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Mergers and Acquisitions

B6015: Corporate & Business Strategy

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1 WAYS TO GROW AND EXPAND

The need for constant growth leads enterprises to expand either their product portfolio or their market reach or ideally both. Expanding their product portfolio means that enterprises try to introduce a larger product variety over the time or engage in more product fields in order to capture more market segments. Before the merger with Chrysler, Daimler-Benz successively tried to enlarge their product spectrum in the field of smaller cars, and the sub-compact “A class” or the “Smart” were new products in customer segments that before had not been the target of the company. With this, the enterprise tried to acquire new customers that valued their brand but that wanted to have a smaller car. In this case, the product itself did not change, but the company captured customer segments bordering one of their existing segment. But new products can also be different from existing products. When Mc Donald’s™ set up if coffee places Mc Café™ in Singapore recently, the company deviated from the product category “Fast Food” and competes with Starbucks™ or Coffee Club™ now. Nokia which is now known for its mobile phones initially was active in shipbuilding and the rubber industry, and when they entered the mobile phones business, this was really a very different product category.

Expanding the market can be done in two ways. Companies can try to increase their *market share* in regions or countries where they have already been active. Or they can expand their *geographic reach* by entering new markets in other regions or even abroad. In today’s business environment, many Western enterprises try to set foot in the rapidly developing markets in China and India, and likewise, Chinese and Indian enterprises try to establish themselves in Western countries.

Such expansions can be done in three different ways:

1. Internal Development: The company relies on its own efforts to grow. Consequently, the company has to increase personnel and manufacturing capabilities and eventually develop new capabilities in research and development or in manufacturing or sometimes even process knowledge. Internal development involves substantial financial commitments and usually needs much time before yielding results. Nevertheless, such investments can be beneficial, for example for highly technical products that require a lot of knowledge in R&D or manufacturing. If a company deems such knowledge or capabilities as a good asset for future products, it may want to invest into their development and thereby advance on the learning curve and achieve superiority over competitors. Sometimes, a company also already has crucial capabilities that are needed for an expansion. FedEx or DHL are excellent logistics companies with strong core

competences in supply chains. For them, a geographic market expansion is surely more likely to end up successful than for an enterprise that has so far only been active in one country.

Porter[1] points out that internal development is confronted with two sources of entry barriers, the structural entry barriers and the expected retaliation of incumbent firms. Structural entry barriers are, for example, large upfront investment in technologies (like in the manufacturing of microchips) or the build-up of extensive infrastructure (like in telecommunication). Retaliation occurs because incumbent enterprises perceive the new products or the market entry of a new player as a threat to their business, unless the new product has not been in the target market before and does not constitute a substitute for an existing product. Retaliation from incumbents can be fierce and is not always based on rational principles. Sometimes, incumbent firms defend their territory on sentimental or tactical grounds rather than on pure financial terms. Retaliation tends to be fiercer the higher the exit barriers of the business are because then incumbent enterprises try to remain in the business even if they incur minor losses.

2. <u>Mergers or Acquisitions</u>: Expansion by a merger or an acquisition is much faster than internal growth because they use an existing resource and capability base, and the acquiring enterprise need not develop these. As to the financial commitment, mergers and acquisitions incur similar costs than an internal development. This is because established and well-run companies are usually not sold cheap, unless the owner wants to get rid of the business for some reasons. Often, there are also several interested parties for a target company, and the price for this target company then increases so that the acquisition costs usually reflect at least the intrinsic value of the target company. Mergers or acquisitions are not subject to retaliation from incumbents because they do not change the number of players or market shares in the short term. However, often cultural differences between the two involved companies are a problem and lead to suboptimal outcomes as research has shown.
3. <u>Alliances</u>: Alliances share resources and activities. A typical alliance is a *joint venture* (JV) in which two companies set up another entity that is partly owned by each of them. Until recently, in China, foreign enterprises could only enter the market by teaming up with a domestic enterprise forming a joint venture rather than setting up a wholly foreign owned entity. JVs can cause problems if both owners have different strategies. For large infrastructure projects like the construction of an airport or of a subway system, some enterprises often form *consortia*. Such consortia then consist of enterprises with different

skills like construction, communication, equipment, etc. Finally, ***networks*** can also be a form of an alliance, and the "Shengzhou Network" for neckties in China[2] can serve as an example of successful networks. In networks, there are no fixed supplier and customer relationships, but sales are done as needed as new players emerge and others exit or evolve within a network. A few enterprises have developed a capability to create and manage networks, like Li & Feng in Hong Kong for apparel[3].

2 MERGERS AND ACQUISITIONS

Mergers are commonly characterized as the consolidation of two organizations into a single organization[4]. This is done usually in a consensual way, and the two existing firms cease to exist as separate entities. An example is the merger between Daimler-Benz and Chrysler. The consent in a merger is beneficial because it creates a readiness for integration efforts in the management of both enterprises. Consequently, we can expect that the management of both firms will be rather inclined to solve upcoming problems. However, management's readiness does not necessarily mean that employees share the same idea or that the subsequent integration is really done in a proper manner.

Acquisitions, by contrast, are commonly characterized as the purchase of one organization from another where the buyer or acquirer maintains control. It is not necessarily the bigger firm that buys the smaller firm, sometimes smaller firm buy bigger ones. An acquisition can be, but need not be consensual. However, if an acquisition is not consensual, integration is usually more difficult and the objecting management levels of the acquired firm has to be "exchanged".

The resulting legal entity from a merger and an acquisition is also different. A new legal entity emerges from a merger, where both participating shareholders retain a certain fraction of ownership. Conversely, an acquisition normally does not produce new entity, the legal form of the acquirer company remains and the acquired company disappears and is incorporated into the former.

