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Effectiveness of Mergers and Acquisitions in Maltese Listed Companies: Financial Performance, Market Reactions and Shareholder Value

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Abstract

Purpose: W The objectives of the paper are to assess the effectiveness of mergers and acquisitions (M&A) in Maltese listed companies on acquirers' financial performance, to examine the market reactions to M&A announcements and to seek to obtain further insights on the perceived value arising from M&A activity.

Methodology: The *methodology* involved an Event Study on acquirers' share price movements and semi-structured interviews with relevant company representatives and Maltese stockbrokers.

Findings: The *findings* of the paper indicate that the few M&A cases wherein profitability -measured by growth in earnings before EBITDA - was enhanced and operational efficiency was improved took sound financing decisions despite facing challenging circumstances. The Maltese market was generally non-reactive within relatively short timeframes around announcements although with positive reactions within longer estimation periods. Furthermore, the perceived value by acquirers and stockbrokers varied considerably, yet such value was commonly attributed to effective due diligence and successful integration. The study therefore *concludes* that recent M& A activity in Malta has often been limited in its effectiveness towards enhancing shareholder value.

Originality/Value: the paper provides both corporate managers and stockbrokers with insights into M&A activity particularly in a small-state market.

Introduction

This research paper carefully examines whether merger and acquisition (M&A) activity constitutes an effective vehicle to enhance shareholder value. More specifically, this paper analyses the impact of M&A activity on the financial performance of acquiring companies, examines whether the local equity market's reaction to M&A announcements reflected a good indicator of M&A success/failure and obtains insights on the perceived value gained through M&As. The study focuses on acquiring companies listed on the Malta Stock Exchange (MSE) which undertook M&A deals between 2007 and 2016.

Given that research attempting to evaluate the financial implications of M&As within the Maltese setting is very limited, this study sheds light on characteristics attributable to a small market. This study could provide stock brokers (brokers), investors and corporate managers with insights into the dynamics of M&A activity.

1 Literature Review

One critical question is whether M&As actually manage to exploit synergistic effects to repay the premium paid for the target and generate greater shareholder returns. This is an empirical question which has resulted in a great deal of research evidence.

Several empirical approaches have been used to measure post-acquisition performance. However, different approaches developed over the past years do not necessarily give consistent conclusions, as they at times diverge in the judgement each seem to support as far as the effectiveness and efficiency of M&As are concerned. As stated by DePamphilis (2011), the two most common methods of analysing M&As are:

A. Accounting-based Measures
B. Event Study

1.1 Accounting-Based Measures

This approach resorts to an analysis of companies' financial statements and accounting ratios. Findings of numerous accounting-based studies are inconsistent, mainly because:

A. there is no agreement on a definite set of financial indicators/ratios that are to be included in such studies,
B. the outcome of the accounting approach seems to be dependent on the number of years included in the study.

According to Thanos and Papadakis (2011), the three most common categories of accounting measures applied globally consist of profitability measures (e.g. *return on assets*), growth measures (*sales, profits or asset growth*) and operating cash flow measures (e.g. $\frac{Cashflow}{Total\ Assets}$).

Table 1 includes findings of some of the studies grouped geographically.

Table 1: Findings on Use of Accounting-based Measures

Location	Results
US	Healy, Palepu and Ruback (1992) used cash flow indicators to conclude that operating performance of merged firms improved significantly post-acquisition. Linn and Switzer, (2001) supported Healy, Palepu and Ruback`s (1992) findings, namely that post-acquisition performance improved. However, the former also concluded that mergers financed by cash were more likely to improve pre-tax cash flows than mergers financed by equity.
Australia	Lau, Proimos and Wright (2008) conducted a more recent study, whereby they also utilised certain accounting operating performance measures to study Australian M&As. This study found some evidence of improved operating performance post-merger, since profitability, cash flow, efficiency and financial gearing measures were higher after the M&A.
Europe	Martynova, Oosting and Renneboog, (2006) investigated the long-term operating performance of European acquisitions. It was concluded that the decrease in profitability post-event was insignificant. However, it was found that hostile takeovers and deals made by tender offers significantly underperformed friendly takeovers and negotiated deals.
UK	Burt and Limmack (2003) analysed the operating cash flow of acquiring companies in the UK retail sector, whereby it was concluded that the operating performance of post-merger firms was higher than the pre-bid performance.
Emerging Capital Markets	Grigorieva and Petrunina (2015) used $\frac{EBITDA}{Sales}$ and economic profit measures to study a sample of M&As in developing countries. They concluded that accounting performance deteriorates post M&A. Thus, merged firms in such countries were unable to exploit expected synergies or to integrate successfully to achieve shareholder value.

