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The Effect of Acquisition Synergy on Firm Perfomance moderated by Firm Reputation

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Abstract

Purpose: This study was conducted to examine the impact of the operating synergy, financial synergy and firm reputation toward firm performance in merger and acquisition processes. This study also examines how firm reputation moderates the impact of operating synergy and financial synergy toward firm performance. The object of this research are companies involved in mergers and acquisitions between 2010 and 2016.

Design/methodology/approach: The purposive sampling method is used to select the research sample. The descriptive statistical test, outlier test and hypothesis test is used to analyze the data using e-eviews program. The study assumed Buy and Hold Abnormal Return (BHAR) as the performance to measure a successful acquisition, and the factors that have an impact on acquisition performance are taken as being operating synergy, financial synergy and firm reputation.

Findings: The results of this study show that by maximizing the operating synergy and firm reputation, this can improve the BHAR of an acquisition event, and a firm will a weak reputation can strengthen the BHAR by maximizing the operating synergy.

Practical implications: These findings will be very helpful to management to maximize their firm performance using merger and acquisition as their strategy and firm reputation as their intangible resources.

Originality/value: This article provides a new insight of acquisition research as to how firm reputation moderates the impact of acquisition synergy to achieve firm performance.

1. Introduction

Mergers and acquisitions are an important tool or strategy for survival used by many companies in today's competitive business environment. The essence of mergers and acquisitions is the assumption that the value of two joint companies will be greater than the one and this is called synergy. Companies join or acquire other companies to harness each other's strengths and this results in an increase in market share and profitability that is essential for the survival of the company. Mergers and acquisitions allow companies to work as a whole and thus increase their total market value. Mergers and acquisitions become a means of survival and as a competitive weapon of business companies use in the world today (Alam, Khan, & Zafar, 2014).

The study of merger and acquisition performance has been part of the science of strategic management, corporate finance, organizational behavior, and international business literature for decades. In economic theory, mergers and acquisitions can increase market power and productivity efficiency with knowledge transfer and relocation of assets or relocation of more efficient resources, thus providing benefits to consumers in the form of higher quality products or lower prices. Companies that make acquisitions from developed countries will achieve a significant value growth, namely a reduction in marginal costs so that marginal profits become higher after the acquisition (Stiebale & Vencappa, 2018).

In acquisition research, there is also an unexplored part, which is firm reputation. A part of the company that consistently achieves stakeholder expectations by delivering valuable results is firm reputation (Haleblian, Pfarrer, & Kiley, 2017; Lange, Lee, & Dai, 2011; Petkova, Wadhwa, Yao, & Jain, 2014; Pfarrer, Pollock, & Rindova, 2010). When the acquisition and merger process occurs, the reputation of the acquisition company becomes an important element to assess the performance after the acquisition, and then will influence consumers to continue to choose the product in the future. Consumers believe acquisition companies with a good reputation will improve or maintain the quality of products of the target company. Similarly, consumers who like acquirers with a good reputation are seen to continue to choose products from the target company. This is because they believe the acquirer will transfer competencies and assets (Haleblian et al., 2017).

There are differences between the acquisition objectives, namely operating synergy and financial synergy. Operating synergy aims to gain profits through a combination of the acquirer company with the resources of the acquired company, such as revenue growth through new product offerings or cost savings due to changes in economies of scale. Whereas financial synergy aims to gain profit through a combination of acquirers and targets through the company's financial structure, including tax savings, lower capital costs, diversification of cash flow or decreases in profits caused by lack of good management so that it is undervalued (Rabier, 2017).