Transactions valuation varies between mergers and acquisitions. In a merger, the parties negotiate over how relative value will translate into the amount of ownership each party will have in the new company. In an acquisition, the parties negotiate over how the buyer pays the seller in terms of cash, in most circumstances, or assets, a hybrid of both, or stock. However, there is not clear-cut separation. Although a merger involves a combination of two or more entities, they are rarely equal participants. Some view a merger as an acquisition financed by common stock.[5]

2.1 Reasons for M&As

There are many reasons for an M&A, but not all of them are good reasons. Here is a list of frequent reasons:

1. Market enlargement: Clearly, an M&A can help to increase the market share or the geographic market reach in almost an instant. Market share can be important if a company can derive economies of scale from the pooled production of goods or if a company wants to have a stronger leverage in setting technical standards or if they want to make the brand more visible in the consumer's mind. As to geographic market reach, enterprises that want to enter a market abroad can acquire a player that has already been active in this market and has already gathered knowledge or important contacts or that has access to distribution systems or production facilities in the target market.
2. Product portfolio enlargement: Companies usually engage in this approach if the new product segment requires different R&D, production or supply chain capabilities than their existing products. In such a case, it can be difficult to achieve the product portfolio enlargement by internal development because the existing structure of the enterprise may not be suitable for the new product line. Cisco, a manufacturer of high-end routers and switches for example, recently bought Linksys[6], a manufacturer of consumer routers in the SOHO environment and has so gained access to the consumer market that so far has not been tapped by Cisco.
3. Brand buying: Companies may acquire other enterprises solely because of the brand name. This was the case with Rolls Royce which is now with the Volkswagen Group or with Jaguar which is now owned by Ford Motors. While Volkswagen and Ford are known brands for the "mass market", the respective companies were lacking a premium brand which attracts high-end customers to their intended new product lines. It should be mentioned that this approach is exceptional because good brands usually do not come cheap, and the case of Jaguar and Rolls Royce were pure luck for Ford and Volkswagen. Toyota, for example, relied on internal development for their luxury brand Lexus.
4. Acquisition of new competences and capabilities: Companies can be acquired because the have crucial capabilities like a best-in-class supply chain or specialized manufacturing capabilities or an excellent process management. Sometimes, the target company has brilliant researchers or holds important patents, and this competence can be

of interest for an acquiring company. An increasing trend is to buy enterprises that own important IPR and to use these IPR for own products or cash in royalties from other enterprises.

5. Resources supporting own products: Often companies have ambitious plans for new products or for entering new markets, but they are lacking the R&D or production capacities to do so. Then they acquire other companies in order to increase their own R&D staff or their manufacturing capacity quickly rather than going through a lengthy process of hiring and training new staff and constructing additional manufacturing plants. This differs from the reason *product portfolio enlargement* in the sense that here, a company is not interested in the products of the acquired company, but merely in the R&D and production capacities that are then immediately used in order to realize the own product ideas. Of course, this implies that the own products yield a much higher return than the products which the acquired company was manufacturing before.
6. Horizontal integration: Economies of scale and scope and cost reduction are the key motivators for this type of M&A. When a company acquires another company in the same business, manufacturing plants and purchasing and sales departments can be consolidated and the same sales volume can then be done with less staff. This usually implies "layoffs". But it is not only the pooling of resources that can yield a decrease in overall costs. By integrating horizontally, a company increases its power over suppliers and decreases its reliance over buyers and therefore can squeeze suppliers and manage customers to their benefit.
7. Vertical integration: In this approach, there are two considerations. An enterprise can try to increase its share in the value chain. An example would be that a car manufacturer acquires a certain supplier in order to capture a larger market and derive additional profits from other parts of the value chain. Similarly, an internet provider may have the idea to become an entertainment supplier and offer "Video on Demand" to its customers. The second consideration is that a manufacturer may realize that the business he is currently in will soon be a mere commodity but that there are higher opportunities in other parts of the value chain. Christensen has shown this in the market for hard disk drives[7]. Consequently, a shrewd enterprise may acquire another company which operates in the target segment of the value chain and subsequently retreat from its original segment.
8. Financial reasons: Shareholders usually expect strong growth and therefore, the management of an existing firm may be tempted to acquire another firm simply in order to show growth in the balance sheets. While this happens frequently, this is actually a bad

reason because it shows that the existing enterprise is not able to grow on its own effort. There is the danger that acquisitions are made purely in order to inflate the financial numbers without considering whether the acquisition makes sense or whether the acquired company can be integrated into the existing company. Another motive makes more sense but that may have ethical impacts is asset stripping in which the acquiring company plans to sell the acquired company piecemeal, deriving a profit over the acquisition costs.

9. Diversification: Some companies may seek diversification in order to stabilize profits or to decrease risk, and a suitable move would be to acquire a business that runs anti-cyclic to the current one. Or an enterprise may want to seek an opportunity in a business segment that can use existing manufacturing capabilities which otherwise only serve a cyclic business. Infineon for example, successfully set foot in the market for automotive and communication microchips because their reliance on the DRAM business resulted in a cyclic business. The very expensive chip factories that previously were exclusively used for manufacturing DRAMs can so be used at a more equilibrated workload.

2.2 Challenges in the Growth by M&A

2.2.1 Assessment of strategic fitness

Mergers and acquisitions are premised on the belief that the combined company will have greater value than the two companies alone. This added value is expressed as "synergy" between the firms. Typically the deal is led by the two companies' top executives, investment bankers and lawyers. Their primary concerns are legal and financial - how much a company is worth, what terms to negotiate, how to structure the transaction, and how to get regulators to go along with it. Balance sheets are scrutinized, projections of demand and capacity are studied, and cost cutting requirements are contemplated. Most of the analysis concerns valuation and the financial contours of the deal[8]. The amount of “synergy” for an M&A deal is somehow fairly judgmental and debatable. Thus, to use M&A as an effective way of growing, it’s critical to manage the “strategic-fit” assessment process. Since there are difficulties in assessing the cross-company synergies in areas like R&D, marketing and human resources and translate them into financial terms. In most acquisitions, a premium over the acquired company’s current market value is offered by the buyer. The premium, to an extent, is a reflection of those ambiguous “synergy” that the acquisition is assumed to generate. That creates a problem in justifying what is the right price for a target company. This problem caused failure of M&As, which were overpaid.

In SingTel's acquisition of Optus, there were many strategic reasons for SingTel to get this deal done, one of which was to seek growth beyond the domestic market. SingTel's share price had been punished by the market for paying too much in the deal. Only recently when the strategic advantage started to materialise, the share price recovered. SingTel totally paid S$13 billion, way beyond the valuation of A$6.5 billion estimated by Merrill Lynch.

