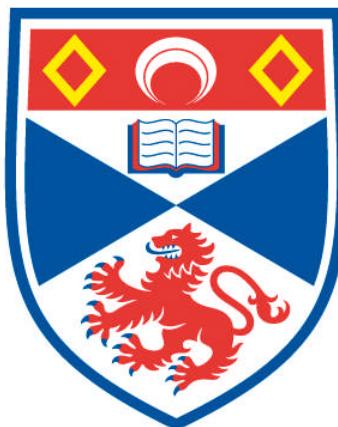


# **ACQUISITIONS AND MERGERS IN SAUDI ARABIA: REASONS AND EFFECTS**

**Abdulmohsen H. Alarfaj**

**A Thesis Submitted for the Degree of PhD  
at the  
University of St Andrews**



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**Acquisitions and Mergers in Saudi Arabia: Reasons and Effects**

**Abdulmohsen H. Alarfaj**

**A Thesis Submitted for the Degree of Doctor of Philosophy  
at the University of St. Andrews**



**Department of Management  
University of St. Andrews**

**October 1996**

## Declaration

I, Abdulmohsen Alarfaj, hereby certify that this thesis, which is approximately 100,000 words in length, has been written by me, that is the record of work carried out by me and that it has not been submitted in any previous application for a higher degree.

Dated: *3rd Oct. 1996*

Abdulmohsen Alarfaj

I was admitted as a researcher student under ordinance No. 12 in December, 1992 and as a candidate for the degree of Doctor of Philosophy in December, 1992; the higher study for which this is a record was carried out in the University of St. Andrews between 1993 and 1996.

Dated: *3rd Oct. 1996*

Abdulmohsen Alarfaj

I hereby certify that the candidate has fulfilled the condition of the Resolution and Regulations appropriate for the degree of doctor of Philosophy in the University of St. Andrews and that the candidate is qualified to submit this thesis in application for that degree.

Dated: *3/10/96*

Professor Mo Malek

Dated: *3-X. 96 .*

Professor Peter McKiernan

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## Acknowledgement

IN THE NAME OF ALLAH, MOST GRACIOUS, MOST MERCIFUL praise be to Allah. The Lord of the worlds and blessings be upon the last Apostle our Master Mohammed, peace be upon him.

I would like to express my sincere thanks to a number of special individuals who have made valuable contributions to this thesis. I owe a debt of gratitude to my joint supervisors, professor Mo Malek and professor Peter McKiernan, for their sustained patience, support and guidance during the design, execution, and completion of this dissertation. Their encouragement, which extended beyond the requirements of an academic relationship is deeply appreciated. My thanks are also due to Mr. Donald Sinclair at the Department of Accountancy and Business Finance, University of Dundee for his advice on the statistical tests used in the thesis.

In addition, I would like to thank King Faisal University, my employer, which provided me with a grant and term of study leave to complete my thesis. I also indebted to Al-Konaim, Al-Shawy, and Salah at Riyadh Chamber of Commerce for the support and help in the conceptualisation of this study and the mailing of the questionnaire.

At the risk of forgetting someone, there are several people that need to be singled out for their help and support in the preparation of this dissertation. A note of thank to Al-Hamad and Al-Basheer (staff members at King Faisal University) who provided the researcher with some relevant materials and helped in translating the English version of the questionnaire to Arabic language. Special appreciation is also due to those who devoted some of their valuable time and responded to the questionnaire as well as to those top-managers who accepted to be interviewed.

Finally, without the encouragement, support, and understanding of my family and especially my wife and my children, I could not have even thought about completing this dissertation. It is, however, sad to recall that while carrying out this work, my mother died (may ALLAH bless her).

*To the memory of my mother*

## Abstract

The high scale of acquisition and merger's activity has produced great interest among academic and policy makers alike, resulting in the development of a considerable amount of research on the advantages and disadvantages of A&Ms. Previous literature however, focused on the A&Ms' activity in advanced capitalist countries, specifically the USA and UK. Studies of A&Ms in developing countries are rare; this research attempts to fill part of this gap by investigating reasons for and effects of A&Ms in Saudi Arabia.

Three main causes are behind the transfers of corporate assets within industry in the Anglo-American nations and some developed countries; managerial, disciplinary and economical. This study, however, suggests that the only group of causes behind A&Ms in S.A., among these three groups, is economical. Recently, the literature described A&Ms' decisions not as comprehensively rational choices but as outcomes of processes governed by several influences. This group of reasons was also tested in this study and gained its support.

With regard to A&Ms' effects on firms' profitability as well as on the economic conditions, the research finds that A&Ms in S.A. are expected to improve merging firms' abilities to compete and to improve their profitability. Moreover, favourable effects on economic welfare was accepted.

A reasonable step in A&Ms activity is to determine whether there are particular characteristics of A&Ms which are systematically linked to positive or negative effects on the performance. The current research finds that determinants of success could be predictive if analysed with a relationship to the type and cause of A&Ms. This study suggests that the type of A&M (consolidation or acquisition) and causes for A&Ms (synergy or assets stripping) affects the factors of A&Ms' success and failure.

These findings were based on a survey of the top 500 Saudi Arabian companies, of whom 124 companies responded to the questionnaire as well as on seven personal interviews with seven executives, who experienced A&Ms before and who answered the questionnaire and accepted to meet the researcher.

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# *Chapter One*

## *Introduction*

### **1.1 Overview**

An acquisition consists of the combination of two or more businesses in which the buyer acquires the assets and liabilities of the seller in exchange for stock or cash. Willingness on the part of both buyer and seller distinguishes an acquisition from a takeover.

A merger (a consolidation) consists of a combination of two or more businesses in which both or all companies are dissolved and assets and liabilities are combined with new stock issued. Unlike an acquisition, a merger causes both of the merged corporations to disappear and a third corporation is formed. (Reid, 1968; Glueck, 1980, Wahid, 1995).

Classifying acquisitions and mergers (A&Ms) by industrial or commercial relationships of the firms involved, is largely a matter of definition. A horizontal acquisition or merger is considered as one involving firms which are engaged principally in the same industry. A vertical acquisition or merger is consummated either to provide facilities to supply goods or services that a firm formerly purchased, or to provide facilities to process or distribute goods at different levels in the distribution process. The conglomerate acquisition or merger can be defined as the unification of firms with no apparent similarities in producing or marketing activities (Reid, 1968; Glueck, 1980, Wahid, 1995).

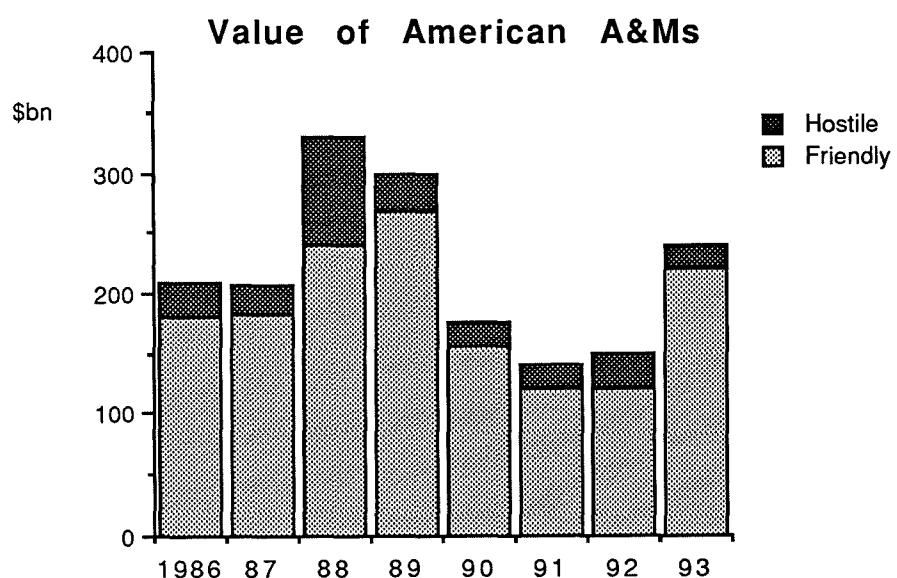
Over the past several decades, A&Ms have become a well-institutionalised phenomenon in the structure and behaviour of business organisations (Hirsch, 1986; Pablo, 1994). Some firms consider acquisitions to be a superior alternative to investing corporate resources (Pablo, 1994). There is also evidence suggesting that some

organisations even invest to acquire financially distressed companies (Bruton et al., 1994).

The amount of resources companies dedicated to expand through A&Ms increased steadily between the middle of the 1960s and the end of the 1980s (Weston and Chung, 1990). In the 1980s, A&Ms' related activity, in the USA accounted for more than 22,000 corporate transactions valued in excess of \$ 955 billion. The approximate twenty-year time period between the end of the 1960s and the beginning of the 1990s has been labelled this century's fourth acquisition wave (Walsh and Kosnik, 1993)

The popularity of this strategic alternative continues in the 1990s (see Figure 1-1), accounting for more than \$ 440 billion of corporate activity in the USA in the first three years of this decade (Mergers & Acquisitions, 1990 and 1993; The Economist, 1994). The cross-border activity increased in terms of the numbers of transactions, with EU companies in 1992 spending £ 19.3 billion. UK companies account for almost a quarter of this activity (Norburn and Schoenberge, 1994).

Figure 1-1: Value of American A&Ms.



Sources: Mergers & Acquisitions, 1990 and 1993; The Economist, 1994.

This level of activity caused some to suggest that a fifth acquisition wave was beginning to develop. As was the case with the fourth wave, 1994's A&M activity was especially prevalent in industries experiencing deregulation, rapid technological growth, and increased foreign competition. In particular, 1994's A&Ms were clustered in fast-changing industries such as defence, telecommunications, health care, food, entertainment, and banking (The Economist, 1994).

Not surprisingly, A&Ms' activity on this scale has produced great interest among academic and policy makers alike, resulting in the development of a considerable amount of research on acquisition and merger. The earliest studies of A&Ms' activity (Dewing, 1921; Penrose, 1959) concentrated on value of A&Ms for the buyer or for the economy. In recent years this interest has expanded exponentially, attracting accountants, finance specialists, economists and behavioural scientists into the debate producing a vast literature on the advantages and disadvantages of A&Ms.

Previous literature focused on the A&Ms' activity in advanced capitalist countries, specifically the United States and the United Kingdom. Studies of A&Ms in developing countries are rare; this research attempts to fill part of this gap by investigating reasons for and effects of A&Ms in Saudi Arabia (S.A.).

## **1.2 Statements of the Problem and Primary Research Questions**

Some governmental officials (Al-Saud, 1989; Ministry of Planning, 1990) and businessmen in Saudi Arabia (Al-Shathry, 1991; Al-Adwan, 1991) believed that the adoption of A&Ms will strengthen the private sector and make it more effective and efficient in the present competitive world of business. There are however a number of sceptics who believe that A&Ms will not solve the problems of the private sector or the economy (Al-Essa, 1992).

Riyadh Chamber of Commerce and Industry is trying to encourage firms to merge. However, Al-Shawy, the manager of the Contracting Committee at the Chamber

has pointed out that management are reluctant to adopt these strategies. The Chamber has turned to the researcher in order to increase its knowledge on how to motivate A&Ms' activity. In an attempt to find answers to these problems, the following questions have been raised by the researcher;

Q1: Will A&Ms help solve the problems of the private sector?

Q2: What potential effects might they have on the economy?

Q3: What motivates A&Ms' activity and what creates barriers to them?

### **1.3 Objectives of the Study**

The precise objectives which this research is aiming to achieve, are derived from the research questions presented earlier. They are as follows:

- 1- To determine the causes why firms' strategic decision makers may choose A&Ms;
- 2- To discover the motives and barriers that affect the rate of A&Ms;
- 3- To establish the effect of A&Ms on firms' performance;
- 4- To examine the potential impact of A&Ms' activity on the S.A. economy.

Due to the limited literature existing with regard to A&Ms' activity in Saudi Arabia, and in order to achieve the research objectives, it was necessary to investigate issues related to the mentioned objectives on countries other than S.A., which have long experience with these issues, such as the USA, Britain and various other countries. Moreover, the context of A&Ms in Saudi Arabia was investigated because occurrences in countries outside S.A. may not follow the same patterns. Propositions about reasons for and effects of A&Ms were developed based on the comparison of S.A. with the other countries studied. The research takes a theoretical look at possible reasons for and effects of A&Ms. This investigation was carried one step further by conducting a survey.

## **1.4 Methodology and Results**

The results are based on a survey of 500 top Saudi Arabian companies, of which 124 responded. This was followed up by seven in-depth personal interviews with the executives of seven of these companies.

Although the literature suggests the causes for A&Ms may be managerial, disciplinary and economic, the research suggests that the management believes that economic causes are behind A&Ms in SA. This result is expected given the ownership structures of business in S.A.

The research has also found that managers perceived acquisition and merger differently with regard to the sources of value gained. For the merger, the main economical gain is improved efficiency and effectiveness due to synergies, whereas for acquisition the main gain is through wealth transfer from acquired firms' owners.

In addition to the economic causes, the study finds that some other factors are relevant to making A&Ms' decisions. Although A&Ms are strategic alternatives which should be taken based on rational evaluation, the research results suggest that the process of making A&Ms' decisions are governed by several irrational influences. These factors include decision-makers attitudes, political power and a lack of complete relevant information.

The study highlights certain potential effects on the private sector; where management expects A&Ms to have a favourable effect on merging firms and to improve profitability and competitiveness. Moreover, it finds that businessmen believe that A&Ms will have positive effects on economic welfare.

Finally, the study finds (based on management perception) that related A&Ms, merging between companies of roughly equal size and A&Ms that don't lead to negative reactions from the employees. Together with a consideration of A&Ms based on their contribution to the overall strategy, these are all vital factors in understanding A&M's success and failure in S.A. This study suggests that the type of strategic expansion (merger or acquisition) and causes for A&Ms (synergy or assets stripping) affects the

factors of A&Ms' success and failure. The factor relevant to success in one situation is not relevant to success in another.

## **1.5 Research Presentation Format**

The dissertation has been organised in eight chapters (see Exhibit 1.1). This chapter represents the introduction which includes a statement of the problem. It gives definitions of acquisition and mergers as well as some statistics of their rates, and discusses the objectives of the study.

Chapter Two is a critical appraisal of the salient literature relating to reasons for and effects of A&Ms applicable to A&Ms in contexts other than that of S.A. Chapter Three reviews the Socio-Political and Economic context of S.A. to provide a clear picture of the business environment where A&Ms are taking place. The information provided in these two chapters was used to construct the research propositions.

Chapter Four presents the study propositions and how they were developed. The study propositions were established along four dimensions. One is related to causes which make managers choose A&Ms. Taking the characteristics of the S.A. context into consideration, the A&Ms' causes that were investigated in Chapter Two were incorporated with the problems of the private sector in S.A. to see if it can be proposed that A&Ms will be used to solve companies' problems or to achieve managerial objectives even if they contradict owners' wealth.

The A&Ms' effect on firms' performance and influencing factors constitute the second dimension. The requirements of successful A&Ms were matched with the characteristics of the S.A. context to establish the relevant propositions.

The third group of propositions is about A&Ms' effect on the economic welfare. They were constructed by studying and comparing the reasons and conditions of positive as well as negative effects on the economy with the characteristics of the S.A. context.

Finally, propositions about A&Ms' rate and what factors influence the decision-makers to adopt A&Ms were developed. These factors were divided into either motives or barriers. Although the motives are prerequisite to A&Ms, they don't lead to a higher

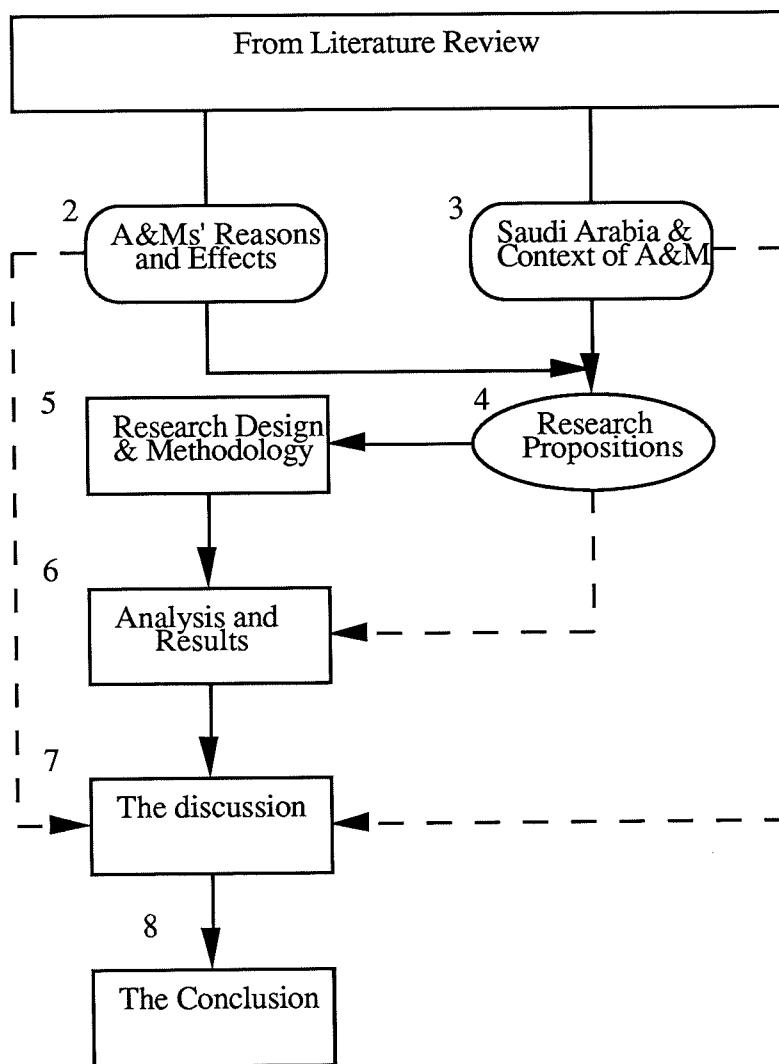
A&Ms' rate if they are not supported by elimination of the barriers. A list that contains these motives and barriers was developed and investigated to establish the propositions of this group.

The methodology adopted for the research was presented in Chapter Five. It explains the research categories, the proposed methodology for data collection, the sample selection, and the data analysis techniques employed.

Chapter Six consists of two parts; results of the quantitative study and outcomes of the conducted interviews. The first part presents the data gathered and reliability/validity testing phase of the research. Moreover, it provides data analysis and drawing of inferences from data relationships (interpretation in its narrower sense).

Two parts constitute Chapter Seven, the first part is devoted for interpretation of the results in its broader sense, that is interpretation which extends beyond the study data to include the comparison of inferences to those of other studies, hypotheses and theories. The second part of Chapter Seven presents the contributions of the study to the existed literature. Finally, Chapter Eight provides a summary of the research, results' implications on management, the government and other parties, as well as the study limitations and suggestions for future research.

Exhibit 1.1: Flow Chart of the Progression of the Thesis.



## ***Chapter Two***

### ***Literature Review on Reasons for and Effects of A&Ms***

#### **2.1 Introduction**

In order to achieve the objectives of this research, it is necessary to review the following areas of literature:

- The causes why management choose A&Ms;
- The contexts that have influences on A&Ms' activities;
- The A&Ms' effects on profitability of firms;
- The factors that influence the success of A&Ms;
- The A&Ms' effects on economic welfare.

Before proceeding, three points should be recognised. First, since the literature concerning A&Ms' activity is mainly Anglo-American (Kay, 1990; Geroski and Vlassopoulos, 1990), here the focus of this chapter will be on the reasons for and effects of A&Ms as they occur in the USA and UK. However, relative information about other nations will also be provided. Second, a major part of the literature about A&Ms can be divided into two broad categories: reasons and effects. Although it is clear that the predicted effects have a relationship with the reasons for A&Ms, this division is useful for conceptualising the basic theories. Third, two categories of reasons for A&Ms can be recognised in the literature. One includes the main reasons why management choose A&Ms. These reasons will be called causes. While the second category contains those factors which influence the decision making of A&Ms. These factors constitute the context of A&Ms.

## 2.2 Causes for A&Ms

### 2.2.1 Overview

A&Ms' causes have been discussed and tested in the literature of strategic management, finance, law and economics (Napier, 1989). A list of these causes is provided in Exhibit 2-1. Hypotheses about the causes for A&Ms have been broadly defined as 'neo-classical' "value maximisation" or 'managerial' "non-value maximisation" (Jemison and Sitkin, 1986; Davis, 1990; Barnatt and Wong, 1992)<sup>1</sup>.

The 'neo-classical' theories suggest that firms will engage in acquisition if this leads to an increase in wealth for the shareholders of the acquiring company (Auerbach, 1988; Manson et al. 1994). While the 'managerial' school suggests that management will seek to maximise its own utility whether or not this is consistent with the maximisation of shareholders' wealth (Jemison and Sitkin, 1986; Barnatt and Wong, 1992). This could take the form of maximising sales (Baumol, 1959), sustainable growth rate of assets (Marris, 1964), a compound variable containing factors such as company cars, excess staff or prestigious investments (Williamson, 1964) or reducing managerial risk (Dodd, 1980; Shleifer and Vishny, 1989).

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1) Distinguishing between profit-maximisation causes and managerial causes is difficult because decisions like those of A&Ms require predictions about uncertain future events. Therefore, managers who adopted A&Ms for personal gains could argue that A&Ms were used to increase owners' wealth but the A&Ms failed to do so. Several factors outside and inside the firms may change after the A&Ms which may affect the firms' profitability. Hence, the lower profitability may not be due to the A&Ms but to other influences. Moreover, the time frame for the profit stream from A&Ms is unpredictable. It may take years before the contributions of A&Ms on firms' profitability can show up in their income statements (Haspeslagh and Jemison, 1987; Scherer and Ross, 1990). Therefore, observing a lower profit during the first three years after A&Ms, for example, does not necessarily mean that these A&Ms are non-value maximising. Finally, it can be argued that behaviour emphasising shareholders' wealth serves managers interests too. Managers may use A&Ms to seek profitability not only for the purpose of increasing owners' wealth but also for securing their own jobs (Weisbach, 1988).

Closely related to these managerial causes is the ‘hubris’ or overpayment hypothesis (Roll, 1986; Black, 1988), which refers to cases where bidding managers, suffering from arrogance, optimism or a lack of information, may pay a price which is higher than a target’s real worth.

**Exhibit 2-1: Causes for A&Ms.**

Causes	References
<b>1- Management use A&amp;Ms to make personal gain.</b>	(Jemison and Sitkin, 1986; Barnatt and Wong, 1992).
<b>2- Improve the efficiency.</b> Reducing cost of obtaining finance. Lower marketing's cost. Lower cost of administration and staffing. Lower cost of Research and Development. Reducing cost of operation and production.	(Barnatt and Wong, 1992; Bruton et al., 1994). (Scherer & Ross, 1990; Barnatt & Wong, 1992). (Prais, 1976; Scherer & Ross, 1990). (Penrose, 1959; Scherer <i>et al.</i> 1975). (Scherer & Ross, 1990). (Davis, 1990; Paris & Munich, 1992).
<b>3- Improve the effectiveness.</b> Increase in debt capacity. Higher level of return on promotion. Gaining access to desirable market segments. Make fruitful use of discoveries made in R&D. Effective use of complementary resources.	(Davis, 1990; Johnson & Scholes, 1993). (Levy & Sarnat, 1970; Halpern, 1983). (Scherer & Ross, 1990). (Silvers, 1992). (Brealey & Myers, 1981; Barnatt & Wong, 1992). (Mullaney, 1992; Johnson & Scholes, 1993).
<b>4- Better management.</b> Replacing inefficient management. Increased specialisation due to increased size. Managers act in the interests of shareholders.	(Franks and Mayer, 1990; Bruton et. al., 1994). (Penrose, 1959 & Scherer <i>et al.</i> 1975). (Manson et al., 1994).
<b>5- Asset stripping.</b> <b>6- Market power.</b> <b>7- Speed.</b> <b>8- Minimise risk.</b> <b>9- An alternative to bankruptcy.</b>	(Kerin & Varaiya, 1985; Haspelagh & Jemison, 1987). (Singh & Montgomery, 1987; Hitt et al., 1993). (Amihud & Lev, 1981; Moynihan, 1994). (Amihud & Lev, 1981). (Tremblay & Tremblay, 1988; Peel & Wilson, 1989).

It should be recognised here that the “managerial theories of the firm” may occur in firms whose management is separated from their ownership, allowing managers to use mergers to make personal gains that are not shared by the owners. Regardless of any country, this is not expected in firms, such as small entrepreneurial and family businesses, who are managed by the owners or whose management’s strategic decisions are closely controlled and observed.

### **2.2.2 ‘Value-Maximisation’ Set of Causes**

Since one objective of this research is to find out what the causes for A&Ms in S.A. are, we must first investigate what the literature suggests are the causes for requiring A&Ms. The ‘value-maximisation’ set of theories suggests that the major cause for A&Ms is to increase the shareholders’ wealth through one or more of the following causes: increasing the market power of the firm, reducing its cost and improving its performance due to complementary resources (Singh and Montgomery, 1987; Davis, 1990; Brush, 1996). These points, found in the literature, will be discussed below. For more details about these causes, see Appendix 2.1.

#### **2.2.2.1 Market Power**

A firm may use A&Ms to reach a market power. This occurs when the merged firms are able to influence price, quantity, and the nature of the product in the market place (Shepherd, 1970; Hitt et al., 1993). In turn, market power may lead to excess return or the same return but for a longer period of time (Mueller, 1980; Singh and Montgomery, 1987).

#### **2.2.2.2 The Synergy (Efficiency and Effectiveness)**

A&Ms are also used to reduce cost and improve effectiveness. The main causes behind the cost reductions are economies of scope where doing multiple things is more efficient than doing fewer things, and economies of scale where larger size or volume of a specific product means that resources are being utilised fuller (Bruton et al., 1994; Millar, 1994; Wahid, 1995).

In addition, effectiveness can be improved by benefiting from the synergy between merging firms’ resources and capabilities. One company may have certain strengths that another firm lacks and the merger allows those strengths to be more fully exploited (Garnsey et al., 1992; Johnson and Scholes, 1993). Efficiency and effectiveness can occur in specific functional areas, i.e. production, marketing, research and development, as well as in the more general areas of management and financing.

Also, sources of economies of scope and effectiveness can be tangible, such as distribution channels, cash, labour, and management, or intangible such as customers' loyalty, managerial and labour skills and values, and information (Davis, 1990; Hall, 1992; Brush, 1996).

### **2.2.2.3 Other Causes**

Efficiency, effectiveness and market power may also be valid causes for expanding internally. However, two other causes, short time and low risk, appear from the firm's point of view, to be attached more to growth via merger (Kumar, 1981; Moynihan, 1994).

Managers quite often use A&M to capture value at the time of transaction rather than create value after the A&M. This has led researchers to propose further causes for adopting A&Ms, i.e. taxes and assets stripping (Haspelagh and Jemison, 1987; Barnatt and Wong, 1992; Bradley and Keppler, 1993). Finally, A&Ms can be used, in addition to creating and capturing values, as alternatives to bankruptcy (Tremblay and Tremblay, 1988).

### **2.2.3 Remarks on Causes for A&Ms**

The literature suggests that managers may use A&Ms for more than one cause (Trautwein, 1990). However, the literature does not indicate which causes are used more or which ones yield more value than others. Moreover, these points were suggested as the causes behind the A&Ms in developed countries and they were based on studies of joint stock companies where the management is presumably separated from the owners. Therefore, the causes for A&Ms' and their relative importance in the developing countries may vary given the distinct contexts of these developing countries.

In addition, the methodologies used to investigate the causes for A&Ms' were either to ask management directly what their causes for A&Ms were (Norburn and Schoenberg, 1994) or to infer the causes from investigating the results of A&Ms

(Mueller, 1980; Haspeslagh and Jemison, 1991). Both of these methods have limitations. Giving untrue responses, such as answers related to decisions made for managerial causes or for monopoly purposes, is the main limitation of the first method. With regard to the second method, most studies used profitability as an indication of efficiency. When researchers recognise that profitability after A&Ms is exceeding pre-merger profitability, they conclude that efficiency is the cause for A&Ms. This conclusion is questionable since the increase could be due to another cause. A&Ms yield real values only if effectiveness and efficiency have improved due to positive synergy between acquiring and acquired companies. Values resulting from other causes represent a transfer of gains from a specific party to the acquiring firm. Market power will lead to a transfer of values from the customers, tax benefits transfer the values from the state and values caused by assets stripping are transferred from the acquired firm's shareholders (Trautwein, 1990; Barnatt and Wong, 1992). Studies using the second method, therefore, did not show the sources of gains.

This study will investigate the causes behind the A&Ms activities in S.A. and their relative weights in management decisions by asking management directly what they think the causes for A&Ms are. This investigation will eventually indicate the source of gains which A&Ms will lead to, either real gains or just transfer of gains. One of the characteristics of this study is that it examines the effects of A&Ms on profitability in connection with causes for A&Ms. This approach is different to most research, which usually studies one in isolation from the other. One more feature of the study is that it analyses causes for and effects of A&Ms with a relationship to the context of A&Ms' in S.A. That context, as will be explained later, will show that the limitation of the first method discussed above is irrelevant or may have minimum effect.

A final remark is that, in addition to what was mentioned earlier, there are other factors (reasons) that have important effects on managerial decisions in choosing A&Ms. It seems that these reasons have not given a great deal of attention in the literature. They

constitute the contexts that surround the A&Ms' activity, which have impacts on both the aggregate level and characteristics of the A&Ms. This topic will be discussed below.

## **2.3 The Contexts of A&Ms**

### **2.3.1 Overview**

The rate of A&Ms activity, their varieties (friendly or hostile and related or conglomerate) and the dominating causes for using A&Ms are all affected by specific factors (contexts). Therefore, the researcher believes that considering the contexts while examining the causes for and effects of A&Ms will give a better picture of these issues. The context of A&Ms (mostly the USA and UK) will be investigated in this section (while effects of the context will be discussed in the next section). However, some differences will be examined between this context and that of other countries.

### **2.3.2 Factors Affecting the Aggregate A&M's Activity**

The literature suggests several factors affecting the A&Ms' activities. They are as follows:

#### **2.3.2.1 Characteristics of Industrial Structure**

In general, USA and UK firms are characterised by their relatively large size and their diversification into several industries. Medium-sized firms in the Anglo-American world have typically obtained public, quoted status and have often then diversified through acquisitions (Scherer and Ross, 1990; Shore, 1990).

In contrast, industries in other European countries, such as Italy and France, have fewer large firms and more medium-sized firms than in either the USA or the UK. Furthermore, they have fewer conglomerate companies (Shore, 1990; Porter, 1990). It is much more common for medium sized firms in such countries to remain under the control of owner-entrepreneurs.

### **2.3.2.2 Factors Related to Management of Firms**

A large number of firms in the USA and the UK are publicly held. With the exception of shares owned by institutional investors, share ownership is wide spread among thousands of stockholders, not one of whom may own a sufficiently large fraction of the outstanding shares to exercise a significant controlling role (Scherer and Ross, 1990; Shore, 1990). Although the institutional investors hold a high fraction of stocks (Brancato and Gaughan, 1991; Davis and Thompson, 1994), there is evidence that institutional investors often fail to exercise their monitoring role and thus tolerate self-serving managerial behaviour (Weisback, 1988; Lorsch and MacIver, 1989)<sup>2</sup>.

The share ownership in the Continental European countries (not in Japan) is less widely spread than in the USA and UK companies. In general, the majority of voting shares, even for the quoted companies, are under the control of persons or institutions with close ties to the existing company management. For example, more than half of the 200 largest companies in France are family controlled. Further more, government share holdings are significantly larger. In Italy, only seven of over 200 listed companies had more than 50% of their shares in public hands (Shore, 1990).

Also, cross-share holdings between industrial partners are common. In France, Germany and Japan, mutual cross-share holdings between corporations is permitted and commonplace. There is an implicit agreement that cross-share holdings should not be used to launch unwelcome take-overs (Franks and Mayer, 1990; Odagiri, 1990).

Furthermore, banks also play a much larger role in both share ownership and strategic management, with bankers prominent on supervisory boards (DTI, 1989; Odagiri, 1990). In Germany, banks are significant shareholders. One important effect of bank control is the protection of firms from interference from external parties, in particular from hostile take-overs (Berger, 1989; Shore, 1990).

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2) See Footnote at the end of chapter.

In addition to these institutional factors, there are regulations which make takeovers difficult. For example, French companies are able to place serious restrictions on the transfer of shares and voting rights of shareholders. Certain classes of shareholders can enjoy privileged voting rights, others have no voting rights at all (Shore, 1990; Franks and Mayer, 1990).

### **2.3.2.3 Role of Capital Markets**

The capital markets play a very important role as a mechanism for carrying out A&M's activities. The primary function of the capital markets is to facilitate the transfer of funds from economic agents in financial surplus to those in financial deficit. Therefore, they are considered as sources of financing which are necessary for the development and growth of the firm. Another function of the capital markets is to provide a facility for the continuous reallocation of financial assets among various investors, allowing some to divest themselves of such assets while others can use their surplus funds to acquire them, which the purpose of the secondary market (Ba-Owaidan)<sup>3</sup>.

The capital markets of the USA and the UK are considered more accessible than markets of other countries (Franks and Mayer, 1990). The central function of the UK and the US stock markets involves take-overs where domestic and foreign acquirers can go to the capital markets and offer X amount for a stock that has been selling for 80 per-cent of X and attempt to acquire all or most of the stocks (Nevin, 1989).

The capital markets in the continental nations are not only less influential, they are also less developed and less fluid (Franks and Mayer, 1990). The tightly controlled patterns of share ownership in these nations has contributed to this outcome.

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3) The security market can be split into two parts; one dealing with securities which are made available for the first time called the "primary market", and one dealing with outstanding securities owned by investors called the "secondary market".

#### **2.3.2.4 Competition**

Some researchers (Kay, 1990; Mullaney, 1992) claim that internationalisation represented by increased imports or entry by multi-nationals, is one motivational factor in all mergers waves.

#### **2.3.2.5 Role of Governments**

Governments, through laws and regulations, have an important influence on A&Ms' activity. The governments of Western European countries played an important role in motivating acquisition activity in Europe during the merger waves of 1950-1970. For example, in the UK the government established the Industrial Reorganisation Corporation specifically to promote some mergers. On the contrary, the government of the USA, by issuing anti-trust laws has discouraged A&Ms that lead to monopolies (Mueller, 1980; Scherer and Ross, 1990).

#### **2.3.2.6 Taxation**

Taxation policies have an important influence on A&Ms' rates. An example of the taxes' effect on acquisition is that corporate profits in the USA and many other nations are taxed directly when realised by the corporation and again at the personal level when they are distributed as dividends to individual stockholders. To avoid this double taxation, management may use acquisition for the sake of utilising the profits instead of paying them out as dividends. If the investment (merger) is successful, the value of the company's stock will increase, permitting shareholders to sell some of their shares (Davidson, 1988; Scherer and Ross, 1990). This factor can be considered as another reason as to why institutional investors may support the management in their A&Ms' decisions.

#### **2.3.2.7 Supporting Infrastructure**

Investment bankers, acquisition brokers, accountants, consultants, and lawyers are all important elements affecting A&M activity (Stacey, 1980; Buchanan, 1990; Garai

and Pravda, 1993). Over the last 30 years investment bankers have played an important role in A&Ms' activities. Some investment bankers suggest possible targets to potential bidders; others provide the needed credits for the acquiring firms (Glazer, 1989)<sup>4</sup>.

#### **2.3.2.8 Others Factors Suggested by Bradley and Korn**

Bradley and Korn (1979) suggested that liquidity, stock prices, accounting rules and political and economic uncertainties were all factors that influenced corporate-management attitudes toward the choice between acquisition and internal development. Moreover, they suggested that the access and availability of information was one of the most important prerequisites for the completion of acquisition processes (Bradley and Korn, 1981). Finally, they provided several assumptions of the forces within the business environment which encourage some companies to become prospective sellers and other companies to become buyers. They suggested that, firms' inability to capitalise through public offering, high interest rates, and the large premiums paid to sellers, had increased pressures on some firms to consider acquisitions over going it alone. The inflation factor which makes purchases of companies less costly than capital investment and the ease of laws that control acquisition activities were some forces affecting buyers which were also mentioned by Bradley and Korn (for more factors affecting the A&Ms' decisions, see Exhibit 2-2).

It should be noted that the factors which were outlined earlier by researchers to explain why A&M's activity are of such a vast scale are based on judgements and intuitive assumptions. Research on factors that explain the fluctuations in aggregate merger activity is sparse and only a few variables were investigated. Melicher et al. (1983) has shown that buoyant stock prices are correlated with merger activity. Also, Polonchek and Sushka (1987) suggested that a tightening of financial conditions and/ or

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4) One criticism can be raised however, regarding a bank's role as a financial advisor and at the same time as a creditor. There is a potential conflict between these two roles.

reduced merger activity. Finally, Teece (1982) and Armit et al. (1989) found that a firm which in the past had diversified through acquisitions tended to continue this method in the future. Conversely, a firm that diversified through internal venturing would continue to do so in the future. Teece (1982) suggested that this process depends on the amount of excess resources that may suddenly become available. If slack resources emerge suddenly, due, for example, to a sudden surge in technological innovation, then merger or acquisition is likely to be the most favoured route.

### **2.3.3 Remarks on the A&M's Contexts**

To achieve the second main objective of this study; to investigate what motivates A&Ms activity and what creates barriers to them, the factors that have been presented earlier were divided into two main categories. The first category includes those factors that increase the acquisition activity. They will be called motives. The second category contains the factors that discourage a firm's decision makers to adopt mergers. They will be called barriers (see Exhibit 2-2). The existence of these motives will not lead to a higher rate of acquisition activity if they are not supported by elimination of the barriers. Regardless of the relative weight of each factor, the context that has more motives and less barriers will be expected to be exposed to a high level of A&Ms. Moreover, each of the motives and barriers have been divided into two parts: external (outside firms) and internal (inside firms). Thus, four categories have been defined: external motives, internal motives, external barriers and internal barriers. It should be noted that this classification is based on the researcher's judgement and these factors are neither exhaustive nor mutually exclusive.

Since these factors represent the context of A&Ms in the developed countries, they may not necessarily be applicable in developing countries, or some of them may have less weight. Moreover, other factors may be involved. These factors were tested to see their plausibility within S.A.

## Exhibit 2-2: Motives and Barriers of A&M.

<u>Factor</u>	<u>References</u>
<b>Motives:</b>	
<b>Internal:</b>	
Ability of management to control increased complexity.	(Bradely & Korn, 1979).
Large size and degree of diversification of the parent company.	(Scherer & Ross, 1990; Shore, 1990).
Awareness that large firms are better equipped to manage business.	(Bradely & Korn, 1979).
Personality (Empire builder).	(Bradely & Korn, 1979).
Excess capacities that a firm can not efficiently deploy internally.	(Teece, 1982).
<b>External:</b>	
Government provides benefits to merging firms.	(Mueller, 1980).
Inability to be capitalised through public offering.	(Bradely & Korn, 1979).
Rapid growth of international trade (competition).	(Kay, 1990; Mullaney, 1992).
Tax laws.	(Davidson, 1988).
Existence of effective and efficient investment bankers.	(Glazer, 1989; Buchanan, 1990).
Existence of effective and efficient acquisition's brokers.	(Stacey, 1980; Buchanan, 1990).
Availability of list of firms willing to be involved in acquisitions.	(Bradely & Korn, 1979).
Availability of financial and personal information of potential firms.	(Bradely & Korn, 1981).
Stock markets as mechanisms of carrying out mergers activities.	(Nevin, 1989; Franks & Mayer, 1990).
<b>Barriers:</b>	
<b>Internal:</b>	
Ownership control (Share ownership is less spread).	(Franks & Mayer, 1990; Odagiri, 1990).
Lack of experience.	(Armit et al., 1989).
Satisfaction with status quo.	(Bradely & Korn, 1979).
Management does not like to share authorities.	(Bradely & Korn, 1979).
Desire for independence of name or image.	(Bradely & Korn, 1979).
Managers fail to take advantage of merger's opportunity.	(Bradely & Korn, 1979).
Restriction of resources , especially financial capital.	(Polonchek & Sushka, 1987).
<b>External:</b>	
Discouraging inflation rate.	(Bradely & Korn, 1979).
High cost of capital (interest rate).	(Polonchek & Sushka, 1987).
Legal restriction.	(Mueller, 1980; Scherer & Ross, 1990).
Legal consideration (liability).	(Bradely & Korn, 1979).
Not a good price.	(Melicher et al., 1983).
Public relation.	(Bradely & Korn, 1979).

## 2.4 Consequences of the Contexts

It was mentioned earlier that the contexts (motives and barriers) not only have effects on the A&Ms' rate but also on some other variables. Moreover, it was suggested that studying the causes for and effects of A&Ms would be more valid if they were explained in connection with their contexts. To get a sense of the effects of A&Ms' context on some issues related to A&Ms, the next section discusses the consequences of the differences between the Anglo-American context and that of other nations, which were presented earlier, on the A&Ms' activity (see Exhibit 2-3).

Exhibit 2-3: Effects of the Contexts.

A&Ms' Characteristics	US and UK	Continental Nations and Japan	References
A&Ms' rate.	High.	Not high.	(Kay, 1990; Mullaney, 1992).
Characteristics of A&Ms.			
Unrelated.	High.	Not high.	(Davis, 1990; Wahid, 1995).
Hostile take-over.	Relatively high.	Rare.	(Berger, 1989; Odagiri, 1990).
Degree of integration.	Full.	Partial.	(Berger, 1989; Odagiri, 1990).
Causes.	Managerial gains. Economical reasons. Market for corporate control.	Synergy.	(Kay, 1990; Odagiri, 1990; Agrawal et al., 1992; Datta et al., 1992).

#### 2.4.1 A&M's Rate

A&Ms are higher in Anglo-American economies than in any other countries. This is likely to be the result of the existence of motivating contexts for A&M's such as the extremely open nature of the capital markets in both countries (Kay, 1990; Mullaney, 1992). Geroski and Vlassopoulos (1990) examined the merger activities of the top 1000 firms in Europe in order to determine the private sector's response to the establishment of a Single European Market. They found that an important part in the flow of cross border mergers accrued between the USA and the UK. Based on Geroski and Vlassopoulos (1990): “**The striking feature about cross border merger activity is that, on the whole, it is not a predominantly European sport so much as it is an Anglo-American game While the UK alone accounts for about 45% of the total mergers**” p. 38.

#### 2.4.2 Characteristics of A&M's Activity

Given the restricted anti-trust laws in the USA, most of the acquisitions in the 1960s and 1970s were increasingly toward pure conglomerate acquisitions (Wahid, 1995) while in the 1980s' merger wave (Scherer and Ross, 1990) and early 1990s (The Economist, 1994) horizontal acquisitions increased in the USA. Following the rejection

of the traditional belief that diversification and being ‘big’ confers advantages, firms are now divesting non-core corporate assets (Barnatt and Wong, 1992). Moreover, in the USA and the UK there is an active market for hostile take-overs. Auerbach (1988) argued that the boom in acquisition activity in the USA in the mid 1980s exhibited many phenomena not observed before, in particular, hostile take-overs and take-over defences. It should be noted though that the 1990s have chiefly seen organisational combinations in the Anglo-American countries that are typically friendly, negotiated transactions (Gupta and Tannenbaum, 1990; Barnatt and Wong, 1992; The Economist, 1994).

In contrast, Continental European mergers are more likely to be related, rather than conglomerate diversification (Davis, 1990; Mullaney, 1992). Furthermore, contested take-overs are rare because of technical and ownership differences. Firms enjoy the protection of large share holding controlled by banks, family concerns and sometimes the state. Therefore, acquisition is typically by agreement rather than take-over by the acquiring firm (Berger, 1989; Odagiri, 1990; Franks and Mayer, 1990).

Finally, due to the differences in structural ownership, full acquisition (buying the majority holding of the outstanding stocks) is the usual approach used in the USA and UK, while in Continental countries and Japan, partial acquisition is dominating (Berger, 1989; Odagiri, 1990). Target firms in the Continental countries and Japan are likely to be family owned which means that acquirers may not be able to control the majority holding of these firms, and therefore accept a partial acquisition.

#### **2.4.3 Causes for A&Ms**

Due to the institutional and regulatory factors related to the management of Firms, A&Ms may be used by managers of Anglo-American firms to make personal gains even if they are against the owners’ wealth. Several researchers measuring the profitability of acquisitions of Anglo-American companies, which will be discussed later, suggested that the maximisation of managerial objectives was a major cause for A&Ms’ activity (Mueller. 1980; Kaplan and Weisbach, 1992). Regardless of the intention of

management, another dominating cause for the 1980s' merger wave in Anglo-American economies was the desire not to concentrate upon production and marketing capabilities but the desire to acquire assets which the acquirer believed were likely to be more valuable under his ownership than in an independent company; as it called "market for corporate control" (Kay, 1990).

This managerial cause may not be found in Japan and Western European countries due to the characteristics of these countries. A higher proportion of mergers in continental European countries and Japan appear to be associated with synergy considerations (Odagiri, 1990; Davis, 1990). In Japan, using an acquired firms' strengths in marketing and technology has explained about 53% of reasons cited by the respondents (Odagiri, 1990).

## **2.5 Effects of A&Ms**

Investigating and explaining the effects of A&M has been the focus of a large volume of literature. The outcomes of A&M have been investigated from two perspectives; profitability of acquiring and acquired firms, and the economic welfare.

### **2.5.1 Effects on Profitability**

The discussion presented earlier with regard to the causes for A&Ms suggested that A&Ms may have positive effects on a companies' performance due to improved effectiveness and/ or efficiency. However, outcomes of empirical studies are, as will be presented later, inconsistent. This inconsistency can be explained by the methodologies used by researchers. Therefore, a discussion of the methods and their limitations will be provided first.

#### **2.5.1.1 Methodological Limitations**

Two dominant methodologies have been used by researchers to examine the effect of acquisitions on the profitability of both the acquiring firms and the acquired firms. The first utilises the published accounting information, while the second uses market based

measures. This latter approach assumes that the capital market forms unbiased estimates of all publicly available information about the firm's future cash flows and their related risks (efficient market theory). The two methods are different in the sense that the accounting approach focuses on past performance whereas the market-based approach focuses on the present value of future streams of income (Seth, 1990; Manson et al., 1994).

Regardless of which method is used, it seems that the main problem was that the methodologies relied on large samples of heterogeneous A&Ms' cases. Types of acquisitions (related vs. unrelated and friendly vs. hostile), management control firms vs. owners controlled, industries and other variables have not been distinguished in most studies to detect if outcomes can be different (Halpern, 1983; Tremblay and Tremblay, 1988). In support of the above argument, Jensen and Ruback (1983) argued that the evidence on the return to acquiring firms was inconclusive because of measurement problems relating to time of merger news (e.g. announcement versus consummation), relative size of buyers and sellers, risk change, and even regulatory changes. Halpern (1983) and Masse et al. (1990) further suggested that abnormal return might be influenced by form of payment (e.g. cash versus stock), as well as type of merger (e.g. horizontal versus conglomerate), and frequency of acquisition.

In addition, certain limitations pertaining to each method may contribute to the inconsistent results (Manson et al., 1994). Using the market approach, the majority of researchers made their conclusions about the outcomes of A&M's effects on profitability based on observing the immediate impact of an acquisition event on a firm's stock's prices. These outcomes represented the security market's expectation within a narrow time span around the acquisition's announcement. This approach is questionable for several reasons. First, it measures prediction, not real effects of mergers. Second, some A&Ms are used to create values that may take several years to unfold (Halpern, 1983; Haspeslagh and Jemison, 1987)<sup>5</sup>. Third, the market model's parameters are sensitive to the time period chosen to represent equilibrium; pre, pooled, or post merger (Scherer and

Ross, 1990). Fourth, stock price performance studies are unable to determine whether acquisitions create real economic gains and also identify the sources of such gains (Healy et al., 1992). Finally, some scholars do not accept the premise that the stock market is always efficient. The market efficiency approach assumes that shareholders can understand the way in which a firm's strategy will evolve and thus value the firm according to their risk preference for that strategy. Research however, contradicts this assumption, suggesting that strategy is not a predictable, deterministic process but an evolving set of decisions about how a firm will relate to its environment (Quinn, 1980).

The accounting-based measures used are considered by some researchers as ambiguous indicators of an acquisition's effect on profitability because of the differences in accounting standards employed by firms, because risk among different strategies is not taken into consideration (Seth, 1990) and because, as the time period between merger's occurrence and measurement increases, other possible economic influences might be affecting the profitability (Sturgess and Wheale, 1984).

#### **2.5.1.2 Results of Empirical Studies**

Some studies have suggested that acquirers realise positive performance outcomes (Chatterjee and Lubatkin, 1990; Healy et al., 1992; Manson et al., 1994) or at least don't perform more poorly than their non-acquiring counterparts (Shelton, 1988; Pablo, 1994). Surveys by Jensen and Ruback (1983) and Jarrel et al., (1988) bring together a variety of different studies and find that in the USA, on average, target company shareholders gain between 20 and 30 percent. Shareholders of bidding companies, on the other hand, gain between 0 and 4 percent.

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5) One may argue however, that this reason supports the market approach rather than the accounting method because, for researchers, deciding when the merger creates value, and hence when to measure its effects, may be impossible.

The preponderance of the evidence suggests that the intended benefits of acquisition are often not realised, with acquired firms exhibiting poor performance in terms of both accounting- and stock-market- based measures (Schmidt and Fowler, 1990; Violano, 1990; Kubilus, 1991; Agrawal et al., 1992; Datta et al., 1992; Moynihan, 1994). Loderer and Martin (1992), for example, reported that an investment in each acquiring firm on the date of 10,000 acquisitions that took place between 1966 and 1986, and held for 500 trading days, would have yielded an equally weighted return of 21%. In comparison, a share in the market portfolio would have yielded a return of 36%, more than 50% higher. Even after controlling for risk, Loderer and Martin (1992) found that acquiring firms often under perform the market.

Research on sources of gains in A&Ms is also inconsistent (Manson et al., 1994). Shleifer and Summers (1988) argued that gains from take-overs arose as new management broke the implicit contracts that existed between the firm and stockholder groups. This gain came from transferring wealth from stakeholders (such as employees or suppliers), by changing employment conditions, wages, or prices for purchased goods. Another view was that gains resulted from tax-related manipulations of the target company's assets (Auerbach and Reishus, 1987). In contrast, some researchers (Healy, et al., 1992) suggested that the increase of post merger returns arose from post merger improvements in asset productivity.

#### **2.5.1.3 Remarks on A&M's Effects on Profitability**

Given the general inconsistency in results, two views have evolved (Haspeslagh and Jemison, 1987). One suggests that A&Ms increase shareholders' wealth of acquiring firms, while the second view indicates that the expected improvements in profitability and the wealth of shareholders do not often materialise, and 44% of acquisitions are later divested (Kaplan and Weisbach, 1992)<sup>6</sup>.

Neither view is true, and both have risky implications. The first view led many managers to see A&Ms as ends in themselves and they became objectives which

managers are eager to achieve without careful consideration of the potential mistakes that occur in either pre or post-acquisition period. Managers adopting the other opinion may miss realistic corporate renewal opportunities for their firms.

A better approach is to study the effects of A&Ms on profitability in connection with specific factors in order to find out if there are particular characteristics that pertain to successful (profitable) A&Ms and to unsuccessful ones. While there has been a significant amount of research on A&M's performance, surprisingly little research has focused on how A&Ms can be successful. One of the purposes of this research was to identify conditions and attributes contributing to A&M's success.

