

THE SYNERGY TRAP: HOW COMPANIES LOSE THE ACQUISITION GAME. BY MARK L. SIROWER. NEW YORK: THE FREE PRESS, 1997

Two of the great economic phenomena of the end of the twentieth century are the bull market in stocks and the great national and international consolidation that has taken place in a wide variety of industries. While the collapse of communism, computer technology, and the Fed's easy money policy have been major contributors, the massive mergers and acquisitions movement has played a very direct role in both the bull market and this process of consolidation and economic development. Indeed, in each of the last several years, we have set new records for the largest single merger, the total number of mergers per year, and the total value of mergers.

Enter Mark Sirower, who asks the simple question, are mergers efficient? Do they really create synergy? And, ultimately, do they reward the shareholders of companies who make acquisitions through mergers? His surprising answer is, no. Mergers are not good for shareholders or, presumably, for the economy.

This corporate self-exploitation starts with the hefty stock-price premiums that companies pay to buy or merge with their "target" company. The author finds that this premium causes a loss to the acquirer's stockholders because the benefits of mergers, often labeled "synergy" are greatly overestimated. In addition, many mergers result in unforeseen difficulties that actually result in even worse stock performance.

While *The Synergy Trap* is a work in "management science," the author is not unfamiliar with economics. He writes knowingly about "economic rents," the competitive-market hypothesis, the winner's curse, and he uses competitive market forces as one of his prime arguments as to why many mergers don't work (because mergers alert competitors to changing competitive conditions and they do not sit still while the two firms merge). This, however, does not a good theory make and he provides little in the way of explaining why mergers fail to improve the lot of stockholders.

Ultimately, the author is led to an explanation of mergers based on economic irrationality. Company executives make "value-destroying acquisitions" as a form of gambling that has their own self-aggrandizement as its goal—"from a policy perspective . . . managers make these decisions because they can." He concludes that there are no mutual gains from exchange. The big capitalist is making irrational bets with the money of little stockholders and destroying billions of dollars of shareholder value in the process.

Why do big corporations pay so much more than you or I do for the stock of their target company? Simple, buying stock increases the demand and price of a stock. The typical small purchase has no perceptible impact on the price of a stock,

but large block trades often have a noticeable positive or negative effect on the stock price. A merger is just a stock purchase on a much larger scale and, therefore, has a much more noticeable effect on price.

The key question that the author fails to ask here is, why is the company willing to pay top dollar on every share when it could buy so many shares at much lower prices on the stock market, and thus preserve a great deal of its own shareholder's value? Regulation causes this anomaly because it prevents companies from acquiring large blocks of stock in companies, without registering their intentions with the government and alerting the market to their intentions. The government protects these "target firms" from "hostile takeovers."

If mergers are so beneficial, why does the acquirer's stock price fall when mergers are announced? Mergers, like divestitures, put the market for a stock in disequilibrium. A merger can increase the supply if the target is purchased with the company's stock, or diminish the company's credit rating if purchased with debt or cash. Mergers can also affect demand if current shareholders find that the new merged company is no longer appropriate for their portfolios. A decrease in stock price for acquisition firms is, therefore, not irrational nor completely unexpected.

But why do most mergers destroy shareholder value? Here lies both the great problem and the great contribution of the book. The vast majority of mergers and acquisitions enhance shareholder wealth of both companies, but Mr. Sirower only looks at the 168 largest mergers of the 1980s. Other research has also shown that the larger the merger, the worse the stock price performance.

The largest companies are precisely the ones that are allowed the fewest opportunities to enhance shareholder value and are also the companies that come under the greatest antitrust scrutiny by government. If a large firm tries to grow too large, it can be accused of unfair trade practices, dumping, of trying to monopolize an industry. Large companies are also more likely to be prevented from expanding their business through vertical and horizontal integration because it might violate antitrust law. Likewise large companies are also more restricted from forming the most efficient mergers possible because such mergers might create too much market power or industry concentration.

While the author does not recognize these constraints on the companies in his sample, he claims that it would be cheaper for shareholders to simply buy shares of the target firm themselves, rather than through their company at such a big premium. This suggestion fails to recognize that such individual purchases would also increase the price, but more importantly, it neglects the fact that if the company were to distribute cash, shareholders would then immediately lose between one-quarter and two-fifths of their dividends to taxes. The high premiums paid to acquire new companies compares favorably to paying these taxes and paying taxes is much worse for society.

Mr. Sirower has done a great service in pointing out the anomaly concerning large-company mergers. While his own interpretation and policy conclusions are far off base, he has provided good evidence for the Austrian theory that antitrust policy is harmful to the competitive process and standard of living in society.

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