2.2.2 <u>Managing the combined business</u>

Buying an existing business versus building the business from scratch, equates to the differences of buying a house versus building a house. With a new house, owners have to deal themselves with everything, similar to the worries when starting a new business. With the purchase of an older house, less risk of development is involved; however you inherit the pros and cons of it, including existing structure, employees, company culture and belief, resources and also obligations. When we discuss M&A strategy, we always talk about strategic fit. However, the real integration of the two entities is far beyond just strategic fitness. It encompasses the acquired company's culture, existing products, markets, customers and suppliers, everything that inherits from the previous business. In comparison to M&A, growing from internal involves less integration issues as that in M&A.

An M&A does not end at the closing of legal transfer; it ends at the successful transfer of the target company's operations and the attainment of the synergies. The importance of M&A integration will be elaborated and demonstrated by cases in the later part of this report. Even if the acquirer can successfully complete the integration process, there are new challenges arising as a result of dramatic enlargement of the entity. With bigger scale of markets, products, employees to manage, the company's infrastructures should be adjusted to adapt the newly changed internal environment. That includes redesign of management structure, re-allocation of corporate resources, etc.

2.2.3 <u>Finance of the deal</u>

Compared to organic growth, M&A requires a huge amount of financial outflows. Organic growth only needs company to invest over a period of time, and allows it to split into a few phases, that will in certain degree, reduce the urgency of financial burden on the company. In contrast, many M&A deals require immediate cash outflow at a much greater amount. Generally, the idea is that return from the M&A investment should outweigh the financial costs of the deal. When a company is growing too fast through M&A, with the drastic increase of financial obligation, company becomes less resourceful and less flexible to external changes. That deteriorates the company's competitiveness by increasing its insolvency.

3 MAJOR MERGERS IN THE PAST 5-10 YEARS

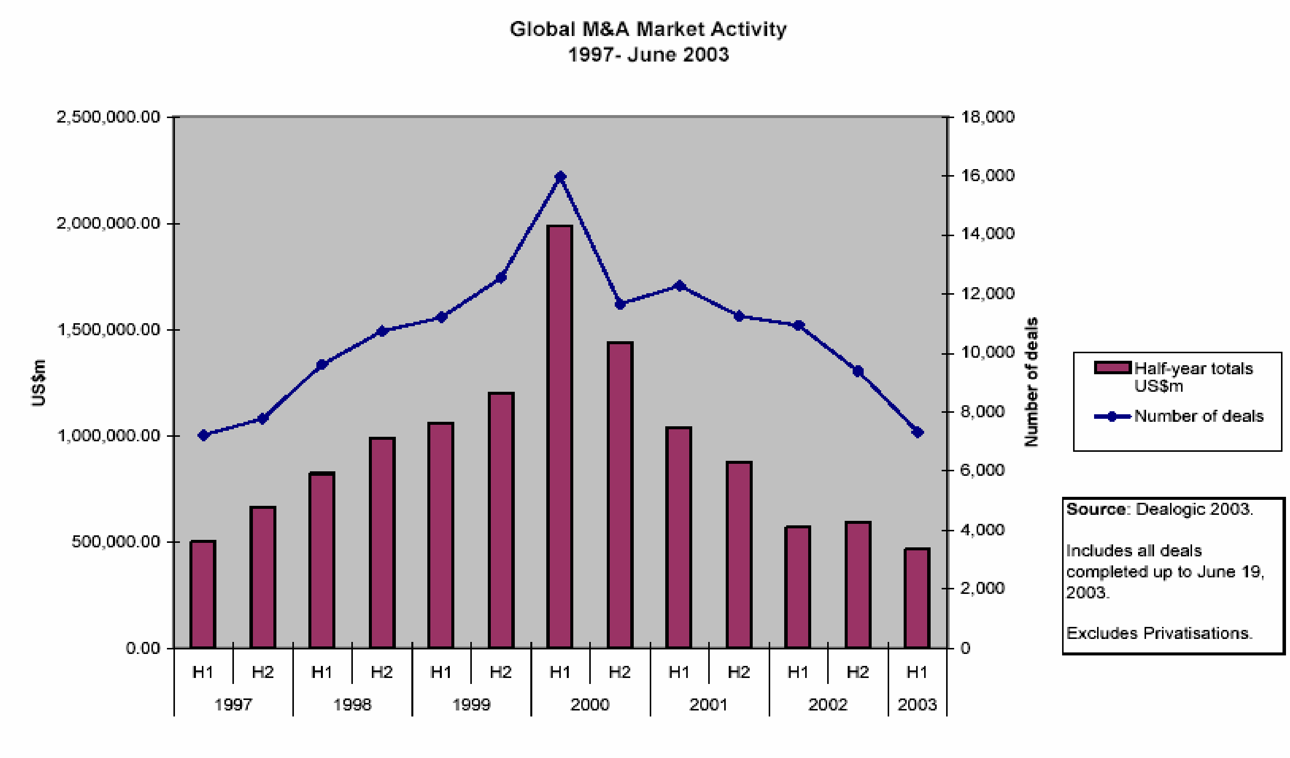

Figure 1: Global M&A Activity from 1997 to June 2003

Mergers and acquisitions have been an important strategic tool for well over a century. They tend to peak in waves when two catalysts are present: a *major discontinuity in the business environment* (caused, for example, by new technologies, new or rapidly growing markets or regulatory change) and the *emergence of a new source of finance for acquisitions*.

Academic research has consistently shown that 50%-75% of all M&A activity destroys value for the acquirer's shareholders. So why have so many CEOs persisted over so many years with such a manifestly destructive strategy? There are two reasons for this triumph of hope over the rather negative experience. First, as is widely acknowledged, it is too easy to get carried away by the adrenaline rush of M&A, particularly when M&A waves overwhelm industries. Caught up in the excitement of deal making and urged on by advisers who say they must acquire or be acquired, and "dare to be great," acquirers select the wrong targets, overpay and become so distracted by post-deal integration that they neglect their pre-existing businesses. The second reason for the survival of M&A in today's strategic armory, however, is that it can create value for an acquirer's shareholders. Study shows that some of the world's top-performing companies are unusually acquisitive[9].

