



ALTERNATIVE INVESTING

A Clinical Exploration of Value Creation and Destruction in Acquisitions

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Chapter in Mergers and Productivity (University of Chicago, 2000)

When, how and why is value created or destroyed in mergers and acquisitions? How well do large sample performance measures reflect the underlying economics of the acquisitions? To answer these questions, we present clinical analyses of two acquisitions: Cooper Industries' acquisition of Cameron Iron Works in 1989 and Premark's acquisition of Florida Tile (formerly known as Sikes Corporation) in 1990.

These acquisitions were selected because they received very different stock price responses at the time of their announcement — Cooper Industries' acquisition was viewed positively, while Premark's acquisition of Florida Tile was viewed negatively. Despite the different market reactions, neither acquisition, ultimately, appears to have created value overall.

Taken together, our analyses suggest it is very difficult to implement a value-creating acquisition strategy. At the same time, we found that standard measures of operating performance used in large-sample studies are weakly correlated, if at all, with actual post-acquisition performance. Standard large-sample measures of operating performance — changes in operating margins and operating return on assets — indicate incorrectly that both acquisitions were successful.

Three lessons can be learned from these acquisitions:

- Acquirers must have a deep understanding of targets' businesses and industries when talks begin.
- Organizational design and structures are important sources of value in acquisitions.
- Incentives matter a great deal in determining the success of an acquisition.

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