The Determinants of Mergers and Acquisitions (M&A) Activity in US and EU

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Abstract: This paper investigates recent trends in Mergers and Acquisitions (M&A) during the 2001-19 period in the US and European Union (EU). The study specifically examines several determinants of M&A activity, encompassing not only conventional macroeconomic and financial factors but also sentiment considerations. As M&A is a larger and riskier investment option compared to other organic growth strategies for firms, its volume is cyclical and highly sensitive to a select set of external drivers. Given the inherent risks and swift pace of M&A, coupled with the far-reaching and long-term implications for the M&A-involved entities, this study introduces and explores the novel concept of "human sentiment" as a determinant of M&A activity. Through empirical analysis, the study establishes that both US and EU M&A volume are positively correlated to regional investor and consumer confidence, as well as stock market performance, while displaying negative correlations with stock market valuations and the cost of debt capital. These correlations prove to be highly statistically significant for both regions, albeit with some noteworthy regional nuances.

Keywords: Mergers and acquisitions (M&A), Investment decisions, Human sentiment.
JEL Classification: G34, G11, and G150.

1. INTRODUCTION

Mergers and Acquisitions (M&A) represent a major deployment of capital: averaging annually ~US$4.1 trillion globally, ~$2.2 trillion (13% of GDP) in the USA, and ~$750 billion (8% of GDP) in the European Union (EU) over the past twenty years (Altman 2023). The immense scale and socioeconomic impact have fostered diverse research interest from both industry practitioners (Bain 2023) and academic scholars in economics and finance (Xie 2017).

M&A can induce fundamental positive transformations for the acquirer but also entail greater risk compared to organic growth. Extensive studies have explored various strategic, economic, and financial determinants of M&A (Eril 2012, Stefkoa 2022), with human factors examined primarily in the context of post-transaction integration (Weber 2014). However, the role of human sentiment in defining the pace and dollar volume of M&A transactions has been relatively underexplored and it requires a more comprehensive analysis.

The objective of this paper is to address a gap in existing literature by conducting a comparative analysis of US and EU M&A trends during the two decades of 21st century (2001-19), pre-COVID-19 epidemic. Along with emphasizing the influence of human sentiment factors on M&A, the analysis also considers traditional financial factors such as stock market performance, valuation, and cost of new debt required for M&A. The findings aim to assist economists, business leaders, and policymakers in understanding the dynamics shaping M&A trends and future prospects.

M&A transactions can be categorized using multiple criteria. The primary classification is based on the acquirer and target relationship, delineated into horizontal (involving competitors in the same industry), vertical (between firms in client-supplier or value chain relationships), and conglomerate M&A (between companies in unrelated businesses), as discussed by Chauri (2003). Another distinguishing factor is geographical, separating transactions into domestic or cross-border within each country or region. Domestic M&A involves parties from the same "home country," while cross-border M&A involves a foreign acquirer. The location of main headquarters usually defines a company's "nationality," regardless of its international scope. Transaction structure distinguishes between mergers and acquisitions. Mergers are typically transactions between companies of comparable size, resulting in a new corporate identity. In contrast, in acquisitions a larger acquirer firm retains its identity post-integration with a smaller target. For this study, total M&A activity encompasses all transactions within a given region, irrespective of size, industry structure, or nationality of the parties.

The M&A process is intricate and sensitive, characterized by confidentiality and often rapid decisions made on limited information by top executives and their legal and investment advisors. Although initial discussions may commence well in