Mergers and acquisitions go in and out of style. The most recent M&A wave and the largest ever, peaked in 2000 with $3.5 trillion worth of deals. The biggest sector involved in cross border M&A activity over the last ten years (1990—2000) has, unsurprisingly, been postal services and telecommunications, accumulating $304 billion, followed by the extraction of mineral oil and natural gas sector with $254 billion, the chemical industry ($263 billion) and banking and finance ($226 billion)[10].

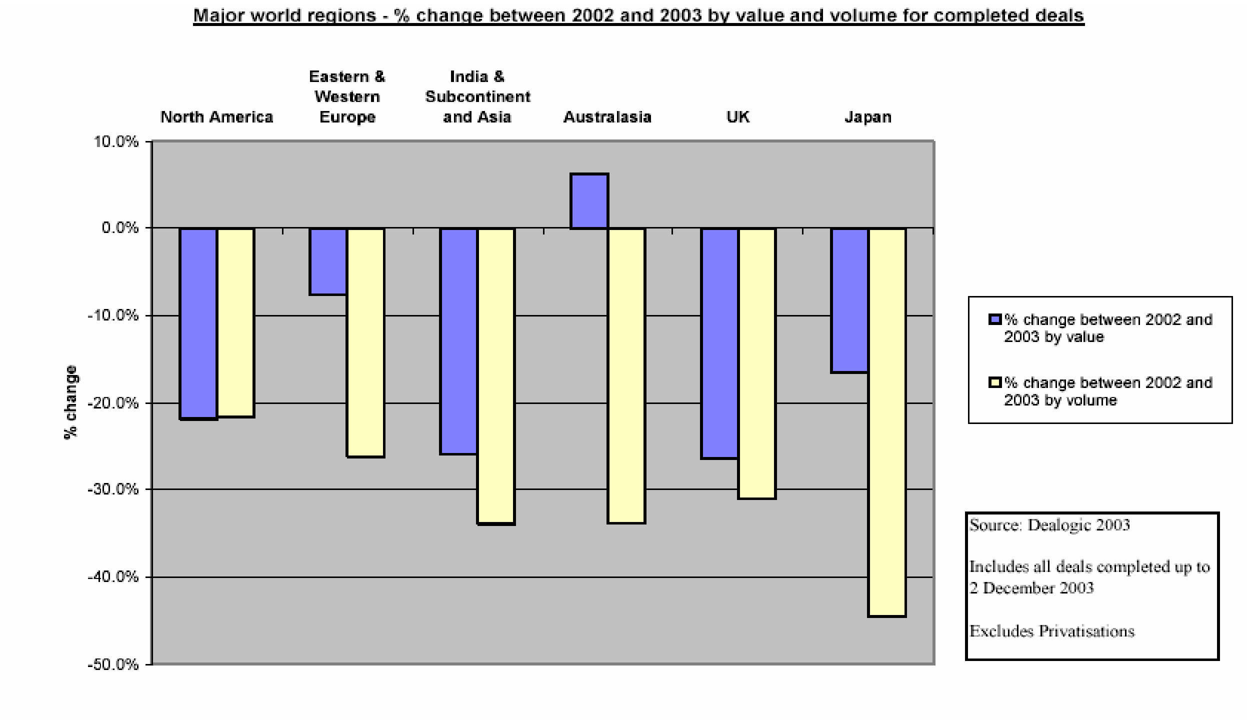

Figure 2: Merger & Acquisitions Breakdown for Major world regions, change between 2002 and 2003 by value and volume for completed deals

But the global M&A activity continues to slow in 2003 (see Figure 1) and has fallen sharply compared to the same period last year. The total value of completed activity is also down, although the decline is less pronounced (see Figure 2). Ian Gomes, Country Managing Partner for KPMG in India, remarks, *"Given the economic uncertainty, the Iraq conflict and the SARS outbreak, it is not surprising that we are now looking at the sixth consecutive half-yearly drop in M&A figures, particularly in the Asia Pacific region."*

The largest and most important M&A of the last ten years globally were:

1. Price-Waterhouse and Cooper & Lybrand (1998)
2. Exxon and Mobil (1998)

3. Vodafone and Airtouch (1999)
4. AOL and Time Warner (2000)
5. Glaxo-Wellcome and SmithKline Beecham (2000)
6. Hewlett-Packard and Compaq (2001)
7. Daimler and Chrysler
8. Bank of America and Fleet Boston Bank (2003)
9. ST Telemedia and Global Crossings (2003)
10. SingTel and Optus (2002)

And two important M&As in Singapore were:

1. UOB / OUB (2001)
2. DBS/POSB (2000)

4 THE M&A PROCESS

Pre-Deal Component	Transaction Component	Integration Component
• **Acquisition criteria** – Strategic Fit – Growth – Price – Shareholder value • **Targeting** – Cost cutting • **Preliminary talks**	• **Announce Bid** • **Due Diligence** • **Prospectus** • **Negotiations** • **Acquisition steps** • **Getting approvals** • **New legal entity**	• **Integration of the two firms:** – Technology – Culture – Systems and Processes – Operations

Figure 3: The Merger & Acquisitions Process

PriceWaterhouseCoopers found that successful dealmakers consistently articulate *clear strategic reasons* for doing each transaction. They also follow a *controlled, actively managed process* that captures and measures value while minimizing risk. Supporting these two overarching principles of successful deals are a number of other attributes including committed people, comprehensive planning and a compelling pace (see Figure 4)[11].