### **2.5.2 Factors Affecting the A&M's Success**

#### **2.5.2.1 Factors Affecting the A&M's Success from Theoretical Perspective**

Although the literature emphasises that each acquisition case is unique and therefore managers are expected to judge capital investments solely on a project-by-project basis (Haspeslagh and Jemison, 1987), the literature suggests that the chances of success (profitability), on average, increase with the existence of the following conditions:

##### **1: Good Management Intentions**

The separation between ownership and management may lead the later to use A&Ms to achieve growth in sales or assets or to control a large empire even if they do not contribute to owners' wealth (Barnatt and Wong, 1992). Compared with managers, employees, investment bankers, commercial bankers and lawyers, share holders are often given the least consideration because they are the furthest from the acquisition process (Haspeslagh and Jemison, 1987).

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6) It should be noted, though, that 34% to 50% of the classified divestitures (44%) were considered unsuccessful by Kaplan and Weisbach (1992).

The Anglo-American business environment and the associated rationale of “market for corporate control”, may induce some firms to enter mergers not necessarily for the intention of creating value for their shareholders but for increasing their size and reducing the probability of being taken-over.

Logically, the management may not choose A&Ms to make personal gains that are against owners’ wealth in the following cases; if the management have a low stockholding ownership, if there is strong inside or outside ownership, and if their salaries and bonuses correlate with the companies’ profitability (Scherer and Ross, 1990)<sup>7</sup>.

## **2: Industrial Fit**

Each industry is unique because each business has its own special sales, marketing, and technical characteristics that are critical to success. A company acquiring a firm functioning in a different industry lessens its chance of success (Davidson, 1988; Campbell, 1995).

## **3: Strategic Fit**

The literature suggests that each project should be viewed in the context of its contribution to the firm’s overall strategy (Kassin and Herrera, 1990; Kroener and Kroener, 1991; Bradley and Keppler, 1993). Strategic fit requires acquiring related businesses to give an ex ante indication of potential sources of value creation (Singh and Montgomery, 1987). It should be noted though that relatedness does not guarantee synergy (Kay, 1990; Haspeslagh and Jemison, 1991).

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7) With regard to the last criteria, it can be argued that salary may not be a valid indication of a management’s good intention because sales and profits correlate strongly, making it difficult to tell whether managers simply care about the size or after the high profit attached to it.

#### **4: Cultural Fit**

The literature stresses that each company has its own distinct personality. Ethical standards and approaches toward research, product quality, customer services and standards and approaches toward research, product quality, customer services and pricing are all varied (Buchanan, 1990; Davidson, 1988). Therefore, if the gap between cultures of two merging firms is wide, the probability of success in general, is low (Kassin and Herrera, 1990; Davidson, 1988; Millar, 1994).

Although theories indicate that horizontal and related acquisitions enhance industrial and strategic fit, little has been proposed as criteria of cultural fit. The literature suggests that a firm's distinct personality is often a reflection of the size of the business, its stage of development and its success (i.e. profitability) (Gates, 1988). Large companies, for example, are usually professionally managed and tend to operate in a highly structured fashion. They move slowly and use formal planning. Smaller companies, on the other hand, are generally entrepreneurial in their orientation. They are run by a few key people and thus can move faster. So, it can be inferred from these differences that acquiring and acquired firms which are close in size, development stage and profitability will contribute to cultural fit.

Given a good management intention, an argument can be raised as to why management sometimes acquire risky businesses (with no industrial, strategic or cultural fit). Several reasons are proposed by some researchers (Haspeslagh and Jemison, 1991; Millar, 1994; Harvey and Lusch, 1995); one is the ineffective analysis and investigation of the target firms because of the speed and diversity of people involved in the acquisition process, which means that legal and financial perspectives dominate negotiation, instead of strategic analysis and organisational integration (Haspeslagh and Jemison, 1991; Millar, 1994; Moynihan, 1994; Harvey and Lusch, 1995).

Another reason for the difficulty in gaining the expected outcome from acquisitions is that acquisition analysts rarely consider implementation issues before the acquisition and, quite often, line managers play a limited role in the pre-acquisition analysis. This means

that a firm is acquired to yield expected outcomes which do not represent a realistic judgement of what firms can achieve together (Haspeslagh and Jemison, 1991).

Moreover, the Anglo-American context related to anti-trust laws, tax laws, institutional investors' expectations, characteristics of firms and the management style can influence the number and qualifications of alternative target firms available for acquisition. For example, Davidson (1988) suggests that the unprofitability of many acquisitions can be due to the tax benefits of mergers which tempt managers to evaluate an acquisition on the basis of the tax savings rather than on expectations that they can improve the operations of the combined firms.

Even if the management executes wisdom in choosing a suitable firm (aiming to create value to shareholders, industrial fit, strategic fit and cultural fit), profitability may not be enhanced if the post-merger period has not been managed effectively (Seth, 1990; Chatterjee, 1986; Cannella and Hambrick, 1993; Millar, 1994). This issue represents the final condition required to maintain profitable acquisitions.

## **5: Effective Post-Merger Management**

The human side of acquisition is probably the main contribution to the effectiveness of post-merger management (Napier, 1989; Buono and Bowditch, 1989; Gall, 1991; Millar, 1994). It has been estimated that about one-third to one-half of all mergers fail because of human resources problems (Davy et al., 1988; Millar, 1994).

Several suggestions and assumptions on how to integrate firms have been provided by researchers (Napier, 1989; Nahavandi and Malekzadeh, 1990; Somers and Bird, 1990; Gall, 1991). For example, Napier (1989) identifies three levels of integrating firms; extension (the acquiring firm leaves the acquired firm alone), collaboration (integrating the two firms operation, assets, or cultures), and redesign (the widespread adoption of policies and practices of one firm by the other) which in turn is expected to suggest how human resources may be affected. The relation between these types and

reasons of acquisitions, form of acquisition (related vs. unrelated) and effects on human resources, as suggested by Napier (1989), is presented in Exhibit 2-4.

Supporting Napier's opinions, Nahavandi and Malekzadeh (1990) claim that if the merger is unrelated, having the two companies remain separate with limited managerial and cultural exchanges, it is more likely not to have a negative impact on human resources. Davidson (1991) went further and suggested that if the acquired firm is small and profitable, it is better to let it operate as much as possible as a separate entity even if it is in the same acquiring firm's business.

**Exhibit 2-4: Relation Between Degree of Integration and Type of A&M, Causes for A&Ms A&M, and Effects on Acquired Firm's Human Resources as Suggested by Napier (1989).**

<u>Degree of Integration</u>	<u>Causes for A&amp;M</u>	<u>Form of A&amp;M</u>	<u>Effect on Human Resources</u>
Extension	Managerial reason & Financial reason	Conglomerate	No effects
Collaborative	Synergy & market power	Horizontal	Anxiety
Redesign	Using acquiring firm's strength (specifically management)	Related	Anxiety-welcome

Supporting Napier's opinions, Nahavandi and Malekzadeh (1990) claim that if the merger is unrelated, having the two companies remain separate with limited managerial and cultural exchanges, it is more likely not to have a negative impact on human resources. Davidson (1991) went further and suggested that if the acquired firm is small and profitable, it is better to let it operate as much as possible as a separate entity even if it is in the same acquiring firm's business.

Several points should be noted here. First, since the majority of A&Ms in the 1990s were horizontal and related, an extended degree of integration was not expected. The extension may contribute to post-merger integration but it may not enhance the aim of synergy achievement. Second, does the difficulty of integrating human resources mean it

is impossible to integrate employees successfully?<sup>8</sup> The literature suggests that successful integration is possible when it involves a relatively balanced give-and-take of cultural and managerial practices between the merger partners, and no strong imposition of cultural change on either company (Napier, 1989; Malekzadeh and Nahavandi, 1990).

The only two factors suggested in the literature as important influences in integrating businesses successfully, are effective communication and experience. Buono et al., (1988) claim that it is important to establish a high level of communication about the transformation that is to take place in order to avoid A&Ms' failure. Haspeslagh and Jemison (1991) suggest that firms that have used A&M before outperform those who do not have experience of them. However, because operating managers who will manage post-merger integration are not included in the analytical process (Haspeslagh and Jemison, 1991) and because of the absence of a considered post-acquisition evaluation process (McKiernan and Merali, 1995), firms may not learn from their valuable experience.

One result of an ineffective integration is the departure of the acquired firm's key personnel after acquisition (or they continue working but not enthusiastically) which is another reason for the potential loss of the productive capacity of the acquired company (Schweiger and Denisi, 1991; Gall, 1991; Cannella and Hambrick, 1993). In attempting to explain acquisition success, Burgman (1983) and Trautwein (1990) suggest that the realisation of plans associated with the retention of top management is positively associated with the success of an acquisition. It should be noted that the departure of an

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8) Although the literature suggests that successful integration is possible when it involves a relatively balanced give-and-take of cultural and managerial practices between the merger partners, and no strong imposition of cultural change on either company (Napier, 1989; Malekzadeh and Nahavandi, 1990), it does not show what techniques or tools should be adopted to achieve such a balance. Moreover, the literature suggests that the most common method used for merging two cultures involves: "**Cultural disintegration of one group due to unwanted and extreme pressure from another to impose its culture and practices**" p. 57 (Malekzadeh and Nahavandi, 1990).

acquired firm's key personnel is more likely to occur in hostile take-overs (Franks and Mayer, 1990) and therefore it is higher in the UK and the USA (Buono and Bowditch, 1989).

### 2.5.2.3 Remarks on Factors Affecting the A&M's Success

Based on the discussion presented earlier, chances of success are theoretically higher in specific A&M's cases (see Exhibit 2-5). It should be noted that this list has not been exhausted. Some other factors may have an effect on the chances of success, such as the sources of finance (debt or equity), and the size of premium paid (Moynihan, 1994).

The literature, unfortunately, does not tell us which factor or package of factors is more important with regards to factors of success. Probably the reason for this limitation is due to measuring these factors in isolation from their contexts. As a result of which, researchers may get different results with different circumstances. This explanation may also explain why the literature suggests that these conditions do not guarantee profitability and that success may be achieved if even one or more of these factors are unavailable (Hunt, 1990).

Exhibit 2-5: Requirements and Characteristics of Profitable Acquisitions.

Requirements	Characteristics of firms	Type of A&M	Degree of integration	Ownership & mgt. structure	References
Good mgt. intention.	--	horizontal & related.	--	Owners control. Mag. compensation correlate with profit. Mag. share ownership.	(Scherer & Ross, 1990).
Industrial & strategic fit.	--	Horizontal & related.	--	--	(Kay, 1990; Haspeslagh & Jemison, 1991).
Cultural fit.	Closeness of size & profitability of merging firms.	--	--	--	(Gates, 1988).
Effective integration	Acquiring firms have experience.	Friendly	Extension (in unrelated or acquired firm is smaller or profitable)	--	(Franks & Mayer, 1990; Davidson, 1991; Haspeslagh & Jemison, 1991).

The direction of the investigation will now move towards the empirical studies to see if there is a consistency between theoretical and empirical outcomes regarding factors that affect the A&Ms' success.

#### **2.5.2.4 Results of Empirical Studies**

When determining the factors that influence post merger performance in empirical studies, it is difficult to draw clear cut conclusions because of the inconsensus between the results and because of the many differences between these studies in terms of sample content. However, there is a tendency towards the following results which are consistent with the characteristics presented in Exhibit 2-5:

- deviation from value maximisation occurs when management has low stockholdings or because no coherent outside ownership coalition exists (Walking and Long, 1984; You et al., 1986; Stulz, 1988), the biggest determinant of the size of top management pay is the size of the company - and the quickest way to increase the size of a company is through acquisition (Moynihan, 1994).
- although unrelated acquisitions can be successful (Montgomery and Wilson, 1986; Chatterjee, 1986; Seth, 1990), firms that diversify into related businesses, on average, outperform those that diversify into unrelated ones (Singh and Montgomery, 1987; Porter, 1987; Hunt, 1990; Bleeke et al., 1990; Healy et al., 1992; Bruton et al., 1994);
- efficiency is reduced on average following the merger of relatively small firms (those which tend to be profitable are absorbed into much larger and more bureaucratic enterprises) (Ravenscraft and Scherer, 1987), mergers between companies of roughly equal size have more favourable post-merger sell-off experiences (Hunt, 1990; Scherer and Ross, 1990), and acquisitions that are small relative to the acquirer do not attract a high level of management attention (Pablo, 1994);
- companies taken over as a direct or indirect result of tender offers suffered significant post merger profitability declines (Ravenscraft and Scherer, 1987), hostile targets in the 1984-1986 period often broken up and were sold (Bhagat et al., 1990), and a friendly acquisition is less destructive in value term than a hostile one (Moynihan, 1994);

- acquired executives' loss of economic benefits and/ or status relative to acquiring executives "relative standing" causes their departure (Swaim, 1985; Hambrick and Cannella, 1993), and the acquired firms would have performed better, on average, had they remained independent (Mueller, 1985; Ravenscraft and Scherer, 1987) and
- experience increases the chances of success (Schmidt and Fowler, 1990; Hitt et al., 1993; Bruton et al., 1994).

### **2.5.3 Remarks on A&M's Effects on Profitability and Factors of Success**

It should be noted that the outcome of A&Ms' effects on profitability are based on studies of A&Ms found in the USA and the UK. The general results of declining profits or the insignificant improvement in profit by acquiring firms, which are recognised after the acquisitions take place, are theoretically expected. This is because several characteristics of successful A&Ms, presented in Exhibit 2-5, on average do not exist due mainly to the Anglo-American context discussed before, and its consequences presented in Exhibit 2-3.

For Continental European countries different results should exist. This is because of the correlation between some of their contextual consequences and the characteristics of profitable A&Ms, such as; ownership control, horizontal acquisitions and friendly acquisitions. The study of A&Ms (1962-1974) in Belgium, Germany, France, the Netherlands, Sweden, UK and US, (Mueller, 1980), using accounting measures, found unexpectedly, that no differences emerged across these countries. Moreover, studies in other countries, including Canada and France, using the market approach, found similar findings to those of the US and UK (Eckbo, 1986).

One possible reason for such an unexpected outcome is that integrating businesses and realising synergy is more difficult to accomplish than management expectations realised. Another reason is suggested by Lubatkin (1983) who proposed that mergers might provide real benefits, but perhaps the methodologies employed were not adequate to reveal these benefits.

The limitations of the studies used to test the effect of A&Ms on profitability and to investigate the factors of A&Ms' success were discussed earlier. The researcher emphasises that studying the effect of A&Ms on a firm's performance, and factors influencing the A&Ms' success may not be reliable if they are not connected with the causes and context of the A&Ms themselves. Such an approach was used to achieve the third objective of this study; investigating the A&Ms' effects on profitability in Saudi Arabia and the requirements of successful acquisitions in that country.

The previous discussion was about the effects of A&Ms on firms. A&Ms, in addition, have consequences on economic welfare. This subject will be discussed next.

#### **2.5.4 Effects on Economic Welfare**

##### **2.5.4.1 Overview**

A&Ms have effects on macroeconomics variables which include: economic growth, unemployment, market concentration, inflation and the balance of trade. Unfortunately, the literature on the wider effects of A&M on the economic welfare is limited (Kroener and Kroener, 1991; Wahid, 1995). The approach adopted in this section is to investigate suggestions of both positive and negative effects on the economy and to indicate whether these effects can be associated within specific contexts. The purpose of such an approach is to help determine whether these positive and negative effects can occur in S.A. given its specific characteristics. This issue is investigated in Chapter Four.

##### **2.5.4.2 Economic Growth**

Some researchers (Mueller, 1980; Davidson, 1988) suggest that A&Ms have a negative impact on economic growth and that increased acquisition activity is likely to be a wasteful thing for the economy as a whole. Their evidence is based on the declining profitability of acquiring and/ or acquired firms after acquisition. The discussion presented earlier with regard to this topic makes such a conclusion incorrect. Several studies found that A&Ms had positive effects on profitability. Moreover, the

unprofitability that occurred could be due to the measurement limitations which were also discussed earlier. Finally, the Anglo-American context could be responsible for the failure of such A&Ms because the prerequisite of successful A&Ms are not found in any part of A&Ms' activity both in the USA and the UK.

Furthermore, some researchers claimed that A&Ms had negative impacts on the economic growth due to their adverse effect on capital investment, R&D and other types of investment (Mueller, 1977; Hitt et al., 1990). The reasons for expecting acquisitions to influence investment adversely, as hypothesised by researchers, are that acquisitions may pre-empt resources necessary for the commissioning of new investment (Davidson, 1991). Also, the willingness to invest may also be adversely affected if acquisition reduces competitive pressure to improve and upgrade ones own business (Porter, 1990). In addition, managers and employees may not have adequate incentives to engage in long-term investment because the "market for corporate control" mechanism imposes a short term horizon on the managers and employees (Franks and Mayer, 1990). More recent research shows that firms active in the market for corporate control introduce fewer new products to the market regardless of their industry than firms not active in the market for corporate control (Hitt et al., 1996).

It should be noted that the last two effects are outcomes of the "market for corporate control" mechanism, and therefore, they are not expected in companies other than those of the Anglo-American countries. The attitudes of British and American companies compare unfavourably with those of continental Europe or Japan where firms are free to approach R&D or the creation of market share with a long time perspective (Kay, 1990; Odagiri, 1990; Garnsey et al., 1992)<sup>9</sup>.

The previous studies suggested that A&Ms' had a negative effect on economic growth. However, there are alternative studies which suggest that mergers may have a positive effect on the economic growth. Jensen (1986), Tremblay and Tremblay (1988) and others have argued that mergers represent a positive shifting of assets into their best use. By acquiring the inefficient firm, the acquiring firm could increase the efficiency of the inefficient firm, thereby producing private as well as social gains. Thus, in these

studies, mergers were seen as an economical way of eliminating bad management, reorganising corporate structures and improving allocation in the market.

Studies on the effect of A&Ms on investment and R&D include Kumar (1981), who analysed the records of over 350 acquisitions in the UK over the period 1967-1974 to see if the acquisitions had an adverse impact. He found that there was an improvement in the average share of the new fixed investment of merging firms over their pre-merger value. This improvement was substantial from an economic point of view and was maintained over several post-merger years. Supporting Kumar's study, Garnsey et al. (1992) explored three UK companies acquired by German companies and they found that the level of investment in the British sites had been higher than expected. Finally, Hall and Henry (1988) and Healy et al. (1992) suggested that there was no evidence of decreased capital expenditures or R&D following mergers.

The literature raised several reasons why A&Ms might lead to a positive impact on the investment and R&D activity. Silvers (1992) argued that reduced competitive uncertainty following acquisition may lead to a higher level of investment. He suggested that this may occur either because the danger of the emergence of excess capacity is reduced, or because of the enhanced ability to exploit the returns accruing from the

9) The comparison between the Japanese managerial goals and the American managerial goals is the evidence of such an assumption (Tadao Kagawa et al., 1988). It is based on a survey of top managers in 1,031 Japanese and 1,000 US industrial corporations during the early 1980s.

Goal	American Managers	Japanese Managers
Return to investment	1	3
Higher stock prices	2	8
Increasing market share	3	2
Improving products and introducing new products	4	1
Streamlining production and distribution systems	5	4
High net worth ratio	6	5
Improvement of social image	7	6
Improving working conditions	8	7

Source: Tadao Kagawa et al. Summarised in Peck, M. in Meyer and Gustafson (1988).

investment. Furthermore, the potential for new investment may increase due to the pooling of complementary resources.

It is often argued that industries with a few large firms will undertake more R&D and hence be more innovative than those with numerous small firms (Silvers, 1992). Table 2.1 provides a measure of R&D intensity in the UK in 1981 alongside the Five Firm Concentration Ratio (The Economic Review, 1988), which supports the above argument.

#### 2.5.4.3 Market Concentration and Competition

The general conclusion of several publications suggests that A&Ms have made a major contribution to the increase of aggregate as well as market concentration levels (Nissan and Caveny, 1993; Wahid, 1995). Nissan and Caveny (1993) assessed the level of concentration of the top 25 USA industrial firms reported annually by Fortune. They concluded that the concentration increased between 1967 and 1990, most noticeably during the 1980's (see Table 2.2).

Table 2-1: UK Industrial Concentration and R&D, 1981.

Industry	<u>Concentration (C5 %)</u>	R&D expenditure (Sales %)
Aerospace	79	16.0
Basic electrical equipment	49	2.3
Computers and office machinery	67	11.9
Electric consumer goods, sub-assemblies, etc.	54	4.2
Insulated wires and cables	83	1.5
Leather, footwear and clothing	19	0
Metal goods	21	0.2
Metal working machine tools	14	0.8
Motor vehicles and parts	67	1.7
Non-ferrous metals	45	0.5
Paper, printing and publishing	24	0.1
Pharmaceutical products	34	11.3
Pottery, china and glass	42	0.9
Rubber and plastics	28	0.5
Shipbuilding and repairs	79	0.3
Textiles (not man-made)	35	0.1
Timber and wooden furniture	15	0

Sources: The Economic Review (1988).

Table 2-2: Concentration of Sales and Assets of the Top 25 Fortune 500 Firms.  
 Percentage of Sales and Assets of the Fortune 500 Firms Held by the Top 25.

Year	Sales	Assets
1968	0.355	0.388
1969	0.343	0.378
1970	0.337	0.377
1971	0.351	0.377
1972	0.354	0.372
1973	0.357	0.383
1974	0.377	0.347
1975	0.376	0.381
1976	0.388	0.388
1977	0.394	0.391
1978	0.392	0.389
1979	0.393	0.388
1980	0.405	0.388
1981	0.412	0.399
1982	0.422	0.412
1983	0.416	0.408
1984	0.427	0.444
1985	0.428	0.448
1986	0.422	0.451
1987	0.414	0.447
1988	0.420	0.510
1989	0.422	0.503
1990	0.435	0.498
Mean	0.391	0.411

Source: Nissan and Caveny (1993).

One can argue, though, that the high concentration might be inevitable. If mergers have not been undertaken (say due to legal restrictions) internal growth might produce the same results. Type of industry and size of population may be more relevant reasons explaining the high concentration ratio than A&Ms activity. Based on a study of three-firm concentration ratios, for twelve identical industries in the USA, the UK, Canada, Sweden, France and West Germany in 1970, Scherer et al. (1975) found that certain industries (cigarettes, bottles, refrigerators, and batteries) tend to be relatively highly concentrated in every nation regardless of the A&Ms' activity level in each country.

Moreover, the 1985 employment of the twenty largest industrial (Manufacturing and minerals industry) corporations in ten nations, presented in Table 2-3, suggests that the lower the nation's work force, the higher the average top-10 or top-20 enterprise tends to be (Scherer and Ross, 1990). Table 2-3 shows that the employment

concentration level is high in countries other than the USA and the UK, where A&M rate is lower than that of the USA and UK.

Table 2-3: Aggregate Industrial Concentration Patterns in Ten Nations, 1985.

<u>Nation</u>	<u>Leading Company Employment as a per cent of Total Industrial Employment</u>	
	Top 10	Top 20
United States	13.1%	18.6%
Japan	7.3	9.9
West Germany	20.1	26.0
United Kingdom	23.1	35.3
France	23.2	32.5
South Korea	14.9	n.a.
Canada	15.3	21.9
Switzerland	49.4	60.2
Holland	84.5	95.1
Sweden	49.4	66.9

Source: Sherer and Ross (1990).

Regardless of what factor caused the high concentration levels, the interest of economists and governments has been focused on market concentration because they are concerned about control over the supply of a product by one firm's "monopoly power". Such control may also give the firm dominance over suppliers of materials and over labour markets which means that a large number of people may depend on their livelihoods on decisions taken by a small number of individuals (Scherer and Ross, 1990; Wahid, 1995). Moreover, they are anxious about inflation which it is believed can be reduced by a tougher competition policy (Mueller, 1980).

In spite of these worries, there is evidence to suggest that rising concentration, due to the growth of dominant firms in an industry, can lead to lower costs, and lower rather than higher prices (Ravenscraft 1984; Smirlock et al., 1984). Ravenscraft (1984) using a carefully constructed database, tried to determine whether concentration or market share was the more important variable explaining differences in profitability. He found market share to be the most important variable. He interprets this finding to be consistent

with the conclusion of others (Demsetz, 1973; Peltzman, 1977); that the superior efficiency of large firms is the primary source of increased profitability in high concentration industries.

Defining the market for which concentration is being measured is important to get an accurate measurement. To define the market properly, all meaningful competitors should be included (Scherer and Ross, 1990; Jackson, 1992). The ideal definition of a market must take into account substitution possibilities in both consumption and production. Therefore, competition from foreign suppliers should be taken into account otherwise the concentration ratio can be over-estimated (The Economic Review, 1988). Anderson and Rynning (1991) found that firms in a monopoly situation could maintain a high profitability when and only when there were extensive barriers to entry. They suggest that there does not seem to be a general linear relationship between concentration and profitability. This is a common assumption in many empirical studies.

#### **2.5.4.4 Unemployment**

In general, there are certain common negative reactions to acquisitions attributed to employees in the acquired firms. Some studies report widespread anxiety and stress resulting from concerns about job security and fears of a decline in status (Ivancevich et al., 1987). Feelings of being ‘sold out’ (Black and Mouton, 1985), a sense of loss (Napier, 1989), an increase in unproductive work time, greater turnover, absenteeism (Cabrera, 1982), and redundancies which aggravate local unemployment problems (Bohl, 1989; Mullaney, 1992) are also worries.

Despite these fears, acquisitions do not necessarily lower wages and increase unemployment (Jensen, 1984). Jensen (1984) claimed that the public's perception was conditioned by a relatively small number of highly publicised and extremely hostile takeovers and he was not aware of any evidence indicating that acquisitions produced more lay-offs and dismissals than would have otherwise occurred. It can be argued that even if A&Ms lead to employees being laid-off, in the long-term the overall results may be good

because the associated cost-cuts should increase firms profits, business investment and consequently future job opportunities.

More studies supporting the claim that positive outcomes can be achieved include Sinetar (1981) who found greater job satisfaction after A&Ms because of improved scope and variety of work, increased status, prospects for promotion, compensation, and more job security. Crouch and Wirth (1989 ) found that the mobility of managers was lower after a merger than under normal organisational circumstances.

#### **2.5.4.5 Balance of Trade**

Some publications suggest that acquisitions may have an adverse affect on exports (Newbould and Luffman, 1978) because if the firm can find profit maximising opportunities by way of acquisitions, it may be unwilling to increase its exports. Also, even if it is willing to do so, the firm may be constrained by the limitation on resources. Finally, acquisitions may occur at the expense of new investment, which may decrease exports because the quality of products and other non price factors is crucial in competing in world markets (Porter, 1990).

Other studies expect that acquisitions may influence exports positively by their effect on the size of the firm, and by the changes in the structure of industry which may occur following A&Ms. A&Ms are considered a quick way to increase a firm's size and size is positively correlated with exports (Kumar, 1981). Exporting is likely to enable firms to reap economies of scale in production by relaxing the constraint of market size. Some of the case studies which have enquired into the individual firms' motives for acquisitions, have also noted the emphasis placed on size for exporting activities by the firms themselves (Newbould, 1970; Cowling et al., 1980). It should also be noted, that entry to a foreign market is likely to raise the quantity sold at home through a reduction in average cost, and so a positive correlation would be expected between domestic sales and exports. Moreover, factors such as high fixed cost elements in information and marketing costs would still lead to the expectation that larger firms would tend to have higher

exports than the smaller ones even if the production economies were unimportant, (Kumar, 1981).

#### **2.5.4.6 Remarks on A&M's Effects on the Economic Welfare**

Exhibit 2-6 shows the potential positive and negative effects of A&Ms' activity on the economic welfare as suggested in the literature, as well as the justifications and the prerequisite conditions for such effects to occur. Several points can be noted. First, the prerequisite conditions which contribute to the negative consequences are closely attached to the Anglo-American context discussed earlier, which means that the A&Ms' negative impacts may not occur in countries other than the USA and UK.

Second, the literature provides two opinions about the impact of A&Ms, one in favour of the positive effects and the other against. Such a way of looking at the effects of A&Ms on the macro-economic variables is impractical and may lead to poor policy implications. A&Ms are one way of increasing a firm's growth, if they are used correctly, they will yield favourable effects or otherwise. Economic growth, for example, may be improved if assets have been shifted from weak firms to firms with qualified management which can make better use of them. But if managers acquire other firms' assets to enlarge their own firms, either to satisfy the investors who have a short term horizon of investment or to avoid being acquired, then acquired assets may not be used effectively. As a result the economic growth level will decrease.

Given the above arguments, it is more appropriate to investigate the A&Ms' effects on the economy in connection with the A&Ms' context to see if the negative impacts can be correlated within a specific context. It is this context that can be judged as good or bad, and not the A&Ms.

Finally, A&Ms need not have negative effects on all the economic variables mentioned earlier. A&Ms may have a positive impact on one side and a negative one on another. For example, they may increase the concentration level but at the same time they may influence exports positively. Supporting this point, Kumar (1981) suggested that the

UK's trade performance depends to a considerable extent on a relatively small number of large industrial enterprises. Therefore, it is not enough to study the effect of A&Ms on only one variable of the economy but as several measures which establish the overall effect.

### Exhibit 2-6: Effects of A&M on Economic Welfare.

#### **First: Positive Effects**

<u>Positive Effects</u>	<u>Reasons and references</u>	<u>Conditions</u>
Higher economic growth.	Shifting assets into their best use. (Tremblay and Tremblay, 1988).	Achieving effectiveness and efficiency.
	Higher level of investment. (reduce competitive uncertainty and pooling of complementary resources). (Silvers, 1992).	Synergy and market concentration.
	Market concentration (lower cost and lower prices). (Ravenscraft 1984; Smirlock <i>et al.</i> , 1984).	Synergy and no barrier to entry.
Improving balance of trade.	Size correlates with exports. (Cowling <i>et al.</i> , 1980; Kumar, 1981).	Achieving efficiency.

#### **Second: Negative effects**

<u>Negative effects</u>	<u>Reasons and references</u>	<u>Conditions</u>
Lower economic growth.	Decline profitability of acquiring firms. (Mueller, 1980; Davidson, 1988).	Managerial control, unrelated A&Ms, hostile A&Ms , Sizes are extremely different, acquired mgt. leaves and Lack of experience.
	Lower investment and R&D (pre-empt resources, reduce pressure to invest and management short-time horizon). (Hitt <i>et al.</i> , 1990; Davidson, 1991).	High premium and many beneficial parties. Monopoly power and barrier to entry. Market for corporate control and investors attitude.
Monopoly power	High level of concentration. (Nissan and Caveny, 1993; Wahid, 1995).	Empire building and Barrier to entry.
Higher level of inflation.	High level of concentration. (Nissan and Caveny, 1993; Wahid, 1995).	Empire building and Barrier to entry.
Aggravate problem of unemployment.	A&Ms lead to employees' layoff. (Bohl, 1989; Mullaney, 1992).	Acquisition is unsuccessful, hostile acquisitions are widespread and unemployment problem exists.
Deteriorate balance of trade.	A&Ms constrain resources and reduce investment to upgrade products necessary for export. (Newbould & Luffman, 1978; Porter, 1990)	High premium and many beneficial parties. Monopoly power and barrier to entry. Market for corporate control and investors attitude.

This research will examine the potential of A&Ms' impact on the economic welfare of S.A., given its unique characteristics. By doing so, the fifth objective of the study will be achieved and eventually more knowledge about the A&Ms effects on the economy can be gained.

To complete the literature review, relevant information about S.A. and the A&Ms activity there should be investigated. This will be the subject of the next chapter.

## **Footnote (2)**

Several studies suggested that shareholders of acquiring firms did not benefit significantly from mergers (Violano, 1990; Kibilus, 1991; Agrawal et al., 1992; Datta et al., 1992). Moreover, they indicated that the shareholders of the acquired firms benefited from A&Ms despite some of these firms' poor financial positions before acquisitions took place (Holl and Pickering, 1988). Furthermore, management in most cases paid a high premium for the acquired firms (Moynihan, 1994). Therefore, paying high prices to acquire weak firms which benefit from such acquisitions while the acquiring firms gain little, if any, gives a good example of managers acting against the interest of shareholders.

Other possible evidence came from a survey of 101 UK company boards designed to obtain information on the extent of their strategic involvement (Stiles and Taylor, 1996). Respondents were asked to state whether the board was wholly involved (full partners in the process), partly involved (involved in review and analysis), or were not involved (adopted a legalistic perspective). Although the results indicated that in most areas, there was significant board involvement, either as full partners or as part of the review and analysis process, raising finance and acquisitions were two exceptions, where 11% said the board had little or no role to play in acquisition's decisions and 45% said the board's role was restricted to the review and analysis of the proposals.

Several reasons may indicate why the institutional investors do not execute their expected monitoring role. One possible reason was suggested by Brickley et al. (1988) and Kochhar and David (1996). They found that not all institutions could affect a firm's actions. Institutions that had business relationships with the firm (pressure-sensitive institutions which include banks, insurance companies, and non bank trusts) were limited in the extent to which they could influence strategies. These institutions might not attempt to influence managerial actions to avoid being penalised by the firm via the withdrawal of business. Brickley et al. (1988) suggested that, when voting on anti-takeover amendments, pressure-resistant institutions were more likely to oppose firm managers than pressure-sensitive institutions. Some institutions may be unwilling to behave actively due to other reasons such as lack of access to firm-specific information (Porter, 1992), avoidance of being a target of similar activism by its institutional owners and, for institutions with small holdings in a firm, it may not be worthwhile to expend the time and money required on monitoring any subsequent influence (Brickley et al., 1988).

Another reason is that since many institutional shareholders have a stake in both selling and buying, they may accept to lose on the buying side in order to make bigger gains on the selling one (The Economist, 1994). Finally, American institutions are under pressure to demonstrate quarterly appreciation. Most of the stocks owned by institutions are held in pension funds whose investment earnings are exempted from taxation. Therefore, managers focus on companies whose shares will appreciate in the near term. The result of this institutional structure is a high rate of trading (Scherer and Ross, 1990; Porter, 1992).

It should be noted that what was mentioned earlier is more applicable to the USA than the UK. Moreover, there are reasons to believe that big shareholders are increasingly monitoring

management behaviour and are being involved in important decisions such as those of A&Ms (The Economist, 1994; Stiles and Taylor, 1996).

## **Appendix 1-1: “Value-Maximisation” Set of Causes.**

### **1: Market Power**

Based on Mueller (1980); “A&Ms may be used to increase the firm’s market power either by affecting the elasticity of demand for the firm’s products or by raising barriers to entry. The latter will allow firms to earn higher profits either by raising their limit price or by allowing them to earn profits at their present price for a longer period of time” p. 29-31.

Mergers can increase a firm's market power in several ways, depending upon the type of acquisitions involved (Mueller, 1980; Auerbach, 1988; Hitt et al., 1993). In horizontal mergers, the increasing market share of the acquiring firm may allow it to charge a higher price and/ or to increase barriers of entry if acquisitions lead to cost reductions. An existing or potential entrant may be deterred from competing with a large firm in an industry if it knows that the firm's costs are lower and, thus, that the firm may engage in a competitive price war.

Vertical and conglomerate acquisitions can have similar potential anti-competitive effects. Two firms may, upon merger, provide captive markets for one another products, thereby increasing the market power of each. Such acquisitions can make competition more difficult for existing firms and can make competition more difficult for those firms willing to enter the market (Porter, 1980).

### **2: The synergy (efficiency and effectiveness)**

A&Ms are also, used to reduce cost and improve effectiveness. The main reasons behind the cost reductions are economies of scale and economies of scope (Seth, 1990; Bruton et al., 1994; Millar, 1994; Wahid, 1995). In addition, effectiveness can be improved by the synergy between merging firms' resources and capabilities. The literature pointed out several areas for a firm's business where efficiency and effectiveness may occur. These areas include finance, selling, marketing, purchasing, production, administration, staffing, research and development and information.

## **2.1: Finance**

The literature suggests that A&Ms can reduce the proportionate cost of obtaining finance in two main ways. First, lower interest rates are charged because larger firms are usually perceived as being less risky than smaller firms. Second, the transaction costs involved in raising finance become proportionately lower as the amount of finance required increases. Therefore, because larger firms, typically raise finance in larger blocks, their financing costs will be lower (Scherer and Ross, 1990; Barnatt and Wong, 1992; Wahid, 1995).

With regard to financial effectiveness, Halpern (1983) and Millar (1994) suggest that the combined debt capacity of the two companies as separate entities is less than the debt capacity of the firm resulting from their merger. Kitching (1967) and Scherer et al. (1975) found that managers of merging firms generally found financial synergy to be the easiest form of synergy to achieve and to have the highest 'pay-off'.

## **2.2: Selling and Marketing**

Higher levels of promotional expenditure can bring proportionally higher returns than smaller levels (Scherer and Ross, 1990). Therefore, as merging increases firm size, thereby enabling advertising expenditure to be increased, it may result in advertising economies being achieved. Another likely economy is that the merged firm will be able to buy larger advertisements which quite often cost proportionally less than smaller ones. Finally, spreading certain fixed selling and marketing resources over two firms' products instead of one, is a third economy which may arise in this area (Scherer and Ross, 1990).

Achieving better or more desirable distribution, acquiring products that have excellent growth potential, obtaining stable brands, and a strong loyal customer base were all market-related reasons suggested by researchers (Hise, 1991; Silvers, 1992; Garnsey et al., 1992).

### **2.3: Administration and Staffing**

Scherer et al. (1975) pointed out two main reasons why economies of size may arise in a firm's administrative and staffing functions. The first is that certain administrative and staffing functions use a fixed set of resources. Hence, their average cost will reduce as size increases. The second economy of size arises because increased specialisation becomes possible. Penrose (1959) summed up this view when she stated: "**when the scale of production is sufficient to justify a specialised production manager, a sales manager, a financial expert, or a specialist in raw materials buying, for example, each function is performed more efficiently than it could be if all of them were performed by one person**" p. 92.

Another justification for choosing acquisition, which is related to increasing management efficiency and effectiveness, is the desire of the acquiring firm to obtain assets which it believes are likely to be more valuable under its ownership than in an independent company. This reason has been called "market for corporate control" (Davis, 1990; Barnatt and Wong, 1992). It should be noted that because management teams in the acquired firms are replaced, the acquisitions are always hostile (acquired firm managers fight the takeover). The active market for corporate control during the 1980s reflects the conviction that takeovers were often completed to eliminate managers' non-value maximising behaviours. This conviction is grounded in agency theory, which suggests that acquisitions have the potential to improve organisational efficiency by transferring scarce resources to higher-value uses.

### **2.4: Research and Development (R&D) and Information**

Scherer and Ross (1990) and Silvers (1992) suggest that merging is supposed to cause R&D economies, as increased size enables increased specialisation and/ or increased spreading of fixed R&D resource costs to be achieved. In addition, it can also be hypothesised that larger firms tend to have a wider range of products. As a result, they

are more likely to make fruitful use of any discoveries made in the research and development department (Barnatt and Wong, 1992; Millar, 1994).

Moreover, a firm may use A&M to utilise another firm's competitive advantage in information and know-how (Loverde, 1990; Davis, 1990; Millar, 1994). McKiernan and Merali (1995) suggest that information should not be treated in the same way as other functional areas, but should be considered at the strategic level. This allows information to be exploited in a proactive role instead of the reactive role that has been assigned to it by the majority of acquisitions' cases to maximise potential outcomes.

## **2.5: Production**

Many of the companies' activities are duplicated in production fields where rationalisation is generally recognised to be of great potential benefit (Scherer and Ross, 1990; Brush, 1996). In addition, researchers claim that the A&Ms can shed duplicated capacity by merging (Teece, 1982; Davis, 1990; Paris and Munich, 1992). This implies that if there is unused capacity in both firms neither one may shed it, but if both of them are merged, they may be able to do so.

Efficiency, effectiveness and market power may also be valid reasons for expanding internally. However, two other causes, short time and low risk, appear to be significantly associated with growth via merger, which probably makes it a more attractive route to follow from the firm's point of view (Kumar, 1981; Moynihan, 1994). Expanding from within requires not only the planning and commission of new capacity, but also the hiring of management and employees, as well as the costs needed to market the products. If the firm has insufficient financial resources, it would be required to resort to external funds. Thus this method of growth means the firm has to enter the labour, capital, and product markets which is likely to be a rather gradual process (Kumar, 1981, Scherer and Ross, 1990). Research by Biggadike (1979) indicates that, on average, eight years are required before new ventures of major U.S. corporations become profitable. If the firm purchases another firm, it may not only bring in production capabilities but also labour resources and the product markets. This process may be much quicker and of less

risk than the first one (Amihud and Lev, 1981)<sup>10</sup>. Moreover, A&Ms also take time to agree the target, to negotiate, to consummate, and to integrate. Unfortunately, the literature does not indicate how long, on average A&Ms need to start paying. Finally, several researchers claim that mergers may not improve profitability as expected, (Bohl, 1989; Linder, 1989; Violano, 1990; Kibilus, 1991; Moynihan, 1994) because of the risks involved. Nevertheless, risks relating to post-merger integration are not considered at an early stage in the A&Ms' planning (Haspelagh and Jemison, 1987; McKiernan and Merali, 1995) and a merger's decision is made under the belief that this case is different from the unsuccessful one (Moynihan, 1994).

Efficiency, effectiveness and probably market power, create value for owners after the merger or acquisition's agreement has been signed. Managers quite often use A&M to capture value at the time of the transaction rather than create value after the A&M. This has led researchers to include two main reasons for adopting A&M , they are taxes and asset stripping (Haspelagh and Jemison, 1987).

### **3: Reasons that Capture Value**

#### **3.1: Taxes**

Sometimes a firm may have potential tax shields but not have the profits to take advantage of them. Therefore, tax exemption of corporate re-organisations, and the use of one company's tax loss carry-overs by its partner provides a possible reason for mergers. In addition, A&Ms have sometimes been used by corporations, to avoid double taxation on their realised profits and on the dividends they distribute to their shareholders (Gilson et al., 1988; Scherer and Ross , 1990; Barnatt and Wong, 1992).

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10) One can however, argue that newcomers to the firm's existing management team may create problems in the short run, but compared to managerial requirements in undertaking new investment, it is still likely to have a more favourable impact (Kumar, 1981). Furthermore, even in the short run, such a problem may not happen if the acquired firm's operations are not fully integrated into that of the acquiring firm.

### **3.2: Assets Stripping**

A “poorly” managed firm would have its share price (asset) decrease in the market relative to other companies in the same industries (Mann, 1965). Therefore, the management of acquiring companies search for firms which can be bought at nominal prices. Based on Kerin and Varaiya (1985) and Haspeslagh and Jemison (1987) a low market valuation of a firm, relative to its book value, is a popular reason for acquisition activity<sup>11</sup>.

## **4: Alternatives to Bankruptcy**

In addition to creating and capturing values, A&M can be used as alternatives to bankruptcy (Tremblay and Tremblay, 1988). Dawey (1961) claimed that most mergers in the US: "... have virtually nothing to do with either the creation of market power or the realisation of scale economies. They are merely a civilised alternative to bankruptcy or the voluntary liquidation that transfers assets from failing to rising firms" p.257.

Researchers have explicitly extended the definition of corporate failure to include distressed acquired firms. They suggest that statistical models can be developed to distinguish between those distressed firms which fail and those where a timely merger appears to serve as a viable alternative to corporate bankruptcy (Peel and Wilson, 1989).

With regard to acquiring firms, some researchers suggest that conglomerate acquisitions occur for "defensive" reasons. That is, acquiring firms frequently have below average industry profitability and merger occurs to avoid adverse effects on profitability (Melicher and Rush, 1973).

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11) This cause can also be grouped under the “market for corporate control” which was mentioned earlier. This cause however, has been put here to indicate that the time horizon of the acquirer is short and the intention is not to create value from the acquired assets but to capture value during the A&M’s transactions.

## ***Chapter Three***

### ***Literature Review on Saudi Arabia and the Context of A&Ms***

#### **3.1 Introduction**

The information provided in this Chapter is a continuation of information collected during the exploration stage and presented in the preceding chapter. Chapter Two investigated the causes for and effects of A&Ms as well as the contexts of Anglo-American countries and some other nations. Since what has been tested and proposed in one country may not apply to another country, this chapter discusses the Saudi Arabian's context of A&Ms. The information contained in this chapter will show clearly that S.A. has unique characteristics which may contribute to specific A&Ms' reasons and effects.

It was mentioned in the introduction chapter that this study aims to find out if A&Ms may help solve the private sector's problems, what potential effects A&Ms may have on the economy, and what barriers affect their adoption. The Saudi Arabian's socio, political and economic contexts, problems of its private sector and issues related to A&Ms in that country were discussed in this chapter in order to determine the context of A&Ms and to help achieve the objectives of the study.

Since a discussion of this topic requires investigation into many interrelated variables, the researcher used a model to capture and understand all the relevant variables. A model suggested by Porter (1990) has proved to be effective. Before discussing that model and investigating the Saudi Arabian business environment based on it, information about the general condition of S.A. will be presented first.

#### **3.2 The General Condition of Saudi Arabia**

The general condition of S.A. will be discussed from two perspectives; economic and socio-political. Although they are discussed separately, it should be born in mind that

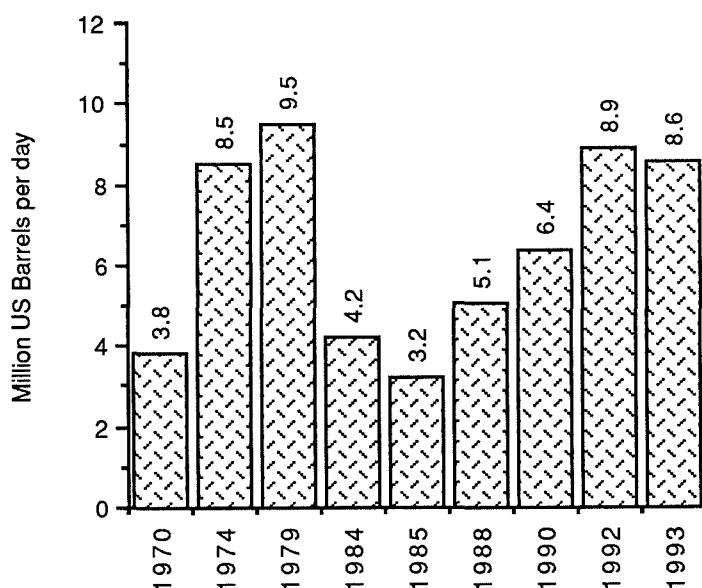
they are interrelated, and neither of them should be judged in isolation. Moreover, most of the economic statistics presented in the various publications are not comprehensive. Further, they are issued by the government which may affect their reliability.

### 3.2.1 The Economic Situation

S.A. was a rich country. In 1981, it earned more than \$ 120 billion (bn) from oil exports, ran a budget surplus of about \$ 35 bn and enjoyed net foreign assets of close to \$ 170 bn. Its per capita gross national product (GNP) was \$ 12,600, one of the world's highest. Today it is ranked by the world bank as a middle-income country with per capita GNP of about \$ 6,750 (Business Monitor International Ltd., 1993).

Oil is the core of the Saudi economy. It accounts for around 60% of Saudi Gross Domestic Product (Ministry of Planning, 1992). Saudi Arabia is the world's biggest producer as well as owner of oil. In 1992, it produced about 420 million (mn) tons of crude oil, while the second biggest producer, the USA, produced 411 mn and Russia 390 mn (Business Monitor International Ltd., 1993). For more information on the production of oil, see Figure 3.1

Figure 3-1: Crude Oil Production.



Sources: Ministry of Planning (1992), Saudi Commerce and Economic Review (1995)

The economy is centrally planned. The government has made National Development Plans, covering every five years since 1970. During the previous four plans (1970-1989), the economy grew at an annual rate of 15% in current prices and 6% in constant, making it one of the fastest growing economies in the world. Since 1990, growth has increased to 10% (Saudi Consulting House, 1994).

Lack of comprehensive statistics makes it difficult to assess how growth is distributed, but observers believe that the private sector's growth is higher than the public sector (Business Monitor International Ltd., 1993). Succinct information about the budget, gross domestic product, current account and inflation rate in S.A. will be provided next.

### **3.2.1.1 The Budget**

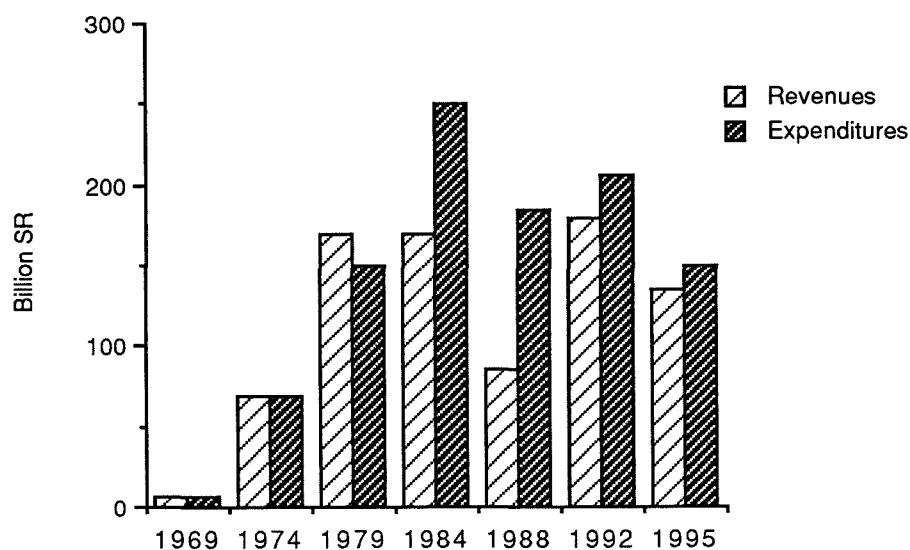
S.A. had a budget surplus until 1982, since then it has run a persistent budget deficit (see Figure 3.2). The government succeeded in reducing the deficit during the five-year period before Iraq invaded Kuwait in August 1990. During the second half of the 1980s, S.A. cut its overall budget deficit by more than half, from over 20% of GNP to less than 10% (Ministry of Planing 1992).

But Saddam Hussein put an end to those achievements. The average budget deficit for the years 1990 and 1991 came to about 17% of GDP. The Kuwait crisis has cost the country some \$ 55 bn - \$ 69 bn (Business Monitor International Ltd., 1993). The budget deficit's problem was enlarged by the loss of a major part of the reserve caused by the Gulf war. Liquid funds available to the Saudi Arabian Monetary Agency (SAMA) were at a fraction over \$ 7 bn, and were unlikely to show much, if any, improvement in the short to medium term (Financial Times, 1993).

To fix its financial position, the government has moved in two directions, increasing revenues and decreasing expenditures. The Kingdom has increased oil revenues to levels that are roughly 50% higher than they were before the crisis broke (Business Monitor International Ltd., 1993).

With regard to expenditure, although its 1992 budget was expected to be the first budget to see a sharp drop in spending with total expenditure set at just over \$ 44 bn, compared with an annualised rate of \$ 61 bn over the two previous war-affected years (this should have seen the deficit decline to a forecast 3.3% of GNP), the government failed to reduce spending by its target of 28% and provisional figures suggest that at about \$ 55 bn, it was some \$ 11 bn over budget. As a percentage of GNP, the deficit was nearly three times larger than the target. The reasons were political. The capital expenditure was substantially larger than forecast and there was also slippage in the announced programme of reducing subsidies (Business Monitor International Ltd., 1993; Financial Times, 1993).

Figure 3-2: The Budget.\*



Sources: Ministry of Planning (1992), Saudi Commerce and Economic Review (1995), Al-Riyadh (1995).

\* The figures for 1995 are projected.

The government has financed the budget deficit through the traditional means of government development bonds. The authorities are confident that the banking sector's

high liquidity level will continue to finance the deficit. The total debt was about 60% of GDP in 1993, and it was expected to rise to 80% in 1997 unless stringent measures were taken in the succeeding years (Business Monitor International Ltd., 1993).