Similar studies have been investigated by other researchers, such as (Cheny & Gayle, 2018; Hamza, Sghaier, & Thraya, 2016; Meier & Schier, 2016; Rabier, 2017; Tarba, Ahammad, Junni, Stokes, & Morag, 2017; Yaghoubi, Yaghoubi, Locke, & Gibb, 2016) who examine the synergy of operations as a goal of acquisition of company performance. Whereas (Duan, & Jin, 2019; Duan & Li, 2015; Erel, Jang, & Weisbach, 2015; Hamza et al., 2016; Yaghoubi et al., 2016) examine financial synergy as an acquisition goal to company performance but there is no research that uses firm reputation as a mediator. Based on research by (Cheny & Gayle, 2018; Fong, Lee, & Du, 2013; Hassan, Ghauri, & Mayrhofer, 2018; Jenner, Sautner, & Suchard, 2017; Matarazzo, De Vanna, Lanzilli, & Resciniti, 2017; Sigera & Cahoon, 2018; Wæraas & Sataøen, 2015) operational synergies and financial synergies as acquisition goals have an impact on (Cabral, 2016; Cellier & Chollet, 2016; Chalençon, Colovic, Lamotte, & Mayrhofer, 2017; Erden, Klang, Sydler, & von Krogh, 2015; Gao, Zuzul, Jones, & Khanna, 2017; Haleblian et al., 2017; Popli, Ladkani, & Gaur, 2017; Zavyalova, Pfarrer, Reger, & Hubbard, 2016) firm reputation and have a significant positive relationship on company performance.

2. Literature Review and Hypothesis Development

2.1 Acquisition Perfomance

Company performance is a topic that continues to exist in merger and acquisition research since 1991 (Ferreira, Santos, Almeida, & Reis, 2014). Company performance in merger and acquisition research has many different definitions. In the research of Popli et al., (2017) and Rabier, (2017) they define the company's performance as measured by Buy and Hold Abnormal Returns (BHARs) which replicate the conditions of a passive investment strategy where investors buy shares and maintain them for a certain period. The time interval of BHARs used is 2 years after the announcement of the acquisition is done to find out whether the acquisition will add value to the company or destroy the company's own supply.

$$BHAR = \frac{MV_{n+2} - MV_n}{MV_n}$$

where:

BHAR = Buy and Hold Abnormal Return

MV_{n+2} *= Share market price after 2 years event*

MV_n *= Share market price on day event.*

Source: (Rabier, 2017)

2.2 Operating Synergy

Operating synergy in acquisition will provide sales resources and human resources that will be mutually used by both companies so they can improve company performance. The purpose of operating synergy in acquisitions is more as an achievement rather than increasing sales potential, decreasing production costs and decreasing operating costs (Malik, Khan, Melati, Khan, & Khan, 2014; Ogada, Njuguna, & Achoki, 2016).

Operating profit margin is a measurement for operation synergy because it is a combination of operational synergy, which includes economies of scale represented by sales, efficiency of production costs represented by gross profit and efficiency of operating costs represented by operating expense. Therefore, one can conclude that operating profit margin can be used to measure operating synergy (Režňáková & Pěta, 2018).

$$OPM = \frac{Operating\ Profit}{Net\ Sales}$$

Source: (Režňáková & Pěta, 2018)

2.3 Financial Synergy

In an acquisition, financial synergy is achieved by reducing tax costs, reducing funding costs, improving financial structure or raising the loan platform (Malik et al., 2014). Financial synergy can be measured by improved debt capacity. Improved debt capacity as measured by leverage ratio, is a financial synergy that can increase company performance. This is because higher debt capacity illustrates that the company will get a more balanced cash flow that can reduce the company's risk rating. The results also found that the improved debt capacity has a significant positive impact on company performance (Moreira & Janda, 2017).

$$Leverage = \frac{Total\ Debt}{Total\ Equity}$$

Source: (Moreira & Janda, 2017).

2.4 Firm Reputation

Firm reputation is a company resource that is difficult to measure because it is an intangible resource. Academics have been constantly looking for the most suitable and generalizable benchmarks for all companies in measuring firm reputation. Firm reputation is a result of perception accompanied by reality. Perceptions about a company are formed from previous experiences, public views, comments from analysts, promotions from the media and opinions from specialists. Reputation is an amalgamation of views and perceptions of stakeholders rather than a combination of profit and the company's price value. This valuation method provides a clear view of the reputation of the company. Firm reputation is an intangible asset of a company that underlies differences in company performance. Firm reputation affects the survival of the company. Firm reputation is an asset that can be utilized in all conditions, and therefore reputation is very helpful for the company (Barney, 1991; Kaur & Singh, 2018; Raithel & Schwaiger, 2015).

