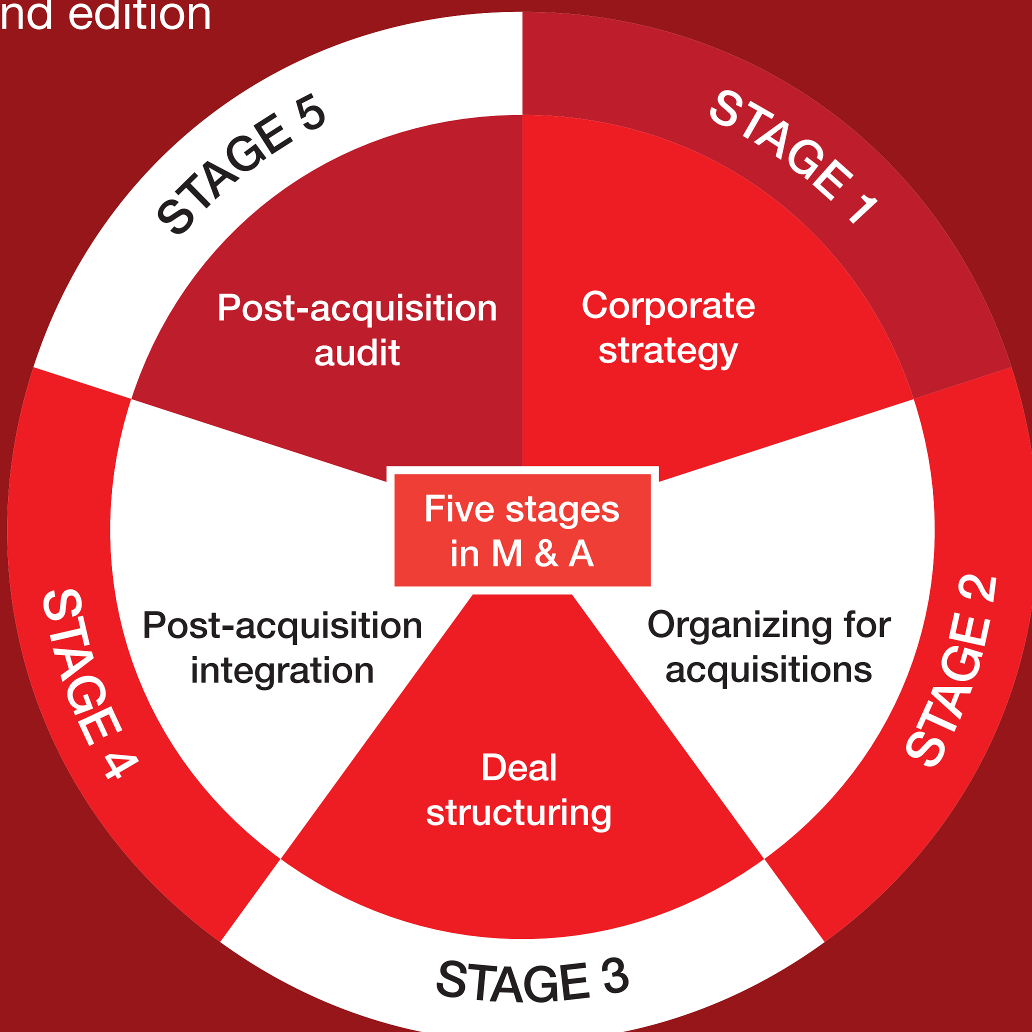
CREATING VALUE FROM MERGERS AND ACQUISITIONS

THE CHALLENGES

Second edition



Pearson

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Creating Value from Mergers and Acquisitions

The Challenges

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Table 8.1 Cross-border acquisitions of, and by, US corporations