The consequence of this pressure is that the government has cut and postponed some military and infrastructure projects, such as some of the \$ 30 bn of weaponry it has contracted to buy since the invasion of Kuwait. Also, it started to make a significant cut in subsidies. Moreover, the government announced in early 1995, as a way of supporting its revenues, the increased charges and fees for several goods and services provided by the government such as oil products, domestic flight tickets and expatriates' permits to work in the Kingdom (Al-Riyadh, 1995). In January 1995, a Saudi Riyals (SR) 15 bn deficit budget for the fiscal year 1995 was announced. Revenues was projected at SR 135 bn and expenditures at SR 150 bn (Al-Riyadh, 1995).

### **3.2.1.2 The Gross Domestic Product (GDP)**

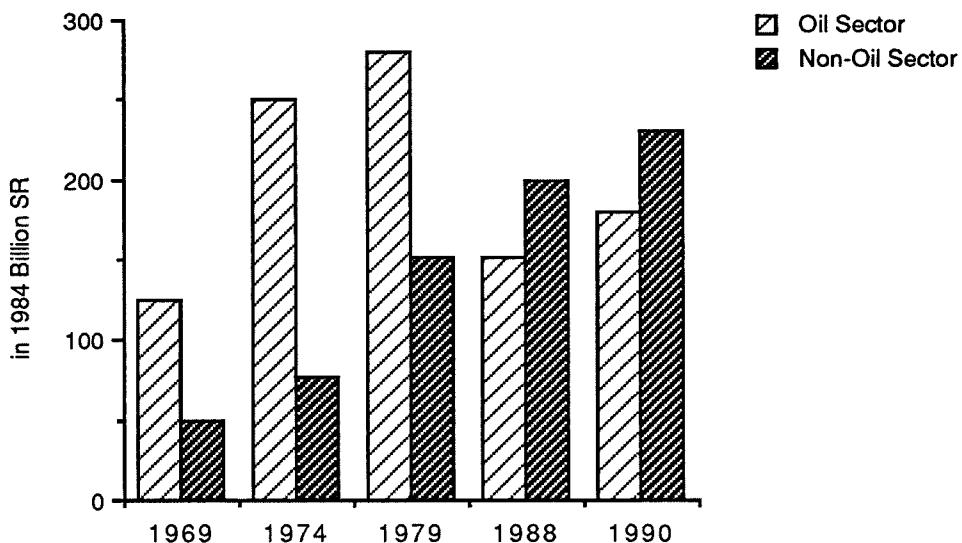
The gross domestic product (GDP), measured at 1984 constant prices, rose sharply from SR 157.8 bn in 1969 to SR 448.8 bn in 1979 and fluctuated up and down to reach SR 423.7 bn in 1990. This makes the average annual growth rate of real GDP during 1969 to 1990 3%. The targeted real growth rate for GDP during the period 1990-1995 was expected 3.8% per year (Ministry of Planning, 1990). The GDP in 1994 has only increased 0.6% (Al-Riyadh, 1995). During the Sixth National Plan, the annual growth rate is estimated to be 3.8% (Tejarat Al-Riyadh, 1995).

Real GDP of the non-oil sectors increased at an annual average growth rate of 8.6%. Rising from SR 48.7 bn in 1969 to SR 214.9 bn in 1984 and then to SR 232.3 bn in 1990 with an increase of 4.1% over the previous year (Ministry of Planning, 1992). In 1994, the growth rate of the non-oil sectors' GDP was 4% (Al-Riyadh, 1995). See Figure 3-3.

The private sector's contribution to real GDP rose from SR 27.6 bn in 1969 to SR 131.4 bn in 1985. However, it declined to SR 126.8 bn in 1986 but rose gradually

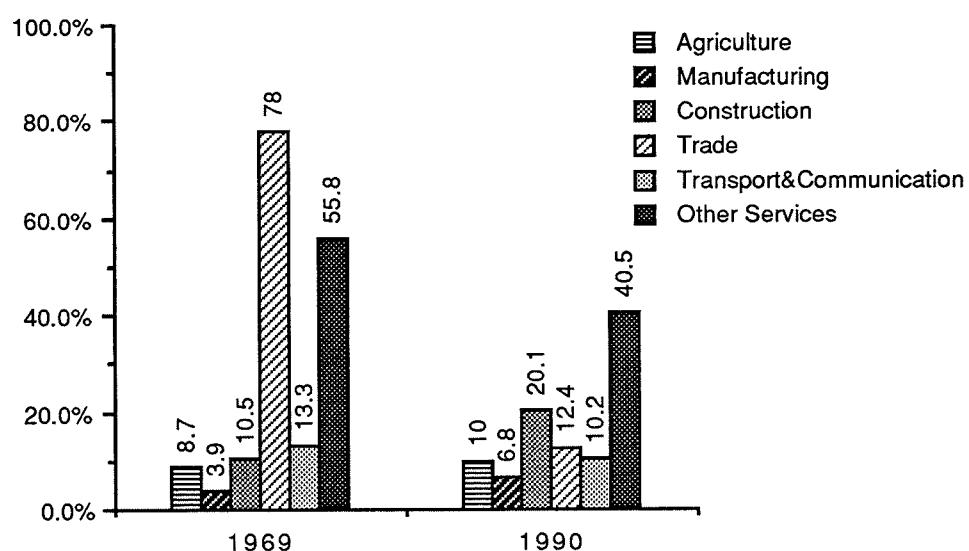
again to SR 137.8 bn in 1990 (Ministry of Planning, 1992). For information about the sectoral composition of the GDP, see Figure 3.4.

Figure 3-3: Gross Domestic Product.



Sources: Ministry of Planning (1992).

Figure 3-4: Percentage Distribution of Non-Oil GDP (at 1984 Constant Prices).

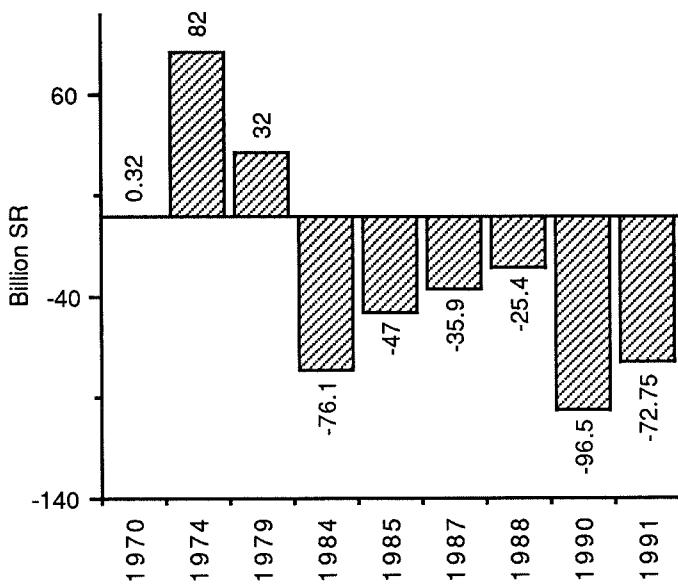


Sources: Ministry of Planning (1992).

### 3.2.1.3 The Current Account

It is now 14 years since S.A. last recorded a current account surplus and, according to some, there is no indication that it will secure one in the next few years. In 1991 and 1992, and as a result of the Kuwait crisis, the Kingdom ran up a current account deficit of no less than SR 96.5 bn and SR 72.75 bn respectively (Business Monitor International Ltd., 1993). Although the expulsion of about 880,000 Yemeni (Financial Times, 1993) has naturally reduced the outflow of expatriate workers' remittances, there are still large numbers of foreigners from India, Pakistan, Egypt and others, seeking work. The country's dependence on foreign labour is likely to be a key fact of life for some years to come. The government, as mentioned before, has made cuts in its 1994 and 1995 budgets aiming to ease the balance of payments problems which have mirrored those of the budget. For more information on the Current Account, see Figure 3.5.

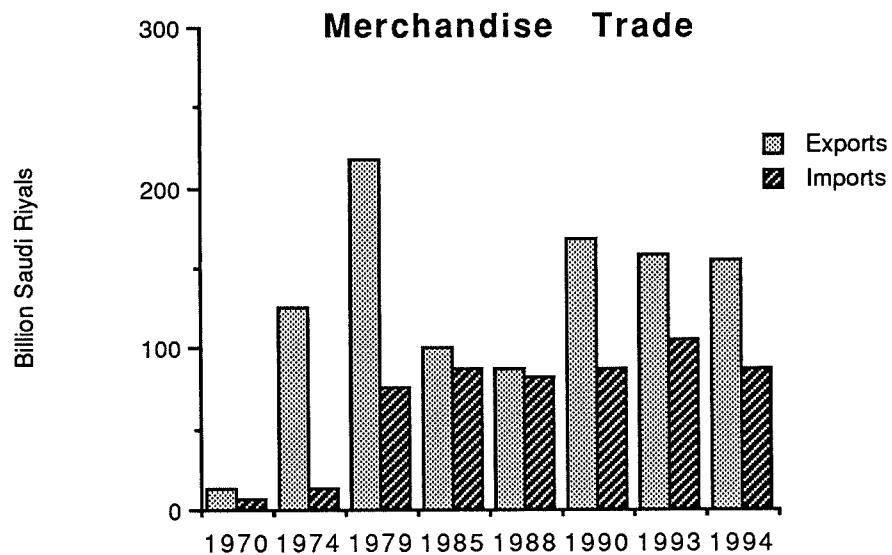
Figure 3-5: The Current Account.



Source: Ministry of Planning (1992) and Business Monitor International Ltd. (1993).

With regard to the trade balance, it remains in favour of the Kingdom regardless of the fluctuation in exports. In 1970 the trade balance reached SR 5.7 bn and rose to SR 110.9 bn in 1979, however, it declined to SR 16.9 bn in 1988 and rose again to SR 76.3 bn in 1990, to SR 52 bn in 1992, to SR 53.2 bn in 1993 and to SR 68.1 bn in 1994 (Ministry of Planning, 1992; Saudi Chambers Council, 1994 and 1995). For more information on the merchandise trade, See Figure 3.6.

Figure 3-6: Merchandise Trade.



Sources: Ministry of Planning (1992), Saudi Commerce and Economic Review (1995),

### 3.2.1.4 The Inflation Rate

The cost of living index is one of the lowest levels of inflation in the world (Ministry of Planning, 1992). On average, the cost of living index rose at an average annual rate of 5.8% during 1970-90. In 1989 and 1990, the average growth rates of the cost of living index rose by 1.1% and 2.1% respectively. It has shown a decline from 0.8% in 1993 to 0.6% in 1994 (Saudi Consulting House, 1994; Al-Riyadh, 1995).

### **3.2.2 Politics**

The literature (Financial Times, 1993; Business Monitor International Ltd., 1993) suggests that the problems facing the government concern expectation, perception and political dynamism. In terms of expectation and perception, the oil boom years of the 1970s and early 1980s gave rise to a feeling that economic development and personal circumstances would be likely to improve rapidly. The pace of urbanisation proceeded at the same time as hundreds of thousands of ordinary Saudis began to benefit from state-supplied jobs, houses and subsidies (Financial Times, 1993; Business Monitor International Ltd., 1993).

The erosion of oil prices throughout the 1980s led to a sharp decrease in government spending, public sector job creation and provision of subsidised housing. This all happened while the population boomed. S.A.'s population growth rate exceeds 4.0% and is one of the highest in the world (Financial Times, 1993; Business Monitor International Ltd., 1993).

At the start of 1993, after the Kuwait crisis, the Kingdom's 12 million citizens found themselves sharing a GDP that probably amounted to around \$ 115 bn, yielding an average income per capita of only \$ 6,760, less than half the level enjoyed just 12 years earlier (Financial Times, 1993; Business Monitor International Ltd., 1993).

Moreover, the internal demographic structure of the Kingdom's population has changed. The high birth rate makes S.A. a society dominated by the very young. More than 60% of its population is now under 18. In other words, they were not born, or at best were less than 10 years old, when the oil boom turned sour. Their parents may have secured government jobs and houses, but they have enjoyed much less material success (Financial Times, 1993; Business Monitor International Ltd., 1993).

Last but not least, there is an Islamic fermentation stemming in part from the perceived economic failure of the late 1980s, and the reliance on western forces to secure the liberation of Kuwait (Financial Times, 1993; Business Monitor International Ltd., 1993). The researcher, however, thinks that suspension of opinions and the deterioration

of the Muslim world in general are the major factors affecting the Islamic movement in S.A.

The government, in a step to lower such pressure, named (in August 1993) the 60 members of a consultative council as well as appointing a new group of highly educated ministers in August 1995 which is hoped, by many, to be an important source for change. Although the previous discussion provided a picture to the overall condition of S.A., more detailed information about that country, the private sector strengths and problems, and factors contributing to these problems will be investigated to achieve the aim of this chapter. As mentioned before, a model suggested by Porter (1990) will be used to achieve that task. A description of that model will be discussed next.

### **3.3 The Competitive Advantage and the Determinants of Advantage as Suggested by Porter**

Porter (1990), in his book “Competitive Advantage of Nations” investigated the competitive advantage of firms, and the reasons why a nation achieves international success in a particular industry.

#### **3.3.1 The Competitive Advantage of Firms**

Based on Porter (1990), firms must choose a position within the industry they function in because positioning embodies the firm’s overall approach to competing. There are two variables in positioning; competitive advantage and competitive scope. In the long run, firms succeed relative to their competitors if they possess sustainable competitive advantage; which can be either lower cost or differentiation. Lower cost is the ability of a firm to design, produce, and market a comparable product more efficiently than its competitors. Differentiation is the ability to provide unique value to the buyer in terms of product quality, special features, or after-sale service.

Moreover, a firm must choose the range of product varieties it will produce, the distribution channels it will employ, the types of buyers it will serve, and the geographic

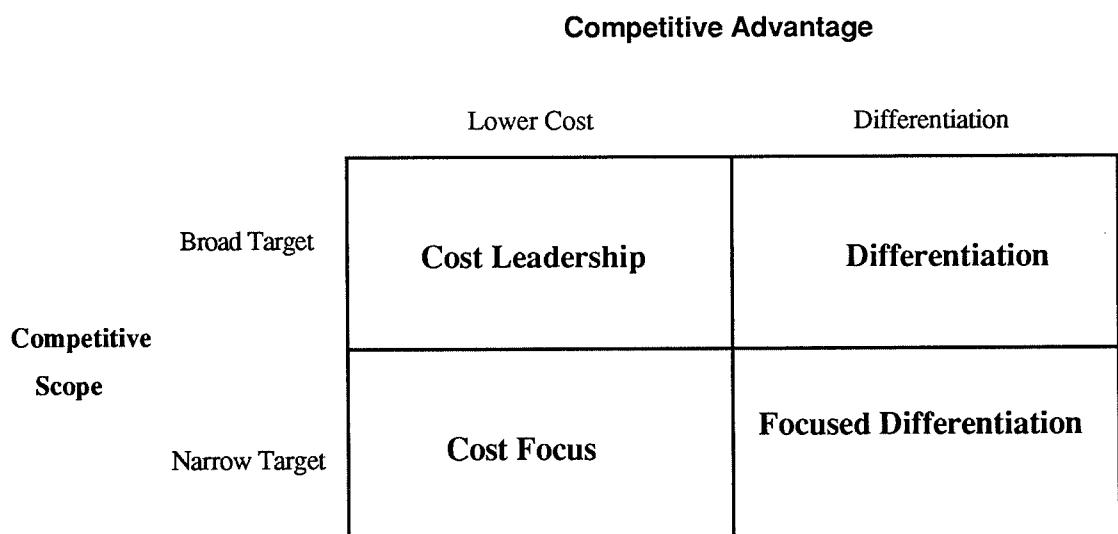
areas in which it will sell. The type of advantage and the scope of advantage were combined into the notion of generic strategies (see Figure 3.7). Each of these strategies represents a different conception of how to compete.

### 3.3.2 The Determinants of National Competitive Advantage

With regard to the reasons why a nation achieves international success in a particular industry, he finds that the answer lies in four broad attributes of a nation. These determinants (diamond; a term which refers to the determinants as a system) shape the environment in which local firms compete that promote or hinder the creation of competitive advantage (see Figure 3-8). Based on Porter, these determinants are as follow:

- 1- Factor condition. The nation's position in factors of production, such as skilled labour or infrastructure, necessary to compete in a given industry;
- 2- Demand condition. The nature of home demand and industry's product or service;
- 3- Related and supporting industries. The presence or absence in the nation of supplier industries and related industries that are internationally competitive and
- 4- Firm strategy, structure, and rivalry. The conditions in the nation governing how companies are created, organised, and managed, and the nature of domestic rivalry.

Figure 3-7: Generic Strategies.

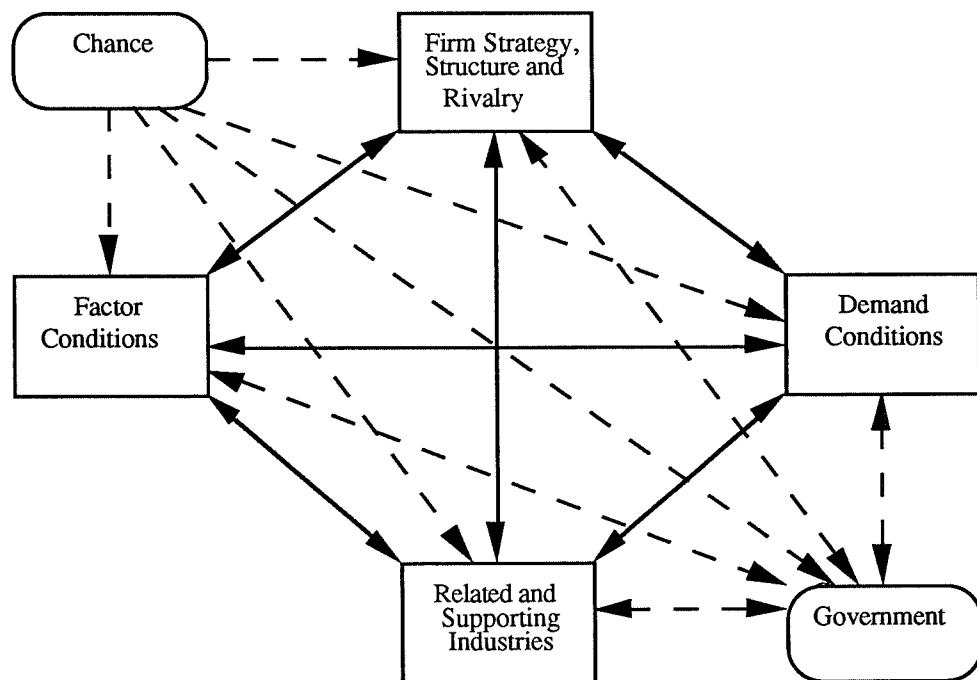


Source: Porter (1990).

Porter finds that nations are most likely to succeed in industries or industry segments where the national diamond is the most favourable and that the “diamond” is a mutually reinforcing system. The effect of one determinant is a contingent on the state of others.

Two additional variables have also been suggested by Porter as having influence on the national system in important ways. These are chance (developments outside the control of firms such as pure inventions, wars, and external political developments) and government (its policy affects each determinant such as an anti-trust policy, regulation, its purchases, and its investment in education).

Figure 3-8: The Determinants of National Advantage.



Source: Porter (1990).

Moreover, he proposes that nations succeed not in isolated industries but in clusters of industries connected through vertical and horizontal relationships. A nation's

economy contains a mix of clusters, whose makeup and sources of competitive advantage reflect the state of the economy's development.

### 3.3.3 Limitations of Porter's Suggestions

Although Porter's suggestions have provided managers and policy makers with ways in which they can think about competitive advantages, several comments can be raised about his propositions; one is that he suggests many variables and factors without explaining their relative importance and how they are generated. “**Some people complain that he is forever producing laundry lists of ‘forces’ and ‘factors’ and passing them off as explanations**” p. 97 (The Economist, 1994). Second his distinction between the two types of competitive strategy, that of keeping down cost and that of differentiation, is not new and applying these strategies in real life is not as simple and straight forward as he claims. For instance, his claims of sustainable cost leadership means having the lowest cost compared with competitors over time. This is unlikely to be achieved simply by running costs. Competitors can and will do that too (Johnson and Scholes, 1993). Third, he did not explain how competitive industries or segments of industries have been evolved to cluster in regions and how he can explain the competitiveness of some industries that are not clustered such as steel industries (The Economist, 1994). Finally, his model may be applicable to the developed nations but it does not give a complete answer to the problems of the developing nations where they lack most of the determinants he suggests, such as efficient financial markets. Moreover, he did not consider that some political issues hinder the ability of developing nations to compete, such as the protectionism of developing countries by developed nations.

The competitive advantages of firms in S.A., and their consequences on exports and imports will be examined next in order to determine the capabilities and problems of the private sector. Then, the determinants that shape the environment in which companies may compete will be discussed in order to give explanations for these strengths and

weaknesses. These investigations will give a clearer picture of the business environment in S.A and the A&Ms' context in that country<sup>1</sup>.

### **3.4 The Competitive Advantage of the S.A. Nation**

Firms in S.A. can be divided into three categories (Mudani, 1987; Saudi Export Development Centre, 1992; Saudi Consulting House, 1994; Al-Motawa, 1994). The first group includes those firms that are successful in both local and foreign markets. The second category includes those firms that are able to compete domestically but are either non-competitive in foreign markets or have not tried to compete outside the Kingdom. Firms that are not competitive in the local market represent the third category.

#### **3.4.1 Internationally Competitive Firms**

An examination of the components of merchandise export shows that S.A. has a competitive advantage in energy and petrochemicals. Also, it shows that few firms are internationally competitive. Two firms, ARAMCO (a state company) and SABIC (70% of its shares are owned by the government) are responsible for about 96% of the Kingdom's total exports. Minerals products exports; which include crude oil and petroleum product (ARAMCO export), constitute the main export component of the total merchandise exports (see Figure 3.9). About 90% of total exports in 1990 were crude oil and petroleum products. The share of crude oil in total exports was 74.1% while petroleum products constituted 16.2% in 1990 (Ministry of Planning, 1990).

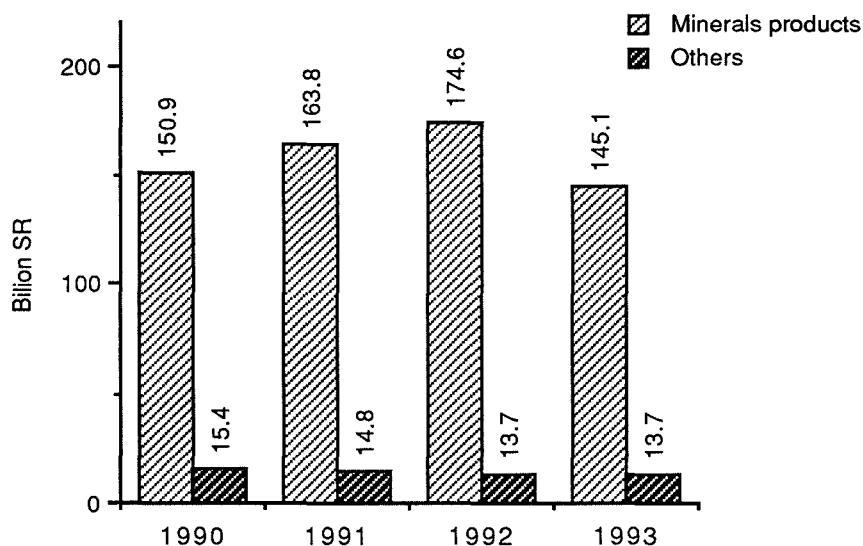
Exports of other commodities, such as chemical, animals, animal products, and agricultural products, constituted less than one percent of total exports until 1979. Since then the share of other commodities in total exports rose gradually to 9.7% in 1990. The

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1) It should be noted that, due to a lack of empirical studies on business related issues in S.A., most of the information provided in this part of the dissertation is based on judgements and observations of experts in the business field.

chemical products exported by SABIC constitute the major part of this group of exports (65.8% in 1992) (Ministry of Planning, 1992; The Ministry of Industry and Electricity, 1992; Saudi Export Development Centre, 1992)<sup>2</sup>.

Figure 3-9: Distribution of Merchandise Exports.



Source: Saudi Commerce and Economic Review (1995)

These two companies are good examples of success due to commitment to sustainable upgrading and improvement. Both of them have invested heavily and rapidly in physical facilities, process technology, marketing, global service networks, research and development and training. According to Ibrahim bin Salamah, SABIC's vice-chairman and managing director, SABIC will have raised around \$ 4 bn to finance expansion projects at 12 of its 18 subsidiaries by the end of 1995, increasing total output to 20 mn tonnes at the start of the decade (Financial Times, 1993). SABIC has also recently consolidated its research and development into a single new research centre in Riyadh as part of a concerted effort to rationalise the group's cost base. Ibn Salamah

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2) This figure represents about 6% of the world petrochemical market (Financial Times, 1993).

estimated Sabic's annual R&D budget at SR 400 mn annually (Financial Times, 1993). Finally, it is putting a great deal of effort into the expansion of the chemical industry by using measures such as research and publishing feasibility studies for several projects. This information is provided free of charge for those who are interested (Saudi Consulting House, 1994).

### **3.4.2 Firms Competitive in the Local Market**

Three subgroups of firms can be identified here based on the competitive advantages they have; national make, closeness to customers, and product differentiation.

#### **3.4.2.1 National Made as a Competitive Advantage**

Many firms' profitability is based on factors such as governmental purchases, subsidies, and protection available to products made in the Kingdom. The government, for example, gives preference to national products over foreign products in contracts for its procurement even if their quality is inferior to foreign products. Moreover, it grants tariff protection from competing imports of about 12%. Finally, several firms in the industrial sector and farmers of wheat, dates and other products receive huge subsidies from the government (Saudi Consulting House, 1994).

Time has proved that firms building their competitive advantages on low labour costs, cheap raw materials, subsidised inputs and protection are unsustainable and relatively easy to imitate. The majority of firms in this subgroup are unable to produce goods that are cheaper than comparable products imported from countries such as Taiwan, China, Hong Kong, and Syria. Also, they are not of better quality, than those imported from the USA and Western Europe, for instance (Mudani, 1987).

In addition to the foreign competition, the changing economic condition of the Kingdom since 1983, which led to minimising subsidies and lowering government spending has made many firms of this subgroup either go bankrupt or have low profit margins. It is estimated that about 300 companies ceased trading in 1983 alone

(Economical Gulf, 1984). Al-Olyan (1985), who is well recognised in the field of business in S.A., suggests that "**The large number of bankruptcies and businesses leaving during the recession of 1983 indicated that there were many defects in planning and management**" p. 22. One can also expect that being dependent on subsidies will contribute to the inefficiency and ineffectiveness of several firms, which are requirements for competing internationally.

Some firms in the dairy industry and contracting industry represent samples of firms that build their success on government purchases, protection and subsidies. Although the potential sales of the dairy products in the Saudi market is high (the total sales in 1988 was SR 4 bn), most of the local dairy companies use only 40% of their production capacity. The Saudi dairy market imports most of its needs. In 1988 the value of the imported dairy products was about SR 3 bn (Riyadh Chamber of Commerce & Industry, 1992).

The contracting sector in S.A. is also experiencing trouble due to the increase of supply relative to demand. The demand on the contracting companies has declined to about 70 - 80% due to the reduction of governmental expenditure (Saudi Chambers Council, 1987; Al-Moalmy, 1991). Based on Al-Moalmy; "**The percentage of exploiting the production capacity in some sectors such as the manufacturing industry was not more than 50% two years ago, and I don't think it is more than 55-60% now. So, there are unutilised sources of factories that were built and cost a lot of money which are not being used to their full capacities**" p. 6.

### **3.4.2.2 Closeness to Customers as a Competitive Advantage**

The second subgroup includes firms that base their success in the local market on being close to their customers. Their products (goods and services) are designed to meet the local market's needs only and are not expected to travel (or succeed to compete) abroad. State monopolies such as public hospitals, universities, rail establishments,

agents of foreign firms and many small to medium firms working in industries such as retailing, farming, maintenance and construction, etc. belong to this group.

Several companies, specifically agents of famous international companies (legally unable to sell outside the local market), are making substantial profits. However, all firms, in general, compete severely with each other which leads to lower sales and profit and hence inferior quality and customers services (Saudi Chambers Council, 1987; Al-Hejelan, 1995).

#### **3.4.2.3 Differentiation as a Competitive Advantage**

Firms that provide goods and services which foreign competitors cannot duplicate because they are differentiated, represent the final subgroup. Several firms produce goods and perform services that require advanced skills and capabilities such as specialised and highly trained personnel, internal technical capability and close relationships with customers. These firms are usually family establishments which inherited such skills. Although the potential for competing internationally is high for such firms, they are unwilling to compete outside the local market because of satisfaction with their status quo, or unable to do so due to the lack of information and resources (Saudi Chambers Council, 1989; Al-Zamil, 1995). Based on the Saudi Chambers Council (1989); “**There are many firms with very competitive products locally and even outside the Saudi market, however, they are not able to maximise their profits due to poor management in general and marketing managers in particular**” p. 74.

#### **3.4.3 Unsuccessful Firms**

Many enterprises have left the business because they are ineffective and/ or inefficient (Habeb and Abdeen, 1987; Al-Motawa, 1994). However, several firms (mainly new and small) can not survive long enough to pass the introductory stage of their life cycle because of the severe and destructive competition from local and foreign companies (Riyadh Chamber of Commerce and Industry, 1994; Al-Hejelan, 1995).

Several of these firms are not necessarily uncompetitive, but because of the lack of skills (managerial or labour) and financial resources, they can not meet the requirement of the introductory stage (Saudi Chambers Council, 1987; Riyadh Chamber of Commerce and Industry, 1994). Since the Saudi Market is open for goods from many countries, the very low percentage of the private sector's export (4% in 1990) indicates that, with some exception, the private sector firms are not only uncompetitive in the international market, but also in the local market. If local firms' goods compete successfully in the local market, they are supposed to be competitive in foreign markets also, and the opposite is actually true. This assumption could be supported by the large amount of money spent on imports. It has increased, for example, from SR 81.5 bn in 1979 to SR 90.1 bn in 1990 and to SR 124.5 bn in 1992 (Riyadh Chamber of Commerce & Industry, 1992). Although one may argue that this could be a result of increasing population growth, given the fact that many firms complain about working less than their production capacity (Riyadh Chamber of Commerce & Industry, 1992) this is only another example of the weakening private sector, see Table 3-1.

Table 3-1: Percentage of Share of Production Used by Local Demand in Some Segments.

<u>Product</u>	<u>No. of manufacturer</u>	<u>Date</u>	<u>% of local demand from production</u>
Cheese	12	1990	13
Biscuits	9	1990	58
Jam	3	1990	39
Macaroni	5	1987	40
Blankets	3	1990	6
Carpets	10	1990	20
Dresses & textile	17	1990	10
Tables for public gardens	20	1990	14
Chemical to kill insects	5	1990	1
Kitchen wares	28	1989	27.6
Shoes	9	1990	10
Leathers (bags & luggage)	21	1993	32
Electrical appliances	3	1990	15
Air-conditioners	3	1989	49
Heaters	9	1992	60
Tyres	4	1990	0.6
Perfume	6	1990	21
Shampoo	8	1991	19

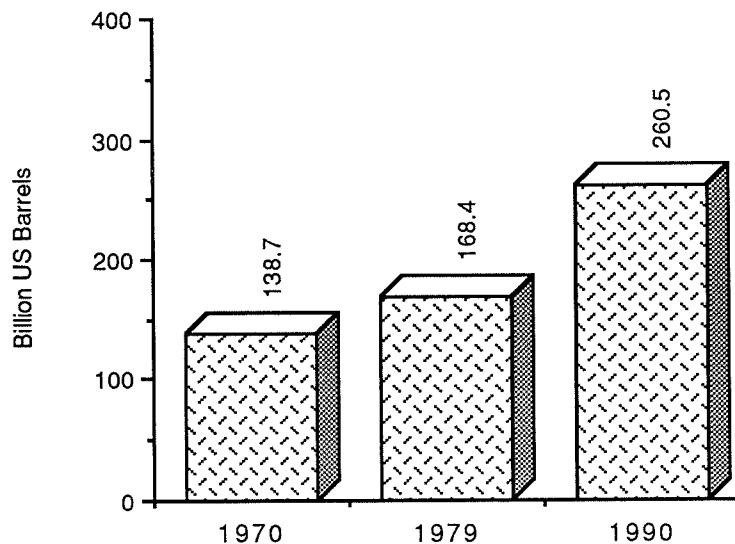
Source: Riyadh Chamber of Commerce & Industry, 1992.

### 3.5 The Determinants of Competitive Advantage in S.A.

#### 3.5.1 Factor Conditions

S.A. has an abundance of oil, gas and other natural resources. At the end of 1970, the Kingdom's proven oil reserves stood at 138.8 bn barrels. As a result of new discoveries and reassessment, known reserves rose to 260.5 bn barrels in 1990 (see Figure 3.10). The production of natural gas associated with oil production increased from 20.6 bn cubic meters in 1970 to about 37.3 bn cubic meters in 1990 (Ministry of Planning, 1992).

Figure 3-10: Crude Oil Reserves.



Source: Ministry of Planning (1992).

S.A. infrastructure is well developed. Airport services, roads, railroads, postal services, telecommunication and financial services have all been modernised. All infrastructure services are state-owned monopolies (Ministry of Planning, 1992). Some regulations controlling these services are characterised by rigidity and bureaucracy which

makes policy execution, to some extent, difficult and time consuming (Saudi Consulting House, 1994).

Although it occupies over 70% of the Arabian peninsula (2,240,000 square kilometres), a large proportion of its land is non-arable (El-Naiem, 1980). Its reputation as one of the driest countries in the world is usually confirmed by its annual rainfall and temperature figures. Most regions have a rainfall of less than 4 inches a year. Temperatures vary widely throughout the year and region by region. The long, hot summer can see temperatures reaching 45 degrees Celsius in Riyadh and the Eastern Province (Saudi Consulting House, 1994).

The Kingdom is seen as a secure commercial environment with low political risk (Rateb, 1996). The defeat of the Iraqi invasion of Kuwait furnishes firm evidence of the determination of the West in general and the US in particular to defend the Kingdom. Internal conditions are also considered secure regardless of the concerns about the challenge posed by the Kingdom's Islamic militant factions. This political stability allows its firms to maintain commercial contacts with any major country and attracts foreign capital from different countries (Business Monitor International Ltd., 1993).

One natural factor of historical importance is the religious positions. The holiest places in the Islamic faith, which more than one million Muslims are required to visit at least once a year are located in S.A. This represents another source of income and an important reason for the distinguished position of S.A. in the world (Al-Hamad, 1988).

Although entrepreneurs seeking to establish or develop projects can be assisted with grants from various governmental institutions (Saudi Consulting House, 1994), capital in S.A. can be considered a disadvantage for the majority of firms, specifically small and medium firms (Saudi Chambers Council, 1987; Riyadh Chamber of Commerce and Industry, 1994). Funds from governmental institutions; as will be shown later, have dropped severely compared to the early 1980s. Moreover, getting

such loans requires a long time and usually benefits only bigger companies (Riyadh Chamber of Commerce and Industry, 1994).

Due to regulations, a public equity market has been all but non-existent until recently. Also, there is a severe restriction on firms willing to go public or to raise financing (Butler and Malaikah, 1992). Therefore few firms are listed (66 companies). Moreover, only Saudis and in some cases individuals of GCC's national (they own about 2.5% only of the issued stocks) can own stocks of Saudi companies (Azam, 1994; Eastern Province Chamber of Commerce and Industry, 1994). This makes the market small and inefficient. The proportion of shares traded is relatively small because 41% of the issued stock is owned by the government and about 56% is owned by the public in which a high percentage of it is in the hand of specific people who are not expected to sell it (Azam, 1994; Eastern Province Chamber of Commerce and Industry, 1994). The management of these companies is under the close control of those individuals (Azam, 1994).

Commercial banks are conservative in giving long-term loans, hesitant to lend to small and medium sized enterprises and they usually require high interest rates (Saudi Chambers Council, 1987; Amer. 1993). Based on a research conducted by Habeb and Abdeen (1987) to investigate the causes of bankruptcy in S.A., 22% of the total sample answered that the high interest rate is one of the main reasons for bankruptcy while 50% think it is a secondary reason. The great majority of bank capital (and that of big firms) flows outside the country (Oman Chamber of Commerce, 1986, Looney, 1991). The total of assets of the private sector which is invested outside the kingdom, is estimated to be SR 317.7 bn (Ministry of Planning, 1990). Some of the banks' capital goes to government projects, and to funding the national debt (Amer, 1993). In addition, borrowing from banks is not preferred by many business-men because the Islamic religion prohibits deals involving interests (Siddiqi, 1983).

This financial market structure is not an efficient mechanism for funding and nurturing independent companies. Most firms in S.A. have financed entry and growth out of private savings, profits, and achieving short-term loans (Butler and Malaikah,

1992). The nature of the capital market means that the great majority of firms are either small or medium and typically characterised by low capital requirements for entry (Al-Hejelan, 1995).

Information about firms, such as the financial information is limited. Although the Companies Act requires firms to prepare a profit and loss account, a balance sheet, a directors' report and an auditor's report, these requirements are general in nature. For example, with regard to the accounting and disclosure requirement, there is no detailed clarifications as to the form and content of financial reports and statements (Al-Bogami, 1996). Moreover, the requirement of disclosure under the Companies Act is only restricted to specific entities (partnerships and corporations). Therefore, there is no access to the financial information of small entrepreneurial and family businesses, which constitute the majority of firms in S.A.

During the early years of development, the Kingdom's population and size of its national work force were insufficient to meet the total manpower requirements of the rapidly developing economy (Ministry of Planning, 1992). Recognising this constraint, hundreds of thousands of non-Saudi labourers were imported. As a result, during the period from 1975 to 1985 over 3 mn non-Saudi workers were added to the labour force (Saudi Chambers Council, 1989). Although the majority of them had been imported from countries where salaries were low, such as Egypt, India, and Philippines, keeping the experienced labourers for a long period away from their countries was difficult. The unsustainability of the foreign labourers was one of the private sector's problems in S.A. (Saudi Chambers Council, 1989; Al-Motawa, 1994). Moreover, some businessmen complained of the high cost of administrative works (Habib and Abdeen, 1987).

With regard to the Saudi labour force, the number has increased due to the population growth and rapid expansion of education. However, the majority of them are attracted to work in the public sector or in the few large companies such as ARAMCO and SABIC. Those who work in small or medium firms are usually less qualified (Saudi Chambers Council, 1989). Therefore, the majority of firms prefer non-Saudis who are more qualified and much cheaper. Only 6.5% of the total labour force

is working with the private sector in S.A. (Saudi Chambers Council, 1989; Shaker, 1995).

Factors have been solely created formally through the government. The education system (schools, training, Research, laboratory, computers etc.) is state run. There are seven universities and several vocational schools with some excellent departments in universities (Saudi Chambers Council, 1989).

However, as Master's and doctoral programmes are few, people have to go abroad to achieve them (Sofe, 1993). Departments are concentrated in general fields (traditional). Courses and research are not adapted to the needs of any specific industry (Sofe, 1993). Programs lack rigour, quality is uneven, and updating is slow (Saudi Chambers Council, 1989).

S.A. is also relatively weak in formal research, either in universities, governmental research centres, or firms. There is a low degree of commitment to research by firms (Mudani, 1987; Saudi Chambers Council, 1994). The universities lack doctoral programs that are usually the core of much university research (Saudi Chambers Council , 1989).

Saudi firms have a strong family orientation which facilitates the process of skills transfer (Sofe, 1993). However, they neither provide sufficient formal training nor do they actively support the universities. Hence advanced training is like other training, informal and on the job (Saudi Chambers Council, 1989; Sofe, 1993).

Although firms are willing and able to seek foreign technologies, through extensive travel and a network of personal relationships (Saudi Consulting House, 1994), foreign technologies are taken as they are without being able to adapt them and apply them to particular needs (Mudani, 1987).

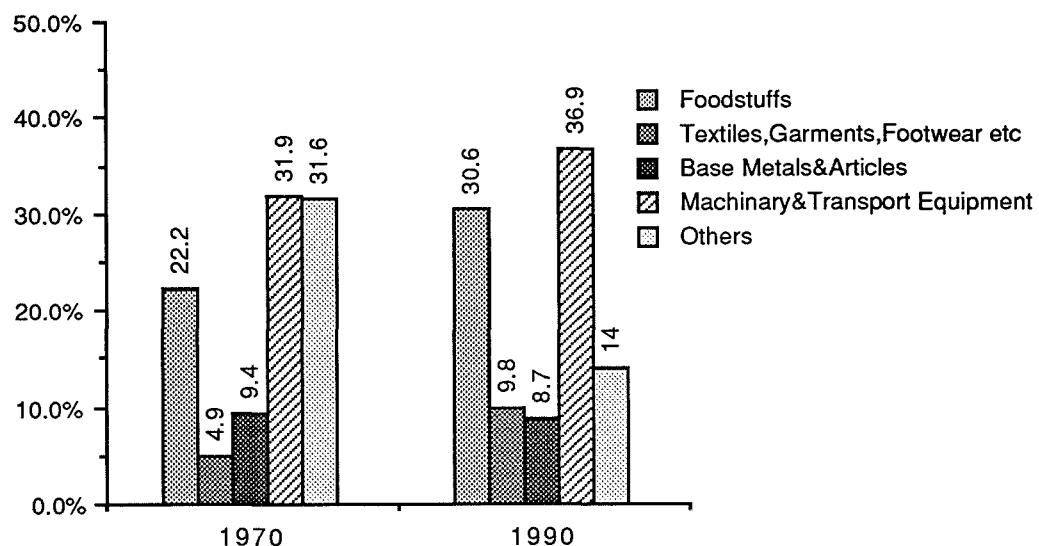
### **3.5.2 Demand Conditions**

The Kingdom, according to the census, contained 12,304,835 nationals, at the time it was conducted on early 1993, and 4,625,459 non-nationals (Saudi Consulting

House, 1994). The size of home market, like the other Gulf Co-operative Council countries' (Saudi Arabia, Kuwait, Qater, Emirate, Bahrain and Oman) markets, is not large relative to other nations. However, its growth rate is one of the highest in the world, in excess of 4.0% (Business Monitor International Ltd., 1993).

The demand condition in S.A. is sophisticated in virtually every consumer goods industry, such as apparel, shoes, jewellery, furniture, food products and several others and that Saudis may spend more per capita on items such as clothes, accessories, food, and shoes than citizens of many other nations (Rateb, 1996). The share of consumer goods and food items of the total imports in 1990, for example, is about 40% (SR 36 bn) (Ministry of Planning, 1992). See Figure 3-11.

Figure 3-11: Percentage Distribution of Merchandise Imports.



Source: Ministry of Planning (1992).

There are several reasons contributing to the sophistication of the demand. The first one is that the Saudi market is open. Goods that satisfy customers' needs are imported from all over the globe (Ministry of Planning, 1992). Throughout the past two decades, the rapid growth process has coincided with the establishment of the Kingdom

as an important market for the world's major exporting countries. During this period the value of imports into the Kingdom reached SR 2000 bn. The entry of most imports into the Kingdom tariff-free and without other barriers (Saudi Chambers Council, 1985; Saudi Consulting House, 1994).

Moreover, the standard of living does varies in S.A. (Business Monitor International Ltd., 1993) which adds complexity to the demand situation. The third reason is that it is a mixture of multiple cultures. About a third of its population are foreigners who come from many countries, each with different cultures, attitudes and requirements (Saudi Consulting House, 1994). Finally, large numbers of its people go outside the country for studying, training, tourism and etc. who bring on return new or improved demand criteria (Saudi Chambers Council, 1989; Al-Aswaq, 1996).

The sophistication of consumers in areas such as clothing, footwear, and furniture is reinforced by the presence of sophisticated distribution channels. They are usually small and familiar with their business and represent knowledgeable and demanding intermediate buyers for the products involved. Firms must constantly come up with new models to secure and maintain distribution. As a result, the product variety available is enormous (Saudi Chambers Council, 1987).

The government, as will be mentioned later, is considered an important buyer (Saudi Consulting House, 1994). Its huge expenditure, and its policy of giving preference to national products over foreign products in contracts for the supply of its procurement has, unfortunately, made several businesses establish themselves to sell mainly to the government (Saudi Chambers Council, 1987).

### **3.5.3 Related and Supporting Industries**

Vertical relationship between firms or industries is weak (Mudani, 1987; Saudi Chambers Council, 1987). Perhaps with exception to the petrochemicals industry, the majority of firms provide goods and services to the end users. Therefore inputs and machinery are usually imported (Mudani, 1987; Saudi Consulting House, 1994). The absence of local suppliers to machinery and other inputs creates several disadvantages.

The first is via inefficient, late and slow inputs. The second is the poor co-ordination and linkages between the value chains of firms and their suppliers. These problems are considered some of the lasting problems that firms have been suffering since their early stages of production (Saudi Chambers Council, 1989; Al-Swalem, 1996).

Absence of important related and supporting industries is considered another weakness in S.A. (Saudi Chambers Council, 1989). This places potential Saudi Arabian competitors at a significant disadvantage vis-a-vis foreign rivals.

Several of Saudi Arabian's successful industries benefited from the establishment of the Saudi Industrial Exports Company as well as the Saudi Export Development Centre. The Company was established in 1989 to develop the export of Saudi industrial products and to open new markets for local factories to promote industry and other productive sectors. The centre was established in 1986 to give the private sector a role at boosting Saudi exports (Saudi Consulting House, 1994).

There are several factors that may positively affect the relationship between firms in one industry or segment of industry or in one location. Firstly, there are 19 chambers of commerce and industry in the major cities of the Kingdom. These chambers provide market information and periodically publish guides of the existing firms. In addition, each chamber has created several committees, in which each one is responsible for specific industry in its location (e.g. agriculture, construction and etc.). Periodical meetings are usually organised between businessmen in each industry. Secondly, The Ministry of Industry and Electricity has established industrial cities equipped with all facilities in which industrial firms are located close to each other. However, the horizontal relationship is considered weak and the competition is, in general, destructive because, as mentioned earlier, most firms compete on prices since they provide undifferentiated goods and services (Abalkeel, 1995).

### **3.5.4 Firms' Strategy, Structure and Rivalry**

The majority of firms are small and medium-sized and privately owned (Saudi Chambers Council, 1985; Saudi Arabian Monetary Agency, 1990). Many of the large

establishments, especially in capital intensive industries, are state owned and domestically oriented. The smallness of businesses can be indicated from Table 3-2. By the end of 1990, the total number of joint stock companies registered in the country had reached 85 (1.2% of the total number of registered companies), of which only shares of 66 companies are offered to the public in the stock market, and their total capital is SR 48.7 bn (56% of the total capital of companies). Moreover, the total number of Individual Proprietorships and Firms which were registered in S.A. up to the end of 1990 is 288,924 (Saudi Arabian Monetary Agency, 1990).

There are several reasons why most firms are small. An important reason, as mentioned before, is the poorly developed capital market. Another reason (Al-Motwa, 1994) is that some individuals have established businesses because they either could not find suitable jobs (either not where they live or not with governmental affiliates), or because their incomes have been reduced compared to what they used to be. These individuals usually get into businesses that require low capital.

Table 3-2: Companies Operating in S.A. in 1990 (Capital in Million SR).

<u>Nature of companies</u>	<u>Number</u>	<u>Capital</u>
Joint stock companies	85	48,746
Limited liability partnership	4,096	33,508
Saudi	2,811	17,343
Non-Saudi	18	61
Joint venture	1,267	16,104
Joint liability partnerships	2,138	2,987
Saudi	2,108	2,932
Non-Saudi	3	7
Joint venture	27	48
Mixed liability partnerships	787	1,596
Saudi	775	1,546
Non-Saudi	3	17
Joint venture	9	33
Mixed liability partnerships by shares	1	1
Total	7,107	86,838

Source : The Saudi Arabian Monetary Agency, Annual Report 1990, P.106.

A third reason is the management style and organisational approach adopted. People do not like to work in hierarchies and aspire to working on their own or in a close-knit company (Al-Adwan, 1991; Kamel, 1995). Based on Al-Adwan; "**.... most of our companies are family controlled, few people make all the decisions**" p.9.

The aspiration and willingness of many individuals to have their own business has made several people, who may lack the skill and experience, establish businesses (specifically small). Habib and Abdeen (1987) find that the most important causes for a firms poor financial position and bankruptcy in S.A. are: establishing businesses without doing economic visibility studies and poor management, with 89% response rate for the first reason and 63% for the second. Ahmad and Al-Fuad (1992) investigate the role of small businesses in S.A. and their problems. They suggest that some of the most important problems that small businesses face are poor management, and the structure of the small business sector.

The oil revenue peaks in 1970s and early 1980s have made many managers expect to gain profit easily and fast (Al-Olyan, 1985). For the conditions mentioned earlier, many firms tend to be un-segmented and un-specialised which make them uncommitted to industry and they easily leave the business (Mudani, 1987).

It should be recognised that this trend has changed. Owners now accept lower profit and they have become concerned for their businesses survival (Al-Kashrmy, 1993). This means that many entrepreneurs concentrate more on their core businesses, but at the same time they diversify into other unrelated sectors, especially into the real-estate industry to minimise risks (Looney, 1991).

The literature suggests that management's style in S.A., like other Arab countries' management style (Atiyyah, 1993; Abuznaid, 1994), is affected by three main factors; Islam, "tribalism" and the West. One outcome of "tribalism" is that Saudis, managers and subordinates, do not like to work for an anonymous company but want to feel that they are part of a family-like organisation where they will be recognised (Hofstede, 1980; Al-Moalmy, 1991). Relations between firms and their employees, regardless of their

nationalities, is usually open and informal (Al-Adwan, 1991). However, employee lay off is acceptable and normal, especially for non Saudis who accept moving from one place to another (Saudi Chambers Council, 1989; Al-Motawa, 1994).

Another feature of traditional Arab management is the conception of competition and wealth aspiration. The Islamic religion has a great and direct impact on Saudis' behaviour (Abdulgader and Bureay, 1993). Its management perspective is characterised by the balance between the material, the spiritual and the psychological well being of the individuals and groups in society (Abdulgader and Bureay, 1993). Therefore, Islam encourages competition that will lead to benefit individuals and society as a whole. Competition that harms either party is not accepted (Abuznaid, 1994). Islam also forbids unjust competition such as the one that is based on monopoly (Al-Habshi, 1993).

Moreover, several individuals are affected by the Islamic perspective with regard to wealth aspiration (Al-Habshi, 1993). Islam teaches its followers that the accumulation of wealth is not the main objective in their lives. Mankind was created to worship God. Gaining wealth and spending it, is considered as worship in Islam if it comes from and is spent on sources and means that are consistent with the Islamic Laws "Sharea". Some example of the forbidden sources of wealth "Haram" are any businesses related to alcoholic drinks, drugs, adultery, stealing, gambling, and money interests "Reba". Monopoly, cheating, maximum profit instead of reasonable profit are some examples of forbidden means to gain wealth even if they come from allowable sources (Al-Habshi, 1993; Abuznaid, 1994).

Unfortunately, some people have misunderstood Islamic values and teachings. Instead of working hard to achieve wealth from the right sources and means and spending it in the correct ways as a method of worship, they accept an easy life, status-quo, and laziness in order to avoid the wealth that needs to be justified on the day of judgement as to where they get it from and where it was spent (Abuznaid, 1994). Although Looney (1989) suggests several reasons why the private sector in S.A. prefers investing in real estate rather than other sectors such as expecting a declinine in

government consumption and subsidised credit, the researcher suggests that the misunderstanding of Islamic values concerning the gathering of wealth should not be underestimated.

