

CRITICAL SUCCESS FACTORS IN MERGER & ACQUISITION STRATEGIES: EVALUATION OF TURKISH MARKET

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ABSTRACT

Merger and acquisitions is defined as a strategic decision to increase a firm's growth and enhance its operations (Saxena, 2012). Some proponents argue that mergers increase efficiency whereas opponents argue that they decrease consumer welfare by monopoly power (Coontz, 2004). There is a growing empirical literature documenting that mergers are efficient means for assets to be reallocated within the economy. In line with all these discussions Mergers and Acquisitions in the corporate world are achieving increasing importance and attention especially in the era of intense globalization. Grubb and Lamb (2000) states that only about 20 percent of all mergers really succeed. In 2014, there was a total of 130 deals with disclosed values totaling US\$17.7 billion in Turkey. Of these, 4 of them were above one billion US dollars and accounted for 51% of total transaction volume. This paper analyzes the sources of value creation in mergers and acquisitions; focus on critical success factors in merger & acquisition strategies and examines the transactions that took place in Turkey in 2014.

Keywords: *Merger, Acquisition, Due Diligence, Integration*

ŞİRKET BİRLEŞMELERİ VE SATIN ALMALARDA KRİTİK BAŞARI FAKTÖRLERİ: TÜRKİYE PAZARI BAĞLAMINDA BİR DEĞERLENDİRME

ÖZ

Şirket Birleşme ve Satın Almaları şirketlerin büyümesi ve faaliyetlerini geliştirmesi için uygulanan stratejik bir karardır (Saxena, 2012). Bu stratejik kararın savunucuları verimlilikteki artışa dikkat çekerken karşı grup monopolleşmeye ve tüketicilerin aleyhindeki etkilere dikkat çekmektedir (Coontz, 2004). Aynı zamanda Şirket Birleşme ve Satın Almalarının ekonomik çevredeki kaynak dağıtımına olumlu yönde katkı verdiği dair araştırmalar bulunmaktadır. Tüm bu tartışmaların yanısıra Şirket Birleşme ve Satın Almaları özellikle küreselleşme etkisi ile tüm dünyada önem arz etmekte ve iş dünyasının dikkatini çekmektedir. Grubb and Lamb'a (2000) göre bu tür birleşmelerin sadece %20 si başarı ile sonuçlanmaktadır. 2014 yılında Türkiye'de 130 adet birleşme raporlanmış ve toplam değer 51 milyar TL'ye ulaşmıştır. Bu işlemlerin sadece 4 tanesi toplam değer %51'ine denk gelmektedir. Bu çalışma Şirket Birleşme ve Satın Almalarında nasıl değer oluşturulduğuna odaklanmakta ve kritik başarı faktörlerini ortaya koymayı amaçlamaktadır. 2014 yılında Türkiye pazarında yaşanan birleşmeler de değerlendirmeye alınmıştır.

Anahtar Sözcükler: *Birleşme, Satın Almalar, Değerleme, Entegrasyon*

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INTRODUCTION

Corporate world is facing a significant economic change. Mergers and acquisitions have become strategic decision that implemented by large number of companies in the world. Mergers and acquisitions form a new economic, social and cultural environment, also enable strong companies grow faster than competitors and provide entrepreneurs rewards for their efforts, ensuring weaker companies are more quickly swallowed, or worse, made irrelevant through exclusion. Mergers and acquisitions are the vital part of any healthy economy and the primary way that companies are able to provide returns to owners and investors. Current study starts with a part on the motivation for merger and acquisitions and then lists the different types of M&A's. Since due diligence and integration concepts are usually taken as critical success factors there are separate sections included. Finally, up to date information and market data given for Turkish context provided through the study.