Year	Foreign acquirer – US target deals			US acquirer – foreign target deals		
	Number	Value ($bn)	% of total value	Number	Value ($bn)	% of total value
1992	188	14	7	197	16	8
1993	181	20	6	194	18	6
1994	273	55	12	263	26	6
1995	274	66	10	314	65	9
1996	333	85	11	387	48	6
1997	446	81	7	506	83	7
1998	470	297	15	681	131	7
1999	525	330	17	550	146	8
2000	674	351	18	591	130	7
2001	439	137	15	428	110	12
2002	372	78	15	351	51	10
2003	344	71	11	362	80	12
2004	376	76	9	471	98	11
2005	452	134	11	509	108	9
2006	554	176	12	516	180	12
2007	602	271	20	503	198	15

All deals completed and the acquirers hold more than 50% of target share after transaction.
Only deals with disclosed transaction value included.
Deals categorized according to announcement year.
Deal value in 2007 US dollars.
US Consumer Price Index – All Urban: All Items used to adjust for inflation.
Source: Cross-border acquisitions of, and by, US corporations, Thomson Reuters, www.thomsonreuters.com.

Table 8.2 Cross-border acquisitions involving EU companies

Year	Between EU member countries			Between EU and non-EU countries		
	Number	Value ($bn)	% of total value	Number	Value ($bn)	% of total value
1992	249	46	26	367	30	17
1993	240	39	23	367	53	32
1994	234	29	16	451	66	36
1995	314	48	15	524	113	34
1996	322	50	13	573	109	28
1997	448	125	23	799	137	25
1998	476	146	17	1017	365	42
1999	655	522	32	1077	471	29
2000	811	356	25	1130	520	37
2001	556	141	23	848	206	34
2002	421	90	18	623	132	27
2003	410	61	14	682	118	27
2004	411	196	28	778	175	25
2005	543	263	30	966	285	32
2006	587	279	26	1025	355	33
2007	595	248	19	1085	459	35

All deals completed and acquirers hold more than 50% of target share after transaction.
Only deals with disclosed transaction value included.
Deals categorized according to announcement year.
Deal value in 2007 US dollars.
US Consumer Price Index – All Urban: All Items used to adjust for inflation.
EU means: 27 current members + Switzerland.
Source: Cross-border acquisitions involving EU companies, Thomson Reuters, www.thomsonreuters.com.

Germany by Vodafone of the UK. In both types of CBA the number and value of deals made quantum leaps, starting from 1997. Even after the meltdown in 2002–3, the total value of deals was in both cases still much higher than in 1992, indicating a longer-term trend towards more and bigger cross-border acquisitions and mergers.

Relative importance of EU- and non-EU-centred CBAs

For the 25 member countries of the EU, in 2006, domestic M & A accounted for 64% of all deals. CBAs within the EU represented 19% and CBAs involving a EU company and a non-EU company were about 17%. The US was the most important source of bidders for EU targets, with 7.5% of non-EU bidders being US and only 1.4% from Asia[3].

Cross-border acquisitions between European countries

Table 8.3 shows the top 10 European countries as originators or recipients of cross-border acquisitions in 2007. Relatively larger countries, such as the UK, France, Germany, Italy, Spain, the Netherlands, Sweden and Switzerland, witnessed both inward and outward acquisitions. The UK and the Netherlands were the most active in CBAs as both acquirers and targets. French, German, Italian and Swiss companies were more active as cross-border acquirers than as targets. Belgian and Spanish firms are more active as targets than as acquirers. In terms of the average deal value, the acquisition of ABN-AMRO, the Dutch financial services conglomerate, in 2007 by a consortium of European banks and insurance companies led by Royal Bank of Scotland for €72bn pushes the Netherlands to the top of the targets' league.