Based on what was mentioned before, the majority of firms (small, and undifferentiated) compete destructively on prices based on cheap foreign labour. The result is that many firms have either left the market or are contented with low profit margins.

### **3.5.5 The Role of the Government**

The government has done a remarkable job in modernising the country in a period of less than twenty five years (Looney, 1989). This can be seen by the thousands of millions of Saudi Riyal spent, by the government, in factor creation since 1970. Government expenditure, for example, rose from SR 5.9 bn in 1969 to SR 175.1 bn in 1979, and to SR 227.3 bn in 1984 (Ministry of Planning, 1992).

The Saudi government at various levels has had a good record in factor creation. In general, the educational system, health service, transportation, telecommunication, electricity and water networks are all modern by world standards (Ministry of Information, 1992). In the 1995 budget, for example, the Education sector was provided with the highest allocation in the budget (SR 26,987 mn) followed by transport then communication (SR 8,374 mn). Allocation for health services and the social development sector are SR 13,366 mn while the expenditures for infrastructure, industry and electricity sectors is expected to amount to SR 5,150 mn (Al-Riyadh, 1995).

In addition, the government has taken several measures to motivate the private sector to get involved in development. It has been providing subsidies and loans for various projects. The specialised Credit Institutions (SCIS) receive direct support from the government budget and provide long-term loans at relatively low cost. During the first three development plans total investment credit disbursed by all public financial institutions recorded a steep growth from SR 15 mn in 1969 to SR 19.5 bn in 1979 and

to SR 19.9 bn in 1984 during the fourth plan period, disbursements were gradually reduced and amounted to SR 4.4 bn in 1990 (Ministry of Planning, 1992). Loans disbursed by the different governmental banks are presented in Table 3-3. It is clear from the table that loans provided by the government have declined sharply.

With regard to subsidies, government subsidies amounted to SR 17 mn in 1970, then it increased to SR 12.1 bn in 1984. Since then it has gradually declined to reach SR 8.6 bn in 1990 (Ministry of Planning, 1992). These subsidies include payments to subsidise cost of food, payments made to farmers, subsidies for the locally produced wheat and barely, social security payments, subsidies paid to electric companies, and other miscellaneous payments related to social care, youth clubs, public transport, etc.

Moreover, the government provides other incentives to the private sector. Some are as follows; industrial cities equipped with all facilities have been established, plots of land in these cities are available at a nominal rent of 2 US cents per square meter annually, electricity and water are also provided at low prices, in addition, all commodities entering the Kingdom for industrial production are exempted from customs duties. Finally, all Saudi companies enjoy exemption from company taxes (Saudi Consulting House, 1994).

Table 3-3: Investment Credit Extended By Government-Sponsored Credit Institutions (Million SR).

	1969	1974	1979	1984	1990
Agriculture bank	15	na	na	2,800	664
Industrial bank	na	16	6,800	na	667
Public bank	na	428	na	4,400	2,500
Credit bank	na	24	na	256	274
Real state bank	na	na	7.700	9,000	2,500
others (contractors, hospitals, hotels, newspapers and etc.)	na	26	636	--	5

Source : Ministry of Planning, 1992.

Expansion at such high rates and in such a short period of time has led to some unlikely consequences. Competition policy is perhaps the single greatest weakness in the

government policy (Kamel, 1995). In areas such as telecommunications, health, education and others, protected local monopolies have led to inefficiencies and lack of innovation. Moreover, many firms, which are dependent on subsidies and government purchases, found themselves not able to compete, not only in the international market but also in the local market, after the economic situation changed and the government started to cut its subsidies and consumption (Loonely, 1989; Kamel, 1995).

Very recently the government announced its intention to launch a privatisation programme for the purpose of increasing private sector investment in the economy, increasing economic efficiency and innovation, increasing competition and reducing subsidies (Al-Riyadh, 1995; Kamel, 1995). Finally, the government activated the primary stock market by supporting and participating in the formation of many joint stock companies through its secondary investment agencies, such as the General Organisation for Social Insurance and the Retirement Pensions Agency, which were among the founder groups of several joint stock companies (Eastern Province Chamber of Commerce and Industry, 1994).

### **3.6 The Determinants as a System**

Saudi Arabian's competitive advantage rests largely on basic factor conditions (principally natural resources). The particular industries or industry segments in which S.A. has succeeded characterised by standardised, mass-produced products, relatively low requirements for customer contact or after-sale service, and the availability of product and process technology on international markets from independent machinery suppliers or faltering Western competitors willing to license their technology. The majority of Saudi Arabian industries produce final products made with imported components using imported machinery.

Saudi Arabia's ability to sustain and extend national competitive advantage is in doubt. The discussion presented in the previous section suggests that the determinants as a system is not expected to lead to sustainable competitiveness in S.A. Although two or three determinants are favourable in some industries or industry segments, they are

insufficient because the determinants work as a system. For example, in the chemical industry where the Kingdom has a good international position, suppliers, infrastructures, and possibly demand combine to make several firms in this sector highly competitive. However, the ineffectiveness of the capital market, firms' strategies that concentrate on low-order advantage, (such as low-cost labour, subsidised inputs and governmental purchases) poor management style (unprofessional management), disconcern of research and development and others have all contributed to the inability of many firms in the chemical industry to compete internationally.

### **3.7 Saudi Arabia in Perspective**

The central task facing S.A. is to refrain from competing on lower advantages such as natural resources, cheap labour, location factors, and other basic factor advantages because these provide a fragile ability to export. Dependence on industries, where exports are invariably sensitive to price, leaves the nation vulnerable to the exchange rate and protection from other countries (e.g. tariff and quota).

To progress, S.A. faces the daunting task of upgrading all four parts of the national "diamond" sufficiently to reach the threshold necessary to compete in advanced industries. Creation of advanced factors is perhaps the first priority. Education, local technical capability, an information base, and modern infrastructure are prerequisites, although sophisticated home demand and supporting industries are necessary for continued development.

The principles reflected in the "diamond" raise questions about an import substitution approach adopted by the government. Import substitution tends to draw a nation into unattractive industries or industries where it has little prospect of gaining competitive advantage. While protection can guarantee the home market, a nation's firms will lack advantage in international markets.

Perhaps, a better model for setting development priorities is the principle of clustering. S.A. will most likely be successful not in isolated industries but in building

whole clusters. It must look for industries that are, or have the potential to be, beneficial to the nation as a whole.

S.A. must move quickly to upgrade its advantages in these industries beyond basic factor costs. With these industries as a base, the next step is to stimulate the development of upstream, downstream, or related industries in which advantage is less factor sensitive. Investments in education, research, and infrastructure should concentrate on these groupings. Indigenous companies should be encouraged to become multinationals, to acquire technology and skills, and to gain direct access to foreign markets.

In addition to building outwardly in groups from factor-driven industries, the government and local firms should identify those industries (industry segments) in which its demand conditions are favourable. These will be industries where there are sophisticated buyers or where local needs are distinctive.

It is out of this research scope to investigate and suggest in detail what measures should be adopted to develop reinforcing determinants “effective diamond”. What is relevant to this study is to determine whether acquisitions and mergers may be good alternatives which can help in solving the private sector’s problems and achieving some of the national development plans’ objectives. These issues will be investigated in Chapter Seven based on the literature review of the last chapter and this chapter as well as the primary data collected and presented in Chapter Six. To complete the literature review of this chapter, the little available information about A&Ms in S.A. will be provided next.

### **3.8 A&Ms in S.A.**

The first time A&Ms was mentioned formally as means of solving some of the private sector’s problems was during the Fourth Saudi Businessmen Conference that was held in Jeddah in March 1989. On behalf of King Fahad Bin Abdulaziz, prince Majed Al-Saud (1989), during his opening of the conference said " ....it could be suitable to encourage small and medium size national companies to merge into bigger

**organisations in order to lower production cost, to increase the performance level, and to improve productivity" p. 16.**

This statement should be familiar to those who know the stimulus to acquisition activity in Europe during the merger waves of 1950-1970. To meet the increased competition from abroad, a number of European governments had a similar attitude to that of S.A. toward mergers which led to the merger waves in that period (Ryden, 1972). In the UK, for example, the government established the Industrial Reorganisation Corporation to promote mergers (Mueller, 1980). In France, the industry minister declared "**The consolidation of French industry has become a national priority.....We must form enterprises that are capable of standing up to foreign groups**" p.11 (Mueller, 1980).

It should be noted that although the government of S.A. encourages firms to merge with each other to be more effective and efficient, it does not provide specific benefits or promotion to the merging firms (Al-Essa, 1991).

### **3.8.1 Legal Considerations**

Article 214 of The S.A. Regulations for Companies (1989) distinguishes between the concept of merger and the concept of consolidation, but they were given the same title, that is merger (Jeddah Chamber of Commerce and Industry, 1989). It states that "**Merger shall be effected by the combination of one or more companies into another existing company, or by the consolidation of two or more companies into a new company under formation" p. 62.**

The laws that control the A&Ms activity are flexible. They do not have any restriction on A&Ms' decisions based on their types (horizontal, or vertical, or diversified) and the size of merging firms (Al-Mola, 1991). Several legal obligations, however, concerning A&Ms are required under the Saudi Arabian Regulations for Companies, the Commercial Register and the Department of Zakat and Income Tax (Whinney Murray & Co., 1991).

The existing regulations under the S.A. Regulations for Companies are as follows (Jeddah Chamber of Commerce & Industry, 1989); the merger shall be valid only if authorised by a resolution adopted by each of the constituent companies; the resolution for merger must be published in a daily newspaper, and the resolution shall take effect only after 90 days from the date of its publication in order to protect the right of creditors of the merged companies (Whinney Murray & Co., 1991).

With regard to the Commercial Register, the legal obligation can be considered according to the type of business combination (Whinney Murray & Co., 1991). The new company which results from the consolidation is registered as a new one. Al-Essa (1991) criticises treating the consolidated firms as a new company regardless of their history and experience which means that, for some sectors such as the contracting sector, the new firm will lose one of its qualifications to win governmental tenders. With regard to acquisitions, normally no change is required in the commercial register other than the change in ownership and possibly the manager.

The Department of Zakat and Income Tax requires that all assessments of the consolidated companies up to the date of transfer should be finalised. Also, specific documents should be submitted, then the amount of the purchase consideration should be determined and any capital gains tax owed must be paid. Finally, a cessation filing for each of the consolidated companies should be made and a new tax file for the new company must be opened (Whinney Murray & Co., 1991).

### **3.8.2 Sources of Identifying Firms Willing to Merge**

Companies which are interested in acquisitions may make their interests known by inserting an advertisement in the leading newspapers of the Kingdom or in selected magazines, or by putting up billboards around the company sites. This method is usually used by small firms (Whinney Murray & Co., 1991).

Another approach is using personal contacts. Family groups who wish to acquire other units primarily use personal contacts because of the importance of secrecy. Also,

family groups who wish to divest may use personal contacts to ensure that their reputation is not affected by adverse publicity (Whinney Murray & Co., 1991).

The Chambers of Commerce and Industry is an important source for identifying a possible partner for a business combination. The Contractors Committee in Riyadh Chamber of Commerce suggested a way to motivate A&Ms between the contracting companies. Specific forms are distributed to contracting companies, every company which is willing to merge with another one is required to fill up a form which includes name, type of activity, its capital and the kind of company it is willing to merge with, then the Contractors Committee will arrange a meeting between the different parties and will provide the information required (Al-Mola, 1991).

The effectiveness of this method is not as yet known. Based on the researcher's discussion with Al-Shawy (the Contracting Committee manager), contracting companies are still reluctant to use A&Ms and it is not known if the reluctance is due to the ineffectiveness of that method, or due to some other barriers. This research will investigate this dilemma.

Finally, there are other possible sources of partner identification, such as banks, real estate offices, lawyers, accountants, and management consultants (Whinney Murray & Co., 1991). This study will be the first one which will investigate the different mechanisms of A&Ms in S.A. and their effectiveness.

It is clear, from the previous discussion, that the A&Ms activity in S.A. is simple and not as complicated as it is in developed countries. Few parties are involved. Also, high premiums are not always required since firms are privately held which means that there is no need to bid to gain a majority of shares.

### **3.8.3 Cases of Acquisitions and Mergers in S.A.**

Unfortunately no list of cases was available from either the Ministries or Chambers of Commerce in S.A. Information had to be obtained from newspapers. Few cases were identified. Their common characteristics are as follows; they are quite recent,

horizontal and consolidation rather than acquisition (Al-Kolawy, 1992; Al-Tijarah, 1992).

The consolidation between the electric companies existing in the different areas of the kingdom in 1980 may be considered the first cases of mergers in the Kingdom (26 companies in the Eastern province, 36 companies in the Central region, 21 companies in the Southern region and 12 companies in the Western region). They occurred from government decisions which resulted in the foundation of four electric companies, each covering specific areas of the Kingdom (Ministry of Industry & Electricity, 1992).

The second consolidation case identified is between Al-Shathry engineering office and AL-Shhaby engineering office in 1991 (Tejarat Al-Riyadh, 1991). Based on the managers of the two firms, several benefits were achieved; increased operational capacity, better competitor, and continuity of their works. With regard to the last objective, they stress that small businesses and sole proprietorship's firms in S.A., are so worried of survival that employees are made to feel insecure in their jobs. It should be noted that before the merger occurred, the two firms had established a three year long partnership through a joint venture. When that project succeeded, the management of the two firms decided to merge all three firms into a new one (Tejarat Al-Riyadh, 1991).

Another experienced case of consolidation existed at the beginning of 1992 between the Saudi Cement company and the Saudi Bahreany Cement company. The new name for the consolidated companies is The Unified Saudi Cement Company, and its capital is SR 2.4 bn (Asharq Al-Awsat, 1992). These two companies are located in the same area (Eastern Province) and they are only 50 km apart. Moreover, the board of directors in the two companies are almost the same (Asharq Al-Awsat, 1992). The merger's objectives cited by the CEO of the new company is the economical concentration, administrative efficiency, expanding marketing range and standardisation of policies and improvement of production quality (Al-Kolawy, 1992).

Another case of merger is between two subsidiaries and their parent company. the parent company is the Saudi Danish Dairy company, while the other two companies are

the Gulf Danish Dairy company and the Medina Danish Dairy company (Al-Kolawy, 1992).

During the conduct of this study, two more major merger's cases have occurred, one between ARAMCO (the first top company) and SAMAREC (the second top company). Both of these two companies are estate-owned and the decision of merging SAMAREC into ARAMCO was issued by the Council of Ministries in 1993 (Jeddah Chamber of Commerce & Industry, 1993). Making such a decision has ranked ARAMCO fourth internationally and it becomes responsible not only for oil production but also for refining, transporting and marketing the oil (Al-Tijarah, 1992). Some analysts believe that this step will lower costs and increase production after standardising managerial and training processes and benefiting from ARAMCO's huge capabilities (Al-Tijarah, 1992).

The second case is between the Almawashi Company, ranked 390 and the Almkyresh Company, ranked 383 (Al-Eqtisadiyah, 1995). These two companies work in the same business, that is transporting and selling live animals and animal products. As can be seen from their ranking, the two companies are close competitors and by merging the two companies into one, the new company is expected not only to dominate the meat industry in the Kingdom but also the Gulf countries (Asharq Al-Awsat, 1995). Based on Alwaleed Bin Talal, who owns 60% of the Almawashi company, the merger decision means the birth of a new, stronger company, and it appears to be the best decision to alleviate the companies losses (Asharq Al-Awsat, 1995).

It should be noted that overall approximate statistics of the A&Ms' rate are not available, and no one can tell how frequently they are used. However, several observers suggest that they are rarely used (Al-Adwan, 1991). Several reasons have been suggested for the infrequent use of A&Ms in S.A. and this issue will be discussed next.

### **3.8.4 Reasons for Infrequency of Mergers in S.A.**

Al-Morbaty (1992) suggests several reasons which might make top-managers reluctant to adapt A&Ms. Some are related to handling the financial responsibilities and

accumulated debts of companies before the merger, how to treat those stockholders who do not want to merge in the new company and how to deal with problems of superfluous employees. The selection of the board of directors and the management team for the new company should also be taken into consideration.

Psychological and social reasons are also barriers to A&Ms which are suggested by Al-Adwan (1991) and Al-Shathry (1991). According to Al-Adwan "**Although the acquisition could be economically beneficial, it is not used because of psychological barriers. The owner of the establishment feels, when he decides to merge that his authority will decline. Also, his name and his prestigious social position in the company and his family name in the market will be affected**" p. 8.

The non-existence of a clear process and mechanism to facilitate A&Ms' activity is another reason for the infrequency of A&Ms in S.A. as claimed by Al-Moalmy (1991). Information about which company is willing to merge and how to approach it is not available. Finally, the insufficient experience of companies' owners and managers concerning acquisitions is suggested by Al-Olyan (1987) as a barrier to the adoption of mergers.

It should be noted that these barriers are not based on empirical studies and it is not known exactly which factors motivate or hinder A&Ms activity in S.A. and the relative weight of each one. This research will examine the occurrence of these barriers.

### **3.9 Final Remarks on the Business Environment of S.A.**

The economic prosperity of S.A. depends almost solely on the oil revenues. Crude oil represents the exclusive source of exports, and budget revenues. At the beginning of 1990s, the Saudi economy entered a new era; which is characterised by the deterioration of oil revenues, the loss of capital reserve and the decline of liquid funds. Diversifying the economy and reducing dependence on oil as the main source of income is the main scheme of all S.A. National Development Plans. The government is putting a lot of hope on the private sector to achieve objectives of National Development Plans (see

Exhibit 3.1). The information provided in this chapter suggests that although the private sector is making some progress in this direction, its achievement is far less than expected.

Exhibit 3-1: Objectives of the National Development Plans.

- Obtaining strong private sector.
  - Profitable firms.
  - Competitive private sector.
- Diversification of the economy.
- Increase direct investment with:
  - GCC's countries .
  - Countries other than those of GCC's.
- Generating employment for Saudis.
- Overcome problem of limited local market.
- Improving balance of trade through:
  - Increase export potential.
  - Competing with imports.

Sources: Ministry of Planning, 1990; Al-Riyadh, 1995; Tejarat Al-Riyadh, 1995.

The private sector faces several problems (see Exhibit 3-2). Poor management, aggressive foreign competition, and an inability to achieve economies of scale and scope because of the smallness of firms' size in S.A. and the small size of the local market are interrelated which lead to uncompetitive products. The main question raised in this study is: can A&Ms contribute in solving these problems and as a result help achieving the economic objectives?

The summary of the literature review on effects of A&Ms in the Anglo-American countries (mentioned in the last chapter) suggests that results were inconsistent and therefore, two opinions were raised; one is in favour of the positive effects and one is against. Moreover, it was explained that specific contexts were behind the potential negative effects. Some characteristics that pertain to the context of S.A. are listed and exhibited in Exhibit 3-3. Its clear from the exhibit that the Saudi Arabian business environment differs from the contexts of the USA, UK and the other developed nations

discussed in the last chapter. This means that the determinants and effects of A&Ms in S.A. should be different.

The information provided in this chapter represents the end of the exploration stage of this study. The information given in the last chapter and also in this one will be incorporated to achieve the main purpose of exploring the situation, to establish investigative questions and/ or to develop precise propositions. This will be the subject of next chapter.

Exhibit 3-2: Problems of the Private Sector.

<u>Problems</u>	<u>References</u>
<ul style="list-style-type: none"><li>• High cost of products:<ul style="list-style-type: none"><li>- Under-utilisation of capacity.</li><li>- High financial cost.</li><li>- High average production costs.</li><li>- Administrative cost is high.</li></ul></li></ul>	(Mudani, 1987). (Al-Moalmy, 1991; Riyadh Chamber of Commerce, 1992). (Habeb and Abdeen, 1987; Amer, 1993) (Mudani, 1987). (Habeb and Abdeen, 1987).
<ul style="list-style-type: none"><li>• Poor management:<ul style="list-style-type: none"><li>- Unconcern of R&amp;D and training.</li><li>- Non-specialisation.</li><li>- Marketing problems.</li><li>- Bankruptcy.</li></ul></li></ul>	(Ahmad and Al-Fuad, 1992; Riyadh Chamber, 1994). (Mudani, 1987, Saudi Chambers Council, 1989). (Al-Moalmy, 1991; Al-Adwan, 1991). (Saudi Chambers Council, 1989; Riyadh Chamber, 1994). (Economical Gulf, 1984; Al-Motawa, 1994).
<ul style="list-style-type: none"><li>• Severe competition:<ul style="list-style-type: none"><li>- Small size of the local market.</li><li>- Undifferentiated goods and services.</li><li>- Strong foreign competition.</li></ul></li></ul>	(Al-Motawa, 1994; Al-Hejelan, 1995). (Business Monitor International Ltd., 1993). (Mudani, 1987). (Mudani, 1987; Al-Motawa, 1994; Al-Hejelan, 1995).
<ul style="list-style-type: none"><li>• Obtaining long term loan is uneasy.</li></ul>	(Eastern Province Chamber, 1994; Riyadh Chamber, 1994)

**Exhibit 3-3: Main Characteristics of the Context of S.A. Which may Affect A&M's Activity.**

<u>Characteristic</u>	<u>References</u>
<ul style="list-style-type: none"> <li>• Characteristics of industrial structure: <ul style="list-style-type: none"> <li>- Sizes of majority of firms are small.</li> <li>- Few firms are publicly held.</li> <li>- Share ownership is concentrated.</li> <li>- Firms are diversified.</li> </ul> </li> </ul>	(SAMA, 1990). (Eastern Province Chamber of Commerce, 1994). (Eastern Province Chamber of Commerce, 1994). (Mudani, 1987; Abalkeel, 1995).
<ul style="list-style-type: none"> <li>• Factors related to the management of firms: <ul style="list-style-type: none"> <li>- Owners are the managers.</li> <li>- A close control of owners on managers.</li> <li>- Kin relationship between owners and mgt.</li> </ul> </li> </ul>	(Al-Moalmy, 1991; Al-Adwan, 1991). (Azam, 1994). (Hofstede, 1980; Al-Moalmy, 1991; Al-Adwan, 1991).
<ul style="list-style-type: none"> <li>• Factors related to Characteristics of A&amp;Ms: <ul style="list-style-type: none"> <li>- No legal restriction on any type of A&amp;M.</li> <li>- Hostile takeovers do not exist.</li> </ul> </li> </ul>	(Jeddah Chamber of Commerce & Industry, 1989). (The researcher's observation).
<ul style="list-style-type: none"> <li>• The market is open (No barriers of imports).</li> </ul>	(Saudi Consulting House, 1994).
<ul style="list-style-type: none"> <li>• The majority of employees are foreigners.</li> </ul>	(Saudi Chambers Council, 1989).
<ul style="list-style-type: none"> <li>• Top firms have extensive resources.</li> </ul>	(Ministry of Planning, 1990; Looney, 1991).
<ul style="list-style-type: none"> <li>• The economy is centrally planned.</li> </ul>	(Ministry of Planning, 1992; Saudi Consulting House, 1994).

## ***Chapter Four***

### ***Research Propositions***

#### **4.1 Introduction**

The purpose of Chapter Two and Chapter Three was to explore the full dimensions of the problem at hand. The researcher discussed in these two chapters the current literature of causes, effects, motives and barriers to A&Ms, and the context of A&Ms in Saudi Arabia. The objective of this chapter is to incorporate the information provided in the previous two chapters in order to develop precise propositions. These propositions were empirically tested. The results of the proposition testing comply with study objectives. Given the basic objectives of this study, the research propositions are concerned with A&M's reasons and effects in Saudi Arabia.

#### **4.2 Study Questions**

In the Introductory Chapter, three major research questions were posed. This study attempts to answer them:

Q1: Will A&Ms help solve the problems of the private sector's firms in S.A. and make them more competitive and profitable?

Q2: What potential effects might they have on the economy?

Q3: Are A&Ms favourable strategic decisions to management? and why?

More specifically, this research attempts to answer the following questions:

Q1: What causes make management choose A&M? Will they be used to make personal gains or to enlarge their firms, or to solve firms' problems or any other reasons?

Q2: What effects A&Ms may have on the profitability and competitive ability of merging firms? What are the factors that influence the success or failure of A&Ms in S.A.?

Q3: What effects A&Ms may have on the economy; economic growth, market power, inflation, employment and trade balance?

Q4: Are A&Ms favourable strategic decisions to management? What are the A&Ms' motives and barriers that exist in the S.A. context?

### 4.3 Study Propositions

The study propositions were developed along four dimensions as follows;

- propositions make managers choose A&Ms;
- propositions that deal with the A&Ms' effects on firms' profits and their competitive positions, and prerequisites of such effects;
- propositions about the effects of A&Ms on the economic welfare;
- propositions about the A&Ms' rate and factors affecting that rate.

#### 4.3.1 Proposition about Causes for A&Ms

Putting the characteristic of Saudi Arabian context in mind (Exhibit 3-3) and incorporating the information provided in Exhibit 2-1 with that of Exhibit 3-1, four propositions were developed (see Exhibit 4-1).

##### 4.3.1.1 The Synergy Cause

It is clear from the match in Exhibit 4-1 that there is a consistency between the problems of Saudi Arabian's private sector and the causes why A&M are selected as alternative strategies. This means that there is a potential that A&Ms will be used to lower firms' costs and improve their effectiveness. The first proposition can be stated as follow;

**Proposition 1:** “A&Ms will be used for synergy purposes; that is to improve effectiveness and efficiency.”

It should be noted that the occurrence of this proposition indicates that A&Ms are effective strategies in solving the private sector's problems.

##### 4.3.1.2 Management Gains Cause

The management's characteristics in S.A. (owner-manager phenomenon, the close control of owners on managers and the kin-ship relationship between firms' owners and their managers) indicates that if a firm is managed by its owner, then it is logical that

the owners will not take any decision damaging to their firms' wealth. And, if the ownership is separated from the management, the managers still may not be willing or able to use A&M for their benefits on the account of the firms' wealth because they usually care for the owners' wealth and they are under close scrutiny by the owners.

Based on the previous expectations, the second proposition is as follows;

**Proposition 2:** “A&Ms will not be used by management to make personal gains on the account of owners' wealth.”

Exhibit 4-1: Causes for A&Ms and Problems of the Private Sector.

- |   |   |
|---|---|
| 1- Management use A&Ms to make personal gain.   | 1- High cost of products:<br>Under-utilisation of capacity.<br>High financial cost.<br>High average production costs.<br>Administrative cost is high. |
| 2- Improve the efficiency.<br>Reducing cost of obtaining finance.<br>Lower marketing's cost.<br>Lower cost of administration and staffing.<br>Lower cost of Research and Development.<br>Reducing cost of operation and production.               | 2- Poor management:<br>Unconcern of R&D and training.<br>Non-specialisation.<br>Marketing problems.<br>Bankruptcy.                                    |
| 3- Improve the effectiveness.<br>Increase in debt capacity.<br>Higher level of return on promotion.<br>Gaining access to desirable market segments.<br>Make fruitful use of discoveries made in R&D.<br>Effective use of complementary resources. | 3- Severe competition:<br>Small size of the local market.<br>Undifferentiated goods and services.<br>Strong foreign competition.                      |
| 4- Better management.<br>Replacing inefficient management.<br>Increased specialisation due to increased size.   | 4- Obtaining long term loan is difficult.   |
| 5- Assets stripping.<br>6- Market power.<br>7- Speed.<br>8- Minimise risk.<br>9- An alternative to bankruptcy.  |   |

#### **4.3.1.3 Market Power Cause**

Three reasons may contribute to the prediction that A&Ms will not be selected to control the industry or the market. One reason is that the economy is centrally planned. The government, through its policies and regulations, can easily interfere with any firms' behaviour if it abuses the societies welfare or contradicts its interest. The Islamic values may also prevent some individuals from gaining profit through the monopoly. Finally,

A&Ms are not expected to lead to a monopoly power due to the severe competition from abroad and/ or from native firms. Goods and services can be imported freely to the Saudi market without any barriers such as tariffs. Even firms that do not compete with foreign firms (either because of protectionism, location or nationality) may not be able to be powerful enough to reach a monopoly position after the A&M because they are not expected to hold the required market share. The previous discussion gives rise to the third proposition.

**Proposition 3:** “Private sector’s decision-makers will not adopt A&Ms for monopoly reasons.”

#### **4.3.1.4 Bankruptcy Cause**

It was explained in Chapter Three that most businesses in S.A are small, undifferentiated, and focus on the small local market. Therefore, they compete destructively with one another which eventually makes them either unprofitable or content with low profits. This environment forces many firms to leave the market and to sell to avoid bankruptcy. This conclusion gives rise to the fourth proposition.

**Proposition 4:** “Avoiding bankruptcy and distressed financial position is the acquired firm’s cause to sell their firms.”

#### **4.3.1.5 Opportunism Cause**

Related with the previous proposition, is the willingness to sell firms to avoid bankruptcy. This causes these firms to be offered at nominal prices which encourages some opportunists to use A&Ms for the purpose of asset-stripping. Hence proposition 5 was generated to highlight this possibility.

**Proposition 5:** “Acquiring firms which can be bought at nominal prices (assets stripping) is one of the A&Ms’ causes.”

### **4.3.2 Propositions about Effects on Profits and Factors of Success**

The A&Ms' effects on firms' performance depend on the effectiveness of the choice and the success of implementation. If the intention of management is to use A&Ms to increase the profit and to make their firms more competitive, the right firm is being selected (industry fit, strategic fit, and cultural fit), and the post-merger stage is being managed effectively, then outcomes will be coherent with planned objectives. Two propositions were constructed concerning these issues.

#### **4.3.2.1 Factors Affecting A&M's Success**

Exhibit 4-2 contains two lists, one includes the main characteristics of S.A. context (Exhibit 3-3) and the second list shows the characteristics of successful A&Ms (Exhibit 2-5). On examination of these lists, some requirements of the successful A&Ms can be found in the A&M activity in S.A. Since there is no legal restriction on type of A&Ms, then related A&Ms are expected to occur which may contribute to successful A&Ms. Moreover, the majority of firms are small and medium, hence the closeness of size of firms can be considered one characteristic of successful A&Ms. In addition, most firms' employees are foreigners who are used to working under different management styles and working locations. Therefore, negative reactions to A&Ms from employees are not expected which can also explain the profitability of firms after the A&Ms. Finally, since management is not expected to deviate from owners' wealth, A&Ms' decisions are expected to be made after careful analysis. Considering A&Ms from a strategic point of view is another expected factor that explains the improved performance of merging firms.

On the other hand, some factors may either negatively affect A&Ms in S.A. or they may not be considered relevant there. Since A&Ms' phenomenon is a new one in S.A., the lack of management experience about A&Ms' activity may affect A&Ms success negatively. Moreover, some A&Ms may be adopted for the reason to benefit from firms that are offered at nominal prices due to their poor management. Therefore, closeness of merging firms' profitability, giving an acquired firm its autonomy, and

maintaining the acquired firm's top management after the A&Ms may be irrelevant in the A&Ms' context in S.A. Proposition 6 addressed these possibilities.

**Proposition 6:** “Some characteristics of successful A&Ms (related A&Ms, no negative reaction from the employees, closeness of firms' sizes and considering A&Ms strategically) exist in S.A. which may contribute to their success. Moreover, some prerequisite conditions of successful A&Ms (management's experience, closeness of firms' profitability, giving acquired firm its autonomy and maintaining acquired firm's top management after the A&Ms) may not be relevant there.”

Exhibit 4-2: Characteristics of Successful A&Ms and the Characteristics of S.A. Context.

<u>Characteristic of S.A. Context</u>	<u>Characteristic of Successful A&amp;Ms</u>
<ul style="list-style-type: none"> <li>Characteristics of industrial structure: <ul style="list-style-type: none"> <li>- Sizes of majority of firms are small and medium.</li> <li>- Few firms are publicly held.</li> <li>- Share ownership is concentrated.</li> <li>- Firms are diversified.</li> </ul> </li> </ul>	Good management intention: <ul style="list-style-type: none"> <li>- Ownership control.</li> <li>- Horizontal &amp; related A&amp;Ms.</li> </ul>
<ul style="list-style-type: none"> <li>Factors related to the management of firms: <ul style="list-style-type: none"> <li>- Owners are the managers.</li> <li>- A close control of owners on managers.</li> <li>- Kin relationship between owners and managers.</li> </ul> </li> </ul>	Industrial and strategic fit: <ul style="list-style-type: none"> <li>- Horizontal &amp; related A&amp;Ms.</li> </ul>
<ul style="list-style-type: none"> <li>Factors related to Characteristics of A&amp;Ms:-</li> </ul>	Cultural fit: <ul style="list-style-type: none"> <li>- Close sizes of firms.</li> <li>- Closeness in profitability.</li> </ul>
<ul style="list-style-type: none"> <li>- No legal restriction on any type of A&amp;M.</li> <li>- Hostile take-overs do not exist.</li> </ul>	Effective integration: <ul style="list-style-type: none"> <li>- Experience about A&amp;Ms.</li> <li>- Friendly A&amp;Ms.</li> <li>- Autonomy.</li> </ul>
<ul style="list-style-type: none"> <li>The market is open (No barriers to imports).</li> <li>The majority of employees are foreigners.</li> <li>Top firms have extensive resources.</li> <li>The economy is centrally planned.</li> </ul>	

#### **4.3.2.2 A&Ms' Effects on Firms' Profitability and their Competitive Positions**

The above mentioned argument suggests that A&Ms in S.A. are suppose to have positive effects on profitability because several requirements of A&M's success are found in A&M's activity. Although some characteristics of successful A&Ms may not exist, these requirements (with exception to the experience about A&Ms) may not be relevant given the context of S.A.

One important reason leading to firms' lowering profits after A&Ms is when management choose A&Ms to make personal gains. The management's characteristics in S.A. indicates that if a firm is managed by its owner, then it is logical that the owners will not take any decision damaging to their firms' wealth. And, if the ownership is separated from the management, the managers still may not be willing or able to use A&M for their benefits on the account of the firms' wealth because they usually care for the owners' wealth and they are under close scrutiny by the owners. These conclusions give rise to the seventh proposition.

**Proposition 7: “A&Ms will improve firms’ profitability and their ability to compete.”**

It should be noted that A&Ms' are expected to lead to higher profits regardless of the causes for A&Ms (synergy, market power, and assets stripping), but they will make firms more competitive only if synergy and/ or monopoly power is achieved.

#### **4.3.3 Propositions about A&M's Effects on the Economic Welfare**

Exhibit 2-6 shows that A&Ms may have positive effects on the economic welfare as well as negative impacts and that there are specific reasons and conditions for each category. With regard to the positive effects, higher economic growth and improving balance of trade is possible if A&Ms improve firms' effectiveness and efficiency, regardless of the causes behind the A&Ms. If a positive synergy is achieved as a main outcome of acquisitions or as a second consequence of other A&Ms' causes (market power, assets stripping), then A&Ms will lead to a stronger private sector. This will

presumably lead to favourable economic conditions (economic growth, diversification of the economy, higher investment, more and better employment and improved balanced of trade).

As discussed earlier in the propositions of causes for A&Ms, there is a high potential that A&Ms will be used for the purposes of synergy. Even if they are adopted for monopoly purposes, they are expected to lead to higher effectiveness and/ or efficiency because the strong foreign competition and government role will influence the management to improve their firms' performance and therefore not to depend on the market power as the sole source of increasing income. If assets stripping is the cause behind acquisitions, acquirers are not expected to purchase such assets if they are not sure how to be managed more effectively under their control. This gave rise to a general proposition about the positive effects on the economy.

**Proposition 8:** “A&M will lead to favourable economic conditions in S.A. which include increasing economic growth, improving balance of trade, improving labour force's structure, diversifying the economy, and increasing investments.”

With regard to the negative impacts of A&Ms on the economy (Exhibit 2-6), examining the prerequisites (conditions) of such outcomes, with the exception of lack of experience, these conditions do not apply in the context of S.A. (see Exhibit 4-3). This led to proposition 9.

**Proposition 9:** “A&M will not lead to negative impacts on the economy (lower economic growth rate, lower investment, monopoly, higher inflation rate, control of power in the hands of a few people, unemployment, deterioration of the balance of trade).”

**Exhibit 4-3: Reasons for A&M's Negative Effects on the Economy, their Conditions and their Possible Occurrence in S.A. and their Justifications.**

<u>Reasons of Negative Economic Impacts.</u>	<u>Conditions.</u>	<u>Expected or Not Expected in S.A and the Reason.</u>
- Decline in profitability of acquiring firms.	- Unrelated A&Ms (antitrust laws). - Hostile A&Ms. - Sizes are extremely different. - Lack of experience.	- Unexpected. See propositions 6 & 7.
- Monopoly power.	- A&Ms are for management gains. - Barriers to entry.	- Unexpected. See proposition 2.
- Aggravate problem of unemployment.	- Unsuccessful A&Ms. - Hostile acquisitions are widespread. - Unemployment problem exists.	- Unexpected. See propositions 6 & 7. - Not existing. Few firms are publicly held & stocks are concentrated for joint stock co. - Unexpected. A&Ms are expected to be profitable which will increase employment, unemployment problem is not existing and Lower dependence on foreign labourers is favourable.
- High level of inflation.	- High level of concentration.	- Unexpected. No barriers to entry and government control.
- Deteriorating balance of trade.	- A&Ms constrain resources and reduce investment.	- Unexpected. Private sector has extensive resources, not high premium, competitive pressure and profitable A&Ms.

#### **4.3.4 Propositions about the A&M's Rate And Factors Affecting It**

As discussed in Chapter Two, there are other reasons which influence the decision of whether or not to use A&Ms. These factors were named motives and barriers. Three propositions were developed with regard to this topic.

##### **4.3.4.1 A&M's Rate**

Although the motives are a prerequisite to acquisitions, they will lead to a higher rate of acquisition activity if they are supported by elimination of the barriers. Exhibit 4-4 contains a list of the motives and barriers to A&M outside S.A. (Exhibit 2-2). Also motives and barriers to A&M which have a direct relationship with the Saudi Arabian context and are not mentioned in the literature outside that country.

Regardless of the relative importance of any single motive or barrier, it is clear from Exhibit 4.4 that while some motives exist in S.A. (five motives) there are five motives which do not. Also, seven variables are found as barriers to mergers activity. These barriers cause A&Ms' activities to slow down. Moreover, there are three motives and six barriers whose existence was not known during the time of developing these propositions but which were discovered after collecting the primary data. Based on previous logic, the tenth proposition was established.

Exhibit 4-4: Motives and Barriers of A&M.

<u>Motives and barriers outside S.A.</u>	<u>Existence or non-existence</u>		
	E	NE	NN
<b>Motives :</b>			
<i>Internal</i>			
Ability of management to control increased complexity.			+
Firms are diversified.	+		
Awareness that large firms are better equipped to manage business.			+
Excess capacities that a firm can not efficiently deploy internally.	+		
<i>External</i> :			
Government provides benefits to merging firms.		+	
Inability to capitalise through public offering.	+		
Severe competition.	+		
Existence of firms that can provide strategic benefits.			+
Existence of effective and efficient investment bankers.		+	
Existence of effective and efficient acquisition's brokers.		+	
Availability of list of firms willing to involve in acquisitions.		+	
Availability of financial and personal information of potential firms.		+	
<b>Barriers :</b>			
<i>Internal</i> :			
Ownership control (Share ownership is less spread).	+		
Lack of experience.	+		
Satisfaction with status quo.	+		
Potential negative personal relationships after A&Ms.			+
Management does not like to share authorities.	+		
Desire of independence of name or image.	+		
Managers fail to take advantage of merger's opportunity.			+
Restriction of resources, especially financial capital.			+
<i>External</i> :			
Discouraging inflation rate.	+		
High cost of capital (interest rate).			+
Legal restriction.		+	
Not a good price.		+	
<u>More motives and barriers which apply to the S.A. context</u>			
<b>Motives of acquisitions:</b>			
Government and Chambers of Commerce support A&Ms.	+		
<b>Barriers to acquisitions :</b>			
Legal ambiguity (e.g. how the merging firms are assorted).	+		

**Proposition 10:** "A&Ms are not preferred by the private sector and, therefore, their rates are low."

#### **4.3.4.2 A&M's Motives and Barriers**

According to the previous discussion, some motives to mergers exist in S.A., and some do not. Moreover, the literature of A&Ms' in S.A. suggests that the ineffective mechanism which can facilitate the A&Ms' activity, and the psychological as well as social factors are the main barriers to acquisition activity in S.A. This gave rise to two propositions.

**Proposition 11:** "Several motives to A&Ms do not exist in S.A. The absence of an effective mechanism to facilitate A&Ms is the major variable."

**Proposition 12:** "Several barriers to A&Ms exist in S.A. Psychological and social factors are the main barriers to acquisition activity."

### **4.4 Concluding Remarks**

It should be noted that the occurrence of proposition one (A&Ms will be used to improve effectiveness and efficiency) is compatible to the assumption that A&Ms are effective strategies in solving the private sector's problems. Moreover, matching the possible economic effects (increasing economic growth, improving balance of trade, improving labour force's structure, diversifying the economy, and increase investments) with the objectives of the Saudi Arabian National Development Plans indicates that if the expected occurs, the A&Ms will contribute to the achievement of the development objectives (see Exhibit 4-5).

Obtaining empirical answers to the questions raised and the propositions expected requires a formal study in which a clear structure and precise procedures are followed. The next chapter discusses in detail aspects of the formal research design.

**Exhibit 4-5: The Potential Positive Effects on the Economy and their Relationship with the National Development Plans.**

<b>A&amp;M's Positive Effects</b>	<b>Objectives of Development Plans Regarding the Private Sector</b>
Effects related to Firms which include: Profitable firms. Facing foreign competitors more effectively.	Obtaining strong private sector. Profitable firms. Competitive private sector.
Effects related to economic welfare which include:	Diversification of the economy.
Higher economic growth: Shifting assets into their best use. Higher level of investment. Higher rate of R&D.	Technology upgrading.  Increase direct investment with: GCC's countries . Countries other than those of GCC's.
Improving balance of trade. Increase of exports. Increase of imports.	Generating employment for Saudis.  Overcome problem of limited local market.
	Improving balance of trade through: Increase export potential. Competing with imports.

## ***Chapter Five***

### ***Research Design and Methodology***

#### **5.1 Introduction**

Several expectations for the reasons for and effects of A&Ms in S.A. were suggested in Chapter Four. As far as one can determine, no empirical research has been conducted to investigate the possible causes that make firms in S.A. adopt A&Ms, the positive and negative effects they may lead to and the barriers that slow down their rate.

The purpose of this chapter is to describe the research design and methodology that has been used to attain the research objectives (answering the investigative questions and testing the propositions). In brief, this chapter consists of four main sections, which will outline the principles underlying the choice of the approaches used to investigate the aims of this study. In the first section, categorisation of research designs and their relationship with this study is discussed. Designing the research instruments in detail and constructing the questionnaire is provided in the second section. The third section is devoted to explaining the sample selection. Finally, data analysis methodology is discussed at the end of this chapter.

#### **5.2 Categories of Research Methods**

Researchers face a number of crucial design choices and these can be summarised in a categorisation of research design types. However, there is no single satisfactory classification system (Emory, 1980). Various writers on research suggest different classification schemes, e.g.

\* Exploratory, descriptive and design which permit inference about causality (Sellitz et al., 1976).

\* Experimental and ex post facto (Kerlinger, 1973).

\* Exploratory, descriptive and causal (Chisnall, 1986).

According to Emory (1980), this confusing array exists because “research design” is a complex concept which cannot be described in a simple manner. Emory suggested that any given study can be viewed in at least seven different perspectives. They are as follows:

- 1- The degree to which the research problem has been crystallised (the study may be either exploratory or formalised);
- 2- The topical scope (breadth and depth of the study). It may be a case or statistical study;
- 3- The research environment (most business research is conducted in a field setting, although laboratory research is not unusual; simulation is a third category, somewhat similar to laboratory research);
- 4- The time dimension (research may be cross-sectional or longitudinal);
- 5- The power of the researcher to affect the variables under study (the two major types of research along this dimension are the experimental and the ex post facto);
- 6- The nature of the relationships among the variables (research studies may be descriptive or causal) and
- 7- The communication mode of data collection (studies may be observational or survey).

In the following sections, a discussion of the above categorisations and their relationship to this study are presented in detail (see Exhibit 5-1).

### **5.2.1 Degree of Problem Crystallisation**

The degree of structure and the immediate objective of the study represent the essence of the distinction between exploratory study and formalised study. The exploratory study is ill-structured and much less focused on predetermined objectives. The immediate purpose of the exploratory study is usually to develop some hypotheses for testing or some investigative questions for further research. The formalised study has much more structure. It begins with hypotheses or investigative questions and the precise procedures are clearly specified (Zikmund, 1989).

According to this description, the progression of this study passed two stages in which each one aims to accomplish specific goals. The first stage is exploration while the

second stage requires a much more formal approach. The first purpose of the exploration study (raising questions for further investigation and developing propositions for testing) has been achieved and presented in the last chapter. Finding answers to these questions is the purpose of the formal study.

Exhibit 5-1: Categories of the Study.

Perspective	Alternatives	This study
Degree of the problem crystallisation.	Exploratory or formalised.	Exploratory in first stage and formalised in second stage.
Topical scope (breadth and depth).	Case (qualitative) or statistical (quantitative).	Mainly Statistical and qualitative (depth interviews are complementary).
Research environment.	Field setting, laboratory, and simulation.	Field setting.
Time dimension.	Cross sectional or longitudinal.	Cross sectional.
Power of researchers to affect variables.	Experimental or ex post facto.	Ex post facto.
Nature of relationships among variables.	Descriptive or causal.	Descriptive.
Communication mode of data collection.	Observational or survey.	Survey.
Communication medium.	Mail survey, telephone survey and personal interview.	Mail survey for quantitative part while personal interview for qualitative part.

Conducting the formal study, requires designing clear structures and precise data collection methodology. When putting together the potential problems discovered in the exploration study (e.g. the unavailability of firms' names which used A&M before and the usual low response rate in S.A.), several considerations had to be taken into account in developing the research method.

### 5.2.2 The Topical Scope

The statistical study (quantitative approach) differs from the case study (qualitative approach) in several ways, although the line between these two may not always be very clear. The case study places more emphasis on the full analysis of a

limited number of events or conditions and their interrelations. The statistical study, on the other hand, is more concerned with the conditions at one point. Ongoing processes and interrelations must be inferred from the statistical findings (Emory, 1980).

The qualitative approach allows the researcher to gain first-hand knowledge about the empirical social world in question (Emory, 1980). The use of qualitative research techniques has many advantages, particularly if it is used as a method of gaining more knowledge of the subject being researched. These advantages include (1) information gain which may not be obtained by the questionnaire; (2) a deeper insight into management thoughts, their feelings and intentions; (3) helping in the construction of the questionnaire by several means, such as, identifying the specific words, idioms, statements and terminology used (all of which will help in the familiarisation with the subject covered); and (4) helping in the interpretation of the quantitative results and informed/ support assumptions (Chisnall, 1991; Davis and Cosenza, 1993).

The conditions under which the research is conducted usually determine which method will be most suitable to obtain the data needed within the time and cost available (Emory, 1980). There are three main reasons which make the use of the case study approach to collect the required data on this study possibly more valid than the quantitative method. One reason is that more detailed information can be gained on the study variables and their inter-relations. Second, it measures the real effects of A&Ms, not the predicted effects. Finally, since the literature suggests that A&Ms may not be favourable strategies in S.A., which means that the private sector's decision-makers may be unfamiliar with several aspects of A&M, then doing case studies on firms that used A&M's before would be more valid than the statistical approach.

However, the quantitative approach was used as the main source of the primary data for several reasons. One is that this study tests many variables, which a case study may not be able to cover. To a high extent the case study method can give reliable answers on the A&Ms' effects on a firm's performance, but to a less extent on causes for A&Ms (e.g. managerial control and market power) as well as on effects on the economy.

The many variables this study covers and attempts to examine, were used to achieve the objective of the research and, also (as mentioned in Chapter Two) to show that reliable answers on A&Ms activity can be achieved if the reasons and effects are studied in connection with each other. Secondly, the unavailability of a list of firms which have adopted A&M's, makes the case study technique unsuitable. Finally, the few listed firms were not contacted to provide detailed information (case study type) in regards to this study. This is because these firms would not provide the information needed which could then be generalised on the population as a whole. This judgement was based on the opinions of experts in the Research Department in Riyadh Chamber of Commerce as well as on the researcher's experience.

For the reasons mentioned above, the quantitative approach was used as the main source of accomplishing this study's objectives. This was done by asking the top-management directly about their opinions on reasons for, and the effects of A&Ms. It should be noted that responses from management who may not have experience about A&Ms should not be underestimated since management intuition is considered a valid source of information (Davis and Cosenza, 1993). This type of information tends to be described as "gut feeling" and "Management's sixth sense". Many managerial decisions appear to be made from these quick flashes of insight (Davis and Cosenza, 1993).

Moreover, several measures were taken to minimise the limitations of the quantitative approach's effects and to compensate for the advantage of the qualitative approach. Some measures are related, for example, the selection of the sample and scaling which will be discussed at a later stage. Another measure was to conduct in-depth interviews with those who responded to the quantitative study and who presented their willingness to discuss the studies questions with the researcher face to face. The last question in the questionnaire asked the respondent if his firm had ever used acquisition before, and if the answer was yes, he was asked if it was possible to meet the researcher to discuss the matter in detail.

In summary, the quantitative approach, represented by the questionnaire survey, has been used as a main source of data collection. To increase the validity and reliability

of the test, a qualitative approach, represented by an in-depth interview, was used as a complementary source for data collection. Interviews were conducted with respondents who had adopted acquisitions or mergers before and showed they were willing to discuss the matter in more detail with the researcher.

### **5.2.3 The Research Environment**

This means of classifying research distinguishes between those studies that take place under actual environmental conditions and those that take place under artificial or simulated conditions. These might be called field and laboratory studies (Emory, 1980). This research is considered as a field study because it is conducted under actual environmental conditions.

### **5.2.4 The Time Dimension**

Some research studies are carried out once; others are repeated over a period of time. The latter have come to be known as longitudinal studies. The obvious advantage of a longitudinal study is that the investigation can follow changes over time. In longitudinal studies the researcher may study the same people over a period of time or may use different subjects for each sequenced measurement (Dillon et al., 1987).

Given the problematical nature of this research, the change over time aspect of the study is not applicable. So, this study is considered as a cross-sectional type. The data is collected from a number of different respondents at a single point in time.

### **5.2.5 Research Control of Variables**

The idealised research concept is often thought to be the experiment in which the researchers attempt to control and/ or manipulate the variables in the study. Experimental design is most appropriate when proof is sought that certain variables affect other variables in some way.

The ex post facto design is more common in social science and business research. With it the investigator has no control over the variables, either because they have already

occurred or because they cannot be controlled or manipulated (Davis and Cosenza, 1993).

Given the previous distinction, this research can be categorised as ex post facto. The research is reporting what is happening without attempting to manipulate the variables. The variables can not be controlled by the researcher.

#### **5.2.6 Nature of Relationships Amongst Variables**

This classification of descriptive versus causal studies is often confused with the above classification of experimental versus ex post facto research. Indeed there is a similarity. Most ex post facto designs are used for descriptive studies in which the researcher seeks to measure such items as sociological characteristics, or attitudes of people. However, ex post facto studies also include attempts by the researcher to discover causes even when the variables cannot be controlled. The essential difference between descriptive and causal studies is in their objectives. If the researcher is concerned with finding out who, what, where, when and how much, then the study is descriptive. If it is concerned with asking why, then it is causal. Causal studies seek to determine what effect one variable has on others or why certain conditions are obtained (Emory, 1980).