BACKGROUND LITERATURE

Motivation for Merger and Acquisition

In today's competitive business environment, organizations need to carefully consider the methods employed in pursuing their strategies. In order to achieve strategic growth via gaining access to new intellectual property, market share and technology; firms can either rely on their own resources or they can employ a dominant growth strategy for companies worldwide (McDonald et al., 2005) "merge/acquire". Merger and acquisitions is defined as a strategic decision to increase a firm's growth and enhance its operations (Saxena, 2012). There are several different motives provided for corporate mergers and acquisitions under literature. However, the prevailing rationale is said to be value creation.

Achieving access to additional resources is not the sole role of merger and acquisition; Chanmugam et al., (2005) states that post-merger integration of two organizations should yield value creation, while McDonald et al., (2005) states that the continued pressure for mergers and acquisitions is the result of stakeholders pursuit of increased shareholder value. Under literature an additional term employed for this value creation is "Synergy". Naude,et al. (2002) defines synergy as the added value and performance created from the combination of two

Critical Success Factors in Merger & Acquisition Strategies: Evaluation of Turkish Market

companies. Meaning that the result will be greater than the sum of the separate individual parts.

Naude, et al. (2002) also argues that sharing activities in the value chain often enhances a competitive advantage by lowering costs or encouraging differentiation, while Pettitt and Ferris (2013) states that the synergy arising from the combination of the acquirer and target's operations not only has the added benefit of increasing pricing power and sales volume in a market, but also the benefit of cost reduction. As firms employ merger and acquisitions as a method for achieving growth, as such the reduction in costs would easily benefit the economies of scale.

Another motivation for merger and acquisitions is the continuous need for adapting to changing environment conditions. In static markets and where shares of companies are steady it can be difficult for a new company to enter the market. In order to survive adverse economic climate, shift the corporation in an entirely new direction merger and acquisitions are stated to be the most extensively used strategy (Goyal and Joshi, 2012). Due to increasing competition (Amoateng, 2006), deregulation (Schuler and Jackson, 2001) mergers and acquisitions have also spread out to transnational markets. Which has had the benefit of lowering manufacturing costs and creating access to new workforce.

Merger and acquisition is also believed to reduce earnings volatility, risk and increase potential value by buying firms in other businesses and diversifying. However, there a mixed views regarding this. While merger and acquisition may hedge a firm against risk in the industry, it does not deliver value for shareholders (Servaes, 1996), since it is possible for shareholders to achieve the same hedge by diversifying their portfolios at a much lower cost than those associated with a merger. Also Wu, (2009) states that if the manager is not familiar with this new domain, he cannot diversify risks but can pick up risks and that the enterprise culture integration after merger could be very difficult.

Further motivation addressed under the literature is the hubris hypothesis. Fairholm, (2015) defines hubris as an excessive confidence, which leads a person to believe that they may do no wrong. Hubris hypothesis is an explanation for a non-rational motive for mergers. Managerial hubris is the unrealistic belief held by managers in bidding firms that they can manage the assets of a target firm more efficiently than the target firm's current management. Roll (1986) hypothesizes that because of this confidence, managers of bidding firms reach for targets

Ali Fatih Dalkılıç and Melissa Nihal Cagle

out of their reach since they overestimate their ability to profitably achieve them. The hubris theory states that when a merger or acquisition announcement is made, the shareholders of the bidding firm incur a loss in terms of the share price while those of the target firm generally have a contrary effect. Bidding firms "infected" by hubris pay too much for their targets. In such a case the merger would destroy value.

Managers' own personal incentive is said to be a much more prominent driving force behind mergers (Demian, 1994). Under agency theory the interests of the shareholders or owners are not parallel to the interests of management, and managers strive for their own interests since there is a separation of capital and control. More power is attached to running a larger corporation than a smaller one, executive salaries are highly correlated with company size. Also, since after most takeovers, some managers of the acquired companies lose their jobs merger can serve as a tool to reduce the chances of a takeover. This is also closely tied in with the empire-building motive for mergers. Ravenscraft and Scherer, (2011) states that even though gaining formal control and organizational integration leads to additional cost, managers seriously over estimate their ability to integrate, motivate and effectively control the companies they acquire.