Table 8.3 Cross-border acquisitions involving EU member states in 2007

Country	*As acquirer's country*			*As target's country*		
	Number	*Value ($bn)*	*Average value ($m)*	*Number*	*Value ($bn)*	*Average value ($m)*
Belgium	31	4	118	31	10	311
Denmark	20	4	201	34	6	185
Finland	21	1	36	29	3	115
France	107	81	754	117	30	256
Germany	91	67	737	181	50	276
Italy	54	49	904	61	20	323
Netherlands	92	60	649	60	60	1001
Poland	9	0	53	20	2	124
Spain	72	18	245	68	57	836
Sweden	72	22	304	58	19	324
Switzerland	39	30	781	27	7	276
United Kingdom	390	145	372	299	136	455
Other EU countries	141	34	240	151	40	268

All deals completed and acquirers hold more than 50% of target share after transaction.
Only deals with disclosed transaction value included.
Deals categorized according to announcement year.
Deal value in 2007 US$. US Consumer Price Index – All Urban: All Items used to adjust for inflation.
EU means: 27 current members + Switzerland.
Figures rounded to the nearest $bn.
Source: Cross-border acquisitions involving EU member states in 2007, Thomson Reuters, www.thomsonreuters.com.

Factors influencing cross-border mergers

While there are company-specific motives for undertaking CBAs, there are also massive economic forces which have acted to unleash the tide of CBAs we have seen. These include the following:

- The economic integration of the EU represented by the Single Market, which began in 1992. European companies increasingly perceive the integrated market as their 'home' market.
- The establishment of european monetary union (EMU) and the introduction of the single currency euro in 12 member countries of the EU in 1999 (called the Eurozone or Euroland). This impacts on cross-border trade and investment not only in financial services such as banking, insurance and investment management, but also in product and services goods markets.
- Enlargement of the EU to include countries from Central and Eastern Europe including Poland and Hungary has created the opportunity for companies in Western Europe and from outside the EU to gain a foothold in these new markets.
- Globalization of product and service goods markets, with the convergence of consumer needs, preferences and tastes creating both the demand for and supply of goods and services by companies originating in different countries.
- Increase in competition, which has assumed a global character with companies competing in several markets, e.g. pharmaceuticals, investment banking.
- Explosion of technology based on massive investments in R & D, design, marketing and distribution. To recover these costs, companies have to sell to the largest market possible, which means globalization, e.g. automobiles, pharmaceuticals.
- Availability of capital to finance acquisitions and innovations in financial markets such as junk bonds (see Chapters 11 and 16).
- Privatization of state enterprises, as in many European countries, which have become targets for foreign acquirers or have felt liberated to follow more aggressive growth strategies both at home and abroad, e.g. in power, gas, telecommunications.
- A more benign and less hostile attitude to foreign ownership of national corporations, induced partly by the economic crisis and the need for corporate restructuring, e.g. the automobile industry or banking in Japan (see Exhibit 8.1)[4].
- Economic reforms undertaken by many developed and developing countries that emphasize competition and free markets and a positive and welcoming attitude to FDI and acquisition by foreign firms.
- The need for massive investments in infrastructure, e.g. gas, electricity, water and telecommunications, has forced many countries to open up these sectors for FDI, including cross-border acquisitions by MNCs.
- Strengthening of international institutions, e.g. the World Trade Organization (WTO), that promote international trade and capital flows, and relaxation or elimination of discriminatory conditions attached to FDI, e.g. local content requirements or export obligations imposed on foreign corporate investors in the automobile or food industries.

Some industries have experienced more upheaval in the form of cross-border takeovers than others. The extent of acquisition activity in an industry reflects the nature of competition in that industry, the product life cycle, changes in regulations, the current level of concentration, and technological changes (see Chapter 2 on industry clustering of M & A in the US and Europe).

Exhibit 8.1

Roche, a friendly 'wolf' at Japan's door?

Roche, the Swiss pharmaceutical company, merged its Japanese operations with those of the leading Japanese pharmaceutical company, Chugai, in December 2001. It acquired 50.1% of the equity in the US firm. Japanese corporations had in the past been very suspicious of European and US takeover bids. One of the reasons was the perceived loss of face in selling out. Another was fear of domination by the foreign partner. However, Osamu Nagayama, Chugai's chief executive, was much more open to Western influence and already had two foreigners on Chugai's board. Roche was nevertheless perceived by many in Japan as 'a wolf at the door'. Roche displayed much cultural sensitivity to Japanese misgivings by agreeing to a minority representation on the board and to preserving Chugai's autonomy, guided by its philosophy of self-governing subsidiaries. This deal reflected a more open attitude to foreign acquisitions by the Japanese.