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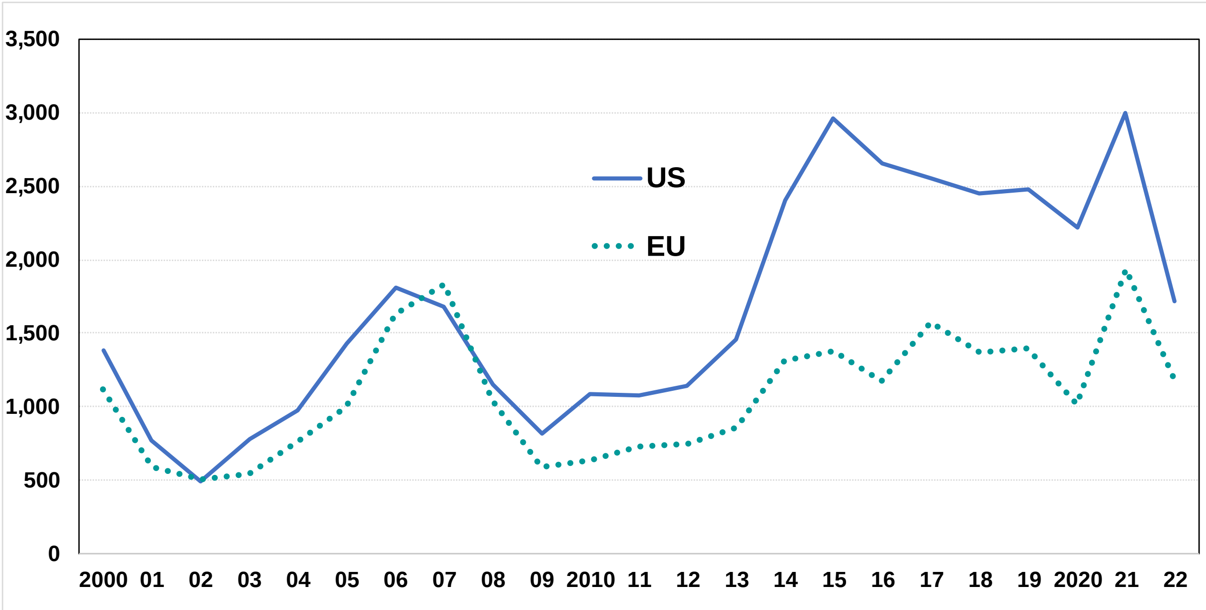

Fig. (1). Cyclical nature of US and EU M&A.

Source: Own calculations based on data compiled by using Dealogic and Bloomberg

advance, the bulk of the M&A due diligence and final decision-making typically occur within a condensed timeframe of 2-3 months immediately prior to the M&A transaction public announcement. This complexity underscores the multifaceted nature of the process, integrating various factors from corporate structure and identity to timeliness and confidentiality in strategic decision-making.

Unlike other major investment decisions, such as opening a new production facility or initiating investment programs, the decision-making process for Mergers and Acquisitions (M&A) is distinctive, involving negotiation between two parties with potentially divergent interests. While the majority of M&A transactions are "friendly", they require the consent of both the acquirer and the target, requiring a compromise on timing, price, and terms that may not be optimal for the acquirer alone.

This complex negotiation process can hinder the identification of clear correlations with external factors. The M&A process is further complicated and delicate, as negotiations could collapse for various reasons, such as premature leaks of highly sensitive information. Objective factors (strategic, operational, financial) and also subjective factors (human sentiment, market sentiment) do influence the M&A process and its final outcome.

Although large investment decisions, including M&A, have consequence horizons measured in decades, they are markedly cyclical and sensitive to business cycles. This cyclical nature stems from the human instincts driving top executives in making significant decisions. The balance between "greed" (attraction of new growth opportunities) and "fear" (concerned with the risks of ill-timed decisions impacting long-term financial return) significantly shapes these choices. Whether in organic growth through company investment or inorganic growth through M&A, these big decisions are underpinned by the complex interplay of strategic considerations, human sentiment, and the timing within economic cycles.

Ghauri (2003) identified five significant multi-year merger waves in over a century of U.S. history, marked by notable accelerations in M&A activity. Figure 1 illustrates this macroeconomic cyclicality in the US and EU over the past twenty years, with M&A peaks aligning with economic cycles in 2000, 2007, and 2021, followed by declines during the recessions of 2002, 2009, and 2020. Clearly, economic cycles are not the sole determinant of M&A, as other factors such as interest rates and stock markets also play a role, and several factors could be intertwined.

This paper is structured in five sections: after Introduction, Section 2 presents literature review, Section 3 explains data sources and methodology, then Section 4 presents results of multivariant regressions. Finally, Section 5 formulates conclusions and policy implications.

2. LITERATURE REVIEW

Research on M&A activity exhibits diverse dimensions, ranging from industry practitioners focusing mostly on post-acquisition financial and operational returns (Ali-Yrkko 2002), to academic explorations of determinants encompassing micro acquirer conditions (Ferreira 2009), macro country factors (Erel 2012), and global conditions (Giovanni 2005). Labor and political economists explored the human side of M&A, namely firms' organizational changes post-transaction and broader societal and implications (Weber 2014).