Tamosiuniene and Duksaitiet (2009) lists the following aspects as seller's motives in a M& A transaction,

- Company doesn't have the resources to grow further; Because a company thinks it has maximized growth in its own market and does not think it can expand to new markets;
- It thinks it reached its historical peak of its valuation;
- Lack of viable replacement for the founder of the company, as the founder nears to retirement;
- Lack of access to capital (including the restrictions of borrowing capacity);
- If the company is owned by investors, they might want to cash out;
- New competitors emerge.

It is obvious that the choice to sell is one of the most dramatic – last and big decision that a company will ever make. It has an influence on everyone, associated with the company. At the same time, the decision to be a buyer today is a standard business tool, utilized by many, if not most, companies.

Critical Success Factors in Merger & Acquisition Strategies: Evaluation of Turkish Market

Types of Mergers and Acquisitions

There are two types of acquisitions; friendly or hostile. When the target firm expresses its agreement to be acquired the acquisition is said to be friendly, contrarily hostile acquisitions do not reach an agreement. Rossi and Volpin (2004) state that hostile takeovers (as the acquirer) are more common in countries with better shareholder protection. Firms in less investor protective countries are more likely to be targets of cross border mergers, than targets of domestic mergers. The authors study cross-border mergers among 49 countries and focus on all hostile bids, regardless of whether or not the deal was completed and analyze the quality of regulatory environment with the events of merger and acquisition activities. They state that, in general, common law countries have better investor protection than code law countries, they also report that the corporate governance quality of acquirers in cross border mergers is significantly higher than the quality of targets. Rossi and Volpin (2004) also state that even failed hostile takeovers will succeed in disciplining the management of the target company and improving governance. As it serves as a wake-up call for management to better their governance.

Zhu et al. (2010) also investigate cross border acquisitions. However, they analyze a partial acquisition of firms in 22 emerging market countries. Partial acquisition means the acquisition of a resource while partitioned into steps to allow only part of the resource to be acquired. The first step of a partial acquisition typically acquires part of the resource to be eagerly acquired while other steps defer further resource acquisition at a later stage. Zhu et al. (2010) report that the pre-acquisition performance of target firms is better when acquirers are foreigners. In contrast, the post-acquisition performance of target firms is better when acquirers are domestic firms.

It has also been observed that acquisition returns are impacted by the method of payment for acquisitions. The three methods available to a bidder are cash, stock, or a mixture of the two. Rossi and Volpin (2004) state that cash payment is negatively correlated with shareholder protection. An increase in the level of shareholder protection results in a reduction of the probability of using all cash. They also state that takeovers are paid entirely by cash in countries with lower investor protection.

There is an alternative form of acquisition referred to as a reverse takeover. Reverse takeover is defined as an acquisition of a publicly

Ali Fatih Dalkılıç and Melissa Nihal Cagle

traded firm by a private business in order to sell shares and raise capital. (Makamson, 2010) Also referred to as “backdoor listing”, this acquisition type is stated to be an important financing vehicle for small and medium sized enterprises and allows for swift and cost effective access to the market (Brock, 2002). Haberberg and Rieple (2008) also state that sometimes the smaller firm will acquire management control of a larger or longer established company and keep its name for the combined entity.

Another type of acquisition is the reverse merger, which allows for a private company to get publicly listed in a short time period (Dash, 2010). Prior to transaction, two separate entities exist; a private and public entity. As the public shell is sold to the private concern, the private entity gains access to the public markets through a consistent process. (Pavkov, 2005) This method is employed when the private company has strong prospects and is eager to raise financing.