Source: Adapted from M. Nakamato, 'Roche deal with Chugai is model for co-operation', *Financial Times*, 14 December 2001

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Industry profile of CBAs in the US

We documented the cross-border mergers and acquisitions above and showed the deal flow within and between the US and Europe. As we have seen in our discussion of merger waves in general (see Chapter 2), different industries experience different levels of M & A activity.

Table 8.4 shows that, in both number and value of the deals, different industries experienced different levels of CBA activity in the US. Activity between the US and other countries is not uniform across the sectors. Acquisitions by US firms in some sectors are much greater than in others, and are also greater or smaller than acquisitions of US firms by foreign firms. This suggests that US and foreign firms seek to enhance their international competitive advantage in different sectors through M & A.

Industry profile of CBAs involving European Union companies

Table 8.5 provides the industry breakdown of CBAs in 2006 by number of deals involving EU targets and EU acquirers[6]. Overall, CBAs made by non-EU acquirers and those made by EU acquirers are similar, unlike in the US. The sectoral intensities of CBAs and purely domestic acquisitions are also similar. This suggests a broad-spread restructuring in the member countries of the EU through inward and outward CBAs as well as the domestic acquisitions.

Geographic versus product diversification

In 2006, in the 25 EU member states (EU25), domestic deals, i.e. both bidders and targets within the same member state, accounted for 63% whereas within-EU CBAs (hereafter EU CBAs) accounted for 19% and non-EU CBAs with the rest of the world (ROW) for the remaining 18%. In some member countries domestic deals dominated EU CBAs and non-EU CBAs, e.g. UK, France, Italy and Spain, and in others EU deals dominated others, e.g. new member states such as the Czech Republic, Hungary, the Slovak Republic and Lithuania. This pattern may be

Table 8.4 Industry distribution of CBAs (US bidders and targets)

Industry	*US firm targets*		*US firm bidders*		*All deals*	
	No.	*Value ($bn)*	*No.*	*Value ($bn)*	*No.*	*Value ($bn)*
Business services	173	14.6	234	7.1	1426	66.9
Chemicals	28	4.5	40	4.3	148	15.7
Drugs	53	35.5	31	2.4	174	54.3
Utilities	30	24.6	27	4.0	136	41.6
Electronic and electrical equipment	56	6.4	61	7.0	258	17.6
Food	26	64.7	46	5.6	162	101.8
Insurance	23	15.1	21	3.2	284	36.0
Investment and commodity trading	41	17.3	53	11.0	246	54.4
Oil and gas	44	9.8	24	13.6	240	53.3
Prepackage software	91	17.6	120	12.9	687	53.5
Real estate, mortgage	35	4.6	37	13.4	225	39.9
Personal care products	7	9.7	9	1.1	38	12.6
Wholesale trade: durables	41	4.9	50	5.5	230	15.8
Measuring, medical, photo equipment	51	27.3	61	2.8	242	44.0
Metal and metal products	54	11.5	29	0.5	201	21.7

Utilities include electricity, gas and water generation and distribution. All deals include purely US domestic deals. Only sectors with value of deals in excess of $5bn in either direction are shown.
Source: Adapted from *Mergers & Acquisitions: The Dealmakers' Journal*, February 2009, p. 59.