Since the objective of this study is to learn the who, what, when, where and how of a topic, then this research can be classified as descriptive in nature. The simplest descriptive study concerns a univariate question or hypothesis in which researchers ask about or state something about the size, form, distribution, or existence of a variable (Emory, 1980).

#### **5.2.7 The Communication Mode**

This classification distinguishes between monitoring and interrogation processes. The former includes observational studies, in which the researcher inspects the activities of a subject without attempting to elicit responses from anyone. The researcher notes and records the information available from observations. When using the survey method in

the interrogation process, the researcher questions the subjects and collects their responses by some means. Studies of this type may also be further classified by the communication medium used; mail survey, telephone survey, or personal interview (Dillon et al., 1987).

The interrogation process (survey) was utilised to get the information needed in this study. Particularly because observation alone is considered unappreciable. Moreover, mail survey has been used as a main source of information. In addition, personal interviews were conducted with those who agreed to provide detailed answers on the study questions and were identified through the questionnaire.

After being familiar with the research categorisations, the following sections will talk about survey instrument design in detail.

### **5.3 Survey Instrument Design**

Survey is used by researchers to seek verbal or written responses to questions or statements. It is the only practical way to learn about different types of information. However, a survey method is criticised due to its dependence solely on verbal behaviour. The respondent can knowingly give untrue or misleading answers. The interviewers, the situations and the questions being studied can also help to foster a distortion of responses (Emory, 1980). Given that these potential pitfalls may affect the research reliability, much thought and consideration was given in designing this study instrument. The steps which were followed in developing the study instrument will be discussed next.

#### **5.3.1 The Instrument Development Process**

Developing an effective research instrument is very important and it is not a straight forward task. The selected instrument has a major impact on the validity and reliability of any test as will be explained later in this chapter. Moreover, it is a task that needs careful thought and precaution.

A useful generalised approach to follow in developing a survey instrument consists of four major steps (Emory, 1980). They are as follows:

- 1-Information Need Determination;
- 2-Data Gathering Process Decision;
- 3-Instrument Drafting and
- 4-Instrument Testing.

#### **5.3.1.1 Information Need Determination**

The first step in making an effective instrument is to understand the full dimensions of the subject itself. Adequate coverage of the topic, and securing the information in its most usable form constitute the researchers' major concerns. To assure that this step's objective was achieved, the researcher used the information collected during the extensive search of the literature, to choose the variables which should be tested. It was these variables which constituted the questionnaire and which were then piloted.

Given the objective of this study, this research was unique in several aspects. One of its distinguished characteristics is that it did not measure only one part of the A&M's phenomenon, such as causes for A&Ms, the influential factors on its rate (motives and barriers), effects on firms' performance, and effects on the economy. It attempted to measures all these elements in Saudi Arabia. One outcome of this characteristic is that this study had to use many studies to identify the variables and to operationalise the study constructs.

The variables which were identified and the studies that suggested them were presented in Chapter Two. The causes for A&Ms, the A&Ms' motives and barriers, factors affecting the success of A&Ms, the positive as well as the negative effects on the economy were provided in Exhibits 2-1, 2-2, 2-5, 2-6 respectively. More variables that were suggested as barriers to A&Ms in S.A. were also identified and presented in Chapter Three.

### **5.3.1.2 Data Gathering Process Decision**

At this stage, researchers choose the manner by which to gather the data. Once the survey approach has been decided as a main source of primary information, there are three strategic decisions that strongly affect the design of the survey instrument. These concern:

- 1- the communication mode that will be used to conduct the questioning;
- 2- the degree of structure that is imposed on the questioning and response processes and
- 3- objective disguise.

The relationship between this study and these issues is presented in Exhibit 5-2.

#### **1: Communication Modes**

Communication interactions between researcher and respondent are either personal, impersonal, or mixed in nature. The personal mode typically involves a one-on-one relationship between interviewer and interviewee. The interviewer uses either an interview schedule or an interview guide. A schedule is a structured set of questions which are usually asked orally and recorded in writing by the interviewer. An interview guide is a list of topic questions or areas which the interviewer uses merely as a prompter during the interview (Emory, 1980; Davis and Cosenza, 1993).

Exhibit 5-2: Issues Regarding the Research Instrument.

Perspective	Alternatives	This study
Communication medium.	Mail survey, telephone survey and personal interview.	Mail survey for quantitative part while personal interview for qualitative part.
Degree of questions' structure.	Structured and unstructured.	Structured in the questionnaire. Relatively unstructured in the personal interview.
Degree of responses' structure.	Open-ended and close-ended.	Close-ended in the questionnaire. Open-ended in the interview
Disguising or not of the study, questions objectives and sponsorship.	Disguise or not to disguise.	All are revealed.

With the impersonal mode, the researcher typically depends upon a printed instrument to carry the two-way communication task. This instrument, a questionnaire, carries both the instructions and questions to respondents. The questionnaire method provides easier access to interviewees, costs less, and is relatively quicker to complete. In addition, it eliminates interviewer bias and interaction bias that exists in the interview method. However, the reliability of the data collected through the questionnaire is sometimes suspect (Emory, 1980).

Sometimes the personal mode (interview) and the impersonal mode (questionnaire) can be combined and used altogether. This approach has been used in this study. As it was explained in the categories of the research design section presented at the beginning of this chapter, the impersonal mode (questionnaire) has been used as the first and the main source of information. Then the personal mode represented by in-depth interviews with those who respond to the questionnaire and accept to meet the researcher to discuss the issues in detail, has been used as a second source.

In this approach, there are several alternative methods of gathering data, including telephone interviews, personal interviews, and mailed questionnaires. Each of these three ways of conducting surveys has its own advantages and disadvantages (Dillon et al., 1987; Davis and Cosenza, 1993). Generally, it is believed that the personal interview is the most effective one. It provides the largest return, but it is the most expensive method. The major benefits of interviews are the higher levels of flexibility that it provides the interviewer, and the greater opportunity it provides the interviewee to make his point. This provides for richness and depth in the information gathered. However, conducting interviews is a time-consuming process. It costs considerably more than a questionnaire type study and is often found to be inappropriate due to the geographically dispersed locations of the interviewees. In addition, interviews are often more difficult to score.

The telephone procedure is usually less expensive especially in interviewing locally or during lower call charge rates. However, it suffers from sampling inadequacies.

Mail surveys are typically lower in cost than personal interviews. Persons such as major corporate executives are difficult to reach in any other way. In a mail survey, the respondent can take more time to collect facts, talk with others, or consider replies at length than is possible with either telephone or personal interviews. Finally, mail surveys are typically perceived as being more impersonal, providing more anonymity than the other communication modes.

The major weakness of the mail survey, however, is that it is usually subject to a strong bias of non response. Many studies have shown that those that are better educated and more interested in the topic, tend to answer mail surveys. Mail survey projects with a return of 30% or so are often considered satisfactory (Dillman, 1978). Researchers can improve returns by making a diligent effort to stimulate responses through careful design, skilful execution, and follow-up procedures (as of which are discussed later in this chapter). When using telephone or personal interview follow-ups, it is usually sufficient to take a random sample of the non respondents, to determine the presence and form of any non response bias (measuring the non response bias is presented in the next chapter). The second major limitation of mail surveys is the type and amount of information which can be secured by this mean. A large amount of information is not expected to be secured. It is generally believed that respondents will refuse to co-operate with a long and/ or complex mail questionnaire. Returned mail questionnaires with many questions unanswered testify to this problem (Emory, 1980).

However, a mailed questionnaire has been used in this study because it has considerable advantages over personal and telephone surveys. Those advantages can be summarised as follows: firstly, the use of the mailed questionnaire can facilitate the collection of the required data from a large sample of 500 firms' managers (as will be explained in the section of sample frame selection in a short period of time). Secondly, the distribution of managers over different cities which are several hundred kilometres apart, make the mailed questionnaire obviously the most convenient method. Hence the expense of distributing them to a large number of managers is considerably less than that of personal interviewing. This study surveys many firms that are geographically

dispersed. On site visits would therefore be impractical, given the time constraints on the research. Thirdly, since the sample units are the executive officers of the top 500 firms in Saudi Arabia, it would have been difficult to reach them in any other way except using the mail survey. Fourthly, the availability of up-to-date communications data for the top 1000 Saudi Companies, which include names of firms, current P.O. Box and post codes, telephone numbers etc., encourages the use of this method. Fifthly, the questionnaire approach, in which firms are asked to comment on A&Ms determinants and effects has been accepted and applied in the literature (Hunt, 1990; Wahid, 1995). The limitation of this method, which as mentioned before relates to reliability, will be overcome in this study by employing several specific measures.

Given the advantages of interviewing and to gain more reliable and valid information, an in-depth personal interview has been used as a second source of information.

## **2: Questioning and Process Structure**

With structured questioning the interviewer asks questions in a standardised format and sequence. This helps to assure that each question is asked consistently in each interview, promoting measurement reliability. On the other extreme, is the relatively unstructured interview processes. These include the so-called in-depth interviews, focused and non predictive methods. An in-depth interview is a loosely structured effort to question a respondent in detail about opinions, feelings and attitudes. Researchers usually use an interview guide to assure coverage of the topic of interest. A focused interview is a special form of in-depth interview where the researcher attempts to focus the discussion on some particular experience to which the respondent has been exposed. A non predictive interview is the least structured of the three. The interviewer's function is to encourage respondents to talk about a given topic with a minimum of prompting or guidance (Hawkins and Tull, 1994).

The lack of a question structure has both advantages and disadvantages. One advantage is that the interviewer can guide the questioning. The disadvantage of this

freedom is that the results of one interview are not comparable with others. Unstructured interviewing is particularly useful in exploratory research where the lines of investigation are not clearly defined. When the emphasis moves to answering specific questions or testing of a hypothesis, then structured questioning is necessary (Emory, 1980).

With regard to the response structure, the forms of response may be classified as open or closed. In the open form, respondents are free to reply with their own choice of words and concepts. Open responses are always found with unstructured questions and are particularly useful in studies where discovery is the objective. In most surveys there will be at least some open-ended questions.

With the closed response structure, the respondent chooses from two or more pre-determined response possibilities. The results are made of standardised answers, which are simple to administer and relatively easy to analyse. Closed questions also have their disadvantages. They force a statement of opinion that is couched in the researcher's terms rather than that of the respondent. Respondents can be easily led to give an opinion which they do not really have and the limited response alternatives may not adequately represent the respondent's viewpoint (Davis and Cosenza, 1993).

The questionnaire for this study was constructed in the Likert method (discussed in the scaling section). This type of measurement has been used because of its suitability in achieving the goals of the project. Given the advantages and disadvantages of the different techniques available to the researcher with regards to the degree of questioning and response structure, the study questions of the mail survey were structured and the form of response was close-ended. While in the in-depth interview, the questions were also structured but the response form was open-ended.

To overcome the limitation of the questionnaire in the closed-ended structure, the researcher has to provide spaces after each group of questions for those who want to make comments or add information.

### **3: Objective Disguise**

A third decision affecting the survey design is whether the objectives of the study, the objectives of the questions, and the study sponsorship should be disguised. The answers to these issues depend on the researcher's judgement of the situation. Any means that can increase the research validity and reliability should be adopted.

In this study, the specific information sought, the purpose of the study and its sponsorship were not disguised because the literature suggests that a higher response rate and more accurate responses would be achieved if this information was revealed (Emory, 1980).

#### **5.3.1.3 Instrument Drafting**

The third step in developing the survey instrument is making a draft of the instrument. The design of a good item for a questionnaire is probably the single most difficult task in the entire study. Questionnaire design is more of an art form than a scientific undertaking and is a skill which a researcher learns through experience rather than by reading a series of guidelines (Berdie and Anderson, 1974).

At this stage, researchers begin actual instrument design by drafting specific measurement questions. The subject content and the wording of the questions, as well as establishing some logical question sequences, should be considered.

It was decided to translate the questionnaire from the English version into Arabic in order that it might be circulated in Arabic. Sending the questionnaire in Arabic is more valid and reliable since Arabic is the language most used by the sample units. However, the questionnaire was available in English for those who requested it to be.

With regard to the questionnaire components, survey instruments normally include three types of information. The most important of these is the data sought such as facts, attitudes, preferences and expectations about the central topic. The second type concerns the respondent characteristics needed for classification and analysis. The third

type of information is administrative, which includes respondent identification, interviewer identification, date, place and the like.

The questionnaire in this study consists of four parts; first is a request for co-operation, which has been stated in the official letter from the Riyadh Chamber of Commerce (see Appendix 5-1). In addition, to which is a covering letter from the researcher with an opening statement outlining the purpose of the study and why the interviewee has been selected (see Appendix 5-2). The second part consists of instructions, which are in the form of notes containing some definitions and an explanation of the method of selection. Moreover, a statement is included which asks the interviewee to call or write to the researcher if there is any inquiry into the questionnaire itself (Appendix 5-3). Third, the information sought. Naturally, this is the major portion of the questionnaire. In short, the purpose here is to measure the opinions of Saudi Arabian firms' managers of reasons for A&Ms and effects of A&Ms in S.A. Fourth, classification data which includes questions about several variables such as companies' ownership, classification of companies expertise, management's level of education and others constitute the fourth part.

#### **5.3.1.4 Instrument Testing**

Once a first draft of the instrument has been developed it should be tested. The first testing was done with two of the researcher's colleagues at King Faisal University, Saudi Arabia. The researcher received effective feed back especially with the translation aspects of the questionnaire from English language to Arabic.

To ensure that the questionnaire achieved its intended purpose, it was revised and taken to the field for pilot testing. An interview was held with Salah (a researcher at the Research Department in the Riyadh Chamber of Commerce) to seek his opinion of the initial draft, which was amended to incorporate his recommendations.

Furthermore, the questionnaire was sent to the Unified Saudi Cement Company which evolved in 1992 as a result of the merger between the Saudi Cement Company and the Saudi Bahrain Cement Company. Some suggestions were received and

incorporated into the development of the final questionnaire. The English version of the questionnaire is shown in Appendix 5-3. According to the opinions of Salah and the researcher's colleagues at King Faisal University as well as the researcher's experience, sending the questionnaire to the Riyadh Chamber of Commerce and to a firm that used acquisition before was sufficient as a pilot study.

Appendix 5-3, Part Two, Section One details the specific questions designed to investigate the reasons for A&Ms. Items 1 through 9 of the questionnaire measure various causes for A&Ms. Section Two, items 1 through 13 measure the potential A&Ms' effects (item 1 and 2 examine the effect on firms' performance; item 1 for the effect on ability to compete, and item 2 for the effect on profitability). While items 3-13 measure some elements of the economy. The factors that may affect the success of A&Ms were assessed in items 1 through 8 in Section Three. Items 1 through 29 in Section Four constitute the variables that test the factors that affect the A&M's rate; that are motives and barriers. Finally, some suggestions related to the A&Ms' phenomenon and measures that the government of S.A. as well as chambers of Commerce and Industry should adopt were covered in Section Five. Results of testing these suggestions provided valuable information, which was used in the study implication part in Chapter Eight.

Appendix 5-3, Part Three, items 1 through 8 provide some classification variables, which include; forms of firms, firms' ownership, type of industry, respondent's relationship to the firm, his level of education and age, and firms that thought and/ or used A&Ms before. These questions were included to assess the characteristics of the respondents and to see if the responses to the variables measuring the reasons for and effects of A&Ms are different based on the differences of the respondents' characteristics.

Item 2 is been used to assess the potential of separation between ownership and control, and the degree of share holdings' dispersion. Item 4 (the respondent's relationship to the firm) is provided to assess the extent of the validity of the test. Only the top-management were asked to fill in the questionnaire, since the A&M's decision is made at the top level. Items 7 and 8 examine if A&Ms were thought of before and

whether they adopted A&Ms as thought of. These variables were used to assess the A&Ms' rate as well as to give indication to the validity and reliability of the test by investigating if the respondents' answers to the variables of reasons for and effects of A&Ms are different between the respondents who used A&Ms before and those who did not. Item 9 tests the factors that prevented those companies which thought of A&Ms before from not using them as planned. This factor can then be further used to assess the reliability of the test with regard to the equivalence perspective. The relationships between the study propositions and the questions that constitute the questionnaire are depicted in Exhibit 5-3.

Exhibit 5-3: The Relationships Between Study Propositions and Survey Questions.

<u>Proposition</u>	<u>Questions</u>
1	Part Two, Section One: 1, 1(a) to 1(f), 2, 2(a) to 2(e), 3, 3(a) and 3(b).
2	Part Two, Section One: 7. Part Three: 2.
3	Part Two, Section One: 9. Part Two, Section Two: 9 to 11.
4	Part Two, Section One: 5.
5	Part Two, Section One: 8.
6	Part Two, Section Three: 1 to 8.
7	Part Two, Section Two: 1 and 2.
8	Part Two, Section Two: 3, 3(a) to 3(c), 4, 4(a), 4(b), 5, 5(a) to 5(c), 6 to 8.
9	Part Two, Section Two: 9 to 13.
10	Part Two, Section Four: 1 to 29. Part Three: 7 and 8.
11	Part Two, Section Four: 2, 4, 11, 12, 13, 17, 18, 21, 22, and 25 to 28.
12	Part Two, Section Four: 1, 3, 5 to 10, 14 to 16, 19, 20, 23, 24, and 29.

The literature and the pilot study suggested several measures which should be taken into account to ensure the success of the survey and of the interviewing. In the next

two sections, what the researcher did to ensure the success of the questionnaire, with regard to the responses, and the success of the interviewing, is discussed.

### **5.3.2 Improving Responses**

Low response rate is one of the greatest obstacles encountered by investigators using mail questionnaires as a research instrument (Berdie and Anderson, 1974). Based on the researcher discussion with Salah (a researcher at Riyadh Chamber of Commerce), a 15 % response rate is normal in Saudi Arabia. Therefore, early in the planning stage of the study, attention was given to matters concerning managers' response rate and a number of measures were taken in an attempt to stimulate response. One measure is concerned with sample selection (discussed later in this chapter) while some other measures are concerned with the following factors:

#### **5.3.2.1 Follow-up**

The mailing of the questionnaire follows this procedure. First, the questionnaire was mailed. Two weeks later, letters were sent to thank those executives who responded to the questionnaire, and a reminder to those who did not respond. Moreover, second follow-up letters were sent three weeks after the first follow-up letters (copies of the two letters are shown in Appendix 5-4 and Appendix 5-5). Finally, the researcher conducted some telephone calls. Although the main reason of this mode of follow-up was to measure the reliability of this study, it was also used to encourage those who did not respond to the questionnaire to do so.

#### **5.3.2.2 Questionnaire Length**

Research evidence does not support the view that short questionnaires obtain higher response rates (Kanuk and Berenson, 1975). However, the researcher tried to make the questionnaire as concise as possible.

### **5.3.2.3 Survey Sponsorship**

Although there is little experimental evidence concerning the influence of survey sponsorship on response rates, the sparse evidence that does exist indicates that official or respected sponsorship tends to increase response (Emory, 1980). Therefore, an official letter from the Riyadh Chamber of Commerce asking the sample unit to participate in this study was attached with the questionnaire. The Riyadh Chamber of Commerce is a highly respected organisation by businessmen. Moreover, a cover letter which mentioned the name of the researcher's employer (King Faisal University) and the name of the university where the researcher is studying were provided.

The cover letter and the letter from the Chamber of Commerce made an appeal to persuade individuals to respond by stressing the importance of their participation in this study to the researcher, the private sector and the economy.

### **5.3.2.4 Deadline Dates**

Although studies found that deadline dates did not increase the response rate (Emory, 1980), they have been used to accelerate the rate of questionnaire return.

### **5.3.2.5 Other Measures**

The envelope and the cover letter were personalised. Each one of them was addressed to the firm's chief executive officer. In addition, the respondents were offered the opportunity of receiving the research results if they so desired. They were also asked to feel free to telephone or write to the researcher if they had any questions or problems. Anonymity to respondents was promised. Finally, a self-addressed envelope was provided with the questionnaire.

Since interviews were planned to be used as a second source of information, different interviewing issues were thought of before the interviews were conducted to insure their success. These issues will be discussed in the next section.

### **5.3.3 Requirements for Interviewing Success**

Research interviewing is not simple. Respondents often react more to their relationships with the interviewer than to the content of the questions they ask. It is also important that the interviewer asks the questions properly, records the responses accurately, and probes meaningfully (Chisnall, 1991; Davis and Cosenza, 1993).

The successful interview has the characteristics of any good interpersonal relationship; a relationship of understanding and confidence exists between the interviewer and the respondent. Therefore, the first goal the interviewer had to accomplish before starting, was to establish a relatively friendly relationship with the respondent. Building such a relationship is very important in Saudi Arabia to get reliable answers. Giving information about the firm's financial position, its performance which could be criticised by the interviewer or others, information which criticises government decisions or behaviour and information about the firm's future plans will not be revealed if the interviewee is not comfortable with the interviewer's confidentiality or integrity.

Another important research decision is the selection of subjects to study. Sampling design will be discussed next.

## **5.4 Sampling Design**

Several issues must be considered in designing a sample. They are related to the following questions (Hawkins and Tull, 1994):

- Who is the relevant population?
- What type of sample shall be drawn?
- What sampling frame shall be used?
- What size of sample is needed?
- How much will the sample cost?

### **5.4.1 Who Make Up the Relevant Population?**

The population of interest is normally apparent from the management problem and the research objectives. Since this research is aiming to find out the opinions of the top-

managers of the private sector firms regarding the possible reasons, effects, motives and barriers of A&Ms in Saudi Arabia, then chief executive officers of all firms in S.A., regardless of their types (e.g. limited liability or joint stock) or sizes, the sectors they function in and their ownership are considered as the population.

#### 5.4.2 What Type of Sample?

There are a variety of sampling techniques available. The researchers selection depends on the requirements of the project, its objectives and the funds available. The different approaches may be classified by their representation basis and the element selection techniques as in Exhibit 5-4 (Emory, 1980; Hawkins and Tull, 1994).

Exhibit 5-4: Types of Sample Design.

Element Selection	Representation Basis	
	Probability	Non probability
Unrestricted	Simple random	Convenience
Restricted	Complex random Systematic Cluster Stratified Double	Purposive Expert choice Quota

With regard to the representation basis, the members of a sample are selected either on a probability basis or by some other means. Probability sampling is based on the concept of random selection; a controlled procedure which assures that each population element is given a known non zero chance of selection. In contrast, non probability selection is “non random”; that is, each member does not have a known non zero chance of being included (Chisnall, 1991; Davis and Cosenza, 1993).

Samples may also be classified by whether the elements are selected individually and directly from the population viewed as a single pool, or whether additional controls are placed on the process of element selection. When each sample element is drawn

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Samples may also be classified by whether the elements are selected individually and directly from the population viewed as a single pool, or whether additional controls are placed on the process of element selection. When each sample element is drawn

individually from the population at large, it is an unrestricted sample (Emory, 1980). The choice of a specific sampling method is influenced by many factors such as the availability of a sampling frame, availability of the resources and the spread of a population.

Probability sampling has some technical advantages over non probability sampling. Through randomisation the danger of unknown sampling bias is minimised, while with non probability designs there is always a chance that some sampling-induced element will distort the results. However, there are some practical reasons for using the non probability sampling (Emory, 1980).

One may use non probability sampling because there is no other feasible alternative. The total population may not be available for study. Moreover, while the probability sampling may be superior in theory, there are breakdowns in its application, e.g. if interviewers are told to select the sample randomly there is always a question as to how skilfully they will do it. Also, a random sample that has a true cross-section of the population may not be the objective of the research. If there is no desire to generalise to a population parameter, then there is less concern about whether or not the sample is fully representative. Often, researchers have more limited objectives and may be looking only for a feel of the range of conditions. Finally, the cost and time required for probability sampling may be so large that the investigator abandons the use of this method.

The top 500 Saudi companies were chosen to be used as a sample. This decision was made because, firstly, the managers of those companies are well educated, have valuable experience and sufficient knowledge about businesses in S.A. and their problems. Therefore, they are capable of providing valid information which can be used to answer the study's questions. Although less successful companies and small firms can provide precise data on reasons of why they do not prefer selling their companies or consolidating with others, which will help identifying A&Ms' barriers, they were not included in the sample. Essentially, they were incapable of giving reliable answers to questions of A&Ms' effects due to their poor knowledge. In addition, an up-dated list of

all firms other than the top one thousand firms in all sectors in Saudi Arabia is not available. So it was not in the interests of the researcher to secure a cross-section of a population. The researcher has selected the chief executive officers of the top 500 firms because they were the best for the provision of required data.

Secondly, based on the researcher's experience, the response rate of top and successful companies will be higher than the response rate of less successful and smaller firms because the managers of top companies are more organised and concerned than smaller companies' managers. Thirdly, an up-to-date list of the top 1000 Saudi Arabian firms is available.

Given the definition of probability and non probability samples, this study can be considered as non-probability sampling since not every population's element has a non zero chance of being selected. The different methods of non probability sampling will be discussed next (Emory, 1980; Davis and Cosenza , 1993).

#### **5.4.2.1 Convenience**

This method is the least reliable sampling design (Emory, 1980). However, it is normally the cheapest and simplest. The researcher selects the sample for his convenience.

#### **5.4.2.2 Judgement (Expert Choice)**

It is one of the two types of purposive samples. Purposive samples normally involve a more deliberate effort to secure a sample that conforms to some predetermined criteria. Judgement samples are most useful in studying those cases which researchers believe are in the best position to provide the needed information.

#### **5.4.2.3 Quota Sample**

The second type of purposive sample is the quota sample. With this type of sampling researchers are interested in selecting subjects to conform to certain pre-designated control measures. For example, researchers may believe that a response to a

question should vary, depending upon the sex of the respondent. If so, they seek proportional responses from both men and women.

Given the definition of non probability sampling methods, this study sample can be considered judgmental since the sample units (top 500 firms in S.A.) were judged by experts (responsible at Riyadh Chamber of Commerce) and the researcher, to be the best for reliability.

#### **5.4.3 What Sampling Frame?**

A sampling frame is a list of elements from which the sample is actually drawn. The 1993 Directory of the Top 1000 Saudi Companies (International Information & Trading Services Co., 1993) was used as the sampling frame in this instance. The 1993 directory of the Top 1000 Saudi Arabian firms, with the full background data needed provides a rich source of secondary data on these firms, such as owners and shareholders, directors, activities, brief history, some financial data and addresses (location, P.O. Box No. and Tel. No.).

#### **5.4.4 How Large a Sample?**

A sample must be an acceptable representation of the population. The top 500 Saudi Arabian firms were selected as the study sample. Although a list of the top 1000 firms is available, the questionnaires were not sent to the bottom 500 firms on this list because the researcher's experience led him to believe that this would not provide any additional information valuable enough to justify the higher cost encountered. Therefore, the first 500 firms were considered sufficient to provide the required information.

#### **5.4.5 How Much will It Cost?**

Cost considerations have a major impact upon decisions about the size and type of sample. The sample was appropriate to provide reliable information and that there was no need for any other sample regardless of how much it would cost.

Another important decision which had to be considered in research design was how to analyse the collected data. Before talking about the methods of data analysis which were used, the characteristics of a sound test will be discussed first.

## **5.5 Validity and Reliability**

There are two major considerations researchers usually use in evaluating a measurement tool. These are validity and reliability. Validity refers to the extent to which a test measures what researchers actually wish to measure. Reliability has to do with the accuracy and precision of a measurement procedure (Nunnally, 1978).

Although some statisticians provide broad guidelines on these two issues, for example Orenstein and Phillips (1978) who discussed the ways of testing validity and reliability, and Kozlov and Ushakov (1970) who devoted a complete book to reliability, unfortunately there is no definite answer to measuring the validity and reliability of research findings (Emory, 1980).

### **5.5.1 Validity**

There are different kinds of validity. Generally, however, there are three basic types of validity of measurement that most researchers are concerned with. They are content validity, construct validity and criterion-related validity (Davis and Cosenza, 1993; Hawkins and Tull, 1994).

#### **5.5.1.1 Content Validity**

The content validity of a measuring instrument is the extent to which it provides adequate coverage of the topic under study. If the instrument contains a representative sample of the range of relevant subject matter, then content validity is good. To evaluate the content validity of an instrument researchers must first agree on what elements constitute adequate coverage of the problem.

The determination of content validity is judgmental. The designer may determine the validity through a careful definition of the topic of concern, the items to be scaled, and

the scales to be used. The research questions hierarchy has as its aim the orderly fractionation of the major research question into specific questions that have content validity (Davis and Cosenza, 1993; Hawkins and Tull, 1994).

The content validity of this study should not be problematical because the questionnaire covers the important aspects identified within the exhaustive search of the literature during the exploratory stage. Moreover, the questionnaire was revised and improved based on opinions of experts (Riyadh Chamber of Commerce), and suggestions from respondents similar to the population (The Unified Saudi Cement Company). In addition, the researcher took two measures to assure the content validity; firstly, space was provided after each main group of questions in the questionnaire for those respondents who were willing to add more on the content of the study, and secondly personal interviews were held with those who had adopted acquisitions/ or mergers before and who were willing to meet the researcher.

#### **5.5.1.2 Criterion-Related Validity**

This form of validity reflects the success of measures used for some empirical estimating purpose. Researchers may want to predict some outcome or estimate the existence of some current behaviour or condition. The criteria used may be subjective (does the evidence agree with what a researcher believes) as well as objective (does the evidence agree with other research findings) (Davis and Cosenza, 1993; Hawkins and Tull, 1994).

The test was successful in providing results that are consistent with what the researcher believes and expected (see following chapter). Also, it provides some results that are consistent with other research findings such as those related with the Arab management style which will be discussed in Chapter Seven. It could be concluded, therefore, that the criterion-related validity of this study is good.

### **5.5.1.3 Construct Validity**

Construct validity deals with the degree to which the scale represents the concept being measured (Davis and Cosenza, 1993; Hawkins and Tull, 1994). Attitude scales and personality tests generally concern concepts that fall into this category. Even though this validation situation is much more difficult, researchers still want assurances that their measurement has an acceptable degree of validity.

The survey questions are clear and direct enough to conclude that the construct validity is acceptable especially as the first draft had been piloted. Moreover, using the personal interview as a second instrument for data gathering contributed positively to the construct validity. This is because the interviewer could explain to the interviewee the actual constructs. Finally, using the Likert scale with its five categories also contributed to improving the construct validity, as will be shown during the discussion of study scaling later on in this chapter.

To evaluate construct validity statistically, one major approach commonly used involves the assessment of convergent validity. Based on Davis and Cosenza (1993), Convergent validity is “... commonly defined as the degree of association between two maximally different measurements that purport to measure essentially the same concept” p. 172-173.

The result obtained from the questionnaire is highly correlated with outcomes of the conducted interviews, which indicates the convergent validity and thus, some degree of construct validity.

### **5.5.2 Reliability**

Reliability is concerned with estimating the degree to which a measurement is free of random or unstable error (Davis and Cosenza, 1993). Reliable instruments are robust; they work well at different times under different conditions. This distinction of time and condition is the basis for two frequently used perspectives on reliability, stability and equivalence (Emory, 1980).

### **5.5.2.1 Stability**

A measure is said to be stable if it can secure consistent results with repeated measurements of the same person with the same instrument. The major problem with this approach is that when there is much time between measurements there is a chance for situational factors to change, thereby affecting the observations.

Stability measurement in survey situations is more difficult and less attractive than observation studies (Emory, 1980). While a researcher can observe a certain action repeatedly, he can usually only survey once. This leads to a test-retest arrangement with comparisons between the two tests to determine how reliable they are. Two difficulties occur in addition to the delay already mentioned. Firstly, if the retest is given too quickly the respondent will remember the answers already given and repeat them. This will result in a biased higher reliability indication than is justified. On the other hand, the test-retest process itself may introduce bias. For example, the respondent may become test wise or at least exhibit less anxiety on the retest. Secondly, it might be that the first test sensitises the respondent to the subject, who may then go on to learn more or form new and different opinions before the retest. In all of these cases the tendency is to produce a downward bias in the stability scores.

Due to these problems, the stability measurement through the test-retest approach was not focused upon in this research, instead interest was centred on equivalence. It should be noted that this decision is in line with the trend in research (Emory, 1980).

### **5.5.2.2 Equivalence**

A second perspective on reliability considers how much error may be introduced by different investigators (in observation) or different samples of items being studied (in questioning). Thus, while stability is concerned with personal and situational fluctuations from one to another, equivalence is concerned with variations at one point in time among observers and sample of items (Emory, 1980).

Researchers test for item sample equivalence by using alternative or parallel tests administered to the same person at roughly the same time. The results of the two tests are

then correlated. A second method, the split-half technique can be used when the measuring toll has a number of similar questions or statements to which the subject can respond. Another approach to the problem of equivalence suggests that random rather than split-halves should be used. This view emphasises internal consistency and homogeneity (Emory, 1980).

Reliability can be improved if researchers assure that external sources of variation are minimised. For example, they can achieve enhanced equivalence through broadening the sample of items used. They can do this by adding similar questions to the questionnaire.

Researchers decide whether reliability is or is not adequate in terms of their objectives and the basic variability of the data. In term of their objectives, if they are interested in some rough ordering of subjects, then a relatively crude instrument will probably suffice. For more precise estimation, reliability standards must be more demanding. In a relatively homogeneous population a crude measure appears to be reliable because variations in the data are limited. Hence, any reliable instrument should score higher on reliability than would be the case in heterogeneous population (Emory, 1980).

Although the researcher was not very concerned with the reliability from an equivalence perspective, because the study objective is not to get very precise measurements (but not so unprecise that the findings are not taken seriously) and the sample is considered to be both a homogenous and reliable source of information, the researcher constructed some of the questionnaire's variables in a way that, if the measurement is reliable, then answers to some questions should be consistent with the results of other questions. Answers to item 1, and item 8 of Section One, Part Two of the questionnaire should (if the test is reliable) be consistent to the answers on items 2-7, and items 9-13 in the same section respectively (the mean scores for the single item measure of the variable falls within the range of the mean scores across the items comprising the variables). In addition, item 3 and item 5 of Section two, Part two should also be consistent to items 3-a, 3-b and 3-c, and 5-a, 5-b and 5-c in Section Two of the

questionnaire respectively. Based on this mechanism, the test is reliable as will be shown in Chapter Six.

#### **5.5.2.3 Accuracy**

A third type of reliability which is suggested by Krippendorff (1980) is accuracy. It is concerned with the degree to which the process confirms to a known standard. This kind of measurement was not suitable for this study as there was no known standard against which these results could be matched.

It should be noted that when the completed questionnaires were received, they were checked for correct completion. This process of editing and checking was conducted to ensure maximum reliability and validity of the data gathered. The methods of analysing the data will now be discussed.

### **5.6 Data Analysis Methodology**

Although data is analysed after the field work, much thought was given to the analysis of results from an early stage of research design. The normal first step in analysis, especially in surveys, is the editing of the collected raw data. The researcher has checked the data to make sure it is as accurate as possible, consistent with other facts secured, uniformly entered, as complete as possible, acceptable for tabulation and arranged to facilitate coding and tabulation.

Before talking about the statistical techniques utilised, it is appropriate to talk about the scale used since the valid statistical tools depend on what type of scaling is used.

#### **5.6.1 Scaling**

Based on Davis and Cosenza (1993), the goal of measurement is “**to translate the characteristics and properties of empirical events into a form that can be analysed by the researcher**” p.159.

Scales can be nominal (no order, distance or origin), ordinal (order but no distance or unique origin), interval (both order and distance but no unique origin) and ratio (order, distance and unique origin) (Chisnall, 1991; Davis and Cosenza, 1993).

Three popular types of scaling techniques are usually used by researchers in the measurement and scaling of attitude. They are single-response format, semantic differentials and likert scales (Emory, 1980). Likert scale has been used in this study because of the following;

- “Hard” data on most of the items would not have been readily available to the respondent. In addition, the subjective nature of the response on some of the items would make the collection of hard data impractical.
- The Likert-type scale is bi-polar, with an upper-bound and a lower-bound. This allows the researcher to use raw data without having to run complex data manipulation techniques to standardise the data, thus reducing cost and time spent on data processing.
- The use of Likert-type scales have been found to be an acceptable method for collecting data in causes and effects of A&Ms (Burgman, 1983).

It was decided to use five categories in this scale, 1= strongly disagree, 2 = agree, 3 = neither agree nor disagree, 4 = agree and 5 = strongly agree. The likert scale is ordinal, respondents are reported as being either more or less favourable to a topic, but not how much more or less favourable they are. Researchers in the behavioural sciences differ in their opinions as to whether the more powerful parametric significance tests are appropriate with ordinal measure. One position is that this use of parametric tests is incorrect on both theoretical and practical grounds. This view was strongly argued by Siegel (1956). According to him; **”If the measurement is weaker than that of an interval scale, by using parametric methods tests the researcher would “add information” and thereby create distortions”** p.32.

At the other extreme some behavioural scientists argue that parametric tests are usually acceptable for ordinal scales on both practical and theoretical grounds. On this

position Anderson (1971) has written, “**Regarding practical problems, it was noted that the difference between parametric and rank-order tests was not great insofar as significance level and power were concerned. It was concluded that parametric procedures are the standard tools of psychological statistics although nonparametric procedures are useful minor techniques**“ p. 316.

Another view, somewhat between these extremes, recognises that there are risks in using parametric procedures on ordinal type but these risks are usually not very great. Kerlinger (1973) expresses this view, “**The best procedure would seem to be to treat ordinal measurements as though they were interval measurements but to be constantly on the alert to the possibility of gross inequality of measurement**“ p. 441. This view was adopted in this research. The parametric techniques were relied on to investigate the research variables. However, the researcher also used nonparametric procedures to measure the study’s propositions for the purpose of comparison and ensuring the reliability of the parametric techniques, which were used.

### **5.6.2 Data Analysis Techniques**

As mentioned before, the research is classified as descriptive in nature because the researcher is concerned with finding out who, what, where, when and how of a topic. The descriptive study is different than the causal study which seeks to determine what effect one variable has on others or why certain conditions are obtained. This study concerns a univariate question or proposition in which the researcher asks about or state something about the size, form, distribution, or existence of a variable.

The above argument suggests that univariate data analysis will be used to analyse the study data. The researcher assessed the statistical significance of a proposition about a single variable. Moreover, measures of association were used to determine the strength of a relationship between two variables,

The study propositions were tested using t-test and Wilcoxon statistic<sup>1</sup>. In making the use of these tests meaningful for hypotheses testing for each of the factors

under investigation, the responses were recorded and the hypotheses were reformulated as follows:

$H_0: \mu < \text{or} = 3$

$H_a: \mu > 3$

(where  $\mu$  is the population mean in t-test while in the Wilcoxon statistic test, the  $\mu$  is the population median).

Moreover, the medians, the means and the percentage of the respondents who agreed and strongly agreed with the variables, were used to investigate the relative importance of the research variables.

To know if the responses to the reasons for and the effects of A&Ms in S.A. are different, based on the differences between firms ownership, forms of firms and their industries, respondents' ages and educational level, and firms that experienced A&Ms before and those which did not, analysis of variance (ANOVA) and Kruskal-Wallis test were used<sup>2</sup>.

Since the analysis of ANOVA and Kruskal-Wallis shows only the significance of the differences. Therefore, Cross-Tabulations were used to allow the inspection and comparison of differences among groups (Davis and Cosenza, 1993).

---

1) The t-distribution is one type of the parametric statistical procedures. It is used to test a hypothesis concerning the population mean because the parametric statistics require interval or ratio scaled data and the mean is the appropriate measure of central tendency for these types of data. The Wilcoxon statistic test is nonparametric test which is used to measure the statistical significance. It is used when the data are ordinal scaled. Since the median is the measure of central tendency for ordinal scaled data, the Wilcoxon statistic test is used to test a hypothesis concerning the population median (Zikmund, 1989).

2) ANOVA is the appropriate statistical tool when the means of more than two groups are to be compared to determine if their differences are statistically significant. In ANOVA, if the observed statistic is greater than the test value for some level of significance, the hypothesis that there is no significant difference in the means of the sample groups may be rejected (Zikmund, 1989). The Kruskal-Wallis test is used to compare three or more groups and the data are ordinal. According to Zikmund (1989) "This test may be thought of as a nonparametric equivalent of analysis of variance" p. 666.

Finally, the relationships between the variables were examined using the Pearson's product-moment correlation coefficient-r. This measure is the most popular technique for indicating the relationship of one variable to another. A correlation coefficient (r) indicates both the magnitude of the linear relationship and the direction of that relationship (Zikmund, 1989).

These techniques were found sufficient to achieve the purpose of this research. However, some multivariate analysis was tried, but unfortunately, interesting results could not be gained that can add more significance to what was already achieved. The data collected through the previously described methodology are analysed and presented in the next chapter.

**Appendix 5-1: The Letter from Riyadh Chamber of Commerce and Industry**

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

**الغرفة التجارية الصناعية  
الرياض - المملكة العربية السعودية**



الرقم:

التاريخ: ٢٠١٤/١٢/٥

المحترم

سعادة المدير العام

السلام عليكم ورحمة الله وبركاته  
نفيدكم أن الباحث الاخ/ عبد المحسن حسين العرفة ، هو أحد مبتعثي كلية  
العلوم الادارية والتخطيط بجامعة الملك فيصل بالاحساء لنيل درجة الدكتوراه من  
جامعة سانت اندروز ببريطانيا .

وموضوع رسالته عن ( الاندماج والاستحواذ بين الشركات في المملكة) ، لذا نأمل  
تسهيل حصوله على المعلومات المطلوبة وتزويدك بكل ما من شأنه انجاز مهمته.

واذ نشكركم سلفا على حسن تعاونكم ،  
تقبلوا تحياتى.

حمد صالح الحميدان  
نائب الأمين العام

## **Appendix 5-2: The Questionnaire Cover Letter**

Date  
Address

Dear Sir;

God's peace and mercy be with you

Although some observers recommend acquisitions and mergers (A&M) between companies in Saudi Arabia to help solve their problems, others are sceptical about their effectiveness. Moreover, there is no consensus agreement on the factors that may encourage A&M activity in business environment of S.A.

Therefore, we at University of St. Andrews (Britain) are conducting a study to learn more about possible positive and negative effects of A&M, and factors that may deter its rate in S.A.

It is believed that the best who can provide reliable information regarding this topic are managers of the most successful companies in S.A. And since your company, according to 1993 Directory of Top 1000 Saudi Companies which published by International Information & Trading Services Co., is one of the top 1000 companies, you have been selected to provide information about that topic.

Attached to this letter is a questionnaire designed to collect data on acquisitions' outcomes and their barriers in S.A. Your assistance is essential to the success of this project and we request your participation in this endeavour.

You are assured that the data and names you give will be absolutely confidential and will not be used for any other purpose than that of scientific research. Also, we offer to provide you with a copy of the findings of this research if you so wish. Thank you for your co-operation in this important project.

Abdulmohsen Al-arfaj  
Researcher  
King Faisal University

Mo Malek  
Professor of Management  
University of St. Andrews

## **Appendix 5-3: The Questionnaire**

College of Management Science  
King Faisal University

Department of Management  
University of St. Andrews

### **Survey of Acquisitions and Mergers in S.A.**

#### **Part one: General Instructions**

- 1) The term "acquisition" in this questionnaire means one firm acquires the assets and liabilities of one or more other firms in exchange for shares, cash or some other consideration. The acquiring firm continues to exist as a separate legal entity. But the acquired firm does not. While the word "merger" refers to a combination of two firms in which both of the merged firms disappear as separate legal entities and a third firm is formed. The two terms, in this questionnaire, will be used synonymously.
- 2) Since acquisition and merger (A&M) are considered important strategic decisions which are usually made by firms' chief executive officers (CEO), I hope that your firm's CEO will answer the survey questions.
- 3) For the statements given below , please indicate how strongly you agree or disagree with each of the statements by circling the number that best reflects your opinion where the following rule is applied:

Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree
1	2	3	4	5

- 4) In case of the need to clarify any question, please do not hesitate to contact by phoning or writing to us at the following address:

Abdulmohsen Alarfaj  
King Faisal University  
College of Management Sciences  
P.O. Box 1760  
Al-AHSA 31982  
Telephone and Fax No. (03) 58 00215

## Part two: Questions about Acquisitions and Mergers

**Section One: Firms in Saudi Arabia may adapt acquisition and merger for the following causes:**

- |  |           |
|--|-----------|
| 1- Improving the efficiency (lower cost).  | 1 2 3 4 5 |
| - A&M may lead to superior efficiency through:   |           |
| a- Reducing cost of obtaining finance.   | 1 2 3 4 5 |
| b- Lower marketing's cost due to economies of scale.   | 1 2 3 4 5 |
| c- Lower cost of administration and staffing.  | 1 2 3 4 5 |
| d- Lower cost of Research and Development.   | 1 2 3 4 5 |
| e- Reducing cost of operation due to economies of scale (cost of raw materials).   | 1 2 3 4 5 |
| f- Reduce production fixed cost because mergers may cut the surplus capacity due, for example to ability to deploy excess capacity of one company internally in another. | 1 2 3 4 5 |
| - Others factors "please specify": -----   |           |
| 2- Increase effectiveness of merging companies due to positive synergy between them.   | 1 2 3 4 5 |
| - Increased effectiveness resulted from the positive synergy can be indicated by:  |           |
| a- Obtaining long term loan in an easier way.  | 1 2 3 4 5 |
| b- Higher level of promotion which brings proportionally higher returns than smaller levels.   | 1 2 3 4 5 |
| c- Gaining access to desirable market segments. , such as providing additional outlets or more desirable distribution for each other's products.                         | 1 2 3 4 5 |
| d- Make fruitful use of discoveries made in research and development activity.   | 1 2 3 4 5 |
| e- Effective use of complementary resources (e.g. strengthening overall product range).  | 1 2 3 4 5 |
| - Others "please specify": -----   |           |
| 3- Better management.  | 1 2 3 4 5 |
| - A&M lead to better management through:   |           |
| a- Replacing inefficient management.   | 1 2 3 4 5 |
| b- Increased specialisation due to increased size.   | 1 2 3 4 5 |
| - Others "please specify":-----  |           |
| 4- Expansion externally through A&M in shorter time than expanding internally.   | 1 2 3 4 5 |
| 5- An alternative to bankruptcy or distressed conditions.  | 1 2 3 4 5 |
| 6- Acquiring or merging with firms in different business in order to minimise risk.  | 1 2 3 4 5 |
| 7- Managers use A&M to make personal gains even if A&M do not lead to maximisation of firms' wealth.   | 1 2 3 4 5 |

8- Benefiting from buying companies that are offered at nominal prices.	1 2 3 4 5
9- Minimising the competition.	1 2 3 4 5
- Other reasons "please specify":-----	

\*\*\*\*\*

**Section Two: Acquisition and merger in Saudi Arabia may lead to the following effects:**

1- Increasing firms' ability to compete in S.A. local market.	1 2 3 4 5
2- Increasing profits.	1 2 3 4 5
3- Higher economic growth.	1 2 3 4 5
- A&M lead to higher economic growth through:	
a- Shift assets into their best use.	1 2 3 4 5
b- Higher level of investment.	1 2 3 4 5
c- Higher level of research and development.	1 2 3 4 5
4- Improving balance of trade.	1 2 3 4 5
- A&M lead to improvement of balance of trade through:	
a- Increasing exports.	1 2 3 4 5
b- Decreasing imports.	1 2 3 4 5
5- Improving private sector's labour force structure.	1 2 3 4 5
- A&M may improve private sector's labour force through:	
a- Generation of employment for Saudi labour force.	1 2 3 4 5
b- Decrease dependence on foreign employment.	1 2 3 4 5
c- Increase wages.	1 2 3 4 5
6- Diversification of the economy in the long run.	1 2 3 4 5
7- Increase investment between GCC's countries' firms in S.A.	1 2 3 4 5
8- Increase direct foreign investment (other than firms of GCC's countries).	1 2 3 4 5
9- Control over the supply of a product by one firm or by a group of firms.	1 2 3 4 5
10- Control over suppliers of raw materials.	1 2 3 4 5
11- Control over labour markets.	1 2 3 4 5
12- Higher rate of inflation due to less competition.	1 2 3 4 5

13- Political power in the hand of few individuals which may influence the government and the society.

1 2 3 4 5

- Other possible effects "please specify":

\*\*\*\*\*

**Section Three: To what extent do you agree or disagree that the success of A&Ms in Saudi Arabia is explained by the following factors and characteristics:**

1- Firms merge or acquire other firms in the same or related businesses. 1 2 3 4 5

2- A&Ms occur between firms that are close to each other with regard to size. 1 2 3 4 5

3- A&Ms occur between firms that are close to each other with regard to profitability. 1 2 3 4 5

4- Strategic issues dominate the A&Ms' analysis. 1 2 3 4 5

5- Employees accept A&Ms without reacting negatively to them. 1 2 3 4 5

6- Acquirer and acquired companies remain separate with limited exchanges. 1 2 3 4 5

7- Acquired top managers (merged firms) stay working with the acquired firms. 1 2 3 4 5

8- Acquirer firms' management has experience about A&Ms. 1 2 3 4 5

- Other factors "Please specify":

\*\*\*\*\*

**Section Four: To what extent do you agree or disagree on the existence of the following factors (motives or barriers) to A&M activities in Saudi Arabia?**

*First : Factors related to the internal environment (inside firms):*

<u>Factor / Phenomenon</u>	<u>Motive</u>	<u>Barrier</u>
1- Management is not separated from ownership (It has no complete control).	1 2 3 4 5	
2- Ability of S.A. firms' managers to manage large firms.	1 2 3 4 5	
3- lack of sufficient experience about A&M by firms' decision makers.	1 2 3 4 5	
4- Awareness that large firms are better equipped to manage today's business.	1 2 3 4 5	
5- No interest in A&Ms because decision makers are satisfied with their status quo.	1 2 3 4 5	
6- Firms' decision makers avoid mergers because of potential negative impacts on personal relationships between owners, managers and labours after A&M.	1 2 3 4 5	
7- Companies' decision makers avoid mergers consciously because they do not like others to share their authority with them.	1 2 3 4 5	

<u>Factor / Phenomenon</u>	<u>Motive</u>	<u>Barrier</u>
8- Decision makers desire independence of name and image.		1 2 3 4 5
9- Firms' decision makers fail to see or get advantage of A&M's opportunities.		1 2 3 4 5
10- Firm's resources are restricted (e.g. financial capital).		1 2 3 4 5
11- Existence of firms with excess production capacity or resources which can not be utilised internally without the need to expand through A&M.	1 2 3 4 5	
- Other factors which are related to the internal environment (please specify):		

*Second : factors related to the external environment (outside firms):*

#### **Economical Factors:**

12- The inflation rate is low which discourages buyers.	1 2 3 4 5
13- High interest rate which makes borrowing to finance A&M unfavourable.	1 2 3 4 5
- Other economical factors "Please specify":	

#### **Legal and Governmental Factors:**

14- legal obligations with respect to Commercial Register are restricted.	1 2 3 4 5
15- Restricted legal obligations under the S.A. Regulations for Companies.	1 2 3 4 5
16- Restricted legal obligations of the Department of Zakat and Income Tax.	1 2 3 4 5
17- Providing benefits to merging firms by the government such as, exemption of accumulated tax or zakat on acquired firms.	1 2 3 4 5
18- Firms are allowed to capitalise through public offering.	1 2 3 4 5
19- Laws that cover important A&M's issues are not available or not implemented effectively (e.g. laws that protect the acquiring firms from unknown liabilities on the acquired firms before acquisition takes place).	1 2 3 4 5
20- Non existence of laws explaining how consolidated firms will be assorted, and how their contracted projects will be treated.	1 2 3 4 5
- Other legal factors "Please specify":	

#### **Competitive Factors:**

21- Severe competition in S.A.	1 2 3 4 5
22- Existence of firms that can provide strategic benefits (lower cost, quality improvement and access to customers or inputs) which are willing to involve in A&M.	1 2 3 4 5
23- Firms (buyers/ sellers / partners in mergers) with good deal (good price or flexible payment terms) are not available.	1 2 3 4 5
- Other competitive factors "Please specify":	

<u>Factor / Phenomenon</u>	<u>Motive</u>	<u>Barrier</u>
<b>Factors related to A&amp;M mechanism in S.A. :</b>		
24- Non existence of effective mechanisms that facilitate A&M in S.A.		1 2 3 4 5
25- Investment bankers which facilitate A&M activity are available.		1 2 3 4 5
26- Acquisition's brokers which facilitate A&M activity are available.		1 2 3 4 5
27- Firms' names which are willing to involve in A&M are available.		1 2 3 4 5
28- Detailed information of potential firms (financial and personal) is accessible.		1 2 3 4 5
29- Effective pricers to evaluate firms' assets are not available.		1 2 3 4 5
*****		
<b>Section Five: To what extent do you agree or disagree with the following suggestions that deal with A&amp;M in Saudi Arabia.</b>		
<b>-suggestions related to firms and their nationalities which include:</b>		
a) A&M should be encouraged between Saudi Arabian firms.		1 2 3 4 5
b) Firms of GCC's countries should be encouraged to acquire S.A. firms.		1 2 3 4 5
c) Foreign companies other than those of GCC's countries should be encouraged to acquire or to merge with Saudi Arabian firms.		1 2 3 4 5
d) A&M should be encouraged between companies regardless of their sizes.		1 2 3 4 5
e) Companies should be encouraged to acquire distressed firms.		1 2 3 4 5
f) Others 'please specify':		
<hr/>		
<b>-Statements related to ways the Government can encourage A&amp;M which include:</b>		
a) Ease of regulations for firms wishing to issue stocks and offer them to public.		1 2 3 4 5
b) Issuing laws to protect acquiring firms from un-known liability on the acquired firms before acquisition takes place.		1 2 3 4 5
c) Measures should be taken to encourage banks to have effective roles in A&M (providing needed financial requirement and identifying buyers and sellers).		1 2 3 4 5
d) Encourage firms to use A&M by exempting them from paying the Zakat or Tax that accumulated during the period before A&M takes place.		1 2 3 4 5
e) Encourage firms to use A&M by paying some or all the debts on acquired firms.		1 2 3 4 5
f) The government should leave the current status as it is.		1 2 3 4 5
g) Others 'please specify':		
<hr/>		
<b>-statements related to ways Chambers of Commerce and Industry can encourage A&amp;M which may include:</b>		
a) Playing a middle-man role by identifying potential sellers and buyers (or merging firms) and get them in contact.		1 2 3 4 5

- b) Providing training programs ( lectures, seminars and others ) for executive officers to give improve their knowledge about A&M's issues.      1 2 3 4 5
- c) Preparing a guideline that explains the procedures and the regulations concerning acquisitions in Saudi Arabia.      1 2 3 4 5
- d) Arranging open public conferences about mergers to increase businessmen awareness.      1 2 3 4 5
- e) others 'please specify':
- 

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### Part Three : Background Information

For the statements and questions which follow, read each choice and circle the letter of the one that best describe you and your firm.