1.2 Event Study

Under market efficiency conditions, the impact of any event is immediately reflected in its respective stock price (Sitthipongpanich, 2011). The Event Study examines whether upon the M&A announcement, stock returns of acquiring of target firms increase, thus generating abnormal returns (ARs). ARs are shareholder gains which exceed the expected return for a specific level of risk. This approach tries to eliminate stock price fluctuations unrelated to the acquisition by calculating the discrepancy between the actual return and the *"theoretical",* or expected, return which is estimated by the Capital Asset Pricing Model or by a stock index (Khanal, Mishra and Mottaleb, 2014).

US and UK literature support the conclusion that target companies experience statistically significant wealth gains. Conversely, the assessment of the returns for bidder firms` shareholders seems to be more ambiguous. Subeniotis *et al.* (2011) conclude that ARs of acquiring firms are insignificant and negative. However, there are also studies which report increases in the shareholder value of acquiring firms around M&A announcements. One such study is that by Khanal, Mishra and Mottaleb (2014), whereby results show that positive financial gains were realised by acquiring firms within four days, ten days as well as sixty days around M&A announcements.

Studies have shown that ARs vary when assessed within different timeframes. Mahate and Sudarsanam (2003) explored whether differences in ARs existed between the short and long-term performance of UK companies. They concluded that generally ARs in the short term are negative and returns are further worsened, resulting in long-term significant underperformance. Zaremba and Płotnicki (2016) also studied the short-term and the long-term effects of European M&As. Results have shown increasing and statistically significant ARs gained within two days after the M&A announcement. However, when capturing a longer time span, ARs decreased though they did not fall in negative territory.

1.3 Critical Success Factors

In view of the apparent mixed impacts of M&A activity, it becomes relevant to identify the critical factors from literature sources that can contribute towards the creation of a value-enhancing M&As.

KPMG (2016) identified a well-executed integration plan as the most important critical success factor of M&A, which, along with effective due diligence, makes it more probable that the deal meets its strategic objectives and improves shareholder return.

According to Rahman and Lambkin (2015) the main contributory factor to low M&A success is acquirers having to pay too high a premium for the target. Other reasons, provided by Burnie, Hurtt and Langsam, (2005) include executives rushing through the M&A process to make the deal; managers overpaying since assumptions about synergistic effects might be overoptimistic; high key employee turnover and major cultural differences between the two firms especially when physical and psychological space exist in cross-border M&A.

2 Methodology

Both primary and secondary data sources were used to reach the paper's objectives. To identify the companies involved in M&As and subject to analysis, financial reports of all Maltese listed entities for the period under review were examined. Company M&A announcements were also reviewed from the MSE website and the dates of such announcements were noted down. Upon identifying M&As, those transactions whose target revenue was less than 10% of that of the acquiring group's were considered as irrelevant for such analysis and were thus eliminated. Such elimination was made upon the view that any impact of immaterial M&As on the financial performance of the acquiring group is expected to be diluted away. This process identified eight relevant acquisitions undertaken by seven companies.

2.1 Research Instrument 1 – Review of Companies' Published Financial Information

Table 2 presents the ratios applied in this study to assess each of the key measures of financial performance. Such measures are based on a study by Lau et al., (2008).

Table 2: Measures for Financial Analysis

Profitability	Return on Assets (ROA) = $\frac{\boldsymbol{Profit\ after\ tax}}{\boldsymbol{Total\ assets}} * \mathbf{100\%}$
Growth	Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) Growth.
Operating Cash Flow (OCF)	$\frac{\boldsymbol{Pre - tax\ OCF}}{\boldsymbol{Opening\ book\ values\ of\ operating\ assets}} * \mathbf{100\%}$ Where: Pre-tax OCF was calculated as operating profit adjusted for non-cash elements within operating assets. Operating assets are defined as *"the total of net fixed assets plus current assets, less cash and marketable securities"* (Burt and Limmack, 2003, p.152).
Financial Gearing	$\frac{\boldsymbol{Total\ Long - term\ Liabilities}}{\boldsymbol{Shareholders'Funds + Total\ long - term\ Liabilities}} * \mathbf{100\%}$
Operational Efficiency	The proportion of cost of sales (CoS) and administrative costs to revenue: $\frac{\boldsymbol{CoS + Administrative\ Costs}}{\boldsymbol{Revenue}} * \mathbf{100\%}$

For each M&A, all the above measures were computed, starting from one year pre-acquisition till 2017, the latter being the latest year for which financial statements were publicly available until the publication of the study.

2.1.1 Limitations

Financial ratios may have possibly captured issues not influenced by the M&As but which still affected companies' performance.