Table 8.5 Industry distribution of CBAs (EU bidders and targets) in 2006

Industry	*EU firm targets*		*EU firm bidders*		*EU domestic*	
	No.	*%*	*No.*	*%*	*No.*	*%*
Agriculture, forestry and fishing	28	0.7	7	0.2	47	0.7
Mining	194	5.0	75	2.6	80	1.2
Construction	74	1.9	40	1.4	233	3.5
Manufacturing	1306	33.6	991	34.9	1820	27.3
Network industries	397	10.2	240	8.4	787	11.8
Wholesale trade	213	5.5	86	3.0	340	5.1
Retail trade	115	3.0	64	2.3	380	5.7
Finance, insurance and real estate	646	16.6	409	14.4	1067	16.0
Other services	910	23.4	929	32.7	1906	28.6

Network industries include electricity, gas and water generation and distribution, and telecommunications. 'Public administration' is left out because of the negligible percentage of deals in that sector. 'EU domestic' is where both bidder and target are from the same member state.
Source: Author's calculations based on European Commission, 'Mergers & Acquisitions Note 4', *Directorate E, Economic Evaluation Service*, No. 4, April 2007, Table 7.

due to the stage of development of these economies, their size, exposure to internationalization, the competitive advantages of their firms, and any protective barriers they have raised against EU and non-EU bidders (for a discussion of such barriers see below). UK firms were more involved in non-EU than in EU CBAs as both bidders and targets, testifying not only to its being a very active M & A market but also as being the most open to international M & As.

Although, on the basis of comparative advantage of firms relative to firms in other geographic markets, one might expect CBAs to be limited to the sectors in which the bidders may have such advantages, we find that cross-sectoral CBAs, where such advantages may be less self-evident, are significant. At a global level, same-sector deals accounted for about 60% and within the EU for 58%. Such deals accounted for 57% of domestic deals but 66% of EU CBAs. This may be interpreted as a high level of market integration within the EU. However, it is important to note that cross-sector diversifying acquisitions are quite a substantial proportion (about 30–40%) of CBAs.

In terms of both EU and non-EU CBAs over 1986 to 2005, same-industry mergers, i.e. within the same two-digit industry, are about 56% in terms of deal value and 49% by number of deals[7]. This implies that diversifying mergers across two-digit industries are about half of the CBAs over a long period. Thus conglomerate diversification is very much a part of the M & A strategies of multinational firms. Thus many EU and non-EU firms engaging in CBAs seek to exploit their comparative advantages in their own industries but in overseas markets, or seek complementary resources and capabilities. Many also use their geographic diversification to achieve product diversification simultaneously. We discuss below the sources of value in diversifying and non-diversifying CBAs.

Impact of Economic and Monetary Union (EMU)

EMU was ushered in in 1999 with the introduction of the single currency, the euro, in 12 member countries of the European Union excluding the UK, Sweden and Denmark. The large number and value of deals in insurance and commercial banking in Europe may reflect the continuing restructuring of these industries in response to the creation of the Eurozone. However, analysis of the growth rates in the number of deals within and outside the Eurozone carried out by the European Commission for sectors such as banking and insurance, which may be regarded as sensitive to the advent of the single currency, suggests that many of the M & A deals represented domestic consolidation within each member state rather than consolidation across member states within the Eurozone. Thus the relationship between the introduction of the Eurozone and CBA in banking and insurance seems weak so far. This also seems true of the distribution sector, which may also be regarded as EMU sensitive[8].

Why do corporations undertake cross-border acquisitions?

Numerous theories seeking to explain the FDI decision in general and the foreign acquisition decision in particular have been developed over the last 40 years. These theories have been drawn from a wide range of disciplines – industrial economics, organizational economics, various competitive strategy models, finance, organizational theory, international economics and trade, and transaction cost economics. Dunning has developed an eclectic paradigm of the FDI decision process that envelops these numerous theories as to what motivates firms to invest in production outside their home countries[9]. We briefly summarize the essential characteristics of this model applied to the cross-border acquisition decision.

The eclectic model of the foreign acquisition decision

The eclectic model breaks down the foreign acquisition decision process into three stages concerned with evaluating:

- whether or not the firm possesses certain competitive advantages that can be exploited to create value through the foreign production decision (***O**wnership* decision);
- whether or not the foreign location for production is superior to location in the firm's home country and subsequent export to the overseas market (***L**ocation* decision); and