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## A STUDY ON IMPACT OF MANAGERIAL ABILITY ON MERGER AND ACQUISITION PERFORMANCE

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**Abstract.** The purpose of this study is to explore the correlation between managerial ability and the performance of mergers and acquisitions (M&A). The research examines the impact of managerial ability on both short-term and long-term performance of the acquiring firm. The period of study is from 2016 to 2021, using two metrics which are Market-to-Book Ratio (MTBR) to assess operating performance and Buy-and-Hold Abnormal return (BHAR) to quantify stock return performance. By analyzing data from a sample of M&A cases conducted by public companies registered within KPPU in Indonesia, this study aims to establish whether a positive correlation exists between managerial ability and M&A success. The research concludes that successful M&As depend on effective decision-making by managers, who play a critical role in navigating the complexities of integration and value creation. The findings can contribute to the understanding of factors that influence M&A outcomes and potentially improve investment decisions by emphasizing the importance of managerial competence in such endeavors.

**Keywords:** business; managerial; merger and acquisition

**For examples:** Accounting; Business; Creative Industry; Digital Marketing; Economic Growth

### 1. INTRODUCTION

Mergers and acquisitions (M&As) are vital growth strategies for organizations in the current changing business climate. Although organizations have the option to expand domestically or through external takeovers, acquisitions typically provide a quicker means of growth and rapid financial inflows. Acquisitions play a crucial role in the efficient allocation of a firm's resources and the creation of valuable assets (Capron and Mitchell, 1998; Capron and Pistre, 2002; Carow et al., 2004). The advantages of acquisitions include reduced initial expenses, bypassing new entrance obstacles, and faster acquisition of resources in comparison to internal development (Roberts and Berry, 1984; Singh and Montgomery, 1987; Capron, 1999; Lambe and Spekman, 1997; King et al., 2003). Therefore, mergers and acquisitions (M&As) are efficient mechanisms for acquiring resources and achieving expansion (Hitt et al., 2002). Nevertheless, empirical studies have frequently been unable to discover consistent proof of enhanced financial resources for purchasing companies after the transaction takes place (Tuch and O'Sullivan, 2007; Agrawal and Jaffe, 2000). Possible causes for this situation include complicated integration processes, insufficient assessment of the objective, substantial debt, or inadequate tactics for integration (Hitt et al., 2007; Vasilaki and O'Regan, 2008).

Many organizations view mergers and acquisitions as strategic investments aimed at improving their competitive advantage (Tuch & O'Sullivan, 2007). The motivations for these actions involve enhancing the reputation of the corporation, broadening its assets, and augmenting the wealth of its shareholders (Aprilita et al., 2011). The resource-based view of the company emphasizes that the capacity of top management is a crucial factor in creating value. This ability plays a significant role in

understanding why organizations make different decisions and achieve different outcomes (Holcomb et al., 2009).

Managerial skill is sometimes assessed indirectly by examining CEO traits, although this approach may not fully encompass management performance (Chikh and Filbien, 2011; Walters et al., 2007; Bertrand and Schoar, 2003). This study utilizes Demerjian et al.'s methodology to empirically examine the influence of management competence on M&A expansion plans. Studies suggest that mergers and acquisitions (M&As) do not consistently result in enhanced profitability and worth. Nevertheless, there is a lack of research investigating the correlation between managerial competence and the performance of mergers and acquisitions in Indonesia. This study overcomes the absence of information by examining the extended-term outcomes of mergers and acquisitions in Indonesia in relation to management competence. This study enhances the existing body of knowledge on M&A strategies in Indonesia by presenting new information on the effects of M&A on company performance.

## 2. LITERATURE REVIEW

### Resourced Based View Theory

Mergers and Acquisitions (M&A) are important strategic choices for companies, however the majority of them lead to unsatisfactory outcomes. This study examines the impact of managerial talents on the results of mergers and acquisitions. Three theoretical viewpoints are analyzed to elucidate this relationship: Resource-Based View (RBV) and Neoclassical Theory. The Resource-Based View (RBV) highlights the importance of a firm's distinctive capabilities, such as experienced staff and efficient processes, which are essential elements for successful mergers and acquisitions (M&A). RBV also acknowledges exceptional managerial aptitude as a valued asset that has a substantial influence on M&A results.

These managerial skills comprise a wide range of abilities. Strategic planning and decision-making are crucial for effectively managing the intricacies of Mergers and Acquisitions (M&A), encompassing tasks such as finding appropriate acquisition targets and devising a prosperous integration strategy. Moreover, possessing proficiency in integration and managing changes is essential for effectively dealing with the difficulties caused by merging two separate entities. Competent managers have the ability to recognize and exploit the combined advantages of the merging companies, optimizing the potential advantages resulting from the merger and acquisition. Ultimately, effectively motivating and directing employees during the frequently disruptive M&A process is crucial for preserving morale and facilitating a seamless transition after the merger.

