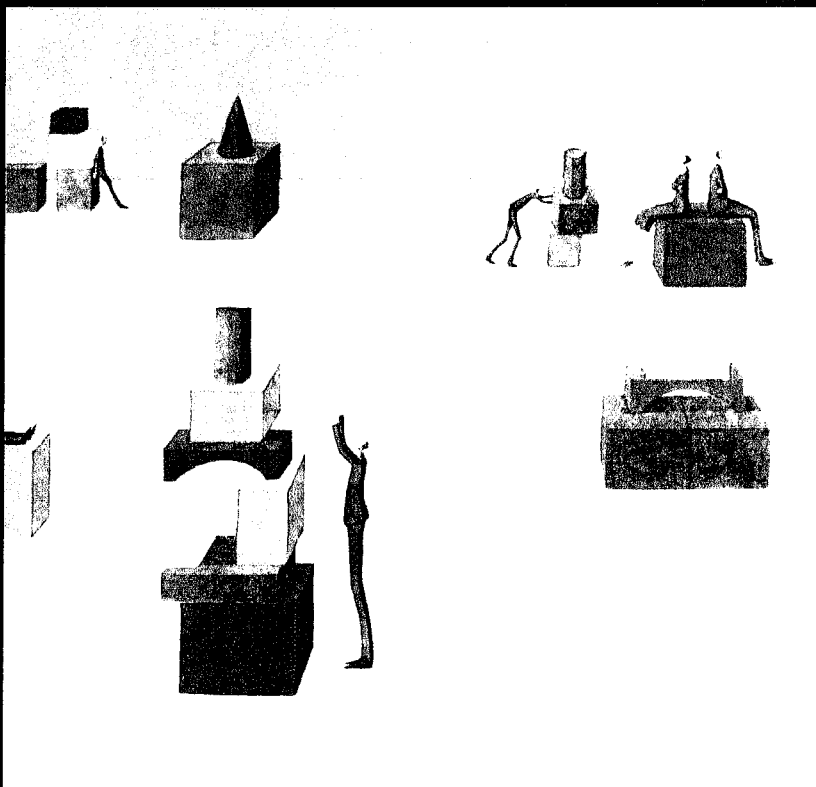


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European Business

Europe's perspective on global management issues



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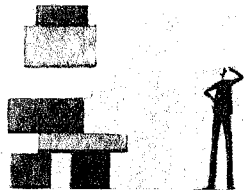
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Catching the right wave

by Günter Müller-Stewens



Faced with overwhelming evidence that most M&A destroys value, the temptation for managers is to do nothing

Look back over the last 100 years and it is clear that mergers and acquisitions come in waves. These waves coincide with surging stock markets (Figure 1) and each has what academics call its own 'dominant logic'. The fourth wave, for example, was driven by financial speculation (the break-up of companies by 'corporate raiders') and the liberalisation and deregulation of some large industries (such as telecommunications). The fifth wave which we are now in is fuelled, among other things, by globalisation, converging European markets, shareholder value and the impact of the internet. AOL/Time Warner, perhaps the most interesting deal of 2000, illustrates how future expectations are powering new and hitherto unimagined combinations of companies.

The question for managers in all this is whether to join the fray. History shows that previous waves came to an end with a stock market collapse but for the moment at least that still seems a distant threat. This year's deal volume, including the record \$186bn European takeover of Mannesmann by Vodafone, is likely to top \$3800bn, ten times the level of transactions in 1992. Wise managers, on the other hand, will be mindful of the extensive body of research which challenges M&A theory and highlights the large number of deals that fail to add shareholder value. How can these studies help and how should managers proceed?

To start with, let's look at the theory. The M&A market can be viewed as an arena in which managerial teams compete for the

right to manage corporate resources. If one team sees that a company's resources are not being leveraged in a way that exploits their potential it will argue that it will be a better owner. It can then offer existing shareholders a better price for the company than today's share price, backed up with ideas for new value creation.