2.2 Research Instrument 2 – Event Study to Examine the Market Reaction to M&A Announcements

The Event Study method was based on the approach adopted by Khanal et al., (2014), whereby one seeks to calculate abnormal returns (ARs) by examining whether the share price of the company involved in the M&A moved in an abnormal manner vis-à-vis the trend established by the equity market during the period. Movements in the MSE Equity Index were taken as a proxy of price movements of the overall local market registered in periods before and after each M&A. The Event Study was only applicable to firms which were equity-listed on the MSE. The comparison of the company's share price with that of the MSE Equity Index was made to decouple movements attributed to systemic conditions affecting the whole market from movements specifically attributed to the acquisition.

The impact of each event was evaluated using different time windows around the announcement date, with the widest window being of 60 days around the announcement date (-30, +30).

2.2.1 The Market Model

To come up with ARs, the Market Model was applied whereby individual price movements were correlated to market index movements through a regression, as shown in equation 1:

Equation 1: The MM Formula

$$R_{it} = \alpha_i + \beta_i R_{mt} + AR_{it}$$

where:

R_{it} =actual return on individual stock *i* at time *t*

α_i and β_i = parameters to be estimated

R_{mt}= actual return on the overall market *i.e.* of the index

t = each day of the time window in consideration

AR_{it}= residual to the regression i.e. AR of stock *i* at time *t*

According to equation 1, the AR is the difference between the actual return of stock i at time t (R_{it}) and actual market return at time t (R_{mt}).

For each firm under analysis, daily share price readings, represented by R_{it}, and corresponding MSE Equity Index data, represented by R_{mt} were imported into the model. Subsequently, for each firm, a regression in the form of $R_{it} = \alpha_i + \beta_i R_{mt}$ was estimated and daily ARs were generated, the latter being the residual values to each regression.

Additionally, cumulative ARs for each time window were obtained to better trace the behaviour of the AR variable over different timeframes. In fact, among the time windows taken for estimation were (-1, +1), (-5, +5), (-10, +10), (-20, +20,), (-30, +30), (-5, +10), (-5, +20) and (-5, +30). Such Cumulative ARs were also averaged across firms. These Average cumulative ARs for each time window in consideration could thus be tested for statistical significance.

2.2.2 Limitations

Firstly, this methodology assumes the presence of market efficiency. However, market inefficiency may have potentially limited this ability for prices to reflect new market information. Moreover, within the estimation time period, factors specifically attributed to the company but unrelated to M&A may have influenced individual share price movements. Such limitations were inherently present within the model.

2.3 Research Instrument 3 – Conduct of the Interviews to Obtain the Perceived Value

The primary data was collected through ten semi-structured interviews: five were held with company representatives (coreps) and five with brokers. Getting brokers' opinion enabled a more objective and external view on M&A's perceived value.

The interview schedules of both respondent groups were made up of both open-ended and close-ended questions. Open-ended questions permitted respondents to delve deeper into the subject and express their opinions on practical issues. Analysis for close-ended questions was carried out using Statistical Package for Social Scientists (SPSS), where the Friedman Test was applied to scaled questions.

2.3.1 Limitations

The small sample size of the study limited the extent of statistical tests which could be performed.

3 Analysis of Results

3.1 Impact of M&As on the Acquiring Group's Financial Performance

This section presents findings on the financial performance of acquiring companies from one year pre-acquisition onwards. Additionally, for each measure, the yearly average percentage point (p.p) change for each company following M&A is shown. It is to be noted that Company A was not considered in the computation of average measures because its outlier results are deemed to be attributable to company-specific management challenges, and such factors could not be attributed to M&A.

A. ROA

Table 3 includes ROA estimators for each company under analysis. Three companies present improvements in ROA while another three companies experienced yearly declines in their ROA position from the year of acquisition onwards.

It is to be noted that on average, ROA declined by 0.53 p.p each year from the year of acquisition onwards, implying that the average ROA position of the companies concerned slightly worsened and so did shareholders' return.

Table 3: ROA Results = $\frac{Profit\ after\ Tax}{Total\ Assets} * 100\%$							
	Companies						
	A	**B**	**C**	**D**	**E**	**F**	**G**
2006					1%		
2007					1%		
2008					2%		
2009					2%		
2010	-6%				2%		
2011	-5%				1%		
2012	6%				1%		
2013	8%				1%		
2014	-2%		1%	-2%	1%		
2015	-30%	13%	2%	0%	1%	6%	2%
2016	-154%	8%	2%	-1%	1%	3%	6%
2017	-94%	7%	2%	1%	1%	-5%	10%
Table 3 - Continued							
Yearly Average p.p Change in ROA for each M&A							
	-	-3 p.p	+0.33 p.p	+1 p.p	0 p.p	-5.5 p.p	+4 p.p
Yearly Average p.p Change in ROA: -0.53 p.p							

B. Growth

Table 4 presents the yearly *growth* registered by each firm during the period under analysis. Clearly, most companies experienced positive and considerable growth measures post-acquisition, except for Companies A and F. On average, one can generalise that growth was impacted positively post-M&A.