Xie (2017) provided a comprehensive review of seven dimensions of M&A: the macroeconomic and financial market environment, accounting standards and valuation guidelines, institutional and regulatory environment, political and taxation environment, and geographical and cultural environments. Erel (2012) highlighted the role of valuation in cross-border M&A, with firms from strong economies more likely as purchasers, and those from weaker economies as targets.

The apprehension towards foreign entities, a deterrent rooted in history, influences modern M&A, often resulting in a larger domestic M&A share in a country's total, except in specific trading economies like Singapore and Hong Kong. Erel (2012) identified geographical proximity, quality of accounting disclosure, and bilateral trade as factors increasing the likelihood of a merger, while cultural or geographic differences can escalate the costs. Stefko (2022) further emphasized that common language and shared borders facilitate M&A activity.

3. DATA AND METHODOLOGY

An extensive review of academic literature and public financial media identified three categories ("dimensions") of independent variables investigated for correlation with M&A activity: economic (GDP, trade, currency rates), financial (stock market, tax rate, accounting policies) and geo-cultural (distance, adjacent border, common culture and language). As discussed in the prior section, many of these factors were found to be associated with M&A activity, although with some deviations due to regional and time-frame differences across many economic studies.

The fourth, yet unexplored dimension of M&A activity could be defined as "external human sentiment", given that M&A transactions tend to be the riskiest, fastest, and most visible of investment types, therefore human sentiment could logically play a meaningful role in timing and occurrence of M&A transactions. Our novel approach is focused on broader external human sentiment is distinctly different from the "internal human side" of M&A, which is focused on emotional and behavioral impact on employees of the M&A-involved firms (Sarala 2019).

3.1. Selection of Independent Variables

Three groups of independent variables were chosen for testing: external human sentiment, stock market, and cost of capital. External sentiment, a novel category, includes two different sentiment factors: regional consumer sentiment and regional investor risk perception. The former is a general broad indicator of stated (survey-generated) perceptions and expectations about the economy, while the latter is different in being actual measurable summary of investment decisions (trading stock options). While generally independent, these two sentiment components are correlated mostly during periodic economic recessions or financial crises.

• **Consumer Sentiment index** is a survey-generated average of qualitative risk perception among a wide range of consumers. It is collected by Michigan survey for the US Consumer Sentiment, and by EU Commission's Business and Consumer Surveys.

• **Investor Sentiment Index** is measured by actual investor behavior in hedging investment risks, specifically through the volume of option trading activity for regional stock market indices: S&P 500 (US) and STOXX 600 (EU). Higher market volatility may lead to diminished M&A volume if both acquirer and target become more hesitant to finalize the transaction, and gaps in fair transaction price expectations widen compared to stable market conditions.

• **Market Valuation index** is defined as the Price / Book (P/B) multiple for US S&P 500 index and for European STOXX 600 index. P/B ratio serves as a more representative valuation metric; though the book value may fluctuate with business cycles, the ratio maintains a positive value and exhibits less volatility compared to the Price/Earnings ratio through financial cycles.

• **Capital Financing Cost** for M&A activity is typically financed from some combinations of new debt (investment grade and high yield, depending on the acquirer's credit rating), new equity (the acquirer's new stock issuance), and the acquirer's own cash reserves. New equity offerings have only a minor actual cash cost impact to acquirers, as cash cost of dividend yields are consistently under 2% for S&P 500 stock index, well below cost of new debt. Consequently, the volatility in the overall financing costs is primarily driven by fluctuations in new debt cost. The debt cost index was structured on equal weightings of investment grade and high yield debt, although specific debt ratios may diverge widely among acquirer firms and across economic cycles.

• **Currency exchange rate (FX rate)** is another aspect of capital cost specifically relevant for cross-border M&A, which represents 22% of the total US M&A and about 36% of the EU M&A, on average for 2001-19. Hence FX rate was included as a potential contributing factor to pace and volume of M&A activity.

3.2. Research Hypotheses

Our research hypotheses could be summarized below, and consistently denoted as (a) for USA and (b) for EU when applied to those regions.

Hypothesis 1 (H1a and H1b). Higher consumer sentiment index is positively associated with M&A, resulting in higher M&A values.

Hypothesis 2 (H2a and H2b). Higher stock market volatility (higher VIX index) is inversely associated with M&A values, resulting in lower M&A values.

Hypothesis 3 (H3a and H3b). Higher value of regional stock markets (higher RSP index value in US and STOXX index in EU) is positively associated in higher M&A values.

