effective integration plan building were defined as the most significant factors, they got 4 points as well as synergy evaporation that was considered as the main risk from the "hard" group, whilst cultural differences and effective communication adjusts got 3 points.

Yu. Rybytska [7] among the threats to successful M&A deals named risks mentioned by competent advisory companies and in foreign studies as well. She divided risks by mergers/acquisitions stages. Each risk was added to that stage at which it is more likely to occur. The author adds that the main threats (caused by corresponding risks) include strategy absence, underestimation of potential losses, lack of control, higher anxiety among employees and conscious biased estimation (i. e. during business-plan constructing too optimistic managers could negatively affect final re-

sult). That is why those risks got 4 points. From the authors' point of view, the main sources of risks are incorrect risk valuation and potential benefits loss [7]. The corresponding risks received 5 points. Other risks, which were mentioned in the article [7] but not described with patterns for forming comparatives and superlatives, got 3 points. Risks were classified according to merger/acquisition stage at which they occur. Two stages were defined: strategy creation and its implementation. Among the risks coming from the strategy building stage, inadequate deal price, incorrect business attractiveness valuation, wrong additional value of investments estimation and improper estimation of links between companies were mentioned. Regarding the strategy execution stage, probable risks vary significantly due to characteristics of the risks. As a result, they were additionally grouped. In the first group there are risks connected with shareholders capital. Thus, there is a probability that business value becomes lower than the sum of separate values of 2 companies. The second group includes risks directly connected with enterprise resources. The risks can considerably vary there, so the author additionally divided them into 3 groups: operational risks (i.e. negative scale effect), infrastructure risks (lower effectiveness because of mistakes during integration: clients and/or employees loss, impossibility to merge corporate cultures, high costs for IS integration), financial risks (aggravation of the financial performance due to the ineffective merge of financial flows). The third group of risks concerning the strategy implementation stage includes risks connected with external influence. Changes in the legislation, competitors' activity and other changes in the government regulation (i.e. in the antitrust law) can lead to lower deal effectiveness [7].

A similar approach to risks classification by project stages was used in D. Verdiev's study [16], while the analysis itself was based on Deloitte report. However, in contrast to Yu. Rybytska, D. Verdiev classified risks by 5 stages: strategy building, analysis of target assets, pre-investment analysis, deal-making, integration. D. Verdiev estimated the analyzed risks with the help of 2 criteria: influence level and likelihood. There are 3 values for these criteria: High, Medium, Low. Thus, final risk importance could get one of 5 values: very high, high, medium, low, very low [16]. This approach fully matches the risk ranking methodology chosen in our article. Turning to the rating point, risk with very high importance got 5 points while that with very low significance – 1 point.

D. Pelland in the abstract to the survey conducted by him [17] wrote that the most important risk in the studied projects is connected with incorrect deal valuation. That is why this risk got 5 points in our ranking, whilst all the other mentioned risks – 4 points. K. Kocourek in article [10] mentioned also risks that are connected with institutional inflexibility (that is especially crucial for Central and Eastern Europe), corruption, ineffective due diligence (rigorous due diligence was defined as the most effective strategy for identifying and managing integrity risks) [10]. These risks got 4 points, while all the others mentioned in the article – 3 points.

In some articles risks and threats (that could result in relevant risks) were mentioned without ranking, statistics and verbal descriptions, which make risk importance evaluation based on the authors' way of thinking possible. As a result, all threats and appropriate risks specified in the studies of such authors as I. Ivanenko [5], E. Allenstrom [8], A. Conkle [9] and investigations of such companies as Protiviti [18] and PwC [13] got 3 points.

Based on Table 1 a more general ranking can be built, which is presented in Table 2.

Having analyzed the results, we can notice that 7 risks among 43 got the highest possible rating according to the authors' descriptions (5 points). However, that was not the key factor that resulted in getting a place in the TOP list. Only 5 of 7 risks with the highest mark got in TOP-11. Other 2 risks (cyber-risk and ineffective due diligence) didn't get the same high mark in other investigations or even was not mentioned in any other research. It is needless to

say that the risk from the 1st place – “Significant cultural differences” is the most crucial for mergers/acquisitions of companies from different countries. Nevertheless, this risk includes also cultural differences between companies in the same country. It could occur during integration of companies from the same industry, with the same position in a production cycle, when employees do not accept another corporate culture and resist it.