Table 4: EBITDA GROWTH							
	Companies						
	A	**B**	**C**	**D**	**E**	**F**	**G**
2006					5%		
2007					14%		
2008					38%		
2009					-9%		
2010	-123%				8%		
2011	38%[1]				-19%		
2012	-619%[2]				-17%		
2013	40%				-25%		
2014	-42%		N/A	-18%	-11%		
2015	-405%	5%	201%	11%	26%	74%	7%
2016	362%[1]	19%	13%	18%	5%	-47%	216%
2017	-66%	6%	43%	69%	9%	-18%	7%
Yearly Average p.p Growth for each M&A							
	-	+12.5 p.p	+86 p.p	+32.7 p.p	+1.73 p.p	-32.5 p.p	+112 p.p
Yearly Average p.p Growth: +35.3 p.p							

C. OCF

Table 5 shows results on the cash flow position of companies under analysis. Three companies, being Companies B, D and G have registered average yearly p.p improvements in their OCF performance while Companies C, E and F have deteriorated their cash flow position.

[1] This figure is only positive because both the denominator and the numerator are negative.
[2] This figure is negative because the numerator is positive while the denominator is negative

Table 5: OCF Results = $\frac{Pre-tax\ OCF}{Opening\ book\ values\ of\ operating\ assets} * 100\%$							
	Companies						
	A	**B**	**C**	**D**	**E**	**F**	**G**
2006					36%		
2007					27%		
2008					12%		
2009					13%		
2010	9%				17%		
2011	-1%				22%		
2012	8%				22%		
2013	16%				25%		
2014	N/A		3%	3%	34%		
2015	N/A	18%	3%	3%	40%	11%	12%
2016	23%	31%	1%	2%	35%	9%	42%
2017	44%	24%	1%	5%	31%	4%	19%
Yearly Average p.p Change in OCF for each M&A							
	-	+3 p.p	-0.67 p.p	+0.67 p.p	-0.45 p.p	-3.5 p.p	+3.5 p.p
Yearly Average p.p Change in OCF: +0.43 p.p							

D. Financial Gearing

Table 6 presents results on the *financial gearing* for all companies under analysis. Four companies under analysis, being Companies B, E, F and G presented yearly improvements in the capital structure's gearing while the remaining two companies experienced yearly gearing increases.

Table 6: Financial Gearing = $\frac{Total\ Long-term\ Liabilities}{Shareholders'Funds + Total\ long-term\ Liabilities} * 100\%$							
	Companies						
	A	**B**	**C**	**D**	**E**	**F**	**G**
2006					91%		
2007					89%		
2008					88%		
2009					87%		
2010	14%				87%		
2011	10%				86%		
2012	8%				86%		
2013	7%				86%		
2014	9%		57%	37%	87%		
2015	103%	35%	69%	43%	88%	84%	67%
2016	-489%	36%	70%	43%	88%	77%	70%
2017	421%	32%	70%	42%	88%	81%	63%
Yearly Average p.p Change in Financial Gearing for each M&A							
	-	-0.67 p.p	+4.33 p.p	+1.67 p.p	-0.27 p.p	-0.67 p.p	-2 p.p
Yearly Average p.p Change in Financial Gearing: +0.40 p.p							

E. Cost-to-Revenue Ratio

Table 7 shows the *cost-to-revenue* proportions pre and post-acquisition. Three companies have registered yearly average reduction in cost proportions post-acquisition, and such companies are the same ones experiencing positive ROA movements, as seen in Table 3. The remaining three companies have registered increased proportions. On average, the *cost-to-revenue* ratio increased yearly by 2.30 p.p from the year of acquisition onwards.

This analysis shows that it may be very challenging for the acquiring group to immediately register and benefit from cost synergies post-acquisition. In fact, only Companies C and G hint elements of operational efficiency in the year of acquisition, while Company D has not effectively gained from lower *cost-to-revenue* proportions before the third year after the acquisition.