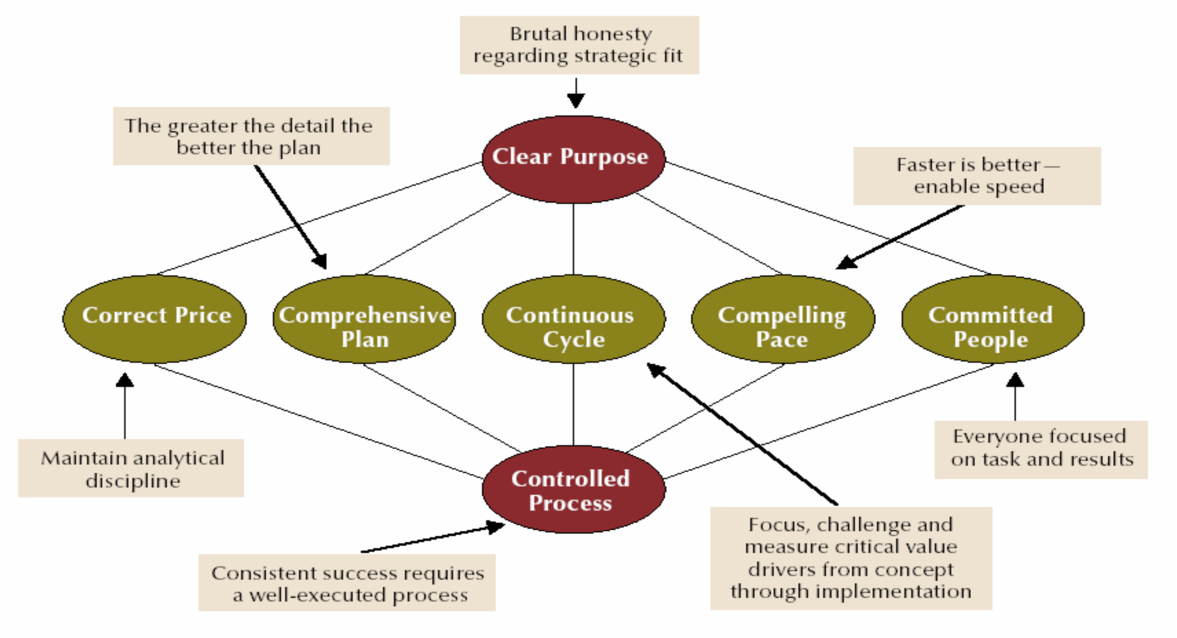

Figure 4: Ingredients of an M&A Process

4.1 The Right Integration Strategy

Companies pursue mergers and acquisitions with the best of intentions - to penetrate new markets, access new competencies and technologies, and to realize economies of scale and scope. Unfortunately, poorly mapped and executed post-deal integration activities often cause the deals to fail. The commonly held assumption that all post-merger integrations should be executed the same way overlooks the widely dissimilar objectives and circumstances that drive acquisitions. The driver behind the deal strongly influences which integration practices a company should adopt. If the driver of the acquisition is the desire to expand into a new business, and if the acquired company is profitable, efficiently run, and growing, the best relationship between the parent and the acquired unit is such a portfolio management relationship. The new parent might impose some financial objectives and targets, but the operation remains distinct and separate. On the other end of the spectrum, however, are those acquisitions driven by the vision of being able to reduce costs and improve profits after acquiring a similar business. In these instances, assimilation is essential. Symbiosis, taking the best from each company, occurs in the middle of the spectrum, when the primary driver of the acquisition is the expansion of products, services, markets or customer segments.

Whether an acquiring company should fully assimilate operations of the target, attempt the often-difficult task of integrating the best from each organization, or manage the new unit autonomously as a portfolio asset depends on the primary driver of the acquisition. As Cisco has demonstrated, recognizing the optimal fit between strategic intent and integration methodology leads to success (see Figure 5)[12].

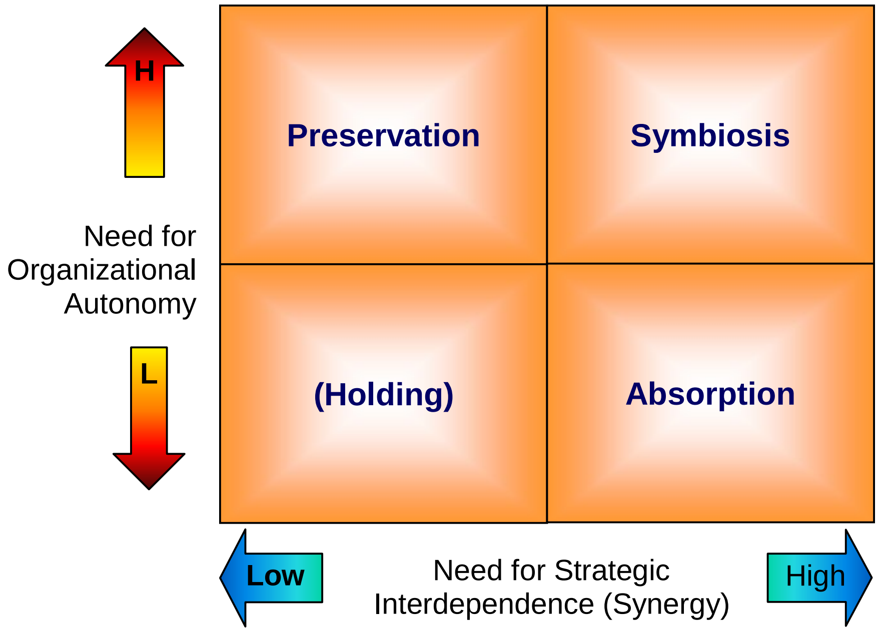

Figure 5: The Right Acquisition Strategy

4.2 A Comprehensive Integration Plan

Once an appropriate match is found and the deal is concluded, the very difficult work of integration begins. Most current M&A failures are largely due to poor post-merger integration. A comprehensive, coherent and flexible plan for transition and integration is essential. The more detailed this plan is, the better it is actually. The top executives, in conjunction with the acquisition team, are responsible for the development and implementation of the transition and integration plan. The plan must include tactics for dealing with important organizational differences ranging from mission, to communication, to control. And how the many upcoming conflicts get resolved contributes greatly to the ultimate success or failure of the endeavor. Conflict resolution strategies that allow the parties to the conflict to maintain dignity and a sense of personal power are the strategies to employ, especially in cross-country M&As. Strategies not leading to these outcomes only compound the underlying tensions and apprehensions and can eventually trigger a destructive battle of wills. As the transition and integration process commences, management must work through a variety of other issues. For example, when two organizations become one, decisions must be made about who will lead the new organization. Filling key positions is a task with significant implications for future effectiveness.