The success of any merger and acquisition depends on the efficient integration of the obtained resources into the current organization. RBV emphasizes that possessing exceptional managerial skills is crucial for successfully addressing these integration obstacles. These proficient managers are capable of establishing unambiguous communication channels, developing effective post-merger procedures, and optimizing integration, finally guaranteeing the seamless operation of the merged organization. Research conducted by (Wernerfelt, 1984) provides evidence that companies with stronger managerial skills achieve better performance after mergers. It highlights the significance of corporate resources in obtaining a lasting competitive advantage. RBV believes that the success of mergers and acquisitions depends on managers' adeptness in effectively leveraging consolidated resources and cultivating novel competencies, thereby enhancing the performance of the company.

### 2.1 The correlation between management ability and Market-To-Book Ratio (MTBR)

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The success of mergers and acquisitions (M&A) depends on the managerial competence. The studies conducted by (Hitt et al. (2005), Eisenhardt & Martin (2000), and Felin & Hesterly (2007)) emphasize the significance of strategic decision-making, adaptive abilities (the ability to adjust resources), and cultivating a culture of learning in order to achieve successful integration in mergers and acquisitions. The acquisition of these managerial talents has the potential to enhance value creation, which in turn can have an impact on a firm's Market-to-Book Ratio (MTBR). Barney (1991) highlights the significance of valuable resources in attaining a competitive advantage, whereas Teece et al. (1997) delve into the ways in which managerial ability can use resources to create value. A high MTBR indicates the market's opinion of a company's potential for future growth. Penrose (1959) emphasizes the significance of firm-specific information in establishing a competitive advantage, whereas Zollo & Winter (2002) examine how effective leadership might facilitate future expansion. This is consistent with the idea that a high MTBR (Mean Time Between Repairs) for a company being targeted for a merger or acquisition could indicate the existence of important intangible assets, such as a strong brand or significant research and development capabilities, which can contribute to the company's potential for future growth.

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H1: The acquiring company's managerial ability positively affects the market-to-book ratio (MTBR).

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The first hypotheses are tested both with and without the control variables.

## 2.2 The correlation between management ability and Buy-Hold Abnormal Return (BHAR)

Buy-and-hold-abnormal-return (BHAR) is considered the most common method for analyzing long-term market performance. It has been calculated by using both the market index and the matching firm approach. Ritter (1991) states that the mean buy-and-hold abnormal return (BHAR) is the most widely used estimator for long-term abnormal performance. Buy-and-hold abnormal returns refer to the average long-term return achieved by investing in all companies that undergo a specific event and then selling them after a predetermined period. This is compared to a similar strategy that involves investing in non-event companies with identical characteristics. Barber and Lyon (1997) and Lyon, Barber, Tsai (1999) contend that BHARs hold significance as they accurately assess investor competence. Buy-and-Hold Abnormal Return (BHAR) serves as a long-term performance metric employed to evaluate the post-merger stock price movement of the acquiring firm. It measures the extra return earned by a share compared with the return earned by the market as a whole over the same period.

A company's management performance plays a significant role in determining its Book-to-Asset Ratio (BHAR). Effective management can increase the company's profitability through various strategies, such as developing attractive products, improving operational efficiency, and making the right decisions. This will positively impact the company's share value, resulting in a positive BHAR. In addition, effective management is also able to build investor trust through clear and transparent communication. A positive BHAR suggests the acquiring firm's management made a strategic decision that benefited shareholders by exceeding the market average return. Conversely, a negative BHAR indicates underperformance, potentially raising questions about the deal's rationale and managerial capabilities (Moeller et al., 2004). Market events unrelated to the M&A can influence BHAR, requiring careful consideration of the chosen timeframe and potential confounding factors. Additionally, BHAR doesn't capture the synergies or strategic benefits that might not be immediately reflected in the stock price but could materialize in the long term (King &

MacKinlay, 2003).

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H2: The acquiring company's managerial ability positively affects buy-and-hold abnormal return (BHAR).

1  
The second hypothesis is tested both with and without the control variables.

### 3. RESEARCH METHODS

This study employs a quantitative methodology. The sampling method used is convenience sampling, which is a type of non-probability sampling approach. According to Andrade (2021) convenience sampling refers to the practice of selecting samples from readily available and reachable sources. This strategy was selected due to the limited number of publicly listed acquiring firms in Indonesia and the unavailability of financial disclosures for certain enterprises. Hence, the researcher employed publicly traded acquiring firms with accessible data for the year preceding and the year after the merger and acquisition occurrences.