Table 7: **Cost-to-Revenue Ratio =** $\frac{CoS+Administrative\ Costs}{Revenue} * 100\%$

	Companies						
	A	**B**	**C**	**D**	**E**	**F**	**G**
2006					36%		
2007					37%		
2008					62%		
2009					62%		
2010	111%				61%		
2011	108%				66%		
2012	93%				70%		
2013	92%				68%		
2014	97%		46%	75%	71%		
2015	92%	79%	38%	76%	72%	82%	96%
2016	248%	84%	39%	77%	74%	102%	91%
2017	179%	83%	33%	73%	78%	117%	91%
Yearly Average p.p Change in Measure for each M&A							
	-	+2 p.p	-4.33 p.p	-0.67 p.p	+3.82 p.p	+17.5 p.p	-2.5 p.p
Yearly Average p.p Change in Measure: +2.30 p.p							

F. Further Financial Indicators: Income Gearing

To further analyse the impact of increased debt on companies' performance, for those acquisitions partly or wholly financed by debt, namely Companies A, C, F and G, the *income gearing* was computed. Results appear in Table 8.

It is found that those companies whose financial performance deteriorated post-M&A, namely Companies A and F, also weakened their position in terms of income gearing, as their interest payments rose more significantly than EBIT. It is noteworthy that the two companies that registered improvements in Income Gearing, namely Companies C and G also showed improved results in terms of ROA and cost containment, as seen in tables 4.1 and 4.6 respectively.

Table 8: Income Gearing: $\frac{\textit{Interest Expense}}{\textit{EBIT}} * 100\%$				
	Companies			
	A	C	F	G
2014	309%	90%		
2015	-10%	46%	20%	58%
2016	-22%	48%	724%	21%
2017	-16%	60%	-122%	18%

3.2 The Market Reaction to M&A Announcements

This section presents the market's reaction in terms of investors' expectations on the likelihood of success of M&As in question as reflected in share price performance around the M&A announcement. After calculating cumulative ARs for each M&A across different time windows, the average cumulative ARs (represented by GR_{NT}) for each separate time window was estimated. Table 9 presents GR_{NT} of five M&As into consideration.

The computed Z score and P-value determine those GR_{NT} values which are statistically different from zero. These reported Z scores indicate that GR_{NT} values are statistically significant when calculated within the following time windows:

- (-5, +20)
- (-5, +30)
- (-20, +20)
- (-30, +30)

Table 9: **Average Cumulative ARs & their Statistical Significance**			
Days	**GR_{NT}**	**Z Score**	**P-Value**
-1, +1	-0.60	-0.25	0.80
-5, +5	1.68	0.70	0.48
-5, +10	2.20	0.92	0.36
-10, +10	0.97	0.41	0.68
-5, +20	8.40	3.50	0.00
-5, +30	9.01	3.76	0.00
-20, +20	8.08	3.37	0.00
-30, +30	13.17	5.49	0.00

Average cumulative ARs are not statistically different from 0 over relatively short-term periods. These results seem to imply that the market does not, in general, react to M&A announcements in the short term. Statistical significance of abnormal positive returns is recorded over a longer time span, specifically within and beyond the 26-day event window.

3.3 Findings on the Perceived Value Created through M&A Activity

Coreps' and brokers' views on the perceived value arising through M&A activity are presented in this section.

3.3.1 Strategic Factors related to M&A

Coreps were asked to identify the corporate strategy chosen by the firm which led to M&A. All M&A cases $_{(5/5)}$ aimed for a *growth strategy*.

Moreover, it was found that the most common motives behind M&A were to *expand customer*

Table 10: Difficulty of challenges to yield operational synergies – Coreps' Schedule

	Mean	Std. Deviation	Minimum	Maximum
Cultural/Organisational Integration	3.60	1.517	1	5
Others	3.20	1.304	1	4
Human resources Rationalisation	2.40	1.342	1	4
Industrial Relations	2.20	1.643	1	4
IT Resources	2.20	1.304	1	4

Where mean score of 1 = very easy and 5 = very difficult
N=5
P-Value = 0.119

base $_{(4/5)}$ followed by the need to *respond to shareholders' investor appetite.* $_{(3/5)}$.

When asked on the most critical M&A success factors, coreps emphasized on the need of a *well-executed integration plan* $_{(3/5)}$ and *effective due diligence* $_{(3/5)}$. None of the respondents $_{(0/5)}$ considered positive economy-wide conditions as a critical success factor.

3.3.2 Operational Considerations to M&A

When coreps were asked whether the acquisition provided opportunities for operational synergy to be effective, it was found that the majority reported scope for operational synergy $_{(4/5)}$, especially on overheads such as IT. However, one respondent $_{(1/5)}$ indicated that operational synergy was *"difficult to achieve when the target is cross-border."*

Revenue Synergy realisation seemed to depend upon the nature of the industry and type of acquisition. Three respondents $_{(3/5)}$ found revenue synergy to be effective since the acquisition was revenue-generating. On the other hand, according to one respondent $_{(1/5)}$, revenue synergy was time-consuming in cases where the industry in which the firm operates is project-based.