A good example of successful M&A leveraging on well-planned integration is Cisco. Cisco developed repeatable process of acquisition, evaluation, due diligence and the integration. It also emphasized on speed of acquisition. Relying on its excellent and speedy integration plan, Cisco successfully finished 40 acquisition deals in six years.

4.3 Measuring success

We define a merger or an acquisition as a failure when one of the following conditions is fulfilled:

1. A proposed merger did not proceed.
2. The merger did not meet the objectives of the involved entities.

An M&A can be considered successful when the merged entity met the objectives of the merger exercise. Generally, the objectives of a merger can be categorized under the following:

1. Strategic Fit & Synergy
2. Paying the right price
3. Growth and revenue enhancement
4. Cost savings
5. Maximize shareholder value

Other than meeting the objectives stated above, there are also other related issues which may affect the success of a merger. Most of it has to do with the processes and the soft issues i.e. the acquisition process, the integration process and problems like misrepresentation or fraud.

4.4 Strategic Fit

The strategic fit is the degree to which the merger has moved the combined firm toward achieving its strategic goals and objectives. It is important to understand that merger is not a strategy, but a means of implementing a strategy. The likelihood of a successful merger is higher when firms have identified and agreed upon their long-range business goals and the steps necessary to achieve them. Each firm should be able to articulate why merger will help them achieve their long-term vision and improve on their ability to serve clients. Also, pursuing merger is usually much easier to sell to the employees and management when they understand it is part of the firm’s strategic plan. If there is enthusiasm for the business rationale for the merger, it is much easier to overcome the structural and deal points that might otherwise derail the discussions.

Once the strategy has been defined and business goals have been clarified, a firm may find that a merger with the right partner would provide the combined firm the proper platform for achieving its goals and objectives. It is important to keep in mind that a merger may be the first step in implementing a strategy, and that ultimately success will come when the firms have integrated and can move forward as a single firm.

In evaluating whether a merger makes sense for your firm, one has to consult a firm's long-term strategic plan, business goals and objectives to determine whether or not a merger would help to achieve the stated goals. The first success measure, establishing a strategic plan with long-term goals and objectives, is really the most critical. If the firm's long-term strategic plan has been well thought out, and merger fits with the strategy, the other success measures will follow naturally[13].

5 EXAMPLES OF M&A

5.1 Examples of failed M&As

When a merger did not proceed as planned, it could also be due to regulatory objections or there could be some major shareholders who may vote against the proposal.

5.1.1 AOL & Time Warner – Strategic Fit

Figure 6: The AOL - Time Warner Merger in the Newspapers

The merger, the largest deal in history, combined U.S. top internet service provider, America Online (AOL), with the world's top media conglomerate, Time Warner, in January, 2000. The deal validated the Internet's role as a leader in the new world economy, while redefining what the next generation of digital-based leaders will look like. It was estimated that the new merged company was worth US$350 billion. The main reason behind the merger was to reach America's home in any one form or the other - Internet and/or media. The deal was struck by exchanging shares of common stock of Time Warner for shares of common stock of the combined company at 1.5 to 1.

	AOL	Time Warner
Sales	US$4.8 billion	US$14.6 billion
Earnings	US$762 million	US$168 million
Headquarters	Dulles (VA)	New York (NY)
Employees	12,100	67,500
Key Assets	AOL, Compuserve	Warner Bros., Time Inc., CNN, HBO

Table 1: Key Data of AOL and Time Warner (Hoover's company reports)

AOL's merger with Time Warner created the world's first fully integrated internet-powered media and communications company[14]. It uniquely positioned them to expand the interactive medium's penetration into consumers' everyday lives, which would ultimately create major new opportunities to deliver value to stockholders. With leading global brands, cost-efficient infrastructure, technological expertise and a shared vision for the internet age, the two companies' complementary assets can act as catalysts to accelerate the growth of both subscription and advertising/e-commerce revenues, while also providing new business opportunities. Creating substantial operating synergies and new business opportunities are the new mantra for the merged company. In all, the management expected that the total EBITDA synergies would be approximately US$1 billion in the first full year of operations and revenue base in excess of US$40 billion in the same period. CNNMoney commented on January 10th, 2000:

"It provides AOL, which already boasts more than 20 million subscribers through its AOL and Compuserve Internet services, high-speed broadband access to Time Warner's more than 13 million cable subscribers, further reinforcing its position as the nation's top online provider."

The strategic benefits expectation of the merged company was to leverage on the Time Warner's broadband infrastructure with AOL's established success in managing consumer migration online. The merger was also expected to accelerate the digital information of Time Warner by infusing all of its business with a heightened digital focus.

But in the course of the "Dotcom bust", the merger suddenly did not look as good as before, and the stock price moved downhill.

“The company is now valued at $100 billion. Its stock has fallen more than 70 percent since the merger two and a half years ago, and left analysts questioning whether the "synergy" of the two companies is in fact still sizzling.”[15]

From hindsight, we can find many reasons for the failure of the merger. Here is our analysis:

1. The frantic rush to corporate wedding - In one crazy weekend, the lawyers and bankers drafted the merger agreement.
2. Clash of Cultures - Time Warner executives saw trouble right away as the AOL and Time Warner combination began to look less and less like a merger of equals.
   “We were told to live by AOL rules”, Okren, an employee of Time Warner told. “The travel policies changed, the compensation changed. Everything that was changing was changing over to the AOL way of doing things”[16]
3. Over promise - the marriage expected that the total EBITDA synergies would be approximately US$1 billion in the first full year of operations and revenue base in excess of US$40 billion in the same period.

This case is a clear strategy implementation failure due to merger of two big giants. The strategic fit of delivering content anytime anywhere using internet and media is over hyped and the steps necessary to achieve this long term vision was not well devised. Also the failure comes from improper communication and cultural clash between the over-hyped technology company and the traditional media giant.

5.1.2 General Electric and Honeywell

The proposed US$42 billion merger of General Electric and Honeywell in 2001 is a classic example of regulators killing the merger. Interestingly, the US regulators gave the two US firms the blessing but the merger was then halted by the European counterpart. European Competition Commissioner Mario Monti stated in his announcement of the EU’s decision:

“The merger between GE and Honeywell, as it was notified, would have severely reduced competition in the aerospace industry and resulted ultimately in higher prices for customers, particularly airlines. However, there were ways of eliminating these concerns and allowing the merger to proceed; I regret that the companies were not able to agree on a solution that would have met the Commission's competition concerns."