Price earning ratio is a type of valuation that illustrates the company's performance in the present, along with the potential for future growth. In general, the price earning ratio indicates how eager investors are to pay in order to get every profit generated by the company. A high price earning ratio is a healthy indicator of corporate finance that also gives an indication that investors have high expectations for the company's future (Kaur & Singh, 2018).

$$\textit{Price Earning Ratio} = \frac{\textit{Share Price}}{\textit{Earning Per Share}}$$

Source: (Kaur & Singh, 2018).

2.5 Operating Synergy and Firm Reputation

Sigera and Cahoon (2018) found that operating synergy has a significant positive impact on firm reputation because mergers and acquisitions are carried out so that companies have access to the intangible assets of companies that they join, such as, management reputation, integration of tasks focused on creating merger value and acquisition by integrating intangible resources such as capabilities, intellectual property, reputation and organizational processes. This integration will increase the economies of scale of companies that open new market potential or access new customers.

Fong et al., (2013) found that operating synergy is a motive for acquisition, especially if new market penetration will have a significant positive impact on firm reputation. Consumers will feel that the acquisition of a local company by a foreign company can provide a better-quality product or service because it will be standardized with the acquiring foreign company. Research conducted by Wæraas and Sataøen, (2015) found that operating synergy as an acquisition motive would have a significant positive impact on firm reputation. Companies that make acquisitions in the same field and companies that have a better reputation can be used to raise their own reputation with the aim of raising their own reputation class.

Matarazzo et al., (2017) found that operating synergy as an acquisition motive will have a significant positive effect on firm reputation. Two companies that become one and have one business culture or the same market segment will look better in the perception of local consumers, because there is not too much cultural differences. In addition to being able to increase company performance, Haleblian et al., (2017) stated that companies that have a high reputation will more often make acquisitions and mergers to maintain the firm's reputation.

H_1 = Operating synergy has a significant effect on firm reputation.

2.6 Financial Synergy and Firm Reputation

In their research, Cheny and Gayle (2018) found that financial synergy will have a significant positive impact on firm reputation because both companies will get greater market access. In the research of Hassan et al., (2018) it was found that the disclosure of information on the purpose of the acquisition, especially the openness of the goal of financial synergy, has a significant effect on firm reputation because the disclosure of information will provide a clear goal for the company to pursue the acquisition goals, making it easier for management to pursue the acquisition goals that make the company, in the eyes of investors, more reputable. Jenner et al., (2017) found that if the purpose of acquisition is financial synergy, this would have a significant positive impact on firm reputation because if a company made full disclosure of information, financial synergy would provide security value to investors that the company is open to improving the financial problems faced and this increases the value of firm reputation in the eyes of investors.

Petkova et al., (2014) also found that if the purpose of acquisition is financial synergy, this would have a significant positive impact on firm reputation because companies tend to choose acquisitions that can reduce financial risk to raise firm reputation. In the research by Nguyen, Yung, & Sun, (2012) they found that the if purpose of acquisition is financial synergy, this will have a significant positive impact on firm reputation due to a hubris theory that corporate management prefers to make acquisitions with financial synergy companies to raise the reputation of management personnel who will in turn raise firm reputation.

In the research of Hassan et al., (2018) they found that the information disclosure relating to acquisition goals, especially the openness of financial synergy goals, has a significant effect on firm reputation because disclosure of information will provide clear goals for companies to pursue the acquisition goals, making it easier for management to pursue the acquisition goals which makes the company in the eyes of investors more reputable.

H_2 = Financial synergy have a significant effect on firm reputation.

2.7 Firm Reputation and Firm Perfomance

Haleblian et al., (2017) found that firm reputation has a significant positive impact on company performance. This is because companies with high reputation will always try to follow the demands or expectations of investors by maintaining competitive advantage in business competition due to the moral burden borne by the company's management to maintain its reputation. Cellier & Chollet, (2016) and Zavyalova et al., (2016) find that firm reputation has a significant positive impact on company performance, since, in case of errors, management will get more bad recognition from stakeholders. It can be concluded that a good reputation is a moral burden for the company to always maintain its performance.