Cost Synergy realisation was also reported to be dependent on the type of acquisition. The majority of coreps $_{(3/5)}$ found cost synergies to be effective since the acquirer became involved in target operations. Synergies were effective within Human Resources in terms of competency sharing, purchasing costs in terms of bulk buying and alignment of certain departmental functions to the group such as Marketing, Public Relations, Legal, Internal audit and Finance. However, one respondent $_{(1/5)}$ stated that cost synergies were quite low since the acquisition's aim was financial, namely *"…to accumulate a net asset value of the portfolio…"* rather than to manage operations.

Coreps were asked about the challenges to yield operational synergies. As seen in Table 10, *cultural/organisation integration* was found to be difficult $_{(m=3.60)}$, while the mean rating scores of the remaining factors varied from neither easy nor difficult in *others* $_{(m=3.20)}$ to easy in both *industrial relations* $_{(m=2.20)}$ and *IT resources* $_{(m=2.20)}$

3.3.3 Perceived Impact on Financial Performance

Coreps were asked to rate the impact of M&A as measured through various financial aspects. Results are presented in Table 11. Respondents expressed positive views on the M&A impact on each financial aspect, with all mean rating scores exceeding 3. However, the highest impact is found to be on *growth* $_{(m=5)}$ while *efficiency* scored lowest $_{(m=3.20)}$. Mean scores differ significantly. This is in line with findings of the financial analysis included in Section 4.1, where *growth* was shown to have benefitted in most companies, while a more diverse pattern emerged from *cost-to-revenue* Ratios.

Table 11: Financial Implications of M&A – Coreps' Schedule

	Mean	Std. Deviation	Minimum	Maximum
Growth	5.00	0.000	5	5
Operating cash flow	4.60	0.548	4	5
Profitability	4.40	0.548	4	5
Financial gearing	3.80	0.837	3	5
Efficiency	3.20	0.837	2	4

Where mean score of 1 = very low and 5 = very high
N=5
P-value=0.009

Brokers were asked to classify those acquisitions which, in their opinion, have been successful. Upon putting forward this question, the main findings on the review of each company's financial information, also presented in Section 4.1, were shown to each respondent.

In this assessment, there was a degree of convergence between the researcher's findings and the brokers' opinion on the perceived success of each M&A. In fact, it was determined that all brokers $_{(5/5)}$ agreed with the researcher's assessments made to classify unsuccessful M&As. With respect to the remaining M&As being classified as successful during the financial analysis, the majority of brokers $_{(4/5)}$ agreed with these companies' success.

Moreover, brokers were asked to comment on the acquisitions' overall financial performance. Respondents delved into the main reasons for the success or failure of the acquisitions under study, with the main findings presented in Tables 12 and 13 respectively.

Table 12: Reasons for Acquisitions' Success – Brokers' Schedule	N=5
Foreign targets were acquired by three companies under analysis, where the main motive was growth. Since the local market is already saturated, such companies were given an immediate boost in growth.	3
Where acquisitions are treated as revenue streams and a way to cross-sell services and reach more customers, performance automatically thrives.	2
Whenever the targets' nature is operationally cash flow generating, any improvement in the group's financial performance is immediately reflected in financial statements.	1
Where the two companies operate in the same sector, probably better cost and revenue synergies can be achieved. Such economies of scale in turn lead to better performance.	1

Table 13: Reasons for Acquisitions' Failure – Brokers' Schedule	N=5
Some failed acquisitions occur because of the nature of the industry they operate in, being highly affected by exogenous shocks. One respondent claimed that one particular *target "is still facing difficulties and until last year, it was still a cash drain on the whole group."* Such exogenous factors cause substantial risks, which according to another respondent should have been factored in the acquisition cost.	3
One particular company did not perform sufficient due diligence to identify the target's weaknesses. Consequently, *"the acquirer ended up paying excessive amounts for the target."* Moreover, issues of internal control in the company were identified and continued to deplete performance.	2
The strategy of some acquisitions was set in the long term. Therefore, any impact takes time to be reflected.	1

Brokers were asked to determine whether M&As between related firms perform significantly different from M&As between unrelated firms. Three brokers $_{(3/5)}$ believed that it depends on the ability to successfully integrate the two companies. One respondent specifically replied: *"This can be done even between unrelated firms as long as there is commitment by management on the corporate strategy chosen"* e.g. by cross selling each others' products. The other two brokers $_{(2/5)}$ replied that conceptually, there are advantages since the market is already known, so it is far easier to acquire a gain after a relatively short period.

Brokers were asked on the main contributory factors of low M&A success, where they could choose more than one response. The most popular factor was *cultural differences between the two firms* $_{(4/5)}$, followed by *paying excessive premiums for targets* $_{(4/5)}$.