Apparently, the proposed merger would have created a market concentration in the markets for aero-engines, avionics and other aircraft components and systems. Despite efforts by both GE and Honeywell to salvage the deal by selling off some stake to non competitors, thereby diluting their shareholding, the EU Commission was not convinced that their suggestion would resolve the market concentration issue and maintained their veto.

Regulators have different anti-trust theories or perspectives. Why does the European Commission focus on the effects that a proposed merger would have on the competition, while U.S. antitrust officials concentrate on the effects it would have on consumers? Though the Commission is European based, it has authority to review all mergers, acquisitions and takeover bids and other deals that can be defined as a "concentration", involving companies with a combined worldwide turnover exceeding of €5 billion and European sales of at least €250 million for at least two of the companies concerned. Interestingly the proposed merger involved two U.S. firms and yet the European Commission has the authority to veto it. Even worse for the involved companies, they do not have recourse for an appeal.
The key test for assessing mergers in Europe is whether they create or strengthen a dominant position. European merger control is not about protecting competitors but about ensuring that markets remain sufficiently competitive in the long run so that consumers benefit from sufficient choice, innovation and competitive prices.

5.1.3 Oracle and Peoplesoft

Another current case that is pending regulatory approval is the proposed merger between Oracle and Peoplesoft though this is a hostile takeover bid by Oracle. Whilst the regulators are due to give their decision soon, what is more interesting to observe is Peoplesoft's effort to resist the merger. More than six months after their offer, Oracle is still unable to get a sufficient number of the Peoplesoft shareholders to sell their shares. In fact, the Peoplesoft Management is working hard to improve their business performance so that their stock price rises so high that finally the gap would make Oracle's bid price less attractive.

5.1.4 DBS and UOB

In Singapore, the proposed merger between DBS and OUB failed as OUB major shareholders did not support the proposed offer bid and successfully persuaded the rest of the shareholders to resist the proposed merger. Instead OUB successfully rallied their shareholders to sell their shares to UOB.

5.2 Examples of successful M&As

The success or failure of a merger can be attributed by many factors; of which some factors are linked and some are independent; some are primary whilst some secondary factors which may not be contributory. For this portion of the discussion, we shall take the approach of citing examples to highlight pertinent factors which may affect the success or failure of a merger though we acknowledge that there could be other contributory factors as well.

5.2.1 UOB & OUB

The UOB/OUB merger was not a simple straightforward case. In fact, it was DBS who started the process by making a bid for OUB first. This led to UOB's response to make a bid for OUB as well; and this resulted in a dramatic two party fight for OUB. UOB emerged the eventual winner and the victory had very much to do with UOB's acquisition process.

When UOB first made the announcement of their interest to bid for OUB, they had already received irrevocable undertakings from the major shareholders of OUB to accept UOB's offer. UOB had also the support of the OUB Board. Apparently, the top management of UOB had made a personal home visit to OUB founder and major shareholder Dr Lien Ying Chow to strike a deal. UOB's strategy of "keeping the business within the Chinese business community" as against "being acquired by the government", as DBS is commonly associated as, strike a common cord with OUB. Both UOB and OUB were started by their Chinese immigrant family and for many years, the two banks are controlled and ran by the respective families. UOB's personal touch was a feather on the cap as this reflects how Chinese businessman deals with each other – based on relationship and trust. In stark contrast, DBS offer was cold, detached and many perceived as a hostile takeover.

Subsequent to the announcements, both banks embarked on a public relations program which aimed to garner support of the rest of the shareholders. DBS's television and press advertisement were offensive as OUB is portrayed as a small immature child which needed the parent DBS to lead the way. The advertisements did not give respect to an old banking establishment as DBS was too presumptuous and audacious to assume that OUB cannot contribute significantly to the merged entity. On the other hand, UOB's public media was portrayed as a merger of equals which together would become a banking powerhouse.

In the UOB's offer document to the OUB shareholders, it was presented in a very layman terms that was very easily read and understood. There was a great use of colorful charts, diagrams, simple financial figures and bullet form facts to send the message across. In comparison, DBS's offer document was only filled with lengthy words and paragraphs without any use of charts or diagrams. Further, DBS document was only printed in English whilst the UOB's document has a Mandarin translation as well.

Though UOB's offer was generally perceived as better due to its higher cash option as compared to DBS' offer and therefore has a better chance to win in the first place, we believe that UOB's acquisition process played a significantly role. On closer analysis, one would note that in their offers, both DBS and UOB did not put close scrutiny in the future synergistic value of the merged entity but emphasis was placed on the cash options offered by the two banks. Clearly, based on the cash option, UOB looked better as compared with DBS but if one look at the stock option, DBS' proposal may have merits which may have tilted the overall scale to its favor.

5.2.2 <u>SingTel and Optus</u>

It is natural for acquirers to focus most of their efforts on determining the value of a target; that is its purchase price. Since so many factors affect valuation, it is also difficult to drive the correct price. Studies most often cite *"The acquirer paid too much for the target"* as one of those important reasons for the failures. But sometimes, acquirers overpay for strategic reason which are not immediately evident.

SingTel, for example, seeking to grow beyond the small domestic market, completed the acquisition of Australia's Cable and Wireless Optus - now named SingTel Optus - on August 30th, 2001. SingTel totally paid S$13.0 billion, including a goodwill of S$11.4 billion. But according to Merrill Lynch, the estimated discounted cash flow (DCF) value for Optus was only A$6.5 billion. That means that SingTel paid a surcharge of about 100%. As a negative net present value (NPV) acquisition project, it actually destroyed shareholder value. SingTel's own shareholders were not at all pleased. The company's share price fell about 40% from when its intentions versus Optus became known to the time of acquisition, in September. But its $13 billion transaction, Asia's largest M&A of the year, has turned the company into what it has long aspired to be: a competitive, regional player in a combat-ready financial shape. SingTel was already invested in more than 20 countries, but the Optus acquisition pushes its non-Singapore revenue from about 10 percent to more than 50%.