In Cabral's (2016) research, firm reputation has a significant positive impact on company performance because companies that already have a high reputation will be more motivated in maintaining reputation by achieving good performance. A good reputation will also make it easy for companies to access new market. Research by Chalençon et al., (2017) found that firm reputation has a significant influence on company performance, especially on electronic reputation or E-reputation, because the openness of information at the present time makes the information on a company's reputation reach consumers faster. Making it easier for companies to penetrate the market.

H_3 = Firm reputation have a significant effect on firm performance.

2.8 Operating Synergy and Firm Perfomance

Rabier, (2017) found that operating synergy will experience a greater increase, if it aims to increase the competitive ability or competitive advantage of the acquirer company. Therefore, if the acquisition goal is operating synergy, this will have a significant positive effect on company performance. The same results were also obtained in the research of Cheny and Gayle, (2018) who found that if the two companies that merged were once tight competitors, the level of competition would decrease, making company performance better because of the greater market share they control.

In their research, Meier and Schier, (2016) found that companies that have operating synergy have a significant positive impact on company performance because the transfer of knowledge will provide new innovations in terms of products and production efficiency that will make company performance improve. Growth through mergers and acquisitions has become a new choice for companies to innovate. Through acquisitions of start-up companies that have been successful, they in turn achieve successful results. Research by Hoberg and Phillips, (2010) found that companies' operating synergy has a significant positive impact on company performance due to the potential for adding new products to increase company performance. Companies that have patents, copyrights and brand rights will more often be targeted for acquisitions because there is potential for the addition of new products.

H_4 = Operating synergy have a significant effect on firm performance.

2.9 Financial Synergy and Firm Perfomance

In the study of Williamson and Yang, (2013) they found that financial synergy as an acquisition motive has a significant positive impact on financial performance because mergers and acquisitions will provide new solutions for companies to obtain wider and newer sources of funding that will help to ease the burden of funding and improve company performance. The same results were also obtained in the study of Erel et al., (2015) who state that financial synergy as an acquisition motive has a significant positive impact on financial performance because mergers and acquisitions will provide a reduction in the cost of capital for the company due to the opening of more new funding sources.

Yun Duan and Li, (2015) found that financial synergy as an acquisition motive would significantly improve financial performance because after mergers and acquisitions, the company would be able to focus on restructuring the company's capital which could increase the company's performance. The results of Yang Duan and Jin, (2019) conducted again in 2019 found that financial synergy as acquisition motive would have a significant positive impact on financial performance because of the transfer of resources or wealth spillover which gives greater access to resources to the acquirer or the acquired company.

The research of Hamza et al., (2016) found that financial synergy as an acquisition objective has a significant positive impact on company performance. This is because companies that have financial synergy as an acquisition motive will be able to reduce the risk of financial distress which will increase company performance.

H_5 = Operating synergy have a significant effect on firm performance.

2.9 Operating Synergy, Financial Synergy and Firm Perfomance with Firm Reputation as Moderator

Resource based theory explains that companies can use their internal resources to achieve sustainable competitive advantage. Companies can obtain sustainable competitive advantage by implementing strategies that exploit internal resources, capture surrounding opportunities, neutralize external threats and avoid internal weaknesses. The resource-based view relates to creating sustainable competitive advantage, which through internal capabilities, can be facilitated by integrating and generating synergies in mergers and acquisitions. All resources are controlled by the company and allow the company to implement its strategy. Competitive advantage refers to when companies implement a value creation strategy, not simultaneously implemented by current competitors or potential competitors (Barney, 1991)

Reputation is a multidimensional, inter-connected resource that can be manipulated independently in experimental settings to influence strategic decisions. In fact, the data shows that there is a relationship between the acquired company's reputation dimensions and the decision to proceed with the acquisition. These include product quality, management and financial reputation. A company's reputation is also an intangible company resource. These resources not only provide opportunities and profits when companies do business but also provide high negotiable power at the time of the transaction (Shen, Tang, & Chen, 2014). Therefore, the relationship between acquisition synergy and acquisition performance will be stronger when the company's reputation resources are higher.

H_{6a} = Firm reputation will strenghten the significant effect of operating synergy to firm performance.