- 1-Which one of the following most accurately describes the current form of company owners:
- a - limited liability                          b - sole proprietorship  
 c - partnerships                                d - joint stock companies  
 e - another form "please specify" : -----
- 2-Which of the following best describes the ownership of your firm:
- a - personally (family) owned and operated.  
 b - personally (family) owned but not operated.  
 c - publicly owned, more than 20% of its shares is held by a person or a family or the government.  
 d - publicly held with no shareholder has more than 20% of the total shares.
- 3-Which one of the following best describes the business activity of your firm:
- a - agriculture.                                b - trading.  
 c - contracting.                                d - services.  
 e - manufacture.                                f - finance.  
 g - diversified (more than one sector).
- 4-Which one of the following best describes your relationship to the firm:
- a - president ( manager )                    b - vice president  
 c - others "please specify" : -----
- 5- What level of education do you have?
- a- less than bachelor degree.  
 b- Bachelor degree.  
 c- Post-graduate.
- 6- Which one of the following age categories are your age:
- a - less than or equal to forty years.  
 b - greater than forty and less than or equal to fifty years.  
 c - greater than fifty and less than or equal to sixty years.  
 d - greater than sixty years.

7- Has your company ever considered acquisition or merger before?

a - yes

b - no

(If the answer to this question is no, please move to question No. 10, otherwise proceed.

8- Has your company used acquisition or merger ?

a - yes

b - no

(if the answer is no , please move to the next question , other wise move to question No. 10 )

9- What are the reasons for not adapting acquisition or merger as it was considered ?

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10- Is your company considering acquisition or merger in the near future?

a - yes

b - no

11- Do you agree to an interview for further discussion on some of the questions, either on the telephone or your office ?

a - yes

b - no

(if you answered yes to the previous question , please complete the following)

name of respondent -----

company name and address -----

company telephone No. -----

On completion of the questionnaire , please mail it to us using the enclosed envelope.

**Thanks you very much, and God's peace be with you**

**Researcher : Abdulmohsen Al-arfaj**

## **Appendix 5-4: The First Follow-up Letter**

Date  
Address

Dear Sir;

God's peace and mercy be with you

About two weeks ago, we mailed you a questionnaire seeking information on matters related to acquisitions and mergers in Saudi Arabia. If you have already completed and returned the questionnaire, please accept our sincere thanks. If not, please do so today.

Because your firm is one of the most successful firms in S.A., it is very important to know your answers to the questionnaire.

We offer our appreciation and thanks to you for your co-operation in this important study.

Abdulmohsen Al-arfaj  
Researcher  
King Faisal University

Mo Malek  
Professor of Management  
University of St. Andrews

## **Appendix 5-5: The Second Follow-up Letter**

Date  
Address

Dear Sir;

God's peace and mercy be with you

About five weeks ago, we mailed you a questionnaire seeking information on matters related to acquisitions and mergers in Saudi Arabia. If you have already completed and returned the questionnaire, please accept our sincere thanks. If not, please do so today.

We would like to remind you of the importance of this study on the private sector of Saudi Arabia and the economy. Therefore, your contribution is significant to the completion of this important study.

Thank you for your co-operation and support. With best wishes.

Abdulmohsen Al-arfaj  
Researcher  
King Faisal University

Mo Malek  
Professor of Management  
University of St. Andrews

## ***Chapter Six***

### ***Analysis and Results***

#### **6.1 Introduction**

Details on the methodology used to collect the study's data were presented in Chapter Five. In this chapter, the data collected through the previously described methodology are analysed and presented. This chapter consists of two main parts. The first part provides results obtained from the quantitative methodology. It started with the examination of response rate, responses' representativeness, non-response bias, and descriptive statistics of the respondents and their firms. Then, the research propositions set forth in Chapter Four were statistically analysed. The second part of this chapter presents results of the qualitative study.

#### **6.2 Results of the Quantitative Study**

Before presenting and analysing data collected from the survey, issues related to the questionnaires' responses is investigated first.

##### **6.2.1 The Response Rate**

The first top five hundred firms in Saudi Arabia were identified to form the sample for this study. Riyadh Chamber of Commerce & Industries sponsored mailing the questionnaires. Only seven letters were returned as undeliverable (1.4 % undeliverable rate).

Of the 493 firms to which the questionnaire were delivered, 131 firms responded, for a 26.6% response rate. Returned questionnaires were coded and each questionnaire was first checked for acceptability. A total of six responses were excluded from the study because the respondents had left too many questions unanswered, leaving a total of 124 usable questionnaires (25%). 73 responses were received during the first two weeks,

while the rest of the collected questionnaire (51) were received after the follow up letters and some telephone calls.

### **6.2.2 Test of Responses' Representativeness**

The 124 firms that responded were checked for representativeness of the original sample of 500 firms. The primary concern was the industry representatives of the firms in the set of the usable responses. Table 6-1 provides a comparison of the firms in the original sample and those in the set of 124 usable responses. Based on the close similarity in the percentage distributions across the original sample and the set of usable responses, the sample did not seem to exhibit any industry group bias. To test this hypothesis statistically, a chi-square goodness-of fit test ( $X^2$ ) was run on the distribution across industry groups of the original sample set to the distribution of the set of usable responses. Depending on the number of d.f., the numbers in each cell should be large enough to make the  $X^2$  test appropriate (Emory, 1980)<sup>1</sup>.

For three degrees of freedom (since there were four industry groups represented in the original sample) and alpha levels of 0.05, the critical value of chi-square is 7.82. The computed chi-square statistic for the sample was 2.16. Thus the null hypothesis that the two distributions were equal could not be rejected.

### **6.2.3 Testing for Non-Response Bias**

In order to ensure that the survey did not suffer from serious non response bias, a random sample of non-respondents were contacted by telephone. Since respondent

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1) The chi-square test is widely used nonparametric test of significance. The logic inherent in the chi-square test allows us to test for significant differences between the observed distribution of data among categories ( $O_i$ ) and the expected distribution based upon the null hypothesis ( $E_i$ ). The greater the difference between them, the less the probability that these differences can be attributed to chance. To calculate the chi-square statistics, the following formula is used (Zikmund, 1989):  $X^2 = (O_i - E_i) / E_i$ . If  $d.f. > 1$ , then the  $X^2$  test should not be used if more than 20% of the expected frequencies are smaller than 5 (Emory, 1980). To fulfil this requirement, the researcher increased the expected frequencies by combining some categories (Table 6-1).

anonymity is assured, each firm contacted by phone was queried as to whether or not they received the survey and whether or not they completed and returned the questionnaire. If a survey was received, but not returned, the non-respondent was asked if he would be willing to complete the questionnaire if another one was mailed. If "yes", then a new survey was sent and the next name was contacted. If "no" then the non-respondent was asked to answer some questions on the phone. Four questions were asked. The first three were about A&Ms' effect on profitability (V22), A&Ms' effects on the supply of a product by one firm or by a group of firms (V44), and the non existence of an effective mechanism (V103) as one of A&Ms' barriers. The respondents were, finally, asked to provide reasons for choosing not to participate in the survey. A total of 26 responses were achieved.

Table 6-1: Sample Representatives of the Data Base of 124 Firms.

<u>Industry group</u>	<u>No. in original sample</u>	<u>No. of usable responses</u>
Producing sectors:		
Agriculture	28 (5.6%)	7 (5.6%)
Manufacturing	<u>87 (17.4)</u>	<u>25 (20.2)</u>
Total	115 (23.0)	32 (25.8)
Trading	98 (19.6)	19 (15.3)
Services:		
Construction	36 (7.2)	8 (6.5)
Finance	18 (3.6)	3 (2.4)
Others	<u>72 (14.4)</u>	<u>18 (14.5)</u>
Total	126 (25.2)	29 (23.4)
Diversified	161 (32.2)	44 (35.5)

The responses to the first three questions were compared to the responses from the 124 respondents (Table 6-2). The t-test for comparing two means was used to assess dissimilarity between the two groups<sup>2</sup>.

Table 6-2 reveals that non-response bias was not a major issue in this study. The calculated t values were less than the critical value (d.f.=148, two-tailed test, alpha=.05.

The critical value=1.976). So, the null hypothesis that there is no difference between the responding and the non-responding groups could not be rejected.

Table 6-2: Test of Non-Response Bias between Respondents and Non-Respondents.

Variable	Respondents n=124		Non-respondents n=26		T
	Mean	STDEV	Mean	STDEV	
Effect on profit (V22)	3.5887	0.8066	3.423	0.643	1.12
Monopoly (V44)	2.8871	0.9729	3.038	0.720	-0.91
Ineffective mechanism (V103)	3.3629	0.9225	3.308	0.736	0.33

Reasons given for not responding to the survey fell broadly into four categories. These categories and the response distribution are presented in Table 6-3. As can be seen from Table 6-3, the primary reason for not responding to the questionnaire was the unavailability of time. Time constraint may consequently be expected to lower the response rate, but not to bias the sample to a significant extent.

Table 6-3: Reasons Given for Non Response.

<u>Reasons for Non Response</u>	<u>Number of Responses</u>
1- Time constraints	16
2- Not interested (no specific reasons)	2
3- Felt the study was not applicable to their firms	4
4- Company policy not to respond	4
<hr/> Total	26

2) The t-test for difference of means is a technique used to test the hypothesis that the mean scores on some variables will be significantly different for two independent samples. It is used when the number of observation (sample size) in either group is small (less than 30), the population standard deviation is unknown, and some conditions are assumed (the two samples are drawn from normal distribution, the variances of the two groups are equal, and the scale has interval scale characteristics (Zikmund, 1989). A verbal expression of the formula for t is:  $t = (\text{Mean 1} - \text{Mean 2}) / \text{Variability of random means}$ .

A comparison between the ‘late’ and ‘early’ respondents along the previous three questions (V22, V44, and V103) was also, performed to test non-response bias. The assumption behind this test for non-response bias (suggested by Oppenheim, 1966) is that the ‘late’ respondents (those responses received after the second mailing) are very similar to non-respondents, given that they would have fallen into that category had a second set of questionnaires not been mailed. Again, as Table 6-4 illustrates, there were no significant differences between the two groups, providing further evidence of the representatives of the sample. The calculated t values were less than the critical value (d.f.=122, two-tailed test, alpha=.05. The critical value=1.98).

Table 6-4: Test of Non-Response Bias between Early Responses and Late Responses.

Variable	Mean of Early (n=73)	Mean of Late (n=51)	T
Effect on profit (V22)	3.6027	3.5686	0.24
Monopoly (V44)	3.2055	3.3333	-0.7
Ineffective mechanism (V103)	3.2740	3.4902	-1.32

#### 6.2.4 Validity and Reliability

It was explained in the last chapter that several measures were used to ensure the validity and reliability of the test. The development of the instrument followed an extensive search of the relevant literature and it was pilot tested in an attempt to refine it. In addition to this, two measures were used to ensure the content validity (defined in the last chapter); providing spaces after each group of questions for the respondents who wanted to add more information, and the implementation of personal interviews with companies who used A&Ms before.

With regard to the reliability, the test can also be considered reliable from the equivalence perspective (defined in Chapter 5) since the mean scores for the single item measure of the variable falls within the range of the mean scores across the items comprising the variables (Table 6-5). Although the mean score (3.46) of responses to the variable that A&Ms lead to a higher economic growth (V23) does not fall within the range score of the means (3.06-3.43) of the items comprising the previous variable (V24-V27),

the deviation between the score and the range is small, which should not cause a worry regarding the test's reliability.

Moreover, results of barriers to A&Ms were closely related (as will be shown later) to results obtained from the response on the question of why those firms that thought of A&Ms before did not use the A&Ms as they had planned. This also indicates the reliability of test.

**Table 6-5: Assessment of the Reliability from the Equivalence Perspective.**

Variable	Mean	Items Comprising the Variable	Range of Means of the Items
Efficiency (V1)	3.56	V2 - V7	3.23 - 3.65
Effectiveness (V8)	3.76	V9 - V13	3.32 - 4.03
Economic growth (V23)	3.46	V24 - V27	3.06 - 3.43
Labour force structure (V35)	3.56	V36 - V38	2.60 - 3.63

### **6.2.5 Sample Descriptive Statistics**

Complete frequencies and Percentage of respondents and their firms are presented in Table 6-6. Only 20% of the respondents are older than fifty years, 91% have Bachelor and post-graduate degrees (about 30% have Master and PhD).

The ownership of 72 firms (58%) were personally (family) owned and operated, and out of the 21 joint stock companies, 20% or more of the shares of 16 companies of them were held by a person or a family or the government. These statistics indicate that ownership is not separated from the management.

About 95% (117) of the respondents were among the top-management (presidents and vice-presidents). This contributes to the validity and reliability of the test since A&Ms are strategic decisions which are made by the top-management. Although 7 responses came from individuals who may not have the authority to make decisions about the A&Ms, their responses were included in the study because their positions required them to be involved in the A&Ms' decision making process (3 financial managers, 2 administrative managers, 1 marketing manager, and 1 manager for public relation). Moreover, they were expected to have knowledge about business in S.A.

Out of the 124 companies that responded to the questionnaire, only 11 firms had used A&Ms before (15.32 %). This rate is undoubtedly low, especially given the fact that it represents the A&Ms between the top companies which are presumably have a higher rate of A&Ms. This low rate indicates that A&Ms are not preferred by the private sector.

Table 6-6: Sample Descriptive Statistics.

Category	Frequency	Percentage
<b>Form of company</b>		
Limited liability	58	46.8
Sole proprietorship	33	26.6
Partnerships	12	9.7
Joint stock companies	21	16.9
<b>Firm's ownership</b>		
Personally owned and operated	74	59.7
Personally owned but not operated	27	21.8
Publicly owned (more than 20% of share owned by one party)	5	4.0
Publicly owned (no one party owns more than 20% of the shares)	16	12.9
Missing	2	1.6
<b>Industry</b>		
Agriculture	7	5.6
Trading	19	15.3
Contracting	8	6.5
Services	18	14.5
Manufacture	25	20.2
Finance	3	2.4
Diversified	44	35.5
<b>Respondent's position</b>		
Owner	23	18.5
Partner	14	11.3
President	53	42.7
Vice president	27	21.8
Others	7	5.7
<b>Level of education</b>		
Less than under-graduate	8	6.5
Bachelor degree	76	61.3
Post-graduate	37	29.8
Missing	3	2.4
<b>Age category</b>		
Less than or equal 40 years	51	41.2
Greater than 40 and less than or equal 50	48	38.7
Greater than 50 and less than or equal 60	21	16.9
Greater than 60 years	2	1.6
Missing	2	1.6
<b>Considered A&amp;Ms before</b>		
Yes	30	24.2
No	93	75.0
Missing	1	0.8
<b>Used A&amp;M before</b>		
Yes	11	8.9
No	113	91.1

### **6.2.6 Propositions Testing**

As mentioned before, responses were assessed using a five-point Likert-type scale (5= strongly agree, 1= strongly disagree). The data collected was organised, tabulated and then analysed. The t-test and Wilcoxon statistics were relied on in testing the statistical significance of the study propositions.

#### **6.2.6.1 Causes for A&Ms**

##### **1: Supported Causes**

Among the nine causes for A&Ms which were tested in this study, six causes were given support. The first cause which was accepted is that A&Ms will be used for synergy purposes; that is to improve the efficiency (V1) and effectiveness (V8). Table 6-7 shows that the p-value<sup>3</sup> for these two variables were less than 0.0001 and the percentage of those agreed and strongly agreed (A&SA) for them were 66% and 69% respectively. These results clearly support proposition one which suggests that “**A&Ms will be used for synergy purposes; that is to improve effectiveness and efficiency.**”

The six sources of efficiency; cost of finance (V2), marketing cost (V3), administrative and staffing cost (V4), cost of research and development (V5), current operation and production cost (V6), and fixed operation cost due to cutting the surplus capacity (V7) were all supported in this study (see Table 6-8). The efficiency in operation

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3) P-value is the probability of getting a value as extreme (as large in magnitude) as the calculated value or more extreme (MINITAB Reference Manual, 1991). When the p value is less than .05 (at .05 level, for one tailed test and n-1 degree of freedom), the test is considered significant, that is the null hypothesis is rejected. The p values for both the t test and Wilcoxon statistic are provided for the purpose of comparison. Results of the p values of the two tests are very close, which supports the validity of the statistical techniques being used.

was given the highest rank (mean = 3.68 and the percentage of A&SA is 65.32). While cost of research and development was considered the least important source of efficiency with a mean of 3.23 and 44.35% A&SA.

**Table 6-7: Summary Statistics, T-tests, Wilcoxon statistics and % of those Who Agreed and Strongly Agreed with the Main Causes for A&Ms.**

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXON Statistic	P-VALUE	A&SA (%)
V1	3.5645	0.7988	7.87	0.0000	4.0000	4195.0	0.000	66.12
V8	3.7581	0.8494	9.94	0.0000	4.0000	4281.0	0.000	69.35
V14	3.6371	0.7997	8.87	0.0000	4.0000	4728.5	0.000	71.77
V17	2.7823	1.0246	-2.37	0.9900	3.0000	1282.0	0.988	27.41
V18	3.3145	1.0151	3.45	0.0004	4.0000	3779.0	0.001	56.45
V19	3.5323	0.9748	6.08	0.0000	4.0000	4236.0	0.000	64.51
V20	2.4274	0.9472	-6.73	1.0000	2.0000	0656.0	1.000	14.51
V28	3.3387	0.8253	4.57	0.0000	3.0000	2575.5	0.000	49.19
V43	3.2581	1.0960	2.62	0.0049	4.0000	3332.0	0.009	51.61
V44	2.8871	0.9729	-1.29	0.9000	3.0000	1788.5	0.886	33.87
V45	2.7581	0.9742	-2.77	1.0000	3.0000	1695.0	0.993	29.83
V46	2.4032	0.9953	-6.68	1.0000	2.0000	0873.5	1.000	17.74

**Table 6-8: Summary Statistics, T-tests, Wilcoxon statistics and % of those Who Agreed and Strongly Agreed with the Sub-Causes for A&Ms.**

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXON Statistic	P-VALUE	A&SA (%)
V2	3.3387	0.8732	4.32	0.0000	3.0000	2600.5	0.000	49.19
V3	3.4597	0.9230	5.55	0.0000	4.0000	3118.0	0.000	54.83
V4	3.2823	0.8886	3.54	0.0003	3.0000	2740.0	0.001	49.19
V5	3.2339	0.8936	2.91	0.0021	3.0000	2516.0	0.005	44.35
V6	3.6855	0.8102	9.42	0.0000	4.0000	3760.5	0.000	65.32
V7	3.5565	0.8770	7.07	0.0000	4.0000	3887.5	0.000	62.90
V9	3.4194	0.8935	5.23	0.0000	4.0000	2756.0	0.000	51.61
V10	3.5645	0.7782	8.08	0.0000	4.0000	3120.0	0.000	58.06
V11	3.8871	0.7566	13.06	0.0000	4.0000	4969.5	0.000	76.61
V12	3.3226	0.8885	4.04	0.0000	3.0000	2674.5	0.000	47.58
V13	4.0323	0.6494	17.70	0.0000	4.0000	5590.0	0.000	83.87
V15	3.5645	0.9815	6.40	0.0000	4.0000	4329.0	0.000	62.90
V16	3.4516	0.9227	5.45	0.0000	4.0000	3232.0	0.000	54.83

With regard to the effectiveness resulting from synergy, all the factors which may contribute to improving the goods or services the firms provide had means significantly larger than 3.00 (Table 6-8). A&Ms were considered capable of positively affecting the

firms' effectiveness, due to the ease of obtaining loans (V9), effective marketing through better promotion (V10), more and better distribution (V11), better use of research and development's discoveries (V12) and the effective use of complementary resources in general (V13). Effective use of complementary resources received the highest relative importance (mean = 4.0323 and the percentage of those who A&SA is 83.87). Effective use of research and development was ranked the least important factor affecting the merging firm's performance (mean = 3.3226 and the percentage of A&SA is 47.58).

In addition to the efficiency and effectiveness causes which were supported in the study, the proposition that some businesses may seek A&Ms to avoid bankruptcy and to fix their distressed position (V18) was accepted. The sample result is statistically significant beyond the .05 level, which leads to the rejection of the null hypothesis. More than half of the respondents A.&SA with this cause (Table 6-7). This outcome is consistent with proposition four "**avoiding bankruptcy and distressed financial position is the acquired firm's cause to sell their firms.**"

Proposition five "**acquiring firms which can be bought at nominal prices (assets stripping) is one of the A&Ms' causes**" was also given support in this study. Table 6-7 indicates that the p-value of the variable measuring this proposition (V28) is less than 0.0001, and almost half of the respondents A&SA that benefit from firms which are offered at nominal prices is a cause for A&Ms (49%).

Another cause which the study result supports is using A&Ms to diversify into unrelated businesses in order to minimise the risk of working in only one business (V19). As Table 6-7 shows, the t value is statistically significant beyond the .05 level .

Finally, this study supports the cause that A&Ms could be selected to improve the management (V14) ( $p\text{-value} < 0.0001$ ). It should be noted that the quite strong correlation between this cause and the other causes; efficiency (0.338), effectiveness (0.305), opportunism (0.359) and avoidance of bankruptcy (0.390) indicates that looking for a better management is a common justification for all of these causes.

Respondents believe that A&Ms will lead to a better management through replacing poor management (V15) and increased specialisation (V16) (the means for both of these factors are significantly greater than 3, p-value < 0.05). Replacing inefficient management is considered as more important than increased specialisation in explaining what better management A&Ms will lead to. The mean values of the two factors respectively are 3.5645 and 3.4516 (Table 6-8).

## **2: Unsupported Causes**

With regard to the other causes tested in this study (managerial gains, expanding in a shorter time and market power), they were not all supported. It is clear from Tables 6-7 that the respondents disagree that A&Ms in S.A. are selected by management to make personal gain (V20) (p-value > 0.10, mean 2.4274). This result is consistent with proposition two which claims that “**A&Ms will not be used by management to make personal gains on the account of owners’ wealth.**” Only 14.51% of the respondents believe that A&Ms may be used by management even if it is against the owners’ wealth. This result was not unexpected given the firms’ ownership structure in S.A. The sample descriptive statistics (discussed earlier) suggest that the ownership is not separated from the management which explains why A&Ms may not be used for managerial cause. The ownership of 72 firms (58%) were personally (family) owned and operated, and out of the 21 joint stock companies, 20% or more of the shares of 16 companies of them were held by a person or a family or the government.

Another cause (V17) with which the respondents in this study disagree is that management use A&Ms to expand in a shorter time, rather than expanding from inside (p-value > 0.10). It should be recognised that this result suggests that time factor is not relevant in Saudi Arabian A&Ms and it does not mean that internal diversification can be accomplished in a shorter time than expanding through A&M.

Finally, the research outcomes suggest that A&Ms will not be used for monopoly purposes which supports proposition three “**private sector’s decision-makers will not adopt A&Ms for monopoly reasons.**” Although A&Ms were seen as methods

to eliminate the competitors (V43) ( $p$ -value < 0.05), that does not mean A&Ms will be used for monopoly purposes. Table 6-7 shows that A&Ms will not lead to a monopoly in either the product's market (V44), suppliers' market (V45) or the labour market (V46). All the means for these variables were not included in the regions of rejection (3.25 for V44, 3.24 for V45 and 3.21 for V46). Therefore, the null hypotheses for these three variables could not be rejected. The percentage of those who agreed and strongly agreed (A&SA) for these variables were 33%, 29% and 17% respectively.

### **3: ANOVA, Kruskal-Wallis and Cross-Tabulation's Analysis**

Analysis of the mean's variance (A), using ANOVA and analysis of the median's variance (K); using Kruskal-Wallis technique were utilised to investigate if the previous responses were different, based on the categorisations examined in this study; forms of firms (V132), ownership (V133), sectors (V136), respondents' level of education (V139), respondents' ages (V140), thought of A&Ms before (V141), and respondents who used A&Ms before compared with those who did not (V142). See Table 6-9. Cross-Tabulations were used to investigate which classification, within a specific category is more supportive to a variable (Table 6-10).

The responses to the proposition that A&Ms will be used for efficiency causes were similar, except for the respondents in the financial sector who strongly supported the proposition and who differed significantly (less than .05) from the respondents of other sectors, specifically the trading and contracting sector. With regard to the effectiveness, the responses of the contracting sector's firms were significantly in less agreement than responses of other sectors. Also, the agreement of this claim is significantly higher among educated respondents compared to less educated individuals. In response to the proposition that looking for a better management is behind the A&Ms, respondents of family firms that are managed by managers other than the owners were significantly different than respondents of firms of other ownership kinds. They do not support this cause compared to the respondents of other firms' ownership. Regarding the diversification cause, age is the factor that contributes to the difference in responses, with

respondents of less than fifty years were more supportive to it than older people. Finally, respondents of joint stock companies, specifically those where no individual shareholder owns more than 20% of the total shares, were significantly more supportive than other respondents to the idea that A&Ms could be used by managers to make personal gains.

Several factors can be recognised based on the previous discussion. First, the responses to the causes for A&Ms given by respondents who have experienced A&Ms do not differ from the responses given from those who have not. This adds support to the validity and reliability of the test. Secondly, the similarities of responses to bankruptcy and assets stripping causes indicate that these variables are common among all the categories. This finding is consistent with the belief that the problems of the private sector are, in general, similar. Third, although A&Ms were not expected to be used to make personal gains, the occurrence of such possibilities were attached more to firms where their ownership is separated from the management itself. This is consistent with the literature. Finally, young individuals (who are presumably more educated) were significantly more supportive to synergy and diversification. This may indicate that they are in favour of A&Ms more than older and possibly less educated individuals.

Table 6-9: P-Value for ANOVA and Kruskal-Wallis Tests of Whether Main Causes for A&Ms Vary According to Different Levels of Categorisation Variables.

V	Form		Ownership		Sector		Education		Age		Thought of A&Ms		Use A&Ms	
	A	K	A	K	A	K	A	K	A	K	A	K	A	K
1	---	---			0.013	0.029			---	---	---	---	---	---
8	---	---			0.000	0.001	0.012	0.005	---	---	---	---	---	---
14	---	0.016	0.017		---	---	---	---	---	---	---	---	---	---
19	---	---			---	---	---	---	0.016	0.024	---	---	---	---
20	0.000	0.000	0.000	0.000	---	---	---	---	---	---	---	---	---	---

Table 6-10: Cross-Tabulation of the Main Causes for A&Ms by Different Levels of Categorisation Variables.

(a) Cross-Tabulation of Efficiency Cause (V1) by Sector (V136).

	Agr.	Tra.	Con.	Ser.	Man.	Fin.	Div.	All
2	1	6	4	1	2	0	4	18
3	2	4	0	2	6	0	10	24
4	3	8	4	14	17	1	29	76
5	1	1	0	1	0	2	1	6
All	7	19	8	18	25	3	44	124

(b) Cross-Tabulation of Effectiveness Cause (V8) by Sector (V136).

	Agr.	Tra.	Con.	Ser.	Man.	Fin.	Div.	All
1	0	1	0	0	0	0	0	1
2	1	2	3	2	1	0	1	10
3	2	8	3	0	5	0	9	27
4	3	7	2	12	16	1	25	66
5	1	1	0	4	3	2	9	20
All	7	19	8	18	25	3	44	124

(c) Cross-Tabulation of Effectiveness Cause (V8) by Level of Education (V139).

	Less than undergraduate	Bachelor degree	Post graduate	All
1	0	1	0	1
2	0	6	3	9
3	1	23	3	27
4	7	39	19	65
5	0	7	12	19
All	8	76	37	121

(d) Cross-Tabulation of Better Management Cause (V14) by Firms' Ownership (V133).

	Personally owned and operated	Personally owned not operated ALL	Publicly owned (> 20% is owned by one party)	Publicly owned (no > 20% is owned by one)	All
1	1	1	0	0	2
2	8	8	0	0	16
3	10	8	0	2	20
4	49	8	5	14	76
5	6	2	0	0	8
All	74	27	5	16	122

(e) Cross-Tabulation of Diversification Cause (V19) by Age Category (V140).

	<or= 40	> 40 and <or= 50	> 50 and <or= 60	> 60	All
1	1	0	2	0	3
2	8	6	6	1	21
3	8	6	5	1	65
5	8	3	2	0	13
All	51	48	21	2	122

(f) Cross-Tabulation of Managerial Cause (V20) by Form of Firm (V132).

	Limited liability	Sole proprietorship	Partnership	Joint stock	All
1	10	6	3	1	20
2	28	12	5	5	50
3	15	15	4	2	36
4	4	0	0	13	17
5	1	0	0	0	1
All	58	33	12	21	124

(g) Cross-Tabulation of Managerial Cause (V20) by Firms' Ownership (V133).

	Personally owned and operated	Personally owned not operated	Publicly owned (> 20% is owned by one party)	Publicly owned (no > 20% is owned by one)	All
1	14	6	0	1	21
2	39	8	3	1	51
3	21	10	1	1	33
4	0	3	1	12	16
5	0	0	0	1	1
All	74	27	5	16	122

#### 4: Final Remarks

Several remarks are worth mentioning here. First, the relative importance of the causes for A&Ms which were investigated in the study is shown in the following ranking (Table 6-11). It is based on the median and the percentage of those who agreed and strongly agreed.

Table 6-11: Ranking of Causes for A&Ms.

Ranking	The Variable
1	Seeking a better management.
2	Improving the effectiveness due to positive synergy.
3	Lower cost (efficiency).
4	Diversification to minimise the risk of focusing in one single business.
5	Avoiding bankruptcy or a distressed condition.
6	Minimising the competition.
7	Asset stripping.

Second, Table 6-12 shows that the correlation between some of the causes for A&Ms are quite strong. It seems that two groups of causes can be distinguished. One group of causes includes achieving efficiency and effectiveness through synergy, better management and reducing the competition level. The second group consists of buying cheap assets from those companies who may be forced to sell their assets to avoid bankruptcy. The buyers' objective in this group, in addition to utilising the opportunity of cheap assets, is to have a diversified portfolio to minimise the risk associated with working in related businesses<sup>4</sup>.

Table 6-12: The Pearson's Product-Moment Correlation Coefficient-r Between the Level of Agreement for Main Causes for A&Ms.

	V1	V8	V14	V17	V18	V19	V20	V28
V8	0.778a***							
V14	0.338a***	0.305a***						
V17	0.072	-0.014	0.117					
V18	0.271a***	0.193a*	0.390a***	0.215**				
V19	0.112	0.059	0.139	-0.062	0.322b***			
V20	0.151	0.109	0.176*	0.021	0.096	0.042		
V28	0.213**	0.083	0.359a***	0.213**	0.551b***	0.289b***	0.063	
V43	0.362a***	0.268a***	0.173*	0.050	0.087	0.091	-0.115	0.019

a Correlation between variables that constitute the merger's causes.

b Correlation between variables that constitute the acquisition's causes.

\* P < .10; \*\* P < .05; \*\*\* P < .01.

Based on the results of the qualitative study and the examination of the findings of the quantitative study, the first group characterises merger (consolidation) cases in S.A., while the second category distinguishes the acquisitions.

Finally, it was mentioned in the last chapter that, one measure which was used to assure the content validity, was to provide spaces after each main group of questions. With regard to the causes for A&Ms, several respondents suggested that one important cause is to maintain valuable assets which include trade marks, management and employees experiences, information, locations, and financial resources (capital and cash).

#### **6.2.6.2: Factors Affecting the A&M's Success**

##### **1: Supported Factors**

Four variables can be accepted as factors affecting the profitability of merging firms (see Table 6-13). The proposition that there is a relatively high chance of success in horizontal and related acquisitions compared with a relatively low one in conglomerate acquisitions was clearly supported in this study (V29) ( $p$ -value < 0.0001).

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4) The principal components suggests two factors with eigenvalues exceeding unity. These two components explain 58.8% of the total variance in the sample set of causes for acquisitions and mergers (the proportion of the first principal component is 37.5% and the proportion of the second one is 21.3%).

Principal component one is approximately the average of all the variables. In principal component two, two groups of variables can be contrasted; the first group includes V1, V8 and V43, while the second group contains V18, V19 and V28. V14 seems to be neutral. These results support the above findings; that two groups of causes seem to be distinguished and that looking for a better management is a shared cause among these two groups.

Eigenvalue	2.6249	1.4934	0.8824	0.7567	0.5965	0.4434	Eigenvalue	0.2028
Proportion	0.375	0.213	0.126	0.108	0.085	0.063	Proportion	0.029
Cumulative	0.375	0.588	0.714	0.822	0.908	0.971	Cumulative	1.000
Variable	PC1	PC2	PC3	PC4	PC5	PC6	PC7	
C1	0.478	0.387	0.070	0.257	0.129	-0.114	-0.721	
C8	0.424	0.454	0.153	0.379	-0.012	0.028	0.668	
C14	0.406	-0.100	0.327	-0.433	-0.727	-0.034	-0.032	
C18	0.412	-0.400	0.084	-0.042	0.314	0.750	-0.011	
C19	0.243	-0.364	-0.686	0.436	-0.378	-0.068	-0.002	
C28	0.360	-0.476	0.160	-0.089	0.415	-0.646	0.144	
C43	0.260	0.339	-0.602	-0.635	0.202	-0.013	0.107	

Moreover, this research replicated the findings of some literature which suggests that A&Ms which occur between firms of close size (V39) have a higher probability of success. The t value (3.33) is statistically significant beyond the .05 level. 51% of the respondents agreed and strongly agreed with this variable.

Table 6-13: Summary Statistics, T-tests, Wilcoxon statistics and % of those Who Agreed and Strongly Agreed with the Factors of Success.

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXON Statistic	P-VALUE	A&SA (%)
V29	3.5560	1.1280	5.49	0.0000	4.0000	3865.0	0.000	56.45
V39	3.3387	0.8253	4.57	0.0000	4.0000	2917.5	0.000	51.61
V50	3.0645	0.9435	0.76	0.2200	3.0000	2161.0	0.259	41.12
V52	3.2500	0.8325	3.34	0.0005	3.0000	2745.0	0.003	49.19
V56	3.2660	0.9120	3.25	0.0007	4.0000	3088.0	0.003	51.61
V58	2.7580	0.9320	-2.89	1.0000	3.0000	1418.0	0.994	25.80
V60	3.0400	0.9230	0.49	0.3100	3.0000	2009.0	0.345	39.51
V64	2.8710	0.9014	-1.59	0.9400	3.0000	1350.0	0.928	29.03

In addition to the previous factors, strategic issue domination of the analysis (V52) was found to be another factor affecting the success of A&Ms. The sample mean (3.25) is included in the region of rejection (3.23). Therefore, the null hypothesis can not be accepted. In other words the respondents believe that choosing A&Ms based on their contribution to the overall strategy is another factor explaining the success of A&Ms. The result that almost half of the respondents agreed on this factor adds support to the previous conclusion..

Finally, one further condition emerged as an important variable which influences success. This research suggests that the employees are not expected to react negatively to the A&Ms (V56). The sample result is statistically significant beyond the .05 level. Although this finding is consistent with the hypothesis that the negative response of human resources is the main factor of A&Ms' failure, it contradicts the widespread belief that A&Ms are unfavourable to employees. This result is not unexpected given the structure and characteristics of the employment in S.A.

Among the four factors; the related diversification is considered to be the major factor contributing to the success of A&Ms in S.A. (mean = 3.5560 and the percentage of

A&SA is 56.45), followed by the similarity between the acquirer and acquired with regard to size (mean = 3.3387), then the acceptance of A&Ms by the employees (mean = 3.2660, and finally the selection of A&Ms based on the strategic analysis (mean = 3.2500).

## **2: Unsupported Factors**

This study does not, however, provide support for the other factors; similarities in profitability (V50), the retention of the acquired top management (V60), giving an acquired firm its autonomy (V58), and the availability of experience about A&M (V64). The observed t values for these variables were less than the critical t value of 1.645 at the .05 level (at  $124-1=123$  degree of freedom).

Giving an acquired firm its autonomy was considered to be the least important factor explaining the success of A&Ms, followed by the availability of experienced managers of A&M's activity (the means of both of these two factors are less than 3.00 and the percentages of those A&SA. for them are less than 30%). The weights given for the other two factors (closeness of merging firms profitability as well as the retention of the acquired firm's top management) are close (the means are 3.06 and 3.04 for the two factors respectively).

## **3: ANOVA, Kruskal-Wallis and Cross-Tabulation's Analysis**

None of the mean (median) responses to the factors of success were significantly different across categories except for two factors; employees' acceptance of A&Ms and giving the acquired firm its autonomy. The ANOVA and Kruskal-Wallis tests and the Cross-Tabulations suggest that respondents of diversified firms are significantly less supportive to the idea that employees' acceptance of A&Ms without reacting negatively to them is a factor which contributes to the success of A&Ms. With regard to letting the acquired firm have independence, the 11 firms that used A&Ms before were against it, compared with the 19 firms that considered A&Ms before but they did not use them (see Table 6-14 and Table 6-15).

The general conclusion which can be drawn from the previous discussion is that responses to the factors affecting the A&M's success are similar within each category tested in the study.

#### **4: Final Remarks**

As expected, the study does not provide evidence that would lead to a rejection of proposition 6 which is “**some characteristics of successful A&Ms (related A&Ms, no negative reaction from the employees, closeness of firms' sizes and considering A&Ms strategically) exist in S.A. which may contribute to their success. Moreover, some prerequisite conditions of successful A&Ms (management's experience, closeness of firms' profitability, giving acquired firm its autonomy and maintaining acquired firm's top management after the A&Ms) may not be relevant there.**” The study results suggest that some prerequisite conditions of successful A&Ms already exist in S.A. These factors include A&Ms occurring between firms in related businesses, employees accepting A&Ms without negative reaction, closeness of merging firms with regard to their sizes, and considering A&Ms from strategic point of view<sup>5</sup>.

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5) Using the multiple regression analysis to investigate the simultaneous effects of these factors on the profitability of merging firms suggests that the variation in these factors accounts for only 17.9% of the variance in the profitability. The results show that V29 and V56 contribute significantly to the variation in profitability (P value < .05 and R-sq = 15.2).

The regression equation is

C22 = 2.01 + 0.210 C29 - 0.134 C39 + 0.0778 C50 + 0.0634 C52 + 0.176 C56 - 0.0215 C58 + 0.0493 C60 + 0.0609 C64				
Predictor	Coef	Stdev	t-ratio	P
Constant	2.0081	0.5702	3.52	0.001
C29	0.20957	0.06899	3.04	0.003
C39	-0.13410	0.09562	-1.40	0.163
C50	0.07783	0.08291	0.94	0.350
C52	0.06336	0.08559	0.74	0.461
C56	0.17596	0.08018	2.19	0.030
C58	-0.02151	0.08448	-0.25	0.799
C60	0.04928	0.07898	0.62	0.534
C64	0.06094	0.07931	0.77	0.444
s = 0.7558	R-sq = 17.9%	R-sq(adj) = 12.2%		

Table 6-14: P-Value for ANOVA and Kruskal-Wallis tests of Whether the Factors of Success Vary According to Different Levels of Categorisation Variables.

V	Form	Ownership	Sector	Education		Age		Considered A&Ms		Used A&Ms	
	A	K	A	K	A	K	A	K	A	K	A
56	---	---		0.033	0.050	---	---	---	---	---	---
58	---	---		---	---	---	---	---	---	0.007	0.013

Table 6-15: Cross-Tabulation of the Factors of Success by Different Levels of Categorisation Variables.

(a) Cross-Tabulation of Employees' Acceptance of A&Ms as a Factor of Success (V56) by Sector (V136).

	Agr.	Tra.	Con.	Ser.	Man.	Fin.	Div.	All
1	0	0	0	0	0	0	2	2
2	1	5	3	1	5	0	15	30
3	1	4	2	5	4	1	11	28
4	5	10	3	11	14	2	16	61
5	0	0	0	1	2	0	0	3
All	7	19	8	18	25	3	44	124

(b) Cross-Tabulation of Giving Acquired Firm Its Independence as a Factor of Success (V58) by Used A&Ms Before or not (V142).

	Yes	No	All
1	0	2	2
2	3	10	13
3	2	5	7
4	5	2	7
5	1	0	1
All	11	19	30

The outcomes also suggest that some characteristics which the literature claims as factors affecting the A&M's success may not be relevant in contributing to the success of A&Ms in Saudi Arabia. Management's experience of A&M's activity, closeness of firms' profitability, leaving the acquired firm working independently, and maintaining acquired firm's top management after the A&M are four factors comprising that category.

With regard to this issue, attention should be paid to the correlation matrix presented in Table 6-16. It is clear from the correlation between the eight factors that may contribute to the success of A&Ms and the causes for A&Ms (efficiency or assets stripping) that the A&Ms' factors of success were perceived differently. There were positive and quite moderate correlation's between the efficiency cause and some of the conditions of success. These factors of success (group one) include related A&Ms,

closeness of sizes, closeness of profitability, strategic analysis of A&Ms, employees' non-negative reactions to A&Ms and keeping the top management of the merged firms working with the firm after A&Ms take place. While, for the same set of factors (with exception to the analysis of A&Ms from strategic point of view and the employees' acceptance of the A&M's decisions), there were negative correlation between the opportunistic cause (assets stripping) and the factors of success. Moreover, there were strong correlation between some factors (group two) and the cause of buying firms that are offered at nominal prices. These factors include the strategic analysis of A&M's decisions, employees' acceptance of A&Ms and management has experience about A&M's activity. It was mentioned earlier that the efficiency cause is attached more to merger's cases, while for acquisition's cases, the dominating cause is the assets stripping. Therefore, the two sets of factors of success investigated earlier can be attached to A&Ms, the first set of factors distinguishes the mergers and the second group pertains to the acquisitions.

**Table 6-16: The Pearson's Product-Moment Correlation Coefficient-r Between Level of Agreement for Factors of A&Ms' Success and Causes for A&Ms (Efficiency or Asset stripping).**

	V1	V28	V29	V39	V50	V52	V56	V58	V60
V28	0.213**								
V29	0.357a***	-0.096							
V39	0.213a**	-0.182*	0.096						
V50	0.340a***	-0.018	0.058	0.431***					
V52	0.446a***	0.207b**	0.190*	-0.053	0.104				
V56	0.216a**	0.538b***	0.094	-0.110	0.112	0.201**			
V58	0.098	-0.368***	0.328***	0.277***	0.166*	0.016	-0.182*		
V60	0.289a***	-0.274***	0.221**	0.185*	0.174*	0.071	-0.023	0.295***	
V64	-0.203**	0.136b	-0.258***	-0.039	-0.086	-0.043	0.052	-0.018	-0.082

a Factors of success where the efficiency is the focus (mergers).

b Factors of success where the assets stripping is the focus (acquisitions).

\* P < .10; \*\* P < .05; \*\*\* P < .01.

### 6.2.6.3 Effects on Firms' Performance

Proposition 7 which suggests that “A&Ms will improve firms' ability to compete and improve their profitability” was accepted. The p-values of the tests

of these two effects (V21 for the effect on ability to compete and V22 for the effect on profitability) were < 0.0001 and the percentages of respondents who A&SA for them were greater than 60% (Table 6-17).

Table 6-17: Summary Statistics, T-tests, Wilcoxon statistics and % of those Agreed and Strongly Agreed with the Effects on Firms' Performance.

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXONP-Statistic	VALUE	A&SA (%)
V21	3.7016	0.8740	8.94	0.0000	4.0000	4251.0	0.000	66.93
V22	3.5887	0.8066	8.13	0.0000	4.0000	3736.5	0.000	63.70

Moreover, examining the correlation between these two factors and the causes for A&Ms (Table 6-18), indicates that efficiency and effectiveness are associated more to competitiveness, followed by market power and then by asset stripping. With regard to profitability, all these causes seem to have relatively the same strength of association with profitability.

Examining the ANOVA and Kruskal-Wallis tests (Table 6-19) as well as the Cross-Tabulations (Table 6-20) indicates that respondents of trading sector's firms are significantly different from the other groups. They do not agree as strongly as the other respondents on the ability of A&Ms to improve a firm's competitive advantages. Concerning the effect on profit, the dissimilarity among firms that are owned and managed by the families, seems to be the only factor explaining the significant differences among the respondents, with respondents of firms that are operated by individuals other than the owners being significantly less supportive to the propositions that A&Ms will improve the profitability than the respondents of family firms that are owned and operated by the same owners.

The conclusion that can be drawn on whether the testing of responses to the A&Ms effects on profit and competitive position are significantly different within each category is that, in general, responses to these variables are similar.

**Table 6-18:** The Pearson's Product-Moment Correlation Coefficient-r Between Level of Agreement for the Effects on Firms' Performance and Causes for A&Ms.

	V1	V8	V14	V28	V29	V43	V21
V8	0.778***						
V14	0.338***	0.305***					
V28	0.213**	0.083	0.359***				
V29	0.352***	0.294***	0.130	-0.108			
V43	0.362***	0.268***	0.173*	0.019	0.764***		
V21	0.476***	0.417***	0.485***	0.119	0.277***	0.285***	
V22	0.376***	0.245**	0.423***	0.321***	0.289***	0.342***	0.574***

\* P < .10; \*\* P < .05; \*\*\* P < .01.

**Table 6-19:** P-Value for ANOVA and Kruskal-Wallis tests of Weather the Effects on Firms' Performance Vary According to Different Levels of Categorisation Variables.

Form	Ownership		Sector		Education		Age		Considered A&Ms		Used A&Ms	
	A	K	A	K	A	K	A	K	A	K	A	K
21	---		---		0.004	0.015	---		---		---	
22	---		0.013	0.019	---		---		---		---	

**Table 6-20:** Cross-Tabulation of the Effects on Firms' Performance by Different Levels of Categorisation Variables.

(a) Cross-Tabulation of A&M's Effect on Firms' Competitive Ability (V21) by Sector (V136).

	Agr.	Tra.	Con.	Ser.	Man.	Fin.	Div.	All
2	1	8	1	0	2	0	3	15
3	2	5	1	4	5	0	9	26
4	2	4	6	11	15	1	25	64
5	2	2	0	3	3	2	7	19
All	7	19	8	18	25	3	44	124

(b) Cross-Tabulation of A&M's Effect on Firms' Profitability (V22) by Firms' Ownership (V133).

	Personally owned and operated	Personally owned not operated	Publicly owned (> 20% is owned by one party)	Publicly owned (no > 20% is owned by one)	All
1	0	1	0	0	1
2	4	7	1	2	14
3	17	6	2	8	33
4	47	12	2	5	66
5	6	1	0	1	8
All	74	27	5	16	122

#### **6.2.6.4 A&M's Effects on the Economic Welfare**

##### **1: Supported Effects**

Table 6-21 shows clearly that respondents believe that A&Ms will have favourable effects on the economic welfare. The propositions that A&Ms will lead to a higher economic growth (V23), improving the balance of trade (V30), a better private sector's labour force structure (V35), diversification of the economy in the long run (V40), increasing foreign investment in the kingdom either from GCC's countries (V41) or other countries (V42) were all accepted. The sample results are statistically significant beyond the .05 level. So, the null hypotheses of  $u < \text{or } = 3$  for these variables can not be accepted. These results give support to proposition 8 "**A&M will lead to favourable economic conditions in S.A. which include increasing economic growth, improving balance of trade, improving labour force's structure, diversifying the economy, and increasing investments.**"

Based on the percentage of A&SA, favourable effects on the balance of trade received the highest ranking (73.38%), while increasing investment of companies of GCC's countries received the highest ranking based on the mean (3.6613). The lowest ranking was for the diversification of the economy (mean = 3.371 and the percentage of A&SA is 47.58).

##### **2: Unsupported Effects**

The positive effects on firms' performance (discussed earlier) and results presented in Table 6-21, show that A&Ms will not lead to negative impacts. Results of A&Ms' effects on monopoly of outputs (V44), raw materials (V45), and labour market (V46), higher inflation rate (V47), and control of political power (V48) are all consistent with what proposition 9 suggests; that is "**A&M will not lead to negative impacts on the economy (lower economic growth rate, lower investment, monopoly, higher inflation rate, control of power in the hands of a few people, unemployment, deterioration of the balance of trade).**" The observed

t values for the potential of monopoly in end products, raw materials and labour markets are all less than the critical t value of 1.645 at the .05 level. The p values of all the negative effects' factors tested in the study are greater than 0.10. This means that the null hypotheses that A&Ms will lead to monopoly of outputs, raw materials, and labour market, higher inflation rate, and control of political power ( $u < \text{or } = 3$ ) can not be rejected.

Table 6-21: Summary Statistics, T-tests, Wilcoxon statistics and % of those Who Agreed and Strongly Agreed with the Main Effects on the Economic Welfare.