There are also other benefits of the much-discussed deal: SingTel had found a second listing on the Australian Stock Exchange, and the deal was financed completely from SingTel's cash reserves (The company's large amount of cash had long made investors uncomfortable.), and it has expanded its free float from 22% to 32%, diluting government ownership of the utility[17].

5.2.3 Daimler Chrysler - Misrepresentation/Fraud

DaimlerChrysler AG, the German-U.S. automotive group formed when Daimler-Benz, a German automobile firm, and Chrysler Motors, US automobile firm, merged in 1998. Since then it has come upon hard times: the company has been confronted by lawsuits on a number of different charges. If we look at the background why different cultural companies across the continent merged in 1998; both had very different but complementary product lines - with the German company serving the high and luxury range car market, while Chrysler had a medium-range car, van and sports-utility vehicle product line. The reason would be for high market share reaching both the high-end and middle segment and also to cover the emerging Asian market.

It all started in the year 2000, not because of Y2K problem, but because of loss in shareholder value, which at the beginning of 2000, had been trading at approximately €75 (US$74.25)[18]. In the year end 2000, the price of the share fell to €49 (US$42.92) in trading. Many investors have attributed this decline in value to the lack of sales and general financial problems within the Chrysler division. During the year, this decrease in value, a loss of 35%, was becoming a growing concern for many investors and analysts. Many directed this displeasure of decreasing share value at CEO Jürgen Schrempp, because at the time of the merger he assured them on numerous occasions that the new entity of DaimlerChrysler was going to increase shareholder value, a promise which to this point he has not fulfilled. In late October 2000, DaimlerChrysler reported that its U.S. division had incurred a €579 million (US$496 million) operating loss in the third quarter. Top management believed the causes of poor performance were antiquated technology, a badly organized corporate structure, poorly designed cars, and a customer incentive plan that was too expensive.

One of the largest shareholders within DaimlerChrysler, Tracinda Corp., owned by billionaire investor Kirk Kerkorian, filed a lawsuit against the firm and some of its executives, claiming that shareholders had been mislead during the merger negotiations into thinking the merger of the companies would be a merger of equals. The lawsuit claims that if the merger documents had stated that Daimler-Benz was planning a takeover, then-Tracinda Corp., which at the time of the vote controlled 13.8% of the shares of Chrysler, would have voted against the transaction. This accused misrepresentation of the combination that the merger would be of equals is what

Tracinda Corp. is calling fraudulent and illegal and is the heart of its lawsuit. As damages, the corporation was seeking US$8 billion, US$2 billion of which are actual damages from the loss in share value and the breakup of DaimlerChrysler into two separate entities.

To further complicate the situation, many German shareholders considered suing DaimlerChrysler as well because they believed that when the merger was announced in 1998, Chrysler had not fully disclosed all its financial data correctly. The stakeholders argue that Chrysler did not accurately depict the financial troubles that they were in and manipulated other financial figures in order to seem to be a much healthier organization. After two years, some long standing problems within Chrysler finally came to light. Many think Tracinda Corp. knew the merger was not one of equals. After all, everyone knew Daimler would hold 58% and Chrysler 42% of the shares within the new entity.

Other interesting features of the merger that highlighted the difficulty of integrating the companies representing different cultures are found within the areas of disclosure and compensation. The disclosure standards that were reached were a combining of the two differing standards from one country to the other. However, due to German regulations of less disclosure, the compromise that was reached could be seen as a loss for American shareholders because the American standard has better disclosure compared to the German standard. In terms of compensation, the American model is more liberal, and if the CEO is able to increase the bottom line by billions, the shareholders are willing to support a much larger compensation plan. The Germans, on the other hand, are more socially conscious and do not support these high compensation plans. In order to merge the different governance regulations together, some American features were added to the German model.

When looking at these different corporate governance issues discussed at the time, many investors saw problems and discrepancies arising. However, in subsequent years, DaimlerChrysler has made huge strides in the area of corporate governance and investor relations and consequently won numerous awards for its relationship with shareholders around the world. Due to this good relationship and its relatively open disclosure policies, many do not agree with the lawsuit. Different shareholders have stated that they believe the intended purpose of having Chrysler as a subsidiary was known from the onset and that anyone who didn't know this had not read any of the circulating reports. But the plaintiffs argued that typically larger premiums are paid to investors for acquisitions than for "mergers of equals". The premiums are meant to compensate shareholders for loss of control in the company.

The settlement, announced during August 2003, amounted to 40 cents to 50 cents a share, depending on the number of shareholders included in the class-action lawsuit. DaimlerChrysler's insurance will cover US$220 million of the US$300 million cost[19]. DaimlerChrysler's shares fell to close at US$37.46 after the agreement on August 23rd 2003 on the New York Stock Exchange. Although the major lawsuit is still in progress, the lessons we learnt from the case is even if the merger is successful and the merged company does good in the long run, some shareholders raise their voice through lawsuits, either due to personal gains or to prove to the world that there is genuine issue in the process of merger. Until the verdict is given the debate is wide open.

6 CONCLUSION

M&A have been an important strategic tool for well over a century. They tend to peak in waves when two catalysts are present: a major discontinuity in the business environment (caused, for example, by new technologies, new or rapidly growing markets or regulatory change) and the emergence of a new source of finance for acquisitions.

M&A is a way of implementing growth strategy for a company. It could be easily said than done as most of the cases end up in failures. As we have seen in our case examples that failures in any one of the phase in M&A process could lead to overall failure of the merger. Many people believe that once the legal deal between two merging companies is signed then the merger would be successful. AOL-Time Warner illustrates the lack in strategic fit could lead to failures after merger. The DaimlerChrysler example illustrates that lawsuits are part and parcel of most of the M&A. It is not only the long term vision but also the execution plan to implement those visions is necessary to achieve synergies in the merger. One of the other major issues always props up in any M&A is change management and communication strategy. Companies should devise a comprehensive integration plan to expect minimum resistance from merged culture employees.

“Just slamming brands together doesn’t create any additional value,” said Mark Sirower, a merger consultant and author of “The Synergy Trap.” “One of the things that has to go along with that is a real organizational structure and reporting relationships and changes in incentives that drive people to cooperate in ways that they've never cooperated before”[20]

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