There are also four types of merger method covered under literature. These are horizontal, vertical, conglomerate, congeneric mergers. Horizontal mergers takes place where the two merging companies produce similar product in the same industry. They are more easily classified (Eckbo, 1983) and are a transaction where a competitor buys another competitor with the purpose to obtain economies of scale in overlapping operations and to eliminate competition (Sevenius, 2003 as cited in Pettersson, et al, 2013). Vertical mergers on the other hand, occurs when two firms working at different stages in the production of the same good combine, with the purpose to reduce transaction costs between the corporate value chains (Sevenius, 2003 as cited in Pettersson, et al, 2013).

Conglomerate mergers take place when the two firms operate in different industries. Levy and Sarnat (1970) states that while horizontal and vertical mergers can potentially produce value, the economic case for conglomerate merger is not clear as the production of economies of scale in production, research, distribution is not relevant, lacking discernible economic relationship between the parties to the merger. Amihud and Lev (1981) on the other hand claims that via diversification effect conglomerate merger leads to reduced risk for the combined entity. However, as addressed before, it has been argued that risk reduction cannot be beneficial to stockholders since it is possible for shareholders to achieve the same hedge by diversifying their portfolios at a much lower cost than those associated with a merger (Servaes, 1996), and if the manager is not familiar with this new domain, they can pick up

Critical Success Factors in Merger & Acquisition Strategies: Evaluation of Turkish Market

additional risk (Wu, 2009). Markovits,(2012) states that there are three types of conglomerate mergers; product diversification, geographic diversification and conglomerate mergers that eliminate an effective potential competitor.

Congeneric merger on the other hand is when a firm acquires another in the same industry, but neither in the same line of business nor a supplier or customer (Gitman, 1991) and produce complimentary activities (Gurusamy, (2009). Gurusamy, (2009) states that the purpose of congeneric merger is to benefit from the economies of scale and not to reduce the number of competitors.

Mergers that take place between or among firms in the same line of business are called horizontal mergers, such as when banks merge. When companies who are at different stages of production and distribution of a product merge, it is a vertical merger. A vertical merger can be a forward or backward vertical merger. In a forward vertical merger, the acquiring company expands forward toward the ultimate consumer. It may purchase a company that supplies it with a distribution net-work for its products, i.e., it acquires a company that it sells to. In a backward vertical merger, the acquiring company expands backward toward the source of its raw materials. For instances, a soft drink company might purchase a sugar manufacturer. A conglomerate merger takes place when the companies involved are in unrelated lines of business (Hock, 2015).

Mergers are undertaken for either strategic or financial reasons. Strategic mergers seek to achieve various economies of scale by eliminating redundant functions, increasing market share, improving raw material sourcing and finished product distribution, and so on. In these mergers, the operations of the acquiring and target firms are combined to achieve synergies, thereby causing the performance of the merged firm to exceed that of the pre-merged firms. Financial mergers are based on the acquisition of companies that can be restructured to improve their cash flow. These mergers involve the acquisition of the target firm by an acquirer, which may be another company or a group of investors that may even include the target firm's existing management. The objective of the acquirer is to cut costs drastically and sell off certain unproductive or non-compatible assets in an effort to increase the target firm's cash flow (Gitman, 2012).

Due Diligence for M&A Transactions

Weiner (2010) defines due diligence as a future-oriented super audit to help minimize the risk and maximize the shareholder value of an M&A transaction. According to White (2005), companies that enter into M&A activities should pursue a thorough and detailed due diligence process. In line with these definition and arguments we can clearly state that due diligence is at the heart of M&A process. White (2005:17) lists the related due diligence areas and goals as stated in Table 1.

Table 1: Areas of Due Diligence

Area	Goal
Strategic Positioning	Confirm an understanding of market position
Operational Performance	Confirm an understanding of operations procedures
Financial and Tax	Validate historical and current numbers
Legal Evaluation	Understand the corporate structure/legal issues

Source: White, B. B. (2005). Getting the most out of the due-diligence process. *Mortgage Banking*, 65(10).