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXON Statistic	P-VALUE	A&SA (%)
V23	3.4597	0.8779	5.83	0.0000	4.0000	4290.0	0.000	65.32
V30	3.6129	0.8526	8.00	0.0000	4.0000	5169.5	0.000	73.38
V35	3.5565	0.8677	7.14	0.0000	4.0000	4404.0	0.000	66.12
V40	3.3710	0.8877	4.65	0.0000	3.0000	2499.5	0.000	47.58
V41	3.6613	0.6854	10.74	0.0000	4.0000	3632.5	0.000	65.32
V42	3.5806	0.6996	9.24	0.0000	4.0000	2649.0	0.000	55.64
V44	2.8871	0.9729	-1.29	0.9000	3.0000	1788.5	0.886	33.87
V45	2.7581	0.9742	-2.77	1.0000	3.0000	1695.0	0.993	29.83
V46	2.4032	0.9953	-6.68	1.0000	2.0000	0873.5	1.000	17.74
V47	3.0081	0.9499	0.09	0.4600	3.0000	1320.0	0.488	30.64
V48	3.0323	1.0035	0.36	0.3600	3.0000	1897.5	0.380	36.29

Although the control of the supply of a product, supply of raw materials and labour market were all rejected as potential negative effects on the economy, the disagreement with the proposition that A&Ms will lead to a monopoly power in the labour market received the highest support (median = 2.0000 and the percentage of A&SA. = 17.74 only) followed by control over the supply of raw materials and then control over the supply of products (percentages of A&SA are 29.83 and 33.87 respectively).

### 3: ANOVA, Kruskal-Wallis and Cross-Tabulation's Analysis

Investigating the differences among the respondents with regard to the A&Ms' effects on the economic welfare suggests that, in general, there are no significant

differences between them (see Table 6-22). The exception that may be worth mentioning is that respondents of Manufacturing firms were significantly less supportive to the A&M's effect on the control of supply of products and raw materials compared to the respondents from other sectors (Table 6-23).

Table 6-22: P-Value for ANOVA and Kruskal-Wallis Tests of Whether Effects on Economic Welfare Vary According to Different Levels of Categorisation Variables.

V	Form	Ownership		Sector		Education		Age		Considered A&Ms		Used A&Ms	
		A	K	A	K	A	K	A	K	A	K	A	K
40		---	---		---		---	0.020	0.034	---	---	---	---
42	0.031	0.040	---		---		---	---	---	---	---	---	---
44	---	---	0.007	0.010		---		---	---	---	---	---	---
45	---	---	0.016	0.017		---		---	---	---	---	---	---
47	---	---	---		0.014	0.024		---	---	---	---	---	---

Table 6-23: Cross-Tabulation of the Effects on Economic Welfare by Different Levels of Categorisation Variables.

(a) Cross-Tabulation of A&M's Effect on Control of Products (V44) by Sector (V136).

	Agr.	Tra.	Con.	Ser.	Man.	Fin.	Div.	All
1	1	0	0	1	2	0	4	8
2	3	6	3	8	17	0	15	52
3	2	3	1	3	5	1	12	27
4	1	10	4	6	1	2	12	36
5	0	0	0	0	0	0	1	1
ALL	7	19	8	18	25	3	44	124

(b) Cross-Tabulation of A&M's Effect on Control over Supply of Raw Materials (V45) by Sector (V136).

	Agr.	Tra.	Con.	Ser.	Man.	Fin.	Div.	All
1	2	1	0	3	8	0	8	22
2	2	8	5	7	14	0	17	53
3	1	5	0	4	3	2	12	27
4	2	5	3	4	0	1	6	21
5	0	0	0	0	0	0	1	1
ALL	7	19	8	18	25	3	44	124

#### 4: Final Remarks

Shifting assets into their best use (V24) and increasing the level of capital investment (V26) were supported in this study (see Table 6-24) as the factors which explain the higher economic growth (p-value for both of these factors < 0.0001).

However, using the assets in better ways was considered more important (median = 4.0000 and the percentage of A&SA = 60.48) than increasing the investment (median = 3.0000 and the percentage of A&SA = 49.19). The positive effects of A&Ms on the economic growth through increasing the level of research and development (V27) was rejected in this study (p-value > 0.10).

**Table 6-24: Summary Statistics, T-tests, Wilcoxon statistics and % of those Who Agreed and Strongly Agreed with the Sub-Effects on the Economic Welfare.**

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXON Statistic	P-VALUE	A&SA (%)
V24	3.4516	0.9049	5.56	0.0000	4.0000	3970.5	0.000	60.48
V26	3.4355	0.8764	5.53	0.0000	3.0000	2517.5	0.000	49.19
V27	3.0645	1.0260	0.70	0.2400	3.0000	2095.0	0.285	40.32
V31	3.5968	0.8735	7.61	0.0000	4.0000	4117.5	0.000	65.32
V32	3.2258	0.9614	2.62	0.0050	3.0000	2301.5	0.011	44.35
V36	3.6371	0.8394	8.45	0.0000	4.0000	3321.0	0.000	59.67
V37	3.2500	0.8422	3.31	0.0006	3.0000	1919.0	0.002	41.12
V38	2.6048	0.7632	-5.77	1.0000	3.0000	0576.0	1.000	12.90

With regard to the trade balance, although increasing exports (V31) and decreasing imports (V32) were both supported as outcomes of A&Ms, the decreasing of imports did not receive as high ranking as the increasing of exports' variable (median = 3.0000 and the percentage of A&SA = 44.35 for the first variable while for the second variable the median = 4.0000 and the percentage of A&SA = 65.32).

Generating employment opportunities for Saudis (V36) and decreasing dependence on foreign labour (V37) were supported as factors contributing to the structure of improving the labour force after A&Ms, with the first variable receiving the higher ranking (the mean = 3.6371) and the percentage of A&SA = 59.67 for generating employment for Saudis. The mean and the percentage of A&SA for the decreasing of dependence on foreign labour are 3.250 and 41.12 respectively. Improving labour force structure through increasing wages (V38), however, could not be accepted (p-value > 0.05 and only 12.90 agreed and strongly agreed with this proposition).

With regard to the A&Ms' effect on the employees, several respondents suggested in the spaces available to them that A&Ms would increase the employees' productivity due to the better ability of merging firms to train their employees, and the opportunity of the labour force to gain new experiences through working with other companies.

Examining the correlation between these variables and the causes for A&Ms (efficiency and opportunistic reason) presented in Table 6-25, with the exception of higher economic growth and the diversification of the economy, the indication is that the respondents who put higher weights for the effectiveness and efficiency as causes for A&Ms, believed that A&Ms would have major positive effects on the economic welfare.

Table 6-25: The Pearson's Product-Moment Correlation Coefficient-r Between the Level of Agreement for Main Effects of A&Ms on the Economic Welfare.

	V1	V28	V23	V30	V35	V40	V41	V42	V47
V28	0.213**								
V23	0.462***	0.288***							
V30	0.395***	0.003	0.381***						
V35	0.306***	-0.050	0.270***	0.228**					
V40	0.264***	0.437***	0.207**	0.159	0.194*				
V41	0.367***	0.003	0.342***	0.316***	0.320***	0.355***			
V42	0.325***	0.051	0.303***	0.175*	0.428***	0.410***	0.668***		
V47	-0.156	0.048	-0.102	-0.217**	-0.084	0.131	-0.083	0.017	
V48	-0.053	-0.013	-0.109	-0.080	-0.039	-0.032	-0.079	-0.120	0.477***

\* P < .10; \*\* P < .05; \*\*\* P < .01.

### 6.2.6.5 A&M's Rate, Motive and Barriers

#### 1: Supported Variables

Proposition 10 suggests that "A&Ms are not preferred by the private sector and, therefore, their rates are low." The finding of this study supports this proposition. Out of the 124 companies that responded to the questionnaire, only 11 firms had used A&Ms before (15.32 %). This rate is undoubtedly low, especially given

the fact that it represents the A&Ms between the top companies which are presumably have a higher rate of A&Ms.

Examining Table 6-26 and Table 6-27, it is clear that several motives for A&Ms are not available and there are several barriers to A&Ms activity which negatively affect its rate. Four variables were accepted as motives existing in S.A. They are; ability of managers to manage large firms (V51), existence of firms with excess capacity and resources which can not be utilised internally (V69), severe competition (V97), and the existence of firms that can provide strategic benefits (V99). The p values for them are less than 0.001 and the percentage of A.&SA for them are greater than 40%.

The highest ranking of the motives existing in S.A. pin-points the severe competition (mean = 3.44 and the percentage of A&SA = 56.45) and the lowest ranking (Percentage of A&SA = 44.35) is devoted to the existence of firms with excess resources that can not be used internally without the need to expand through A&Ms.

With regard to the barriers, Table 6-27 shows that twelve variables were given support as barriers to A&Ms. They are as follows; management is not separated from ownership (V49), lack of sufficient experience about A&Ms (V53), decision makers are satisfied with their status quo (V57), they do not like others to share their authority with them (V61), they desire independence of name and image (V63), they fail to see or gain any advantages of A&Ms' opportunities (V65), the inflation rate is low (V71), laws and regulations that cover some A&Ms issues, such as laws that protect acquiring firms from unknown liabilities on the acquired firms (V93) and regulations that explain how the consolidated firms will be assorted (V95) do not exist, firms with good deals are not available (V101), an effective mechanism that facilitates A&Ms (V103) and effective pricers (V113) are not available. The sample means of these variables are greater than the critical value. Therefore, the sample results are statistically significant beyond the .05 level.

Among these barriers, six variables received the highest ranking (median = 4.0000). They are as follows; management is not separated from ownership and has no

freedom in decision making, decision-makers are satisfied with their status quo, unwillingness to share authority, desire of independence with name and image, failure to see or get any advantages of A&Ms' opportunities and, finally, non existence of an effective mechanism that can facilitate A&Ms.

Table 6-26: Summary Statistics, T-tests, Wilcoxon statistics and % of those Who Agreed and Strongly Agreed with A&Ms' Motives.

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXON Statistic	P-VALUE	A&SA (%)
V51	3.2258	0.9529	2.64	0.0047	3.0000	2852.0	0.010	46.77
V55	3.0242	1.0551	0.26	0.4000	3.0000	2065.5	0.399	36.29
V69	3.2903	0.8814	3.67	0.0002	3.0000	2229.0	0.001	44.35
V83	2.5726	0.8942	-5.32	1.0000	3.0000	0417.0	1.000	11.29
V85	2.8060	1.1730	-1.84	0.9700	3.0000	0981.0	0.969	24.19
V97	3.4435	0.9397	5.26	0.0000	4.0000	3592.0	0.000	56.45
V99	3.3387	0.8638	4.37	0.0000	3.0000	2499.5	0.000	47.58
V105	2.5726	1.0451	-4.55	1.0000	2.0000	1177.0	1.000	22.58
V107	2.4758	0.9915	-5.89	1.0000	2.0000	0894.0	1.000	16.93
V109	2.2097	0.9219	-9.55	1.0000	2.0000	0497.0	1.000	11.29
V111	2.8952	0.9612	-1.21	0.8900	3.0000	1809.5	0.870	33.87

Table 6-27: Summary Statistics, T-tests, Wilcoxon statistics and % of those Who Agreed and Strongly Agreed With A&Ms' Barriers.

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXON Statistic	P-VALUE	A&SA (%)
V49	3.6613	0.8916	8.26	0.0000	4.0000	3935.0	0.000	64.51
V53	3.3468	0.9546	4.05	0.0000	3.0000	2627.5	0.000	48.38
V57	3.5645	0.8577	7.33	0.0000	4.0000	3502.5	0.000	61.29
V59	3.1129	0.9125	1.38	0.0850	3.0000	2450.5	0.113	42.74
V61	3.4919	1.0398	5.27	0.0000	4.0000	3640.5	0.000	55.64
V63	3.6694	0.9854	7.56	0.0000	4.0000	4252.0	0.000	63.70
V65	3.6748	0.8916	8.39	0.0000	4.0000	3388.5	0.000	60.97
V67	2.4758	0.9058	-6.44	1.0000	2.0000	0866.0	1.000	13.70
V71	3.1452	0.9168	1.76	0.0400	3.0000	1897.5	0.061	39.51
V75	3.1613	1.0924	1.64	0.0510	3.0000	2412.0	0.072	43.54
V77	2.5887	0.9107	-5.03	1.0000	3.0000	0630.0	1.000	12.90
V79	2.6613	0.8543	-4.41	1.0000	3.0000	0625.0	1.000	13.70
V81	2.8468	0.8930	-1.91	0.9700	3.0000	1076.0	0.954	21.77
V93	3.4194	0.8468	5.51	0.0000	3.0000	2223.0	0.000	48.38
V95	3.4435	0.7576	6.52	0.0000	3.0000	1719.0	0.000	42.74
V101	3.3468	0.9110	4.24	0.0000	3.5000	2947.0	0.000	50.00
V103	3.3629	0.9225	4.38	0.0000	4.0000	3214.0	0.000	53.22
V113	3.2823	0.9674	3.25	0.0007	3.0000	2879.0	0.002	47.58

These findings give support to proposition 12 which claims that “**several barriers to A&Ms exist in S.A. and psychological and social factors are the main barriers to acquisition activity.**” Although the results suggest that psychological and social factors (unwillingness to share authority, desire of independence of name and image) are important barriers to A&Ms, the study finds that one more factor clearly contributes to the A&Ms’ barriers, that is poor management which can be manifested in their limited freedom of decision-making, satisfaction of their firms’ status quo and failure to see or get any advantages of A&Ms’ opportunities.

## **2: Unsupported Variables**

This study rejects the existence of seven motives; awareness that larger firms are better equipped to manage today’s businesses (V55), the government provides benefits to merging firms (V83), ability of firms to capitalise through public offering (V85), availability of investment bankers (V105) and acquisition’s brokers (V107) which facilitate A&Ms’ activity, firms names which are willing to sell/ buy or to merge (V109) and information about them are accessible (V111). The observed t values for these variables are less than the critical t value at the .05 level. Therefore, the assumption that these variables’ means were less than or equal 3 could not be rejected (Table 6-26).

The unavailability of a list of firms’ names that are willing to merge, acquire or be acquired received the highest ranking of those motives that do not exist (median = 2.0000 and the percentage of A&SA = 11.29) followed by the government providing benefits to merging firms (mean = 3.5726 and the percentage of A&SA = 11.29). The lowest ranking goes for the lack of awareness that large firms are better equipped to manage today’s businesses (the percentage of A&SA = 36.29). These findings support proposition 11, which suggests that “**several motives to A&Ms do not exist in S.A and the absence of an effective mechanism to facilitate A&Ms is the major variable.**” The absence of an effective mechanism is manifested in the non existence of a list of firms’ names that are willing to merge and the unavailability of effective bankers and brokers).

Regarding barriers, six factors were not accepted in this study (Table 6-26). These are: decision makers do not like A&Ms due to potential negative impacts on their personal relationships with the management and employees (V59), restricted resources (V67), high interest rates which make borrowing unfavourable (V75), legal obligations with respect to the Commercial Register (V77), Regulations for Companies (V79) and Department of Zakat and Income Tax are restricted (V81).

Among the six variables that are rejected as barriers to A&Ms, the restricted legal obligations of the Commercial Register received the lowest ranking (mean = 2.5887 and the percentage of A&SA = 12.90), followed by a firms resource being restricted (median = 2.0000 and the percentage of A&SA = 13.70), then the restriction of legal requirements for both the S.A Regulations for companies and the Department of Zakat and income Tax with means = 2.6613 and 2.8468 respectively. Finally, the last two variables; the existence of high interest rates which makes the borrowing to finance A&Ms unfavourable, and avoiding A&Ms because of potential negative impacts on personal relationships between owners, managers and employees received the highest ranking as barriers that exist in S.A.

### **3: ANOVA, Kruskal-Wallis and Cross-Tabulation's Analysis**

Results of the ANOVA and Kruskal-Wallis tests (Table 6-28) and the Cross-Tabulation (Table 6-29) indicate that there are significant differences among the respondents of firms that thought of A&Ms before and those which did not regard the claim that the legal requirements of Commercial Register and the Regulations for Companies are restricted, with the first group significantly against this proposition. Also, they exhibited significant disagreement with the statement that the government provides benefits to acquiring and merging firms as a motive to A&Ms compared to the other respondents. With regard to the legal obligations of the Department of Zakat and Income Tax, responses of firms that used A&Ms before are significantly less supportive to the existence of this barrier compared to firms that thought of A&Ms before but they did not adopt them.

#### 4: Final Remarks

According to the previous discussion, some motives for mergers don't exist, and some barriers are found in S.A<sup>6</sup>. This gives support to both propositions 11 and 12. Of course this finding, also supports the proposition that A&Ms' rate is low. It should be noted, also, that 30 respondents considered A&Ms before and that a total of 19 of them did not use A&Ms (almost two third did not use the A&Ms as thought of before). This indicates that there must be some barriers that stop them from adopting the A&Ms. This can be used to support the proposition that there are several barriers to A&Ms which should be eliminated in order to have a higher rate of A&Ms.

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6) Factor analysis was used to summarise the information contained in a large number of variables (18 barriers and 11 motives) into a smaller number of factors. The results indicated that the barriers could be reduced to 7 factors and the motives to 5 factors (eigenvalue >1). These reductions are not huge and the cumulative proportions for the barriers' factors is only 66% and for the motives is only 65%. Moreover, the researcher found that there was no meaningful interpretation of the factors that were employed, and the researcher is satisfied with the categorisations presented in the study (variables related to the internal environment, economical variables, legal and governmental factors, competitive factors and variables related to the mechanism of A&Ms. Given the above argument, the researcher did not proceed further with the factor analysis.

Eigenanalysis of the Correlation Matrix for the A&Ms' barriers (18 variables)

Eigenvalue	2.5566	2.2628	1.9699	1.6035	1.2288	1.1617
Proportion	0.142	0.126	0.109	0.089	0.068	0.065
Cumulative	0.142	0.268	0.377	0.466	0.535	0.599
Eigenvalue	1.0489	0.9712	0.8966	0.7469	0.6348	0.6180
Proportion	0.058	0.054	0.050	0.041	0.035	0.034
Cumulative	0.657	0.711	0.761	0.803	0.838	0.872
Eigenvalue	0.5239	0.4587	0.4434	0.3912	0.2760	0.2071
Proportion	0.029	0.025	0.025	0.022	0.015	0.012
Cumulative	0.901	0.927	0.951	0.973	0.988	1.000

Eigenanalysis of the Correlation Matrix for the A&Ms' motives (11 variables)

Eigenvalue	2.3723	1.4213	1.2286	1.1313	1.0553	0.9401
Proportion	0.216	0.129	0.112	0.103	0.096	0.085
Cumulative	0.216	0.345	0.457	0.559	0.655	0.741
Eigenvalue	0.7332	0.6825	0.5751	0.5106	0.3498	
Proportion	0.067	0.062	0.052	0.046	0.032	
Cumulative	0.807	0.870	0.922	0.968	1.000	

Most of the factors, that were mentioned (in the provided space) by those 11 respondents who thought of A&Ms before but who did not go with the A&M's decision, were related to the mechanism of A&M itself. The non-existence of a middle-man who can be trusted to facilitate the A&M, the inability of one party of an A&M to provide the required information for the other party, and the non-existence of effective pricers (which caused the disagreement with regard to prices and shares) were some barriers mentioned by the respondents.

Table 6-28: P-Value for ANOVA and Kruskal-Wallis Tests of Whether A&Ms' Motives and Barriers Vary According to Different Levels of the Categorisation Variables.

V	Form		Ownership		Sector		Education		Age		Considered A&Ms		Used A&Ms	
	A	K	A	K	A	K	A	K	A	K	A	K	A	K
77	---	---	---	---	---	---	---	---	---	---	0.008	0.006	---	---
79	---	---	---	---	---	---	---	---	---	---	0.000	0.000	---	---
81	---	---	---	---	---	---	---	---	---	---	---	---	0.001	0.003
83	---	---	---	---	---	---	---	---	---	---	0.018	0.013	---	---

Table 6-29: Cross-Tabulation of the Motives and Barriers by Different Levels of Categorisation Variables.

- (a) Cross-Tabulation of Restricted Obligation of Commercial Register (V77) by Considered A&Ms Before (V141).

	Yes	No	All
1	4	8	12
2	17	30	47
3	8	41	49
4	1	10	11
5	0	4	4
All	30	93	123

- (b) Cross-Tabulation of Restricted Obligation of Regulation for Co. (V79) by Considered A&Ms Before (V141).

	Yes	No	All
1	4	4	8
2	18	28	46
3	7	45	52
4	1	3	14
5	0	3	3
All	30	93	123

(c) Cross-Tabulation of Government Provides Benefits (V83) by Considered A&Ms Before (V141).

	<b>Yes</b>	<b>No</b>	<b>All</b>
1	5	11	16
2	14	23	37
3	10	46	56
4	1	11	12
5	0	2	2
ALL	30	93	123

(d) Cross-Tabulation of Restricted Obligation of Zakat and Income Tax (V81) by Used A&Ms Before (V142).

	<b>Yes</b>	<b>No</b>	<b>All</b>
1	2	1	3
2	3	10	13
3	5	8	13
4	1	0	1
5	0	0	0
All	11	19	30

It should be noted that these findings may add strength to the equivalence reliability of the test since these results are consistent with the previous findings of A&Ms' barriers. Other reasons suggested for not adopting the A&Ms as planned include the following; discouraging economical studies, disagreement on the management style and work practise that should be used after the A&Ms take place, and the non-preference or acceptance to the idea behind the A&Ms.

#### **6.2.6.6 Suggestions Related to A&Ms**

##### **1: Supported Suggestions**

With regard to the respondents' agreement or disagreement with the suggestions tested in this study, several suggestions were supported while some others were rejected (Table 6-30). The respondents disagree that the government should keep the current situation as it is (V127) (mean = 2.2984). They agree that some things should be done with regard to encouraging the A&Ms between firms' in S.A. (V115) (mean = 3.9516) and to encourage firms of GCC countries to acquire or to merge with firms in the country (V116) (mean = 3.6290). They accept the proposition that the acquisition of distressed firms should be encouraged (V120) ( $p$ -value < 0.05). They, however, do not agree on

encouraging foreign firms to enter into the kingdom through these activities (V117) (p-value > 0.05).

It should be noted that less educated respondents and respondents older than 60 years were significantly less supportive to the suggestion of encouraging of A&Ms compared to the other respondents, and that those who considered A&Ms before were significantly more supportive to the suggestion of encouraging the A&Ms of distressed firms (Table 6-31 and Table 6-32).

Results also suggest that the Chambers of Commerce and Industries, can have an effective role in encouraging A&Ms by performing several tasks, such as identifying potential sellers and buyers and get them in contact with each other (V128), providing training programmes (V129), preparing a guideline to explain A&Ms' procedures and regulations (V130), and by arranging public conferences to increase business-men's awareness of A&Ms activity (V131).

Table 6-30: Summary Statistics, T-tests, Wilcoxon statistics and % of those that Agreed and Strongly Agreed with the Study Suggestions.

	MEAN	STDEV	T	P VALUE	MEDIAN	WILCOXON Statistic	P-VALUE	A&SA (%)
V115	3.9516	0.8050	13.16	0.0000	4.0000	5494.5	0.000	81.45
V116	3.6290	0.8503	08.24	0.0000	4.0000	3771.5	0.000	63.70
V117	2.9758	1.1295	-00.24	0.5900	3.0000	2051.0	0.567	34.67
V118	3.1613	1.0924	01.64	0.0510	3.0000	2723.0	0.075	46.77
V120	3.3871	1.0098	04.27	0.0000	4.0000	3330.0	0.000	54.83
V121	4.0645	0.6954	17.05	0.0000	4.0000	6228.5	0.000	87.09
V122	4.1774	0.5710	22.96	0.0000	4.0000	6743.5	0.000	92.74
V123	4.2097	0.6536	20.61	0.0000	4.0000	6480.0	0.000	90.32
V124	3.6048	1.1030	06.11	0.0000	4.0000	4149.0	0.000	62.09
V126	3.1613	1.0849	01.66	0.0500	3.0000	2634.5	0.065	44.35
V127	2.2984	0.8647	-09.04	1.0000	2.0000	0354.0	1.000	04.83
V128	4.0968	0.7260	16.82	0.0000	4.0000	6421.0	0.000	87.90
V129	4.2097	0.6018	22.38	0.0000	4.0000	6630.5	0.000	91.93
V130	4.3468	0.5417	27.69	0.0000	4.0000	7260.0	0.000	96.77
V131	4.2581	0.6359	22.03	0.0000	4.0000	7121.0	0.000	95.16

Some of the suggestions encouraging A&Ms which gained support in this research include the ease of regulations for firms wishing to go public (V121), protecting firms from any unknown liabilities on acquired firms (V122) (respondents of

partnership's firms are significantly more supportive to this suggestion than the others), encouraging banks to have more effective roles to facilitate A&Ms activity (V123), and exempting acquiring firms from paying the Zakat or tax that accumulated during the period before A&M takes place (V124).

Several respondents also suggested that establishing specialised centres that can provide detailed information about the market and competitors, and creating communication channels between firms, are important factors that can help the private sector and the A&Ms' activity.

## 2: Unsupported Suggestions

Encouraging firms by allowing them to merge or acquire other firms, regardless of their sizes (V119) ( $p$ -value > 0.05) and paying some or all the debts for the acquired firms (V126) were not accepted as methods to encourage A&Ms ( $p$ -value > 0.05).

Table 6-31: P-Value for ANOVA and Kruskal-Wallis Tests of Whether the Study Suggestions Vary According to the Different Level of the Categorisation Variables.

V	Form		Ownership		Sector		Education		Age		Considered A&Ms		Used A&Ms	
	A	K	A	K	A	K	A	K	A	K	A	K	A	K
115	--		--		--		0.007	0.030	0.020	0.055	--		--	
120	--		--		--		--	--	--	--	0.016	0.032	--	

Table 6-32: Cross-Tabulation of the Study Suggestions by Different Levels of Categorisation Variables.

(a) Cross-Tabulation of A&Ms should be Encouraged between S.A. Firms (V115) by Level of Education (V139).

Less than undergraduate		Bachelor degree	Post graduate	All
1	1	1	0	2
2	1	3	1	5
3	2	11	3	16
4	4	44	24	72
5	0	17	9	26
All	8	76	37	121

(b) Cross-Tabulation of A&Ms should be Encouraged between S.A. Firms (V115) by Age Category (V140).

	$<\text{or}= 40$	$> 40 \text{ and } <\text{or}= 50$	$> 50 \text{ and } <\text{or}= 60$	$> 60$	All
1	2	0	0	0	2
2	2	2	0	1	5
3	11	2	2	1	16
4	24	34	15	0	73
5	12	10	4	0	26
All	51	48	21	2	122

(c) Cross-Tabulation of Encouraging A&Ms of Distressed Firms (V120) by Considered A&Ms Before (V141).

	Yes	No	All
1	0	4	4
2	1	23	24
3	10	18	28
4	14	41	55
5	5	7	12
ALL	30	93	123

### **6.3 Results of the Qualitative Study**

Seven respondents who had experience with A&Ms, agreed to meet the researcher to discuss some of the study's issues in more detail. One point should be noted here. Although the interviewees were co-operative and helpful, they were reserved in giving any detailed information about the A&Ms that their firms experienced. They also mentioned that they preferred to keep their names and their firms' names confidential. This conservatism is understood, given the sensitivity of the A&Ms activity and the attitude of businessmen in S.A. towards giving detailed information. The result of this situation is that the interviews conducted do not constitute case studies. However, the information obtained will provide a better understanding of the A&Ms' reasons and effects. A summary of the finding is depicted in Exhibit 6-1.

#### **6.3.1 First Interview**

The first interview was with the general manager of a company that is a leading system integrator and distributor of networking technologies. The company has over 500 major installations and 30 dealers distributed throughout the Kingdom. It functions in the import and trade of computers, software, network technologies installation and maintenance of computers. It is located in Riyadh, and its sales were about SR 70 million in 1993.

This firm bought another firm in 1992 which used to work in the buyer's same business; that is in selling and service of computers. According to the interviewee, his company used the acquisition for financial reasons. The purchased firm was offered at a low price because of marketing problems which led to a reduction in sales. Moreover, he believes that there was a high potential for the achievement of synergy since the two firms work in the same business and each one of them has specific strengths which can be utilised more effectively. He mentioned that his firm has strong distribution channels and is capable of marketing expertise as well as cash. Added to which the firm has a good reputation in the computer business. while the purchased firm has strong creative

abilities. It had dedicated its activities to the introduction of various systems that were tailored to suit the Saudi market; such as customer training for example.

Exhibit 6-1: Main Characteristics of the A&Ms Experienced by the Interviewees.

Interview no.	1	2	3	4	5	6	7
<b>Study variable</b>							
Type of industry	Trading	Banking	Services	Services	Agriculture	Manufacture	Manufacture
Acquisition or merger	A	M	A	M	A	M	M
Causes:							
Synergy	+	+	+	+			+
Assets stripping	+						
Government request		+					
Avoiding distressed position			+				
Minimise competition				+			
Time					+		
Effects:							
Profit	+			+			
Competitive ability	+			+			
Employees layoff							+
Factors of success:							
Relatedness	+	+	+	+	+	+	+
Positive employees' reaction	+			+			
No pressure from outside party	+						+
Integrating the firms		+					+
Closeness in size				+		+	+
Closeness in profitability				+			+
Management commitment				+			
Mechanism:							
Personal	+		+				
No outside parties involved	+					+	
Newspaper							
Motives:							
Severe competition	+		+	+	+		
Firms with good deal	+						
No legal barriers	+						
Barriers:							
No list of firms.	+				+		+
No effective facilitators	+		+			+	+
Psychological & social factors	+			+			
No stock market	+						
Difficulty to change to stock co.	+						
No agreement on price	+		+				+
Potential conflict between Mgt.				+			+
Weak implementation of laws					+		
Remarks:							
Autonomy	+						
Management changed	+						
No monopoly effect	+		+	+	+		+
A. or M. is under process		+		+			+
Deal was not reached			+			+	

The interviewee explained the decision-making process for the acquisition as follows; a friend of the purchased firm's owner approached the acquirer and told him about the other party's willingness to be acquired. This matter was then discussed with the management who were not only able to get the required information concerning the acquired firm but who also had a sound knowledge in the computer industry. The acquisition decision was carried entirely within the companies. Accountants, lawyers and management belonged only to the relevant firms. The acquirer did not face any obstacles which would hinder the deal. The proposed price was accepted and the acquirer had the money to pay without the need to go to banks.

The interviewee claimed that the acquired firm is now more successful than before. He thought that the success of the acquisition decision could be contributed to the ability of the acquiring firm to understand the strengths and weaknesses of the acquired firm as well as the nature of the computer industry. Although the company was given its autonomy, the name of the acquired firm and its top management were changed. He also stated that the acquired firm's employees welcomed the acquisition because they felt that they would be more able to get their ideas into reality (due to the strength of the acquirer).

In response to the researcher's question that acquisition might lead to a monopoly, the interviewee claimed that his firm's acquisition would not cause a monopoly since the market is open and there are many competitors. The interviewee suggested that based on his experience of acquisition, the most important barriers with regard to A&Ms, are the non-existence of effective mechanisms that facilitate the A&M's activities as well as psychological reasons. Names of firms willing to sell or to buy, as well as firms that want to merge are not available. The firm's owner who is willing to sell or to merge has to approach the potential firm directly. Moreover, some owners do not like these alternatives because they are emotionally attached to their firms which they built.

The interviewee expects that more firms, specifically those that were established in the 1970s, may be offered for sale since their owners become old resulting in

retirement or death, and their inheritors may then not be willing or able to run these firms.

Finally, he mentioned that there is no legal barrier to A&Ms. The procedures and requirements are clear and unrestricted. He also claimed that some banks and consulting offices take a middle-man role to facilitate the A&Ms, especially in deals that cost higher than SR. 20 million in order to make good commissions.

### **6.3.2 Second Interview**

The owner and manager of an enterprise that made a sale of SR. 4,600 million in 1993 was the second interviewee. Its core business is banking, investment and money changing. From the time of its inception, this financial institution has made sustainable progress and set up branches all over the Kingdom (more than 80) as well as abroad.

The interviewee thinks that the current time is suitable for A&Ms in S.A. He believes that firms in S.A. are small. They compete with each other severely. Moreover, competing with foreign products in the local market or abroad requires strengths which are usually associated with large firms.

Recently, a deal was signed between the interviewee's establishment and several other financial institutions, mainly money exchangers, which consolidated all of them in one company. That decision was made in line with the government's request as one condition for changing the interviewee's firm from a limited liability establishment to a joint stock company.

His answer to the question as to whether he thinks that A&Ms may lead to negative results was; "Like any other decision, A&Ms may be good or bad. Achieving the expected results depends on the management." He said with regard to the advantages he expected from the merger of his company that, the new company will be able to provide better services within the market place and therefore, it will compete more effectively with rival businesses. There was some concern however, that the once informal relationship between the merged firms and their customers may be affected.

The non-existence of a stock market in the Kingdom was considered by him as the main obstacle to A&Ms activity, as well as to the poor performance of several firms. He believes that a stock market will provide many benefits to firms and it will contribute to a stronger private sector. In his opinion, the non-existence of a stock market and the difficulty of changing firms to joint stock companies, based on his opinion, is "a mistake." When asked specifically about the problems he faced with regard to his firm's merger, he stated that the estimation of the assets belonging to each company and the hesitancy of some owners towards the concept of merger were the major obstacles.

He mentioned that a plan was made to integrate all the participated firms in the merger, which would result in the standardisation of policy and procedures and a building of new organisational structure. With exception to few cases, the majority of the employees will be kept after the merger because they will be needed to fill up positions in the new branches the company is planning to open. He also stated that specific training schemes will provided for the employees.

His final comment is that A&Ms should be encouraged with all firms regardless of their nationalities, in order to pull foreign capital and knowledge.

### **6.3.3 Third Interview**

The third interview was held with the owner and manager of a company that represents the situation of many firms in the Kingdom, especially those that are agents to foreign companies and/ or those whose sales are affected by government spending. The interviewee was the owner of a well known firm in the travel agency. It has progressed well and established branches in some major cities and acts as a general agent for many airlines. Its total sales were SR. 125 million at the end of 1993. However, its sales have dropped dramatically and it concurred a loss of about SR. 300,000 during the first quarter of 1994.

According to the interviewee, the deteriorated financial position is a consequence of the destructive competition between firms in this sector. The number of travel agencies has increased from 800 in 1990 to about 3200 in 1994. This large number of small firms

has caused two consequences, one is that they, as agents of airlines' companies, become weak and unable to bargain with the airlines' companies on some important issues, such as the commission rate and payment term. Depending on the relative power of the agents, the commission can usually be any rate between 9% and 15%. Also, the agents that are large and powerful can postpone the payment of the issued tickets to the airlines' companies from the normal period (15 days) to a longer period of time. In his opinion, this issue is very important, since most firms' major shares come from sales to companies that have a huge number of foreign employees and which usually do business with the government sector. And because of the declining ability of the government to pay for these companies on time, the travel agents, in order to make business, have to wait a longer period of time before they can get the value of the tickets they sold to these companies. Being a strong agent may give them a bargaining power to extend the payment required time from 15 days to a longer date.

The second outcome resulting from the weak position of the agents in relation to the airline companies is that some of the airline companies started to go directly to main customers and offer them tickets that cost less than if they bought them from the travel agents, which also increased their own profit margin.

For all of these reasons, the interviewee mentioned that he had decided to sell his firm. Due to the lack of dependable, trustworthy dealers that can facilitate his plan to sell with confidentiality (which is needed to protect the company's image in front of banks, airlines' companies and his employees) he approached two firms that work in the same business and he expressed his intention to sell his firm or to merge with them. Although one of the two companies wanted to buy, the deal was not accomplished because, according to him, the absence of qualified pricers made the two parties disagree on the firm's value. Only SR. 14 million was offered to him while he wanted to get SR. 20 million. The interviewee stressed that although he preferred to sell the firm rather than accepting such a deteriorated position, he felt that the SR. 14 million was significantly lower than he expected.

The interviewee ended his comments and thoughts by stressing again the severely destructive competition among travel agencies, and suggested that there should be a reshaping of a market's structure. He also suggested establishing a joint stock company that will consist of the travel agencies who agree to participate in this company, as well as the general public.

Having one or few large companies, based on his expectation, will not hurt the customers. On the contrary, better services as well as lower costs are expected to be provided. He also does not expect such a restructuring of the market to lead to a monopoly since the prices of tickets are fixed and the government, represented by the Civil Aviation Authority, can involve itself at any time to stop unjustifiable action. Moreover, he thinks that such large companies will be in a better position to recruit and train a Saudi Arabian labour force.

#### **6.3.4 Fourth Interview**

Ending the year of 1993, this firm made SR. 112 million worth of sales. In addition to several activities, its main function is in the catering services. The focus of its business transactions was with government organisations. This firm faced two problems which caused its sales to drop to about 12% in 1993 compared to 1992. The first problem is that its sales depend heavily on a government spending and the budget. The second problem is the increased level of competition. "Of course, there is no doubt the government projects and bidding has declined after the Gulf War" he said. In addition, he explained the effect of the severe competition as follows; when the government organisations announce in the newspapers about some projects and they ask firms interested to submit their bids, many firms will fight to win the bidding. This kind of competition is usually destructive since it is based on price factor only. This led many firms to accept very low profits and some firms to get into problems in completing the bidding requirements. Employees whose salaries are low, are usually recruited. These employees, of course, are not as qualified as other specialised employees who usually ask for higher salaries. Another outcome of such a situation, is that firms which do not

win the project have to fire their employees whom they do not now need and whom they had originally recruited from winning a previous project. This instability and uncertainty is a common problem for many firms that do business for the public sector. According to the interviewee, this instability has negative impacts on productivity.

For these reasons, this firm has consolidated with its next lower competitor. The interviewee said that the merger was successful and it achieved its objective, particularly the stability of labour. With regards to success, the researcher asked the interviewee about which factors made his firms' merger successful. He answered that the common characteristics between the two merging firms explain the success. The two firms are in the same business and the way they do business is quite similar. Moreover, he believes that the employees' stability and the close control and attention of the owners are important factors explaining the success of his firm's merger.

In the catering sector, the monopoly was not expected by the interviewee since he claimed that there are many firms functioning in this sector. Also, he thinks that the major barrier to A&Ms in S.A. is a social one which relates to the name and image of the firm after its sold. Factors related to who manages the company and the potential conflict in making decisions among the management after the acquisition takes place, are potential barriers to A&Ms. Also, he mentioned the insufficient awareness management have of the importance of large firms, which are capable of doing business more effectively and efficiently is a possible barrier to A&Ms. Finally, he suggested that the Chambers of Commerce and Industries should play a middle-man role to facilitate A&Ms between firms since they are able to do so either free of charge or at a low cost compared with banks and other dealers, their sources of information are greater, and they have a stronger credibility.

#### **6.3.5 Fifth Interview**

The general manager of a joint stock company that engaged in agriculture through processing and marketing was the fifth interviewee. His company's sales reached about SR. 277 million for the year of 1993. His experience with acquisition is through the

buying of another firm working in the cool storage industry. The reason for this acquisition was time. The company needed to have the storage facility fast. He followed a procedure whereby he announced his firm's willingness for acquisition in the newspapers to encourage interested sellers to approach him. He mentioned that various bidders suggested different proposals and their willingness to sell precipitated a good deal.

He stressed that the current time is suitable for A&Ms' activities for several reasons. One is that the government subsidies were cut or declined. Secondly, he drew attention to the severe competition which was creating difficulties in managing firms, especially in marketing fields. The large number of family businesses which their owners' sons do not want to continue working on after the creators retired or die, were also discussed, as was the existence of several firms with weak financial positions.

He perceived that the main barriers to A&Ms are the lack of experience, lack of information, non existence of reliable sources of information which can be trusted, non existence of effective dealers that facilitate such important activities, and the inavailability of effective accounting and legal offices. Finally, he claimed that the non existence of a legal system that protects all parties is also another important barrier. He wanted to focus the attention upon the last barrier which is not only applicable to A&Ms but to any business transaction with others. Many people could play around. This made dealing with others insecure and the relationship is built on mistrust.

The awareness that the government is able at any time to take action to stop firms from using their market power to hurt the customers or other parties is a potential factor for the non expectation of a monopoly occurrence after A&Ms. Moreover, he believes that one of the advantages of A&Ms is fixing the unsuitable market structure, since firms are many and small, and competing in an ineffective manner.

Finally, he mentioned that acquiring the storage firm was not the only time his company thought of A&Ms. He proposed to buy a company that worked in the same areas his company is functioning in, which is located in Dubai, but the government of Dubai refused the proposal.

### **6.3.6 Sixth Interview**

All the previous interviews were about firms that work in the non-industrial sector. This interview and the next one are about firms in the industrial sector which is very important in S.A. because the government is putting a high expectation on them to achieve some of its national development plans.

This interview concerns a manufacturer and distributor of wheat based pastry products, meat products, and several other frozen foods. It utilises modern techniques and automated production methods. It has made steady progress. It achieved SR. 93,5 million worth of sales for the year of 1993.

The interviewee is the management director and he is one of the three owners. He experienced a trial to merge his company with a foreign company, but the deal was not reached due to disagreement on the assets' value. His company's reason for the merger was to develop and improve its products, whilst the foreign company wanted to enter the Saudi Arabian's market.

He believes that A&Ms in the industrial sector will lead to bigger companies, who will be able to improve the quality of their products due to the effectiveness of research and development activities, and the lower cost in production and marketing. However, he thinks that, in rare cases, A&Ms may lead to a monopoly and therefore, the government has to take a role to stop any unfavourable behaviour, or to stop the A&M before it is made.

### **6.3.7 Seventh Interview**

This final interview was conducted with the general manager of the finance and administration of a company that is a joint venture equally shared by two large companies in S.A. Its total sales during the 1993 year was about SR. 315 million. This company was merged with one of the two companies that established it. Both of them produce the same products and they are the only producers of these products in S.A. The merger's decision was carried out by the board of directors of both companies, who were significantly major owners of both firms.

The causes for the merger, as were expressed in the plan, are to lower costs (about 30-40% of the labour costs in the purchasing and financial departments and the managerial costs), benefiting from the complementary strengths, increasing the productivity while maintaining the high products' quality. He stated that the labour costs will be reduced due to the number of employees who will be laid off after the merger of the two companies. This will not however, affect the salaries of the remaining employees, which will continue at the existing level. Moreover, in his opinion the merger is expected to lead to a more effective research and development activity as well as to reduce its cost. In response to the question as to whether the merger may lead to a monopoly, the interviewee claimed that his company merger will not lead to a monopolistic practice because 70% of the other company's owner is the government.

The interviewee mentioned that each company stayed working in its own location (about 70 km apart). However, some changes were done which included the standardisation of policies and procedures between the two companies, and the resources and capacities of managerial and labours as well as experience and knowledge were organised between the two companies in a way that optimises the overall results. Because the merger process was in its early stages, the interviewee mentioned that the merger's effects on the firm's performance could not be judged yet.

The interviewee also mentioned two points which might prove to be problematic after the merger has taken place. Firstly, the high costs in transportation between the two companies and secondly, the change in the management style might create a feeling of negativity within the workforce. To overcome any difficulty created by the second problems, the management and the employees will undergo a training programme to minimise impact of changes.

Finally, he believes that the current period is suitable for A&Ms since there are many firms with excess production capacity that are not utilised. The mergers could improve products and then be able to utilise these unused capacities.

### **6.3.8 Concluding Remarks**

The interviews which were conducted provide a comprehensive base of information on acquisition and merger. This is due to the fact that those firms approached for the interviews encompass a cross section of relevant areas; including firms which are both joint stock and private, buyers, seller and merger's partners, and firms from wide variety of businesses.

The results of the qualitative study are found to be consistent with those of the quantitative study, which in turn adds strength to the validity of the research and reliability of its results. Exhibit 6-1 shows that there are differences between the causes for acquisitions and mergers. Acquisitions are largely dependant on the willingness of the seller to avoid bankruptcy or a distressed financial condition. This contributes to why firms are offered at significantly lower prices. The availability of firms that are offered at nominal prices, attracts buyers who want to benefit from these financial favourable opportunities. On the other hand, mergers result from a firm's desire to achieve the synergy and lower the competition.

Moreover, results of the qualitative study show that firms adopted acquisitions and mergers have experienced increased ability to compete and improvement in their profitability as a result of the A&Ms. With regard to the factors that contribute to an explanation of A&M's success, Exhibit 6-1 suggests that relatedness is a major factor for the success of A&Ms. It should be recognised that those firms who desire synergy, look for relatedness in term of complementary resources. This perception is different from that of firms using A&Ms to minimise the competition. It seems that these firms have the same strengths.

Another significant factor affecting the A&M's success (which the qualitative study suggests) is the positive reaction from the employees of the firms concerned. The A&Ms are expected to lead to better opportunities for the employees. This may contribute to explain the employees' positive reaction to A&Ms. In addition, the results suggest that successful mergers usually occur between firms of similar size and profitability. These two factors may not be required in the cases of acquisitions to be successful.

Regarding motives and barriers to A&Ms, exhibit 6-1 shows that the most important motivational factor is the severe competition between firms. With regard to the barriers, there are three significant factors. One barrier, is the non-existence of an effective mechanism; no list of firms' names willing to merge exists and the non-existence of effective accountants, brokers and pricers who can facilitate the A&M's activity. Psychological barriers exist where the owners of companies concerned are attached to their firms and finally, there is a potential for problem in decision making and dividing authority between the management after the A&Ms have occurred. It is both the psychological and managerial problems that are attached specifically to mergers, rather than acquisitions. This may be explained by the fact that owners of firms in mergers, have not experienced enough pressure which will induce them to merge with other firms. Decision making problems arise because the management of firms is expected to stay after the merger has occurred and this precipitate conflict.

Finally, the qualitative study suggests that A&Ms will not lead to a monopoly because the competition is too severe and the potential of a governmental intervention to prevent this effect from occurring.

## ***Chapter Seven***

### ***The Discussion***

#### **7.1 Introduction**

Two areas of discussion will be presented in this chapter. First, the reasons for and effects of A&Ms in S.A. The significance of the study can be recognised by its contributions to the existing literature as well as its implications which several parties can benefit from in the future. The contribution of the research results on the existing literature is the focus of the second part of this chapter.

#### **7.2 Reasons for and Effects of A&Ms**

Although this research strongly suggests that business-men expect A&Ms in S.A. to have positive effects on the merging firms as well as on acquiring and acquired firms, these good results can not be granted in each A&M. There must be specific conditions that work together to contribute to such success. Also, the study claims that the side effects of A&Ms, which have impacts on the economic welfare are expected to be favourable and, with the same logic, there are certain contexts where their existence or not has major impacts on the economic prosperity. These conditions and contexts will be discussed in this section.

##### **7.2.1 Reasons for A&Ms**

Most observers agree that A&Ms are driven by a complex pattern of causes, and that no single approach can provide a full account, however, ordering the A&Ms' causes according to their plausibility and their relevant importance was attempted in this study.

Although there are three main causes behind the transfer of corporate assets within industry in the Anglo-Saxon nations and some developed countries; managerial,

disciplinary and economic, in S.A. the management believes that the only cause behind A&Ms, among these three groups, is the economical causes.

#### **7.2.1.1 The Managerial Causes**

The managerial causes suggest that the managers, in order to maximise the size of assets under their control, may proceed with A&Ms knowing full well that they represent negative net present value investments. This desire for empire building may be attributed to the positive relationship between managerial remuneration and organisational size, or the entrenching strategy to protect one's job.

The plausibility of this theory depends on the existence of a separation between ownership and control and the dispersed nature of share holdings. Since the majority of firms in S.A are family enterprises which are managed by the same owners or the management is under close control by the owners, the possibility that A&Ms will be used for managerial reasons is very low. Even for joint stock companies, the management may not be able to deviate from the owners' benefits due to the concentrated ownership among a few individuals and the state.

These results, of course, contradict the empire-building theory, which enjoys popularity in the business press and the support of related evidence from work concerned with merger consequences. You et al. (1986) found that management share ownership and the number of inside directors were negatively associated with merger results. Amihud and Lev (1981) found management control to be associated with engagement in conglomerate mergers. Both results support the empire-building theory.

#### **7.2.1.2 The Disciplinary Causes**

The disciplinary cause is mainly associated with the buyer's belief that the performance of target firms can be improved by replacing inefficient managers. Managers may be inefficient because their abilities are inferior to those of potential alternative management teams and/ or the separation of ownership and control and the dispersed

nature of share holdings may allow them to behave in opposition to their owners' expenses.

There is no doubt that many firms in S.A. are inefficiently managed. This can be indicated by the high consensus among the respondents that looking for better management is a major cause behind A&Ms. However, the implausibility of the managerial cause means that it is only the first case that explains the inefficiency of management, that is inferior abilities.

In addition to the managerial cause, the disciplinary cause can not explain the A&Ms in S.A. The disciplinary cause is usually associated with take-overs and these are very rare in S.A. The fact that the majority of firms are owned by one or few individuals means that their firms cannot be acquired without their full agreement. Even in the few joint-stock companies, the management for corporate control cause is not possible given the concentrated ownership. There has been no visible evidence for take-overs other than the acquisition of Alwaleed Bin Talal's of the majority holding of Albank Almotahed and Almawashy company.

#### **7.2.1.3 Economic Causes**

This leaves the economical cause; that is maximising owners' wealth as the only possible logical explanation for the A&Ms in the Kingdom of S.A. The literature suggests several theories among this major group. Those theories can be distinguished according to the postulated source of merger gains. These are either net gains through synergies or wealth transfer from target's shareholders or from customers. Further possible sources of wealth transfers are employees and the state.

##### **1: The State as a Source of Gain**

In the case of A&Ms in S.A., wealth transfers from the state cannot be accepted. The government does not provide any benefits to merging firms, such as tax exemption. This is different to the A&Ms in some developed nations where wealth transfers through tax savings are prominent in many mergers.

This research suggests that A&Ms in S.A. are used to achieve gains from the other sources, however their relative importance is different and these seem to depend on the type of business combination, either merger or acquisition. In the case of mergers, aiming to gain from the synergy, customers, and employees is the expected cause perceived by the management behind the mergers, while in cases of acquisitions, it is the prospect of gaining from the wealth transfer from the acquirees which can then be added to the other sources.

## **2: Sources of Gains in the Mergers Activity**

Mergers in S.A. usually occur between firms in related businesses. This gives rise to a high potential of improving merging firms' efficiency and effectiveness. The most important source of such a gain comes from synergies due to the complementary of resources. Several types of synergies can be distinguished. One is managerial synergies which are realised when managers possess superior planning and monitoring abilities that benefit the merging firms' performance. Operational synergies represents the second type which can stem from combining operations of separate units or from knowledge transfer. Both kinds of operational synergies may lower the cost of the involved business units or may enable the company to offer unique products and services. Synergies in marketing is a third type which leads to better marketing effectiveness and/ or efficiency. Finally, financial synergies result in lower costs of capital through increasing its size, which gives it access to cheaper capital. Thus firms in S.A. engage in merger activities to exploit internal synergies.

Regarding wealth transfer from employees, there is a possibility of this happening, but this can be achieved only through laying off the unneeded employees. Gaining wealth from reducing the employees' salaries is not expected and this might be explained by the low salaries of many employees, whom are recruited from poor countries, which can not be reduced any further. Although some other employees' salaries are high, they, also, are not expected to be reduced. These employees are usually

well trained and a reduction in their salaries will jeopardise their continuity in working with the firms.