H_{6a} = Firm reputation will strenghten the significant effect of financial synergy to firm performance.

3. Research Methodology

This research is a quantitative study where the research data uses financial statements over a period of 5 years. The sampled financial statements used belonged to companies listed on the IDX and conduct M & A activities from 2010 - 2016. Companies that carry out M & A activities must be accompanied by an M & A decree on the KPPU website. The method of selecting samples used was purposive sampling. Descriptive statistical test and hypothesis test were used to test the data.

4. Research Finding

Table 1: Descriptive Statistics Result

	FP	PER	OPM	LEV
Mean	0.230667	2382.568	63.75713	1.570109
Median	0.000000	12.71788	21.72000	1.038075
Maximum	5.020000	349417.9	4320.220	13.54323
Minimum	-0.910000	-116.0093	-232.7900	0.000362
Std. Dev.	0.943132	28526.36	387.3018	1.979315
Observations	165	165	165	165

Source: *Authors' calculations (2019)*

Table 2: P Value Result & Summary of Hypothesis

No.	**IV**		**DV**	**Coefficient**	**P value**	**Criteria**	**Status**
H_1	*Operating Synergy*	→	*Firm Reputation*	14.76	0.0068	< 0.05	Significant
H_2	*Financial Synergy*	→	*Firm Reputation*	-3928.70	0.0002	< 0.05	Not Significant
H_3	*Firm Reputation*	→	*Firm Perfomance*	9.42	0.0015	< 0.05	Significant
H_4	*Operating Synergy*	→	*Firm Performance*	0.000490	0.0129	< 0.05	Significant
H_5	*Financial Synergy*	→	*Firm Performance*	-0.098593	0.0117	< 0.05	Not Significant
H_{6a}	*Operating Synergy moderated by firm reputation*	→	*Firm Performance*	1.9867	0.0469	< 0.05	Significant Weaken
H_{6b}	*Financial Synergy moderated by firm reputation*	→	*Firm Performance*	2.0048	0.0449	< 0.05	Significant Strenghten

Source: *Authors' calculations (2019)*

The results of the study show that operating synergy will significantly increase firm reputation. Different results are obtained from the financial synergy variable on firm reputation where the test results obtained show that this influence is insignificant. The results found that financial synergy would have a significantly negative effect on firm reputation. It is suspected that companies that make acquisitions because of financial problems is an indication that the company's management is unable to perform well. This can significantly reduce the firm's reputation in the eyes of the public and investors.

The results found that firm reputation has a significant effect on company performance. This result is in accordance with the resource based theory that firm reputation has a significant influence on company performance, andis consistent with the discussions of (Barney, 1991; Carmo & Marcondes, 2016; Shen et al., 2014) in which firm reputation can provide its own competitive advantage in improving performance as companies can focus more on improving performance.

Stakeholders will like a group of companies that have a good reputation. A company's good reputation is judged based on the company's ability to meet investor expectations. Among them are consistent achievements in high growth rates, growth values, and quality of growth (Flanagan et al., 2011). However, investors also expect companies with a good reputation to stimulate growth rates, growth value, and quality of growth relative to similar companies (Cabral, 2016; Graffin et al., 2013; Mishina et al., 2012; Petkova et al., 2014).

The results found that companies with operating synergy would have a significant effect on company performance, compared to companies with financial synergy (Rabier, 2017). The motives for merging acquisitions are complex, diverse and change over time, which causes each acquisition to be valued individually. Management is motivated for and against mergers in many ways, for example, as a business growth strategy or as a means to implement a business strategy, and not the business strategy itself. Mergers and acquisitions can also be a means to create shareholder value by utilizing synergies, increasing growth, replacing inefficient managers, gaining market power, and taking advantage of financial and operational restructuring.

Acquisitions based on operating synergy can also provide a larger and wider market share to the company. If an acquisition is made in the form of an acquisition between two companies in the same industry, of course this can be done because the transfer of knowledge will provide new innovations in terms of products and in terms of production efficiency which will make the company's performance improve (Meier & Schier, 2016). It can also have the potential for adding new products (Hoberg & Phillips, 2010). Acquisitions in the same industry can also reduce competitors in the market, reduce choice in customers, increase negotiation power to customers which can increase the company's market share (Basmah & Rahatullah, 2014; Cheny & Gayle, 2018) and reduced the number of competitors in the market which will make the company focus more on market expansion (Hamza et al., 2016; Tarba et al., 2017) so that it can improve company performance directly.