The M&A transactions data associated with the examined cases were gathered from the published reports (2016–2021) by KPPU, which aligns with the Indonesian government's requirement for transparency and fair play in M&A. A total of 46 mergers and acquisitions events completed by 46 firms listed on the Indonesian Stock Exchange between 2016 and 2021 have publicly available data. The data in this study are derived from secondary sources, particularly the Center for Data Lab Refinitiv at Petra Christian University. The data covers a period of one year prior to and one year following the mergers and acquisitions of the organizations under investigation.

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This research adopts an explanatory correlation model based on deterministic philosophy, which focuses on uncovering cause-and-effect relationships objectively (Bhattacharjee, 2012; Meressa, 2022). Panel data regression analysis is used in this study to combine cross-sectional and time series data. This approach is used due to its capability to analyze data over numerous time periods and different subjects, thus delivering a comprehensive viewpoint on the relationships being investigated.

Performance in this research is proxied by Market-to-Book Ratio (MTBR) and Buy-and-Hold Abnormal Return (BHAR). MTBR is determined using market capitalization and netbook value proxies (Gitman, 2009). BHAR is calculated using the share price of the company, cumulative dividend of stock, and IHSG price one year after and before the M&A (Fakhri, 2019; Doeswijk et al., 2006; Abid & Muharam, 2015).

The independent variable in this study is managerial ability (MA), which reflects the efficiency of operational performance. Managerial ability is measured using the Data Envelopment Analysis (DEA) method, incorporating inputs such as COGS, SG&A, PPE, operating lease, R&D, goodwill, and other intangibles, with sales as the output (Demerjian et al., 2012).

The study uses size, leverage (LEV), and market-to-book value (MB) as control variables. Size is quantified by taking the natural logarithm of the total assets at the conclusion of the fiscal year prior to the announcement of the takeover (Cui & Chi-Moon Leung, 2020). Leverage is determined by dividing the total liabilities by the total assets at the conclusion of the fiscal year before the announcement of the takeover (Cui & Chi-Moon Leung, 2020). The market-to-book value is calculated by dividing the market value of common stock by the book value of equity at the end of the fiscal year prior to the announcement of the takeover (Cui & Chi-Moon Leung, 2020).

#### 4. RESULTS AND DISCUSSION

For both the year prior to (pre) and the year after (post) the merger or acquisition, the data came from the sample company's yearly financial statements and dividends event report. The data was analyzed descriptively using STATA 18 software. To provide information that is easily comprehensible, organized, and clear, the statistics are presented numerically in tables. The T-test is employed to compare two sets of interrelated data, namely the performance data of organizations utilizing MTBR and BHAR in relation to their management ability. To find out if there is a statistically significant difference, the test technique involves calculating the average difference over each of the data sets and the standard error.

**Table 1. t-test With Control Variables**

VARIABLES Y	VARIABLES X & CONTROL	(1) N	(2) Sig (2-tailed)	(3) Sd.error	(4) Hypothesis
MTBR	Managerial Ability	46	0.817	0.095	Dissignificant
	Size	46	0.558	0.348	Dissignificant
	Leverage	46	0.417	3.485	Dissignificant
	Market to book value	46	0.000**	0.251	Significant
BHAR	Managerial Ability	46	0.693	10.908	Dissignificant
	Size	46	0.539	40.024	Dissignificant
	Leverage	46	0.878	400.452	Dissignificant
	Market to book value	46	0.907	28.798	Dissignificant

Note: \*\* significance at 5%

**Table 2. t-test Without Control Variables**

VARIABLES Y	VARIABLES X	(1) N	(2) Sig (2-tailed)	(3) Sd.error	(4) Hypothesis
MTBR	Managerial Ability	46	0.655	0.104	Dissignificant
BHAR	Managerial Ability	46	0.711	9.750	Dissignificant

Note: \*\* significance at 5%

A statistically significant result ( $t=0$ ) for the market-to-book value with MTBR at the time of the M&A ( $t=0$ ) compared to one year later ( $t+1$ ) implies a potential correlation between the target firm's pre-merger valuation and the short-term performance of the M&A. This could be due to the acquirer's selection of target firms which may indicate a high level of managerial proficiency. The presence of valuable intangible assets or robust future growth prospects may be suggested by firms with a high MTBR ( $t=0$ ). Skilled managers who are in alignment with the RBV perspective may prioritize the acquisition of such targets in order to improve their own resource base and potentially achieve improved post-merger performance. Additionally, the market's initial response to the M&A announcement may be indicated by a substantial disparity in the MTBR ratio. The market's optimistic anticipation of the deal's potential to unlock value may be indicated by a high MTBR at  $t=0$ . Nevertheless, the MTBR ratio at  $t+1$  may suggest a more measured market evaluation following the initial

euphoria. This could be the result of unforeseeable circumstances or integration challenges.