In contrast to internal synergy gains, collusive (external) synergies, arising from the increased power of the combined organisation, are allegedly responsible for transferring wealth from customers to the organisation, even though no claims that a merger is made to achieve monopoly power was found in this study. This should not be surprising, however (management is not expected to say that A&Ms were used for monopoly purposes). One of the research findings is that managers think that mergers will be used to minimise the competition and therefore it has the potential of achieving a market power which may allow a firm to make an illusive value through the transfer of wealth from the customers rather than a real value through synergies. It should be noted, though, that such a value cannot explain more than a small fraction of the gain achieved. Two justifications can support such a claim. Firstly, the government, through its different agencies and bodies can involve and stop any unaccepted behaviour that may have negative impacts on customers. Another possible reason is that the number of competitors, either native or foreign competitors are large, which makes reaching a monopoly position after mergers unattainable.

In summary, mergers are expected by management to be used to create value through synergies achieved between merging firms, and although gains may be achieved through the transfer of wealth from the customers, due to a higher market power of the firms after the mergers, these gains will not be as high as the others and, therefore managers do not give much consideration when making the mergers' decisions.

These results are hardly surprising. At the macro-level, the economic conditions have deteriorated. At the firm level, many firms may consider mergers (consolidations) to defend against the severe competition, both local and foreign.

### **3: Sources of Gains in the Acquisition Activity (Acquirer Causes)**

In addition to the previous sources of gains, an acquirers' willingness to get benefits from the undervalued market price of target firms, as well as motivating sales'

terms is the most important cause behind the acquisition activity in S.A. There is no doubt that such a gain comes from the acquired firms' owners.

Another important cause which explains an acquisition is diversifying into unrelated businesses to minimise risk. Although this cause may be focused to achieve financial synergies (lower costs of capital through lowering the risk of company's investment portfolio by investing in unrelated businesses), having a combination of businesses with different levels of profitability and risk is more important than achieving financial synergies.

It should be noted that, these causes are not necessarily mutually exclusive. But their relative importance is different, with asset stripping representing the most important cause behind the acquisition in S.A.

#### **4: Acquired Firms' Causes**

The causes mentioned earlier cannot explain the acquirees' objectives to sell their firms. Perceiving acquisitions as an alternative root to avoid the deterioration of the owner's wealth in a particular firm if the firm is kept rather than sold is the cause for the sellers. This situation may occur when management recognises (or expects) that their firms cannot compete successfully, and that selling them will be better to avoid bankruptcy.

Another cause for selling is that some individuals may decide to sell the firms they inherit because they either cannot or do not want to continue running them. It should be noted that this group of firms are presumably more competitive and successful than the group that sell to avoid bankruptcies or to improve the distressed position, and therefore they should be offered at higher prices. However, the non-existence of effective mechanisms which can get all interested buyers to bid on the firms offered for sale means that their prices will be less than their real values.

This context is different than what happens in the Anglo-American nations since general evidence suggests that targets' shareholders' gains from acquisitions. Moynihan

(1994) claims that the premium paid is rarely lower than 20%, on average, it is perhaps 30% to 50% beyond the intrinsic value of the acquired company.

So far, three main causes behind the transfers of corporate assets within industry, managerial, disciplinary and economic were discussed. Only the economical group of causes were supported as causes behind A&Ms in S.A. Another group of reasons which were tested in this study is related to the process of making a strategic decision. This group of reasons is called in the literature, the process theory (Trautwein, 1990).

#### **7.2.1.4 The Process Theory**

This theory has its background in the literature of the strategic decisions process. This research field has produced a vast amount of models that describe strategic decisions not as comprehensively rational choices but as outcomes of processes governed by several influences. Before discussing the reasons that affect management's decisions either to use A&Ms or not from a strategic management point of view, a brief discussion of the process of formulating strategies (regardless if they are A&Ms or not) as well as their implementation, which will be needed in discussing other issues later in this chapter, is presented in Appendix 7-1. This discussion will be used to determine the influencing factors on the A&M's decisions. It should be noted that these factors were called in this study motives and barriers.

Although this research claims that A&Ms are expected to be profitable decisions (factors that explain the success of A&Ms will be discussed later), there is no doubt that they are not preferred by management and, therefore, their rates are low. The context of A&Ms in S.A. provides several factors that encourage the management to choose A&Ms to achieve their firms' objectives. These factors include the ability of managers to manage large firms, the existence of firms with excess capacity and resources which can not be utilised internally, severe competition, the existence of firms that can provide strategic benefits, availability of buyers/ sellers and partners in mergers with good deals, legal obligations are flexible and financial requirements to finance the A&Ms are available either from within the firms or from banks, which provide loans with low interest rates.

So, it is clear that if management thinks rationally, they will go for A&Ms strategies. But, as the process theory suggests, several irrational factors are involved which may make management take other decisions. It should be noted that some rational factors are also involved in building the unfavourable attitude toward A&Ms in S.A. such as the non-existence of laws that protect acquiring firms from unknown liabilities on the acquired firms and regulations that explain how the consolidated firms will be assorted.

Regarding the irrational factors, this study suggests three types of factors. First, factors related to the decision-makers attitudes towards A&Ms. Several factors indicate that these attitudes are negative, which include the decision-makers' avoidance of A&Ms because they do not like others to share their authority with them and they desire independence of name and image. It is clear that these barriers are emotional.

Related to the previous group is the political power category which affects strategic decisions. This study suggests that management in S.A. is not separated from ownership and, therefore, they do not have enough control and power to choose A&Ms which, as mentioned earlier is not preferred by the owners. Political power may be different not only between individuals within an organisation, but between the organisation and outsiders. There is no doubt that the private sector's enterprises have less political power than the governmental bodies. So, as explained earlier, taking A&Ms' decisions to have a monopoly position and then to behave in opposition to the customers or the government interests is not expected.

Finally, lack of full information represents the third reason which may make managers unable to evaluate rationally all strategies, and therefore they may not consider A&Ms. There is, almost a consensus among the study's respondents that investment bankers and acquisition's brokers which facilitate A&Ms' activity, firms names which are willing to sell/ buy or to merge and financial and other information about them are not available. These reasons explain why about 60% of the respondents think that one barrier to A&Ms in S.A. is the failure of management to see or gain advantage of A&Ms' opportunities.

It should be noted that although the literature suggests that the multiplicity of participants and their limited rationality prevent a comprehensively rational solution of problems (Trautwein, 1990, Haspeslagh and Jemison, 1991), this factor is not relevant in S.A. The A&Ms are simple and carried out among few individuals within the merging firms. More discussion about some other barriers is presented next.

### **7.2.2 Effects of A&Ms**

This study examined the potential effects of A&Ms on the profitability and competitive abilities of firms after they use A&Ms as well as the effects on the economic welfare. The first type of effect and the factors contributing to such an effect will be discussed next.

#### **7.2.2.1 Effects on Competitive Capabilities and the Profitability**

One of this research findings is that A&Ms in S.A. are expected to improve merging firms' abilities to compete and to improve their profitability. Since the effects relate to the causes, the better competitive position will be the outcome of improved effectiveness and efficiency due to synergies. These outcomes are attached more to mergers. While for the acquisitions' cases, the wealth transferred from the acquiree's owners, because of the under market value of the acquired firms, explains the profitability of the acquiring firms. This is a major source for gains which can be added to the gains achieved from synergies, specifically the utilisation of the managerial and financial strengths of the acquiring firms to improve the acquired firms' conditions.

#### **7.2.2.2 Factors of Success**

A reasonable step in A&Ms activity is to determine whether there are particular characteristics of A&Ms which are systematically linked to positive or negative effects on the performance. The current research finds that related diversification, mergers between companies of roughly equal size, A&Ms that don't lead to negative reactions from the employees and considering A&Ms based on their contribution to the overall strategy are

vital factors in understanding success and failure in S.A. This finding is consistent with the literature. Also, their relative importance, which was presented in the last chapter adds depth to the existing literature.

Although the literature was important in pointing to the variables which may have effects on the success of A&Ms, it gave less insight to the effects of the context on them and the relation between these factors and the causes and types of business combinations. It is this argument which is developed below.

The contexts of A&Ms in S.A. have specific characteristics, which may explain the factors of success and their relative importance. The majority of firms are small or medium sized, their management is not separated from ownership, the dates of their establishments are close, which means that their development stages are quite similar, employees are foreigners who are, presumably ready to adjust to work under different environments, the availability of attractive targets (where they have the capacity to be successful if they are managed effectively), and the government has no restrictions on any type of A&Ms; are among several variables in the Saudi Arabian context.

From a strategic point of view, this context does not only help in making the right decision but also ensures its effective implementation. With regard to the choice, several potential firms are available to choose from since there is no legal restriction on types of A&Ms. There is no reason to make managements choose a firm in an unfamiliar business if they perceive a potential profit from acquiring or merging with a firm in an industry that they understand. Related A&Ms, as mentioned before, have a higher chance of success because the probability of achieving positive synergy due to the resources' complementarity is high. Therefore, finding out that the most important factor explaining the success of A&Ms in S.A. is acquiring of or merging with firms in related businesses is not implausible.

Another factor that explains the success of A&Ms is considering A&Ms from a strategic management perspective. Due to the togetherness between ownership and management, owners are usually involved in making decisions, especially strategic decisions such as those of A&Ms. This means that these decisions will be made only

after a thorough analysis and with deep caution. Although this can add weeks to a deal, it means that they usually haven't bought trouble when the deal is completed. There is no doubt that rushed acquisitions have a much greater failure rate than those with a longer time frame. This context may explain why respondents think that one factor of A&Ms' success is considering them from a strategic management perspective.

The owners concern for their businesses allows them to compensate for their inability to gather extensive data on the target firm by thinking deeply before they make such important decisions. This careful judgement seems to apply more in cases of acquisitions, where decision makers look for assets that are offered for sale at nominal prices (distressed firms) rather than in mergers' activities. The acquisition's decision is, in general, made with less data and the management will consider purchasing less profitable firms.

Regarding the implementation stage of the strategic management process, the contexts as well as the successful choice contribute to make effective implementation. After a related acquisition is agreed upon, managers begin working with familiar types of businesses and can, therefore, integrate the business combination relatively easily and quickly. Moreover, the fact that integrating human beings is the most difficult task in integrating merging firms, and since human resources will not create reverse unexpected responses after A&Ms in S.A. due to their structure (and possibly due to their positive perceptions to the causes and effect of A&Ms), the implementation is expected to be successful. Finally, the closeness of firms in S.A. with regard to the size and development stage indicates that firms have relatively similar cultures, which contributes to the A&Ms' success.

The previous discussion was about factors of success that this study supports. However, some other variables, which were suggested in the literature as important factors for success were given less weight to explain the success of A&Ms in S.A. These factors include the closeness of profitability of merging firms, acquired firms should be given their autonomy, retention of acquired firms' top management, and management that has experience about A&Ms.

Again the contexts of A&Ms' in S.A. have specific characteristics, which explain why these factors were perceived as irrelevant in S.A. As mentioned in Chapter Three, many firms in S.A. have a good potential to succeed if they have the right management and financial resources and that many firms are available for sale with attractive deals. Added to this is the employment structure (mostly foreigners) and the management style (due to the tribalism effect, trust is usually given to relatives or close friends).

The non-retention of an acquired firm's top management and leaving it to function independently can probably be explained by the previous context. Being liberated from weak or ineffective management is a relevant thrust for A&Ms' of an unhealthy company. Since acquisition activity was prompted by a desire to improve the target firm's managerial competence, then the structural scenario would clearly be where an acquiring firm absorbed the target firm into its traditional, hierarchical organisational structure. Similarly, this case would apply to acquisitions inspired by size and/ or sale maximisation criteria, whether prompted by synergy or market power objectives. In both these instances, the management of the target firm will be removed, control of the acquired firm's assets being surrendered to managers within the bidder's organisational structure.

Moreover, the previous context may justify why A&Ms succeed in S.A. even if they occur between profitable firms and less profitable ones. Two factors should be recognised. Firstly, the closeness of profitability of acquiring and acquired firms does not seem to be an unambiguous indicator of A&Ms' success because although it contributes to cultural fit and post-merger integration, it has fewer justifications for integration since firms of close profitability have presumably the same relative strengths and weaknesses (specifically where firms provide undifferentiated goods and services, such as the majority of firms in S.A.) which makes synergy based on complementary resources unattainable. Harrison et al (1991) suggested that when the acquiring and acquired firms emphasised different but complementary resources (thereby producing less public similarities), the merged firm obtained higher performance. Secondly, since the closeness of the profitability of merging firms as well as their sizes are used to operationalise the

construct of a similar culture, the study suggests that the last criteria (size) is a more valid indication of cultural closeness than the profitability criteria.

Regarding the rejection that acquisition experience might have a better chance of success than inexperience, practically, this should not be unexpected. Indeed, some inexperienced buyers could be very successful (Hunt, 1990). Although, the private sector in S.A. has little experience about A&Ms because this phenomenon is a new one, several firms have considerable experience in adaptation to changes that was gained after the economic conditions were adversely changed after 1983. As a result, these firms are more flexible, with developed adaptation skills. Although the finding that past acquisition experience is not associated with acquisition success, does not confirm the results of other studies, this study suggests that experience about A&Ms can be compensated by the ability and experience of management to control large firms and complex operations.

In conclusion, this study found that the determinants of success could be predicted if analysed with a relationship to the type of business combination (merger or acquisition) and the cause for A&Ms (synergy or assets stripping). This study suggests that the type of business combination and the causes for A&Ms affect the factors of A&Ms' success and failure. The factor relevant to success in one situation is not relevant to success in another. Two scenarios for success in different contexts were suggested by this research.

### *Scenario 1: The merger (consolidation)*

#### The factors

Causes: the synergy and/ or market power.

Industry: same industry; horizontal diversification.

level of profitability: quite similar (well managed).

Relative size: quite similar.

Employees' reaction: quite positive.

Top management's reaction: quite positive.

Experience: not essential to success.

***Scenario 2: The acquisition of a fairly or unhealthy firm***

**The factors**

Buyer causes: better use of cheap assets (financial) and synergy (managerial and financing).

Industry: same or different industry.

level of profitability: health of seller is poor (weak management).

Relative size: buyer larger than seller.

Employees' reaction: positive.

Top management's reaction: negative.

Experience: experienced buyer.

These two radically different approaches were all successful in this study and they indicate that different contexts require different factors of success. Moreover, this study suggests that factors of success are insufficient to explain the success or failure of A&Ms if they are taken individually. The combination of the variables in context scenarios offers a better way to explain significant variation in success (failure) than do single-context variables. Now the focus of discussion will shift from the direct effects of A&Ms on firms' performances to the potential side effects on the economy.

**7.2.2.3 A&M's Effects on the Economic Welfare**

As mentioned in Chapter Three, many firms in S.A. are not making enough profit because some firms have difficulties in controlling costs and/ or they are unable to provide the right goods and services to customers. Moreover, some firms are competitive but because of the severely unfair competition, they do not make sufficient profits. The negative impacts on corporate profitability ultimately limits a nation's long-term growth prospects and improvement in living standards.

Several factors have contributed to this poor performance. Most importantly, the small size of firms in S.A. as well as the small size of the Saudi Arabian market has prevented firms from spreading their capital investment and R&D costs over a larger size,

thereby preventing the full exploitation of economies of scale. There is no doubt that there is a need for corporate restructure, which leads to reduced cost inefficiencies and improved productivity and hence paves the way for a stronger expansion in a business fixed investment.

This study suggests that A&Ms are possible ways to having a stronger and more competitive private sector, which contributes positively to the economic welfare of the country and people of S.A. The study finds that businessmen expect A&Ms to have favourable effects on economic welfare, which includes a higher economic growth, improving balance of trade, a better private sector's labour force structure, diversification of the economy in the long run, increasing foreign investment in the kingdom either from GCC's countries or other countries. Also, it suggests that A&Ms are not expected to lead to negative impacts on the economy, such as a monopoly, a higher inflation rate and the control of power in the hands of a few individuals.

These results should not be unexpected given the causes and effects of A&Ms on the profitability in S.A., which was found and discussed earlier. A&Ms in S.A., in general, will shift assets to their best uses. This occurs because A&Ms are chosen for synergy purposes to lower costs and improve firms' products and services. These purposes lead to values' creation and produce private as well as social gains.

In addition, several A&Ms will be used as alternatives to bankruptcy. Many industries in S.A. have unexploited resources, specifically production capacity. This surplus often causes a period of intense short-period price competition. Apart from destroying profits this is disruptive and wasteful to resources. The inability to solve this problem leads to bankruptcies which benefit no one in the long run.

Probably the biggest worry of A&Ms in the literature is that A&Ms will lead to high concentration levels, and therefore will lead to a monopoly. Such a dominating position may cause higher prices, less variety of products/ services offered, and too much influence on the government and society by a few individuals. Moreover, dominant firms may not have strong pressures to invest and improve their activities due to the lack of competition. And there is also a growth in the role of the government in aiding large

firms and key industries with either outright grants, guaranteed loans, import quotas, price supports and other forms of support.

Two main issues concerning this matter need to be highlighted. First, the high concentration level need not lead to a monopoly power. Having, for example three or even two dominating firms in a market, there is still room for keen competition between them. Related to this point, the number of firms in a relevant market should be identified to examine the potential for a possible monopoly. Most goods and services in S.A. can be imported and there is no barriers to entry. If businessmen see any chance to make profit by importing the goods and services that are provided by potential monopolistic firms, they will do so. So, having one local firm does not mean that it has a monopoly power. It should be noted that this situation will occur only if such a firm is not protected by the government through applying barriers to entry, for instance. Given the context of S.A., the government is not expected to allow too much concentration of economic and political power which can lead to unfavourable impacts on the economy. This potential prevention is also expected for firms whose goods and services can not be substituted from foreign competitors.

Second, even if some A&Ms led to a high concentration level and monopoly power, there are other conditions under which benefits probably exceed costs. These benefits may occur if firms are competing with each other in a way that benefits no one. In S.A., and probably everywhere, there must be a distinction between the use of the word competition with a purely structural connotation (as in perfect competition) and its use in the sense of actual conduct (effective competition). The benefits of A&Ms may be higher than the costs of an increased aggregation level if A&Ms occur to save failing firms, which deserve to be saved, or if A&Ms occur to firms that have great products/service but which lacks financial or other expertise, where the A&Ms will improve this firm's capability. Moreover, there are often natural explanations for some industries to be concentrated rather than others because of their need for massive capital investment, expensive R&D work, and costly advertising campaigns to give them a chance of competing with the foreign competitors. Finally, the monopoly should not be considered

‘socially inefficient’ since it may make firms provide goods and services with greater value.

### 7.3 Contributions

The study reported here was unique in several perspectives. Some of the contributions are related directly to A&Ms, while some contributions can be inferred from this study.

#### 7.3.1 Contributions Related Directly to A&Ms

Firstly, although there is a huge number of research on A&Ms, this study is the first on A&Ms in S.A. and surely among the few on developing nations. The research is the first to explore, describe and analyse empirically reasons for and effects of A&Ms in S.A. Of course, the study results will add value to the existing literature related to A&Ms' reasons and effects.

Second, it highlights that causes for and effects of acquisitions are perceived differently than the causes for and effects of the mergers cases and hence data on acquisition should not be used to interpret theories of mergers. Treating acquisition and merger as a single phenomenon, as most research does would be a serious conceptual mistake.

Third, although studies on A&Ms causes and effects made a huge contribution to knowledge in this discipline, they were examined in isolation from each other and in isolation from the contexts. This research suggests that studying the causes for A&Ms in connection to the A&Ms' effects and considering the contexts that surround the A&Ms' activities will give better explanations to these issues, and therefore, it argues that the Saudi Arabian business environment has specific characteristics which make the causes and effects of A&Ms in S.A. different to those in other contexts.

Related to the previous contribution, the current study suggests that existing A&M's theories focused on reasons for A&Ms (financial and market conditions or managerial causes) must be expanded to include other factors that constitute the context of

A&Ms (such as the social context). Moreover, factors of success such as compatibility of industry, size and profitability, management and employees response, experience and access to information are insufficient to explain the success or failure of A&Ms if they are analysed without considering their relationship to the type of external growth (acquisition or merger) and the cause for A&Ms (synergy or assets stripping). The factor relevant to the success in mergers is not relevant to the success in acquisitions. Two scenarios for success in different contexts were suggested by this research.

Fourth, some of its results confirm the results of other studies while some findings contradict what others found. The results provided strong support for the theory that A&Ms improve firms' performance due to synergy achievement. The research has shown that in addition to financial synergy, other synergies can be achieved between merging firms. This conclusion contradicts the poor performance of merging firms which was found by some studies (Ravenscraft and Scherer, 1987). Also, the study results contradict with what some researchers suggested; that managerial and operational synergies were often claimed for mergers but seldom realised (Chatterjee, 1986; Porter, 1987). One explanation that may reconcile these contradictions is that the negative performance may occur in the A&Ms' cases which lack the relevant factors of success. Efficiency through synergies can be achieved but there may be some areas where efficiency is deteriorated, for example due to poor integration, which makes the overall management and operational synergies negative.

Furthermore, the current study supports what Hunt (1990) found with regard to A&Ms' factors of success; that factors are insufficient to explain the success or failure of A&Ms if they are taken individually. The variation in A&Ms' success (failure) can be explained in a better way if a combination of the relevant variables are used rather than taking them one by one.

Finally, this research contributes to the limited literature with regard to the process theory and suggests that rational factors are not the only reasons behind A&Ms' decisions, but also there are some other influences which may motivate or hinder the making of A&Ms' decisions. These factors include the attitude of the decision makers

towards the A&Ms, the degree of power the decision makers have, and the availability of information which can help the decision maker analyse the A&M's decision rationally.

It should be recognised that the process theory gains the support of the available evidence, though they are few (Trautwein, 1990). The studies that support this theory concluded that the acquisition indeed was not a comprehensively rational decision (Power, 1983; Duhaime and Schwenk, 1985; Roll, 1986; Gaddis, 1987; Sterngold, 1988). They found suppressed uncertainty, lack of planning, political influences and varying processes participants in the A&M's process.

### **7.3.2 Contributions Inferred from the Study**

This research may contribute to the existing knowledge regarding the Arab management style, barriers to growth, and the reasons that lead some firms to expand internally while some others expand externally by A&Ms.

#### **7.3.2.1 Saudi Arabian Management Style**

The study provides insight to the style of Arab management in general, and the style of Saudi Arabian management in particular. This is an area where research is in early stage, and therefore some of the study results may contribute to research in this field. The findings of the current study indicate several features of the Saudi Arabian management style. One feature is the willingness of the top-management (owners) to be powerful. This can be inferred from their avoidance of A&Ms because they do not want others to share their authority. Also, this feature is manifested in managing firms where the owners or the management is under the close control of the owners.

A personalised superior and subordinate relationship is another feature which can be indicated from this study. The discussion held with the interviewees show that the relationship between the management and the employees is usually informal and personalised. Therefore, the management is also concerned about their employees reaction to the A&M's decision.

It should be noted that these two features are consistent with other studies' findings (Atiyyah, 1993 and 1994). This can add support to the reliability of the current study. A final feature of the management style which can be inferred from the study, is the management's concern of image and reputation. Owners may accept lower profit instead of selling their firms or merging with other firms, even if the acquisition or merger will lead to a better situation than before, because of their concern of what their relatives and business colleagues may think of their ability to manage their firms. This study should be given credit for identifying such a feature since no study had suggested this characteristic before.

#### **7.3.2.2 Barriers to Growth**

With regard to barriers to growth, Susbauer (1979) suggested some barriers to organisational growth. Based on his research, he said "**It is obvious that a major research emphasis should be given to these factors and their actual relevance to the growth process**" p. 5. Since A&Ms are a kind of growth strategy, then barriers to them can be considered as barriers to growth.

#### **7.3.2.3 Internal Growth Versus External Growth**

Armit et al. (1989) investigate empirically few motives for selecting between internal expansion and acquisitions. One of their recommendations was that further efforts should be directed to the study of the reasons that make some companies engage in internal venturing while others engage in acquisitions. This study provides and tests empirically the variables that affect A&Ms' activities positively (motives) or negatively (barriers). Of course, the non-existence of the motives and/ or the existence of the barriers will increase internal expansion rather than acquisitions.

## **Appendix 7-1: The Process of Formulating, Choosing and Implementing A Strategy**

### **1: Formulating Strategic Alternatives**

The literature of strategic management (Glueck, 1980; Johnson and Scholes, 1993) suggests that there are two levels of strategic management, one at the corporate level and the second one at the business-units level. After specifying a clear mission, the second step of formulating corporate strategies is a careful appraisal of the business-units presently owned. For each unit, the results to date, the standing position relative to competitors, threats and opportunities in its environment, and projected future results based on existing plans should be studied.

This step requires identifying the dimensions of the intended portfolio. A good portfolio has several dimensions. Four dimensions are always significant; growth and profitability of the business-units considered separately, synergy among the units, risk and profit balance, and cash-flow balance.

Also it requires investigating the environment to determine external conditions, threats, and opportunities. Finally, strategists should examine their organisations to determine where the firm has significant strengths (and weaknesses) so it can most effectively exploit the opportunities and meet the threats the environment is providing the firm with.

After analysing each unit separately, the projections for all business-units should be combined into a consolidated picture of what the corporation will be and do if the status quo is maintained. If this combined picture is not entirely satisfactory, then the second broad step is to decide what changes, executed within the projected environment, would put the corporation in the best balanced position.

Armed with this background, management identifies each unit's strategy (the strategies of all the units constitute the overall corporate strategy). Wise strategy calls for an adroit mating of opportunity and threats in the environment with the strengths and weaknesses of the company. In addition to judgement about the environment and

company outlook, predicting the behaviour of key actors, such as competitors, suppliers, the government and major customers, is important. A forecast of likely moves and reactions of the key actors should be taken into consideration.

## **2: Choosing A Strategy**

After generating suitable alternative strategies, strategists have to select one from among the alternatives. Corporate and SBU executives decide upon their preferred strategic choice. Strategic choice decisions are made in the light of four selection factors. They are: managerial perception of external dependence, managerial attitude towards risk, managerial awareness of past enterprise strategies, and managerial power relationships.

The strategic choice is limited by the extent to which the firm is dependent for its survival on owners, competitors, customers, the government, and the community. The more dependent the firm, the less flexibility it has in strategic choice. Also, attitude towards risk will eliminate some strategic alternatives. Moreover, past strategies are the beginning point of the strategic choice and therefore may eliminate some strategic choices as a result. Finally, power relationships are a key factor in determining which choice is made. Personalities get involved.

## **3: Implementing the Strategy**

Strategic choice is not the end of the strategic management process. After the selection of a strategy, that strategy should be implemented. In discussing strategy activation, six sub activities will be considered. They are as follows:

- a) Imposition of structure on the organisation. This part of implementation is concerned about determining which structure works for which strategy. The best organisation structure is one which fits the organisation's size, volatility, complexity, personal characteristics, and dependence on the environment.

- b) Issuance of policies. The term policy refers to a rule, procedure, or guide to action. Within the functional areas of finance, personnel, production, and marketing, policies should be determined.
- c) Resource commitment. Nothing really happens until resources are committed. Corporations should provide distinctive resources to their business-units in order to add power to them. This can be done by providing one or more valuable resource(s) on attractive terms such as low-cost capital, outstanding executives, corporate research and development, and centralised marketing.
- d) Organisational leadership. Firms accomplish leadership implementation in several ways; changes in current leadership at appropriate levels, reinforcement of manager's motivation through financial incentives, etc., and involvement in career development for future strategists. The first dimension of leadership implementation is to make sure that the right strategists are in the right positions for the strategy chosen.
- e) Creating a focused climate. Every established organisation has its own climate, or culture. The organisation embodies traditional values about customer service, spending money, accepting risks, beating competitors, taking the initiative, and many other matters. This climate affects the ease or difficulty of carrying out a specific programme.
- f) Managing major changes. Activating often involves changes. A change in strategy always involves a difficult transition. Top management can aid in the transition by relieving anxiety promptly, providing time to learn new patterns of behaviour, and giving positive reinforcement to desired behaviour. Rumours about changes that might upset cherished relationships spread rapidly. Once the status quo is shattered, employees give attention to all sorts of idle speculation. Anxiety builds up, each

minor statement or action of top management is interpreted many ways, efficiency drops, and employees begin looking for other jobs.

Much of the anxiety comes from uncertainty. Therefore, prompt communication is vital. Even though specific answers to precisely what will happen can not often be given because plans have not yet been developed in full detail, full discussion of the known facts is helpful. If decisions are not yet made, then a statement of when they will be made and how they will be communicated is much better than no news at all.

Adjustments in behaviour take time. Management should recognise the need for this learning period. Even when employees have no reluctance to adopt new objectives, the early operations will be hard and slow. Practice is needed, and minor adjustments often have to be made.

Finally, learning the new pattern of behaviour will occur faster if management notices and strongly encourages new actions that are along the desired lines. Such recognition of desired behaviour also helps relieve anxiety built up during the transition.

After the strategic plan is activated, the strategy must be continuously evaluated and changed in order to ensure that actual performance conforms to plans.

## ***Chapter Eight***

### ***Conclusions***

#### **8.1 The Driving Question of the Research**

Previous literature on the advantages and disadvantages of acquisitions and mergers focused on the A&Ms' activity in advanced capitalist countries, specifically the United States and the United Kingdom. Studies of A&Ms in developing countries are rare; this research attempts to fill part of this gap by investigating reasons for and effects of A&Ms in Saudi Arabia.

The main question raised in this study is: can A&Ms contribute in solving the problems of the private sector and as a result help achieving the economic objectives? The summary of the literature review on effects of A&Ms on merging firms' profitability and on the economic welfare in the Anglo-American countries suggests that results were inconsistent. Therefore, two opinions were raised; one is in favour of the positive effects and one is against. In Saudi Arabia several attempts were made to answer this question in which none of them was based on empirical study. The precise objectives which this research is aiming to achieve, are derived from the research question. They are as follows:

- 1- To determine the causes why firms' strategic decision makers may choose A&Ms;
- 2- To discover the motives and barriers that affect the rate of A&Ms;
- 3- To establish the effect of A&Ms on firms' performance and factors affecting the effect;
- 4- To examine the potential impact of A&Ms' activity on the S.A. economy.

#### **8.2 The Propositions**

The propositions of the study were generated based on the appraisal of the literature relating to reasons for and effects of A&Ms applicable to A&Ms in the USA, UK and some other developed countries as well as on the reviews of the Socio-Political

and Economic context of S.A. The study propositions were established along four dimensions. One is related to causes for A&Ms. Taking the characteristics of S.A. context into consideration, five propositions addressed the causes which make managers choose A&Ms. It was proposed that A&Ms will be used for one or more than one of the following causes: synergy purposes; that is to improve effectiveness and efficiency (proposition 1), avoiding bankruptcy and distressed financial position (proposition 4), and acquiring firms which can be bought at nominal prices (proposition 5). Using A&Ms by management to make personal gains on the account of owners' wealth (proposition 2) and adopting A&Ms for monopoly causes (proposition 3) were not expected.

The A&Ms' effect on firms' performance and influencing factors constitute the second dimension. Proposition 7 suggested that A&Ms would improve firms' profitability and their ability to compete, and that related A&Ms, no negative reaction from the employees, closeness of firms' sizes and considering A&Ms strategically were factors contributing to the success of A&Ms (proposition 6). These expectations were made based on the matching of the requirements of successful A&Ms with the characteristics of S.A. context.

The third group of propositions is about A&Ms' effect on the economic welfare. They were developed by studying and comparing the reasons and conditions of positive as well as negative effects on the economy with the characteristics of S.A. context. Proposition 8 suggested that A&M would lead to favourable economic conditions in S.A. which include increasing economic growth, improving balance of trade, improving labour force's structure, diversifying the economy, and increasing investments. In addition, it was expected that A&M would not lead to monopoly, higher inflation rate, control of power in the hands of a few people, and unemployment (proposition 9).

Finally, propositions about A&Ms' rate and what factors influence the decision-makers to adopt A&Ms were developed. These factors were divided into either motives or barriers. Although the motives are prerequisite to A&Ms, they don't lead to a higher A&Ms' rate if they are not supported by elimination of the barriers. A list that contains these motives and barriers was developed. An investigation of this list suggested that

A&Ms are not preferred by the private sector and, therefore, their rates are low (proposition 10). Moreover, it suggested that several motives to A&Ms are not existed in S.A. The absence of effective mechanism to facilitate A&Ms is the major variable (proposition 11), and that several barriers to A&Ms exist in S.A. Psychological and social factors are the main barriers to acquisition activity (proposition 12).

### **8.3 The Methodology**

The quantitative approach was used as the main source of accomplishing the study objectives. This was done by asking the top-management directly about their opinions on reasons for and effects of A&Ms. In addition, seven personal interviews with seven executives who experienced A&Ms before were conducted. The quantitative part of the study therefore, measures the prediction of managers and, hence, the study results by no means be taken for granted. A mailed questionnaire has been used in this study because it has considerable advantages over personal and telephone surveys.

Although chief executive officers of all firms in S.A., regardless of their types (e.g. limited liability or joint stock) or sizes, the sectors they function in and their ownership are considered as the population, the top 500 Saudi companies were chosen to be used as a sample. This decision was made because the managers of those companies are capable of providing valid information, and an up-dated list of the top 1000 Saudi companies was available.

Likert scale of five categories has been used in this study. The study propositions were tested using Wilcoxon statistic and t-test. Moreover, the medians, the means and the percentage of the respondents who agree and strongly agree with the variables, were used to investigate the relative importance of the research variables. To know if the responses to the reasons for and effects of A&Ms in S.A. are different, based on the classifications' differences examined in the study (e.g. firms ownership, forms of firms and their industries), ANOVA and Kruskal-Wallis were used. Since ANOVA and Kruskal-Wallis show only the significance of the differences, Cross-tabulations were used to investigate

which classification, within a specific category is more supportive to a variable. Finally, the relationships between the variables were examined using the Pearson correlation.

## 8.4 The Results

The findings are discussed in Chapter Six. The major findings were:

- 1) A&Ms in S.A. are expected to have a favourable impact on the private sector (profit and competitive strength).
- 2) The businessmen believe that sources of gains (profit) are improved by effectiveness and efficiency due to synergies. These sources are attached more to mergers. While for the acquisitions' cases, the wealth transferred from the acquiree's owners, because of the under market value of the acquired firms, represents the major source explaining the profitability of the acquiring firms.
- 3) A&M's rates are low because several factors (mainly irrational) are involved which may make management not consider A&Ms. The negative decision-makers attitudes towards A&Ms, management's lack of power and autonomy to choose A&Ms (or to choose them for monopoly reasons), and lack of full information are three factors which may make managers unable to evaluate A&Ms rationally.
- 4) The current research finds that respondents believe that related diversification (complementary resources), mergers between companies of roughly equal size, A&Ms that don't lead to negative reactions from the employees and considering A&Ms based on their contribution to the overall strategy are vital factors in understanding success and failure in S.A. This study however, found that the determinants of success could be predicted if analysed with a relationship to the type of business combination (merger or acquisition) and the cause for A&Ms (synergy or assets stripping). Moreover, the study suggests that factors of success are insufficient to explain the success or failure of A&Ms if they are taken individually. The

combination of the variables in context scenarios offers a better way to explain significant variations in success (failure) than do single-context variables.

- 5) The study finds that A&Ms are expected to have favourable effects on economic welfare, which includes a higher economic growth, improving balance of trade, a better private sector's labour force structure, diversification of the economy in the long run, increasing foreign investment in the kingdom either from GCC's countries or other countries. Also, it suggests that A&Ms are not expected to lead to and the control of power in the hands of a few individuals.
- 6) The study suggests that, in general, there were no ownership and industry effects observed among the responses. The respondents represented multiple ownership and industries. Therefore, the results may be widely generalised, assuming that future research supports these findings.

## **8.5 Implications**

It should be noted that the results of this study incorporate the effects of A&Ms on firms' profitability and on the economy are on average. They can not be guaranteed in each A&M's case. Although this study suggests favourable outcomes to A&Ms, it shows that these results depend on the existence of specific contexts. It is impractical to consider A&Ms as good or bad without considering the circumstances and area of precaution. A&Ms are one way to improve a firm's growth, if they are used correctly, they will yield to favourable effects.

Based on this opinion, the following discussion is about what the management as well as the government should do to make the best of A&Ms. These proposals are based on the study results as well as on the literature presented in Chapter Two.

### **8.5.1 Implications for Management**

This thesis will be used hopefully as a reference for the decision makers in a firm who are looking for business opportunities through acquisitions or mergers. It will show

them the benefits of A&Ms and their potentially negative effects. Several implications can be inferred from the study. Before discussing these implications, it should be recognised that they do not represent an exhaustive list. Moreover, although they are beneficial to all management, they are related more closely to the Saudi Arabian context. The implications are as follow:

- Management should be aware that A&Ms are strategic alternatives available for problem solving and achieving objectives. However, they are not a magic wand to make problems vanish. They should be chosen after a careful analysis of their firms' capabilities and weaknesses as well as the environment;
- Management should think and act rationally when considering the usage of A&Ms. For example, problems relating to the sharing of authority, name and image should not be given more emphasis than the value creation that can be achieved by adopting A&Ms;
- It may be insufficient to focus only on one or two of the factors that contribute to A&M's success. A&Ms will not achieve their objectives if they are not correctly selected, implemented and supported. Several suggestions were provided in Appendix 7-1, which should be taken into consideration.
- If managed separately, owners should be involved in the management's strategic decisions, such as A&Ms, to avoid potential manipulation of management decisions for personal gain;
- Although acquisitions of unrelated businesses may minimise risk, acquisitions of core related companies have a higher chance of success. It should be noted that relatedness may enhance the achievement of integration, but it does not guarantee the positive synergy. Alternatively, the resource complementarity is more important to the A&M's success than the relatedness per se;

- Given the nature of human resource structures, cultural problems might arise in integrating the firms. Two separate forms of cultural clash could occur. Firstly, there is the risk that the corporate cultures of the two partners will embody different ways of doing things, for example differing power structures, control systems of attitudes towards investment and risk. Secondly, A&Ms may bring together two sets of employees whose national culture gives them fundamentally different views on what constitutes a desirable management style or appropriate organisational hierarchy. The management should be aware of such potential problems;
- Management should know that not every acquisition or merger case is similar to another, and therefore they should evaluate each case in its merit. However, their experience about A&Ms should be evaluated and recorded in order to benefit future decisions;
- Although investment bankers, brokers, lawyers and accountants are useful in the facilitation of A&Ms' activity, over-reliance may give unfavourable results.

### **8.5.2 Implications for the Government of S.A.**

This study may have public policy implications. Its results can aid the establishment of several governmental policies and laws. What the government should do can be divided into two parts; one is what things should be adopted to encourage the A&Ms, second is what measures should be used to optimise the benefits of A&Ms. It should be noted that the researcher's intention for providing the following suggestions, is to provide a general direction and guidelines which the government should take into consideration. They do not represent exhaustive and detailed laws or rules. Moreover, how these suggestions can be implemented has not been focused upon by the researcher.

#### **8.5.2.1 Measures that Encourage A&Ms**

- a) This study suggests that the government should not keep to the current situation with regard to A&Ms as it stands. Some things should be done to encourage the A&Ms

between firms' in S.A., specifically the acquisition of distressed firms, and to encourage firms of GCC's countries to acquire or to merge with firms in S.A. The finding of the study, however, does not agree on encouraging foreign firms (except those of GCC's countries) to get into the kingdom through these activities.

b) Some measures which were suggested as factors encouraging the A&Ms include:

- Improving the legal system which helps to protect the acquirer from unknown liabilities on the acquired firms;
- Ease of regulations for firms wishing to go public in order to be able to raise capital. The priority for firms wishing to go public should be given to consolidated firms;
- Encouraging banks to have more effective roles to facilitate A&Ms activity;
- Exempting acquiring firms from paying the Zakat or tax that accumulated on the acquired firm (which is in a distressed position) during the period before A&M takes place;
- Issue laws that explain how merging firms will be assorted and how their contracted projects will be treated.

It should be noted that the current study does not recommend that the government should provide benefit to the acquirer, such as exempting it from paying the Zakat or tax accumulated on the acquired firm (except if the acquired firm is in a distressed position and it deserves to be saved) and paying some or all the debts on acquired firms. The merging firms should be convinced of the benefits of A&Ms without getting benefits from the government. Moreover, easing the laws pertaining to the A&Ms are not required. The current obligations are not restrictive. However, the government could do something to increase the awareness of firms' owners to the flexibility of these regulations.

### **8.5.2.2 Measures that Optimise the Benefits of A&Ms**

The A&Ms in Saudi Arabia must have two criteria to contribute in improving the private sector and achieving some of the National Development Plans' objectives. The first criteria states that any improvement in firms' performance resulted from A&Ms, should depend on real gains from synergy rather than a transfer of gains from the customers due to a monopoly power. The second criteria suggests that A&Ms should not reduce a firm's willingness to invest due to a decline in competitive pressures to improve or upgrade businesses, which leads to unprofitability in the long-run.

Although it is reasonable to expect the government to investigate each A&M before it occurs, to ensure that each A&M includes the above mentioned criteria, such an investigation would prove very problematical. An investigation of this kind could be complex and might last for several weeks. Therefore, it would cause serious delay, possibly giving a long period of valuable warning to competitors, it might upset the stock prices, and perhaps create personal hardship. The overall result of such investigation is the discouragement of A&Ms activity.

The researcher does not recommend therefore, that a government investigation into A&Ms would be beneficial. There are however, certain measures which the government should follow to help create the wanted A&Ms. The government should before the A&Ms occur, communicate with the management willing to acquire or to merge with another company that neither the customers' interests or the country's economy is negatively affected by the proposed A&M. Any behaviour that is negative in this way is unacceptable.

After the A&M occurs, the government should monitor and investigate the situation to ensure that the A&M is not contrary to the national interests. It should be recognised that since A&Ms may give rise to increased market power and provide for increased productivity, from the point of view of public policy it is necessary to separate those A&Ms which, on balance, may increase market power and promote economic efficiency, from those which increase the concentration level and do not realise significant economies. Concentration, especially in some industries which require a lot of scale to

achieve economy of scale, or which require high level of fixed investment and R&D should not be discouraged.

It is therefore necessary for part of the machinery to operate before a merger takes place, but for any really time-consuming investigation to be carried out afterwards.

Finally, the government should ensure that the market place is kept open without any barriers to entry (the government has applied for accession to the GATT in July 1993), this means that big companies which evolve from an A&M should not be assisted by the government itself. The second criteria (mentioned above) is eradicated when big companies benefit from subsidies, granted home demand or favouritism of from the government.

Other parties, in addition to the management and the government will benefit from the research such as Chambers of Commerce and Industry, and researchers.

### **8.5.3 Implications for Chambers of Commerce and Industry**

Another important party which will benefit from this study is the Chambers of Commerce and Industry because of their important role in affecting the private sector in Saudi Arabia. Riyadh Chamber of Commerce has shown its interest to the researcher in finding out the potential effects of A&Ms and what motives and barriers affect their rates in order that it can build a plan of its moves according to the research results.

The study suggests that the Chambers of Commerce and Industries can perform an effective role in encouraging A&Ms, by performing several tasks such as identifying potential sellers and buyers and getting them in contact, providing training programs, preparing a guideline to explain A&Ms' procedures and regulations and by arranging public conferences to increase businessmen's awareness of A&Ms activities. Areas of precautions in both the choosing stage of A&M and the implementing stage should be communicated to the businessmen. Finally, the Chambers of Commerce should provide detailed information about the market and the competitors, and create effective communication channels between firms. These are important factors that can facilitate the A&Ms' activity.

#### **8.5.4 Implications for Researchers and Other Parties**

Researchers in the field of A&Ms will benefit from the contributions of this study as well as from the suggested further research which is presented later in this chapter. In addition, management, the governments and the Chambers of Commerce in several countries, specifically those with similar business environments to Saudi Arabia such as the Gulf Cooperative Countries (GCCs) will gain from the study. Based on the literature (Al-Morbaty, 1992) and on the researcher's written communications with the Chambers of Commerce in the GCCs, all are concerned about the effectiveness of A&Ms, their possible negative impacts, and how A&Ms' activities can be facilitated. Some literature (Al-Shorbagy, 1993) even suggests that the natural way to begin to deal with the current international economy is by increasing the A&Ms between companies in GCCs.

### **8.6 A&Ms in Perspective**

The results of the quantitative and qualitative studies suggest that there is a high potential for A&Ms between firms in S.A to lead to a stronger and profitable private sector and, therefore A&Ms may contribute positively to the economic welfare of the country. The reasons for these expectations are due to the existence of specific contexts.

The fact that the majority of firms in S.A. are managed by the same owners or their management, is under a close control by the owners, means that the decisions of A&M will not be taken if they are not consistent with the owners' benefits. Moreover, the small size of firms in S.A. as well as the small size of the Saudi Arabian market and the severe competition (mainly from the foreign competitors) have prevented firms from spreading their capital investment and R&D costs over a larger size, thereby preventing the full exploitation of economies of scale. Many industries in S.A. have unexploited resources, specifically production capacity. This surplus often causes a period of intense short-period price competition. Apart from destroying profits this is disruptive and wasteful to resources. These contexts may explain why business-people expect A&Ms to be used to create real value due to synergy. Although A&Ms may be used to transfer wealth from the customers, suppliers and the employees, this outcome should not be

considered unfavourable because of two reasons. First, the transfer of gain is expected to represent only a small fraction of the total gains. This is because the management expects the government to resist decisions that lead to too much influence on the government and society by a few individuals (monopoly power). Moreover, maintaining qualified and dependable employees and suppliers is an important asset that many firms complain of lacking. Second, the majority of the employees as well as the suppliers of raw materials are non Saudis, this means that the reduction of expenses goes to them and this has a positive impact on the economy.

With regard to the factors that contribute to the A&M's success, the study suggests that management believes that relatedness is a major factor for the success of A&Ms. It should be recognised that relatedness is perceived as complementary resources in the cases of A&Ms that are motivated by creating real value due to synergy. This perception is different from that of firms using A&Ms to minimise the competition. It seems that these firms have the same strengths and they use A&Ms to transfer wealth from customers or suppliers or employees. Another predicted factor affecting the A&M's success is the positive reaction from the employees of the firms concerned. The A&Ms are expected to lead to better opportunities for the employees. This may contribute to explain the employees' positive reaction to A&Ms.

Although there are reasons to support for more competitive and profitable firms after A&Ms, the management does not prefer the A&Ms' alternatives. This lack of preference is due to some rational barriers such as the inadequacy of the legal system and the non-existence of an effective mechanism (the less influential capital market, the non-existence of effective bankers, accountants, brokers and pricers who can facilitate the A&M's activity), and irrational factors which include the negative attitude of owners towards A&Ms (not willing to share authority and who desire independence of name and image) and the lack of information about firms' names willing to merge and some other information, such as the non-existence of effective accountants, brokers and pricers who can facilitate the A&M's activity.

The lack of an effective mechanism that can get all the interested buyers to bid on the firms offered for sale means that their prices will be less than their real values. This situation has led to several consequences. One is that many firms are reluctant to sell which means that they may become financially distressed and go bankrupt. Another outcome is that several buyers may not evaluate the target firms effectively and acquire firms for financial reasons. There is a potential for failure in this context. Moreover, even if the acquirer gains from the acquisition, this gain represents a transfer of wealth from the acquired firms' owners.

The study may have public policy implications. Since there is a high chance that A&Ms will help solve the problems of the private sector as well as achieve some of the economic development objectives, the government should not keep to the current situation as it is. The relevant legal matters should be considered and improved. In addition, Effective mechanisms that facilitate the A&Ms activity should be created. Ease of regulations for firms wishing to go public and encouraging banks to have more effective roles may be considered wise decisions in this direction.

The A&Ms in Saudi Arabia must have two criteria to be beneficial for both the individual firms and the economy in general. The first criteria suggests that A&Ms should lead to gains from synergy rather than a transfer of gains from the customers due to a monopoly power. The second criteria suggests that A&Ms should not reduce a firm's willingness to invest due to a decline in competitive pressures to improve or upgrade businesses, which leads to unprofitability in the long-run.

The government should encourage the A&Ms that maintain these criterion. The government may, before the acquisition or merger occurs, make it explicit that the A&Ms will not be accepted if either the customers' interests or the country's economy is negatively affected by the proposed A&M. After the A&M occurs, the government should monitor and investigate the situation to ensure that the A&M is not contrary to the national interests. The government should separate those A&Ms which, on balance, may increase market power and promote economic efficiency, from those which increase the

concentration level and do not realise significant economies. Therefore, the high concentration in some industries which require a lot of scale to achieve economy of scale, or which require a high level of fixed investment and R&D may not be unfavourable. Finally, the government should ensure that the market place is kept open without any barriers to entry

## 8.7 Limitations

Focusing primarily on reasons for and effects of A&Ms in S.A., this study has generated some important insights. The inferences made from the analysis and the implications discussed need, however, to be interpreted in the light of some important assumptions and limitations of the study. The limitations include the following:

- Although the test did not suffer any measurement bias with regard to the representatives of the original sample of 500 firms, the low response rate (25%) may raise a worry to the reliability of the results;
- Although the total sample of 124 responses is of a reasonable size for analysis, the relatively small number of respondents who had experienced an organisational acquisition or merger, places a limitation on the external validity of the results. Also, only 3 firms in the financial sector and 2 respondents older than 60 years responded, which is not enough to make reliable judgements on these two categories;
- A further limitation is associated with the assumption that the firms and managers included are representative of Saudi Arabian firms and managers. Firms' higher level of success and their management's higher level of education suggest that this may not be so. This, however may be inevitable since the frame from which the sample was drawn influenced the characteristics of the companies in the survey. This is one of the dangers of a non probability sample;
- This study measured the current management opinions and perceptions to the causes and effects of A&Ms. Therefore it measured predictions, not real causes and effects.

The results however, should not be underestimated since the management's intuition is considered a valid source of information;

- This research investigates the reasons for and effects of A&Ms in the local market of S.A by Saudi Arabian firms. It should be recognised that there must be another complex structure of reasons to invest in A&Ms in different countries by the Saudi Arabian firms which may include providing a base for export expansion and technology upgrading.

Given these limitations, it should be noted that the researcher believes that the study findings provide a generality to the issues studied and sheds light on the under researched area of the reasons for and effects of A&Ms in S.A.

## 8.8 Future Research

The study reported above and its overall limitations, suggest directions for future research. In an area where empirical data is scarce this exploratory investigation reaches some conclusions which should guide future research. If future research can replicate these findings using a greater number of respondents and another method of collecting data, the results would have strong managerial as well as governmental implications. The researcher stresses that further research on reasons for and effects of A&Ms would be of value because they would help to strengthen interest in a research area that has been beleaguered by methodological problems.

Researchers might use comparative case studies to provide in-depth understanding and improve theory in the area of determinants and effects of A&Ms. Future investigations of this topic may have samples large enough to permit replication of this investigation and to include consideration of additional explanatory factors. Some of those factors might be industry conditions, differences between acquisition and merger and between an acquiring and acquired firms, cultural differences between the combined entities.

This research investigates the reasons for and effects of A&Ms in the local market of S.A by Saudi Arabian firms. Therefore, future studies can be conducted to investigate the causes and effects of investing in A&Ms in S.A. by foreign companies as well as the reasons why Saudi Arabian firms go to the foreign markets to invest in A&Ms. Moreover, moving across broader perspective can bring clashes of differing national management styles, philosophies, and ways of dealing with customers. This is an area for future research to examine.

Although the study results suggest that A&Ms have positive effects on a firm's performance, the process of selection and implementation of A&Ms' decisions were not covered in this research. Therefore, research in this area needs to be expanded to examine the process of A&Ms. For example, relationships among integration design decisions, integration implementation activities and processes, and acquisition outcomes should be investigated so that researchers will be able to draw clearer links among these variables.

Another area for future research is related with how the suggestions provided for the government (presented earlier) can be operationalised and implemented.

In conclusion, the research on A&Ms in Saudi Arabia is still in the development stage. There is a need to conduct more research in order to provide managers with guidance in future decisions. The present research may act as a starting point to begin developing such insight.

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