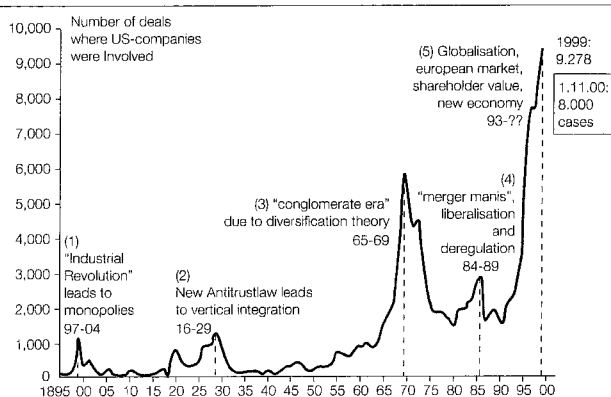
At least two problems can complicate this neat picture – government interference and less than 'pure' individual motives.

Although the situation is improving there is still a tendency in Europe to interfere in the efficient operation of capital markets, as seen in the way Italian politicians sought to obstruct Deutsche Telekom's bid for Italian Telekom. German and Austrian attempts to require bidders to finance acquisitions partly in cash was another example this year, not least because of the way this would be likely to prejudice the ability of small companies to take advantage of their stock market rating to buy larger ones. A more encouraging sign in Germany was the behaviour of the 'voting premium' (the difference between the price of voting shares and non-voting shares in companies which have these two classes of capital) when shareholders sensed that the Vodafone/Mannesmann deal might work. The rise in the premium was a reflection that increased competition for control can be mirrored in higher prices for control rights.

Then there is the question of motivations. In theory there are two – a desire to improve value by realising synergies between the buying company and its target (so called efficiency theory); and the ambition to take advantage of increased market power to charge higher prices to clients or put a squeeze on suppliers (so called monopoly theory). In practice there are other motives including very individual ones such as empire building which, until the advent of the e-economy, had proved to be the fastest way to grow. As far back as 1934, Joseph Schumpeter wrote that 'by mergers managers can realise their 'dream'... to found a private kingdom'. There are other non-rational motives which arise from a lack of transparency (e.g. not having the courage to halt a flawed transaction once it is under way).

Such market and human imperfections no doubt contribute to the poor record of M&A, which has been the subject of dozens of studies over many years of management research. Few confirm any significant improvement in the efficiency of organisations as a result of mergers. Many show that synergies over and above the costs of acquisition are hard to achieve. The same goes for higher prices as a result of enhanced market power. Some competitors actually increase their combined capacities after a merger to effect economies of scale. As for profitability the evidence suggests this usually declines after a merger, while the general tendency of the buying company's share price not to change suggests that the capital markets do not anticipate that mergers will increase future earnings. The main positive outcomes are in areas where there is an overlap between companies (products, markets, technologies, knowledge base etc.) but the overall conclusion seems to be that the main winners of an acquisition are the shareholders of the target who, on average, see an increase in their investment of about 20 per cent.

Figure 1



Source: 1895-1920: Nelson (1959); 1921-1939: Thorp/Crowder (1941); 1940-1962; 1963-99: MergerStat Review

Faced with the risks of failure one temptation is to do nothing. Managers know that M&A can be a nightmare for those involved, Rover/BMW and Fokker/Daimler-Benz being two recent cases in point. They know that it can take time for an acquisition to be declared successful or a failure – take the Daimler-Chrysler-deal, which was initially received with great enthusiasm but about which observers are much more cautious. At the same time, however, they are almost certainly under industry and stock market pressure to adapt to a changing environment and will therefore understandably feel that merging or acquiring may be the most appropriate and quickest way of doing it. Should they believe that they can be one of the exceptions and that embarking on M&A can be justified as part of the normal risk of an entrepreneur?