Other than that, the market book value may be affected by accounting adjustments that are frequently implemented during mergers and acquisitions. Due to amortization or impairment charges associated with these intangible assets, firms that acquire firms with high intangible assets (as evidenced by a high MTBR at  $t=0$ ) may experience a decrease in the MTBR at  $t+1$ ).

#### 3 4.1 The relationship between managerial ability and market-to-book ratio (MTBR)

The relationship between managerial skill and a company's Market-to-Book Ratio (MTBR) may be more complex than a straightforward cause-and-effect scenario. While some studies indicate a beneficial relationship such as research conducted by Chen and Lin (2018), which found a positive association between managerial ability and both short-term and long-term stock returns. The Cui and Leung's (2020) research supports this, showing that a company's managerial skill is favorably and significantly influenced by its operating performance and long-term stock return performance after deciding whether to merge or acquire. However, these results correlate with the research of (Wibowo & Hamdani 2020), who demonstrate that mergers and acquisitions are unlikely to have a favorable impact on value creation and firm performance, both in the short and long term of the organization.

Establishing a statistically meaningful association can be challenging for plenty of reasons. One significant barrier is the difficulty in assessing managerial talent. It is a multidimensional notion that includes leadership, strategic thinking, and decision-making, all of which are difficult to quantify.

Furthermore, the association between administrative decisions and MTBR can develop gradually. Managerial decisions have both short and long-term consequences. The MTBR, which reflects market perception of a company's value relative to its book value, can be a lagging indicator. The true impact of excellent managerial actions on a company's MTBR may take some time to be completely reflected in market price. External factors beyond management's control complicate things even further. Industry developments, economic conditions, interest rates, and even investor mood can all affect a company's MTBR. These external circumstances might obscure the impact of administrative decisions, making it harder to determine the underlying cause and effect link.

There's also the question of short-term pressures vs long-term perspective. Publicly traded corporations are frequently under strong pressure to produce fast financial results. This can cause managers to prioritize short-term profits over long-term investments in resources or capabilities that might ultimately contribute to a higher MTBR. In some circumstances, a concentration on short-term benefits may impair the relationship between managerial aptitude and MTBR.

Finally, M&A transactions are complicated integrations with many moving components, including target company selection, strategy execution, and post-merger integration. Even in successful M&A transactions where MTBR increases, determining the particular contribution of managerial competence can be difficult. Other factors, such as synergy realization or market conditions, may also play an important impact.

#### 3 4.2 The relationship between managerial ability and buy-hold abnormal return (BHAR)

The results of this study indicate that there is no significant relationship between managerial ability and buy-and-hold abnormal return (BHAR). This finding aligns with the research by Agrawal and Jaffe (2000), which demonstrated that the abnormal returns to acquiring firms in the years following an acquisition are either negative or not statistically different from zero. This suggests that managerial ability

may not have a strong impact on the long-term abnormal stock price performance of acquiring firms post-merger.

This result contradicts the hypothesis (H2) that managerial ability positively affects BHAR, and diverges from previous studies such as those by Holcomb et al. (2009), which emphasized the importance of managerial capability in driving organizational outcomes. One possible explanation for this discrepancy is that the impact of managerial ability on BHAR might be overshadowed by other factors such as market conditions, industry characteristics, or the specifics of the merger itself. Additionally, as Moeller et al. (2004) noted, market events unrelated to the M&A can influence BHAR, complicating the isolation of managerial ability as a sole contributor to long-term abnormal returns.

Moreover, the lack of significance in this study could be attributed to the chosen timeframe and the potential confounding factors that were not fully accounted for. King and MacKinlay (2003) highlighted that BHAR might not capture the synergies or strategic benefits that could materialize over a more extended period, which might also explain why no significant relationship was found in the present analysis.

In conclusion, while managerial ability is a critical factor in organizational success, its direct impact on BHAR following M&As appears to be less clear-cut, suggesting that future research should consider additional variables and a broader context when examining the influence of managerial capability on long-term stock performance.

## CONCLUSION

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Our empirical findings reveal that post-acquisition operating performance and long-term stock return performance are not significantly related to the managerial abilities of acquiring enterprises. The market to book value plays a significant role towards company performance measured by MTBR. To maintain or increase MTBR, it is necessary to implement measures that improve the perceived worth of the combined business in the market, surpassing its net asset value. The success of a merger and acquisition depends on the ability to realize and maximize synergies between the companies involved. This could mean lowering costs by combining activities, making more money by expanding markets, or using combined research and development to come up with new products. Achieving these synergies increases market confidence towards the combined company's future growth prospects, potentially raising MTBR, and covers the cost paid during the M&A. In addition, it is important to consider strategic growth efforts such as introducing new products, expanding into new markets, or making strategic acquisitions that will improve the merged company's competitive position and potential for future growth. This might result in a greater market valuation compared to the value of assets, hence favorably influencing MTBR.

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