Mergers and acquisitions typically involve a substantial amount of due diligence by the buyer. Before committing to the transaction, the buyer will want to ensure that it knows what it is buying and what obligations it is assuming, the nature and extent of the target company's contingent liabilities, problematic contracts, litigation risks and intellectual property issues, and much more. This is particularly true in private company acquisitions, where the target company has not been subject to the scrutiny of the public markets, and where the buyer has little (if any) ability to obtain the information it requires from public sources (Harroch and Lipkin, 2014).

Byington et al. (2005) lists some critical questions that should be asked during M&A process as follows;

- If the acquiring company is in the same general business field, are the software systems being used by the target company compatible? In which direction is a transition most feasible?
- Will the management team of the target company be willing to stay at a reasonable salary until a viable transition can take place?
- Will a significant increase in volume allow for decreased cost per unit?
- Will new technology be required to increase volume?
- What is the growth pattern trend of the targeted company?
- Is this an enthusiastic workplace?
- How difficult is it for the targeted company to recruit and maintain staff?
- Are effective training programs in place?

Critical Success Factors in Merger & Acquisition Strategies: Evaluation of Turkish Market

- Who has made the decisions as to how major costs have been booked?
- Have independent accountants/auditors reviewed booking procedures?
- What is the preferred method of this purchase, cash or stock?
- What would be a reasonable time period for the acquiring company to assume all management responsibility?

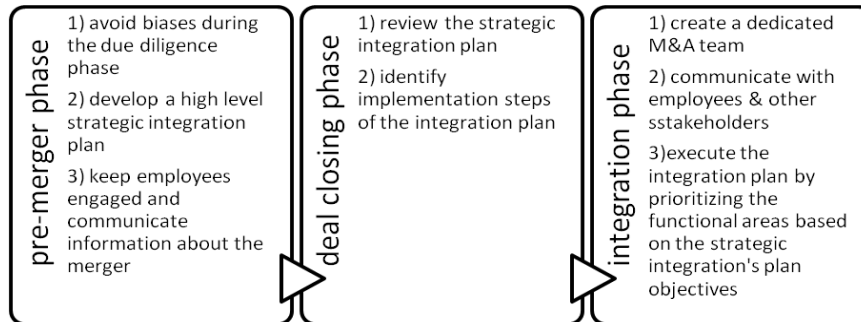
The potential risk in due diligence is not that companies fail to do it, but that they fail to do it well. Due diligence process should be considered as a vital step and companies should act accordingly.

Integration

Mergers have the potential for profit but Weber et al. (2013) lists three factors about this potential; organizational problems that occur after the merger entail many costs that negate the potential profit or do not allow for the realization of the M&A. secondly, there is a methodological problem with the measurement of the success and profitability of mergers and acquisitions, and therefore the existing profitability is not evident. Finally, the M&A causes reactions among external stakeholders that offset possible positive consequence. Such reactions include how customers decide to change their ways of buying products, whereas a continuous cash flow from these customers was part of the valuation of the acquired party. It is possible that only certain types of mergers bring a profit to the stockholders, whereas others do not.

Most mergers and acquisitions (M&A) fail to meet the expectations of the purchasers. It is clear that the due diligence, valuation analysis, and negotiation that precede the closing of a transaction cannot guarantee its success. Instead, the synergies and assumptions that supported the decision to acquire a target business will be realized only if the purchaser effectively integrates the target. Unfortunately, many purchasers either fail to plan the integration of the target adequately or conduct the integration process too slowly (Venema, 2015). Schmid et al. (2012) explains best practises for integration under 3 phases that explained in graph below.

Executives know instinctively that corporate culture matters in capturing value from M&A. In a recent survey by McKinsey and the Conference Board, 50 percent said that "cultural fit" lies at the heart of a value enhancing merger, and 25 percent called its absence the key reason a merger had failed. But 80 percent also admitted that culture is hard to define (McKinsey, 2010).