3.3.4 Perceived Impact on Shareholder Value

Brokers were asked on the local investor sentiment upon announcement of an acquisition. All brokers $_{(5/5)}$ indicated a generally positive investor sentiment. However, respondents questioned the validity of such assessments by commenting that share prices still generally do not increase because of local market inefficiency and asymmetric information $_{(2/5)}$. Two respondents $_{(2/5)}$ further stated that not all announcements cause positive reactions because of Malta's small and inefficient market.

The last question to brokers asked whether local M&As signify positive shareholder value. Most brokers $_{(4/5)}$ answered that positive shareholder value is created if supported by good figures and if M&A coincides with a positive vibe of the general market. One particular broker specifically commented that the only issue locally is that it takes time for prices to react to M&A as *"the market does not internalise new information in the share price immediately".*

4 Discussion

4.1 Growth as the Main M&A Driver

Inevidently, companies believed that M&As are critical to corporate growth strategy since all interviewed acquiring companies aimed for a growth strategy as their main objective behind M&A.

In fact, this growth motive seemed to have been reflected in financial results as worked out by the researcher, since M&As made a considerable impact on their respective companies' EBITDA Growth. Furthermore, Growth's significance was also highlighted by coreps as this measure was perceived by them to benefit more from M&A activity than other aspects of corporate performance. This could be the result of the principle of the materiality, as set out in Section 3, of the target to the acquiring firm which was followed when determining those firms that were to be included in the present analysis.

The fact that most acquired targets were foreign might indicate that the local market poses constraints to further growth by the acquiring local company. Therefore, growing inorganically and overseas through M&A was an effective vehicle through which companies expand their operations and register actual growth measures in their financial statements.

4.2 Have Financial Results shown Improved Financial Performance post-M&A?

Despite the impact of M&A on Growth was considerable, very few firms actually experienced improvements in ROA, OCF and Cost-to-Revenue measures. Such findings are contrary to those by Lau, Proimos and Wright (2008) who found post-M&A improvements in profitability, cash flows, efficiency and financial gearing amongst acquiring firms.

It can be argued that those firms which performed successfully had certain common characteristics. Those companies which managed to achieve higher profitability were also the ones showing effective operational cost control as well as sound financing strategies.

4.2.1 Profitability as the True Success Measure

The average deteriorating ROA position of the acquiring companies after the M&A implies that the simple average increase in profits for all companies did not keep pace with the increased capital employed by the business ventures under analysis. This highlights the challenge to improve or even maintain asset utilisation post-acquisition. An increase in ROA is crucial to prove to shareholders that their financial resources are being used in the best way possible to maximise their own wealth. As long as shareholders' return is not maintained or improved, questions arise on whether management is employing shareholders' funds in the best way possible. The achievement of higher ROA post-acquisition seems to be time-consuming and several years may have to pass for the combined assets to start operating as efficiently as possible and realise higher profitability.

4.2.2 Increased Operational Efficiency

Research findings also revealed that companies experiencing lower Cost-to-Revenue ratios from the year of acquisition onwards, implying improved operational efficiency, were the same ones which achieved higher ROA measures during the same periods in consideration. This indicates that improved cost containment might be one key factor for improved shareholders' return. Similar to ROA, it is very challenging for cost control to be evident in the first post-acquisition years since it could take a number of years until the two combined firms benefit from any shared costs and realise operational synergies. Moreover, such synergies may potentially be more challenging whenever the target is located overseas.

4.2.3 Sound Financing Decisions

M&A success also seems to depend on management's ability to determine the best financing method of acquisition for the benefit of the company. Debt financing is not necessarily a wrong decision, as long as the company earns enough operating income to be able to make interest payments. Indeed, as shown in Section 4.1, when considering those companies being financed by debt which improved their income gearing, in spite of their reliance on a higher gearing, they also managed to improve their *ROA* and *Cost-to-Revenue* dynamics. In such successful cases, income gearing improved because EBIT grew substantially. It is management's role to identify the respective companies' most ideal financing method and be confident that interest payments arising from debt financing will not deteriorate EBIT. Otherwise, as proven by results, debt financing is detrimental to the financial performance if no sufficient EBIT is earned from which interest payments have to be made.

However, one must still exercise caution with further debt financing, since increasing the gearing ratio even further poses adverse implications upon a company's ability to manage risks that a decline in demand for a firm's output might generate.

4.3 Was the Market Reaction a Good Indicator of M&A Success?

Results indicated that investors did not show any statistically significant market reaction within the short-term. This is probably attributed to elements of illiquidity and inefficiency which characterise the equity market in a small economy like Malta's. Contrary to market efficiency assumptions posed by Sitthipongpanich (2011), the MSE is limited in terms of size and depth. Indeed, observed stock prices may not fully and immediately reflect all information available to investors.