The most important M&A risks that were chosen from the articles written by scientists from Central and Eastern Europe (CEE) (D. Verdiev [16], I. Ivanenko [5], V. Makedon [6], Yu. Rybytska [7], K. Kocourek [10]) are presented in Table 3. The most considerable M&A risks that were mentioned by experts from other countries, mainly the USA and European countries (E. Allenstrom [8], S. Alloca [15], A. Armstrong [14], A. Conkle [9], PwC [13], Protivity Inc. [18], D. Pelland [17], Deloitte [12], H. Ridgeway [11]) are presented in Table 4.

Table 2

TOP-11 most important risks and associated threats in M&A

Rank	M&A risks and associated threats	Number of points
1	Significant cultural differences	30
2	Risks associated with an insufficiently planned strategy	24
3	Incorrect deal valuation	23
4	Problems with informational systems integration	20
5	Risks associated with ineffective management	19
6	Employee anxiety, morale, and/or engagement issues	16
7	Unexpected market changes	15
8	Regulatory interference, unknown violation of antitrust law	14
9	Risks connected with taxation	14
10	Customers attrition	13
11	Risks associated with incorrect estimation and an incomplete list of basic opportunities	13

Source: compiled by the authors based on [5–18].

Table 3

TOP-8 most important risks and associated threats in M&A in CEE region

Rank	M&A risks and associated threats	Number of points
1	Significant cultural differences	12
2	Risks connected with taxation	11
3	Problems with informational systems integration	10
4	Regulatory interference, unknown violation of antitrust law	9
5	Risks associated with an insufficiently planned strategy	8
6	Incorrect estimation and an incomplete list of basic opportunities	7
7	M&A strategy doesn't consider legislative changes	6
8	Unexpected market changes	6

Source: compiled by authors based on [5–7; 10; 16].

Table 4

TOP-9 most important M&A risks and associated threats in the world

Rank	M&A risks and associated threats	Number of points
1	Incorrect deal valuation	19
2	Significant cultural differences	18
3	Risks associated with an insufficiently planned strategy	16
4	Employee anxiety, morale, and/or engagement issues	16
5	Underestimated capital needs	10
6	Problems with informational systems integration	10
7	Customers attrition	10
8	Ineffective management	9
9	Unexpected market changes	9

Source: compiled by the authors based on [8; 9; 11–15; 17; 18].

According to Tables 3 and 4, both scientific groups defined that such risks as “Significant cultural differences”, “Problems with informational systems integration”, “Inappropriate strategy planning” and “Unexpected market changes” have critical importance. These risks are quite general and can be found in all mergers/acquisitions deals. Scientists from Europe and the USA added to this list wrong deal valuation, capital needs underestimation, problems with employees, customer attrition and ineffective management. Compared to the researches of scientists from CEE, these risks are more business- and human-oriented. They pay more attention to clients, problems that employees can face due to these changes and such basic things as effective management and correct deal valuation. As for ranking according to the studies of CEE scientists, we see that the main emphasis was made on external challenges: taxation process, regulatory interference, unexpected changes in legislation. As a result, it can be claimed that during M&A consolidation in CEE companies faced an unexpected regulatory influence, which negatively affected the development of this segment in the region. At the same time in more developed countries, the most significant risks could be controlled and resulted from the company performance.

CONCLUSIONS

Conducted investigations showed that despite different changes in economics of particular countries as well as in the whole world, M&A deals value hasn't declined. Moreover, the problem of risk consideration became more crucial during M&A deal-making. Different authors proposed to consider different types of M&A risks. Having analyzed up-to-date investigations of M&A risks, we have built general M&A risk and associated threats importance ranking by M&A stages (see Table 1), TOP-11 most significant M&A risks and associated threats (see Table 2), provided comparison of separate M&A risks and associated threats rankings based on experts' opinions from CEE region (see Table 3) and other countries (see Table 4). The ranking of M&A risk importance, which is presented in Table 1, could be considered as one of the most comprehensive lists nowadays.

To our way of thinking, in further investigations it is necessary to concentrate on analysis, evaluation, modeling, and management of M&A risks that occupy the highest places in the compiled ranking. ■

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