Hypothesis 4 (H4a and H4b). Higher valuation multiple (lower Price/Book ratio) is inversely associated with in higher M&A values.

Hypothesis 5 (H5a and H5b). Higher financing cost (higher blended interest rate for loans) is inversely associated with M&A values.

Hypothesis 6 (H6a and H6b). Higher value of local currency is positively associated with M&A values.

Cumulatively, M&A hypotheses result in the following equation for a region *i* in a month *t*:

$$M\&A_{it} = \beta_0 + \beta_1 * CS - \beta_2 * VIX + \beta_3 * SM - \beta_4 * \frac{P}{B} - \beta_5 * IR + \beta_6 * FX + \varepsilon_{it} \quad (1)$$

Table 1. Descriptive Statistics for US M&A (Monthly, Jan 2000 – Dec 2019).

						R2 correlation of pairs among listed factors						
							Sentiment		Stock Market		Cost of capital	
#	Factor	Mean	Median	St.Dev	SD / Mean, %	2	3	4	5	6	7	8
1	Monthly Value ($B) US M&A	139	124	81	58%	75%	38%	-46%	71%	34%	-47%	5%
2	Monthly Deals number US M&A	1,148	991	456	40%	- -	45%	-51%	94%	39%	-67%	6%
3	Consumer Sentiment	83.9	86.1	13.1	16%		- -	-55%	44%	84%	-34%	58%
4	Market Sentiment Volatility (VIX)	20.3	18.4	8.1	40%			- -	-46%	-52%	61%	4%
5	Stock Market (RSP)	59	41	38	65%				- -	38%	-67%	11%
6	Market Valuation Price / Book	2.88	2.79	0.64	22%					- -	-11%	62%
7	Blended Cost of Debt, %	7.00	6.76	2.09	30%						- -	20%
8	USD FX	91.6	91.0	11.4	12%							- -

Where CS = Consumer Sentiment, VIX = Stock Market Volatility, SM = Stock Market Index Price, P/B = Price to Book ratio (Market Valuation), IR = Interest Rates on High Grade and High Yield Bonds (weighted 50%/50%), FX = Foreign Exchange rate: (a) US dollar trade-weighted global index for USA and (b) Euro/USD exchange rate for EU.

Table **1** elucidates initial observations regarding the relationships between US M&A and several independent variables. M&A volume and number of transactions have a positive association with US Consumer Sentiment, inverse association with Market Sentiment (Volatility), very positive correlation with Stock Market Value, a moderate positive relationship to Stock Market Valuation, a negative correlation with higher cost of debt, and an insubstantial correlation with US dollar trade-weighted foreign exchange rate. These pair correlations predominantly align with preliminary theoretical expectations, with the possible exception of the less pronounced impact of the Stock Market Valuation multiple. This anomalous result could be explained by required compromise of both M&A parties on transaction value and terms. The minimal correlation with the U.S. dollar index can likely be attributed to the fact that cross-border U.S. M&A transactions constitute only 22% of the total U.S. M&A volume.

Table **2** presents an analogous set of initial observations on pair relationships between EU M&A (mergers and acquisitions) and corresponding independent variables, leading to comparable conclusions. This confirms the intuitive assumption that in the large and efficient market systems (USA and EU) market forces operate in a similar fashion. However, a closer examination displays certain nuanced regional disparities. US pair correlations tend to be a greater magnitude (both positively and negatively), likely explained by the US being one country, while the EU is a more diverse composite of 27 countries. Another possible explanation is due to opposite correlations of independent variables with currency factor: positive for US and moderately negative for EU. In reality, the currency trends are the same for both US and EU M&A, just expressed slightly differently. USD index is proportional to strength of US dollar (local currency for US), while FX rate used in the EU dataset (expressed as USD/Euro exchange rate) is inverse to strength of Euro: thus, the same fundamental relationship of M&A to local currency is evident in both regions.

4. RESULTS

The domain of M&A research is extensive and intricate. Economists often restrict their analytical scope and resultant dataset by one of several parameters: economic sector (such as energy, industrials, or technology), region, time frame, or a performance factor. The latter most often defined as financial performance in the aftermath of M&A, objectively measurable for public firms by their relative to peers and absolute share price metrics.

Table 2. Descriptive Statistics for EU M&A (monthly, Jan 2000 – Dec 2019).