This market limitation was also mentioned by brokers when they were asked about local investor sentiment upon announcement of an M&A. One particular respondent further commented*: "Many Maltese listed companies are family owned, thus only a small proportion of shares are traded in a free-float manner."* This makes it even more difficult for the market to internalise any new public information in the share price.

4.3.1 Positive Reaction only appeared within Wider Time Windows

Positive financial gains over the wider time windows indicate that investors took the new public information with positive sentiment, but it took a considerable number of days, specifically 26 days around the announcement, for that positive response to be reflected in the share price. This probably occurred due to the domestic market's limitations in relaying changes in any firm's economic prospects on to the firm's share price.

The general positive sentiment might imply that since the local market is quite inactive, M&A announcements are perceived as a major event around which period, prices tend to overreact. In fact, one stockbroker suggested that the shallow level of daily trading tends to push the domestic equity market to overshoot share price rises.

Positive market perceptions of M&A's are not a prevailing belief in the literature. M&A literature provides a vast array of studies on shareholder wealth arising from M&A, the results of which seem inconsistent. Among the studies indicating shareholder loss of value upon M&A are those by Subeniotis *et al.* (2011).

4.3.2 Tendency for the Market to be Off-track

It is noteworthy that positive ARs exhibited over wider time windows contrasts with the actual shareholder value registered in the financial statements. Local investors may have raised expectations of future financial gains resulting from M&A activity. Yet, financial indicators including ROA, OCF and Cost-to-Revenue ratios have not shown added company value pre vs post-acquisition.

These findings highlight the possibility that the market may not always be a good indicator of the actual M&A success registered in the financial statements. One plausible reason for this occurrence might be that share prices may include excessive market sentiment hype generated through overestimated synergy expectations.

4.4 Perceived Value vs Financial Results

Coreps' perceptions of the M&A impact on the financial performance were more optimistic than the researcher's workings of actual financial performance. Moreover, brokers' assessment of acquiring firms' financial performance generally converged with those of the researcher. This indicates a high degree of objectivity exercised by both the brokers and by the researcher in their assessments, while coreps' relatively optimistic views on the perceived value probably emerged due to their intrinsic bias in favour of their respective companies' M&A activity.

4.5 Factors Contributing to the Success/Failure of M&A Activity

Coreps' insights shed light on certain traits which add the likelihood of M&A success. This implies that management should exercise crucial importance to well-executed pre- and post-M&A

stages.

Firstly, the alignment of M&A within the corporate strategy should be taken seriously by management such that well-developed strategic plans specify how to widen the product/service portfolio. Such strategies help the firm act proactively to any changes in the business segment in which it operates.

Coreps also considered due diligence to be crucial for M&A success. Effective due diligence can identify potential issues just before the deal closes so that any issue which affects target valuation is identified. In fact, inadequate due diligence was also identified by brokers as one of the reasons for target overvaluation and consequently, M&A failure.

Moreover, operational considerations such as well-executed integration was identified as crucial but may also be potentially challenging to achieve. Indeed, the integration process might cause major cultural differences, especially in cross-border deals. As stated by one respondent: *"When the target is run by people of a different culture and work ethic across different time zones, cultural shock will occur."* Human resources can be one of the most unpredictable elements of an M&A, and in these circumstances, there is the risk that people from different cultures do not bond well together.

5 Conclusion

The M&A deals which exhibited evidence of value creation possessed certain common characteristics. Companies which have registered increases in shareholders' rate of return in fact tended to be accompanied by enhanced operational efficiency and sound financing decisions. However, the attainment of improved results following M&A is proved to be quite challenging and time consuming to realise in practice. Overall, although M&As managed to achieve growth potential, operational efficiency suffered, indicating that the attainment of a smooth consolidation process seemed to consume a considerable management effort. In other words, the theoretical positive impact of M&As on shareholder value tends to be elusive for the larger number of companies analysed in this study. This could easily be the case if target companies need major enhancements before being integrated with the acquiring company.

Furthermore, the local equity market reaction around M&A announcements was not a good indicator of M&A success. Indeed, initial market reactions, which tended to be positive, contrasted with less optimistic actual results registered yearly. It is likely that this positive market sentiment could have originated from the shallow level of trading in the MSE, causing prices to overshoot upon such announcements.

It also turned out that certain key factors, namely the need for a focused strategic plan, the importance of an effective due diligence and a strong management that can push successful integration, add the likelihood of M&A success. It all depends on managerial expertise to recognise the importance of these issues while avoiding exertion of any over-enthusiasm upon the deal.

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