Source: Schmid, Sanchez, and Goldberg (2012) M&A Today: Great Challenges, But Great Opportunities The Journal of Corporate Accounting & Finance 2012

Figure 1: Best Practises for Integration Through the M&A Process

Integration can be defined in general terms as the process of combining two companies into one entity at every level. Specifically, integration involves the synthesis of people into one corporate culture. The new culture may simply be the culture of the acquiring company that is superimposed on the acquired company or some new entity that is a combination of the best aspects of both corporate cultures. Integration is also the combining of the two companies' systems into one set. These may range from information systems like company e-mail and intranets to, human systems like HR and purchasing departments and their accompanying policies and procedures (Knilians, 2009)

According to Knilians (2009) there are seven key levers that can influence the success or failure of a cultural integration initiative:

- Integration teams, which can build the necessary relationships between the two companies;
- Speed, which refers to the sense of urgency (not haste) that must accompany the integration;
- Leadership ,or buy-in to the process from key members of the management team;
- Communication, which must be consistent both internally (associates, board) and externally (shareholders, customers);
- Retention of valuable employees who can help smooth the transition;
- Culture, second in importance only to results; and
- Results, which are the ultimate goals of the merger, and which should guide the process.

Critical Success Factors in Merger & Acquisition Strategies: Evaluation of Turkish Market

M&A in Turkish Market

In 2014, there was a total of 130 deals with disclosed values totalling US\$17.7 billion. Of these, 4 of them were above one billion US dollars and accounted for 51% of total transaction volume. While high value transactions increased the total transaction volume, considering the fact that only 21 deals were larger than US\$100 million, we observed a continuation of the interest in SMEs as in previous years. On the other hand, of the deals with undisclosed values, we know that many of them were realized with deal values greater than US\$100 million. Including our estimates for the deals with undisclosed values, we anticipate that the total transaction volume in 2014 was US\$22 billion.

As an emerging market dependent on external finance, exporting to Europe but also bordering Syria, Turkey faced more than its fair share of challenges in 2014. However the level of Turkish mergers & acquisitions activity remained resilient, largely thanks to the depth of investor interest and the continued dynamism of the middle market. Under Table 2 the top 10 deals in the year of 2014 are presented.

With the transportation sector dominating the deal values (with a total of 6386 million dollars), the Energy sector struck a close second (with 4283 million dollars). National Lottery M&A activity resulted in a total of US\$2,755.0 million during 2014, which was acquired by the Net Şans-Hitay Joint Venture e in Turkey. The most prominent M&A activity we see under the Energy sector (Kemerköy and Yeniköy Thermal Power Plants) however resulted in a total of US\$2,671.0 million during 2014 with a stake of 100% acquired by IC İċtaş in Turkey. Garanti Bank, which is the second largest operating bank in Turkey on the other hand, was acquired by a foreign group (BBVA) with a stake of 14.89% for US\$2,463.0. The only retail firm on the list, Migros, was acquired by Anadolu Endüstri Holding for a stake of 40.25% for a deal value of US\$799.2. Under Table 3 the Merger and Acquisition deals in the years between 2010-2014 are presented.