						R2 correlation of pairs among listed factors						
							Sentiment		Stock Market		Cost of capital	
#	Factor	Mean	Median	St.Dev	SD / Mean, %	2	3	4	5	6	7	8
1	Monthly Value ($B) EU M&A	86	71	41	48%	65%	54%	-39%	70%	43%	-38%	3%
2	Monthly Deals number EU M&A	704	655	103	15%	- -	55%	-31%	86%	19%	-53%	-14%
3	EU Consumer Sentiment	99	100	10	10%		- -	-48%	69%	54%	-31%	-27%
4	Market Volatility (VIX)	24	21	9	38%			- -	-48%	-49%	59%	-13%
5	Stock Market (SPXX 600)	321	328	72	22%				- -	36%	-47%	-25%
6	Market Valuation Price / Book	1.74	1.68	0.33	19%					- -	-23%	-4%
7	Blended Cost of Debt, %	3.43	2.76	1.92	56%						- -	-14%
8	FX rate Euro / USD	1.21	1.21	0.15	13%							- -

Table 3. Results of Linear Model regression analysis for US M&A (monthly 2001 – 2019).

		Coefficients	*t Stat*	*P-value*	P-Significance
	Intercept	-6.3403	-1.8623	0.0837	*
1	Consumer Sentiment	1.2250	2.3710	0.0186	* *
2	Market Volatility	-2.0348	-3.4995	0.0006	* * *
3	Stock Market Index	2.5043	15.398	0.0000	* * *
4	Valuation (Price / Book)	-19.526	-2.1274	0.0344	* *
5	Debt Cost, %	10.6487	4.1652	0.0000	* * *
6	FX USD (trade-weighted)	-0.7764	-2.0421	0.0423	* *

Our research approach is distinguished in two key respects: 1) the innovative incorporation of external human sentiment variables, and 2) an extensive 19-year duration encompassing three complete economic cycles. To our knowledge, gleaned from a comprehensive literature review, no other study has addressed the external sentiment aspect of M&A determinants, despite its considerable significance to the pace and volume of M&A activity.

Tables **3** and **4** summarize the results on multivariant linear regression analysis for US and EU, respectively. Note that p-values are marked in their statistical significance: * $p < 0.1$, ** $p < 0.05$, and *** $p < 0.01$.

As discussed previously in this paper, M&A decisions, being significant in financial scale and consequences for the acquirer, are demonstrably influenced by human sentiment factors, a relationship corroborated by our analysis.

Hypothesis H1a was confirmed for US M&A: US Consumer Confidence is positively associated with US M&A activity value (expressed in $Billion, for all other conclu-

Table 4. Results of Linear Model regression analysis for EU M&A (monthly 2001 – 2019)

		Coefficients	*t Stat*	*P-value*	P-Significance
	Intercept	-23.550	-4.591	0.0000	* * *
1	Consumer Sentiment	0.674	1.778	0.0933	*
2	Market Volatility	0.944	2.172	0.0307	* *
3	Stock Market Index	0.313	5.870	0.0000	* * *
4	Valuation (Price / Book)	37.935	3.568	0.0004	* * *
5	Debt Cost, %	-2.341	-2.135	0.0336	* *
6	FX USD-Euro	65.951	3.505	0.0005	* * *

sions in this paper), with sufficient degree of statistical significance ($p<0.02$).

Hypothesis H2a was confirmed, as shown by inverse correlation of higher stock market volatility (higher VIX index) with M&A values, with high degree of statistical significance ($p<0.001$).

Hypothesis H3a was confirmed as well: value of US stock market (higher RSP index value) is positively associated in higher M&A values with very high degree of statistical significance ($p<0.0001$).

Hypothesis H4a was confirmed, as *"cheaper is better, part 1":* valuation multiple (Price/Book ratio) is found to be inversely associated with in M&A values, with high degree of statistical significance ($p<0.04$).

Hypothesis H5a was also confirmed, *"cheaper is better, part 2":* financing costs (blended interest rate for new loans directed to financing M&A trransactions) is indeed inversely associated with in higher M&A values, with very high degree of statistical significance ($p<0.0001$).

Hypothesis H6a was confirmed, as higher USD FX rate is positively associated with increased M&A values, with sufficient degree of statistical significance ($p<0.05$). This association typically reflects robust performance of the U.S. economy or its "safe haven" status during economic turmoil or /political unrest globally. In either case, that backdrop makes US target assets more attractive, hence results in higher US M&A activity.