I do not believe there can be a general recommendation to acquire or not. But there are huge differences between knowing about the risks of M&A and acting on them, as opposed to leaping into the dark. Too many acquisitions at the moment are announced but never finalised. A good start is therefore to think the acquisition through. 'Thinking through' means both examining the logic of the merger and identifying the value creation potential in the context of a strategic discussion inside the company, and ensuring that the resources, capabilities, skills, motivations, attitudes, procedures and routines are in place so that the potential can be realised.

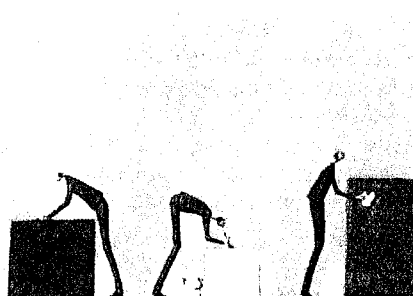
In the ex post phase the quality of commitments will be critical. This can be improved by the early involvement of the people who will ultimately be responsible for integration, by transparent decision making, by adjusting incentive systems to the goals of integration, and by staging the cultural processes. A major task is to 'bridge' both organisations. Another aspect is to agree a challenging, but realistic, time schedule. The progress of the integration has constantly to be measured against goals so as to give the organisation early feedback on where the process stands. This includes tracking major risks such as the loss of key clients and people. GE Capital, which acquires a company almost every day somewhere in the world, is doing this quite successfully.

In summary I would say that M&A can be the right way forward to secure the future of a company in the current dynamic environment. But most acquisitions are as much a threat as an opportunity. Those involved are entitled to expect that management decisions should be both the result of deep and serious thinking (not only on the strategic logic of the merger, but also on its implementation) and that the decisions taken follow a visible 'procedural justice'. Communication and authentic behaviour are perhaps the most critical factors in a successful acquisition. Managers should not, for example, talk about a merger of equals if everybody in the company knows that this will never happen. They need to develop a more human face than many show at the moment, something which is particularly important in many European countries where ill conceived and poorly executed deals have tarnished the M&A phenomenon.

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M&A art and science

by Sir William Castell



Nycomed Amersham has grown spectacularly in the last 10 years. Sales growth and investment have been most spectacular in the United States – but success has been built around two well-executed European mergers

When I joined Amersham International as Chief Executive in January 1990, the company already had an excellent scientific base. What we lacked, though, was innovative management and the sort of global presence needed to establish a number one position in those niche markets of the health science industries we had chosen to compete in.

A year later we were still a largely European organisation when we started to reflect in-depth on how we could combine organic growth and growth through either acquisitions or mergers. As it turned out, our first discussions were in Japan where we already had a distribution company and where we later (1996) merged with the market leader in nuclear medicine. But the shape and scale of our business today has been principally influenced by subsequent mergers with Nycomed of Norway and Pharmacia Biotech of Sweden.

We identified Nycomed as being an excellent match for our imaging business as early as 1994. Amersham was already a world-wide leader in nuclear medicine making agents tagged with radioactivity that show what is happening inside the body – but our ambition was to acquire a strong position in the total imaging market which includes Magnetic Resonance (MRI) and X-Ray technologies. Fortunately the interest was reciprocal, on top of which Nycomed was attracted to what we were doing in the life sciences side of the company, notably our focus on genetic science. Here we went through the same sort of evaluation of our competencies and global ambitions in 1996 – an exercise that highlighted the attractions of linking up with Pharmacia.

Approaches to both potential partners were made at the highest level, directly with either the chairman or the chief executive of the two organisations – and both came to fruition in 1997 (Pharmacia in August, Nycomed in October). The result was a tremendous boost to our competencies – the 'missing' technologies in imaging, a better understanding of protein science and enhanced instrumentation and software capability in life sciences. I say this to stress that these were no 'bolt-on' acquisitions of the kind which so often destroy value.

Both deals were complementary to each side and fulfilled the objective of providing a base from which the merged companies