Ali Fatih Dalkılıç and Melissa Nihal Cagle

Table 2: Top 10 Deals in 2014

Target	Sector	Acquirer	Country of Acquirer	Stake	Deal Value (US\$ million)
National Lottery	Services	Net Şans-Hitay Joint Venture	Turkey	N/A	2,755.0
Kemerköy and Yeniköy Thermal Power Plants	Energy	IC İçtaş	Turkey	100.00 %	2,671.0
Garanti Bank	Financial Services	BBVA	Spain	14.89%	2,463.4
Yatağan Thermal Power Plant	Energy	Elsan Elektrik	Turkey	100.00 %	1,091.0
Milas-Bodrum Airport	Transportation	TAV Havalimanları Holding	Turkey	N/A	989.0
Dalaman Airport	Transportation	YDA İnşaat	Turkey	N/A	977.0
Migros	Retail	Anadolu Endüstri Holding	Turkey	40.25%	799.2
Fenerbahçe -Kalamış Marina	Transportation	Tek-Art Kalamış and Fenerbahçe Marmara Tourism Facilities	Turkey	N/A	664.0
Derince Port	Transportation	Safı Katı Yakıt	Turkey	N/A	543.0
Orhaneli and Tunçbilek Thermal Power Plants and BLI Immovable Assets	Energy	Çelikler İnşaat	Turkey	100.00 %	521.0

Source: Ernst and Young (2015). Mergers and Acquisitions Report Turkey 2014

**Critical Success Factors in Merger & Acquisition Strategies:
Evaluation of Turkish Market**

Table 3: M&A deals in 5 years Deloitte 2014 report

Year	2010	2011	2012	2013	2014
Deal Number	190	237	253	215	236
Deal Volume	US\$17.3 billion	US\$15.0 billion	US\$22.0 billion	US\$17.5 billion	US\$21 billion
Privatizations / Share in Total	US\$2.9 billion / 17%	US\$1 billion / 7%	US\$6.4 billion / 29%	US\$6.6 billion / 38%	US\$8.6 billion / 41%
Foreign Investors	60% of deal value	74% of deal value	59% of deal value	30% (*) of deal value	38% (*) of deal value
Financial Investors	5% of deal value	8% of deal value	7% of deal value	12% of deal value	10% of deal value
Average Deal Size (**)	US\$91 mn	US \$63 mn	US\$87 mn	US\$81 mn	US\$89 mn
Share of Largest 10 Deals in Total Volume	61%	56%	71%	49%	58%
Largest Deal Value / Share in Total	US\$5.8 bn (Garanti Bank) / 34%	US\$2.1 bn (Genel Enerji) / 14%	US\$3.8 bn (Denizbank) / 17%	US\$1.7 bn (Toroşlar Electricity Disco) / 10%	US\$2.8 bn (Milli Piyango) / 13%

Source: Deloitte (2014) Annual Turkish M&A Review

The deal numbers have generally increased over the years. However, the largest number of deals went down in the year of 2012 with a total of 253 and volume of US\$22.0 billion. This accounted for US\$6.4 billion (which equals 29% of shares) in privatizations and 59% of which the deal value was provided by foreign investors. Out of the 10 largest shares in deal volume 2012 was equal to roughly 71%- the largest out of the 5 example years. An example of the largest deal that went down in this year is Denizbank at US\$3.8 billion (17% in shares).

DISCUSSION AND CONCLUSION

M&A is a tactic to execute strategy. It is not the strategy itself. Companies need to have a clear, well-defined strategy for their specific business pursuits. As part of the process, the business leader (typically the CEO) needs to consider all possible alternatives such as in-house development, license, partner, co-investment, acquire, merge, and so on, and come to the specific conclusion that a specific acquisition or merger

is the best way to go. There are three primary motivations for companies to make acquisitions (Edwards, 2014):

- Fill a strategic gap in the company's products/services, capabilities, technology, labor, processes, capacities, and so on.
- Enter or expand market access.
- Economies of scale, efficiency, effectiveness, and other profit-enhancing opportunities.

Andrade and Stafford (2004) states that there is a growing empirical literature documenting that mergers are efficient means for assets to be reallocated within the economy. M&A's are not easy to undertake and require a great deal of legal, financial and tax planning. Mergers and acquisitions are the vital part of any healthy economy and the primary way that companies are able to provide returns to owners and investors.

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**Critical Success Factors in Merger & Acquisition Strategies:
Evaluation of Turkish Market**

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Ali Fatih Dalkılıç and Melissa Nihal Cagle

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**Critical Success Factors in Merger & Acquisition Strategies:
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