The results found that financial synergy has a significant negative effect on company performance. This is allegedly because the company chooses the acquisition because of financial factors in the form of problems in the company's capital system, resulting in the company having to focus on fixing the existing financial problems first. So, it cannot focus on increasing company performance. This is based on the fact that operating synergy is aimed to increase performance through market expansion, production cost efficiency and operational cost efficiency. This is different from financial synergy, which is aimed to improve company finances that are being hit by financial problems and facing financial distress. This will decrease the company's performance significantly.

Operating synergy without high reputation will get better performance than a company that has a good reputation. It is suspected that a company with a high reputation already has a better performance than a low reputation one.

Companies which have financial synergy and a high reputation will get better performance than companies that do not have a good reputation. It is suspected that a company with a high reputation already has better performance, only experiencing problems in financial management so that the company must go through corporate actions to improve its financial management. This is different from a company without a high reputation, because the performance of the company is still low, whilst still experiencing financial management problems, and the performance of the company will not certain to be better despite the corporate action of the merger or acquisition by the company.

5. Conclusion

This research has broadly answered several questions relating to problems that occur in the acquisition and merger research, and how the purpose of the acquisition can have an impact on company performance. Mergers and acquisitions can be a strategy for achieving sustainable competitive advantage, but these benefits depend on orders and access to effective utilization of organizational resources and knowledge expressed in resource based theory.

In accordance to resource based theory, mergers and acquisitions are carried out so that companies have access to intangible assets from companies they acquire or join. Companies that have operating synergy without a high reputation will perform better than companies that have a good reputation. Financial synergy of companies with a high reputation will perform better than companies that do not have a good reputation.

Firm reputation is an intangible resource that will provide competitive advantage to companies, especially in increasing company performance. The better a firm’s reputation, the higher the company's performance that will be achieved. A company that is getting better or has a good reputation will find it increasingly difficult to increase its performance through corporate actions.

The main implication in this research is that a company can increase its company performance through corporate action acquisitions by maximizing operating synergy, especially in companies that have a low reputation. A company with a high reputation will benefit from competitive advantage in the business world which can increase company performance. Companies should continue to maximize operating synergy and acquisitions to maximize company performance and company reputation. Companies that experience financial problems should not choose mergers and acquisitions as a solution to fix said financial problems. This action will significantly reduce company performance or company reputation. If the company's reputation has reached a high point, mergers and acquisitions can no longer be used as an action in maximizing company performance.

The limitation of this research,, which could be addressed in future studies, is the measuring of firm reputation using price earning ratio as a measurement variable. This measurement is limited in representing firm reputation since it cannot represent perceptions of other stakeholders' reputation such as customers, management company and others. The measurement on operating synergy variables was measured only by operating profit margins and this limits the analysis which could be more detailed in terms of the growth of other operating synergy. Measurement on the financial synergy variable was measured only by leverage that only represents the capacity of the company's capital structure and cannot represent savings in funding costs or savings in tax costs. The acquisition objective variable is limited only to the goal of operational synergy and financial synergy. The stance that the best acquisition objective is to increase the company's performance could be analyzed in more detail.

Future research could use other acquisition objective variables such as diversification, or conglomerate acquisition as acquisition goal variables to find out more detail about the best acquisition goals in achieving the best company performance. In addition to firm reputation as the basis for resource based theory in intangible resources, future research can use competitive advantage, intellectual property resources, organizational assets and capabilities which are extensions of intangible assets as intervening variables. This is because, in the acquisition process, the possibility of intangible assets will be transferred from the acquired company to the acquiring company or vice versa. Subsequent research could explore the measurement of reputation variables other than using price earning ratio as a measure of firm reputation variables. In addition to firm reputation, future research could also try to use a more detailed definition of reputation such as brand reputation owned by the company and/or the reputation of the board of directors rather than firm reputation based on intangible assets owned by the company.

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