Results of EU M&A correlations are presented in Table **4**, along with conclusions on research hypotheses.

Hypothesis H1b was confirmed for EU M&A: higher EU Consumer Confidence is positively associated with EU M&A value, although with only moderate level of statistical significance.

Hypothesis H2b was rejected, as shown by positive correlation of higher stock market volatility (higher VIX index) with M&A values, with sufficient degree of statistical significance ($p<0.04$).

Hypothesis H3b was confirmed: value of EU stock market is positively associated in higher M&A values with very high degree of statistical significance ($p<0.0001$).

Hypothesis H4b was rejected, as valuation multiple (Price/Book ratio) is found to be positively associated with in higher M&A values, contrary to initial expectations. This is likely due to previously mentioned required compromise on the transaction price between acquirers and targets prior to concluding M&A transactions.

Hypothesis H5b was confirmed, as lower financing costs (lower blended interest rate for loans) are indeed positively associated with in higher M&A values, with high degree of statistical significance ($p<0.04$).

Hypothesis H6b was confirmed, as higher USD FX rate is positively associated with in larger M&A values, with high degree of statistical significance ($p<0.001$). This relationship may be partially attributed to the fact that EU M&A volume, initially denominated in Euros, is reported by Bloomberg in U.S. dollars. Consequently, a higher FX rate (indicating a stronger Euro) translates into larger M&A values measured in dollars, facilitating comparison of M&A activity volume across different regions.

5. DISCUSSION AND CONCLUSION

This paper identified and examined the "fourth dimension" of M&A activity, the human sentiment determinant. This represents a novel contribution to M&A research, which has traditionally emphasized objective macroeconomic factors such as GDP growth rates, return on capital, and local legal, tax, and cultural systems.

Given that most of M&A transactions are consensual ("friendly"), they necessitate a compromise between acquirer and target, rather than a unilateral optimization of value and timing for self-benefit of either the acquirer or the target. This consideration accounts for considerable cyclical volatility in M&A volumes when human sentiment variables stray from the "mutual comfort zone." Unlike more static macroeconomic determinants (GDP growth, structural differences between acquirer's and target's countries), human sentiment indices exhibit greater dynamism. Thus, human sentiment warrants closer scrutiny in both retrospective analysis and forecasting of future M&A activity, highlighting its critical role in shaping the M&A landscape.

This paper examined the correlation between macroeconomic factors and the volume of U.S. and EU M&A activity for the period of 2001-2019, encompassing the inception of the Euro as the common currency to the pre-COVID era. The majority of the six initial hypotheses were validated for both regions. Specifically, U.S. M&A volume (in $B) was found to be directly correlated with consumer and investor confidence, stock market performance, and FX rate, and inversely correlated with stock market valuations and the cost of debt capital used for M&A. Correlations for EU M&A were generally similar, with a few discussed exceptions. These findings of correlations were statistically significant in both the U.S. and EU contexts.

The identified trends and correlations between independent variables in both the U.S. and EU regions were found to be similar, a finding consistent with two highly developed market economies operating under generally analogous legal, political, and financial frameworks.

The analysis was deliberately confined to two decades of "normal" economic cycles pre-COVID (concluding in Dec 2019). The COVID pandemic disrupted the traditional economic cycle, initially through its abrupt and acute shock to economic and social systems, followed by governmental responses that included significant financial interventions and liquidity injections. This context delineates promising avenues for future research in the M&A domain, particularly the analysis of both the COVID (early 2020 – early 2022) and post-COVID periods (early 2022 to the present). These three years witnessed unprecedented volatility in economic and financial sectors, including a recent swift rise in interest rates, impacting stock markets and M&A activity. Such a unique environment furnishes fertile ground for further exploration, encompassing two extraordinary epochs in economic history: M&A dynamics during the COVID pandemic (2020-2022) and the M&A response to rapid interest rate adjustments by major central banks during the past 18 months (2022 – 2023).

LIST OF ABBREVIATIONS

EU	=	European Union
FX	=	Foreign Exchange rate for currencies
GDP	=	Gross Domestic Product
M&A	=	Mergers and acquisitions
P/B	=	Price / Book value Ratio (measure of stock valuation)
USD	=	US dollar trade-weighted global index

CONFLICT OF INTEREST STATEMENT

The authors declare that they have no conflict of interest.

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